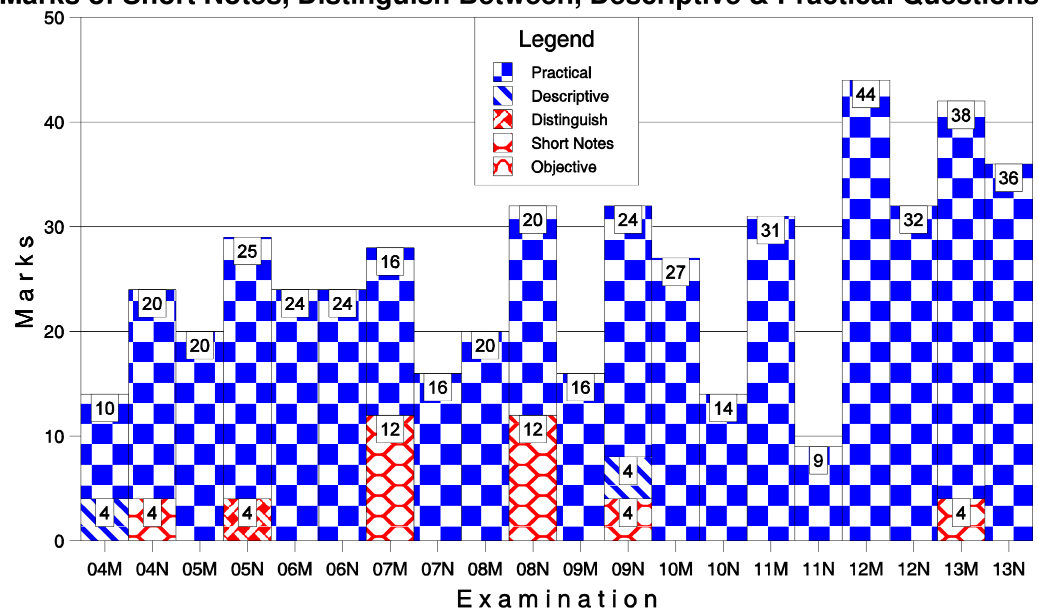
Star Rating

On the basis of Maximum marks from a chapter	☆☆☆☆☆
On the basis of Questions included every year from a chapter	☆☆☆☆☆
On the basis of Compulsory questions from a chapter	☆☆☆☆☆

1 Accounting Standards & Guidance Notes

This Chapter Includes : Accounting standards, Guidance Notes

Marks of Short Notes, Distinguish Between, Descriptive & Practical Questions



CA Final Gr. I

SHORT NOTES

2004 - Nov [6] Write short notes on the following :

(d) Advantages and disadvantages of setting of Accounting Standards. (4 marks)

Answer :

Accounting Standards are prescribed by ICAI, which are to be followed in performing accounting transactions. Various accounting principles, techniques and methods are described in these standards, which assist the user in preparation and presentation of financial statements, with a true and fair view.

The various advantages of setting accounting standard are follows :-

Advantages of setting Accounting Standard

1. Accounting standards reduces the possibilities of variation in the accounting treatment used while preparing financial statements.
2. Accounting standards call for certain disclosures which makes the financial statement more true & fair.
3. Accounting standard makes comparison of financial statements possible.

Disadvantages of setting Accounting Standard

1. Accounting problems may have alternative solutions. Accounting Standards makes the choice between different alternative accounting treatments difficult.
2. Accounting standards leads to rigidity and is less flexible.
3. Accounting standards are framed within the limits set by statutes. It cannot overrule the statutes.

2007 - May [6] Write short notes on the following :

(d) Impairment of asset and its application to inventory. (4 marks)

(e) Treatment of borrowing costs. (4 marks)

(f) Accounting for investment by a holding company in subsidiaries. (4 marks)

Answer :

(d) **AS-28 Impairment of assets,** Provides the process that ensure that an asset is carried at no more that its recoverable amount, in an enterprise. If an asset is carried at more than its recoverable amount, then the asset is called impaired asset, and thus, the enterprise have to recognise the impairment loss.

As-28 is applicable on all the business assets except-

(i) Inventories

(ii) Assets arising from construction contracts

(iii) Financial Assets

(iv) Differed tax assets.

As- 28 is not applicable on above all 4 types of assets because other accounting standards are applicable on them.

(e) **AS-16 'Borrowing costs'** Borrowing cost includes the interest and other costs incurred by an enterprise, like interest and commitment charges on bank borrowing's, amortization of premium on debentures, amortization of discounts etc.

Treatment:-

(i) Borrowing costs that are directly attributable to the acquisition, construction, or production of a qualifying asset should be capitalized.
A qualifying asset is an asset which generally takes 12 months to get ready for its intended use or sale.

(ii) other borrowing cost should be treated as an expense in the period, in which they are incurred.

(f) AS-13 'Accounting for Investments' classify the investment as long term and current investment .An investment made by a holding company in its subsidiary company, generally are long term Investment. Indian holding company shows its investments in their subsidiary company, just like any other investment and categorize it as trade investment. Investment cost includes brokerage, fees, duties etc. along with the acquisition cost.

The acquisition cost is determined by taking fair market value of the securities issued, if investment is made by issue of securities, partly or wholly.

But, in case if investment is made wholly or partly on account of any other assets the value of such assets are taken as cost of investment.

DISTINGUISH BETWEEN

2001 - Nov [6] (a) Explain the difference between direct and indirect methods of reporting cash flows from operating activities with reference to Accounting Standard 3, revised. (8 marks)

Answer :

Direct Method of Reporting cash flows from Operating Activities.	**Indirect Method of Reporting cash flows from Operating Activities**.
Information [Para 19]: Under the Direct Method, information about major classes of gross cash receipts and gross cash payments may be obtained either- (a) From the accounting records of the enterprise; or (b) By adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial enterprise)	**Information [Para 20]:** Under the Indirect Method, the net cash flow from determined by adjusting Net Profit or Loss for the effects of - (a) Changes during the period in inventories and operating receivables and payables; (b) Non-cash items such as depreciation, provisions, deferred taxes, and unrealised and losses; and

and other items in the statement of profit and loss for- • Changes during the period in inventories and operating receivables and payables; • Other non-cash items; and • Other items for which the cash effects are investing or financing cash flows.	(c) All other items for which the cash effects are investing or financing cash flows.

Format : The Direct Method of reporting Cash Flows from Operating Activities is illustrated below -

Particulars	***Amount***	***Amount***
Cash Receipts from Customers for sale of goods / rendering of services Cash Receipts from Royalties, fees, commission and other revenue Cash Payments to Suppliers for goods and services Cash Payment to and on behalf of Employees Cash receipts and payments relating to futures/forward/option/swap contracts when the contracts are held for dealing or trading purposes.		
Cash Generated from Operations before taxes and extraordinary items		
Less : Cash Payments (Refunds) of income taxes unless they can be specifically identified with financing and investing activities		
Cash Flows before extraordinary items		
Add / **Less :** Cash Receipts (Payments) in relation to extraordinary items, e.g. earthquake disaster settlement etc.		
NET CASH FROM OPERATING ACTIVITIES		

Whereas the Formal under Indirect Method of reporting Cash Flows from Operating Activities is illustrated below:-

Particulars	***Amount***	***Amount***
Net Profit Before Taxes and Extra-ordinary Items **Adjustments for :-** Depreciation and similar non-cash items Foreign Exchange Losses, if any Interest/Dividend/Other Incomes relating to investing/ financing activities Interest Paid Taxes Paid (if PAT is considered initially instead of PBT)		
Operating Profit before Working Capital Changes		
Add/ (Less) : Decrease / (Increase) in Current Assets excluding Cash/ Cash Equivalents. Increase/(Decrease) in Current Liabilities excluding Cash/ Cash Equivalents		
Cash Generated From Operations		
Less : Cash Payments (Refunds) of income taxes unless they can be specifically identified with financing and investing activities		
Cash Flows before extraordinary items **Add/Less :** Cash Receipts (Payments) in relation to extraordinary items, e.g. earthquake disaster settlement etc.		
NET CASH FROM OPERATING ACTIVITIES		

2005 - Nov [6] (c) Distinguish between "Timing differences" and "Permanent differences" referred to in AS-22 on accounting for Taxes, giving 2 examples of each. (4 marks)

Answer :

Please refer 2008 - Nov [7] (e) on page no. 96

DESCRIPTIVE QUESTIONS

2001 - May [6] (b) Briefly indicate the items, which are included in the expression "borrowing cost" as explained in AS-16. (6 marks)

Answer :

As - 16 (Para 4), Borrowing Cost. It may includes the following items:-

(i) Amortization of premium on debentures.

(ii) Amortization of discounts, etc, related with the borrowing.

(iii) Amortization of ancillary costs, e.g. CA fees.

(iv) Interest and commitment charges on bank borrowings whether short term or long term.

(v) Exchange differences arising from foreign currency borrowing up to the extent that they are regarded as an adjustment to cost of interest.

2002 - May [3] (a) What are the advantages of setting Accounting Standard? (4 marks)

Answer :

Please refer 2004 - Nov [6] (d) on page no. 11

2002 - Nov [4] (b) Write a note on recommendations given in the Guidance note on Accounting in respect of Minimum Alternate Tax (MAT) issued by Institute of Chartered Accountants of India. (4 marks)

Answer :

According to the Guidance Note on Accounting for Taxes on Income, (issued in August 1991), the tax charge for the period should be determined on the basis of the "tax effect accounting method", although the "taxes payable method" is also permitted for the time being. Thus, an entity following the "tax effect accounting method" should follow aforesaid Guidance Note in respect of accounting for MAT also.

Taxes Payable Method: The current accounting practice generally followed in India regarding accounting for income taxes is the "taxes payable method". According to this, the tax charged to the P&L A/c of a year is the amount of taxes payable for that year to the revenue authorities. MAT is the amount payable to the revenue authorities in the year in which the normal tax liability is less than MAT, therefore, as per the "taxes payable method", the amount of tax to be charged (i.e. provision for taxation) to the P & L A/c should be the amount of MAT. The possibility of obtaining a credit in a year later does not reduce the tax liability of the current year. Such possibility is dependent on conditions existing in a subsequent year and should not be recognised in the financial statements. In the year in which set off of MAT is availed against the normal tax liability, the amount payable to the revenue authorities would be the amount of normal tax liability as reduced by the permissible set-off in respect of MAT. Thus the amount of tax to be charged in the P & L A/c of the year in which the set-off is availed would be the actual amount of tax payable.

Note:

1. In the absence of any information regarding interest on foreign currency loan taken for financing purchase of fixed assets, no provision has been made for interest liability.
2. It has been assumed that restructuring costs are of revenue nature and thus are allowed for tax purposes.

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

Answer :

The counter guarantee given by the company is, infact, an undertaking to perform what is, in any event, the obligation of the company itself. This is purely a matter which is in the control of the company and a were possibility of a default by the company in future cannot be said to involve the existence of a contingent liability on Balance Sheet date.

Thus no separate disclosure is required in case of counter guarantees as per guidance note on guarantees and counter guarantees.

PRACTICAL QUESTIONS

1998 - Nov [2] E Ltd. manufactures and sells food products. The following draft financial statements were prepared by the chief accountant for the year ended 31.3.98 and placed before you for advice :

Profit and Loss Statement for the year ended 31.3.98

	(Figures in ₹ lakhs)
Sales and other income	3,500
Cost of goods sold including operating expenses and depreciation	2,740
Operating profit	760
Profit on sale of property	200
Interest charges	300
Profit before tax	660
Tax provision	330
Profit after tax	330

Proposed dividend	300
Profit retained	30
Add opening balance of profit	360
Profit carried to Balance Sheet	390

Balance Sheet as on 31.3.98

(Figures in ₹ lakhs)

Liabilities			*Assets*		
Share capital		3,000	Fixed assets	5,000	
General reserve		540	Less depreciation	1,000	4,000
Profit and loss account balance		390	Current Assets Stock	800	
Secured loans		2,000	Debtors	1,000	
Current Liabilities and			Royalty receivable	100	
Provisions			Advance tax	200	
Creditors	240		Cash balance	550	2,650
Provision for tax	330		Miscellaneous expenditure		
Proposed dividend	300	870	to the extent not written of		150
		6,800			6,800

You are provided with further information as follows :

(a) On 1.4.97 E Ltd. had sold some of its fixed assets for ₹ 100 lakhs [written down value ₹ 250 lakhs]. These assets were revalued earlier. As on 1.4.97 the revaluation reserve corresponding to these assets stood at ₹ 200 lakhs. The profit on sale of property as shown in the profit and loss statement represented the transfer of this amount. Loss on sale of the asset was included in the cost of goods sold etc.

(b) During the year E Ltd. undertook restructuring exercise of its operations at a cost of ₹ 150 lakhs. This amount stood included in "miscellaneous expenditure to the extent not written off".

(c) Included in sales and other income is a sum of ₹ 100 lakhs representing royalty receivable for supply of know-how to a company in South-East Asia. As per agreement the amount is to be received in US Dollars. However, exchange permission was denied to the company in South-East Asia for remitting the same.

(d) E Ltd. purchased fixed assets costing ₹ 1,825 lakhs on 1.4.97 and the same was fully financed by foreign currency loan [i.e. US Dollars] repayable in five equal instalments annually. [Exchange rate at the time of purchase was 1 US Dollar = ₹ 36.50]. As on 31.3.98 the first instalment was paid when 1 US Dollar fetched ₹ 41.50. The entire loss on exchange was included in cost of goods sold etc. E Ltd. normally provides depreciation on fixed assets at 20% on WDV basis.

(e) Dividend at 10% on paid up equity capital is to be maintained as in prior years.

You are required to redraft the financial statements of E Ltd. for the year ended 31.3.98 in accordance with relevant provisions of accounting standards. Journal entries (wherever applicable) in respect of the information given are to be shown. Schedules, previous year's figures and cash flow statement are not required. (20 marks)

Answer :

(1) As per Para 14.4 and Para 32 of AS-10 on Accounting for Fixed Assets, on disposal of a previously revalued item of fixed asset, the difference between net disposal proceeds and the net book value is normally charged or credited to the profit and loss statement except that to the extent such a loss is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilised, it is charged directly to that account. The amount standing in revaluation reserve following the retirement or disposal of an asset which relates to that asset may be transferred to general reserve.

Accordingly, the following journal entries are to be passed :

			(₹ in lakhs)
Profit on sale of Property	Dr.	200	
To Loss on Sale of Fixed Assets			150
To General Reserve			50

[Alternatively, these entries can be passed through Revaluation Reserve Account. That is, ‘Profit on Sale of Property’ can be credited first to Revaluation Reserve Account and then, this Reserve will be debited with loss on sale of fixed assets (included in ‘Cost of Goods Sold etc.’) and the balance will be transferred to General Reserve.]

(2) As per Para 12 of AS-5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, 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.

Accordingly, the entire restructuring cost ₹ 150 lakh requires separate disclosure in the statement of profit and loss instead of deferring and showing it under miscellaneous expenditure.

(3) According to Para 9.2 of AS-9 Revenue Recognition, where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g. for escalation of price, export incentives, interest, etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made.

Thus, 'Sales and other income' should be reduced by ₹ 100 lakh with equivalent credit to Royalty Receivable Account.

Alternatively, the students may apply Para 9.3 of AS-9, after making reasonable assumption as to the timing of the uncertainty. According to Para 9.3 when the uncertainty relating to collectibility arises subsequent to the time of sale or the rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

(4) As per Para 10 of AS-11 (Revised) on Accounting for the Effects of Changes in Foreign Exchange Rates, exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets, which are carried in terms of historical cost, should be adjusted in the carrying amount of the respective fixed assets. The carrying amount of such fixed assets should, to the extent not already so adjusted or otherwise accounted for, also be adjusted to account for any increase or decrease in the liability of the enterprise, as expressed in the reporting currency by applying the closing rate, for making payment towards the whole or a part of the cost of the assets or for repayment of the whole or a part of the money borrowed by the enterprise from any person, directly or indirectly, in foreign currency specifically for the purpose of acquiring those assets.

Thus the entire loss on exchange should be added to the carrying amount of fixed assets and not to the cost of goods sold.

Further, depreciation on the revised unamortised depreciable amount should also be provided, in accordance with Para 25 of AS-6 (Revised) on Depreciation Accounting.

Calculation of Exchange Loss :

Foreign currency loan = $\frac{₹\ 1,825 \text{ lakhs}}{₹\ 36.50}$ = 50 lakh US dollars

Exchange loss = 50 lakhs US dollars × (41.50 – 36.50) = ₹ 250 lakhs (including exchange loss on payment of first instalment)

Calculation of additional depreciation on account of increase in the depreciable amount of fixed assets:

20% on ₹ 250 lakh = ₹ 50 lakh

The following journal entries are required to be passed :

(₹ in lakhs)

Fixed Assets	Dr.	250	
To Exchange Loss (or 'Cost of Goods Sold etc.')			250
Depreciation	Dr.	50	
To Provision for Depreciation			50

E. Ltd.
Balance Sheet as at 31st March, 1998

(₹ in lakhs)

I.	**SOURCES OF FUNDS**			
	(1) Shareholders Funds			
	(a) Capital		3,000	
	(b) Reserves and Surplus :			
	General Reserve	590		
	Profit and Loss Account	340	930	3,930
	(2) Loan Funds :			
	(a) Secured Loans		2,000	
	(b) Unsecured loans		—	2,000
		TOTAL		5,930
II	**APPLICATION OF FUNDS**			
	(1) Fixed Assets :			
	(a) Gross block	5,000		
	Exchange difference capitalised	250	5,250	
	(b) Less: Depreciation (1,000 + 50)		1,050	
	(c) Net block		4,200	
	(d) Capital work in progress		—	4,200
	(2) Investments			—
	(3) Current Assets, Loan and Advances :			
	(a) Inventories			
	(b) Sundry debtors		800	
	(c) Cash balance		1,000	
	(d) Other current assets		550	
	(e) Loans and Advances (Advance tax)		—	
			200	
	Less : Current Liabilities and Provisions :		2,550	
	(a) Liabilities			
	(b) Provisions :		240	
	Provision for Taxation	280		
	Proposed Dividend	300	580	
			820	
	Net Current Assets			
	(4) Miscellaneous expenditure			1,730
	(to the extent not written off or adjusted)			
		TOTAL		5,930

Profit and Loss Account
for the year ended 31st March, 1998

	(₹ in lakhs)
Sales and other income (3,500 - 100)	3,400
Cost of goods sold including operating expenses and depreciation (2,740 - 150 - 250 + 50)	(2,390)
Restructuring cost	(150)
Interest charges :	(300)
Profit before Taxation	560
Provision for tax @ 50%)	(280)
Net Profit	280
Balance brought forward from previous year	360
Profit available for Appropriation	640
Proposed Dividend	(300)
Balance carried forward	340

Current year profit after tax is only ₹ 280 lakh as against the proposed dividend of ₹ 300 lakh. Hence, in order to ensure sufficient compliance with section 205 of the Companies. Act, 1956, past profits are utilised to make up the shortfall (assuming that there are no arrears of depreciation).

Note on Account : The royalty receivable in US dollars for supply of know-how to a company in South-East Asia amounting to ₹ 100 lakh has not been recognised as exchange permission has been denied to the company in South-east Asia for remitting the same.

Notes :

1. In the absence of any information regarding interest on foreign currency loan taken for financing purchase of fixed assets, no provision has been made for interest liability.
2. It has been assumed that restructuring costs are of revenue nature and thus are allowed for tax purposes.

1998 - Nov [3] The following are the changes in the account balances taken from the Balance Sheets of PQ Ltd. as at the beginning and end of the year :

	Changes in Rupees in debit or [credit]
Equity share capital 30,000 shares of ₹ 10 each issued and fully paid	0
Capital reserve	[49,200]
8% debentures	[50,000]
Debenture discount	1,000
Freehold property at cost/revaluation	43,000

Plant and machinery at cost	60,000
Depreciation on plant and machinery	[14,400]
Debtors	50,000
Stock and work-in-progress	38,500
Creditors	[11,800]
Net profit for the year	[76,500]
Dividend paid in respect of earlier year	30,000
Provision for doubtful debts	[3,300]
Trade investments at cost	47,000
Bank	[64,300]
	0

You are informed that :

(a) Capital reserve as at the end of the year represented realised profits on sale of one freehold property together with surplus arising on the revaluation of balance of freehold properties.

(b) During the year plant costing ₹ 18,000 against which depreciation provision of ₹ 13,500 was lying, was sold for ₹ 7,000.

(c) During the middle of the year ₹ 50,000 debentures were issued for cash at a discount of ₹ 1,000.

(d) The net profit for the year was after crediting the profit on sale of plant and charging debenture interest.

You are required to prepare a statement which will explain, why bank borrowing has increased by ₹ 64,300 during the year end. Ignore taxation. (15 marks)

Answer :

PQ Ltd. Cash flow statement for the year ended...

		₹
Cash flows from operating activities		
Net Profit		76,500
Adjustments for :		
Depreciation	27,900	
Profit on sale of plant	(2,500)	
Interest expense	2,000	
Operating profit before working capital changes	1,03,900	
Increase in debtors (less provision)	(46,700)	
Increase in stock and work-in-progress	(38,500)	
Increase in creditors	11,800	
Net cash from operating activities		30,500
Cash flows from investing activities		
Purchase of plant and machinery	(78,000)	
Proceeds from sale of plant	7,000	

Proceeds from sale of freehold property	6,200	
Increase in trade investments	(47,000)	
Net cash used in investing activities		(1,11,800)
Cash flows from financing activities		
Proceeds from issuance of debentures at discount	49,000	
Debenture interest paid	(2,000)	
Dividend paid in respect of earlier year	(30,000)	
Net cash from financing activities		17,000
Excess of outflows over inflows		64,300

Thus the shortfall of ₹ 64,300 was made up through borrowing from bank.

