6F ACCOUNTING STANDARDS

Accounting Standards: Refer Institute Study Material on CA Final - "Financial Reporting."

No.	Question Bank	Exam	Marks
	AS - 1		
1	Write short noes on "Changes in Accounting Policies". Hint: Refer AS 1	N02	4
	AS - 2		
2	Write short notes on "Normal Capacity for the purpose of Inventory Valuation". Hint: Refer AS 2`	M04 PM	4
3	XYZ Pvt. Ltd., manufacturing garments, has valued at the year end its closing stock of packed finished goods for which firm export contracts have been received, at realizable value inclusive of profit and export cash incentive. As at the year end, the ownership of the goods has not been transferred to the foreign buyers.	M08 PM	5
Ans	• AS 2 requires that inventories should be valued as lower of cost and Net realizable value (NRV). A departure from the general principle can be made if the AS-2 is not applicable or having regard to the nature of industry. • AS 2 also states that (a) WIP arising under construction contracts, including directly related service contracts (b) WIP arising in the ordinary course of business of service providers;(c) shares, debentures and other financial instruments held as stock-in-trade; and(d) producers' inventories of livestock, agricultural and forest products are measured as NRV Based on established practices. • In the present case the sale is assumed under a forward contract but the goods are not of a nature covered by the above exceptions. Taking into account the facts the closing stock of finished goods should have been valued at cost, as it is lower than the realisable value (as it includes profit). Further, export cash incentives should not be included for valuation purposes. • The policy adopted by the company for valuing its closing stock of inventory of finished goods on selling price plus export incentives is not correct. The statutory auditor should give a qualified report.		
4	T Ltd. commenced its manufacturing activities from 1st April 2012. In the course of production the company generated certain by - products. As at 31st March 13 the company did not value the by-products considering the value as insignificant. The auditor of the company is of the opinion that the by-products are inventory of the company and it should be valued and brought into books of account. omment.	M13 PM	5
Ans	• As per AS-2 on "Valuation of Inventories", issued by ICAI, a production process may result in more than one product (joint product or by-product) being produced simultaneously. If the costs of conversion of each product are not separable, they are allocated on a rational & consistent basis. Most of the by-products (scrap/waste materials etc) by their nature, are immaterial. They are often measured at net realizable value & this value is deducted from the cost of the main product. • In the given case, as the value of the by-products is insignificant, the realizable value of by products should be ascertained and it should be deducted from the cost of the main product. • An asset is a resource controlled by an enterprise as a result of past events from which the future economic benefits are expected. • As per AS 2- Inventories are assets (a) held for sale in the ordinary course of business (b) in the process of production for such sale (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.		

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	• In present case, the stock of by-product is a resource controlled by T Ltd. It is an asset and it is inventory ,because it is held for sale in the ordinary course of business. Hence, T Ltd. should deduct the realizable value of its by products from the cost of production of main product.		
5	You have been appointed a statutory auditor of a limited company engaged in the manufacture of chemicals. What would be your views on the following? “ The management tells you that the WIP is not valued since it is difficult to ascertain the same in view of the multiple processes involved and in any case the value of opening and closing work in process would be more or less the same”	Case Study	
Ans	• As per AS 2 (Revised) on "Valuation of Inventories", the inventories also include those assets which are in the process of production for sale in the ordinary course of business apart from finished goods and those materials or supplies to be consumed in the production process or in the rendering of services. It is, thus, necessary for a company to ensure that each and every component of inventory is valued properly. The argument given by the company that it is difficult to ascertain the same in view of the multiple processes involved is not acceptable. Because, the Guidance Note on "Audit of Inventories" also recognise the likely difficulties in valuation of WIP and states that, "in general , the audit procedures regarding WIP are similar to those used for raw materials and finished goods. However, the auditor has to carefully assess the stage of completion of the WIP for assessing the appropriateness of its valuation. For this purpose, the auditor may examine the production / costing records (for example, cost sheets), hold discussions with the personnel concerned and obtain expert opinion, where necessary". • The argument that the opening and closing WIP would be more or less the same is also not justified because the omission of those would lead to distortion in true and fair view. Further, costs incurred for raw materials and the overheads would normally be different and would give rise to different value of opening and closing stock. The Guidance Note even requires the auditor to ascertain the system from which the value of WIP is obtained is reliable, and to examine subsequent records of production / sales. Therefore, in view of the above provision, the auditor shall have to qualify the audit report in case WIP is not valued and shown in the financial statements.		
6	As an auditor state your views on the following situations: “Included under Current Assets of XYZ Ltd. is inventory aggregating to Rs 20 crores. A part of the said inventory manufactured for export had to be sold earlier at a discounted price off-shore due to moisture content present at the time of delivery. A part of similar inventory is included in Rs 20 crores.	Case Study	
Ans	A part of the inventory exported earlier had to be sold at a discounted price off shore due to moisture content present at the time of delivery. The auditor will therefore have to examine what part of the inventory is included in the inventory valued at Rs. 20 crores, a part of which had been exported at a discounted price. He will also have to satisfy himself that whether such part left with the company has also been damaged on account of moisture content. If required, the auditor may obtain a certificate from an expert (SA 620) about the condition of the inventory. Thereafter, it should be verified whether the principle of valuation enunciated in AS 2 (Revised) “Valuation of Inventories” have been followed in such a case. The AS 2 requires that the inventories should be valued at the lower of cost or net realisable value. AS 2 (Revised) defines the net realisable value as the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Accordingly, such part of inventory which is damaged should be valued at estimated realisable value if the same is lower than the cost. In the present case the auditor should satisfy himself whether the balance inventory lying with the company is carrying the same quality issue. If yes, than value of inventory will be revised based on the past performance as per its net relisable value.		

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	AS-4		
7	What are your views on the following? "A Ltd. was under audit for the year ended 31-03-2015. An appeal filed by A Ltd. against the demand of Excise Duty of Rs. 26 crores was pending before the Supreme Court for which neither provision was made nor was disclosed in the notes to the financial statements. On 12th July, 2015, the auditor came to know through paper reports that the point involved in the appeal of A Ltd. was adjudicated by the Supreme Court in the case of some other assessee, which is in favour of the department of Excise Duty. The auditor insisted that provisions be made of Rs. 26 crores in the financial statements. The Management was of the view that since its own case is still pending, no provision is called for. It was also of the view that the event does not have any effect on the financial position of the company on the date of the Balance Sheet. Is the view of the Management tenable"?	N04 PM	5
Ans	• Accounting Standard 4 on "Contingencies and Events Occurring after the Balance Sheet Date" deals with all those significant events both favorable and unfavorable, that occur between the BS date and the date on which the FSs are approved by the BODs of the company. • As per AS 4, those events can be identified as adjustable event which provide further evidence of conditions that existed at the balance sheet date; and non-adjustable events are those which are indicative of conditions that arise subsequent to the Balance Sheet Date. • SA 560 on "Subsequent Events" lays down that the 'auditor should consider the effect of subsequent events on the financial statements and on the auditor's report". • In the present case, A Ltd. had a pending demand of Rs. 26 crores made by the Excise Department for which appeal was made in the Supreme Court. Since the issue involved in the appeal of A Ltd. was similar to the point in case of same other company and since the appeal of that company was decided against that company and in favour of the Excise Department it is necessary for A Ltd. to make a provision of Rs. 26 crores. The case settled by the Supreme Court on similar point reflects significant development affecting the assessment about the potential risk faced by the company. • The view of the management that its own appeal is undecided or that it has no effect on the financial position of the company as on 31.03.2015 is not at all tenable. Since the financial position is materially affected, the auditor should express a qualified opinion or an adverse opinion as may be appropriate.		
8	During the course of audit of D Co. Ltd. you as an auditor have observed that Inter corporate deposit of Rs. 50 lakhs has been overdue. The D Co. Ltd. have disclosed this in the notes to accounts note No. 15 in schedule no. 21 stating that Rs.50 lakhs is overdue from XYZ Co. Ltd. and the said company is in the process of liquidation. The management is taking steps to appoint the liquidator.	N10 PM	5
Ans	As per AS 4 "Contingencies and Events occurring after the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the BS sheet dates that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. In the instant case, it appears from the note no. 15 that the overdue of outstanding inter corporate deposit may not be realizable in full. The company is in the process of liquidation, makes it clear that on the balance sheet date, the amount of deposit is not safe and is not likely to be realised. Therefore, as per AS 4 provision for the loss is required in the accounts. Hence the auditor should qualify the Audit Report.		
	AS - 5		
9	As a Statutory Auditor, how would you deal with the following? "Y Ltd. provided Rs. 25 lakhs for inventory obsolescence in 2014-15. In the subsequent year, it was determined that 50 % of such stock was usable. The company wants to adjust the same through prior period adjustment account as the provision was made in the earlier year.	M00 N07 N11 PM	5

