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Accounting Standards and Guidance Notes

Question 1

A company has given counter guarantees of ₹ 2.25 crores to various banks in respect of the guarantees given by the said banks in favour of Government authorities. Outstanding counter guarantees as at the end of financial year 2003-2004 were ₹ 1.95 crores. How this information should be shown in the Financial Statements of the Company. (4 Marks, May, 2004)

Answer

Note: This question is based on 'Guidance Note on Guarantees and Counter-Guarantees given by Companies'. However, after issuance of AS 30, 31 and 32, this Guidance Note has been withdrawn. Therefore, the question is redundant now.

Question 2

(a) *At the end of the financial year ending on 31st December, 2003, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:*

	Probability	*Loss (₹)*
In respect of five cases (Win)	*100%*	*–*
Next ten cases (Win)	*60%*	*–*
Lose (Low damages)	*30%*	*1,20,000*
Lose (High damages)	*10%*	*2,00,000*
Remaining five cases		
Win	*50%*	*–*
Lose (Low damages)	*30%*	*1,00,000*
Lose (High damages)	*20%*	*2,10,000*

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof.

(b) *Z Ltd. presents the following information for the year ending 31.03.2002 and 31.03.2003 from which you are required to calculate the Deferred Tax Asset/Liability and state how*

the same should be dealt with as per relevant accounting standard.

	31.03.2002	*31.03.2003*
	₹ (lakhs)	*₹ (lakhs)*
Depreciation	*4,010.10*	*4,023.54*
Unabsorbed carry forward business loss and depreciation allowance	*2,016.60*	*4,110.00*
Disallowance under Section 43B of Income tax Act, 1961	*518.35*	*611.45*
Deferred Revenue Expenses	*4.88*	*–*
Provision for Doubtful Debts	*282.51*	*294.35*

Z Ltd. had incurred a loss of ₹ 504 lakhs for the year ending 31.03.2003 before providing for Current Tax of ₹ 26.00 lakhs. *(4+6 = 10 Marks, May, 2004)*

Answer

(a) Para 10 of AS 4 (Revised) on 'Contingencies and Events Occurring after the Balance Sheet Date' states that the amount of a contingent loss should be provided for by a charge in the statement of profit and loss if:

(i) it is probable that future events will confirm that, after taking into account any related probable recovery, an asset has been impaired or a liability has been incurred as at the balance sheet date, and

(ii) a reasonable estimate of the amount of the resulting loss can be made.

In the given case, the probability of winning is 100% in respect of first five cases and hence, question of providing for contingent loss does not arise. The condition (i) of Para 10 of AS 4, as stated above, is not met in the other cases since the probability of winning the suits is 60% for next ten cases and 50% for the remaining five cases. Therefore, the proper treatment is to disclose the contingent loss in respect of these cases as per para 11 of AS 4. The maximum loss for each of the next ten cases is ₹ 2,00,000 whereas the expected loss is ₹ 56,000 (₹ 1,20,000 × 0.3 + ₹ 2,00,000 × 0.1). The maximum loss for each of the remaining five cases is ₹ 2,10,000 whereas the expected loss is ₹ 72,000 (₹ 1,00,000 × 0.3 + ₹ 2,10,000 × 0.2). To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of ₹ 9,20,000 (₹ 56,000 × 10 + ₹ 72,000 × 5) as contingent liability.

(b)

	₹ in lakhs	*₹ in lakhs*
	31.3.2002	31.3.2003
Carried Forward Business Loss and Depreciation Allowance	2,016.60	4,110.00
Add: Disallowance under Section 43 B of Income Tax		

Act,1961	518.35	611.45
Provision for Doubtful Debts	282.51	294.35
	2,817.46	5,015.80
Less: Depreciation	4,010.10	4,023.54
	(–) 1,192.64	992.26
Less: Deferred Revenue Expenditure	4.88	–
Timing Differences	(–) 1,197.52	992.26

Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognized only to the extent that there is virtual certainty supported by convincing evidence that future taxable income will be available against which such deferred tax assets can be realized. The existence of unabsorbed depreciation or carry forward of losses is strong evidence that future taxable income may no be available. Deferred Tax Asset on ₹ 992.26 lakhs should not be recognized as an asset as per para 17 of AS 22 on 'Accounting for Taxes on Income'. Deferred Tax Liability on ₹ 1,197.52 lakhs should be disclosed under a separate heading in the balance sheet of Z Ltd., separately from current assets and current liabilities.

Question 3

(a) *X Co. Ltd. supplied the following information. You are required to compute the basic earning per share:*

(Accounting year 1.1.2002 – 31.12.2002)

Net Profit	:	*Year 2002 : ₹ 20,00,000*
	:	*Year 2003 : ₹ 30,00,000*
No. of shares outstanding prior to Right Issue	:	*10,00,000 shares*
Right Issue	:	*One new share for each four outstanding i.e., 2,50,000 shares.* *Right Issue price – ₹ 20* *Last date of exercise rights – 31.3.2003.*
Fair rate of one Equity share immediately prior to exercise of rights on 31.3.2003	:	*₹ 25*

(b) *A Ltd. leased a machinery to B Ltd. on the following terms:*

	(₹ in Lakhs)
Fair value of the machinery	*20.00*
Lease term	*5 years*

Lease Rental per annum	*5.00*
Guaranteed Residual value	*1.00*
Expected Residual value	*2.00*
Internal Rate of Return	*15%*

Depreciation is provided on straight line method @ 10% per annum. Ascertain unearned financial income and necessary entries may be passed in the books of the Lessee in the First year.

(c) The following particulars are stated in the Balance Sheet of M/s Exe Ltd. as on 31.03.2003:

	(₹ in Lakhs)
Deferred Tax Liability (Cr.)	*20.00*
Deferred Tax Assets (Dr.)	*10.00*

The following transactions were reported during the year 2003-04:

(i)	*Tax Rate*	*50%*
(ii)	*Depreciation – As per Books*	*50.00*
	Depreciation – for Tax purposes	*30.00*
	There were no additions to Fixed Assets during the year.	
(iii)	*Items disallowed in 2002-03 and allowed for Tax purposes in 2003-04*	*10.00*
(iv)	*Interest to Financial Institutions accounted in the Books on accrual basis, but actual payment was made on 30.09.2004*	*20.00*
(v)	*Donations to Private Trusts made in 2003-04*	*10.00*
(vi)	*Share issue expenses allowed under 35(D) of the I.T. Act, 1961 for the year 2003-04 (1/10th of ₹ 50.00 lakhs incurred in 1999-2000)*	*5.00*
(vii)	*Repairs to Plant and Machinery ₹ 100.00 lakhs was spread over the period 2003-04 and 2004-05 equally in the books. However, the entire expenditure was allowed for Income-tax purposes.*	

Indicate clearly the impact of above items in terms of Deferred Tax liability/Deferred Tax Assets and the balances of Deferred Tax Liability/Deferred Tax Asset as on 31.03.2004.

(8 + 8 + 4 = 20 Marks, November, 2004)

Answer

(a) **Computation of Basic Earnings Per Share**

(as per paragraphs 10 and 26 of AS 20 on Earnings Per Share)

	Year 2002	*Year 2003*
	₹	₹
EPS for the year 2002 as originally reported		
$= \frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$		
= (₹ 20,00,000 / 10,00,000 shares)	2.00	
EPS for the year 2002 restated for rights issue		
= [₹ 20,00,000 / (10,00,000 shares × 1.04*)]	1.92 (approx.)	
EPS for the year 2003 including effects of rights issue		
$\frac{₹\ 30,00,000}{(10,00,000 \text{ shares} \times 1.04 \times 3/12) + (12,50,000 \text{ shares} \times 9/12)}$		
$\frac{₹\ 30,00,000}{11,97,500 \text{ shares}}$	2.51 (approx.)	

Working Notes:

1. Computation of theoretical ex-rights fair value per share

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

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

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

2. Computation of adjustment factor

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

* Refer working note 2.

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

(b) Computation of Unearned Finance Income

As per AS 19 on Leases, ***unearned finance income*** is the difference between (a) the ***gross investment*** in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

where :

(a) ***Gross investment*** in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

Gross investment = Minimum lease payments + Unguaranteed residual value

= (Total lease rent + Guaranteed residual value) + Unguaranteed residual value

= [(₹ 5,00,000 × 5 years) + ₹ 1,00,000] + ₹ 1,00,000 = ₹ 27,00,000

(b) Table showing present value of (i) Minimum lease payments (MLP) and (ii) Unguaranteed residual value (URV).

Year	*MLP inclusive of URV*	*Internal rate of return (Discount factor 15%)*	*Present Value*	
	₹		₹	
1	5,00,000	.8696	4,34,800	
2	5,00,000	.7561	3,78,050	
3	5,00,000	.6575	3,28,750	
4	5,00,000	.5718	2,85,900	
5	5,00,000	.4972	2,48,600	
	1,00,000	.4972	49,720	
	(guaranteed residual value)			
			17,25,820	(i)
	1,00,000	.4972	49,720	(ii)
	(unguaranteed residual value)			
		(i) + (ii)	17,75,540	(b)

Unearned Finance Income = (a) – (b)

= ₹ 27,00,000 – ₹ 17,75,540 = ₹ 9,24,460

Journal Entries in the books of B Ltd.

		₹	₹
At the inception of lease			
Machinery account	Dr.	17,25,820*	
To A Ltd.'s account			17,25,820*
(Being lease of machinery recorded at present value of MLP)			
At the end of the first year of lease			
Finance charges account (Refer Working Note)	Dr.	2,58,873	
To A Ltd.'s account			2,58,873
(Being the finance charges for first year due)			
A Ltd.'s account	Dr.	5,00,000	
To Bank account			5,00,000
(Being the lease rent paid to the lessor which includes outstanding liability of ₹ 2,41,127 and finance charge of ₹ 2,58,873)			
Depreciation account	Dr.	1,72,582	
To Machinery account			1,72,582
(Being the depreciation provided @ 10% p.a. on straight line method)			
Profit and loss account	Dr.	4,31,455	
To Depreciation account			1,72,582
To Finance charges account			2,58,873
(Being the depreciation and finance charges transferred to profit and loss account)			

* As per para 11 of AS 19, the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payments from the standpoint of lessee, the amount recorded should be the present value of these minimum lease payments. Therefore, in this case, as the fair value of ₹ 20,00,000 is more than the present value amounting ₹ 17,25,820, the machinery has been recorded at ₹ 17,25,820 in the books of B Ltd. (the lessee) at the inception of the lease. According to para 13 of the standard, at the inception of the lease, the asset and liability for the future lease payments are recognised in the balance sheet at the same amounts.

Working Note:

Table showing apportionment of lease payments by B Ltd. between the finance charges and the reduction of outstanding liability.

Year	*Outstanding liability (opening balance)*	*Lease rent*	*Finance charge*	*Reduction in outstanding liability*	*Outstanding liability (closing balance)*
	₹	₹	₹	₹	₹
1	17,25,820	5,00,000	2,58,873	2,41,127	14,84,693
2	14,84,693	5,00,000	2,22,704	2,77,296	12,07,397
3	12,07,397	5,00,000	1,81,110	3,18,890	8,88,507
4	8,88,507	5,00,000	1,33,276	3,66,724	5,21,783
5	5,21,783	5,00,000	78,267	5,21,783	1,00,050*
			8,74,230	17,25,820	

* The difference between this figure and guaranteed residual value (₹ 1,00,000) is due to approximation in computing the interest rate implicit in the lease.

(c) Impact of various items in terms of deferred tax liability/deferred tax asset

Transactions	*Analysis*	*Nature of difference*	*Effect*	*Amount*
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	₹ 20 lakhs × 50% = ₹ 10 lakhs
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	₹ 10 lakhs × 50% = ₹ 5 lakhs

Interest to financial institutions	It is allowed as deduction under section 43B of the IT Act, if the payment is made before the due date of filing the return of income (i.e. 31st October, 2004).	No timing difference	Not applicable	Not applicable
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable
Share issue expenses	Due to disallowance of full expenditure under IT Act, tax payable in the earlier years was higher.	Responding timing difference	Reversal of DTA	₹ 5 lakhs × 50% = ₹ 2.5 lakhs
Repairs to plant and machinery	Due to allowance of full expenditure under IT Act, tax payable of the current year will be less.	Originating timing difference	Increase in DTL	₹ 50 lakhs × 50% = ₹ 25 lakhs

Deferred Tax Liability Account

		₹ in lakhs			*₹ in lakhs*
31.3.2004	To Profit and Loss account (Depreciation)	10.00	1.4.2003	By Balance b/d	20.00
				By Profit and Loss Account (Repairs to plant)	25.00
	To Balance c/d	35.00			
		45.00			45.00
			1.4.2004	By Balance b/d	35.00

Deferred Tax Asset Account

		₹ in lakhs			*₹ in lakhs*
1.4.2003	To Balance b/d	10.00	31.3.2004	By Profit and Loss Account: Items disallowed in 2002-03 and	

				allowed as per I.T. Act in	
				2003-04	5.00
				Share issue expenses	2.50
				By Balance c/d	2.50
		10.00			10.00
1.4.2004	To Balance b/d	2.50			

Question 4

Write short note on advantages and disadvantages of setting of Accounting Standards.

(4 Marks, November, 2004)

Answer

The Accounting Standards seek to describe the accounting principles, the valuation techniques and the methods of applying the accounting principles in the preparation and presentation of financial statements so that they may give a true and fair view. The ostensible purpose of the standard setting bodies is to promote the dissemination of timely and useful financial information to investors and certain other parties having an interest in companies' economic performance. The setting of accounting standards has the following advantages:

(i) Standards reduce to a reasonable extent or eliminate altogether confusing variations in the accounting treatments used to prepare financial statements.

(ii) There are certain areas where important information are not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.

(iii) The application of accounting standards would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in accounting standards practised in different countries.

However, there are some disadvantages of setting of accounting standards:

(i) Alternative solutions to certain accounting problems may each have arguments to recommend them. Therefore, the choice between different alternative accounting treatments may become difficult.

(ii) There may be a trend towards rigidity and away from flexibility in applying the accounting standards.

(iii) Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.

Question 5

(a) Prepare a segmental report for publication in Diversifiers Ltd. from the following details of the company's three divisions and the head office:

	₹ ('000)
Forging Shop Division	
Sales to Bright Bar Division	*4,575*
Other Domestic Sales	*90*
Export Sales	*6,135*
	10,800
Bright Bar Division	
Sales to Fitting Division	*45*
Export Sales to Rwanda	*300*
	345
Fitting Division	
Export Sales to Maldives	*270*

Particulars	*Head Office ₹ ('000)*	*Forging Shop Division ₹ ('000)*	*Bright Bar Division ₹ ('000)*	*Fitting Division ₹ ('000)*
Pre-tax operating result		*240*	*30*	*(12)*
Head office cost reallocated		*72*	*36*	*36*
Interest costs		*6*	*8*	*2*
Fixed assets	*75*	*300*	*60*	*180*
Net current assets	*72*	*180*	*60*	*135*
Long-term liabilities	*57*	*30*	*15*	*180*

(b) An equipment is leased for 3 years and its useful life is 5 years. Both the cost and the fair value of the equipment are ₹ 3,00,000. The amount will be paid in 3 instalments and at the termination of lease lessor will get back the equipment. The unguaranteed residual value at the end of 3 years is ₹ 40,000. The (internal rate of return) IRR of the investment is 10%. The present value of annuity factor of Re. 1 due at the end of

3rd year at 10% IRR is 2.4868. The present value of Re. 1 due at the end of 3rd year at 10% rate of interest is 0.7513.

(i) State with reason whether the lease constitutes finance lease.

(ii) Calculate unearned finance income.

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

Quarter I	II	III	IV
Ending 31st March	30th June	30th September	31st December
-	-	-	-*

For the First quarter ending 31st March, 2005, I–Corp. gives you the following information:

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

While preparing interim financial report for the first quarter 'I–Corp.' wants to defer ₹ 21 crores expenditure to third quarter on the argument that third quarter is having more sales, therefore third quarter should be debited by higher expenditure, considering the seasonal nature of business. The expenditures are uniform throughout all quarters.

Calculate the result of first quarter as per AS 25 and comment on the company's view.

(d) Top & Top Limited has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment. Having fulfilled all the conditions under the scheme, the company on its investment of ₹ 50 crore in capital assets, received ₹ 10 crore from the Government in January, 2005 (accounting period being 2004-2005). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 2005.

Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not. *(8 + 4 + 4 + 4 = 20 marks, May, 2005)*

* There may be some percentage of sales given herein.

Answer

(a)

Diversifiers Ltd.
Segmental Report

					(₹'000)
Particulars	*Divisions*				
	Forging shop	*Bright Bar*	*Fitting*	*Inter Segment Eliminations*	*Consolidated Total*
Segment revenue					
Sales:					
Domestic	90	–	–	–	90
Export	6,135	300	270	–	6,705
External Sales	6,225	300	270	–	6,795
Inter-segment sales	4,575	45	–	4,620	–
Total revenue	10,800	345	270	4,620	6,795
Segment result (given)	240	30	(12)		258
Head office expenses					(144)
Operating profit					114
Interest expense					(16)
Profit before tax					98
Information in relation to assets and liabilities:					
Fixed assets	300	60	180	–	540
Net current assets	180	60	135	–	375
Segment assets	480	120	315	–	915
Unallocated corporate assets (75 + 72)	–	–	–	–	147
Total assets					1,062
Segment liabilities	30	15	180	–	225
Unallocated corporate liabilities					57
Total liabilities					282

Sales Revenue by Geographical Market

	Home Sales	*Export Sales (by forging shop division)*	*Export to Rwanda*	*Export to Maldives*	*(₹'000) Consolidated Total*
External sales	90	6,135	300	270	6,795

(b) (i) Present value of residual value = ₹ 40,000 × 0.7513 = ₹ 30,052

Present value of lease payments = ₹ 3,00,000 – ₹ 30,052 = ₹ 2,69,948.

The present value of lease payments being 89.98% $\left(\frac{2,69,948}{3,00,000} \times 100\right)$ of the fair value, i.e. being a substantial portion thereof, the lease constitutes a finance lease.

(ii) Calculation of unearned finance income

	₹
Gross investment in the lease [(₹ 1,08,552* × 3) + ₹ 40,000]	3,65,656
Less: Cost of the equipment	3,00,000
Unearned finance income	65,656

Note: - In the above solution, annual lease payment has been determined on the basis that the present value of lease payments plus residual value is equal to the fair value (cost) of the asset.

(c) **Result of the first quarter ended 31st March, 2005**

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

* Annual lease payments = $\frac{₹\ 2,69,948}{2.4868}$ = ₹ 1,08,552 (approx.)

As per AS 25 on Interim Financial Reporting, the income and expense should be recognised when they are earned and incurred respectively. As per para 38 of AS 25, the costs should be anticipated or deferred only when

(i) it is appropriate to anticipate that type of cost at the end of the financial year, and

(ii) costs are incurred unevenly during the financial year of an enterprise.

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

(d) As per para 10 of AS 12 'Accounting for Government Grants', where the government grants are of the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus, it is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs. The correct treatment is to credit the subsidy to capital reserve. Therefore, the accounting treatment followed by the company is not proper.

Question 6

(a) Venus Ltd. has an asset, which is carried in the Balance Sheet on 31.3.2005 at ₹ 500 lakhs. As at that date the value in use is ₹ 400 lakhs and the net selling price is ₹ 375 lakhs.

From the above data:

(i) Calculate impairment loss.

(ii) Prepare journal entries for adjustment of impairment loss.

(iii) Show, how impairment loss will be shown in the Balance Sheet.

(b) Himalaya Ltd. in the past three years spent ₹ 75,00,000 to develop a Drug to treat Cancer, which was charged to Profit and Loss Account since they did not meet AS 8 criteria for capitalization. In the current year approval of the concerned Government Authority has been received. The Company wishes to capitalize ₹ 75,00,000 and disclose it as a prior period item. Is it correct? Give reason for your views.

(c) Bottom Ltd. entered into a sale deed for its immovable property before the end of the year. But registration was done with registrar subsequent to Balance Sheet date. But before finalisation, is it possible to recognise the sale and the gain at the Balance Sheet date? Give your view with reasons. (6 + 5 + 5 = 16 Marks, November, 2005)

Answer

(a) (i) Impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Thus, Impairment loss = Carried amount – Recoverable amount*

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

*Recoverable amount is higher of asset's net selling price ₹ 375 lakhs and its value in use ₹ 400 lakhs.

Recoverable amount = ₹ 400 lakhs

(ii) **Journal Entries**

	Particulars		*Dr. Amount ₹ in lakhs*	*Cr. Amount ₹ in lakhs*
(i)	Impairment loss account	Dr.	100	
	To Asset account			100
	(Being the entry for accounting impairment loss)			
(ii)	Profit and loss account	Dr.	100	
	To Impairment loss account			100
	(Being the entry to transfer impairment loss to profit and loss account)			

(iii) **Balance Sheet of Venus Ltd. as on 31.3.2005**

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

(b) AS 8 'Accounting for Research and Development' stands withdrawn w.e.f. 1st April, 2003 i.e. the date from which AS 26 'Intangible Assets' becomes mandatory. In any case, under either standard, the condition for recognition of a research and development asset has to be fulfilled when the expenditure was incurred. If the recognition conditions are not fulfilled the amount has to be charged to the profit and loss account. Once the amount is charged to the profit and loss account, such amount cannot be restated later as a research and development asset when the condition for recognition get fulfilled. The company therefore cannot capitalize ₹ 75,00,000 even as a prior period item.

(c) Yes, it is possible for the Bottom Ltd. to recognize the sale and the gain at the balance sheet date according to AS 9* 'Revenue Recognition'. It is evident that the significant risks and rewards of ownership had passed before the balance sheet date and the delay in transfer of property was merely because of formality in getting the transfer deed registered. Further the registration post the balance sheet date confirms the condition of sale at the balance sheet date as per AS 4 'Contingencies and Events occurring after the Balance Sheet Date'.

Question 7

In view of the provisions of Accounting Standard 25 on Interim Financial Reporting, on what basis will you calculate, for an interim period, the provision in respect of defined benefit schemes like pension, gratuity etc. for the employees? (5 Marks, November, 2005)

Answer

Accounting Standard 25 suggests that provision in respect of defined benefit schemes like pension and gratuity for an interim period should be calculated on year-to-date basis by using the actuarially determined rates at the end of the prior financial year, adjusted for significant market fluctuations since that time and for significant curtailments, settlements or other significant one-time events.

Question 8

(a) In May, 2004 Speed Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2005 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2005 amounted to ₹ 25 lakhs.

Can ₹ 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building?

(b) Distinguish between "Timing differences" and "Permanent differences" referred to in AS 22 on Accounting for Taxes, giving 2 examples of each.

(4 + 4 = 8 Marks, November, 2005)

Answer

(a) As per para 19 of AS 16 'Borrowing Costs', capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Therefore, interest on the amount that has been used for the construction of the building upto the date of completion (January, 2005) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

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* On the basis, that Bottom Ltd. deals in immovable property.

(b) As per AS 22, timing differences are the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.

Examples:

- Unabsorbed depreciation and carry forward of losses which can be set-off against future taxable income.
- Statutory dues deferred for payment under Section 43B of the Income-Tax Act.

"Permanent Differences" are the differences between taxable income and accounting income for a period that originate in one period but do not reverse subsequently.

Examples:

- Agricultural income.
- Donations/contributions disallowed for tax purposes.

Question 9

Global Ltd. has initiated a lease for three years in respect of an equipment costing ₹ 1,50,000 with expected useful life of 4 years. The asset would revert to Global Limited under the lease agreement. The other information available in respect of lease agreement is:

(i) The unguaranteed residual value of the equipment after the expiry of the lease term is estimated at ₹ 20,000.

(ii) The implicit rate of interest is 10%.

(iii) The annual payments have been determined in such a way that the present value of the lease payment plus the residual value is equal to the cost of asset.

Ascertain in the hands of Global Ltd.

(i) The annual lease payment.

(ii) The unearned finance income.

(iii) The segregation of finance income, and also,

(iv) Show how necessary items will appear in its profit and loss account and balance sheet for the various years. *(8 Marks, May, 2006)*

Answer

(i) Calculation of Annual Lease Payment*

	₹
Cost of the equipment	1,50,000

* Annual lease payments are considered to be made at the end of each accounting year.

Unguaranteed Residual Value	20,000
PV of residual value for 3 years @ 10% (₹ 20,000 x 0.751)	15,020
Fair value to be recovered from Lease Payment (₹ 1,50,000 – ₹ 15,020)	1,34,980
PV Factor for 3 years @ 10%	2.487
Annual Lease Payment (₹ 1,34,980 / PV Factor for 3 years @ 10% i.e. 2.487)	54,275

(ii) **Unearned Financial Income**

Total lease payments [₹ 54,275 x 3]	1,62,825
Add: Residual value	20,000
Gross Investments	1,82,825
Less: Present value of Investments (₹ 1,34,980 + ₹ 15,020)	1,50,000
Unearned Financial Income	32,825

(iii) **Segregation of Finance Income**

Year	*Lease Rentals* ₹	*Finance Charges @ 10% on outstanding amount of the year* ₹	*Repayment* ₹	*Outstanding Amount* ₹
0	-	-	-	1,50,000
I	54,275	15,000	39,275	1,10,725
II	54,275	11,073	43,202	67,523
III	74,275**	6,752	67,523	--
	1,82,825	32,825	1,50,000	

(iv) **Profit and Loss Account (Relevant Extracts)**

Credit side		₹
I Year	By Finance Income	15,000
II year	By Finance Income	11,073
III year	By Finance Income	6,752

** ₹ 74,275 includes unguaranteed residual value of equipment amounting ₹ 20,000.

Balance Sheet (Relevant Extracts)

Assets side	₹	₹
I year Lease Receivable	1,50,000	
Less: Amount Received	39,275	1,10,725
II year Lease Receivable	1,10,725	
Less: Received	43,202	67,523
III year :Lease Amount Receivable	67,523	
Less: Amount received	47,523	
Residual value	20,000	NIL

Notes to Balance Sheet

	₹
Year 1	
Minimum Lease Payments (54,275 + 54,275)	1,08,550
Residual Value	20,000
	1,28,550
Unearned Finance Income(11,073+ 6,752)	17,825
Lease Receivables	1,10,725
Classification:	
Not later than 1 year	43,202
Later than 1 year but not more than 5 years	67,523
Total	1,10,725
Year II:	
Minimum Lease Payments	54,275
Residual Value (Estimated)	20,000
	74,275
Unearned Finance Income	6,752
Lease Receivables (not later than 1year)	67,523
III Year:	
Lease Receivables (including residual value)	67,523
Amount Received	67,523
	NIL

Question 10

(a) *Swift Ltd. acquired a patent at a cost of ₹ 80,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started*

amortizing the asset at ₹ 10,00,000 per annum. After two years it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be ₹ 36,00,000, ₹ 46,00,000, ₹ 44,00,000, ₹ 40,00,000 and ₹ 34,00,000. Find out the amortization cost of the patent for each of the years.

