<u>100 Questions that a CA final applicant must know…..!!!</u>

Applicability of Accounting Standards to various entities

1. State the exemptions/relaxations available to Small and Medium Sized Corporates (SMCs) in complying with the notified Accounting Standards as provided by the Central Government.
   ANS:
   The SMCs are given the following exemptions / relaxations in complying with the notified accounting standards:
   NON APPLICABILITY:
   AS 3 "Cash flow Statement", AS 17 "Segment Reporting", AS 21 "Consoildated Financial Statements", AS 23 "Accounting for Investment in Associates in Consolidated Financial Statements" and AS 27 "Financial Reporting of Interests in Joint Ventures" are are not applicable to SMCs in their entirety.
   RELAXATIONS:
   The SMCs have been given following relaxations as regards

   <u>AS 15 "Employee Benefits":</u>
   SMCs need not comply paras 11 to 16 of AS 15 to extent they deal with **recognition and measurement of short-term accumulated compensating absences.**
   Discounting the amount payable after 12 months of balance sheet as regards defined contribution plans and termination benefits.

   SMCs need not disclose diluted EPS as per <u>AS 20 "Earnings Per Share".</u>

   SMCs are exempt from disclosure requirements of paras 66 and 67 of AS 29 "Provisions, Contingent Liabilities and Contingent Assets" **regarding provisions and its descriptions.**

   As per Rule 5 of the Companies (Accounting Standards) Rules, 2006, an **existing company**, which was previously not an SMC and subsequently becomes an SMC, shall **not be qualified** for exemption or relaxation in respect of accounting standards available to an SMC **until the company remains an SMC for two consecutive accounting periods**.
2. M/s Omega & Co. (a partnership firm), had a turnover of Rs. 1.25 crores (excluding other income) and borrowings of Rs. 0.95 crores in the previous year. It wants to avail the exemptions available in application of Accounting Standards to non-corporate entities for the year ended 31.3.2013. Advise the management of M/s Omega & Co in respect of the exemptions of provisions of ASs, as per the directive issued by the ICAI.
   ANS:
   Discussed in class

AS 1

3. X Limited has sold its building for Rs. 50 lakhs to the purchaser who has paid the full price. Company has given possession to the purchaser. The book value of the building is Rs. 35 lakhs. As at 31st March, 2013, documentation and legal formalities are pending. The company has not recorded the disposal. It has shown the amount received as advance. Do you agree with this accounting treatment done by X Ltd.? If not, then

suggest the correct accounting treatment in this regard.

ANS:

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

In view of this, X Ltd. should record the sales and recognize the profit of Rs. 15 lakhs in its Statement of Profit & Loss. It should remove building account from its balance sheet. Further, in its 'Notes to Accounts', X Ltd. should disclose the following:

"Building has been sold and full consideration has been received and possession of the same has been handed over to the buyer. However, documentation and legal formalities are pending as on 31.3.2013."

4. FINMIN Ltd. is engaged in the business of financial services and is undergoing tight liquidity position, since most of the assets of the company are blocked in various claim/petitions in a Special Court. FINMIN Ltd. has accepted Inter-Corporate Deposits (ICDs) and is making its best efforts to settle the dues. There were claims at varied rates of interest from lenders from the due date of ICDs to the date of repayment. The company has provided interest, as per the terms of the contract till the due date and a note for non provision of interest from the due date to date of repayment was affected in the financial statements. On account of uncertainties existing regarding the determination of the amount and in the absence of any specific legal obligation at present as per the terms of contracts, the company considers that these claims are in the nature of "claims against the company not acknowledged as debt," and the same has been disclosed by way of a note in the accounts instead of making a provision in the Statement of profits and loss. Comment on the correctness of the treatment for such claims as done by the company.

ANS:

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

Further, '**accrual' is one of the fundamental accounting assumptions** as per AS 1.

Irrespective of the terms of the contract, so long as the principal amount of a loan is not repaid, the lender cannot be placed in a disadvantageous position for non-payment of interest in respect of claim for interest from the due date to date of repayment of loan.

From the aforesaid, it is apparent that the company **should provide for the liability** (since it is not waived by the lenders) at an amount estimated or on reasonable basis based on facts and circumstances of each case. **Non-provision of the interest from the**

due date to the date of repayment of loan amounts to violation of accrual basis of accounting.

AS 2

5. From the following information, ascertain the value of stock as on 31st March, 2013:

Stock as on 01.04.2012	28,500
Purchases	1,52,500
Manufacturing Expenses	30,000
Selling Expenses	12,100
Administration Expenses	6,000
Financial Expenses	4,300
Sales	2,49,000

At the time of valuing stock as on 31st March, 2012 a sum of Rs. 3,500 was written off on a particular item, which was originally purchased for Rs. 10,000 and was sold during the year for Rs. 9,000. Barring the transaction relating to this item, the gross profit earned during the year was 20% on sales.

ANS:

Statement showing valuation of stock as on 31.3.2013

	Rs.	Rs.
Stock as on 01.04.2012	28,500	
Less: Book value of abnormal stock		
(Rs. 10,000 – Rs. 3,500)	(6,500)	22,000
Add: Purchases		1,52,500
Manufacturing Expenses		30,000
Less: Cost of Sales:		
Sales as per Books	2,49,000	
Less: Sales of Abnormal item	(9,000)	
	2,40,000	
Less: G.P. @ 20%	(48,000)	(1,92,000)
Value of Stock as on 31st March, 2013		12,500

6. 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.

ANS:

Accounting Standard 2 "Valuation of Inventories" states that inventories should be valued at lower of historical cost and net realisable value. AS 9 on "Revenue Recognition" 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 assured 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.

7. The closing inventory at cost of a Company amounted to Rs. 9,56,700. The following items were included at cost in the total:

(i) 350 Shirts, which had cost Rs. 380 each and normally sold for Rs. 750 each. Owing to a defect in manufacture, they were all sold after the balance sheet date at 50% of their normal price. Selling expenses amounted to 5% of the proceeds.

(ii) 700 Trousers, which had cost Rs. 520 each. These too were found to be defective. Selling expenses for the batch totaled Rs. 3,800. They were sold for Rs. 950 each.

What should be the closing inventory value (to the nearest rupee), after considering the above items?

Calculation of value of closing inventory:

ANS:

Value of closing inventory (given)	9,56,700
Less: Adjustment to bring the stock of shirts at net realizable value (W.N.1)	(8,313)
Revised value of closing inventory as per AS 2	9,48,387

Working Notes:

1. Valuation of Shirts as per AS 2

Cost price (per shirt)			
Net realizable value per shirt :			
Selling price of a shirt	Rs. 750 ×	375.00	

	50% =		
Less : Selling expense	(5% of Rs. 375) =	(18.75)	
NRV of a shirt		356.25	
As per AS 2, inventories are valued at cost or NRV whichever			(356.25)
Difference of cost and NRV			
Therefore, value of inventory of shirts is to be reduced by Rs. 8,313 (Rs. 23.75 x 350 shirts)			

2. Valuation of Trousers as per AS 2

Cost price (per trouser)		520
NRV per trouser:		
Selling price of a trouser	Rs. 950.00	
Less: Selling expense of a trous (Rs. 3,800/700)	Rs. (5.43)	
NRV of a trouser	Rs. 944.57	
As per AS 2, inventories are valued at cost or NRV whichever is less.		520
Since, inventory of trousers is already carried at cost, no further adjustment is required in the total value of closing inventories.		

AS 3

8. Garden Ltd. acquired fixed assets viz. plant and machinery for Rs.20 lakhs. During the same year it sold its furniture and fixtures for Rs.5 lakhs. Can the company disclose, net cash outflow towards purchase of fixed assets in the cash flow statement as per AS-3?

   ANS:

   According to Para 21 of AS 3 (Revised) 'Cash Flow Statements', an enterprise should **report separately major classes of gross cash receipts and gross cash payments** arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22 and 24 are reported on a net basis. Acquisition and disposal of fixed assets is not prescribed in para 22 and 24 of the standard. Hence, the company cannot disclose net cash flow in respect of acquisition of plant and machinery and disposal of furniture and fixtures.

9. Classify the following under operating, financing and investing activity as per AS 3 (Revised)

(i) Interest and dividends received by financial institutions .
(ii) Redemption of preference share capital.
(iii) Receipt from trade debtors.
(iv) Payment for acquisition of long term assets.
(v) Payment to employees.
(vi) Dividend paid to shareholders.
(vii) Acquisition of equity or debt securities.

ANS:

Operating activity – (i), (iii), (v) Financing activity – (ii), (vi) Investing activity – (iv), (vii)

AS 4

10. A company deals in petroleum products. The sale price of petrol is fixed by the government. After the Balance Sheet date, but before the finalization 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.

ANS:

According to para 8 of AS 4, the unexpected increase in sale price of petrol by the government after the balance sheet date 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. The retrospective increase in the petrol price should not be considered as a prior period item, as per AS 5, because there was no error in the preparation of previous period's financial statements.

11. 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.

ANS:

According to para 8 of AS 4 (Revised 1995), the **unexpected increase** in sale price of petrol by the government after the balance sheet date **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. The retrospective increase in the petrol price should not be considered as a prior period item, as per AS 5, because there was no error in the preparation of previous period's financial statements.

12. A company has filed a legal suit against the debtor from whom Rs. 15 lakh is recoverable as on 31.3.2012. The chances of recovery by way of legal suit are not good as per legal opinion given by the counsel in April, 2012. Can the company provide for full amount of Rs. 15 lakhs as provision for doubtful debts? Discuss in detail.

ANS:

As per para 13 of AS 4 "Contingencies and Events Ocurring After the Balance Sheet Date", **assets and liabilities should be adjusted** for events occurring after the balance sheet date **that provide additional evidence** to assist the estimation of amounts **relating to conditions**

existing at the balance sheet date.

In the given case, company should make the provision for doubtful debts, as legal suit has been filed on 31st March, 2012 and the chances of recovery from the suit are not good. Though, the actual result of legal suit will be known in future yet situation of non-recovery from the debtors exists before finalisation of financial statements. Therefore, provision for doubtful debts should be made for the year ended on 31st March, 2012.