Working Notes :

		₹
(1)	**Plant and Machinery**	
	Amount of increase (at cost)	60,000
	Add : Disposal (at cost)	18,000
	Acquisition during the year	78,000
	Disposal of plant :	
	Proceeds from sale	7,000
	Net book value (18,000 - 13,500)	4,500
	Profit on sale	2,500
(2)	**Freehold property**	
	Capital Reserve	49,200
	Less : Increase in freehold property (closing balance minus opening balance)	43,000
	Proceeds from sale of freehold property	6,200

(a) Memorandum Accounts

Plant and Machinery Account

		₹		₹
To	Balance b/d	—	By Bank (Sale proceeds)	7,000
To	Profit and Loss A/c (Profit on sale)	2,500	By Provision for Depreciation	13,500
			By Balance c/d	60,000
To	Bank (Balancing figure)	78,000		
		80,500		80,500

(b) Provisions for Depreciation (Plant and Machinery) Account

		₹		₹
To	Plant and Machinery A/c	13,500	By Balance b/d	—
To	Balance c/d	14,400	By Profit and Loss A/c (Balancing figure)	27,900
		27,900		27,900

(c) **Freehold Property Account**

		₹		₹
To	Balance b/d	—	By Bank A/c (Balancing figure)	6,200
To	Capital Reserve	49,200	By Balance c/d	43,000
		49,200		49,200

In the absence of information about the opening balances, the entire amount of change has been considered under the closing balances for the purpose of calculation of missing figures.

Notes :

(1) Investment income and dividend pertaining to the current year have not been considered in the absence of any related information.

(2) Debenture interest has been calculated for six months @ 8% on ₹ 50,000.

(3) The statement required in the question has been prepared in accordance with AS-3 (Revised) on Cash Flow Statements (Indirect Method).

1999 - May [6] (a) A Limited Company closed its accounting year on 30-6-98 and the accounts for that period were considered and approved by the board of directors on 20th August, 1998. The company was engaged in laying pipe line for an oil company, deep beneath the earth. While doing the boring work on 1-9-98 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of ₹ 80 lakhs. You are required to state with reasons, how the event would be dealt within the financial statements for the year ended 30-6-98. (3 marks)

(b) X Co. Ltd., has obtained an Institutional Loan of ₹ 680 lakhs for modernisation and renovation of its plant & machinery. Plant & machinery acquired under the modernisation scheme and installation completed on 31-3-98 amounted to ₹ 520 lakhs, 30 lakhs has been advanced to suppliers for additional assets and the balance loan of ₹ 130 lakhs has been utilised for working capital purpose. The total interest paid for the above loan amounted to ₹ 68 lakhs during 1997-98.

You are required to state how the interest on the institutional loan is to be accounted for in the year 1997-98. (4 marks)

(c) Y Co. Ltd., used certain resources of X Co. Ltd. In return X Co. Ltd. received ₹ 10 lakhs and ₹ 15 lakhs as interest and royalties respectively from Y Co. Ltd. during the year 1997-98.

You are required to state whether and on what basis these revenues can be recognised by X Co. Ltd. (3 marks)

(d) Ltd. purchased fixed assets costing ₹ 3,000 lakhs on 1-1-98 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40.00 and ₹ 42.50 as on 1-1-98 and 31-12-98 respectively. First instalment was paid on 31-12-98. The entire difference in foreign exchange has been charged to revenue for the year 1998.

You are required to state, how these transactions would be accounted for.

(3 marks)

(e) Limited Company finds that the stock sheets as on 31-3-97 had included twice an item the cost of which was ₹ 20,000.

You are asked to suggest, how the error would be dealt with in the accounts of the year ended 31-3-98. (3 marks)

Answer :

(a) According to Para 3.2 of AS 4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date 'events occurring after the balance sheet date' are 'significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors in the case of a company'.

In this case the incidence, which was expected to push up cost became evident after the date of approval of the accounts. So that was not an 'event occurring after the balance sheet date.' However, this may be mentioned in the Director's Report.

(b) The treatment for total interest amount of ₹ 68 lakhs can be given as follows :

Purpose	*Nature*	*Interest to be capitalized ₹in lakhs*	*Interest to be charged to Profit and loss account ₹ in lakhs*
Modernisation and renovation of plant and machinery	Qualifying assets*	$\frac{62 \times 520}{680} = 47.41$	
Advance to Suppliers for additional assets	Qualifying assets*	$\frac{62 \times 30}{680} = 2.74$	
Working Capital	Not a qualifying asset	$\frac{62 \times 130}{680}$	= 11.85
		50.15	11.85

(c) According to 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 collectibility exists. These revenues are recognised on the following basis :

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

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

(d) According to para 13 of AS 11 (Revised 2003) ' The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognized as income or expense.

Calculation of Exchange Difference :

Foreign currency loan = $\frac{₹\ 3,000 \text{ lakhs}}{₹\ 40}$ = 75 lakhs US Dollars

Exchange difference = 75 lakhs US Dollars × (42.50 - 40.00)
= ₹ 187.50 lakhs

(including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting ₹ 187.50 lakhs should be charged to profit and loss account for the year.

(e) The error in the recording of closing stock of the year ended 31st March, 1997 must have also resulted in overstatement of profits of previous year, brought forward to the current year ended 31st March, 1998. Vide para 4 of AS-5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, the rectifications as required in the current year are 'Prior Period Items'. Accordingly, ₹ 20,000 should be deducted from opening stock in the profit and loss account. And ₹ 20,000 should be charged as prior period adjustment in the profit and loss account for the year ended 31st March 1998 in accordance with para 15 of AS-5 (Revised) which requires that the nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.

1999 - Nov [4] History Ltd. set up a factory on 1st Jan., 1980 at a cost of ₹ 100 crores financed 50% by debentures, 30% by preference capital and 20% by equity capital. By 31st December, 1989 the debentures were repaid and preference capital redeemed.

The net asset value per rupee of equity investment made on 1st Jan., 1980 as on 31-12-1989 was ₹ 8 of which 10% was in fixed assets and the balance 90% was in net working capital.

On 1st January, 1990 the company made a rights issue of equity shares at a premium of 50% in the ratio of 1:1; it also made a public issue of equity shares at a premium of 200% to the tune of 80% of equity capital after the rights issue. The entire proceeds of rights and public issue were earmarked for capital expenditure.

On 31st December, 1998 the net asset value of one rupee of equity capital based on the position as on 1-1-1990 was ₹ 41 of which only 1% was in fixed assets and the balance was in net working capital.

You are informed that :

(i) Capital expenditure was made only in 1980 and 1990

(ii) Re. 1 of 1980 is equal to ₹ 3 of 1990 and ₹ 15 of 1999.

History Ltd. asks you to:

(a) Prepare Balance Sheets as on 1st Jan., 1980, 31st Dec., 1989, 1st Jan., 1990, 31st Dec., 1998.

(b) Work out the retained profit over the period 1st Jan., 1980, to 31st Dec., 1998 under the concept of physical capital maintenance. (16 marks)

Answer :

History Ltd.
Balance Sheet as on 1st January, 1980

		(₹ in crores)
I. SOURCES OF FUNDS		
1. Shareholder's funds:		
Equity Share capital	20	50
Preference share capital	30	50
2. Loan funds:		
Debentures		
TOTAL		100
II. APPLICATION OF FUNDS		
1. Fixed assets		
TOTAL		100
		100

Balance Sheet as on 31st December, 1989

			(₹ in crores)
I.	SOURCES OF FUNDS		
	1. Shareholder's funds:		
	Equity Share capital	20	
	Reserves and Surplus	140	160
	2. Loan funds:		—
	TOTAL		160
II.	APPLICATION OF FUNDS		
	1. Fixed assets		16
	2. Net working capital		144
			160

Balance Sheet as on 1st January, 1990

			(₹ in crores)
I.	SOURCES OF FUNDS		
	1. Shareholder's funds:		
	Equity share capital		72
	Share premium	74	
	Other reserves and surplus	140	214
			286
	2. Loan funds		—
	TOTAL		286
II.	APPLICATION OF FUNDS		
	1. Fixed assets		142
	2. Net working capital		144
	TOTAL		286

Balance Sheet as on 1st December, 1998

			(₹ in crores)
I.	SOURCES OF FUNDS		
	1. Shareholder's funds:		
	Equity share capital	72.00	

	Share premium	74.00		
	Other reserves and surplus	2,806.00	2,880.00	2,952.00
2.	Loan funds			—
	TOTAL			2,952.00
II.	APPLICATION OF FUNDS			
1.	Fixed assets			29.52
2.	Net working capital			2,922.48
	TOTAL			2,952.00

(b) Retained Profit under Concept of Physical Capital Maintenance (from 1st January, 1980 to 31st December, 1998)

(₹ in crores)

Equity on 31st December, 1998 (including premium)		2,952	
Less: Indexed value of equity share capital (including premium)			
20 × 15	300		
126 × 15/3	630	930	2,022

Working Notes:

1. Issue of equity shares on 1st January, 1990:

(₹ in crores)

	Paid-up value	Share premium	Total
Rights issue	20	10	30
Public issue (80% of 40)	32	64	96
	52	74	126

2. Calculation of net assets

As on 31st December, 1989:

(₹ in crores)

Net asset value of equity share capital ₹ 20 crore (20 × 8) 160

As on 31st December, 1998 :

Net asset value of equity share capital ₹ 72 crore (72 × 41) 2,952

2000 - May [2] (b) (i) Advise P Co. Ltd. about the treatment of the following in the Final Statement of Accounts for the year ended 31st March, 2000.

A claim lodged with the Railways in March, 1997 for loss of goods of ₹ 2,00,000 had been passed for payment in March, 2000 for ₹ 1,50,000. No entry was passed in the books of the Company, when the claim was lodged. (3 marks)

(ii) The notes to accounts of X Ltd. for the year 1999-2000 include the following:

"Interest on bridge loan from banks and Financial Institutions and on Debentures specifically obtained for the Company's Fertiliser Project amounting to ₹ 1,80,80,000 has been capitalised during the year, which includes approximately ₹ 1,70,33,465 capitalised in respect of the utilisation of loan and debenture money for the said purpose". Is the treatment correct? Briefly comment. (3 marks)

Answer :

(i) According to Para 9.2 of AS-9 on 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. Para 9.5 of AS-9 states that when recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised. In this case it may be assumed that collectibility of claim was not certain in the earlier periods.. This is supposed from the fact that only ₹ 1,50,000 were collected against a claim of ₹ 2,00,000. So this transaction can not be taken as a Prior Period Item.

Accordingly as per revised AS-5, it will not be treated as extraordinary item. However, para 12 of AS-5 (Revised) states that 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. Accordingly the nature and amount of this item should be disclosed separately as per para 12 of AS-5 (Revised).

(ii) The treatment done by the company is not in accordance with AS-16 'Borrowing Costs'. As per para 10 of AS-16, 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. Hence, the capitalisation of borrowing costs should be restricted to the actual amount of interest expenditure i.e. ₹ 1,70,33,465. Thus, there is an excess capitalisation of ₹ 10,46,535. This has resulted in overstatement of profits by ₹ 10,46,535 and amount of fixed assets has also gone up by this amount.

2000 - Nov [4] (a) M Ltd. Group has three divisions A, B and C. Details of their turnover, results and net assets are given below:

	₹ ('000)
Division A	
Sales to B	3,050

Other Sales (Home)	60
Export Sales	4,090
	7,200
Division B	
Sales to C	30
Export Sales to Europe	200
	230
Division C	
Export Sales to America	180

	Head Office ₹ ('000)	A ('000)	Divisions B ('000)	C ('000)
Operating Profit or Loss before tax		160	20	(8)
Re-allocated cost from Head Office		48	24	24
Interest costs		4	5	1
Fixed assets	50	200	40	120
Net current assets	48	120	40	90
Long-term liabilities	38	20	10	120

Prepare a Segmental Report for publication in M Ltd. Group. (8 marks)

Answer :

M Ltd.
Segmental Report

	Divisions			*Inter segment eliminations*	*Consolidated Total (₹ 000)*
	A	*B*	*C*		
Segment Revenue					
Sales					
Domestic	60	—	—	—	60
Export	4,090	200	200	—	4,470
External sales	4,150	200	180	—	4,530
Inter Segment sales	3,050	30	—	3,080	—
Total Revenue	7,200	230	180	3,080	4,530
Segment result (given)	160	20	(8)		172
Head office expenses					96
Operating profit					76

Interest expenses					(10)
Profit before tax					
Other Information :					
Fixed assets	200	40	120		360
Net current assets	120	40	90		250
Segment assets	320	80	210		610
Unallocated corporate assets					98
Segment liabilities	20	10	120		150
Unallocated corporate liabilities					38

Sales Revenue by Geographical Market

	Domestic Sales	*Export Sales 9by division A)*	*Export to Europe*	*Export to America*	*Consolidated Total (₹ 000')*
External sales	60	4,090	200	180	4,530

2000 - Nov [6] (a) State with reference to accounting standard, how will you value the inventories in the following cases :

(i) Raw material was purchased at ₹ 100 per kilo. Price of raw material is on the decline. The finished goods in which the raw material is incorporated is expected to be sold at below cost. 10,000 kg. of raw material is on stock at the year end. Replacement cost is ₹ 80 per kg.

(ii) In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in a wastage of 300 MT. Cost per MT of input is ₹ 1,000. The entire quantity of waste is on stock at the year end.

(iii) Per kg. of finished goods consisted of:
Material cost ₹ 100 per kg.
Direct labour cost ₹ 20 per kg.
Direct variable Production overhead ₹ 10 per kg.

Fixed production charges for the year on normal capacity of one lakh kg. is ₹ 10 lakhs. 2,000 kg. of finished goods are on stock at the year end. (3 × 4 = 12 marks)

Answer :

(i) As per para 24 of AS 2 (Revised) on Valuation of Inventories, materials and other supplies held for use in the production of inventories are not written down below cost if the finished product in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

Hence, in the given case, the stock of 10,000 kgs of raw material will be valued at ₹ 80 per kg. The finished goods, if on stock, should be valued at cost or net realisable value whichever is lower.

(ii) As per para 13 of AS 2 (Revised), abnormal amounts of waste materials, labour or other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred.

In this case, normal waste is 250 MT and abnormal waste is 50 MT. The cost of 250 MT will be included in determining the cost of inventories (finished goods) at the year end. The cost of abnormal waste amounting to ₹ 50,000 (50 MT × ₹ 1,000) will be charged in the profit and loss statement.

(iii) In accordance with paras 8 and 9 of AS-2 (Revised), the cost of conversion include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. The allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion is based on the normal capacity of the production facilities.

Thus, cost per kg. of finished goods can be computed as follows :

	₹
Material cost	100
Direct labour cost	20
Direct variable production overhead	10
Fixed production overhead $\left(\frac{₹\ 10,00,000}{₹\ 1,00,000}\right)$	10
	140

Thus, the value of 2,000 kgs. of finished goods on stock at the year end will be ₹ 2,80,000 (2,000 kgs × ₹ 140).

2001 - May [1] Marks Limited manufactures a special type of Computer. The company has a software division for developing programs with respect to specialised areas such as Medical Imaging, Process Control and Information System.

Following is the draft of Profit and Loss Account prepared by the Chief Accountant for the year ended 31st March, 2000:

Figures in Lakhs

	₹	₹
Sales: Hardware division	1,200	
Software division	800	2,000

Opening stock of finished goods		90
Raw materials consumed	400	
Direct labour — Hardware division	250	
— Software division	150	
Variable production overheads — Hardware division	150	
— Software division	50	
Fixed Production Overheads (including interest and depreciation).		
— Hardware division	290	
— Software division	100	
Closing stock of finished goods	(180)	1,300
Gross Profit		700
Administration Expenses	50	
Selling and distribution expenses	150	200
Profit before tax		500
Tax at 40%		200
Profit after tax		300
Add: Balance of profit b/f		200
Profit carried forward		500

The following further informations are given :

(a) 10 employees, who were working in a software division were made redundant on account of abandoning a particular software program and each of them were paid a compensation of ₹ 5 lakhs on the average. This cost is included in direct labour.

(b) The fixed production overheads of Hardware division included interest of ₹ 50 lakhs and depreciation of ₹ 50 lakhs. Further this sum of ₹ 50 lakhs included an additional depreciation of ₹ 10 lakhs on a special machinery used in the manufacture of computer parts for better display purposes.

(c) During the year, the Software division supplied a special program for a foreign firm on a consideration of ₹ 100 lakhs. It was found on June 1st, 2000 that the foreign firm has become bankrupt. The company had received an advance of ₹ 50 lakhs in the year ended 31st March, 2000 from the foreign firm.

(d) The Software division was involved in a special program on hospital information system. The company so far incurred a sum of ₹ 20 lakhs as salaries and ₹ 10 lakhs as overheads, which were included in direct labour and fixed production overheads, respectively. Management feels that a further ₹ 50 lakhs will be required to complete the program, so that it can be effectively marketed.

(e) Included in Fixed production overheads of Hardware division is a sum of ₹ 50 lakhs being the cost of prototype computers manufactured by the company. These are not to be sold, but to be kept back for demonstrating the medical imaging software program.

(f) The company manufactured 550 computers during the year. It has a policy of valuing finished stock of goods at a standard cost of ₹ 1.8 lakhs per computer.

(i) Redraft the Profit and Loss Account for the year ended 31st March, 2000 with reference to relevant Accounting Standards issued by the institute. (15 marks)

(ii) Compute the value of Closing Stock of finished goods. (5 marks)

Answer :

Marks Limited
Profit and Loss Account
For the year ended 31st March, 2000

	(₹ in lakhs)	
Sales - Hardware division	1,200	
- Software division	800	2,000
Less : Expenditure		
Opening stock of finished goods	90	
Raw material consumed	400	
Direct labour -Hardware division	250	
-Software division	80	
Variable production overheads — Hardware division	150	
— Software division	50	
Fixed Production Overheads — Hardware division	140	
— Software division	90	
Closing stock of finished goods	(180)	
Cost of prototype computer written off	10	
Administration Expenses	50	
Selling and distribution expenses	150	
Provision for bad debts	50	
Redundancy payment	50	
Depreciation (including additional depreciation of ₹ 10 lakhs)	50	
Interest	50	(1,480)
Profit before tax		520
Provision for tax (40%)		(208)
Profit after tax		312
Add : Balance of profit b/f		200
Surplus carried to balance sheet		512

Comments :

(a) Compensation : The compensation on account of redundancy ₹ 50 lakhs should be disclosed separately as per para 12 of AS-5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

(b) Interest and Depreciation : Interest of ₹ 50 lakhs cannot be treated as production overheads. It will be disclosed separately in the profit and loss account as per the requirements of Part II of schedule VI to the Companies Act. Similarly depreciation is also to be disclosed separately.

(c) Sales to foreign firm : This is an event occurring after the balance sheet date and accounts are only at draft stage. In accordance with para 13 of AS-4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date, adjustments to assets and liabilities are required. Hence the sum of ₹ 50 lakhs (₹ 100 lakhs - advance of ₹ 50 lakhs) should be provided for by way of provision for bad debts.

(d) Special program on hospital information system : As per para 9 of AS-8 on Accounting for Research and Development, research and development costs of a project may be deferred to future periods, if the following criteria are satisfied:

(i) The product or process is clearly defined and the costs attributable to the product or process can be separately identified ;

(ii) The technical feasibility of the product or process has been demonstrated ;

(iii) The management of the enterprise has indicated its intention to produce and market, or use, the product or process;

(iv) There is a reasonable indication that current and future research and development costs to be incurred on the project together with expected production, selling and administration costs are likely to be more than covered by related future revenues/benefits; and

(v) Adequate resources exist or are reasonable expected to be available, to complete the project and market the product or process.

From the information given, it may be inferred that the above conditions are more or less satisfied. Hence ₹ 30 lakhs i.e. ₹ 20 lakhs direct labour and ₹ 10 lakhs production overheads will have to be deferred.

(e) Cost of prototype computers : An accounting policy is necessary regarding the writing off of the cost of these prototype computers as per AS-1 on Disclosure of Accounting Policies. Hence assuming that expenditure is to be written off over a period of five years, the amount to be treated as expense of the year is ₹ 10 lakhs. (**Note :** Students may assume any appropriate number of years for the purpose of writing off)

2001 - May [5] Ms. Jyothi of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year 2000 :

	(₹ in Lakhs)
Net Profit	25,000
Dividend (including dividend tax) paid	8,535
Provision for Income-tax	5,000

Income-tax paid during the year	4,248
Loss on sale of assets (net)	40
Book value of the assets sold	185
Depreciation charged to Profit & Loss Account	20,000
Amortisation of Capital grant	6
Profit on sale of Investments	100
Carrying amount of Investment sold	27,765
Interest income on investments	2,506
Interest expenses	10,000
Interest paid during the year	10,520
Increase in Working Capital (excluding Cash & Bank balance)	56,075
Purchase of fixed assets	14,560
Investment in joint venture	3,850
Expenditure on construction work in progress	34,740
Proceeds from calls in arrear	2
Receipt of grant for capital projects	12
Proceeds from long-term borrowings	25,980
Proceeds from short-term borrowings	20,575
Opening cash and Bank balance	5,003
Closing cash and Bank balance	6,988

Required : Prepare the Cash Flow Statement for the year 2000 in accordance with AS-3, Cash Flow Statements issued by the Institute of Chartered Accountants of India. (Make necessary assumptions). (16 marks)

Answer :

Star Oils Limited
Cash Flow Statement
for the year ended 31st December, 2000

	(₹ in lakhs)
Cash flows from operating activities	
Net profit before taxation (25,000 + 5,000)	30,000
Adjustments for :	
Depreciation	20,000
Loss on sale of assets (Net)	40
Amortisation of capital grant	(6)
Profit on sale of investments	(100)
Interest income on investments	(2,506)
Interest expenses	10,000
Operating profit before working capital changes	57,428
Changes in working capital (excluding cash and bank balance)	(56,075)

Cash generated from operations	1,353	
Income taxes paid	(4,248)	
Net cash used in operating activities		(2,895)
Cash flow from investing activities		
Sale of assets	145	
Sale of investments (27,765 + 100)	27,865	
Interest income on investments	2,506	
Purchase of fixed assets	(14,560)	
Investment in joint venture	(3,850)	
Expenditure on construction work-in-progress	(34,740)	
Net cash used in investing activities		(22,634)
Cash flows from financing activities		
Proceeds from calls in arrear	2	
Receipts of grant for capital projects	12	
Proceeds from long-term borrowings	25,980	
Proceeds from short-term borrowing	20,575	
Interest paid	(10,520)	
Dividend (including dividend tax) paid	(8,535)	
		27,514
Net increase in cash and cash equivalents		1,985
Cash and cash equivalents at the beginning of the period		5,003
Cash and cash equivalents at the end of the period		6,988

Working Notes :

Book value of the assets sold	185
Less : Loss on sale of assets	40
Proceeds on sale	145

Assumption :

Interest income on investments ₹ 2,506 has been received during the year.