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Ans	• As per AS 5, prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the FS of one or more prior periods. The write back of provision made in respect of inventories in the earlier year does not constitute prior period adjustment since it neither constitutes error nor omission but it merely involves making estimates based on prevailing circumstances when financial statements were being prepared: It is a mere estimate process involving judgment based on the latest information available. • An estimate may 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 revision of the estimate, does not bring the adjustment within the definitions of an extraordinary item or, a prior period item. • Further, as per SA 540, the auditor shall review the outcome of accounting estimates included in the prior period financial statements or where applicable, their subsequent re-estimation for the purpose of the current period. • In the present case, revision of an estimate does not bring the resulting amount of Rs.12.5 lakhs within the definition of a prior period item or extraordinary item. The amount involved is however, material and requires separate' disclosure to understand the financial position and performance of an enterprise. Hence, adjustment in the value of the inventory through prior period item would not be proper.		
	AS-6		
10	Write short notes on "Depreciable assets as defined in AS-6". **Hint:** Refer AS 6	N98	4
	AS-7		
11	B Co. Ltd. is engaged in the business of developing mass scale housing projects including development of small commercial complexes. The flats/commercial spaces are booked by the public and are allotted by way of allotments letter to each allottee. Major construction activities pertaining to buildings are undertaken after, allotment is over. After completing the construction, possession of flats/commercial spaces is given to allottees by executing legal document. The CEO of the B. Co. Ltd. says that AS 7 is not applicable to the company.	N10 PM	5
Ans	• The contention of the CEO of B Co. Ltd. is correct. AS 7 "Construction Contract", should be applied in accounting for construction contracts in the financial statements of contractors. • The activity of the B Co. Ltd. is not that of a contractor. The company is developing projects on its own account as a commercial venture and is in the nature of production activity and not that of a contractor. Therefore AS 7 "Construction Contract", will not be applicable to B Co. Ltd. For the purpose of recognition of Revenue and valuation of inventories. B Co. Ltd should follow the principles contained in AS 9 "Revenue recognition" and AS 2" Valuation of Inventories".		
	AS-9		
12	Write short notes on "Effect of uncertainties on revenue recognition". **Hint:** Refer AS 9	N06 PM	4
13	As an auditor, state your views on the following: "M Ltd. manufactures machinery used in Steel Plants. It quotes prices in various tenders issued by Steel Plants. As per terms of contract, full price of machinery is not released by the steel plants, but 10% thereof is retained and paid after one year if there is satisfactory performance of the machinery supplied. The company accounts for only 90% of the invoice value as sales income and the balance amount in the year of receipt to the extent of actual receipts only".	M02	5
Ans	• AS-9 on 'Revenue Recognition', states that revenue from sale of goods should be recognised when the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership and no significant uncertainty exists regarding the amount of consideration. • In the case of M Ltd., the goods, as well as the risks and rewards of ownership have been transferred to		

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	the steel plants. The invoice raised by M Ltd. is for the full price, but 10% less is received as the same 'is kept as 'Retention Money. • In present case, therefore, revenue has to be recognised at the full invoice price, i.e., 100% has to be accounted as Sales Income. Depending on the past experience of recovering the balance 10% from the steel plants, M Ltd. can, however, make a provision for sales income which is not likely to realised. In the absence of the above, the auditor will have to qualify his report.		
14	LM Ltd. has 2 divisions L and M. The finished products of division L are transferred to division M where further processing is carried out before sale to customers. To achieve transparency and accountability between the divisions, division L raises an invoice on division M at cost plus normal margins. At the year end the unrealised profits on inter-division stocks are eliminated. However, the transfers are recorded at the invoice value as sales and purchases in the respective divisions for the purpose of preparing the Profit and Loss Account. Suitable disclosures, for this are given in then 'Notes to Accounts'.	N05 PM	5
Ans	• As per the definition of the term "Revenue" in AS 9,"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. Revenue is measured by the Charges made to customers or clients for goods supplied and services rendered to them and by the Charges and rewards arising from the use of resources by them. • As per the clarification issued by ICAI, the use of the word "enterprise" in the above definition clearly implies that the transfers within the enterprise cannot to considered as fulfilling the definition of the term "revenue". • Thus, the recognition of inter-divisional transfers as sales is an inappropriate accounting treatment and is inconsistent with AS-9. • Further, in case of inter-divisional transfers, risk and rewards remain within the enterprise and also there is no consideration from the point of view of the enterprise as a whole. Thus, the recognition criteria for revenue recognition are also not fulfilled in respect of inter-divisional transfers. • In view of the above, LM Ltd. cannot recognize inter-division transfers from L to M as sales and the same will have to be eliminated during finalization. If not so done, the statutory auditor will have to qualify his report.		
15	A infrastructure company has constructed a mall and entered into agreement with tenants towards license fees (monthly rental) and variable licence fees, a percentage on the turnover of the tenant (on an annual basis). Chief Finance Officer wants to account/ recognize licence fee as income for 12 months during current year under audit and variable licence fees as income during next year, since invoice is raised in the subsequent year. As an auditor, how would you deal and state in the statement of Accounting policies?	N11	6
Ans	• Revenue Recognition: As 9 is mainly concerned with the timing of recognition of revenue in the statements of P&L of an enterprises. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. However, when uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition. • As per accrual concept of fundamental accounting assumptions given in AS 1, revenue should be recognised as and when it is accrued i.e. recorded in the FSs of the periods to which they relate. • In the given case, monthly rental towards license fees and variable license fees as a percentage on the turnover of the tenant though on annual basis is the income related to same financial year. Hence, recognition of the fees as revenue cannot be deferred simply because the invoice is raised in subsequent period. Therefore, it should be recognised in the financial year of accrual. • Hence, the contention of the CFO is not in accordance with the provisions of As 9 and the auditor may qualify the report indicating the understatement of income/profit and that the P&L A/c does not exhibit a true and fair view of the profit or loss.		

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16	A ltd. is a manufacturer of readymade garments. It sells its products to franchisees located across the country. Readymade garment industry is subject to change in trends of fashion and as such, some of the goods are returned and A Ltd. accepts them back as sales returns. On the basis of past trends such returns are estimated to be at 20% of the sales of any year. For the financial year 2011-12, A Ltd. had accounted for the actual sales return made up to 31s1 March 2012 but has not reversed the possible expected return that are likely to happen after 31s1 March 2012, in respect of the sale made for the FY 11-12. Mr. X the auditor of A Ltd. wants this to be considered in the accounts for the year ended on 31st March 2012 but the company is of the opinion that although there is a probability of some goods being returned by the franchisees, there is no significant uncertainty regarding the amount of consideration that will be derived from the sale of goods, since the goods are not in the possession of the company and risk and rewards of ownership still lie with the franchisees and the company cannot record sales returns in its books of account in respect of goods that are likely to be received after the date of balance sheet.	M12 PM	5
Ans	• AS 9 on 'Revenue Recognition', states that revenue from sale of goods should be recognised when the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership and no significant uncertainty exists regarding the amount of consideration. • Further, revenue recognition is mainly concerned with the timing of recognition of revenue in statement of P&L of an enterprise. The amount of revenue arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition. • In the present case, A Ltd. is a manufacturer of readymade garments and sells its products to franchisees located across the country. Due to change in trends of fashion etc sold goods are being returned and A Ltd. accepts them back as sales returns. On the basis of past trends such returns are estimated as 20% of the sales of any year. In this case, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 20% of its sales. The company may disclose suitable revenue recognition policy in its financial statements separately. In the absence of the above, the auditor must qualify his report. • Note: Alternative Answer is possible on the basis of AS 29 on Provisions, Contingent Liabilities and Contingent Assets by recognizing the whole sales as revenue, i.e., 100% accounted in P&L A/c as Sales Income as there is no significant uncertainty regarding the amount of consideration. However, keeping in view its past performance, A Ltd. should make a provision for sales income which is not likely to realise. • In the absence of the above, the auditor will have to qualify his report.		
17	AS a statutory auditor of a company, comment on the following: "The accounting policy on Revenue Recognition for a company engaged in manufacture and sale of chemical products was stated as "Revenue is recognized only when it can be reliably measured and it is reasonable to expect ultimate collection.	N12 PM	5
Ans	According to AS 9 Revenue Recognition, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled: • the seller of goods has transferred to the buyer, the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and • No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods. Therefore revenue from sale transactions should be recognised when the above conditions are satisfied.		