13. During the year 2012-2013, Raj Ltd. was sued by a competitor for Rs. 15 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Raj Ltd. provided for a sum of Rs. 10 lakhs in its financial statements for the year ended 31st March, 2013. On 18th May, 2013, the Court decided in favour of the party alleging infringement of the trademark and ordered Raj Ltd. to pay the aggrieved party a sum of Rs. 14 lakhs. The financial statements were prepared by the company's management on 30th April, 2013, and approved by the board on 30th May, 2013.Should Raj Ltd. adjust its financial statements for the year ended 31st March, 2013? What whould be the treatment of the above, in case the court decision was held on 1st June, 2013.

ANS:

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.

In the given case, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 2012-13 for which the provision was also made by it, the decision of the Court on 18th May, 2013, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Raj Ltd. should adjust the provision upward by Rs. 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

Had the judgment of the Court been delivered on 1st June, 2013, it would be considered as post reporting period i.e. event occurred after the approval of the financial statements. In that case, no adjustment in the financial statements of 2012-13 would have been required.

AS 5

14. (a) Give two examples on each of the following items:

(i) Change in Accounting Policy

(ii) Change in Accounting Estimate

(iii) Extra Ordinary Items

(iv) Prior Period Items.

ANS:

i) <u>Examples of Changes in Accounting Policy:</u>

a. Change of depreciation method from WDV to SLM and vice-versa.

b. Change in cost formula in measuring the cost of inventories.

(ii) <u>Examples of Changes in Accounting Estimates:</u>

a. Estimation of provision for doubtful debts on sundry debtors / trade receivables.

b. Estimation of useful life of fixed assets.

(iii) Examples of Extraordinary items:

a. Loss due to earthquakes / fire / strike.
b. Attachment of property of the enterprise.

(iv) Examples of Prior period items:

a. Applying incorrect rate of depreciation in prior periods.
b. Omission to account for income or expenditure in one or more prior periods.

AS 6

15. A plant was depreciated under two different methods as under:

Year	SLM (Rs. in lakhs)	W.D.V. (Rs. in lakhs)
1	7.80	21.38
2	7.80	15.80
3	7.80	11.68
4	7.80	8.64
5	7.80	6.38

What should be the amount of resultant surplus/deficiency, if the company decides to switch over from W.D.V. method to SLM method for first four years? Also state, how will you treat the same in Accounts.

ANS:

As per para 21 of AS 6 on Depreciation Accounting, when a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. In the given case, there is a surplus of Rs. 26.30 lakhs on account of change in the method of depreciation, which will be credited to Profit and Loss Account. Such a change should be treated as a change in accounting policy and its effect **should be quantified and disclosed.**

AS 6 and Guidance Note on Accounting for Depreciation in Companies

16. Topsy Ltd. has two divisions. It provides depreciation for both the divisions on straight line basis as per the rates prescribed by Schedule XIV to the Companies Act. While finalizing the accounts for the year ended 31.3.2012, the company wants to change the method to Written Down Value method for one of its divisions as the management thinks that the assets of the said division suffer faster wear and tear. Please advise the company on the above and also state whether the change should be prospective or retrospective?

ANS:

According to the Guidance Note on 'Accounting for Depreciation in Companies', 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 in accordance with Section 205(2) of the Companies Act.

According to provisions of AS 5 and AS 6, such a change is permissible only when at least one of the following three conditions is satisfied

(i) Such change is required by law;
(ii) Such change is required for compliance with an accounting standard;
(iii) Such change will result in more appropriate preparation or presentation of the financial statements of the enterprise.

Here, from the facts given it appears that condition (iii) is satisfied i.e., change will lead to more appropriate presentation (since, WDV method better represents pattern of wear and tear instead of SLM).

According to para 15 of AS 6 'Depreciation Accounting', when such a change in the method of depreciation is made, depreciation is recalculated in accordance with the new method from the date of the asset coming into use i.e. the change should be retrospective. Any difference arising thereon should be charged / credited to the Statement of Profit and Loss in the year of change. Such a change in the method of depreciation is considered as a change in the accounting policy and its effect is quantified and disclosed.

AS 7 Construction Contract

17. Speedy Construction Ltd. has recognised contract revenue on a contract awarded in the financial year 2012-13. The target period of completion is 5 years. The contract provides for incentives for early completion at the rate of Rs. 1,000 per day subject to a maximum of Rs. 3,00,000. The company has included this amount in contract revenue on the ground that based on the previous experience in similar contracts, it is confident of completing the contract in 4 years. The company's past track record shows that company was able to complete such contracts well in time and earn incentives. Comment on the company's accounting policy for recognition of such incentives.

ANS:

According to para 14 of AS 7 (Revised), 'Construction Contracts', **incentive payments are included in contract revenue only when**

a. the contract is <u>sufficiently advanced</u> that it is probable that the specified performance standards will be met or exceeded; and
b. the <u>amount of the incentive</u> payment can be <u>measured reliably.</u>

In the given case, the contract is **not sufficiently advanced as it is in the first year of construction and its normal time for cnstruction is 4 to 5 years.**

Further, the **<u>past track record is not the criteria for recognition</u>** of incentive payments receivable for early completion of the contract.

Since, the recognition criteria's are not met, it is inappropriate to recognize incentive payments in the current year as part of contract revenue. Therefore, Speedy Construction Ltd.'s accounting policy to recognise incentive payments in the first year of construction as contract revenue, based on past performance, is not in accordance with AS 7.

18. Trustworthy Ltd. is a construction company, well known for its expertise in building flyovers and maintaining these structures. Impressed with Trustworthy Ltd.'s track record, the local municipal authorities have awarded them a contract for two years to build a super flyover in the heart of the city (the largest in the region) and another contract for maintenance of the flyover for ten years after completion of the construction. Payment for both the contracts is paid considering it as a single package.

Evaluate whether these two contracts should be segmented or combined into one contract for the purpose of AS 7.

ANS:

As per para 8 of AS 7 'Construction Contracts', a group of contracts with a single customer, should be treated as a single construction contract when:

(i) the group of contracts is **negotiated as a single package**

(ii) the contracts are so **closely interrelated** that they are, in effect, part of a **single project with an overall profit margin** and

(iii) the contracts are **performed concurrently** or in a continuous sequence.

Accordingly, in the given case, the two contracts should be combined and treated as a single contract since they meet all the three criteria stated above.

19. On 1st December, 2008, Vishwakarma Construction Co. Ltd. undertook a contract to construct a building for Rs. 85 lakhs. On 31st March, 2009 the company found that it had already spent Rs. 64,99,000 on the construction. Prudent estimate of additional cost for completion was Rs. 32,01,000. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2009 as per provisions of Accounting Standard 7 (Revised)?

ANS

	Rs.
Cost incurred till 31st March, 2009	64,99,000
Prudent estimate of additional cost for completion	32,01,000
Total cost of construction	97,00,000
Less: Contract price	85,00,000
Total foreseeable loss	12,00,000

According to para 35 of AS 7 (Revised 2002), the amount of Rs. 12,00,000 is required to be recognized as an expense.

Contract work in	Rs. 64,99,000 *100	= 67%

progress =	97,00,000

Proportion of total contract value recognized as turnover as per para 21 of AS 7 (Revised) on Construction Contracts.
= 67% of Rs.85,00,000 = Rs.56,95,000.

20. 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 Rs.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.

ANS:
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.

AS 9

21. Sahara Ltd. is in regular business with Railways and dealings with them are shown in its financial statements as ordinary activities of the business. A claim was lodged by it, with the Railways in March, 2010 for loss of goods of Rs. 2,00,000. The claim had been passed for payment in March, 2013 for Rs. 1,50,000. No entry was passed in the books of the company, when the claim was lodged. Advise Sahara Ltd. about the treatment of the above in the final statement of accounts for the year ended on 31st March, 2013.

ANS:

Para 9 of AS 9 'Revenue Recognition' states that where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. Further it also states that when recognition of revenue is postponed due to effect of uncertainties, it is considered as revenue of the period in which it is properly recognized. In this case it may be assumed that liability of claim was not certain in the earlier periods i.e. in years 2009-10, 2010-11 and 2011-12. This is also evident from the fact that only Rs. 1,50,000 were collected against a claim of Rs. 2,00,000. So this transaction cannot be taken as a prior period item.

Since dealings with the Railways are an ordinary business activities for Sahara Ltd., it will not be treated as extraordinary item as per para 4.2 of AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'. However, para 12 of AS 5 states that when items of income and expense within profit and loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of enterprises for the period, the nature and amount of such items should be disclosed separately. Accordingly, the nature and amount of this claim should be disclosed separately in the financial statements of Sahara Ltd. for the year ended 31st March, 2013.

22. Y Co. Ltd., used certain resources of X Co. Ltd. In return X Co. Ltd. received Rs. 10 lakhs and Rs. 15 lakhs as interest and royalties respective from Y Co. Ltd. during the year 2007-08. You are required to state whether and on what basis these revenues can be recognised by X Co. Ltd.

ANS:

As per para 13 of AS 9 on Revenue Recognition, revenue arising from the use by others of enterprise resources yielding interest and royalties should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognised on the following bases:

(i) Interest: on a **time proportion basis** taking into account the amount outstanding and the rate applicable.

(ii) Royalties: on an **accrual basis** in accordance with the terms of the relevant agreement.

23. Perfect Ltd. manufactures machinery used in Power Plants. In response to the tenders issued by Power Plants, Perfect Ltd. quotes its price. As per terms of contract, full price of machinery is not released by the power plants, but 10% thereof is retained and paid after one year if there is satisfactory performance of the machinery supplied. From the past experience, it is observed that Perfect Ltd. normally performs satisfactorily and fulfills the expectations of the Power Plants. Perfect Ltd. accounts for only 90% of the invoice value as sales revenue and book the balance amount in the year of receipt to the extent of actual receipts only. Comment on the treatment done by the company.

ANS:

As per para 11 of AS 9, 'Revenue Recognition', revenue from sale of goods should be recognised when:

(i) the seller has transferred the property in the goods to the buyer for a consideration and the transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer and the seller retains no effective control of the goods transferred; and

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

In the present case, the goods, as well as the risks and rewards of ownership have been transferred to the power plants. Since, the invoice raised by Perfect Ltd. is for the full price (though it receives only 90% of the invoice value in the year of sale and 10% is kept as 'Retention Money'), Perfect Ltd. should recognise revenue at the full invoice price, i.e., 100% of the sales price. The company should make a separate provision for the balance 10% amount to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

Therefore, the practice adopted of recognising only 90% of sales price as revenue by Perfect

Ltd. is not in consonance with AS 9.