2001 - Nov [2] (a) R Limited (the Lessee) acquired a machinery on lease from S Limited (the Lessor) on January 1, 2000. The lease term covers the entire economic life of the machinery i.e. 3 years. The fair value of the machinery on January 1, 2000 is ₹ 3,50,000. The lease agreement requires the lessee to pay an amount of ₹ 1,50,000 per year beginning December 31, 2000. The lessee has guaranteed a residual value of ₹ 11,400 on December 31, 2002 to the lessor. The lessor however estimates that the machinery will have a salvage value of only ₹ 10,000 on December 31, 2002. The implicit rate of interest is 15% p.a. Compute the value of machinery to be recognised by the lessee and also the finance charges every year on the basis of AS 19. P.V. Factor of 15% in three years is 2.283. (8 marks)

(b) X Limited sold to Y Limited goods having a sales value of ₹ 25 lakhs during the financial year ended 31.03.2001. Mr. A, the Managing Director and Chief Executive of X Limited owns nearly 100 percent of the capital of Y Limited. The sales were made to Y Limited at the normal selling price of X Limited.

The Chief Accountant of X Limited does not consider that these sales should be treated any differently from any other sale made by the company despite being made to a controlled company, because the sales were made at normal and, that too, at arms' length prices.

Discuss the above issue from the new point of AS 18. (8 marks)

Answer :

(a) Taking the fair value of the machinery, the value of machinery to be recognised by R Limited i.e. the lessee would be ₹ 3,50,000

The lease payments would be apportioned by the lessee between the finance charge and the reduction of the outstanding liability as follows :

Year		*Finance Charge (₹)*	*Payment (₹)*	*Reduction in Outstanding Liability (₹)*	*Outstanding Liability (₹)*
Year 1	(January 1)	—	—	—	3,50,000
	(December 31)	52,500	1,50,000	97,500	2,52,500
Year 2	(December 31)	37,875	1,50,000	1,12,125	1,40,375
Year 3	(December 31)	21,056	1,50,000	1,28,944	11,431*]

The difference between this figure and guaranteed residual value of ₹ 11,400 is due to approximation in computing the interest rate implicit in the lease.

Alternatively, the students may, first, calculate the present value of the minimum lease payments, as shown below :

Present value of minimum lease payments :

Annual lease rental × P.V. Factor + Present value of Guaranteed residual value

$$= 1{,}50{,}000 \times 2.283 + 11{,}400 \times \frac{1}{(1+.15)^3}$$

$$= 3{,}42{,}450 + 7{,}495.69$$

$$= ₹\ 3{,}49{,}945.69$$

As the calculated amount ₹ 3,49,946 is lower than the fair value of the leased asset ₹ 3,50,000 the amount of machinery recognised as an asset and the amount of outstanding liability arising from the lease could be recorded at ₹ 3,49,946 by the lessee. In this case, the calculations will be made as given below :

Year		Finance Charge (₹)	Payment (₹)	Reduction in Outstanding Liability (₹)	Outstanding Liability (₹)
Year 1	(January 1)	—	—	—	3,49,946
	(December 31)	52,500	1,50,000	97,508	2,52,438
Year 2	(December 31)	37,875	1,50,000	1,12,134	1,40,304
Year 3	(December 31)	21,046	1,50,000	1,28,954	11,350*

(b) Para 3 of AS 18 on Related Party Disclosures describes related party relationship as follows:

(a) Enterprises that directly, or indirectly through one or more intermediaries, control or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fallow subsidiaries);

(b) Associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture;

(c) Individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual;

(d) Key management personnel and relatives of such personnel; and

(e) Enterprises over which any person described in (c) or (d) is able to exercise significant influence.

This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.

The sale of goods worth ₹ 25 lakhs falls under AS 18 and hence the following information should be disclosed by X Limited as per para 23 of AS 18.

(1) The name of the transacting related party ;

(2) A description of the relationship between the parties;

(3) A description of the nature of transactions;

(4) Volume of the transactions either as an amount or as an appropriate proportion;

(5) Any other elements of the related party transactions necessary for an understanding of the financial statements;

(6) The amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet and provision for doubtful debts due from such parties at that date; and

(7) Amounts written off or written back in the period in respect of debts due from or to related parties.

2001 - Nov [6] (b) From the following Summary Cash Account of X Ltd. Prepare Cash Flow Statement for the year ended 31st March, 2001 in accordance with AS-3 (Revised) using the direct method. The Company does not have any cash equivalents.

Summary Cash Account for the year ended 31.3.2001

	₹ '000		₹ '000
Balance on 1.4.2000	50	Payment to Suppliers	2,000
Issue of Equity Shares	300	Purchase of Fixed Assets	200
Receipts from Customers	2,800	Overhead expense	200
Sale of Fixed Assets	100	Wages and Salaries	100
		Taxation	250
		Dividend	50
		Repayment of Bank Loan	300
		Balance of 31.3.2001	150
	3,250		3,250

(8 marks)

Answer :

X Ltd.
Cash Flow Statement for the year ended 31st March, 2001
(Using the direct method)

	₹ '000	*₹ '000*
Cash flows from operating activities		
Cash receipts from customers	2,800	
Cash payments to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payment for overheads	(200)	
Cash generated from operations	500	
Income tax paid	(250)	
Net cash from operating activities		250
Cash flows from investing activities		
Payment for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	100	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	
Dividend paid	(50)	

Net cash used in financing activities	(50)
Net increase in cash	100
Cash at beginning of period	50
Cash at end of period	150

2002 - May [3] (b) Answer the following questions by quoting the relevant Accounting Standard:

(i) During the year 2001-02, a medium size manufacturing company wrote down its inventories to net realisable value by ₹ 5,00,000. Is a separate disclosure necessary? (4 marks)

(ii) A limited company has been including interest in the valuation of closing stock. In 2001-02, the management of the company decided to follow AS-2 and accordingly interest has been excluded from the valuation of closing stock. This has resulted in a decrease in profits by ₹ 3,00,000. Is a disclosure necessary? If so, draft the same. (4 marks)

(iii) A company signed an agreement with the Employees Union on 1.9.2001 for revision of wages with retrospective effect from 30.9.2000. This would cost the company an additional liability of ₹ 5,00,000 per annum. Is a disclosure necessary for the amount paid in 2001-02? (4 marks)

Answer :

(i) Although the case under consideration does not relate to extraordinary item, but the nature and amount of such item may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. Para 12 of AS-5 (Revised in 1997) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies states that :

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

Circumstances which may give to separate disclosure of items of income and expense in accordance with para 12 of AS 5 include the write-down of inventories to net realisable value as well as the reversal of such writ-downs.

(ii) As per AS 5 (Revised), change in accounting policy can be made for many reasons, one of these is for compliance with an accounting standard. In the instant case, the company has changed its accounting policy in order to conform with the AS-2 (Revised) on Valuation of Inventories. Therefore, a disclosure is necessary in the following lines by way of notes to the annual accounts for the year 2001-2002.

"To be in conformity with the Accounting Standard on Valuation of Inventories issued by ICAI, interest has been excluded from the valuation of closing stock unlike preceding years. Had the same principle been followed in previous years, profit for the year and its corresponding effect on the year end net assets would have been higher by ₹ 3,00,000."

(iii) It is given that revision of wages took place on 1st September, 2001 with retrospective effect from 30.9.2000. Therefore wages payable for the half year from 1.10.2000 to 31.3.2001 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item.

Additional wages liability of ₹ 7,50,000 (for $1\frac{1}{2}$ years @ ₹ 5,00,000 per annum) should be included in current year's wages.

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 of the period, the nature and amount of such items should be disclosed separately.

2002 - Nov [1] On 30th September, 1999 Beta Enterprises Ltd. was incorporated with an Authorised Capital of ₹ 50 lakhs. Its first accounts were closed on 31st March, 2000 by which time it had become a listed company with an issued subscribed and paid up Capital of ₹ 40 lakhs in 4,00,000 Equity Shares of ₹ 10 each.

The company started off with two lines of business namely 'Engineering Division' and 'Chemicals Division', with equal asset base with effect from 1st April, 2000. The 'Ceramics Division' was added by the company on 1st April, 2001. The following data is gathered from the books of account of Beta Enterprises Ltd.:

Trial Balance as on 31st March, 2002

(Rupees in 000's)

	Dr.	Cr.
Engineering Division sales	—	6,000
Cost of Engineering Division sales	2,600	—
Chemicals Division sales	—	8,000
Cost of sales of Chemicals Division	4,300	—
Ceramics Division sales	—	1,500
Cost of sales of Ceramics Division	900	—
Administration costs	2,000	—

Distribution costs	1,500	—
Dividend-Interim	1,200	—
Fixed Assets at cost	9,000	—
Depreciation on Fixed Assets	—	1,500
Stock on 31st March, 2002	400	—
Trade Debtors	440	—
Cash at Bank	160	—
Trade Creditors	—	500
Equity Share Capital in shares of ₹ 10 each	—	4,000
Retained Profits	—	1,000
	22,500	22,500

Additional Information :

(a) Administration costs should be split between the Divisions in the ratio of 5 : 3 : 2.

(b) Distribution costs should be spread over the Divisions in the ratio of 3 : 1 : 1.

(c) Directors have proposed a Final Dividend of ₹ 8 lakhs.

(d) Some of the users of Ceramics Division are unhappy with the product and have lodged claims against the company for damages of ₹ 7.5 lakhs. The claim is hotly contested by the company on legal advice.

(e) Fixed Assets worth ₹ 30 lakhs were added in the Ceramics Division on 1.4.2001.

(f) Fixed Assets are written off over a period of 10 years on straight line basis in the books. However for Income tax purposes depreciation at 20% on written down value of the assets is allowed by Tax Authorities.

(g) Income tax rate may be assumed at 35%.

(h) During the year Engineering Division has sold to Alpha Ltd. goods having a sales value of ₹ 25 lakhs. Mr. Gamma, the Managing Director of Beta Enterprises Ltd. owns 100% of the issued Equity Shares of Alpha Ltd. The sales made to Alpha Ltd. were at normal selling price of Beta Enterprises Ltd.

You are required to prepare Profit and Loss Account for the year ended 31st March, 2002 and the Balance Sheet as at the date. Your answer should include notes and disclosures as per Accounting Standards. (20 marks)

Answer : **Beta Enterprises Ltd.**

Profit and Loss Account for the year ending 31st March, 2002

	₹ '000
Sales	15,500
Cost of Sales	(7,800)
	7,700
Distribution costs	(1,500)
Administration costs	(2,000)
Profit before tax	4,200

Taxation	1,239	
Deferred tax (35% of ₹ 660)	231	(1,470)
Profit after tax		2,730
Dividends (₹ 1,200 + ₹ 800)		(2,000)
Profit for the year		730
Retained profit brought forward (₹ 1,000 - ₹ 210)		790
Retained Profit carried forward		1,520

Beta Enterprises Ltd.
Balance Sheet as at 31st March, 2002

Liabilities	Amount ₹ '000	Assets	₹ '000	Amount ₹ '000
Share Capital :		*Fixed Assets:*		
Issued and subscribed		Gross block	9,000	
4,00,000 shares of ₹ 10 each,		Less: Depreciation	1,500	7,500
fully paid up	4,000			
Reserve and Surplus :		*Current Assets*		
		Loans and Advances :		
Retained profit	1,520	(a) Current Assets :		
Deferred Tax Liability	441	Stock	400	
Current liabilities and provision :		Debtors	440	
		Cash-at-Bank	160	1,000
(a) Current liabilities :		(b) Loans and Advances		NIL
Creditors	500			
(b) Provisions :				
Provision for tax	1,239			
Proposed dividend	800			
	8,500			8,500

Notes to Accounts:

1. Segmental Disclosures (Business Segments)

(Figures in ₹ 000's)

	Engineering Division	*Chemical Division*	*Ceramics Division*	*Total*
Sales	6,000	8,000	1,500	15,500
Cost of Sales	2,600	4,300	900	7,800
Administration Cost (5 : 3 : 2)	1,000	600	400	2,000
Distribution Cost (3 : 1 : 1)	900	300	300	1,500
Profit / Loss	1,500	2,800	(100)	4,200
	6,000	8,000	1,500	15,500
Original cost of Assets (Equal Capital Base)	3,000	3,000	3,000	9,000

Depreciation @ 10% p.a.				
For the year ended 31.3.2001	300	300	NIL	600
For the year ended 31.3.2002	300	300	300	900

Note : Ceramics division is a reportable segment as per assets criteria.

2. Tax Computation

	(₹ in 000's)
Profit before tax for the year ended 31.3.2002	4,200
Add: Depreciation provided in the books (300 + 300 + 300)	900
	5,100
Less: Depreciation as per Income Tax Act (480 + 480 + 600)	1,560
Taxable Income	3,540
Tax at 35%	1,239

3. Deferred Tax liability (as per AS 22 on Accounting for Taxes on Income)

	₹ '000
Opening Timing Difference on 1.4.2001	
WDV of fixed assets as per books	5,400
WDV of fixed assets as per Income Tax Act	4,800
Difference	600
Deferred Tax Liability @ 35% on 600	210

This has been adjusted against opening balance of retained profits.

Current year (ended 31st March, 2002)

	₹ '000
Depreciation as per Books	900
Depreciation as per Income Tax Act (480 + 480 + 600)	1,560
Difference	660
Deferred Tax Liability @ 35% on 660 (to be carried forward)	231

4. **Contingent Liabilities not provided : Company** is contesting claim for damages for ₹ 7,50,000 and as such the same is not acknowledged as debts.

5. **Related Party Disclosure :** Para 3 of AS 18 lists out related party relationship. It includes, individuals owning, directly or indirectly, an interest in voting power of reporting enterprise which gives them control or significant influence over the enterprises and relatives of any such individual. In the instant case, Mr. Gamma as a managing director controls operating and financial actions of Beta Enterprise Ltd. He is also owning 100% share Capital of Alpha Ltd. thereby exercising control over it. Hence, Alpha Ltd. Is a related party as per para 3 of AS 18.

   Disclosure to be made :

Name of the related party and nature of relationship	Alpha Ltd. Common director
Nature of the transaction	Sale of goods at normal commercial terms
Name of the transaction	Sales to Alpha Ltd. worth ₹25 lakhs.

2002 - Nov [2] (b) A company obtained term loan during the year ended 31st March, 2002 in an extent of ₹ 650 lakhs for modernisation and development of its factory. Buildings worth ₹ 120 lakhs were completed and Plant and Machinery worth ₹ 350 lakhs were installed by 31st March, 2002. A sum of ₹ 70 lakhs has been advanced for Assets the installation of which is expected in the following year. ₹ 110 lakhs has been utilised for Working Capital requirements. Interest paid on the loan of ₹ 650 lakhs during the year 2001-2002 amounted to ₹ 58.50 lakhs. How should the interest amount be treated in the Accounts of the Company? (6 marks)

Answer :

The treatment for total interest amount of ₹ 58.50 Lakhs can be given as follows.

Purpose	*Nature*	*Interest to be capitalized ₹ in lakhs*	*Interest to be charged to Profit and loss account ₹ in lakhs*
Building	Qualifying asset	$\frac{58.5 \times 120}{650} = 10.8$	
Plant and machinery	Qualifying asset	$\frac{58.5 \times 350}{650} = 31.5$	
Advance to suppliers for additional assets	Qualifying asset	$\frac{58.5 \times 70}{650} = 6.3$	
Working capital	Not a qualifying asset		$\frac{58.5 \times 110}{650} = 9.9$
		48.6	9.9

2002 - Nov [6] In the context of relevant Accounting Standards, give your comments on any **four** of the following matters for the financial year ending on 31.3.2002.

(a) Assets and liabilities and income and expenditure items in respect of foreign branches are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to revenue.

(b) Leave encashment benefit is accounted for as per "Pay-as-you-go" method.

(c) Increase in pension liability on account of wage revision in 1999-2000 is being provided for in 5 instalments commencing from that year. The remaining liability of ₹ 300 lakhs as re-determined in actuarial valuation will be provided for in the next 2 years.

(d) A Pharma Company spent ₹ 33 lakhs during the accounting year ended 31st March, 2002 on a research project to develop a drug to treat "AIDS". Experts are of the view that it may take four years to establish whether the drug will be effective or not and even if found effective it may take two to three more years to produce the medicine, which can be marketed. The company wants to treat the expenditure as deferred revenue expenditure.

(e) While preparing its final accounts for the year ended 31st March, 2002 Rainbow Limited created a provision for Bad and Doubtful debts are 2% on trade debtors. A few weeks later the company found that payments from some of the major debtors were not forthcoming. Consequently the company decided to increase the provision by 10% on the debtors as on 31st March, 2002 as the accounts were still open awaiting approval of the Board of Directors. Is this to be considered as an extra-ordinary item or prior period item? (4×4 = 16 marks)

Answer :

(a) The financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures described in paragraphs 8 to 16 of AS 11 (Revised 2003). The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself.

Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. For practical reasons, a rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate.

Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account. Exchange difference arising on the translation of the financial statement of foreign operation may have tax effect which should be dealt as per AS-22 'Accounting for Taxes on Income'.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS-11 (Revised 2003).

Note : for the purpose of translation of assets, liabilities, income and expenditure items of foreign operations, AS-11 (Revised 2003) classifies the foreign operation into two types- Integral foreign operation, Non-integral foreign operation. Integral foreign operation is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. Non-integral foreign operation is a foreign operation that is not an integral foreign operation. The above answer has been given on the basis that the foreign branches referred in the question are integral foreign operations.

(b) As per para 12 of AS-15 on 'Accounting for Retirement Benefits in the Financial Statements of Employers', the cost of retirement benefits to an employer results from receiving services from the employees who are entitled to receive such benefits. Consequently, the cost of retirement benefits is accounted for in the period during which these services are rendered. Accounting for retirement benefit cost only when employees retire or receive benefits payments (i.e. as per pay as you go method) does not achieve the objective of allocation of those costs to the periods in which the services were rendered. Hence, the treatment of leave encashment benefit by the management is not in consonance with AS-15.

Note : AS 15 was revised in March, 2005. AS-15 (revised 2005) covers the leave encashment benefits under the category of short-term employee benefits. Accumulating short-term compensated absence (i.e. earned leaves) are those that are carried forward and can be used for future periods if the current period's entitlement is not used in full [para 13 of AS-15 (Revised)]. Earned leaves which are encashable on retirement or resignation are vesting (which entitle employees to receive cash payment for unused entitlements on leaving the enterprise) accumulating compensated absences. 'An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet dates [Para 14 of AS-15 (Revised)].

(c) Revision of wages and consequential increase in pension liability of employer is not a prior period item as it has not arisen out of errors or omissions of previous year. It is also not an extraordinary item as defined in AS-5 on Net profit or loss for the period, Prior Period Items and Changes in Accounting policies. It is an expense arising out of the ordinary activity of the enterprise. Therefore, it should have been charged during the year 1999-2000, and disclosed separately.

The treatment of deferring to two years, ₹ 30 crores remaining pension liability as redetermined by actuarial valuation is also not in consonance with AS-15 relating to Accounting for Retirement Benefits in the Financial Statements of Employers. As per para 29 of AS-15, any alternations in the retirement benefit costs arising from changes in the actuarial method used or assumptions adopted should be charged or credited to the statement of profit and loss as they arise in accordance with AS-5 "Prior Period and Extraordinary Items and Changes in Accounting Policies". Additionally, a change in the actuarial method used should be treated as a change in an accounting policy and disclosed in accordance with AS-5.

Note : AS-15 was revised in March, 2005. As per para 92 of AS 15 (Revised 2005) 'Employee Benefits', actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense.

(d) As per para 41 of AS-26 'Intangible Assets', no intangible asset arising from research (or from the research phase of an internal project) should be recognized. Expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred. Thus the company cannot treat the expenditure as deferred revenue expenditure. The entire amount of ₹ 33 Lakhs spent on research project should be charged as an expense in the year ended 31st March, 2002.

(e) The preparation of financial statements involve making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revised an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate does not bring the resulting amount within the definition either of prior period items or of an extraordinary item [para 21, AS-5 (Revised)].

In the given case, Rainbow Limited created a provision for bad and doubtful debts at 2% on trade debtors while preparing its final accounts for the year ended 31st March, 2002. Subsequently, the company decided to increase the provision by 10%. As per AS 5 (Revised), this change in estimate is neither a prior period item nor an extraordinary item.

However, as per para 27 of AS-5 (Revised), a change in accounting estimate which has a material effect in the current period should be disclosed and quantified. Any change in an accounting estimate which is expected to have a material effect in later periods should also be disclosed.

2003 - May [1] (a) From the Books of Bharati Ltd., following informations are available as on 1.4.2001 and 1.4.2002 :

		₹
(1)	Equity Shares of ₹ 10 each	1,00,000
(2)	Partly paid Equity Shares of ₹ 10 each ₹ 5 paid	1,00,000
(3)	Options outstanding at an exercise price of ₹ 60 for one equity share ₹ 10 each. Average Fair value of equity share during both years ₹ 75	10,000
(4)	10% convertible preference shares of ₹ 100 each. Conversion ratio 2 equity shares for each preference share	80,000
(5)	12% convertible debentures of ₹ 100 Conversion ratio 4 equity shares for each debenture	10,000

(6) 10% dividend tax is payable for the years ending 31.3.2003 and 31.3.2002.
(7) On 1.10.2002 the partly paid shares were fully paid up.
(8) On 1.1.2003 the company issued 1 bonus share for 8 shares held on that date.
Net profit attributable to the equity shareholders for the years ending 31.3.2003 and 31.3.2002 were ₹ 10,00,000.

Calculate:

(i) Earnings per share for years ending 31.3.2003 and 31.3.2002.
(ii) Diluted earnings per share for years ending 31.3.2003 and 31.3.2002.
(iii) Adjusted earnings per share and diluted EPS for the year ending 31.3.2002, assuming the same information for previous year, also assume that partly paid shares are eligible for proportionate dividend only. (14 marks)

Answer :

(i) Earnings per share

	Year ended 31.3.2003 ₹	Year ended 31.3.2002 ₹
Net profit attributable to equity shareholders	10,00,000	10,00,000
Weight average number of equity shares [(W.N. 1)- without considering bonus issue for the year ended 31.3.2002]	2,00,000	1,50,000
Earning per share	5	6.667

(ii) Diluted earnings per share : Options are most dilutive as their earnings per incremental share is nil. Hence, for the purpose of computation of diluted earnings per share, options will be considered first. 12% convertible debentures being second most dilutive will be considered next and thereafter convertible preference shares will be considered (as per W.N. 2).

