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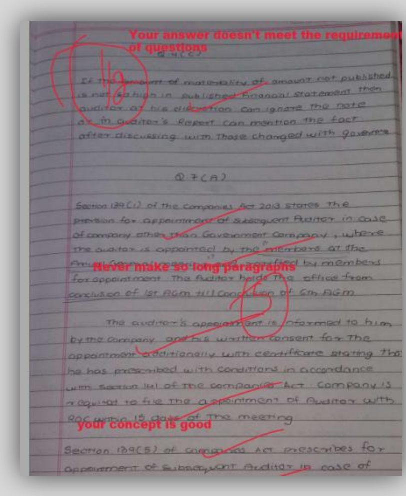

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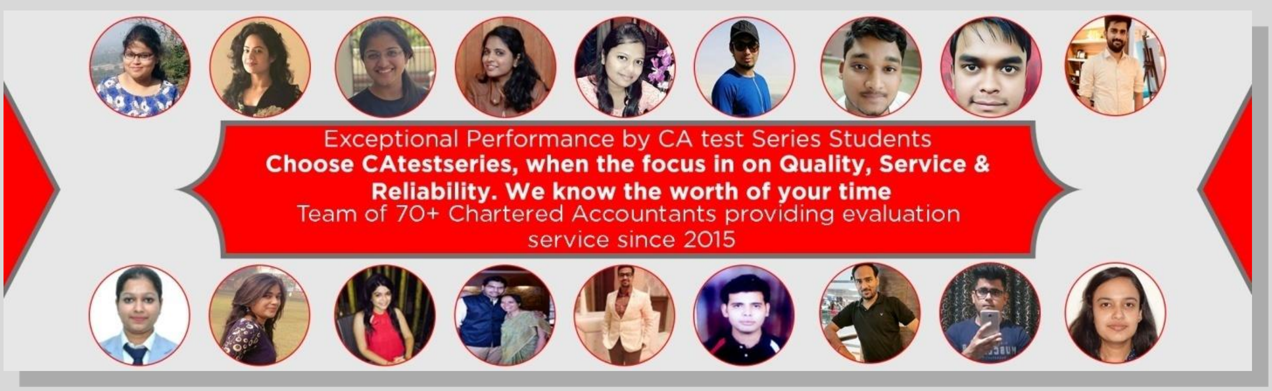

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AS 4 - Events Occurring after Balance Sheet Date

Question 1

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

Solution

As per Para 13 of AS 4 "Contingencies and events occurring after the balance sheet date", assets and liabilities should be for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

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

Question 2

During the year 2012-2013, Raj Ltd. was sued by a competitor for Rs 15 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Raj Ltd. provided for a sum of Rs 10 lakhs in its financial statements for the year ended 31st March, 2013. on 18th May,2013, the Court decided in favour of the party alleging infringement of the trademark and ordered Raj Ltd., to pay the aggrieved party a sum of Rs 14 lakhs. The financial statements were prepared by the company's management on 30th April, 2013, and approved by the board on 30th May, 2013.

Should Raj Ltd. adjust its financial statements for the year ended 31st March, 2013? What would be the treatment of the above, in case the court decision was held on 1st June, 2013.

Solution

As per para 8 of AS 4 “Contingencies and Events Occuring After the Balance Sheet Date, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

In the given case, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 2012-13 for which the provision was also made by it, the decision of the

Court on 18th May 2013, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Raj Ltd., should adjust the provision upward by Rs.4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

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

Question 3

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 Rs. 30 lakh to another company was entered into on 1st March, 2013. The value of land is shown at Rs. 20 lakh in the balance Sheet as on 31st March, 2012. However, the Sale Deed was registered on 15th April, 2013.

Solution

Accordingly to 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 asset the estimation of amounts relating to conditions existing at the balance sheet date.

In the given case, sale if immovable property was carried out before the closure of the books of accounts. 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 of Praddep Ltd. For the year ended 31st March 2013.