AS 10

24. ABC Ltd. gave 50,000 equity shares of Rs.10 each (fully paid up) in consideration for supply of certain machinery by X & Co. The shares exchanged for machinery are quoted on Bombay Stock Exchange (BSE) at Rs.15 per share, at the time of transaction. In the absence of fair market value of the machinery acquired, how the value of machinery would be recorded in the books of the company?

ANS:

As per paragraph 22 of AS 10 'Accounting for Fixed Assets' , fixed asset acquired in exchange for shares or other securities in the enterprise should be recorded at its fair market value, or the fair market value of the securities issued, whichever is more clearly evident. Since, the market value of the shares exchanged for the asset is more clearly evident, the company should record the value of machinery at Rs.7,50,000. (i.e., 50,000 shares of Rs.15 per share being the market price)

25. Value Ltd. acquired a plant on 1.4.2004 for Rs. 100 lakhs. The company charges straight line depreciation on the basis of estimated useful life of the asset as 10 years and scrap value at the end as 2.5% of the cost. At the beginning of the 5th year, the asset was revalued upward by 40% of the written down value and the revaluation profit was transferred to Revaluation Reserve. While charging depreciation after revaluation, estimated remaining useful life was assumed to be 6 years and scrap realisation was expected to be 2.5% of the revalued figure. No additional depreciation was adjusted through Revaluation Reserve account. At the beginning of the 8th year the company found the asset useless and accordingly, decided to retire it. On the date of retirement the estimated realisable value of the asset is Rs. 3,80,000. Ascertain the loss on retirement of the asset to be charged to the Statement of Profit and Loss.

ANS:

Table showing computation of net loss on retirement of a revalued asset of Value Ltd.

Particulars	Rs.
Original cost	1,00,00,000
Less: SLM depreciation up to 4th year $\frac{1,00,00,000 - 2,50,000 \times 4}{10}$	(39,00,000)
Net book value at the end of 4th year or at the Beginning of 5th year	61,00,000
Add: Revaluation profit (credited to Revaluation	24,40,000
Revised carrying a	85,40,000
Revised residual value (2.5% of 85,40,000) = Rs. 2,13,500	
Less: Depreciation for 5th, 6th and 7th years $\frac{85,40,000 - 2,13,500 \times 3 \text{ years}}{6 \text{ years}}$	(41,63,250)

Net book value at the end of 7th year or at the Beginning of 8th year	43,76,750
Net realizable value on date of retirement	(3,80,000)
Loss on retirement of plant	39,96,750
Less: Revaluation reserve	(24,40,000)
Net loss charged to Statement of Profit and Loss	15,56,750

26. PQR Ltd. constructed a fixed asset and incurred the following expenses on its construction:

	Rs.
Material	16,00,000
Direct Expenses	3,00,000
Direct Labour (1/15th of the total labour time was chargeable to the construction)	6,00,000
Total Office & Administrative Expenses (4% is specifically attributable to the construction of a fixed asset)	9,00,000
Depreciation on assets used for the construction of fixed asset	15,000

Calculate the cost of the fixed asset.

ANS:

Calculation of cost of fixed assets

	Rs.
Material	16,00,000
Direct expenses	3,00,000
Direct labour (1/15th of Rs. 6,00,000)	40,000
Office and administrative expenses (4% of Rs. 9,00,000)	36,000
Depreciation on assets used for the construction of this asset	15,000
Cost of fixed assets constructed	19,91,000

AS 11 The Effects of Changes in Foreign Exchange Rates

27. Option Ltd. is engaged in the manufacturing of steel. For its steel plant, it required machineries of latest technology. It usually resorts to Long Term Foreign Currency Borrowings for its fund requirements. On 1st April, 2011, it borrowed US $1 million from International Funding Agency, USA when exchange rate was 1 $ = Rs. 52. The funds were used for acquiring machineries on the same date to be used in three different steel plants. The useful life of the machineries is 10 years and their residual value is Rs. 2,00,000.

Earlier also the company used to purchase machineries out of foreign borrowings. The exchange differences arising on such borrowings were charged to profit and loss account and were not capitalised even though the company had an option to capitalise it as per notified AS

11 (notification issued by the MCA in 2009).

Now for this new purchase of machinery, Option Ltd, is interested to avail the option of capitalising the same to the cost of asset. Exchange rate on 31st March, 2012 is 1 US $ = Rs. 51. Assume that on 31st March, 2012, Option Ltd. is not having any old Long term foreign currency borrowings except for the amount borrowed for machinery purchased on 1st April, 2011.

Can Option Ltd. capitalise the exchange difference to the cost of asset on 31st March, 2012? If yes, then calculate the depreciation amount on machineries as on 31st March, 2012.

Would your answer differ, if Option Ltd. was not a company and was a LLP?

ANS:

Ministry of Corporate Affairs, Government of India, inserted paragraph 46A in notified AS 11 by Notification dated 29th December, 2011, which is relevant for companies. It states that in respect of accounting periods commencing on or after 1st April, 2011, for an enterprise which had earlier exercised the option under paragraph 46 or not (such option to be irrevocable and to be applied to all such foreign currency monetary items), the exchange differences arising on reporting of long term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset.

Accordingly, though Option Ltd. had not earlier exercised the option as given by the notification on AS 11, issued in 2009, yet it can avail the option to capitalise the exchange difference to the cost of machinery by virtue of para 46A inserted in the notified AS 11 in December, 2011.

Exchange difference to be capitalised

Cost of the asset in $		$ 10 lakhs
Exhange rate on 1st April, 2011		Rs. 52 = 1$
Cost of the asset in Rs.	($ 10 lakhs x Rs. 52)	520 lakhs
Less: Exchange differences as on 31st March, 2012 (52-51) x $ 1 million	(Gain)	(10 lakhs)
		510 lakhs
Less: Depreciation for 2011-12	(510 lakhs - 20 lakhs)/10 years	(49 lakhs)
		461 lakhs

Notification number G.S.R 914(E), dated 29th December, 2011, is relevant only for companies. If Option Ltd. is a LLP, then this notification is not applicable and it can not capitalise the exchange difference to the cost of the machinery. The amount recognised to Profit and Loss account would be Rs. 10 lakhs.

28. Explain briefly the accounting treatment needed in the following cases as per AS 11 'The Effects of Changes in Foreign Exchanges Rates'.
Sundry Debtors include amount receivable from Ted Rs. 5,00,000 recorded at the prevailing exchange rate on the date of sales, transactions recorded at $1 = Rs. 38.70

Long term loan taken from a U.S. Company, amounting to Rs. 60,00,000. It was recorded at $1 = Rs. 35.60, taking exchange rate prevailing at the date of transactions.

Another long term loan was there in Pound Sterling for purchase of machinery amounting to Rs. 10,00,000. It was recorded at Pounds Rs. 62.80.

Exchange rates at the end of the year were as under:

$1 Receivable = Rs. 45.80

ANS:
AS 11, The "Effects of Changes in Foreign Exchange Rates" provides that exchange differences attributable to monetary items should be taken to Profit and Loss account. In case the option under para 46A is exercised, the exchange differences arising on long-term foreign currency monetary items can be adjusted in the cost of the depreciable capital asset or in other cases parked in Foreign Currency Monetary Item Translation Difference Account and amortised.

Item 1. Sundry Debtors: This is a monetary item.

Particulars	Foreign currency	Rate	Rupees
Initial recognition	US $12,919.90	38.70	5,00,000
Rate on B/S date		45.80	
Exchange Difference	US $12,919.90	7.10	91,731
Gain or loss			Gain
Treatment			Credit P/L Rs. 91,731

Item 2. Long Term loan

Particulars	Foreign currency	Rate	Rupees
Initial recognition	US $ 1,68,539.33	35.60	60,00,000
Rate on B/S date		45.90	
Exchange Difference	US $ 1,68,539.	10.30	17,35,955
Gain or loss			Loss
Treatment			Debit P/L Rs.

			17,35,955 or transfer to FCMITD A/c and amortise

Item 3. Loan for acquisition of a depreciable capital

Particulars	Foreign curren	Rate	Rupees
Initial recognition	P.St. 15,923.57	62.80	10,00,000
Rate on B/S date		72.30	
Exchange Difference	P.St. 15,923.57	9.50	1,51,274
Gain or loss			Loss
Treatment			Debit P/L Rs. 1,51,274 or adjust in the cost of the asset and depreciate accordingly.

AS 13 Investments

29. Take Ltd. has borrowed Rs. 30 lakhs from State Bank of India during the financial year 2011-12. The borrowings are used to invest in shares of Give Ltd., a subsidiary company of Take Ltd., which is implementing a new project, estimated to cost Rs. 50 lakhs. As on 31st March, 2012, since the said project was not complete, the directors of Take Ltd. resolved to capitalize the interest accruing on borrowings amounting to Rs. 4 lakhs and add it to the cost of investments. Comment.

ANS:

As per para 9 of AS 13 "Accounting for Investments", the cost of investment includes acquisition charges such as brokerage, fees and duties. In the present case, Take Ltd. has used borrowed funds for purchasing shares of its subsidiary company Give Ltd. Rs. 4 lakhs interest payable by Take Ltd. to State Bank of India cannot be called as acquisition charges, therefore, cannot be constituted as cost of investment.

Further, as per para 3 of AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Since, shares are ready for its intended use at the time of sale, it cannot be considered as qualifying asset that can enable a company to add the borrowing cost to investments. Therefore, the directors of Take Ltd. cannot capitalise the borrowing cost as part of cost of investment. Rather, it has to be charged to the Statement of Profit and Loss for the year ended 31st March, 2012.

30. An unquoted long term investment is carried in the books at a cost of Rs. 2 lakhs. The published accounts of the unlisted company received in May, 2006 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than Rs. 20,000. How will you deal with this in preparing the financial statements

of R Ltd. for the year ended 31st March, 2006?

ANS:

As it is stated in the question that financial statements for the year ended 31st March, 2006 are under preparation, the views have been given on the basis that the financial statements are yet to be completed and approved by the Board of Directors.

Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. Para 17 of AS 13 'Accounting for Investments' states that 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. On these bases, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to Rs. 20,000 in the financial statements for the year ended 31st March, 2006.

