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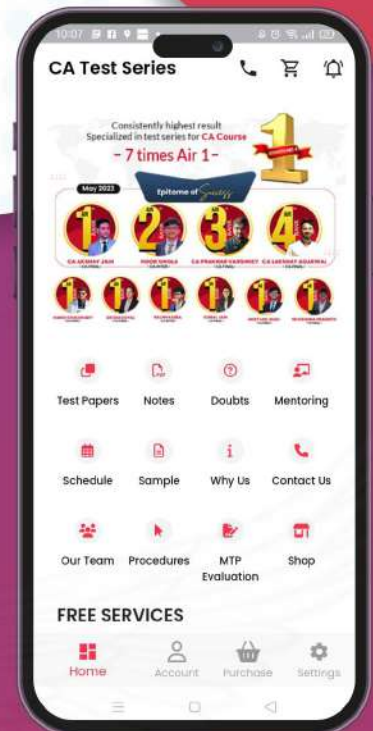


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ADVANCE ACCOUNTING

100 IMPORTANT QUESTIONS

Q-1 What drives the necessity for converging towards global standards across industries, and what benefits does this convergence bring to the international business landscape?

Ans:

The global economic landscape has changed significantly in the past decade, with multinational companies seeking funds internationally. This trend highlights the need for convergence towards global accounting standards. Here are key reasons:

1. Raising Funds Globally: Different countries have different rules for financial reporting. When a company raises capital internationally, it must follow the rules of that country. Translation and reinstatements are crucial for global understanding.

2. Comparability of Financial Statements: Investors want to compare financial statements based on similar accounting standards (ASs). The harmonization of financial reporting globally builds investor confidence.

3. Uniformity, Comparability, and Transparency: Legislation aims for uniform, rational, and transparent financial statements. Multiple accounting standards worldwide can create confusion and errors. A single set of global standards ensures transparency and adaptability.

4. Global Investment: Convergence benefits global investment by promoting a free flow of capital. It allows investors to compare global investments, reducing the risk of errors. Simplifies accounting for companies with global operations, lowering operational challenges. Enhances accountability, transparency, and value for all market participants.

In summary, global convergence in accounting standards is essential for facilitating international fundraising, ensuring comparability, promoting transparency, and supporting global investments.

Q-2 What is the significance of carve-outs and carve-ins within the framework of Indian Accounting Standards (IND AS)? Can you elaborate on how these concepts are applied and their impact on financial reporting practices in the context of IND AS?

Ans:

The Government of India in consultation with the ICAI decided to converge and not to adopt IFRS issued by the IASB. The decision of convergence rather than adoption was taken after the detailed analysis of IFRS requirements and extensive discussion with various stakeholders.

Accordingly, while formulating Ind AS, efforts have been made to keep these Standards, as far as possible, in line with the corresponding IAS/IFRS and departures have been made where considered absolutely essential. **These changes have been made considering various factors, such as:**

➤ **Terminology differences**

Various terminology related changes have been made to make it consistent with the terminology used in law, e.g., 'statement of profit and loss' in place of 'statement of comprehensive income' (SOI) and 'balance sheet' in place of 'statement of financial position' (SOFPI).

➤ **Removal of options in accounting principles and practices**

Removal of options in accounting principles and practices in Ind AS vis-a-vis IFRS, have been made to maintain consistency and comparability of the financial statements to be prepared by following Ind AS. However, these changes will not result into carve outs.

➤ **Difference in economic environment**

Certain changes have been made considering the economic environment of the country, which is different as compared to the economic environment presumed to be in existence by IFRS. These differences are due to differences in economic conditions prevailing in India. These differences which are in deviation to the accounting principles and practices stated in IFRS, are commonly known as 'Carve-outs'.

Q-3 What are the historical factors that prompted India to adopt IFRS-converged Ind AS, and how might this transition impact the financial reporting practices of the manufacturing company? Provide recommendations to the company's management, considering both the potential benefits and challenges associated with the adoption of Ind AS.

Ans:

First Step towards IFRS

In 2006, the Institute of Chartered Accountants of India (ICAI) began the transition towards International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). The aim was to improve the acceptance and transparency of financial information in the statements of Indian corporates. This shift to IFRS was later endorsed by the Government of India.

Government of India - Commitment to IFRS Converged Ind AS

Originally, India planned to adopt Ind AS, which are in line with International Financial Reporting Standards (IFRS), from 2011. However, due to unresolved issues, including tax matters, the implementation was delayed. In July 2014, Finance Minister Arun Jaitley announced the urgent adoption of Ind AS during his Budget Speech. Subsequently, the Ministry of Corporate Affairs (MCA) issued rules in February 2015, specifying a revised roadmap for Ind AS implementation. According to these rules, companies, excluding banks, insurance companies, and NBFCs, could voluntarily adopt Ind AS from April 1, 2015, and it became mandatory from April 1, 2016. Different timelines were outlined for the implementation of Ind AS in banking, insurance, and NBFC sectors.

Q-4 How do Accounting Standards enhance transparency and accountability in financial reporting, and what role do they play in fostering investor confidence and facilitating effective decision-making for stakeholders in the business environment?

Ans:

The following are the benefits of Accounting Standards:

(i) Consistent Recording:

Accounting Standards make sure that businesses follow a consistent approach in how they record and present financial events. This helps in avoiding confusion and ensures transparency. For instance, they guide on methods for valuing inventory and depreciating assets, but companies must disclose the specific methods they use.

(ii) Extra Transparency through Disclosures:

Beyond legal requirements, Accounting Standards may demand additional disclosures, providing readers with more insight into how various items are treated in financial statements.

(iii) Improved Comparisons:

By standardizing accounting procedures, financial statements become more comparable. This comparability is vital for evaluating a company's financial health and performance. Consistent use of accounting policies over the years enables meaningful intra-enterprise (within the same company) and inter-enterprise (with other companies) comparisons.

Q-5 A trader commenced business on 01/01/20X1 with Rs 12,000 represented by 6,000 units of a certain product at Rs 2 per unit. During the year 20X1 he sold these units at Rs 3 per unit and had withdrawn Rs 6,000. Let us assume that the price of the product at the end of year is Rs 2.50 per unit. In other words, the specific price index applicable to the product is 125.

Current cost of opening stock = $(Rs\ 12,000 / 100) \times 125 = 6,000 \times Rs\ 2.50 = Rs\ 15,000$

Current cost of closing cash = Rs 12,000 (Rs 18,000 – Rs 6,000)

Opening equity at closing current costs = Rs 15,000

Closing equity at closing current costs = Rs 12,000

Retained Profit = Rs 12,000 – Rs 15,000 = (-) Rs 3,000

The negative retained profit indicates that the trader has failed to maintain his capital. The available fund of Rs 12,000 is not sufficient to buy 6,000 units again at increased price of Rs 2.50 per unit. The drawings should have been restricted to Rs 3,000 (Rs 6,000 – Rs 3,000).

Had the trader withdrawn Rs 3,000 instead of Rs 6,000, he would have left with Rs 15,000, the fund required to buy 6,000 units at Rs 2.50 per unit.

You are required to compute the Capital maintenance under all three bases ie. (i) Historical costs, (ii) Current purchasing power and (iii) Physical capital maintenance.

Ans:

Financial Capital Maintenance at historical costs

	Rs	Rs
Closing capital (At historical cost)		12,000
Less: Capital to be maintained		
Opening capital (At historical cost)	12,000	
Introduction (At historical cost)	Nil	(12,000)
Retained profit		Nil

Financial Capital Maintenance at current purchasing power

		RS
Closing capital (At closing price)		12,000
Less: Capital to be maintained		
Opening capital (At closing price)	14,400	
Introduction (At closing price)	Nil	(14,400)
Retained profit/(loss)		(2,400)

Physical Capital Maintenance

	Rs	Rs
Closing capital (At current cost) (4,800 units)		12,000
Less: Capital to be maintained		
Opening capital (At current cost) (6,000 units)	15,000	
Introduction (At current cost)	Nil	(15,000)
Loss resulting in non-maintenance of capital		(3,000)

Q-6 What are the key considerations for a country when deciding whether to achieve IFRS compliance, and how do they impact the country's financial reporting framework, regulatory environment, and international economic integration?

Ans:

Any country can become IFRS compliant either by adoption process or by convergence process.

Technique I – Adoption Process: Adoption would mean that the country sets a specific timetable when specific entities would be required to use IFRS as issued by the IASB.

Technique II – Convergence Process: Convergence means that the country will develop high quality, compatible accounting standards and there would be alignment of the standards of different standard setters with a certain rate of compromise, by adopting the requirements of the standards either fully or partially.

Ind AS are almost similar to IFRS but with few carve outs so as to make them suitable for Indian Environment.

Q-7 Can you provide a comprehensive analysis of the standard-setting procedure employed by the Accounting Standards Board (ASB), highlighting the key stages, stakeholders' involvement, and the factors influencing the development and implementation of accounting standards? Additionally, how does the ASB ensure that the standards align with the evolving needs of the business environment and contribute to the overall financial reporting quality?

Ans:

The standard-setting procedure of ASB can be briefly outlined as follows:

Step I – Identification of area: Identification of broad areas by ASB for formulation of AS.

Step II – Constitution of study groups: Constitution of study groups by ASB to consider specific projects and to prepare preliminary drafts of the proposed accounting standards. The draft normally includes objective and scope of the standard, definitions of the terms

used in the standard, recognition and measurement principles wherever applicable and presentation and disclosure requirements.

Consideration of the preliminary draft prepared by the study group of ASB and revision, if any, of the draft on the basis of deliberations.

Step III - Preparation of draft and its circulation: Circulation of draft of accounting standard (after revision by ASB) to the Council members of the ICAI and specified outside bodies such as MCA, Securities and Exchange Board of India (SEBI), Comptroller and Auditor General of India (C&AG), Central Board of Direct Taxes (CBDT), Standing Conference of Public Enterprises (SCOPE), etc. for comments.

Step IV - Ascertainment of views of different bodies on draft: Meeting with the representatives of the specified outside bodies to ascertain their views on the draft of the proposed accounting standard.

Step V - Finalisation of exposure draft (E.D): Finalisation of the exposure draft of the proposed accounting standard and its issuance inviting public comments.

Step VI – Comments received on exposure draft (E.D.): Consideration of comments received on the exposure draft and finalisation of the draft accounting standard by the ASB for submission to the Council of the ICAI for its consideration and approval for issuance.

Step VII – Modification of the draft: Consideration of the final draft of the proposed standard by the Council of the ICAI and if found necessary, modification of the draft in consultation with the ASB is done.

Step VIII – Issue of AS: The accounting standard on the relevant subject (for non-corporate entities) is then issued by the ICAI. For corporate entities the accounting standards are issued by the Ministry of Corporate Affairs in consultation with the NFRA.

Q-8 What are the key components of financial statements, and how do these components contribute to providing a comprehensive overview of an organization's financial performance and position? Additionally, how does the accurate presentation of these components enhance transparency and aid stakeholders, including investors and creditors, in making informed decisions about the company?

Ans:

Alright, let's break it down in simpler terms. Imagine a company's financial statements like a report card for a business. **There are three main parts to this report card:**

1. Balance Sheet: Think of this as a snapshot of what the company owns (like assets) and what it owes (like liabilities). It's like looking at the company's wallet and its IOUs. This helps you see if the company can pay its bills and how financially strong it is.

2. Statement of Profit and Loss: This part shows how well the company performed in terms of making money during a specific period. It's like checking if the company made a profit or a loss—it tells you how good they are at their job of running the business.

3. Cash Flow Statement: Picture this as a diary of the company's cash movements. It reveals where the money came from and where it went. This helps you see if the company is managing its cash wisely and making smart financial decisions.

Now, the notes and other statements are like footnotes in a book—they provide extra details and explanations. For instance, they might clarify certain numbers on the balance sheet or profit and loss statement. These details could include things like how they calculate earnings, info about different parts of the business, or any special transactions.

So, the financial statements work together to give you a full picture of how a company is doing financially. It's like looking at different angles of the same story to understand it better.

Q-9 In the context of the fundamental accounting assumptions, **how would the company's adherence to the assumptions impact the presentation of its financial statements?** Provide specific examples and discuss the potential implications for stakeholders such as investors and creditors.

Ans:

As per the framework, there are three fundamental accounting assumptions: Financial statement users assume that fundamental accounting assumptions are followed during

preparation. No separate disclosure is needed if adhered to. Lack of mention implies adherence. Non-compliance requires explicit disclosure for transparency.

(a) Going Concern: Financial statements are normally prepared on the assumption that an enterprise will continue in operation in the foreseeable future and neither there is an intention, nor there is a need to materially curtail the scale of operations.

Financial statements prepared on going concern basis recognise among other things the need for sufficient retention of profit to replace assets consumed in operation and for making adequate provision for settlement of its liabilities. If any financial statement is prepared on a different basis, e.g. when assets of an enterprise are stated at net realisable values in its financial statements, the basis used should be disclosed.

(b) Accrual Basis: According to AS 1, revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate. Further Section 128(1) of the Companies Act, 2013 makes it mandatory for companies to maintain accounts on accrual basis only. It is not necessary to expressly state that accrual basis of accounting has been followed in preparation of a financial statement. In case, any income/ expense is recognised on cash basis, the fact should be stated.

(c) Consistency: It is assumed that accounting policies are consistent from one period to another. The consistency improves comparability of financial statements through time. According to Accounting Standards, an accounting policy can be changed if the change is required

(i) by a statute or

(ii) by an Accounting Standard or

(iii) for more appropriate presentation of financial statements.

Q-10 Balance Sheet of Mohit Trading Co. on 31st March, 20X1 is given below:

Liabilities	Amount (Rs)	Assets	Amount (Rs)
Capital	50,000	Property, Plant and Equipment	69,000
Profit and Loss A/c	22,000	Stock in Trade	36,000

10% Loan	43,000	Trade Receivables	10,000
Trade Payables	18,000	Deferred Expenditure	15,000
		Bank	3,000
	1,33,000		1,33,000

Additional Information:

(i) Remaining life of Property, Plant and Equipment is 5 years with even use. The net realisable value of Property, Plant and Equipment as on 31st March, 20X2 was ` 64,000.

(ii) Firm's sales and purchases for the year 20X1-X2 amounted to ` 5 lacs and ` 4.50 lacs respectively.

(iii) The cost and net realisable value of the stock were ` 34,000 and ` 38,000 respectively.

(iv) General Expenses for the year 20X1-X2 were ` 16,500.

(v) Deferred Expenditure is normally amortised equally over 4 years starting from F.Y. 20X0-X1 i.e. ` 5,000 per year.

(vi) Out of trade receivables worth `10,000, collection of `4,000 depends on successful re-design of certain product already supplied to the customer.

(vii) Closing trade payable is `10,000, which is likely to be settled at 95%.

(viii) There is pre-payment penalty of `2,000 for Bank loan outstanding.

Prepare Profit & loss Account for the year ended 31st March, 20X2 by assuming it is not a Going Concern.

Ans:

**Profit and Loss Account of Mohit Trading Co. for the year ended 31st March, 20X2
(Assuming business is not a going concern)**

	Rs		RS
To Opening Stock	36,000	By Sales	5,00,000
To Purchases	4,50,000	By Trade payables	500
To General expenses	16,500	By Closing Stock	38,000
To Depreciation (69,000-64,000)	5,000		
To Provision for doubtful debts	4,000		
To Deferred expenditure	15,000		

To Loan penalty	2,000		
To Net Profit (b.f.)	10,000		
	5,38,500		5,38,500

Q-11 How do the qualitative characteristics of financial statements, such as relevance and faithful representation, impact the decision-making process of external users, specifically investors, when evaluating the financial performance and position of a company?

Ans:

Qualitative characteristics of financial statements:

1. Understandability: The financial statements should present information in a manner as to be readily understandable by the users with reasonable knowledge of business and economic activities and accounting.

2. Relevance: Not all information is equally useful. Information should be relevant to influence economic decisions. Materiality, which depends on the size and nature of the information, is a key factor in determining relevance. Further it is important to know the constraints also on Relevant and Reliable Information to better understand the qualitative characteristics of financial statements. **Following are some of the constraints:**

(a) Timeliness: Reporting should strike a balance between providing timely information and ensuring reliability. Delayed information might be reliable but less useful to users.

(b) Balance between Benefit and Cost: The benefits of providing information should outweigh the costs. This involves a judgmental process, and it's crucial to consider how well the information meets user needs.

3. Reliability: For information to be reliable, it needs to be trustworthy and free from mistakes or bias. This means:

(a) The information accurately represents what really happened.

(b) It focuses on the actual significance of transactions, not just their formal appearance.

(c) The reporting is unbiased and doesn't favor any particular viewpoint.

- (d) When there's uncertainty about an outcome, caution is taken in reporting it.
- (e) The information in financial statements is complete, not leaving out important details.

4. Comparability: Comparability in financial statements is crucial for effective analysis, allowing for both inter-firm and intra-firm comparisons. Disclosure of the financial impact of changes in accounting policies is essential for achieving comparability. However, it's important to distinguish comparability from mere uniformity and not hinder the adoption of improved accounting standards. Enterprises should align their accounting policies with the qualitative characteristics of relevance and reliability. Failure to adopt more relevant and reliable alternatives when available is inappropriate, emphasizing the need for dynamic and responsive accounting practices.

Q-12 In a business scenario, how do you justify and implement effective methods for the **measurement of elements in financial statements** to ensure accurate and meaningful financial reporting?

Ans:

Measurement of elements of financial statements

Historical Cost: Historical cost means acquisition price. For example, the businessman paid ₹ 7,00,000 to purchase the machine, its acquisition price including installation charges is ₹ 8,00,000. The historical cost of machine would be ₹ 8,00,000.

Assets are recorded at the amount paid or the fair value at acquisition. Liabilities are recorded at the proceeds received. In some cases, a liability is recorded at the expected cash amount to satisfy the obligation in the normal course of business.

2. Current Cost: Current cost is another way to measure things. For assets, it means recording them at the current cash value needed to buy the same or a similar item now. Liabilities are noted at the current undiscounted cash amount needed to fulfill the obligation at present.

3. Realisable (Settlement) Value: For assets, it's the cash you'd get from selling it. For liabilities, it's the cash you expect to pay to settle the obligation.

4. Present Value: For assets, it's the current value of future cash it will bring. For liabilities, it's the current value of future cash you'll need to settle the obligations.

Q-13 Identify and discuss the **financial items to which accounting standards apply**. Provide an in-depth analysis, outlining the specific financial elements that fall under the purview of accounting standards and the importance of adhering to these standards in financial reporting.

Ans:

Financial items to which the accounting standards apply

The Accounting Standards are intended to apply only to items, which are material. An item is considered material, if its omission or misstatement is likely to affect economic decision of the user. Materiality is not necessarily a function of size; it is the information content i.e. the financial item which is important. A penalty of ₹ 50,000 paid for breach of law by a company can seem to be a relatively small amount for a company incurring crores of rupees in a year, yet is a material item because of the information it conveys. The materiality should, therefore, be judged on a case-to-case basis. If an item is material, it should be shown separately instead of clubbing it with other items. For example, it is not appropriate to club the penalties paid with legal charges.

Q-14 Given the **Income Computation and Disclosure Standards (ICDS)**, discuss a specific case where these standards play a crucial role in determining and disclosing income. Provide a detailed analysis, outlining the key aspects of ICDS.

Ans:

Certainly! Section 145(2) of the Income Tax Act, 1961, gives the Central Government the authority to announce Income Computation and Disclosure Standards (ICDS) through official notifications. These standards are guidelines that certain taxpayers must follow when calculating their income for tax purposes. The Central Government has issued ten ICDS applicable to all taxpayers (except individuals or Hindu undivided families not required to undergo audit under Section 44AB of the Income Tax Act) using the accrual basis of

accounting. These standards are in effect from the Assessment Year 2017-18 and are essential for computing income under the heads "Profit and gains of business or profession" or "Income from other sources." The ten notified ICDSs are:

ICDS I : Accounting Policies

ICDS II: Valuation of Inventories

ICDS III: Construction Contracts

ICDS IV: Revenue Recognition

ICDS V: Tangible Fixed Assets

ICDS VI: The Effects of Changes in Foreign Exchange Rates

ICDS VII: Government Grants

ICDS VIII: Securities

ICDS IX: Borrowing Costs

ICDS X: Provisions, Contingent Liabilities and Contingent Assets

Q-15 Crossword Agency, a company initially classified as Non-Small and Medium-sized Company (Non-SMC) in the financial year 2021-22, has now been reclassified as a Small and Medium-sized Company (SMC) for the financial year 2022-23. The management is interested in availing the exemptions or relaxations available for SMCs in the current financial year. However, the accountant of Crossword Agency disagrees with this decision. **Provide your comments on the situation.**

Ans:

As per the Companies (Accounting Standards) Rules, 2021, an existing company that was not classified as a Small and Medium-sized Company (SMC) and subsequently becomes an SMC is not qualified for exemptions or relaxations in respect of accounting standards available to SMCs until the company remains an SMC for two consecutive accounting periods.