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	In the instant case, the company has made disclosure in the accounting policy on revenue recognition as per AS 1 stating the revenue is recognised only when it can be reliably measured and it is reasonable to expect ultimate collection is correct. . However, accounting policy disclosed above should also cover the aspect of transfer of risk and reward for the purpose of revenue recognition as per AS 9.		
18	In the course of audit of T Ltd. you observed that export incentives are not accounted on accrual basis. The company's management contended that these would be accounted on cash basis citing the uncertainty about its receipts as they are not admitted as due by the customs authorities. Comment.	M11 PM	4
Ans	**Accountability of Export Incentives:** • The exporters receive certain incentives (monetary or non-monetary) from the GOI on export of goods. However due to various procedural delays and laws involved which keep changing frequently, there is generally a delay in actual receipt of the export incentives. Further the receipt of the export incentives may not be assured in certain situations due to frequent changes in the policies of the Government. In such cases, it may be reasonable to presume that the receipt of the incentives is uncertain till the time they are actually received. • As per section 128 of Company Act, 2013, books of Accounts shall be kept on accrual basis and according to the double entry system of accounting. However, As per AS 9 "Revenue Recognition", if at the time of raising the claim for incentive, it is unreasonable to expect ultimate collection, revenue recognition should be postponed. Therefore, as per AS 9, if there is uncertainty in the receipt of the amounts, then the revenue in respect of such incentives ought not to be recognized in the books of accounts. • Therefore revenue is to be recognized only when there is reasonable certainty in the receipt of the same. Hence, in instant case, contention of management of T Ltd. to record the export incentive on cash basis is correct. • **Note:** An Alternative view is also possible, since the export incentives are due as and when the exports have been made from India, though customs authorities does not acknowledge them as due. This does not mean that an uncertainty arises about its receipt. If at all customs authorities have an objection it should be at the time of clearance of the goods for export. The only uncertainty is the timing of the receipt of such incentives, but not the incentive itself. Hence, in present case T Ltd. has to account the export incentives on Accrual basis.		
19	A infrastructure company has constructed a mall and entered into agreement with tenants towards license fees (monthly rental) and variable license fees, a percentage on the turnover of the tenant (on an annual basis). CFO wants to account/recognize license fee as income for 12 months during current year under audit and variable license fees as income during next year, since invoice is raised in the subsequent year. As an auditor, how would you deal and state in the statement of Accounting policies?	Case Study PM	
Ans	• AS 9 on Revenue Recognition, is mainly concerned with the timing of recognition of revenue in the statement of P&L of an enterprise. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. However, when uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition. • Further, as per accrual concept of fundamental accounting assumptions given in AS 1 "Disclosure of Accounting Policies", revenue should be recognised as and when it is accrued i.e. recorded in the FS of the periods to which they relate. • In the instant case, monthly rental towards license fees and variable license fees as a % on the turnover of the tenant though on annual basis is the income related to common financial year. Therefore, recognising the fees as revenue cannot be deferred simply because the invoice is raised in subsequent period. Hence it should be recognised in the financial year of accrual. • Therefore, the contention of the CFO is not in accordance with AS 9 and hence the auditor may qualify the report indicating the understatement of income/profit and that the P&L A/c does not exhibit a true and fair view of the profit or loss.		

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AS-10

20	An old car of a company having a nominal book value has found a buyer, who is willing to pay Rs. 1 lakh for it. The company proposes not to sell the car, but to neglect its valuation in its accounts at Rs. 1 lakh. Should the auditor permit the company to do so?	N03	8
Ans	• The old car formed part of the fixed assets of the company and ordinarily the same should be valued at actual cost less depreciation written off. The market price of any of such assets is not relevant for balance sheet valuation of a going concern. • However, there is no prohibition in law for revaluation of fixed assets. The accounting principle also allows revaluation, to reflect the fixed assets at their replacement cost. But when all other assets are presumably shown at historical cost, revaluation only of one motor car seems illogical and has the effect of distorting the overall view of the accounts. • Further, revaluation should be carried out on the basis of proper appraisal, normally undertaken by competent valuers. AS 10, "Accounting for Fixed Assets" also clarifies, that selective revaluation of assets can lead to unrepresentative amounts being reported in financial statements. • Accordingly, when revaluations do not cover all the assets of a given class, it is appropriate that the selection of assets to be revalued on a systematic basis. For example, an enterprise may revalue a whole class of assets within a unit. Thus, as per AS 10, when a fixed asset is revalued in financial statements, an entire class of assets should be revalued, or the selection of assets for revaluation should be made on a systematic basis. This basis should also be disclosed. • In the present case, there is no proper appraisal and a revaluation based on bid from a single buyer, is not proper to establish a proper replacement value or an antiquated item of asset. The willingness of a buyer to pay the particular price is not logical basis to work out the value of the asset. Because, by this process it may happen that the net book value of the assets might be greater than the recoverable amount of the asset. • In view of the fact that the company has been taking proper step, the auditor should permit the company to neglect the valuation of car in the accounts because it is in accordance with the relevant requirements of the ASs.		
21	In the notes to accounts of C Co. Ltd. as on 31-03-2015 Note no. 11 states that Certain machinery items are lying at customs warehouses and company has paid Rs. 900 lakhs up to 30-06-14 as detention Charges, out of which a sum of Rs. 580 lakhs is written back during the year 2014-15 based on settlement with the concerned authorities in respect of a major spares of machinery. For the remaining machinery items negotiations are pending and a provision of Rs. 44 lakhs is made. As such total amount of Rs. 364 lakhs paid/provided on account of detention charges have been capitalized and included in the Fixed Assets/Capital work in progress. The management is of the view that these expenses are directly attributable to the acquisition of the related Fixed Asset.' As the auditor how would you respond to this ?	N10 N14 PM	5
Ans	• As per AS 10 "Accounting for Fixed Assets", the cost of an item of fixed asset comprise its purchase price, including import duties and other non-refundable taxes or levies and any directly attributable cost of bringing the asset to its working condition for its intended use. • Generally, detention charges represent an abnormal expenditure, as these expenditures are not directly attributable to the cost of asset. • The auditor will qualify the audit report appropriately in the paragraph before stating that the balance sheet gives true and fair view and the P&L A/c shows true and fair profit of the year ending on 31-3-2010. The qualification will be as follows: "Attention is invited to Note no. 11 regarding Capitalization of detention charges of Rs. 364 lakhs during the year and on account of delays in respect of clearing from custom warehouses for certain machinery items". In our opinion the detention charge are not directly attributable to the acquisition of related fixed assets. The said amount of Rs.364 lakhs should have been written off in the P&L A/c. Had these expenses		