	Year ended 31.3.03			*year ended 31.3.02*	
	Net profit attributable to equity Shareholders ₹	*No. of equity shares*	*Net Profit attributable Per share* ₹	*No. of equity shares(without considering bonus issue)*	*Net Profit attributable per share* ₹
As reported (for years ended 31.3.2003 and 31.3.2002)	10,00,000	2,00,000	5	1,50,000	6.667
Options				2,000	
	10,00,000	2,02,000	4.95 Dilutive	1,52,000	6.579 Dilutive
12% Convertible Debentures	84,000		40,000		40,000
	10,84,000	2,42,000	4.48 Dilutive	1,92,000	5.646 Dilutive
10% Convertible Preference Shares	8,80,000		1,60,000		1,60,000
	19,64,000	4,02,000	4.886 Anti-Dilutive	3,52,000	5.58 Dilutive

Since diluted earnings per share is increased when taking the convertible preference shares into account (₹ 4.48 to ₹ 4.886), the convertible preference shares are anti-dilutive and are ignored in the calculation of diluted earnings per share for the year ended 31.3.2003. Therefore, diluted earnings per share for the year ended 31st March, 2003 are ₹ 4.48

For the year ended 31st March, 2002, Options, 12% Convertible debentures and Convertible preference shares will be considered dilutive and diluted earnings per share will be taken as ₹ 5.58

	Year ended 31.3.2003	*year ended 31.3.2003*
Diluted earnings per share	4.48	5.58

(iii) Adjusted earnings per share and diluted earnings per share for the year ending 31.3.2002.

Net profit attributable to equity shareholders	₹ 10,00,000
Weight average number of equity shares [(W.N. 1)- considering bonus issue]	1,75,000
Adjusted earnings per share	₹ 5.714

Calculation of adjusted diluted earnings per share

	Net profit attributable to equity shareholders	No .of equity shares (after considering bonus issue)	Net profit attributable per share
	₹	₹	₹
As reported	10,00,000	1,75,000	5,714
Options		2,000	
	10,00,000	1,77,000	5.65 Dilutive
12% Convertible Debentures	84,000	40,000	
	10,84,000	2,17,000	4.995 Dilutive
10% Convertible-Preference Shares	8,80,000	1,60,000	
	19,64,000	3,77,000	5.21 Anti-Dilutive

Since diluted earnings per share are increased when taking the convertible preference shares into account (from ₹ 4.995 to ₹ 5.21), the convertible preference shares are anti-dilutive and are ignored in the calculation of diluted earnings per share. Therefore, adjusted diluted earnings per share for the year ended 31.3.2002 are ₹ 4.995

Adjusted diluted earnings per share ₹ 4.995

Working Notes :

(1) Weighted average number of equity shares

		31.3.2003 No.of shares	31.3.2002 No.of shares
(a)	Fully paid equity shares	1,00,000	1,00,000
(b)	Partly paid equity shares [Note-1]		50,000
	Partly paid equity shares [Note-2]	25,000	
	Fully paid equity shares [Note-3] (Partly paid shares converted into fully paid up on 1.10.2002)	50,000	

(c)	Bonus Shares [Note 5]	25,000	
	Weighted average number of equity shares (without considering bonus issue for the year ended 31.3.2002)	2,00,000	1,50,000
	Bonus shares		25,000
	Weighted average number of equity shares (after considering bonus issue for the year ended 31.3.2002).		1,75,000

Note-1 : Since partly paid equity shares are entitled to participate in dividend to the extent of amount paid, 1,00,000 equity shares of ₹ 10 each, ₹ 5 paid up will be considered as 50,000 equity shares for the year ended 31st March, 2002

Note-2 : On 1st October, 2002 the partly paid shares were converted into fully paid up. Thus, the weighted average equity shares (for six months ended 30th September, 2002) will be calculated as :

$$50{,}000 \times \frac{6}{12} = 25{,}000 \text{ shares}$$

Note-3 : Weighted average shares (for six months ended 31st March, 2003) will be calculated as :

$$1{,}00{,}000 \times \frac{6}{12} = 50{,}000 \text{ shares}$$

Note-4 : Total number of fully paid shares on 1st January, 2003

Fully paid shares on 1st April, 2002	1,00,000
Partly paid shares being made fully paid up on 1st October, 2002	1,00,000
	2,00,000

Note-5 : Calculation of bonus share :
The company issued 1 bonus share for 8 shares held on 1st January, 2003.
Thus, 2,00,000/8 = 25,000 bonus shares will be issued.
Bonus is an issue without consideration, thus it will be treated as if it had occurred prior to the beginning of 1st April, 2001, the earliest period reported.

(2) Increase in earnings attributable to equity shareholders on conversion of potential equity shares

	Increase in earnings (1) ₹	*Increase in number of equity shares (2)* ₹	*Earnings per incremental share (3) = (1) ÷ (2)* ₹
Options			
Increase in earnings	Nil		
No. of incremental shares issued for no. consideration [10,000 × (75 - 60) / 75]		2,000	Nil
Convertible Preference Shares			
Increase in net profit attributable to equity shareholders as adjusted by attributable dividend tax [(₹ 10 × 80,000) + 10% (₹ 10 × 80,000)]	8,80,000		
No. of incremental shares (2 × 80,000)		1,60,000	5.50
12% Convertible Debentures increase in net profit [(₹ 10,00,000 × 0.12) × (1 - 0.30)]*	84,000		
No. of incremental shares (10,000 × 4)		40,000	2.10

* Tax rate has been taken at 30% in the absence of any information in the question.

2003 - May [2] (b) A Ltd. acquired 25% of shares in B Ltd. as on 31.3.2002 for ₹ 3 lakhs. The Balance Sheet of B Ltd. as on 31.3.2002 is given below :

	₹
Share Capital	5,00,000
Reserves and Surplus	5,00,000
	10,00,000
Fixed Assets	5,00,000
Investments	2,00,000
Current Assets	3,00,000
	10,00,000

During the year ended 31.3.2003 the following are the additional information available :

(i) A Ltd. received dividend from B Ltd., for this year ended 31.3.2002 at 40% from the Reserves.

(ii) B Ltd., made a profit after tax of ₹ 7 lakhs for the year ended 31.3.2003.

(iii) B Ltd., declared a dividend @ 50% for the year ended 31.3.2003 on 30.4.2003.

A Ltd. is preparing Consolidated Financial Statements in accordance with AS-21 for its various subsidiaries. Calculate:

(i) Goodwill if any on acquisition of B Ltd.'s shares.

(ii) How A Ltd., will reflect the value of investment Ltd., in the Consolidated Financial Statements?

(iii) How the dividend received from B Ltd. will be shown in the Consolidated Financial Statements? (6 marks)

Answer :

In terms of AS-23 B Ltd. will be considered as on associate company of A Ltd. as shares acquired represent to more than 20%.

(i) Calculation of Goodwill

	₹ in lakhs
Cost of investment	3.00
Less: Share in the value of Equity of B Ltd. as at the date of investment [25% of ₹ 10 lakh (₹ 5 lakh + ₹ 5 lakh)]	2.50
Goodwill	0.50

(ii) A Ltd.

Consolidated Profit and Loss Account for the year ended 31st March, 2003

		₹ in lakhs
By Share of profits in B Ltd.		1.75
By Dividend received from B Ltd.	0.50	
Transfer to investment account	0.50	Nil

(iii) A Ltd.

Consolidated Balance Sheet as on 31.3.2003

		₹ in lakhs
Goodwill		0.50
Investment in B Ltd.		
Investment	3.00	
Less: Goodwill	0.50	
Less: Dividend received	0.50	
	2.00	
Share of profit for year 2002-2003	1.75	3.75

1. Dividend received from B Ltd. amounting to ₹ 0.50 lakh will be reduced from investment value in the books of A Ltd. However goodwill will not change.

2. B Ltd. made a profit of ₹ 7 lakhs for the year ended 31st March, 2003. A Ltd.'s share in the profit of ₹ 7 lakhs in ₹ 1.75 lakhs. Investment in B Ltd. will be increased by ₹ 1.75 lakh and consolidated profit and loss account of A Ltd. will be credited with ₹ 1.75 lakh in the consolidated financial statement of A Ltd.
3. Dividend declared on 30th April, 2003 will not be recognised in the consolidated financial statements of A Ltd.

2003 - May [5] (a) XYZ Ltd., has undertaken a project for expansion of capacity as per the following details :

	Plan	Actual
	₹	₹
April, 2002	2,00,000	2,00,000
May, 2002	2,00,000	3,00,000
June, 2002	10,00,000	—
July, 2002	1,00,000	—
August, 2002	2,00,000	1,00,000
September, 2002	5,00,000	7,00,000

The company pays to its bankers at the rate of 12% p.a., interest being debited on a monthly basis. During the half year company had ₹ 10 lakhs overdraft upto 31st July, surplus cash in August and again overdraft of over ₹ 10 lakhs from 1.9.2002. The company had a strike during June and hence could not continue the work during June.

Work was again commenced on 1st July and all the works were completed on 30th September. Assume that expenditure were incurred on 1st day of each month. Calculate :

(i) Interest to be capitalised.
(ii) Give reasons wherever necessary.
Assume:
(a) Overdraft will be less, if there is no capital expenditure.
(b) The Board of Directors based on facts and circumstances of the case has decided that any capital expenditure taking more than 3 months as substantial period of time. (8 marks)

Answer :

XYZ Ltd.

Month	Actual Expenditure	Interest Capitalised	Cumulative Amount	
	₹	₹	₹	
April, 2002	2,00,000	2,000	2,02,000	
May, 2002	3,00,000	5,020	5,07,020	
June, 2002	—	5,070	5,12,090	Note 2

July, 2002	—	5,120	5,17,210	
August, 2002	1,00,000	—	6,17,210	Note 3
September, 2002	7,00,000	10,000	13,27,210	Note 4
	13,00,000	27,210	13,27,210	

Note :

(1) There would not have been overdraft, if there is no capital expenditure. Hence, it is a case of specific borrowing as per AS - 16 on Borrowing Costs.

(2) The company had a strike in June and hence could not continue the work during June. As per para 14(c) of AS-16, the activities that are necessary to prepare the asset for its intended use or sale are in progress. The strike is not during extended period. Thus, during strike period, interest need to be capitalised.

(3) During August the company did not incur any interest as there was surplus cash in August. Therefore, no amount should be capitalised during August as per para 14(b) of AS- 16.

(4) During September, it has been taken that actual overdraft is ₹ 10 lakh only. Hence, only ₹ 10,000 interest has been capitalised even though actual expenditure exceeds ₹10 lakh.

Alternatively, interest may be charged on total amount of (₹ 6,17,210 + ₹ 7,00,000 = 13,17,210) for the month of September, 2002 as it is given in the question that overdraft was over ₹ 10 lakh from 1.9.2002 and not exactly ₹ 10 lakh. In that case, interest amount ₹ 13,172 will be capitalised for the month of September.

2003 - May [6] Briefly explain as per relevant Accounting Standard/Guidance Notes :

(a) TVSM company has taken a Transit Insurance Policy. Suddenly in the year 2002-2003 the percentage of accident has gone upto 7% and the company wants to recognise insurance claim as revenue in 2002-2003 in accordance with relevant Accounting Standards. Do you agree? (4 marks)

(b) SCL Ltd., sells agriculture products to dealers. One of the condition of sale is that interest is payable at the rate of 2% p.m., for delayed payments. Percentage of interest recovery is only 10% on such overdue outstandings due to various reasons. During the year 2002-2003 the company wants to recognise the entire interest receivable. Do you agree? (4 marks)

(c) HSL Ltd. is manufacturing goods for local sale and exports. As on 31st March, 2003, it has the following finished stocks in the factory warehouse:

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

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

Excise duty is payable at the rate of 16%. The company's Managing Director says that excise duty is payable only on clearance of goods and hence is not a cost. Please advise HSL using guidance note, if any issued on this, including valuation of stock. (4 marks)

(e) ABC Ltd. was making provision for non-moving stocks based on no issues for the last 12 months upto 31.3.2002. The company wants to provide during the year ending 31.3.2003 based on technical evaluation:

Total value of stock	₹ 100 lakhs
Provision required based on 12 months issue	₹ 3.5 lakhs
Provision required based on technical evaluation	₹ 2.5 lakhs

Does this amount to change in Accounting Policy? Can the company change the method of provision? (4 marks)

(f) XYZ is an export oriented unit and was enjoying tax holiday upto 31.3.2002. No provision for deferred tax liability was made in accounts for the year ended 31.3.2002. While finalising the accounts for the year ended 31.3.2003, the Accountant says that the entire deferred tax liability upto 31.3.2002 and current years deferred tax liability should be routed through Profit and Loss Account as the relevant Accounting Standard has already become mandatory from 1.4.2001. Do you agree? (4 marks)

Answer :

(a) AS 9 on Revenue Recognition defines revenue as 'gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of the 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'.

To recognise revenue AS-9 requires that revenue arises from ordinary activities and that it is measurable and there should be no uncertainty. As per para 9.2 of the Standard, 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. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made.

In the given case, TVSM company wants to suddenly recognise Insurance claim because it has increased over the previous year. But, there are uncertainties involved in the settlement of the claim. Also the claim does not seem to be in the course of ordinary activity of the company.

Hence, TVSM company is not advised to recognise the Insurance claim as revenue.

(b) As per para 9.2 of AS-9 on Revenue Recognition, where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g. for escalation of price, export incentives, interest etc, revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.

Thus, SCL Ltd. cannot recognise the interest amount unless the company actually receives it. 10% rate of recovery on overdue outstandings is also an estimate and is not certain. Hence, the company is advised to recognise interest receivable only on receipt basis.

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

Central Excise Rules, 1944 provide that “excise duty shall be collected at the time of removal of goods from factory premises or from approved place of storage.” Therefore, the levy of excise duty is and remains upon the manufacture or production alone. Only the collection part of it is shifted to the stage of removal.

Further, paragraph 23(i) of the Guidance Note makes it clear that excise duty should be considered as a manufacturing expense and like other manufacturing expense and like other manufacturing expenses be considered as an element of cost for inventory valuation.

Therefore, in the given case of HSL Ltd., the Managing Director’s contention that “excise duty is payable only on clearance of goods and hence is not a cost is incorrect. Excise duty on the goods meant for local sales should be provided for at the rate of 16% on the selling price, that is, ₹ 100 lakhs for valuation of stock.

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

(e) The decision of making provision for non-moving stocks on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving stocks should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of stock, the change in the amount of required provision of non-moving stock from ₹ 3.5 lakhs to ₹ 2.5 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2002-03.

"The company has provided for non-moving stocks on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been higher by ₹ 1 lakh."

(f) Paragraph 33 of AS-22 on "Accounting For Taxes on Income" relates to the transitional provisions. It says, " On the first occasion that the taxes on income are accounted for in accordance with this statement, the enterprise should recognise, in the financial statements, the deferred tax balance that has accumulated prior to the adoption of this statement as deferred tax asset / liability with a corresponding credit / charge to the revenue reserves, subject to the consideration of prudence in case of deferred tax assets.

Further Paragraph 34 lays down, "For the purpose of determining accumulated deferred tax in the period in which this statement is applied for the first time, the opening balances of assets and liabilities for accounting purposes and for tax purposes are compared and the differences, if any, are determined. The tax effects of these differences, if any, should be recognised as deferred tax assets or liabilities, if these differences are timing differences".

Therefore, in the case of XYZ, even though AS-22 has come into effect from 1.4.2001, the transitional provisions permit adjustment of deferred tax liability/asset upto the previous year to be adjusted from opening reserve. In other words, the deferred taxes not provided for alone can be adjusted against opening reserves. Provision for deferred tax asset/liability for the current year should be routed through profit and loss account like normal provision.

2003 - Nov [1] (b) PQR Ltd.'s accounting year ends on 31st March. The company made a loss of ₹ 2,00,000 for the year ending 31.3.2001. For the years ending 31.3.2002 and 31.3.2003, it made profits of ₹ 1,00,000 and ₹ 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.2001, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the years ending 2002 and 2003 for tax purposes. Prepare a statement of Profit and Loss for the years ending 2001, 2002 and 2003. (4 marks)

Answer :

Statement of Profit and loss

	31.3.2001 ₹	31.3.2002 ₹	31.3.2003 ₹
Profit (Loss)	(2,00,000)	1,00,000	1,20,000
Less : Current tax			(8,000)
Deferred tax :			
Tax effect of timing differences originating during the year	80,000		
Tax effect of timing differences reversed/ adjusted during the Year		(40,000)	(40,000)
Profit (loss) after tax effect	(1,20,000)	60,000	72,000

2003 - Nov [4] (b) State, how you will deal with the following matters in the accounts of U Ltd. for the year ended 31st March, 2003 with reference to Accounting standards :

(i) The company finds that the stock sheets of 31.3.2002 did not include two pages containing details of inventory worth ₹ 14.5 lakhs. (4 marks)

(ii) The company had spent ₹ 45 lakhs for publicity and research expenses on one of its new consumer product, which was marketed in the accounting year 2002-2003, but proved to be a failure. (4 marks)

Answer :

(i) Paragraph 4 of Accounting Standard 5 on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, defines Prior Period items as " income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods".

Rectification of error in stock valuation is a prior period item vide Para 4 of AS-5. ₹14.5 lakhs must be added to the opening stock of 1.4.2002. It is also necessary to show ₹ 14.5 lakhs as a prior period adjustment in the Profit and loss Account below the line. Separate disclosure of this item as a prior period item is required as per para 15 of AS-5.

(ii) In the given case, the company spent ₹ 45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/benefit because of the failure of the product. Thus according to para's 41 to 43 of AS-26 'Intangible Assets', the company should charge the total amount of ₹ 45 lakhs as an expense in the profit and loss account.

2003 - Nov [5] (b) On 1st December, 2002, Vishwakarma Construction Co. Ltd. undertook a contract to construct a building for ₹ 85 lakhs. On 31st March, 2003 the company found that it had already spent ₹ 64,99,000 on the construction. Prudent estimate of additional cost for completion was ₹ 32,01,000. What is the additional provision for foreseeable loss, which must be made in the final accounts for the year ended 31st March, 2003 as per provisions of Accounting Standard 7 on "Accounting for Construction Contracts"? (5 marks)

(c) While preparing its final accounts for the year ended 31st March, 2003 a company made a provision for bad debts @ 5% of its total debtors. In the last week of February, 2003 a debtor for ₹ 2 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2003 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2003? (5 marks)

Answer :

(b)

	₹
Cost incurred till 31st March, 2003	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 ₹ 12,00,000 is required to be recognized as an expense.

Contract work in progress = $\dfrac{₹\ 64,99,000 \times 100}{97,00,000}$ = 67%

Proportion of total contract value recognized as turnover as per para 7.02 of AS 7 (Revised) on Construction Contracts.

= 67% of ₹ 85,00,000 = ₹ 56,95,000.

Thus, Loss to be recognised

= ₹ 64,99,000 – ₹ 56,95,000

= ₹ 8,04,000

Since, total foreseeable loss = ₹ 12,00,000

Therefore, Additional provision to be made

= ₹ 12,00,000 – ₹ 8,04,000

= ₹ 3,96,000

(c) As per para's 8.2 and 13 of Accounting Standard 4 on Contingencies and Events Occurring 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 estimation of amounts relating to conditions existing at the balance sheet date.

So full provision for bad debt amounting to ₹ 2 lakhs should be made to cover the loss arising due to the insolvency in the Final Accounts for the year ended 31st March, 2003. It is because earthquake took place before the balance sheet date.

Had the earthquake taken place after 31st March, 2003, then mere disclosure required as per para 15, would have been sufficient.

Thus loss to be recognised
= ₹ 64,99,000 – ₹ 56,95,000
= ₹ 8,04,000
Since total foreseeable loss = ₹ 12,00,000
∴ Additional provision to be made
= 12,00,000 – 8,04,000 = ₹ 3,96,000

2004 - May [5] (a) At the end of the financial year ending on 31st December, 2003, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows :

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

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof. (4 marks)

(b) Z Ltd. presents the following information for the year ending 31/3/2002 and 31/3/2003 from which you are required to calculate the Deferred Tax Asset/Liability and state how the same should be dealt with as per relevant accounting standard.

	31/3/2002 ₹ (lakhs)	31/3/2003 ₹ (lakhs)
Depreciation	4010.10	4023.54
Unabsorbed carry forward business loss and depreciation allowance	2016.60	4110.00
Disallowance under Section 43/B of Income Tax Act, 1961	518.35	611.45
Deferred Revenue Expenses	4.88	—
Provision for Doubtful Debts	282.51	294.35

Z Ltd. had incurred a loss of ₹ 504 lakhs for the year ending 31/3/2003 before providing for Current Tax of ₹ 26.00 lakhs. (6 marks)

Answer :

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

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

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

In the given case, the probability of winning is 100% in respect of first five cases and hence, question of providing for contingent loss does not arise. The condition (i) of Para 10 of AS-4, as stated above, is not met in the other cases since the probability of winning the suits is 60% for next ten cases and 50% for the remaining five cases. Therefore, the proper treatment is to disclose the contingent loss in respect of these cases as per para 11 of AS-4. The maximum loss for each of the next ten cases is ₹ 2,00,000 whereas the expected loss is ₹ 56,000 (₹ 1,20,000 × 0.3 + ₹ 200,000 × 0.1). The maximum loss for each of the remaining five cases is ₹ 2,10,000 whereas the expected loss is ₹ 72,000 (₹ 1,00,000 × 0.3 + ₹ 2,10,000 × 0.2). To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of ₹ 9,20,000 (₹ 56,000 × 10 + ₹ 72,000× 5) as contingent liability.

(b)

	₹ in lakhs 31.3.2002	*₹ in lakhs* 31.3.2003
Carried Forward Business Loss and Depreciation Allowance	2,016.60	4,110.00
Add : Disallowance under Section 43B of Income Tax Act, 1961	518.35	611.45
Provision for Doubtful Debts	282.51	294.35
	2,817.46	5,015.80
Less : Depreciation	4,010.10	4,023.54
	(-) 1,192.64	992.26
Less : Deferred Revenue Expenditure	4.88	—
Timing Differences	(-)1,197.52	992.26

Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognized only to the extent that there is virtual certainty supported by convincing evidence that future taxable income will be available against which such deferred tax assets can be realized. The existence of unabsorbed depreciation or carry forward of losses is strong evidence that future taxable income may not be available. Deferred Tax Asset on ₹992.26 lakh should not be recognized as an asset as per para 17 of AS-22 on 'Accounting for Taxes on Income'. Deferred Tax Liability on ₹ 1,197.52 lakh should be disclosed under a separate heading in the balance sheet of Z Ltd., separately from current assets and current liabilities.