In the case of Crossword Agency, which was initially classified as a Non-Small and Medium-sized Company (Non-SMC) in the financial year 2021-22 and has now been reclassified as an SMC for the financial year 2022-23, the management's desire to avail the exemptions or relaxations available for SMCs in the current financial year may not be in accordance with the regulatory framework.

The disagreement between the management and the accountant may stem from a misunderstanding of the eligibility criteria for availing exemptions and relaxations as an SMC. It is crucial for Crossword Agency to adhere to the regulatory provision, which requires the company to remain an SMC for two consecutive accounting periods before qualifying for such exemptions.

Therefore, based on the assumption provided, the accountant's disagreement is valid, and the management of Crossword Agency should refrain from availing the exemptions or relaxations available to SMCs for the financial year 2022-23. They should revisit this decision in subsequent accounting periods, ensuring compliance with the stipulated requirements.

Q-16 Examine the criteria established by the Institute of Chartered Accountants of India for classifying **non-company entities into Level I and Level II entities**. Provide a comprehensive overview, highlighting the key factors and considerations that determine the classification of entities under these levels. Discuss the implications of such classification on financial reporting and compliance standards.

Ans:

Criteria for classification of Non-company Entities as decided by the Institute of Chartered Accountants of India

(A) Level I Entities

Non-company entities which fall in any one or more of the following categories, at the end of the relevant accounting period, are classified as Level I entities:

- (i)** Entities whose securities are listed or are in the process of listing on any stock exchange, whether in India or outside India.
- (ii)** Banks (including co-operative banks), financial institutions or entities carrying on insurance business.
- (iii)** All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds rupees two-fifty crore in the immediately preceding accounting year.

(iv) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees fifty crore at any time during the immediately preceding accounting year.

(v) Holding and subsidiary entities of any one of the above.

(B) Level II Entities

Non-company entities which are not Level I entities but fall in any one or more of the following categories are classified as Level II entities:

(i) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds rupees fifty crore but does not exceed rupees two-fifty crore in the immediately preceding accounting year.

(ii) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees ten crore but not in excess of rupees fifty crore at any time during the immediately preceding accounting year.

(iii) Holding and subsidiary entities of any one of the above.

Q-17 Explore a scenario where a non-company entity falls outside the classification of Level I, Level II, and Level III, thereby being categorized as a Level IV entity. Discuss the specific characteristics and circumstances that lead to this classification, emphasizing the implications for financial reporting and compliance. Provide insights into how the entity's status as a Level IV entity influences its accounting practices and regulatory considerations.

Ans:

Non-company entities which are not covered under Level I, Level II and Level III are considered as Level IV entities.

Additional requirements:

(1) An MSME which avails the exemptions or relaxations given to it shall disclose (by way of a note to its financial statements) the fact that it is an MSME, the Level of MSME and that it has complied with the Accounting Standards insofar as they are applicable to entities falling in Level II or Level III or Level IV, as the case may be.

(2) Where an entity, being covered in Level II or Level III or Level IV, had qualified for any exemption or relaxation previously but no longer qualifies for the relevant exemption or relaxation in the current accounting period, the relevant standards or requirements become applicable from the current period and the figures for the corresponding period of the previous accounting period need not be revised merely by reason of its having ceased to be covered in Level II or Level III or Level IV, as the case may be. The fact that the entity was covered in Level II or Level III or Level IV, as the case may be, in the previous period and it had availed of the exemptions or relaxations available to that Level of entities shall be disclosed in the notes to the financial statements. The fact that previous period figures have not been revised shall also be disclosed in the notes to the financial statements.

(3) Where an entity has been covered in Level I and subsequently, ceases to be so covered and gets covered in Level II or Level III or Level IV, the entity will not qualify for exemption/relaxation available to that Level, until the entity ceases to be covered in Level I for two consecutive years. Similar is the case in respect of an entity, which has been covered in Level II or Level III and subsequently, gets covered under Level III or Level IV.

(4) If an entity covered in Level II or Level III or Level IV opts not to avail of the exemptions or relaxations available to that Level of entities in respect of any but not all of the Accounting Standards, it shall disclose the Standard(s) in respect of which it has availed the exemption or relaxation.

(5) If an entity covered in Level II or Level III or Level IV opts not to avail any one or more of the exemptions or relaxations available to that Level of entities, it shall comply with the relevant requirements of the Accounting Standard.

(6) An entity covered in Level II or Level III or Level IV may opt for availing certain exemptions or relaxations from compliance with the requirements prescribed in an Accounting Standard:

Provided that such a partial exemption or relaxation and disclosure shall not be permitted to mislead any person or public.

(7) In respect of Accounting Standard (AS) 15, Employee Benefits, exemptions/ relaxations are available to Level II and Level III entities, under two sub-classifications, viz., (i) entities whose average number of persons employed during the year is 50 or more, and (ii) entities

whose average number of persons employed during the year is less than 50. The requirements stated in paragraphs (1) to (6) above, mutatis mutandis, apply to these sub-classifications.

Q-18 XYZ Ltd., with a turnover of ` 50 crores during previous year and borrowings of ` 1 crore during any time in the previous year, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3.20X1. **Advise the management on the exemptions that are available as per the Companies (Accounting Standards) Rules, 2021.**

Ans:

The question deals with the issue of Applicability of Accounting Standards for corporate entities.

The companies can be classified under two categories viz SMCs and Non SMCs under the Companies (Accounting Standards) Rules, 2021.

As per the Companies (Accounting Standards) Rules, 2021, criteria for above classification as SMCs, are:

“Small and Medium Sized Company” (SMC) means, a company-

- whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;
- which is not a bank, financial institution or an insurance company;
- whose turnover (excluding other income) does not exceed rupees two-fifty crores in the immediately preceding accounting year;
- which does not have borrowings (including public deposits) in excess of rupees fifty crores at any time during the immediately preceding accounting year; and
- which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Since, XYZ Ltd.’s turnover was ` 50 crores which does not exceed ` 250 crores and borrowings of ` 1 crore are less than ` 50 crores, it is a small and medium sized company (SMC).

Q-19 Investigate and elucidate the applicability of accounting standards in the contemporary business landscape. Provide an in-depth analysis of the criteria and scenarios under which accounting standards are deemed applicable, and discuss the significance of adherence to these standards in ensuring transparent and standardized financial reporting practices.

Ans:

For the purpose of compliance of the accounting Standards, the ICAI has issued an announcement on 'Criteria for Classification of Entities and Applicability of Accounting Standards'. As per the announcement, entities are classified into four levels. Level IV, Level III and Level II entities as per the said Announcement were referred to as Micro, Small and Medium Entities (MSMEs).

However, when the accounting standards were notified by the Central Government in consultation with the National Advisory Committee on Accounting Standards the Central Government also issued the 'Criteria for Classification of Entities and Applicability of Accounting Standards' for the companies.

According to the 'Criteria for Classification of Entities and Applicability of Accounting Standards' as issued by the Government, there are two levels, namely, Small and Medium-sized Companies (SMCs) as defined in the Companies (Accounting Standards) Rules, 2021 and companies other than SMCs (Non-SMCs). Non-SMCs are required to comply with all the Accounting Standards in their entirety, while certain exemptions/ relaxations have been given to SMCs.

"Criteria for Classification of Entities and Applicability of Accounting Standards" for corporate entities and non-corporate entities have been explained in the coming paragraphs.

Q-20 Lady Shri Ram & Co., a partnership firm, with a turnover of Rs 5 crores (excluding other income) and borrowings of Rs 1.05 crores in the preceding year, seeks guidance on availing exemptions applicable to non-corporate entities in the application of Accounting Standards (ASs) for the year ending 31.3.2022. **Provide strategic advice to the management of Lady**

Shri Ram & Co. regarding the exemptions prescribed by the ICAI for ASs, considering the firm's specific financial parameters.

Ans:

The question deals with the issue of Applicability of Accounting Standards to a non-corporate entity. For availment of the exemptions, first of all, it has to be seen that Lady Shri Ram & Co. falls in which level of the non-corporate entities. Its classification will be done on the basis of the classification of non-corporate entities as prescribed by the ICAI. According to the ICAI, non-corporate entities can be classified under four levels viz Level I, Level II, Level III and Level IV entities.

Non-corporate entities which meet following criteria are classified as Level IV entities:

- (i) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) does not exceed rupees ten crores in the immediately preceding accounting year.
- (ii) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) does not exceed rupees two crores at any time during the immediately preceding accounting year.
- (iii) Holding and subsidiary entities of any one of the above.

As the turnover of Lady Shri Ram & Co. is less than ` 10 crores and borrowings less than ` 2 crores, it falls under Level IV non-corporate entities. In this case, AS 3, AS 14, AS 17, AS 18, AS 20, AS 21, AS 23, AS 24, AS 25, AS 27 and AS 28 will not be applicable to Lady Shri Ram & Co. Relaxations from certain requirements in respect of AS 10, AS 11, AS 13, AS 15, AS 19, AS 22, AS 26 and AS 29 are also available to Lady Shri Ram & Co.

Q-21 Discuss the fundamental accounting assumptions that serve as the foundation for financial reporting. Provide a comprehensive overview, delving into the key assumptions guiding the preparation of financial statements and their significance in maintaining consistency and reliability in accounting practices.

Ans:

Going Concern: Financial statements are like a snapshot of a company's health, and usually, we assume the company will keep doing its thing in the future. It means the company plans to stick around and won't significantly shrink its operations. When we make financial statements, we consider that the company needs to save some of its profit to replace things it used up and also to pay off its debts. This way, the financial statements show a more accurate picture of what the company owns and owes.

Consistency: Consistency is like playing fair in accounting. It means a company uses the same rules for similar things in all its financial reports. This helps us compare how well the company is doing over time. However, if there's a good reason, like a new law or a better way to show the numbers, the company can change its rules. But they need to tell everyone about it to keep things transparent.

Accrual Basis of Accounting: This is like keeping track of things as soon as they happen, even if no money has changed hands yet. It's more accurate because it shows the real action in the business. But there's a catch – sometimes, a company might count its chickens before they hatch. That means they might say they've made money, but they haven't actually received it yet. To avoid problems, accounting rules say you can only count money you're sure to get.

Even though this system can sometimes make it look like the company earned more than it really did, we still use it because it makes more sense than just counting cash. Laws, like the Companies Act, 2013, say companies have to use this method. If a company ever uses a different way, they have to tell everyone.

Q-22 In the selection of accounting policies, what factors should be considered, and how does this decision-making process impact financial reporting? Provide a detailed analysis, outlining the key considerations and implications involved in the selection of accounting policies within an organizational context.

Ans:

Selection of accounting policy

(i) True and Fair View: Financial statements aim to show an accurate picture of how well a business is doing. When choosing how to show this, different options are considered. Key factors influencing this choice include:

(ii) Prudence: To be cautious, we don't predict profits but plan for potential losses. This ensures that profits aren't exaggerated, losses aren't downplayed, assets aren't overvalued, and liabilities aren't understated. Best estimates are made for known uncertainties.

(ii) Substance over Form: We account for transactions based on their real financial impact, not just their legal appearance.

(iv) Materiality: Financial statements should highlight important items that can influence decisions. Materiality isn't just about size; even small amounts linked to potential issues need attention. Specific limits for disclosure are set, like revealing income or expenses over 1% of revenue or ₹1,00,000, and disclosing significant shareholdings.

(v) Manner of Disclosure: All major accounting policies used in financial statements should be clearly explained. This disclosure is an integral part of the financial statements, ensuring transparency and consistency.

Q-23 What are the different types of cash flows in financial reporting, and how do they contribute to understanding an entity's financial position?

Ans:

Types of cash flow

Cash flows in an enterprise happen through various channels like operating activities, borrowing, or dealing with fixed assets. The impact of each type of cash flow is distinct. The standard recognizes three types: operating cash flows, investing cash flows, and financing cash flows. This separation enhances the clarity and usefulness of cash flow information.

1. Operating Cash Flows: Generated by principal revenue-producing activities. **For examples:** Cash transactions for goods, customer collections, payments to suppliers, and employee salaries.

2. Investing Cash Flows: Arise from acquiring and disposing of long-term assets and other investments. **For examples:** Receipts from fixed asset disposals, loans given or recovered from other entities, payments to acquire fixed assets, and earnings from interests and dividends.

3. Financing Cash Flows: Generated by activities changing the size and composition of owners' capital and borrowings. **For examples:** Issuing or redeeming shares/debentures, dividend payments, and interest payments (excluding financial institutions).

Q-24 From the following condensed comparative Balance Sheets of Hotel Hills Ltd., and additional information, **prepare a Cash Flow Statement** for the year 2015.

I. Equity and Liabilities	2014 (Rs.)	2015 (Rs.)
Share Capital	7000	8000
Share Premium	900	1100
Retained earnings	2382	3082
7% Mortgage loan	-	2000
Creditors	690	600
Outstanding salaries	200	140
Provision for taxation	100	140
	11272	15062

II. Assets		
Plant & Machinery	62000	6600
Accumulation Dep. on plant and machinery	(3700)	(2620)
Building	9500	11600
Accumulation dep. on building	(4300)	(4500)
Land	1000	1200
Stock	1022	962

Debtors	860	760
Prepaid expenses	72	80
Cash	618	980
	11272	15062

Additional information:

1. Plant costing Rs. 1600 (accumulated depreciation Rs. 1480) was sold during the year for Rs. 120.
2. Building was acquired during the year at a cost of Rs. 2100. In addition to cash payment of Rs. 100 a 7% mortgage loan was raised for the balance.
3. Dividend of Rs. 800 was paid during the year.
4. A sum of Rs. 1390 was transferred to provision for taxation account in 2015.

Solution:

Cash Flow Statement for the year 2015

(i) Cash flow from operating activities :		Amount (Rs.)
Net profit during the year (before dividend payment and provision for tax)		2890
Add : Depreciation – Building (4500 – 3000)	200	
Plant (6600 – 6200)	400	
Decrease in stock (C.A.) (1022 – 962)	60	
Decrease in debtors (C.A.) (860 – 760)	100	
	760	
Less : Decrease in creditors (600 – 690)	(-) 90	
Decrease in outstanding salaries (140 – 200)	(-) 60	
Increase in prepaid expenses (72 – 80)	(-) 8	
Income tax paid (– 1390 – 100 + 140)	(-) 1350	
Net cash inflow from operating activities		(-) 748
(ii) Cash flow from investing activities :		2142
Purchase of Building	(-) 100	

Purchase of plant and machinery	(-) 2000	
Purchase of land	(-) 200	
Sale of plant	120	(-) 2180
Net cash outflow from investing activities		
(iii) Cash flow from financing activities :		
Issue of shares	1000	
Share premium	200	
Dividend paid	(-) 800	
Net cash inflow from financing activities		400
Net Increase in cash		362
Cash in the beginning		618
Cash at the end of 2015		980

Working Notes:

Retained Earnings Account

Particulars	Amt	Particulars	Amt
To Dividend paid	800	By Balance b/d	2382
To Balance c/d	3082	By Profit during the year (B.F.)	1500
	3882		3882

Plant and Machinery Account

Particulars	Amt	Particulars	Amt
To Balance b/d	6200	By Sale of plant	120
To Bank-Purchase(B.F.)	2000	By Dep. on plant sold	1480
		By Balanced c/d	6600
	8200		8200

Accumulated Depreciation on Plant & Mach. Account

Particulars	Amt	Particulars	Amt
To Plant (Dep.)	1480	By Balance b/d	3700
To Balance c/d	2620	By P & L A/c (Dep.)	400

	4100		4100
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Building Account

Particulars	Amt	Particulars	Amt
To Balance b/d	9500	By Balance b/d	11600
To Bank (purchase)	100		
To Mortgage Loan (Purchase)	2000		
	11600		11600

Accumulated Depreciation on Building Account

Particulars	Amt	Particulars	Amt
To Balance c/d	4500	By Balance b/d	4300
		By P & L A/c (Dep.)	200
	4500		4500

Provision for Taxation Account

Particulars	Amt	Particulars	Amt
To Income tax paid (B.F.)	1350	By Balance b/d By P & L A/c	100
To Balance c/d	140	(provision during the year)	1390
	1490		1490

Q-25 Discuss the concept of reporting cash flows on a net basis in financial statements.

Provide insights into the circumstances and considerations under which reporting cash flows on net basis is deemed appropriate, along with its impact on financial reporting transparency.

Ans:

Reporting cash flows on net basis

AS 3 (Accounting Standard 3) doesn't allow combining money received and spent on buying and selling things like machinery or furniture. So, if a company pays ₹50,000 for new

machinery and gets ₹10,000 from selling old furniture, you shouldn't just subtract them to show a net cash outflow of ₹40,000. **The exceptions to this rule are stated below.**

Cash flows from the following operating, investing or financing activities may be reported on a net basis.

(a) Cash receipts and payments on behalf of customers, e.g. cash received and paid by a bank against acceptances and repayment of demand deposits.

(b) Cash receipts and payments for items in which the turnover is quick, the amounts are large and the maturities are short, e.g. purchase and sale of investments by an investment company.

AS 3 permits financial enterprises to report cash flows on a net basis in the following three circumstances.

(a) Cash flows on acceptance and repayment of fixed deposits with a fixed maturity date

(b) Cash flows on placement and withdrawal deposits from other financial enterprises

(c) Cash flows on advances/loans given to customers and repayments received therefrom.

Interest and Dividends: Alright, let's break it down. AS 3 says you can't combine money coming in from selling stuff with money going out to buy stuff in the investing and financing activities part of your financial statement. So, if you spend 50,000 on machinery and make 10,000 selling furniture, don't just show a net cash outflow of ₹40,000. However, there are some exceptions to this rule.

Non-Cash transactions: If a company does things like issuing bonus shares that don't involve actual money changing hands, those activities shouldn't be included in the cash flow statement. Instead, they should be mentioned in other parts of the financial statements to give a complete picture of those investing and financing activities.

Q-26 As an auditor, outline the process and criteria for identifying reportable segments within an organization. Detailing the factors considered, challenges faced, and the ultimate determination of reportable segments.

Ans:

Identifying reportable segments

A business segment or geographical segment should be identified as a reportable segment if: **(a)** Its revenue from sales to external customers and from transactions with other segments is 10% or more of the total revenue, external and internal, of all segments; or

(b) Its segment result, whether profit or loss, is 10% or more of –

(i) The combined result of all segments in profit, or

(ii) The combined result of all segments in loss,

Whichever is greater in absolute amount; or

(c) Its segment assets are 10% or more of the total assets of all segments. A business segment or a geographical segment which is not a reportable segment as per above paragraph, may be designated as a reportable segment despite its size at the discretion of the management of the enterprise. If that segment is not designated as a reportable segment, it should be included as an unallocated reconciling item.

If total external revenue attributable to reportable segments constitutes less than 75% of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10% thresholds, until at least 75% of total enterprise revenue is included in reportable segments. **We can summarize the steps as under:**

Step I – Apply 10% Test (Materiality Test)

Any 1 Test needs to be met – For Reportable Segment:	
Revenue Test	Revenue (External + Internal) of the segment is 10% or more of the Total Revenue of all segments
Profit/Loss Test	Case I – All segments have profits: Profit of the segment is 10% or more of the total profit of all segments Case II – Few segments have profit + Few segments have losses: 1. Add the profits of profitable segments only. 2. Add the losses of loss-making segments only. 3. Take the figure (from 1 and 2) whichever is greater (in absolute values). 4. The segment which has profit/loss equal to 10% or more of the absolute figure computed in Point 3 becomes reportable.
Asset Test	The segment assets are 10% or more of the total assets of all segments.
Note: A business segment or a geographical segment which is not a reportable segment as per	

above steps, **may be designated** as a reportable segment despite its size at the **discretion of the management** of the enterprise.

