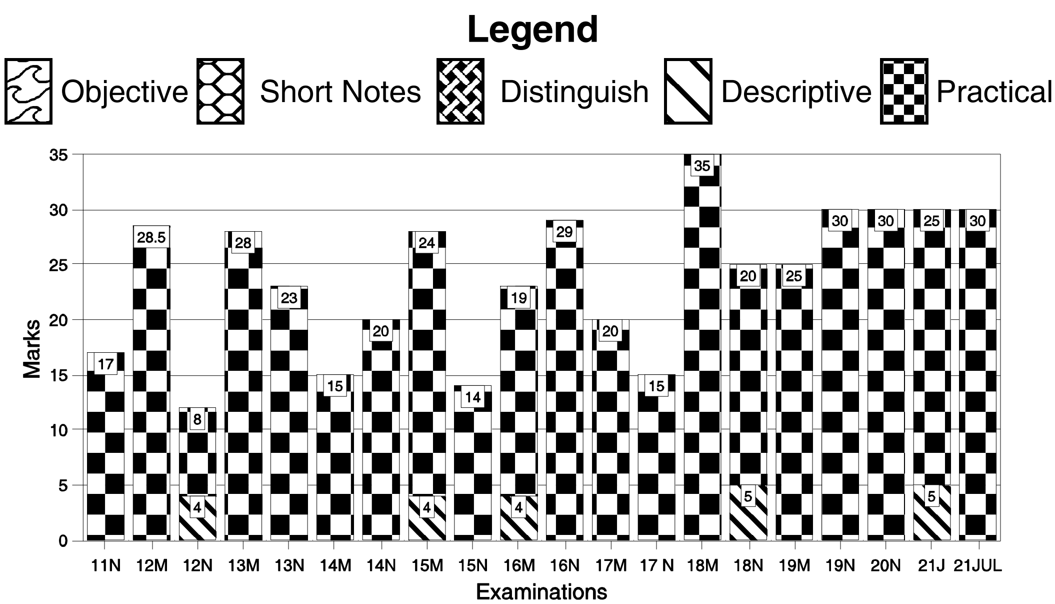
CHAPTER	
1	**Application of Accounting Standards**

This Chapter Covers: Study's Chapter: 1

Chapter Comprises: ☞ *AS 4, AS 5, AS 7, AS 9, AS 14, AS 17, AS 18, AS 19, AS 20, AS 22, AS 24, AS 26, AS 29*

THE GRAPH . . . . ***Trend Analysis***

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



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TIME MANAGER		. . . . ***Plan and Manage your Time***						
Time	***First In-depth learning***	***Instant Revision (in hours)***		***Periodic Revision (in hours)***				
	i.e..... .... Day 1	Next day i.e.... .... Day 2	After 7 days i.e. on .... Day 8	After 30 days i.e. on .... Day 30	After 60 days i.e. on .... Day 60	After 90 days i.e. on .... Day 90	Fix as per your need.	
1. Budgeted	16	4.00	3.12	2.20	1.35	1.35		
2. Actual								
3. Variance (1-2)								

QUICK LOOK	. . . . ***Weightage Analysis***	
Repeatedly Asked Questions	**Common Answered Questions**	**Must Try Question**
7.1	10.1	1.10, 1.11, 2.8, 2.12, 3.4, 3.7, 3.14, 4.3, 6.6, 8.3, 10.1, 12.14, 13.1

1 *AS - 4 Contingencies and Events occurring after the Balance Sheet Date*

Q.1.1	**2009 - Nov [1] (vi)**	**Practical**

A company entered into an agreement to sell its immovable property to another company for 35 lakhs. The property was shown in the Balance Sheet at ₹ 7 lakhs. The agreement to sell was concluded on 15th February, 2008 and sale deed was registered on 30th April, 2008. The financial statements for the year 2007-08 were approved by the board on 12th May, 08.

You are required to state, how this transaction would be dealt with in the financial statements for the year ended 31st March, 2008.

(2 marks) *[IPCC Gr. II]*

Answer:

Provision:

According to Para 13 of AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern is not appropriate.

Analysis and Conclusion:

In the given question, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 15th February 2009 i.e. before the balance sheet date. Registration of the sale deed on 30th April, 2009, simply provides additional information relating to the conditions existing at the balance sheet date. Hence, adjustment to assets for sale of immovable property is necessary in the financial statements for the year ended 31st March, 2009.

—— Space to write important points for revision ——

Q.1.2	2010 - May [1] (iv)	Practical

A Company follows April to March as its Financial Year. The Company recognizes cheques dated 31st March or before, received from customers after balance sheet date, but before approval of Financial statement by debiting cheques in hand A/c and crediting Debtors A/c. The cheques in hand is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques in hand are presented to bank in the month of April and are also realised in the same month in normal course after deposit in the bank. State with reasons, whether the collection of cheques bearing date 31st March or before, but received after Balance Sheet date is an adjusting event and how this fact is to be disclosed by the company ?

(2 marks) *[IPCC Gr. II]*

Answer:

Analysis and Conclusion:

Even if the cheques bear the date 31st March or before, the cheques received after 31st March do not represent any condition existing on the balance sheet date i.e. 31st March. Therefore, the collection of cheques after balance sheet date is not an adjusting event. Cheques that are received after the balance sheet date should be accounted for in the period in which they are received even though the same may be dated 31st March or before as per AS 4 "Contingencies and Events Occurring after the Balance Sheet Date". Moreover, the collection of cheques after balance sheet date does not represent any material change affecting financial position of the enterprise, therefore, no disclosure in the Director's Report is necessary.

—— Space to write important points for revision ——

Q.1.3	2010 - Nov [1] {C} (iii)	Practical
While preparing its final accounts for the year ended 31st March 2010, a company made a provision for bad-debts @ 4% of its total debtors (as per trend follows from the previous years). In the first week of March 2010 a debtor for ₹ 3,00,000 had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April 2010 the debtor becomes bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2010. (5 marks) *[IPCC Gr. II]*		

Answer :

Provision:

According to AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

Analysis and Conclusion:

A debtor for ₹ 3,00,000 suffered heavy loss due to earthquake in the first week of March, 2010 and he became bankrupt in April, 2010 (after the balance sheet date). The loss was also not covered by any insurance policy. Accordingly, full provision for bad debts amounting ₹ 3,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31^{st} March, 2010.

—— Space to write important points for revision ——

Q.1.4	2011 - Nov [7] (a), RTP	Practical

MEC Limited could not recover an amount of ₹ 8 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company for the year ended 31.3.2011 were finalized by making a provision @ 25% of the amount due from that debtor. In May 2011, the debtor became bankrupt and nothing is recoverable from him. Do you advise the company to provide for the entire loss of ₹ 8 lakhs in books of account for the year ended 31.3.2011? (4 marks) *[IPCC Gr. II]*

Answer :

Provision:

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 balance sheet date if such event provides/relates to additional information to the conditions existing at the balance sheet date and is also materially affecting the valuation of assets and liabilities on the balance sheet date.

Analysis and Conclusion:

As per the information given in the question, the debtor was already in a great financial difficulty at the time of closing of accounts. Bankruptcy of the debtor in May 2011 is only an additional information to the condition existing on the balance sheet date. Also the effect of a debtor becoming bankrupt is material as total amount of ₹ 8 lakhs will be a loss to the company. Therefore, the company is advised to provide for the entire amount of ₹ 8 lakhs in the books of account for the year ended 31^{st} March, 2011.

—— Space to write important points for revision ——

Q.1.5	2012 - May [7] (e), RTP	Practical

Cashier of A-One Limited embezzled cash amounting to ₹ 6,00,000 during March, 2012. However same comes to the notice of company management during April, 2012 only. Financial statements of the company is not yet approved by the Board of Directors of the company. With the help of provisions of AS 4 "Contingencies and Events Occurring after the Balance Sheet Date" decide, whether the embezzlement of cash should be adjusted in the books of accounts for the year ending March, 2012 ?
What will be your reply, if embezzlement of cash comes to the notice of company management only after approval of financial statements by the Board of Directors of the company ? (4 marks) *[IPCC Gr. II]*

Answer:

Provision:

According to AS 4, assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

Analysis and Conclusion:

- Though the theft, by the cashier ₹ 6,00,000 was detected after the balance sheet date (before approval of financial statements) but it is an additional information materially affecting the determination of the cash amount relating to conditions existing at the balance sheet date.
- Therefore it is necessary to make the necessary adjustments in the financial statements of the company for the year ended 31st March, 2012 for recognition of the loss amounting ₹ 6,00,000.
- When embezzlement of cash comes to the notice of company management only after approval of financial statements by Board of Directors of the company, then the treatment will be done as per the provisions of AS 5. This being extra ordinary item should be disclosed in the statement of profit and loss as a part of loss for the year ending March, 2013. The nature and the amount of prior period items should be separately disclosed on the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

Q.1.6	2013 - May [7] (a)	Practical

Neel Limited has its corporate office in Mumbai and sells its products to stockists all over India. On 31st March, 2013, the company wants to recognize receipt of cheques bearing date 31st March, 2013 or before, as "Cheques in Hand" by reducing "Trade Receivables". The "Cheques in Hand" is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques are presented to the bank in the month of April 2013 and are also realized in the same month in normal course after deposit in the bank. State with reasons, whether each of the following is an adjusting event and how this fact is to be disclosed by the company, with reference to the relevant accounting standard.

(i) Cheques collected by the marketing personnel of the company from the stockists on or before 31st March, 2013.

(ii) Cheques sent by the stockists through courier on or before 31st March, 2013. (4 marks) *[IPCC Gr. II]*

Answer:

(i)
- Cheques collected by the marketing personnel of the company is an adjusting event as the marketing personnels are employees of the company and therefore, are representatives of the company.
- Handing over of cheques by the stockist to the marketing employees discharges the liability of the stockist.
- Thus, cheques collected by the marketing personnel of the company on or before 31st March, 2013 require adjustment from the stockists' accounts i.e. from 'Trade Receivables A/c' even though these cheques (dated on or before 31st March, 2013) are presented in the bank in the month of April, 2013 in the normal course.
- Therefore, collection of cheques by the marketing personnel is an adjusting event as per AS 4 'Contingencies and Events Occurring after the Balance Sheet Date'. Such 'cheques in hand' will be shown in the Balance Sheet as 'Cash and Cash equivalents' with a disclosure in the Notes to accounts about the accounting policy followed by the company for such cheques.

(ii)
- In case if the cheques bear the date 31st March or before and are sent by the stockists through courier on or before 31st March, 2013, it is presumed that the cheques will be received after 31st March.
- Collection of cheques after 31st March, 2013 does not represent any condition existing on the balance sheet date i.e. 31st March. Thus, the collection of cheques after balance sheet date is not an adjusting event.
- Cheques that are received after the balance sheet date should be accounted for in the period in which they are received even though the same may be dated 31st March or before as per AS 4.
- Thus, the collection of cheques after balance sheet date does not represent any material change affecting financial position of the enterprise, so no disclosure in the Director's Report is necessary.

—— Space to write important points for revision ——

Q.1.7	2013 - Nov [1] {C} (a)	Practical

State with reasons, how the following events would be dealt with in the financial statements of Pradeep Ltd. for the year ended 31st March, 2013:

(i) An agreement to sell a land for ₹ 30 lakh to another company was entered into on 1st March, 2013. The value of land is shown at ₹ 20 lakh in the Balance Sheet as on 31st March, 2012. However, the Sale Deed was registered on 15th April, 2013.

(ii) The negotiation with another company for acquisition of its business was started on 2nd February, 2013. Pradeep Ltd. invested ₹ 40 lakh on 12th April, 2013. (5 marks) *[IPCC Gr. II]*

Answer:

(i) **Provision:**

As per AS - 4 "Contingencies and Events Occurring after the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

Analysis and Conclusion:

In the given situation, sale of land was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 1st March, 2013 i.e. before the balance sheet date. Registration of the sale deed on 15th April, 2013, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of land is necessary in the financial statements for the year 31st March, 2013.

(ii) **Provision:**

According to AS - 4 "Contingencies and Events Occurring after the Balance Sheet Date", which do not affect the figures stated in the financial statements would not normally require disclosure in the financial statements, although they may be of such significance that they may require a disclosure in the report of the approving authority to enable users of financial statements to make proper evaluations and decisions.

Analysis and Conclusion:

The investment of ₹ 40 lakhs in April 2013 for acquisition of another company is under negotiation stage, and has not been finalized yet. Also it is not affecting the figures stated in the financial statements of 2012 - 13, hence the details of the negotiation should be disclosed in the Directors Report to enable users of financial statements to make proper evaluations and decision.

Space to write important points for revision

Q.1.8	2016 - May [1] {C} (a)	Practical
With reference to AS 4 "Contingencies and events occurring after the balance sheet date", state whether the following events will be treated as contingencies, adjusting events or non-adjusting events occurring after balance sheet in case of a company which follows April to March as its financial year.		

(i) A major fire has damaged the assets in a factory on 5th April, 5 days after the year end. However, the assets are fully insured and the books have not been approved by the Directors.

(ii) A suit against the company's advertisement was filed by a party on 10th April, 10 days after the year end claiming damages of ₹ 20 lakhs.

(iii) It sends a proposal to purchase an immovable property for ₹ 30 lakhs in March. The book value of the property is ₹ 20 lakhs as on year end date. However, the deed was registered as on 15th April.

(iv) The terms and conditions for acquisition of business of another company have been decided by March end. But the financial resources were arranged in April and amount invested was ₹ 40 lakhs.

(v) Theft of cash of ₹ 2 lakhs by the cashier on 31st March but was detected the next day after the financial statements have been approved by the Directors. (5 marks) *[IPCC Gr. II]*

Answer:

(i) **As per AS-4,** the loss due to major fire is an example of event occurring after balance sheet date. This event does not relate to conditions existed at the balance sheet date. It has not affected financial position as on the balance sheet date and therefore requires no specific adjustments in the financial statements. However, paragraph 8.6 of AS-4 states that disclosure is generally made of events occurring after balance sheet date i.e. subsequent periods that represent unusual changes affecting the existence or substratum of the enterprise after the balance sheet date.

In this given case, a major fire has damaged the assets in a factory on 5th April and assets are fully insured so that it may be considered as an event affecting the substratum of the enterprise because asset is insured but the loss due to it may not be fully recovered from insurance company. So that it is considered as non adjusting events occurring after balance sheet date and should be disclosed in the report of the approving authority.

(ii) **As per AS-4**, events occurring after balance sheet date are those significant events, both favourable and unfavourable that occur between the balance sheet date and the date on which financial statements are approved by board of directors or any other approving authority.

In this case, a suit against company's advertisement was filed by a party on 10th April, for amount of ₹ 20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a non-adjusting event.

(iii) **In the given case,** proposal for deal of immovable property was sent before the closure of the books of accounts. This is a **non-adjusting** event as only the proposal was sent and no agreement was effected in the month of March i.e. before the balance sheet date.

(iv) As the term and conditions of acquisition of business of another company had been decided by the end of March, acquisition of business is an **adjusting event** occurring after the balance sheet date. Adjustment to assets and liabilities is required since the event affects the determination and the condition of the amounts stated in the financial statements for the financial year ended on 31st March.

(v) Since the financial statements have been approved before detection of theft by the cashier of ₹ 2,00,000, it becomes a non-adjusting event and no disclosure is required in the report of the Approving Authority.

Space to write important points for revision

Q.1.9	2016 - May [1] {C} (b)	Practical

M/s AB Ltd. is in the process of finalizing its account for the year ended 31st March, 2015. The company seeks your advice on the following:

(i) The company's sale tax assessment for assessment year 2012-13 has been completed on 14th February, 2015 with a demand of ₹ 5.40 crore. The company paid the entire due under protest without prejudice to its right of appeal. The company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of ₹ 3.70 crore.

(ii) The company has entered into a wage agreement in May 2015 whereby the labour union has accepted a revision in wage from June 2014. The agreement provides that the hike till May 2015 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September 2015. (5 marks) *[IPCC Gr. II]*

Answer:

(i) This given situation is considered as per provision of **AS-4. Contingencies and events occurring after the balance sheet date.** As per AS-4 events that occur between balance sheet date and date of approval of financial statement should be disclosed.
In this case, the company is not appealing against addition of ₹ 1.7 crore, the same should be provided for in its accounts for the year ended 31st March, 2015. The amount paid under protest can be kept under the sub heading 'Short-Term Loans and Advances' and disclosed along with the contingent liability of ₹ 3.70 crore.

(ii) **As per AS-4 Contingencies and events occurring after balance sheet date,** the events should be disclosed which have effect in the current financial year and such events have occurred during the financial year. The principle of accrual is applied here. As per this principle the income and expenses are realised in books they are earned and incurred but not by receipt and payment. So that in this case wage agreement decided in May 2015 so that it is event occurring after balance sheet date. The arrears for period from June 2014 to March 2015 are required to be provided for in the accounts of the company for the year ended 31st March, 2015.

—— Space to write important points for revision ——

Q.1.10	2016 - Nov [1] {C} (c), RTP	Practical

While preparing its final accounts for the year ended 31st March, 2016, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2016 a debtor for ₹ 20 lakhs had suffered heavy

loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2016 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2016?
Comment with reference to relevant Accounting Standard.

(5 marks) *[IPCC Gr. II]*

Answer:

Provision:

As per para 8 of AS 4 'Contingencies and Events Occurring after the Balance Sheet Date' Adjustment 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.

Analysis & Conclusion:

A debtor for ₹ 20,00,000 suffered heavy loss due to earthquake in the last week of February, 2016, which was not covered by insurance. This information was already known to the company. The fact that he become bankrupt in April, 2016 is only an additional information related to the existing condition on the Balance Sheet date.

Accordingly, full provision for bad debts amounting ₹ 20,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the Final A/c for the year ended 31st March, 2016.

—— Space to write important points for revision ——

Q.1.11	2017 - May [1] {C} (d), RTP	Practical

The Board of Directors of M/s. New Graphics Ltd. in its Board Meeting held on 18th April, 2017, considered and approved the Audited Financial results along with Auditors Report for the Financial Year ended 31st March, 2017 and recommended a divided of ₹ 2 per equity share (on 2 crore fully paid up equity shares of ₹ 10 each) for the year ended 31st March, 2017 and if approved by the members at the forthcoming Annual General Meeting of the company on 18th June, 2017, the same will be paid to all the eligible shareholders.

Discuss on the accounting treatment and presentation of the said proposed dividend in the annual accounts of the company for the year ended 31st March, 2017 as per the applicable Accounting Standard and Other Statutory Requirements. (5 marks) *[CA Inter Gr. I]*

Answer:

As per the amendment in AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" vide Companies (Accounting Standards) Amendments Rules, 2016 the events which take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. However, dividends declared after the balance sheet date but before approval of financial statements are not recognized as a liability at the balance sheet date because no statutory obligation exists at that time. Hence, such dividends are disclosed in the notes to financial statements.

Present Case:

Provision for proposed dividends is not required to be made. Such proposed dividends are to be disclosed in the notes to financial statements. Accordingly, the dividend of ₹ 4 Crores recommended by New Graphics Ltd. in its Board meeting on 18th April, 2017 shall not be accounted for in the books for the year 2016-17 irrespective of the fact that it pertains to the year 2016-17 and will be paid after approval in the Annual General Meeting of the members / shareholders.

—— Space to write important points for revision ——

Q.1.12	2018 - Nov [1] {C} (d)	Practical

The accounting year of Dee Limited ended on 31st March, 2018 but the accounts were approved on 30th April, 2018. On 15th April, 2018 a fire occurred in the factory and office premises. The loss by fire is of such a magnitude that it was not possible to expect the enterprise Dee Limited to start operation again.

State with reasons, whether the loss due to fire is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company in the context of the provisions of AS-4 (Revised).

(5 marks) *[CA Inter Gr. I]*

Answer:

AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date,"states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. However, an event occurring after the balance sheet date should be an adjusting event even if it does not reflect any condition existing on the balance sheet date, if the event is such as to indicate that the fundamental accounting assumption of going concern is no longer appropriate.

Present Case:

A fire occurred in the factory and office premises of an enterprise after 31/03/2018. But before approval of financial statement of 2017-18. The loss on fire is of such a magnitude that it is not reasonable to expect the company to start its operation again. i.e. the going concern assumption is not valid. Since the fire occurred after 31/03/2018, the loss on fire is not a result of any condition existing on 31/03/2018. In such a case, the entire accounts need to be prepared on a liquidation basis with adequate disclosures.

—— Space to write important points for revision ——

Q.1.13	2019 - May [1] {C} (c) (v)	Objective

State whether the following statement is 'True' or False'. Also give reason for your answer.

As per the provisions of AS-4, a contingency is a condition or situation, the ultimate outcome of which (gain or loss) will be known or determined only on the occurrence of one or more uncertain future events.

(1 mark) *[CA Inter Gr. I]*

This statement is False

As per AS 4, a contingency is a condition or situation the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence of one or more uncertain future events.

—— Space to write important points for revision ——

Q.1.14	2019 - May [1] {C} (d)	Practical

The financial statements of PQ Ltd. for the year 2017-18 approved by the Board of Directors on 15th July, 2018. The following information was provided :

(i) A suit against the company's advertisement was filed by a party on 20th April, 2018, claiming damages of ₹ 25 lakhs.

(ii) The terms and conditions for acquisition of business of another company have been decided by March, 2018. But the financial resources were arranged in April, 2018 and amount invested was ₹ 50 lakhs.

(iii) Theft of cash of ₹ 5 lakhs by the cashier on 31st March, 2018 but was detected on 16th July, 2018.

(iv) Company sends a proposal to sell an immovable property for ₹ 40 lakhs in March, 2018. The book value of the property is ₹ 30 lakhs on 31st March, 2018. However, the deed was registered on 15th April, 2018.

(v) A major fire has damaged the assets in a factory on 5th April, 2018. However, the assets are fully insured.

With reference to AS-4 "Contingencies and events occurring after the balance sheet date", state whether the above mentioned events will be treated as contingencies, adjusting events or non- adjusting events occurring after the balance sheet date. (5 marks) *[CA Inter Gr. I]*

Answer:

(i) Suit filed against the company is a contingent liability but it was not existing as on balance sheet date as the suit was filed on 20th April after the balance Sheet date. As per AS 4, 'Contingencies' used in the Standard is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur. Hence, it will have no effect on financial statements and will be a non-adjusting event.

(ii) In the given case, terms and conditions for acquisition of business were finalised and carried out before the closure of the books of accounts but transaction for payment of financial resources was effected in April, 2018. This is clearly an event occurring after the balance sheet date. Hence, necessary adjustment to assets and liabilities for acquisition of business is necessary in the financial statements for the year ended 31st March 2018.

(iii) Only those significant events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustment to assets and liabilities existing on the balance sheet date or may require disclosure. In the given case, theft of cash was detected on 16th July, 18 after approval of financial statements by the Board of Directors, hence no treatment is required.

(iv) Adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. In the given case, sale of immovable property was under proposal stage (negotiations also not started) on the balance sheet date. Therefore, no adjustment to assets for sale of immovable property is required in the financial statements for the year ended 31st March, 2018.

(v) The condition of fire occurrence was not existing on the balance sheet date. Only the disclosure regarding event of fire and loss being completely insured may be given in the report of approving authority.

Q.1.15	2021 - July [1] {C} (c)	Practical

Surya Limited follows the financial year from April to March. It has provided the following information.

(i) A suit against the Company's Advertisement was filed by a party on 5^{th} April, 2021, claiming damages of ₹ 5 lakhs.

(ii) Company sends a proposal to sell an immovable property for ₹ 45 lakhs in March 2021. The book value of the property is ₹ 30 lakhs as on year end date. However, the Deed was registered on 15^{th} April, 2021.

(iii) The terms and conditions for acquisition of business of another company have been decided by the end of March 2021, but the financial resources were arranged in April 2021. The amount invested was ₹ 50 lakhs.

(iv) Theft of cash amounting to ₹ 4 lakhs was done by the Cashier in the month of March 2021 but was detected on the next day after the Financial Statements have been approved by the Directors.

Keeping in view the provisions of AS-4, you are required to state with reasons whether the above events are to be treated as Contingencies, Adjusting Events or Non-Adjusting Events occurring after Balance Sheet date. (5 marks)

2 *AS - 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies*

Q.2.1	2008 - May [6] (a)	Descriptive

When can an item qualify to be a prior period item as per AS-5?

(4 marks) *[IPCC Gr. II]*

Answer :

Prior Period Item [Para 16 of AS-5 (Revised)]:

When incomes or expenses arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods, the said incomes or expenses must be classified as prior period items. The errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, mis-interpretation of facts or oversight.

The term does not include other adjustments necessitated by circumstances, which though related to prior periods, are determined in the current period e.g. arrears payable to workers in current period as a result of revision of wages with retrospective effect.

—— Space to write important points for revision ——

Q.2.2	2008 - Nov [5] (i)	Practical
The company finds that the stock sheets of 31.3.2007 did not include two pages containing details of inventory worth ₹ 20 lakhs. State, how will you deal with this matter in the accounts of A Ltd. for the year ended 31st March, 2008 with reference to AS 5. (2 marks) *[IPCC Gr. II]*		

Answer :

Provision:

As per AS -5, Prior Period Items are incomes or expenses which arise in current period as a result of **error of omission** in the preparation of financial statement of one or more prior periods.

Analysis and Conclusion:

In the above case, 2 pages of stock sheet were missing in financial statements of 2007. Due to this the closing stock of 2007 was shown short by ₹ 20 lakhs as a result of which the opening stock of 2008 was understated resulting into an overvaluation of profit in 2008.

In the current year 2008, the prior period item will be adjusted by reducing the profit by ₹ 20 lakhs.

Therefore, as per AS-5 a separate disclosure of prior period items should be shown separately in the statement of trading and Profit & Loss A/c in a manner that the impact on the current profit or loss can be perceived.

Space to write important points for revision

Q.2.3	2009 - May [6] (b)	Descriptive
Explain the provisions of AS-5 regarding accounting treatment of prior period items. (4 marks) *[IPCC Gr. II]*		

Answer :

As per AS 5, Prior Periods Items are income or expenses, which arise, in the current period as a result of errors or omission in the preparation of financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods, are determined in the current period. Example: arrears payable to workers in current period as a result of retrospective revision of wages.

The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on current profit or loss can be perceived.

As per para 19 of AS 5, prior period items are normally included in determination of net profit or loss for the current profit, they can be added (or deducted as the case may be) from the current profit. An **alternative approach** is to show such items in the statement of profit or loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

Space to write important points for revision

Q.2.4	2009 - Nov [1] (i)	Practical
Goods worth ₹ 5,00,000 were destroyed due to flood in September, 2006. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2006-07.		

In March, 2008, the claim was passed and the company received a payment of ₹ 3,50,000 against the claim. Explain the treatment of such receipt in final accounts for the year ended 31st March, 2008.
(2 marks) *[IPCC Gr. II]*

Answer :

According to the provisions, of AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", prior period items are incomes or expenses, which arise in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. The nature and amount of prior period items should be separately disclosed in the statement of profit and loss.

Present case:

In the given question, it is clearly a case of error in preparation of financial statements for the financial year 2006-07. Therefore claim received in the financial year 2007-08 is a prior period item and should be separately disclosed in the statement of profit and loss for the year ended 31st March, 2008.