2004 - Nov [4] (a) X Co. Ltd. supplied the following information. You are required to compute the basic earning per share :

(Accounting year 1.1.2002-31.12.2002)

Net Profit	:	Year 2002 : ₹ 20,00,000
	:	Year 2003 : ₹ 30,00,000
No. of shares outstanding prior to Right issue	:	10,00,000 shares.
Right Issue	:	One new share for each four outstanding i.e., 2,50,000 shares. Right Issue price - ₹ 20 Last date of exercise rights - 31.3.2003.
Fair rate of one Equity share immediately prior to exercise right on 31.3.03	:	₹ 25

(8 marks)

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

	(₹ in Lakhs)
Fair value of the machinery	20.00
Lease term	5 years
Lease Rental per annum	5.00
Guaranteed Residual value	1.00
Expected Residual value	2.00
Internal Rate of Return	15%

Depreciation is provided on Straight line method @10% per annum. Ascertain unearned financial Income and necessary entries may be passed in the books of the Lessee in the First year. (8 marks)

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

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

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

(i)	Tax Rate	50%
(ii)	Depreciation – As per Book	50.00
	Depreciation – for Tax purposes	30.00
	There were no addition to Fixed Assets during the year.	
(iii)	Items disallowed in 2002-03 and allowed for Tax purposes in 2003-04	10.00
(iv)	Interest to Financial Institutions to accounted in the Books on accrual basis, but actual payment was made on 30.9.2004	20.00
(v)	Donations to Private Trusts made in 2003-04	10.00
(vi)	Share issue expenses allowed under 35(D) of the I.T. Act, 1961 for the year 2003-04 (1/10th of ₹ 50.00 lakhs incurred in 1999-2000)	5.00
(vii)	Repairs to Plant and Machinery ₹ 100.00 lakhs was spread over the period 2003-04 and 2004-05 equally in the books. However the entire expenditure was allowed for Income-tax purposes.	

Indicate clearly the impact of above items in terms of Deferred Tax liability/Deferred Tax Assets and the balances of Deferred Tax Liability/Deferred Tax Asset as on 31.03.2004. (4 marks)

Answer :

(a) Computation of Basic Earnings per share

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

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

*Refer Working Note 2

Working Notes :

(1) Computation of theoretical ex-rights fair value per share

$$= \frac{\text{Fair value of all outstanding share immediately}}{\text{Numbers of shares outstanding}}$$

$$= \frac{\text{prior to exercise of rights + total amount received exercise}}{\text{prior to exercise + Number of shares issued} \in \text{the exercise}}$$

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

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

(2) Computation of adjustment factor

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

$$= \frac{₹\ 25}{₹\ 24 (\text{Refer Working Note1})} = 1.04 \text{ (approx.)}$$

(b) Computation of Unearned Finance Income

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

Where :

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

Gross investment = Minimum lease payments + Unguaranteed residual value

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

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

= ₹ 27,00,000

(b) Table showing present value of (i) Minimum Lease payments (MLP) and (ii) Unguaranteed Residual Value (URV).

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

Unearned Finance Income = (a) – (b)
= ₹ 27,00,000 - ₹ 17,75,540
= ₹ 9,24,460

Journal Entries in the Books of B Ltd.

	₹	₹
At the inception of lease : Machinery Account Dr. To A Ltd,s. account (Being lease of machinery recorded at present value of MLP)	17,25,820	17,25,820*
At the end of the first year of lease : Finance charges account (Refer Working Note) Dr. To A Ltd.'s Account (Being the finance charges for fist year due)	2,58,873	2,58,873
A Ltd.'s Account Dr. To Bank Account (Being the lease rent paid to the lessor which includes outstanding liability of ₹ 2,41,127 and finance charge of ₹ 2,58,873)	5,00,000	5,00,000

Depreciation Account Dr. To Machinery Account (Being the depreciation provided @ 10% p.a. on straight line method)	1,72,582	 1,72,582
Profit and Loss Account Dr. To Depreciation Account To Finance Charges Account (Being the depreciation and finance charges transferred to Profit and Loss Account)	4,31,455	 1,72,582 2,58,873

Note : According to AS-19, the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value exceeds the present value of minimum lease payments from the views of lessee, the amount recorded should be the present value of these minimum lease payments. So, in this case, as the fair value of ₹ 20,00,000 is more than the P.V. amounting ₹ 17,25,820, the machinery has been recorded at ₹ 17,25,820 in the books of B Ltd. (Lessee) at the inception of lease. As per As, at the inception of the lease, the asset & liability for the future lease payments are recognised in the balance sheet at the same amount.

Working Note :

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

Year	*Outstanding liability (opening balance)* ₹	*Lease rent* ₹	*Finance charge* ₹	*Reduction in outstanding liability* ₹	*Outstanding liability (closing balance)* ₹
1	17,25,820	5,00,000	2,58,873	2,41,727	14,84,693
2	14,84,693	5,00,000	2,22,704	2,77,396	12,07,397
3	12,07,397	5,00,000	1,81,110	3,18,890	8,88,507
4	8,88,507	5,00,000	1,33,176	3,66,724	5,21,783
5	5,21,783	5,00,000	78,267	5,21,783	1,00,050
			8,74,230	17,25,830	

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

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

Transactions	Analysis	Nature of difference	Effect	Amount
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	₹ 20 lakh × 50% = ₹ 10 lakh
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	₹ 10 lakh × 50% = ₹ 5 lakh
Interest to financial institutions	It is allowed as deduction under section 43 B of the IT Act, if the payment is made before the due date of filing the return of income (i.e. 31st October, 2004).	No timing difference	Not applicable	Not applicable
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable
share issue expenses	Due to disallowance of full expenditure under IT Act, tax payable in the earlier years was higher. Due to allowance of full expenditure under IT Act, tax payable of the current year will be less.	Responding timing difference	Reversal of DTA	₹ 5 lakh × 50% = ₹ 2.5 lakh
Repairs to plant and machinery		Originating timing difference	Increase in DTL	₹ 50 lakh × 50% = ₹ 2.5 lakh

Deferred Tax Liability Account

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

Deferred Tax Assets Account

Dr.		₹ in lakhs			Cr. ₹ in lakhs
1.4.2003	To Balance b/d	10.00	31.3.2004	By Profit and Loss Account :	
				Items disallowed in 2002-03 and allowed as per I.T. Act in 2003-04	5.00
				Share issue expenses	2.50
				By Balance c/d	2.50
		10.00			10.00
1.4.2004	To Balance c/d	2.50			

2005 - May [4] (a) Prepare a segmental report for publication in Diversifiers Ltd. from the following details of the company's three divisions and the head office :

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

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

(8 marks)

(b) An equipment is leased for 3 years and its useful life is 5 years. Both the cost and the fair market value of the equipment are ₹ 3,00,000. The amount will be paid in 3 instalments and at the termination of lease lessor will get back the equipment. The unguaranteed residual value at the end of 3 years is ₹ 40,000. The (internal rate of return) IRR of the investment is 10%. The present value of annuity factor of Re.1 due at the end of 3rd year at 10% IRR is 2.4868. The present value of Re.1 due at the end of 3rd year at 10% rate of interest is 0.7513.

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

(ii) Calculate unearned finance income. (4 marks)

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

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

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

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

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

Calculate the result of first quarter as per **AS-25** and comment on the company's view. (4 marks)

(d) Top & Top Limited has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment. Having fulfilled all the conditions under the scheme, the company on its investment of ₹ 50 crore in capital assets, received ₹ 10 crore from the Government in January, 2005 (accounting period being 2004-05). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 2005.

Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not. (4 marks)

Answer :

(a)

Diversifiers Ltd.
Segment Report Divisions

	Divisions			*Inter segment eliminations*	*Consolidated Total (₹ 000)*
	Forging	*Bright Bar*	*Fitting*	*Inter segment eliminations*	*Consolidate Total (₹ 000')*
Segment Revenue					
Sales					
Domestic	90	—	—	—	90
Export	6,135	300	270	—	6,705
External sales	6,225	300	270	—	6,795
Inter Segment sales	4,575	45	—	4,620	—
Total Revenue	10,800	345	270	4,620	6,795
Segment result (given)	240	30	(12)		258
Head office expenses					(144)
Operating profit					144
Interest expenses					(16)
Profit before tax					98
Other Information :					
Fixed assets	300	60	180		540
Net current assets	180	60	135		375
Segment assets	480	120	315		915
Unallocated corporate assets					147

Segment liabilities	30	15	180		225
Unallocated corporate liabilities					57

Sales Revenue by Geographical Market

Particulars	*Domestic Sales*	*Export Sales 9by division A)*	*Export to Europe*	*Export to America*	*Consolidated Total (₹ 000')*
External sales	90	6,135	300	270	6,795

(b) (i) The lease constitutes finance lease :

Para 20 of AS 10 as accounting for fixed assets states that interest on borrowed funds attributable to the construction or acquisition of fixed assets for the period upto the completion of construction or acquisition of fixed assets should be included in the gross block value of the assets to which they relate.

(ii) Unearned finance income

	₹
The cost of equipment is	3,00,000
Less : Depreciation	
$= \frac{\text{Cost of equipment}}{\text{Life of assets}}$	60,000
$= \frac{3,00,000}{5}$ = ₹ 60	
Net Cost	2,40,000
Unearned Income for equipment	₹
Depreciation	60,000
Residual value	40,000
	1,00,000
Internal rate of return on investment will be	
10% of 3,00,000	30,000
Add: 3,00,000 + 30,000	3,30,000
Present value of Re. 1 at 70% IRR at the end of 3rd year	
2.4868 × 3,00,000	7,46,040
Less: The present value of ₹ 1 due at the end of 3rd year at 10% rate interest	
0.7513 ×3,00,000	2,25,190
	5,20,850

Total unearned finance income will be

5,20,850 - 3,30,000 = 1,90,850

(c) The result of first quarter calculated as :

Statement on Interim financial reporting
(Ending on 31st March, 2005)

		(₹ *in crore)*
Sales		50
Less: Salary and other expenses	30	
Advertisement expenses	02	
Administrative and selling expenses	08	40
Net Margin		10

(d) This problem is related to Accounting Standard 12, AS 12 concerned with "Accounting for Government Grants". It deals with accounting for Government grants in financial statements reflecting the effects of changing prices or in supplementary information of similar nature, other Government assistance and Government participation in ownership of the enterprise. It is mandatory in nature cases.

Top and Top limited has set up its business in designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment. Having fulfilled all the conditions under the scheme, the company on its investment of ₹ 50 crore in capital assets, received ₹ 10 crore from the Government in January, 2005 (accounting period being 2004-05). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March ,2005.

The action taken by company is justified as per rules of Accounting Standard - 12.

2005 - Nov [4] (a) Venus Ltd. has an asset, which is carried in the Balance Sheet on 31-3-2005 at ₹ 500 lakhs. As at that date the value in use is ₹ 400 lakhs and the net selling price ₹ 375 lakhs.

From the above data :

(i) Calculate impairment loss.

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

(iii) Show, how impairment loss will be shown in the Balance Sheet. (6 marks)

(b) Himalaya Ltd. in the past three years spent ₹ 75,00,000 to develop a Drug to treat Cancer, which was charged to Profit and Loss Account since they did not meet AS-8 criteria for capitalisation. In the current year approval of the concerned Govt. Authority has been received. The Company wishes to capitalise ₹ 75,00,000 and disclose it as a prior period item. Is it correct? Give reason for your views. (5 marks)

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

Answer :

(a)(i) Impairment loss calculated as follows :

	₹ In (Lakhs)
Carrying amount before impairment loss	500
Less : Recoverable amount	400
Impairment loss	100
Carrying amount after impairment loss	400

An impairment loss should be recognised for a cash generating unit if, and only if its recoverable amount is less than its carrying amount. The impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order:

(a) First, to goodwill allocated to the cash generating unit (if any), and

(b) Then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit

(ii) An impairment loss should be recognised as an expense in the statement of profit and loss immediately, unless the asset is carried at revalued amount in accordance with another Account Standard (AS - 10) in which cash any impairment loss of a revalued asset should be treated as a revaluation decrease under the Accounting standard. The following journal entry will be passed :

(i) Impairment loss A/c	Dr.	100	
To Profit and loss (Adjustment) A/c			100
(ii) Revaluation A/c	Dr.	400	
To Assets A/c			400

(iii) **Balance Sheet**

Liabilities	*Amount*	*Assets*	*Amount*
		Assets	400
			400

(b) Himalaya Ltd. In the past three years spent ₹ 75,00,000 to develop a Drug to treat cancer, which was charged to Profit and Loss A/c. The company wishes to capitalise ₹ 75,00,000 and disclose it as a prior period item. It is correct. The reason in respect are given as follows :

(i) Accounting standard of accounting for R and D issued by the ICAI deals with the issues which suggests expensing of R and D expenses and deferral only on fulfilment of certain conditions.

(ii) This is a part of commercial production.

(iii) Research is original and planned investigation undertake with the prospect of gaining new scientific or technical knowledge and understanding search or critical investigation aimed at discovery of new knowledge with the hope that such knowledge will be useful in developing a new product or service or a new process or technique or in bringing about a significant improvement to an existing product or process.

(iv) Prudential policy as per AS-8 are also covered by the Himalaya Ltd :

(a) As on 31st March, 1994, expected revenue ₹ 75 lakhs which was more than the current and estimated future R and D cost of ₹ 65 lakhs. Product has been defined and R and D costs have been clearly linked to the product and the board of directors has indicated their willingness to use the research. As per para 9 of AS-8, the R and 2D costs of ₹ 50 lakhs may be deferred.

(b) As on 31st March, 1995 the accumulated R and D costs including current costs of ₹ 5 lakhs were ₹ 55 lakhs. The expected future R and D costs incurred of the project were ₹ 8 lakhs. Thus, the aggregate of R and D cost incurred and future R and D cost to be incurred to complete the project works out to be ₹ 63 lakhs whereas expected future revenue was ₹ 60 lakhs. So it was necessary to write off ₹ 3 lakhs (₹ 63 lakhs - ₹ 3 lakhs) Can be deferred.

(c) Revenue Recognition : Bottom Ltd., entered into a sale deed for immovable property before the end of the year (Generally after 31st Dec.). But registration was done with register subsequent to Balance Sheet date. But before finalisation, it is not possible to recognise the sale and the gain at the balance sheet date. The reasons in such problems are as follows :

(i) It not covers the revenue recognition criteria as specified in para 3 of AS - 9 like :
Realised capital gains arising and of disposal of non-current assets (immovable property) and unrealised capital gains, i.e. appreciation in the value of fixed assets.

(ii) As per paras 10-11 of AS-9 revenue from sale of goods is recognised when the seller transfers the goods to the buyer for a consideration. Sale is performed if :

(a) The seller of goods has transferred the property in the goods to the buyer for a price or all significant risks and rewards of ownership have been transferred to the buyer.

(b) The seller retains no effective control of the goods transferred to a degree usually associated with the ownership.

(c) There is no significant uncertainty as regards the consideration to be derived from the sale of goods.

(iii) Revenue is the gross inflow of cash receivable or other consideration arising in the course of ordinary activities of the reporting entity from sale of goods, rendering services and from the use of entity's resources by other yielding interest, dividend and royalties.

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

Answer :

Interim Financial Reporting (AS-25) : An interim period will be calculated on the following basis for gratuity provision in respect of defined benefit schemes like pension, etc. For the employees;

(i) Balance Sheet as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year.

(ii) Statements of profit and loss for the current interim period and commutatively for the current financial year to date, with comparative statements of profit and loss for the comparable interim periods (current and year to date) of the immediately preceding financial year.

(iii) Cash flows statement commutatively for the current financial year to date, with a comparative statement for the comparable year to date period of the immediately preceding financial year.

(iv) For an enterprise where business is highly seasonal, financial information for the twelve months ending on the interim reporting date the comparative information for the prior twelve month period may be useful.
Accordingly, enterprises whose business is highly seasonal are encouraged to consider reporting such information in addition to the information called for in the preceding paragraph.

(v) The objective of such statement is to prescribe the minimum content of an interim financial report and to prescribe the principles for recognition and measurement in a complete or condensed financial statements for an interim period. Timely and reliable financial reporting improves the ability of investors, creditors and others to understand an enterprise's capacity to generate earnings and cash flows, etc. financial condition and liquidity.

2005 - Nov [6] (b) In May, 2004 Speed Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2005 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakh, whereas the total interest payable to the bank on the loan for the period till 31st March, 2005 amounted to 25 lakh.

Can ₹ 25 lakh be treated as part of the cost of factory building and thus be capitalised on the plea that the loan was specifically taken for the construction of factory building? (4 marks)

Answer :

In May, 2004 Speed Ltd. takes a bank loan for the construction of a new factory building. The construction was completed in January, 2005 and the building is using by the company from the date of construction. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakh, whereas the total interest payable to the bank on the loan for the period till 31^{st} March, 2005 amounted to 25 lakh.

₹ 25 lakh can be treated as part of the cost of Factory building and thus be capitalised on the plea that the loan was specially taken by the company for the construction of factory building as per AS-7. Accounting for construction contracts under the paragraph (3). It states that the cost included in the amount at which construction contract work is stated should comprise those costs that relate directly to a specific contract and those that are attributable to the contract activity in general and can be allocated to specific contracts.

Profit in the case of fixed price contract normally should not be recognised unless the work on a contract has progressed to a reasonable extent.

2006 - May [4] (a) Global Ltd. has initiated a lease for three years in respect of an equipment costing ₹ 1,50,000 with expected useful life of 4 years. The asset would revert to Global Limited under the lease agreement. The other information available in respect of lease agreement is :

(i) The unguaranteed residual value of the equipment after the expiry of the lease term is estimated at ₹ 20,000.
(ii) The implicit rate of interest is 10%.
(iii) The annual payments have been determined in such a way that the present value of the lease payment plus the residual value is equal to the cost of asset.

Ascertain in the hands of Global Ltd.

(i) The annual lease payment.
(ii) The unearned finance income.
(iii) The segregation of finance income, and also

(iv) Show how necessary items will appear in its profit and loss account and balance sheet for the various years. (8 marks)

Answer :

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

(i) Calculation of annual lease Payment

	₹
Cost of the equipment	1,50,000
Unguaranteed residual value	20,000
PV of residual value for 3 years @ 10% (₹ 20,000 × 0.751)	15,020
Fair value to be recovered from lease payment (₹ 1,50,000 – ₹ 15,020)	1,34,980
PV factor for 3 years @ 10%	2,487
Annual lease payment (₹ 1,34,980/PV Factor for 3 years @ 10% i.e. 2.487)	54,275

(ii) Unearned Financial Income

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

(iii) Segregation of Finance Income

Year	*Lease Rentals*	*Finance Charges @ 10% on outstanding amount of the year*	*Repayment*	*Outstanding Amount*
	₹	₹	₹	₹
0	—	—	—	1,50,000
I	54.275	15,000	39,275	1,10,725
II	54.275	11,073	43,202	67,523
III	74,275Note	6,752	67,523	—
	1,82,825	32,825	1,50,000	

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

(iv) Profit and Loss Account (Relevant Extracts)

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

Balance Sheet (Relevant Extracts)

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

Notes to Balance Sheet

		₹
Year I	Minimum lease payments (₹ 54,275 + ₹ 54,275)	1,08,550
	Residual value	20,000
		1,28,550
	Unearned finance income (₹ 11,073 + ₹ 6,752)	17,825
	Lease receivable	1,10,725
	Classification:	
	Not later than 1 year	43,202
	Later than 1 year but not more than 5 years	67,523
	Total	1,10,725
Year II	Minimum lease payments	54,275
	Residual value (estimated)	20,000
		74,275
	Unearned finance income	6,752
	Lease receivables (not later than 1 year)	67,523

Year III	Lease receivables (including residual value)	67,523
	Amount received	67,523
		Nil

2006 - May [6] (a) Narmada Ltd. sold goods for ₹ 90 lakhs to Ganga Ltd. during financial year ended 31-3-2006. The Managing Director of Narmada Ltd. own 100% of Ganga Ltd. The sales were made to Ganga Ltd. at normal selling prices followed by Narmada Ltd. The Chief Accountant of Narmada Ltd. contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per accounting standard. Is the Chief Accountant correct? (4 marks)

(b) Milton Ltd. is a full tax free enterprise for the first 10 years of its existence and is in the second year of its operations. Depreciation timing difference resulting in a deferred tax liability in years 1 and 2 is ₹ 200 lakhs and 400 lakhs respectively. From the 3rd year onwards, it is expected that the timing difference would reverse each year by ₹ 10 lakhs. Assuming tax rate @ 35%, find out the deferred tax liability at the end of the second year and any charge to the profit and loss account. (4 marks)

(c) Victory Ltd. purchased goods on credit from Lucky Ltd. for ₹ 250 crores for export. The export order was cancelled. Victory Limited decided to sell the same goods in the local market with a price discount. Lucky Limited was requested to offer a price discount of 15%. The Chief Accountant of Lucky Ltd. wants to adjust the sales figure to the extent of the discount requested by Victory Ltd. Discuss whether this treatment is justified. (4 marks)

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

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

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

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

Ascertain the correct quarterly income. (4 marks)

Answer :

(a) No, the Chief Accountant is not correct. As per AS-18 " Related Party Disclosure", the name of related party relationship, the nature of transaction has to be disclosed irrespective of the fact that the sale were made at normal selling price or arms-length price.

In this case, Narmada Ltd. Sold goods for ₹ 90 lakhs to Ganga Ltd. During the year ended 31.3.2006 as the transaction falls under related party transaction, the disclosure is necessary as per AS-18, in spite of the fact that the sales were made at normal selling price.

(b) **As per AS-22** "Accounting for Taxes on Income" read with ASI-5 issued by the Institute of Chartered Accountant of India :-

- The deferred tax in respect of timing difference which originate during the tax holiday period, but reverse during the tax holiday period, should not be recognised to the extent the gross total income of the enterprises is subject to such deductions.
- The deferred tax in respect of timing difference which originate during the tax holiday period, and reverse after the tax holiday period, should be recognised in the years which the timing differences originate, subject to consideration of prudence.
- Timing differences which originate first should be recognised as reversing first.
- In this case, the Milton Ltd. is full tax free enterprise for the first 10 years of its existence and therefore, as per the above interpretation the depreciation deferred tax liability arose in year 1 of ₹ 200 lakhs will be reversed first from year 3 onwards to the extend of ₹ 80 lakhs, the balance ₹ 120 lakhs is not reversed during tax holiday period and ₹ 400 lakhs which resulted in year 2 is also not reversed during the tax holiday period. Therefore, deferred tax liability on account of... difference of ₹ 182 lakhs should be recognised at the end of the 2nd year and charged to profit and loss account.