Step II – Apply 75% Test (Overall Test)

Ensure that the total external revenue attributable to reportable segments constitutes at least 75% of the total enterprise revenue.

If not, additional segments should be identified as reportable segments, even if they do not meet the 10% thresholds, until at least 75% of total enterprise revenue is included in reportable segments.

Notes:

1. A segment identified as a reportable segment in the immediately preceding period because it satisfied the relevant 10% thresholds should continue to be a reportable segment for the current period notwithstanding that its revenue, result, and assets all no longer meet the 10% thresholds.
2. If a segment is identified as a reportable segment in the current period because it satisfies the relevant 10% thresholds, preceding-period segment data that is presented for comparative purposes should, unless it is impracticable to do so, be restated to reflect the newly reportable segment as a separate segment, even if that segment did not satisfy the 10% thresholds in the preceding period.

Q-27 M Ltd. Group has three divisions A, B and C. Details of their turnover, results and net assets are given below:

Division A

Sales to B	9,150
Other Sales (Home)	180
Export Sales	12,270
	<u>21,600</u>

Division B

Sales to C	90
Exports Sales to Europe	600
	<u>690</u>

Division C

Export Sales to America

540

	Head Office Rs ('000)	A Rs ('000)	B Rs ('000)	C Rs ('000)
Operating Profit or Loss before tax		480	60	(24)
Re-allocated cost from Head Office		144	72	72
Interest cost		12	15	3
Fixed assets	150	600	120	360
Net current assets	144	360	120	270
Long-term liabilities	114	60	30	360

Prepare a Segmental Report for publication in M Ltd. Group

Solution:

M Ltd.

Segmental Report

(` in '000)

	Division				
Segment Revenue	A	B	C	Inter segment Eliminations	Consolidated Total
Sales:					
Domestic	180				180
Export	12270	600	540		13410
External Sales	12450	600	540		13590
Inter-segment Sales	9150	90		9240	
Total Revenue	21600	690	540	9240	13590
Segment result (given)	480	60	(24)		516
Head office expenses					(288)
Operating profit					228
Interest expenses					(30)
Profit before tax					198

Other information:					
Fixed assets	600	120	360		1080
Net current assets	360	120	270		750
Segment assets	960	240	630		1830
Unallocated corporate assets					294
Segment liabilities	60	30	360		450
Unallocated corporate liabilities					114

Sales Revenue by Geographical Market

(` in '000)

	Home Sales	Export Sales (by division A)	Export to Europe	Export to America	Consolidated Total
External Sales	180	12270	600	540	13590

Q-28 What are the **segment accounting policies prescribed by AS-17**? Additionally, could you specify the disclosures that must be made for each **reportable segment based on the primary reporting format**?

Ans:

Segment accounting policies

Segment information should be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the enterprise as a whole. AS 17 does not prohibit the disclosure of additional segment information that is prepared on a basis other than the accounting policies adopted for the enterprise financial statements provided that-

- (a)** The information is reported internally to the board of directors and the chief executive officer for purposes of making decisions about allocating resources to the segment and assessing its performance; and
- (b)** The basis of measurement for this additional information is clearly described.

Primary reporting format

An enterprise should disclose the following for each reportable segment:

- a) Segment revenue, classified into segment revenue from sales to external customers and segment revenue from transactions with other segments;
- b) Segment result;
- c) Total carrying amount of segment assets;
- d) Total amount of segment liabilities;
- e) Total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets);
- f) Total amount of expense included in the segment result for depreciation and amortisation in respect of segment assets for the period; and
- g) Total amount of significant non-cash expenses, other than depreciation and amortisation in respect of segment assets that were included in segment expense and, therefore, deducted in measuring segment result.

An enterprise that reports the amount of cash flows arising from operating, investing and financing activities of a segment need not disclose depreciation and amortisation expense and non-cash expenses.

An enterprise should present a reconciliation between the information disclosed for reportable segments and the aggregated information in the enterprise financial statements.

In presenting the reconciliation:

- ◆ segment revenue should be reconciled to enterprise revenue;
- ◆ segment result should be reconciled to enterprise net profit or loss;
- ◆ segment assets should be reconciled to enterprise assets; and
- ◆ segment liabilities should be reconciled to enterprise liabilities.

Q-29 Is it necessary to identify Dinesh, a relative of key management personnel, who was paid Rs 150000 for services provided to the company from 1.4.2021 to 30.6.2021 and left the company on 1.7.2021, as of the closing date, i.e., on 31.3.2022, in accordance with the requirements of AS 18?

Ans:

According to AS 18 on 'Related Party Disclosures', parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Hence Dinesh, a relative of key management personnel, should be identified as related party for disclosure in the financial statements for the year ended 31.3.2022.

Q-30 Identify and elaborate on the entities or relationships that, under the guidelines of AS-18 (Related Party Disclosures), are not considered as related parties. Provide detailed insights into the criteria that exempt these entities from the classification of related parties in accounting practices.

Ans:

In the context of AS 18, the following are deemed not to be related parties:

(a) Two companies are not related parties simply because they have a director in common (unless the director is able to affect the policies of both companies in their mutual dealings). Accordingly, if the common director is able to influence the policies of both the companies in their mutual dealings – then related party relationship exists.

(b) A single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence; and

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

(i) Providers of finance

(ii) Trade unions

(iii) Public utilities

(iv) Government departments and government agencies including government sponsored bodies.

Q-31 Explore the circumstances under which entities may be exempted from related party disclosure requirements in financial reporting. Provide a detailed analysis, outlining the

specific situations and considerations that warrant such exemptions, and discuss the implications of these exemptions on transparency and disclosure in financial statements.

Ans:

- 1. Conflict with Confidentiality Duties:** If disclosing related party information, as required by Accounting Standard 18 (AS 18), conflicts with an enterprise's legal obligation to maintain confidentiality (as specified by a statute or regulator), the enterprise is exempt from disclosure. For instance, banks must keep customer transactions confidential by law, and AS 18 wouldn't override this obligation.
- 2. Consolidated Financial Statements:** In consolidated financial statements that represent a group of companies as a single entity, there's no need to disclose transactions between the group members. This is because consolidated statements focus on presenting information about the holding company and its subsidiaries as a unified reporting entity.
- 3. State-Controlled Enterprises:** State-controlled enterprises are not required to disclose related party relationships or transactions with other state-controlled enterprises in their financial statements. This exemption acknowledges the unique nature of these entities' relationships and transactions within a government-controlled framework.

Q-32 Discuss the accounting treatment and disclosure requirements for shares issued in a scheme of amalgamation. Provide a comprehensive overview, outlining the key considerations, principles, and reporting obligations associated with the issuance of shares in the context of business amalgamation.

Ans:

- 1. Purchase Amalgamation:** In a purchase-type amalgamation, equity shares issued as part of the deal are included in the weighted average number of shares from the acquisition date. This is because the acquiring company adds the transferor's operations into its financials starting from the acquisition date.
- 2. Merger Amalgamation:** In a merger-type amalgamation, equity shares issued as part of the deal are included in the weighted average number of shares from the beginning of the reporting period. This is because the financial statements assume the combined entity

existed from the start of the reporting period. The number of shares is adjusted to match the outstanding shares of the merged company post-amalgamation.

3. Partly Paid Equity Shares: Partly paid equity shares are considered a fraction of a fully paid share for the period they were entitled to dividends. This recognizes the partial contribution and entitlement of partly paid shares during the reporting period.

Q-33 E Ltd. had 10, 00,000 ordinary shares outstanding on 01.04.2020. Profit for 2020-21 was Rs 24, 00,000. Average fair value per share during 2020-21 was Rs 20. E Ltd. has given share option to its employees of 2, 00,000 shares at option price of Rs 15. **Calculate basic EPS and diluted EPS.**

Solution:

Profit for the year = Rs 24, 00, 000

Weighted average number of shares = 10, 00,000

Basic EPS = $24, 00,000 / 10, 00,000 = \text{Rs } 2.40$

No. of shares under option = 2, 00,000

No. of shares that would have been issued at fair value = $2, 00,000 \times 15/20 = 1, 50,000$

Weighted average number of shares = $10, 00,000 + (2, 00,000 - 1, 50,000) = 10, 50,000$

Adjusted earnings = Rs 24, 00,000

Diluted EPS = $24, 00,000 / 10, 50,000 = \text{Rs } 2.29$

Q-34 Y Ltd. supplied the following information:

Net Profit for 2019-20 = RS 10, 00,000

Net Profit for 2020-21 = RS 15, 00,000

No. of shares prior to right issue = 5, 00,000

Terms of right issue: 1 new share for every 4 shares held; right issue price = RS 20

Fair value of 1 ordinary share immediately prior to exercise of right = RS 25

Calculate basic EPS.

Solution:

Basic EPS for 2019-20 = $10, 00,000 / 5, 00,000 = \text{RS } 2.00$

Theoretical Ex-right fair value

$$= \frac{\text{Aggregate Market value of share immediately prior to the exercise of the rights} + \text{Proceeds from exercise of the rights}}{\text{Number of shares outstanding immediately after the right issue}}$$

$$= (5,00,000 \times 25 + 1,25,000 \times 20) / (5,00,000 + 1,25,000) = \text{Rs } 24$$

Right factor

$$= \frac{\text{Fairvalue per share immediately prior to right issue}}{\text{Theoretical ex-right fair value per share}} = 25/24 = 1.04$$

$$\text{Basic EPS for 2020-21} = 15,00,000 / (5,00,000 \times 1.04 \times 3/12 + 6,25,000 \times 9/12) = \text{Rs } 2.50$$

$$\text{Restated EPS for 2019-20} = 10,00,000 / (5,00,000 \times 1.04) = \text{Rs } 1.92$$

Q-35 How are share options factored into the calculation of diluted earnings per share (EPS), and what key aspects should be considered for accurate financial reporting?

Ans:

Diluted EPS in case of share options

For the purpose of calculating diluted earnings per share, an enterprise should assume the exercise of dilutive options and other dilutive potential equity shares of the enterprise. The assumed proceeds from these issues should be considered to have been received from the issue of shares at fair value. The difference between the number of shares issuable and the number of shares that would have been issued at fair value should be treated as an issue of equity shares for no consideration.

Options and other share purchase arrangements are dilutive when they would result in the issue of equity shares for less than fair value. The amount of the dilution is fair value less the issue price. **Therefore, in order to calculate diluted earnings per share, each such arrangement is treated as consisting of:**

- (a)** A contract to issue a certain number of equity shares at their average fair value during the period. The shares to be so issued are fairly priced and are assumed to be neither dilutive nor anti-dilutive. They are ignored in the computation of diluted earnings per share; and
- (b)** A contract to issue the remaining equity shares for no consideration. Such equity shares generate no proceeds and have no effect on the net profit attributable to equity shares

outstanding. Therefore, such shares are dilutive and are added to the number of equity shares outstanding in the computation of diluted earnings per share.

Q-36 Explore the accounting implications of discontinuing operations and the critical aspects involved in the initial disclosure event. Discuss the reporting requirements, considerations, and financial impact when entities decide to discontinue specific business activities.

Ans:

Discontinuing operation: A discontinuing operation is a component of an enterprise

(a) That the enterprise, pursuant to a single plan, is:

(i) Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders; or

(ii) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or

(iii) Terminating through abandonment; and

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

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

Separate major line of business or geographical area of operations:

◆ A reportable business segment or geographical segment as defined in AS 17 'Segment Reporting', would normally satisfy criteria and it would represent a separate major line of business or geographical area of operations.

◆ A part of such a segment may also satisfy criteria and it would represent a separate major line of business or geographical area of operations

◆ For an enterprise that operates in a single business or geographical segment which does not report segment information, a major product or service line may also satisfy the criteria (see example below)

Initial disclosure event

With respect to a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

- (a) The enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or
- (b) The enterprise's board of directors or similar governing body has both
- (i) Approved a detailed, formal plan for the discontinuance and
- (ii) Made an announcement of the plan.

A detailed, formal plan for the discontinuance normally includes:

- ✓ Identification of the major assets to be disposed of;
- ✓ The expected method of disposal;
- ✓ The period expected to be required for completion of the disposal;
- ✓ The principal locations affected;
- ✓ The location, function, and approximate number of employees who will be
- ✓ compensated for terminating their services; and
- ✓ The estimated proceeds or salvage to be realised by disposal.

An enterprise's board of directors or similar governing body is considered to have made the announcement of a detailed, formal plan for discontinuance, if it has announced the main features of the plan to those affected by it, such as, lenders, stock exchanges, trade payables, trade unions, etc. in a sufficiently specific manner so as to make the enterprise demonstrably committed to the discontinuance.

Q-37 A Company belonging to the process industry carries out three consecutive processes. The output of the first process is taken as input of the second process, and the output of the second process is taken as input of the third process. The final product emerges out of the third process. It is also possible to outsource the intermediate products. It has been found that over a period time cost of production of the first process is 10% higher than the market price of the intermediate product available freely in the market. The company has decided to close down the first process as a measure of cost saving (vertical spin off) and outsource. **Should this event be treated as discontinuing operation?**

Ans:

The change made by the company is focused on outsourcing of services, in respect of one single process – in a sequence of process. The net effect of this change is closure of facility relating to process.

This has been done by the company with a view to achieving productivity improvement and savings in costs.

Such a change does not meet definition criteria in paragraph 3(a) of AS-24 namely, disposing of substantially in its entirety, such as by selling a component of the enterprise in a single transaction. The change is merely a cost-saving endeavor. Hence, this change over is not a discontinuing operation.

Q-38 Detail the **disclosure and presentation requirements mandated by Accounting Standard 24 (AS 24) concerning discontinuing operations**. Provide a comprehensive explanation of the specific reporting obligations and presentation guidelines outlined by AS 24 when entities decide to discontinue certain operations.

Ans:

Initial Disclosure

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

- (a)** A description of the discontinuing operation(s);
- (b)** The business or geographical segment(s) in which it is reported as per AS 17;
- (c)** The date and nature of the initial disclosure event;
- (d)** The date or period in which the discontinuance is expected to be completed if known or determinable;
- (e)** The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
- (f)** The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;

(g) The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto;

(h) The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period;

Disclosures Other Than Initial Disclosures Note

All the disclosures above should be presented in the notes to the financial statements except for amounts pertaining to pre-tax profit/loss of the discontinuing operation and the income tax expense thereon (second last bullet above) which should be shown on the face of the statement of profit and loss.

Other disclosures

When an enterprise disposes of assets or settles liabilities attributable to a discontinuing operation or enters into binding agreements for the sale of such assets or the settlement of such liabilities, it should include, in its financial statements, the following information when the events occur:

(a) For any gain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation, (i) the amount of the pre-tax gain or loss and (ii) income tax expense relating to the gain or loss and

(b) The net selling price or range of prices (which is after deducting expected disposal costs) of those net assets for which the enterprise has entered into one or more binding sale agreements, the expected timing of receipt of those cash flows and the carrying amount of those net assets on the balance sheet date.

Q-39 S Ltd. presents interim financial report quarterly on 1.4.2014. S Ltd. has carried forward loss of `800 lakhs for income tax purpose for which deferred tax asset has not been recognized. S Ltd. earns ` 600 lakhs; `700 lakhs; `750 lakhs and `800 lakhs respectively in the subsequent quarters, excluding the carried forward losses. Income tax rate is 30%. **Calculate the amount of tax expense to be reported in each quarter.**

Solution:

The estimated payment of the annual tax on Rs 2,850 lakhs earnings for the current year = Rs (2,850 – 800) lakhs = Rs 2,050 lakhs.

Therefore, tax = 30% of Rs 2,050 lakhs = Rs 615 lakhs.

Average annual effective tax rate = $(615/2,850) \times 100 = 21.58\%$

Tax expense to be shown: Rs lakhs

1st quarter = $600 \times 21.58\% = 129.48$

2nd quarter = $700 \times 21.58\% = 151.06$

3rd quarter = $750 \times 21.58\% = 161.85$

4th quarter = $800 \times 21.58\% = 172.64$

Q-40 What are the key components of an interim financial statement? What are the essential components that must be included in a condensed interim financial statement as a minimum requirement?

Ans:

Form and contents of interim financial statement:

- a)** AS 25 doesn't prohibit an enterprise from presenting a complete set of financial statements (e.g. balance sheet, profit & loss statement, cash flow statement notes to account and accounting policies, other statements and other explanatory' materials as forming integral part of the financial statement).
- b)** The recognition and measurement principles as stated in AS-25 also apply to complete set of financial statements for an interim period, full disclosure under this statement and other accounting standard will be required.
- c)** Alternatively, the statement allows preparation and presentation 'of interim financial report in a condensed form, containing as a minimum, a set of condensed financial statements, providing update on the latest annual financial statements (does not duplicate the information already reported)

Contents of a condensed Interim Financial Statements as a minimum:

- 1.** A statement that the same accounting policies are followed as in the most recent annual financial statements - for change, description of the nature and effect of the change. Explanatory comment, about the seasonality of the interim operations the nature and

amount of items affecting assets, liability, equity, net income or cash flows that are unusual because of their nature, size or incidence.

2. The nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amount reported in prior financial year – if the those changes have a material effect in the current interim period.

3. Issues, buy-back, repayment and restructuring of debt, equity and potential equity shares.

4. Dividends, aggregate per share (in absolute or percentage) separately for equity and other shares

5. If compliance required under AS-17, segment revenue, segment capital employed and segment result for Business or Geographical segments (whichever is primary for reporting).

6. Effect of changes in the composition of the enterprise during the interim period (e.g. amalgamation, acquisition. or disposal of subsidiaries and long term investments, restructuring and discontinuing operation.

7. Material change in contingent liabilities since last annual B/S date.

Q-41 What does the Accounting Standard on Valuation of Inventories (AS-2) stipulate regarding the treatment of inventories as assets? Specifically, could you elaborate on the principle that inventories should be valued at the lower of cost or net realizable value (NRV)?

Ans:

Valuation of inventories

At the outset AS -2 excludes the following though appears to be inventory in common parlance:

(a) Work-in-progress in construction contract and directly related service contract (ref: AS-2), inventories not forming part of construction work-in-progress will attract AS-2

(b) Work-in-progress arising in the ordinary course of business of service providers Shares, debentures and other financial instruments held as stock-in-trade (ref: AS-13 as Current Investments)

(c) Livestock, agricultural and forest product, mineral oil/gasses as measured at net realizable value as per trade practices at certain stage of production.

AS-2 covers inventories as an item of assets which are

- (a) Held for sale in the ordinary course of business
- (b) In the process of production for such sale
- (c) In the form of material or supplies for the process of production or rendering of service

Inventories are valued at lower of cost or net realizable value (NRV)

(a) Cost to include purchase price, conversion and other costs incurred in bringing the inventories to their present location and condition. An enterprise should use the same cost formula for all inventories having similar nature and use - specific cost, FIFO, weighted average, standard cost, adjusted selling price

(b) Net realizable value is the estimated selling price in the ordinary course of business reduced by the estimated cost to bring the item in saleable condition, considered on each balance sheet date, usually on item by item basis or under suitable group of similar or related item.

Q-42 Cost of Production of product A is given below:

Raw material per unit	Rs 150
Wages per unit	Rs 50
Overhead per unit	Rs 50
	<u>Rs 250</u>

As on the balance sheet date the replacement cost of raw material is Rs 110 per unit. There are 100 units of raw material on 31.3.15.

Calculate the value of closing stock of raw materials in the following conditions:

- (i) If finished product is sold at Rs 275 per unit, what will be the value of closing stock of raw material?
- (ii) If finished product is sold at Rs 230 per unit, what will be the value of closing stock of raw material?

Solution:

(i) The realizable value of the product is more than the total cost of the product. The cost of raw material per unit is more than the replacement cost, hence, raw materials should be valued on actual cost.