(b) The Chief Accountant of Sports Ltd. gives the following data regarding its six segments:

							₹ in lakhs
Particulars	*M*	*N*	*O*	*P*	*Q*	*R*	*Total*
Segment Assets	*40*	*80*	*30*	*20*	*20*	*10*	*200*
Segment Results	*50*	*-190*	*10*	*10*	*-10*	*30*	*-100*
Segment Revenue	*300*	*620*	*80*	*60*	*80*	*60*	*1,200*

The Chief accountant is of the opinion that segments "M" and "N" alone should be reported. Is he justified in his view? Discuss.

(c) On 24th January, 2006 Chinnaswamy of Chennai sold goods to Watson of Washington, U.S.A. for an invoice price of $40,000 when the spot market rate was ₹ 44.20 per US $. Payment was to be received after three months on 24th April, 2006. To mitigate the risk of loss from decline in the exchange-rate on the date of receipt of payment, Chinnnaswamy immediately acquired a forward contract to sell on 24th April, 2006 US $ 40,000 @ ₹ 43.70. Chinnaswamy closed his books of account on 31st March, 2006 when the spot rate was ₹ 43.20 per US $. On 24th April, 2006, the date of receipt of money by Chinnaswamy, the spot rate was ₹ 42.70 per US $.

Pass journal entries in the books of Chinnaswamy to record the effect of all the above mentioned effects. (4+4+8= 16 Marks, May, 2006)

Answer

(a) Swift Limited amortised ₹ 10,00,000 per annum for the first two years i.e. ₹ 20,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	*Net cash flows* ₹	*Amortization Ratio*	*Amortization Amount* ₹
I	-	0.125	10,00,000[1]
II	-	0.125	10,00,000
III	36,00,000	0.180	10,80,000

[1] It has been assumed that the company had amortized the patent at ₹ 10,00,000 per annum in the first two years on the basis of economic benefits derived from the product manufactured under the patent.

IV	46,00,000	0.230	13,80,000
V	44,00,000	0.220	13,20,000
VI	40,00,000	0.200	12,00,000
VII	34,00,000	0.170	10,20,000
Total	2,00,00,000	1.000	80,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹ 60,00,000 has been amortized in the ratio of net cash flows arising from the product of Swift Ltd.

Note*:* The answer has been given on the basis that the patent is renewable and Swift Ltd. got it renewed after expiry of five years.

(b) As per para 27 of AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

(i) Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or

(ii) Its segment result whether profit or loss is 10% or more of:

(1) The combined result of all segments in profit; or

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

whichever is greater in absolute amount; or

(iii) Its segment assets are 10% or more of the total assets of all segments.

If the total external revenue attributable to reportable segments constitutes less than 75% of total enterprise revenue, additional segments should be identified as reportable segments even if they do not meet the 10% thresholds until atleast 75% of total enterprise revenue is included in reportable segments.

(a) On the basis of turnover criteria segments M and N are reportable segments.

(b) On the basis of the result criteria, segments M, N and R are reportable segments (since their results in absolute amount are 10% or more of ₹ 200 lakhs).

(c) On the basis of asset criteria, all segments except R are reportable segments.

Since all the segments are covered in atleast one of the above criteria all segments have to be reported upon in accordance with Accounting Standard (AS) 17. Hence, the opinion of chief accountant is wrong.

(c) **Journal Entries in the books of Chinnaswamy**

2006		₹	₹
Jan. 24	Watson Dr.	17,68,000	

	To Sales Account			17,68,000
	(Credit sales made to Watson of Washington, USA for $40,000 recorded at spot market rate of ₹ 44.20 per US $)			
" "	Forward (₹) Contract Receivable Account	Dr.	17,48,000	
	Deferred Discount Account	Dr.	20,000	
	To Forward ($) Contract Payable			17,68,000
	(Forward contract acquired to sell on 24th April, 2006 US $40,000 @ ₹ 43.70)			
March 31	Exchange LossAccount	Dr.	40,000	
	To Watson			40,000
	(Record of exchange loss @ Re.1 per $ due to market rate becoming ₹ 43.20 per US $ rather than ₹ 44.20 per US $)			
" "	Forward ($) Contract Payable	Dr.	40,000	
	To Exchange Gain Account			40,000
	(Decrease in liability on forward contract due to fall in exchange rate)			
" "	Discount Account	Dr.	14,667	
	To Deferred Discount Account			14,667
	(Record of proportionate discount expense for 66 days out of 90 days)			
April 24	Bank Account	Dr.	17,08,000	
	Exchange LossAccount	Dr.	20,000	
	To Watson			17,28,000
	(Receipt of $40,000 from Watson, USA customer @ ₹ 42.70 per US $; exchange loss being ₹ 20,000)			
" "	Forward ($) Contract Payable Account	Dr.	17,28,000	
	To Exchange Gain Account			20,000
	To Bank Account			17,08,000
	(Settlement of forward contract by payment of $40,000)			

" "	BankAccount	Dr.	17,48,000	
" "	To Forward (₹) Contract Receivable			17,48,000
	(Receipt of cash in settlement of forward contract receivable)			
" "	Discount Account	Dr.	5,333	
	To Deferred Discount Account			5,333
	(Recording of discount expense for 24 days: ₹20,000 x $\frac{24 \text{ days}}{90 \text{ days}}$ = ₹ 5,333)			

Question 11

(a) *Narmada Ltd. sold goods for ₹ 90 lakhs to Ganga Ltd. during financial year ended 31-3-2006. The Managing Director of Narmada Ltd. own 100% of Ganga Ltd. The sales were made to Ganga Ltd. at normal selling prices followed by Narmada Ltd. The Chief accountant of Narmada Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. Is the Chief Accountant correct?*

(b) *Milton Ltd. is a full tax free enterprise for the first 10 years of its existence and is in the second year of its operations. Depreciation timing difference resulting in a deferred tax liability in years 1 and 2 is ₹ 200 lakhs and 400 lakhs respectively. From the 3rd year onwards, it is expected that the timing difference would reverse each year by ₹ 10 lakhs. Assuming tax rate @ 35%, find out the deferred tax liability at the end of the second year and any charge to the profit and loss account.*

(c) *Victory Ltd. purchased goods on credit from Lucky Ltd. for ₹ 250 crores for export. The export order was cancelled. Victory Ltd. decided to sell the same goods in the local market with a price discount. Lucky Ltd. was requested to offer a price discount of 15%. The Chief Accountant of Lucky Ltd. wants to adjust the sales figure to the extent of the discount requested by Victory Ltd. Discuss whether this treatment is justified.*

(d) *Accountants of Poornima Ltd. show a net profit of ₹ 7,20,000 for the third quarter of 2005 after incorporating the following:*

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

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

   (iii) *Additional depreciation of ₹ 45,000 resulting from the change in the method of charge of depreciation.*

   Ascertain the correct quarterly income. *(4 x 4=16 Marks, May, 2006)*

Answer

(a) As per paragraph 13 of AS 18 'Related Party Disclosures', Enterprises over which a key management personnel is able to exercise significant influence are related parties. This includes enterprises owned by directors or major shareholders of the reporting enterprise that have a member of key management in common with the reporting enterprise.

In the given case, Narmada Ltd. and Ganga Ltd are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price.

Hence the contention of Chief Accountant of Narmada Ltd is wrong.

(b) In the case of tax free companies, no deferred tax liability is recognized, in respect of timing differences that originate and reverse in the tax holiday period. Deferred tax liability or asset is created in respect of timing differences that originate in a tax holiday period but are expected to reverse after the tax holiday period. For this purpose, adjustments are done in accordance with the FIFO method.

Of ₹ 200 lakhs, ₹ 80 lakhs will reverse in the tax holiday period. Therefore, Deferred Tax Liability will be created on ₹ 120 lakhs @ 35% (i.e.) ₹ 42 lakhs.

In the second year, the entire ₹ 400 lakhs will reverse only after the tax holiday period.

Therefore, deferred tax charge in the Profit and Loss Account will be ₹ 400 x 35% = 140 lakhs and deferred tax liability in the Balance Sheet will be (42+140) = ₹ 182 lakhs.

(c) Lucky Ltd. had sold goods to Victory Ltd on credit worth for ₹ 250 crores and the sale was completed in all respects. Victory Ltd's decision to sell the same in the domestic market at a discount does not affect the amount recorded as sales by Lucky Ltd. The price discount of 15% offered by Lucky Ltd. after request of Victory Ltd. was not in the nature of a discount given during the ordinary course of trade because otherwise the same would have been given at the time of sale itself. Now, as far Lucky Ltd is concerned, there appears to be an uncertainty relating to the collectability of the debt, which has arisen subsequent to the time of sale therefore, it would be appropriate to make a separate provision to reflect the uncertainty relating to collectability rather than to adjust the amount of revenue originally recorded. Therefore, such discount should be written off to the profit and loss account and not shown as deduction from the sales figure.

(d) In the above case, the quarterly income has not been correctly stated. As per AS 25 "Interim Financial Reporting", the quarterly income should be adjusted and restated as follows:

Bad debts of ₹ 40,000 have been incurred during current quarter. Out of this, the company has deferred 50% (i.e.) ₹ 20,000 to the next quarter. Therefore, ₹ 20,000 should be deducted from ₹ 7,20,000. The treatment of extra-ordinary loss of ₹ 35,000 being recognized in the same quarter is correct.

Recognising additional depreciation of ₹ 45,000 in the same quarter is in tune with AS 25 .Hence, no adjustments are required for these two items.

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

Question 12

(a) *A company had imported raw materials worth US Dollars 6,00,000 on 5th January, 2005, when the exchange rate was ₹ 43 per US Dollar. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transaction was made on 5th April, 2005 when the exchange rate was ₹ 47 per US Dollar. However, on 31st March, 2005, the rate of exchange was ₹ 48 per US Dollar. The company passed an entry on 31st March, 2005 adjusting the cost of raw materials consumed for the difference between ₹ 47 and ₹ 43 per US Dollar.*

In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss.

(b) *A private limited company manufacturing fancy terry towels had valued its closing stock of inventories of finished goods at the realisable value, inclusive of profit and the export cash incentives. Firm contracts had been received and goods were packed for export, but the ownership in these goods had not been transferred to the foreign buyers.*

Comment on the valuation of the stocks by the company.

(c) *A company with a turnover of ₹ 250 crores and an annual advertising budget of ₹ 2 crore had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹ 25 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of ₹ 2 crore incurred on extensive special initial advertisement campaign for the new product.*

Is the procedure adopted by the company correct?

(d) *A company deals in petroleum products. The sale price of petrol is fixed by the government. After the Balance Sheet date, but before the finalisation of the company's accounts, the government unexpectedly increased the price retrospectively. Can the company account for additional revenue at the close of the year? Discuss.*

(4 x 4 =16 Marks, November, 2006)

Answer

(a) As per AS 11 (revised), monetary items denominated in a foreign currency should be reported using the closing rate. The effect of exchange difference should be taken into profit and loss account. Sundry creditors is a monetary item hence should be valued at the closing rate i.e, ₹ 48 at 31st March, 2005 irrespective of the payment for the same subsequently at lower rate. The difference of ₹ 5 (48 - 43) per US dollar should be shown as an exchange loss in the profit and loss account and is not to be adjusted against the cost of raw- materials. In the subsequent year, the company would record an

exchange gain of ₹ 1 per US dollar, i.e., the difference between ₹ 48 and ₹ 47 per US dollar. Hence, the accounting treatment adopted by the company is incorrect.

(b) Accounting Standard 2 on "Valuation of Inventories" states that inventories should be valued at lower of historical cost and net realisable value subject to certain exceptions such as inventory of consumable stores and maintenance supplies, inventory of by-product, inventory of re-usable waste and the inventory of non-usable waste. AS 9 on "Revenue Recognitions" states, "at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases, when sale is assumed under forward contract or a Government guarantee or when market exists and there is a negligible risk of failure to sell, the goods invoiced are often valued at Net-realisable value."

Terry Towels do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing stock of finished goods (Fancy terry Towel) should have been valued at lower of cost and net-realisable value and not at net realisable value. Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing stock of inventories of finished goods is not correct.

(c) With the introduction of AS 26 'Intangible Assets', the concept of deferred revenue expenditure no longer prevails except in respect of a very few items, such as ancillary costs on borrowings, shares issue expenses etc. AS 26 does not permit the capitalization of expenses incurred on advertising or brand promotion, etc. Thus, the accounting treatment by the company of debiting the entire advertising expenditure of ₹ 1 crore to the P & L account of the year is correct.

(d) According to AS 5 (Revised) It cannot be regarded as an event occurring after the Balance Sheet date which requires an adjustment at the Balance Sheet date, since it does not represent a condition present at the balance sheet date. The revenue should be recognized only in the subsequent year with proper disclosures. It should not be considered as a prior period item, because there was no error in the preparation of previous period's financial statements.

Question 13

Mohur Ltd. has equity capital of ₹ 40,00,000 consisting of fully paid equity shares of ₹ 10 each. The net profit for the year 2004-05 was ₹ 60,00,000. It has also issued 36,000, 10% convertible debentures of ₹ 50 each. Each debenture is convertible into five equity shares. The tax rate applicable is 30%. Compute the diluted earnings. (8 Marks, November, 2006)

Answer

Interest on Debentures @ 10% for the year $36{,}000 \times 50 \times \frac{10}{100}$

	=	₹ 1,80,000
Tax on interest @ 30%	=	₹ 54,000
Diluted Earnings (Adjusted net profit)	=	(60,00,000 + 1,80,000-54,000)
	=	₹ 61,26,000

Question 14

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

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

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

Is X correct in his proposal? Discuss.

(c) *A Company is in the process of setting up a production line for manufacturing a new product. Based on trial runs conducted by the company, it was noticed that the production lines output was not of the desired quality. However, company has taken a decision to manufacture and sell the sub-standard product over the next one year due to the huge investment involved.*

In the background of the relevant accounting standard, advise the company on the cut-off date for capitalization of the project cost.

(d) *A Company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 25% above cost. Is the policy adopted by the company correct?* *(4 x 4 = 16 Marks, May, 2007)*

Answer

(a) The balance amount of maintenance provision written back to profit and loss account, no longer required due to crash of the helicopters, is not a prior period item because there was no error in the preparation of previous periods' financial statements. The term 'prior period items', as defined in AS 5 (revised) "Net Profit or Loss for the Period, Prior Period Items and Changes In Accounting Policies", refer only to income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. As per paragraph 8 of AS 5, extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit

or loss can be perceived. The amount so written-back (If material) should be disclosed as an extraordinary item as per AS 5.

(b) According to para 14 of AS 7 (Revised) 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when: (i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and (ii) the amount of the incentive payment can be measured reliably. In the given problem, the contract has not even begun and hence the contractor (Mr. X) should not recognize any revenue of this contract.

(c) As per provisions of AS 10 'Accounting for Fixed Assets', expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, is usually capitalized as an indirect element of the construction cost. However, the expenditure incurred after the plant has begun commercial production *i.e.,* production intended for sale or captive consumption, is not capitalized and is treated as revenue expenditure even though the contract may stipulate that the plant will not be finally taken over until after the satisfactory completion of the guarantee period. In the present case, the company did stop production even if the output was not of the desired quality, and continued the sub-standard production due to huge investment involved in the project. Capitalization should cease at the end of the trial run, since the cut-off date would be the date when the trial run was completed.

(d) AS 17 'Segment Reporting' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

Question 15

(a) Impairment of asset and its application to inventory.

(b) Treatment of borrowing costs.

(c) Accounting for investment by a holding company in subsidiaries. (3 x 4 = 12 Marks, May, 2007)

Answer

(a) The objective of AS 28 'Impairment of Assets' is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case,

the asset is described as impaired and this Statement requires the enterprise to recognize an impairment loss. This standard should be applied in accounting for the impairment of all assets, other than (i) inventories (AS 2, Valuation of Inventories); (ii) assets arising from construction contracts (AS 7, Accounting for Construction Contracts); (iii) financial assets, including investments that are included in the scope of AS 13, Accounting for Investments; and (iv) deferred tax assets (AS 22, Accounting for Taxes on Income). AS 28 does not apply to inventories, assets arising from construction contracts, deferred tax assets or investments because other accounting standards applicable to these assets already contain specific requirements for recognizing and measuring the impairment related to these assets.

(b) According to AS 16, borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds. Borrowing costs may include: (i) interest and commitment charges on bank borrowings and other short-term and long-term borrowings; (ii) amortization of discounts or premiums relating to borrowings; (iii) amortization of ancillary costs incurred in connection with the arrangement of borrowings; (iv) finance charges in respect of assets acquired under finance leases or under other similar arrangements; and (v) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset• should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. The capitalization of borrowing costs as part of the cost of a qualifying asset should commence when the conditions specified in AS 16 are satisfied.

(c) Investments by a holding company in the shares of its subsidiary company are normally considered as long term investments. Indian holding companies show investment in subsidiary just like any other investment and generally classify it as trade investment. As per AS 13 'Accounting for Investments', investments are classified as long term and current investments. A current investment is an investment that by its nature is readily realizable and is intended to be held for more than one year from the date of acquisition. A long term investment is one that is not a current one.

Costs of investment include besides acquisition charges, expenses such as brokerage, fees and duties. If an investment is acquired wholly or partly by an issue of shares or other securities, the acquisition cost is determined by taking the fair value of the shares/securities issued. If an investment were to be acquired in exchange – part or whole – for another asset, the acquisition cost of the investment is determined with reference to the value of the other asset exchanged. Dividends received out of incomes earned by a subsidiary before the acquisition of the shares by the holding company and

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• A qualifying asset is an asset that necessarily takes a substantial period of time[1] to get ready for its intended use or sale.

not treated as income but treated as recovery of cost of the assets (investment made in the subsidiary). The carrying cost for current investment is the lower of cost or fair/market value whereas investment in the shares of the subsidiary (treated as long term) is carried normally at cost.

Question 16

Shivaji Ltd. purchased Fixed assets worth ₹ 90,00,000 on 1st April, 2002. The life of the assets is 10 years and they are to be depreciated on straight line basis. The assets were revalued on 1st April, 2004 when 50% of the assets was assessed at 10% less than the book value, and the remaining assets were revalued at 15% higher than book value. The assets were ultimately sold on 1.4.2006 for ₹ 54,80,000. Excess depreciation on revaluation, if any, should be charged to Revaluation Reserve.

Show Fixed Assets A/c, Depreciation A/c and Revaluation Reserve A/c, supported by Workings wherever necessary. (8 Marks, November, 2007)

Answer

In the books of Shivaji Ltd.

Fixed Assets Account

		₹			₹
1.4.2002	To Bank	90,00,000	31.3.2003	By Depreciation	9,00,000
				By Balance c/d	81,00,000
		90,00,000			90,00,000
1.4.2003	To Balance b/d	81,00,000	31.3.2004	By Depreciation	9,00,000
				By Balance c/d	72,00,000
		81,00,000			81,00,000
1.4.2004	To Balance b/d	72,00,000	1.4.2004	By Revaluation Reserve (W.N.2)	3,60,000
	To Revaluation Reserve (W.N.1)	5,40,000	31.3.2005	By Depreciation (W.N.3)	9,22,500
				By Balance c/d	64,57,500
		77,40,000			77,40,000
1.4.2005	To Balance b/d	64,57,500	31.3.2006	By Depreciation	9,22,500
				By Balance c/d	55,35,000
		64,57,500			64,57,500
1.4.2006	To Balance b/d	55,35,000	1.4.2006	By Bank	54,80,000
				By Revaluation	

				Reserve (loss)	55,000
		55,35,000			55,35,000

Depreciation Account

		₹			₹
31.3.2003	To Fixed assets	9,00,000	31.3.2003	By P&L Account	9,00,000
31.3.2004	To Fixed assets	9,00,000	31.3.2004	By P&L Account	9,00,000
31.3.2005	To Fixed assets	9,22,500	31.3.2005	By P&L Account	9,00,000
				By Revaluation Reserve Account (W.N.4)	22,500
		9,22,500			9,22,500
31.3.2006	To Fixed assets	9,22,500	31.3.2006	By P&L Account	9,00,000
				By Revaluation Reserve Account	22,500
		9,22,500			9,22,500

Revaluation Reserve Account

		₹			₹
1.4.2004	To Fixed assets (Loss on revaluation)	3,60,000	1.4.2004	By Fixed Assets (upward revaluation)	5,40,000
31.3.2005	To Depreciation (W.N.4)	22,500			
	To Balance c/d	1,57,500			
		5,40,000			5,40,000
31.3.2006	To Depreciation	22,500	1.4.2005	By Balance b/d	1,57,500
	To Balance c/d	1,35,000			
		1,57,500			1,57,500
1.4.2006	To Fixed assets (Loss on sale of revalued assets)	55,000	1.4.2006	By Balance b/d	1,35,000
	To General				

	Reserve	80,000			
		1,35,000			1,35,000

Workings Notes:

1. **Calculation of Revaluation amount to be shown in revaluation reserve account:**

   Downward revision of 50% of fixed assets = (₹ 72,00,000 x ½) x 10% = ₹ 3,60,000

   Upward revision of remaining 50% of fixed assets = (₹ 72,00,000 x ½) x 15%

   = ₹ 5,40,000

2. **Value of Fixed assets after revaluation as on 1.4.04:**

   [(72,00,000 x ½) – 3,60,000] + {(72,00,000 x ½) + 5,40,000} = ₹ 32,40,000 + 41,40,000

   = ₹ 73,80,000

3. **Depreciation per annum for remaining 8 years**

   Value of Fixed Assets = ₹ 73,80,000 (W.N.2)

   Remaining life of the asset = 8 years

   New Depreciation = ₹ 73,80,000/8 = ₹ 9,22,500

4. **Depreciation to be charged to Revaluation Reserve Account**

   = ₹ 9,22,500 – ₹ 9,00,000 = ₹ 22,500

Question 17

(a) Arrange and redraft the following Cash Flow Statement in proper order keeping in mind the requirements of AS 3:

		(₹ in lacs)	*(₹ in lacs)*
Net Profit			*60,000*
Add:	*Sale of Investments*		*70,000*
	Depreciation on Assets		*11,000*
	Issue of Preference Shares		*9,000*
	Loan raised		*4,500*
	Decrease in Stock		*12,000*
			1,66,500
Less:	*Purchase of Fixed Assets*	*65,000*	
	Decrease in Creditors	*6,000*	
	Increase in Debtors	*8,000*	
	Exchange gain	*8,000*	

Profit on sale of investments	*12,000*	
Redemption of Debenture	*5,700*	
Dividend paid	*1,400*	
Interest paid	*945*	*1,07,045*
		59,455
Add: Opening cash and cash equivalent		*12,341*
Closing cash and cash equivalent		*71,796*

(b) P Ltd. has 60% voting right in Q Ltd. Q Ltd. has 20% voting right in R Ltd. Also, P Ltd. directly enjoys voting right of 14% in R Ltd. R Ltd. is a listed company and regularly supplies goods to P Ltd. The management of R Ltd. has not disclosed its relationship with P Ltd.

How would you assess the situation from the viewpoint of AS 18 on Related Party Disclosures?

(c) Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being ₹ 7,00,000. The economic life of the machine as well as the lease term is 3 years. At the end of each year Lessee Ltd. pays ₹ 3,00,000. Guaranteed Residual Value (GRV) is ₹ 22,000 on expiry of the lease. Implicit Rate of Return (IRR) is 15% p.a. and present value factors at 15% are 0.869, 0.756 and 0.657 at the end of first, second and third years respectively.

Calculate the value of machine to be considered by Lessee Ltd. and the interest (Finance charges) in each year. (6 + 4 + 6 = 16 Marks, November, 2007)

Answer

(a) **Cash Flow Statement**

		(₹ in lacs)
Cash flows from operating activities		
Net profit		60,000
Less: Exchange gain		(8,000)
Less: Profit on sale of investments		(12,000)
		40,000
Add: Depreciation on assets		11,000
Change in current assets and current liabilities		51,000
(-) Increase in debtors	(8,000)	
(+) Decrease in stock	12,000	
(-) Decrease in creditors	(6,000)	(2,000)

Net cash from operating activities		49,000
Cash flows from investing activities		
Sale of investments	70,000	
Purchase of fixed assets	(65,000)	
Net cash from Investing activities		5,000
Cash flows from financing activities		
Issue of preference shares	9,000	
Loan raised	4,500	
Redemption of Debentures	(5,700)	
Interest paid	(945)	
Dividend paid	(1,400)	
Net cash from financing activities		5,455
Net increase in cash & cash equivalents		59,455
Add: Opening cash and cash equivalents		12,341
Closing cash and cash equivalents		71,796

(b) P Ltd. has direct economic interest in R Ltd to the extent of 14%, and through Q Ltd. in which it is the majority shareholders, it has further control of 12% in R Ltd. (60% of Q Ltd's 20%). These two taken together (14% + 12%) make the total control of 26%.

Para 10 of AS 18 'Related Party Disclosures', defines *related party* as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Here, *Control* is defined as ownership directly or indirectly of more than one-half of the voting power of an enterprise; and *Significant Influence* is defined as participation in the financial and/or operating policy decisions of an enterprise but not control of those policies.

In the present case, control of P Ltd. in R Ltd. directly and through Q Ltd., does not go beyond 26%. However, as per para 12 of AS 18, significant influence may be exercised as an investing party (P Ltd.) holds, directly or indirectly through intermediaries 20% or more of the voting power of the R Ltd. As R Ltd. is a listed company and regularly supplies goods to P Ltd. therefore, related party disclosure, as per AS 18, is required.