31. X Ltd. on 1-1- 2012 had made an investment of Rs. 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 Rs. 200 lakhs as Y Ltd. lost a case of copyright. From the given market conditions, it is apparent that the reduction in the value is permanent in nature. How will you recognize the reduction in financial statements for the year ended on 31-3-2012?

ANS: As per para 21 of AS 12, amount refundable in respect of a grant related to revenue should be applied first against any unamortised deferred credit remaining in respect of the grant. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

(i) In this case the grant refunded is Rs. 300 lakhs and balance in deferred income is Rs. 210 lakhs, therefore, Rs. 90 lakhs shall be charged to the profit and loss account for the year 2012-13. There will be no effect on the cost of the fixed asset and depreciation charge will be same as charged in the earlier years.

(ii) As per para 21 of AS 12, the amount refundable in respect of grant which was related to specific fixed assets should be recorded by increasing the book value of the assets by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case the book value of the plant shall be increased by Rs. 300 lakhs. The increased cost of Rs. 300 lakhs of the plant should be amortised over 7 years (residual life). Depreciation charged during the year 2012-13 shall be 1200/10 + 300/7 = Rs. 162.86 lakhs.

32. Accounting for investment by a holding company in subsidiaries.

ANS:

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 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) are carried normally at cost.

33.(a) Explain the nature of classification and disclosure requirements in the Statement of profit and loss account of an entity in case of disposal of long-term investment of a trading entity in accordance with AS 13.

ANS:

(a) As per AS 13, in case of disposal of a long-term investment, the difference between the carrying amount and net disposal proceeds should be charged / credited to profit and loss account.

Also, AS 5 requires that all items of income and expense, which are recognized in a period, should be included in the determination of net profit or loss for the period. It also requires separate disclosure of the nature and amount of such items of income and expense within profit or loss from ordinary activities, which by their size, nature or incidence require disclosure to explain the enterprise's performance for the period.

Since the company is a trading entity (i.e. in commodities), disposal of long- term investments falls in the category of special items (as per AS 5). Hence, its nature and amount should be disclosed separately. This disclosure will also comply with AS –13.

AS 16 Borrowing Cost

34.PRM Ltd. obtained a loan from a bank for Rs. 50 lakhs on 30-04-2005. It was utilized as follows:

in lakhs)

of a shed

a machinery

pital

purchase of truck

Construction of shed was completed in March 2006. The machinery was installed on the same date. Delivery truck was not received. Total interest charged by the bank for the year ending 31-03-2006 was Rs.18 lakhs. Show the treatment of interest.

ANS:
Qualifying Asset as per AS-16 = Rs. 50 lakhs (construction of a shed) Borrowing cost to be capitalized = 18X 50/120 =Rs. 7.5 lakhs Interest to be debited to Profit or Loss account = Rs. (18 – 7.5) lakhs = Rs. 10.5 lakhs

35. Write short note on Treatment of borrowing costs.
ANS:
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.

(A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.)

AS 17

36. 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?
ANS:
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.

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

				Rs. 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.

ANS

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

				Rs. 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.

ANS:

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.

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

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

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.

38. From the following information of a company having two primary segments, prepare a statement classifying the same under appropriate heads:

		(Rs. in lakh)
Segment Revenue	A	27,050
Segment Revenue	B	3,280
Inter Segment Revenue	A	50
Segment Profit	A	4,640
Segment Profit	B (Loss)	197
Dividend Income		285
Interest expenses		35
Tax Provision		1,675
Capital Expenditure	A	1,300
Capital Expenditure	B	16
Non Cash Expenses (excluding depreciation)		
Segment	A	114
Segment	B	16
Liabilities	A	3,430
Liabilities	B	770
Other Liabilities		2,200
Assets	A	19,450
Assets	B	2,700
Other Assets		6,550
Depreciation	A	110
Depreciation	B	15

ANS:

			(Rs. in lakhs)	(Rs. in lakhs)
I	**Segment Revenue**	A	27,050	
	Inter segment		50	
			27,100	
		B	3,280	30,380
	Less: Inter segment Revenue			50
				30,330
II	**Segment Results**			
	A (Profit)		4,640	
	B (Loss)		197	

	Operating Profit			4,443		
	Interest expenses			(35)		
	Dividend Income			285		
	Tax Provision			(1,675)		
	Profit after tax			**3018**		
III	**Other Information**					
	(a)	**Segment Assets**	A	19,450		
			B	2,700		
				22,150		
	Unallocated Assets			6,550		
				28,700		
	(b)	**Segment liabilities**	A	3,430		
			B	770		
				4,200		
	Unallocated liabilities			2,200		
				6,400		
	(c)	Capital expenditure	A	1,300		
			B	16		
				1,316		
	(d)	Depreciation	A	110		
			B	75		
				185		
	Non Cash expenses		A	114		
			B	16		
				130		

39. Comment whether other income like (i) export incentives; and (ii) interest from customers should be considered/included as segment revenue or not as per AS 17.

ANS:

As per para 5 of AS 17 'Segment Reporting', enterprise revenue is revenue from sales to external customers as reported in the statement of profit and loss and segment revenue is the aggregate of:

(i) the portion of enterprise revenue that is directly attributable to a segment,

(ii) the relevant portion of enterprise revenue that can be allocated on a reasonable basis to a segment, and

(iii) revenue from transactions with other segments of the enterprise. Further as per the definition segment revenue excludes:

(a) extraordinary items as defined in AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies;

(b) interest or dividend income, including interest earned on advances or loans to other segments unless the operations of the segment are primarily of a financial nature; and
(c) gains on sales of investments or on extinguishment of debt unless the operations of the segment are primarily of a financial nature.

Accordingly, other income should be included as part of the segment revenue if they do not fall under the exclusion definition and if it is essentially operating in nature. Other income will have to be analyzed into what is operating and non-operating, i.e. what belongs to be segment and what does not. Segment result is the difference between segment revenue and segment expenses and therefore includes income incidental to external turnover or the main activity of the segment. Export incentives are price subsidies for achieving exports in a fiercely competitive export market. Therefore they are indirectly a component of export turnover and should be included in segment revenue.

Non-operating interest should be excluded from segment revenue. However, interest received from customers due to delay in making payment is an operating income. Segment assets are those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Since receivables are part of the segment asset. The related income should be included in segment revenue.
(Please note interest received from customer for delayed payment is other income and not operating income in Revised Schdule VI- This is one of the area where AS does not supersede RS VI as preferred by guidance note on RS VI)

AS 18

40. Kismis Ltd. is a 100% subsidiary of Kaju Ltd. Which of the followings are related party transactions for the purpose of consolidated financial statements?
(i) Salary paid to employees of Kismis Ltd.
(ii) Loans given to employees of Kaju Ltd.
(iii) Inter-company sales between Kaju Ltd. and Kismis Ltd.
(iv) Loan given by Kismis Ltd. to managing director of Kaju Ltd.
(v) Transfer of Asset by Kaju Ltd. to Kismis Ltd.

ANS:

As per para 3 of AS 18 'Related Party Disclosures', employees are not considered as Related Party for an entity. Salaries and loans given to employees are in the course of normal dealings of business. Therefore, the first two transactions cannot be considered as related party transactions.

As per para 3(a) of the standrad, holding and subsidiary companies are said to be related parties since they are said to be under common control for the purpose of consolidated financial statements. Therefore, 'inter-company sales between holding and subsidiary companies' is a related party transaction. However, as per para 7 of the standard, no disclosure is required for the same in consolidated financial statements.

Since, managing director of Kaju Ltd. directly or indirectly owns an interest in the voting power of the reporting enterprise that gives him control or significant influence over its subsidiary Kismis Ltd., the loan given to him by Kismis Ltd. will be treated as related party transaction.

Since, holding and subsidiary companies are said to be related parties as per para 3(a) of the standard, transfer of asset by holding company Kaju Ltd. to its subsidiary Kismis Ltd. will be considered as related party transaction.

41. 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?

ANS:

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 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, 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. Hence, related party disclosure, as per AS 18, is required.

42. Narmada Ltd. sold goods for Rs.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?

ANS:

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.

43. 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?

ANS:

P Ltd. has direct economic interest in R Ltd to the extent of 14%, and through Q Ltd. in which it is the majority shareholder, 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%.

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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, 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. Hence, related party disclosure, as per AS 18, is required.

44. X Limited is a wholly owned subsidiary of Z Limited and a 50% co-venturer in joint venture XY. Whether transactions between joint venture XY and Z would require disclosures?

ANS:

As per para 3(a) of AS 18 "Related Party Disclosures", enterprises that directly or indirectly through one or more intermediaries, control or are controlled by, or are under common control with the reporting enterprise are said to be in related party relarionships.

Control is defined as to include substantial interest in voting power and the power to direct, by statute or agreement, the financial and/ or operating policies of the enterprise.

In the given case, Z Limited controls X Limited, due to holding subsidiary relationship. X Limited is a 50% co-venturer and accordingly Z Limited has the joint control over the joint venture XY through X Limited. Hence, transactions between Z Limited and the joint venture may be considered as related party transactions under AS 18.

45. Classify the following into either operating or finance leases.

(i) Ownership of an asset gets vested to the lessee at the end of lease term

(ii) Lessee has option to purchase the asset at lower than fair value, at the end of lease term.

(iii) Economic life of the asset is 5 years, lease term is 4½ years, but asset is not acquired at the end of lease term.

(iv) PV of MLP = "X", Fair value of the asset is Y.

(v) Economic life is 5 years, lease term is 2 years, but the asset is of a special nature, and has been procured only for use of lessee.

ANS:

(i) Finance Lease.

(ii) If it becomes certain at the inception of lease itself that the option will be exercised by the lessee it is a Finance Lease.

(iii) It will still be classified as a finance lease, since substantial portion of the life of the asset is covered by the lease term.

(iv) Where X = Y, or where X substantially equals Y, it is a finance lease.

(v) Since the asset is procured only for the use of lessee, it is a finance lease.

46. 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 Rs. 3,00,000. The amount will be paid in 3 installments and at the termination of lease lessor will get back the equipment. The unguaranteed residual value at the end of 3 years is Rs. 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.