—— Space to write important points for revision ——

Q.2.5	2009 - Nov [1] (iv)	Practical

A company created a provision of ₹ 75,000 for staff welfare while preparing the financial statements for the year 2007-08. On 31st March, in a meeting with staff welfare association, it was decided to increase the amount of provision for staff welfare to ₹ 1,00,000. The accounts were approved by Board of Directors on 15th April, 2008.
Explain the treatment of such revision in financial statements for the year ended 31st March, 2008. (2 marks) *[IPCC Gr. II]*

Answer:

Provision:

According the provisions of AS - 5, all items of income and expense which are recognised in a period are included in the determination of the net profit or loss for the period. This includes extraordinary items and the effects of changes in accounting estimates. However, the effect of such change in accounting estimate should be classified using the same classification in the statement of profit and loss, as was used previously, for the estimate.

Analysis and Conclusion:

According to AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the change in amount of staff welfare provision amounting ₹ 25,000 is neither a prior period item nor an extraordinary item. It is a change in estimate, which has occurred in the year 2007-2008.

—— Space to write important points for revision ——

Q.2.6	**2009 - Nov [1] (vii)**	**Practical**

A Ltd. entered into a binding contract with C Ltd. to buy a machine for ₹ 1,00,000. The machine is to be delivered on 15th February, 2009. On 1st January, 09 A Ltd. changed its process of production. The new process will not require the machine ordered and it shall have to be scrapped after delivery. The expected scrap value of the machine is nil.

Explain how A Ltd. should recognise the entire transaction in the books of account for the year ended 31st March, 2009. (2 marks) *[IPCC Gr. II]*

Answer:

A Ltd. entered into a binding contract with C Ltd. and therefore, it should recognise a liability of ₹ 1,00,000. The entire amount of purchase price of the machine should be recognised in the year ended 31st March, 2009 as loss because future economic benefit from the machine to the enterprise is improbable.

The accounting entry should be as follows:

	₹	₹
Profit and Loss A/c Dr. To C Ltd. (Being value of machinery fully depreciated because of change in the process of production i.e. obsolescence)	1,00,000	 1,00,000

Q.2.7	2010 - May [1] (x)	Practical

Closing stock for the year ending on 31.3.2010 is ₹ 50,000 which includes stock damaged in a fire in 2008-09. On 31.3.2009 the estimated net realisable value of the damaged stock was ₹ 12,000. The revised estimate of net realisable value included in closing stock of 2009-10 is ₹ 4,000. Find the value of Closing stock to be shown in Profit and Loss account for the year 2009-10. (2 marks) *[IPCC Gr. II]*

Answer :

The fall in estimated net realisable value of damaged stock ₹ 8,000 is the effect of change in accounting estimate. As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the effect of a change in accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate.

Therefore, the value of closing stock for the year 2009-10 will be as follows:

Particulars	₹
Closing Stock (including damaged goods)	50,000
Less : Revised value of damaged goods	(4,000)
Closing stock (excluding damaged goods)	46,000

Space to write important points for revision

Q.2.8	2011 - May [7] (d), RTP	Practical

A company signed an agreement with the employee's union on 01-09-2010 for revision of wages with retrospective effect from 01-04-2009. This would cost the company an additional liability of ₹ 10 lakhs per annum. Is a disclosure necessary for the amount paid in 2010-11.

(4 marks) *[IPCC Gr. II]*

Answer:

Provisions:

According to AS 5 (Revised), "Net Profit or Loss for the Period, Prior, period items and Changes in Accounting Policies", when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Analysis and Conclusion:

- It is given that revision of wages took place on 1st September, 2010 with retrospective effect from 1.4.2009. The arrear of wages payable for the period 01.4.2009 to 31.3.2010, cannot be taken as an error or omission in the preparation of financial statement and hence this expenditure cannot be taken as a prior period item. Additional wages liability of ₹ 20 lakhs should be included in current years' wages.

1. It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extra-ordinary item.
2. Thus, necessary disclosure should be made for the additional liability amounting ₹ 20 lakhs.

—— Space to write important points for revision ——

Q.2.9	2012 - May [7] (b)	Practical

Tiger Motor Car Limited signed an agreement with its employees union for revision of wages on 01.07.2011. The revision of wages is with retrospective effect from 01.04.2008. The arrear wages up to 31.03.2011 amounts to ₹ 40,00,000 and that for the period from 01.04.2011 to 01.07.2011 amount to ₹ 3,50,000. In view of the provisions of AS 5 "Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies", decide whether a separate disclosure of arrear wages is required while preparing financial statements for the year ending 31.03.2012. (4 marks) *[IPCC Gr. II]*

Answer :

Question shows that revision of wages took place in July, 2011 with retrospective effect from 1. 4. 2008. The arrear wages payable for the period from 1.4.2008 to 31.3.2011 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item.

- Additional wages liability of ₹ 40,00,000 (from 1.4.2008 to 31.3.2011) should be included in current year's wages.
- It may be considered that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, AS 5, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.
- However, wages payable for the current year (from 1.4.2011 to 1.7.2011) amounting ₹ 3,50,000 is not a prior period item hence need not be disclosed separately. This may be shown as current year wages.

Space to write important points for revision

Q.2.10	2013 - May [1] {C} (b)	Practical
Closing Stock for the year ending on 31st March, 2013 is ₹ 1,50,000 which includes stock damaged in a fire in 2011-12. On 31st March, 2012, the estimated net realizable value of the damaged stock was ₹ 12,000. The revised estimate of net realizable value of damaged stock included in closing stock at 2012-13 is ₹ 4,000. Find the value of closing stock to be shown in Profit and Loss Account for the year 2012-13, using provisions of Accounting Standard 5. (5 marks) *[IPCC Gr. II]*		

Answer:

Provision:

- **According to AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies',** the effect of a change in accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate.

- It is presumed that the loss by fire in the year ended 31.3.2012, i.e. difference of cost and NRV was shown in the profit and loss account as an extra-ordinary item.
- Reduction in estimated net realisable value of damaged stock ₹ 8,000 is the effect of change in accounting estimate.

Analysis and Conclusion:

- Thus, in the year 2012-13, revision in accounting estimate should also be classified as extra-ordinary item in the profit and loss account and closing stock should be shown excluding the value of damaged stock. Value of closing stock for the year 2012-13 will be as follows:

Particulars	₹
Closing Stock (including damaged goods)	1,50,000
Less: Revised value of damaged goods	(4,000)
Closing stock (excluding damaged goods)	1,46,000

Space to write important points for revision

Q.2.11	2017 - Nov [1] {C} (d), RTP	Practical

The Accountant of **Mobile Limited** has sought your **opinion with** relevant reasons, whether the following transactions will be treated as change in **Accounting Policy** or not for the year ended 31st March, 2017. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

(i) Provision for doubtful debts was created @ 2% till 31st March, 2016. From the Financial year 2016-2017, the rate of provision has been changed to 3%.

(ii) During the year ended 31st March, 2017, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years . From current year, the useful life of furniture has been changed to 3 years.

(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.

(v) During the year ended 31st March, 2017, there was change in cost formula in measuring the cost of inventories.

(5 marks) *[IPCC Gr. II]*

Answer:

AS-5 Changes in Accounting Policies

(i) Creating a provision for doubtful debts is an Accounting Estimate.
An Accounting Estimate may have to be revised (a) if there are changes in circumstances on which the estimate was based, or (b) as a result of new information, more experience or subsequent developments. Hence, this is not a change in Accounting Policy.

(ii) Adaptation of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions does not constitute a change in Accounting Policy.

(iii) As per AS 5 & AS 10 PPE, change in the estimate of useful life of fixed assets (PPE) should be considered as changes Accounting Estimates. Hence, this is not a change in Accounting Policy.

(iv) Adoption of a new Accounting Policy for events or transactions which did not occur previously or that were immaterial does not constitute a change in Accounting Policy.

(v) Change in cost formula in measuring the cost of inventories is a change in Accounting Policy.

Q.2.12	2018 - May [1] {C} (d), RTP	Practical

M/s PQR Ltd. is in the process of finalising its accounts for the year ended 31st March, 2018. The company seeks your advice on the following:

(i) Goods worth ₹ 5,00,000 were destroyed due to flood in September, 2015. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2015-16. In March, 2018, the claim was passed and the company received a payment of ₹ 3,50,000 against the claim. Explain the treatment of such receipt in final account for the year ended 31st March, 2018.

(ii) Company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2017-18. Subsequently, on a review of the credit period allowed and financial capacity of the customers, the company decides to increase the provision to 8% on debtors as on 31.03.2018. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard, can this revision be considered as an extra ordinary item or prior period item?

(5 marks) *[CA Inter Gr. I]*

Answer:

(i) **As per the provisions of AS - 5, "Net Profit or Loss for the period, prior period items and changes, in Accounting policies",** prior period items are income or expenses, which arise, in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. Further, the nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on current profit or loss can be perceived.

In the given case, it is clearly a case of error in preparation of financial statements for the year 2015-16. Hence claim received in the financial year 2017-18 is a prior period item and should be separately disclosed in the statement of Profit and Loss.

(ii) **As per para 21 of AS 5, "Net Profit or Loss for the period, prior period Items and changes in Accounting policies",** the preparation of financial statements involves making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revise an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate, by its nature, does not bring the adjustment within definitions of a prior period item or an extraordinary item [para 21 of AS 5 (Revised) on Net Profit or Loss for the period, prior period Items and changes in Accounting Policies].

In the given case, a limited company created 2.5% provision for doubtful debts for the year 2017-18. Subsequently in 2018 the company revised th estimates based on the changed circumstances and wants to create 8% provision. As per AS -5 (Revised), this change in estimate is neither a prior period item nor an extraordinary item.

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

Space to write important points for revision

Q.2.13	**2019 - May [1] {C} (c)**	**Objective**

State whether the following statement is 'True' or False'. Also give reason for your answer.

1. As per the provisions of AS-5, extraordinary items should not be disclosed in the statement of profit and loss as a part of net profit or loss for the period. (1 mark) *[CA Inter Gr. I]*

Answer:

This statement is False.

As per AS 5 "Net profit or loss for the period, prior period items and change in accounting policies".

Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period.

Q.2.14	2021 - Jan [1] {C} (b)	Practical

State whether the following items are an example of change in Accounting Policy/Change in Accounting Estimates/Extraordinary items/Prior period items/Ordinary Activity.

(i) Actual bad debts turning out to be more than provisions.
(ii) Change from Cost model to Revaluation model for measurement of carrying amount of PPE.
(iii) Government grant receivable as compensation for expenses incurred in previous accounting period.
(iv) Treating operating lease as finance lease.
(v) Capitalisation of borrowing cost on working capital.
(vi) Legislative changes having long term retrospective application.
(vii) Change in the method of depreciation from straight line to WDV.
(viii) Government grant becoming refundable.
(ix) Applying 10% depreciation instead of 15% on furniture.
(x) Change in useful life of fixed assets (PPE). (5 marks)

Answer:

Classification of given items is as follows:

Sr. No.	Particulars	Remarks
(i)	Actual bad debts turning out to be more than provisions	Change in Accounting Estimates
(ii)	Change from Cost model to Revaluation model for measurement of carrying amount of PPE	Change in Accounting Policy
(iii)	Government grant receivable as compensation for expenses incurred in previous accounting period	Extra -ordinary Items
(iv)	Treating operating lease as finance lease.	Prior- period Items

(v)	Capitalisation of borrowing cost on working capital	Prior-period Items (as interest on working capital loans is not eligible for capitalization)
(vi)	Legislative changes having long term retrospective application	Ordinary Activity
(vii)	Change in the method of depreciation from straight line to WDV	Change in Accounting Estimates
(viii)	Government grant becoming refundable	Extra -ordinary Items
(ix)	Applying 10% depreciation instead of 15% on furniture	Prior- period Items
(x)	Change in useful life of fixed assets (PPE)	Change in Accounting Estimates

Space to write important points for revision

3 *AS - 7 Construction Contracts*

Q.3.1	2009 - Nov [1] (viii)	Descriptive
Explain contract costs as per Accounting Standard-7 related to 'Construction Contracts'. (2 marks) *[IPCC Gr. I]*		

Answer:

According to AS 7 "Construction Contracts (revised 2002)", contract cost should comprise:

1. Costs that relate directly to the specific contract;
2. Costs that are attributable to contract activity in general and can be allocated to the contract;
3. Other costs as are specifically chargeable to the customer under the terms of the contract.

Space to write important points for revision

Q.3.2	2010 - Nov [7] (c)	Practical

Answer the following :
An amount of ₹ 9,90,000 was incurred on a contract work upto 31-3-2010. Certificates have been received to date to the value of ₹ 12,00,000 against which ₹ 10,80,000 has been received in cash. The cost of work done but not certified amounted to ₹ 22,500. It is estimated that by spending an additional amount of ₹ 60,000 (including provision for contingencies) the work can be completed in all respects in another two months. The agreed contract price of work is ₹ 12,50,000. Compute a conservative estimate of the profit to be taken to the Profit and Loss Account as per AS-7. (4 marks)

Answer:

Computation of Estimated Profit as per AS 7

Particulars	**₹**
Expenditure incurred upto 31.3.2010	9,90,000
Estimated additional expenses (including provision for contingency)	60,000
Estimated cost (A)	10,50,000
Contract price (B)	12,50,000
Total estimated profit [(B-A)]	2,00,000
Percentage of completion (9,90,000/10,50,000) × 100	94.29%

Computation of estimate of the profit to be taken to Profit and Loss Account:

$$= \text{Total estimated profit} \times \frac{\text{Expenses incurred till 31.3.2010}}{\text{Total estimated cost}}$$

$$= 2,00,000 \times \frac{9,90,000}{10,50,000} = 1,88,571$$

Provision:

According to AS-7, 'Construction Contracts', when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to stage of completion of the contract activity at the reporting date.

Analysis and Conclusion:

Therefore estimated profit amounting ₹ 1,88,571 should be recognised as revenue in the statement of profit and loss.

—— Space to write important points for revision ——

Q.3.3	2011 - Nov [7] (d)	Practical

Answer the following:

From the following data, show. Profit and Loss A/c (Extract) as would appear in the books of a contractor following Accounting Standard -7:

	(₹ in lakhs)
Contract Price (fixed)	480.00
Cost incurred to date	300.00
Estimated cost to complete	200.00

(4 marks) *[IPCC Gr. I]*

Answer :

Calculation of Estimated Total Cost

Particulars	**(₹ in lakhs)**
Cost incurred to date	300
Estimate of cost completion	200
Estimated total cost in completing the contract	500

Percentage of completion (300/500) × 100 = 60%

Revenue recognised as a percentage to contract price

= 60% of ₹ 480 lakhs = ₹ 288 lakhs

As per para 35 of AS 7 'Construction Contracts', when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Accordingly, expenses to be recognized in the Profit and Loss Account will be

	(₹ in lakhs)
Total foreseeable loss (500 - 480)	20
Less: Loss for the current year (300 - 288)	(12)
Expected loss to be recognized immediately as per para 35 of AS 7	8

Profit and Loss A/c (An Extract)

	(₹ in lakhs)		(₹ in lakhs)
To Construction cost	300	By Contract price	288
To Estimated loss on completion of contract	8		
	?		?

Space to write important points for revision

Q.3.4	2012 - May [1] {C} (a), RTP	Practical

M/s Excellent Construction Company Limited undertook a contract to construct a building for ₹ 3 Crore on 1st September, 2011. On 31st March, 2012 the company found that it had already spent ₹ 1 Crore 80 Lakhs on the construction. Prudent estimate of additional cost for completion was ₹ 1 Crore 40 Lakhs. What amount should be charged, to revenue in the final accounts for the year ended on 31st March, 2012, as per the provisions of Accounting Standard 7 "Construction Contracts (Revised)"?

(5 marks) *[IPCC Gr. I]*

Answer:

Computation of Estimated Cost of Construction:

Particulars	₹ in crores
Cost of construction incurred till date	1.80
Add: Estimated future cost	1.40
Total estimated cost of construction	3.20

Percentage of completion of contract till date to total estimated cost of construction = ₹ (1.80/3.20) × 100 = 56.25%

Proportion of total contract price considered as revenue as per AS 7 (Revised)

= Contract price × percentage of completion

= ₹ 3 crores × 56.25% = ₹ 1.6875 crores

Space to write important points for revision

Q.3.5	2014 - May [1] {C} (d)	Practical

M/s. Highway Constructions undertook the construction of a highway on 01.04.2013. The contract was to be completed in 2 years. The contract price was estimated at ₹ 150 crores. Up to 31.03.2014 the company incurred ₹ 120 crores on the construction. The engineers involved in the project estimated that a further ₹ 45 crores would be incurred for completing the work.

What amount should be charged to revenue for the year 2013-14 as per the provisions of Accounting Standard 7 "Construction Contracts"? Show the extract of the Profit & Loss A/c in the books of M/s. Highway Constructions. (5 marks) *[IPCC Gr. I]*

Answer :

Statement showing the amount to be charged to Revenue as per AS 7

	₹ in crores
Cost of construction incurred upto 31.03.2014	120
Add: Estimated future cost	45
Total estimated cost of construction	165
Degree of completion (120/165x100)	72.73%
Revenue recognized (72.73% of 150)	109 (approx)
Total foreseeable loss (165 - 150)	15
Less: Loss for the current year (120-109)	11
Loss to be provided for	4

Profit and Loss Account (Extract)

	₹ in crores		₹ in crores
To Construction Costs	120	By Contract Price	109
To Provision for loss	4	By Net loss	15
	124		124

—— Space to write important points for revision ——

Q.3.6	2015 - May [1] {C} (b)	Practical

A construction contractor has a fixed price contract for ₹ 9,000 lacs to build a bridge in 3 years time frame. A summary of some of the financial data is as under:

(Amount ₹ in lacs)

	Year 1	Year 2	Year 3
Initial Amount for revenue agreed in contract	9,000	9,000	9,000
Variation in Revenue (+)	–	200	200
Contracts costs incurred up to the reporting date	2093	6168*	8100**
Estimated profit for whole contract	950	1,000	1,000

*Includes ₹ 100 lacs for standard materials stored at the site to be used in year 3 to complete the work.

**Excludes ₹ 100 lacs for standard material brought forward from year 2.

The variation in cost and revenue in year 2 has been approved by customer.

Compute year wise amount of revenue, expenses, contract cost to complete and profit or loss to be recognized in the Statement of Profit and Loss as per AS-7 (revised). (5 marks) *[IPCC Gr. I]*

Answer:

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are shown below:

(Amount in ₹ lakhs)

	Upto the reporting date	**Recognized in prior years**	**Recognized in current year**
Year 1			
Revenue (9,000 x 26%)	2,340	–	2,340
Expenses (8,050 x 26%)	2,093	–	2,093
Profit	247	–	247
Year 2			
Revenue (9,200 x 74%)	6,808	2,340	4,468
Expenses (8,200 x 74%)	6,068	2,093	3,975
Profit	740	247	493
Year 3			
Revenue (9,200 x 100%)	9,200	6,808	2,392
Expenses (8,200 x 100%)	8,200	6,068	2,132
Profit	1,000	740	260

Working Note :

	Year 1	**Year 2**	**Year 3**
Revenue after consider variations	9,000	9,200	9,200
Less: Estimated profit for whole contract	950	1,000	1,000
Estimated total cost of the contract (A)	8,050	8,200	8,200
Actual cost incurred upto the reporting date (B)	2,093	6,068	8,200
		(6,168-100)	(8,100+100)
Degree of completion (B/A)	26%	74%	100%

Space to write important points for revision

Q.3.7	2016 - May [1] {C} (a), RTP	Practical

Uday Constructions undertake to construct a bridge for the Government of Uttar Pradesh. The construction commenced during the financial year ending 31.03.2016 and is likely to be completed by the next financial year. The contract is for a fixed price of ₹ 12 crores with an escalation clause. The costs to complete the whole contract are estimated at ₹ 9.50 crores of rupees. You are given the following information for the year ended 31.03.2016:

Cost incurred upto 31.03.2016 ₹ 4 crores

Cost estimated to complete the contract ₹ 6 crores

Escalation in cost by 5% and accordingly the contract price is increased by 5%.

You are required to ascertain the state of completion and state the revenue and profit to be recognized for the year as per AS-7.

(5 marks) *[IPCC Gr. I]*

Answer:

	₹ in crore
Cost of construction of bridge incurred 31.3.16	4.00
Add: Estimated future cost	6.00
Total estimated cost of construction	10.00
Contract Price (12 crore x 1.05)	12.60 crore

Stage of completion

Percentage of completion till date to total estimated cost of construction

= $(4/10)\times 100$

= 40%

Revenue and Profit to be recognized for the year ended 31st March, 2016 as per AS-7

Proportion of total contract value recognized as revenue = Contract price × percentage of completion

= ₹ 12.60 crore × 40% = ₹ 5.04 crore

Profit for the year ended 31st March, 2016 = ₹ 5.04 crore less ₹ 4 crore = 1.04 crore.

—— Space to write important points for revision ——

Q.3.8	2016 - Nov [1] {C} (a)	Practical

GTI Ltd. negotiates with Bharat Oil Corporation Ltd. (BOCL), for construction of "Retail Petrol and Diesel Outlet Stations". Based on proposals submitted to different Regional Offices of BOCL, the final approval for one outlet each in Region X, Region Y, Region Z is awarded to GTI Ltd. A single agreement is entered into between two. The agreement lays down values for each of the three outlets i.e. ₹ 102 Lakhs, ₹ 150 Lakhs, ₹ 130 Lakhs for Region X, Region Y, Region Z respectively. Agreement also lays down completion time for each Region.

Comment whether GTI Ltd. will treat it as single contract or three separate contracts with reference to AS-7? (5 marks) *[IPCC Gr. I]*

Answer:

Provision:

As per AS-7 'Construction Contracts' when a contract covers a number of assets, the construction of each asset should be treated as a separate contract when:

1. separate proposal have been submitted for each asset;
2. each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and
3. the costs and revenues of each asset can be identified.

Analysis:

In the given case, GTI Ltd. negotiates with Bharat Oil Corporation Ltd.

Separate proposal is submitted for each construction, though a single agreement is entered between the two. Also values for each contract is defined separately such as ₹ 102 Lakhs, ₹ 150 Lakhs and ₹ 130 Lakhs for Region X, Region Y and Region Z respectively.

Conclusion:
Thus, GTI Ltd. is required to treat construction of each unit as a separate construction contract. Therefore, three separate contract accounts must be recorded and maintained in the books of GTI Ltd. For each contract principles of revenue and cost recognition must be applied separately and net income will be determined for each asset as per AS-7.

—— Space to write important points for revision ——

Q.3.9	2017 - May [1] {C} (c)	Practical

Akar Ltd. signed on 01/04/16, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the period ending 31/03/17.

— Materials issued ₹ 75,00,000
— Labour charges paid ₹ 36,00,000
— Hire charges of plant ₹ 10,00,000
— Other contract cost incurred ₹ 15,00,000
— Out of material issued, material lying unused at the end of period is ₹ 4,00,000
— Labour charges of ₹ 2,00,000 are still outstanding on 31.3.17.
— It is estimated that by spending further ₹ 33,50,000 the work can be completed in all respect.

You are required to compute profit/loss to be taken to Profit and Loss Account and additional provision for foreseeable loss as per AS-7.

(5 marks) *[IPCC Gr. I]*

Answer:

Computation of Amount to be charged to P & L and additional Provision (As per AS-7)

Particulars	Amount (₹)
Cost of construction incurred upto 31.03.17 (W. N.-1)	1,34,00,000
Add: Estimated Future cost	33,50,000
Total Estimated cost of construction	1,67,50,000

	Degree of Completion $\left(\frac{1,34,00,000}{1,67,50,000} \times 100\right)$	80%
	Revenue Recognized (1,50,00,000 × 80%)	1,20,00,000
	Total Foreseeable loss (1,67,50,000 – 1,50,00,000)	17,50,000
Less:	Loss of Current Year (1,34,00,000 – 1,20,00,000)	(14,00,000)
	Additional Provision for Foreseeable loss	3,50,000

Working Note:

1. **Cost of Construction incurred upto 31.03.17**

Particulars	Amount (₹)	Amount (₹)
Material Issued	75,00,000	
(–) Unused Material	(4,00,000)	71,00,000
Labour Charges Paid	36,00,000	
+ Outstanding	2,00,000	38,00,000
Hire Charges of Plant		10,00,000
Other Contract Cost		15,00,000
		1,34,00,000

—— Space to write important points for revision ——

Q.3.10	2018 - May [1] {C} (a)	Practical

Sarita Construction Co. obtained a contract for construction of a dam. The following details are available in records of company for the year ended 31st March, 2018:

	₹ in lakhs
Total Contract Price	12,000
Work Certified	6,250
Work not certified	1,250
Estimated further cost to completion	8,750
Progress payment received	5,500
Progress payment to be received	1,500

Applying the provisions of Accounting Standard 7 "Accounting for Construction Contracts" you are required to compute:

(i) Profit/Loss for the year ended 31st March, 2018.
(ii) Contract work in progress as at end of financial year 2017-18.
(iii) Revenue to be recognized out of the total contract value.
(iv) Amount due from / to customers as at the year end. (5 marks)

Answer:

(i) Profit / Loss for the year ended 31st March, 2018.

Particulars	**(₹ In Lakhs)**
Total Cost of Construction (6,250 + 1,250 + 8,750)	16,250
Less : Total Contract Price	(12,000)
Total Foreseeable loss to be recognised as expense	4,250

According to AS-7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

(ii) Contract work in progress as at end of financial Year 2017-18.

Particulars	**(₹ In lakhs)**
Work Certified	6,250
Work not Certified	1,250
	7,500

This is 46.15% (7,500 / 16,250 × 100) of total costs of construction.

(iii) Revenue to be recognised out of the total contract value

46.15% of ₹ 12,000 Lakhs = ₹ 5,538 Lakhs.

(iv) Amount due from / to customers as at the year end

Amount due from / to customers = (Contract Costs + Recognised Profits – Losses) – (Progress Payments Received + Progress Payments to be Received)

= (7,500 + Nil – 4,250) – (5,500 + 1,500) ₹ in Lakhs

= [3,250 – 7,000] ₹ in Lakhs

Amount due to customers = ₹ 3,750 lakhs

The amount of ₹ 3,750 Lakhs will be shown in the balance sheet as liability.

—— Space to write important points for revision ——

Q.3.11	2019 - May [1] {C} (a)	Practical

Answer the following questions :

(i) AP Ltd., a construction contractor, undertakes the construction of commercial complex for Kay Ltd. AP Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreement is entered into between the two parties. The agreement lays down the value of each of the 3 units, i.e. ₹ 50 Lakh, ₹ 60 Lakh and ₹ 75 Lakh respectively. Agreement also lays down the completion time for each unit.

Comment, with reference to AS-7, whether AP Ltd., should treat it as a single contract or three separate contracts.

(ii) On 1st December, 2017, GR Construction Co. Ltd. undertook a contract to construct a building for ₹ 45 lakhs. On 31st March, 2018, the company found that it had already spent ₹ 32.50 lakhs on the construction. Additional cost of completion is estimated at ₹ 15.10 lakhs. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2018 as per provisions of AS-7? (5 marks)

Answer:

(i) **As per AS 7 'Construction Contracts'**, when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

Therefore, AP. Ltd. is required to treat construction of each unit as a separate construction contract.

(ii)

	₹ in lakhs
Cost incurred till 31st March, 2018	32.50
Estimation of additional cost of completion	15.10
Total cost of construction	47.60
Less: Contract price	(45.00)
Total foreseeable loss	2.60

According to AS 7, the amount of ₹ 2.60 lakh is required to be recognised as an expense.

Contract work in progress $= \dfrac{₹32.50 \text{ lakhs} \times 100}{₹47.60 \text{ lakhs}}$

= 68.28%

Proportion of total contract value recognised as turnover.

= 68.28% of ₹ 45 lakhs

= ₹ 30.726 lakhs

Q.3.12	**2020 - Nov [1] {C} (a)**	**Practical**

Answer the following:

Rajendra undertook a contract for ₹ 20,00,000 on an arrangement that 80% of the value of work done as certified by the architect of the contractee, should be paid immediately and that the remaining 20% be retained until the Contract was completed.