(c) As per the AS 9 "Revenue Recognition", trade discount and volume rebates received are not encompassed within the definition determining the revenue. However the price discount of 15% in the instant case, is not the discount given during the ordinary course of the trade therefore it can not be treated in the nature of discount eligible for deduction from sales price, the better alternate is to treat the amount as bad debt, therefore the chief accountant of lucky Ltd. is not correct to this extent.

(d) In this case, the quarterly income has not been correctly states as per AS - 25 "Interim financial Reporting". The quarterly income should be adjusted and restated as follows :

Bad debt of ₹ 40,000 has been incurred during the current quarter. Out of this, the company has deferred 50% i.e. ₹ 20,000 to next quarter. This is not correct. ₹ 20,000 therefore should be deducted from ₹ 7,20,000.

The treatment of extraordinary loss of ₹ 35,000 being recognised in the same quarter and recognised the additional depreciation of ₹ 45,000 in the same quarter is correct and in tune with AS - 25, so no adjustment required for the two items.

The company should report the quarterly income as ₹ 7,20,000 - 20,000 = ₹ 7,00,000.

2006 - Nov [3] (a) A company had imported raw materials worth US Dollars 6,00,000 on 5th January, 2005, when the exchange rate was ₹ 43 per US Dollar. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transaction was made on 5th April, 2005 when the exchange rate was ₹ 47 per US Dollar. However on 31st March, 2005 the rate of exchange was ₹ 48 per US Dollar. The company passed an entry on 31st March, 2005 adjusting the cost of raw materials consumed for the difference between ₹ 47 and ₹ 43 per US Dollar.

In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss. (4 marks)

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

Comment on the valuation of the stocks by the company. (4 marks)

(c) A company with a turnover of ₹ 250 crores and an annual advertising budget of ₹ 2 crore had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹ 25 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of ₹ 2 crore incurred on extensive special initial advertisement campaign for the new product. Is the procedure adopted by the company correct? (4 marks)

(d) A company deals in petroleum products. The sale price of petrol is fixed by the government. After the Balance Sheet date, but before the finalisation of the company's accounts, the government unexpectedly increased the price retrospectively. Can the company account for additional revenue at the close of the year? Discuss. (4 marks)

Answer :

(a) As per AS-11 (Revised 2003), 'The effects of changes in Foreign Exchange Rates', monetary items denominated in a foreign currency should be reported using the closing rate at each balance sheet date. The effect of exchange difference should be taken into profit and loss account. Sundry creditors is a monetary item, hence should be valued at the closing rate i.e. ₹ 48 at 31st March, 2005 irrespective of the payment for the same subsequently at lower rate in the next financial year. The difference of ₹ 5 (48 - 43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2005 and is not to be adjusted against the cost of raw-materials. In the subsequent year, the company would record an exchange gain of Re. 1 per US dollar, i.e., the difference between ₹ 48 and ₹ 47 per Us dollar. Hence, the accounting treatment adopted by the company is incorrect.

(b) Accounting Standard -2 "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 agriculture crops or mineral ores. Accordingly, talking into account the fact stated, the closing stock of finished goods. (Fancy terry towel) should have been valued at lower of cost and net-realisable value and not at net realisable value. Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing stock of inventories of finished goods is not correct.

(c) According to AS 26 'Intangible Assets' "expenditure or an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset".

In the given case, advertisement expenditure of ₹ 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 ₹ 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 ₹ 2 crores to the Profit and Loss account of the year is correct.

(d) 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.

2006 - Nov [5] (a) Mohur Ltd. has equity capital of ₹ 40,00,000 consisting of fully paid equity shares of ₹ 10 each. The net profit for the year 2004-05 was ₹ 60,00,000. It has also issued 36,000, 10% convertible debentures of ₹ 50 each. Each debenture is convertible into five equity shares. The tax rate applicable is 30%. Compute the diluted earnings. (8 marks)

Answer :

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

= ₹ 1,80,000

Tax on interest @ 30% = ₹ 54,000

Diluted Earnings (Adjusted net profit) = (60,00,000 + 1,80,000 − 54,000)

= ₹ 61,26,000

2007 - May [5] (a) During the course of the last three years, a company owning and operating Helicopters lost four Helicopters. The company Accountant felt that after the crash, the maintenance provision created in respect of the respective helicopters was no longer required, and proposed to write back to the Profit and Loss account as a prior period item.

Is the Company's proposed accounting treatment correct ? Discuss. (4 marks)

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

Is X correct in his proposal ? Discuss. (4 marks)

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

In the background of the relevant accounting standard, advise the company on the cut-off date for capitalisation of the project cost. (4 marks)

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

Answer :

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

(b) According to para 14 of AS-7 (Revised) on 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. Incentive payment are included in contract revenue when : (I) the contract is sufficiently advanced and 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 Mr. X the contractor should not recognize any revenue of this contract.

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

(d) According to AS-17 'Segment Reporting' the 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. 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. In the given case inter-segment transfer pricing policy adopted by the company is correct but it should be followed consistently.

2007 - Nov [5] (a) Arrange and redraft the following Cash Flow Statement in proper order keeping in mind the requirements of AS-3 :

	₹ (in lacs)	₹ (in lacs)
Net Profit		60,000
Add: Sale of Investments		70,000
Depreciation on Assets		11,000
Issue of Preference Shares		9,000
Loan raised		4,500
Decrease in Stock		12,000
		1,66,500
Less: Purchase of Fixed Assets	65,000	
Decrease in Creditors	6,000	
Increase in Debtors	8,000	
Exchange gain	8,000	
Profit on sale of investments	12,000	
Redemption of Debenture	5,700	
Dividend paid	1,400	
Interest paid	945	1,07,045
		59,455
Add: opening cash and cash equivalent		12,341
Closing cash and cash equivalent		71,796

(6 marks)

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

How would you assess the situation from the viewpoint of AS-18 on Related Party Disclosures ? (4 marks)

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

Calculate the value of machine to be considered by Lessee Ltd. and the interest (Finance charges) in each year. (6 marks)

Answer :

(a) **Cash Flow Statement**

Particulars		***(₹ in Lakhs)***
Cash flows from operating activities		
Net profit		60,000
Less: Exchange again		(8,000)
Less: Profit on sale of investments		(12,000)
		40,000
Add: Depreciation on assets		11,000
Change in current assets and current liabilities		51,000
*Less :*Increase in debtors	(8,000)	
Add : Decrease in stock	12,000	
Less : Decrease in creditors	(6,000)	(2,000)
Net cash from operating activities		49,000
Cash flow from investing activities		
Sale of investments	70,000	
Purchase of fixed assets	(65,000)	
Net cash from investing activities		5,000
Cash flows from financing activities		
Issue of preference shares	9,000	
Loan raised	4,500	
Redemption of Debentures	(5,700)	
Interest paid	(945)	
Dividend paid	(1,400)	
Net cash from financing activities		5,455
Net increase in cash & cash equivalents		59,455
Add: Opening cash and cash equivalents		12,341
Closing cash and cash equivalents		71,796

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

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.

Fact of this case: 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%)

Therefore, these two makes total control of 26% (i.e. 14% + 12%).

Finding:- In this case, control of P Ltd. in R Ltd. / M.P s/c directly and through Q Ltd. does not go beyond 26%. But according to AS-18, significant influence may be exercised as an investing party (i.e. P Ltd.) holds, directly or indirectly through intermediaries 20% or more of the voting power of the R Ltd. Since R Ltd. is a listed company and regularly.

(c) 1. Computation of value of machine:- Machine is valued at Fair Value or Present Value of Minimum Lease Payment (MLP) whichever is less.

(i) Present value of Minimum Lease Payment (MLP)

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

(ii) Fair value of the machine is ₹ 7,00,000. Value of the machine will be taken as ₹ 6,99,054.

2. Computation of Interest (i.e. finance an charges)

Year		***Liability***	***Interest at 15%***	***Principal***	***Lease rental***
		₹	₹	₹	₹
1st	*Less:* Principal	6,99,054 1,95,1	1,04,858	1,95,142 (Rental- interest)	3,00,000

		5,03,912	75,587	2,24,413 (Rental-interest)	3,00,000
2nd	*Less:* Principal	2,24,413		2,58,075	3,00,000
		2,79,499	41,925	(Rental-interest)	
3rd	*Less:* Principal	2,58,075			
	Residual value	21,424			

Note:- Difference between guaranteed residual value ₹ 22,000 and the Residual Value as calculated above i.e. 21,424 is arises due to approximation in computing the interest rate implicit in the lease.

2008 - May [4] (a) X Ltd. began construction of a new building on 1st January, 2007. It obtained ₹ 1 lakh special loan to finance the construction of the building on 1st January, 2007 at an interest rate of 10%. The company's other outstanding two non-specific loans were :

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

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

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

Building was completed by 31st December, 2007. Following the principles prescribed in AS-16 ' borrowing cost' calculate the amount of interest to be capitalised and pass one Journal Entry for capitalising the cost and borrowing cost in respect of the building. (10 marks)

Answer :

(a) (i) Computation of average accumulated expenses

	₹
₹ 2,00,000 ×12/12	2,00,000
₹ 2,50,000 × 9/12	1,87,500
₹ 4,50,000 × 6/12	2,25,000
₹ 1,20,000 × 1/12	10,000
	6,22,500

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

Account of loan (in ₹)	Rate of interest	Amount of interest (in ₹)
5,00,000	11%	55.000
9,00,000	13%	1,17,000
14,00,000		1,72,000
Weighted average rate of interest $\left(\frac{1,72,000}{14,00,000}\times 100\right)$		12.285% (approx)

(iii) Interest on average accumulated expenses

	₹
Specific borrowings (₹ 1,00,000 ×10%**)**	10,000
Non-specific borrowings [₹ 6,22,500 – ₹ 1,00,000] × 12.285%	64,189
Amount of interest to be capitalized	74,189

(iv) Total expenses to be capitalized for building

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

Journal Entry

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

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

(d) A Cosmetic articles producing company provides the following information:

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

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

Answer :

(c) As per AS 29 Provisions, Contingent Liabilities and Contingent Assets and ASI 30 'Applicability of AS 29 to Onerous Contracts, when an enterprise has a contract that is onerous, the present obligation under the contract should be recognized and measured as a provision. In the given case, the operating lease contract has become onerous (For a contract to qualify as an onerous contract, the unavoidable costs of meeting the obligation under the contract should exceed the economic benefits expected to be received under it.) as the economic benefit of lease contract for next 33 months up to 31.12.2010 will be nil. However, the lessee, Mini Ltd., has to pay lease rent of ₹ 66,00,000 (i.e. 2,00,000 p.m. for next 33 months)

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

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

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

CA Final Gr. I (New Course)

SHORT NOTES

2008 - Nov [7] Write short notes on the following:

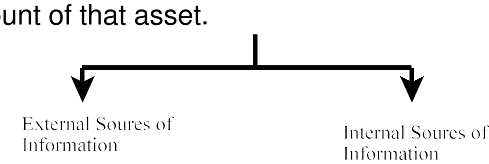
(b) Reversal of an Impairment Loss. (4 marks)

(d) What are the types of Employees benefit and what is the objective of Introduction of this Standard i.e. AS-15? (4 marks)

(e) What are Timing differences and Permanent differences ? (4 marks)

Answer :

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

External Sources:

1. Assets Market Value has increased significantly during the period.
2. 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.
3. 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 assets value in use and increase the asset's recoverable amount materially.

Internal Sources :

1. 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.
2. Evidence is available from internal reporting that indicates that the economic performance of the asset is or will be. better than expected.

(d) As per AS-15 (revised), the following are the various types of employees benefits:-

(i) Short term Employees Benefits:-

These are those benefits, which falls due wholly within 12 months after the end of period, in which such service is rendered by the employees. These benefits are like - wages and salaries, profit sharing bonus, ESI contributions and various non monetary benefits like medical, subsidies, rent free house etc.

(ii) Long term Employees' Benefits:-

It includes long term service leave etc. Such benefits are not payable wholly within 12 month, after the end of period, in which such service is rendered by the employees.

(iii) Post- Employment Benefits:-

It includes,

(a) retirement benefits, like gratuity and pension etc.

(b) other benefits, like, post- employment medical, post employment life insurance cover and so on.

(iv) Termination Benefits:-

These are those benefits given to employees for terminating them from there service. It normally includes-

(a) Voluntary Retirement Compensation

(b) Retirement Compensation, etc.

Termination Benefits are differed, and shown in the Balance Sheet, as miscellaneous expenditure of the Employer Company.

The various objective of As-15 on Employees benefits are:-

(i) To recognize such benefits as an expense, when enterprise consume the economic benefit, arising from service provided by employees.

(ii) To recognize such benefits as a liability, at the time of providing services in exchange of employee's benefits payable in future.

(e) (a) Timing difference is the difference between the accounting income and taxable income that originated in the same period and are capable of reversal in one or more subsequent periods. Examples of timing differences are as follows:-

(i) Expenditure of nature mentioned is 43 B, like taxes, duty, cess, fees etc. if are accrued in the P/L A/c on accrual basis; but are allowed only on actual payment for tax purpose.

(ii) Provision made in P/L A/c, but the relevant liability is allowed in the year in which it actualize.

(b) Permanent difference is the difference between the accounting income and taxable income that originated in the same period; but are not capable of reversal. Examples of permanent differences are as follows:-

(i) Personal expenditure

(ii) Contribution to National Laboratory.

(iii) Donations, etc.

2009 - Nov [6] Write short notes on the following :

(b) Treatment of refund of Government grants. (4 marks)

Answer :

AS-12' Accounting for Government Grants. A Government Grant that is refundable is treated as an extra ordinary items in the following ways.

(i) Amount refundable as government grant related to any specific fixed asset, is to be recorded in books, by increasing the book value of such asset or by reducing the capital reserve of deferred income balance, with same amount.

(ii) Refundable amount, which is related with revenue, is applied first against any unamortized deferred credit remaining in respect of such grant.
If there is no unamortized deferred credit, then the amount is directly charged to from P/L A/c.

(iii) If there is any amount refundable, in respect of promoters' contribution, then the same is to be reduced from capital reserve.

2013 - May [7] Answer the following:

(d) Write short notes on "Disclosure of carrying amounts of financial assets and financial liabilities in balance sheet". (4 marks)

Answer:

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

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

Financial Assets

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

(b) held-to-maturity investments;
(c) loans and receivables;
(d) available-for-sale financial assets;

Financial Liabilities

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

Descriptive Questions

2009 - Nov [6] (c) Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS—24, but that might do so in combination with other circumstances. (4 marks)

Answer :

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

(i) Closing of a facility to achieve productivity improvement or any other cost saving.
(ii) Gradual/Evolutionary phasing out any product line or service or class.
(iii) Discontinuing several products, within an ongoing line of business.
(iv) Changing of location of production or marketing activities for a particular business line.

Practical Questions

2008 - Nov [1] {C} (a) On 30.6.2007, Asmitha Ltd. incurred ₹ 2,00,000. Net Loss from disposal of a business segment. Also, on 30.7.2007, the company paid ₹ 60,000 for Property taxes Assessed for the calendar year 2007. How the above transactions should be included in determination of Net Income of Asmitha Ltd. for the six months interim period ended on 30.9.2007.

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

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

(d) M/s Prima Co. Ltd. sold goods worth ₹ 50,000 to M/s Y and Company. M/s Y and Co. asked for discount of ₹ 8,000 which was agreed by M/s Prima Co. Ltd. the sale was effected and Goods were despatched. After receiving, Goods worth ₹ 7,000 was found defective, which they returned immediately. They made the payment of ₹35,000. to M/s Prima Co. Ltd. Accountant booked the sales for ₹ 35,000. Please discuss. (5 marks each)

Answer :

(a) As per para 10 of AS 25 "Interim Financial Reporting", if an enterprise prepares and presents a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial statements. As on 30.9.2007. Asmitha Ltd., would report the entire ₹ 2,00,000 loss on the disposal of its business segment since the loss was incurred during interim period. A cost charged as an expense in an annual period should be allocated to Interim periods on accrual basis. Since ₹ 60,000 Property Tax payment relates to entire calendar year 2007, ₹ 30,000 would be reported as an expense for six months ended on 30.09.07 while remaining ₹ 30,000 would be reported as prepaid expenses.

(b) As per 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 segments are reportable segments. As all the three segments hold more than 10% of the total assets.

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

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per Para 12 of AS 5 (Revised), when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

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

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

2009 - May [1] {C} Answer any **four** out of the following :

(a) From the following details of an asset

(i) Find out impairment loss

(ii) Treatment of impairment loss

(iii) Current year depreciation

Particulars of asset :

Cost of asset	₹ 56 lakhs	
Life period useful	10 years	
Salvage value	Nil	
Current carrying value	₹ 27.30 lakhs	
Life remaining useful	3 years	
Recoverable amount	₹ 12 lakhs	
Upward revaluation done in last year	₹ 14 lakhs	(4 marks)

(b) Rainbow Limited borrowed an amount of ₹ 150 crores on 1.4. 2008 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Rainbow Ltd. capitalised ₹ 19.50 crores for the accounting period ending on 31.3.2009. Due to surplus fund out of ₹ 150 crores, an income of ₹ 3.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard. (4 marks)

(c) Suraj Limited wishes to obtain a machine costing ₹ 30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 5 years. It enters into an agreement with Ashok Ltd. for a lease rental for ₹ 3 lakhs p.a. payable in arrears and that 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. (4 marks)

(d) Omega Limited is working on different projects those are likely to be completed within 3 years period. It recognises revenue from these contracts on percentage of completion method for financial statement during 2006, 2007 and 2008 for ₹ 11,00,000, ₹ 16,00,000 and ₹ 21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognised revenue of ₹ 7,00,000, ₹ 18,00,000 and ₹ 23,00,000 for the years 2006, 2007 and 2008 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 2006, 2007 and 2008. (4 marks)

(e) While preparing its final accounts for the year ended 31st March, 2009, a company made a provision for bad debts @ 5% of its total debtors. In the last week of February 2009, a debtor for 2 lakhs had suffered heavy loss due to a 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? (4 marks)

Answer :

(a) As per 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 the same asset.

Impairment Loss and its treatment	(₹ in lakhs)
Current carrying amount (including revaluation amount of ₹14 lakhs)	27.30
Less: Current recoverable amount	12.00
Impairment Loss	15.30
Impairment loss charged to revaluation reserve	14.00
Impairment loss charged to profit and loss account	1.30

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

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

(b) As per 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 ₹ 150 crores)	₹ 16.50 crores
Less : Income on temporary investment from specific borrowings	₹ 3.50 crores
Borrowing costs to be capitalized during year 2008-2009	₹ 13,00 crores

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

Annuity Factor (Year 1 to year5)	3.36 (approx)

Present value of minimum lease payments (for ₹ 3 lakhs each year) ₹ 10.08 lakhs (approx.)

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

Note : For the computation of present value of minimum lease payments, the discounting rate is the interest rate implicit in the lease, which is calculated by using this formula.

$$D.F. = \frac{1}{(1+r)^n}$$

(d) **Omega Limited**

Calculation of deferred Tax Asset/Liability

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

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

2009 - Nov [1] (a) The following data apply to 'X' Ltd. defined benefit pension plan for the year ended 31.03.09, calculate the actual return on Plan assets:

— Benefits Paid	2,00,000
— Employer contribution	2,80,000
— Fair market value of plan assets on 31.03.09	11,40,000
— Fair market value of plan asset as on 31.03.08	8,00,000

(b) U.S.A. Ltd. purchased raw material @ ₹ 400 per kg. company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year company is having 10000 kg. of raw material in stock. As the company never sells the raw material, it does not know the selling price of raw material and hence can not calculate the realisable value of the raw material for valuation of inventories at the end of the year. However replacement cost of raw material is ₹ 300 per kg. How will you value the inventory of raw material ?

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

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

Total value of stock - ₹ 150 lakhs.

Provisions required based on 12 months issue ₹ 4.0 lakhs.

Provisions required based on technical evaluation ₹ 3.20 lakhs.

Does this amount to change in accounting policy ? Can the company change the method of provision ? (5 × 4 = 20 marks)

Answer :

(a)

		₹ in lacs
Fair value of plan assets on 31.03.088.00		8.00
Add: Employer contribution 2.80		2.80
Less: Benefits paid		2.00
	(A)	8.80
Fair market value of plan assets at	(B)	11.40
Actual return on plan assets	(B-A)	2.60

(b) As per AS 2 (Revised) "Valuation of inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such a situation the replacement cost of the material may be the best available measure of their net realizable value.

There, in the case, USA Ltd. will value the stock of raw material at ₹ 30,00,000 (10,000 kg. @ ₹ 300 per kg.)

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

Journal Entries in the books of Moon Ltd.

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

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

(d) The decision of making provision for non-moving stocks on the basis of technical evaluation does not amount to change in accounting policy as per AS 5 "Net Profit or loss for the Period, Prior items and Changes in Accounting Policies." The method of estimating the amount of provision may be changed, in case, a more prudent estimate can be made by adopting the changed method.

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

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

Pass journal entries in the books of H Ltd .to record the above arrangement of 31.03.09 and prepare the Balance Sheet of Ltd. after absorption of S Ltd. Workings should form part of your answer.

2009 - Nov [6] (d) From the following information compute diluted earnings per share.

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

(4 marks)

Answer :

Journal Entries in the books of H Ltd.
computation of diluted earnings per share

Earnings		**Shares ₹**	**Earning per share ₹**
Net profit for the year 2008	12,00,000	5,00,000	2.40
Weighted average number of equity shares outstanding during the year 2008			
Basic earnings per share (1,20,00,000/5,00,000)		1,00,000	2.29
Weighted average number of shares under option			
Number of shares that would have been issued at fair value (1,00,000 × 15.00)/20.00)			
Diluted earnings per share		(75,000)	
(12,00,000/5,25,000)	12,00,000	5,25,000	

The earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of computation to have been issued for no consideration as per (para 37 (b) of AS20)

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

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

(ii) Should provision is measured as the excess of compensation to be paid over the profit ? (5 marks)

(c) Rainbow Limited borrowed an amount of ₹ 150 crores on 1.4.2009 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. The weighted average cost of capital is 13% p.a. The accountant of Rainbow Ltd., capitalised interest of ₹ 19.50 crores for the accounting period ending on 31.3.2010. Due to surplus fund out of ₹ 150 crores, an income of ₹ 3.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard. (5 marks)

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

Answer :

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

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

(c) Para 10 of the AS 16 'Borrowing Cost' states, "To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowing". 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. In the given case, the amount of ₹ 150 crores was specifically borrowed for construction of boiler plant. Therefore, treatment of accountant of Rainbow Ltd. is not correct and the amount of borrowing costs to be capitalised for the financial year 2009-10 should be calculated as follows :

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

(d) As per Accounting Standard Interpretation (ASI) 5 "Accounting for Taxes on Income in the situations of Tax Holiday under sections 10A and 10B of the Income-Tax Act,1961 Accounting standard (AS) 22 Accounting for Taxes on Income", deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognised to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income-Tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognised in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence as laid down in As 22. For this purpose, the timing differences which originate first should be considered to reverse first.