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	been so written off the profit for the year would have been lower by Rs.364 lakhs and Reserves & Surplus as well as Fixed Assets/Capital WIP would have been lower by Rs.364 lakhs."		
22	As a statutory auditor of a Public Limited Company, how would you deal with the following situations? " The company has sold some old machinery for Rs. 1 crore. The details of the cost of such machinery are not available since the entire records relating to fixed assets have been destroyed in an earthquake".	Case Study	
Ans	AS 10 on "Accounting for Fixed Assets", gains or losses arising on disposal are generally recognised in the P&L A/c. Therefore, when the company sells old machinery, profit/loss on sale thereof has to be determined. Such profit or loss can be determined provided the cost and WDV of the said machinery is available. In the given case, since the entire records of fixed assets have been destroyed, the cost and the WDV of the machinery sold could not be arrived at. The company may therefore, have to determine the same on some estimated basis provided all reasonable efforts to determine the cost/WDVs of the machinery do not yield any better result. An all out attempt should be made by the management to reconstruct the old records. Such records may be constructed by obtaining old copies of annual reports distributed to shareholders, annual accounts filed with ROC; IT Returns filed by the auditor may also be having record of physical verification of earlier years etc. In fact, through this process, the company shall be able to determine the WDV of the asset because the machinery sold seems to be quite big and must have been recorded on standalone basis. The auditor will have to see whether the estimate of cost and WDV arrived at in the above manner by the company is reasonable and whether the profit or loss is determined accordingly. A note to that effect would also have to be given by the management in the accounts. If the auditor is of the opinion that thesaid estimates are satisfactory based on available records and the note given by management explains the said fact, he may not qualify his report. If he is not so satisfied, he would have to give disclaimer in the audit report that in the absence of proper records, the said profit/loss has been arrived on an estimated basis and in that view he has been unable to form an opinion.		
23	As a statutory auditor of a Public Limited Company, how would you deal with the following situations? " As at the beginning of the year, the company has a capital of Rs 2.50 crores, free reserves of Rs 0.50 crore and Revaluation Reserve of Rs 4.50 crores. In the relevant year under audit the company has incurred a loss of Rs. 4 crores. The company proposes to adjust the loss with the Revaluation Reserve".	Case Study	
Ans	• AS 10 on "Accounting for Fixed Assets" states that an increase in net book value arising on revaluation of fixed assets is normally credited directly to owner's interests under the heading of revaluation reserves and is regarded as not available for distribution. • The Guidance Note on Treatment of Reserve created on Revaluation of Fixed Assets states that where the value of fixed assets is written up in the books of account of a company, the corresponding credit appearing as revaluation reserve does not represent a realised gain and therefore it is not available for distribution as dividend. Similarly, accumulated losses and the depreciation on the acquisition cost (including arrears of depreciation) should not be adjusted against revaluation reserve since this would amount to setting off actual losses against unrealised gains. • The auditor should explain to the management that accumulated losses cannot be adjusted against the revaluation reserve created on revaluation of the fixed assets. In case the company in question does so, the BS of the company will not reflect a true and fair view of the state of affairs of the company keeping in view the magnitude of the amounts involved (Rs. 4 crores loss and share capital and reserves amount to Rs 3 crores). If the management does not agree with the auditor's opinion, the auditor may even issue an adverse report.		
24	Comment on the following: "F Limited includes in the Schedule of Inventory, those items of Fixed assets which have not been in active use and held for disposal, as inventory item".	M10 PM	5
Ans	AS-10 "Accounting for Fixed Assets", requires that the items of fixed assets that have been retired from active use and are held for disposal be stated at the lower of their net book value and net realizable value and are shown separately in the financial statements. As per AS-2 "Valuation of Inventories", "inventories" are assets "held for sale in the ordinary course of business, in the process of production for such sale; or in		

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	the form of materials or supplies to be consumed in the production process or in the rendering of services.", whereas, the sale of fixed assets cannot be treated as sale arising from the ordinary course of business.		
	AS-11		
25	Write short notes on "Monetary items and its treatment on balance sheet date". **Hint:** Refer AS 11	N01	4
26	Write short notes on "Treatment of foreign currency monetary items on balance sheet date". **Hint:** Refer AS 11	M04	4
27	Write short notes on "Integral Foreign Operations". **Hint:** Refer AS 11	M04 PM	4
28	Z Ltd. changed its employee remuneration policy from 1st of April 2014 to provide for 12% contribution to provident fund on leave encashment also. As per the leave encashment policy the employees can either utilize or encash it. As at 31st March 15 the company obtained an actuarial valuation for leave encashment liability. However it did not provide for 12% PF contribution on it. The auditor of the company wants it to be provided but the management replied that as and when the employees availed leave encashment, the provident fund contribution was made. The company further contends that this is the correct treatment as it is not sure whether the employees will avail leave encashment or utilize It. Comment.	M13 PM	5
Ans	• As per para 11 of AS-15 on "Employee Benefits", issued by ICAI, an enterprise should recognize the expected cost of short-term employee benefits in the form of compensated absences in the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences. Since the company obtained actuarial valuation for leave encashment, it is obvious that the compensated absences are accumulating in nature. • Therefore it is necessary for an enterprise to 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 date. • In given case, Z Ltd will accumulate the amount of leave encashment benefits as it is the liability of the company to provide 12% PF on amount of leave encashment. Hence the contention of the auditor is correct that full provision should be provided by the company.		
29	X Limited, a newly incorporated company in India commenced its business from April 1, 2012. The Company purchased fixed assets costing Rs. 4,000 lakhs on 01-04-2012 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal installments. Exchange rates were 1 Dollar = Rs 40.00 and Rs 42.50 as on 01-04-2012 and 31-03-2013 respectively. The company worked out foreign exchange loss as per AS 11 at Rs 250 Lakhs and expensed the entire amount in the profit and loss account. The Managing Director of the company was worried about this heavy revenue loss and asked the accountant not to follow AS 11 issued by the ICAI for this particular transaction. The Accountant of the company followed the instruction of the Managing Director and removed exchange loss from the profit and loss account but then he added the entire exchange locss to the value of fixed asset and computed the depreciation thereon. As an Auditor of X Limited how you would deal with this particular transaction?	N13 PM	5
Ans	• As per AS 11 "The Effects of Changes in Foreign Exchange Rates", the exchange differences arising on reporting of long- term foreign currency monetary items in so far as they relate to the acquisition of a depreciable capital asset in respect of accounting periods commencing on or after the 1st April, 2011. • Such exchange differences can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset, and in other cases, it can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's FS and amortized over the balance period of such long term asset or liability, by recognition as income or expense in each of such periods. • Thus, in present case, X Ltd. has the choice to avail this option. However, the company should disclose the fact of such option and of the amount remaining to be amortized in the financial statements of		

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	• the period in which such option is exercised and in every subsequent period so long as any exchange difference remains unamortized.		
	AS-12		
30	As a statutory Auditor, how would you deal with the following: "XYZ Ltd. had received a grant of Rs. 50 lacs in 1997 from a State Government towards installation of pollution control machinery on fulfillment of certain conditions. The Company, however, failed to comply with the said conditions and consequently was required to refund the said amount in 2015. The Company debited the said amount to its Machinery in 2015 on payment of the same. It also reworked the depreciation for the said Machinery from the date of its purchase and passed necessary adjusting entries in the year 2015 to incorporate the retrospective impact of the same".	M06 PM	5
Ans	• Refund of Government Grant: In given case, XYZ Ltd., had received a grant of Rs. 50 lacs in 1997 from a SG towards installation of pollution control machinery on fulfillment of certain conditions. However, the amount of grant has to be refunded since it failed to comply with the prescribed conditions. • In such circumstances, AS 12, "Accounting for Government Grants", requires that the amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. This Standard further makes it clear that in the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life' of the asset. • Accordingly the accounting treatment given by XYZ Ltd. For increasing the value of the plant and machinery is quite proper. However, the accounting treatment in respect of depreciation given by the company for adjustment of depreciation with retrospective effect is improper and constitutes violation of both the AS 6, "Depreciation Accounting" and AS 12, "Accounting for Government Grants." • The auditor, therefore, should discuss with the management to make necessary changes in respect of the same and if not agreed to, qualify the report quantifying the impact of the same on profit as well as assets of the company.		
31	As a Statutory Auditor, how would you deal with the following? "Dark Ltd. has received a grant of Rs. 20 lacs under the Government's Subsidy Scheme for acquiring an imported machinery for setting up an oil exploration plant and the entire grant received is credited to Profit and Loss account".	N06 N09 PM	4
Ans	• According to AS 12, "Accounting for Government Grants" where grant is received for the acquisition of a specific fixed asset, the same cannot be credited to P&L A/c since it fails to match revenue with the cost. • As per AS 12, such grants should be presented in the balance sheet showing the grant as a deduction from the gross value of the asset concerned (in arriving at its book value). Alternately, the grants related to a depreciable fixed asset may be treated as deferred income which should be recognised in the P&L A/c on a systematic and rational basis over the useful life of the asset. By crediting the entire amount of grant to P&L A/c, the company has treated it as a revenue income which is not in accordance with the requirements of the accounting standard 12. • Therefore, the statutory auditor would have to qualify appropriately that the income has been overstated to the extent of the amount of grant net of proportionate credit that would have been worked out.		
	AS-13		
32	K Ltd. had 5 subsidiaries as at 31st March 2015 and the investments in subsidiaries are considered as long term and valued at cost. Two of the subsidiaries net worth eroded as at 31st March 15 and the prospects of their recovery are very bleak and the other three subsidiaries are doing exceptionally well. The company did not provide for the decline in the value of investments in two subsidiaries because the overall investment portfolio in subsidiaries did not suffer any decline as the other three subsidiaries are doing exceptionally well. Comment.	M13 PM	5