II. The negotiation with another company for acquisition of its business was stated on 2nd February, 2013. Pradeep Ltd. Invested s. 40 lakh on 12th April, 2013

Solution

As 4 (revised) defined "Events occurring after the balance sheet date" as those significant events, both favorable and unfavorable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is reburied as the event does not affect the determination and the condition is required as the event

does not affect the determination and the condition of the amounts stated in the financial states for the year ended 31st March, 2013.

Applying provisions of the standard which delay state that discloser should be made in the report of the approving authority of this events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of Rs. 40 lakhs in April, 2013 in the acquisition of another company should be disclosed in the port of the Board of Directors to enable users of financial statements to make proper evaluation and decisions.

Question 4

For seven companies whose financial year ended on 31st March, 2014, the financial statements were approved by their approving authority on 15th June, 2014.

During 2014-15, the following material events took place;

a. A Ltd sold a major property which was included in the balance sheet at Rs. 1,00,000 and for which contracts had been exchanged on 15tyh June 2014. The sale was completed on 15th

Mary, 2014 at a price of Rs. 2,50,000.

b. On 30th April, 2014, a 100% subsidiary of B Ltd. Declared a dividend of Rs. 3,00,000 in respect of its own shares for the year ended on 31st March 2014.

c. On 31st May, 2014, he email order activities of C Ltd. (a retail trading group) were shut down with closure costs amounting to Rs. 2.5 million

d. On 1st July, 2014 the discovery of sand under D Ltd.'s major civil engineering contract site causes the cost of the contract to increase by 25% for which there would be no corresponding recovery from the customer.

e. A fire, on 2nd April, 2014, completely destroyed a manufacturing plant of E Ltd. It was expected that the loss of Rs. 10 million would be fully covered by the insurance company.

f. A claim for damage amounting to Rs. 8 million for breach of patent had been received by G Ltd. Prior to the year-end. It is the director's opinion, backed by legal advice that the claim will ultimately prove to be baseless. But it is still estimated that it would involve a considerable expenditure on legal fees.

g. The change in foreign exchange rate of 8% between 1st April, 2014 and 1st June, 2014 has resulted in G Ltd.'s foreign assets being reduced by Rs. 1.3 million.

You are required to state with reasons, how each of the above items numbered (a) to (g) should be dealt with in the financial statement of the various companies for the year ended 31st March 2014.

Solution

(a)	A Ltd.	The sale of property should be treated as an adjusting event since contracts had been exchanged prior to the year-end. The effect of the sale would be reflected in the financial statements ended of the sale would be reelected in the finical statements ended on 31.03.2014 and the profit on sale of property Rs. 1,50,000 would be treated as an extraordinary item.
(b)	B Ltd.	The declaration of dividend on 30th April, 2014 of 3,00,000 would be treated as a non-adjusting event in the financial statements of 2013-14. This is because, the dividend has been declared after the balance sheet date and no

		conditions existed on the balance sheet date for such declaration of divined. Further as per AS 9, night to receive dividend is established when it is declared and not before that.
(c)	C Ltd.	A closure not anticipated at the year-end would be treated as a non-adjusting event. Memorandum disclosure would be required for closure of mail order activities since non-disclosure would affect user's understanding of the financial statements.
(d)	D Ltd.	The event took place after the financial statements were approved by the approving authority and is this outside the purview of AS 74. However, in view of its significant of the transaction, the directors may consider publishing a separate financial statement/additional statement for the attention of the members in general meeting.
(e)	E Ltd.	The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover. Also since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.
(f)	F Ltd.	On the basis of evidence provided, the claim against the company will not succeed. Thus, 8 million should not be provided in the account, but should be disclosed by means of contingent liability with full details of the facts as per AS 9. Provision should be made for legal fee expected to be incurred to the extent that they are not expected to be recovered.
(g)	G Ltd.	The change in exchange rates is a non-adjusting event since it does not relate to the conditions existing at the balance sheet date. However, they may be of such significance that they may require a discourse in the report of the approving authority to enable users of financial statements to make proper evaluations and decisions.

Question 5

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

Solution

According to para 8 of AS 4 Contingencies and Events Occurring After the Balance Sheet Date, the unexpected increase in sale price of petrol by the government after the balance sheet date cannot be regarded as an event occurring after the Balance Sheet date, which requires an adjustment at the Balance Sheet date, since it does not represent a condition present at the balance sheet date. The revenue should be recognized only in the subsequent year with proper disclosure. The retrospective increase in the petrol price should not be considered as a prior item as per AS 5 because there was no error in the preparation of previous period's financial statements.