In Year 1, the amounts expended were ₹ 8,60,000, the work was certified for ₹ 8,00,000 and 80% of this was paid as agreed. It was estimated that future expenditure to complete the Contract would be ₹ 10,00,000.

In Year 2, the amounts expended were ₹ 4,75,000. Three-fourths of the Contract was certified as done by December 31st and 80% of this was received accordingly. It was estimated that future expenditure to complete the Contract would be ₹ 4,00,000.

In Year 3, the amounts expended were ₹ 3,10,000 and on June 30th the whole Contract was completed.

Show how Contract revenue would be recognized in the P & L A/c of Mr. Rajendra each year. (5 marks)

Answer:

As per, AS 7, Construction contract, contract revenue would be recognized in the P & L A/c of Mr. Rajendra is as follows:

	Year 1	Year 2	Year 3
1. Contract Price	20,00,000	20,00,000	20,00,000
2. Cost incurred till date	8,60,000	13,35,000	16,45,006
3. *Add:* Cost Expected	10,00,000	4,00,000	–
4. Expected Total Contract Cost	18,60,000	17,35,000	16,45,000
5. % of completion	46.24%	76.95%	100%
$\boxed{y.1}$ $\left[\frac{8,60,000}{18,60,000} \times 100\right]$			
$\boxed{y.2}$ $\left[\frac{13,35,000}{17,35,000} \times 100\right]$			
$\boxed{y.3}$ $\left[\frac{16,45,000}{16,45,000} \times 100\right]$			
6. Total Contract Revenue	20,00,000	20,00,000	20,00,000
7. Contract Revenue to be Recognised [20 lakhs × % of completion]	9,24,800	15,39,000	20,00,000
8. Contract Revenue Recognised in Previous year	0	9,24,800	15,39,000
9. **Revenue recognised in current year**	**9,24,800**	**6,14,200**	**4,61,000**

Q.3.13	2021 - July [1] {C} (a)	Practical

The following data is provided for M/s. Raj Construction Co.

(i) Contract Price – ₹ 85 Lakhs

(ii) Materials issued – ₹ 21 Lakhs out of which Materials costing ₹ 4 Lakhs is still lying unused at the end of the period.

(iii) Labour Expenses for workers engaged at site – ₹ 16 Lakhs (out of which ₹ 1 Lakh is still unpaid)

(iv) Specific Contract Costs – ₹ 5 Lakhs

(v) Sub-Contract Costs for work executed – ₹ 7 Lakhs, Advances paid to Sub-Contractors – ₹ 4 Lakhs

(vi) Further Cost estimated to be incurred to complete the contract – ₹ 35 Lakhs

You are required to compute the Percentage of Completion, the Contract Revenue and Cost to be recognized as per AS-7. (5 marks)

Q.3.14	RTP	Practical

X Undertook a Contract for ₹ 15,00,000 on an arrangement that 80% of the value of work done as certified by the architect of the Contractee, should be paid immediately and that the remaining 20% be retained until the Contract was completed.

In Year 1, the amounts expended were ₹ 3,60,000, the work was certified for ₹ 3,00,000 and 80% of this was paid as agreed. It was estimated that future expenditure to complete the Contract would be ₹ 10,00,000.

In Year 2, the amounts expended were ₹ 4,75,000. Three-fourths of the Contract was certified as done by December 31st and 80% of this was received accordingly. It was estimated that future expenditure to complete the Contract would be ₹ 4,00,000.

In Year 3, the amounts expended were ₹ 3,10,000 and on June 30th the whole Contract was completed.

Show how Contract Revenue would be recognised in the P&L A/c each year.

Answer:

Particulars	Year 1	Year 2	Year 3
1. Contract Price	15,00,000	15,00,000	15,00,000
2. Cost Incurred till date	3,60,000	8,35,000	11,45,000
3. *Add:* Costs Expected	10,00,000	4,00,000	—
4. **Expected Total Contract Cost**	**13,60,000**	**12,35,000**	**11,45,000**
5. % of Completion $= \frac{\text{Cost Till Date}}{\text{Total Contract Costs}}$	26.47%	67.61%	100%
6. Total Contract Revenue	15,00,000	15,00,000	15,00,000
7. Contract Revenue to be recognised = Total Revenue × % of Completion	3,97,050	10,14,150	15,00,000
8. Contract Costs	3,60,000	8,35,000	11,45,000
9. **Profit**	**37,050**	**1,79,150**	**3,55,000**

Space to write important points for revision

Q.3.15	RTP	Practical

XYZ & Co. a Firm of Contractors, obtained a Contract for Construction of bridges across the river Revathi. The following details are available in the records kept for the year ending 31st March. (information in ₹ Lakhs)

Total Contract Price	1,000	Progress Payment Received	400
Costs incurred till date	605	Progress Payment to be Received	140
Estimated further Cost to Completion	495		

The Firm seeks your advice and assistance in the presentation of accounts keeping in view the requirements of AS - 7

Answer:

- Percentage of Completion = $\frac{\text{Cost Incurred Till Date}}{\text{Estimated Total Costs}} = \frac{₹605}{₹1,100} = 55\%$
- Total Expected Loss to be provided for, as per Para 35 = Contract Price (-) Total Costs = ₹ 100 Lakhs.

Contract Revenue as per Para 21 = 55% of ₹ 1,000 Lakhs	= 550 Lakhs
Less: Contract Costs as per Para 21	= 605 Lakhs
Loss on Contract	= 55 Lakhs
Less: Further provision required in respect of Expected Loss (Bal. Figure)	= 45 Lakhs
Expected Loss recognised as per Para 35 =	100 Lakhs

Amount due from / to customers = Contract Costs + Recognised Profits (–) Recognised Losses (–) Progress Billings
= 605 + Nil (–) 100 (–) 540 = (35) Lakhs Amount Due to Customers.

This amount of ₹ 35 Lakhs will be shown in the Balance Sheet as a Liability.

Note: Progress Billings = Payments Received + Payments billed but not received.

—— Space to write important points for revision ——

Q.3.16	RTP	Practical

XYZ Construction Co. Ltd. undertook a contract on 1st January to construct a building for ₹ 80 Lakhs. The Company found on 31st March that it had already spent ₹ 58,50,000 on the construction. Prudent estimate of additional cost for completion was ₹ 31,50,000.
What amount should be charged to Revenue and what amount of Contract Value to be recognized as Turnover in the accounts for the year ended 31st March as per provisions of AS-7?

Answer:

Estimated Total Contract Costs = Cost till date + Further Costs = ₹ 58,50,000 + ₹ 31,50,000 = ₹ 90,00,000

Percentage of Completion = $\frac{\text{Cost Incurred Till Date}}{\text{Estimated Total Costs}} = \frac{₹ 58.50}{₹ 90.00}$ = 65%

Total Expected Loss to be provided for = Contract Price (–) Total Costs = ₹ 80 (–) ₹ 90 = ₹ 10,00,000.

Contract Revenue as per Para 21 = 60% of ₹ 80 Lakhs = ₹ 52,00,000 (Contract Revenue to be recognized)

—— Space to write important points for revision ——

Q.3.17	RTP	Practical

XYZ Ltd. undertook a Contract for building a Crane for ₹ 10 Lakhs. As on 31st March of a financial year, it incurred a cost of ₹ 1.50 Lakhs and expects that ₹ 9 Lakhs more will be required for completing the crane. It has received so far ₹ 1.20 Lakhs as Progress Payment. Discuss the treatment of the above under AS-7.

Answer:

- Percentage of Completion = $\frac{\text{Cost Incurred Till Date}}{\text{Estimated Total Costs}} = \frac{₹ 1.50}{₹ 10.50}$ = 14.29%
- Total Expected Loss to be provided for, as per Para 35 = Contract Price (–) Total Costs = ₹ 0.50 Lakhs.

Contract Revenue as per Para 21	=	14.29% of ₹ 10 Lakhs
	=	1.43 Lakhs
Less: Contract Costs	=	<u>1.50 Lakhs</u>
Loss on Contract	=	0.07 Lakhs
Less: Further provision required in respect of Expected Loss		
	=	0.43 Lakhs (Bal. Figure)
Expected Loss recognised as per Para 35	=	0.50 Lakhs

Amount due from / to customers = Contract Costs + Recognised Profits (–) Recognised Losses (–) Progress Billings

= 1.50 + Nil (–) 0.50 (–) 1.20 = (0.20) Lakhs Amount Due to Customers.

This amount of ₹ 0.20 Lakhs will be shown in the Balance Sheet as a Liability.

4 AS - 9 Revenue Recognition

Q.4.1	2008 - Nov [5] (iii)	Practical

Answer the following :
Y Ltd. used certain resources of X Ltd. In return X Ltd. receives ₹ 10 lakhs and ₹ 15 lakhs as interest and royalties respectively, from Y Ltd. during the year 2007-08. State on what basis X Ltd. should recognize their revenue, as per AS 9. (2 marks) *[IPCC Gr. I]*

Answer:

According to AS-9 on 'Revenue Recognition', interest of ₹ 10 lakhs received in the year 2007-08 should be recognized on the time proportion basis taking into account the amount outstanding and the rate applicable; whereas royalty of ₹ 15 lakhs received in the same year should be recognized on accrual basis as per the terms of relevant agreement.

—— Space to write important points for revision ——

Q.4.2	2010 - May [1] (viii)	Descriptive

According to Accounting Standard-9, when revenue from sales should be recognised? (2 marks) *[IPCC Gr. I]*

Answer:

According to AS 9 'Revenue Recognition', revenue from sales should be recognised only when requirements as to performance are satisfied provided that at the time of performance it is not unreasonable to expect ultimate collection. These requirements can be given as follows:

(i) 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

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

—— Space to write important points for revision ——

Q.4.3	2011 - Nov [7] (b), RTP	Practical

Answer the following:
M/s. SEA Ltd. recognized ₹ 5.00 lakhs on accrual basis income from dividend during the year 2010-11, on shares of the face value of ₹ 25.00 lakhs held by it in Rock Ltd. as at 31st March, 2011. Rock Ltd. proposed dividend @ 20% on 10th April, 2011. However, dividend was declared on 30th June, 2011. Please state with reference to relevant Accounting Standard, whether the treatment accorded by SEA Ltd. is in order.

(4 marks) *[IPCC Gr. I]*

Answer:

Provision:

According to para 8.4 of AS-9 "Revenue Recognition", dividends from investments in shares are not recognized in the statement of Profit and Loss until the right to receive dividends is established.

Analysis and Conclusion:

In the given situation the dividend is proposed on 10th April, 2011, while it was declared on 30th June, 2011. Hence, the right to receive dividend is established on 30th June, 2011 only. Therefore, on applying the provisions stated in the standard, income from dividend on shares should be recognized by Sea Ltd. in the financial year 2011-2012 only.

Therefore, the recognition of income from dividend of ₹ 5 lakhs, on accrual basis, in the financial year 2010-11 is not in accordance with AS-9.

—— Space to write important points for revision ——

Q.4.4	2013 - May [7] (d)	Practical

Answer the following:

(d) M/s. Moon Ltd. sold goods worth ₹ 6,50,000 to Mr. Star. Mr. Star asked for a trade discount amounting to ₹ 53,000 and same was agreed to by M/s. Moon Ltd. The sales was effected and goods were dispatched. On receipt of goods, Mr. Star has found that goods worth ₹ 67,000 are defective. Mr. Star returned defective goods to

M/s. Moon Ltd. and made payment due amounting to ₹ 5,30,000. The accountant of M/s. Moon Ltd. booked the sale for ₹ 5,30,000. Discuss the contention of the accountant with reference to Accounting Standard (AS) 9. (4 marks) *[IPCC Gr. I]*

Answer:

Provisions

- **As per AS-9, Revenue Recognition,** revenue is the gross inflow of cash, receivable or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods.
- However, trade discounts and volume rebates given in the ordinary course of business should be deducted in determining revenue.
- Revenue from sales should be recognized at the time of transfer of significant risks and rewards.
- If the delivery of the sales is not subject to approval from customers, then the transfer of significant risks and rewards would take place when the sale is affected and goods are dispatched.

Analysis and Conclusion:

- In the given case, if trade discounts allowed by M/s. Moon Ltd. are given in the ordinary course of business, M/s. Moon Ltd. should record the sales at ₹ 5,97,000 (i.e. ₹ 6,50,000 – ₹ 53,000) and goods returned worth ₹ 67,000 are to be recorded in the form of sales return.
- However, when trade discount allowed by M/s. Moon Ltd. is not in the ordinary course of business, M/s. Moon Ltd. should record the sales at gross value of ₹ 6,50,000. Discount of ₹ 53,000 in price and return of goods worth ₹ 67,000 are to be adjusted by suitable provisions.
- M/s Moon Ltd. might have sent the credit note of ₹ 1,20,000 to Mr. Star to account for these adjustments. In both the cases, the contention of the accountant to book the sales for ₹ 5,30,000 is not correct.

Space to write important points for revision

Q.4.5	2013 - Nov [1] {C} (c), RTP	Practical

A Ltd. entered into a contract with B Ltd. to despatch goods valuing ₹ 25,000 every month for 4 months upon receipt of entire payment. B Ltd. accordingly made the payment of ₹ 1,00,000 and A Ltd. started despatching the goods. In third month, due to a natural calamity, B Ltd. requested A Ltd. not to despatch goods until further notice though A Ltd. is holding the remaining goods worth ₹ 50,000 ready for despatch. A Ltd. accounted ₹ 50,000 as sales and transferred the balance to Advance Received against Sales. Comment upon the treatment of balance amount with reference to the provisions of Accounting Standard 9. (5 marks) *[IPCC Gr. I]*

Answer:

Analysis:

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 are fulfilled:

(i) 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

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

Conclusion:

In the given problem transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. Also, the sale price has been recovered by the seller. Hence, the sale is complete but delivery has been postponed at buyer's request. A Ltd. should recognize the entire sale of ₹ 1,00,000 (₹ 25,000 x 4) and no part of the same is to be treated as Advance Receipt against Sales.

Space to write important points for revision

Q.4.6	2014 - Nov [1] {C} (b)	Practical

Sarita Publications publishes a monthly magazine on the 15^{th} of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The sale of space for the March 2014 issue was made in February 2014. The magazine was published on its scheduled date. It received ₹ 2,40,000 on 10.3.2014 and ₹ 60,000 on 10.4.2014 for the March 2014 issue.
Discuss in the context of AS 9 the amount of revenue to be recognized and the treatment of the amount received from advertisers for the year ending 31.3.2014. What will be the treatment if the publication is delayed till 2.4.2014? (5 marks) *[IPCC Gr. I]*

Answer:

According to AS-9, 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method as the service is performed, whichever relates the revenue to the work accomplished.

In this case, income accrues when the related advertisement appears before public.

The advertisement service would be considered as performed on the day the advertisement is seen by public and hence revenue is recognized on that date, so in this case, it is 15.03.2014, the date of publication of the magazine.

Therefore, ₹ 3,00,000 (₹ 2,40,000 + ₹ 60,000) is recognized as income in March, 2014. The terms of payment are not relevant for considering the date on which revenue is to be recognized. ₹ 60,000 is treated as amount due from advertisers as on 31.03.2014 and ₹ 2,40,000 will be treated as payment received against the sale.

Whereas, if the publication is delayed till 02.04.2014 revenue recognition will also be delayed till the advertisements get published in the magazine. In such case revenue of ₹ 3,00,000 will be recognized for the year ended 31.03.2015 after the magazine is published on 02.04.2014. The amount received from sale of advertising space on 10.03.2014 of ₹ 2,40,000 will be considered as an advance from advertisers as on 31.03.2014.

Space to write important points for revision

Q.4.7	2015 - May [7] (c)	Practical

Answer the following:

Given the following information of M/s. Paper Products Ltd.

(i) Goods of ₹ 60,000 were sold on 20-3-2015 but at the request of the buyer these were delivered on 10-4-2015.

(ii) On 15-1-2015 goods of ₹ 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-2015.

(iii) ₹ 1,20,000 worth of goods were sold on approval basis on 1-12-2014. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-2015 and no approval or disapproval received for the remaining goods till 31-3-2015.

(iv) Apart from the above, the company has made cash sales of ₹ 7,80,000 (gross). Trade discount of 5% was allowed on the cash sales.

You are required to advise the accountant of M/s. Paper Products Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS-9 and also determine the total revenue to be recognized for the year ending 31-3-2015. (4 marks) *[IPCC Gr. I]*

Answer:

(i) As per AS-9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(a) 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

(b) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.
In this transaction, the buyer sold goods of ₹ 60,000 on 20-3-2015 but at the request of the buyer these were delivered on 10-4-2015.

As per AS-9, goods sold by company the right becomes to revenue recognised whether, the actual physical delivery of goods taken place or not. So here ₹ 60,000 of revenue is to be recognised as Sales in Trading A/c.

(ii) **As per AS-9,** if the goods are sent on consignment basis and if the agent sells them to third party then only the revenue is recognised by consignor.

- So here, goods of ₹ 1,50,000 sent on consignment and only 80% goods were sold. Thus, sales recorded will be only ₹ 1,20,000 in Trading A/c as per AS-9.

(iii) **As per AS-9,** revenue should be recognised on sale on approval basis as follows:

- Revenue shall be recognised if the buyer formally accepted the goods.
- Revenue shall also be recognised if the period of rejection has elapsed or where no time has been fixed or a reasonable time has elapsed.
- Here, total goods worth ₹ 1,20,000 are sold to customers on 1-12-2014, on approval period of 3 months. Buyer sent approval for 75% goods up to 31-1-2015 and no approval or disapproval received for the remaining goods till 31-3-2015. As the approval time is elapsed on 31-3-2015, so all the goods sold on' 1-12-2014 is to be considered as sales.
- So, ₹ 1,20,000 to be shown in Trading P&L A/c as sales as on 31-3-2015.

(iv) Apart, from above the company has made cash sales of ₹ 7,80,000 (gross). Trade discount of 5% allowed on cash sales, so sale is to be recorded as 7,80,000 – 39,000 = ₹ 7,41,000.

* **Calculation for total revenue to be recognised for the year ending 31-3-2015**

Particulars	Amount (₹)
(i) Sale as on 20-3-2015	60,000
(ii) Sale on consignment basis on 15-2-2015	1,20,000
(iii) Sale on approval basis on 1-12-2014	1,20,000
(iv) Sale (Cash) after discount	7,41,000
Total revenue recognized	10,41,000

Space to write important points for revision

Q.4.8	2015 - Nov [1] {C} (a)	Practical

M/s Umang Ltd. sold goods through its agent. As per terms of sales, consideration is payable within one month. In the event of delay in payment, interest is chargeable @ 12% p.a. from the agent. The company has not realized interest from the agent in the past. For the year ended 31st March, 2015 interest due from agent (because of delay in payment) amounts to ₹ 1,72,000. The accountant of M/s Umang Ltd. booked ₹ 1,72,000 as interest income in the year ended 31st March, 2015. Discuss the contention of the accountant with reference to Accounting Standard-9. (5 marks) *[IPCC Gr. I]*

Answer:

As per AS-9 "Revenue Recognition", where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of rising any claim, the revenue recognition is postponed to the extent of uncertainty. In such cases, the revenue is recognised only when it is reasonably certain that the ultimate collection will be made.

So in this case M/s Umang Ltd. never realised interest for the delayed payments made by the agents. Hence, it has to recognize the interest only if the ultimate collection is certain. The interest income of ₹ 1,72,000 is not be recognised in the year ended 31st March, 2015.
So the contention of the accountant is wrong. It should not recognize it as interest income in the books of account for year ended 31st March, 2015.

—— Space to write important points for revision ——

Q.4.9	2016 - Nov [1] {C} (d)	Practical

A manufacturing company has the following stages of production and sale in manufacturing Fine paper rolls:

Date	Activity	Costs to Date (₹)	Net Realizable Value (₹)
15.1.16	Raw material	1,00,000	80,000
20.1.16	Pulp (WIP 1)	1,20,000	1,20,000
27.1.16	Rough & thick paper (WIP 2)	1,50,000	1,80,000
15.2.16	Fine Paper Rolls	1,80,000	3,50,000
20.2.16	Ready for sale	1,80,000	3,50,000
15.3.16	Sale agreed and invoice raised	2,00,000	3,50,000
02.4.16	Delivered and paid for	2,00,000	3,50,000

Explain the stage on which you think revenue will be generated and state how much would be net profit for year ending 31-3-16 on this product according to AS-9. (5 marks) *[IPCC Gr. I]*

Answer:

Provision:

As per AS-9 'Revenue Recognition' revenue in terms of sales could be recognised only when ownership has been passed by the seller to the buyer and there is no uncertainty regarding collection of consideration (sale proceeds) and it is reasonable to expect ultimate collection at the time of performance. Thus, sales will be recognized only when following two conditions are satisfied:

(i) The sale value is fixed and determinable.

(ii) Property of the goods is transferred to the customer.

Analysis:

In the given situation, company has sold goods and raised invoice on 15.3.16 and goods are ready for delivery. In that case company is entitled to recognise sale for the year ended 31.3.2016, provided delay in delivery is due to buyer's request.

Calculation of NP is as under:

Sale price	₹ 3,50,000
Less: Cost	₹ (1,80,000)
∴ Gross profit	₹ 1,70,000
Less: Expenses	₹ (20,000)
Thus, Net profit	₹ 1,50,000

Space to write important points for revision

Q.4.10	2017 - May [1] {C} (d)	Practical

Raj Ltd. entered into an agreement with Heena Ltd. to dispatch goods valuing ₹ 5,00,000 every month for next 6 months on receipt of entire payment. Heena Ltd. accordingly made the entire payment of ₹ 30,00,000 and Raj Ltd. started dispatching the goods. In fourth month, due to fire in premise of Heena Ltd., Heena Ltd. requested to Raj Ltd. not to dispatch goods untill further notice. Due to this, Raj Ltd. is holding the remaining goods worth ₹ 15,00,000 ready for dispatch. Raj Ltd. accounted ₹ 15,00,000 as sales and transferred the balance to Advance received against Sales account.

Comment upon the above treatment by Raj Ltd. with reference to the provision of AS-9. (5 marks) *[IPCC Gr. I]*

Answer:

As per AS-9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

1. The seller of goods has transferred to the buyer the property in the goods for 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
2. No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

In the given case, transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. Also, the sale price has been recovered by the seller. Hence, the sale is complete but delivery has been postponed at buyer's request. Raj Ltd. should recognize the entire sale of ₹ 30,00,000 (₹ 5,00,000 × 6) and no part of the same is to be treated as Advance Receipt against Sales.

—— Space to write important points for revision ——

Q.4.11	2017 - Nov [1] {C} (c), RTP	Practical

Fashion Limited is engaged in manufacturing of readymade garments. They provide you the following information on 31st March, 2017:

(i) On 15th January, 2017 garments worth ₹ 4,00,000 were sent to Anand on consignment basis of which 25% garments unsold were lying with Anand as on 31st March, 2017.

(ii) Garments worth ₹ 1,95,000 were sold to Shine boutique on 25th March, 2017 but at the request of Shine Boutique, these were delivered on 15th April, 2017.

(iii) On 1st November, 2016 garments worth ₹ 2,50,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods up to 31st December, 2016 and no approval or disapproval received for the remaining goods till 31st March, 2017.

You are required to advise the accountant of Fashion Limited, the amount to be recognised as revenue in above cases in the context of AS-9.
(5 marks) *[IPCC Gr. I]*

Answer:

(i) **As per As 9 "Revenue Recognition",** in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) 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

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

Situation: Consignment Sales**.**

Amount to be recognised as Revenue: ₹ 4,00,000 × 75% = ₹ 3,00,000

Reason: Revenue on Consignment Sales is recognised only when goods are sold by the agent to a third party. Since 25% is unsold, 75% would have been sold.

Note: Cost of Inventory 25% should also be accounted for.

(ii) **Situation:** Delay in delivery at Buyer's request.

Amount to be recognised as Revenue: ₹ 1,95,000

Reason: Revenue should be recognised notwithstanding that physically delivery has not been completed so long as there is expectation that delivery will be made.

(iii) **Situation:** Sales on approval basis.

Amount to be recognised as Revenue: ₹ 2,50,000

Reason:

- **For 75% approved:** Revenue should be recognised since the buyer has formally accepted the goods.
- **For 25%:** Revenue should be recognised as time period for rejection has elapsed.

Q.4.12	2019 - May [1] {C} (b)	Practical

Given below are the following informations of M/s B.S. Ltd.

(i) Goods of ₹ 50,000 were sold on 18-03-2018 but at the request of the buyer these were delivered on 15-04-2018.

(ii) On 13-01-2018 goods of ₹ 1,25,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-03-2018.

(iii) ₹ 1,00,000 worth of goods were sold on approval basis 01-12-2017. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-01-2018 and no approval or disapproval received for the remaining goods till 31-03-2018.

You are required to advise the accountant of M/s B.S. Ltd., with valid reasons, the amount to be recognized as revenue for the year ended 31st March, 2018 in above cases in the context of AS-9. (5 marks)

Answer:

(i) **As per As 9 'Revenue Recognition'** revenue should be recongised notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made. However, the item must be on hand, identified and ready for delivery to the buyer at the time the sale is recognised rather than there being simply an intention to acquire or manufacture the goods in time for delivery.

So, sale of goods of ₹ 50,000 should be recorded in the books of account on 18/03/2018 and recognised as revenue for the year ended on 31/03/2018.

(ii) **As per AS 9, 'Revenue Recognition'** when the goods are sent on consignment basis, revenue should not be recognised untill the goods are sold to a third party.

In this case, M/s. B.S. Ltd. should recognised sale of ₹ 1,00,000 (₹ 1,25,000 × 80%) for the year ended on 31/03/2018. And sale of ₹ 20,000 shall be recognised when the sales actually made to the third party.

(iii) **As per AS 9, 'Revenue Recognition',** revenue should not be recognised until the goods have been formally accepted by buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed.

In this case, M/s. B.S. Ltd. shall recognised full sale of ₹ 1,00,000. As sale made on 01/12/2017 on sale on approval basis and approval is received on 31/01/2018 for 75% goods but no approval or disapproval received for 25% goods till 31/03/2018. So, 3 months has completed on 01/03/2018.

So, full sale of ₹ 1,00,000 shall be record for the year ended on 31/03/2018.

—— Space to write important points for revision ——

Q.4.13	2019 - Nov [1] {C} (c)	Practical

Indicate in each case whether revenue can be recognized and when it will be recognized as per AS-9.

1. Trade discount and volume rebate received.
2. Where goods are sold to distributor or others for resale.
3. Where seller concurrently agrees to repurchase the same goods at a later date.
4. Insurance agency commission for rendering services.
5. On 11-03-2019 cloths worth ₹ 50,000 were sold to X mart, but due to refurbishing of their showroom being underway, on their request cloths were delivered on 12-04-2019. (5 marks)

Answer:

(1) **As per AS - 9, 'Revenue Recognition',** trade discount and volume rebate received not be recognised separately in the profit & loss account but it is deducted directly from the purchases.

(2) In the case where the goods are sold to others or distributor for resale, for the purpose of revenue recognition, the nature of contract need to be checked. If it is the contract of agency, then revenue to be recognised when goods are finally sold to the customers. If it is not the agency then revenue can be recognised immediately.

(3) In the given case, a seller of the goods concurrently agrees to repurchase the same goods at a later date. As per As-9, it is just a finance transaction and revenue cannot be recognised.
(4) As per AS - 9, 'Revenue Recognition', insurance agency commission should be recognised on the effective commencement or renewal dates of the related policies.
(5) In this case, on 11-03-2019 clothes worth ₹ 50,000 were sold to X mart, but due to refurbishing of their showroom being underway, goods are delivered on 12-04-2019. Here, as per AS - 9, revenue to be recognised immediately on the date of sale i.e. on 11-03-2019.