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Ans	• As per AS-13 "Accounting for Investments" issued by ICAI, long-term investments are usually of individual importance to the investing enterprise. • The' carrying amount of long-term investments is therefore determined on an individual investment basis. • Investments classified as long - term investments should be carried in the financial statements at cost. However, the provision for diminution shall be made to recognize a decline, other than temporary, in the value of investments, such reduction being determined and made for each investment individually. • Considering above provision, K Ltd. should provide for the decline in the value of investments in two subsidiaries despite the fact that the overall investment portfolio in subsidiaries did not suffer any decline.		
	AS-14		
33	As a Statutory Auditor, how would you deal with the following: "P Pvt. Ltd. was amalgamated with PQR Ltd. with effect from 1st April, 2013. As per the scheme of amalgamation approved by the High Court, the amalgamation was to be accounted by the "Pooling of Interests Method". The scheme further provided that the balance in Revaluation Reserve of P Pvt. Ltd. as on 31st March, 2013 was to be treated as a General Reserve on amalgamation. During the F.Y. 2014-15, PQR Ltd issued bonus shares out of General Reserve (which included the amount of revaluation reserve of P (Pvt.) Ltd.	PM	
Ans	• As per AS 14, "Accounting for Amalgamations" if the amalgamation is in the nature of merger and the 'Pooling of Interest Method' is followed, the identity of the reserves is preserved and it appears in the financial statements of the transferee company in the same form in which they appeared in the FSs of the transferor company. • In the instant case, P Pvt. Ltd is amalgamated with PQR Ltd. and the amalgamation is in the nature of merger. Accordingly, Revaluation Reserves of P Pvt. Ltd. would have normally continued to remain so in PQR Ltd. • However, since the scheme mentions that Revaluation Reserve is to be treated as General Reserves, the scheme will override AS 14 "Accounting for Amalgamations". AS 14 also requires that in case of any approved scheme of amalgamation if the treatment in accounting is not as per the AS, a specific disclosure of the same will have to be made alongwith the financial effect on the financial statements due to such deviation. • The statutory auditor will accordingly have to ensure that the company complies with the requirements regarding treatment of reserves and other related disclosure requirements or he may be required to modify his report.		
	AS-15		
34	Excellent Limited, a Company incorporated in India and listed with SEBI, has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for class they are entitled to as per company Rules and regulations. Employees are also entitled to claim a lump-sum payment to cover expenses on food and stay during the travel. The Company also gives option to employees that they can claim a lump-sum amount equal to three months pay last drawn. Excellent Limited have following accounting policies to record these travel expenses: (i) Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the travel rule of the company therefore all travel expenses fall under the category of defined contribution plans. (ii) Since it is not related to the length of service of the employees, it is difficult to estimate reliably and there is no present obligation to pay employees as per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", hence it is accounted for on claim basis. You are statutory auditor of Excellent Limited. What would be your guidance to audit team?	N13 PM	5
Ans	• The present case falls under the category of defined benefit scheme under AS 15 "Employee Benefits". The said scheme encompasses cases where payment promised to be made to an employee at or near retirement, presents significant difficulties in the determination of periodic charge to the statement of P&L A/c. • The contention of the Company that the settlement allowance will be accounted for on claim basis is not		

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	correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. • Thus, settlement allowance payable by the company is a defined retirement benefit, covered by AS 15. Accordingly, a provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation. • However, the amount of provision so determined is not material; the company can follow some other method of accounting for settlement allowances.		
	AS-16		
35	Write short notes on "Suspension of capitalization of borrowing costs". **Hint:** Refer AS 16	N01	4
36	As a Statutory Auditor, how would you deal with the following? "ABC Ltd. commenced construction of a flyover in Mumbai in January, 2004 under BOLT scheme. The same was completed in February, 2015. Due to seasonal heavy rains in July, 2014 in the area; the work on the flyover had to be suspended for 1 month. The company accordingly suspended borrowing costs of Rs. 12.50 lakhs for that month from capitalization".	N05 PM	5
Ans	• Borrowing costs may be incurred during an extended period in which the activities necessary to prepare an asset for intended use or sale are interrupted. • According to AS-16, "Borrowing Costs", capitalization of such borrowing costs should be suspended during extended periods in which active development is interrupted. • The standard, however, clarifies that capitalisation of borrowing costs is not suspended when a temporary delay is necessary as a part of the process or substantial technical and administrative work is being carried out. • Thus, the test as to whether or not to capitalize the borrowing costs depends primarily upon the nature of interruption of activities during "extended periods". • In the present case, it has been mentioned that the construction activity was interrupted due to seasonal rain and hence being regular feature. Though the rain was heavy, the period cannot be considered as an "extended period" leading to substantial delay in suspension of construction activities. • Therefore, in view of the above borrowing cost of Rs. 12.50 lakhs should be capitalised. Hence, suspension of capitalisation by the company is not a correct treatment and statutory auditor should report accordingly.		
37	Big Ltd. has borrowed Rs. 30 lakhs from State Bank of India during the financial year 2014-15. The borrowings are used to invest in shares of Small Ltd., a subsidiary company of Big Ltd., which is implementing a new project, estimated to cost Rs. 50 lakhs. As on 31st March, 2015, since the said project was not complete, the directors of Big Ltd. resolved to capitalize the interest accruing on borrowings amounting to Rs. 41akhs and add it to the cost of investments.	N04 PM	4
	As a Statutory Auditor, how would you deal with the following? "A company capitalizes interest on borrowings incurred for holding investments by adding the same to the cost of investment every year".	N07 PM	4
Ans	• Investments are assets held by an enterprise for the purpose of earning income by way of dividends interest, rentals, for capital appreciation, or for other benefits to the investing enterprise. As per AS· 13 "Accounting for Investment" cost of investments includes acquisition Charges such as brokerage, fees and duties. • As per AS 16 "Borrowing Costs" borrowing costs should be recognised as an expense in the period in which they are incurred. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Assets that are ready for their intended use or sale when acquired are not qualifying assets. Therefore such investment is not a qualifying asset; therefore interest cost of holding such investments cannot be capitalized. • In light of the above provision the decision taken by the Directors to capitalize the interest on borrowings is not proper. So the Auditor should qualify his report and state the financial effect of deviation from A.S.		

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AS-18			
38	Write short notes on "Key Management Personnel". **Hint:** Refer AS 18	N02 M08 PM	4
39	A firm of a father and a son is receiving Rs. 2 lakhs towards job work done for XYZ Ltd. during the year ended on 31-03-15. The total job work charges paid by XYZ Ltd. during the year are over Rs. 50 lakhs. The father is a Managing Director of XYZ Ltd. having substantial holding. The Managing Director told the auditor that since he is not involved in the activities of the firm and since the amount paid to it is insignificant; there is no need to disclose the transaction. He further contended that such a payment made in the last year was not disclosed. Is Managing Director right in his approach?	PM	
Ans	**Disclosure of Transactions with Related Parties:** As per AS 18 "Related Party Disclosures' parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise Significant influence over the other party in making financial and/or operating decisions. In the given case, the managing director of XYZ Ltd. is a partner in the firm with his son which has been paid Rs. 2 lakhs as job work charges. The managing director is having a substantial holding in XYZ Ltd. The case is squarely covered by AS 18. According to AS•18, in the case of related party transactions, the reporting enterprise should disclose the following: • the name of the transacting related party; • a description of the relationship between the parties; • a description of the nature of transactions; • volume of the transactions either as an amount or as an appropriate proportion; • any other elements of the related party transactions necessary for an understanding of the financial statements; • the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and • amounts written off or written back in the period in respect of debts due from or to related parties." Further, SA 550 on "Related Parties", also prescribes the auditor's responsibilities and audit procedures regarding related party transactions. The approach of the managing director is not tenable under the law and accordingly all disclosure requirements have to be complied with in accordance with the AS 18. Auditor should insist to make proper disclosure as per the AS and if management refuses, the auditor shall have to modify his report. Also it has to be seen whether section 184 of the Co. Act, 2013 regarding disclosure of interest by director has been complied. If it is not complied with, the auditor needs to modify the report appropriately.		
AS-20			
40	What are your views on the following? “Kevin Industries Ltd. has a paid up capital of Rs. 20 crores divided into equity shares of Rs. 10 each as on 31-03-2014. During the financial year 20014-15 it has issued bonus shares In the ratio 1 : 1. The net profit after tax for the years 31-03-2014 and 31-03-2015 is Rs. 10 crores and Rs. 15 crores respectively. The Earnings Per Share (EPS) disclosed in the financial statements for the above two years is Rs. 5.00 and R. 3.75 respectively. Is the disclosure correct?	N04 PM	5
Ans	**Disclosure of Earnings per Share:** • As 20 on Earning Per Share (EPS) prescribes principles for the determination and presentation of EPS. • As per AS 20, the earnings per share have to be disclosed as basic and diluted earnings per share on the face of the statement of P&L A/c for each class of equity shares that has a different right to share in the net profit for the period.		