(c) Value of machine will be lower of the fair value or present value (PV) of Minimum Lease Payments (MLP).

Present value (PV) of Minimum Lease Payments (MLP)

Year	*MLP*	*PV at 15%*	*PV Amount*
		₹	₹
1	3,00,000	0.869	2,60,700
2	3,00,000	0.756	2,26,800
3	3,22,000 (considering residual value)	0.657	2,11,554
			6,99,054

Since PV of MLP ₹ 6,99,054 being lower than the fair value ₹ 7,00,000, therefore, value of machine will be taken as ₹ 6,99,054.

Calculation of interest (finance charges)

Year	*Liability*		*Interest at 15%*	*Principal*	*Lease rental*
		₹	₹	₹	₹
		6,99,054	1,04,858	1,95,142	3,00,000
1st	*Less:* Principal	1,95,142		(Rental – Interest)	
		5,03,912	75,587	2,24,413	3,00,000
2nd	*Less:* Principal	2,24,413		(Rental – Interest)	
		2,79,499	41,925	2,58,075	3,00,000
				(Rental – Interest)	
3rd	*Less:* Principal	2,58,075			
	Residual value	21,424*			

Question 18

Write short note on the concept of Materiality. *(6 Marks, November, 2007)*

Answer

Para 17 of AS 1 'Disclosure of Accounting Policies', states that financial statements should disclose all material items, i.e., items the knowledge of which might influence the decisions of the user of the financial statements. Materiality depends on the size of item or error judged in the particular circumstances of its omission or misstatement. From a positive perspective,

* The difference between this figure and guaranteed residual value (₹ 22,000) is due to approximation in computing the interest rate implicit in the lease.

materiality has to do with the significance of an item or event to warrant attention in the accounting process. From a negative view point, materiality is critical because otherwise a great deal of time might be spent on trivial matters in the accounting process. Individual judgements are required to assess materiality, or to decide what the appropriate minimum quantitative criteria are to be set for given situations. What is material to one organisation, may not be material for another organisation.

The relevance of information is affected by its materiality. Information is material if its misstatements (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information. Materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which the information must have if it is to be useful.

Question 19

X Ltd. began construction of a new building on 1st January, 2007. It obtained ₹ 1 lakh special loan to finance the construction of the building on 1st January, 2007 at an interest rate of 10%. The company's other outstanding two non-specific loans were:

Amount	*Rate of Interest*
₹ 5,00,000	*11%*
₹ 9,00,000	*13%*

The expenditure that were made on the building project were as follows:

		₹
January	*2007*	*2,00,000*
April	*2007*	*2,50,000*
July	*2007*	*4,50,000*
December	*2007*	*1,20,000*

Building was completed by 31st December, 2007. Following the principles prescribed in AS 16 'Borrowing Cost,' calculate the amount of interest to be capitalized and pass one Journal Entry for capitalizing the cost and borrowing cost in respect of the building. (10 Marks, May, 2008)

Answer

(i) Computation of average accumulated expenses

		₹
₹ 2,00,000 x 12 / 12	=	2,00,000
₹ 2,50,000 x 9 / 12	=	1,87,500
₹ 4,50,000 x 6 / 12	=	2,25,000

₹ 1,20,000 x 1 / 12	=	10,000
		6,22,500

(ii) Calculation of average interest rate other than for specific borrowings

Amount of loan (in ₹)	Rate of interest		Ampount of interest (in ₹)
5,00,000	11%	=	55,000
9,00,000	13%	=	1,17,000
14,00,000			1,72,000
Weighted average rate of interest $\left(\frac{1,72,000}{14,00,000}\times 100\right)$		=	12.285% (approx)

(iii) Interest on average accumulated expenses

		₹
Specific borrowings (₹ 1,00,000 X 10%)	=	10,000
Non-specific borrowings (₹ 5,22,500* X 12.285%)	=	64,189
Amount of interest to be capitalized	=	74,189

(iv) Total expenses to be capitalized for building

	₹
Cost of building ₹ (2,00,000 + 2,50,000 + 4,50,000 + 1,20,000)	10,20,000
Add: Amount of interest to be capitalised	74,189
	10,94,189

(v) Journal Entry

Date	*Particulars*		*Dr. (₹)*	*Cr. (₹)*
31.12.2007	Building account	Dr.	10,94,189	
	To Bank account			10,94,189
	(Being amount of cost of building and borrowing cost thereon capitalized)			

* (₹ 6,22,500 – ₹ 1,00,000)

Question 20

U.K. International Ltd. is developing a new production process. During the financial year ending 31st March, 2007, the total expenditure incurred was ₹ 50 lakhs. This process met the criteria for recognition as an intangible asset on 1st December, 2006. Expenditure incurred till this date was ₹ 22 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2008 was ₹ 80 lakhs. As at 31st March, 2008, the recoverable amount of know-how embodied in the process is estimated to be ₹ 72 lakhs. This includes estimates of future cash outflows as well as inflows.

You are required to calculate:

(i) Amount to be charged to Profit and Loss A/c for the year ending 31st March, 2007 and carrying value of intangible as on that date.

(ii) Amount to be charged to Profit and Loss A/c and carrying value of intangible as on 31st March, 2008.

Ignore depreciation. *(5 Marks, May, 2008)*

Answer

As per AS 26 'Intangible Assets'

(i) For the year ending 31.03.2007

(1) Carrying value of intangiblet as on 31.03.2007:

At the end of financial year 31st March 2007, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹ 28 lakhs (expenditure incurred since the date the recognition criteria were met, i.e., on 1st December 2006).

(2) Expenditure to be charged to Profit and Loss account:

The ₹ 22 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2007. This expenditure will not form part of the cost of the production process recognized in the balance sheet.

(ii) For the year ending 31.03.2008

(1) Expenditure to be charged to Profit and Loss account:

	(₹ in lakhs)
Carrying Amount as on 31.03.2007	28
Expenditure during 2007 – 2008	80
Total book cost	108
Recoverable Amount	72
Impairment loss	36

₹ 36 lakhs to be charged to Profit and loss account for the year ending 31.03.2008.

(2) *Carrying value of intangible as on 31.03.2008:*

	(₹ in lakhs)
Total Book Cost	108
Less: Impairment loss	36
Carrying amount as on 31.03.2008	72

Question 21

Mini Ltd. took a factory premises on lease on 1.4.07 for ₹ 2,00,000 per month. The lease is operating lease. During March, 2008, Mini Ltd. relocates its operation to a new factory building. The lease on the old factory premises continues to be live upto 31.12.2010. The lease cannot be cancelled and cannot be sub-let to another user. The auditor insists that lease rent of balance 33 months upto 31.12.2010 should be provided in the accounts for the year ending 31.3.2008. Mini Ltd. seeks your advice. (5 Marks, May, 2008)

Answer

In accordance with Para 1(b) of AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', 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 31.12.2010 will be nil. However, the lessee, Mini Ltd., has to pay lease rent of ₹ 66,00,000 (i.e.2,00,000 p.m. for next 33 months).

Question 22

A Cosmetic articles producing company provides the following information:

	Cold Cream	*Vanishing Cream*
January, 2006 – September, 2006 per month	*2,00,000*	*2,00,000*
October, 2006 – December, 2006 per month	*1,00,000*	*3,00,000*
January, 2007- March, 2007 per month	*0*	*4,00,000*

The company has enforced a gradual change in product-line on the basis of an overall plan. The Board of Directors of the company has passed a resolution in March, 2006 to this effect. The company follows calendar year as its accounting year. Should this be treated as a discontinuing operation? Give reasons in support of your answer. (5 Marks, May, 2008)

* For a contract to qualify as an onerous contract, the unavoidable costs of meeting the obligation under the contract should exceed the economic benefits expected to be received under it.

Answer

In response to the market forces, business enterprises often abandon products or even product lines and reduce the size of their work-force. These actions are not in themselves discontinuing operations unless they satisfy the definition criteria.

In the instant case the company has been gradually reducing operation in the product line of cold creams, simultaneously increasing operation in the product line of vanishing creams. The company was not disposing of any of its components. Phasing out a product line as undertaken by the company does not meet definition criteria in paragraph 3 of AS 24, namely, disposing of substantially in its entirety a component of the enterprise. Therefore, this change over is not a discontinuing operation.

Question 23

How are capital expenditures not represented by any specific or tangible assets dealt in financial statements? *(5 Marks, May, 2008)*

Answer

Sometimes circumstances force a project to incur capital expenditure which is not represented by any specific or tangible assets. For example, a project may have to pay the cost of laying pipelines in order to facilitate the supply of its products or raw materials to or from a sea port but the port trust or other similar authorities may insist that the pipelines belong to them even though the cost thereof is paid by the company. In such a case, the capital expenditure incurred by the project for the stated purpose would not be represented by any actual assets, since the pipeline would remain the property of the relevant port trust or other similar authorities even though the whole or a part of their cost may have been defrayed by the company in order to facilitate its business. In such cases the expenditure so incurred would have to be treated in the books of account as the capital expenditure.

There seems to be no valid objection to disclose the expenditure under the general heading of "Capital Expenditure" subject to two conditions. In the first place the description of the specific items on the balance sheet should be such as to indicate quite clearly that the capital expenditure is not represented by any assets owned by the company. In the second place the capital expenditure should be written off over the approximate period of its utility or over a relatively brief period not exceeding five years whichever is less.

In fact having regard to the nature of expenditure and purpose for which it is incurred, it would be more appropriate and realistic to classify such expenditure in the balance sheet under the heading of "Capital Expenditure" rather than either, write off the expenditure to revenue or classify the expenditure under the heading of "Miscellaneous Expenditure".

Question 24

Write short note on Reversal of an Impairment Loss. *(4 Marks, November, 2008)*

Answer

As per AS 28 on Impairment of Assets, an enterprise should assess at each balance sheet date whether there is any indication that an impairment loss recognised for an asset in prior accounting periods may no longer exist or may have decreased. If any such indication exists, the enterprise should estimate the recoverable amount of that asset.

In assessing whether there is any indication that an impairment loss recognised for an asset in prior accounting periods may no longer exist or may have decreased, an enterprise should consider, as a minimum, the following indications:

External sources of information

(a) the asset's market value has increased significantly during the period;

(b) significant changes with a favourable effect on the enterprise have taken place during the period, or will take place in the near future, in the technological market, economic or legal environment in which the enterprise operates or in the market to which the asset is dedicated;

(c) market interest rates or other market rates of return on investments have decreased during the period, and those decreases are likely to affect the discount rate used in calculating the asset's value in use and increase the asset's recoverable amount materially.

Internal sources of information

(d) significant changes with a favourable effect on the enterprise have taken place during the period, or are expected to take place in the near future, to the extent to which, or manner in which, the asset is used or is expected to be used. These changes include capital expenditure that has been incurred during the period to improve or enhance an asset in excess of its originally assessed standard of performance or a commitment to discontinue or restructure the operation to which the asset belongs; and

(e) evidence is available from internal reporting that indicates that the economic performance of the asset is, or will be, better than expected.

Question 25

What are the types of Employees benefit and what is the objective of Introduction of this Standard i.e. AS 15? *(4 Marks, November, 2008)*

Answer

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.

Question 26

What are Timing differences and Permanent differences? *(4 Marks, November, 2008)*

Answer

AS 22 states that timing differences are those differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods. Unabsorbed depreciation and carry forward of losses which can be set off against future taxable income are also considered as timing differences and result in deferred tax assets subject to consideration of prudence i.e., deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

Permanent differences are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently. For instance, if for the purpose of computing taxable income, the tax laws allow only a part of an item of expenditure, the disallowed amount would result in a permanent difference.

Question 27

(a) On 30.6.2007, Asmitha Ltd. incurred ₹ 2,00,000, net loss from disposal of a business segment. Also, on 30.7.2007, the company paid ₹ 60,000 for property taxes assessed for

the calendar year 2007. How the above transactions should be included in determination of net income of Asmitha Ltd. for the six months interim period ended on 30.9.2007.

(b) *M/s XYZ Ltd. has three segments namely X, Y, Z. The total assets of the Company are ₹ 10.00 crs. Segment X has ₹ 2.00 crs., segment Y has ₹ 3.00 crs. and segment Z has ₹ 5.00 crs. Deferred tax assets included in the assets of each segments are X - ₹ 0.50 crs., Y — ₹ 0.40 crs. and Z — ₹ 0.30 crs. The accountant contends that all the three segments are reportable segments. Comment.*

(c) *M/s Dinesh & Company signed an agreement with workers for increase in wages with retrospective effect. The outflow on account of arrears was for 2005-06—₹ 10.00 lakhs, for 2006-07—₹ 12.00 lakhs and for 2007-08—₹ 12.00 lakhs. This amount is payable in September, 2008. The accountant wants to charge ₹ 22.00 lakhs as prior period charges in financial statement for 2008-09. Discuss.*

(d) *M/s Prima Co. Ltd. sold goods worth ₹ 50,000 to M/s Y and Company. M/s Y and Co. asked for discount of ₹ 8,000 which was agreed by M/s Prima Co. Ltd. The sale was affected and goods were despatched. After receiving goods worth ₹ 7,000 was found defective, which they returned immediately. They made the payment of ₹ 35,000 to M/s Prima Co. Ltd. Accountant booked the sales for ₹ 35,000. Please discuss.*

(e) *Himalayas Ltd. is showing an intangible Asset at ₹ 72 lakhs as on 01.04.2007 and that item was required for ₹ 96 lakhs on 01.04.2004 and that item was available for use from that date. Himalayas Ltd. has been following the policy of amortisation of the intangible asset over a period of 12 years on straight line basis. Comment on the accounting treatment of the above with reference to relevant accounting standard.*

(5 x 5= 25 Marks, November, 2008)

Answer

(a) According to Para 10 of AS 25 "Interim Financial Reporting", If an enterprise prepares and presents a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial statements. As on 30.9.2007, Asmitha Ltd., would report the entire ₹ 2,00,000 loss on the disposal of its business segment since the loss was incurred during interim period. A cost charged as an expense in an annual period should be allocated to Interim periods on accrual basis. Since ₹ 60,000 Property Tax payment relates to entire calendar year 2007, ₹ 30,000 would be reported as an expense for six months ended on 30th September, 2007 while remaining ₹ 30,000 would be reported as prepaid expenses.

(b) According to AS 17 "Segment Reporting", segment assets do not include income tax assets. Therefore, the revised total assets are 8.8 crores [10 crores – (0.5+0.4+0.3)]. Segment X holds total assets of 1.5 crores (2 crores – 0.5 crores); Segment Y holds 2.6 crores (3 crores – 0.4 crores); and Segment Z holds 4.7 crores (5 crores –

0.3 crores). Thus all the three segments hold more than 10% of the total assets, all segments are reportable segments.

(c) According to AS 5 (Revised) "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the term prior period item refers only to income or expenses which arise in the current period as a result of errors or omission in the preparation of the financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods are determined in the current period. The full amount of wage arrears paid to workers will be treated as an expense of current year and it will be charged to profit and loss account as current expenses and not as prior period expenses.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per Para 12 of AS 5 (Revised), 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.

(d) As per Para 4.1 of AS 9 "Revenue Recognition", revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends.

In the given case, M/s Prima Co. Ltd. should record the sales at gross value of ₹ 50,000. Discount of ₹ 8,000 in price and goods returned worth ₹ 7,000 are to be adjusted by suitable provisions. M/s Prime Co. Ltd. might have sent the credit note of ₹ 15,000 to M/s Y & Co. to account for these adjustments. The contention of the accountant to book the sales for ₹ 35,000 is not correct.

(e) As per para 63 of AS 26 "Intangible Assets", the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.

Himalayas Ltd. has been following the policy of amortisation of the intangible asset over a period of 12 years on straight line basis. The period of 12 years is more than the maximum period of 10 years specified under AS 26. Accordingly, Himalayas Ltd. would be required to restate the carrying amount of intangible asset as on 1.4.2007 at ₹ 96 lakhs less ₹ 28.8 lakhs (₹ 9.6 lakhs × 3 years) = ₹ 67.2 lakhs. If amortisation had been as per AS 26, the carrying amount would have been ₹ 67.2 lakhs. The difference of ₹ 4.8 lakhs i.e. (₹ 72 lakhs – 67.2 lakhs) would be required to be adjusted against the opening balance of revenue reserves. The carrying amount of ₹ 67.2 lakhs would be amortised over 7 (10 less 3) years in future.

Question 28

(a) From the following details of an asset

(i) Find out impairment loss

(ii) Treatment of impairment loss

(iii) Current year depreciation

Particulars of asset:

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

(b) Rainbow Limited borrowed an amount of ₹ 150 crores on 1.4.2008 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Rainbow Ltd. capitalized ₹ 19.50 crores for the accounting period ending on 31.3.2009. Due to surplus fund out of ₹ 150 crores, an income of ₹ 3.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

(c) Suraj Limited wishes to obtain a machine costing ₹ 30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 5 years. It enters into an agreement with Ashok Ltd., for a lease rental for ₹ 3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Suraj Limited is not sure about the treatment of these lease rentals and seeks your advise.

(d) Omega 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 2006, 2007 and 2008 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 2006, 2007 and 2008 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 2006, 2007 and 2008.

(e) While preparing its final accounts for the year ended 31st March, 2009, a company made a provision for bad debts @ 5% of its total debtors. In the last week of February 2009, a debtor for 2 lakhs had suffered heavy loss due to earthquake. The loss was not covered

by any insurance policy. In April, 2009, the debtor became bankrupt. Can the company provide for full loss arising out of insolvency of debtor in the final accounts for year ended 31st March, 2009? *(5 x 5 = 25 Marks, June, 2009)*

Answer

(a) According to para 59 of AS 28 "Impairment of Assets", an impairment loss on a revalued asset is recognised as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

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

As per para 61 of AS 28, "after the recognition of an impairment loss, the depreciation (amortization) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life."

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

(b) Para 10 of AS 16 'Borrowing Costs' states "To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings." The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Rainbow Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2008-09 should be calculated as follows:

Actual interest for 2008-09 (11% of ₹ 150 crores)	₹ 16.50 crores
Less: Income on temporary investment from specific borrowings	(₹ 3.50 crores)
Borrowing costs to be capitalized during year 2008-2009	₹ 13.00 crores

(c) As per AS 19 'Leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment* amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV - Annuity Factor can be computed as follows:

Annuity Factor (Year 1 to Year 5)	3.36** (approx.)
Present value of minimum lease payments (for ₹ 3 lakhs each year)	₹ 10.08 lakhs (approx.)

Thus, present value of minimum lease payments is ₹ 10.08 lakhs and the fair value of the machine is ₹ 30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for five years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

(d) **Omega Limited**

Calculation of Deferred Tax Asset/Liability

Year	*Accounting Income*	*Taxable Income*	*Timing Difference (balance)*	*Deferred Tax Liability (balance)*
2006	11,00,000	7,00,000	4,00,000	1,40,000
2007	16,00,000	18,00,000	2,00,000	70,000
2008	21,00,000	23,00,000	NIL	NIL
	48,00,000	48,00,000		

(e) As per Para 8.2 and 13 of Accounting Standard 4 'Contingencies and Events occurring after the Balance Sheet Date', assets and liabilities should be adjusted for events occurring after the date of balance sheet, that provide additional evidence to assist estimation of amounts relating to conditions existing at the Balance Sheet Date. Therefore, in the given case, full provision for bad debt amounting ₹ 2 lakhs should be

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* In calculating the present value of the of minimum lease payments, the discount rate is the interest rate implicit in the lease.

** This is calculated using the following formula:

$$\frac{1}{(1+.15)^1}+\frac{1}{(1+.15)^2}+\frac{1}{(1+.15)^3}+\frac{1}{(1+.15)^4}+\frac{1}{(1+.15)^5}$$

made to cover the loss arising due to insolvency in the final accounts for the year ended 31st March, 2009 as earthquake took place before the balance sheet date.

Question 29

Write short note on treatment of refund of Government grants. (4 Marks, November, 2009)

Answer

As per Para 11 of AS 12 "Accounting for Government Grants", government grant that becomes refundable should be treated as an extraordinary item. The amount refundable in respect of a government grant related to revenue is applied first against any unamortized deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement. The amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. In the first alternative, *i.e.,* where the book value of the asset is increased, depreciation on the revised book value is provided prospectively over the residual useful life of the asset. Where a grant which is in the nature of promoters' contribution becomes refundable, in part or in full, to the government on non-fulfillment of some specified conditions, the relevant amount recoverable by the government is reduced from the capital reserve.

Question 30

Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances. (4 Marks, November, 2009)

Answer

Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations. According to Paragraph 9 of AS 24, examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include:

(i) Gradual or evolutionary phasing out of a product line or class of service;

(ii) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;

(iii) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(iv) Closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

Question 31

(a) The following data apply to 'X' Ltd. defined benefit pension plan for the year ended

31.03.09, calculate the actual return on plan assets:

- Benefits paid	*2,00,000*
- Employer contribution	*2,80,000*
- Fair market value of plan assets on 31.03.09	*11,40,000*
- Fair market value of plan assets as on 31.03.08	*8,00,000*

(b) U.S.A Ltd. purchased raw material @ ₹ 400 per kg. Company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year, company is having 10,000 kg of raw material in stock. As the company never sells the raw material, it does not know the selling price of raw material and hence can not calculate the realizable value of the raw material for valuation of inventories at the end of the year. However replacement cost of raw material is ₹ 300 per kg. How will you value the inventory of raw material?

(c) Moon Ltd. entered into agreement with Sun Ltd. for sale of goods of ₹ 8 lakhs at a profit of 20 % on cost. The sale transaction took place on 1st February, 2009. On the same day Sun Ltd. entered into another agreement with Moon Ltd. to resell the same goods at ₹ 10.80 lakhs on 1st August, 2009. State the treatment of this transaction in the financial statements of Moon Ltd. as on 31.03.09. The pre-determined re-selling price covers the holding cost of Sun Ltd. Give the Journal Entries as on 31.03.09 in the books of Moon Ltd.

(d) XY Ltd. was making provisions for non-moving stocks based on no issues for the last 12 months upto 31.03.08. Based on technical evaluation the company wants to make provisions during the year 31.03.09.

Total value of stock --- ₹ 150 lakhs.

Provisions required based on 12 months issue ₹ 4.0 lakhs.

Provisions required based on technical evaluation ₹ 3.20 lakhs.

Does this amount to change in accounting policy? Can the company change the method of provision? (4 x 5 = 20 Marks, November, 2009)

Answer

(a)

	₹
Fair value of plan assets on 31.3.08	8,00,000
Add: Employer contribution	2,80,000
Less: Benefits paid	2,00,000
(A)	8,80,000

Fair market value of plan assets at 31.3.09	(B)	11,40,000
Actual return on plan assets	(B-A)	2,60,000

(b) As per Para 24 of AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. Therefore, in this case, USA Ltd. will value the stock of raw material at ₹ 30,00,000 (10,000 Kg. @ ₹ 300 per kg.).

(c) In the given case, Moon Ltd. concurrently agreed to repurchase the same goods from Sun Ltd. on 1st Feb., 2009. Also the re-selling price is pre-determined and covers purchasing and holding costs of Sun Ltd. Hence, the transaction between Moon Ltd. and Sun Ltd. on 1st Feb., 2009 should be accounted for as financing rather than sale. The resulting cash flow of ₹ 9.60 lakhs received by Moon Ltd., cannot be considered as revenue as per AS 9 "Revenue Recognition".

Journal Entries in the books of Moon Ltd.

				₹ in lakhs
1.02.09	Bank Account	Dr.	9.60	
	To Advance from Sun Ltd*.			9.60
	(Being advance received from Sun Ltd amounting [₹ 8 lakhs + 20% of ₹ 8 lakhs= 9.60 lakhs] under sale and re-purchase agreement)			
31.03.09	Financing Charges Account	Dr.	0.40	
	To Sun Ltd.			0.40
	(Financing charges for 2 months at ₹ 1.20 lakhs [10.80 – 9.60] i.e. 1.2 lakhs x 2/6)			
31.03.09	Profit and Loss Account	Dr.	0.40	
	To Financing Charges Account			0.40
	(Being amount of finance charges transferred to P& L Account)			

(d) The decision of making provision for non-moving stocks on the basis of technical evaluation does not amount to change in accounting policy as per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies". The method

* The balance of Sun Ltd. account will be disclosed as an advance under the heading liabilities in the balance sheet of Moon Ltd. as on 31st March, 2009.

of estimating the amount of provision may be changed, in case, a more prudent estimate can be made by adopting the changed method.

In the given case, considering the total value of stocks, the change in the amount of required provision of non-moving stocks from ₹ 4.0 lakhs to ₹ 3.20 lakhs is also not material. The disclosure can be made for such change by way of notes to the accounts in the financial statements of XY Ltd. for the year ending on 31.03.09, in the following manner:

"The company has provided for non-moving stocks on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end, the net assets would have been lower by ₹ 0.80 lakhs".

Question 32

From the following information compute diluted earnings per share:

Net profit for the year 2008	*₹ 12,00,000*
Weighted average number of equity shares outstanding during year 2008	*5,00,000 shares*
Average fair value of one equity share during the year 2008	*₹ 20*
Weighted average number of shares under option during the year 2008	*1,00,000 shares*
Exercise price per share under option during the year 2008	*₹ 15*

(4 Marks, November, 2009)

Answer

Computation of diluted earnings per share

	Earnings (₹)	*Shares*	*Earning per share (₹)*
Net profit for the year 2008	12,00,000		
Weighted average number of equity shares outstanding during the year 2008		5,00,000	
Basic earnings per share (12,00,0000/5,00,000)			2.40
Weighted average number of shares under option		1,00,000	
Number of shares that would have been issued at fair value (1,00,000 × 15.00)/20.00)	*	(75,000)	—
Diluted earnings per share (12,00,0000/5,25,000)	12,00,000	5,25,000	2.29

*The earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of computation to have been issued for no consideration (Para 37(b) of AS 20).