Question 6

F Ltd. has finalized their financial statements for the year ending 31st March, 2015 and approved by their approving authority on 30th June, 2015.

1. A major fire broke out in the night of 31st May, 2015 destroying factory premises. Loss of property estimated to be Rs 25 lakhs.

2. On 15th May, 2015, one of the manufacturing unit was closed resulting shutdown cost of Rs 25 lakhs.

3. Negotiations with another company started in April 2015 for acquisition of two manufacturing units which may involve additional investment of Rs 50 lakhs.

4. On 30th April, 2015, a 100% subsidiary of F Ltd. declared dividend of Rs 10 lakhs for the year ended 31st March, 2015.

5. Foreign exchange loss during the period between 1st April, 2015 and 1st June 2015 has resulted into reduction of value of assets by Rs 30 lakhs.

You are requested to state how to deal with the above information in the annual accounts

Solution

For the information given, the following will be recommended treatment with reference to the provisions of AS 4 'Contingencies and Events Occurring After the Balance Sheet Date'.

1. The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, the event appears to be of such significance as to require a disclosure in the report of the approving authority to enable users of the financial statements to make proper evaluation and decision, hence, such disclosure is recommended.

2. The closure of one of the manufacturing units on 15th May, 2015 is assumed not to have been anticipated at the year-end on 31.03.2015, hence, it would be treated as a non-adjusting event. Appropriate disclosure would be required in the report of the approving authority as non-disclosure would affect users' understanding of the financial statements.

3. AS 4 defines events occurring after the balance sheet date as those significant event- both favorable and unfavorable that occur between the balance sheet date and the date on which the financial statements are approved by the approving authority. Accordingly, negotiation for acquisition of two manufacturing units which started in April, 2015 should be disclosed in the Board's Report. No adjustments of assets and liabilities are required, as the negotiation (which has only started) does not affect the determination and the conditions of the amounts stated in the financial statements for the year ended 31st March, 2015.

4. The declaration of dividend by the subsidiary company on 30th April, 2015 would be treated as a non-adjusting event. Further, it is to be noted that as per AS 9, the right to receive the dividend is established on 30th April 2015 only i.e. on the date of declaration.

5. The foreign exchange loss due to changes in exchange rates during the period between 1st April 2015 and 1st June 2015, is a non-adjusting event since it does not relate to the conditions existing at the balance sheet date. The amount of loss appears material and may be of such significance that requires disclosure in the report of the approving authority.

Question 1

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

Solution

According to para 8 of AS 4 (Revised 1995), the unexpected increase in sale price of petrol by the government after the balance sheet date cannot be regarded as an event occurring after the Balance sheet date, which requires an adjustment at the Balance Sheet date, since it does not represent a condition present at the balance sheet date. The revenue should be recognized only in the subsequent year with proper disclosures. The retrospective increase in the petrol price should not be considered as a prior period item, as per AS 5, because there was no error in the preparation of previous period's financial statements.

Question 2

Vijaya Ltd. Had to pay delayed cotton clearing charges over and above the negotiated price for taking the delayed delivery of cotton from the supplier's godwon upto 2010-2121, the company has regularly included such charges in the valuation of closing stock this charge, being in the nature of interest, the company has decided to exclude it from closing stock valuation. This would result in decease of profit by Rs.8.60 lakhs.

What is the treatment in the final statement of accounts for the year ended 31.03.2012?