Therefore, the value of raw materials: 100 units x Rs 150 per unit= Rs 15,000

(ii) The realizable value of the product is less than the total cost of the product. Though the cost of raw material per unit is more than the replacement cost, hence, raw materials should be valued on replacement cost.

Therefore, the value of raw materials: 100 units x Rs 110 per unit= Rs 11,000

Q-43 Discuss the factors that a company should take into consideration when determining the useful life of its assets. Highlight the relevance of these factors in the context of accounting practices and their impact on financial reporting, adhering to the relevant accounting standards.

Ans:

All the following factors are considered in determining the useful life of an asset:

(a) Expected usage of the asset. Usage is assessed by reference to the expected capacity or physical output of the asset.

(b) Expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

(c) Technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.

(d) Legal or similar limits on the use of the asset, such as the expiry dates of related leases.

Q-44 What additional disclosure requirements should a lessee follow for finance leases, beyond the stipulations of AS 10 (Revised), Property, Plant and Equipment, and the relevant

governing statute? Can you outline the specific disclosures that lessees are expected to make in the context of finance leases?

Ans:

DISCLOSURES MADE BY THE LESSEE

The lessee should, in addition to the requirements of AS 10 (Revised), Property, Plant and Equipment, and the governing statute, make the following disclosures for finance leases:

- (a)** Assets acquired under finance lease as segregated from the assets owned;
- (b)** For each class of assets, the net carrying amount at the balance sheet date;
- (c)** A reconciliation between the total of minimum lease payments at the balance sheet date and their present value. In addition, an enterprise should disclose the total of minimum lease payments at the balance sheet date, and their present value, for each of the following periods:
 - (i)** Not later than one year;
 - (ii)** Later than one year and not later than five years;
 - (iii)** Later than five years;
- (d)** Contingent rents recognised as expense in the statement of profit and loss for the period;
- (e)** The total of future minimum sublease payments expected to be received under non-cancelable subleases at the balance sheet date; and
- (f)** A general description of the lessee's significant leasing arrangements including, but not limited to, the following:
 - (i)** The basis on which contingent rent payments are determined;
 - (ii)** The existence and terms of renewal or purchase options and escalation clauses; and
 - (iii)** Restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Q-45 In the case of Company Y, a real estate development firm, they are acquiring a unique piece of land for a new project. The land has historical significance and includes certain preservation requirements. **How should Company Y approach determining the cost of this**

Property, Plant, and Equipment (PPE) in accordance with accounting standards, considering the special case of historical preservation considerations?

Ans:

Determination of Cost in special cases:

Cost of an item of PPE is the cash price equivalent at the recognition date.

A. If payment is deferred beyond normal credit terms: Total payment minus Cash price equivalent

1. is recognised as an interest expense over the period of credit
2. unless such interest is capitalised in accordance with AS 16

B. PPE purchased for a Consolidated Price:

Where several items of PPE are purchased for a consolidated price, the consideration is apportioned to the various items on the basis of their respective fair values at the date of acquisition.

Note: In case the fair values of the items acquired cannot be measured reliably, these values are estimated on a fair basis as determined by competent valuers.

C. PPE held by a lessee under a Finance Lease:

The cost of an item of PPE held by a lessee under a finance lease is determined in accordance with AS 19 (Leases).

D. Government Grant related to PPE:

The carrying amount of an item of PPE may be reduced by government grants in accordance with AS 12 (Accounting for Government Grants).

Q-46 In preparing the financial statements of X Ltd. for the year ended 31st March, 2015, you come across the following information. State with reasons, how would you deal with them in the financial statements: "An unquoted long term investment is carried in the books at a cost of Rs 5 lakhs. **The published accounts of the unlisted company received in June 2016 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than Rs 1 lakh**"

Solution:

As per AS-13, the long term investments should be carried in the financial statements at cost. If there is a diminution in the value of long term investments, which is not temporary in nature, provision should be made for each investment individually. Any reduction in the carrying amount should be charged to the Profit and Loss Account.

The long term investments are carried at a cost of Rs 5 lakhs in the books of accounts. The value of investments fall down to Rs 1 lakh due to cash losses and the declining market share of the company in which the investments were made.

In view of the provision contained in AS-13, the carrying amount of long-term investments should be brought down to Rs 1 lakh and Rs 4 lakhs should be charged to Profit and Loss Account for the year ended 31st March, 2016.

Q-47 According to AS 13, how would you **classify investments? Provide a concise explanation of the classification criteria outlined in the standard.** Discuss the key factors that influence the classification of investments and highlight any specific considerations that entities need to take into account when applying AS 13.

Ans:

Classification of investments**(1) Current investment/Short term investment:**

- ◆ Readily realizable and not intended to be held for more than a year from date of investment.
- ◆ The carrying amount on the reporting date is taken at lower of cost or fair value to prudently account for the unrealized losses but not the unrealized gains, considering individual or category of investments (not on overall basis).
- ◆ Any reduction to the fair value and any reversal to such reduction is included in the P/L Account.

(2) Long-term investment:

- ◆ Investments held otherwise even if readily marketable are long term investments
- ◆ Intended to protect, facilitate and furtherance to existing operation, also known as Trade investments (not meant to provide additional cash resources)

◆ Long-term investments are normally carried at cost unless there is a permanent diminution in the value when the same is recognized in the carrying amount by charging or reversing through P/L Account.

◆ The carrying amount is determined on individual investment basis.

On disposal, the difference between the carrying amount and the net proceed of disposal is recognized in the P/L Account.

Investment in Property is in Land or Building, not intended for occupation substantially for use by or in the operation of the Investing Enterprise, should be treated as long-term investment.

Q-48 On 1.1.2013, 6% 200 Debentures of Rs 100 each of Y and were held as investments by X Ltd. at a cost of Rs 18,200. Interest is payable on 31st December.

On 1.4.2013, Rs 4,000 of such Debentures were purchased by X Ltd. @ Rs 98 and on 1.1.2013. Rs 6,000 Debentures were sold at Rs 96 ex-interest. On 1.12.2013 Rs 8,000 Debentures were sold @ Rs 99 cum-interest. On 31.12.2013, X Ltd. sold Rs 10,000 Debentures @ Rs 95.

Prepare Investment Account for 6% Debentures of X Ltd. in the books of X Ltd. ignore income-tax.

Solution:

In the Books of X Ltd. Investment Account

(6% Debentures of Y Ltd. of Rs 100 each)

Date	Particulars	No. of Debentures	Value	Date	Particulars	No. of Debentures	Value
2013				2013			
Jan. 1	To Balance b/d	200	18,200	Jan. 1	By Bank – Sale	60	5,760
April 1	" Bank –	40	3,920	Dec. 1	" Bank – Sale	80	7,480
	" Purchases			Dec 31	" Bank - Sale	100	9,500
	" Profit & Loss						
	A/c						
	Profit	—	620				
		240	22,740			240	22,740

Working Note:

80 Debentures which were sold on 1.12.2013 at Rs 99 cum-interest is inclusive of accrued interest for 11 months (i.e., Rs 5.50). The same is to be deducted from the sale price (i.e., Rs 99 – Rs 5.50 = Rs 93.50).

Q-49 In the context of Firm Z, a construction company undertaking a major infrastructure project, the company has incurred significant borrowing costs related to financing the project. In compliance with Accounting Standard 16 (AS-16), **what are the specific accounting treatment guidelines for incorporating these borrowing costs into the cost of qualifying assets, and what disclosure requirements does AS-16 mandate for these borrowing costs in Firm Z's financial statements?**

Ans:

Accounting treatment of borrowing cost as per AS-16:

- ➔ Borrowing costs should either be capitalized or charged to P/L Account depending on the situation but deferment is not permitted.
- ➔ Borrowing costs are capitalized as part of cost of qualifying asset when it is probable that they will result in future economic benefits and cost can be measured reliably - other borrowing costs are charged to P/L Account in the accounting period in which they are incurred.
- ➔ Capitalization, on one hand reflects closely the total investment in the asset and on the other hand to charge the cost to future period against accrual of revenue.
- ➔ Notional interest cost are not allowed to be capitalized.
- ➔ A qualifying asset is an asset that necessarily takes a substantial period of time (usually a period of 12 months unless otherwise justified on the basis of facts and circumstances) to get ready for its intended use or sale.
- ➔ Capitalization should be suspended during extended period in which active development is interrupted.
- ➔ Capitalization should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

➔ Capitalization also ceases 'when part is completed, which is capable of being used independent of the whole.

Disclosure under AS- 16

- Accounting Policy adopted
- Amount of borrowing cost capitalized during the accounting period

Q-50 A Ltd. has undertaken a project for expansion of capacity as per the following details (all figures in rupees):

		Plan	Actual
April	2013	2,00,000	2,00,000
May	2013	2,00,000	3,00,000
June	2013	10,00,000	-
July	2013	1,00,000	-
August	2013	2,00,000	1,00,000
September	2013	5,00,000	7,00,000

The company pays to its bankers @ 12% p.a. interest being debited on a monthly basis. During the half- year the company had ` 10 lakhs overdraft up to 31st July, surplus cash in August as against overdraft of over ` 10 lakhs from 1.9.2013. The company had a strike during June and, hence, could not continue the work during June. Work was again commenced on 1st July and all the works were completed on 30th September. Assume that expenditures were incurred on 1st day of each month.

Calculate: (i) Interest to be capitalised; and (ii) Give reasons whenever necessary.

Assume: (a) Overdraft will be less if there is no capital expenditure: (b) The Board of Directors, based on the facts and circumstances of the case, has decided that any capital expenditure taking more than 3 months as substantial period of time.

Solution:

(i) Interest to be Capitalised

Calculation of Interest to be Capitalised

Period	Actual amount of Expenditure	Interest @ 12% p.a. i.e. 1% p.m.	Cumulative expenditure including Interest
2013	,	,	,

April	2,00,000	2,000	2,02,000
May	3,00,000	5,020	5,07,020
June	—	5,070	5,12,090
July	—	5,121	5,17,211
August	1,00,000	—*	6,17,211
September	7,00,000	13,172	13,30,383

* Cash surplus and no overdraft hence no interest cost.

As per of AS 10:

Borrowing costs may be incurred during an extended period in which the activities necessary to prepare an asset for its intended use or sale are interrupted. Such costs are costs of holding partially completed assets and do not qualify for capitalisation. However, capitalisation of borrowing costs is not normally suspended during a period when substantial, technical and administrative work is being carried out. Capitalisation of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

(ii) In the present case, Board of Directors has decided that any capital expenditure taking more than 3 months as substantial period of time. Thus, strike period may be ignored and interest for that period may be capitalised accordingly. In the month of August, as there was surplus amount of cash, no interest should, as such, be capitalised.

Q-51 Milind Softex Ltd. has taken the assets on lease from ABC Impex Ltd. The following information is given below:

Lease Term	= 4 years
Fair value at inception of lease	= Rs 16, 00,000
Lease Rent	= Rs 5, 00,000 p.a. at the end of year
Guaranteed Residual Value	= Rs 1, 00,000
Expected Residual Value	= Rs 2, 00,000
Implicit Interest Rate	= 14.97%

How the accounting is done in the book of lessor?

Solution:

Lessor should recognize asset given under lease at net investment in lease.

Net investment in lease = Gross investment – unearned finance income

Gross Investment = MLP + Guaranteed residual value + Unguaranteed residual value

= Rs 20, 00,000 + Rs 1, 00,000 + Rs 1, 00,000

= Rs 22, 00,000

Unearned Finance Income = Gross Investment – present value of gross investment

Year	Value of MLP Rs	Gross investment discount factor	Present Value Rs
1	5,00,000	0.8698	4,34,900
2	5,00,000	0.7565	3,78,250
3	5,00,000	0.6580	3,29,000
4	7,00,000	0.5724	4,00,680
	22,00,000		15,42,830

Unearned Finance Income = Rs 22, 00,000 – Rs 15, 42,830 = Rs 6, 57,170

Apportionment of MLP into Capital recovery & Finance income

Year	Balance of lease receivable	Cash receipts	Finance	Capital recovery reduced from receivable
0	15,42,830	-	-	-
1	12,73,792	5,00,000	2,30,962	2,69,038
2	9,64,479	5,00,000	1,90,687	3,09,313
3	6,08,862	5,00,000	1,44,383	3,55,617
4		7,00,000	91,147	6,08,853
			6,57,179	15,42,821

The lease receivable account shown in the books of lessor will not tally with the lease liability account as shown by the lessee in his book. Difference will remain because of guaranteed residual value from the third party or/ and unguaranteed residual value from the lessee point of view.

Q-52 Define the concept of accounting treatment for both the Lessor and Lessee in their financial books. Provide a comprehensive understanding of how lease transactions are

recorded and reported, and analyze the implications for financial statements of both parties involved.

Ans:

AS -19: LEASES

Accounting for Finance Lease – In the books of Lessee

- ◆ Leased asset as well as liability for lease should be recognized at the lower of –
 - Fair value of the leased asset at the inception of lease or
 - Present value of minimum lease payment from the lessee point of view.
- ◆ Apportionment of lease payment-Each lease payment is apportioned between finance charge and principal amount.
- ◆ The lessee in its books should charge depreciation on finance lease asset as per AS-6(in this case, straight line method will be followed)
- ◆ Initial direct cost for financial lease is included in asset under lease.

Accounting for Finance Lease – In the books of Lessor

➔ The Lessor should recognize asset given under finance lease as receivable at an amount equal to net investment in the lease and corresponding credit to sale of asset.

Net Investment = Gross Investment – Unearned Finance Income.

Gross Investment = Minimum lease payment from Lessor point of view + Unguaranteed residual value.

Unearned Finance Income = Gross Investment – Present Value of Gross Investment.

➔ Recognition of Finance Income

The Lessor should recognize the finance income based on a pattern reflecting, constant periodic return on the net investment outstanding in respect of the finance lease. In simple words interest / finance income will be recognized in proportion to outstanding balance receivable from lease over lease period.

Accounting for Operating Lease- In the books of Lessor:

- ◆ Record leased out asset as the fixed asset in the balance sheet.
- ◆ Charge depreciation as per AS-6

- ◆ Recognize lease income in profit & loss account using straight line method. If any other method reflects more systematic allocation of earning derived from the diminishing value of leased out asset, that approach can be adopted.
- ◆ Other costs of operating lease should be recognized as expenses in the year in which they are incurred.
- ◆ Initial direct cost of the lease may be expensed immediately or deferred.

Accounting for operating lease – In the Books of Lessee

Lease payments should be recognized as an expense in the profit and loss account on a straight line basis over the lease term. If any other method is more representative of the time pattern of the user's benefit, such method can be used.

"Sale and Lease back"

A sale and lease back transaction involves the sale of an asset by vendor and leasing of the same asset back to the vendor

Accounting treatment of Sale and Lease back

1. If lease back is Finance Lease

- ✓ Any profit or loss of sale proceeds over the carrying amount should not be immediately recognized as profit or loss in the financial statements of a seller-lessee.
- ✓ It should be deferred and amortized over lease term in proportion to the depreciation of leased asset.

Q-53 What is the criteria for recognition and measurement of Internally generated intangible assets. **Describe which kind of cost is considered for capitalisation with respect to provisions of AS 26.** Whether the same applies for internally generated goodwill also?

Ans:

To assess whether an internally generated intangible asset meets the criteria for recognition, an enterprise classifies the generation of the asset into 2 phases:

- Research Phase &
- Development Phase

Research Phase - The expenses related to Research phase is expensed off in statement of Profit and loss.

Development Phase - Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the conditions given in para 6.15.

Cost of an Internally Generated Intangible Asset

The cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria. Reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports is prohibited.

The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and making the asset ready for its intended use from the time when the intangible asset first meets the recognition criteria. For details, refer para 6.16.

Internally generated goodwill is not recognised as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

Q-54 D Ltd. is developing a new distribution system of its material, following the costs incurred at different stages on research and development of the system:

Year ended 31.3	Phase/Expenses	Amount (Rs In lakhs)
2012	Research	8
2013	Research	10
2014	Development	30
2015	Development	36
2016	Development	50

On 31.3.12, D Ltd. identified the level of cost savings at Rs 16 lakhs expected to be achieved by the new system over a period of 5 years, in addition this system developed can be marketed by way of consultancy which will earn cash flow of Rs 10 lakhs per annum. D Ltd. demonstrated that new system meet the criteria of asset recognition as on 1.4.2014.

Determine the amount/cash which will be expensed and to be capitalized as intangible assets, presuming that no active market exist to determine the selling price of product i.e. system developed. System shall be available for use from 1.4.2012.

Solution:

As per AS-26, research cost of Rs 18 lakhs to be treated as an expense in respective year ended 31st March 2012 and 2013 respectively.

The development expenses can be capitalized from the date the internally generated assets (new distribution system in this given case) meet the recognition criteria on and from 1.4.2012. Therefore, cost of Rs 30 + 36 + 50 = Rs 116 lakhs is to be capitalized as an intangible asset.

However, as per para 62 of AS-26, the intangible asset should be carried at cost less accumulated amortization and accumulated impairment losses.

At the end of 31st March, 2016, D Ltd. should recognize impairment loss of `22.322 lakhs = (116 - 93.678) and carry the new distribution system at ` 93.678 lakhs in the Balance Sheet as per the calculation given below:

Impairment loss is excess of carrying amount of asset over recoverable amount. Recoverable amount is higher of two i.e. value in use (discounted future cash inflow) and market realizable value of asset.

The calculation of discounted future cash flow is as under assuming 12% discount rate.

Year	Cost Savings	Inflow by introducing the system	Total cash inflow	Discounted at 12%	Discounted cash flow
2017	16	10	26	0.893	23.218
2018	16	10	26	0.797	20.722
2019	16	10	26	0.711	18.486
2020	16	10	26	0.635	16.51

2021	16	10	26	0.567	14.742
Total					93.678

No amortization of asset shall be done in 2012 as amortization starts after use of asset which is during the year 2016-17.

Q-55 How is the recoverable amount measured in accounting, and what specific criteria are employed in the determination of this financial metric?

Ans:

- An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.
- Recoverable amount is the higher of an asset's net selling price and its value in use.
- Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.
- Costs of disposal are incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense. The best evidence for net selling price is a price in the bidding sales agreement for the disposal of the assets or similar assets. In the absence of this, net selling price is estimated from the transactions for the assets in active market, if the asset has the active market. If there is no binding sale agreement or active market for an asset, net selling price is based on the best information available to reflect the amount that an enterprise could obtain, at the balance sheet date, for the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal.
- Value in Use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

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

- a. Estimating the future cash inflows and outflows arising from continuing use of the asset and from its ultimate disposal; and
- b. Applying the appropriate discount rate to these future cash flows.

- Carrying amount is the amount at which an asset is recognised in the balance sheet after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.
- Depreciation (Amortisation) is a systematic allocation of the depreciable amount of an asset over its useful life.
- Depreciable amount is the cost of an asset, or other amount substituted for cost in the financial statements, less its residual value.
- Useful life is either:
 - The period of time over which an asset is expected to be used by the enterprise; or
 - The number of production or similar units expected to be obtained from the asset by the enterprise.

Q-56 AB Ltd. acquired C Ltd. as on 31.03.2010 for ` 6,000 Lakhs [Goodwill (to be amortised in 5 years) ` 1,000 Lakhs and other Fixed Assets ` 5,000 Lakhs]. The anticipated useful life of the acquired assets is 8 years. The company uses straight-line method of depreciation with no residual values. On 31.03.2012, due to change in Government policies, the company estimates the significant decline in production. The Net Selling Price is ` 3,000 Lakhs.

The cash flow forecast based on recent financial budget for the next 6 years after considering changed Government policies are as follows, incremental financing cost is 10% which represent current market assessment of the time value of money.

Year	Cash Flow (` in Lakh)
2012-13	700
2013-14	700
2014-15	600
2015-16	500
2016-17	500
2017-18	400

You are required to calculate the amount of impairment loss and revised carrying amount.