Question 33

(a) *Mr. A bought a forward contract for three months of US $ 1,00,000 on 1st December at 1 US $ = ₹ 47.10 when exchange rate was US $ 1 = ₹ 47.02. On 31st December when he closed his books, exchange rate was US $ 1 = ₹ 47.15. On 31st January, he decided to sell the contract at ₹ 47.18 per dollar. Show how the profits from contract will be recognised in the books.*

(b) *Sun Ltd. has entered into a sale contract of ₹ 5 crores with X Ltd. during 2009-10 financial year. The profit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 2010-11 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of ₹ 1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 2009-10 financial year. As on balance sheet date (31.3.2010), the goods were not manufactured and it was unlikely that Sun Ltd. will be in a position to meet the contractual obligation.*

   (i) *Should Sun Ltd. provide for contingency as per AS 29?*

   (ii) *Should provision be measured as the excess of compensation to be paid over the profit?*

(c) *Rainbow Limited borrowed an amount of ₹ 150 crores on 1.4.2009 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. The weighted average cost of capital is 13% p.a. The accountant of Rainbow Ltd., capitalised interest of ₹ 19.50 crores for the accounting period ending on 31.3.2010. Due to surplus fund out of ₹ 150 crores, an income of ₹ 3.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.*

(d) *Y Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference resulting in a tax liability in year 1 and 2 is ₹ 200 lakhs and ₹ 400 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by ₹ 10 lakhs. Assuming tax rate of 40%, find out the deferred tax liability at the end of the second year and any charge to the Profit and Loss account.* *(4 × 5 = 20 Marks, May, 2010)*

Answer

(a) It is apparent from the facts given in the question that Mr. A entered into forward exchange contract for speculation purpose*. According to paragraphs 38 and 39 of AS 11 (Revised) 'The Effects of Changes in Foreign Exchange Rates', gain or loss on

* The forward contract is sold before its due date, hence considered as speculative.

forward exchange contracts intended for trading or speculation purpose should be computed by multiplying the foreign currency amount of the forward exchange contract by the difference between the forward rate available at the reporting date for the remaining maturity of the contract and the contracted forward rate (or the forward rate last used to measure a gain or loss on that contract for an earlier period). The gain or loss so computed should be recognised in the statement of profit and loss for the period and the premium or discount on the forward exchange contract is ignored and not recognised separately. In recording such contract, at each balance sheet date, the value of the contract is marked to its current market value and the gain or loss on the contract is recognised.

Thus, the premium on contract i.e., the difference between the contract rate and the spot rate amounting ₹ 8,000 [US$ 1,00,000 x (₹ 47.10 – ₹ 47.02)] will be ignored and not be recorded in the books. However, the profit on contract i.e. the difference between the sale rate and contract rate amounting ₹ 8,000 [US$ 1,00,000 x 0.08* (₹ 47.18 – ₹ 47.10)] will be recognized in the books of Mr. A on 31st January.

Note: The answer has been given on the basis that Mr. A is a small and medium-sized entity and AS 30 "Financial Instruments: Recognition and Measurement" is not applicable to him.

(b) (i) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Sun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for the contingency amounting ₹ 1.5 crores as per AS 29.

(ii) Provision should not be measured as the excess of compensation to be paid over the profit. The goods were not manufactured before 31st March, 2010 and no profit had accrued for the financial year 2009-2010. Therefore, provision should be made for the full amount of compensation amounting ₹ 1.50 crores.

(c) Para 10 of the AS 16 'Borrowing Cost' states, "To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings". The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding

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* The current market value of the forward contract on 31st December has not been given in the question. Therefore, no gain or loss can be recognised in the books on 31st December. The profit amounting ₹ 8,000 will be recognised in the year of sale only.

during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. In the given case, the amount of ₹ 150 crores was specifically borrowed for construction of boiler plant. Therefore, treatment of accountant of Rainbow Ltd. is not correct and the amount of borrowing costs to be capitalised for the financial year 2009-10 should be calculated as follows:

	₹ (in crores)
Interest paid for 2009-10 (11% on ₹ 150 crores)	16.50
Less: Income on temporary investment from specific borrowings	3.50
Borrowing costs to be capitalised during 2009-10	13.00

(d) As per an Explanation to para 13 of AS 22 'Accounting for Taxes on Income', deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognised to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income-tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognised in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence as laid down in AS 22. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of ₹ 200 lakhs depreciation timing difference, amount of ₹ 80 lakhs (₹ 10 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognised. However, for ₹ 120 lakhs (₹ 200 lakhs – ₹ 80 lakhs), deferred tax liability will be recognised for ₹ 48 lakhs (40% of ₹ 120 lakhs) in first year. In the second year, the entire amount of timing difference of ₹ 400 lakhs will reverse only after tax holiday period and hence, will be recognised in full. Deferred tax liability amounting ₹ 160 lakhs (40% of ₹ 400 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be ₹ 208 lakhs (48 lakhs + 160 lakhs).

Question 34

(a) Night Ltd. sells beer to customers; some of the customers consume the beer in the bars run by Night Limited. While leaving the bars, the consumers leave the empty bottles in the bars and the company takes possession of these empty bottles. The company has laid down a detailed internal record procedure for accounting for these empty bottles which are sold by the company by calling for tenders. Keeping this in view:

(i) Decide whether the stock of empty bottles is an asset of the company;

(ii) If so, whether the stock of empty bottles existing as on the date of Balance Sheet is to be considered as inventories of the company and valued as per AS 2 or to be treated as scrap and shown at realizable value with corresponding credit to 'Other Income'?

(b) AS 4 prescribes that 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 amount relating to conditions existing at the Balance sheet date-generally called adjusting events. "Proposed Dividend" is shown and adjusted in the Balance Sheet even if it is not an adjusting event as per AS 4 because it is proposed by the Board of Directors of the company after the Balance sheet date.

Keeping this in view, is it not violation of AS 4 to show proposed dividends as current liabilities and provisions? Comment.

(c) Bright Ltd. acquired 30% of East India Ltd. Shares for ₹ 2,00,000 on 01-06-09. By such an acquisition Bright can exercise significant influence over East India Ltd. During the financial year ending on 31-03-09 East India earned profits ₹ 80,000 and declared a dividend of ₹ 50,000 on 12-08-2009. East India reported earnings of ₹ 3,00,000 for the financial year ending on 31-03-10 and declared dividends of ₹ 60,000 on 12-06-2010.

Calculate the carrying amount of investment in:

(i) Separate financial statements of Bright Ltd. as on 31-03-10;

(ii) Consolidated financial statements of Bright Ltd.; as on 31-03-10;

(iii) What will be the carrying amount as on 30-06-2010 in consolidated financial statements?

(d) An asset does not meet the requirements of environment laws which have been recently enacted. The asset has to be destroyed as per the law. The asset is carried in the Balance Sheet at the year end at ₹ 6,00,000. The estimated cost of destroying the asset is ₹ 70,000. How is the asset to be accounted for? (4 × 5 =20 Marks, November, 2010)

Answer

(a) (i) Tangible objects or intangible rights carrying probable future benefits, owned by an enterprise are called assets. Night Ltd. sells these empty bottles by calling tenders. It means further benefits are accrued on its sale. Therefore, empty bottles are assets for the company.

(ii) As per AS 2 "Valuation of Inventories", inventories are assets held for sale in the ordinary course of business. Stock of empty bottles existing on the Balance Sheet date is the inventory and Night Ltd. has detailed controlled recording and accounting procedure which duly signify its materiality. Hence stock of empty bottles cannot be considered as scrap and should be valued as inventory in accordance with AS 2.

(b) As per para 8 of AS 4 "Contingencies and Events occurring after the Balance Sheet Date", 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. Accordingly, proposed dividend is not an adjusting event. However, para 14 of the

standard states that 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 in the financial statements because of the statutory requirement. However, as per Schedule III to the Companies Act, 2013*, there is no statutory requirement to adjust the proposed dividend declared after the balance sheet date but before approval of the financial statements from the profits. Therefore, the dividends declared after the balance sheet date shall not be provided for in the books.

Note: The ICAI has issued an exposure draft for limited revision in AS 4 on account of revision in the Schedule VI to the Companies Act**. This limited revision is yet to be notified by the Central Government.

(c) (i) **Carrying amount of investment in Separate Financial Statement of Bright Ltd. as on 31.03.10**

	₹
Amount paid for investment in Associate (on 1.06.2009)	2,00,000
Less: Pre-acquisition dividend (₹50,000 x 30%)	15,000
Carrying amount as on 31.3.2010 as per AS 13	1,85,000

(ii) **Carrying amount of investment in Consolidated Financial Statements* of Bright Ltd. as on 31.3.2010 as per AS 23**

	₹
Carrying amount as per separate financial statements	1,85,000
Add: Proportionate share of profit of investee as per equity method (30% of ₹3,00,000)	90,000
Carrying amount as on 31.3.2010	2,75,000

(iii) Carrying amount of investment in Consolidated Financial Statement of Bright Ltd. as on 30.6.2010 as per AS 23

	₹
Carrying amount as on 31.3.2010	2,75,000
Less: Dividend received (₹ 60,000 x 30%)	18,000
Carrying amount as on 30.6.2010	2,57,000

* Erstwhile revised Schedule VI to the Companies Act, 1956.

** Now Schedule III to the Companies Act, 2013.

* It is assumed that Bright Ltd. has a subsidiary company and it is preparing Consolidated Financial Statements.

(d) As per AS 28 "Impairment of Assets", impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount, where, recoverable amount is the higher of an asset's net selling price* and its value in use•. In the given case, recoverable amount will be nil [higher of value in use (nil) and net selling price (₹70,000)]. Thus impairment loss will be calculated as ₹ 6,00,000 [carrying amount (₹6,00,000) – recoverable amount (nil)]. Therefore, asset is to be fully impaired and impairment loss of ₹ 6,00,000 has to be recognized as an expense immediately in the statement of Profit and Loss as per para 58 of AS 28.

Question 35

X Ltd. sold its building to Mini Ltd. for ₹ 60 lakhs on 30.09-2009 and gave possession of the property to Mini Ltd. However, documentation and legal formalities are pending. Due to this, the company has not recorded the sale and has shown the amount received as an advance. The book value of the building is ₹ 25 lakhs as on 31st March, 2010. Do you agree with this treatment? If you do not agree, explain the reasons with reference to the accounting standard. (4 Marks, November, 2010)

Answer

Principles of prudence, substance over form and materiality should be looked into, to ensure true and fair consideration in a transaction. In the given case, the economic reality and substance of the transaction is that the rights and beneficial interest in the property has been transferred although legal title has not been transferred. Hence, X Ltd. should record the sale and recognize the profit of ₹ 35 lakhs in its financial statements for the year ended 31st March, 2010; value of building should be removed from the balance sheet. Therefore the treatment given by the company is not correct.

Question 36

Southern Tower Ltd. purchased a plant from M/s. Tatamaco Ltd. on 30-09-2008 with a quoted price of ₹ 180 lakhs. Tatamaco offer 3 months credit with a condition that discount of 1.25% will be allowed if the payment were made within one month. VAT is 12.5% on the quoted price. Company incurred 2% on transportation costs and 3% on erection costs of the quoted price. Preoperative cost amount to ₹ 1.50 lakhs. To finance the purchase of the machinery, company took a term bank loan of ₹ 125 lakhs at an interest rate of 14.50% per annum. The machine was ready for use on 31-12-2008; however, it was put to use only on 01-04-2009.

(i) Find out the original cost.

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*Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. In the given case, Net Selling Price = Selling price – Cost of disposal = Nil – ₹70,000 = ₹ (70,000)

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

(ii) Suggest the accounting treatment for the cost incurred during the period between the date the machine was ready for use and the actual date the machine was put to use.

(4 Marks, November, 2010)

Answer

(i) Original cost of the machine

Particulars	*₹ in lakhs*	*₹ in lakhs*
Quoted price	180.00	
Less: Discount @1.25%	(2.25)	177.75
Add: VAT @12.5%		22.50
Transportation @ 2%		3.60
Erection cost @ 3%		5.40
Pre-operative cost		1.50
Finance cost (14.5% on ₹ 125 lakhs for the period 01.10.08 to 31.12.08)		4.53
Total		215.28

(ii) Cost incurred during the period between the date the machine was ready for use and the actual date the machine was put to use

Finance cost amounting ₹ 4.53 lakhs (14.50% on ₹ 125 lakhs for the period 01.01.2009 to 31.03.2009) will be charged to profit and loss account as per AS 16 "Borrowing Costs".

Question 37

S. Square Private Limited has taken machinery on lease from S.K. Ltd. The information is as under:

Lease term = 4 years

Fair value at inception of lease = ₹ 20,00,000

Lease rent = ₹ 6,25,000 p.a. at the end of year

Guaranteed residual value = ₹ 1,25,000

Expected residual value = ₹ 3,75,000

Implicit interest rate = 15%

Discounted rates for 1st year, 2nd year, 3rd year and 4th year are 0.8696, 0.7561, 0.6575 and 0.5718 respectively.

Calculate the value of the lease liability as per AS 19. *(4 Marks, November, 2010)*

Answer

According to para 11 of AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of the finance lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee. In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease. Present value of minimum lease payments will be calculated as follows:

Year	*Minimum Lease Payment* ₹	*Internal rate of return (Discount rate @5%)*	*Present value* ₹
1	6,25,000	0.8696	5,43,500
2	6,25,000	0.7561	4,72,563
3	6,25,000	0.6575	4,10,937
4	7,50,000*	0.5718	4,28,850
Total	26,25,000		18,55,850

Present value of minimum lease payments ₹ 18,55,850 is less than fair value at the inception of lease i.e. ₹ 20,00,000, therefore, the lease liability should be recognized at ₹ 18,55,850 as per AS 19.

Question 38

(a) *The fair value of plan assets of Anupam Ltd. was ₹ 2,00,000 in respect of employee benefit pension plan as on 1st April, 2009. On 30th September, 2009 the plan paid out benefits of ₹ 25,000 and received inward contributions of ₹ 55,000. On 31st March, 2010 the fair value of plan assets was ₹ 3,00,000. On 1st April, 2009 the company made the following estimates, based on its market studies and prevailing prices.*

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

Calculate the expected and actual returns on plan assets as on 31st March, 2010, as per AS 15.

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* *Minimum Lease Payment of 4th year includes guaranteed residual value amounting ₹ 1,25,000.*

(b) HSL Ltd., is manufacturing goods for local sale and exports. As on 31st March, 2010, it has the following finished stock in the factory warehouse:

(i) Goods meant for local sales ₹ 100 lakhs (cost ₹ 75 lakhs)

(ii) Goods meant for exports ₹ 50 lakhs (cost ₹ 20 lakhs)

Excise duty is payable at the rate of 12%. The company's Managing Director says that excise duty is payable only on clearance of goods and hence not a cost. Please advise HSL using guidance note, if any issued on this, including valuation of stock.

(c) Rama Ltd, has provided the following information:

Depreciation as per accounting records	*= ₹ 2,00,000*
Depreciation as per income tax records	*= ₹ 5,00,000*
Unamortized preliminary expenses as per tax record	*= ₹ 30,000*

There is adequate evidence of future profit sufficiency. How much deferred tax asset/liability should be recognized as transition adjustment? Tax rate 50%.

(3 x 5 = 15 Marks, May, 2011)

Answer

(a) Computation of Expected Returns on Plan Assets as on 31st March, 2010, as per AS 15

	₹
Return on opening value of plan assets of ₹ 2,00,000 (held for the year) @ 10.25%	20,500
Add: Return on net gain of ₹ 30,000 (i.e. ₹ 55,000 – ₹ 25,000) during the year i.e. held for six months @ 5% (equivalent to 10.25% annually, compounded every six months)	1,500
Expected return on plan assets as on 31st March, 2010	22,000

Computation of Actual Returns on Plan Assets as on 31st March, 2010, as per AS 15

	₹	₹
Fair value of Plan Assets as on 31st March, 2010		3,00,000
Less: Fair value of Plan Assets as on 1st April, 2009	2,00,000	
Add: Contribution received as on 30th September, 2009	55,000	(2,55,000)
		45,000
Add: Benefits paid as on 30th September, 2009		25,000
Actual returns on Plan Assets as on 31st March, 2010		70,000

(b) According to Central Excise Rules, 2002, excise duty is levied upon the manufacture or production of goods. However, it is collected only at the time of removal of goods from factory premises or factory warehouse.

Guidance Note on 'Accounting Treatment for Excise Duty' says that excise duty is a duty on manufacture or production of excisable goods in India.

As explained in the Guidance Note, the liability for excise duty arises at the point of time at which the manufacture is completed. The excise duty paid or provided on finished goods should, therefore, be included in inventory valuation.

Further, the Guidance Note states that excise duty should be considered as a manufacturing expense and like other manufacturing expenses are considered as an element of cost for the purpose of inventory valuation, excise duty should also be considered as an element of cost while valuing the inventory.

Therefore, in the given case of HSL Ltd., the Managing Director's contention that "excise duty is payable only on clearance of goods and hence is not a cost" is incorrect. Excise duty on the goods meant for local sales should be provided for at the rate of 12% on the selling price that is on ₹ 100 lakhs for valuation of stock.

Excise duty on goods meant for exports, should also be provided for, since the liability for excise duty arises when the manufacture of the goods is completed. However, if it is assumed that all the conditions specified in Rule 19 of the Central Excise Rules, 2002 regarding export of excisable goods without payment of duty are fulfilled by HSL Ltd. excise duty may not be provided for.

(c) Table showing calculation of Deferred tax asset / liability

Particulars	*Amount*	*Timing differences*	*Deferred tax*	*Amount @ 50%*
	₹			₹
Excess depreciation as per tax records (5,00,000 – 2,00,000)	3,00,000	Timing	Deferred tax liability	1,50,000
Unamortised preliminary expenses as per tax records	30,000	Timing	Deferred tax asset	(15,000)
Net deferred tax liability				1,35,000

Question 39

(a) Anil Pharma Ltd. ordered 16,000 kg of certain material at ₹ 160 per unit. The purchase price includes excise duty ₹ 10 per kg in respect of which full CENVAT credit is admissible. Freight incurred amounted to ₹ 1,40,160. Normal transit loss is 2%. The company actually received 15,500 kg and consumed 13,600 kg of material. Compute cost of inventory under AS 2 and amount of abnormal loss.

(b) Jain Construction Co. Ltd. undertook a contract on 1st January, 2010 to construct a building for ₹ 80 lakhs. The company found on 31st March, 2010 that it had already spent

₹ 58,50,000 on the construction. Prudent estimate of additional cost for completion was ₹ 31,50,000.

What amount should be charged to revenue and what amount of contract value to be recognized as turnover in the final accounts for the year ended 31st March 2010 as per provisions of AS 7 (revised)?

(c) Kumar Ltd., is in engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of ₹ 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 2 lakhs instead of ₹ 5 lakhs. The average remaining life of the employee is estimated to be 6 years.

You are required to advise the company.

(d) An enterprise reports quarterly, estimates an annual income of ₹ 10 lakhs. Assume tax rates on 1st ₹ 5,00,000 at 30% and on the balance income at 40%. The estimated quarterly income are ₹ 75,000, ₹ 2,50,000, ₹ 3,75,000 and ₹ 3,00,000.

Calculate the tax expense to be recognized in each quarter. (4 x 4=16 Marks, May, 2011)

Answer

(a) Calculation of total cost of material

	₹
Purchase price (16,000 kg. x ₹ 160)	25,60,000
Less : CENVAT credit (16,000 kg. x ₹ 10)	(1,60,000)
	24,00,000
Add : Freight	1,40,160
Total material cost	25,40,160

Number of units after normal loss = 16,000 kg. x (100-2)% = 15,680 kg

Revised cost per kg. = $\frac{25,40,160}{15,680 \text{ kg}}$ = ₹ 162

Closing inventory = Material actually received – Material consumed
= 15,500 kg – 13,600 kg = 1,900 kg

Value of closing stock
= 1,900 kg x ₹ 162 = ₹ 3,07,800

Abnormal loss in kg = 15,680 kg. – 15,500 kg = 180 kg.

Abnormal loss in value = 180 kg x ₹ 162 = ₹ 29,160

(b)

	₹
Cost incurred till 31st March, 2010	58,50,000
Prudent estimate of additional cost for completion	31,50,000
Total cost of construction	90,00,000
Less: Contract price	(80,00,000)
Total foreseeable loss	10,00,000

As per para 35 of AS 7 (Revised) 'Construction Contracts' when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

Accordingly, the loss of ₹10,00,000 is required to be recognized as an expense in the year 2009-10.

Also as per para 21 of the said standard when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date.

Accordingly,

$$\text{Contract work in progress} = \frac{58,50,000 \times 100}{90,00,000} = 65\%$$

Proportion of total contract value to be recognized as turnover

= 65% of ₹ 80,00,000 = ₹ 52,00,000

(c) According to para 92 of AS 15 (Revised) "Employee Benefits", actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense. Therefore, surplus of ₹ 6 lakhs in the pension scheme on its actuarial valuation is required to be credited to the profit and loss statement of the current year. Hence, Kumar Ltd. cannot spread the actuarial gain of ₹ 6 lakhs over the next 2 years by reducing the annual contributions to ₹ 2 lakhs instead of ₹ 5 lakhs. It has to contribute ₹ 5 lakhs annually for its pension schemes.

(d) As per para 29 of AS 25 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

		₹
Estimated Annual Income	(A)	10,00,000
Tax expense:		
30% on ₹ 5,00,000		1,50,000

40% on remaining ₹ 5,00,000	2,00,000
(B)	3,50,000

Weighted average annual income tax rate = $\frac{B}{A} = \frac{3,50,000}{10,00,000}$ = 35%

Tax expense to be recognised in each of the quarterly reports	
Quarter I - ₹ 75,000 x 35%	26,250
Quarter II - ₹ 2,50,000 x 35%	87,500
Quarter III - ₹ 3,75,000 x 35%	1,31,250
Quarter IV - ₹ 3,00,000 x 35%	1,05,000
₹ 10,00,000	3,50,000

Question 40

(a) *Primus Hospitals Ltd. had acquired 40 units of Doppler Scan machines from Holiver USA at a cost of US$ 165,100 per unit in the beginning of financial year 2008-09. The prevailing rate of exchange was ₹ 50 to 1 US $. The acquisition was partly funded out of a government grant of ₹ 5 crores. The grant relating to such machines was given with a rider that in the event of a change in management, the entity is bound to return the grant. In April 2011, 51% control in the company was taken over by an overseas investor. The expected productive period of such an asset is normally reckoned as 5 years. The depreciation rate adopted was 20% p.a. on S.L.M. basis. The company had incurred expenditure of US $ 4000 towards bank charges and ₹ 7500 per unit as sea freight. You are also informed that neither capital reserve nor deferred income account has been maintained by the company. You are required to suggest the accounting treatment as a result of the return of the grant, in the light of the relevant AS.*

(b) *The following balances are extracted from the books of Ram Ltd. a real estate company on 31st March, 2011:*

	Dr. (₹ in '000)	*Cr. (₹ in '000)*
Lease hold premises	*42*	
Equipment, fixtures and fittings at cost on 1.4.2010	*264*	
Deprecation on equipments, fixtures and fittings on 1.4.2010		*164*

The following additional information's are also provided:

1. *Depreciation on equipment, fittings and fixtures is provided @ 15% on written down value.*
2. *On 1st October 2010, the company moved to a new premise. The premise is on a 12 year lease and the lease premium paid amounted to ₹ 42,000. The company*

used sub-contract labour of ₹ 40,000 and materials at cost of ₹ 38,000 in the refurbishment of the premise. These are to be considered as part of the cost of lease hold premise.

You are required to prepare the 'Notes to accounts' including significant accounting policies forming part of the financial statements, for disclosure of above facts and information provided. *(2 x 5 = 10 Marks, Nov. 2011)*

Answer

(a) Calculation of Revised Book Value of Machine as on 1st April, 2011

Particulars	*(₹)*
Acquisition of 40 Doppler Scan machines [US $ 165,100 x ₹ 50 x 40 machines]	33,02,00,000
Add: Bank charges paid ($ 4,000 x ₹ 50)	2,00,000
Add: Sea Freight on the above machines (₹ 7,500 per unit x 40 machines)	3,00,000
Total landed cost as on 1st April, 2008	33,07,00,000
Less: Government grant	(5,00,00,000)
Value of 40 Doppler Scan machines	28,07,00,000
Less: Depreciation @ 20% for 3 years on SLM basis (i.e ₹ 28,07,00,000 x 20% x 3 years)	(16,84,20,000)
WDV at the beginning of the year 2011-12	11,22,80,000
Add: Refund of government grant on 1st April, 2011	5,00,00,000
Revised book value of machine as on 1st April, 2011	16,22,80,000

Note: As per para 16 of AS 6 'Depreciation Accounting', where the historical cost of a depreciable asset has undergone a change due to increase or decrease in long term liability on account of exchange fluctuations, price adjustments, changes in duties or similar factors, the depreciation on the revised unamortized depreciable amount should be provided prospectively over the residual useful life of the asset. In this case, on 1st April, 2011, the remaining useful life is only two years i.e. 2011-12 & 2012-13. Hence, the WDV of ₹ 16,22,80,000 is to be written off under SLM @ 50% each year i.e. ₹ 8,11,40,000 per year.

The government grant of ₹ 5 crores that becomes refundable should be accounted for as an extraordinary item as per AS 12 'Government Grants', with related disclosure of the increased depreciation of ₹ 2.5 crores (i.e. ₹ 8,11,40,000 – ₹ 5,61,40,000) consequent to the return of such grant.

(b) Since the implicit rate of interest is not mentioned in the question, it is assumed that value of lease premium paid along with the refurbishment cost is the fair value of the leased asset. Accordingly, question has been solved assuming the lease as finance lease.

Notes on Accounts for the year ended 31st March, 2011:

The cost of leasehold premises includes the cost of refurbishment to the extent of ₹ 78,000 (Materials ₹ 38,000 + Labour ₹ 40,000).

Working Notes:

(a)	Fixed Assets:	(₹ in 000)	
	Equipment, fixtures & fittings	264	
	* Lease hold premises (42+40+38)	120	
		384	
(b)	Depreciation		
	Equipment, fixtures & fittings as on 1.4.2010	164	
	For the year 2010-11	15	179
	* Cost of leasehold premises written off [(42+40+38) x 1/12 x ½]		5
			184

Significant Accounting Policies

1. Depreciation has been charged on equipment, fixtures & fittings on the basis of written down value method year after year. Equipment fixtures & fittings are shown at cost in the Balance Sheet & depreciation accumulated thereon is shown on the liability side of the balance sheet.