Also draft a suitable note for disclosure

Solution

AS-5 states that a change in an accounting policy should be made only if the adoption of a different accounting policy is required by statute or for compliance with an accounting standard or if it is considered that the change will result in a more appropriate preparation or presentation of the financial statement of and enterprises. Therefore, the change in the method of stock valuation is justified in view of the fact that the change is in line with the recommendations of AS-2 and would result in more appropriate preparation of the financial statements. As per AS-2, this accounting policy adopted for valuation of inventories including the cost formulae used should be disclosed in the financial statements. Also, appropriate disclosure of the change and the amount by which any item in the financial statements is affected by such change is necessary as per AS-1, AS-2 and AS-5. Therefore, the under, mentioned note should be given in the Annual Accounts. "In compliance with the Accounting Standard issued by AI, delayed cotton clearing changes which are in the nature of interest have been excluded from t the valuation of closing stock unlike preceding years. Had there company continued the accounting practice followed earlier, the value of closing stock as well as profit before tax for the year would have been higher by Rs. 8.60 lakhs".

Question 3

Give two examples on each of the following items.

i. Change in Accounting Policy

ii. Change in Accounting Estimate

iii. Extra Ordinary Items

iv. Prior Period Items

Solution

(i) Examples of Change in Accounting Policy :

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

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

(ii) Examples of Change in Accounting Estimates:

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

b. Estimation of useful life of fixed assets.

(iii) Examples of Extraordinary items:

a. loss due to earthquakes / fire / strike.

b. attachment of property of the enterprise.

(iv) Examples of Prior period items :

a. Applying incorrect rate of depreciation in prior periods.

b. omission to account for income or expenditure in one or more prior periods.

Question 4

Cost of a machine acquired on 01.04.2009 was Rs. 5,00,000. The machine is expected to realize Rs. 50,000 at the end of its working life of 10 years. Straight-line depreciation of Rs. 45,000 per year has been changed upto 2011-2012. For and form 2012-13, the company switched over to 15% p.a. reducing balance method of depreciation in respect of the machine. The new rate of depreciation is based on revised useful life of 15 years. The new rate shall apply with retrospective effect from 01.04.2009. State how would you deal with the above in the annual accounts of the Company for the year ended 31st March, 2013 in the light of AS-5.

Solution

WDV of asset at the end of year 2011-12=Rs. 5,00,000 –(Rs. 45,000×3)

=Rs. 3.65,000

WDV of asset at the end of year 2011-12 (by reducing balance method)

= Rs. 5,00,000(1-0.15)3 =Rs. 3,07,062.50

Depreciation to be charged in year 2012-13

=(Rs. 3,65,000 –Rs. 3,07,062.50) + 15% of Rs. 3,07,062.50

Rs. 57,937.50 +46,059.38 =Rs. 1,03,997 (approx.)

As per AS 5 ‘Net profit or loss for the period, Prior items and Changes in Accounting Policies’ the revision of remaining useful life is change in accounting estimate, and adoption of reducing balance method of depreciation instead of the straight-line method is change in accounting policy. Since it is difficult to segregate impact of these two changes, the entire amount of difference between depreciation at old rate and depreciation charged in 2012-13(Rs. 1,03,997 – Rs. 45,000 =Rs. 58,997) is regarded as an effect of change in accounting estimate as per provisions of the standard. The effect of this change in accounting estimate should be properly disclosed in the financial statements of the company for the year ended 31st March, 2013.

Question 5

Explain whether the following will constitute a change in accounting policy or not as per AS. 5.

(i) Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement.

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

Solution

As per Para 31 of AS 5 'Net Profit or Loss for the Period, Prior Period items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transaction, will not be considered as a change in accounting policy.

(i) Accordingly, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy.

(ii) Similar, the adoption of a new accounting policy for events or transaction which dis not occur previously or that ere immaterial will not be treated as a change in an accounting policy.

Question 6

Finished Goods costing Rs.10 lacs were damaged due to flood in July 2013. These goods were included in Closing Stock as on March 31, 2014 at an estimated realizable value of Rs.4.00 lacs. These goods could be ultimately sold for Rs.3 lacs only in August 2014. The difference of 1 lac was debited as prior period expenditure in financial year 2014-15. As an auditor please comments in the light of provisions of accounting standards.

Solution

The difference of Rs.100000 cannot be a prior period item as no error took place in the preparation of financial statement of past period. The estimated write off of the inventory Rs.6,00,000 (10-4) is revised to Rs.7,00,000. This is change in Accounting Estimates as per AS-5. Many items in the financial statement cannot be exactly calculated but can only be estimated. Estimation changes because of change in circumstances, more development in the case. In the given case the company is required to just disclose the change in a/c estimate in the financial statement.