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- In the present case, Kevin Industries Ltd., both the basic as well as the diluted earnings per share would be the same since there are not dilutive instruments that have been issued by the company.
- As per As 20, in the case of a bonus issue, equity shares are issued to existing shareholders for no additional consideration and thus it would lead to increase in number of equity shares without any
- adjustment to outstanding capital amount. Therefore, the number of equity shares outstanding is increased without an increase in resources.
- The standard further requires that the number of equity shares outstanding before the event of a bonus issue to be adjusted for the proportionate change in the number of equity shares outstanding as if the event had occurred at the beginning of the earliest period reported. Hence the EPS calculated as on 31.03.2014 would be Adjusted EPS and the same would be disclosed.
- In view of the above, the EPS will be calculated as under:

Liabilities	As on 31-03-2003	As on 31-03-2004
Profits	100,000,000	150,000,000
Adjusted No. Of Share	40,000,000	40,000,000
Adjusted EPS	= Profit/Adjusted No. of Share	
EPS		= Profit/No. of Share
Adjusted EPS in Rs.	2.5	
EPS in Rs.		3.75

- Since the above figures of EPS have not been disclosed, Kevin Industries Ltd. Has not complied with the provisions of AS 20. Therefore, the auditor would have to qualify his report in terms of section 143 (3)(e) of the Companies Act, 2013.

41	T Pvt. Ltd. is an unlisted closely held Company with turnover less than 50 crores. While finalizing the accounts, Mr. M the Director (finance) disputed the applicability of AS 20 to the Company.	N05 PM	3

Ans

Applicability of Accounting Standard:

- AS-20, "Earning Per Share", came into effect in respect of accounting periods commencing on or after 1-4-2001 and is mandatory in nature, from that date, in respect of enterprises whose equity shares or potential equity shares are listed on a recognised stock exchange in India.
- As such AS 20 does not mandate an enterprise, which has neither equity shares nor potential equity shares which are so listed, to calculate and disclose EPS, but, if that enterprise discloses EPS for complying with the requirements of any statute or otherwise, it should calculate and disclose EPS in accordance with AS 20.
- Part II of Schedule III to the Companies, Act, 2013, requires, among other things, disclosure of EPS, Accordingly, every company, which is required to give information under Part II of Schedule III to the Co. Act, 2013, should calculate and disclose EPS in accordance with AS 20, whether or not its equity shares or potential equity shares are listed on a recognized stock exchange in India.
- Accordingly the company, T Pvt., Ltd should compute and disclose EPS according to AS 20. Therefore, the contention of Director (Finance) is incorrect.
- The auditor will have to ensure that EPS is disclosed as per AS 20 or else the auditor should appropriately modify the audit report.

AS-22

42	Write short notes on "Permanent Difference and Timing Difference". **Hint:** Refer AS 22	M99	4
43	Write short notes on"Recognition of Deferred Tax Assets". **Hint:** Refer AS 22	N05 PM	4
44	Write short notes on "Deferred Taxation". **Hint:** Refer AS 22	M06 PM	4

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45	Do you approve of the following? If not, why? "Trimurthy Pan Masala (P) Ltd. was incurring heavy losses in the last several years since it could not withstand the competition in the market. The State in which the company had its registered office and also its major sales had moved a bill in the State Assembly to ban manufacture and sale of all kinds of Pan Masalas in the State. While finalising the accounts for the year ended 31-03-2015, the CFO of the Company created a Deferred Tax Asset for the tax benefits that would arise in future years from the earlier year's losses that had remained unabsorbed in Income Tax.	N04 PM	4
Ans	**Creation of Deferred Tax Asset:** • Accounting Standard 22 on "Accounting for Taxes" requires that DTA should be recognized for all timing differences subject to the considerations of prudence. • The Standard further states that unabsorbed losses of the business can be considered for creation of DTA provided there is virtual certainly supported by convincing evidence that sufficient future taxable income will be available against which such DTA can be realised. • In view of the above, the DTA created by the CFO is not in order. Since the company which is in the business of manufacturing of pan masala has been incurring heavy losses and in addition to this the State in which the company is having its major sales is proposing the ban on sale and manufacture of pan masala. • Therefore, the statutory auditor would have to qualify his report and mention the extent of amounts of loss and reserves which are under and overstated respectively.		
46	Comment on the following: "T Ltd. an Indian company, subject to Indian Income tax Act, 1961, discloses advance Income-tax paid (Current tax asset) and provision for Income-tax (Current tax liability), separately in Balance Sheet for the year ended 31.3.2015., i.e., it do not offset the amount.	M10 PM	5
Ans	• As per paragraph 27 of AS 22 "Accounting for Taxes on Income", an enterprise should offset assets and liabilities representing current tax if the enterprise: • Has a legally enforceable right to set off the recognized amounts and • Intends to settle the asset and liability on a net basis. • An enterprise will normally have a legally enforceable right to set off an asset and liability representing current tax when they relate to income taxes levied under the same governing taxation laws and the taxation law permits the enterprise to make or receive a single net payment. • Since T Ltd is an Indian Company, and as per Income Tax Act, 1961, such set off is allowed which is legally enforceable. Thus, in view of the above Provisions and Income Tax Laws, T Ltd. should offset advance tax paid against provision for income tax and show only the net amount in the balance sheet.		
	AS-26		
47	As a Statutory Auditor, how would you deal with the following? "B Pvt. Ltd., implements a Voluntary Retirement Scheme (VRS) for its employees. It follows a policy of amorting the expenditure over 10 years. As at 1st April, 2004, the unamortised VRS expenditure was Rs.15 lakhs. During the years 2004-05, it incurred further Rs. 12 lakhs as VRS. For the year ended 31st March, 2005, the company proposes to revise the period of amortisation to 5 years. It also proposes to follow the revised period for the opening balance".	M05 PM	5
Ans	• Expenditure on VRS: As 26, "Intangible Assets, deals with expenditure incurred on intangible items by all enterprises, except amongst others, is not applicable to expenditure in respect of termination benefits. • As per the standard, termination benefits are employee benefits payable as a result of either an enterprises decision to terminate an employee's employment before the normal retirement date; or an employee's decision to accept VRS in exchange for those benefits (Voluntary retirement), • Accordingly, VRS is one form of termination benefit and hence As 26 principles are not applicable. The same has to be, therefore, accounted as per general accepted accounting practices.		

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	• Hence in light of the above provision, VRS expenditure would have to be written off/amortised over a reasonable period. In fact, the change of the accounting policy followed by the company to reduce the amortisation period to 5 years for the entire VRS expenditure including opening balance seems appropriate and reasonable. • The auditor, however, has to examine that the requirements of AS 5 and impact of change in accounting policy is also disclosed as per AS 1 "Disclosure of Accounting Policies.		
48	X Ltd is engaged in the business of newspaper and radio broadcasting. It operates through different brand names. During FY 14-15 it incurred substantial amounts on external trade, business communication and branding expenses by participation in various corporate social responsibility (CSR) initiatives. The company expects to benefits by this expenditure by attracting new customers over a period of time and accordingly it has capitalized the same under brand development expenses and intends to amortize the same over the period in which it expects the benefits to flow. As the statutory auditor of the company do you concur? Give reasons.	N13 PM	4
Ans	• As per AS-26 on "Intangible Assets", expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria. • In the given case, it incurred substantial amounts on external trade, business communication and branding expenses by participation in various CSR initiatives. The company expects to benefits by this expenditure by attracting new customers over a period of time and accordingly it has capitalized the same under brand development expenses. • In the present case, no intangible assets or other asset is acquired or created that can be recognized. Therefore the accounting treatment by the company to amortize the entire expenditure over the period in which it expects the benefits to flow is not correct and the same should be debited to the P&L A/c.		
49	As a statutory Auditor, how would you deal with the following: "A Pvt. Ltd. started stock broking activities in 2015. For this purpose it acquired Membership of a Stock Exchange for Rs. 110 lacs. While finalizing the accounts, the company disclosed the above amount under the Fixed Assets Schedule as "Stock Exchange Membership Rights". The company also did not write off any amount since the rights would enable the company to perpetually carry on its business".	M06 PM	5
Ans	• The SEBI has issued guidelines as regards provisioning for stock membership rights. A Pvt. Ltd. has paid Rs. 110 lacs-tor acquiring membership of stock exchange. Such membership rights provide exclusive right to A Pvt. Ltd. for carrying out stock broking activities. • Thus, stock exchange membership rights are controlled by A Pvt. Ltd. and provide the basis for generating economic benefits to it. All these criteria appear to meet the definition of intangible assets as laid down in AS 26 (Intangible assets). • According to AS-26 if it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise and the cost of the asset can be measured reliably, then entity should recognize intangible asset. • In the above, case, membership rights of stock exchange acquired by A Pvt. Ltd meet the criteria of identifiability, control and arising of future benefits as well as reliability of the amount of cost. Thus recognizing the membership rights as fixed Assets is proper. • However, the fact that the company did not write off any amount since it would enable company to perpetually carry on its business is not proper, since AS 26 requires that all Intangible Asssets to be amortised. For this purpose, a rebuttable presumption of 10 Year is to be considered. Hence in the given case, the company should have amortised such rights over 10 years. Since the company has not amortised any amount, the auditor will have to qualify his report and state the fact of non-compliance with AS 26.		