2 According to AS 19 'Leases', the lease has been classified as finance lease assuming that lessor has transferred substantially all the risks and rewards incident to ownership to Ram Ltd. At the inception of lease, asset under finance lease is capitalized in the books of the lessee with the corresponding liability wherein lease payments are recognized as an expense in the profit and loss account on a systematic basis (i.e straight line) over the lease term.

Question 41

Eagle Ltd. had acquired 51% in Sparrow Ltd. for ₹ 75.80 lakhs on April 1st, 2010. On the date of the acquisition Sparrow's Assets stood at ₹ 196 lakhs and liabilities at ₹ 16 lakhs. The Net asset position of Sparrow Ltd. as on 31st March, 2011 & 30th September 2011 were ₹ 280 lakhs & ₹ 395 lakhs respectively, the increase resulting from profits earned during the period.

On 1st October, 2011, 25.5% holdings were sold for ₹ 125 lakhs. You are required to explain the nature of the relationship between the two companies on the relevant dates and the accounting adjustments that are necessary as a result of any change in the relationship. The profit arising on part sale of investment, carrying value of the portion unsold & goodwill/capital reserve that arises on change in nature of the investment may also be worked out by you.

(8 Marks, Nov. 2011)

Answer

Sparrow Ltd. became a subsidiary of Eagle Ltd. on 1st April 2010 when 51% thereof was acquired. The holding–subsidiary relationship continued till 30th September 2011 and from 1st October, 2011 the relationship between the two companies will change to Associate. As per para 24 of AS 21, "Consolidated Financial Statements", the carrying value of the investment at the date it ceases to be subsidiary is regarded as cost thereafter. Accordingly, if the nature of the investee changes to that of an associate, the carrying amount of the investment in Consolidated Financial Statements of the investor, as on date it ceases to be a subsidiary, would be considered as cost of investment in the associate. Goodwill or capital reserve arising on account of the change in the nature of the investment will be computed as on the date of such change. Accordingly, when a part of the investment takes the form of an investment in an associate, the results of operations of the subsidiary will be included in the consolidated statement of Profit and Loss for the period from the beginning of the period until it ceased to be a subsidiary.

Ascertainment of Gain or Loss

on the Disposal of the Part of the Investment in Sparrow Ltd.

		₹
Proceeds received on sale of 25.5% holdings in Sparrow Ltd.		1,25,00,000
Net Assets of sparrow Ltd. on the date of disposal	3,95,00,000	
Less: Minority's interest in Sparrow Ltd. on the date of disposal	(1,93,55,000)	
Share of Eagle Ltd. in Net Assets	2,01,45,000	
Less: Capital reserve on acquisition (Refer W.N.)	(16,00,000)	
Total value of investment in consolidated financial statements of Eagle Ltd.	1,85,45,000	
Less: Carrying Value of investment disposed off		92,72,500
Profit on sale of 25.5% of investment		32,27,500

Carrying Value of the Investment retained in the Consolidated Financial Statements

		₹
Total value of investment in consolidated financial statements of Eagle Ltd.	1,85,45,000	
Less: Carrying value of investment disposed off	(92,72,500)	
Carrying Value of the investment retained in consolidated financial statements including capital reserve		92,72,500
This amount of ₹ 92,72,500 would be used to apply the equity method of accounting as specified in AS 23		

Goodwill / Capital Reserve arising on the Carrying Value of Unsold Portion of the Investment

	₹
Carrying value of 25.5% holdings in Sparrow Ltd. as on 1st October, 2011	92,72,500
Less: Share in value of equity of Sparrow Ltd., as at date of investment when subsidiary relationship is transformed to an associate (3,95,00,000 x 25.5%)	(1,00,72,500)
Capital reserve arising on such investment under Equity method as per AS 23	(8,00,000)

Working Note:

Calculation of Goodwill / Capital Reserve on the Date of Acquisition of Shares in Sparrow Ltd.

	₹
Net Assets on Acquisition date (₹ 1,96,00,000 – ₹ 16,00,000)	1,80,00,000
51% thereof	91,80,000
Less: Cost of investment	(75,80,000)
Capital reserve on acquisition	16,00,000

Question 42

(a) *Mega Ltd. issued ₹ 1,00,00,000 worth of 8% Debentures of face value ₹ 100 each on par value basis on 1st January, 2011. These debentures are redeemable at 12% premium at the end of 2014 or exchangeable for ordinary shares of Mega Ltd. on 1:1 basis. The interest rate for similar debentures that do not carry conversion entitlement is 12%. You are required to calculate the value of the debt portion of the above compound financial instrument. The present value of the rupee at the end of years 1 to 4 at 8% and 12% are supplied to you as:*

	8%	*12%*
End of year 1	*0.926*	*0.893*
End of year 2	*0.857*	*0.797*
End of year 3	*0.794*	*0.712*
End of year 4	*0.735*	*0.636*

(b) G Ltd., acquired a machine on 1st April, 2005 for ₹ 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 2009, the carrying value of the machine was reassessed at ₹ 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March 2011, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only ₹ 79 lakhs. You are required to calculate the loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd. G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

(c) Fee Ltd. borrows a sum of ₹ 20 crore from Cofee Ltd., repayable as a single bullet payment at the end of 5 years. The interest thereon @ 5% p.a. is payable at yearly rests. Since the market is 8%, Fee Ltd. paid an origination fee of ₹ 2.40 crores to Cofee Ltd. to compensate Cofee Ltd. for the lower rate of interest. Apart from the above, there are no other transactions between the two parties. You are required to show the value at which Cofee Ltd., would recognize the loan and the annual interest thereon.

(d) Bee Ltd., has entered into a contract by which it has the option to sell its identified property, plant and equipment (PPE) to Axe Ltd. for ₹ 100 lakhs after 3 years whereas its current market price is ₹ 150 lakhs. Is the put option of Bee Ltd., a financial instrument? Explain (4 × 4 = 16 Marks, Nov. 2011)

Answer

(a) Present value of Debentures redeemable in 2014 ₹ 71,23,200

[₹ 1,00,00,000 x 1.12 x 0.636]

Present value of interest on debentures

[₹ 8,00,000* x 3.038 (sum of 4 years discount factors @12%)] ₹ 24,30,400

Value of Debt component of the convertible debentures ₹ 95,53,600

* Interest payable on debentures every year = ₹ 1,00,00,000 x 8% = ₹ 8,00,000.

(b) Statement Showing Impairment Loss

	(₹ in crores)
Carrying amount of the machine as on 1st April 2005	7.00

Depreciation for 4 years i.e. 2005-06 to 2008-09 $\left(\frac{7\text{crores}}{7\text{years}} \times 4\text{years}\right)$	(4.00)
Carrying amount as on 31.03.2009	3.00
Add: Upward Revaluation (credited to Revaluation Reserve account)	2.10
Carrying amount of the machine as on 1st April 2009 (revalued)	5.10
Less: Depreciation for 2 years i.e. 2009-10 & 2010-11 $\left(\frac{5.10\text{ crores}}{3\text{ years}} \times 2\text{ years}\right)$	(3.40)
Carrying amount as on 31.03.2011	1.70
Less: Recoverable amount	(0.79)
Impairment loss	0.91
Less: Balance in revaluation reserve as on 31.03.2011:	
Balance in revaluation reserve as on 31.03.2009 2.10	
Less: Enhanced depreciation met from revaluation reserve	
2009-10 & 2010-11=[(1.70 – 1.00) x 2 years] (1.40)	
Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 "Impairment of Assets"	(0.70)
Impairment Loss to be debited to profit and loss account	0.21

(c) The fair value of the Loan to Cofee Ltd. is the present value of the interest it will receive over the next 5 years and the present value of repayment at the end of 5th year.

P.V. of interest discounted @ 8% = [(20,00,00,000 × 5%) × 3.9926] = ₹ 3,99,26,000 (A)

P.V. of principal amount = ₹ 20,00,00,000 discounted @ 8%

= ₹ 20,00,00,000 × 0.6806 =13,61,20,000 (B)

Fair Value of Loan (A + B) i.e. ₹ 17,60,46,000 (i.e. approximately ₹ 17,60,00,000 which is loan amount net of origination fee)

Therefore, Cofee Ltd will recognize the loan at ₹ 17.60 crores only.

Cofee Ltd will recognize the interest using the effective interest rate method as worked out below:

Year	*Amortised Cost (Opening Balance)*	*Interest income @ 8% to be recognised*	*Total*	*Payment received*	*Amortised Cost (Closing Balance)*
	(1)	*(2)*	*(3)*	*(4)*	*(5) = (3) – (4)*
1	17,60,00,000	1,40,80,000	19,00,80,000	1,00,00,000	18,00,80,000
2	18,00,80,000	1,44,06,400	19,44,86,400	1,00,00,000	18,44,86,400

3	18,44,86,400	1,47,58,912	19,92,45,312	1,00,00,000	18,92,45,312
4	18,92,45,312	1,51,39,625	20,43,84,937	1,00,00,000	19,43,84,937
5	19,43,84,937	1,56,15,063*	21,00,00,000	21,00,00,000	Nil

*Note: The interest in the 5th year, has been adjusted in accordance to the value received on closure.

(d) As per AS 31, financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. In the given case, for the purpose of the definition of financial instrument, Property, Plant and Equipment do not qualify the definition of financial asset as per the standard.

To asses whether the put option of BEE Ltd., is a financial instrument or not it is necessary to evaluate the past practice of Bee Ltd. If Bee Ltd. has the past practice of settling net, then it becomes a financial instrument.

If Bee Ltd. intends to sell the identified Property, Plant and Equipment and settle by delivery and there is no past practice of settling net, then the contract should not be accounted for as financial instrument under AS 30 " Financial Instruments: Recognitions Measurement" and AS 31 "Financial Instrument: Presentation".

Question 43

(a) Sun Co-operative Society Ltd. has borrowed a sum of US$12.50 million at the commencement of the financial year 2011-12 for its solar energy project at LIBOR (London Interbank Offered Rate) of 1% + 4%. The interest is payable at the end of the respective financial year. The loan was availed at the then rate of ₹ 45 to the US dollar while the rate as on 31st March, 2012 is ₹ 48 to the US dollar. Had Sun Co-operative Society Ltd. borrowed the Rupee equivalent in India, the interest would have been 11%. You are required to compute 'Borrowing Cost'. Also show the amount of exchange difference as per prevailing Accounting Standards.

(b) Acute Ltd. is the owner of a CGU (Cash Generating Unit) block of assets whose current carrying cost is ₹ 999 lakhs. The company, after a detailed study by its technical team, has assessed the present recoverable amount of this CGU block of assets at ₹ 555 lakhs. The value of the block of assets as per the Income tax Records is ₹ 777 lakhs. The Board of Directors of the company have issued a signed statement confirming that the impairment in the value of the CGU is only a temporary phenomenon which is reversible in subsequent periods and also assuring virtual certainty of taxable incomes in the foreseeable future. You are required to show Deferred Tax workings as per Accounting Standards in force, given the tax rate of 30% plus 10% surcharge thereon. The depreciation rate for tax purposes is 15% and that per books is 13.91%.

(c) PRZ & Sons Ltd. are Heavy Engineering contractors specializing in construction of dams. From the records of the company, the following data is available pertaining to year ended

31st March, 2012. Using this data and applying the relevant Accounting Standard you are required to:

(i) Compute the amount of profit/loss for the year ended 31st March, 2012.

(ii) Arrive at the contract work in progress as at the end of financial year 2011-12.

(iii) Determine the amount of revenue to be recognized out of the total contract value.

(iv) Work out the amount due from/to customers as at year end.

(v) List down relevant disclosures with figures as per relevant Account Standard

	(₹ crore)
Total Contract Price	2,400
Work Certified	1,250
Work pending certification	250
Estimated further cost to completion	1,750
Stage wise payments received	1,100
Progress payments in pipe line	300

(d) On 30-6-2011, X Limited incurred ₹ 3,00,000 net loss from disposal of a business segment. Also on 31-7-2011, the company paid ₹ 80,000 for property taxes assessed for the calendar year 2011. How should the above transactions be included in determination of net income of X Limited for the six months interim period ended on 30-9-2011?

(4 × 5 = 20 Marks, May, 2012)

Answer

(a) Computation of Borrowing Cost as per para 4(e) of AS 16" Borrowing Costs" and Amount of Exchange Difference as per AS 11 "The Effects of Changes in Foreign Exchange Rates":

(a) Interest for the period 2011-12

= US$ 12.5 million x 5% × ₹ 48 per US$ = ₹ 30 million

(b) Increase in the liability towards the principal amount

= US $ 12.5 million × ₹ (48 - 45) = ₹ 37.5 million

(c) Interest that would have resulted if the loan was taken in Indian currency

= US$ 12.5 million × ₹ 45 x 11% = ₹ 61.875 million

(d) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 61.875 million - ₹ 30 million = ₹ 31.875 million.

Therefore, out of ₹ 37.5 million increase in the liability towards principal amount, only ₹ 31.875 million will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 61.875 million being the aggregate of interest of ₹ 30 million on foreign

currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 31.875 million.

Hence, ₹ 61.875 million would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 5.625 million (37.5 - 31.875) would be considered as the exchange difference to be accounted for as per AS 11.

Note: After insertion of para 46/46A to AS 11, companies have an option to capitalise the exchange difference on foreign borrowings taken for the purchase capital asset, to the cost of the asset. In such a case, para 4(e) of AS 16 will not be applicable (as clarified by the MCA*)

(b) **Assumption**: It is assumed that current carrying cost of the CGU block of asset as per Accounting and Tax Records are after charging depreciation of the current year. The assumption has been taken on the basis that impairment loss is calculated on carrying value after charging depreciation of the year.

In the absence of specific instructions, deferred tax workings of current year have been shown as below:

Statement showing Deferred Tax workings for the current year

	₹ in lakhs
Depreciation as per Accounting books for the current year $\frac{999}{(1-.1391)} \times .1391$	161.41
Depreciation as per Income Tax Records for the current year $\frac{777}{(1-.15)} \times .15$	137.12
Timing difference	24.29
Tax effect of the above timing difference at 33%* (deferred tax asset) (A)	8.02
Impairment Loss recognised in the profit and loss account (999- 555)	444
Impairment Loss allowed for tax purposes	Nil
Timing difference	444
Tax effect of the above timing difference at 33% (deferred tax asset) (B)	146.52
Total deferred tax asset (A+B)	154.54

* MCA had clarified vide Circular No. 25/2012 dated 09.08.2012 that Para 6 of AS 11 and Para 4(e) of the AS 16 shall not apply to a company which is applying clause Para 46A of AS 11.

* Tax rate = 30%x 110%= 33%.

Note:

1. Deferred tax asset should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax asset can be realised. The Board of Directors of Acute Ltd. have issued signed statement confirming virtual certainty of taxable incomes in the foreseeable future. Therefore, the company can recognize deferred tax asset during the current year.
2. The deferred tax asset calculated on account of difference of depreciation as per accounting and tax records is actually a reversal of deferred tax liability created in the previous years.

(c)

(i)	***Calculation of profit/ loss for the year ended 31st March, 2012***	*(₹ in crores)*
	Total estimated cost of construction (1,250 + 250 + 1,750)	3,250
	Less: Total contract price	(2,400)
	Total foreseeable loss to be recognized as expense	850

According to para 35 of AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(ii)	**Contract work-in-progress i.e. cost incurred to date**	*(₹ in crores)*
	Work certified	1,250
	Work not certified	250
		1,500

(iii) Proportion of total contract value recognised as revenue

Percentage of completion of contract to total estimated cost of construction

= (1,500 / 3,250)×100 = 46.15%

Revenue to be recognized till date = 46.15% of ₹ 2,400 crores = ₹ 1,107.60 crores.

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

= ₹ [1,500 + Nil – 850 – (1100 + 300)] crores

= ₹ [1,500 – 850 – 1,400] crores

Amount due to customers (shown as liability) = ₹ 750 crores.

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

	₹ in crores
Contract revenue till 31st March, 2012	1,107.60
Contract expenses till 31st March, 2012	1,500.00
Recognized losses for the year 31st March, 2012	(850)
Progress billings ₹ (1,100 + 300)	1,400
Retentions (billed but not received from contractee)	300
Gross amount due to customers	750

(d) Para 28 of AS 25 "Interim Financial Reporting" states that revenues and gains should be recognised in interim reports on the same basis as used in annual reports. As at September 30, 2011, X Ltd. would report the entire ₹ 3,00,000 loss on the disposal of its business segment since the loss was incurred during the interim period.

A cost charged as an expense in an annual period should be allocated among the interim periods, which are clearly benefited from the expense, through the use of accruals and/or deferrals. Since ₹ 80,000 property tax payment relates to the entire 2011 calendar year, only ₹ 40,000 of the payment would be reported as an expense at September 30, 2011, while out of the remaining ₹ 40,000, ₹ 20,000 for Jan. 2011 to March, 2011 would be shown as payment of the outstanding amount of previous year and another ₹ 20,000 related to quarter October, 2011 to December, 2011, would be reported as a prepaid expense.

Question 44

As point of staff welfare measures, Y Co. Ltd. has contracted to lend to its employees sums of money at 5 percent per annum rate of interest. The amounts lent are to be repaid alongwith the interest in five equal annual instalments. The market rate of interest is 10 per cent per annum.

Y lent ₹ 16,00,000 to its employees on 1st January, 2011.

Following the principles of recognition and measurement as laid down in AS 30, you are required to record the entries for the year ended 31st December, 2011 for the transaction and also calculate the value of the loan initially to be recognized and the amortized cost for all the subsequent years.

For purposes of calculation, the following discount factors at interest rate of 10 percent may be adopted

At the end of year	
1	*.909*
2	*.827*
3	*.751*

4 *.683*
5 *.620*
(8 Marks, May, 2012)

Answer

(i) Calculation of initial recognition amount of loan to employees

Year end	*Cash Inflow*		*Total*	*P.V. factor @10%*	*Present value*
	Principal ₹	*Interest @ 5%* ₹	₹		₹
2011	3,20,000	80,000	4,00,000	0.909	3,63,600
2012	3,20,000	64,000	3,84,000	0.827	3,17,568
2013	3,20,000	48,000	3,68,000	0.751	2,76,368
2014	3,20,000	32,000	3,52,000	0.683	2,40,416
2015	3,20,000	16,000	3,36,000	0.620	2,08,320
Present value or Fair value					14,06,272

(ii) Calculation of amortised cost of loan to employees

Year	*Amortised cost (Opening balance) [1]* ₹	*Interest to be recognised@10% [2]* ₹	*Repayment (including interest) [3]* ₹	*Amortised Cost (Closing balance) [4]=[1]+ [2]–[3]* ₹
2011	14,06,272	1,40,627	4,00,000	11,46,899
2012	11,46,899	1,14,690	3,84,000	8,77,589
2013	8,77,589	87,759	3,68,000	5,97,348
2014	5,97,348	59,735	3,52,000	3,05,083
2015	3,05,083	30,917*	3,36,000	Nil

(iii) Journal Entries in the books of Y Ltd.
For the year ended 31st December, 2011 (regarding loan to employees)

		Dr. Amount (₹)	*Cr. Amount (₹)*
Staff loan A/c	Dr.	16,00,000	

* ₹ 3,05,083 x 10% = ₹ 30,508. The difference of ₹ 409 (₹ 30,917 – ₹ 30,508) is due to approximation in computation.

To Bank A/c (Being the disbursement of loans to staff)			16,00,000
Staff cost A/c ₹ (16,00,000 –14,06,272) [Refer part (ii]) To Staff loan A/c (Being the write off of excess of loan balance over present value thereof in order to reflect the loan at its present value of ₹ 14,06,272)	Dr.	1,93,728	 1,93,728
Staff loan A/c To Interest on staff loan A/c (Being the charge of interest @ market rate of 10% on the loan)	Dr.	1,40,627	 1,40,627
Bank A/c To Staff loan A/c (Being the repayment of first instalment with interest for the year)	Dr.	4,00,000	 4,00,000
Interest on staff loan A/c To Profit and loss A/c (Being transfer of balance of staff loan Interest account to profit and loss account)	Dr.	1,40,627	 1,40,627
Profit and loss A/c To Staff cost A/c (Being transfer of balance of staff cost account to profit and loss account)	Dr.	1,93,728	 1,93,728

Question 45

*Answer any **four** of the following:*

(a) *Bellhop LLC submits the following information pertaining to year 2011. Using the data, you are required to find the ending cash and bank balances given an opening figure thereof was ₹ 1.55 million.*

	(₹ millions)
Additional shares issued	*6.50*
CAPEX (Capital expenditure)	*9.90*
Proceeds from assets sold	*1.60*
Dividends declared	*0.50*
Gain from disposal of assets	*(1.20)*

Net income	*3.30*
Increase in Accounts Receivable	*1.50*
Redemption of 4.5% debentures	*2.50*
Depreciation & Amortization	*0.75*

(b) From the information furnished you are required to compute the Basic and Diluted EPS (earnings per share) for accounting year 01-04-2011 to 31-03-2012 and adjusted EPS for the year 01-04-2010 to 31-03-2011.

Net profit for year ended 31-03-2011	*₹ 75,50,000*
Net profit for year ended 31-03-2012	*₹ 1,00,25,000*
No. of equity shares as on 01-04-2011	*50,00,250*
Bonus issue on 01-01-2012	*1 share for every 2 held*
No. of 12% Convertible Debentures of ₹ 100 each issued on 01-01-2012	*1,00,000*
Conversion ratio of Debentures	*10 shares per debenture*
Tax rate	*30 percent*

(c) X Limited was making provisions up to 31-3-2011 for non-moving stocks based on no issues for the last 12 months. Based on a technical evaluation the company wants to make provisions during the year 31-03-2012 in the following manner:

Total value of stock ₹ 3 crores.

Provision required based on 12 months ₹ 8 lakhs.

Provision required based on technical evaluation ₹7.50 lakhs.

Does this amount to change in accounting policy?

Can the company change the method of provision?

(d) X Limited began construction of a new plant on 1st April 2011 and obtained a special loan of 8 lakhs to finance the construction of the plant. The rate of interest on loan was 10 per cent per annum.

The expenditure that was made on the project of plant construction was as follows:

	₹
1-4-2011	*10,00,000*
1-8-2011	*24,00,000*
1-1-2012	*4,00,000*

The Company's other outstanding non specific loan was ₹ 46,00,000 at an interest of 12 percent per annum.

The construction of the plant was completed on 31-3-2012. You are required to calculate the amount of interest to be capitalized as per the provision of AS 16 of the borrowing cost (including cost).

(e) *X Ltd. on 1-1-2012 had made an investment of ₹600 lakhs in the equity shares of Y Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realizable value of all such investment on 31-3-2012 became ₹ 200 lakhs as Y* Ltd. lost a case of copyright. How will you recognize the reduction in financial statements for the year ended on 31-3-2012.* *(4 × 4 = 16 Marks, May, 2012)*

Answer

(a) **Bellhop LLC**

Cash Flow Statement for the year ended 31st March, 2011

	₹ in millions	*₹ in millions*
Cash flows from operating activities		
Net income	3.30	
Add: Depreciation & amortization	0.75	
Loss from disposal of assets	1.20	
Less: Increase in accounts receivables	(1.50)	
Net cash generated from operating activities		3.75
Cash flows from investing activities		
Capital expenditure	(9.90)	
Proceeds from sale of fixed assets	1.60	
Net cash used in investing activities		(8.30)
Cash flows from financing activities		
Proceeds from issuance of additional shares	6.50	
Dividend declared	(0.50)	
Redemption of 4.5% debentures	(2.50)	
Net cash generated from financing activities		3.50
Net decrease in cash		(1.05)
Cash at beginning of the period		1.55
Cash at end of the period (Balancing figure)		0.50

Note: Since, question is not specifying to use Cash Flow Statement for finding the closing cash balance, therefore, one can prepare cash and bank account for calculation of closing cash and bank balance.

* 'X Ltd.' Printed in the question paper should be read as 'Y Ltd.'.

(b) No. of Bonus shares issued as on 1.1.2012

On existing shares (50,00,250 x ½) 25,00,125 shares

On convertible debentures as per SEBI Guidelines on Bonus Issue

(1,00,000 debentures x 10 shares x ½) 5,00,000 shares

Basic Earnings per share for the year 2011-12=

$$\frac{\text{Net profit for the year ended 31.3.2012}}{\text{Weighted average number of equity share as on 31.3.2012}}$$

$$\frac{₹\ 1,00,25,000}{(50,00,250+25,00,125+5,00,000)} = ₹\ 1.25$$

Adjusted earnings per share for the year 2010-11

$$= \frac{₹\ 75,50,000}{(50,00,250+25,00,125+5,00,000)} = ₹\ 0.94$$

For Diluted EPS

Interest expense for the current year = ₹ 12,00,000

Tax relating to interest expense (30%) = ₹ 3,60,000

Adjusted net profit for the current year = ₹ 1,00,25,000 + (12,00,000 -3,60,000) x3/12

= ₹ 1,02,35,000

No. of equity shares resulting from conversion of debentures

= 1,00,000 x 10 shares = 10,00,000

No. of equity shares used to compute diluted earnings per share

= 50,00,250 + 25,00,125 + 5,00,000 + (10,00,000 x 3/12)

= 50,00,250 + 25,00,125 + 5,00,000 + 2,50,000

= 82,50,375 shares

Diluted earnings per share = 1,02,35,000/82,50,375 = ₹ 1.24

Note: As per AS 20, bonus shares issued to existing shareholders and to convertible debenture holders (on conversion of debentures into shares) are an issue without consideration. Therefore, it is treated as if it had occurred prior to the beginning of the year 2010- 11, the earliest period reported.

(c) Basis of provisioning whether on no issues or on technical evaluation is the basis of making estimates and cannot be considered as Accounting Policy. As per AS 5, due to uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. An estimate may have to be revised

if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.

The basis of change in provisioning is a guideline and the better way of estimating the provision for non-moving stock on account of change. Hence, it is not a change in accounting policy. Accounting policy is the valuation of inventory on cost or on net realizable value or on lower of cost or net realizable value. Any interchange of this valuation base would have constituted change in accounting policy.

Further, the company should be able to demonstrate satisfactorily that having regard to circumstances provision made on the basis of technical evaluation provides more satisfactory results than provision based on 12 months issue. If that is the case, then the company can change the method of provision.