Question 7

ABC Ltd. was making provision for non-moving stocks based on no issues for the last 12 months up-to 31-03-2005.

The company wants to provide during the year ending 31/03/2006 based on technical evaluation:

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

Does this amount to change in Accounting Policy ? Can the company change the method of provision?

Solution

It is a change in accounting policy.

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

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

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

Question 8

U.P Rajya Setu Nigam Ltd. was awarded a contract of construction of a bridge for Rs. 100 crores on 1-6-2011. Total contract at estimated was Rs. 80 crores. The position of the contract on 31-3-2014 and 31-3-2015 was under: -

	As on 31-3-2014	**As on 31-3-2015**
Contract Price	100	100
Contract oust incurred up to date	25	95 (100% complete)
Estimate contract cost of completion	60	Nil

While closing books of account on 31-3-2015, the chief accountant treated mess cost of 10 crores incurred as against estimated cost of 25 + 60 = 85 crores as on 31-3-2014 as mistakes in estimation of cost, hence classified 10 acres (95-85) as prior period expenses. Comment on the treatment made by the chief accountant.

Solution

Cost estimated by U.P Rajya Setu Nigam Ltd. In 2013 -14	Rs 85 crores
Excess Cost incurred in 2014 -15	Rs 10 crores
Treatment given by the company	Prior period item

As per para 16of the AS 5 Net Profit or Loss for the Period Prior Period Items and Changes in Accounting policies , prior period items refers only to income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods . Since the increase in the estimated cost is not an error so cannot be said as prior period item.

This increase in the cost is due to change in estimation which involves judgments based on the latest information available. A change in estimate is neither a prior period item nor an extraordinary item. Hence, the treatment given by the company is not correct.

AS 7 - Construction Contracts

Question 1

Speedy Construction Ltd. Has recognised contract revenue on a contract awarded in the financial year 2012-13. The target period of completion is 5 years. The contract provides for incentives for early completion is 5 years. The contract provides for incentives for early completion at the rate of Rs. 1000 per day subject to a maximum of Rs. 3,00,000. The company has included this amount in contract revenue on the ground that based on the previous experience in similar contracts, it is confident of completing the contract in 4 years. The company's past track record shows that company was able to complete such contracts well in time and earn incentives Comment on the company's accounting policy for recognition of such incentives.

Solution

Accounting to para 14 of As 7 (revised), ' Construction contracts' , incentive payments are included in contract revenue only when

- the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded ; and
- the amount of the incentive payments can be measures reliably.

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

Further, the past track record is not the criteria for recognition of incentive payments receivable for early completion of the contract.

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

Question 2

M/s. Highway constructions undertook the construction of a highway on 01.04.2013. the contract was to be completed in 10 years. The contract price was estimated at Rs. 150 cores. Up to 31.03.2014 the company incurred Rs. 120 cores on the construction. The engineers involved in the project estimated that a further Rs. 45 cores would be incurred for completing the work. What amount should be charged to revenue for the year 2013-14 as per the provisions of AS 7 'Construction Contracts? Show the extract of the Profit & Loss Account in the e-books of M/s. Highway Constructions.

Solution

	(Rs.in crores)
Cost of construction incurred upto 31.03.2014	120
Ass:- Estimated future cost	45
Total estimated cost of construction	165
Degree of completion (120/165 X100)	72.73%
Revenue recognized (72,.73% of 150)	109(approx.)
Total Foreseeable loss (165-150)	15
Less: Loss for current year (120 -109)	11
Expenses loss to be provided for	4

Profit and Loss Account (Extract)

	In crores		**In crores**
To Construction Costs	120	By Contract Price	169

To Provision for loss	4	By Net Loss	15
	124		124

Question 3

Five Star Construction Limited commenced a construction contract on 1st April, 2014. The fixed contract price agreed was Rs.50,00,000. The company incurred Rs.21,00,000 in 2014-15 for 40% work and received Rs.19,00,000 as progress payment from the customer.

The company estimated that a further Rs 31,50,000 would be incurred to complete it. What amount should be charged to revenue for the year 2014-15 as per AS 7?