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Comment on the following: "SRS Ltd. has drawn the financial statement as on 31-3-2011 and presented to' you along with additional information"

Liabilities	Amount	Assets	Amount
Share Capital	5000000	Fixed Assets	
Reserve & Surplus		Gross Block	10000000
Profit & Loss A/c	400000	Less: Dep.	
Secured Loans	7500000	Loan & Advances	2500000
Creditors for trade	300000	Advance paid	1000000
Advance received	300000	Debtors	
	13500000		**13500000**

Additional Information:

(a) Entire pre-operative expenses of Rs.7, 00,000/- was charged to Profit and Loss Account whereas for the purpose of Income Tax, only what is allowable is claimed.

(b) Depreciation as per Books - Rs. 35, 00,000/-
Depreciation as per Income tax - Rs. 50, 00,000/-

(c) Losses to be carried forward
as per Income - Tax Act - Rs.16, 00,000/-

(d) Donation disallowed while computing tax - Rs.50,000/-

Considering the additional information, Can you certify that the company has complied with the Accounting Standards and issue an unqualified report?

N11 PM

5

Ans

- Compliance with the Accounting Standards: As per As 26 "Intangible Assets", when an expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised, then such an expenditure is recognised as an expense when it is incurred. Therefore, expenditures for commencing new operations or launching new products or process (i.e. pre-operating costs) should be shown as an expense in the year of incurrence as no asset is created.
- Further, as per As 22, tax expense for the period, comprising current tax and deferred tax, should be included in the determination of the net profit or loss for the period. Deferred Tax is the tax effect of timing difference. Hence deferred tax should be recognised for all the timing differences however, permanent differences do not result in deferred tax assets (DTA) or deferred tax liabilities (DTL). Thus, Tax Expense = Current Tax + Deferred Tax.
- Point (a) of additional information complies with AS 26 hence no qualification is required in view of AS26, but at the same time it leads to timing difference which will require the creation of DTA/DTL as per AS 22. Similarly, point (b) and (c) related to depreciation also lead to timing differences which creates DTA/DTL.
- Creation of DTA/DTL due to such timing differences needs to be reported in the Financial Statements.
- However, point (d) is a situation of permanent difference as per As 22. Hence no DTA/DTL is required to be accounted for.
- In the given balance sheet no tax expense has been provided for. Accordingly, audit report should be qualified in view of non compliance of AS 22. Also, presentations of Fixed Assets are not in compliance with disclosure requirement of AS 6 an AS 10. Hence, it cannot be certified that the company has complied with all the Accounting Standards.

51

Write short notes on "Intangible Asset vs. Intangible Item".

N14

4

Ans

- As per AS 26 on "Intangible Assets", enterprises frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licences, intellectual property, market knowledge and trademarks (including brand names and publishing titles).

	• Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, mortgage servicing rights, import quotas, franchises, customer or supplier relationships, customer loyalty, customer lists, market share and marketing rights. • Goodwill is another example of an item of intangible nature which either arises on acquisition or is internally generated. • If above discussed items fulfils the conditions given in the definition of an intangible asset, that is, identifiability, control over a resource and expectation of future economic benefits flowing to the enterprise, will be considered as intangible asset. • But if any of such discussed items does not satisfied these 3 conditions then it will not constitute intangible asset, like expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. • However, if the item is acquired in an amalgamation in the nature of purchase, it forms part of the goodwill recognised at the date of the amalgamation. Further, Intangible assets are shown in BS whereas intangible items which are not intangible assets are provided as expenditure in P&L A/c.		
AS-29			
52	As a Statutory Auditor, how would you deal with the following: "V Ltd. sold 1 lakh vacuum pumps during the year 2014-15 with a condition to make good by repair/replacement any manufacturing defects reported within 6 months from the date of sale. Past experience in this regard showed that there were no replacements carried out, but minor/major repairs were necessitated to the extent of 5%/10% respectively of the units sold. The cost of such minor/major repairs would amount to Rs. 1,000/Rs 6,000 respectively. While finalizing the accounts for the year, the company does not reflect any provision in this regard.	M08 PM	5
Ans	• Provisions: As per AS - 29, 'Provisions, Contingent Liabilities and Contingent Assets, a provision is a liability which can be measured only by using a substantial degree of estimation. As per AS - 29, Provision should be recognized when: • An entity has a present obligation as a result of a past event. • It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and • A reliable estimate can be made of the amount of the obligation. • If these conditions are not met, no provision should be recognized. • In the given case, V Ltd fulfils all the above conditions. The sale of pumps with a warranty obligation constitutes the present obligation as a result of past event. It is probable that some outflow will be involved in setting the warranty obligation, satisfy the second condition. As per the details based on past precedence reliable estimate can be made as under: • [6000 x (5% of 1,00,000) + 1,000 x (10% of 1,00,000) = Rs. 400 lakhs • Thus, we can say that, V Ltd as on 31.3.07 should make a provision for warranty obligation against sale of vacuum pumps to the extent of rupees 400 lakhs. The auditor should insist on such provision being created. If provision is not made he should qualify his audit report.		
53	ABC Company files a law suit against Unlucky Company for Rs. 5 crores. The Attorney of Unlucky Company feels that the suit is without merit, so Unlucky Company merely discloses the existence of the law suit in the notes accompanying its financial statements. As an auditor of Unlucky Company, how will you deal with the situation?	M14	5
Ans	• As per AS 29 "Provisions, Contingent liabilities and Contingent Assets", a contingent liability is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence/ non-occurrence of one or more uncertain future events not wholly within the control of the enterprise. • Further, future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that the event will occur.		

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	• As per SA 570 "Going Concern" (GC), there are certain examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. AS given in the present case, Pending legal or regulatory proceedings against the entity that may, if Successful, result in claims that the entity is unlikely to be able to satisfy is one of the example of such event. • When the auditor concludes that the use of the GC assumption is appropriate in the circumstances but a material uncertainty exists, the auditor should determine whether the FS adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a GC. • In the given case, ABC Company has filed a law suit against Unlucky Company for Rs 5 crores. Though, the attorney of Unlucky Company feels that the suit is without merit so the company merely discloses the existence of law suit in the notes accompanying its FS. But the auditor may evaluate the source data on which basis the opinion is formed. If the auditor finds the uncertainty, he may request the management to adjust the sum of Rs. 5 crore by making provision for expenses as per AS 29. If the management does not accept the request the auditor should qualify the audit report.		
54	A Ltd. was under audit for the year ended 31.03.2015. An appeal filed by A Ltd. Against the demand of Excise Duty of Rs. 26 crores was pending before the Supreme Court for which neither provision was made nor was disclosed in the notes to the financial statements. On 12th July, 2015, the auditor came to know through paper reports that the point involved in the appeal of A Ltd. was adjudicated by the Supreme Court in the case of some other assessee, which is in favour of the department of Excise Duty. The auditor insisted that provisions be made of Rs. 26 crores in the financial statements. The Management was of the view that since its own case is still pending, no provision is called for. It was also of the view that the event does not have any effect on the financial position of the company on the date of the Balance Sheet. Is the view of the Management tenable?	PM	
Ans	Provision to be provided for in the Financial Statement: As per AS 29 'Provisions, Contingent liabilities and Contingent Assets", a contingent liability is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise. Further, future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that the event will occur. As per **SA 570 "Going Concern"**, there are certain examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy is one of the example of such event. When the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor should determine whether the financial statements adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business. Since the issue involved in the appeal of A Ltd. was similar to the point in case of some other company and since the appeal of that company was decided against that company and in favour of the Excise Department, it is necessary for A Ltd. to make a provision of Rs. 26 crores as per AS 29. The case settled by the Supreme Court on similar point reflects significant developments affecting the assessment about the potential risk faced by the company. The view of the management that its own appeal is undecided or that it has no effect on the financial position as on 31.03.2015 is not at all tenable. Since the financial position is materially affected, the auditor should express a qualified opinion or an adverse opinion as may be appropriate.		
55	Comment: A Co. Ltd. has not included in the Balance Sheet as on 31-03-2010 a sum of Rs.1.50 crores being amount in the arrears of salaries and wages payable to the staff for	N10 PM	5