Present value of residual value = Rs. 40,000 *0.7513 = Rs. 30,052 Present value of lease payments = Rs. 3,00,000 – Rs. 30,052 = Rs. 2,69,948.

Refer working note (ii).

	2,69,948
(i)The present value of lease payments	3,00,000

being 89.98%

fair value, i.e. being a substantial portion thereof, the lease constitutes finance lease.

(ii) Calculation of unearned finance income

	Rs.
Gross investment in the lease [(Rs.1,08,552 *3) + Rs. 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.

47.Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being Rs.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 Rs.3,00,000. Guaranteed Residual Value (GRV) is Rs.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.

ANS:

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

PV of MLP

Year	**MLP**	**PV at 15%**	**PV Amount**
	Rs.		Rs.
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

PV of MLP being lower than the fair value, value of machine will be taken as Rs.6,99,054.

Calculation of interest (finance charges)

Year		**Liability**	**Interest at 15%**	**Principal**	**Lease rent**
		Rs.	Rs.	Rs.	Rs.
		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	42,501	2,79,499	3,22,000
3rd	Less: Principal	2,79,499	(Lease rental– Principal)	*(including residual value)	
		Nil			

48. What basic criteria are used for classification of leases into Operating Lease and Finance Lease?

ANS:

Leases are classified based on the extent to which **risks and rewards incident to ownership** of a leased asset lie with the Lessor or the Lessee.

Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return due to changing economic conditions.

Rewards may be represented by the expectation of profitable operation over the economic life of the asset and of gain from appreciation in value or realisation of residual value.

A lease is called a Finance Lease if it transfers substantially all the risks and rewards incident to ownership. Title may or may not eventually be transferred. A lease is called an Operating Lease if it does not transfer substantially all the risks and rewards incident to ownership.

AS 20

From the information furnished you are required to compute the Basic and Diluted EPS for accounting year 01-04-2012 to 31-03-2013 and adjusted EPS for the year 01-04-2011 to 31-03-2012.

Net profit for year ended 31-03-2012	Rs. 75,50,000
Net profit for year ended 31-03-2013	Rs. 1,00,25,000
No. of equity shares as on 01-04-2012	50,00,250
Bonus issue on 01-01-2013	1 share for every 2 held
No. of 12% Convertible Debentures of Rs. 100 each	1,00,000
issued on 01-01-2013	
Conversion ratio of Debentures	10 shares per debenture
Tax rate	30 percent

ANS:

Number of Bonus shares issued as on 1.1.2013

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 2012-13= Rs.1.25	

Net profit for the year ended 31.3.2013	Rs. 1,00,25,000
Weighted average number of equity sha 31.3.2013	(50,00,250 +25,00,125 +5,00,000)

Adjusted earnings per share for the year 2011-12			
Rs. 75,50,000			
=	(50,00,250 +25,00,125 +5,00,000) = Rs. 0.94		
Diluted Earnings Per Share for the year 2012-13			
Interest ~~expense for the current~~ year		= Rs. 12,00,000	
Tax relating to interest expense (30%)		=Rs. 3,60,000	
Adjusted net profit for the current year		=[Rs. 1,00,25,000 + {(12,00,000 x 3/12}]	
		=Rs. 1,02,35,000	

Number of equity shares resulting from conversion of debentures = 1,00,000 x 10 shares = 10,00,000

Number 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 = Rs. 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 2011- 12, the earliest period reported.

AS 22

49. What is the tax effect of sale of fixed assets, considering the block of assets approach followed in the Income-tax Act, 1961?

Company X has a block of assets with a written down value of Rs. 1,00,000 on 1st April, 2011 for tax purposes. The book value of the assets for accounting purposes is also Rs. 1,00,000. The assets are depreciated on written down value basis at 25 per cent per annum for both accounting and tax purposes. Of the entire block, assets costing Rs. 5,000 on April 1, 2011, were sold for Rs. 10,000 on 31st March, 2013. Compute the deferred tax asset/liability assuming tax rate of 40 percent.

ANS:

In the case of Company A, the following computations will be made:

2011-12

In this year, depreciation for both accounting and taxation purposes would be Rs. 25,000 (25 per cent of Rs. 1,00,000). Accordingly, no timing difference arises on this account.

2012-13

Depreciation for the year would Rs. 18,750 (25 per cent of Rs. 75,000) as per the books of account, while for tax purposes it would be Rs. 16,250 as sale proceeds of Rs. 10,000 would be reduced from the block of assets prior to the computation of depreciation. Accordingly, the following timing differences arise:

(i) Depreciation for tax purposes is Rs. 16,250 and for accounting purposes Rs. 18,750 giving rise to a timing difference of Rs. 2,500.

(ii) Profit on sale of fixed asset amounting to Rs. 7,188 (Rs. 10,000 - Rs. 2,812 being the WDV of the asset as on 31^{st} March, 2013) is recognized for accounting purposes. However, for tax purposes this income is not considered. This will result in a timing difference of Rs. 7,188.

The net timing difference would be Rs. 4,688 by which the accounting income would exceed the taxable income, thus requiring creation of a deferred tax liability of Rs. 1,875 (4,688 X 0.4).

The difference of Rs. 4,688 would reverse in future years when depreciation for accounting purposes would be higher as compared to depreciation for tax purposes because depreciation for accounting purposes would be computed on higher carrying amount of fixed assets as compared to carrying amount of those block of assets for tax purposes. Rs. 4,688 is also the difference between the accounting book value and tax written down value of the assets as on 31^{st} March, 2013 [i.e., assets for accounting purposes of Rs. 53,438 (75,000 – 18,750 – 2,812) less block of assets for tax purposes of Rs. 48,750 (75,000 - 10,000 - 16,250)].

50. 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 Rs.200 lakhs and 400 lakhs respectively. From the 3^{rd} year onwards, it is expected that the timing difference would reverse each year by Rs.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.

ANS:

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

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

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

51.Classify the following as “Timing Difference” and “Permanent Difference”.

ANS:

(i) Interest on loans payable to Scheduled Banks not paid during current year but accounted as an expenditure in the books.
(ii) Difference in Depreciation rates as per Income Tax and as per Books.
(iii) Unabsorbed losses.
(iv) Revaluation Reserve.

ANS:

Classification of the items into timing and permanent differences is as under :-

(i) Interest paid to bank is a timing difference.
(ii) Difference in depreciation rates is a timing difference.
(iii) Unabsorbed losses is a timing difference.
(iv) Revaluation Reserve is a permanent difference.

52.The following details are available in the books of ABC Ltd.,

Particulars	Rs. in lakhs
Provision for tax:	
For 2005-2006	200
For 2006-2007	300
For 2007-2008	250

Advance tax paid:	
For 2005-2006	175
For 2006-2007	350
For 2007-2008	270

ABC Ltd. estimates its Deferred Tax Liabilities to be Rs.100 lakhs and its Deferred Tax Assets to be Rs.20 lakhs. How will the above be disclosed?

ANS

Disclosure of Current and Deferred Tax balances will be on the basis of principles laid down in AS-22. These are:

(a) Current tax assets and liabilities can be set off, if the enterprise has a legally enforceable right to set off the recognized amounts and intends to settle them on a net basis.
(b) Deferred tax assets and liabilities can be set off, if the items relate to taxes on income levied by the same governing taxation laws.

Applying these principles, the required disclosures will be as follows:

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Deferred tax liabilities	100		Current assets, loans and advances		
Less:Deferred tax assets	20 80		Advance tax paid	795	

				Less:Provisions	750	45

AS 23

53. X Limited holds 6% shares of Y Limited. Z Limited holds 8% shares of Y Limited. Z Limited is a subsidiary of X Limited, which virtually participate in most of the policy making process of Y Limited. Does X Limited have significant influence over Y Ltd.
Explain?

ANS:

Yes. As per para 4 of AS 23 "Accounting for Investments in Associates in Consolidated Financial Statements", if the investor holds directly or indirectly through subsidiaries, 20% or more of voting power, he is said to have significant influence. In the given case, X Ltd., holds only 14% (directly and indirectly) of the shares of Y Ltd. Although it holds only 14%, it is said to have significant influence because its subsidiary Z Ltd. virtually participate in most of the policy making process of the company. As per para 5, significant influence can be evidenced by participating in policy decision making, therefore, X Ltd. has significant influence over Y Ltd.

54. Disclosure requirements as regards to the investor, where the associate has contingent liabilities.

ANS:

Paragraph 21 of Accounting Standard 23 on Accounting for Investments in Associates says that where the associate has a contingent liability , the investor has to disclose the following in the consolidated financial statements in accordance with AS 4:-

Its share of the contingencies and capital commitments of an associate for which it is also contingently liable; and those contingencies that arise because the investor is severally liable for the liabilities of the associate.

AS 24

55. A cosmetic items producing company provides the following information:

		Fairness Cream	Vanishing Cream
January, 2012 - September, 2012 per month		2,00,000	2,00,000
October, 2012 - December, 2012 per month		2,00,000	3,00,000
January, 2013 - March, 2013 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, 2012 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.

ANS:

Business enterprises frequently close facilities, abandon products or even product lines and reduce the size of their workforce in response to market forces. These kinds of terminations, generally, are not in themselves discontinuing operations unless they satisfy the definition criteria. By gradually reducing the size of operations in the product line of Fairness cream, as given in para 3 of AS 24 "Discontinuing Operations", the company has increased its scale of operations in vanishing cream. Such a change is a gradual or evolutionary, phasing out of a product line or class of services does not meet definition criteria in paragraph 3(a) of AS 24 namely, disposing of substantially in its entirety a component of the enterprise. Hence, this change over is not a discontinuing operation.

AS 25

56. How should the following be recognised and measured in the interim financial statements?

(i) Gratuity and other defined benefit schemes;
(ii) Year-end bonus;
(iii) Income-tax expense;
(iv) Provisions
(v) Foreign currency translation gains and losses.

ANS:

(i) As illustrated in AS 25, 'Interim Financial Reporting', provisions in respect of gratuity and other defined benefit schemes for an interim period are calculated on a 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.

(ii) A year-end bonus is anticipated for interim reporting purposes if, and only if,
(1) the bonus is a legal obligation or an obligation arising from past practice for which the enterprise has no realistic alternative but to make the payments, and
(2) a reliable estimate of the obligation can be made.

(iii) For income-tax expense, apply estimated average annual effective income-tax rate to the pre-tax income of the interim period.