Solution:

Computation of Value in Use

[` in Lakh]

Year	Cash Flow	Discount as per 10%	Discounted Cash Flow
2012-13	700	0.909	636.3
2013-14	700	0.826	578.2
2014-15	600	0.751	450.6
2015-16	500	0.683	341.5
2016-17	500	0.621	310.5
2017-18	400	0.564	225.6
Total			2,542.7

Computation of Impairment Loss and Revised Carrying Amount

[` in Lakh]

	Goodwill	Other Fixed Assets	Total
Cost of Acquisition	1,000	5,000	6,000
Less : Depreciation for 2 years	400	1,250	1,650
Carrying Amount	600	3,750	4,350
Recoverable Amount (Higher of Value in Use ` 2,542.7 Lakhs or Net Selling Price ` 3,000 Lakhs			3,000
Impairment Loss			1,350
Allocation of Loss	600	750	
Carrying Amount after Impairment Loss	Nil	3,000	3,000

Q-57 Following are the major differences between Ind AS 19, Accounting for Employee Benefits and AS 15, Employee Benefits:

Ans:

S. No.	Ind AS 19	AS 15
1.	In Ind AS 19, employee benefits arising from constructive obligations are also covered.	AS 15 does not deal with the same.

2.	Ind AS 19 the term 'employee' includes directors.	As per AS 15, the term 'employee' includes whole-time directors.
3.	Ind AS 19 deals with situations where there is a contractual agreement between a multi-employer plan and its participants that determines how the surplus in the plan will be distributed to the participants (or the deficit funded).	AS 15 does not deal with it.
4.	Ind AS 19 encourages, but does not mandate, entities to involve a qualified actuary in the measurement of all material postemployment benefit obligations.	No such guidelines are present in AS 15. AS 15 does recognise that enterprises would normally use the services of a qualified actuary.
5.	Ind AS 19 requires that the same shall be recognised in other comprehensive income and should not be recognised in profit or loss.	AS 15 requires recognition of actuarial gains and losses immediately in the profit and loss.
6.	Ind AS 19 makes it clear that financial assumptions shall be based on market expectations, at the end of the reporting period, the period over which the obligations are to be settled.	AS 15 does not clarify the same.
7.	Under Ind AS 19, more guidance has been given for timing of recognition of termination benefits.	Recognition criteria for termination benefits differ from the criteria given in Ind AS 19.
8.	It provides guidance on accounting for contributions from employees or third parties to defined benefit plans, which are linked to service - both dependent and independent of the number of years of	No specific guidance.

	service.	
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Q-58 The Company revised an actuarial valuation for the first time for its pension scheme, which revalued a surplus of Rs 12 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to Rs 4 lakhs instead of Rs 10 lakhs. The average remaining life of the employees, if estimated to be 6 years, **you are required to advise the company considering the Accounting Standards 15 and 5.**

Solution:

As per para 92 of AS 15 (Revised in 2005), Employee Benefits, any actuarial gains or losses should be recognised immediately in the Profit and Loss Statement as incomes or expenses. As such, in the present case, a surplus amounting to Rs 12 lakhs from pension scheme is an actuarial gain. The same should be recognised as an income and, hence, should be adjusted against current year's Profit and Loss Account. It must not be adjusted against the contribution of the current year.

It is needless to say that the surplus that arises as a result of reviewing actual valuation of pension scheme by a company must be treated as a change in accounting policy. Application of AS 15 (Revised) may give rise to change in accounting policy as per para 32 of AS 5.

Q-59 What are the main **provisions of Accounting Standard 15 (AS 15) regarding post-employment benefits?** How does AS 15 impact the treatment of these benefits in financial statements, including recognition, measurement, and disclosure requirements? Also, how does AS 15 contribute to increased transparency in an organization's reporting of post-employment benefit obligations?

Ans:

The accounting treatment and disclosures required for a post-employment benefit plan depend upon whether it is defined contribution or defined benefit plan. In addition to addressing defined contribution and defined benefit plans generally, the Standard also gives

guidance as to how its requirements should be applied to insured benefits, multi-employment benefit plans.

1. Defined contribution plans (DCP) are post-employment benefit plans under which an enterprise pays fixed contributions into a separate fund and will have no obligation to pay further contributions. Under defined contribution plans, actuarial risk and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the employee. A common example of Defined Contribution plans is Provident Fund.

2. Defined benefit plans are post-employment benefit plans other than defined contribution plans. In defined benefits plans, the actuarial and investment risk fall on the employer.

In defined contribution plans, the contribution is charged to income statement, whereas in defined benefit plans, detailed actuarial calculation is performed to determine the charge.

Q-60 The following data apply to a company's defined benefit pension plan for the year:

Fair market value of plan assets (beginning of year)	40,000
Fair market value of plan assets	57,000
Employer Contribution	14,000
Benefit Paid	10,000

Calculate the Actual Return on plan assets.

Solution:

The actual return is computed as follows:

Amount (Rs)

Fair Market Value of plan assets (end of year)		57,000
Fair Market Value of plan assets (beginning of year)		40,000
Change in plan assets		17,000
Adjusted for		
Employer Contributions	14,000	
Less: Benefit Paid	10,000	4,000
Actual Return on plan assets		13,000

Q-61 (i) In what manner does the **accounting treatment for Gratuity benefit and other defined benefit schemes** differ based on the specific arrangements established by the employer?

(ii) Provide a detailed **explanation of the disclosure requirements as stipulated under Accounting Standard 15 (AS-15)** in the context of these benefit schemes?

Ans:

i) Accounting treatment for Gratuity benefit and other defined benefit schemes depends on the arrangement made by the employer

A) No separate fund i.e. out of nonspecific own fund:

- ◆ Provision for accruing liability in the P/L Account for the accounting period is made.
- ◆ The provision is based on an actuarial method or some other rational method (assumption that all employers are eligible at the end of the accounting period)

B) Own separate/specific fund established through Trust:

The amount required to be contributed on actuarial basis is certified by the Actuary, and the actual contribution plus and shortfall to meet the actuarial amount is charged to P/L Account for the accounting period, any excess payment treated as prepayment.

C) Fund established through Insurer: in the same manner as in (b) above:

Actual valuation may be carried out annually (cost can be easily determined for the purpose of contribution as a charge to P/L) or periodically (say, once in 3 years) where Actuary's certificate specifies contribution on annual basis during inter-valuation period.

Leave encashment is an accrued estimated liability based on employers' past experience as to such benefit actually availed off and probability of encashment in future and therefore should relate to the period in which relevant service is rendered in compliance with section 128 – accrual basis and AS-15.

ii) Disclosure under AS-15

A) In view of the varying practices, adequate disclosure of method of accounting for an understanding of the significance of such costs to an employer.

B) Disclosure separately made for statutory compliance or otherwise the retirement benefit costs are treated as an element of employee remuneration without specific disclosure.

C) Financial statements should disclose whether actuarial valuation is made at the end of the accounting period or earlier (in which case the date of actuarial valuation and the method used for accrual period if not based on actuary report).

Q-62 Explain the different types of employee benefits under AS 15 and discuss the objectives behind its implementation to improve financial reporting and transparency in disclosing employee benefit obligations.

Ans:

There are four types of employee benefits according to AS 15 (Revised 2005). They are:

- (a)** Short-term employee benefits, such as wages, salaries and social security contributions. (e.g., contribution to an insurance company by an employer to pay for medical care of its employees), paid annual leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;
- (b)** Post-employment benefits such as gratuity, pension, other retirement benefits, post-employment life insurance and post-employment medical care;
- (c)** other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation; and
- (d)** Termination benefits.

Because each category identified in (a) to (d) above has different characteristics, this Statement establishes separate requirements for each category.

The objective of AS 15 is to prescribe the accounting and disclosure for employee benefits.

The statement requires an enterprise to recognise:

- (a)** a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

(b) an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Q-63 You are an accountant preparing accounts of P Ltd. as on 31.3.2013. After year-end the following events have taken place in April 2013:

(i) A fire broke out in the premises damaging un-insured stock worth Rs 10 lakhs (Salvage value Rs 2 lakhs).

(ii) A suit against the company's advertisement was filed by a party claiming damage of Rs 20 lakhs.

(iii) Dividend approved @ Rs 20 on share capital of Rs 100 lakhs.

Describe how the above will be dealt with in the account of the company for the year ended 31st March 2013.

Solution:

(i) As per AS 4, Events Occurring after the Balance Sheet Date, events occurring after the Balance Sheet date that represent material changes and commitments which affect the financial position must be disclosed. Thus loss by fire must be disclosed but they do not require any adjustment since the event is not related to circumstances existing on the date of preparing Balance Sheet.

(ii) As per AS 4, an estimate of the financial effect and uncertainties which may affect the future outcome must be disclosed. As such, the claim which was filed against the company may be treated as contingent liability which must be disclosed in the financial statement.

(iii) As per AS 4, Dividends stated to be in respect of the period covered by the financial statements, which are proposed or declared by the enterprise after the balance sheet date but before approval of the financial statements, should be adjusted.

Thus, the dividends which were proposed or declared by the company after the Balance Sheet date but before approval of the financial statements should be adjusted.

Q-64 A Corporation is adopting the recognition and measurement rules in its financial reporting. As the auditor, discuss the key considerations and steps involved in applying

these rules and **how the recognition and measurement rules are practically implemented in the financial statements of a Corporation.**

Ans:

Application of the recognition and measurement rules

1) Future Operating Losses: Future operating losses do not meet the definition of a liability and the general recognition criteria; therefore, provisions should not be recognized for future operating losses.

2) Restructuring

The following are examples of events that may fall under the definition of restructuring:

- (a)** Sale or termination of a line of business
- (b)** The closure of business locations in a country or region or the relocation of business activities from one country or region to another
- (c)** Changes in management structure, for example, eliminating a layer of management
- (d)** Fundamental re-organizations that have a material effect on the nature and focus of the enterprise's operations

A provision for restructuring costs is recognized only when the recognition criteria for provisions are met. No obligation arises for the sale of an operation until the enterprise is committed to the sale, i.e., there is a binding sale agreement. Until there is a binding sale agreement, the enterprise will be able to change its mind and indeed will have to take another course of action if a purchaser cannot be found on acceptable terms.

A restructuring provision should include only the direct expenditures arising from the restructuring, **which are those that are both:**

- (i)** Necessarily entailed by the restructuring; and
- (ii)** Not associated with the ongoing activities of the enterprise.

A restructuring provision does not include such costs as:

- (i)** Retraining or relocating continuing staff;
- (ii)** Marketing; or
- (iii)** Investment in new systems and distribution networks.

These expenditures relate to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognized on the same basis as if they arose independently of a restructuring.

Identifiable future operating losses up to the date of a restructuring are not included in a provision.

Gains on the expected disposal of assets are not taken into account in measuring a restructuring provision, even if the sale of assets is envisaged as part of the restructuring.

Q-65 Mega Ltd. took a factory premises on lease on 1.4.2014 for Rs 2, 00,000 per month. The lease is operating lease. During March, 2015, Mega Ltd. relocates its operation to a new factory building. The lease on the old factory premises continues to be live upto 31.12.2017. The lease cannot be cancelled and cannot be sub-let to another user. The auditor insists that lease rent of balance 33 months upto 31.12.2017 should be provided in the accounts for the year ending 31.3.2015. **Mega Ltd. seeks your advice.**

Solution:

In accordance with AS 29 'Provisions, Contingent Liabilities and Contingent Assets' and ASI 30

'Applicability of AS 29 to Onerous Contracts', if an enterprise has a contract that is onerous, the present obligation under the contract should be recognized and measured as a provision. In the given case, the operating lease contract has become onerous as the economic benefit of lease contract for next 33 months up to 31.12.2017 will be nil. However, the lessee, Mega Ltd., has to pay lease rent of RS 66, 00,000 (i.e. 2, 00,000 p.m. for next 33 months).

Therefore, provision on account of Rs 66, 00,000 is to be provided in the accounts for the year ending 31.03.15. Hence auditor is right.

Q-66 What is the **treatment of contingent assets and contingent liabilities** in financial reporting, and under **what circumstances does an enterprise recognize or disclose them** in its financial statements?

Ans:

1) Contingent assets

Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain.

An enterprise should not recognize a contingent asset, since this may result in the recognition of income that may never be realized. However, when the realization of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate. A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and, the corresponding approving authority in the case of any other enterprise), where an inflow of economic benefits is probable.

Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognized in the financial statements of the period in which the change occurs.

2) Contingent liabilities

An enterprise should not recognize a contingent liability but should be disclosed. A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote.

Where an enterprise is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. The enterprise recognizes a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable, except in the extremely rare circumstances where no reliable estimate can be made.

Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognized in the financial statements of the period in which the change in probability occurs.

Q-67 What are contingencies in accounting, and how are contingent losses and gains treated? Explain the conditions under which contingent losses are recognized, and the criteria for recognizing contingent gains. Additionally, **outline the accounting treatment**, emphasizing the disclosure in financial statements and potential accrual for losses.

Ans:

Contingencies

Contingency is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events.

Accounting Treatment of Contingent Losses

The accounting treatment of a contingent loss is determined by the expected outcome of the contingency. If it is likely that a contingency will result in a loss to the enterprise, then it is prudent to provide for that loss in the financial statements.

Accounting Treatment of Contingent Gains

Contingent gains are not recognised in financial statements since their recognition may result in the recognition of revenue which may never be realised. However, when the realisation of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate.

The amount at which a contingency is stated in the financial statements is based on the information which is available at the date on which the financial statements are approved.

Q-68 During the year 2021-2022, Raj Ltd. was sued by a competitor for RS 15 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Raj Ltd. provided for a sum of Rs 10 lakhs in its financial statements for the year ended 31st March, 2022. On 18th May, 2022, the Court decided in favour of the party alleging infringement of the trademark and ordered Raj Ltd. to pay the aggrieved party a sum of Rs 14 lakhs. The financial statements were prepared by the company's management on 30th April, 2022, and approved by the board on 30th May, 2022.

Solution:

As per **AS 4 (Revised)**, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

In the given case, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 2021-22 for which the provision was also made by it, the decision of the Court on 18th May, 2022, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Raj Ltd. should adjust the provision upward by Rs 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

Had the judgment of the Court been delivered on 1st June, 2022, it would be considered as an event occurring after the approval of the financial statements which is not covered by AS 4 (Revised). In that case, no adjustment in the financial statements of 2021-22 would have been required.

Q-69 What are events **occurring after the balance sheet date in accounting**, and what are the **types of such events**? Provide an explanation of how these post-balance sheet events are considered in financial reporting and decision-making processes.

Ans:

Events occurring after the balance sheet date

Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity.

There are two types of events can be identified:

➔ **Adjusting events:** Adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. For example, an adjustment may be made for a loss on a trade receivable account which is confirmed by the insolvency of a customer which occurs after the balance sheet date.

➔ **Non-adjusting events:** Adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. An example is the decline in market value of investments between the balance sheet date and the date on which the financial statements are approved. Ordinary fluctuations in market values do not normally relate to the condition of the investments at the balance sheet date but reflect circumstances which have occurred in the following period. Events occurring after the balance sheet date which do not affect the figures stated in the financial statements would not normally require disclosure in the financial statements although they may be of such significance that they may require a disclosure in the report of the approving authority to enable users of financial statements to make proper evaluations and decisions.

Q-70 How does a Company break down its net profit or loss for the period on the statement of profit and loss? Discuss the significance of each component in assessing the company's financial performance. Explore potential external factors that could influence these components. Based on the disclosed components, propose strategies for a Company to improve its net profit in the upcoming reporting period.

Ans:

Net profit or loss for the period

All items of income and expense which are recognized in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise.

The net profit or loss for the period comprises the following components, each of which should be disclosed on the face of the statement of profit and loss:

(a) Profit or loss from ordinary activities

Any activities which are undertaken by an enterprise as part of its business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities. For example, profit on sale of merchandise, loss on sale of unsold inventory at the end of the season.

(b) Extraordinary items

Income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

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 or in notes to accounts in a manner that its impact on current profit or loss can be perceived. Whether an event or transaction is clearly distinct from the ordinary activities of the enterprise is determined by the nature of the event or transaction in relation to the business ordinarily carried on by the enterprise rather than by the frequency with which such events are expected to occur. Therefore, an event or transaction may be extraordinary for one enterprise but not so for another enterprise because of the differences between their respective ordinary activities. For example, losses sustained as a result of an earthquake may qualify as an extraordinary item for many enterprises. However, claims from policyholders arising from an earthquake do not qualify as an extraordinary item for an insurance enterprise that insures against such risks.

Examples of events or transactions that generally give rise to extraordinary items for most enterprises are:

- Attachment of property of the enterprise
- An earthquake

(c) Exceptional items

When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Circumstances which may give rise to the separate disclosure of items of income and expense include:

- (a)** The write-down of inventories to net realisable value as well as the reversal of such write-downs

- (b) A restructuring of the activities of an enterprise and the reversal of any provisions for the costs of restructuring
- (c) Disposals of items of property, plant and equipment
- (d) Disposals of long-term investments
- (e) Legislative changes having retrospective application
- (f) Litigation settlements
- (g) Other reversals of provisions

Q-71 Mr.Pradip an employee of CCL Ltd.went on leave with a pay for 9 months on 1.1.2015 up to 30.09.2015. His monthly pay was ` 25,000. While preparing the financial statement on 30.6.2015 for the year ended 31.03.15, the expense of salary of Mr.Pradip for 3 months (1.1.15 to 31.03.15) was not provided due to omission. **When Mr.Pradip joined on 1.10.15, the whole salary for 9 months was duly paid to him.**

Solution:

In this case, three months salary of Rs 75,000 is prior period expense and following entry should be passed:

Salary A/c	Dr. 1, 50,000	
Prior period expense (Salary) A/c	Dr. 75,000	
To Bank A/c		2,25,000

If Mr. Pradip was terminated from service on 1.1.15 and was re-instated in service by the Court on 30.09.15 with full pay protection (i.e. total salary was rewarded to him). As the employee was reinstated in service as per the Court's Order as on 1.10.2015, the following entry should be made:

Salary A/c	Dr. 2,25,000	
To Bank A/c		2,25,000

In such a case, there shall arise no error or omission while preparing the financial statements for the earlier years.

Q-72 Under what conditions is a **Corporation permitted to change its accounting policies**, and what potential effects might such changes have on the company's financial statements and overall financial perception?

Ans:

Changes in accounting policies

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

Accounting Policies can be changed only:

- When the adoption of a different accounting policy is required by statute; or
- For compliance with an Accounting Standard; or
- When it is considered that the change would result in a more appropriate presentation of the financial statements of the enterprise.

The following are not changes in accounting policies:

(a) The adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, e.g., introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement;

(b) The adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial.

Any change in an accounting policy which has a material effect should be disclosed. The impact of, and the adjustments resulting from, such change, if material, should be shown in the financial statements of the period in which such change is made, to reflect the effect of such change. Where the effect of such change is not ascertainable, wholly or in part, the fact should be indicated. If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

A change in accounting policy consequent upon the adoption of an Accounting Standard should be accounted for in accordance with the specific transitional provisions, if any,

contained in that Accounting Standard. However, disclosures required by paragraph 32 of this Standard should be made unless the transitional provisions of any other Accounting Standard require alternative disclosures in this regard.

Q-73 How is the process of **combining and segmenting construction contracts** typically addressed in accounting? Can you elaborate on the considerations and methods involved when combining or segmenting construction contracts, and how this impacts financial reporting in the construction industry?

Ans:

COMBINING AND SEGMENTING CONSTRUCTION CONTRACTS

A contractor may undertake a number of contracts.

The standard identifies certain cases where for the purposes of accounting, it is necessary to apply the Standard to the separately identifiable components of a single contract or to a group of contracts together in order to reflect the substance of a contract or a group of contracts.

(a) When a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

- (i)** Separate proposals have been submitted for each asset;
- (ii)** Each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and
- (iii)** The costs and revenues of each asset can be identified.

(b) A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when:

- (i)** The group of contracts is negotiated as a single package;
- (ii)** the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and
- (iii)** The contracts are performed concurrently or in a continuous sequence.

(c) A contract may provide for the construction of an additional asset at the option of the customer or may be amended to include the construction of an additional asset. The

construction of the additional asset should be treated as a separate construction contract when:

- (i) The asset differs significantly in design, technology or function from the asset or assets covered by the original contract; or
- (ii) The price of the asset is negotiated without regard to the original contract price.

Q-74 Calculate the loss/gain for the financial years 2014-15 and 2015-16.