Space to write important points for revision

Q.4.14	2021 - July [6] (c)	Practical

Answer the following:
A Limited sells goods with unlimited right of return to its customers.
The following pattern has been observed in the Return of Sales :

Time frame of Return from date of purchase	% of Cumulative Sales
Between 0-1 month	6%
Between 1-2 months	7%
Between 2-3 months	8%

The Company has made Sales of ₹ 36 Lakhs in the month of January, ₹ 48 Lakhs in the month of February and of ₹ 60 Lakhs in the month of March. The Total Sales for the Financial Year have been ₹ 400 Lakhs and the Cost of Sales was ₹ 320 Lakhs. You are required to determine the amount of Provision to be made and Revenue to be recognized as on 31st March. (5 marks)

5 AS - 14 Accounting for Amalgamations

Q.5.1	2013 - Nov [1] {C} (d), RTP	Practical

A Ltd. is amalgamating with B Ltd. They are undecided on the method of accounting to be followed. You are required to advice the management of B Ltd. on the method of accounting that can be adopted under AS-14.

(5 marks) *[IPCC Gr. I]*

Answer :

- An amalgamation may be either – an amalgamation in the nature of merger, or an amalgamation in the nature of purchase.
- The selection of method of accounting for amalgamation (pooling of interests or purchase method) is to be judged after considering the intentions of the both the companies.
- If genuine pooling of all assets, liabilities, shareholders' interest is intended; separate businesses of both the companies are continued and their amalgamation scheme satisfies all the conditions necessary for merger as specified in AS-14 Accounting for Amalgamations, pooling of interests method is adopted.
- If B Ltd. or A Ltd. wants to acquire the other company, then purchase method needs to be adopted. In that case, the shareholders of the acquired company don't continue to have proportional share in equity of the combined company and the business of the acquired company is not intended to be continued.
- The object of the purchase method is to account for the amalgamation by applying the same principles as are applied in the normal purchase of assets.
- Thus choice of accounting method depends on the fact whether B Ltd. wants to continue its business or not.

—— Space to write important points for revision ——

Q.5.2	2016 - May [7] (a)	Practical

Answer the followings:

Anjana Ltd., is absorbed by Sanjana Ltd., the consideration being the takeover of liabilities, the payment of cost of absorption not exceeding ₹ 10,000 (actual cost ₹ 9,000) the payment of the 9% debentures of ₹ 50,000 at a premium of 20% in 8% debentures issued at a premium of 25% at face value and the payment of ₹ 15 per share in cash and allotment of three 11% preference share of ₹ 10 each at a discount of 10% and four equity share of ₹ 10 each at a premium of 20% fully paid for every five shares in Anjana Ltd. The number of share of the vendor company are 1,50,000 of ₹ 10 each fully paid.

Calculate purchase consideration as per Accounting Standard – 14.

(4 marks) *[IPCC Gr. I]*

Answer :

Calculation of Purchase Consideration:

As per AS - 14

Amount to be paid in	
Cash (1,50,000 × ₹ 15)	₹ 22,50,000
equity shares	
4 : 5 @ ₹ 10 + 20% premium	
∴ $\frac{1,50,000}{5} \times 4 \times 12$	₹ 14,40,000
Preference shares	
3 : 5 @ ₹ 9	
∴ $\frac{1,50,000}{5} \times 3 \times 9$	₹ 8,10,000
Total purchase consideration	₹ **45,00,000**

Note:

Amount paid to debenture holders will not be included in calculation of purchase consideration.

Space to write important points for revision

Q.5.3	2018 - Nov [1] {C} (b)	Practical

On 1st April, 2018, Tina Ltd. take over the business of Rina Ltd. and discharged purchase consideration as follows :

(i) Issued 50,000 fully paid Equity shares of ₹ 10 each at a premium of ₹ 5 per share to the equity shareholders of Rina Ltd.

(ii) Cash, payment of ₹ 50,000 was made to equity shareholders of Rina Ltd.

(iii) Issued 2,000 fully paid 12% Preference shares of ₹ 100 each at par to discharge the preference shareholders of Rina Ltd.

(iv) Debentures of Rina Ltd. (₹ 1,20,000) will be converted into equal number and amount of 10% debentures of Tina Ltd.

Calculate the amount of Purchase consideration as per AS-14 and pass Journal Entry relating to discharge of purchase consideration in the books of Tina Ltd. (5 marks)

Answer:

Calculation of Purchase Consideration:

Particulars	**(₹)**
Equity Shares (50,000 equity shares of ₹ 10 each at a premium of ₹ 5 per share) (50,000 shares × ₹ 15)	7,50,000
Cash payment to Equity Shareholders	50,000
12% Preference share capital (2,000 × 100)	2,00,000
Purchase Consideration	10,00,000

Note: As per AS 14, consideration for the amalgamation means the aggregate of the shares and other securities issued and the amount of the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. Thus, payment to debenture holders are not covered by the term 'consideration'.

Journal Entry in the books of Tina Ltd.

Particulars	Dr. (₹)	Cr. (₹)
Liquidators of Rina Ltd. A/c Dr.	10,00,000	
To Equity Share Capital A/c		5,00,000
To Securities Premium A/c		2,50,000
To Cash A/c		50,000
To 12% Preference Share Capital A/c		2,00,000
(Being discharge of Purchase Consideration)		

Space to write important points for revision

Q.5.4	2021 - Jan [6] (b)	Descriptive

Answer the following:
List the conditions to be fulfilled as per AS-14 (Revised) for an amalgamation to be in the nature of merger. (5 marks)

Answer:

Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

Space to write important points for revision

6 *AS - 17 Segment Reporting*

Q.6.1	2008 - Nov [1] {C} (b)	Practical

M/s XYZ Ltd. has three segments namely X, Y, Z. The total Assets of the Company are ₹ 10.00 crs. segment X has ₹ 2.00 crs., segment Y has ₹ 3.00 crs. and segment Z has ₹ 5.00 crs. deferred tax Assets included in the Assets of each segments are X-₹ 0.50 crs., Y-₹ 0.40 crs. and Z-₹ 0.30 crs. The accountant contends that all the three segments are reportable segments. Comment. (5 marks) *[CA Final - I]*

Answer :

As per AS 17 "Segment Reporting", segment assets do not include income tax assets. Therefore, the revised total assets are 8.8 crores (10 crores - (0.5+0. 4+0.3). Segment X holds total assets of 1.5 crores (2 crores - 0.5 crores); Segment Y holds 2.6 crores (3 crores - 0.4 crores); and Segment Z holds 4.7 crores (5 crores - 0.3 crores). Thus, all segments are reportable segments. As all the three segments hold more than 10% of the total assets.

Space to write important points for revision

Q.6.2	2014 - Nov [1] {C} (b)	Practical

ABC Limited has three segments viz. A, B and C. The total assets of the company is ₹ 15 Crores. The assets of Segment A is 1.85 Crores, Segment B is 6.15 Crores and Segment C is ₹ 7.00 Crores. Assets of each segment include deferred tax assets of ₹ 0.50 Crores in A, ₹ 0.40 Crores in B and ₹ 0.30 Crores in C. The accountant of ABC Limited contends that all segments are reportable segments. Based on segment assets criteria, determine the veracity of the contention of the accountant.

(5 marks) *[CA Final -I]*

Answer:

Statement showing percentage of Segment net assets to Total assets of the company

₹ in crores

Particulars	Segments			Total
	A	B	C	
Segment assets	1.85	6.15	7.00	15.00
Less: Deferred tax assets	(0.50)	(0.40)	(0.30)	(1.20)
Net segment assets	1.35	5.75	6.70	13.80
Percentage to total net segment assets	9.78%	41.67%	48.55%	100%

As per AS 17 'Segment Reporting', one of the basis of segment asset criteria for identification of a business segment or geographical segment as a reportable segment is when its segment assets are 10% or more of the total assets of all segments. Accordingly, the reportable segments will be segments B and C only. Therefore, the contention of the accountant that all the segments are reportable segments is not tenable.

—— Space to write important points for revision ——

Q.6.3	2018 - May [6] (d)	Practical

Answer the following:

M/s Nathan Limited has three segments namely P, Q and R. The total assets of the company are ₹ 15 crores. Segment P has 4 crores, Segment Q has 6 crores and Segment R has 5 crores. Deferred tax assets included in the assets of each segments are P – ₹ 1 crore, Q - ₹ 0.90 crores and R - ₹ 0.80 crores. The accountant contends that all these three segments are reportable segments. Comment. (5 marks) *[CA Inter Gr. I]*

Answer:

According to AS 17 "Segment Reporting", segment assets do not include income tax assets.

Therefore the revised total assets are ₹ 12.3 crore [₹ 15 crores - (₹ 1 crore + ₹ 0.90 crore + ₹ 0.80 crore)].

Segment P holds total assets of ₹ 3 crores (₹ 4 crores - ₹ 1 crore);

Segment Q holds ₹ 5.1 crores (₹ 6 crores - ₹ 0.90 crores); and
Segment R holds ₹ 4.2 crores (₹ 5 crores - ₹ 0.80 crores).
Thus all the three segments hold more than 10% of the total assets, all Segments are reportable Segments.

—— Space to write important points for revision ——

Q.6.4	2020 - Nov [1] {C} (c)	Practical

Answer the following:
The accountant of Parag Limited has furnished you with the following data related to its Business Divisions:

(₹ in Lacs)

Division	A	B	C	D	Total
Segment Revenue	100	300	200	400	1000
Segment Result	45	-70	80	-10	45
Segment Assets	39	51	48	12	150

You are requested to identify the reportable segments in accordance with the criteria laid down in AS 17. (5 marks)

Answer:

As per AS 17, "Segment Reporting", Identification of whether Segment Reportable or not, is as follows: **(₹ in lakhs)**

	A	B	C	D	Total
1. Segment Revenue	100	300	200	400	1,000
2. % of Segment Revenue	10%	30%	20%	40%	100 %
3. Segment Result: Profit/Loss)	45	(70)	80	(10)	125 (80)
4. % of Segment Result, Absolute amount of Profit/Loss whether/ whichever is higher i.e. as a % of 125	36%	56%	64%	8%	

5. Segment Assets	39	51	48	12	150
6. % of Segment Assets	26%	34%	32%	8%	100%
7. Reportable Segment	yes	yes	yes	yes	
8. Criteria Satisfied	Revenue Result and Assets	Revenue Result and Assets	Revenue Result and Assets	Revenue	

On the basis of revenue criteria, segments A,B,C and D- all are reportable segments.

On the basis of the result criteria, segments A, B and C are reportable segments (since their results in absolute amount is 10% or more of 125 Lakhs).

On the basis of asset criteria, all segments except D are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reported upon in accordance with Accounting Standard (AS) 17.

—— Space to write important points for revision ——

Q.6.5	**2021 - Jan [1] {C} (c)**	**Practical**

The Senior Accountant of AMF Ltd. gives the following data regarding its five segments:

(₹ in lakhs)

Particulars	**P (₹)**	**Q (₹)**	**R (₹)**	**S (₹)**	**T (₹)**	**Total (₹)**
Segment Assets	80	30	20	20	10	160
Segment Results	(190)	10	10	(10)	30	(150)
Segment Revenue	620	80	60	80	60	900

The Senior Accountant is of the opinion that segment "P" alone should be reported. Is he justified in his view? Examine his opinion in the light of provision of AS-17 'Segment Reporting'. (5 marks)

Answer:

According to AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

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

(ii) **Its segment result whether profit or loss is 10% or more of:**
  1. The combined result of all segments in profit; or
  2. The combined result of all segments in loss, whichever is greater in absolute amount; or

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

Thus,

(a) On the basis of revenue from sales criteria, segment P is a reportable segment.

(b) On the basis of the result criteria, segments P & T are reportable segments (since their results in absolute amount is 10% or more of ₹ 200 Lakhs).

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

Since all the segments are covered in at least one of the above criteria, all segments have to be reported upon in accordance with AS 17. Hence, the opinion of chief accountant that only segment 'P' is reportable is wrong.

—— Space to write important points for revision ——

Q.6.6	RTP	Practical

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

Particulars	A (₹ in Lakhs)	B (₹ in Lakhs)	Particulars	(₹ in Lakhs)
Segment Revenue	27,050	3,280	Dividend Income	285
Inter Segment Revenue	50	–	Interest Expenses	35
Segment Profit	4,640	Loss 197	Tax Provision	1,675
Capital Expenditure	1,300	16		
Non-Cash Expenses (exct. Depreciation)	114	16		
Segment Liabilities	3,430	770	Other Liabilities	2,200
Segment Assets	19,450	2,700	Other Assets	6,550
Depreciation on Assets	110	15		
				[CA Inter Gr. I]

Answer:

Particulars	A (₹ in Lakhs)	B (₹ in Lakhs)	Total (₹ in Lakhs)
I. **Segment Revenue**	27,050	3,280	30,330
Inter Segment Revenue	50	–	50
Sub-Total	27,100	3,280	30,380
Less: Inter Segment Revenue			(50)
Total			**30,330**
II. **Segment Result**	4,640	(197)	4,443
Interest Expenses			(35)
Dividend Income			285
Tax Provision			(1,675)
Profit after Tax			**3,018**
III. **Other Information**			
(a) **Segment Assets**	19,150	2,700	22,150
Unallocated Assets			6,550

(b)	**Segment Liabilities**	3,430	770	4,200
	Unallocated Liabilities			6,400
(c)	**Capital Expenditure**	1,300	16	1,316
(d)	**Depreciation**	110	75	185
	Non Cash Expenses	114	16	130

Space to write important points for revision

Q.6.7	RTP	Practical

The Chief Accountant of Govind Ltd. gives the following data regarding its six segments: (₹ in Lakhs)

Particulars	A	B	C	D	E	F	Total
Segment Assets	40	80	30	20	20	10	200
Segments Results	50	-190	10	10	-10	30	-100
Segment Revenue	300	620	80	60	80	60	1200

The Chief Accountant is of the opinion that Segment 'M' and 'N' alone should be reported. Is he justified in his view? Discuss. *[CA Inter Gr. I]*

Answer:

Particulars (₹ in Lakhs)	A	B	C	D	E	F	Total
1. Segment Revenue	300	620	80	60	80	60	1,200
2. Percentage of Segment Revenue	25%	52%	7%	5%	6%	5%	100%
3. Segment Result:Profit (Loss)	50	 (190)	10	10	 (10)	30	100 (200)
4. Percentage of Segment Result, absolute amount of Profit or Loss, whichever is higher i.e. percentage of Loss of 200	25%	95%	5%	5%	5%	15%	100%
5. Segment Assets	40	80	30	20	20	10	200
6. Percentage of Segment Assets	20%	40%	15%	10%	10%	5%	100%

7. Reportable Segment	YES	YES	YES	YES	YES	YES	
8. Criteria satisfied	S, R, A	S, R, A	A	A	A	R	

Note: S = Sales Condition, R = Result Condition, A = Assets Condition
Conclusion: Therefore, the Reportable Segments are M, N, O, P, Q and R, i.e. all the given segments.

—— Space to write important points for revision ——

Q.6.8	**RTP**	**Practical**

Calculate the segment results of a manufacturing organization from the following information:

Segments	**A**	**B**	**C**	**Total**
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5 : 4 : 2 basis)				1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in 5 : 4 : 2 basis)				77,000
Expenses on transactions with other segments				
Transaction from B	75,000		30,000	
Transaction from C	6,000	40,000		
Transaction from A		18,000	82,000	

Answer:

Calculation of Segment result

Segments	A	B	C	Total
	₹	₹	₹	₹
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5 : 4 : 2 basis)	50,000	40,000	20,000	1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Total segment revenue as per AS 17 (A)	6,60,000	4,15,000	2,70,000	13,45,000
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in 5 : 4 : 2 basis)	35,000	28,000	14,000	77,000
Expenses on transactions with other segments				
Transaction from B	75,000		30,000	1,05,000
Transaction from C	6,000	40,000		46,000
Transaction from A		18,000	82,000	1,00,000
Total segment expenses as per AS 17 (B)	4,16,000	2,36,000	2,01,000	8,53,000
Segment result (A-B)	2,44,000	1,79,000	69,000	4,92,000

Space to write important points for revision

7 AS - 18 Related Party Disclosures

Q.7.1	2007 - Nov [5] (b), 2012 - Nov [7] (b)	Practical

P Ltd. has 60% voting right in Q Ltd. Q Ltd. has 20% voting right in R Ltd. Also, P Ltd. directly enjoys voting right of 14% in R Ltd. R Ltd. is a listed company and regularly supplies goods to P. Ltd. The management of R Ltd. has not disclosed its relationship with P Ltd.
How would you assess the situation from the viewpoint of AS-18 on Related Party Disclosures? (4 marks) *[CA Final Gr. I]*

Answer :

- P Ltd. has direct economic interest in R Ltd. to the extent of 14%, and through Q Ltd. (in which it is the majority shareholders) it has further control of 12% in R Ltd. (60% of Q Ltd.'s 20%). These two taken together (14% + 12%) make the total control of 26%.
- AS 18 'Related Party Disclosures', defines related party as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other party in making financial and / or operating decisions.
- Since, P Ltd. has total control of 26% (directly and indirectly by Q Ltd.) in R Ltd. which is less than half of the voting power of R Ltd., P Ltd. is said to have significant influence over R Ltd. Also it is given in the question that R Ltd. is a listed company and regularly supplies goods to P Ltd.
- Hence, related party disclosure, as per AS-18, is required by R Ltd. in its financial statements, in respect of goods supplied to P Ltd.

Space to write important points for revision

Q.7.2	2018 - Nov [1] {C} (c)	Practical

Following transactions are disclosed as on 31st March, 2018 :

(i) Mr. Sumit, a relative of Managing Director, received remuneration of ₹ 2,10,000 for his services in the company for the period from 1st

April, 2017 to 30th June, 2017. He left the service on 1st July, 2017. Should the relative be identified as on closing date i.e. on 31-3-2018 for the purpose of AS-18.

(ii) Goods sold amounting to ₹ 50 lakhs to associate company during the 1st quarter ended on 30th June, 2017. After that related party relationship ceased to exist. However, goods were supplied as was supplied to any other ordinary customer.

Decide whether transactions of the entire year have to be disclosed as related party transactions. (5 marks)

Answer:

(i) **According to AS 18 on 'Related Party Disclosures',** parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and /or operating decisions. Hence, Mr. Sumit, a relative of key management personnel should be identified as relative as at the closing date i.e on 31.03.2018.

(ii) **As per AS 18, 'Related Party Disclosures',** transactions of the company with its associate company for the first quarter ending on 30.06.2017 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did not exist need not be reported.

Space to write important points for revision

Q.7.3	2019 - May [1] {C} (d)	Practical

Identify the related parties in the following cases as per AS-18

(i) Maya Ltd. holds 61% shares of Sheetal Ltd.
Sheetal Ltd. holds 51% shares of Fair Ltd.
Care Ltd. holds 49% shares of Fair Ltd.
(Give your answer Reporting Entity wise for Maya Ltd., Sheetal Ltd., Care Ltd. and Fair Ltd.)

(ii) Mr. Subhash Kumar is Managing Director of A Ltd. and also holds 72% capital of B Ltd. (B Ltd. is subsidiary of A Ltd.) (5 marks)

Answer:

(i) **Reporting entity-Maya Ltd.**

- Sheetal Ltd. (Subsidiary) is a related party.
- Fair Ltd. (Subsidiary) is a related party.

Reporting Entity-Sheetal Ltd.

- Maya Ltd. (holding company) is a related party.
- Fair Ltd. (subsidiary) is a related party.

Reporting Entity-Fair Ltd.

- Maya Ltd. (holding company) is a related party.
- Sheetal Ltd. (holding company) is a related party.
- Care Ltd. (investor/investing party) is a related party.

Reporting Entity-Care Ltd.

- Fair Ltd. (associate) is a related party.

(ii) **Reporting Entity-A Ltd.**

- Mr. Subhash Kumar (Managing Director) is a related party.
- B Ltd. (subsidiary) is a related party.

Reporting Entity - B Ltd.

- Mr. Subhash Kumar (investor) is a related party.
- A Ltd. (holding company) is a related party.

Space to write important points for revision

Q.7.4	2021 - July [1] {C} (d)	Practical

(i) Khushi Limited enter into an agreement with Mr. Happy for running a business for a fixed amount payable to the later every year. The contract states that the day-to-day management of the business will be handled by Mr. Happy, while all financial and operating policy decisions are taken by the Board of Directors of the Company. Mr. Happy does not own any voting power in Khushi Limited.

(ii) Shri Bhanu a relative of key management personnel received remuneration of ₹ 3,50,000 for his services in the company for the period from 1st April, 2020 to 30th June, 2020. On 1st July, 2020, he left the service.

You are required to suggest how the above transactions will be treated as at the closing date i.e. on 31st March, 2021 for the purposes of AS 18-Related Party Disclosures. (5 marks)

Q.7.5	RTP	Practical

Sun Ltd. sold goods for ₹ 50 lakhs to Moon Ltd. during financial year ended 31st March 2017 at normal selling price followed by Sun Ltd. The Managing Director of Sun Ltd. holds 75% shares of Moon Ltd. The Chief accountant of Sun Ltd. contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. You are required to examine and advise whether the contention of the Chief Accountant correct?

Answer:

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

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

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

—— Space to write important points for revision ——

8 AS - 19 Leases

Q.8.1	2010 - May [6] (c)	Practical

B & P Ltd. availed a lease from N & L Ltd. The conditions of the lease terms are as under:

(i) Lease period is 3 years, in the beginning of the year 2009, for equipment costing ₹ 10,00,000 and has an expected useful life of 5 year

(ii) The Fair market value is also ₹ 10,00,000.
(iii) The property reverts back to the lessor on termination of the lease.
(iv) The unguaranteed value is estimated at ₹ 1,00,000 at the end of the year 2011.
(v) 3 equal annual payments are made at the end of each year.
Consider IRR = 10%

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

The present value of annuity of ₹ 1 due at the end of 3rd year at 10% IRR is ₹ 2.4868.

State whether the lease constitute finance lease and also calculate unearned Finance income. (4 marks)

Answer :

(i) **Computation of annual lease payment to the lessor**

Particulars	₹
Cost of equipment	10,00,000
Unguaranteed residual value	1,00,000
Present value of residual value after third year @ 10% (₹1,00,000 × 0.7513)	75,130
Fair value to be recovered from lease payments (₹ 10,00,000 – ₹ 75,130)	9,24,870
Present value of annuity for three years is 2.4868	
Annual lease payment = ₹ 9,24,870/2.4868	3,71,911.70

The present value of lease payment i.e. ₹ 9,24,870 equals 92.48% of the fair market value i.e., 10,00,000. As the present value of minimum lease payments substantially covers the initial fair value of the leased asset and lease term (i.e.3 years) covers the major part of the life of asset (i.e. 5 years). Therefore, it constitutes a finance lease.

(ii) **Computation of Unearned Finance Income**

Particulars	₹
Total lease payments (₹ 3,71,911.70 × 3)	11,15,735
Add : Unguaranteed residual value	1,00,000
Gross investment in the lease	12,15,735
Less : Present value of investment (lease payments and residual value) (₹ 75,130 + ₹ 9,24,870)	(10,00,000)
Unearned finance income	2,15,735

Space to write important points for revision

Q.8.2	2011 - May [6] (a)	Practical

Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being ₹ 7,00,000. The economic life of machine as well as the lease term is 3 years. At the end of each year Lessee Ltd. pays ₹ 3,00,000. The Lessee has guaranteed a residual value of ₹ 22,000 on expiry of the lease to the Lessor. However Lessor Ltd., estimates that the residual value of the machinery will be only ₹ 15,000. The implicit rate of return is 15% p.a. and present value factors at 15% are 0.869, 0.756 and 0.657 at the end of first, second and third years respectively.

Calculate the value of machinery to be considered by Lessee Ltd. and the finance charges in each year. (8 marks)

Answer :

Provision:

According to AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

Value of machinery:

In the given question, fair value of the machinery is ₹ 7,00,000 and the net present value of minimum lease payments is ₹ 6,99,054 (Note 1). As the present value of the machine is less than the fair value of the machine, the machine will be recorded at value of ₹ 6,99,054.

Computation of finance charges for each year

Year	Finance charge ₹	Payment ₹	Reduction in outstanding liability ₹	Outstanding liability ₹
1st year beginning	—	—	—	6,99,054
End of 1st year	1,04,858	3,00,000	1,95,142	5,03,912
End of 2nd year	75,587	3,00,000	2,24,413	2,79,499
End of 3rd year	41,925	3,00,000	2,58,075	21,424 **(Note 2)**

Note 1 : *Present value of minimum lease payments :

Annual lease rental x PV factor + Present value of guaranteed residual value

= ₹ 3,00,000 x (0.869 + 0.756 + 0.657) + ₹ 22,000 x (0.657)

= ₹ 6,84,600 + ₹ 14,454 = ₹ 6,99,054.

Note 2 : The difference between this figure and guaranteed residual value (₹ 22,000) is due to approximation in computing the interest rate implicit in the lease.

—— Space to write important points for revision ——

Q.8.3	2011 - Nov [1] {C} (b), RTP	Practical

Answer the following:

An equipment having expected useful life of 5 years, is leased for 3 years. Both the cost and the fair value of the equipment are ₹ 6,00,000. The amount will be paid in 3 equal instalments and at the termination of lease, lessor will get back the equipment. The unguaranteed residual value at the end of 3 years is ₹ 60,000. The IRR of the investment is 10%. The present value of annuity factor of ₹ 1 due at the end of 3rd year at 10% IRR is 2.4868. The present value of ₹ 1 due at the end of 3rd year at 10% rate of interest is 0.7513. State with reason whether the lease constitutes finance lease and also compute the unearned finance income. (5 marks)

Answer :

(i) **Determination of Nature of Lease:**

Present value of residual value at the end of 3rd year= ₹ 60,000 × 0.7513 = ₹ 45,078

Present value of lease payments= ₹ 6,00,000 – ₹ 45,078 = ₹ 5,54,922

The percentage of present value of lease payments to fair value of the equipment is (₹ 5,54,922 / ₹ 6,00,000) × 100 = 92.487%

Since, it substantially covers the major portion of the lease payments, the lease constitutes a finance lease.

Assumption:

It is assumed that the fair value of the leased equipments is equal to the present value of minimum lease payments.

(ii) **Calculation of Unearned Finance Income:**

Annual lease payment = ₹ 5,54,922 / 2.4868 = ₹ 2,23,147 (approx)

Gross investment in the lease = Total minimum lease payment + unguaranteed residual value

= (₹ 2,23,147 × 3) + ₹ 60,000 = ₹ 6,69,441 + ₹ 60,000 = ₹ 7,29,441

Unearned finance income = Gross investment – Present value of minimum lease payments and unguaranteed residual value

= ₹ 7,29,441 – ₹ 6,00,000 = ₹ 1,29,441

Space to write important points for revision

Q.8.4	2012 - May [7] (d)	Practical

Answer the following:

X Ltd. sold JCB Machine having WDV of ₹ 50 Lakhs to Y Ltd. for ₹ 60 Lakhs and the same JCB was leased back by Y Ltd. to X Ltd. The lease is operating lease.

Comment according to relevant Accounting Standard if

(i) Sale price of ₹ 60 Lakhs is equal to fair value.

(ii) Fair value is ₹ 50 Lakhs and sale price is ₹ 45 Lakhs.

(iii) Fair value is ₹ 55 Lakhs and sale price is ₹ 62 Lakhs.