(iv) An enterprise should apply the same criteria for recognising and measuring a provision at an interim date as it would at the end of its financial year.

(v) Foreign currency translation gains and losses are measured for interim financial reporting by the same principles as at financial year end in accordance with the principles as stipulated in AS 11.

57. The accounting year of X Ltd. ends on 30th September, 2006 and it makes its reports quarterly. However for the purpose of tax, year ends on 31st March every year. For the Accounting year beginning on 1-10-2005 and ends on 30-9-2006, the quarterly income is as under:-

1st quarter ending on 31-12-2005	Rs. 200 crores
2nd quarter ending on 31-3-2006	Rs. 200 crores
3rd quarter ending on 30-6-2006	Rs. 200 crores
4th quarter ending on 30-9-2006	Rs. 200 crores
Total	**Rs. 800 crores**

Average actual tax rate for the financial year ending on 31-3-2006 is 20% and for financial year ending 31-3-2007 is 30%. Calculate tax expense for each quarter.

ANS:
Calculation of difference between taxable income and accounting income

Particulars	Amount (Rs.)
Excess depreciation as per tax (5,00,000 – 2,00,000)	3,00,000
Less: Expenses provided in taxable income	30,000
Timing difference	2,70,000
Tax expense is more than the current tax due to timing difference.	

Therefore deferred tax liability = 50% x 2,70,000 = Rs. 1,35,000 **33.**

Calculation of tax expense

1st quarter ending on 31-12-2005	200*20%	Rs. 40 lakhs
2nd quarter ending on 31-3-2006	200*20%	Rs. 40 lakhs
3rd quarter ending on 30-6-2006	200*30%	Rs. 60 lakhs
4th quarter ending on 30-9-2006	200*30%	Rs. 60 lakhs

58. Accountants of Poornima Ltd. show a net profit of Rs.7,20,000 for the third quarter of 2005 after incorporating the following:

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

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

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

Ascertain the correct quarterly income.

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

Recognising additional depreciation of Rs. 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 Rs.7,00,000 (Rs. 7,20,000–Rs. 20,000).

AS 26 Intangible Asset

59. London International Ltd. is developing a new production process. During the financial year ending 31st March, 2011, the total expenditure incurred was Rs. 50 lakhs. This process met the criteria for recognition as an intangible asset on 1st December, 2010. Expenditure

incurred till this date was Rs. 22 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2012 was Rs. 80 lakhs. As at 31st March, 2012, the recoverable amount of know-how embodied in the process is estimated to be Rs. 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, 2011 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, 2012.

Ignore depreciation.

(i) **For the year ending 31.03.2011**

(1) Carrying value of intangible as on 31.03.2011:

At the end of financial year 31st March 2011, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of Rs. 28 lakhs (expenditure incurred since the date the recognition criteria were met, i.e., on 1st December 2010).

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

The Rs. 22 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2011. This expenditure will not form part of the cost of the production process recognized in the balance sheet.

(ii) **For the year ending 31.03.2012**

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

	(Rs. in
Carrying Amount as on 31.03.2011	28
Expenditure during 2011 – 2012	80
Total book cost	108
Recoverable Amount	72
Impairment loss	36

Rs. 36 lakhs to be charged to Profit and loss account
year ending 31.03.2012.

(2) Carrying value of intangible as on 31.03.2012:

	(Rs. in
Total Book Cost	108
Less: Impairment loss	36
Carrying amount as on 31.03.2012	72

60. A company acquired for its internal use a software on 28.01.2012 from the USA for US $ 1,00,000. The exchange rate on that date was Rs. 52 per US $. The seller allowed trade discount @ 5 %. The other expenditure were:

(i) Import Duty : 20%
(ii) Purchase Tax : 10 %
(iii) Entry Tax : 5 % (Recoverable later from tax department)

(iv) Installation expenses : Rs. 25,000
(v) Profession fees for Clearance from Customs : Rs. 20,000

Compute the cost of software to be capitalized.

ANS:

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

Purchase cost of the software	$ 1,00,000
Less: Trade discount @ 5%	($ 5,000)
	$ 95,000
Cost in Rs. (US $ 95,000 x Rs. 52)	49,40,000
Add: Import duty on cost @ 20% (Rs.)	9,88,000
	59,28,000
Add: Purchase tax @ 10% (Rs.)	5,92,800
Installation expenses (Rs.)	25,000
Profession fee for clearance from customs (Rs.)	20,000
Cost of the software to be capitalised (Rs.)	65,65,800

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

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

Is the procedure adopted by the company correct?

ANS:

According to paras 55 and 56 of AS 26 'Intangible Assets', "expenditure on an intangible item should be recognised as an expense when it is incurret unless it forms part of the cost of an intangible asset".

In the given case, advertisement expenditure of Rs. 2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of Rs.25 crores. Here, no intangible asset or other asset is acquired or created that can be recognised. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of Rs.2 crores to the Profit and Loss account of the year is correct.

62. During 2004, an enterprise incurred costs to develop and produce a routine, low risk computer software product, as follows:

	Amount
Completion of detailed programme and design	25,000
Coding and Testing	20,000
Other coding costs	42,000
Testing costs	12,000
Product masters for training materials	13,000
Duplication of computer software and training materials, from product masters(2,000 units)	40,000
Packing the product (1,000 units)	11,000

What amount should be capitalized as software costs in the books of the company, on Balance Sheet date?

ANS: As per para 44 of AS-26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria has been established upon completion of detailed programme design or working model. In this case, Rs. 45,000 would be recorded as an expense (Rs. 25,000 for completion of detailed program design and Rs. 20,000 for coding and testing to establish technological feasibility/asset recognition criteria). Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (Rs. 42,000 + Rs. 12,000 + Rs.13,000) Rs. 67,000.

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

ANS

As per AS 26 'Intangible Assets'

(i) For the year ending 31.03.2007

(1) Carrying value of intangible 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 Rs. 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:
Rs. 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:	**(Rs. 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
Rs. 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:	
	(Rs. in lakhs)
Total Book Cost	108
Less: Impairment loss	36
Carrying amount as on 31.03.2008	72

AS 28

64. The following information is available as regards to the fixed asset of a company:

(i) Carrying amount of the asset shown in the balance sheet net of accumulated depreciation is Rs. 340 lakhs. Assets are 2 years old. The present market price of the asset is Rs. 300 lakhs. The company charges depreciation @10% on SLM assuming 10 years as its useful life.

(ii) At the beginning of the current year, on review, remaining useful life of the asset has been assessed as 5 years because of technological changes.

(iii) Market rate of interest has declined. Accordingly, there is decline in the discount factor from 16% to 15%.

(iv) Book value to market capitalization ratio of the company is 0.80.

Is there an indication of impairment of asset? If yes, then how should it be adjusted?

ANS:

Impairment loss is said to occur when the carrying amount is more than recoverable amount. Recoverable amount, in turn, is the higher of Net Selling Price and Value in Use. Based on this, the following determination is made. Para 8 of AS 28 'Impairment of Assets' states some minimum indications for assessing whether there can be any impairment of an asset. These are:

(i) **Decline in Net Selling Price:** In the instant case, market price is indicated at Rs. 300 lakhs. This is lower than carrying amount i.e. Rs. 340 lakhs. Hence, there is an indication of impairment loss.

(ii) **Estimated remaining useful life of the asset:** Estimated remaining useful life of the asset has declined from 8 years to five years due to technological changes that have taken place. This change from eight to five years is considered as a "significant change in the useful life of asset". Therefore, there is an indication of impairment of assets

(iii) **Decline in market interest rates:** The decline in market interest rate from 16% to 15% does not indicate impairment.

(iv) **Higher carrying amount of the net assets to its market capitalization:**
Here, carrying amount of the asset to market capitalisation ratio is also favourable i.e. 0.80 (i.e., book value is 0.8, and market capitalisation is 1). Therefore, there is no indication of impairment.

Out of the above four parameters, two are unfavourable. More particularly, market price being lower by Rs. 40 lakhs is an important element. Hence, there is an indication of impairment of asset. It is advisable to review the adequacy of depreciation charge, and if this is readjusted to fall in line with the remaining useful life of five years, the impairment would be taken care automatically.

Where the useful life of a depreciable asset undergoes a change i.e. reduced, impairment is automatically taken care of since the unamortised amount is depreciated over the shorter remaining useful life resulting into higher depreciation amount. When higher depreciation amount is charged, the net book value of the asset shown in books is less.

In this case, annual depreciation charge would be Rs. 340 lakhs/5 = Rs. 68.00 lakhs and the revised net book value would be Rs. 272.00 lakhs (340-68). This is well below the market price, and the impairment is automatically taken care of.

65. Write short notes on:
Impairment of asset and its application to inventory.
ANS:
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.

AS 29

66. A company is in a dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of Rs. 900 lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal with the same in the annual accounts of the company?

ANS:

As per para 14 of AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognised 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. If these conditions are not met, no provision should be recognised.

If these conditions are not met, no provision should be recognised.

In the given situation the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of Rs. 900 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

67. Mini Ltd. took a factory premises on lease on 1.4.07 for Rs.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.

ANS:

In accordance with AS 29 'Provisions, Contingent Liabilities and Contingent Assets' and ASI 30 'Applicability of AS 29 to Onerous Contracts', if an enterprise has a contract that is onerous, the present obligation under the contract should be recognized and measured as a provision. In the given case, the operating lease contract has become onerousas 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 Rs. 66,00,000 (i.e.2,00,000 p.m. for next 33 months).

Therefore, provision on account of Rs.66,00,000 is to be provided in the accounts for the year ending 31.03.08. Hence auditor is right.

AS 30 31 32 Accounting and Reporting of Financial Instruments

68. Identify the host and embedded derivative in the following cases:

(i) Entity A holds a debenture bond of entity B which is convertible into ordinary shares of entity B at the option of entity A.

(ii) Sun Ltd. enters into a lease agreement for usage of plant and equipment, rentals in respect of which lease rentals are payable annually. The lease includes a clause that lease rentals payable will be linked to changes in Cost Inflation Index announced u/s 48 of Income tax Act, and contingent rentals will be payable on the basis of Benchmark interest of PLR of SBI.