	Exchange Rate
Goods purchased on 24.3.15 of US \$1,00,000	Rs 46.60
Exchange rate on 31.3.2015	Rs 47.00
Date of actual payment 5.6.2016	Rs 47.50

Solution:

As per AS-11, all foreign currency transactions should be recorded by applying the exchange rate at the date of transaction. Therefore, goods purchased on 24.03.2015 and corresponding creditor would be recorded at Rs 46.60

$$= 1,00,000 \times 46.60 = 46,60,000$$

As per AS-11, at the balance sheet date all monetary items should be reported using the closing rate. Therefore, the creditors of US \$1,00,000 outstanding on 31.3.2015 will be reported as:

$$1,00,000 \times 47.00 = 47,00,000.$$

Exchange loss Rs 40,000 (= 47,00,000 – 46,60,000) should be debited in Profit and Loss Account for 2014-15.

As per AS-11, exchange difference on settlement on monetary items should be transferred to Profit and Loss Account as gain or loss thereof:

$1,00,000 \times 47.50 = 47,50,000$ - 47,00,000 = RS 50,000 should be debited to profit or loss for the year 2014-15.

Q-75 Describe the considerations and criteria influencing the **treatment of foreign currency items at the balance sheet date**. Discuss how the nature of an item determines its specific treatment in terms of foreign currency translation.

Ans:

Reporting at each balance sheet date

The treatment of foreign currency items at the balance sheet date depends on whether the item is:

- monetary or non-monetary; and
- carried at historical cost or fair value (for non-monetary items).

(a) Foreign currency monetary items should be reported using the closing rate. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date, e.g., where there are restrictions on remittances or where the closing rate is unrealistic and it is not possible to effect an exchange of currencies at that rate at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from or required to disburse, such item at the balance sheet date.

(b) Non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction.

(c) Non-monetary items which are carried at fair value or other similar valuation denominated in a foreign currency should be reported using the exchange rates that existed when the values were determined.

(d) The contingent liability denominated in foreign currency at the balance sheet date is disclosed by using the closing rate.

Q-76 A multinational corporation, has a subsidiary operating as a non-integral foreign operation. **Define a non-integral foreign operation and explain the specific steps and considerations involved in translating the accounts of this subsidiary for consolidated financial statements.**

Ans:

Non-integral foreign operation

Accounting Standard -11 does not define the non-integral foreign operation, however it describes the same. As per the accounting standard following are the indications of non-integral foreign operation—

- Control by reporting enterprises - While the reporting enterprise may control the foreign operation; the activities of foreign operation are carried independently without much dependence in reporting enterprise.
- Transactions with the reporting enterprises are not a high proportion of the foreign operation's activities.
- Activities of foreign operation are mainly financed by its operations or from local borrowings. In other words it raises its finance independently and is in no way dependent on reporting enterprises.
- Foreign operation sales are mainly in currencies other than reporting currency.
- All the expenses by foreign operations are primarily paid in local currency not in the reporting currency.
- Day to day cash flows of the reporting enterprises is independent of the foreign enterprises cash flows.
- Sales prices of the foreign enterprises are not affected by the day to day changes in exchange rate of the reporting currency of the foreign operation.
- There is an active sales market for the foreign operation product.

The above are only indicators and not decisive/conclusive factors to classify the foreign operations as non-integral, much will depend on factual information, situations of the particular case and therefore, judgment is necessary to determine the appropriate classification.

Controversies may arise in deciding the foreign branches of the enterprises into integral or non-integral.

However there may not be any controversy that subsidiary associates and joint venture are non-integral foreign operation.

In case of branches classified as independent for the purpose of accounting are generally classified as non-integral foreign operations.

Translations of accounts of non-integral foreign operation –

Accounts of non-integral foreign operation are translated using the following principles:

- Balance sheet items i.e. Assets and Liabilities both monetary and non-monetary - apply closing rate.
- Items of income and expenses - at actual exchange rates on the date of transactions. However accounting standard allows average rate subject to materiality.
- Resulting exchange rate difference should be accumulated in a “foreign currency translation reserve” until the disposal of “net investment in non-integral foreign operation”.
- What is net investment in a non-integral foreign operation- An item for which settlement is neither planned nor likely to occur in foreseeable future which is in substance a net investment in nonintegral foreign operation, which may be calculated as - all assets exclude trade receivable less outside liabilities excluding trade payable.
- Contingent liability - at closing rate.
- Tax effects, if any may be accounted for as per AS-22.

Q-77 Om Limited is working on different projects which are likely to be completed within 3 years period. It recognizes revenue from these contracts on percentage of completion method for financial statements during 2015, 2016 and 2017 for `11,00,000, `16,00,000 and `21,00,000 respectively. However, for income-tax purpose, it has adopted the completed contract method under which it has recognized revenue of `7,00,000, `18,00,000 and `23,00,000 for the years 2015, 2016 and 2017 respectively. Income-tax rate is 40%. **Compute the amount of deferred tax asset/liability for the years 2015, 2016 and 2017.**

Solution:

Om Limited

Calculation of Deferred Tax Asset/Liability

Year	Accounting Income	Taxable Income	Timing Difference (balance)	Deferred Tax Liability (balance)
2015	11,00,000	7,00,000	4,00,000	1,40,000
2016	16,00,000	18,00,000	2,00,000	70,000
2017	21,00,000	23,00,000	NIL	NIL
	48,00,000	48,00,000		

Q-78 A Construction Company is undertaking a major infrastructure project. **Define what a construction contract** is and discuss the various **types of construction contracts** that Construction Company might encounter in its projects. Additionally, highlight the key characteristics and considerations associated with each type of construction contract.

Ans:

Accounting standard 7 construction contracts

Accounting Standard 7 prescribes the principles of accounting for construction contracts in the financial statements of contractors. The focus of the standard is to determine when the contractor should recognise contract revenue and contract costs in the statement of profit and loss.

A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

A construction contract is a formal agreement between parties for building something, like a bridge or a building. It could involve a single structure or a group of closely connected projects, like a refinery. Construction contracts also cover services linked to building, such as project management, and even contracts for tearing down or rebuilding structures and environmental restoration after demolition. Essentially, it includes everything from creating new things to fixing or getting rid of old ones.

Types of construction contracts

In a **fixed price contract**, the price is agreed as fixed sum or a fixed rate per unit of output. In some cases, the contract may require the customer to pay additional sums to compensate the contractor against cost escalations.

Fixed price contracts are common in case of public tenders (construction of roads, flyovers, office buildings). Such constructions usually have a budgeted costs and the public entity does not intend to spend more than the tender amount. At the same time, there can be various reasons where the cost of construction may increase. For example, a sudden increase in wage rates, construction material costs, may require the contractor to add **cost-**

escalation clauses and recover from the contractee. These cost escalations still meet the category of fixed price contracts.

A **cost-plus contract** is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus percentage of these costs or a fixed fee. Cost-plus contracts are common in case there is uncertainty of measurement of costs or time of completion. In such cases, a contractor does not expect to bear the loss due to those uncertainties. For example, if the scope of the contract cannot be fully assessed in the contract, both parties may agree to **cost-plus contracts**. Under such contracts, the contractor is compensated for the costs incurred by him plus agreed profit-margin.

Q-79 A firm of contractors obtained a contract for completion of bridges across river Revathi.

The following details are available in the records kept the year ended 31st March, 2012:

Particulars	₹ in Lakhs
Total Contract Price	1,000
Works Certified	500
Works not Certified	105
Estimated further cost	495
Progress payment received	400
Progress payment to be received	140

The firm seeks your advice and assistance in presentation of accounts keeping in view the requirements of AS-7 “Accounting for Construction Contract”.

Solution:

As per AS 7, ‘Construction Contract’, when it is probable that total contract costs will exceed total revenue, the expected loss should be immediately recognized as an expense. The amount of such a loss is determined irrespective of (a) Whether or not work has commenced on the contract, (b) the stage of completion of contract activity as per AS 7.

We are to compute the anticipated loss and current loss which are computed as:

Anticipated or Foreseeable Loss

Particulars	₹ in lakhs
Cost of Total Contract:	
Work Certified	500
Add: Work not certified	105
Add: Estimated further cost to completion	495
	1,100
Less: Contract Price	1,000
Anticipated / Foreseeable loss	100

Work-in-Progress/Stage of Completion: = Work certified+ Work not certified

= ₹ (500 +105) = ₹ 605

% of work completed

$605/1100 \times 100 = 55\%$

Recognition of Contract Revenue:

Total Contract Price x 55% = ₹ (1,000 × 55%) = ₹ 550 lakhs

Amount due from/to customers = Contract costs + Recognised profits – Recognised losses –
(Progress payments received + Progress payments to be received)

= [605 + Nil – 100 – (400 + 140)] ₹ in lakhs

= [605 – 100 – 540] ₹ in lakhs

Amount due to customers = ₹ 35 lakhs

The amount of ₹ 35 lakhs will be shown in the balance sheet as liability.

The relevant disclosures under AS 7 (Revised) are given below:

Particulars	₹ In lakhs
Contract revenue	550
Contract expenses	605
Expected Losses	45
Recognized profits less recognized losses	(100)
Progress billings (400 + 140)	540
Retentions (billed but not received from contractee)	140

Q-80 Advise P Ltd. about the treatment of the following in final statement of accounts for the year ended 31.03.13:

A claim lodged with the Railways in March 2010, for loss of goods of ₹ 2,00,000 had been passed for payment in March 2013 for ₹ 1,50,000. No entry was passed in the books of the company when claim was lodged.

Solution:

It becomes clear from the above statement that accounts were prepared for the year ended 31.03.13.

The problem states that there was a loss amounting for ₹ 2,00,000 in 2009-10, which was lodged in March 2010 with the Railways. The problem further states that, when the claim was lodged, no entry was passed in the books of account. This corroborate AS 9 and it says, "Revenue recognition is postponed if there is any uncertainty regarding its ultimate collection."

But, ₹ 1,50,000 was settled for payment against the claim of ₹ 2,00,000 in March 2013. Needless to say that the revenue is recognized in the Financial Statement prepared for the period ended 31.03.2013 as it was passed for payment.

Q-81 In a sale of electronic devices, with the buyer emphasizing warranty terms and the seller ensuring product quality, **how do the conditions for the sale of goods**, as per relevant legal frameworks, apply? Discuss the implications, obligations, and potential legal remedies for both parties, underscoring the importance of adhering to these conditions in the transaction.

Ans:

Conditions for sale of goods

- 1. Delayed Delivery at Buyer's Request:** If the buyer asks to delay receiving goods already identified and ready for delivery, the sale is complete. **(Conditions)** Goods identified, delivery delayed at buyer's request, and goods ready for delivery.
- 2. Sale on Approval Basis:** Revenue isn't recognized until the buyer formally accepts the goods or a set time for rejection has passed.
- 3. Goods Sold Subject to Inspection/Installation:** For complex installations, revenue waits until successful completion. Simple installations (e.g., plugging in a refrigerator) allow revenue recognition upon customer agreement.
- 4. Sale and Repurchase Arrangement:** Treated as a financing arrangement; no sale is recognized. Seller records a borrowing.
- 5. Trade Discounts and Volume Rebates:** Received discounts and rebates don't count as revenue; they reduce costs. Given discounts/rebates are deducted from revenue.
- 6. Cash Discounts:** Revenue is recognized at the gross amount, and cash discounts are recorded as an expense when the seller receives payment.
- 7. Consignment Sale:** Revenue isn't recognized until consigned goods are sold to a third party by the recipient.

Q-82 What is the '**Presentation of Grants Related to Specific Fixed Assets,**' and could you elaborate on **two acceptable alternative methods for presenting such grants in financial statements**, ensuring clarity and adherence to accounting standards?

Ans:

Presentation of grants related to specific fixed assets

Grants related to specific fixed assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such assets. Other conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

Two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives.

Method 1:

➔ The grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value.

➔ The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge.

➔ Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.

Method 2:

➔ Grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

➔ Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets.

➔ If a grant related to a non-depreciable asset requires the fulfilment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income.

Q-83 X Ltd. having a share capital of ₹ 20 lakhs and Y Ltd. having a share capital of ₹ 30 lakhs. Z Ltd. was formed to take over the business of X Ltd and Y Ltd. at a purchase consideration of ₹ 25 lakhs and ₹ 28 lakhs, payable in shares of Z Ltd. **The assets and liabilities were taken at their carrying amounts.**

Solution:

Since the purchase consideration is payable in shares of the transferee company and all the assets and liabilities are taken over at their carrying amounts, the amalgamation is in the nature of merger, i.e. **pooling of interests method**.

For X Ltd. Purchase consideration = ₹ 25 lakhs

Less: Share capital of X Ltd = ₹ 20 lakhs

Excess of purchase consideration = ₹ 5 lakhs. This shall have to be adjusted against the Reserves of Z Ltd.

For Y Ltd. Purchase Consideration = ₹ 28 lakhs

Less: Share Capital of Y Ltd = ₹ 30 lakhs

Since purchase consideration is less than share capital of the transferor company, ₹ 2 lakhs shall be treated as Capital Reserve.

Note: In case of amalgamation in the nature of purchase, goodwill shall have to be shown in the Balance Sheet of the Transferee Company. Such goodwill shall have to be written off over a maximum period of 5 years.

Q-84 H Ltd and its subsidiary S Ltd provide the following information for the year ended 31st March, 20X3:

	H Ltd. (₹ in lacs)	S Ltd. (₹ in lacs)
Sales and other income	5,000	1,000
Increase in Inventory (closing less opening)	1,000	200
Raw material consumed	800	200
Wages and Salaries	800	150
Production expenses	200	100
Administrative Expenses	200	100
Selling and Distribution Expenses	200	50
Interest	100	50
Depreciation	100	50

Other Information:

H Ltd. sold goods to S Ltd. of ₹ 120 lacs at cost plus 20%. Inventory of S Ltd. includes such goods valuing ₹ 24 lacs. Administrative expenses of S Ltd. include ₹ 5 lacs paid to H Ltd. as consultancy fees. Selling and distribution expenses of H Ltd. include ₹ 10 lacs paid to S Ltd. as commission.

H Ltd. holds 80% of equity share capital of ₹ 1,000 lacs in S Ltd. prior to 20X1-20X2. H Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by S Ltd. for the year 20X1-20X2.

Prepare a consolidated statement of profit and loss.

Solution:

Consolidated statement of profit and loss of H Ltd. and its subsidiary S Ltd. for the year ended on 31st March, 20X3

Particulars	Note No.	₹ in Lacs
I. Revenue from operations	1	5,865
II. Total Income		<u>5,865</u>
III. Expenses		
Cost of material purchased/consumed	2	1,180
Changes of inventories of finished goods	3	(1,196)
Employee benefit expense	4	950
Finance cost	5	150
Depreciation and amortization expense	6	150
Other expenses	7	535
Total expenses		<u>1,769</u>
IV. Profit before tax (II-III)		<u>4,096</u>

Notes to Accounts

		₹ in Lacs	₹ in Lacs
1.	Revenue from operations		
	Sales and other income		
	H Ltd.	5,000	
	S Ltd.	<u>1,000</u>	
		6,000	
	Less: Inter-company sales	(120)	
	Consultancy fees received by H Ltd. from S Ltd.	(5)	
	Commission received by S Ltd. from H Ltd.	<u>(10)</u>	5,865
2.	Cost of material purchased/consumed		
	H Ltd.	800	
	S Ltd.	<u>200</u>	
		1,000	
	Less: Purchases by S Ltd. from H Ltd.	<u>(120)</u>	880

	Direct expenses (Production)		
	H Ltd.	200	
	S Ltd.	<u>100</u>	<u>300</u>
			<u>1,180</u>
3.	Changes of inventories of finished goods		
	H Ltd.	1,000	
	S Ltd.	<u>200</u>	
	Less: Unrealized profits ₹ 24 lacs $\times \frac{20}{120}$	<u>(4)</u>	<u>1,196</u>
4.	Employee benefits and expenses		
	Wages and salaries:		
	H Ltd.	800	
	S Ltd.	<u>150</u>	<u>950</u>
5.	Finance cost		
	Interest:		
	H Ltd.	100	
	S Ltd.	<u>50</u>	<u>150</u>
6.	Depreciation		
	H Ltd.	100	
	S Ltd.	<u>50</u>	<u>150</u>
7.	Other expenses		
	Administrative expenses		
	H Ltd.	200	
	S Ltd.	<u>100</u>	
	Less: Consultancy fees received by H Ltd. from S Ltd.	<u>(5)</u>	295
	Selling and distribution Expenses:		
	H Ltd.	200	
	S Ltd.	<u>50</u>	
	Less: Commission received by S Ltd. from H Ltd.	<u>(10)</u>	<u>240</u>
			<u>535</u>

Q-85 Under what **conditions is the equity method of accounting** deemed appropriate, and which enterprises are obligated to employ this method? Could you elaborate on the specific criteria that determine significant influence over associates, thereby necessitating the adoption of the equity method in financial reporting?

Ans:

CIRCUMSTANCES UNDER WHICH EQUITY METHOD IS FOLLOWED

Equity method of accounting is to be followed by all the enterprises having significant influence on their associates except in the following cases:

a. Control is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future.

The term 'Near Future' is explained with AS 21.

b. Or it operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the investor.

In both the above cases, investment of investor in the share of the investee is treated as investment according to AS 13.

An investor should discontinue the use of the equity method from the date that:

a. It ceases to have significant influence in an associate but retains, either in whole or in part, its investment.

b. The use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.

From the date of discontinuing the use of the equity method, investments in such associates should be accounted for in accordance with AS 13, Accounting for

Investments. For this purpose, the carrying amount of the investment at that date should be regarded as cost thereafter. The reasons for not applying the equity method in accounting for investments in an associate should be disclosed in the consolidated financial statements.

Q-86 A Ltd. entered into a joint venture with B Ltd. on 1:1 basis and a new company C Ltd. was formed for the same purpose and following is the balance sheet of all the three companies:

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

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

Solution:

Balance Sheet of A Ltd.

		Note No.	(₹)
I	Equity and liabilities		
	1. Shareholders' funds:		
	Share Capital		10,00,000
	Reserves and Surplus	1	24,00,000
	2. Non-current liabilities	2	4,00,000
	3. Current Liabilities	3	4,50,000
	TOTAL		<u>42,50,000</u>
II	Assets		
	Non-current Assets		
	Property, Plant and Equipment:	4	40,25,000
	Current Assets	5	2,25,000
			<u>42,50,000</u>

Notes to Accounts

		₹	₹
1.	Reserves and Surplus		
	A Ltd.	18,00,000	
	C Ltd.	<u>6,00,000</u>	24,00,000
2.	Long Term Borrowings Loans:		
	A Ltd.	3,00,000	
	C Ltd.	<u>1,00,000</u>	4,00,000
3.	Current Liabilities:		
	A Ltd.	4,00,000	
	C Ltd.	<u>50,000</u>	4,50,000
4.	Property, Plant and Equipment:		
	A Ltd.	30,50,000	
	C Ltd.	<u>9,75,000</u>	40,25,000
5.	Current Assets:		
	A Ltd.	2,00,000	
	C Ltd.	<u>25,000</u>	2,25,000

Balance Sheet of B Ltd.