(iv) Fair value is ₹ 45 Lakhs and sale price is ₹ 48 Lakhs. (4 marks)

Answer:

According to AS 19, following will be the treatment in the given situations:

(i) If the sales price of ₹ 60 lakhs is equal to fair value, X Ltd. should immediately recognize the profit of ₹ 10 lakhs (i.e. 60 - 50) in its books.

(ii) If the fair value of leased JCB machine is ₹ 50 lakhs & sales price is ₹ 45 lakhs, then loss of ₹ 5 lakhs (50 - 45) to be immediately recognized by X Ltd. in its books provided loss is not compensated by future lease payments.

(iii) If the fair value is ₹ 55 lakhs & sales price is ₹ 62 lakhs, profit of ₹ 5 lakhs (55 - 50) to be immediately recognized by X Ltd. in its books and balance profit of ₹ 7 lakhs (62 - 55) is to be amortised/deferred over lease period.

(iv) If the fair value is ₹ 45 lakhs & sales price is ₹ 48 lakhs, then the loss of ₹ 5 lakhs (50-45) to be immediately recognized by X Ltd. in its books and profit of ₹ 3 lakhs (48 - 45) should be amortised/deferred over lease period.

Space to write important points for revision

Q.8.5	**2012 - Nov [3] (b)**	**Descriptive**
Define the term Finance Lease. State any three situations when a lease would be classified as finance lease. (4 marks)		

Answer :

As per AS-19 'Leases', a finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset.

As per para 8 of the standard, classification of lease into a finance lease or an operating lease depends on the substance of the transaction rather than its form. Three situations which would normally lead to a lease being classified as a finance lease are:

(i) The lessor transfers ownership of the asset to the lessee by the end of the lease term;

(ii) The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;

(iii) The lease term is for the major part of the economic life of the asset even if title is not transferred.

Other situations when a lease would be classified as finance lease

(i) At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased as set; and

(ii) the leased asset is of a specialised nature such that only the lessee can use it without major modifications being made.
Situations which individually or in combination could also lead to a lease being classified as a finance lease are:

(iii) If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee,

(iv) gains or losses from the fluctuation in the fair value of the residual fall to the lessee, and

(v) the lessee can continue the lease for a secondary period at a rent which is substantially lower than market rent.

—— Space to write important points for revision ——

Q.8.6	2012 - Nov [7] (a)	Practical

Answer the following :
Annual lease rent = ₹ 40,000 at the end of each year
Lease period = 5 years
Guaranteed residual value = ₹ 14,000
Fair value at the inception (beginning) of lease = ₹ 1,50,000
Interest rate implicit on lease is 12.6%. The present value factors at 12.6% are 0.89, 0.79, 0.7, 0.622, 0.552 at the end of first, second, third, fourth and fifth year respectively.
Show the Journal entry to record the asset taken on finance lease in the books of the lessee. (4 marks)

Answer :

In the books of Lessee
Journal entry

Particulars		₹	₹
Asset A/c To Lessor (Being recognition of finance lease as an asset and a liability)	Dr.	1,49,888	1,49,888

Working Notes:

Year	Lease Payments ₹	Discounting Factor (12.6%)	Present Value ₹
1	40,000	0.89	35,600
2	40,000	0.79	31,600
3	40,000	0.70	28,000
4	40,000	0.622	24,880
5	40,000	0.552	22,080
5	14,000 (GRV)	0.552	7,728
			1,49,888

—— Space to write important points for revision ——

Q.8.7	2013 - Nov [7] (a)	Practical

Answer the following:
Classify the following into either operating or finance lease :

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

(ii) Economic life of the asset is 7 years, lease term is 6 years, but asset is not acquired at the end of the lease term;

(iii) Economic life of the asset is 6 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee;

(iv) Present value (PV) of Minimum lease payment (MLP) = "X". Fair value of the asset is "Y". (4 marks)

Answer :

(i) Finance lease if it becomes certain at the inception of lease itself that the option will be exercised.

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

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

(iv) Where X = 4, or where X substantially equals 4, it is a finance lease.

Space to write important points for revision

Q.8.8	2014 - May [1] {C} (c)	Practical

Answer the following:
What do you understand by the term “Interest rate implicit on lease”?
Calculate the interest rate implicit on lease from the following details:

Annual Lease Rent	: ₹ 80,000 at the end of each year
Lease Period	: 5 Years
Guaranteed Residual Value	: ₹ 40,000
Unguaranteed Residual Value	: ₹ 24,000
Fair Value at the inception of the lease	: ₹ 3,20,000

Discounted rates for the first 5 years are as below:

At 10%	0.909,	0.826,	0.751,	0.683,	0.621,
At 14%	0.877,	0.769,	0.675,	0.592,	0.519,

(5 marks)

Answer :

According to AS- 19 ‘Leases’ the interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of:

(a) the minimum lease payments under a finance lease from the standpoint of the lessor; and

(b) any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.

Present value at discount rate of 10%

Year	Lease Payments (₹)	Disc. Factor(10%)	Present Value (₹)
1	80,000	0.909	72,720
2	80,000	0.826	66,080
3	80,000	0.751	60,080
4	80,000	0.683	54,640
5	80,000	0.621	49,680
5	40,000	0.621	24,840
5	24,000	0.621	14,904
	Total		**3,42,944**

Present value at discount rate of 14%

Year	Lease Payments (₹)	Disc. Factor(14%)	Present Value (₹)
1	80,000	0.877	70,160
2	80,000	0.769	61,520
3	80,000	0.675	54,000
4	80,000	0.592	47,360
5	80,000	0.519	41,520
5	40,000	0.519	20,760
5	24,000	0.519	12,456
	Total		**3,07,776**

Interest Rate Implicit on Lease $= 10\% + \frac{14\% - 10\%}{3{,}42{,}944 - 3{,}07{,}776} \times (3{,}42{,}944 - 3{,}20{,}000) = 10\% + 2.609\% = 12.609\%$ or say 12.61%

Space to write important points for revision

Q.8.9	2014 - Nov [1] {C} (a)	Practical

Answer the following:
A machine having expected useful life of 6 years, is leased for 4 years. Both the cost and the fair value of the machinery are ₹ 7,00,000. The amount will be paid in 4 equal instalments and at the termination of lease, lessor will get back the machinery. The unguaranteed residual value at the end of the 4^{th} year is ₹ 70,000. The IRR of the investment is 10%. The present value of annuity factor of ₹ 1 due at the end of 4^{th} year at 10% IRR is 3.169. The present value of ₹ 1 due at the end of 4^{th} year at 10% rate of interest is 0.683.
State with reasons whether the lease constitutes finance lease and also compute the unearned finance income. (5 marks)

Answer :

(i) The lease term is 66.67% of asset's useful life. Also present value of lease payments is around 93% of the fair value, constituting substantial portion of the fair value.

Therefore, the lease is a finance lease on the basis of calculation below:

(a) **Present value of Unguaranteed Residual Value (UGRV):**
$= 70{,}000 \times 0.683 =$ ₹ 47,810

(b) **Present value of Lease Payments (PV of MLP):**
$= 7{,}00{,}000 - 47{,}810 =$ ₹ 6,52,190

(c) **% of PV of MLP to fair value:**
$$= \frac{6{,}52{,}190}{7{,}00{,}000} \times 100 = 93.17\%$$

Since it substantially covers the major portion of lease payment and life of the asset, the lease constitutes a financial lease.

(ii) **Computation of Unearned Finance Income:**

Annual Lease Payments = $\frac{\text{PV of Lease Payments}}{\text{Annuity factor for 3 years at 20\%}}$

= $\frac{6,52,190}{3.169}$ = ₹ 2,05,803 p.a.

		₹
Total lease rentals for the lease period		
= 2,05,803 p.a.× 4 years	=	8,23,212
+ Residual value	=	70,000
Gross investment in lease	=	8,93,212
(-) P.V. of MLP & UGRV = (6,52,190 + 47,810)	=	(7,00,000)
Unearned Finance Income	=	1,93,212

—— Space to write important points for revision ——

Q.8.10	2015 - May [7] (d)	Descriptive
Answer the following: State any four situations when a lease would be classified as Finance Lease. (4 marks)		

Answer :

Situation when a lease would be classified as finance lease:

Finance Lease is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership.

As per AS-19, in following situations, the lease transactions would be classified as Finance lease:

1. When there is transfer of ownership in finance lease of the asset to the lessee by the end of the lease term.
2. When option to purchase the asset is available to the lessee, at a price which is sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised.
3. When lease term is for the major part of the economic life of the asset even if title is not transferred.

4. When present value of minimum lease payment at the inception of the lease amounts to atleast substantially all of fair value of leased asset (i.e. PV of MLP = Fair value approx.)

Space to write important points for revision

Q.8.11	2015 - Nov [1] {C} (b)	Practical

Answer the following:

Aksat International Limited has given a machinery on lease for 36 months and its useful life is 60 months. Cost and fair market value of the machinery is ₹ 5,00,000. The amount will be paid in 3 equal annual installments and the lessee will return the machinery to lessor at termination of lease. The unguaranteed residual value at the end of 3 years is ₹ 50,000. IRR of investment is 10% and present value of annuity factor of ₹ 1 due at the end of 3 years at 10% IRR is 2.4868 and present value of ₹ 1 due at the end of 3^{rd} year at 10% IRR is 0.7513.

You are required to comment with reason whether the lease constitute finance lease or operating lease. If it is finance lease, calculate unearned finance income. (5 marks)

Answer :

Determination of Nature of Lease

Present value of unguaranteed residual value at the end of 3^{rd} year

= ₹ 50,000 x 0.7513

= ₹ 37,565

Present value of lease payments = ₹ 5,00,000 – ₹ 37,565

= ₹ 4,62,435

The percentage of present value of lease payments to fair value of the equipment is (₹ 4,62,435/ ₹ 5,00,000) x 100 = 92.487%.

Since, lease payments substantially covers the major portion of the fair value; the lease constitutes a finance lease.

Calculation of Unearned Finance Income

Annual lease payment = ₹ 4,62,435/ 2.4868 = ₹ 1,85,956 (approx.)

Gross investment in the lease = Total minimum lease payments + unguaranteed residual value
= (₹ 1,85,956 × 3) + ₹ 50,000
= ₹ 5,57,868 + ₹ 50,000
= ₹ 6,07,868

Unearned finance income = Gross investment - Present value of minimum lease payments and unguaranteed residual value
= ₹ 6,07,868 – ₹ 5,00,000
= ₹ 1,07,868

—— Space to write important points for revision ——

Q.8.12	2018 - May [1] {C} (d)	Practical

A Ltd. sold JCB having WDV of ₹ 20 lakhs to B Ltd. for ₹ 24 lakhs and the same JCB was leased back by B Ltd. to A Ltd. The lease is operating lease. In context of Accounting Standard 19 "Leases" explain the accounting treatment of profit or loss in the books of A Ltd. if

(i) Sale price of ₹ 24 lakhs is equal to fair value.
(ii) Fair value is ₹ 20 lakhs and sale price is ₹ 24 lakhs
(iii) Fair value is ₹ 22 lakhs and sale price is ₹ 25 lakhs.
(iv) Fair value is ₹ 25 lakhs and sale price is ₹ 18 lakhs
(v) Fair value is ₹ 18 lakhs and sale price is ₹ 19 lakhs. (5 marks)

Answer:

Following will be the treatment in the given cases:

(i) When sales price of ₹ 24 lakhs is equal to fair value, A Ltd. should immediately recognise the profit of ₹ 4 lakhs (i.e. 24-20) in its books.
(ii) When fair value is ₹ 20 lakhs and sales price is ₹ 24 lakhs then, profit of ₹ 4 lakhs is to be deferred and amortised over the lease period.
(iii) When fair value is ₹ 22 lakhs and sales price is ₹ 25 lakhs, profit of ₹ 2 lakhs (22-20) to be immediately recognised in its books and balance profit of ₹ 3 lakhs (25-22) is to be amorised / deferred over lease period.

(iv) When fair value of leased machinery is ₹ 25 lakhs and sales price is ₹ 18 lakhs, then the loss of ₹ 2 lakhs (20-18) to be immediately recognised by A Ltd. in its books provided loss is not compensated by future lease payment.

(v) When fair value is ₹ 18 lakhs and sales price is ₹ 19 lakhs, then the loss of ₹ 2 lakhs (20-18) to be immediately recognised by A Ltd. in its books and profit of ₹ 1 lakh (19-18) should be amortised /deferred over lease period.

—— Space to write important points for revision ——

Q.8.13	**2019 - May [1] {C}** (c)	**Practical**

Jaya Ltd. took a machine on lease from Deluxe Ltd., the fair value being ₹ 11,50,000. Economic life of the machine as well as lease term is 4 years. At the end of each year, lessee pays ₹ 3,50,000 to lessor. Jaya Ltd. has guaranteed a residual value of ₹ 70,000 on expiry of the lease to Deluxe Ltd., however Deluxe Ltd. estimates that residual value will be only ₹ 25,000. The implicit rate of return is 10% p.a. and present value factors at 10% are : 0.909, 0.826, 0.751 and 0.683 at the end of 1st, 2nd, 3rd and 4th year respectively.

Calculate the value of machinery to be considered by Jaya Ltd. and the value of the lease liability as per AS-19. (5 marks)

Answer:

As per Para 11 of AS 19, "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

Value of Machinery:

In the given case, fair value of the machinery is ₹ 11,50,000 and the net present value of minimum lease payments is ₹ 11,56,960. As the fair value of machine is less than the present value of machine, the machine will be recorded at value of ₹ 11,50,000.

Present value of Minimum lease Payments =
(Annual lease rental × PV factor) + PV of guaranteed residual value.
= ₹ 3,50,000 × (0.909 + 0.826 + 0.751 + 0.683) + ₹ 70,000 × 0.683
= ₹ 11,56,960

Calculation of Value of outstanding lease liability each year:

Year	Finance Charge (₹)	Payment (₹)	Reduction in outstanding liability (₹)	Outstanding liability (₹)
1st year beginning	–	–	–	11,50,000
End of 1st Yr.	1,15,000	3,50,000	2,35,000	9,15,000
End of 2nd Yr.	91,500	3,50,000	2,58,500	6,56,500
End of 3rd Yr.	65,650	3,50,000	2,84,350	3,72,150
End of 4th Yr.	37,215	3,50,000	3,12,785	59,365*

Note:
*The difference between this figure and guaranteed residual value ₹ 70,000 is due to approximation in computing the interest rate implicit in the lease.

—— Space to write important points for revision ——

Q.8.14	2019 - Nov [6] (a)	Practical

Answer the following:

(a) X Ltd. is a group engaged in manufacture and sale of industrial and FMCG products. One of their division also deals in Leasing of properties – Mobile Towers. The accountant showed the rent arising from the leasing of such properties as other income in the Statement of Profit and Loss.
Comment whether the classification of the rent income made by the accountant is correct or not in the light of Schedule III to the Companies Act, 2013. (5 marks)

Answer:

According to para 4 of the 'General Instructions for preparation of Statement of Profit and Loss' given in the Schedule III to the Companies Act, 2013, 'other income' does not include operating income.

Again the term "Revenue from operations" has not been defined under Schedule III to the Companies Act, 2013. But as per Guidance Note on Schedule III to the Companies Act, 2013 this would include revenue arising from a company's operating activities i.e. either its principal or ancillary revenue-generating activities. Whether a particular income constitutes "Revenue from operations" or "other income" is to be decided based on the facts of each case and detailed understanding of the company's activities. The classification of income would also depend on the purpose for which the particular asset is acquired or held.

In the given case, X Ltd. is a group engaged in manufacture and sale of industrial and FMCG products and its one of the division deals in leasing of properties- Mobile Towers. Since its one division is continuously engaged in leasing of properties, it shall be considered as its principal or ancillary revenue-generating activities. Therefore, the rent arising from such leasing shall be shown under the head "Revenue from operations" and not as "Other Income".

Thus, the presentation of rent arising from the leasing of such properties as "other income" in the statement of Profit and Loss is not correct. It should be shown under the head "Revenue from operations".

Space to write important points for revision

Q.8.15	2019 - Nov [6] (e)	Practical

Answer the following:

(e) Classify the following into either operating lease or finance lease with reason:
   1. Economic life of asset is 10 years, lease term is 9 years, but asset is not acquired at the end of lease term.
   2. Lessee has option to purchase the asset at lower than fair value at the end of lease term.

3. Lease payments should be recognized as an expense in the statement of Profit and Loss of a lessee.
4. Present Value (PV) of Minimum Lease Payment (MLP) = “X”. Fair value of the asset is “Y”. And X = Y
5. Economic life of the asset is 5 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee. (5 marks)

Answer:

1. The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.
2. If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, it is a Finance Lease.
3. If lease payments is recognised as an expense in the statement of profit and loss of a lessee, then it is considered as an operating lease.
4. The lease is a finance lease if X = Y, or where X Substantially equals Y.
5. Since the asset is procured only for the use of lessee, it is a finance lease.

Space to write important points for revision

Q.8.16	2021 - Jan [6] (a)	Practical

Answer the following:

(a) X Ltd. sold machinery having WDV of ₹ 300 lakhs to Y Ltd. for ₹ 400 lakhs and the same machinery was leased back by Y Ltd. to X Ltd. The lease back arrangement is operating lease. Give your comments in the following situations:

(i) Sale price of ₹ 400 lakhs is equal to fair value.
(ii) Fair value is ₹ 450 lakhs.
(iii) Fair value is ₹ 350 lakhs and the sale price is ₹ 250 lakhs.
(iv) Fair value is ₹ 300 lakhs and sale price is ₹ 400 lakhs.
(v) Fair value is ₹ 250 lakhs and sale price is ₹ 290 lakhs.

(5 marks)

Answer:

Following will be the treatment in the given cases:

(i) When sale price of ₹ 400 lakhs is equal to fair value, X Ltd. should immediately recognise the profit of ₹ 100 lakhs (i.e. 400 – 300) in its books.

(ii) When fair value is ₹ 450 lakhs then also profit of ₹ 100 lakhs should be immediately recognised by X Ltd.

(iii) When fair value of leased machinery is ₹ 350 lakhs & sales price is ₹ 250 lakhs, then loss of ₹ 50 lakhs (300 – 250) to be immediately recognised by X Ltd. in its books provided loss is not compensated by future lease payment.

(iv) When fair value is ₹ 300 lakhs & sales price is ₹ 400 lakhs then, profit of ₹ 100 lakhs is to be deferred and amortised over the lease period.

(v) When fair value is ₹ 250 lakhs & sales price is ₹ 290 lakhs, then the loss of ₹ 50 lakhs (300 – 250) to be immediately recognised by X Ltd. in its books and profit of ₹ 40 lakhs (290 – 250) should be amortised/deferred over lease period.

Space to write important points for revision

Q.8.17	RTP	Practical

XYZ Ltd. has taken an asset on lease from ABC Ltd. for a period of 3 years. Annual Lease Rentals are ₹ 6 Lakhs payable at the end of every year. The Residual Value guaranteed by XYZ is ₹ 2 Lakhs whereas ABC expects the estimated salvage value to be ₹ 5 Lakhs at the end of the lease term. If the Fair Value of the asset at the lease inception is ₹ 15 Lakhs and the interest rate implicit in the lease is 12%, compute the Net Investment in the Lease from the viewpoint of ABC Ltd. and the annual Finance Income.

Answer:

1.	Minimum Lease Payments (MLP)	= ₹ 6 Lakhs × 3 years	= ₹ 18,00,000
2.	Guaranteed Residual Value (GRV)		₹ 2,00,000 Given
3.	MLP from the viewpoint of the Lessor (XYZ)	= MLP as above + GRV	= ₹ 20,00,000
4.	Unguaranteed Residual Value (URV)	= Total Residual Value - GRV	= ₹ 3,00,000
5.	Gross Investment in the Lease	MLP for Lessor + URV	= ₹ 23,00,000
6.	PV of MLP, GRV and URV	As per computation below	₹ 17,97,040
7.	Unearned Finance Income	(5) - (6)	₹ 5,02,960
8.	Net Investment in the Lease	(5) - (7)	₹ 17,97,040

Note: PV of Gross Investment in the Lease is computed as under:

PV of MLP = ₹ 6,00,000 × PVF at 12% for 3 years = ₹ 6,00,000 × (0.8929 + 0.7972 + 0.7118) =	₹ 14,41,140
PV of (GRV + URV) = ₹ 5,00,000 × PVF at 12% for year 3 = ₹ 5,00,000 × 0.7118 =	₹ 3,55,900
Total of the above	**₹ 17,97,040**

Recognition of Finance Income by Lessor

Year	Net Investment in the Lease = Receivable	Finance Income at 12% on NI	Total Lease Payments received from Lessee	Balance Reduction in Receivable (i.e. Principal)
(1)	(2)	(3) = (2) × 12%	(4)	(5) = (4) - (3)
1	₹ 17,97,040	₹17,97,040 × 12% = ₹ 2,15,645	₹ 6,00,000	₹ 6,00,000 - ₹ 2,15,645 = ₹ 3,84,355
2.	₹ 17,97,040 - ₹ 3,84,355 = ₹ 14,12,685	₹ 14,12,685 × 12% = ₹ 1,69,522	₹ 6,00,000	₹ 6,00,000 - ₹ 1,69,522 = ₹ 4,30,478
3.	₹ 14,12,685 - ₹ 4,30,478 = ₹ 9,82,207	₹ 9,82,207 × 12% = ₹ 1,17,865	₹ 6,00,000	₹ 6,00,000 - ₹ 1,17,865 = ₹ 4,82,135
3 (end)	₹ 9,82,207 - ₹ 4,82,135 = ₹ 5,00,072	Nil	(GRV + URV) ₹ 5,00,000	Nil (difference ₹ 72 due to R/Off)

Space to write important points for revision

Q.8.18	RTP	Practical

ABC Silk Mills leased its looms to XYZ Looms Ltd. for a period of five years from 1st April, 2016, for a lumpsum lease of ₹ 10,50,000 payable in full in advance. The Lessor agreed to incur the expenditure for Repairs and Maintenance of the looms which were as under: Financial Year 2016-2017 ₹ 4,700, Financial Year 2017-2018 ₹ 5,200.

WDV of the Looms on 01.04.2016 was ₹ 4,60,000 and depreciation at 33 1/3% was to be charged.

Pass Journal Entries in the books of the Lessor. Show relevant entries in the P & L A/c and the Balance Sheet for the year 2016-2017, if the Lessor closes its account on 31st March every year.

Answer :

1. Journal Entries in the Books of the Lessee

Date	Particulars	Dr. (₹)	Cr. (₹)
1st April 2016	Bank A/c Dr. To Lease Rent Advance A/c (Being Lease Rent for 5 years received in advance.)	10,50,000	 10,50,000
31st March 2017	Repairs and Maintenance A/c Dr. To Bank A/c (Being Maintenance Expenses Incurred for the year)	4,700	 4,700
31st March 2017	Lease Rent Advance A/c Dr. To Lease Rental Income A/c (Being Lease Rental Income recognised for year 1)	2,10,000	 2,10,000
31st March 2017	Depreciation A/c Dr. To Plant and Machinery A/c (Being Depreciation at 33.33% on WDV of Asset) (4,60,000 × 33.33% for Year 1)	1,53,333	 1,53,333
31st March 2017	Profit and Loss A/c Dr. To Depreciation A/c To Repairs and Maintenance A/c (Being Depreciation and R & M Expense for the year transferred to P&L Account)	1,58,033	 1,53,333 4,700

31st March 2017	Lease Rent Income A/c Dr. To Profit and Loss A/c (Being Lease Rental Income for the year transferred to P&L Account)	2,10,000	 2,10,000

2. Profit and Loss A/c (extract)

Particulars	₹	Particulars	₹
To Depreciation A/c	1,53,333	By Lease Rental Income A/c	2,10,000
To Repairs and Maintenance A/c	4,700		

3. Balance Sheet (extract)

Liabilities	₹	Assets		₹
Lease Rent in Advance (10,50,000 - 2,10,000)	8,40,000	Loom: WDV at beginning:	4,60,000	
Repairs and maintenance A/c	4,700	Less: Depreciation	1,53,333	3,06,667

Space to write important points for revision

Q.8.19	RTP	Practical
Lease Ltd. has an asset of ₹ 1 Lakh, which it depreciates at 10% on SLM method. At the end of the 5th year, it sells the asset at ₹ 60,000 (Fair Value) and leases it back for the remaining useful life of 5 years. Lessee Ltd. agrees to pay at the end of each of the 5 years, a Lease Rental of ₹ 15,000 and guarantees a Residual Value of ₹ 6,000 at the end of the lease term. Lessee's Incremental borrowing rate is 10%. The PV of ₹ 1 at 10% at the end of 5th year is 0.62, and annuity is 3.79. Advice on accounting in the books of both the Lessor and Lessee Ltd.		

Answer :

A. In the books of the Lessee:

1. Since SLM depreciation is 10%, useful life is taken as 10 years. Since the lease period covers the balance useful life of the asset, it is a Finance Lease.
2. PV of MLP & GRV = (3.79 × 15,000) + (0.62 × 6,000) = ₹ 60,570.

3. The asset should be capitalized at - (a) Fair Value ₹ 60,000, or (b) PV of MLP & GRV ₹ 60,570, whichever is lower. Hence, Cost of Asset in Lessor's Books = ₹ 60,000.
4. Depreciation to be charged for the next 5 years

$$= \frac{\text{Cost less Residual Value}}{\text{Useful Life}} = \frac{₹ 60,000 - ₹ 6,000}{5 \text{ years}} = ₹ 10,800 \text{ p.a.}$$

5. Profit on Sale and Lease Back = Revised Book Value - Old Book Value = ₹ 60,000 - ₹ 50,000 = ₹ 10,000 p.a.
   This Profit will be credited to P & L A/c in the next 5 years, in proportion to the depreciation charge. In this case, ₹ 2,000 p.a. will be credited to the P & L A/c over the next 5 years. (Since Depreciation is constant on SLM basis)
6. Interest Charge to be debited in P & L A/c is determined as under:

Year	Opening Balance	Interest at 10% on Opening Balance	Lease Payment	Balance Principal repaid	Closing Balance
1	60,000	6,000	15,000	9,000	51,000
2	51,000	5,100	15,000	9,900	41,100
3	41,100	4,110	15,000	10,590	30,510
4	30,510	3,051	15,000	12,949	17,561
5	17,561	1,756	15,000	13,244	4,317

Note: Difference between ₹ 4,317 and GRV ₹ 6,000 is due to approximation in using 10% as IRR.

B. In the books of the Lessor: The Lessor makes an investment of ₹ 60,000 in respect of which he receives ₹ 75,000 (at ₹ 15,000 p.a.) over the next 5 years and also a Residual Value of ₹ 6,000. This gives him an IRR of 9.98%, which will be recognized as follows:

Year	Opg. Bal. of Principal Outstanding	MLPs	Finance Income at 9.98%	Principal repaid during the year
1	60,000	15,000	5,988	9,012
2	50,988	15,000	5,089	9,911
3	41,077	15,000	4,099	10,901
4	30,176	15,000	3,012	11,988
5	18,188	21,000	1,812	18,188
	Total		**20,000**	**60,000**

Note: The Principal Outstanding will appear as a Recoverable Amount (Asset) in the Balance Sheet of the Lessor.

Space to write important points for revision

Q.8.20	RTP	Practical

ABC Ltd. took a machine on lease from XYZ Ltd., the fair value being ₹ 10,00,000. The economic life of the machine as well as the lease term is 4 years. At the end of each year, ABC Ltd. pays ₹ 3,50,000. The lessee has guaranteed a residual value of ₹ 40,000 on expiry of the lease to the lessor. However, XYZ Ltd. estimates that the residential value of the machinery will be ₹ 35,000 only. The implicit rate of return is 16% and PV factors at 16% for year 1, year 2, year 3 and year 4 are 0.8621, 0.7432, 0.6407 and 0.5523 respectively. You are required to calculate the value of machinery to be considered by ABC Ltd. and the finance charges for each year.