(d) (i) Computation of average accumulated expenses

		₹
₹ 10,00,000 x 12 / 12	=	10,00,000
₹ 24,00,000 x 8 / 12	=	16,00,000
₹ 4,00,000 x 3 / 12	=	1,00,000
		27,00,000

(ii) Non-specific Borrowings

Non-specific Borrowings = Average accumulated capital expenses – Specific borrowings

= ₹ 27,00,000 – ₹ 8,00,000 = ₹ 19,00,000

(ii) Interest on average accumulated expenses

		₹
Specific borrowings (₹ 8,00,000 X 10%)	=	80,000
Non-specific borrowings (₹ 19,00,000 × 12%)	=	2,28,000
Amount of interest to be capitalized	=	3,08,000

(iii) Total expenses to be capitalized for Plant

	₹
Cost of plant ₹ (10,00,000 + 24,00,000 + 4,00,000)	38,00,000
Add: Amount of interest to be capitalised	3,08,000
Total cost of plant	41,08,000

(e) X limited invested ₹ 600 lakhs in the equity shares of Y Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. ₹ 300 lakhs and remaining as temporary (current) investment i.e. ₹ 300 lakhs. Irrespective of the fact that

investment has been held by X Limited only for 3 months (from 1.1.2012 to 31.3.2012), AS 13 lays emphasis on intention of the investor to classify the investment as current or long term even though the long term investment may be readily marketable.

In the given situation, the realizable value of all such investments on 31.3.2012 became ₹ 200 lakhs i.e. ₹ 100 lakhs in respect of current investment and ₹ 100 lakhs in respect of long term investment.

As per AS 13, 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value.

Accordingly, the carrying value of investment held as temporary investment should be shown at realizable value i.e. at ₹ 100 lakhs. The reduction of ₹ 200 lakhs in the carrying value of current investment will be included in the profit and loss account.

Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long term investment, the carrying amount is reduced to recognise the decline.

Here, Y Limited lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quiet a substantial figure. Losing the case of copyright may affect the business and the performance of the company in long run. Accordingly, it will be appropriate to reduce the carrying amount of long term investment by ₹ 200 lakhs and shown the investments at ₹ 100 lakhs, considering the downfall in the value of shares as decline other than temporary. The reduction of ₹ 200 lakhs in the carrying value of long term investment will be included in the profit and loss account.

Alternatively for treatment of long term investment

If one assumes that the decline in the value of long term investment is temporary and Y Limited will overcome this downfall in short period by filing a case against this decision of government, with strong arguments. In such a case, long term investment will be shown at cost.

Question 46

(a) Prakash Limited leased a machine to Badal Limited on the following terms:

		(₹ in lakhs)
(i)	*Fair value of the machine*	*48.00*
(ii)	*Lease term*	*5 years*
(iii)	*Lease rental per annum*	*8.00*
(iv)	*Guaranteed residual value*	*1.60*
(v)	*Expected residual value*	*3.00*
(vi)	*Internal rate of return*	*15%*

Discounted rates for 1st year to 5th year are 0.8696, 0.7561, 0.6575, 0.5718, and 0.4972 respectively.

Ascertain Unearned Finance Income.

(b) *Goodwill Limited is a full tax free enterprise tor the 1st 12 years of its existence and is in third year of operations. Depreciation timing difference resulting in a deferred tax liability in 1st, 2nd and 3rd year is ₹ 200 lakhs, ₹ 300 lakhs and ₹ 400 lakhs respectively. From the 4th year onwards, it is expected that the timing difference would reverse each year by ₹ 10 lakhs. Assuming tax rate @ 35%, find out the deferred tax liability at the end of 3rd year and any charge to the Profit and Loss Account.*

(c) *In a manufacturing process of Vijoy Limited, one by-product BP emerges besides two main products MP1 and MP2 apart from scrap. Details of cost of production process is here under:*

Item	Unit	Amount (₹)	Output (unit)	Closing stock as on 31-03-2012
Raw material	15,000	1,60,000	MP 1 - 6,250	800
Wages	-	82,000	MP 2 - 5,000	200
Fixed overhead	-	58,000	BP - 1,600	-
Variable overhead	-	40,000	-	-

Average market price of MP1 and MP2 is ₹ 80 per unit and ₹ 50 per unit respectively, by-product is sold @ ₹ 25 per unit. There is a profit of ₹ 5,000 on sale of by-product after incurring separate processing charges of ₹ 4,000 and packing charges of ₹ 6,000, ₹ 6,000 was realised from sale of scrap.

Calculate the value of closing stock of MP1 and MP2 as on 31-03-2012.

(d) *Antarbarti Limited reported a Profit Before Tax (PBT) of ₹ 4 lakhs for the third quarter ending 30-09-2011. On enquiry you observe the following. Give the treatment required under AS 25:*

(i) *Dividend income of ₹ 4 lakhs received during the quarter has been recognized to the extent of ₹ 1 lakh only.*

(ii) *80% of sales promotion expenses ₹ 15 lakhs incurred in the third quarter has been deferred to the fourth quarter as the sales in the last quarter is high.*

(iii) *In the third quarter, the company changed depreciation method from WDV to SLM, which resulted in excess depreciation of ₹ 12 lakhs. The entire amount has been debited in the third quarter, though the share of the third quarter is only ₹ 3 lakhs.*

(iv) *₹ 2 lakhs extra-ordinary gain received in third quarter was allocated equally to the third and fourth quarter.*

(v) Cumulative loss resulting from change in method of inventory valuation was recognized in the third quarter of ₹ 3 lakhs. Out of this loss ₹ 1 lakh relates to previous quarters.

(vi) Sale of investment in the first quarter resulted in a gain of ₹ 20 lakhs. The company had apportioned this equally to the four quarters.

Prepare the adjusted profit before tax for the third quarter. (4 x 5 = 20 Marks, November, 2012)

Answer

(a) As per AS 19 on Leases, ***unearned finance income*** is the difference between (a) the ***gross investment*** in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

Where:

(a) ***Gross investment*** in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

Gross investment = Minimum lease payments + Unguaranteed residual value

= [Total lease rent + Guaranteed residual value (GRV)] + Unguaranteed residual value (URV)

= [(₹ 8,00,000 × 5 years) + ₹ 1,60,000] + ₹ 1,40,000 = ₹ 43,00,000 (a)

(b) Table showing present value of (i) Minimum lease payments (MLP) and (ii) Unguaranteed residual value (URV).

Year	*MLP inclusive of URV ₹*	*Internal rate of return (Discount factor @ 15%)*	*Present Value ₹*
1	8,00,000	0.8696	6,95,680
2	8,00,000	0.7561	6,04,880
3	8,00,000	0.6575	5,26,000
4	8,00,000	0.5718	4,57,440
5	8,00,000	0.4972	3,97,760
	1,60,000 (GRV)	0.4972	79,552
	41,60,000		27,61,312 (i)
	1,40,000 (URV)	0.4972	69,608 (ii)
	43,00,000	(i)+ (ii)	28,30,920(b)

Unearned Finance Income (a) - (b) = ₹ 43,00,000 – ₹ 28,30,920= ₹ 14,69,080.

(b) As per an explanation to para 13 of AS 22, "Accounting for Taxes on Income", in the case of tax free enterprises, no deferred tax liability is recognized, in respect of timing differences that originate and reverse in the tax holiday period. Deferred tax liability or asset is created in respect of timing differences that originate in a tax holiday period but are expected to reverse after the tax holiday period. For this purpose, adjustments are done in accordance with the FIFO method.

Accordingly, depreciation timing difference of ₹ 90 lakhs (₹ 10 lakhs x 9 years) will reverse in the tax holiday period i.e. from 4th year to 12th year. Therefore, no deferred liability on ₹ 90 lakhs out of ₹ 200 lakhs, will be created. In the 1st year, deferred tax liability of ₹ 38.5 lakhs will be created @ 35% on ₹ 110 lakhs (₹ 200 lakhs – ₹ 90 lakhs) only.

However, the entire depreciation timing difference of 2nd and 3rd year i.e ₹ 300 lakhs and ₹ 400 lakhs will reverse only after the tax holiday period. So, deferred tax liability will be created in the 2nd year for ₹ 105 lakhs (₹ 300 x 35%) and in the 3rd year for ₹ 140 lakhs (₹ 400 x 35%).

Therefore, total deferred tax liability in the Balance Sheet at the end of 3rd year will be ₹ (38.5+105+140) lakhs = ₹ 283.5 lakhs and charge to Profit and Loss account in the 3rd year will be ₹ 140 lakhs (₹ 400 x 35%).

(c) As per para 10 of AS 2 'Valuation of Inventories', most by-products as well as scrap or waste materials, by their nature, are immaterial. They are often measured at net realizable value and this value is deducted from the cost of the main product.

1. Calculation of net realizable value of by-product, BP

		₹
Selling price of by-product BP	(1,600 units x ₹ 25 per unit)	40,000
Less: Separate processing charges of by-product BP		(4,000)
Packing charges		(6,000)
Net realizable value of by-product BP		30,000

2. Calculation of cost of conversion for allocation between joint products MP1 and MP2

	₹	₹
Raw material		1,60,000
Wages		82,000
Fixed overhead		58,000
Variable overhead		40,000

		3,40,000
Less: NRV of by-product BP (See calculation 1)	(30,000)	
Sale value of scrap	(6,000)	(36,000)
Joint cost to be allocated between MP1 and MP2		3,04,000

3. Determination of "basis for allocation" and allocation of joint cost to MP1 and MP2

	MP1	*MP2*
Output in units (a)	6,250 units	5,000 units
Sales price per unit (b)	₹ 80	₹ 50
Sales value (a x b)	₹ 5,00,000	₹2,50,000
Ratio of allocation	2	1
Joint cost of ₹ 3,04,000 allocated in the ratio of 2:1 (c)	₹ 2,02,667	₹ 1,01,333
Cost per unit [c/a]	₹ 32.43	₹ 20.27

4. Determination of value of closing stock of MP1 and MP2

	MP1	*MP2*
Closing stock in units	800 units	200 units
Cost per unit	₹ 32.43	₹ 20.27
Value of closing stock	₹ 25,944	₹ 4,054

(d) As per para 36 of AS 25 "Interim Financial Reporting", seasonal or occasional revenue and cost within a financial year should not be deferred as of interim date untill it is appropriate to defer at the end of the enterprise's financial year. Therefore dividend income, extra-ordinary gain, and gain on sale of investment received during 3rd quarter should be recognised in the 3rd quarter only. Similarly, sales promotion expenses incurred in the 3rd quarter should also be charged in the 3rd quarter only.

Further, as per the standard, if there is change in the accounting policy within the current financial year, then such a change should be applied retrospectively by restating the financial statements of prior interim periods of the current financial year. The change in the method of depreciation or inventory valuation is a change in the accounting policy. Therefore, the prior interim periods' financial statements should be restated by applying the change in the method of valuation retrospectively.

Accordingly, the adjusted profit before tax for the 3rd quarter will be as follows:

Statement showing Adjusted Profit Before Tax for the third quarter

	(₹ in lakhs)
Profit before tax (as reported)	4
Add: Dividend income ₹ (4-1) lakhs	3
Excess depreciation charged in the 3rd quarter, due to change in the method, should be applied retrospectively ₹ (12-3) lakhs	9
Extra ordinary gain ₹ (2-1) lakhs	1
Cumulative loss due to change in the method of inventory valuation should be applied retrospectively ₹ (3-2) lakhs	1
	18
Less: Sales promotion expenses (80% of ₹ 15 lakhs)	(12)
Gain on sale of investment (occasional gain should not be deferred)	(5)
Adjusted Profit before tax for the third quarter	1

Question 47

H Ltd. engaged in the business of manufacturing lotus wine. The process of manufacturing this wine takes around 18 months. Due to this reason H Ltd. has prepared its financial statements considering its operating cycle as 18 months and accordingly classified the raw material purchased and held in stock for less than 18 months as current asset. Comment on the accuracy of the decision and the treatment of asset by H Ltd. as per revised Schedule VI.*

(4 Marks, Nov. 2012)

Answer

Note: Schedule III to the Companies Act, 2013 has been notified in April, 2014, which replaces revised Schedule VI to the Companies Act, 1956. Since Schedule III is applicable to students, the answer to the question is given in reference to Schedule III to the Companies Act, 2013 and not as per revised Schedule VI to the Companies Act, 1956.

As per Schedule III, one of the criteria for classification of an asset as a current asset is that the asset is expected to be realised in the company's operating cycle or is intended for sale or consumption in the company's normal operating cycle.

Further, revised Schedule III defines that an operating cycle is the time between the acquisition of assets for processing and their realization in cash or cash equivalents.

* Now Schedule III to the Companies Act, 2013.

However, when the normal operating cycle cannot be identified, it is assumed to have duration of 12 months.

As per the facts given in the question, the process of manufacturing of lotus wine takes around 18 months; therefore, its realisation into cash and cash equivalents will be done only when it is ready for sale i.e. after 18 months. This means that normal operating cycle of the product is 18 months. Therefore, the contention of the company's management that the operating cycle of the product lotus wine is 18 months and not 12 months is correct. H. Ltd. will classify the raw material purchased and held in stock as current asset in its Balance Sheet.

Question 48

(a) P Ltd. has 60% voting right in Q Ltd. Q Ltd. has 20% voting right in R Ltd. Also, P Ltd. directly enjoys voting right of 14% in R Ltd. R Ltd. is a listed company and regularly supplies goods to P Ltd. The management of R Ltd. has not disclosed its relationship with P Ltd.

How would you assess the situation from the view point of AS 18 on related party disclosures?

(b) An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. At 31st March 2012, it is virtually certain that a law requiring a clean up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary?

(c) Vijaya Ltd. had to pay delayed cotton clearing charges over and above the negotiated price for taking delayed delivery of cotton from the supplier's godown. Upto 2010-11, the company has regularly included such charges in the valuation of closing stock. This charge, being in the nature of interest, the company has decided to exclude it from closing stock valuation. This would result in decrease of profit by ₹ 8.60 lakhs.

What is the treatment in the Final Statement of accounts for the year ended 31-03-2012? Also draft a suitable note for disclosure. (3 x 4 = 12 Marks, November, 2012)

Answer

(a) P Ltd. has direct economic interest in R Ltd. to the extent of 14%, and through Q Ltd. (in which it is the majority shareholders) it has further control of 12% in R Ltd. (60% of Q Ltd.'s 20%). These two taken together (14% + 12%) make the total control of 26%.

AS 18 'Related Party Disclosures', defines *related party* as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Since, P Ltd. has total control of 26% (directly and indirectly by Q Ltd.) in R Ltd. which is less than half of the voting power of R Ltd., P Ltd. is said to have significant influence over R Ltd. Also it is given in the question that R Ltd. is a listed company and regularly supplies goods to P Ltd. Therefore, related party disclosure, as per AS 18, is required by R Ltd. in its financial statements, in respect of goods supplied to P Ltd.

(b) As per para 29 of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event.

However, when environmental damage is caused there may be no obligation to remedy the consequences. The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted.

In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean up cost in the year in which the law is virtually certain to be enacted.

(c) AS 5 (Revised) 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" states that a change in an accounting policy should be made only if

a. it is required by statute, or

b. for compliance with an accounting standard, or

c. if it is considered that the change would result in a more appropriate presentation of the financial statements of an enterprise.

The change in the method of stock valuation is justified in view of the fact that the change is in line with the recommendations of AS 2 (Revised) 'Valuation of Inventories' and would result in more appropriate preparation of the financial statements.

Accordingly, cost formula used for inventory valuation will exclude the delayed cotton clearing charges being in the nature of interest. Due to change in the cost formula, the value of inventory and resulting profit will decrease by ₹ 8.60 lakhs.

Disclosure: As per AS 2, the accounting policy adopted for valuation of inventories including the cost formula used should be disclosed in the financial statements by way of a note.

Also, appropriate disclosure of the change and the amount by which any item in the financial statements is affected by such change, is necessary as per AS 1, AS 2 and AS 5. Therefore, the under mentioned note should be given in the annual accounts.

"In compliance with the Accounting Standards issued by the ICAI, delayed cotton clearing charges which are in the nature of interest have been excluded from the valuation of closing stock unlike preceding years. Had the company continued the accounting practice followed earlier, the value of closing stock as well as profit before tax for the year would have been higher by ₹ 8.60 lakhs."

Question 49

(a) J Ltd. purchased a machine from K Ltd. on 31-08-2012. Quoted price was ₹ 275 lakhs. The vendor offers 2% trade discount. Sales tax on quoted price is 6%. J Ltd. spent ₹ 60,000 for transportation and ₹ 45,000 for architect's fees. They borrowed money from HDFC Bank of ₹ 250 lakhs for acquisition of asset @ 15% p.a. They also spent ₹ 15,000 for material, ₹ 10,000 for labour and ₹ 4,000 as overheads during trial run of the machine. The machine was ready for use on 15-01-2013 but it was put to use on 15-3-2013. Find out the original cost of the machine. Also suggest the accounting treatment for the cost incurred during the period between the date the machine was ready for use and the date on which it was actually put to use.

(b) A Ltd. had acquired 80% shares in the B Ltd. for ₹ 15 lakhs. The net assets of B Ltd. on that day are ₹ 22 lakhs. During the year, A Ltd. sold the investment for ₹ 30 lakhs and net assets of B Ltd. on the date of disposal was ₹ 35 lakhs. Calculate the profit or loss on disposal of this investment to be recognized in the Financial Statements of A Ltd.

(c) On 1st January, 2011, Santa Ltd. sold equipment for ₹ 6,14,460. The carrying amount of the equipment on that date was ₹ 1,00,000. The sale was a part of the package under which Banta Ltd. leased the asset to Santa Ltd. for ten years term. The economic life of the asset is estimated as 10 years. The minimum lease rents payable by the lessee has been fixed at ₹ 1,00,000 payable annually beginning from 31st December, 2011. The incremental borrowing interest rate of Santa Ltd. is estimated at 10% p.a. Calculate the net effect on the Statement of profit and loss in the books of Santa Ltd.

(d) X Ltd. purchased a fixed asset four years ago for ₹ 150 lakhs and depreciates it at 10% p.a. on straight line method. At the end of the fourth year, it has revalued the asset at ₹ 75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of revaluation, the market price is ₹ 67.50 lakhs and expected disposal costs are ₹ 3 lakhs. What will be the treatment in respect of impairment loss on the basis that fair value for revaluation purpose is determined by market value and the value in use is estimated at ₹ 60 lakhs? (4 x 5 = 20 Marks, May, 2013)

Answer

(a) (i) Original cost of the machinery

Particulars	₹
Quoted price	2,75,00,000
Less: Trade discount @ 2%	(5,50,000)
	2,69,50,000

Add: Sales Tax @ 6% on quoted price*	16,50,000
Transportation charges	60,000
Architect's Fees	45,000
Trial run expenses	29,000
(Material ₹ 15,000 + Labour ₹ 10,000 + Overheads ₹ 4,000)	
Finance cost (15% on ₹ 250 lakhs for the 4.5 months ie. for the period 01.9.12 to 15.1.13)	14,06,250
Total amount to be capitalised for machine	3,01,40,250

(ii) Cost incurred during the period between the date the machinery was ready for use and the actual date the machine was put to use

Finance cost amounting ₹ 6,25,000 i.e. 15% of ₹ 250 lakhs for 2 months ie. for the period 15.01.2013 to 15.03.2013 will be charged to statement of profit and loss as per AS 16 "Borrowing Costs".

(b) Calculation of Profit/Loss on disposal of investment in subsidiary

Particulars	₹
Proceeds from the sale of Investment	30,00,000
Less: A Ltd.'s share in net assets of B Ltd. (W.N.1)	(28,00,000)
	2,00,000
Add: Capital Reserve at the time of acquisition of shares in B Ltd. (W.N.2)	2,60,000
Profit on sale of investment	4,60,000

Working Notes:

1. A Ltd.'s share in net assets of B Ltd.

	₹
Net Assets of B Ltd. on the date of disposal	35,00,000
Less: Minority Interest (20% of ₹ 35 lakhs)	(7,00,000)
A Ltd.'s share in the net assets of B Ltd.	28,00,000

* In general practice, sales tax is calculated on amount arrived at after deduction of trade discount. However, sales tax has been computed on the basis of the requirement of the question i.e. sales tax is calculated on quoted price.

2. Capital Reserve at time of acquisition of shares in B Ltd.

	₹
A Ltd.'s share in the net assets of B Ltd. on the date of acquisition (80% of ₹ 22 lakhs)	17,60,000
Less: Cost of investment	(15,00,000)
Capital Reserve at time of acquisition of shares in B Ltd.	2,60,000

(c) Net effect on the Statement of Profit and Loss in the year of sale in the books of Lessee (Santa Ltd.)

For calculation of net effect on the statement of profit and loss on sale of equipment, it has to be judged whether lease is an operating lease or finance lease.

The lease term is for 10 years which covers the entire economic life of the equipment. At the inception of the lease, the present value of the minimum lease payments (MLP) is ₹ 6,14,400 [₹ 1,00,000 x 6.144 (Annuity factor of ₹ 1 @10% for 10 years)] and amounts to at least substantially all of the fair value (sale price ie. ₹ 6,14,460) of the leased equipment. Thus lease is a finance lease.

As per para 48 of AS 19 "Leases", if a sale and leaseback transaction results in a finance lease, profit of ₹ 5,14,460 (Sale value ₹ 6,14,460 less carrying amount ₹1,00,000) will not be recognized as income in the year of sale in the books of lessee i.e. Santa Ltd. It should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

Therefore, assuming that depreciation is charged on straight line basis, Santa Ltd. will recognize depreciation of ₹ 61,446 per annum for 10 years (₹ 6,14,460 / 10) and amortise profit of ₹ 5,14,460 over the lease term of 10 years, i.e. ₹ 51,446 p.a. The net effect is a debit of (₹ 61,446 - ₹ 51,446) ₹ 10,000 p.a. to the Statement of profit and loss, for 10 years as covered under the lease term.

Note: Had there been no sale and lease back transaction, the Statement of profit and loss for each year (covered in the lease term) would have been charged by (₹ 1,00,000/10) ₹ 10,000, towards depreciation. Thus, the sale and lease back transaction will have no impact on profit or loss account to be reported by the lessee (vendor in the sales transaction) over the lease period.

(d) Treatment of Impairment Loss

As per para 57 of AS 28 "Impairment of assets", if the recoverable amount (higher of net selling price and its value in use) of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. In the given case, net selling price is ₹ 64.50 lakhs (₹ 67.50 lakhs – ₹ 3 lakhs) and value in use is ₹ 60 lakhs. Therefore, recoverable amount will be ₹ 64.50 lakhs. Impairment loss will be

calculated as ₹ 10.50 lakhs [₹ 75 lakhs (Carrying Amount after revaluation - Refer Working Note) less ₹ 64.50 lakhs (Recoverable Amount)].

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

Working Note:

Calculation of carrying amount of the fixed asset at the end of the fourth year on revaluation

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

Question 50

On 1st April, 2011, the fair value of plan assets were ₹ 2,50,000 in respect of a pension plan of Q Ltd.

On 30th September, the plan paid out benefits of ₹ 47,500 and received further contribution of ₹ 1,22,500.

On 31st March, 2012, the fair value of plan asset was ₹ 3,75,000 and the present value of the benefit obligation was ₹ 3,69,800. Actuarial losses on the obligation for 2011-12 were ₹ 1,500.

On 1st April, 2011, the company had made the following estimates:

Particulars	*%*
(i) Interest and dividend income after tax payable by the fund	*9.25*
(ii) Realised and unrealised gain on plan asset (after tax)	*2.00*
(iii) Fund expenses	*(1.00)*
Expected rate of return	*10.25*

Find out the expected and unexpected return on plan assets. *(6 Marks, May, 2013)*

Answer

Computation of Expected and Unexpected Returns on Plan Assets

	₹
Return on ₹ 2,50,000 held for 12 months at 10.25%	25,625

Return on ₹ 75,000 (1,22,500-47,500) held for six months at 5% (equivalent to 10.25% annually, compounded every six months)		3,750
Expected return on plan assets for 2011-12		29,375
Fair value of plan assets as on 31st March, 2012		3,75,000
Less: Fair value of plan assets as on 1st April, 2011	2,50,000	
Contributions received	1,22,500	(3,72,500)
		2,500
Add: Benefits paid		47,500
Actual return on plan assets		50,000

Unexpected Return on Plan Asset = Actual return – Expected return

= ₹ 50,000 – ₹ 29,375 = ₹ 20,625.

Question 51

(a) *From the following information relating to W Ltd., calculate diluted earnings per share as per AS 20:*

		₹
(i)	*Net profit for the current year*	*5,00,00,000*
(ii)	*Number of equity shares outstanding*	*1,00,00,000*
(iii)	*11% convertible debentures of ₹ 100 each (Nos.)*	*1,25,000*
(iv)	*Interest expenses for current year*	*13,75,000*
(v)	*Tax saving relating to interest expense*	*30%*
(vi)	*Each debenture is convertible into eight equity shares.*	

(b) *W Ltd. purchased machinery for ₹ 80 lakhs from X Ltd. during 2010-11 and installed the same immediately. Price includes excise duty of ₹ 8 lakhs. During the year 2010-11, the company produced exciseable goods on which excise duty of ₹ 7.20 lakhs was charged.*

Give necessary entries explaining the treatment of Cenvat Credit.

(c) *Write short note on "Disclosure of carrying amounts of financial assets and financial liabilities in balance sheet".*

(d) *Vishnu Company has at its financial year ended 31st March, 2013, fifteen law suits outstanding none of which has been settled by the time the accounts are approved by the directors. The directors have estimated the possible outcomes as below:*

Result	*Probability*	*Amount of loss*
For first ten cases:		
Win	*0.6*	

Loss-low damages	*0.3*	*90,000*
Loss-high damages	*0.1*	*1,60,000*
For remaining five cases:		
Win	*0.5*	
Loss-low damages	*0.3*	*60,000*
Loss-high damages	*0.2*	*95,000*

The directors believe that the outcome of each case is independent of the outcome of all the others.