		Note No.	(₹)
I	Equity and liabilities		
	1. Shareholders' funds:		
	Share Capital		7,50,000
	Reserves and Surplus	1	22,00,000
	2. Non-current liabilities	2	5,00,000
	3. Current Liabilities	3	3,00,000
			<u>37,50,000</u>
II	Assets		
	1. Non-current Assets		
	Property, Plant and Equipment	4	36,00,000
	2. Current Assets	5	1,50,000
			<u>37,50,000</u>

Notes to Accounts

		₹	₹
1.	Reserves and Surplus		
	A Ltd.	16,00,000	
	C Ltd.	<u>6,00,000</u>	22,00,000
2.	Long Term Borrowings Loans:		
	A Ltd.	4,00,000	
	C Ltd.	<u>1,00,000</u>	5,00,000
3.	Current Liabilities:		
	A Ltd.	2,50,000	
	C Ltd.	<u>50,000</u>	3,00,000
4.	Property, Plant and Equipment:		+36,00,000
	A Ltd.	26,25,000	-36,00,000
	C Ltd.	<u>9,75,000</u>	36,00,000
5.	Current Assets:		
	A Ltd.	1,25,000	
	C Ltd.	<u>25,000</u>	1,50,000

Q-87 The following is the Trial Balance of Omega Limited as on 31.3.2022:

	Debit		Credit
Land at cost	220	Equity Capital (Shares of ₹ 10 each)	300
Plant & Machinery at cost	770	10% Debentures	200
Trade Receivables	96	General Reserve	130
Inventories (31.3.22)	86	Profit & Loss A/c	72
Bank	20	Securities Premium	40
Adjusted Purchases	320	Sales	700
Factory Expenses	60	Trade Payables	52
Administration Expenses	30	Provision for Depreciation	172

Selling Expenses	30	Suspense Account	4
Debenture Interest	20		
Interim Dividend Paid	18		
	1670		1670

Additional Information:

- (i) The authorised share capital of the company is 40,000 shares of ₹ 10 each.
- (ii) The company on the advice of independent valuer wish to revalue the land at ₹ 3,60,000.
- (iii) Declared final dividend @ 10% on 2nd April, 2022.
- (iv) Suspense account of ₹ 4,000 represents cash received for the sale of some of the machinery on 1.4.2021. The cost of the machinery was ₹ 10,000 and the accumulated depreciation thereon being ₹ 8,000.
- (v) Depreciation is to be provided on plant and machinery at 10% on cost.

You are required to prepare Omega Limited's Balance Sheet as on 31.3.2022 and Statement of Profit and Loss with notes to accounts for the year ended 31.3.20X2 as per Schedule III. Ignore previous years' figures & taxation.

Solution:

Omega Limited
Balance Sheet as at 31st March, 20X2

Particulars	Note No.	(₹ In 000)
Equity and Liabilities		
1. Shareholders' funds		
A) Share capital	1	300
B) Reserves and Surplus	2	530
2. Non-Current liabilities		
A) Long term borrowings	3	200
3. Current liabilities		
A) Trade Payables		52
Total		<u>1082</u>
Assets		

1. Non-current assets		
A) PPE (Property, Plant & Equipment)	4	880
2. Current assets		
A) Inventories		86
B) Trade receivables		96
C) Cash and bank balances		20
Total		<u>1082</u>

Omega Limited

Statement of Profit and Loss for the year ended 31st March, 20X2

Particulars	Notes	(₹ in 000)
I. Revenue from operations		700
II. Other Income	5	2
III Total Income		<u>702</u>
IV Expenses:		
Purchases		320
Finance costs	6	20
Depreciation (10% of 7600)		76
Other expenses	7	120
Total		<u>536</u>
Expenses		
V. Profit (Loss) for the period (III – IV)		166

Notes to accounts

		(₹ in 000)
1. Share Capital		
Equity share capital		
Authorised		
40,000 shares of ₹ 10 each		<u>400</u>
Issued & subscribed & called up		

	30,000 shares of ₹ 10 each		300
2.	Reserves and Surplus		
	Securities Premium Account		40
	Revaluation reserve (360 – 220)		140
	General reserve		130
	Profit & loss Balance		
	Opening balance	72	
	Profit for the period	<u>166</u>	238
	Less: Appropriations		
	Interim Dividend	<u>(18)</u>	<u>(220)</u>
			<u>530</u>
3.	Long term borrowing		
	10% Debentures		200
4.	PPE		
	Land		
	Opening balance	220	
	Add: Revaluation adjustment	<u>140</u>	
	Closing balance		360
	Plant and Machinery		
	Opening balance	770	
	Less: Disposed off	<u>(10)</u>	
		760	
	Less: Depreciation (172-8+76)	<u>(240)</u>	
	Closing balance		520
	Total		<u>880</u>
5.	Other Income		
	Profit on sale of machinery:		
	Sale value of machinery	4	
	Less: Book value of machinery (10-8)	<u>(2)</u>	2
6.	Finance costs		

	Debenture interest		20
7.	Other expenses:		
	Factory expenses	60	
	Selling expenses	30	
	Administrative expenses	<u>30</u>	120

Q-88 From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 2015 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31.03.2015

Particulars	₹ in 000	Particulars	₹ in 000
Balance on 1.04.2014	50	Payment to Suppliers	2000
Issue of Equity Shares	300	Purchase of Fixed Assets	200
Receipts from Customers	2800	Overhead expense	200
Sale of Fixed Assets	100	Wages and Salaries	100
		Taxation	250
		Dividend	50
		Repayment of Bank Loan	300
		Balance on 31.3.2015	150
	3250		3250

Solution:

(X Ltd.) Cash Flow Statement for the year ended 31st March, 2015 (with direct method)

	₹ in 000	₹ in 000
Cash flows from operating activities		
Cash receipts from customers	2,800	
Cash payment to suppliers	(2000)	
Cash paid to employees	(100)	
Cash payments for overheads	<u>(200)</u>	

Cash generated from operations	500	
Income tax paid	<u>(250)</u>	
Net cash from operating activities		250
Cash flows from investing activities		
Payment for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	<u>100</u>	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	
Dividend paid	<u>(50)</u>	
Net cash used in financing activities		(50)
Net increase in cash		100
Cash at beginning of the period		<u>50</u>
Cash at end of the period		150

Q-89 Under **what conditions** are companies permitted to engage in the buy-back of their **own shares and other specified securities**, and what are the key provisions governing this process?

Additionally, what is the **essential requirement** that no company can overlook when considering the purchase of its own shares or other specified securities?

Ans:

The Companies Act, 2013 under Section 68 (1) permits companies to buy-back their own shares and other specified securities out of:

- (i) Its free reserves; or
- (ii) The securities premium account; or
- (iii) The proceeds of the issue of any shares or other specified securities.

Note: No buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified

securities. For example, if equity shares are to be bought-back, then, preference shares may be used for the purpose.

The other important provisions relating to the buy-back are:

Section 68 (2) further states that no company shall purchase its own shares or other specified securities unless—

(a) The buy-back is authorised by its articles;

(b) A special resolution has been passed in general meeting of the company authorising the buy-back;

However, the above provisions do not apply where the buy-back is ten percent or less of the paid-up equity capital + free reserves and is authorized by a board resolution passed at a duly convened meeting of the directors. Hence, in case the buy-back is up to 10% of paid up equity + free reserves, the same may be done with the authorization of the Board Resolution without the necessity of its being authorized by the articles of association of the company and by a special resolution of its members passed at a general meeting of the company.

(c) The buy-back must be equal or less than twenty-five per cent of the total paid-up capital and free reserves of the company: (Resource Test)

(d) Further, the buy-back of shares in any financial year must not exceed 25% of its total paid-up capital and free reserves: (Share Outstanding Test)

(e) The ratio of the debt owed by the company (both secured and unsecured) after such buy-back is not more than twice the total of its paid-up capital and its free reserves: (Debt-Equity Ratio Test)

Note: Central Government may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies. Debt here should include both long-term debt as well as short term debt.

(f) All the shares or other specified securities for buy-back are fully paid-up;

(g) The buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by the Securities and Exchange Board of India in this behalf;

(h) The buy-back in respect of shares or other specified securities other than those specified in clause (f) is in accordance with the guidelines as may be prescribed.

Provided that no offer of the buy-back under this sub section shall be made within a period of one year reckoned from the date of closure of a previous offer of buy-back if any. This means that there cannot be more than one buy-back in one year.

Q-90 Following is the summarized Balance Sheet of Complicated Ltd. As on 31st March,2016:

Liabilities	Amount ₹
Equity shares of 10 each, fully paid up	12,50,000
Bonus shares of 10 each, fully paid up	1,00,000
Share option outstanding Account	4,00,000
Revenue Reserve	15,00,000
Securities Premium	2,50,000
Profit & Loss Account	1,25,000
Capital Reserve	2,00,000
Unpaid dividends	1,00,000
12% Debentures (Secured)	18,75,000
Advance from related parties (Unsecured)	10,00,000
Current maturities of long term borrowings	16,50,000
Application money received for allotment due for refund	<u>2,00,000</u>
	<u>86,50,000</u>
Fixed Assets	46,50,000
Current Assets	40,00,000
	<u>86,50,000</u>

The Company wants to buy back 25,000 equity shares of 10 each, on 1 April, 2016 at 20 per share. Buy back of shares is duly authorized by its Articles and necessary resolution has been passed by the Company towards this. The buy-back of shares by the Company is also within the provisions of the Companies Act, 2013. The payment for buy back of shares will be made by the Company out of sufficient bank balance available shown as part of Current Assets.

You are required to give the necessary journal entries towards buy back of shares and prepare the Balance sheet after buy back of shares

Solution:

As per the information given in the question, buy-back of 25,000 shares @ 20, as desired by the company is within the provisions of the Companies Act, 2013.

Journal Entries for buy-back of shares.

Date	Particulars	Debit ₹	Credit ₹
(a)	Equity Shares buy-back account To Bank account (Being buy back of 25,000 equity shares of 10 each @ 20 per share)	5,00,000	5,00,000
(b)	Equity share capital account. .Dr Securities premium account. . Dr To Equity shares buy-back account (Being cancellation of shares bought back)	2,50,000 2,50,000	5,00,000
(c)	Revenue reserve account. .Dr To Capital redemption reserve account (Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)	2,50,000	2,50,000

Balance Sheet of Complicated Led. As on 1st April, 2016

Particulars	Note no.	₹
EQUITY AND LIABILITIES		
1. Shareholders' funds		
(a) Share capital	1	11,00,000
(b) Reserves and Surplus	2	22,25,000
2. Non-current liabilities		
(a) Long-term borrowings	3	28,75,000
3. Current liabilities		

(a) Other current liabilities		4	19,50,000
	Total		81,50,000
ASSETS			
1. Non-current assets			
(a) Fixed assets			46,50,000
2. Current assets (40,00,000-5,00,000)			35,00,000
	Total		81,50,000

Note to Accounts

		₹	₹
1	Share Capital		
	Equity share capital		
	110,000 Equity shares of 10 each		11,00,000
2	Reserves and Surplus		
	Profit and Loss A/c	1,25,000	
	Revenue reserves.	15,00,000	
	Less Transfer to CRR	12,50,000	12,50,000
	Securities premium.	2,50,000	
	Less: Utilization for share buy-back	2,50,000	Nil
	Share Option Outstanding Account	4,00,000	
	Capital reserve	2,00,000	
	Capital Redemption Reserve	2,50,000	22,25,000
3	Long-term borrowings		
	Secured		
	12% Debentures	18,75,009	
	Unsecured loans	10,00,000	28,75,000
4	Other Current Liabilities		
	Current maturities of long term borrowings	16,50,000	
	Unpaid dividend	1,00,000	

	Application money received for allotment due for refund	2,00,000	19,50,000
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Q-91 Difference between amalgamation in the nature of merger and amalgamation in the nature of purchase

Solution:

Best of Distinction	Amalgamation in the Nature of Merger	Amalgamation in the Nature of Purchase
(a) Transfer of Assets and Liabilities	There is transfer of all assets & liabilities.	There need not be transfer for all assets & liabilities.
(b) Shareholders of transferor company	Equity shareholders holding 90% equity shares in transferor company become shareholders of transferee company.	Equity shareholders need not become shareholders of transferee company.
(c) Purchase Consideration	Purchase consideration is discharged wholly by issue of equity shares of transferee company (except cash only for fractional shares)	Purchase consideration need not be discharged wholly by issue of equity shares.
(d) Same Business	The same business of the transferor company is intended to be carried on by the transferee company.	The business of the transferor company need not be intended to be carried on by the transferee company.
(e) Recording of Assets & Liabilities	The assets & liabilities taken over are recorded at their existing carrying amounts except where adjustment is	The assets & liabilities taken over are recorded at their existing carrying amounts or the basis of their fair values.

	required to ensure uniformity of accounting policies	
(f) Method of Accounting	Journal entries for recording the merger are passed by pooling of interest method.	Journal entries for recording the purchase of business are passed by purchase method.

Q-92 Two partnership firms, carrying on business under the style of R & Co. (Partners A & B) and W & Co. (Partners C & D) respectively, decided to amalgamate into RW & Co. with effect from 1st April 2013. The respective Balance Sheets of both the firms as on 31st March, 2013 are in below:

Liabilities	R (₹)	W (₹)	Assets	R (₹)	W (₹)
Capital B	19,000	-	Goodwill	-	5,000
Capital C	-	10,000	Machinery	10,000	-
Capital D	-	2,000	Stock-in-trade	20,000	5,000
Bank loan	15,000	-	Sundry Debtors	10,000	10,000
Creditors	10,000	9,500	Cash-in-hand	-	1,500
			Capital -A	4,000	-
	44,000	21,500		44,000	21,500

Profit sharing ratios are: A & B = 1:2; C & D = 1:1. Agreed terms are:

1. All fixed assets are to be devalued by 20%.
2. All stock in trade is to be appreciated by 50%.
3. R & Co. owes ` 5,000 to W & Co. as on 31st March 2013. This is settled at ` 2,000. Goodwill is to be ignored for the purpose of amalgamation.
4. The fixed capital accounts in the new firm (RW & Co.) are to be: Mr A ` 2,000; Mr. B ` 3,000; Mr C ` 1,000 and D ` 4,000.
5. Mr. B takes over bank overdraft of R & Co. and contributed to Mr. A the amount of money to be brought in by Mr. A to make up his capital contribution.
6. Mr C is paid off in cash from W & Co. and Mr. D brings in sufficient cash to make up his required capital contribution.

Pass necessary Journal entries to close the books of both the firms as on 31st March 2013.

Solution:

Calculation of Purchase Consideration

Assets taken over :		R & Co.	W & Co.
Plant & Machinery		8,000	-
Stock-in-trade		30,000	7,500
Sundry Debtors [(* After adjustment of ₹ 3,000 (₹ 5,000 – 2,000)]		10,000	7,000
	(A)	48,000	14,500
Liability taken over:			
Sundry Creditors [(* ₹ (10,000 – 3000)]	(B)	7,000	9,500
Purchase consideration	(A-B)	41,000	5,000

In the books of R & Co. Journals

Date	Particulars	L.F	Amount ₹	Amount ₹
31.3.13	Realisation A/c Dr. To Plant and Machinery A/c To Stock-in-trade A/c To Sundry Debtors A/c (Different assets transferred)		40,000	10,000 20,000 10,000
	Sundry Creditors A/c Dr. To Realisation A/c (Sundry creditors transferred to Realisation Account)		10,000	10,000
	Bank Loan A/c Dr. To B Capital A/c (Bank overdraft taken over by B)		15,000	15,000
	RW & Co. A/c Dr. To Realisation A/c (Purchase consideration due)		41,000	41,000

	Realisation A/c To A Capital A/c To B Capital A/c (Profit on realisation transferred to partners capital in the ratio of 1:2)	Dr.	11,000	3,667 7,333
	B Capital A/c To A Capital A/c (Deficit in A's capital made good by B)	Dr.	2,333	2,333
	A Capital A/c B Capital A/c (3,000 + 36,000) To RW & Co. A/c (Capital accounts of the partners closed by transfer to RW & Co.) Alternatively Shows: A Capital A/c B Capital A/c Loan from B A/c To RW & Co. A/c	Dr. Dr. Dr.	2,000 39,000 36,000	41,000 41,000

Note: It should be noted that the credit balance in B's capital account is ` 39,000. His agreed capital in RW & Co is ` 3,000 only. Since there is no liquid assets in R & Co. from which B can be repaid, the excess amount of ` 36,000 should be taken over by RW & Co. as loan from B.

In the books of W & Co. Journals

Date	Particulars	L.F	Amount ₹	Amount ₹
31.3.13	Realisation A/c To Goodwill A/c To Stock-in-trade A/c To Sundry Debtors A/c (Different Assets transferred)	Dr.	20,000	5,000 5,000 10,000
	Sundry Creditors A/c To Realisation A/c	Dr.	9,500	9,500

	(Sundry creditors transferred to Realisation Account)			
	RW & Co. A/c Dr. To Realisation A/c (Purchase consideration due)		5,000	5,000
	C's Capital A/c Dr. D's Capital A/c Dr. To Realisation A/c (Loss on realisation transferred to Capital Account equally)		2,750 2,750	5,500
	Cash A/c Dr. To D's Capital A/c (Being the necessary amount brought in by D to make up his required capital contribution)		4,750	4,750
	C's Capital A/c Dr. D's Capital A/c Dr. To RW & Co. A/c To Cash A/c (Capital accounts of the partners closed by transfer to RW & Co. and balance paid by cash) Alternatively Shows: C's Capital A/c Dr. To Cash A/c (Being the C's Capital is paid off)		7,250 4,000 6,250	5,000 6,250
	C's Capital A/c Dr. D's Capital A/c Dr. To RW & Co. A/c (Being the Partner's Capital transferred to RW & Co.)		1,000 4,000	5,000

Dr.

Realization Account

Cr.

Particulars	R & Co. ₹	W & Co. ₹	Particulars	R & Co. ₹	W & Co. ₹
To Goodwill	-	5,000	By Creditors	10,000	9,500
- Machinery	10,000	-	By RW & Co.	41,000	5,000
- Stock-in-trade	20,000	5,000	By C's Capital		2,750
- Sundry Debtors	10,000	10,000	By D's Capital		2,750
- Cash in hand	-				
- A's Capital	3,667				
- B's Capital	7,333				
	51,000	20,000		51,000	20,000

Dr.

Partners' Capital Accounts of R & Co.

Cr.

Particulars	A (₹)	B (₹)	Particulars	A (₹)	B (₹)
To Balance b/d	4,000	—	By Balance b/d	—	19,000
“ A Capital A/c	—	2,333	“ Realisation A/c (Profit)	3,667	7,333
“ Loan A/c	—	36,000	“ Bank overdraft A/c	—	15,000
“ R W & Co. A/c	2,000	3,000	“ B's Capital A/c	2,333	—
	6,000	41,333		6,000	41,333

Dr.

Partners' Capital Accounts of W & Co.

Cr.

Particulars	C (₹)	D (₹)	Particulars	C (₹)	D (₹)
To Realisation A/c (Loss)	2,750	2,750	By Balance b/d	10,000	2,000
“ Cash A/c	6,250	—	“ Cash A/c	—	4,750
“ R W & Co. A/c	1,000	4,000			
	10,000	6,750		10,000	6,750

Q-93 When incorporating the trading results of a branch into the head office books, the chosen method hinges on a crucial factor. What criterion dictates the method selection, and what specific outcome does this decision influence in the preparation process?

Ans:

INCORPORATION OF BRANCH BALANCE IN HEAD OFFICE BOOKS

The method that will be adopted for incorporating the trading result of the branch with that of the head office would depend on whether it is desired to prepare

(a) Standalone P&L & Balance Sheet for each Branch, or

(b) Consolidated statement of Branch & H.O.

Method I: Separate P&L & Balance Sheet for each Branch

Amount of P&L is shown by Branch & is transfer to H.O. in Branch books & converse entry is passed in H.O. Books as:

Branch A/c Dr.
 To Profit & Loss A/c

In such a case, not only P&L but also separate Balance Sheet for Branch & H.O. is to be prepared. The Branch Balance Sheet would show the amount advanced by H.O. to it as "Capital." In H.O. Books such amount would be shown as "Advance to Branch"

Method II: Prepare a consolidated Profit & Loss Account and Balance Sheet

Individual balances of all the revenue accounts would be separately transferred to the Head Office Account by debit or credit in the branch books and the converse entries would be passed in the head office books. The effect thereof will be similar to the amount of net profit or loss of the branch having been transferred since it would be composed of the balances that have been transferred. In case it is also desired that consolidated balance sheet of the branch and the head office should be prepared, it will also be necessary to transfer the balance of assets and liabilities of the branch to the head office. The adjusting entries that would be passed in this respect in the books of branch are shown below:

(a) Head Office Account Dr.
 To Asset (individual) Account
(b) (Individual) Liability Account Dr.
 To Head Office Account

Converse entries are passed in the head office books.

It is obvious that after afore-mentioned entries have been passed, the Branch Account in the Head Office books and Head Office Account in the branch books will be closed and it will be necessary to restart them at the beginning of the next year.

In consequence, at the beginning of the following year, the under-mentioned entry is recorded by the branch:

Asset Account (In Detail)

Dr.