Answer:

As per AS-19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

Value of machinery

In the given case, fair value of the machinery is ₹ 10, 00,000 and the net present value of minimum lease payments is ₹ 10,01,497 (Refer working Note). As the present value of the machine is more than the fair value of the machine, the machine and the corresponding liability will be recorded at fair value of ₹ 10,00,000.

Calculation of finance charges for each year

Year	Finance charge (₹)	Payment (₹)	Reduction in outstanding liability (₹)	Outstanding liability (₹)
1^{st} year beginning	-	-	-	10,00,000
End of 1st year	1,60,000	3,50,000	1,90,000	8,10,000
End of 2nd year	1,29,600	3,50,000	2,20,400	5,89,600
End of 3rd year	94,336	3,50,000	2,55,664	3,33,936
End of 4th year	53,430	3,50,000	2,96,570	37,366*

Working Note:

Present value of minimum lease payments

Annual lease rental x PV factor ₹ 3,50,000 x (0.8621 + 0.7432 + 0.6407+ 0.5523)	₹ 9,79,405
Present value of guaranteed residual value ₹ 40,000 x (0.5523)	₹ 22,092
	₹ 10,01,497

9 AS - 20 Earnings Per Share

Q.9.1	2007 - Nov [6] (f)	Practical

Answer the following:

(f) From the following information relating to Y Ltd. Calculate Earnings Per Share (EPS):

	₹ in Crores
Profit before VRS Payments but after depreciation	75.00
Depreciation	10.00
VRS payments	32.10
Provision for taxation	10.00
Fringe benefit tax	5.00
Paid up Share Capital (Shares of ₹ 10 each fully Paid)	93.00

(4 marks)

Answer :

Profit before tax	75,00,00,000
Less : VRS payment	10,00,00,000
Provision for tax	32,10,00,000
Fringe benefit tax	5,00,00,000
Earning available to shareholders	27,90,00,000
No. of shares	9,30,00,000

∴ E.P.S. (27,90,00,000 ÷ 9,30,00,000) ₹ 3 per share

Space to write important points for revision

Q.9.2	2009 - May [6] (d)	Practical

Answer the following:

From the following information relating to X Ltd. calculate Diluted earning per share as per AS-20:

Net profit for the current year	₹ 2,00,00,000
Number of equity shares outstanding	40,00,000

Basic earning per share	₹ 5.00
Number of 11% convertible debentures of ₹ 100 each	50,000
Each debenture is convertible into 8 equity shares.	
Interest expense for the current year	₹ 5,50,000
Tax saving relating to interest expense (30%)	₹ 1,65,000
	(4 marks)

Answer :

Adjusted Net profit for the current year

= 2,00,00,000 + 5,50,000 – 1,65,000 = ₹ 2,03,85,000

Number of equity shares resulting from conversion of debentures

= 50,000 × 8 = 4,00,000 equity shares

Total number of equity shares resulting from conversion of debentures

= 40,00,000 + 4,00,000 = 44,00,000 shares

Diluted Earnings per share $= \frac{₹2,03,85,000}{44,00,000}$

= ₹ 4.63 (Approximately)

Space to write important points for revision

Q.9.3	2009 - Nov [6] (b) (ii), RTP	Practical

Answer the following :

Compute Basic earning per share from the following information :

Date	Particulars	No. of Shares
1st April, 08	Balance at the beginning of the year	1,500
1st August, 08	Issue of shares for cash	600
31st March, 09	Buy back of shares	500

Net profit for the year ended 31st March, 2009 was ₹ 2,75,000.

(5 marks)

Answer :

Computation of weighted average number of shares outstanding during the period:

Date	No. of equity shares	Period outstand-ing	Weights (months)	Weighted average number of shares
(1)	(2)	(3)	(4)	(5) = (2) × (4)
1st April, 2008	1,500 (Opening)	12 months	12/12	1,500
1st August, 2008	600 (Additional issue)	8 months	8/12	400
31st March, 2009	500 (Buy back)	0 months	0/12	–
Total				1900

Basic Earnings Per Share =

$$\frac{\text{Net Profit or Loss for the period attributable to Equity Shareholders}}{\text{Weighted Average Number of Equity Shares outstanding during the period}}$$

$$= \frac{₹\,2,75,000}{1,900 \text{ shares}} = ₹\ 144.74$$

—— Space to write important points for revision ——

Q.9.4	2010 - Nov [7] (b)	Practical

Answer the following :

Ram Ltd. had 12,00,000 equity shares on April, 1, 2009. The company earned a profit of ₹ 30,00,000 during the year 2009-10. The average fair value per share during 2009-10 was ₹ 25. The company has given share option to its employees of 2,00,000 equity shares at option price of ₹ 15. Calculate basic E.P.S. and diluted E.P.S. (4 marks)

Answer :

Computation of Earnings Per Share

	Earnings	Share	Earnings Per Share
Net Profit for the year 2009-10	30,00,000		
Weighted average number of shares outstanding during the year 2009-10		12,00,000	
Basic Earning Per Share = $\frac{30,00,000}{12,00,000}$			2.50
Number of shares under option		2,00,000	
Number of shares that would have been issued at fair value (As indicated in Working Note) $2,00,000 \times \frac{15}{25}$		(1,20,000)	
Diluted Earnings Per Share $\left[\frac{30,00,000}{12,80,000}\right]$	30,00,000	12,80,000	2.34

Working Note:

The earnings have not increased as the total number of shares has been increased only by the number of shares (80,000) deemed for the purpose of the computation to have been issued for no consideration.

—— Space to write important points for revision ——

Q.9.5	2011 - May [1] {C} (a)	Practical

Answer the following:

The following information is available for Raja Ltd. for the accounting year 2009-10 and 2010-11.

Net Profit :	Year 2009 -10	₹	25,00,000
	Year 2010 -11	₹	40,00,000

No. of shares outstanding prior to right issue 12,00,000 shares.

Right issue : One new share for each three outstanding i.e. 4,00,000 shares
: Right issue Price ₹ 22
: Last date of exercise rights 30-6-2010
Fair rate of one equity share immediately prior to exercise of rights on 30-6-2010 = ₹ 28
You are required to compute the basic earnings per share for the years 2009-10 and 2010-11 (5 marks)

Answer:

Calculation of basic earnings per share (EPS)

Particulars	**Year 2009-10 (₹)**	**Year 2010-11 (₹)**
EPS for the year 2009-10 as (original) $\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$ $= \frac{₹25,00,000}{12,00,000 \text{ shares}}$	2.08	
EPS for the year 2009-10 restated for rights issue $= \frac{₹25,00,000}{12,00,000 \text{ shares} \times 1.06}$ * (Ref. Note)	1.97 (approx)	
EPS for the year 2010-11 including effects of right issue $= \frac{40,00,000}{\left(12,00,000 \times 1.06 \times \frac{3}{12}\right) + \left(16,00,000 \times \frac{9}{12}\right)}$		2.64 (approx)

Note : * The number of equity shares to be used in calculating basic earnings per share for periods prior to the rights issue is the number of equity shares outstanding prior to the issue, multiplied by the adjustment factor. The adjustment factor has been calculated as in Working Note 2.

Working Notes :

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

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

$$= \frac{(₹28 \times 12,00,000 \text{ shares}) + (₹22 \times 4,00,000 \text{ shares})}{12,00,000 \text{ shares} + 4,00,000 \text{ shares}} = ₹\ 26.50$$

2. Calculation of adjustment factor

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

$$= \frac{₹28}{₹26.5} = 1.06\ (approx.)$$

—— Space to write important points for revision ——

Q.9.6	2012 - May [1] {C} (d) (i)	Practical

Answer the following:

Explain the concept of 'Weighted average number of equity shares outstanding during the period'.

State how would you compute, based on AS-20, the weighted average number of equity shares in the following case:

		No. of Shares
1st April, 2011	Balance of Equity Shares	4,80,000
31st August, 2011	Equity shares issued for cash	3,60,000
1st February, 2012	Equity shares bought back	1,80,000
31st March, 2012	Balance of equity shares	6,60,000

($2\frac{1}{2}$ marks)

Answer :

(a) Provision:

According to Para 16 of AS-20, the weighted average number of equity shares outstanding during the period reflects the fact that the amount at any time. Hence, for the purpose of calculating basic or diluted earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

(b) Weighted average number of equity shares

Period		**Weighted shares**
1st April, 2011 to 31st August, 2011	4,80,000 shares x 5/12	2,00,000 shares
1st September, 2011 to 31st January, 2012	8,40,000 shares x 5/12	3,50,000 shares
1st February, 2012 to 31st March, 2012	6,60,000 shares x 2/12	1,10,000 shares
		6,60,000 shares

Space to write important points for revision

Q.9.7	**2013 - May [1] {C} (a)**	**Practical**

Answer the following:

(a) Net profit for the year 2012 : ₹ 24,00,000

Weighted average number of equity shares outstanding during the year 2012: 10,00,000

Average Fair value of one equity share during the year 2012 : ₹ 25.00

Weighted average number of shares under option during the year 2012: 2,00,000

Exercise price for shares under option during the year 2012 : ₹ 20.00

Compute Basic and Diluted earning per share. (5 marks)

Answer :

Calculation of earnings per share

Particulars	Earnings (₹)	Shares	Earnings per share
Net profit for the year 2012	24,00,000		
Weighted average number of shares outstanding during the year 2012		10,00,000	
Basic earnings per share			₹ 2.40
Number of shares under option		2,00,000	
Number of shares that would have been issued at fair value: (2,00,000 × 20.00)/25.00 (Note)		(1,60,000)	
Diluted earnings per share	24,00,000	10,40,000	₹ 2.31

Note: The earnings have not been increased as the total number of shares has been increased only by the number of shares (40,000) deemed for the purpose of computation to have been issued for no consideration.

Space to write important points for revision

Q.9.8	2014 - May [1] {C} (d), RTP	Practical

Answer the following:

The following information is available for AB Ltd. for the accounting year 2012-13 and 2013-14 :

Net profit for		₹
Year	2012-13	22,00,000
Year	2013-14	30,00,000

No. of shares outstanding prior to right issue 10,00,000 shares.

Right issue : One new share for each five shares Outstanding i.e. 2,00,000 shares.

: Right Issue price ₹ 25

: Last date to exercise right 31st July, 2013

Fair value of one equity share immediately prior to exercise of rights on 31.07.2013 is ₹ 32.

You are required to compute

(i) Basic earnings per share for the year 2012-13.

(ii) Restated basic earnings per share for the year 2012-13 for right issue.

(iii) Basic earnings per share for the year 2013-14. (5 marks)

Answer :

(i) Computation of Basic Earning per share for 2012-13.

$$= \frac{\text{Net profit for the year attributable to equity shareholders}}{\text{No. of Equity shares outstanding during the year}}$$

$$= \frac{22,00,000}{10,00,000} = ₹\ 2.20$$

(ii) Restated basic earnings per share for the year 2012-13 for right issue

$$\frac{\text{Net profit for the year attributable to equity shareholders}}{\text{Weighted average no. of Equity shares outstanding prior to right issue} \times \text{Adjustment factor}}$$

$$= \frac{22,00,000}{10,00,000 \times 1.04} \text{(w.n. 2)}$$

$$= \frac{22,00,000}{10,40,000}$$

$= ₹\ 2.12$

(iii) Computation of basic Earning per share for year 2013-14

$$= \frac{\text{Net profit for the year attributable to equity shareholders}}{\text{Weighted average no. of Equity shares outstanding duringthe year}}$$

$$= \frac{30,00,000}{\left(10,00,000 \times 1.04 \times \frac{4}{12}\right) + 12,00,000 \times \frac{8}{12}}$$

$$= \frac{30,00,000}{3,46,667 + 8,00,000}$$

$$= \frac{30,00,000}{11,46,667}$$

$= ₹\ 2.62$

Working Notes :

1. Computation of Theoretical Ex-Rights price.

$$= \frac{\text{Fair value of all o/s shares immediately prior to exercise of right + Total amount received exercise}}{\text{No. of shares o/s prior to exercise + no. of shares issued in exercise}}$$

$$= \frac{(32 \times 10,00,000) + (25 \times 2,00,000)}{10,00,000 + 2,00,000}$$

$$= \frac{3,20,00,000 + 50,00,000}{12,00,000}$$

= ₹ 30.833

2. Computation of adjusted factor

$$= \frac{\text{Fair value per share prior to exercise price}}{\text{Theoritical ex-right value per share}}$$

$$= \frac{32}{30.833} = 1.04 \text{ (approx.)}$$

—— Space to write important points for revision ——

Q.9.9	2015 - May [1] {C} (d)	Practical

Answer the following:

M/s. A Ltd. had 8,00,000 Equity Shares outstanding on 1st April, 2013. The Company earned a profit of ₹ 20,00,000 during the year 2013 - 14. The average fair value per share during 2013 - 14 was ₹ 40. The Company has given Share Option to its employees of 1,00,000 Equity Shares at option price of ₹ 20.

Calculate Basic EPS and Diluted EPS. (5 marks)

Answer :

	Earning (₹)	**Shares**	**Earning per Share (₹)**
Net Profit for the year 2013 - 14	20,00,000		
Number of shares outstanding during the year 2013 -14		8,00,000	

Basic Earnings Per Share $= \frac{20,00,000}{8,00,000}$			2.50
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value (Refer Note) [1,00,000 x 20/40]		(50,000)	
Diluted Earning Per Share $= \frac{20,00,000}{8,50,000}$	20,00,000	8,50,000	2.35

Note:

The earnings have not been increased as the total number of shares has been increased only by the number of shares (50,000) deemed for the purpose of the computation to have been issued for no consideration.

—— Space to write important points for revision ——

Q.9.10	**2015 - Nov [7] (a)**	**Practical**

Answer the following:

What do you mean by "Weighted average number of equity shares outstanding during the period" and why is it required to be calculated? Compute weighted average number of equity shares in the following case:

		No. of shares
1st April, 2014	Balance of Equity Shares	5,00,000
30th June, 2014	Equity Shares issued for cash	1,00,000
15th January, 2015	Equity Shares bought back	50,000
31st March, 2015	Balance of Equity Shares	5,50,000
		(4 marks)

Answer :

Weighted average number of equity shares outstanding at the end of the year is the shares as adjusted by the number of equity shares bought back or issued during the period as multiplied by the time weighting factor. Time weighting factor is the number of days for which the specific shares are outstanding as a proportion of the total number of days in the periods a reasonable approximation of the weighted average is adequate in many circumstances.

Calculation weighted average no. of shares:

$$= \left(5,00,000 \times \frac{3}{12}\right) + \left(6,00,000 \times \frac{6.5}{12}\right) + \left(5,50,000 \times \frac{2.5}{12}\right)$$

= 1,25,000 + 3,25,000 + 1,14,583

= weighted average No. of shares = 5,64,583

—— Space to write important points for revision ——

Q.9.11	2016 - Nov [1] {C} (a)	Practical

Answer the following question:

"While calculating diluted EPS, effect is given to all dilutive potential equity shares that were outstanding during the period." Explain this statement in the light of relevant AS.

Also calculate the diluted EPS from the following information:

Net Profit for the current year (After Tax)	₹ 1,00,00,000
No. of Equity shares outstanding	10,00,000
No. of 10% Fully Convertible Debentures of ₹ 100 each (Each Debentures is compulsorily & fully convertible into 10 equity shares)	1,00,000
Debenture interest expense for the current year	₹ 5,00,000
Assume applicable Income Tax rate @ 30%	(5 marks)

Answer :

According to AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares for calculation of diluted earnings per share. Hence, "in calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period."

Calculation of Diluted Earnings per Share =

$$\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$$

Particulars	Net profit for the period attributable to Equity Shareholders	Weighted Average no. of Equity Shareholders
For Basic EPS	1,00,00,000	10,00,000
Add: Adjustment for Dilution	3,50,000 (W.N.1)	5,00,000 (W.N.1)
∴ Adjusted EPS	**1,03,50,000**	**15,00,000**

∴ Basic EPS $= \frac{1,00,00,000}{10,00,000}$ = ₹ 10

∴ Diluted EPS $= \frac{1,03,50,000}{15,00,000}$ = ₹ 6.90 per share

Working Note:

1. Tax adjusted interest on 10% Convertible Debentures
   = Interest × (100% – Tax Rate)
   = 5,00,000 × (100% – 30%)
   = 3,50,000
2. 1,00,000 × 10 × $\frac{6}{12}$ = 5,00,000 **Assumption:**

Annual Interest on Debentures
   = 10% × ₹ 100 × 1,00,000 Debentures
   = ₹ 10,00,000

But interest expense for the current year is given as ₹ 5,00,000

Hence: It can be implied that debentures are issued during the year. Period = 6 months (By comparing Annual Interest Rate @ 10% on ₹ 10,00,000 with given interest expense of ₹ 5,00,000)

Space to write important points for revision

Q.9.12	2018 - May [1] {C} (b)	Practical

As at 1st April, 2016 a company had 6,00,000 equity shares of ₹ 10 each (₹ 5 paid up by all shareholders). On 1st September, 2016 the remaining ₹ 5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 2017 was ₹ 21,96,000 after considering dividend on preference shares and dividend distribution tax on such dividend totalling to ₹ 3,40,000.
Compute Basic EPS for the year ended 31st March, 2017 as per Accounting Standard 20 "Earnings Per Share". (5 marks)

Answer:

Basic Earnings Per Share (EPS)

$$= \frac{\text{Net Profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{₹ 21,96,000}{\text{4,57,500 shares (as per Working note)}}$$

= ₹ 4.80 per share

Working Note:

- Calculation of weighted average number of equity shares.

  As per Para 19 of AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extend that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extend of amount paid, weighted average number of shares will be calculated as follows:

Date	No. of equity shares ₹	Amount paid per share ₹	Weighted average no. of equity shares ₹
01.04.2016	6,00,000	5	6,00,000 × 5/10 × 5/12 = 1,25,000
01.09.2016	5,40,000	10	5,40,000 × 7/12 = 3,15,000
01.09.2016	60,000	5	60,000 × 5/10 × 7/12 = 17,500
Total Shares			4,57,500

Space to write important points for revision

Q.9.13	2018 - Nov [1] {C} (a)	Practical

Answer the following question :
From the following information given by Sampark Ltd., Calculate Basis EPS and Diluted EPS as per AS 20 :

	₹
Net Profit for the current year	2,50,00,000
No. of Equity Shares Outstanding	50,00,000
No. of 12% convertible debentures of ₹ 100 each	50,000
Each debenture is convertible into 8 Equity Shares	
Interest expense for the current year	6,00,000
Tax saving relating to interest expense (30%)	1,80,000
	(5 marks)

Answer:

Calculation of Basic EPS:

$$\text{Basic EPS} = \frac{\text{Net Profit for the Current year}}{\text{No. of Equity Shares Outstanding}}$$

$$= \frac{₹2,50,00,000}{5000000 \text{ shares}}$$

Basic EPS = ₹ 5.00

Calculation of Diluted EPS:

Adjusted net profit for the Current year

= ₹ 2,54,20,000 (₹ 2,50,00,000 + ₹ 6,00,000 – ₹ 1,80,000)

No. of equity shares resulting from conversion of debentures

= 4,00,000 shares

No. of equity shares used to compute diluted EPS

= 54,00,000 shares (50,00,000 + 4,00,000)

$$\text{Diluted EPS} = \frac{₹2,54,20,000}{5400000 \text{ shares}}$$

Diluted EPS = ₹ 4.71

—— Space to write important points for revision ——

Q.9.14	2019 - Nov [1] {C} (d)	Practical

Following information is supplied by K Ltd.
Number of shares outstanding prior to right issue — 2,50,000 shares.
Right issue — two new share for each 5 outstanding shares (i.e. 1,00,000 new shares)
Right issue price — ₹ 98
Last date of exercising rights — 30-06-2018.
Fair value of one equity share immediately prior to exercise of right on 30-06-2018 is ₹ 102.
Net Profit to equity shareholders:
2017-2018 — ₹ 50,00,000
2018-2019 — ₹ 75,00,000
You are required to calculate the basic earnings per share as per AS-20 Earning per Share. (5 marks)

Answer:

Computation of basic earnings per share (EPS)

	Year 2017-18 (₹)	**Year 2018-19 (₹)**
EPS for the year 2017-18 as originally reported = Net profit of the year attributable to equity shareholders / Weighted average number of equity shares outstanding during the year $= \frac{₹50,00,000}{2,50,000 \text{ shares}}$	20	
EPS for the year 2017-18 restated for rights issue $= \frac{₹50,00,000}{(2,50,000 \text{ shares} \times 1.01)*}$	19.80 (approx.)	

EPS for the year 2018-19 including effects of right issue $= \frac{75,00,000}{3,25,625}$ $(2,50,000 \times 1.01 \times \frac{3}{12}) + (3,50,000 \times \frac{9}{12})$ = 63,125 + 2,62,500 = 3,25,625 shares		23.03 (approx.)

Working Notes:

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

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

$$= \frac{(₹102 \times 2,50,000 \text{ shares}) + (₹98 \times 1,00,000 \text{ shares})}{2,50,000 \text{ shares} + 1,00,000 \text{ shares}} = ₹\ 100.86$$

2. **Computation of adjustment factor:**

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

$$= \frac{₹\,102}{₹\,100.86} = 1.01 \text{ (approx.)}$$

Note:

The number of equity shares to be used in calculating basic earnings per share for periods prior to the rights issue is the number of equity shares outstanding prior to the issue, multiplied by the adjustment factor, (as calculated in W.N.2).

Space to write important points for revision

Q.9.15	RTP	Practical
XYZ Ltd. is engaged in manufacturing Industrial Packaging Equipment. As per the terms of an agreement entered into with its Debentureholders, the Company is required to appropriate adequate portion of its Profits to a		

Specific Reserve over the period of maturity of the Debentures such that at the redemption date, the Reserve constitutes at least half the value of such Debentures. As such, appropriations are not available for distribution to the Equity Shareholders. Kashyapa Ltd. has excluded this from the Numerator, in the Computation of Basic EPS. Is this treatment correct?

Answer :

Provision:

As per Para 11 of AS - 20, Earning per share "For the purpose of calculating Basic earnings Per Share, the Net Profit or Loss for the period attributable to Equity Shareholders should be the Net Profit or Loss for the period after deducting Preference Dividends and any attributable Tax thereto for the period".

Analysis: With an emphasis on the phrase "attributable to Equity Shareholders", it may be construed that amounts appropriated to Mandatory Reserves as described in this case, though not available for distribution as dividend, are still attributable to Equity Shareholders.

Conclusion: So, the appropriation made to a Mandatory Reserve created for the redemption of Debentures would be included in the Net Profit attributable to Equity Shareholders for the computation of Basic EPS. The treatment given by the Company is not correct.

Space to write important points for revision

Q.9.16	**RTP**	**Practical**

From the following information, calculate Earnings Per Share (EPS), (₹ in Crores)

Profit before VRS Payment but after depreciation	75.00	Provision for Taxation	10.00
Depreciation	10.00	Fringe Benefit Tax	5.00
VRS payments	32.10	Paid Up Share Capital (Shares of ₹ 10 each fully paid)	93.00

Answer :

Particulars		₹ in Crores
Profit after depreciation but before VRS Payment		75.00
Less: Depreciation - already adjusted, hence no adjustment required.	—	
VRS Payments - all items are considered in determining Profit/Loss	32.10	
Provision for Taxation	10.00	
Fringe Benefit Tax	5.00	47.10
Net Profit available for Equity Shareholders		27.90
Number of Equity Shares		9.30 Crores
EPS = $\frac{\text{Net Profit}}{\text{No. of shares}} = \frac{27.90}{9.30}$ = ₹ 3 per Share.		

Space to write important points for revision

Q.9.17	RTP	Practical

XYZ Ltd. has the following different classes of Equity Shares of ₹ 10 each, outstanding as at 31st March, having disproportionate rights with respect to voting and dividends:

Number of Shares	Rights as to Share in Net Profit to the extent of Capital
1,00,000 "A" Class Equity Shares	Proportionate to Capital
30,000 "B" Class Equity Shares	In the proportion of 3:2 with respect to "A" Class Shares
30,000 "C" Class Equity Shares	In the proportion of 5:2 with respect to "A" Class Shares
40,000 "D" Class Equity Shares	In the proportion of 3:1 with respect to "A" Class Shares

Profit for the year ended 31st March was ₹ 8,00,000. The Company believes that Net Profit is to be allocated to the Shares in the ratio or 2:3:5:6 as derived from their rights to Share Net Profit. The Company has calculated the Basic EPS in the following manner. You are required to confirm whether this calculation is correct.

Class	Apportionment of Net Profit	No. of Shares	Basic EPS
Class A	₹ 8,00,000 × 2/16 =₹ 1,00,000	1,00,000	₹ 1.00
Class B	₹ 8,00,000 × 3/16 =₹ 1,50,000	30,000	₹ 5.00
Class C	₹ 8,00,000 × 5/16 =₹ 2,50,000	30,000	₹ 8.33
Class D	₹ 8,00,000 × 6/16 =₹ 3,00,000	40,000	₹ 7.50

Answer :

As per Para 14, "If an Enterprise has more than one class of Equity Shares, Net Profit or Loss for the period is apportioned over the different classes of Shares in accordance with their dividend rights". In the instant case, Net Profit should first be apportioned to various classes of Equity Shares in accordance with their Dividend Rights in the following manner:

Class (1)	**No. of Shares (2)**	**Ratio of rights in Profit (3)**	**Adjusted Number of Shares (4)**	**Apportioned Profit (in the ratio of adjusted number of Shares) (5)**	**Basic EPS (6) = (5) ÷ (2)**
A	1,00,000	1:1	$1,00,000 \times \frac{1}{1} = 1,00,000$	$8,00,000 \times \frac{100}{340}$ = ₹ 2,35,294	₹ 2.35
B	30,000	3:2	$30,000 \times \frac{3}{2} = 45,000$	$8,00,000 \times \frac{45}{340}$ = ₹ 1,05,882	₹ 3.53
C	30,000	5:2	$30,000 \times \frac{5}{2} = 75,000$	$8,00,000 \times \frac{75}{340}$ = ₹ 1,76,471	₹ 5.88

D	40,000	3:1	$40{,}000 \times \frac{3}{1} = 1{,}20{,}000$	$8{,}00{,}000 \times \frac{120}{340}$ = ₹ 2,82,353	₹ 7.06
		Total	**3,40,000**	**₹ 8,00,000**	

Conclusion: The Company's EPS computation is not correct. The amounts presented above should be considered.

Space to write important points for revision

Q.9.18	RTP	Practical

From the information given below, calculate the Diluted EPS of XYZ Ltd.:
Profit available for appropriation = ₹ 3750 Crores.
Equity Shares (of ₹ 10 each fully paid) outstanding as at beginning of year = 250 Crores.
No. of Loan Bonds convertible into 100 Equity Shares of ₹ 10 each for each Loan Bond = 5.25 Lakhs.
No. of Equity Shares likely to arise on conversion of Series III Debentures = 3.90 Lakhs.
Interest on Loan Bonds and Series III Debentures = ₹ 50 Crores, Tax Rate = 40%.
Potential Equity Shares on account of Stock Options = 1.15 Crores.