Estimate the amount of contingent loss and state the accounting treatment of such contingent loss. *(4 x 3=12 Marks, May, 2013)*

Answer

(a) Adjusted net profit for the current year

	₹
Net profit for the current year (assumed to be after tax)	5,00,00,000
Add: Interest expense for the current year	13,75,000
Less: Tax relating to interest expense (30% of ₹ 13,75,000)	(4,12,500)
Adjusted net profit for the current year	5,09,62,500

Weighted Average Number of Equity Shares

Number of equity shares resulting from conversion of debentures:

1,25,000 debentures x 8 = 10,00,000 shares

Number of equity shares for computation of diluted EPS:

1,00,00,000 + 10,00,000 = 1,10,00,000 shares

Computation of diluted earnings per share

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

= (5,09,62,500/1,10,00,000) = ₹ 4.63 (approx.)

(b) Journal Entries

			₹ in lakhs	
(a)	Machinery A/c	Dr.	72	
	CENVAT credit receivable on capital goods A/c	Dr.	8	

	To Bank A/c or Creditors A/c			80
	(Being capitalization of machinery)			
(b)	Excise duty A/c	Dr.	7.2	
	To CENVAT credit receivable on capital goods A/c			4.0
	To Bank A/c			3.2
	(Being excise duty set off to the extent of 50% of excise duty paid in the first year of acquisition of capital asset)			

(c) "Disclosure of carrying amounts of financial assets and financial liabilities in Balance Sheet".

As per para 8 of AS 32 'Financial instruments: Disclosures', the carrying amounts of financial assets and financial liabilities should be disclosed either on the face of the balance sheet or in the notes as follows:

Financial Assets

(a) financial assets at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading,

(b) held-to-maturity investments;

(c) loans and receivables;

(d) available-for-sale financial assets;

Financial Liabilities

(a) financial liabilities at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading, and

(b) financial liabilities measured at amortised cost.

(d) In the given case, the probability of winning first 10 cases is 60% and for remaining five cases is 50%. In other words, probability of losing 10 cases and 5 cases is 40% and 50% respectively. According to AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where it is not probable that a present obligation exists, an enterprise discloses a contingent liability. Since in the given case, chances of winning the case is more and losing the case is less, no provision will be recognized. In fact, it is a contingent loss / liability.

The amount of contingent loss may be calculated as under:

Expected contingent loss in first ten cases = [₹ 90,000 x 0.3 + ₹ 1,60,000 x 0.1] x 10 cases

= [₹ 27,000 + ₹ 16,000] x 10 cases

= ₹ 43,000 x 10 cases = ₹ 4,30,000

Expected contingent loss in remaining five cases = [₹ 60,000 x 0.3 + ₹ 95,000 x 0.2] x 5 cases

= [₹ 18,000 + ₹ 19,000] x 5 cases

= ₹ 37,000 x 5 cases = ₹ 1,85,000

Total contingent liability = ₹ 4,30,000 + ₹ 1,85,000

= ₹ 6,15,000.

An enterprise should not recognise a contingent liability. For each class of contingent loss / liability at the balance sheet date, an enterprise should disclose, by way of a note, a brief description of the nature of the contingent liability.

Question 52

(a) *P Ltd. has three business segments which are FMCG, Batteries and Sports Equipment. The Battery segment has been consistently underperforming and P Ltd. after several discussions with Labour unions have finally decided on closure of this segment. Under the agreement with the Labour Union the employees of the Battery Segment will earn no further benefit as the arrangement is a curtailment without settlement wherein the employees of the discontinued segment will continue to receive benefits for services rendered when the segment was functioning. As a result of the curtailment, the company's obligations that were arrived on the basis of actuarial valuations before the curtailment have come down. The following information is also furnished:*

(i) The value of gross obligations before the curtailment calculated on actuarial basis was ₹4,000 lakhs.

(ii) The value of Unamortized past service costs is ₹100 lakhs.

(iii) The Curtailment will bring down gross obligations by ₹ 500 lakbs and P Ltd. anticipates a proportional decline in the value of unamortized past service costs also.

(iv) The Fair Value of plan assets on date is estimated at ₹3,250 lakhs.

You are required to calculate the gain from curtailment and also show the liability to be recognized in the Balance Sheet of P Ltd. after the curtailment.

(b) *To comply with listing requirements and other statutory obligations Quaker Ltd. prepares interim financial reports at the end of each quarter. The company has brought forward losses of ₹700 lakhs under Income Tax Law, of which 90% is eligible for set off as per the recent verdict of the Court, that has attained finality. No Deferred Tax Asset has been recognized on such losses in view of the uncertainty over its eligibility for set off. The company has reported quarterly earnings of ₹700 lakhs and ₹300 lakhs respectively for the first two quarters of Financial year 2013-14 and ·anticipates a net earning of*

₹ 800 lakhs in the coming half year ended March 2014 of which ₹ 100 lakhs will be the loss in the quarter ended Dec. 2013. The tax rate for the company is 30% with a 10% surcharge. You are required to calculate the amount of Tax Expense to be reported for each quarter of financial year 2013-14.

(c) *B Ltd. entered into an agreement on 1st March, 2013 to buy computer spares from S Ltd. at prevailing market price for ₹ 1200 lakhs on which S Ltd. made a profit of 20% and received full advance payment. The transaction was concluded on 15th March, 2013. On the same day S Ltd. agrees to buy on 15th Sept., 2013 the same goods from B Ltd. at 20% over cost. The 20% mark up compensates B Ltd. for its inventory holding costs till sale date. You are required to show how both the buyer and seller account for the above transaction in the year 2012-13 explaining in brief the justification for your treatment and also draft the Notes on Account on disclosure if any required in the annual accounts of year ended 31st March, 2013.*

(d) *Vintage Ltd. has been in the business of sale of Vintage Wines for the last 12 years and is an extremely cash rich company. In FY 2011-12 the Board of the company decided to venture into new areas of business and identified the activity of acquiring Vintage Properties such as old Bungalows, Heritage buildings and the like at prime locations and after carrying out renovation and refurbishment of the same to let out these properties on lease to willing parties. The new business was commenced as a separate division of the company in FY 2012-13 during which the company managed to identify 19 such properties of which 17 were acquired and 9 given on lease. Being the initial year of operations and also since some of the lease arrangements were entered into at the fag end of the year the income from leasing was only a paltry amount. After the acquisition of the properties as aforesaid very attractive offers for sale of 14 of the properties were received. Vintage Ltd. after negotiation accepted 12 of the offers and sold these 12 properties making large profits in the bargain. The accountant of Vintage Ltd. has accounted the acquisition and disposals of properties as 'Purchases' and 'Sales' in the Profit & Loss account of the Property Division and treated the lease incomes as part of the other income of the company. The contention of the accountant of Vintage Ltd., was that since a majority of the properties were disposed off within a short span of time, the properties are to be considered as stock in trade only. Further since the lease income was insignificant it does not become the main source of income and hence considered as part of other income. You are required to examine the correctness of the contentions of the accountant of Vintage Ltd. considering the relevant Accounting Standards and provisions of Revised Schedule VI of Companies Act, 1956*.*

(4 x 5 =20 Marks, November, 2013)

* Now Schedule III to the Companies Act, 2013.

Answer

(a) Gain from curtailment

	(₹) in lakhs
Reduction in gross obligation (12.5% of 4,000)	500.00
Less: Proportion of unamortised past service cost (12.5% of ₹ 100)	(12.50)
Gain from curtailment	487.50

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

	₹
Reduced gross obligation (₹ 4,000 less ₹ 500)	3,500.00
Less: Fair value of plan assets	(3,250.00)
	250.00
Less: Unamortised past service cost (87.5% of ₹ 100)	(87.50)
Liability to be recognised in the balance sheet	162.50

(b) Estimated tax liability on annual income = [Income ₹1,800 lakhs less b/f losses ₹ 630 lakhs (90% of 700)] x 33%

= 33% of ₹ 1,170lakhs = ₹ 386.10 lakhs

As per Para 29(c) of AS 25 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

Thus, estimated weighted average annual income tax rate = ₹ 386.10 lakhs divided by ₹ 1,800 lakhs=21.45%

Tax expense to be recognised in each quarter	*₹ in lakhs*
Quarter I – ₹ 700 lakhs x 21.45%	150.15
Quarter II – ₹ 300 lakhs x 21.45%	64.35
Quarter III – (₹ 100 lakhs) x 21.45%	(21.45)
Quarter IV – ₹ 900 lakhs x 21.45%	193.05
	386.10

(c) In this case S Ltd. concurrently agrees to repurchase the same goods from B Ltd. at a later date. Also, the repurchase price is predetermined and covers B Limited's purchasing and holding costs. Hence, the transaction between S Limited and B Limited on 15th March, 2013 should be accounted for as financing transaction rather than as sale.

The resulting cash inflow of ₹ 1,200 lakhs is not revenue as per AS 9 'Revenue Recognition'.

Journal entries in the books of S Limited

			₹ in lakhs
15.3.2013	Bank A/c Dr. To Advance from B Limited A/c (Being amount received from B Ltd. as per sale and repurchasing agreement)	1,200	 1,200
31.3.2013	Financing Charges A/c Dr. To Advance from B Ltd. A/c (Financing charges 20% of ₹ 1200 lakhs for 1/2 month i.e. 240 x 0.5/6)	20	 20
31.3.2013	Profit and Loss A/c Dr. To Financing charges (Being amount transferred to profit and loss account)	20	 20

Disclosure in the Balance Sheet

1 Balance Sheet of S Limited as on 31.3.2013 (Extract)

	(₹) in lakhs
Assets (Under the head "Current Assets")	
Short-term loans and advances	
Goods lying with B Limited (under sale and repurchase agreement)	1,000*
Liabilities (under the head "Secured Loans')	
Advance from B Limited	1,200
Add: Accrued finance charges	20
	1,220

2. Notes to accounts:

(a) Goods lying with B Limited costing ₹ 1,000 lakhs to be repurchased after 6 months at ₹ 1,440 lakhs.

(b) Goods sold to B Limited for ₹ 1,200 lakhs (cost ₹ 1,000 lakhs) on repurchase

* 20% profit on cost price has been considered in the sale transaction between B Ltd. and S Ltd.

agreement. The difference between sale price and repurchase price is treated as financing charges and allocated proportionately in the current accounting period.

Journal entries in the Books of B Limited

₹ in lakhs

15.3.2013	Advance from B Limited A/c To Bank A/c (Being amount paid to S Ltd. as per sale and repurchase agreement)	Dr.	1,200	 1,200
31.3.2013	Accrued Finance Income A/c To Finance income (Financing charges 20% of ₹1200 lakhs for 1/2 month i.e. 240 x0 .5/6)	Dr.	20	 20
31.3.2013	Financing Income A/c To Profit and Loss A/c (Being financing charges received transferred to profit and loss account)	Dr.	20	 20

Disclosure in the Balance Sheet

1. Balance sheet of B Ltd. as on 31.3.2013 (An Extract)

   Assets (Under the head 'Current Assets)'

   Short-term loans and advances

   Advance to S Ltd. (Under sale and repurchase agreement) - ₹ 1,200 lakhs

   Accrued Finance income - ₹ 20 lakhs

   (This advance is fully secured by goods of S Ltd. Market value of ₹ 1,200 lakhs lying with company as security)

2. **Notes to Account**

   ₹ 1,200 lakhs paid to S Limited against the sale and repurchase agreement against the security of goods of S Limited whose market value is ₹ 1,200 Lakhs.

   The transaction being in the nature of a financing arrangement is not recognized as a sale and hence the excess of repurchase price over sale price amounting to ₹ 240 lakhs have been treated as Finance charges allocated proportionately between accounting periods 2012-13 and 2013-14. The value of the computer spares lying with B Ltd. on Balance Sheet date is considered as part of the company's inventory held as security for the Financing obligation.

(d) <u>Note:</u> Schedule III to the Companies Act, 2013 has been notified in April, 2014, which replaces revised Schedule VI to the Companies Act, 1956. Since now Schedule III is applicable to students, the answer to the question is given in reference to Schedule III to the Companies Act, 2013 and not as per revised Schedule VI to the Companies Act, 1956.

As per para 3 of AS 2 "Valuation of Inventories", inventories are assets that are (a) held for sale in the ordinary course of business; (b) in the process of production for such sale; or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services. The properties acquired by Vintage Ltd. should not be construed as stock in trade in spite of the fact that they are being sold within a short span of time.

As per the definition of Fixed asset given in para 6 of AS 10 'Accounting for Fixed Assets', a fixed asset is one which is held with the intention of being used for the purpose of producing goods or services and is not held for sale in the normal course of business. In the given question the acquisition of the heritage properties is done by the company with the intention to provide the service of leasing of such properties. Hence the intention of the company was to use such property for generating revenue for the company by leasing out such properties. The sale of 12 properties can't be considered as part of normal business operations of the company. Hence the treatment of the properties as 'Stock-in-Trade' is incorrect as the properties are to be considered only as Fixed Assets of the company. The purchase and sale in short span of time to make huge profit will require disclosure as per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'. The lease income from these properties will be considered as main business income and cannot be considered as part of other income. Such income will be disclosed under the head Revenue from operations.

Thus the contentions of the accountant regarding accounting the acquisition and sale of these properties as sale and purchase, treating them as stock in trade, considering lease income as other income are incorrect in line with provisions of relevant accounting standards.

Question 53

Sea Ltd. has lent a sum of ₹ 10 lakhs @ 18% per annum for 10 years. The loan had a Fair Value of ₹ 12,23,960 at the effective interest rate of 13%. To mitigate prepayment risks but at the same time retaining control over the loan, Sea Ltd. transferred its right to receive the Principal amount of the loan on its maturity with interest, after retaining rights over 10% of principal and 4% interest that carries Fair Value of ₹ 29,000 and ₹ 1,84,620 respectively. The consideration for the transaction was ₹ 9,90,000. The interest component retained included a 2% fee towards collection of principal and interest that has a Fair Value of ₹ 65,160. Defaults if any are deductible to a maximum extent of the company's claim on Principal portion. You are required to show the Journal Entries to record derecognition of the Loan.

(6 Marks, Nov. 2013)

Answer

(i) Calculation of securitized component of loan

		₹	₹
Fair Value			12,23,960
Less: Principal strip receivable (fair value)		29,000	
Less: Interest strip receivable (fair value)	1,19,460		
Less: Value of service asset (fair value)	65,160	1,84,620	2,13,620
			10,10,340

(ii) Appointment of carrying amount in the ratio of fair values:

	Fair value (₹)		Appointment (₹)
Securitized component of loan	10,10,340	$\frac{10,10,340 \times 10,00,000}{12,23,960}$	8,25,468
Principal strip receivable	29,000	$\frac{29,000 \times 10,00,000}{12,23,960}$	23,694
Interest strip receivable	1,19,460	$\frac{1,19,460 \times 10,00,000}{12,23,960}$	97,601
Servicing asset	65,160	$\frac{65,160 \times 10,00,000}{12,23,960}$	53,237
			10,00,000

(iii) Entries to record the derecognition of the Loan

		₹	₹
Bank A/c	Dr.	9,90,000	
To Loan A/c			8,25,468
To Profit & Loss A/c			1,64,532
(Being entry for securitization of 90% principal with 14% interest)			
Interest strip a/c	Dr.	97,601	
Servicing asset A/c	Dr.	53,237	
Principal strip A/c	Dr.	23,694	
To Loan A/c			1,74,532
(Being entry for interest, servicing asset and principal strips received)			

Alternative set of Journal Entries

Sea Ltd.

			₹	₹
(i)	Recognition of loan			
	18% loan A/c	Dr.	10,00,000	
	To Bank A/c			10,00,000
(ii)	Deregnition of loan Fair Value			
	Bank A/c	Dr.	9,90,000	
	10% Principal Loan A/c	Dr.	29,000	
	4% Interest receivable A/c	Dr.	1,84,620	
	To 18% Loan A/c			10,00,000
	To Profit & Loss A/c			2,03,620
	(Being the balance transferred to Profit and Loss A/c)			
(iii)	Fee Advance received towards collection of Principal and Interest	Dr.	65,160	
	4% Balance Interest receivable A/c	Dr.	1,19,460	
	To 4% Interest receivable A/c			1,84,620
	(Being the bifurcation of Interest into two parts i.e first part will be offset against expenses and the second part will go to Profit & Loss A/c at the end of 10th year i.e. Loan realization)			
(iv)	Impairment of Loan recognition at 13%			
	Profit & Loss A/c	Dr.	2,76,040	
	To impairment loss on loan			2,76,040

Working Notes

Sea Ltd.

Loan given- ₹ 10,00,000 @ 18% per annum for 10 years

Fair Value – ₹ 12,23,960

Interest @ 13% per annum

Transferred – Right → to received Principal of the loan on its maturity with interest.

4% of interest = ₹ 40,000

Fair Value = ₹ 1,84,620

Interest 13% = ₹ 1,30,000

Fair Value of principal = ₹ 29,000

Consideration = ₹ 9,90,000

Out of 4% - includes 2% fee towards collection of Principal and interest that has a fair value ₹ 65,160

Balance = 1,84,620 (-) 65,160= ₹ 1,19,460 (2% Pure interest)

Default if any, = deductible from Company's claim on principal position.

Journal entry to record derecognition of the Loan : → AS-30 Para 26 and Para 61(b).

Ser. No.	*Balance O/S*	*Interest income @ 18%*	*Total*	*Cash Received*	*Balance at the end*
1	10,00,000	1,80,000	11,80,000	1,30,000	10,50,000
2	10,50,000	1,80,000	12,30,000	1,30,000	11,00,000
3	11,00,000	1,80,000	12,80,000	1,30,000	11,50,000
4	11,50,000	1,80,000	13,30,000	1,30,000	12,00,000
5	12,00,000	1,80,000	13,80,000	1,30,000	12,50,000
6	12,50,000	1,80,000	14,30,000	1,30,000	13,00,000
7	13,00,000	1,80,000	14,80,000	1,30,000	13,50,000
8	13,50,000	1,80,000	15,30,000	1,30,000	14,00,000
9	14,00,000	1,80,000	15,80,000	1,30,000	14,50,000
10	14,50,000	180,000	16,30,000	1,30,000	15,00,000

The Fair Value of the effective Interest rate at the end of 10th year is = ₹ 12,23,960 and the Book Value is ₹ 15,00,000 . The difference in between i.e. ₹ 2,76,040 to be recognized and transferred to Profit & Loss A/c.

Question 54

(a) *K Ltd. issued 5,00,000, 6% Convertible Debentures of ₹ 10 each on the First of April 2010. The debentures are due for redemption on 31st March, 2014 at a premium of 10% convertible into equity shares to the extent of 50% and the balance to be settled in cash to the debenture holders. The interest rate on equivalent debentures without conversion rights was 10%. You are required to separate the debt & equity components at the time of the issue and show the accounting entry in the company's books at initial recognition.*

The following Present Values of ₹ 1 at 6% and at 10% are supplied to you.

Interest Rate	*Year 1*	*Year 2*	*Year 3*	*Year 4*
6%	*0.94*	*0.89*	*0.84*	*0.79*
10%	*0.91*	*0.83*	*0.75*	*0.68*

(b) *WIN Ltd. has entered into a three year lease arrangement with Tanya sports club in respect of Fitness Equipments costing ₹ 16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Values of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be ₹ 1,33,500. The assets would revert to the lessor at the end of the lease. Given that the implicit rate of interest is 10% you are required to compute the amount of the annul lease and the unearned finance income. Discounting Factor at 10% for years 1, 2 and 3 are 0.909, 0.826 and 0.751 respectively.*

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

   (i) *You are required to comment if mere gradual phasing out in itself can be considered as a 'Discontinuing Operation' within the meaning of AS 24.*

   (ii) *If the company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS 24 ?*

   (iii) *Would your answer to the above be different if the company resolves to sell the assets of the Passenger Car Division in a phased but time bound manner?*

(d) *Grant Medicare Ltd. acquired 5 units of Brain Scan Equipment for US$ 5,00,000 in April 2010 incurring ₹ 20,00,000 on sea freight and US$ 12,000 per unit towards transit Insurance, bank charges etc. The purchase was partly funded out of the company's internal accruals and from Government Grant of ₹ 94 Lakhs. The prevailing exchange rate to the US$ was 50. The company estimated the useful life of the equipment at 4 years with an estimated salvage value of 13% (approx). The grant was considered as Deferred Income up to 2012-13 and in April 2013 the company had to return the entire grant received due to non fulfillment of certain conditions. You are required to show the deprecation and the grant that is to be recognized in the Profit & Loss accounts for the period commencing, 2010-11 onwards and also draw up the entry that is passed in April 2013 for the return of the Grant. The Company follows the written down value method for depreciating its assets.*

(e) *Blow Glass Limited manufactures Glass Bottles of various sizes and shapes at its 3 manufacturing facilities in UP, Haryana and MP. The company follows the WDV method*

of depreciation for all assets at these units and at its corporate office. In 2013 May it acquired a new unit making plastic containers in Gujarat. The method of depreciation followed in the newly acquired unit was the SLM method for its assets, till the unit was acquired by Blow Glass Ltd. The Chief Accountant of Blow Glass is of the view that since the company has adopted the WDV method at all its existing assets it is mandatory to follow the WDV method in respect of the new unit also, especially since the same class of assets exist at the existing units and new unit. You are requested to comment on stand of the Chief Accountant. *(4 x 3 Marks, November, 2013)*

Answer

(a) Computation of Debt Component of Convertible Debentures as on 1.4.2014

Particulars	*₹*
Present value of the principal repayable after four years	
[50,00,000 x 50%× 1.10 × 0.68 (10% Discount factor)] (a)	18,70,000
Present value of Interest [3,00,000 x 3.17 (4 years cumulative 10% discount factor)](b)	9,51,000
Total present Value of debt component (I) (a+b)	28,21,000
Issue proceeds from convertible debenture(II)	50,00,000
Value of equity component (II – I)	21,79,000

Journal entry at initial recognition

		Dr. (₹)	*Cr. (₹)*
Cash / Bank A/c	Dr.	50,00,000	
To 6% Debenture (Liability component) A/c			28,21,000
To 6% Debenture (Equity component) A/c			21,79,000
(Being the disbursement recorded at fair value)			

(b) (i) Computation of annual lease payment to the lessor

	₹
Cost of equipment	16,99,999.50
Unguaranteed residual value	1,33,500.00
Present value of residual value after third year @ 10% (₹ 1,33,500 × 0.751)	1,00,258.50
Fair value to be recovered from lease payments (₹ 16,99,999.50– ₹ 1,00,258.50)	15,99,741.00
Present value of annuity for three years is 2.486	
Annual lease payment = ₹ 15,99,741/ 2.486	6,43,500.00

(ii) Computation of Unearned Finance Income

	₹
Total lease payments (₹ 6,43,500 x 3)	19,30,500.00
Add: Unguaranteed residual value	1,33,500.00
Gross investment in the lease	20,64,000.00
Less: Present value of investment (lease payments and residual value) (₹ 1,00,258.50+ ₹ 15,99,741)	(16,99,999.50)
Unearned finance income	3,64,000.50

(c) Mere gradual phasing is not considered as discontinuing operation as defined under para 3 of AS 24, 'Discontinuing Operation'.

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

(1) Gradual or evolutionary phasing out of a product line or class of service.

(2) Shifting of some production or marketing activities for a particular line of business from one location to another and

(3) Closing of a facility to achieve productivity improvements or other cost savings.

A Reportable business segment or geographical segment as defined in AS 17, would normally satisfy criteria (b) of the definition.

In view of the above the answers are:

(i) No. The companys' strategic plan has no final approval from the board through a resolution and no specific time bound activities like shifting of Assets and employees and above all the new segment commercial vehicle production line and factory has started.

(ii) No. The resolution is salient about stoppage of the Car segment in definite time period. Though, some assets sales and transfer proposal was passed through a resolution to the new factory, closure road map and new segment starting road map is missing. Hence, AS-24 will not be applicable.

(iii) Yes. Phased and time bound programme resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and clear road map. Hence, this action will attract AS-24 compliance.

(d) Statement showing annual depreciation and amount of Grant to be recognized in P& L A/c

(Rupees in Lakhs)

Year	Value of asset	Depr.@40%	Closing Value	Deferred grant to be recognized (94) X dep. for the year / Total Depreciation
2010-11	300.00	120.00	180.00	43.20
2011-12	180.00	72.00	108.00	25.92
2012-13	108.00	43.20	64.80	15.55
2013-14	64.80	25.92	38.88	9.33
Total		261.12		94.00

The entries for depreciation & recognition of the grant will be as per the above table for the year 2010-11, 2011-12 & 2012-13

The entry for the return of the Grant of ₹ 94 lakhs in April 2013 will be as under:

Deferred Grant Account	Dr.	9.33	
Profit & Loss Account(43.20+25.92+15.55)	Dr.	84.67	
To Bank			94.00

(Being the return of the Grant received in April 2010 due to non-fulfillment of conditions)

Working Note:

1. Calculation of Revised Book Value of Machine as on 1st April, 2010

Particulars	*(₹ in lakhs)*
Acquisition of 5 units of brain scan units [US $ 5,00,000 x ₹ 50]	250
Add: Sea Freight on the above units	20
Add: Transit insurance, Bank charges etc. paid ($ 12,000 x ₹ 50 x 5)	30
Total landed cost as on 1st April, 2010	300

2. Calculation of WDV rate

$$\text{WDV rate of depreciation} = 1 - \sqrt[n]{\frac{\text{Residual value}}{\text{Cost of Asset}}} \times 100$$

$$= 1 - \sqrt[4]{\frac{39}{300}} \times 100 = 40\%$$

(e) According to Para 5 of the Guidance Note on 'Accounting for Depreciation in Companies', issued by The Institute of Chartered Accountants of India a company may adopt more than one method of depreciation. It is also permissible to follow different methods for different types of assets provided the same methods are consistently adopted from year to year. It is also permissible for a company to have different methods of depreciation for units at different locations provided consistency is maintained.

Hence, the view of the chief accountant that the company cannot follow SLM method of depreciation at the newly acquired unit is not correct and Blow Glass Ltd. can follow the SLM method of depreciation at the newly acquired unit.

Question 55

(a) An employee Roshan has joined a company XYZ Ltd. in the year 2013. The annual emoluments of Roshan as decided is ₹ 14,90,210. The company also has a policy of giving a lump sum payment of 25% of the last drawn salary of the employee for each completed year of service if the employee retires after completing minimum 5 years of service. The salary of the Roshan is expected to grow @ 10% per annum.