(iii) Moon Ltd. enters into a lease agreement for usage of plant and equipment, rentals in respect of which are payable annually. The lease includes a clause that lease rentals payable will be increasing annually by Rs. 1,20,000

(iv) A floating rate debt -
(1) with no cap
(2) with a cap on interest and
(3) a separate agreement for a cap on interest.

(v) Interest rate on a fixed deposit linked to fluctuation of BSE sensex.

ANS:

(i) The debenture bond is the host contract. The option to convert into shares is the embedded derivative.

(ii)The lease contract is the host contract. The adjustment linked to Cost Inflation Index is the embedded derivative contract.

(iii)The price adjustment is not a derivative - it does not meet the definition of derivative - there is no underlying.

(iv)A floating rate debt with no cap- there is no derivative.
A floating rate debt with a cap on interest - the cap is the derivative and the debt instrument is the host contract.
Separate agreement for a cap on interest - the cap is a derivative because it is based on the interest rate of the underlying instrument

(v)Fixed deposit is the host contract and interest payment linked to BSE sensex is the embedded derivative.

69. A Ltd. holds an option to purchase equity shares in a listed company B Ltd. for Rs. 5 per share at the end of a 90 day period. State whether the option is a derivative financial asset or not with reasons.

ANS:

The above call option gives A Ltd. a contractual right to exchange cash of Rs. 5 for an equity share in another entity and will be exercised if the market value of the share exceeds Rs. 5 at the end of the 90 day period because it will be favourable to A Ltd., if it exercises the call option. Since A Ltd. stands to gain if the call option is exercised, the exchange is potentially favourable to the company. Therefore, the option is a derivative financial asset from the time the company becomes a party to the option contract.

HUMAN RESOURCE ACCOUNTING

70. "Jaggi & Lau suggested that a proper valuation of human resource is not possible unless the contribution of individuals as a group is taken into consideration." Comment.

ANS:

Jaggi and Lau suggested a model for valuation of human resources. According to them, **proper valuation of human resources is not possible** unless the contributions of individuals as a group are taken into consideration. They referred group to homogeneous employees whether working in the same department or division of the organization or not. They believed that an individual's expected service tenure in an organization is difficult to predict, but on a group basis, it is relatively easy to estimate the percentage of people in a group likely to leave the organization in future. Accordingly, they developed a model which attempts to calculate the present value of all existing employees in each rank. Such present value is measured with the help of the following steps:

(i) Ascertain the number of employees in each rank.

(ii) Estimate the probability that an employee will be in his rank within the organization on terminated/promoted in the next period. This probability will be estimated for a specified time-period.

(iii) Ascertain the economic value of an employee in a specified rank during each time period.

(iv) The present value of existing employees in each rank is obtained by multiplying the above three factors and applying an appropriate discount rate.

Merit

Jaggi and Lau model approached the valuation of human resources on the basis of grouping of employees. Under this method, calculations get simplified and the chances of errors get reduced.

Demerit

1. This model ignores individual skills of the employees. The varied skills of the employees are not recognized in the valuation process under Jaggi and Lau model.
2. The performance of a group may be seriously affected in the event of exit of a single individual.

71. Briefly describe the method of valuation of human resources as suggested by Jaggi and Lau.

ANS:

Jaggi and Lau suggested a model for valuation of human resources. According to them, proper valuation of human resources is not possible unless the contributions of individuals as a group are taken into consideration. A group refers to homogeneous employees whether working in the same department or division of the organization or not. An individual's expected service tenure in an organization is difficult to predict, but on a group basis, it is relatively easy to estimate the percentage of people in a group likely to leave the organization in future. This model attempts to calculate the present value of all existing employees in each rank. Such present value is measured with the help of the following steps:

(i) Ascertain the number of employees in each rank.

(ii) Estimate the probability that an employee will be in his rank within the organization on terminated/promoted in the next period. This probability will be estimated for a specified time-period.

(iii) Ascertain the economic value of an employee in a specified rank during each time period.

(iv) The present value of existing employees in each rank is obtained by multiplying the above three factors and applying an appropriate discount rate.

Jaggi and Lau tried to simplify the process of measuring the value of human resources by considering a group of employees as basis of valuation. But in the process they ignored the exceptional qualities of certain skilled employees. The performance of a group may be seriously affected in the event of exit of a single individual.

Mutual Funds

72. Black Rock Mutual Fund has invested in 2,00,000 shares of Profit Ltd. No quotation is available for last thirty days prior to the valuation date. The P/E ratio of a comparable company, which is regularly traded, is 12. Earnings per share of Profit Ltd. is Rs. 20. The Net Asset Value of Profit Ltd. is Rs. 160 and the comparable company is Rs. 200. The current market price of comparable equity share is Rs. 240. A policy is taken to give 40% weightage to net assets value and to reduce from comparable P/E ratio for relatively less liquidity of Profit Ltd. stock.

Required:

(a) Explain whether the investment in Profit Ltd. will be classified as trade investment, or 'non-trade investment' giving the reason for the stand taken by you.

(b) What do you think, to be the appropriate criteria for selection of comparable stock?

(c) How much discounting should be made from comparable P/E ratio for valuing investment in non- traded scrip?

(d) What should be the value of 2,00,000 equity shares of Profit Ltd.?

ANS:

(a) A scrip is treated as non-traded, if it is not traded in stock exchange for a period of more than 30 days (Eighth schedule of SEBI (Mutual Funds) Regulations 1996). In the given case, investment in Profit Ltd. will be a 'non-traded investment, as no quotation is available for last thirty days prior the valuation date.

(b) A comparable stock is generally selected from the same industry. It should be of same size and the return of capital employed should be in the same range.

(c) The valuation of investment should be linked both to degree of liquidity and also the level of current net assets value. In case the comparable stock is quoted at a discount to net assets value, the same discount can be used to estimate the applicable discount factor to P/E Ratio.

In the given case, market value of the comparable equity is 20% [i.e. {(240 - 200) / 200} x 100] above the net asset value. So, market value of Profit Ltd.'s share should be Rs. 160 + 20% of Rs. 160 i.e. Rs. 192. Given EPS of Rs. 20, the P/E ratio of Profit Ltd. can be derived as Rs. 192/20 = 9.6, which is 2.4 less than the P/E ratio of 12 of the comparable firm.

(d) Value per equity share of Profit Ltd. = (Rs. 192 + Rs. 160) / 2 = Rs. 176 Total Value = 2,00,000 x Rs. 176 = Rs. 3,52,00,000.

73. What books of account are required to be maintained by a Stock Broker? Explain in brief.

ANS:

Every stock broker is required to maintain the following books of account and records as per Rule 15 of the Securities Contracts (Regulation) Rules, 1957 and Regulation 17 of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992:

(a) Register of transactions (Sauda book)/Daily transaction list;
(b) Clients ledger;
(c) General ledger;
(d) Journals;
(e) Cash book;
(f) Bank Pass Book;
(g) Documents register/Inward-outward register showing full particulars of shares and securities received and delivered;
(h) Members' contract book showing details of all contracts entered into by him with other members of the stock exchange or counterfoils or duplicates of memos of confirmation issued to such other members;
(i) Counterfoils or duplicates of contract notes issued to clients;
(j) Written consent of clients in respect of contracts entered into as principals;
(k) Margin deposit book;
(l) Register of accounts of sub-brokers;
(m) An agreement with a sub-broker specifying the scope of authority and responsibilities of the stock broker and such sub-brokers.

In addition to the above statutory requirements, stock brokers are also required to maintain scripwise clientwise list in respect of scripts of specified group, client upla statement, duplicate copies of self -certificates submitted on monthly basis, copies of margin statements downloaded by the stock exchange, copies of valan balance sheet (Form 31), details of spot delivery transactions, client data base and broker client agreement, copy of registration certificate of each sub-broker issued by SEBI, copies of the power of attorney/board resolution authorising directors and employees and copies of pool account statements.

NBFC

74. Mahindra Finance Ltd. is a non-banking finance company. The extracts of its balance sheet are given below:

Liabilities	Amount	Assets	Amount
Paid up equity share capital	100	Leased out Assets Investment:	800
Free Reserves	500	In shares of subsidiaries and group companies	100
Loans	400		
Deposits	400	In debentures of subsidiaries and group companies	100
		Cash and Bank balances	200
		Deferred Expenditure	200
	1,400		1,400

You are required to compute Tier – I Capital of Mahindra Finance Ltd. according to NBFC Prudential Norms (RBI) Directions 1998.

ANS:

Statement Showing Computation of Tier	**I Capital**	
		(Rs. in lakh
Paid up Equity Capital		100
Free Reserve		500
	(A)	600
Deduct deferred expenditure	(B)	200
	(C)	400
Investments		
In shares of subsidiaries and Group Companies		100
In Debenture of subsidiaries and Group Companies		100
		200
10% (C)	(D)	40
Excess of Investment over 10% of (C) = (E)		160
TierI Capital [(C + E)]		

Additional expected theory questions

75. Write short notes on:

Asset Management company in the context of mutual fund.

ANS:

"Asset management company" means a company formed and registered under the Companies

Act, 1956 and approved as such by the Securities and Exchange Board of India to manage the funds of a mutual fund.

76. Embedded derivatives.

ANS:

An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract, with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

An embedded derivative should be separated from the host contract and accounted for as a derivative if (i) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract and (ii) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative. However, a derivative that is embedded in a financial asset or financial liability at fair value through profit or loss need not be separated.

77. Explain currency options related to foreign exchange.

ANS:

Currency Options give the client the right, but not the obligation, to buy/sell a specific amount of currency at a specific price on a specific date. Currency options provide a tool for hedging foreign exchange risk arising out of the firm's operations. Currency options enable the business house to remove downside risk without limiting the upride potential. Options can be put option or call option. A put option is a contract that specifies the currency that the holder has the right to sell. A call option is a contract that specifies the currency that the holder has the right to buy.

78. Define the term 'Beta' in the context of Economic Value Added.

ANS

Beta is a relative measure of volatility that is determined by comparing the return on a share to the return on the stock market. In simple terms, greater the volatility, more risky the share and higher the Beta. If a company is affected by the macroeconomic factors in the same way as the market is, then the company will have a Beta of one and will be expected to have returns equal to the market. A company having a Beta of 1.2 implies that it stock market increases by 10% the company's share price will increase by 12 % (i.e., 10% x 1.2) and if the stock market decreases by 10% the company's share price will decrease by 12%. Beta is a statistical measure of volatility and is calculated as the Covariance of daily return on stock market indices and the return on daily share prices of a particular company divided by the Variance of the return on daily Stock Market indices. While considering market index a broad based index like S & P 500 should be considered.