Answer :

1. Computation of Number of Equity Shares after conversion

Number of Equity Shares at the beginning of the year		2,50,00,00,000
Add:	Potential Equity Shares on Conversion of Bonds (5,25,000 × 100)	5,25,00,000
Add:	Potential Equity Shares on Conversion of Series III Debentures	3,90,000
Add:	Potential Equity Shares towards Stock Options (Profit Adjustment not required for Options)	1,15,00,000
Number of Equity Shares Outstanding during the year		**2,56,43,90,000**

2. Computation of Basic and Diluted EPS

Particulars	For Basic EPS	Adjustment for Dilution	For Adjusted EPS
(1)	**(2)**	**(3)**	**(4) = (2) + (3)**
1. Net Profit for the period attributable to Equity Share-holders	Given ₹ 3,750 Crores	(Note) ₹ 30 Crores	₹ 3,780 Crores
2. Weighted Avg. No. of Equity Shares	2,50,00,00,000	6,43,90,000	2,56,43,90,000
3. EPS = 1 ÷ 2	Basic EPS = ₹ 15.00		Diluted EPS = ₹ 14.74

Note: Tax Adjusted Interest on Convertible Debentures
= Interest × (100% - Tax Rate)
= ₹ 50 Crores × (100% - 40%) = ₹ 30 Crores.

—— Space to write important points for revision ——

Q.9.19	RTP	Practical

Calculate Basic and Diluted EPS of Marthanda Ltd. if:
Equity Shares (₹ 10 each) as at the beginning of the financial year - 50,00,000 Shares,
Net Profit after Tax for the year - ₹ 2,00,00,000,
Issue of Shares for Cash on 1^{st} July - 10,00,000 Shares (₹ 10 each)
Issue of Bonus Shares on 1^{st} October = 1:5 as at the beginning of year, i.e. 10,00,000 Shares.
Convertible Debentures outstanding at beginning of the year = 10% Debentures for ₹ 1,00,00,000.
Company's Tax Rate is 40%.

Answer :

1. Weighted Average Number of Equity Shares

Date	No. of Equity Shares	Period Outstanding (upto 31st Dec.)	Time Weighting Factor	Weighted Average Number of Shares
(1)	(2)	(3)	(4)	(5) = (2) × (4)
1st Apr.	50,00,000	12 months	12/12	50,00,000
1st July	10,00,000	9 months	9/12	7,50,000
1st Oct.	(deemed as from the previous reporting period) 10,00,000	12 months	12/12	10,00,000
Weighted Average Number of Equity Shares Outstanding during the period.				67,50,000

2. Computation of Basic and Diluted EPS

Particulars	For Basic EPS	Adjustment for Dilution	For Adjusted EPS
(1)	(2)	(3)	(4) = (2) + (3)
1. Net Profit for the period attributable to Equity Shareholders	Given ₹ 2,00,00,000	(Note) ₹6,00,000	₹ 2,06,00,000
2. Weighted Avg. No. of Equity Shares	(WN 1) 67,50,000	1,00,00,000 ÷ 10 = 10,00,000	77,50,000
3. EPS = 1 ÷ 2	Basic EPS = ₹ 2.96		Diluted EPS = ₹ 2.66

Note: Tax Adjusted Interest on Convertible Debentures = Interest × (100% - Tax Rate) = (₹ 1,00,00,000 × 10%) × (100% - 40%) = ₹ 6,00,000.

Space to write important points for revision

Q.9.20	RTP	Practical

The following information is available for TON Ltd. for the accounting year 2015-16 and 2016-17:

	Net profit for	₹
Year Year	2015-16 2016-17	35,00,000 45,00,000

No of shares outstanding prior to right issue 15,00,000 shares.

Right issue : One new share for each 3 shares outstanding i.e. 5,00,000 shares.

: Right Issue price ₹ 25

: Last date to exercise rights 31st July, 2016

Fair value of one equity share immediately prior to exercise of rights on 31.07.2016 is ₹ 35.

You are required to compute:

(i) Basic earnings per share for the year 2015-16.

(ii) Restated basic earnings per share for the year 2015-16 for right issue.

(iii) Basic earnings per share for the year 2016-17.

Answer:

Computation of Basic Earnings per Share

		Year 2015-16 (₹)	Year 2016-17 (₹)
(i)	EPS for the year 2015-16 as originally reported = Net profit for the year attributable to equity share holder / weighted average number of equity shares outstanding during the year ₹ 35,00,000/ 15,00,000 shares	2.33	

(ii)	EPS for the year 2015-16 restated for the right issue ₹ 35,00,000/15,00,000 shares x 1.08	2.16	
(iii)	EPS for the year 2016-17 (including effect of right issue) ₹ 45,00,000/[(15,00,000x1.08 x 4/12) + (20,00,000 x 8/12)]		2.40

Working Notes:

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

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

[(₹ 35 × 15,00,000) + (₹ 25 × 5,00,000)]/(15,00,000 + 5,00,000) = ₹ 32.5

2. Computation of adjustment factor

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

= ₹ 35 /32.50 = 1.08 (approx.)

Space to write important points for revision

10 AS-22 Accounting for Taxes

Q.10.1	2008 - Nov [7] (e)	Short Notes
Write short note on the following: What are Timing differences and Permanent differences? (4 marks) *[CA Final - I]*		
OR	**2014 - May [7] (c)**	**Descriptive**
Answer the following : What are Timing Differences and Permanent Differences as per Accounting Standard - 22? Explain with example. (4 marks) *[CA Final - I]*		

Answer:

1. **Timing difference** is the difference between the accounting income and taxable income that originated in the same period and are capable of reversal in one or more subsequent periods. Examples of timing differences are as follows:
   (i) Expenditure of nature mentioned in Section 43(B), like taxes, duty, cess, fees etc. if are accrued in the P/L A/c on accrual basis; but are allowed only on actual payment for tax purpose.
   (ii) Provision made in P/L A/c, but the relevant liability is allowed in the year in which it actualize.
2. **Permanent difference** is the difference between the accounting income and taxable income that originated in the same period; but are not capable of reversal. Examples of permanent differences are as follows:-
   (i) Personal expenditure
   (ii) Contribution to National Laboratory.
   (iii) Donations, etc.

—— Space to write important points for revision ——

Q.10.2	2009 - May [1] {C} (d)	Practical

Answer the following :

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

(4 marks) *[CA Final - I]*

Answer:

Omega Limited

Calculation of deferred Tax Asset/Liability

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

—— Space to write important points for revision ——

Q.10.3	2009 - Dec [3] (b)	Descriptive
What do you understand by 'provision for taxation'? What factors are to be considered while estimating the provision for taxation? (6 marks) *[CS Exe - I]*		

Answer:

Provision for Taxation :

Provision for Income Tax to be created for current year is shown in the debit side of profit and loss account as well as under provision in liabilities side in the balance sheet. If rate of Income Tax is given it will be applied on net profit. Surcharge, if any, will be calculated on Income Tax, while calculating income tax provision as a percentage of net profit. Some adjustment may be required. Net profit as shown by profit and loss account may be different from the taxable profit.

While making the estimate of provision for taxation, due consideration should be given to the following points:

(i) Whether the income tax has been computed at the rates prescribed.

(ii) Whether profit sur- tax is payable or not.

(iii) Whether capital gains tax is payable or not.

(iv) Whether penalty is payable under any tax laws.

(v) Whether rebates are available for double taxation.

(vi) Whether adjustment has made for the last year`s actual tax liability or not.

—— Space to write important points for revision ——

Q.10.4	2011 - May [1] {C} (d)	Practical

Rama Ltd. has provided the following information:

Depreciation as per accounting records = ₹ 2,00,000

Depreciation as per income-tax records = ₹ 5,00,000

Unamortised preliminary expenses as per tax record = ₹ 30,000

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

Answer:

Table showing calculation of Deferred tax asset/liability.

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

Space to write important points for revision

Q.10.5	2011 - Dec [4] (b)	Short Notes

Write short notes on the following:

Provision for taxation and advance payment of tax. (3 marks) *[CS Exe - I]*

Answer:

Provision for Taxation:

Provision for Income Tax to be created for current year is shown in the debit side of profit and loss account as well as under provision in liabilities side in the balance sheet. If rate of Income Tax is given it will be applied on net profit. Surcharge if any, will be calculated on Income Tax, while calculating income tax provision as a percentage of net profit. Some adjustment may be required. Net profit as shown by profit and loss account may be different from the taxable profit.

Advance Tax:

Any advance tax paid by company will be shown on the assets side of the balance sheet under Short term 'Loans and Advances'. Alternatively, it may be shown as a deduction from provision for Income Tax. If amount of advance tax is more than the amount of tax assessed, the excess is refundable by income. Tax department. This excess will be shown in the assets side under Short terms 'Loans and Advances' until refund is received.

—— Space to write important points for revision ——

Q.10.6	2012 - Nov [1] {C} (b)	Practical
Goodwill Limited is a full tax free enterprise for the 1st 12 years of its existence and is in third year of operations. Depreciation timing difference resulting in a deferred tax liability in 1st, 2nd and 3rd year is ₹ 200 lakhs, ₹ 300 lakhs and ₹ 400 lakhs respectively. From the 4th year onwards, it is expected that the timing difference would reverse each year by ₹ 10 lakhs. Assuming tax rate @ 35%, find out the deferred tax liability at the end of 3rd year and any charge to the Profit and Loss Account. (5 marks) *[CA Final - I]*		

Answer:

- **According to an explanation to AS 22, "Accounting for Taxes on Income",** in the case of tax free enterprises, no deferred tax liability is recognized, in respect of timing differences that originate and reverse in the tax holiday period. Deferred tax liability or asset is created in respect of timing differences that originate in a tax holiday period but are expected to reverse after the tax holiday period. For this purpose, adjustments are done in accordance with the FIFO method.
- **Accordingly,** depreciation timing difference of ₹ 90 lakhs (₹ 10 lakhs x 9 years) will reverse in the tax holiday period i.e. from 4th year to 12th year. Therefore, no deferred liability on ₹ 90 lakhs out of ₹ 200 lakhs, will be created. In the 1st year, deferred tax liability of ₹ 38.5 lakhs will be created @ 35% on ₹ 110 lakhs (₹ 200 lakhs - ₹ 90 lakhs) only.

- **However,** the entire depreciation timing difference of 2^{nd} and 3^{rd} year i.e. ₹ 300 lakhs and ₹ 400 lakhs will reverse only after the tax holiday period. So, deferred tax liability will be created in the 2^{nd} year for ₹ 105 lakhs (₹ 300 × 35%) and in the 3^{rd} year for ₹ 140 lakhs (₹ 400 × 35%).
- **Therefore,** total deferred tax liability in the Balance Sheet at the end of 3^{rd} year will be ₹ (38.5 + 105 + 140) lakhs = ₹ 283.5 lakhs and charge to Profit and Loss account in the 3^{rd} year will be ₹ 140 lakhs (₹ 400 × 35%).

—— Space to write important points for revision ——

Q.10.7	2018 - May [1] {C} (c)	Practical

Rohit Ltd. has provided the following information:

Particulars	**₹**
Depreciation as per accounting record	2,50,000
Depreciation as per tax records	5,50,000
Unamortized preliminary expenses as per tax record	40,000

There is adequate evidence of future profit sufficiency. How much deferred tax asset/liability should be recognised as transition adjustment when the tax rate is 50%? (5 marks) *[CA Inter Gr. I]*

Answer:

Table showing calculation of deferred tax asset/liability

Particulars	Amount ₹	Timing Difference	Deferred Tax	Amount @ 50% ₹
Excess depreciation as per tax records (₹ 5,50,000 – ₹ 2,50,000)	3,00,000	Timing	Deferred tax liability	1,50,000
Unamortised preliminary expenses as per tax records	40,000	Timing	Deferred tax asset	(20,000)
Net deferred tax liability				1,30,000

Net deferred tax liability amounting ₹ 1,30,000 should be recognized as transition adjustment.

—— Space to write important points for revision ——

Q.10.8	2020 - Nov [1] {C} (d)	Practical

Answer the following:
From the following details of Aditya Limited for accounting year ended on 31st March, 2020:

Particulars	₹
Accounting profit	15,00,000
Book profit as per MAT	7,50,000
Profit as per Income tax Act	2,50,000
Tax Rate	20%
MAT Rate	7.5%

Calculate the deferred tax asset/liability as per AS 22 and amount of tax to be debited to the profit and loss account for the year. (5 marks)

Answer:

Tax as per accounting profit ₹ 3,00,000
[15,00,000 × 20%]
Tax as per Income-tax Act ₹ 50,000
[2,50,000 × 20%]
Tax as per MAT
[7,50,000 × 7.50%] ₹ 56,250

Tax expense = Current tax + Deferred tax
3,00,000 = 50,000 + Deferred tax
∴ Deferred tax = 2,50,000
Amount of tax to be debited in Profit & Loss Account for the year 31.3.20.
Current Tax + Deferred tax liability + Excess of MAT over current tax
= 50,000 + 2,50,000 + 6,250 [56,250 – 50,000]
= ₹ 3,06,250

—— Space to write important points for revision ——

Q.10.9	2021 - Jan [1] {C} (d)	Practical

The following particulars are stated in the Balance Sheet of HS Ltd. as on 31-3-2019:

Particulars	(₹ in lakhs)
Deferred Tax Liability (Cr.)	60.00
Deferred Tax Assets (Dr.)	30.00

The following transactions were reported during the year 2019-20:

	(₹ in lakhs)
Depreciation as per accounting records	160.00
Depreciation as per income tax records	140.00
Items disallowed for tax purposes in 2018-19 but allowed in 2019-20	20.00
Donation to Private Trust	20.00
Tax rate	30%

There were no additions to fixed assets (PPE) during the year. You are required to show the impact of various items on Deferred Tax Assets and Deferred Tax Liability as on 31-3-2020 as per AS-22. (5 marks)

Answer:

Impact of various items in terms of AS 22 deferred tax liability/deferred tax asset:

1. **Difference in Depreciation:** Generally, written down value method of depreciation is adopted under income Tax Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years. It is timing difference for which reversal of Deferred tax liability is required.
   Reversal of DTL = ₹ (160 – 140) Lakhs × 30% = ₹ 6 Lakhs
2. **Disallowances, as per IT Act of earlier years:** Due to disallowance tax payable for the earlier years was higher on this account. It is responding timing difference which required Reversal of Deferred tax assets.
   Reversal of Deferred tax assets = ₹ 20 Lakhs × 30% = ₹ 6 Lakhs

3. **Donations to private trusts** is not an allowable expenditure under IT Act. It is permanent difference. Hence, no reversal of tax is required.

—— Space to write important points for revision ——

Q.10.10	**2021 - July [6] (a)**	**Practical**

Answer the following:

The following particulars are stated in the Balance Sheet of Deep Limited as on 31st March, 2020:

	(₹In Lakhs)
Deferred Tax Liability (Cr.)	28.00
Deferred Tax Assets (Dr.)	14.00

The following transactions were reported during the year 2020-2021 :

(i) Depreciation as per books was ₹ 70 Lakhs whereas Depreciation for Tax purposes was ₹ 42 Lakhs. There were no additions to Fixed Assets (PPE) during the year.

(ii) Expenses disallowed in 2019-20 and allowed for tax purposes in 2020-21 were ₹ 14 Lakhs.

(iii) Share issue expenses allowed under section 35(D) of the Income Tax Act, 1961 for the year 2020-21 (1/10th of ₹ 70.00 lakhs incurred in 2019-20)

(iv) Repairs to Plant and Machinery were made during the year for ₹ 140.00 Lakhs and was spread over the period 2020-21 and 2021-22 equally in the books. However, the entire expenditure was allowed for income-tax purposes in the year 2020-21.

Tax Rate to be taken at 40%.

You are required to show the impact of above items on Deferred Tax Assets and Deferred Tax Liability as on 31st March, 2021. (5 marks)

Q.10.11	RTP	Practical

The Trial Balance of Q Ltd. as at 31.3.2018 shows the following items:

Particulars	Dr. (₹)	Cr. (₹)
Advance payment of Income Tax	2,20,000	–
Provision for Income Tax for the year ended 31.3.2017	–	1,20,000

The following further information are given:
1. Advance Payment of Income Tax include ₹ 1,40,000 for 2016-17.
2. Actual Tax Liability for 2016-17 came to ₹ 1,52,000 and no effect for the same has so far been given in accounts.
3. Provision for Income Tax has to be made for 2013-14 for ₹ 1,60,000.

Prepare: (1) Provision for Income Tax Account, (2) Advance Payment of Income Tax Account, and (3) Liabilities for Taxation Account. Also show, how the relevant items will appear in the Profit and Loss Account and Balance Sheet of the Company. *[CA Inter Gr. I]*

Answer:

1. Provision for Income Tax A/c (2016-17)

Date	Particulars	₹	Date	Particulars	₹
31.03.17	To Adv. Pymt of Tax A/c - transfer	1,40,000	01.04.16	By Balance b/d - given	1,20,000
	To Liability for Taxation A/c - balancing figure	12,000	31.03.17	By Profit & Loss A/c - additional provision required	32,000
	Total	**1,52,000**		**Total**	**1,52,000**

2. Advance Payment of Income Tax A/c

Date	Particulars	₹	Date	Particulars	₹
31.03.18	To Balance b/d - given	2,20,000	31.03.18	By Provision for Tax A/c - (2016-17) - transfer	1,40,000
				By Balance c/d - Bal. figure	80,000
	Total	**2,20,000**		**Total**	**2,20,000**

3. Provision for Income Tax A/c (2017-18)

Date	Particulars	₹	Date	Particulars	₹
31.03.18	To Balance c/d - bal. figure	1,60,000	31.03.18	By P&L A/c - Provision for the year	1,60,000
	Total	**1,60,000**		**Total**	**1,60,000**

4. Liability for Taxation A/c

Date	Particulars	₹	Date	Particulars	₹
31.03.18	To Balance c/d - bal. figure	12,000	31.03.18	By Provision for Tax A/c - tfr	12,000
	Total	**12,000**		**Total**	**12,000**

5. Profit and Loss A/c for the year ended 31.03.2018 (Extracts)

	Particulars	This Yr.	Prev. Yr.
IX	Profit Before Tax (VII-VIII)		
X	**Tax Expense:** - Current Tax (including Prior Period Tax Expense of ₹ 32,000) - Deferred Tax	1,92,000	
XI	Profit/ (Loss) for the period from Continuing Operations (IX-X)		

6. Balance Sheet as at 31st March (Extracts)

	Particulars	Note	This Yr.	Prev. Yr.
I	**Equity and Liabilities:**			
	Current Liabilities:			
	(a) Short Term Borrowings			
	(b) Trade Payables - Liability for Taxation (2016-17)		12,000	
	(c) Other Current Liabilities			
	(d) Short Term Provisions - Provision for Taxation net of Advance Tax (1,60,000 - 80,000)		80,000	
	Total			

Space to write important points for revision

11 AS - 24 Discontinuing Operations

Q.11.1	2009 - Nov [6] (c), RTP	Descriptive

Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS-24, but that might do so in combination with other circumstances. (4 marks) *[CA Final - I]*

Answer :

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

1. Closing of a facility to achieve productivity improvement or any other cost saving.
2. Gradual/Evolutionary phasing out any product line or service or class.
3. Discontinuing several products, within an ongoing line of business.
4. Changing of location of production or marketing activities for a particular business line.

—— Space to write important points for revision ——

Q.11.2	2013 - Nov [7] (c)	Practical

Qu Ltd. is in the business of manufacture of Passenger cars and commercial vehicles. The company is working on a strategic plan to shift from the Passenger car segment over the coming 5 years. However no specific plans have been drawn up for sale of neither the division nor its assets. As part of its plan it will reduce the production of passenger cars by 20% annually. It also plans to commence another new factory for the manufacture of commercial vehicles and transfer surplus employees in a phased manner.

(i) You are required to comment if mere gradual phasing out in itself can be considered as a 'Discontinuing Operation' within the meaning of AS-24.

(ii) If the company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24 ?

(iii) Would your answer to the above be different if the company resolves to sell the assets of the Passenger Car Division in a phased but time bound manner? (4 marks) *[CA Final - I]*

Answer :

Mere gradual phasing is not considered as discontinuing operation as defined under para 3 of AS 24, ‘ Discontinuing Operation’.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

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

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

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

A Reportable business segment or geographical segment as defined in AS-17, would normally satisfy criteria (b) of the definition.

In view of the above the answers are:

(i) No. The companies strategic plan has no final approval from the board through a resolution and no specific time bound activities like shifting of Assets and employees and above all the new segment commercial vehicle production line and factory has started.

(ii) No. The resolution is salient about stoppage of the Car segment in definite time period. Though, some assets sales and transfer proposal was passed through a resolution to the new factory, closure road map and new segment starting road map is missing. Hence, AS-24 will not be applicable.

(iii) Yes. Phased and time bound programme resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and clear road map. Hence, this action will attract AS-24 compliance.

—— Space to write important points for revision ——

Q.11.3	2018 - Nov [6] (b)	Descriptive
Answer the following: What are the initial disclosure requirements of AS 24 for discontinuing operations? (5 marks)		

Answer:

Initial Disclosure requirement of AS 24 for discontinuing operation:

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

1. A description of the discontinuing operation(s).
2. The business or geographical segment(s) in which it is reported as per AS 17.
3. The date and nature of the initial disclosure event.
4. The date or period in which the discontinuance is expected to be completed if known or determinable.
5. The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled.
6. The amounts of revenue and expenses in respect of the ordinary activities attributable to the discounting operation during the current financial reporting period.
7. The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto.
8. The amounts of net cash flows attributable to the operating, investing and financing activities of the discontinuing operation during the current financial reporting period.

—— Space to write important points for revision ——

Q.11.4	2021 - July [1] {C} (b)	Practical

Rohini Limited is in the business of manufacture of passenger cars and commercial vehicles. The Company is working on a strategic plan to close the production of passenger cars and to produce only commercial vehicles over the coming 5 years. However no specific plans have been drawn up for sale of neither the division nor its assets. As part of its prospective plan it will reduce the production of passenger cars by 20% annually. It also plans to establish another new factory for the manufacture of commercial vehicles and transfer surplus employees in a phased manner. You are required to comment:

(i) If mere gradual phasing out in itself can be considered as a 'discounting operation' within the meaning of AS– 24.

(ii) If the Company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS– 24?

(iii) Would your answer to the above be different if the Company resolves to sell the assets of the passenger car division in a phased but time bound manner? (5 marks)

12 AS - 26 Intangible Assets

Q.12.1	2010 - Nov [7] (e)	Practical

Answer the following :

M Ltd. launched a project for producing product A in Nov. 2008. The company incurred ₹ 30 lakhs towards Research and Development expenses upto 31st March 2010. Due to unfavourable market conditions the management feels that it is not possible to manufacture and sold the product in the market for next so many years.

The management hence wants to defer the expenditure write off to future years. Advise the company as per the applicable Accounting Standard.

(4 marks)

Answer :

Provision:

As per AS - 26, expenditure on research should be recognised as an expense when it is incurred.

An intangible asset arising from development (or from the development phase of an internal project) should be recognized if and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard.

An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to the provisions of AS-26.

Analysis and Conclusion:

The management cannot defer the expenditure write off to future years and the company is required to expense the entire amount of 30 lakhs in the Profit and Loss account of the year ended 31st March, 2010.

—— Space to write important points for revision ——

Q.12.2	2012 - May [1] {C} (a)	Practical

Answer the following:

(a) A company had deferred research and development cost of ₹ 450 Lakhs. Sales expected in the subsequent years are as under:

Years	**Sales (₹ in Lakhs)**
1	1200
2	900
3	600
4	300

You are asked to suggest how should research and development cost be charged to Profit and Loss Account assuming entire cost of ₹ 450 Lakhs is development cost. If at the end of 3rd year, it is felt that no further benefit will accrue in the 4th year, how the unamortized expenditure would be dealt with in the accounts of the Company? (5 marks)

Answer :

(i) Research and development cost based on sales (assumed that entire cost of ₹ 450 lakhs is development cost) is allocated as follows :

Year	Research and Development cost allocation
	(₹ in lakhs)
1st	$\frac{450}{3,000}$ x 1,200 = 180
2nd	$\frac{450}{3,000}$ x 900 = 135
3rd	$\frac{450}{3,000}$ x 600 = 90
4th	$\frac{450}{3,000}$ x 300 = 45

(ii) If at the end of the 3rd year, the conditions do not justify that further benefit will accrue in the 4th year, then the company has to charge the unamortised amount i.e. remaining ₹ 135 lakhs [450 - (180 + 135)] as revenue expense in 3rd year.

Space to write important points for revision

Q.12.3	2013 - May [1] {C} (d)	Practical

Answer the following:
An enterprise acquired patent right for ₹ 400 lakhs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of estimated future cash flows which are as under :

Year	Estimated Future Cash Flows (₹ in lakhs)
1	200
2	200
3	200
4	100
5	100

After 3rd year, it was ascertained that the patent would have an estimated balance future life of 3 years and the estimated cash flow after 5th year is expected to be ₹ 50 lakhs each year. Determine the amortization under Accounting Standard 26. (5 marks)

Answer :

Amortization of cost of patent as per AS- 26

Year	Estimated future cash flow (₹ in lakhs)	Amortization Ratio	Amortized Amount (₹ in lakhs)
1	200	.25	100
2	200	.25	100
3	200	.25	100
4	100	.40 (Revised)	40
5	100	.40 (Revised)	40
6	50	.20 (Revised)	20
			400

1. In the first three years, the patent cost will be amortised in the ratio of estimated future cash flows i.e. (200: 200: 200: 100: 100).
2. The unamortized portion of the patent after third year will be ₹ 100 (400-300) which will be amortised in the ratio of revised estimated future cash flows (100:100:50) in the fourth, fifth and sixth year.

—— Space to write important points for revision ——

Q.12.4	2013 - Nov [7] (b)	Practical

Answer the following:

Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred ₹ 10 lakhs on research during first 5 months of the financial year 2012-13. The development of the process began on 1st September, 2012 and upto 31st March, 2013, a sum of ₹ 8 lakhs was incurred as Development Phase Expenditure, which meets assets recognition criteria.

From 1st April, 2013, the Company has implemented the new process design and it is likely that this will result in after tax saving of ₹ 2 lakhs per annum for next five years.

The cost of capital is 10%. The present value of annuity factor of ₹ 1 for 5 years @ 10% is 3.7908.
Decide the treatment of Research and Development Cost of the project as per AS-26. (4 marks)

Answer :

Research Expenditure: According to AS-26 'Intangible Assets', the expenditure on research of new process design for its product ₹ 10 lakhs should be charged to "Profit and Loss Account in the year in which it is incurred". It is presumed that the entire expenditure is incurred in the financial year 2012-13. Hence, it should be written off as an expense in that year itself.

Cost of internally generated intangible asset: it is given that development phase expenditure amounting ₹ 8 lakhs incurred upto 31st March, 2013 meets asset recognition criteria. As per AS-26, for measurement of such internally generated intangible asset, fair value can be estimated by discounting estimated future net cash flows.

Savings (after tax) from implementation of new design for next 5 years	₹ 2 lakhs p.a.
Company's cost of capital	10%
Annuity factor @ 10% for 5 years	3.7908
Present value of net cash flows (₹ 2 lakhs x 3.7908)	₹ 7.582 lakhs

The cost of an internally generated intangible asset would be lower of cost value ₹ 8 lakhs or present value of future net cash flows ₹ 7.582 lakhs.
Hence, cost of an internally generated intangible asset will be 7.582 lakhs. The difference of ₹ 0.418 lakhs (i.e. ₹ 8 lakhs – ₹ 7.582 lakhs) will be amortized by Plymouth for the financial year 2012-13.

Amortisation: The company can amortise ₹ 7.582 lakhs over a period of five years by charging ₹ 1.5164 lakhs per annum from the financial year 2013-2014 onwards.