To Liability Accounts (In Detail)

To H.O. Account (The difference between assets and liabilities)

Q-94 How do venturers recognize **jointly controlled assets in their separate financial statements and subsequently in the Consolidated Financial Statements (CFS)**? Can you explain the concept of a jointly controlled entity and how it is established, **particularly in terms of the contractual arrangements** and interests of each venturer?

Ans:

In respect of jointly controlled assets, each venturer recognize in its separate financial statement and consequently in its CFS:

- a)** Share of the jointly controlled assets under distinct head of each asset and not as an investment
- b)** Any liability incurred (e.g. financing its share of the assets)
- c)** Share of joint liability in respect of the venturer
- d)** Any income from sale or use of its share of the output in the joint venture and share of expenses.
- e)** Expense is incurred in respect of its in the joint ventures e.g. financing the venturer's interests in the asset and selling its share of output. The treatment of jointly controlled assets, recognizes the substance and economic reality (legal form of the joint venture) separate financial statements may not be prepared for the joint venture itself.

A jointly controlled entity involves the establishment of a corporation, partnership or other entity in which each venturer has an interest as per contractual arrangement.

a) in a separate/standalone financial statement of each venturer, the interest in a jointly controlled entity should be accounted for as an investment as per AS- 13 only the resources contributed, forms a part of the investment and the share' of joint venture result is treated in the income statement of the venturers.

b) Proportionate consolidation for joint venture is applied in case where the preparation and presenting a CFS is required, reflecting the substance and economic reality of the

arrangement in the CFS. Many of the procedure in this regard are similar to AS-21 and require to be followed for treatment and disclosure.

Joint venture interest in the financial statements, of an investor is treated appropriately in terms of AS- 13, AS-21 or AS-23 in CFS but for separate financial statements is should be accounted for as per AS-13.

Q-95 M Ltd. is in the hands of a Receiver for debenture holders who holds a charge on all assets except uncalled capital. **The following statement shows the position as regards creditors as on 31st March, 2015:**

Ans:

Liabilities	₹	Assets	₹
Share capital in shares of ₹ 60 each ₹ 30 paid up	3,60,000 -	Property, Machinery and Plant etc. (Cost ₹ 3,90,000) estimated at	15,00,00
First Debentures	3,00,000	Cash in hand	2,10,000
Second Debentures	6,00,000	Investment	4,20,000
Unsecured Creditors	4,50,000	Uncalled Capital	1,80,000
		Deficiency	7,50,000
	17,10,000		17,10,000

A holds the First Debentures for ₹ 3,00,000 and Second Debentures for ₹ 3,00,000. He is also an unsecured creditor for ₹ 90,000. B holds Second Debentures for ₹ 3,00,000 and is an unsecured creditor for ₹ 60,000.

The following scheme of reconstruction is proposed:-

1. A is to cancel ₹ 2,10,000 of the total debt owing to him, to advance ₹ 30,000 in cash and to take First Debentures (in cancellation of those already issued to him) for ₹ 5,10,000 in satisfaction of all his claims.
2. B is to accept ₹ 90,000 in cash in satisfaction of all claims by him.
3. Unsecured creditors (other than A and B) are to accept four shares of ₹ 7.50 each, fully paid in satisfaction of 75% of every ₹ 60 of their claim. The balance of 25% is to be

postponed and to be payable at the end of three years from the date of Court's approval of the scheme. The nominal Share capital is to be increased accordingly.

4. Uncalled capital is to be called up in full and ₹ 52.50 per share cancelled, thus taking the shares of ₹ 7.50 each.

Assuming that the scheme is duly approved by all parties interested and by the Court, give necessary journal entries and the Balance Sheet of the Company after the scheme has been carried into effect.

Solution:

WN # 1: Calculation of P & L Debit Balance at the time of Reconstruction

Liabilities	₹	Assets	₹
Share capital	1,80,000	Fixed assets (Book value)	3,90,000
1st Debenture	3,00,000	Cash	2,70,000
2nd Debenture	5,00,000	Profit and Loss A/c (Bal. fig.)	8,70,000
Unsecured creditors	4,50,000		
	15,30,000		15,30,000

Particulars	Debit ₹	Credit ₹
1. Restructuring of A's liability:		
a. Ascertainment of amount due		
1st Debentures A/c	Dr. 3,00,000	
2nd Debentures A/c	Dr. 3,00,000	
Unsecured Creditors A/c	Dr. 90,000	
To A's A/c		6,90,000
b. Waiver		
A's A/c	Dr. 2,10,000	
To Reconstruction A/c		2,10,000
c. Cash brought in		
Bank A/c	Dr. 30,000	
To A's A/c		30,000

d. Conversion of liability			
Dr. A's	A/c	5,10,000	
	To 1st Debentures A/c		5,10,000
2. Restructuring of B's liability:			
2nd Debentures A/c	Dr.	3,00,000	
Unsecured creditors A/c	Dr.	60,000	
	To Bank A/c		90,000
	To Reconstruction A/c		2,70,000
3. Restructuring of other unsecured creditors*			
(4,50,000 - 90,000 - 60,000 = 3,00,000)			
Unsecured Creditors A/c	Dr.	3,00,000	
	To Equity Share capital A/c		1,50,000
	To Loan (Unsecured) A/c		75,000
	To Reconstruction A/c		75,000
4. Share capital			
a. Call money due:			
Share call A/c	Dr.	1,80,000	
	To Share capital A/c		1,80,000
b. Share Call Money Received :			
Bank A/c	Dr.	1,80,000	
	To Share call A/c		1,80,000
c. Capital Reduction :			
Equity Share Capital A/c (Face value ₹ 60)		3,60,000	
Dr.			45,000
	To Equity Share capital (Face value ₹ 7.50)		3,15,000
	To Reconstruction A/c		
5. Utilisation of reconstruction surplus			
Reconstruction	A/c	8,70,000	
Dr.			8,70,000
	To Profit and Loss A/c		

a. Scheme of settlement unit of liability is	60
b. 75% share (60 x .75)	45
i. 4 Equity shares @ ₹ 7.5	30
ii. Waiver	15
c. 25% share (60 x .25)[Can be carried forward as unsecured loan]	15
Note: Liability is settled in the Ratio of 30:15:15 (i.e. 2:1:1)	

Balance Sheet (and Reduced)

Liabilities	₹	Assets	₹
Share capital	1,95,000	Fixed assets	3,90,000
Debentures	5,10,000	Cash	3,90,000
Unsecured Loans	75,000		
	7,80,000		7,80,000

Reconstruction Account

Particulars	₹	Particulars	₹
To Profit and Loss A/c	8,70,000	By A's A/c	2,10,000
		By B's A/c	2,70,000
		By Unsecured creditors	75,000
		By Equity Share Capital	3,15,000
	8,70,000		8,70,000

Cash/Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	2,70,000	By B's A/c	90,000
To A's A/c	30,000	By Balance c/d	3,90,000
To Share call A/c	1,80,000		
	4,80,000		4,80,000

Q-96 What are the commonly employed **methods of internal reconstruction** that companies typically follow to address financial challenges or reorganize their structure? Additionally, could you elaborate on the key considerations and steps involved in each of these methods, highlighting their implications and potential benefits for the companies undergoing internal reconstruction?

Ans:

METHODS OF INTERNAL RECONSTRUCTION

1. Alteration of Share Capital

According to Section 61, A limited company can alter its share capital, if so authorized by its Articles, by passing an ordinary resolution in the general meeting. The provisions of the relevant sections of Companies Act will be applicable, but we are going to focus on the accounting treatment of the various conditions pertaining to internal reconstruction.

The following types of Alteration can be done under Section 61-

- (a) Increase of authorized share capital
- (b) Consolidation and sub-division into shares of larger or smaller denominations
- (c) Conversion of all or any of the shares into stock or vice versa
- (d) Cancellation of shares which have not been taken or agreed to be taken by any person.

In Addition:

- Sub-division and Consolidation of Shares
- Conversion of Fully Paid Shares into Stock and Stock into Shares

2. Variation of Shareholders Rights

Section 48 of the Companies Act, 2013 provides that when a company has issued different classes of shares with different rights or privileges attached to such shares e.g. rights as to dividend, voting rights etc., any of such right may be changed in any manner. The provisions will be applicable as per the Companies Act 2013 , the accounting treatment is discussed in detail here.

3. Reduction of Share Capital

Section 66 of the Companies Act, 2013 lays down the procedure in respect of reduction of share capital. Subject to confirmation by the Tribunal on an application by the company, a company may, by a special resolution, reduce the share capital in the following manner-

- (a) Extinguishing or reducing the liability of the shareholders in respect of unpaid amount on the shares held by them; or
- (b) Paying off any paid-up share capital which is in excess of its requirements;
- (c) Cancelling any paid-up share capital which is lost or is unrepresented by available assets.

The accounting treatment is as follows:

(a) When liability of the shareholders is extinguished or reduced in respect of unpaid amount on the shares held by them: Here the shareholders are not called upon to pay the unpaid amount on shares held by them in future.

(b) When excess paid up capital is paid off: When its not possible for the company to employ profitably its paid up capital, then in such case it may decide to refund the excess capital to its shareholders

(c) When the paid up capital which is lost or not represented is cancelled:

Reduction in paid up value only- Here the nominal value of the share remains the same and only the paid value is reduced.

Reduction in both nominal and paid up values- In this case, both the paid up capital and nominal value of the shares are reduced.

4. Compromise/Arrangements

A scheme of compromise and arrangement is an agreement between a company and its members and outside liabilities when the company faces financial problems. Such an arrangement therefore also involves sacrifices by shareholders, or creditors or debenture holders or by all of them.

Accounting treatment for some of the cases is as follows:

a) When equity shareholders give up their right over the reserves and accumulated profits of the company:

Reserves Account Dr. (With the amount of reserves)
To Reconstruction Account

b) Settlement of outside liabilities at lesser amount: Liabilities such as sundry creditors may agree to accept less amount in lieu of final settlement. Treatment will be as follows:

Outside Liabilities Account Dr. (With the amount of sacrifice)

Provision Account (if any)
etc.)

Dr. (made by creditors, debenture holders

To Reconstruction Account

5. Surrender of Shares

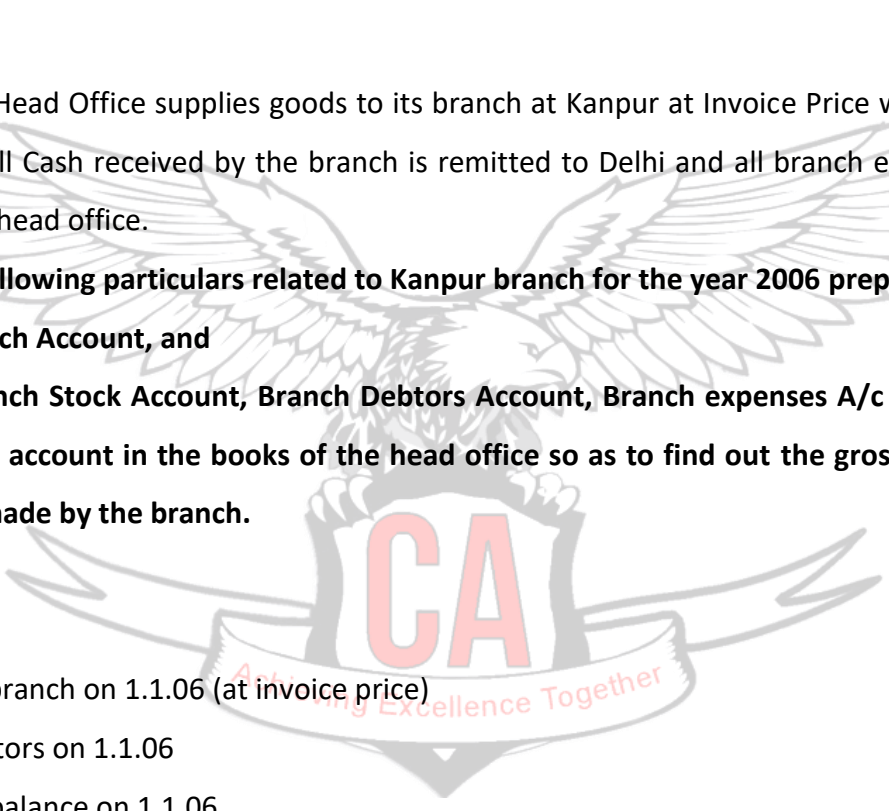
In this method, shares are divided into shares of smaller denominations and then the shareholders are made to surrender their shares to the company. These shares are then allotted to debenture holders and creditors so that their liabilities are reduced. The unutilized surrendered shares are then cancelled by transferring them to Reconstruction Account.

Q-97 Delhi Head Office supplies goods to its branch at Kanpur at Invoice Price which is cost plus 50%. All Cash received by the branch is remitted to Delhi and all branch expenses are paid by the head office.

From the following particulars related to Kanpur branch for the year 2006 prepare:

(i) Branch Account, and

(ii) Branch Stock Account, Branch Debtors Account, Branch expenses A/c and Branch Adjustment account in the books of the head office so as to find out the gross profit and net profit made by the branch.



	Rs.
Stock with branch on 1.1.06 (at invoice price)	60,000
Branch Debtors on 1.1.06	12,000
Petty Cash balance on 1.1.06	10
Goods received from head office (at invoice price)	1,86,000
Goods returned to head office	3,000
Credit sales less returns	84,000
Allowances to customer at selling price (already adjusted while invoicing)	2,000
Cash received from Debtors	90,000
Discount allowed to Debtors	2,400
Expenses (Cash paid by head office):	

Rent	2,400	
Salaries	24,000	
Petty Cash	<u>1,000</u>	27,400
Cash sales	1,04,000	
Stock with Branch on 31.12.06 (at invoice price)		54,000
Petty Cash balance on 31.12.06		100

Dr. Branch Debtors Accounts Cr.

Particulars	₹	Particulars	₹
To Balance b/d	12,000	By Cash Received	90,000
To Credit Sales	84,000	By Discount Allowed	2,400
		By balance c/d	3,600
	96,000		96,000

Dr. Branch Stock Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	60,000	By Cash Sales	1,04,000
To Goods Sent to Branch	1,86,000	By Credit sales	84,000
		By Goods Sent to H.P. (Returned)	3,000
		By Shortage (Loss)	1,000
		By balance (Given)	54,000
	2,46,000		2,46,000

Dr. Kanpur Branch Account Cr.

Particulars	₹	Particulars	₹
To Stock	60,000	By Cash-Remittance	
To Branch Cash	12,000	Cash Sales	1,04,000
To Petty Cash	10	Cash from Debtor	<u>90,000</u>
To Goods Sent to Branch	1,86,000	By Goods Sent to H.O. (Returns)	3,000
To Reserve for returns (1/3 of 3,000)	1,000	By Stock Reserve (1/3 of 60,000)	20,000
		By Reserve for Goods Sent (1/3	

To Stock Reserve (1/3 of 54,000)	18,000	of 1,86,000)	62,000
To Branch Expenses	27,400	By Stock at Branch (Given)	54,000
To Cash (Petty expenses)	90	By Branch debtors A/c	3,600
To Profit transferred to Gen. P & L A/c	32,200	By Petty Cash	100
	3,36,700		3,36,700

Dr. Branch Adjustment Account Cr.

Particulars	₹	Particulars	₹
To Reserve for returns	1,000	By Stock Reserve	20,000
To Stock reserve	18,000	By Reserve for Goods Sent	62,000
To Shortage	333		
To Profit transferred to P & L A/c	62,667		
	82,000		82,000

Dr. Branch Expenses Account Cr.

Particulars	₹	Particulars	₹
To Cash	27,310	By Profit & Loss A/c	27,310

Dr. Branch Profit and Loss A/c Cr.

Particulars	₹	Particulars	₹
To Branch Expenses	27,400	By Profit & Loss A/c	62,667
To Branch debtors (Discount A/c)	2,400		
To Loss (Shortage)	667		
To Net Profit	32,200		
	62,667		62,667

Q-98 What are the various **methods used for accounting in amalgamations**? Can you provide insights into the accounting procedures and considerations involved in the process of amalgamations?

Ans:

METHODS OF ACCOUNTING FOR AMALGAMATIONS

There are two main methods of accounting for amalgamations.

- For an amalgamation in the nature of merger - pooling of interests method and
- For an amalgamation in the nature of purchase - purchase method.

1. Pooling of Interests Method

Pooling of interests is a method of accounting for amalgamations the object of which is to account for the amalgamation as if the separate businesses of the amalgamating companies were intended to be continued by the transferee company. Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating companies.

Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts

If, at the time of the amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with AS 5.

2. Purchase Method

Under the purchase method, the transferee company accounts for the amalgamation either

- By incorporating the assets and liabilities at their existing carrying amounts **or**
- By allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

Q-99 What factors should be considered in the **composition of estimates of future cash flows**? Additionally, what specific precautions or **considerations are highlighted for ensuring accuracy and reliability in the estimation process**?

Ans:

COMPOSITION OF ESTIMATES OF FUTURE CASH FLOWS

Estimates of future cash flows should include

- (i)** Projections of net cash inflows from the continuing use of the asset
- (ii)** projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset and that can be directly attributed, or allocated on a reasonable and consistent basis, to the asset; and
- (iii)** Net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life.

Care should be taken for the following points:

- a.** When the carrying amount of an asset does not yet include all the cash outflows to be incurred before it is ready for use or sale, estimate of any further cash outflow that is expected to be incurred before the asset is ready for use or sale should be included.
- b.** Cash inflows from assets that generate cash inflows from continuing use that are largely independent of the cash inflows from the asset under review should not be included.
- c.** Cash outflows that relate to obligations that have already been recognised as liabilities to be excluded.
- d.** Future cash outflows or inflows expected to arise because of restructuring of the organization should be not considered.
- e.** Any future capital expenditure enhancing the capacity of the assets and its related savings/outflow should be excluded.
- f.** Any increase in expected cash inflow from the above expenditure should also be excluded.
- g.** Estimates of future cash flows should not include cash inflows or outflows from financing activities and also income tax receipts or payments.
- h.** The estimate of net cash flow upon disposal of the asset should be the amount that an enterprise expects to obtain from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties prevailing at the date of the estimates, after deducting the estimated costs of disposal.

When an enterprise becomes committed to a restructuring, some assets are likely to be affected by this restructuring. Once the enterprise is committed to the restructuring, in determining value in use, estimates of future cash inflows and cash outflows reflect the cost savings and other benefits from the restructuring (based on the most recent financial budgets/forecasts that have been approved by management).

Foreign Currency Future Cash Flows are estimated in the currency in which it will be generated and then they are discounted for the time value of money using a discount rate appropriate for that currency. We convert cash flow in the reporting currency on the basis of AS 11.

Q-100 How is the **adjustment and reconciliation process carried out for branch and head office accounts in accounting?** Could you provide insights into the key considerations and methods involved in ensuring accurate adjustments and reconciliations between branch and head office accounts?

Ans:

ADJUSTMENT AND RECONCILIATION OF BRANCH AND HEAD OFFICE ACCOUNTS

If the branch and the head office accounts, converse of each other, do not tally, these must be reconciled before the preparation of the final accounts of the concern as a whole.

1. Reasons for Disagreement

Following are the possible reasons for the disagreement between Branch A/c in Head office books and Head office A/c in Branch books on the closing date:

2. Other points

(i) Inter-Branch Transactions

Inter-branch transactions (i.e. transaction between two branches) are usually adjusted as if they were entered into only with the head office. It is a very convenient method of treating such transaction especially where the number of branches are large.

(ii) Fixed Assets

Often the accounts of fixed assets of a branch are kept in the head office books; in such a case, at the end of the year, the amount of depreciation on the assets is debited to the branch concerned by recording the following entry by head office:

Branch Account	Dr.
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To Branch Asset Account

The branch will pass the following entry:

Depreciation Account Dr.

To Head Office Account

(iii) Head office Expenses charged to Branch

Usually the head office devotes considerable time in attending to the affairs of the branch; on that account, it may decide to raise a charge against the branch in respect of the cost of such time. In such a case the amount is debited to the branch (being receivable from branch) and is credited to appropriate expense head such as Salaries Accounts, General Charges Account, Entertainment Account etc (i.e. reducing the expense in head office books). The branch credits the H.O. Account and debits Expenses Account.