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

2010 - May [2] (b) Comforts Ltd. granted ₹ 10,00,000 loan to its employees on January 1, 2009 at a concessional interest rate of 4% per annum. Loan is to be repaid in five equal annual instalments alongwith interest. Market rate of interest for such loan is 10% per annum. Following the principles of recognition and measurement as laid down in AS-30—'Financial instruments : Recognition and measurement', record the entries for the year ended 31st December, 2009 for the loan transaction, and also calculate the value of loan initially to be recognised and amortised cost for all the subsequent years. The present value of ₹ 1 receivable at the end of each year based on discount factor of 10% can be taken as :

Year end	1	0.9090
	2	0.8263
	3	0.7512
	4	0.6829
	5	0.6208

(12 marks)

Answer :

Journal Entries in the books of Comfort Ltd.

(i) for the year ended 31st December,2009 (regarding loan to employees)

		Dr. Amount (₹)	Cr. Amount (₹)
Staff loan A/c To Bank A/c (Being the disbursement of loans to staff)	Dr.	10,00,000	 10,00,000
Staff cost A/c (10,00,000 – 8,54,763) [Refer part (ii)] To Staff loan A/c (Being the write off of excess of loan balance over present value thereof, in order to reflect the loan at its present value of ₹ 8,54,763)	Dr.	1,45,237	 1,45,237
Staff loan A/c To Interest on staff loan A/c (Being the charge of interest @ market rate of 10% to the loan)	Dr.	85,476	 85,476
Bank A/c To Staff loan A/c (Being the repayment of first instalment with interest for the year)	Dr.	2,40,000	 2,40,000
Interest on staff loan A/c To Profit and loss A/c (Being transfer of balance in staff loan interest account to profit and loss account)	Dr.	85,476	 85,476
Profit and loss A/c To Staff cost A/c (Being transfer of balance in staff cost account to profit and loss Account)	Dr.	1,45,237	 1,45,237

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

Year end	Cash Inflow Principal	Interest @4%	Total	P.V. factor	Present value
	₹	₹	₹	₹	₹
2009	2,00,000	40,000	2,40,000	0.9090	2,18,160
2010	2,00,000	32,000	2,32,000	0.8263	1,91,702
2011	2,00,000	24,000	2,24,000	0.7512	1,68,269
2012	2,00,000	16,000	2,16,000	0.6829	1,47,506
2013	2,00,000	8,000	2,08,000	0.6208	1,29,126
Present value or Fair value					8,54,763

(iii) Calculation of amortised cost of loan to employees

Year	*Amortised Cost (Opening balance) [1]*	*Interest to be recognised@ 10% [2]*	*Repayment including (interest) [3]*	*Amortised Cost (Closing balance) [4]=[1]+[2]–[3]*
	₹	₹	₹	₹
2009	8,54,763	85,476	2,40,000	7,00,239
2010	7,00,239	70,024	2,32,000	5,38,263
2011	5,38,263	53,826	2,24,000	3,68,089
2012	3,68,089	36,809	2,16,000	1,88,898
2013	1,88,898	(Bal.fig.) 19,102	2,08,000	Nil

2010 - Nov [1] {C} (a) Night Ltd. sells beer to customers; some of the customers consume the beer in the bars run by Night Limited. While leaving the bars, the consumers leave the empty bottles in the bars and the company takes possession of these empty bottles. The company has laid down a detailed internal record procedure for accounting for these empty bottles which are sold by the company by calling for tenders. Keeping this in view :

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

(ii) If so, whether the stock of empty bottles existing as on the date of Balance Sheet is to be considered as inventories of the company and valued as per AS-2 or to be treated as scrap and shown at realizable value with corresponding credit to 'Other Income' ? (5 marks)

(b) AS-4 prescribes that adjustments to assets and liabilities are required for events occurring after the Balance Sheet date that provide additional information materially affecting the determination of the amount relating to conditions existing at the Balance Sheet date-generally called adjusting events. "Proposed Dividend" is shown and adjusted in the Balance Sheet even if it is not an adjusting event as per AS-4 because it is proposed by the Board of Directors of the company after the Balance Sheet date.

Keeping this in view, is it not violation of AS-4 to show proposed dividends as current liabilities and provisions ? Comment. (5 marks)

Answer :

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

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

(b)
- According to 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. On the basis of such provisions, proposed dividend is not an adjusting event.
- However this standard again states that dividends stated to be in respect of the period covered by the financial statements, which are proposed or declared by the enterprise after the balance sheet date but before approval of the financial statements, should be adjusted in the financial statements.
- Schedule VI of the Companies Act 1956 also prescribes that proposed dividend should be shown under the heading 'Current Liabilities and Provisions' in the balance sheet. Hence, showing proposed dividends as 'current liability and provision' by adjusting it in the Balance Sheet is not in violation of AS 4.

2010 - Nov [7] Answer the following :

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

Lease term	= 4 years
Fair value at inception of lease	= ₹ 20,00,000
Lease rent	= ₹ 6,25,000 p.a. at the end of year
Guaranteed residual value	= ₹ 1,25,000
Expected residual value	= ₹ 3,75,000
Implicit interest rate	= ₹ 15%

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

Calculate the value of the lease liability as per AS-19. (4 marks)

Answer :

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

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

Note :

1. Present value of minimum lease payments 18,55,850 is less than fair value at the inception of lease i.e. 20,00,000, therefore, the lease liability should be recognized at 18,55,850 according to AS 19.
2. Minimum Lease Payment of 4th year includes guaranteed residual value amounting 1,25,000.

2011 - May [1] {C} (a) The fair value of plan assets of Anupam Ltd. was ₹ 2,00,000 in respect of employee benefit pension plan as on 1st April, 2009. On 30th September, 2009 the plan paid out benefits of ₹ 25,000 and received inward contributions of ₹ 55,000. On 31st March, 2010 the fair value of plan assets was ₹ 3,00,000. On 1st April, 2009 the company made the following estimates, based on its market studies and prevailing prices.

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

Calculate the expected and actual returns on plan assets as on 31st March, 2010, as per AS-15. (5 marks)

(c) HSL Ltd., is manufacturing goods for local sale and exports. As on 31st March, 2010, it has the following finished stock in the factory warehouse:
  (i) Goods meant for local sales ₹ 100 lakhs (cost ₹ 75 lakhs)
  (ii) Goods meant for exports ₹ 50 lakhs (cost ₹ 20 lakhs)

Excise duty is payable at the rate of 12%. The company's Managing Director says that excise duty is payable only on clearance of goods and hence not a cost. Please advice HSL using guidance note, if any issued on this, including valuation of stock. (5 marks)

(d) Rama Ltd. has provided the following information:

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

There is adequate evidence of future profit sufficiency. How much deferred Tax asset/liability should be recognized as transition adjustment ? Tax rate 50%. (5 marks)

Answer :

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

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

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

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

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

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

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

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

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

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

(d) Table showing calculation of Deferred tax asset/liability.

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

2011 - May [7] Answer the following :

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

(b) Jain Construction Co. Ltd. undertook a contract on 1st January, 2010 to construct a building for ₹ 80 lakhs. The company found on 31st March, 2010 that it had already spent ₹ 58,50,000 on the construction. Prudent estimate of additional cost for completion was ₹ 31, 50,000.

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

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

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

The estimated quarterly income are ₹ 75,000, ₹ 2,50,000, ₹ 3,75,000 and ₹ 3,00,000.

Calculate the tax expense to be recognized in each quarter. (4 × 4 = 16 marks)

Answer :

(a) Calculation of total cost of material

Particulars	₹
Purchase price (16,000 kg. x ₹ 160)	25,60,000
Less: CENVAT credit (16,000 kg. x ₹ 10)	(1,60,000)
	24,00,000
Add: Freight	1,40,160
Total material cost	25,40,160
Number of units after normal loss =16,000 kg. x(100 - 2)% =15,680 kg	
Revised cost per kg. $= \frac{25,40,160}{15,680 \text{ kg}}$ ₹ 162	
Closing inventory = Material actually received - Material consumed = 15,500 kg.- 13,600 kg = 1,900 kg	
Value of closing stock = 1,900 kg x ₹ 162 = ₹ 3,07,800	
Abnormal loss in kg. = 15,680 kg. - 15,500 kg = 180 kg.	
Abnormal loss in value = 180 kg x ₹ 162 = ₹ 29,160	

(b)

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

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

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

Also as per para 21 of the said standard when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. Accordingly, Contract work in progress = $\frac{58,50,000 \times 100}{90,00,000}$ = 65%

Proportion of total contract value to be recognized as turnover
= 65% of ₹ 80,00,000 = ₹ 52,00,000

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

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

Estimated Annual Income	₹ 10,00,000
Tax expense:	
30% on ₹ 5,00,000	₹ 1,50,000
40% on remaining ₹ 5,00,000	₹ 2,00,000
	₹ 3,50,000

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

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

2011 - Nov [1] {C} (a) Primus Hospitals Ltd. had acquired 40 units of Doppler scan machines from Holiver USA at a cost of US $ 1,65,100 per unit in the beginning of Financial Year 2008-09. The prevailing rate of exchange was ₹ 50 to the US $. The acquisition was partly funded out of a government grant of ₹ 5 crore. The grant relating to such machines was given with a rider that in the event of a change in management, the entity is bound to return the grant. In April 2011, 51% control in the company was taken over by an overseas investor. The expected productive period of such an asset is normally reckoned at 5 years. The depreciation rate adopted was 20% p.a. S.L.M.

basis. The company had incurred expenditure of US $ 4,000 towards Bank charges and ₹ 7,500 per unit as sea freight. You are also informed that neither Capital Reserve nor deferred Income account has been maintained by the company. You are required to suggest the accounting treatment as a result of the return of the grant, in the light of the relevant AS. (5 marks)

Answer :

Calculation of Revised Book value as on 1st April, 2010

Particulars	(₹)
Acquisition of 40 Doppler Scan machines [US $ 1,65,100 × ₹ 50 × 40 machines]	33,02,00,000
Add: Bank charges paid ($ 4,000 × ₹ 50)	2,00,000
Add: Sea Freight on the above machine (₹ 7,500 per unit × 40 machines)	3,00,000
Total landed cost as on 1st April, 2008	33,07,00,000
Less: Government grant	(5,00,00,000)
Value of 40 Doppler Scan machines	28,07,00,000
Less: Depreciation @ 20% for 3 years on SLM basis (i.e. ₹ 28,07,00,000 × 20% × 3 years)	(16,84,20,000)
WDV at the beginning of the year 2011-12	11,22,80,000
Add: Refund of Government grant	5,00,00,000
Revised Book value on 1st April, 2011	16,22,80,000

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

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

2011 - Nov [7] Answer this question:

(b) G Ltd. acquired a machine on 1st April, 2005 for ₹ 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 2009, the carrying value of the machine was reassessed at ₹ 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the YE March 2011 conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only ₹ 79 lakhs. You are required to calculate the loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd. G Ltd. had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation. (4 marks)

Answer :

		(₹ in crores)
Carrying amount of the machine as on 1st April 2005		7.00
Depreciation for 4 years i.e. 2005-06 to 2008-09 [$\frac{7\,\text{crores}}{7\,\text{years}}$ × 4 years]		(4.00)
Carrying amount as on 31.03.2009		3.00
Add: Upward Revaluation (credited to Revaluation Reserve account)		2.10
Carrying amount of the machine as on 1st April 2009 (revalued)		5.10
Less: Depreciation for 2 years i.e. 2009-10 & 2010-11[$\frac{5.10\,\text{crores}}{3\,\text{years}}$ × 2 years]		(3.40)
Carrying amount as on 31.03.2011		1.70
Less: Recoverable amount		(0.79)
Impairment loss		0.91
Less: Balance in revaluation reserve as on 31.03.2011:		
Balance in revaluation reserve as on 31.03.2009	2.10	
Less: Enhanced depreciation met from revaluation reserve 2009-10 & 2010-11 = [(1.70 - 1.00) × 2 years]	(1.40)	
Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 "Impairment of Assets"		(0.70)
Impairment Loss to be debited to profit and loss account		0.21

2012 - May [1] {C} (a) Sun Co-operative Society Ltd. has borrowed a sum of US$ 12.50 million at the commencement of the financial year 2011-12 for its solar energy project at LIBOR (London Interbank offered rate of 1%) + 4%. The interest is payable at the end of the respective financial year. The loan was availed at the then rate of ₹ 45 to the US dollar while the rate as on 31st March 2012 is ₹ 48 to the US dollar. Had Sun Co-operative Society Ltd. borrowed the Rupee equivalent in India, the interest would have been 11%. You are required to compute ‘Borrowing Cost’ also showing the amount of exchange difference as per prevailing Accounting Standards. (5 marks)

(b) Acute Ltd. is the owner of a CGU (Cash Generating Unit) block of assets whose current carrying cost is ₹ 999 lakhs. The company, after a detailed study by its technical team, has assessed the present recoverable amount of this CGU block of assets is ₹ 555 lakhs. The value of the block of assets as per the Income tax Records is ₹ 777 lakhs. The Board of Directors of the company have issued a signed statement confirming that the impairment in the value of the CGU is only a temporary phenomenon which is reversible in subsequent periods and also assuring virtual certainty of taxable incomes in the foreseeable future. You are required to show Deferred Tax workings as per Accounting Standards in force, given the tax rate of 30% plus 10% surcharge thereon. The depreciation rate for tax purposes is 15% and that per books is 13.91%. (5 marks)

(c) PRZ & Sons Ltd. are Heavy Engineering contractors specializing in construction of dams. From the records of the company, the following data is available pertaining to year ended 31st March, 2012. Using this data and applying the relevant Accounting Standard you are required to:

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

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

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

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

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

	(₹ Crore)	
Total Contact Price	2,400	
Work Certified	1,250	
Work pending certification	250	
Estimated further cost to completion	1,750	
Stage wise payments received	1,100	
Progress payments in pipe line	300	(5 marks)

(d) On 30-6-2011, X Limited incurred ₹ 3,00,000 net loss from disposal of a business segment. Also on 31-7-2011, the company paid ₹ 80,000 for Property taxes assessed for the calendar year 2011. How should the above transactions be included in determination of net income of X Limited for the six months interim period ended on 30-9-2011? (5 marks)

Answer :

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

(a)	Interest for the period 2011-12	= US$ 12.5 million × 5% × ₹ 48 per US$ = ₹ 30 million
(b)	Increase in the liability towards the principal amount	= US$ 12.5 million × ₹ (48 - 45) = ₹ 37.5 million
(c)	Interest that would have resulted if the loan was taken in Indian currency	= US$ 12.5 million × ₹ 45 × 11% = ₹ 61.875 million
(d)	Difference between interest on local currency borrowing and foreign currency borrowing	= ₹ 61.875 million - ₹ 30 million = ₹ 31.875 million.

- Therefore, out of ₹ 37.5 million increase in the liability towards principal amount, only ₹ 31.875 million will be considered as the borrowing cost.
- Thus, total borrowing cost would be ₹ 61.875 million being the aggregate of interest of ₹ 30 million on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 31.875 million.
- Therefore, ₹ 61.875 million would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 5.625 million (37.5 - 31.875) would be considered as the exchange difference to be accounted for as per AS 11.

(b) Assumption:

(i) It is assumed that current carrying cost of the CGU block of asset as per Accounting and Tax Records are after charging depreciation of the current year.

(ii) The assumption has been taken on the basis that impairment loss is calculated on carrying value after charging depreciation of the year.

(iii) In the absence of specific instructions. deferred tax workings of current year have been shown as below:

Statement showing Deferred Tax workings for the current year

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

Timing difference		444
Tax effect of the above timing difference at 33% (deferred tax asset)	(B)	146.52
Total deferred tax asset (A + B)		154.54

Note:

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

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

(c)

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

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

*Tax rate = 30% × 110% = 33%.

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

(iii) Proportion of total contract value recognised as revenue

Percentage of completion of contract to total estimated cost of construction

= (1,500/3,250) × 100 = 46.15%

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

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

= ₹ [1,500 + Nil - 850 - (1,100 + 300)] crores

= ₹ [1,500 - 850 -1,400] crores

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

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

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

(d)
- As per AS 25 "Interim Financial Reporting" states that revenues and gains should be recognised in interim reports on the same basis as used in annual reports.
- As at September 30,2011, X Ltd. would report the entire ₹ 3,00,000 loss on the disposal of its business segment since the loss was incurred during the interim period.
- A cost charged as an expense in an annual period should be allocated among the interim periods, which are clearly benefited from the expense. through the use of accruals and/or deferrals.
- Since ₹ 80,000 property tax payment relates to the entire 2011 calender year, only ₹ 40,000 of the payment would be reported as an expense at September 30, 2011, while out of the remaining ₹ 40,000 ₹ 20,000 for Jan. 2011 to March, 2011 would be shown as payment of the outstanding amount of previous year and another ₹ 20,000 related to quarter October, 2011 to December, 2011 would be reported as a prepaid expense.

2012 - May [5] (a) As point of staff welfare measures, Y Co. Ltd has contracted to lend to its employees sums of money at 5 percent per annum rate of interest. The amounts lent are to be repaid alongwith the interest in five equal annual instalments. The market rate of interest is 10 percent per annum.

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

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

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

At the end of year

1	.909
2	.827
3	.751
4	.683
5	.620

(8 marks)

Answer :

(a) (i) Computation of initial recognition amount of loan to employees

Year end	**Cash Inflow**		***Total***	***P.V. factor @10%***	***Present value***
	Principal ₹	***Interest @ 5%*** ₹	₹		₹
2011	3,20,000	80,000	4,00,000	0.909	3,63,600
2012	3,20,000	64,000	3,84,000	0.827	3,17,568
2013	3,20,000	48,000	3,68,000	0.751	2,76,368
2014	3,20,000	32,000	3,52,000	0.683	2,40,416
2015	3,20,000	16,000	3,36,000	.0620	2,08,320
Present value or Fair value					14,06,272

(ii) Computation of amortised cost of loan to employees

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

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

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

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

2012 - May [7] Answer any **four** of the following:

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

	(₹ millions)
Additional shares issued	6.50
CAPEX (Capital expenditure)	9.90
Proceeds from Assets sold	1.60
Dividends declared	0.50
Gains from disposal of Assets	(1.20)
Net Income	3.30
Increase in Accounts Receivable	1.50
Redemption of 4.5% debentures	2.50
Depreciation & Amortization	0.75

(4 marks)

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

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

(4 marks)

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

Total value of stock ₹ 3 crores.

Provision required based on 12 months ₹ 8 lakhs

Provision required based on technical evaluation ₹ 7.50 lakhs.

Does this amount to change in accounting policy ?

Can the company change the method of provision ? (4 marks)

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

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

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

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

The construction of the plant was completed on 31-3-2012 . You are required to calculate the amount of interest to be capitalized as per the provision of AS-16 of the borrowing cost (including cost) (4 marks)

(e) X Limited on 1-1-2012 had made an investment of ₹ 600 lakhs in the equity shares of Y limited of which 50% is made in the long term category and the rest as temporary investment. The realisable value of all such investment on 31-3-2012 become ₹ 200 lakhs as X limited lost a case of copy right. How will you recognize the reduction in financial statements for the year ended on 31-3-2012. (4 marks)

Answer :

(a) **Bellhop LLC**

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

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

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

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

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

On convertible debentures as per SEBI Guidelines on Bonus Issue

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

Basic Earnings per share for the year 2011-12

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

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

Adjusted earnings per share for the year 2010-11

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

For Diluted EPS

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

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

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

= ₹ 1,02,35,000

No. of equity shares resulting from conversion of debentures

= 1,00,000 × 10 shares = 10,00,000

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

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

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

= 82,50,375 shares

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

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

(c)

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

- An estimate may have to be revised if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.
- The basis of change in provisioning is a guideline and the better way of estimating the provision for non-moving stock on account of change. Therefore, it is not a change in accounting policy. Accounting policy is the valuation of inventory on cost or on net realizable value or on lower of cost or net realizable value. Any interchange of this valuation base would have constituted change in accounting policy.
- After word, the company should be able to demonstrate satisfactorily that having regard to circumstances provision made on the basis of technical evaluation provides more satisfactory results than provision based on 12 months issue. If that is the case, then the company can change the method of provision.

(d) (i) Calculation of average accumulated expenses

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

(ii) Non-specific Borrowings

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

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

(iii) Interest on average accumulated expenses

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

(iv) Total expenses to be capitalized for Plant

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

(e)
- X limited invested ₹ 600 lakhs in the equity shares of Y Ltd. Out of which, the company intends to hold 50% shares for long term i.e. ₹ 300 lakhs and remaining as temporary (current) investment i.e. ₹ 300 lakhs. Irrespective of the fact that investment has been held by X Limited only for 3 months (from 1.1.2012 to 31.3.2012).
- AS 13 lays emphasis on intention of the investor to classify the investment as current or long term even though the long term investment may be readily marketable.
- In the given problem, the realizable value of all such investments on 31.3.2012 became ₹ 200 lakhs i.e. ₹ 100 lakhs in respect of current investment and ₹ 100 lakhs in respect of long term investment.
- According to AS 13, 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value.
- On the afforsaid basis, the carrying value of investment held as temporary investment should be shown at realizable value i.e. at ₹ 100 lakhs. The reduction of ₹ 200 lakhs in the carrying value of current investment will be included in the profit and loss account.
- Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long term investment, the carrying amount is reduced to recognise the decline.
- In this case, Y Limited lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quiet a substantial figure. Losing the case of copyright may affect the business and the performance of the company in long run. Accordingly, it will be appropriate to reduce the carrying amount of long term investment by ₹ 200 lakhs and shown the investments at ₹100 lakhs, considering the downfall in the value of shares as decline other than temporary. The reduction of ₹ 200 lakhs in the carrying value of long term investment will be included in the profit and loss account.