Space to write important points for revision

Q.12.5	2014 - Nov [1] {C} (b)	Practical

Answer the following:
A company is showing an intangible asset at ₹ 88 lakhs as on 01.04.2013. This asset was acquired for ₹ 120 lakhs on 01.04.2009 and the same was available for use from that date. The company has been following the policy of amortization of the intangible assets over a period of 15 years on straight line basis. Comment on the accounting treatment of the above with reference to the relevant Accounting Standard. (5 marks)

Answer :

According to AS-26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on systematic basis over the best estimate of its useful life.

There is a rebuttable presumption that the useful life of an intangible asset will not exceed 10 years from the date when the asset is available for use.

Company has been following the policy of amortisation of the intangible asset over a period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS-26.

According to the above, the company would be required to restate the carrying amount of intangible asset as on 01.04.2013 at ₹ 72 lakhs i.e. ₹ 120 lakhs less 48 lakhs

$$\left(\frac{₹\,120\text{ Lakhs}}{10\text{ Years}} \times 4\text{ years} = 48\text{ Lakhs}\right)$$

Difference of ₹ 16 Lakhs (i.e. ₹ 88 lakhs – ₹ 72 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹ 72 lakhs will be amortised over remaining 6 years by amortising ₹ 12 lakhs per year.

—— Space to write important points for revision ——

Q.12.6	2015 - May [1] {C} (b)	Practical

Answer the following:
M/s. Mahesh Ltd. is developing a new production process. During the Financial Year ended 31st March, 2013, the total expenditure incurred on

the process was ₹ 60 Lakhs. The production process met the criteria for recognition as an intangible asset on 1st December, 2012. Expenditure incurred till this date was ₹ 32 Lakhs.

Further expenditure incurred on the process for the Financial Year ending 31st March, 2014 was ₹ 90 Lakhs. As on 31.03.2014, the recoverable amount of know-how embodied in the process is estimated to be ₹ 82 Lakhs. This includes estimates of future cash outflows and inflows.

You are required to work out:

(i) What is the expenditure to be charged to Profit & Loss Account for the year ended 31st March, 2013?

(ii) What is the carrying amount of the intangible asset as on 31st March, 2013?

(iii) What is the expenditure to be charged to Profit & Loss Account for the year ended 31st March, 2014?

(iv) What is the carrying amount of the intangible asset as on 31st March, 2014? (5 marks)

Answer:

As per AS-26, the amount charged and recognised are as follows:

(i) **The expenditure to be charged to Profit & Loss A/c for year ended 31st March, 2013:**

- ₹ 32 lakhs will be recognised as an Expense because the recognition criteria were not met until 1st December, 2012.
  This expenditure will not form part of the cost of the production process recognised in the Balance Sheet.

(ii) **The carrying amount of the asset as on 31st March, 2013:**

- The production process will be recognised (i.e. carrying amount) as an intangible asset at a cost of ₹ 28 lakhs (i.e. expenditure incurred since the date the recognition criteria were met, i.e. total during 2012-13 ₹ 60 lakhs -Expenses incurred upto 1st December, 2012 ₹ 32 lakhs).

(iii) **The expenditure to be charged to Profit & Loss A/c for year ended 31st March, 2014:**

		₹
• Book Value on 31/03/14		
Carrying Amount on 31/03/13 + Exp. in 2013-14	=	28 + 90 lakhs
	=	118 lakhs
Less: Recoverable Amount	=	(82 lakhs)
Impairment loss to be charged to Profit & Loss A/c	=	₹ 36 lakhs

(iv) **The Carrying Amount of asset as on 31st March, 2014:**

- The production process will be shown at book value ₹ 118 lakhs or, recoverable amount ₹ 82 lakhs, whichever is less, hence carrying amount is ₹ 82 lakhs.

—— Space to write important points for revision ——

Q.12.7	2016 - Nov [1] {C} (d)	Practical

Answer the following question:
A Company with a turnover of ₹ 375 crores and an annual advertising budget of ₹ 3 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹ 37.5 crores from the new product. The Company had debited to its Profit and Loss Account the total expenditure of ₹ 3 crores incurred on extensive special initial advertisement campaign for the new product.
Is the procedure adopted by the Company correct? (5 marks)

Answer :

Provision:

According to para 55 and 56 of AS-26 "Intangible Assets", expenditure on an intangible items should be recognised as an expense when it is incurred, unless it forms part of the cost of an Intangible Asset.

Analysis:

In the given case, advertisement expenditure of 3 crore had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹ 37.5 crores. Here, no intangible asset or other asset is acquired or created that can be recognised.

Conclusion:

Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹ 3 crore to the Profit and Loss Account of the year is correct.

—— Space to write important points for revision ——

Q.12.8	2017 - May [1] {C} (a)	Practical

Answer the following question:

Fast Ltd. acquired a patent at a cost of ₹ 40,00,000 for a period of five years and its product life-cycle is also five years. The company capitalized the cost and started amortizing the asset at ₹ 5,00,000 per annum. After two years, it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years are expected to be ₹ 18,00,000, ₹ 23,00,000, ₹ 22,00,000, ₹ 20,00,000 and ₹ 17,00,000. Find out the amortization cost of the patent for each of the years. (5 marks)

Answer :

As per AS-26, "Intangible Assets", Fast Ltd. amortized ₹ 5,00,000 per annum for the first two years i.e., ₹ 10,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortization may be found as follow:

Year	Net Cash flows (₹)	Amortization Ratio	Amortization Amt. (₹)
1	—	—	5,00,000
2	—	—	5,00,000
3	18,00,000	18%	5,40,000
4	23,00,000	23%	6,90,000

5	22,00,000	22%	6,60,000
6	20,00,000	20%	6,00,000
7	17,00,000	17%	5,10,000
Total	1,00,00,000	100%	40,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹ 30,00,000 has been amortized in the ratio of net cash flows arising from the product of Fast Ltd.

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

—— Space to write important points for revision ——

Q.12.9	2018 - May [1] {C} (c)	Practical

A company acquired a patent at a cost of ₹ 160 lakhs for a period of 5 years and the product life cycle is also 5 years. The company capitalized the cost and started amortising the asset at ₹ 16 lakhs per year based on the economic benefits derived from the product manufactured under the patent. After 2 years it was found that the product life cycle may continue for another 5 years from then (the patent is renewable and the company can get it renewed after 5 years). The net cash flows from the product during these 5 years were expected to be ₹ 50 lakhs, ₹ 30 lakhs, ₹ 60 lakhs, ₹ 70 lakhs and ₹ 40 lakhs. Find out the amortization cost of the patent for each of the years. (5 marks)

Answer:

The company amortised ₹ 16,00,000 per annum for the first two years i.e. ₹ 32,00,000. The remaining carrying cost can be amortised during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	Net Cash flows (₹)	Amortisation Ratio	Amortisation Amount (₹)
1	–	0.10	16,00,000
2	–	0.10	16,00,000
3	50,00,000	0.20	25,60,000
4	30,00,000	0.12	15,36,000
5	60,00,000	0.24	30,72,000
6	70,00,000	0.28	35,84,000
7	40,00,000	0.16	20,48,000
	2,50,00,000	1.00	1,60,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e. ₹ 1,28,00,000 has been amortised in the ratio of net cash flows arising from the product of the company.

—— Space to write important points for revision ——

Q.12.10	2019 - Nov [1] {C} (b)	Practical

As per provision of AS-26, how would you deal to the following situations:

1. ₹ 23,00,000 paid by a manufacturing company to the legal advisor defending the patent of a product is treated as a capital expenditure.
2. During the year 2018-19, a company spent ₹ 7,00,000 for publicity and research expenses on one of its new consumer product which was marketed in the same accounting year but proved to be a failure.
3. A company spent ₹ 25,00,000 in the past three years to develop a product, these expenses were charged to profit and loss account since they did not meet AS-26 criteria for capitalization. In the current year approval of the concerned authority has been received. The company wishes to capitalize ₹ 25,00,000 by disclosing it as a prior period item.

4. A company with a turnover of ₹ 200 crores and an annual advertising budget of ₹ 50,00,000 had taken up for the marketing of a new product by a company. It was estimated that the company would have a turnover of ₹ 20 crore from the new product. The company had debited to its Profit & Loss Account the total expenditure of ₹ 50,00,000 incurred on extensive special initial advertisement campaign for the new product. (5 marks)

Answer:

As per AS 26 'Intangible Assets', expenditure on an intangible item should be recognised as an expense when it is incurred unless:

(a) It forms part of the cost of an intangible asset that meets the recognition criteria.

(b) The item is acquired in an amalgamation in the nature of purchase and cannot be recognised as an intangible asset. It forms part of the amount attributed to goodwill (Capital reserve) at the date of acquisition.

In some cases, 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. In these cases, the expenditure is recognised as an expense when it is incurred.

(1) Here, no intangible asset or other asset is created and does not meet recognition criteria fulfilled by paying ₹ 23,00,000 to legal advisor for defending the patent. So that ₹ 23,00,000 is to be recognised as expenditure and charged to profit and loss account, hence, ₹ 23,00,000 should not be capitalised.

(2) In the given case, the company spent ₹ 7,00,000 for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/ benefit because of the failure of the product. Thus, according to AS-26 'Intangible Assets', the company should charge total amount of ₹7,00,000 as an expense in the Profit and Loss Account.

(3) In this case, the company spent ₹ 25,00,000 in the past three years to develop a product, these expenses were charged to profit and loss account since they did not meet AS-26 criteria for capitalization. In the current year after receiving approval from concerned authority, the company wishes to capitalize ₹ 25,00,000 by disclosing it as a prior period item. According to AS 26, once the amount charged to profit and loss account, it cannot be capitalized. So here, the company cannot capitalize ₹ 25,00,000 as a prior period item.

(4) According to AS 26 '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."

- As 26 mentions that expenditure on advertising and promotional activities should be recognised as an expense when incurred.
- In the given case, advertisement expenditure of ₹ 50,00,000 had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹ 20 crore. Here, no intangible asset or other asset is acquired or created that can be recognised.

  Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹ 50,00,000 to the Profit and Loss Account of the year is correct.

Space to write important points for revision

Q.12.11	2020 - Nov [1] {C} (b)	Practical

Answer the following:

Swift Limited acquired patent rights to manufacture Solar Roof Top Panels at a cost of ₹ 600 lacs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of future cash flows which are estimated as under:

Year	1	2	3	4	5
Cash Flows (₹ in lacs)	300	300	300	150	150

After 3rd year, it was estimated that the patents would have an estimated balance future life of 3 years and Swift Ltd. expected the estimated cash flow after 5th year to be ₹ 75 Lacs. Determine the amortization cost of the patent for each of the above years as per Accounting Standard 26.

(5 marks)

Answer:

As per AS 26, Intangible Assets, amortization cost of patent for each year would be as follow:

(₹ in lacs)

Year	Ratio	Amt. (₹)
1	–	150
2	–	150
3	–	150
4	150 : 150 : 75	60
5	150 : 150 : 75	60
6	150 : 150 : 75	30
	Total	600

Notes:

In first 3 years amortization of patent cost in the Ratio of 300 : 300 : 300 : 150 : 150.

In remaining 3 years amortization of patent cost in the ratio of 150 : 150 : 75.

Space to write important points for revision

Q.12.12	2020 - Nov [6] (c)	Practical

Answer the following:

M/s. Pasa Ltd. is developing a new production process. During the financial year ended 31st March, 2019, the total expenditure incurred on the process was ₹ 80 lakhs. The production process met the criteria for recognition as an intangible asset on 1st November, 2018. Expenditure incurred till this date was ₹ 42 lakhs.

Further expenditure incurred on the process for the financial year ending 31st March, 2020 was ₹ 90 lakhs. As on 31.03.2020, the recoverable amount of know how embodied in the process is estimated to be ₹ 82 lakhs. This includes estimates of future cash outflows and inflows.

You are required to work out:

(1) What is the expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2019?

(2) What is the carrying amount of the intangible asset as on 31st March, 2019?

(3) What is the expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2020?

What is the carrying amount of the intangible asset as on 31st March, 2020? (5 marks)

Answer:

As per AS 26 Intangible Assets,

(i) Expenditure to be charged to P & L A/c for the year ending 31.3.19
₹ 42 lakhs is recognized as an expense because the recognition criteria were not met until 1.11.18. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the Balance Sheet.

(ii) At the end of financial year, on 31.3.20, the production will be recognized is an intangible asset at a cost of ₹ 38 lakhs.

(iii) Expenditure to be charged to P & L A/c:

	(₹ in lakhs)
Carrying amount as on 31.3.20	38
Expenditure during	90
Book value	128
Recoverable Amount	(82)
Impairment Loss	46

(iv) Carrying value of intangible asset as on 31.3.20.

Book value	128
Less: Impairment Loss	(46)
	82

Q.12.13	2021 - Jan [1] {C} (a)	Practical

A Company acquired for its internal use a software on 01.03.2020 from U.K. for £ 1,50,000. The exchange rate on the date was as ₹ 100 per £. The seller allowed trade discount @ 2.5%. The other expenditures were;

(i) Import Duty 10%
(ii) Additional Import Duty 5%
(iii) Entry Tax 2% (Recoverable later from tax department)
(iv) Installation expenses ₹ 1,50,000
(v) Professional fees for clearance from customs ₹ 50,000.

Compute the cost of software to be Capitalised as per relevant AS.

(5 marks)

Answer:

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

Purchase cost of the software	£ 1,50,000
Less: Trade discount @ 2.5%	£ (3,750)
	£1,46,250
Cost in ₹ (UK £1,46,250 × ₹ 100)	1,46,25,000
Add: Import duty on cost @ 10% (₹)	14,62,500
	1,60,87,500
Add: Additional import duty @ 5% (₹)	8,04,375
	1,68,91,875
Add: Installation expenses (₹)	1,50,000
Add: Professional fee for clearance from customs (₹)	50,000
Cost of the software to be capitalized (₹)	1,70,91,875

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

Space to write important points for revision

Q.12.14	RTP	Practical

Desire Ltd. acquired a patent at a cost of ₹ 1,00,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset on SLM. After two years it was found that the product life -cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be ₹ 45,00,000, ₹ 42,00,000, ₹ 40,00,000, ₹ 38,00,000 and ₹ 35,00,000. Patent is renewable and company changed amortization method from 3rd year (i.e. from SLM to ratio of expected new cash flows). You are required to compute the amortization cost of the patent for each of the years (1st year to 7th year).

Answer:

Desire Limited amortised ₹ 20,00,000 per annum for the first two years i.e. ₹ 40,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	Net cash flows ₹	Amortization Ratio	Amortization Amount ₹
I	-	0.200	20,00,000
II	-	0.200	20,00,000
III	45,00,000	0.225	13,50,000
IV	42,00,000	0.21	12,60,000
V	40,00,000	0.20	12,00,000
VI	38,00,000	0.19	11,40,000
VII	35,00,000	0.175	10,50,000
Total	2,00,00,000	1.000	1,00,00,000

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

Space to write important points for revision

13 AS - 29 Provisions, Contingent Liabilities and Contingent Assets

Q.13.1	2012 - May [7] (c), RTP	Practical

Answer the following :
An airline is required by law to overhaul its aircraft once in every five years. The Pacific Airlines which operates aircrafts does not provide any provision as required by law in its final accounts. Discuss with reference to relevant Accounting Standard 29. (4 marks)

Answer :

A provision should be recognised only when an enterprise has a present obligation as a result of a past event. In the given case, there is no present obligation, therefore no provision is recognised as per AS 29.

- The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts.
- Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts.
- Further, the enterprise can avoid the future expenditure by its future action, for example by selling the aircraft.
- However, an obligation might arise to pay fines or penalties under the legislation after completion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime.
- A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than five years.

—— Space to write important points for revision ——

Q.13.2	2012 - Nov [7] (c)	Practical

Answer the following:
A company is in a dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of ₹ 900

lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal the same in the annual accounts of the company? (4 marks)

Answer :

Provision:

As per AS-29, (Revised) 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognised when:

(a) an enterprise has a present obligation as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

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

Analysis and Conclusion:

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

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

Space to write important points for revision

Q.13.3	2013 - May [1] {C} (c)	Practical

Answer the following:

An engineering goods company provides after sales warranty for 2 years to its customers. Based on past experience, the company has the following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period :

Less than 1 year : 2% provision

More than 1 year : 3% provision

The company has raised invoices as under:

Invoice Date	Amount (₹)
19th January, 2011	40,000
29th January, 2012	25,000
15th October, 2012	90,000

Calculate the provision to be made for warranty under Accounting Standard 29 as at 31st March, 2012 and 31st March, 2013. Also compute amount to be debited to Profit and Loss Account for the year ended 31st March, 2013. (5 marks)

Answer:

Provision to be made for warranty under AS 29 'Provisions, Contingent Liabilities and Contingent Assets'

As at 31st March, 2012 = ₹ 40,000 × .02 + ₹ 25,000 × .03
= ₹ 800 + ₹ 750
= ₹ 1,550

As at 31st March, 2013 = ₹ 25,000 × .02 + ₹ 90,000 × .03
= ₹ 500 + ₹ 2,700 = ₹ 3,200

Amount debited to Profit and Loss Account for year ended 31st March, 2013

Particulars	₹
Balance of provision required as on 31.03.2013	3,200
Less: Opening Balance as on 1.4.2012	(1,550)
Amount debited to profit and loss account	1,650

Note: No provision will be computed on 31st March, 2013 in respect of sales amounting ₹ 40,000 made on 19th January, 2011 as the warranty period of 2 years has already expired.

—— Space to write important points for revision ——

Q.13.4	2014 - Nov [1] {C} (d)	Practical

Answer the following:
WZW Ltd. is in dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of ₹ 1,000 Lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal the same in the Annual Accounts of the company? (5 marks)

Answer :

According to AS-29 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognised when:

(i) An enterprise has a present obligation as a result of past event;

(ii) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(iii) A reliable estimate can be made of the amount of the obligation.

- If such conditions are not met, no provision should be recognised.
- A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote. The possibility of an outflow of resources embodying economic benefits is remote in the given situation, since the directors of the company are of the opinion that the claim can be successfully resisted by the company. Therefore, the company shall not disclose the same as contingent liability.
- Where as the following note in this regard may be given in annual accounts:
  "Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of ₹ 1,000 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company".

Q.13.5	2015 - May [1] {C} (a)	Practical

Answer the following:
M/s. Shishir Ltd., a public Sector Company, provides consultancy and engineering services to its clients. In the year 2014-15, the Government set up a commission to decide about the pay revision. The pay will be revised with respect from 1 - 1 - 2012 based on the recommendations of the commission. The company makes the provision of ₹ 1,250 lakhs for pay revision in the financial year 2014 - 15 on the estimated basis as the report of the commission is yet to come. As per the contracts with client on cost plus job, the billing is done on the actual payment made to the employees and allocated to jobs based on hours booked by these employees on each job.
The company discloses through notes to accounts:
"Salaries and benefits include the provision of ₹ 1,250 lakhs in respect of pay revision. The amount chargeable from reimbursable jobs will be billed as per the contract when the actual payment is made."
The Accountant feels that the company should also book/recognize the income by ₹ 1,250 lakhs in Profit & Loss Account as per the terms of the contract. Otherwise, it will be the violation of matching concept and understatement of profit.
Comment on the opinion of the Accountant with reference to relevant Accounting Standards. (5 marks)

Answer :

Provision:

As per AS-29, 'Provisions, Contingent Liabilities and Contingent Assets', where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision.

Thus, potential loss to an enterprise may be reduced or avoided because a contingent liability is matched by a related counter-claim or claim against a third party. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim if no significant uncertainty as to its measurability or collectability exists.

Present Case: The provision of salary to employees of ₹ 1,250 lakhs will be ultimately collected from the client, as per the terms of the contract. Therefore, the liability of ₹ 1,250 lakhs is matched by the counter claim from the client. Hence, the provision for salary of employees should be matched with the reimbursable asset to be claimed from the client. It appears that the whole amount of ₹ 1,250 lakhs is recoverable from client and there is no significant uncertainty about the collection. Hence, the net charge to profit and loss account should be nil.

The opinion of the accountant regarding recognition of income of ₹ 1,250 lakhs is not as per AS-29 and also the concept of prudence will not be followed if ₹ 1,250 lakhs is simultaneously recognized as income. ₹ 1,250 lakhs is not the revenue at present but only reimbursement of claim for which an asset is created. However, the accountant is correct to the extent as that non- recognition of ₹ 1,250 lakhs as income will result in the understatement of profit. To avoid this, in the statement of profit and loss, expense relating to provision may be presented net of the amount recognized for reimbursement.

Space to write important points for revision

Q.13.6	2016 - May [7] (b)	Descriptive

Answer the following:

With reference to AS 29 "Provisions, Contingent Liabilities and Contingent Assets", define:

(i) A Provision

(ii) A Liability

(iii) A Contingent Asset

(iv) Present Obligation (4 marks)

Answer:

(i) **A Provision:**
A Provision is a liability, which can be measured only by using a substantial degree of estimation.

(ii) **A Liability:**
A Liability is an obligation which the enterprise has to pay to some parties based on some contractual or any other trading arrangements within some specified or reasonable time period. So that it is considered as amount payable.

(iii) **A Contingent Asset:**
A Contingent Asset is a possible asset that arises from past events 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.

(iv) **Present Obligation:**
Present Obligation is an obligation of outflow of resources that is probable and reliable. It is estimated that amount is payable in present situation.

Space to write important points for revision

Q.13.7	2016 - Nov [7] (b)	Practical

M/s. XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of ₹ 200 Lakhs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS-29? Explain in brief giving reasons for your answer.

(4 marks)

Answer :

Provision:

As per para 14 of AS-29, 'provisions,' Contingent Liabilities and Contingent Assets' a provision should be recognised when:

(a) an enterprise has a present obligation as a result of a past event;

(b) a reliable estimate can be made of the amount of the obligation;

(c) it is probable that the outflow of resources embodying economic benefits will be required to settle the obligation.

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

Analysis & Conclusion:

In the given situation, since the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be not outflow of the resources. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of ₹ 200 lakhs.

However, the directors are of the opinion that the claim can be successfully resisted by the company".

—— Space to write important points for revision ——

Q.13.8	**2017 - Nov [1] (b)**	**Practical**

Legal department of XYZ Limited provides that as on 31st March, 2017, there were 25 law suits pending which have not been settled till the approval of accounts by the Board of Directors. The possible outcome of suits are follows:

Particulars	**Probability**	**Loss (₹)**
In respect of Seven cases (Win)	100%	
Next Twelve cases (Win)	60%	
Loss (Low damages)	30%	1,50,000
Loss (High damages)	10%	2,50,000
Remaining Six cases (Win)	50%	

Loss (Low damages)	35%	1,25,000
Loss (High damages)	15%	3,00,000

Outcome of each case is to be taken as a separate one. Ascertain the amount of contingent loss to be reported in the Financial Statement.

(5 marks)

Answer :

According to AS- 29 'Provisions, contingent liabilities and contingent assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

(i) There is a present obligation arising out of past events but not recognized as provision.

(ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

(iii) The possibility of an outflow of resources embodying economic benefits is also remote.

(iv) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning first 7 cases is 100%.

The probability of winning next twelve cases is 60% and for remaining six cases is 50%.

In other word, probability of losing the cases is 40% and 50% respectively. According to AS- 29, we make a provision if the loss is probable. As the loss does not appear to be probable and the probability or possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore, disclosure by way of note of contingent liability amount may be calculated as under:

Expected loss in next twelve cases

= [₹ 1,50,000 × 30% + ₹ 2,50,000 × 10%] × 12

= [45,000 + 25,000] × 12

= 70,000 × 12

= ₹ 8,40,000

Expected loss in remaining six cases

= [₹ 1,25,000 × 35% + ₹ 3,00,000 × 15%] × 6
= [43,750 + 45,000] × 6
= 88,750 × 6
= 5,32,500

Total contingent liability = 8,40,000 + 5,32,500 = ₹ 13,72,500

Expected loss in next twelve cases

= ₹ 2,50,000 × 12 cases
= ₹ 30,00,000

Expected loss in remaining six cases

= ₹ 3,00,000 × 6 cases
= ₹ 18,00,000

Total = ₹ 30,00,000 + ₹ 18,00,000
= ₹ 48,00,000

Disclosure:

(a) Disclosure of contingent liability on the basis of maximum loss at ₹ 48,00,000 will be highly unrealistic since it does not recognize the probability of winning some cases and paying low damages in some cases.

(b) It will be advisable to disclose the overall expected loss of ₹ 13,72,500 as contingent liability not provided for in the accounts.

—— Space to write important points for revision ——

Q.13.9	2019 - Nov [1] {C} (a)	Practical

A Ltd. provides after sales warranty for two years to its customers. Based on past experience, the company has the following policy for making provision for warranties on the invoice amount on the remaining balance warranty period.

Less than 1 year : 2% provision

More than 1 year : 3% provision

The company has raised invoices as under :

Invoice Date	**Amount (₹)**
11^{th} Feb, 2017	60,000
25^{th} Dec, 2017	40,000
04^{th} Oct, 2018	1,35,000

Calculate the provision to be made for warranty under AS-29 as at 31^{st} March, 2018 and 31^{st} March, 2019. Also compute amount to be debited to P & L account for the year ended 31^{st} March, 2019. (5 marks)

Answer:

Provision to be made for warranty under AS 29, 'Provisions, Contingent Liabilities and Contingent Assets':

As at 31^{st} March, 2018 = ₹ 60,000 × 0.02 + ₹ 40,000 × 0.03
= ₹ 1,200 + ₹ 1,200
= ₹ 2,400

As at 31^{st} March, 2019 = ₹ 40,000 × 0.02 + ₹ 1,35,000 × 0.03
= ₹ 800 + ₹ 4,050
= 4,850

Amount Debited to Profit and Loss Account for the year ended 31^{st} March, 2019

	₹
Balance of provision required as on 31.03.2019	4,850
Less: Opening Balance as on 01.04.2018	(2,400)
Amount debited to profit and loss account	2,450

Note: No provision will be made on 31^{st} March, 2019 in respect of sales amounting ₹ 60,000 made on 11^{th} February, 2017 as the warranty period of 2 years has already expired.

Space to write important points for revision

Q.13.10	2020 - Nov [6] (e)	Practical

Answer the following:

With reference to AS 29, how would you deal with the following in the Annual Accounts of the company at the Balance Sheet date:

(i) The company operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Eighty five percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and fifteen percent arise through the extraction of oil. At the balance sheet date, rig has been constructed but no oil has been extracted.

(ii) The Government introduces a number of changes to the taxation laws. As a result of these changes, the company will need to train a large proportion of its accounting and legal workforce in order to ensure continued compliances with tax law regulations. At the balance sheet date, no retraining of staff has taken place. (5 marks)

Answer:

(i) The construction of the oil Rig creates an obligation under the terms of the license to remove the Rig & Restore the seabed and is thus an obligating event. At the Balance Sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of Resources Embodying economic benefits in settlement is probable. Thus, a provision is recognized for the best estimate of 85% of the individual costs that relate to removal of the oil Rig & Restoration of damage caused by building it. These costs are included as part of the cost of the oil Rig.

So, no 15% of costs that arise through the extraction of oil are recognized as a liability, when the oil is extracted.

(ii) As per AS 29, a provision for restructuring costs is recognized only when the recognition criteria for provisions are met. A restructuring provision does not include costs as of retraining or relocating continuing staff.

The expenditures of training the staff related to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognized on the same basis as if they arose independently of a restructuring. At the balance sheet date, no such expenditure has been incurred hence no provision is required.

—— Space to write important points for revision ——

Q.13.11	RTP	Practical

M/s. XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of ₹ 200 lakhs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS-29? You are required to explain in brief giving reasons for your answer.

Answer:

As per AS-29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when

(a) an enterprise has a present obligation as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

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

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

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of ₹ 200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."