For the companies, which are not listed in stock exchanges, beta of the similar industry may be considered after transforming it to un-geared beta and then re-gearing it according to the debt equity ratio of the company. The formula for un-gearing and gearing beta is shown below:

Un-geared Beta = Industry Beta / [1+ (1- Tax Rate)(Industry Debt Equity Ratio)

79. A company has given counter guarantees of Rs. 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 2007-2008 were Rs. 1.95 crores. How should this information be shown in the Financial Statements of the Company.

ANS:

The counter guarantee given by the company is, infact, an undertaking to perform what is, in any event, the obligation of the company itself. In any case, this is a matter which is in the control of the company itself and the mere possibility of a default by the company in the future cannot be said to involve the existence of a contingent liability on the balance sheet date.Thus, as per 'Guidance Note on Guarantees and Counter-Guarantees given by Companies', no separate disclosure is required in respect of counter guarantees.

GUIDENCE NOTES

80. SFL Ltd. is a mutual fund. The fund values the investment on "mark to market basis". The Accountant argues since investment are valued on the above basis there is no necessity to disclose depreciation separately in the financial statements. Do you agree?

ANS:

The Guidance Note on Accounting for Investments in the Financial statements of Mutual Funds provides that the investments should be marked to market on the balance sheet date. The provision for depreciation in the value of investments should be made in the books by debiting the Revenue Account. The provision so created should be shown as a deduction from the value of investments in the balance sheet. Clause 2(i) of the Eleventh Schedule provides that "where the financial statements are prepared on a mark to market basis, there need not be a separate provision for depreciation." However keeping in view, 'prudence' as a factor for preparation of financial statements and correct disclosure of the amount of depreciation on investments, the guidance note recommends that the gross value of depreciation on investments should be reflected in the Revenue Account rather than the same being netted off with the appreciation in the value of other investments. In other words, depreciation/appreciation on investments should be worked out on an individual investment basis or by category of investment basis, but not on an overall basis or by category of investment. In the given case of SFL Ltd., depreciation should be separately disclosed in the financial statements.

81. While executing a new project, the company had to pay Rs. 50 lakhs to the State Government as part of the cost of roads built by the State Government in the vicinity of the project for the purpose of carrying machinery and materials to the project site. The road so built is the property of the State Government. Advise the company on the following item while from the view point of finalisation of accounts.

ANS:

In this case, the capital expenditure incurred by the company would not be represented by any actual assets, since the roads would remain the property of the relevant State authorities even though a part of their cost has been defrayed by the company in order to facilitate its business.

Having regard to the nature of the expenditure and the purpose for which it is incurred, it is suggested in para 10 of Guidance Note on Treatment of Expenditure During Construction Period that 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" or "Deferred Revenue Expenditure" subject to two conditions. In the first place, the description of the specific item 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.

NO TOLERANCE ZONE:
NOV 2008

82. On 30.6.2007, Asmitha Ltd. incurred Rs. 2,00,000, net loss from disposal of a business segment. Also, on 30.7.2007, the company paid Rs. 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.

ANS:

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 Rs.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 Rs.60,000 Property Tax payment relates to entire calendar year 2007, Rs.30,000 would be reported as an expense for six months ended on 30th September, 2007 while remaining Rs.30,000 would be reported as prepaid expenses.

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

ANS:

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.

84. M/s Dinesh & Company signed an agreement with workers for increase in wages with retrospective effect. The out-flow on account of arrears was for 2005-06—Rs. 10.00 lakhs,

for 2006-07—Rs. 12.00 lakhs and for 2007-08—Rs. 12.00 lakhs. This amount is payable in September, 2008. The accountant wants to charge Rs. 22.00 lakhs as prior period charges in financial statement for 2008-09. Discuss.

ANS:

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.

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

ANS:

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

86. Himalayas Ltd. is showing an intangible Asset at Rs. 72 lakhs as on 01.04.2007 and that item was required for Rs. 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.

ANS:

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 Rs.96 lakhs less Rs. 28.8 lakhs (Rs. 9.6 lakhs × 3 years) = Rs. 67.2 lakhs. If amortisation had been as per AS 26, the carrying amount would have been Rs.67.2 lakhs. The difference of Rs. 4.8 lakhs i.e. (Rs. 72lakhs – 67.2 lakhs) would be required to be adjusted against the opening balance of revenue reserves. The carrying amount of Rs.67.2 lakhs would be amortised over 7 (10 less 3) years in future.

87.Reversal of an Impairment Loss.

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:

<u>External sources of information</u>

(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.

<u>Internal sources of information</u>

(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.

88.Market value Added.

ANS:

Market value added is the market value of capital employed in the firm less the book value of capital employed. Market value added is calculated by summing up the paid up value of equity and preference share capital, Retained earnings, long term and short term debts and subtracting this sum from the market value of equity and debt.

Market value added measures cumulatively the performance of corporate entity.

A High market value added means that the company has created substantial wealth for share holders. On the other hand negative MVA means that the value of management's actions and investments are less than the value of the capital contributed to the company by the capital market or that the wealth and value has been destroyed.

89. What are the types of Employees benefit and what is the objective of Introduction of this Standard i.e. AS-15?

ANS:

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

(a) short-term employee benefits, such as wages, salaries and social security contributions (e.g., contribution to an insurance company by an employer to pay for medical care of its employees), paid annual leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

(b) post-employment benefits such as gratuity, pension, other retirement benefits, post-employment life insurance and post-employment medical care;

(c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation; and

(d) termination benefits.

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

The objective of AS 15 is to prescribe the accounting and disclosure for employee benefits. The statement requires an enterprise to recognise:

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

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

90. What are Timing differences and Permanent differences?

ANS:

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.

MAY 2009

91. From the following details of an asset
Find out impairment loss
Treatment of impairment loss
Current year depreciation Particulars of asset:

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

ANS:

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

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 Rs.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 Rs.4,00,000.

92. Rainbow Limited borrowed an amount of Rs.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 Rs.19.50 crores for the accounting period ending on 31.3.2009. Due to surplus fund, out of Rs.150 crores, an income of Rs.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.

ANS:

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 2008-2009 should be calculated as follows:

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

93. Suraj Limited wishes to obtain a machine costing Rs.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 Rs.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.

ANS:

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 Rs.3 lakhs each year)	Rs.10.08 lakhs (approx.)

Thus, present value of minimum lease payments is Rs.10.08 lakhs and the fair value of the machine is Rs.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.

94. 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 Rs.11,00,000, Rs.16,00,000 and Rs.21,00,000 respectively. However, for income-tax purpose, it has adopted the completed contract method under which it has recognized revenue of Rs.7,00,000, Rs.18,00,000 and Rs.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.

ANS:

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		

95. 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?

ANS:

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 Rs.2 lakhs should be 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.

96. What are the objectives of financial reporting?

ANS:

The following are the objectives of financial reporting:

(i) To provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions.

(ii) To provide information to help investors, creditors, and others to assess the amount, timing and uncertainty of prospective net cash inflows to the related enterprise.

(iii) To provide information about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of transactions, events and circumstances that change resources and claims to those resources.

(iv) To provide information about an enterprise's financial performance during a period.

(v) To give information about an enterprise's performance provided by measures of earnings and its components.

(vi) To provide information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital transactions, including cash dividends and other distributions of enterprise's resources to owners, and about other factors that may affect an enterprise's liquidity or solvency.

97. What do you mean by "Net asset value" (NAV) in case of mutual fund units?

ANS:

Mutual funds sell their shares to public and redeem them at current net assets value (NAV) which is calculated as under:–

$$\frac{\text{Total market value of all Mutual Fund holdings - All Mutual Fund liabilities}}{\text{Unit size}}$$

The net asset value of a mutual fund scheme is basically the per unit market value of all the assets of the scheme. Simply stated, NAV is the value of the assets of each unit of the scheme. Thus, if the NAV is more than the face value (Rs. 10), it means your money has appreciated and vice versa. NAV also includes dividends, interest accruals and reduction of liabilities and expenses, besides market value of investments. NAV is the value of net assets under a mutual fund scheme. The NAV per unit is NAV of the scheme divided by number of units outstanding. NAV of a scheme keeps on changing with change in market value of portfolio under the scheme.

98. Forward contract.

ANS:

A forward contract is an agreement between two parties whereby one party agrees to buy from, or sell to, the other party an asset at a future time for an agreed price (usually referred to as the 'contract price'). The parties to forward contracts may be individuals, corporates or financial institutions. At maturity, a forward contract is settled by delivery of the asset by the seller to the buyer in return for payment of the contract price. For example, a person (X) may enter into a forward contract with another person (Y) on June 15, 20x3 to buy 10 kgs. of silver at the end of 90 days at a price of Rs. 8,200 per kg. At the end of the 90 days, Y will deliver 10 kgs. of silver to X against payment of Rs. 82,000. If the price of silver, at the end of the 90 days, is Rs. 8,300 per kg., X would make a profit of Rs. 1,000 and Y would lose Rs. 1,000, as X could sell silver bought at Rs. 82,000 for Rs. 83,000, whereas Y would have to buy silver for Rs. 83,000 and sell for Rs. 82,000. On the other hand, if the price of silver at the end of the 90 days is Rs. 7,800 per kg., X would lose Rs. 4,000, whereas Y would make a profit of Rs. 4,000, as X would have to sell silver bought at Rs. 82,000 for Rs. 78,000, whereas Y would buy silver for Rs. 78,000, which he would sell to X at Rs. 82,000.

MAY 2010

99. Sun Ltd. has entered into a sale contract of Rs.5 crores with X Ltd. during 2009-10 financial year. The profit on this transaction is Rs.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 Rs.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.
Should Sun Ltd. provide for contingency as per AS 29?
Should provision be measured as the excess of compensation to be paid over the profit?

ANS:

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 Rs. 1.5 crores as per AS 29.

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 Rs.1.50 crores.

Nov 11

100. 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 Rs. 100 lakhs after 3 years whereas its current market price is Rs. 150 lakhs. Is the put option of Bee Ltd., a financial instrument? Explain

ANS:

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".