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	the last 2 years as a result of successful negotiations which were going on during the last 18 months and conclude on 30-04-2010. The auditor wants to sign the said Balance Sheet and give the audit report on 31-05-2010. The auditor came to know the result of the negotiations on 15-05-2010.		
Ans	• This case requires attention to: • SA 560 "Subsequent Events" • AS 4 "Contingencies and Events occurring after the Balance Sheet Date" and • AS 29 "Provisions, Contingent liabilities and Contingent Assets". • As per AS 4 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. • Similarly as per AS 29, future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that will occur. • In the instant case, the amount of Rs. 1.50 crores is a material amount and it is the result of an event, which has occurred after the Balance Sheet date. The facts have become known to the auditor before the date of issue of the Audit Report and Financial Statements. • The auditor has to perform the procedure to obtain sufficient, appropriate evidence covering the period from the date of the FS i.e. 31-3-2010 to the date of Auditors Report i.e, 31-05-2010. It will be observed that as a result of long pending negotiations a sum of Rs. 1.50 cores representing arrears of salaries of the year 2008-09 and 2009-1 0 have not been included in the financial statements. It is quite clear that the obligation requires provision for outstanding expenses as per AS 4 and AS 29. • As per SA 560 "Subsequent Events", the auditor should assure that all events occurring subsequent to the date of the financial statements and for which the applicable FRF requires adjustment or disclosure have been adjusted or disclosed. • So the auditor should request the management to adjust the sum of Rs. 1.50 crores by making provision for expenses. If the management does not accept the request the auditor should qualify the audit report.		
Miscellaneous			
56	Comment "The Accounting Standards issued by the Institute of Chartered Accountants of India need to be followed only by limited companies and not by partnership firms or proprietorships".	M01	4
Ans	**Applicability of Accounting Standards:** • The Preface to the Statements of Accounting Standards clarifies that the Accounting Standards are issued "for use in the presentation of general purpose financial statements issued to the public by such commercial, industrial or business enterprises, as may be specified by the Institute from time to time and subject to the attest function of its members. • The term 'General Purpose Financial Statements' includes balance sheet, statement of P&L and other statements and explanatory notes which form part thereof, issued for use of shareholders/ members, creditors, employees and public at large". • All companies whether limited or unlimited incorporated under the Companies Act, 1956 are expected to adhere to specified ASs in terms of section 211 (3A) of the said Act. Even otherwise, such a requirement seems to be implicit even in the absence of specific statutory provisions since the application of accounting standards is an integral component so as to ensure that the financial statements give a true and fair view. • Accordingly, the compliance with ASs has to be examined by the auditors while auditing general purpose financial statements which are statutorily required to be audited under any law. Thus, compliance with ASs is required to be examined by an auditor in an audit of financial statements of individuals and non-corporate enterprises (viz., sole proprietary concerns, partnership firm, societies registered under the Societies Registration Act, trust, Hindu Undivided Families, and associations of persons) only where the financial statements are statutorily required to be audited under any law.		

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	• The ASs are also applicable to commercial, industrial or business activities of even charitable or religious organisations. • ASs do not apply to those organisations whose entire activities are not of commercial, industrial or business nature, e.g., an organization collecting donations to finance education of poor children etc. However, even if a very small proportion of the activities of an entity are commercial, industrial or business in nature, the ASs will apply to all its activities. • Thus, the Council has made it clear that compliance with ASs required to be examined in an audit of financial statements of non-corporate enterprises only where the financial statements are required to be audited under any statutory enactment. For instance, in case there is no statutory requirement for such entities to prepare accounts on accrual basis, the auditor would not qualify but simply disclose the basis of accounting followed. Therefore, ASs are applicable not only to limited companies but also to partnership firms or proprietorships.		
57	As a Statutory Auditor for the year ended 31st March, 2002, how would you deal with the following? “P Ltd. has filed a petition in the High Court for adjustment of product development expenses of Rs. 50 crores against the balance in Securities Premium account. While finalizing the accounts, the directors carried out the said adjustment since they were certain that the High Court approval would be received. The said petition has not come up for hearing till the date of signing of the accounts by the auditor”.	N02	5
Ans	• Product development expenses are normally classified as revenue expenditure. They can in some cases also be classified as Deferred Revenue Expenditure. If it is classified as Deferred Revenue Expenditure, the same have to be written off to the P&L A/c over a reasonable period of time. • In the present case, the company adjusted the said expenses with the balance standing in the Securities-Premium Account. Such an accounting treatment is not permissible having regard to the normally acceptable accounting principles. However any adjustment that is approved by the High Court will override the normally acceptable accounting principles. • In the given case, though the company has filed a petition in the High Court for carrying out the above adjustment and though the directors are certain that the High Court would approve the adjustment, the said petition has not been finalized or approved by the High Court till the date of signing of accounts. • In view of the above, the company cannot carry out the said adjustment. The statutory auditor, therefore, will have to qualify his report by stating that the product development expenses have been adjusted against the Securities Premium Account rather than treating them as the revenue expenditure and writing it off to the P&L A/c. The statutory auditor would also have to mention the amount by which the profit for the year has been overstated.		
58	X Ltd. is engaged in manufacture of Cement. In the Profit and Loss Account for the year ended 31 March, 2015, it discloses its revenue from sales transactions (turnover) net of excise duty. The excise duty collected and paid on sales transactions and that related to difference between Closing stock and Opening stock is, however, disclosed in the "Notes to Accounts".	N07 PM	4
Ans	As per Accounting Standard Interpretation – ASI 14 'Disclosure of Revenue from Sales Transactions' (Revised) issued by ICAI in Aug 2006, turnover should be disclosed as follows on the face of the statement of Profit & Loss: Turnover (Gross) XX Less: Excise duty XX Turnover (Net) XX Further, the excise duty shown above should be the total duty except the duty related to the difference between closing stock & opening stock which should be recognized separately in the statement of profit and loss, with an explanatory note in the notes to accounts to explain the nature of the two amounts of excise duty. Since the company, X Ltd has not followed the above ASI 14, the auditor would have to qualify his report accordingly.		

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59	State your views as an auditor on the following: "T Ltd. purchased goods on credit for Rs 5 crores for export from ABC Ltd. Upon the export order being cancelled, T Ltd. decided to sell the same in the domestic market at a discounted price. Accordingly ABC Ltd was requested to offer a price discount of 25%. ABC Ltd. wants to adjust the sales figure to the extent of discount requested by T Ltd".	Case Study	
Ans	ABC Ltd. had sold goods on credit worth Rs 5 crores to T Ltd. and, therefore, the sale was complete in all respects. T Ltd's decision to sell the same in the domestic market at a discount does not affect the amount booked under sales by ABC Ltd. The price discount of 25% offered by ABC Ltd. at the request of T Ltd. was not in the nature of discount given during the ordinary course of trade because otherwise same would have been given at the time of sale itself. Now as far as ABC Ltd. is concerned, there appears to be an uncertainty relating to collectability, which has arisen subsequent to the time of sale. Therefore, it would be appropriate to make a separate provision to reflect the uncertainty relating to collectability rather than to adjust the amount of revenue originally recorded. Therefore such discount should be charged to the P&L A/c separately and not shown as deduction from the sales figure.		

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