The company has inducted Roshan in the beginning of the year and it is expected that he will complete the minimum five year term before retiring.

What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined Benefit obligation? Also calculate the current service cost and the interest cost to be charged per year assuming a discount rate of 8%.

(P.V factor for 8% - 0.735, 0.794, 0.857, 0.926, 1)

(b) Quick Ltd. is a company engaged in the trading of spare parts used in the repair of automobiles. The company has been regular in depositing the tax, as such there is no liability of Income Tax etc. for the Financial Year 2012-13.

The figures for the year are as under:

Income chargeable to tax	*₹ 211.64 lakhs*
Total income after adjustments	*₹ 228.48 lakhs*
Tax thereon	*₹ 74.13 lakhs*
TDS deducted during the year	*₹ 30.45 lakhs*
Tax paid for the year	*₹ 43.68 lakhs*

The company has prepared its Balance Sheet as per above figures. However, during the assessment proceeding held before the finalization of the Balance Sheet the Income Tax Officer has issued demand of ₹ 7.52 lakhs, insisting that this amount of TDS has not been uploaded online and thus is not acceptable as deduction.

The company has in reply to the same filed a rectification with the Assessing Officer. The company is trying to collect the TDS certificates, but ₹ 2.39 lakhs deducted by XY LTD., is not traceable. The rectification is lying pending with the Assessing Officer.

Please suggest the treatment of ₹ 2.39 lakhs and ₹ 7.52 lakhs in Balance Sheet.

(c) *Comptech Ltd. having office at Chennai, acquired a sophisticated three dimensional (3D) computer printer having all inclusive MRP (Maximum Retail Price) of ₹ 50 lakhs from a supplier located at New Delhi. The terms of the purchase were as under:*

(i) *The supplier would buy back the existing unit with Comptech that has carrying amount of ₹ 10.20 lakhs. Prevailing CST rate is 2%.*

(ii) *The supplier would give a special discount of 10% on MRP to Comptech considering their long standing relationship.*

(iii) *A cash payment of ₹ 38.25 lakhs would be made by Comptech Ltd. to the supplier.*

(iv) *Accessories required to operate the machine costing ₹ 7.60 lakhs (inclusive of all taxes) will be purchased by Comptech.*

(v) *The supplier will deliver free of cost certain heavy duty cables etc. having MRP of ₹ 5.75 lakhs, that are required to run the machine.*

(vi) *Transit insurance cost will be borne by Comptech @ 2% of MRP.*

(vii) *Freight and other incidentals amounting to ₹ 2.30 lakhs is borne by Comptech.*

You are required to arrive at the cost of the new asset and show the profit/(loss) incurred by Comptech on the buy back arrangement and also draft the Journal Entries to record the above transaction.

(d) *Compute Basic and Adjusted Earnings per share from the following information:*

Net Profit for 2012-13	*₹ 22 lakhs*
Net Profit for 2013-14	*₹ 33 lakhs*
No. of shares before Rights Issue	*1,10,000*
Rights issue Ratio	*One for Every Four Held*
Rights Issue Price	*₹ 180*
Date of exercising Rights option	*31.7.2013 (fully subscribed on this date)*
Fair value of share before Rights Issue	*₹ 270*

All workings may be rounded off to two decimals. *(5 Marks each, May, 2014)*

Answer

(a) Calculation of Defined Benefit Obligation

Expected last drawn salary = ₹ 14,90,210 x 110% x 110% x 110% x 110% x 110%

= ₹ 24,00,000

Defined Benefit Obligation (DBO) = ₹ 24,00,000 x 25% x 5 = ₹ 30,00,000

Amount of ₹ 6,00,000 will be charged to Profit and Loss Account of the company every year as cost for Defined Benefit Obligation.

Calculation of Current Service Cost

Year	Equal apportioned amount of DBO [i.e. ₹ 30,00,000/5 years]	Discounting @ 8% PV factor	Current service cost (Present Value)
a	b	c	d = b x c
1	6,00,000	0.735 (4 Years)	4,41,000
2	6,00,000	0.794 (3 Years)	4,76,400
3	6,00,000	0.857 (2 Years)	5,14,200
4	6,00,000	0.926 (1 Year)	5,55,600
5	6,00,000	1 (0 Year)	6,00,000

Calculation of Interest Cost to be charged per year

Year	Opening balance	Interest cost	Current service cost	Closing balance
a	b	c = b x 8%	d	e = b + c + d
1	0	0	4,41,000	4,41,000
2	4,41,000	35,280	4,76,400	9,52,680
3	9,52,680	76,214	5,14,200	15,43,094
4	15,43,094	1,23,447	5,55,600	22,22,141
5	22,22,141	1,77,859*	6,00,000	30,00,000

*Due to approximations used in calculation, this figure is adjusted accordingly.

(b) As per para 10 of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a contingent liability is: (a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or (b) a present obligation that arises from past events but is not recognised because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) a reliable estimate of the amount of the obligation cannot be

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

In the given case, TDS shall be allowed by the IT department on submission of duplicate TDS certificates. Since the company is making efforts and is hopeful for its ultimate collection, contingent liability will be made for ₹ 2.39 lakhs in the books of account.

Further as per para 15 of the standard, where it is more likely that no present obligation exists at the balance sheet date and the possibility of an outflow of resources embodying economic benefits is remote, no contingent liability is disclosed.

TDS certificates for ₹ 5.13 lakhs (₹ 7.52 lakhs less ₹ 2.39 lakhs) have been submitted and the company has filed a rectification with the Assessing Officer. Therefore, the possibility of an outflow of resources embodying economic benefits is remote; the company shall not disclose it as contingent liability. This amount should be disclosed by way of a note to the accounts.

Note: An alternative view can also be considered on the basis of the paragraph 14 of the standard which states that a provision should be recognised in the books when (a) an enterprise has a present obligation as a result of a past event; (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation.

Accordingly, in the given case, since there is a probability of outflow of resources and also the amount can be quantified on account of non-traceability of TDS certificates, a provision may be made for ₹ 2.39 lakhs in the books of account.

Regarding the balance amount of ₹ 5.13 lakhs (₹ 7.52 lakhs less ₹ 2.39 lakhs), since TDS certificated have been submitted, it is likely that the Income-tax Officer may accept the rectification filed by the assessee. However, since the TDS details have not been uploaded online because of which demand has been issued, there may be a possibility that the rectification may also not be accepted. Therefore, taking a conservative approach, ₹ 5.13 lakhs may be disclosed as a contingent liability.

(c) As per para 22 of AS 10 'Accounting for Fixed Assets', when a fixed asset is acquired in part exchange for another asset, the cost of the asset acquired should be recorded either at fair market value or at the net book value of the asset given up, adjusted for any balancing payment. In the given question the FMV of the new machine is its MRP net of special concession given to the buyer.

1. Calculation of Cost of New Asset

	₹ in lakhs
MRP of Printer	50
Less: Special Discount 10% of MRP	5
	45

Add: Accessories	7.6
Add: Transit Insurance Cost (2% of 50 lakh)	1
Add: Freight and other incidental amount	2.30
	55.09

2. Calculation of Profit /Loss incurred on buy-back arrangement

	₹ in lakhs
Discounted price of new machine	45.00
Less: Cash portion thereof	38.25
FMV of old machine	6.75*
Less: Book Value thereof	10.20
Loss on Buy back	3.45
*This includes CST of 2%. Thus the CST will be 6.75 x 2/102 = 0.13 lakh	

3. Journal Entries

1.	3D Computer Printer A/c	Dr.	49.15	
	To Cash A/c			49.15

(Being the expenses incurred for purchase of 3D computer – cash payment 38.25 + accessory 7.6 + insurance 1 and freight 2.3)

2.	3D Computer Printer A/c	Dr.	6.75	
	Loss on buy back of old machine A/c	Dr.	3.45	
	To Old Machine A/c			10.20

(Being the transfer of FMV of ₹ 6.75 lakhs of old machine to new printer under buy-back scheme and recognition of loss on buy back)

Note: It is assumed that the cash payment of ₹ 38.25 lakhs is the full and final payment to the supplier for the printer.

(d) Computation of earnings per share

EPS for the year 2012-13 as originally reported

= ₹ 22,00,000/1,10,000 shares = ₹ 20

EPS for the year 2012-13 restated for rights issue

= ₹ 22,00,000/ (1,10,000 shares x 1.07) = ₹ 18.69

EPS for the year 2013-14 including effects of rights issue

$$= (1,10,000 \times 1.07 \times 4/12) + (1,37,500 \times 8/12) = 1,30,900$$

$$= \frac{33,00,000}{1,30,900} = 25.21$$

Working Note:

1. Calculation of Theoretical ex-rights fair value per share

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

$$\frac{(₹\,270 \times 1,10,000 \text{ shares}) + (₹\,180 \times 27,500 \text{ Shares})}{1,10,000 + 27,500 \text{ Shares}} = \frac{3,46,50,000}{1,37,500}$$

Theoretical ex-rights fair value per share = ₹ 252

2. Calculation of Computation of adjustment factor:

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}} = \frac{₹\,(270)}{₹\,(252)} = 1.071$$

Question 56

Answer the following:

(a) KAY Ltd. is in the process of finalizing its accounts for year ended 31st March, 2014 and furnishes the following information:

(i) Finished goods normally are held for 30 days before sale.

(ii) Sales realization from Debtors usually takes 60 days from date of credit invoice.

(iii) Raw materials are held in stock to cover one month's production requirements.

(iv) Packing materials, being specifically made for the company and having lead time of 90 days is held in stock for 90 days.

(v) The holding period in respect of unfinished goods is 30 days.

(vi) Being a monopoly KAY Ltd. enjoys a credit period of 12.5 months from its suppliers who sometimes at the end of their credit period opt for conversion of their dues into long term debt of KAY Ltd.

You are required to compute the operating cycle of KAY Ltd. as per revised Schedule IV of Companies Act, 1956. As the suppliers of the company are paid off after a credit period of 12.5 months should this be part of Current Liability? Would your answer be the same if the creditors are settled in 330 days?*

(b) *What are Timing Differences and Permanent Differences as per Accounting Standard 22? Explain with example.*

(c) *X Ltd. has leased equipment over its useful life that costs ₹ 7,46,55,100 for a three year lease period. After the lease term the asset would revert to the Lessor. You are informed that:*

(i) The estimated unguaranteed residual value would be ₹ 1 lakh only.

(ii) The annual lease payments have been structured in such a way that the sum of their present values together with that of the residual value of the asset will equal the cost thereof.

(iii) Implicit interest rate is 10%.

You are required to ascertain the annual lease payment and the unearned finance income. P.V. factor @ 10% for years 1 to 3 are 0.909, 0.826 and 0.751 respectively.

(d) *AQ Ltd., an investment company is finalizing its account for the Financial Year ending 2013 in the month of August 2013.*

How will the following incomes be accounted for in the books of AQ Ltd.?

(1) X Ltd., has declared interim dividend which has not been received till 31-3-2013 but received on 25-4-2013.

(2) Y Ltd., has declared dividend on 8th May 2013 for the year ending 31-3-2013 which has been approved by the shareholders of the company on 30th June 2013.

(3) Z Ltd., a subsidiary of AQ Ltd., has declared dividend for the year ended 31-3-2013 on 25th May 2013 the AGM for which is to be held on September 2013.

(4 Marks each, May, 2014)

Answer

(a) Operating cycle of Kay Ltd. will be computed as under:

Raw material stock holding period + Work-in-progress holding period + Packing Materials holding period+ Finished goods holding period + Debtors collection period

= 1 + 1 + 3 + 1 + 2 = 8 months

Classification of liability to suppliers: Revised Schedule VI provides that:

"A liability shall be classified as current when it satisfies any of the following criteria:

* PS : Read Schedule IV as Schedule VI.

(i) it is expected to be settled in the company's normal operating cycle;

(ii) it is held primarily for the purpose of being traded;

(iii) it is due to be settled within twelve months after the reporting date; or

(iv) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments and do not affect its classification."

There are two situations:

(a) **When credit period given by supplier is 12.5 months:** The nature of classification of liability is to be seen with reference to the reporting date. Hence all liabilities except those that arise in the last fortnight of the accounting period will be "Current" as this will have to be settled within 12 months of the reporting date. Thus, all liabilities that do not arise in the last fortnight of the accounting period will be "Non - Current".

(b) **When credit period given by suppliers is 330 days (i.e. 11 months approx.):** If the creditors are settled in 330 days i.e. within 11 months. This satisfies the third condition i.e. it is due to be settled within twelve months after the reporting date and there is no option to defer it. Hence, in the case it will be treated as current liability.

(b) The differences between taxable income and accounting income can be classified into permanent differences and timing differences as follows:

(i) **Permanent differences** are those differences between taxable income and accounting income which originate in one period and do not reverse subsequently. For instance, if for the purpose of computing taxable income, the tax laws allow only a part of an item of expenditure, the disallowed amount would result in a permanent difference.

(ii) **Timing differences** are those differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods. Timing differences arise because the period in which some items of revenue and expenses are included in taxable income do not coincide with the period in which such items of revenue and expenses are included or considered in arriving at accounting income. **For example**, machinery purchased for scientific research related to business is fully allowed as deduction in the first year for tax purposes whereas the same would be charged to the statement of profit and loss as depreciation over its useful life. The total depreciation charged on the machinery for accounting purposes and the amount allowed as deduction for tax purposes will ultimately be the same, but periods over which the depreciation is charged and the deduction is allowed will differ.

(c) (i) Calculation of Annual Lease Payment*

	₹
Cost of the equipment	7,46,55,100
Unguaranteed Residual Value	1,00,000
PV of unguaranteed residual value for 3 years @ 10% (₹ 1,00,000 x 0.751)	75,100
Fair value to be recovered from Lease Payment (₹ 7,46,55,100 – ₹ 75,100)	7,45,80,000
PV Factor for 3 years @ 10%	2.486
Annual Lease Payment (₹ 7,45,80,000 / PV Factor for 3 years @ 10% i.e. 2.486)	3,00,00,000

(ii) Unearned Finance Income

Total lease payments [₹ 3,00,00,000 x 3]	9,00,00,000
Add: Residual value	1,00,000
Gross Investments	9,01,00,000
Less: Present value of Investments (₹ 7,45,80,000+ ₹ 75,100)	(7,46,55,100)
Unearned Finance Income	1,54,44,900

(d) As per para 8 of AS 9 "Revenue Recognition", dividends from investment in shares is recognized in the statement of Profit and Loss only when the owner's right to receive the payment is established.

(i) In the first case, it is clear that interim dividend was declared by X Ltd. before 31st March 2013 which implies that the dividend had been vested (accrued) to the shareholders of AQ Ltd. in the year 2012-13. Therefore, though it is received on 25.4.13 (before finalization of accounts) yet it should be recognized in the financial statements for the year ended 31st March, 2013.

(ii) Dividend declared by Y Ltd and approved by the shareholders of AQ Ltd. after balance sheet date but before finalization of accounts cannot be accounted for in the financial statements for the year ended 31st March, 2013. This will be accounted in 2013-14 as the right to receive dividend will arise when the AGM will approve the dividend i.e. on 30th June 2013. Since right to receive the dividend was not established on or before 31st March, 2013, it will not be accounted for in the books for the year ended 31st March, 2013.

* Annual lease payments are considered to be made at the end of each accounting year.

(iii) In the given case, dividend declared by Z Ltd. will be approved in the AGM to be held on 30th September, 2013. Before that right to receive dividend cannot be established. Hence it will not be accounted for in the financial year ended on 31st March, 2013.

Question 57

(a) From the given information, you are required to compute the deferred tax assets and deferred tax liability for Ramanujam Limited as on 31st March 2014. The tax rate applicable is 35%.

(i) The company has charged depreciation of ₹ 7,42,900 in its books of accounts while as per income-tax computation, the depreciation available to the company is ₹ 8,65,400.

(ii) The company has made provision for doubtful debts for ₹ 54,300 during the year.

(iii) The company has debited share issue expenses of ₹ 6,23,500 which will be available for deduction under the Income-tax Act from the next year.

(iv) The expense of ₹ 7,84,500 has been charged to profit and loss account which are disallowed under the Income-tax Act.

(v) The company has made donation of ₹ 2,00,000 which has been debited to profit and loss account and only 50% thereof will be allowed as deduction as per Income-tax law.

(b) ABC Limited has three segments viz. A, B and C. The total assets of the company is ₹ 15 crores. The assets of Segment A is ₹ 1.85 crores, Segment B is ₹ 6.15 crores and Segment C is ₹ 7.00 crores. Assets of each segment include deferred tax assets of ₹ 0.50 crores in A, ₹ 0.40 crores in B and ₹ 0.30 crores in C. The accountant of ABC Limited contends that all segments are reportable segments. Based on segment assets criteria, determine the veracity of the contention of the accountant.

(c) Sunny Limited, is developing a new production process. During the financial year ended 31st March 2013, the company has incurred total expenditure of ₹ 40 lacs on the process. On 1st December, 2012, the process has met the norms to be recognized as 'intangible assets' and the expenditure incurred till that date is ₹ 16 lacs. During the financial year ending on 31st March 2014, the company has further incurred ₹ 70 lacs. The recoverable amount as on 31st March 2014 of the process is estimated to be ₹ 62 lacs. You are required to work out:

(i) Expenditure to be charged to profit and loss account for the financial year ending on 31st March 2013 and 31st March 2014. (ignore depreciation)

(ii) Carrying amount of the 'Intangible asset' as at 31st March 2013 and 31st March 2014.

(5 Marks each, November, 2014)

Answer

(a) Statement showing calculation of Deferred Tax Asset (DTA) and Deferred Tax Liability (DTL)

S. No.	*Particulars*	*Amount of difference*	*Nature of difference*	*DTA @ 35%*	*DTL @ 35%*
		₹		₹	₹
(i)	Excess allowable depreciation as per income-tax law	1,22,500	Timing	-	42,875
(ii)	Provision for doubtful debts - disallowed as per income-tax law in the current year but reversible in future years.	54,300	Timing	19,005	-
(iii)	Share issue expenses charged in the accounting books but allowed as deduction in the income-tax law from the next year	6,23,500	Timing	2,18,225	-
(iv)	Disallowed expenses as per income tax law	7,84,500	Permanent	-	-
(v)	Donation debited to Profit & Loss Account				
	Allowed as per income tax	1,00,000	No difference	-	-
	Disallowed as per income tax	1,00,000	Permanent	-	-
				2,37,230	42,875

(b) Statement showing percentage of Segment net assets to Total assets of the company

₹ in crores

Particulars	*Segments*			
	A	*B*	*C*	*Total*
Segment assets	1.85	6.15	7.00	15.00
Less: Deferred tax assets	(0.50)	(0.40)	(0.30)	(1.20)
Net segment assets	1.35	5.75	6.70	13.80
Percentage to total net segment assets	9.78%	41.67%	48.55%	100%

As per the definition given in para 5 of AS 17 'Segment Reporting', segment assets do not include income tax assets. Therefore, for identification of reporting segment on the basis of segment assets, deferred tax assets have been deducted from segment assets to arrive at net segment assets for the purpose of AS 17.

Further, as per para 27 of AS 17, one of the basis of segment asset criteria for identification of a business segment or geographical segment as a reportable segment is when its segment assets are 10% or more of the total assets of all segments. Accordingly, the reportable segments will be segments B and C only. Therefore, the contention of the accountant that all the segments are reportable segments is not tenable.

(c) Statement showing amount to be charged to Profit and Loss Account and Carrying Amount of an intangible asset *₹ in lacs*

S. No.	*Details*	*For the year ending on 31st March, 2013*	*For the year ending on 31st March, 2014*
(i)	Expenditure to be charged to Profit and Loss account	16	32 (W.N. 2)
(ii)	Carrying amount of an intangible asset	24 (W.N.1)	62

Working Notes:

1. Carrying amount as on 31st March, 2013 will be the expenditure incurred after 1st December, 2012 till 31st March, 2013

	₹ in lacs
Total expenditure incurred	40
Less: Expenditure incurred till 1st December, 2012 to be expensed off	(16)
Expenditure incurred from 1.1.2012 to 31.3.2013 to be capitalised	24

2. Total cost of an intangible asset till 31.3.2014

	₹ in lacs
Capitalised cost as on 31.3.2013	24
Add: Further capitalised cost till 31.3.14	70
Total book cost of an intangible asset till 31.3.2014	94

3. Impairment loss

	₹ in lacs
Book cost as on 31.3.2014 (W.N.2)	94
Less: Recoverable amount as estimated on 31.3.2014	(62)
Difference to be charged to Profit and Loss account as impairment loss	32

Therefore, carrying amount as on 31.3.2014 = ₹ 94 lacs – ₹ 32 lacs = ₹ 62 lakhs.

Question 58

*Answer any **FOUR** of the followings:*

(a) JVR Limited has made investments of ₹ 97.84 crores in equity shares of QSR Limited in pursuance of Joint Venture agreement till 2001-02. The investment has been made at par. QSR Limited has been in continuous losses for the last 2 years. JVR Limited is willing to re-assess the carrying amount of its investment in QSR Limited and wish to provide for diminution in value of investments. However, QSR Limited has a futuristic and profitable business plans and projection for the coming years. Discuss whether the contention of JVR Limited to bring down the carrying amount of investment in QSR Limited is in accordance with the Accounting Standard.

(b) What is a derivative? Define with reference to AS 30, Financial Instruments: Recognition and Measurement.

(c) Finished Goods costing ₹ 10 lacs were damaged due to flood in July 2013. These goods were included in Closing Stock as on March 31, 2014 at an estimated realizable value of ₹ 4.00 lacs. These goods could be ultimately sold for ₹ 3 lacs only in August 2014. The difference of ₹ 1 lac was debited as 'prior period' expenditure in financial year 2014-15. As an auditor, please comment in the light of provisions of accounting standards.

(d) XYZ Limited acquired a bank loan of ₹ 40 lacs on interest rate of 20% per annum on 1st July 2013. The said loan was utilized by the company for three transactions as under:

(i)	*Construction of factory shed*	*₹ 10,00,000*
(ii)	*Purchase of Plant and Machinery*	*₹ 25,00,000*
(iii)	*Balance loan was unallocated and used generally for the purpose of business*	

The accountant of the company has charged the total interest to the Profit and Loss account. Comment in view of provisions of AS 16.

(e) Samrat Limited has set up its business in a designated backward area which entitles the company for subsidy of 25% of the total investment from Government of India. The company has invested ₹ 80 crores in the eligible investments. The company is eligible for the subsidy and has received ₹ 20 crores from the government in February 2014. The company wants to recognize the said subsidy as its income to improve the bottom line of the company.

Do you approve the action of the company in accordance with the Accounting Standard?

(4 Marks each, November, 2014)

Answer

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

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

Since the investment was made in the year 2001-02, it implies that the shares are held for more than a year and is a long term investment. In the given case, though the QSR Ltd. is in continuous losses for past 2 years, yet it has a futuristic and profitable business plans and projections for the coming years. Here, one of the indicators i.e. 'losses incurred to the company' may lead to diminution in the value of the shares while the other indicator that 'the company has positive expected cash flows from its business plans' does not lead to decline in the value of shares.

Considering both the facts, the decline in the value of shares of QSR Ltd. will be taken as other than temporary in nature. Therefore, the investment in equity shares should be carried at cost only. Hence, the contention of JVR Ltd. to bring down the carrying amount of investment in QSR Ltd. is not in line with the provisions of AS 13.

(b) As per para 8 of AS 30, "Financial Instruments: Recognition and Measurement", a derivative is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics:

(i) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying');

(ii) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and

(iii) it is settled at a future date.

(c) Paragraph 4 of AS 5 on "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", defines Prior Period items as "income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods".

Prior period items should be distinguished from changes in Accounting Estimates. As a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. Accounting Estimates are

approximations that may need revision. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

In the instant case, there is no error or omission in prior periods. It is a case of a change in an accounting estimate when the damaged goods are finally sold.

Thus, the difference of ₹ 1,00,000 should be treated as a change in accounting estimate and not prior period item. Therefore, the accounting treatment done i.e. difference of ₹ 1,00,000 debited as prior period expenditure in financial year 2014-15 is not correct. It should be debited to profit and loss account as a change in an accounting estimate in the financial year 2014-15.

(d) Total interest amounting ₹ 6,00,000 (interest for 9 months @ 20% on ₹ 40,00,000) cannot be charged to Profit and Loss account.

The amount to be charged to Profit and Loss account will be computed as under:

Treatment of Interest (Borrowing cost) as per AS 16 'Borrowing Costs'

S. No.	*Particulars*	*Nature*	*Interest to be capitalized*	*Interest to be charged to P & L A/c*
(i)	Construction of Factory Shed (Refer Note 1)	Qualifying Asset	6,00,000 x 10/ 40= 1,50,000	
(ii)	Purchase of Machinery (Refer Note 2)	Not a Qualifying Asset		6,00,000 x 25/40= 3,75,000
(iii)	Working Capital (used generally for business) (Refer Note 3)	Not a Qualifying Asset		6,00,000 x 5/ 40 = 75,000
Total			1,50,000	4,50,000

Notes:

1. Construction of a factory shed necessarily takes a substantial period of time to get ready for its intended use or sale;
2. It is assumed that the machinery purchased is immediately ready for use. Therefore, it is a non-qualifying asset. Hence, the interest cost on it, would not be capitalized.
3. As per AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets* should be capitalized as part of the cost of that asset. Other borrowing costs are recognized as expense in the period in which they are incurred. Therefore, interest on balance loan used for

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

general purpose of business will not qualify for capitalization and will be charged to profit and loss account.

(e) As per para 10 of AS 12 "Accounting for Government Grants", where the government grants are in the nature of promoters' contribution, *i.e.,* they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, Central Investment Subsidy Scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

The subsidy received by Samrat Ltd. for setting up its business in a designated backward area will be treated as grant by the government in the nature of promoter's contribution as the grant is given with reference to the total investment in an undertaking i.e. subsidy is 25% of the eligible investment and also no repayment is apparently expected in respect thereof.

Since the subsidy received is neither in relation to specific fixed assets nor in relation to revenue. Thus, the company cannot recognize the said subsidy as income in its financial statements in the given case. It should be recognized as capital reserve which can be neither distributed as dividend nor considered as deferred income.