Alternative approach for treatment of long term investment

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

2012 - Nov [1] {C} (a) Prakash Limited leased a machine to Badal Limited on the following terms:

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

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

Ascertain Unearned Financial Income. (5 marks)

(b) Goodwill Limited is a full tax free enterprise for the 1st 12 years of its existence and is in third year of operations. Depreciation timing difference resulting in a deferred tax liability in 1st, 2nd and 3rd year is ₹ 200 lakhs, ₹ 300 lakhs and ₹ 400 lakhs respectively. From the 4th year onwards, it is expected that the timing difference would reverse each year by ₹ 10 lakhs. Assuming tax rate @ 35%, find out the deferred tax liability at the end of 3rd year and any charge to the Profit and Loss Account. (5 marks)

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

Item	Unit	Amount (₹)	Output (Unit)	Closing stock as on 31-03-2012
Raw-Material	15,000	1,60,000	MP1 - 6,250	800
Wages	–	82,000	MP2 - 5,000	200
Fixed Overhead	–	58,000	BP - 1,600	–
Variable Overhead	–	40,000	–	–

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

Calculate the value of Closing Stock of MP1 and MP2 as on 31-03-2012. (5 marks)

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

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

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

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

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

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

(vi) Sale of investment in the first quarter resulted in a gain of ₹ 20 lakhs.

The company had apportioned this equally to the four quarters.

Prepare the adjusted profit before tax for the third quarter. (5 marks)

Answer:

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

Where:

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

Gross investment = Minimum lease payments + Unguaranteed residual value

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

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

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

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

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

(b)
- According to an explanation to AS 22, "Accounting for Taxes on Income", in the case of tax free enterprises, no deferred tax liability is recognized, in respect of timing differences that originate and reverse in the tax holiday period. Deferred tax liability or asset is created in respect of timing differences that originate in a tax holiday period but are expected to reverse after the tax holiday period. For this purpose, adjustments are done in accordance with the FIFO method.
- Accordingly, depreciation timing difference of ₹ 90 lakhs (₹ 10 lakhs x 9 years) will reverse in the tax holiday period i.e. from 4th year to 12th year. Therefore, no deferred liability on ₹ 90 lakhs out of ₹ 200 lakhs, will be created. In the 1st year, deferred tax liability of ₹ 38.5 lakhs will be created @ 35% on ₹ 110 lakhs (₹ 200 lakhs - ₹ 90 lakhs) only.
- However, the entire depreciation timing difference of 2nd and 3rd year i.e. ₹ 300 lakhs and ₹ 400 lakhs will reverse only after the tax holiday period. So, deferred tax liability will be created in the 2nd year for ₹ 105 lakhs (₹ 300 x 35%) and in the 3rd year for ₹ 140 lakhs (₹ 400 x 35%).
- Therefore, total deferred tax liability in the Balance Sheet at the end of 3rd year will be ₹ (38.5 + 105 + 140) lakhs = ₹ 283.5 lakhs and charge to Profit and Loss account in the 3rd year will be ₹ 140 lakhs (₹ 400 x 35%).

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

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

		₹
Selling price of by-product BP	(1,600 units x ₹ 25 per unit)	40,000
Less: Separate processing charges of by-product BP		(4,000)
Packing charges		(6000)
Net realizable value of by-product BP		30,000

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

	₹	₹
Raw material		1,60,000
Wages		82,000
Fixed overhead		58,000
Variable overhead		40,000
		3,40,000
Less: NRV of by-product BP (See calculation1)	(30,000)	
Sale value of scrap	(6,000)	(36,000)
Joint cost to be allocated between MP1 and MP2		3,04,000

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

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

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

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

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

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

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

Statement showing Adjusted Profit Before Tax for the third quarter

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

2012 - Nov [7] Answer the following :

(b) P Ltd. has 60% voting right in Q Ltd. Q Ltd. has 20% voting right in R Ltd. Also, P Ltd. directly enjoys voting right of 14% in R Ltd. R Ltd. is a listed company and regularly supplies goods to P Ltd. The management of R Ltd. has not disclosed its relationship with P Ltd.
How would you assess the situation from the view point of AS-18 on related party disclosures ? (4 marks)

(c) An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. At 31st March 2012, it is virtually certain that a law requiring a clean up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary ? (4 marks)

(d) Vijaya Ltd. had to pay delayed cotton clearing charges over and above the negotiated price for taking delayed delivery of cotton from the supplier's godown. Upto 2010-11, the company has regularly included such charges in the valuation of closing stock. This charge, being in the nature of interest, the company has decided to exclude it from closing stock valuation. This would result in decrease of profit by ₹ 8.60 lakhs.
What is the treatment in the Final Statement of accounts for the year ended 31.03.2012 ? Also draft a suitable note for disclosure. (4 marks)

Answer:

(b)
- P Ltd. has direct economic interest in R Ltd. to the extent of 14%, and through Q Ltd. (in which it is the majority shareholders) it has further control of 12% in R Ltd. (60% of Q Ltd.'s 20%). These two taken together (14% + 12%) make the total control of 26%.
- AS 18 'Related Party Disclosures', defines related party as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other party in making financial and / or operating decisions.
- Since, P Ltd. has total control of 26% (directly and indirectly by Q Ltd.) in R Ltd. which is less than half of the voting power of R Ltd., P Ltd. is said to have significant influence over R Ltd. Also it is given in the question that R Ltd. is a listed company and regularly supplies goods to P Ltd.
- Hence related party disclosure, as per AS 18, is required by R Ltd. in its financial statements, in respect of goods supplied to P Ltd.

(c)
- According to AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event.

- However, when environmental damage is caused there may be no obligation to remedy the consequences.
- The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted.
- In the given situation it is virtually certain that law will be enacted requiring clean-up of a land already contaminated.
- Therefore, an oil company has to provide for such clean up cost in the year in which the law is virtually certain to be enacted.

(d)
- AS 5 (Revised) "Net Profit or Loss for the Period, Prior Period items and Changes in Accounting Policies" states that a change in an accounting policy should be made only if
  (a) it is required by statute, or
  (b) for compliance with an accounting standard, or
  (c) if it is considered that the change would result in a more appropriate presentation of the financial statements of an enterprise.
- The change in the method of stock valuation is justified in view of the fact that the change is in line with the recommendations of AS 2 (Revised) 'Valuation of Inventories' and would result in more appropriate preparation of the financial statements.
- Accordingly, cost formula used for inventory valuation will exclude the delayed cotton clearing charges being in the nature of interest. Due to change in the cost formula, the value of inventory and resulting profit will decrease by ₹ 8.60 lakhs.

Disclosure :

- As per AS 2, the accounting policy adopted for valuation of inventories including the cost formula used should be disclosed in the financial statements by way of a note.
  Also, appropriate disclosure of the change and the amount by which any item in the financial statements is affected by such change, is necessary as per AS 1, AS 2 and AS 5.
- Therefore, the under mentioned note should be given in the annual accounts.
- "In compliance with the Accounting Standards issued by the ICAI, delayed cotton clearing charges which are in the nature of interest have been excluded from the valuation of closing stock unlike preceding years. Had the company continued the accounting practice followed earlier, the value of closing stock as well as profit before tax for the year would have been higher by ₹ 8.60 lakhs."

2013 - May [1] {C} (a) J Ltd. purchased a machinery from K Ltd. on 31-08-2012. Quoted price was ₹ 275 lakhs. The vendor offers 2% trade discount. Sales tax on quoted price is 6%. J Ltd. spent ₹ 60,000 for transportation and ₹ 45,000 for architect's fees. They borrowed money from HDFC Bank of ₹ 250 lakhs for acquisition of asset @ 15% p.a. They also spent ₹ 15,000 for material, ₹ 10,000 for labour and ₹ 4,000 as overheads during trial run of the machine. The machine was ready for use on 15-01-2013 but it was put to use on 15-3-2013. Find out the original cost of the machine. Also suggest the accounting treatment for between the date, the machine was ready for use and the date at which it was actually put to use. (5 marks)

(b) A Ltd. had acquired 80% shares in the B Ltd. for ₹ 15 lakhs. The net assets of B Ltd. on the day are ₹ 22 lakhs. During the year A Ltd. sold the investment for ₹ 30 lakhs and net assets of B Ltd. on the date of disposal was ₹ 35 lakhs. Calculate the profit or loss on disposal of this investment to be recognized in Consolidated Financial Statement. (5 marks)

(c) On 1st January, 2011 Santa Ltd. sold equipment for ₹ 6,14,460. The carrying amount of the equipment on that date was ₹ 1,00,000. The sale was a part of the package under which Banta Ltd. leased the asset to Santa Ltd. for Ten Year term. The economic life of the asset is estimated at 10 years. The minimum lease rents payable by the leaser has been fixed at ₹ 1,00,000 payable annually beginning 31st December, 2011. The incremental borrowing interest rate of Santa Ltd. is estimated at 10% p.a. Calculate the net effect on the profit and loss account. (5 marks)

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

Answer:

(a) (i) Original cost of the machinery:–

Particulars	***Amount (₹)***
Quoted price	2,75,00,000
Less: Trade discount @ 2%	(5,50,000)
	2,69,50,000
Add: Sales Tax @ 6% on quoted price*	16,50,000
Transportation charges	60,000
Architect's Fees	45,000
Trial run expenses	29,000

(Material ₹ 15,000 + Labour ₹ 10,000 + Overheads ₹ 4,000)	
Finance cost (15% on ₹ 250 lakhs for the 4.5 months i.e. for the period 01.9.12 to 15.1.13)	14,06,250
Total amount to be capitalised for machine	3,01,40,250

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

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

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

(b) Computation of Profit/Loss on disposal of investment in subsidiary:–

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

Working Notes:

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

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

2. Capital Reserve (At the time of acquisition of shares in B Ltd.)

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

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

- For the computation of net effect on the statement of profit and loss on sale of equipment, it has to be judged whether lease is an operating lease or finance lease.
- The lease term is for 10 years which covers the entire economic life of the equipment. At the inception of the lease, the present value of the MLP (i.e. minimum lease payments) is ₹ 6,14,400 [₹ 1,00,000 × 6.144 (Annuity factor of ₹ 1 @ 10% for 10 years)] and amounts to at least substantially all of the fair value (sale price i.e. ₹ 6,14,460) of the leased equipment. ***Hence the lease is a finance lease.***
- According to AS 19 "Leases", if a sale and leaseback transaction results in a finance lease, profit of ₹ 5,14,460 (Sale value ₹ 6,14,460 less carrying amount ₹ 1,00,000) will not be recognized as income in the year of sale in the books of lessee i.e. Santa Ltd.
- It should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.
- Thus, assuming that depreciation is charged on straight line basis, Santa Ltd. will recognize depreciation of ₹ 61,446 per annum for 10 years (₹ 6,14,460/10) and amortise profit of ₹ 5,14,460 over the lease term of 10 years, i.e. ₹ 51,446 p.a. The net effect is a debit of (₹ 61,446 – ₹ 51,446) ₹ 10,000 p.a. to the Statement of profit and loss, for 10 years as covered under the lease term. **Note:** There is no sale and lease back transaction, the Statement of profit and loss for each year (covered in the lease term) would have been charged by (₹ 1,00,000/10) ₹ 10,000, towards depreciation. Therefore, the sale and lease back transaction will have no impact on profit or loss account to be reported by the lessee (vendor in the sales transaction) over the lease period.

(d) Treatment of Impairment Loss

- According to AS 28 "Impairment of Assets", if the recoverable amount (higher of net selling price and its value in use) of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount.
- In the given case, net selling price is ₹ 64.50 lakhs (₹ 67.50 lakhs −₹ 3 lakhs) and value in use is ₹ 60 lakhs.
- Thus, recoverable amount will be ₹ 64.50 lakhs. Impairment loss will be calculated as ₹ 10.50 lakhs [₹ 75 lakhs (Carrying Amount after revaluation - Refer Working Note) less ₹ 64.50 lakhs (Recoverable Amount)].
- Therefore, impairment loss of 10.50 lakhs should be recognised as an expense in the Statement of Profit and Loss immediately since there was downward revaluation of asset which was already charged to Statement of Profit and Loss.

Working Note:

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

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

2013 - May [5] (b) On 1st April, 2011, the fair value of plan assets were ₹ 2,50,000 in respect of a pension plan of Q Ltd.

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

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

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

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

Find out the expected and unexpected return on plan assets. (6 marks)

Answer:

Computation of Expected and Unexpected Returns on Plan Assets

Particulars		***Amount (₹)***
Return on ₹ 2,50,000 held for 12 months at 10.25%		25,625
Return on ₹ 75,000 (1,22,500 - 47,500) held for six months at 5% (equivalent to 10.25% annually, compounded every six months)		3,750
Expected return on plan assets for 2011-12		29,375
Fair value of plan assets as on 31st March, 2012		3,75,000
Less: Fair value of plan assets as on 1st April, 2011	2,50,000	
Contributions received	1,22,500	(3,72,500)
		2,500
Add: Benefits paid		47,500
Actual return on plan assets		50,000

Unexpected Return on Plan Asset = Actual return – Expected return
= 50,000 – 29,375 = ₹ 20,625.

2013 - May [7] Answer the following:

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

(i)	Net profit for the current year	₹ 5,00,00,000
(ii)	Number of equity shares outstanding	1,00,00,000
(iii)	11% convertible debentures of ₹ 100 each (Nos.)	1,25,000
(iv)	Interest expenses for current year	₹ 13,75,000
(v)	Tax saving relating to interest expense	30%
(vi)	Each debenture is convertible into eight equity shares.	(4 marks)

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

Give necessary entries explaining the treatment of Cenvat Credit. (4 marks)

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

Result	Probability	Amount of loss
For first ten cases:		
Win	0.6	
Loss-low damages	0.3	90,000

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

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

Estimate the amount of contingent loss and state the accounting treatment of such contingent loss. (4 marks)

Answer:

(b) Adjusted net profit for the current year

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

Weighted Average Number of Equity Shares

Number of equity shares resulting from conversion of debentures:

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

Number of equity shares for computation of diluted EPS:

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

Calculation of diluted earnings per share

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

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

(c) Journal Entries

	Particulars		*₹ in lakhs*	
(a)	Machinery A/c	Dr.	72	
	Cenvat credit receivable on capital goods A/c	Dr.	8	
	To Bank A/c or Creditors A/c			80
	(Being capitalization of machinery)			
(b)	Excise duty A/c	Dr.	7.2	
	To Cenvat credit receivable on capital goods A/c			4.0
	To Bank A/c			3.2
	(Being excise duty set off to the extent of 50% of excise duty paid in the first year of acquisition of capital asset)			

(e) In the given question:

- The probability of winning first 10 cases is 60% and for remaining five cases is 50%.
- In other words, probability of losing 10 cases and 5 cases is 40% and 50% respectively.
- According to AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where it is not probable that a present obligation exists, an enterprise discloses a contingent liability.
- Since in the given case, chances of winning the case is more and losing the case is less, no provision will be recognized. In fact, it is a contingent loss/liability.
- The amount of contingent loss may be calculated as under:
- Expected contingent loss in first ten cases
  = [₹ 90,000 × 0.3 + ₹ 1,60,000 × 0.1] × 10 cases
  = [₹ 27,000 + ₹ 16,000] × 10 cases
  = ₹ 43,000 × 10 cases = ₹ 4,30,000
- Expected contingent loss in remaining five cases
  = [₹ 60,000 × 0.3 + ₹ 95,000 × 0.2] × 5 cases
  = [₹ 18,000 + ₹ 19,000] × 5 cases
  = ₹ 37,000 × 5 cases = ₹ 1,85,000
- Total contingent liability = ₹ 4,30,000 + ₹ 1,85,000
  = ₹ 6,15,000
- As enterprise should not recognise a contingent liability. For each class of contingent loss/liability at the balance sheet date, an enterprise should disclose, by way of a note, a brief description of the nature of the contingent liability.

2013 - Nov {C} [1] (a) P Ltd. has three business segments which are FMCG, Batteries and Sports Equipment. The Battery segment has been consistently underperforming and P Ltd. after several discussions with Labour unions have finally decided on closure of this segment. Under the agreement with the Labour Union the employees of the Battery Segment will earn no further benefit as the arrangement is a curtailment without settlement wherein the employees of the discontinued segment will continue to receive benefits for services rendered when the segment was functioning. As a result of the curtailment, the company's obligations that were arrived on the basis of actuarial valuations before the curtailment have come down. The following information is also furnished:

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

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

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

(iv) The Fair Value of plan assets on date is estimated at ₹ 3,250 lakhs.
You are required to calculate the gain from curtailment and also show the liability lo be recognized in the Balance Sheet of P Ltd. after the curtailment. (5 marks)

(b) To comply with listing requirements and other statutory obligations Quaker Ltd. prepares interim financial reports at the end of each quarter. The company has brought forward losses of ₹ 700 lakhs under Income Tax Law, of which 90% is eligible for set off as per the recent verdict of the Court, that has attained finality. No Deferred Tax Asset has been recognized on such losses in view of the uncertainty over its eligibility for set off. The company has reported quarterly earnings of ₹ 700 lakhs and ₹ 300 lakhs respectively for the first two quarters of Financial year 2013-14 and anticipates a net earning of ₹ 800 lakhs in the coming half year ended March 2014 of which ₹ 100 lakhs will be the loss in the quarter ended Dec. 2013. The tax rate for the company is 30% with a 10% surcharge. You are required to calculate the amount of Tax Expense to be reported for each quarter of financial year 2013-14. (5 marks)

(c) B Ltd. entered into an agreement on 1st March, 2013 to buy computer spares from S Ltd. at prevailing market price for ₹ 1200 lakhs on which S Ltd. made a profit of 20% and received full advance payment. The transaction was concluded on 15th March, 2013. On the same day S Ltd. agrees to buy on 15th Sept., 2013 the same goods from B Ltd. at 20% over cost. The 20% mark up compensates B Ltd. for its inventory holding costs till sale date. You are required to show how both the buyer & seller account for the above transaction in the year 2012-13 explaining in brief the justification for your treatment and also draft the Notes on Account on disclosure if any required in the annual accounts of year ended 31st March, 2013. (5 marks)

(d) Vintage Ltd. has been in the business of sale of Vintage Wines for the last 12 years and is an extremely cash rich company. In FY 2011-12 the Board of the company decided to venture into new areas of business and identified the activity of acquiring Vintage Properties such as old Bungalows, Heritage buildings and the like at prime locations and after carrying out renovation and refurbishment of the same to let out these properties on lease to willing parties. The new business was commenced as a separate division of the company in FY 2012-13 during which the company managed to identify 19 such properties of which 17 were acquired and 9 given on lease. Being the initial year of operations and also since some of the lease arrangements were entered into at the fag end of the year the income from leasing was only a paltry amount. After the acquisition of the properties as aforesaid very attractive offers for sale of 14 of the properties were received. Vintage Ltd. after negotiation accepted 12 of the offers and sold these 12 properties making large profits in the bargain. The accountant of Vintage Ltd. has accounted the acquisition and disposals of properties as 'Purchases' and 'Sales' in the Profit & Loss account of the Property Division and treated the lease incomes as part of the other income of the company. The contention of the accountant of Vintage Ltd. was that since a majority of the properties were disposed off within a short span of time, the properties are to be considered as stock in trade only. Further since the lease income was insignificant it does not become the main source of income and hence considered as part of other income. You are required to examine the correctness of the contentions of the accountant of Vintage Ltd. considering the relevant Accounting Standards and provisions of Revised Schedule IV of Companies Act, 1956. (5 marks)

2013 - Nov [7] (b) WIN Ltd. has entered into a three year lease arrangement with Tanya sports club in respect of Fitness Equipments costing ₹ 16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Values of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be ₹ 1,33,500. The assets would revert to the lessor at the end of the lease. Given that the implicit rate of interest is 10% you are required to compute the amount of the annual lease and the unearned finance income. Discounting Factor at 10% for years 1, 2 and 3 are 0.909, 0.826 and 0.751 respectively (4 marks)

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

(i) You are required to comment if mere gradual phasing out in itself can be considered as a 'Discontinuing Operation' within the meaning of AS 24.

(ii) If the company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS 24 ?

(iii) Would your answer to the above be different if the company resolves to sell the assets of the Passenger Car Division in a phased but time bound manner? (4 marks)

(d) Grant Medicare Ltd. acquired 5 units of Brain Scan Equipment for US$ 5,00,000 in April 2010 incurring ₹ 20,00,000 on sea freight and US$ 12,000 per unit towards transit Insurance, bank charges etc. The purchase was partly funded out of the company's internal accruals and from Government Grant of ₹ 94 Lakhs. The prevailing exchange rate to the US$ was ₹ 50. The company estimated the useful life of the equipment at 4 years with an estimated salvage value of 13% (approx). The grant was considered as Deferred Income up to 2012-13 and in April 2013 the company had to return the entire grant received due to non fulfillment of certain conditions. You are required to show the deprecation and the grant that is to be recognized in the Profit & Loss accounts for the period commencing 2010-11 onwards and also draw up the entry that is passed in April 2013 for the return of the Grant. The Company follows the written down value method for depreciating its assets. (4 marks)

(e) Blow Glass Limited manufactures Glass Bottles of various sizes and shapes at its 3 manufacturing facilities in UP, Haryana and MP. The company follows the WDV method of depreciation for all assets at these units and at its corporate office. In 2013 May it acquired a new unit making plastic containers in Gujarat. The method of depreciation followed in the newly acquired unit was the SLM method for all its assets, till the unit was acquired by Blow Glass Ltd. The Chief Accountant of Blow Glass is of the view that since the company has adopted the WDV method at all its existing assets it is mandatory to follow the WDV method in respect of the new unit also, especially since the same class of assets exist at the existing units and new unit. You are requested to comment on the stand of the Chief Accountant. (4 marks)

Similarly Asked Questions

No.	Category	Question	Marks	Frequency
1	Distinguish Between / Short Notes.	What are Timing differences and Permanent differences ? 2008 - Nov [7] (e), 2005 - Nov [6] (c)	4, 4	2 Times
2	Practical	Practical Question of 09- May [1] (b) 10 - May [1] (b)	4, 5	2 Times

Table Showing Marks of Compulsory Questions										
Year	09 M	09 N	10 M	10 N	11 M	11 N	12 M	12 N	13 M	13 N
Practical	16			10	15	5	20	20	20	20
Total	16			10	15	5	20	20	20	20