Show the extract of Profit & Loss A/c and Customer A/c for the year 2014-15 in the books of the company.

Solution

Total expected loss to be provided for = Contract Price —Total Cost

=Rs 50,00,000 — (21,00,000 + 31,50,000) = Rs.2,50,000

Calculation for 2014-15 on 40% work

Contract Revenue = Rs.21,00,000

Contract Cost = Rs.21,00,000

Current loss on contract (2,50,000 x 40%) = Rs.1,00,000

Total expected loss recognized as per AS 7 = Rs.2,50,000

Further provision required in respect of Expected Loss = 2,50,000 -1,00,000

= Rs.1,50,000

In the Books of Five Star Construction Limited

Profit & Loss A/c (Extract for the year ended 31st March 2015)

Particulars	Amount	Particulars	Amount
To Construction Costs (for 40% work)	2100000	By Contract Revenue	2000000
To Provision for Loss	150000	By Net Loss	250000

	2250000		2250000

Customer A/c

Particulars	Amount	Particulars	Amount
To Contract Revenue	2000000	By Bank	1900000
		By Balance c/d	100000
	2000000		2000000

AS 9 - Recognition of Revenue

Question 1

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

Solution

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

i. the seller has transferred the property in the goods to the buyer for a consideration and the transfer of property in goods results in or coincidences with the transfer of significant risks and rewards of ownership to the buyer and the seller retains no effective control of the goods transferred; and
ii. no significant uncertainly exists regarding the amount of the consideration that will be derived from the sale of the goods.

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

Therefore, the practice adopted of recognizing only 90% of sales price as revenue by Perfect Ltd. Is not in consonance with AS 9.

Question 2

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

Evaluate whether these two contracts should be segmented or combined into one contract for the purpose of AS7.

Solution

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

i. the group pf contracts is negotiated as a single package:
ii. the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin ; and
iii. the contracts are performed concurrently or in a continuous sequence.

Question 3

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

Solution

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

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

Question 4

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

Solution

In case of Repo transactions AS-9 treats both the sale and buy back transaction as one and the same part of the whole package. The first transaction negates the impact of the second one.

IN THE BOOKS OF S LIMITED (Rs in lakhs)

15.3	Bank Dr. To Advance from B . Ltd	1200	1200	15.9	Bank Dr. To Advance from B . Ltd	220	220
31.3	Finance charges Dr. To Advance from B Ltd.	20	20	15.9	P/L Dr. To Finance charges	220	220
31.3	P/L Dr. To Finance charges	20	20	15.9	Advance from B .Ltd Dr. To Bank	1440	1440

Financial Statement Disclosures:

P/L Statement: Finance Charges is charged to P/L under the head financial expenses. B/S : Liability side: Advance from B Ltd is disclosed under Short term Loans.

Disclosure: Inventories includes goods costing Rs 1000 lakhs sold on repo basis.

Similarly on the other hand B Ltd has to record the Finance income with similar calculations.

Question 5

A Ltd. Entered into a contract with B Ltd. To dispatch goods valuing Rs. 25,000 every month for 4 months upon receipt of entire payment. B Ltd accordingly made the payment of Rs. 1,00,000 and A Ltd. Requested A Ltd. Not to dispatch goods until further notice through A Ltd. Is holding the remaining goods worth Rs. 50,000 ready for dispatch. A Ltd. Accounted Rs. 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

Solution

As per Para 11 of AS 9 "Revenue Recognition", in 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.

In the given case, transfer of property in goods results in or coincides with the transfer of significant risks as 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 Rs. 1,00,000 (rs. 25,000 X4) and no part of the same is to be treated as Advance Receipt against Sales.

Question 6

AQ Ltd, an investment Company is finalizing its account for the Financial Year ending 2013 in the month of August 2013.

How will the following incomes to accounted for in the books of AQ Ltd?

i. X Ltd has declared Interim Dividend which has not been received till 31.03.2013, but received on 25.04.2013.

ii. Y Ltd has declared dividend on 8th May 2013 for the year ending 31.03.2013, which has been approved by the shareholders of the company on 30th June 2013.

iii. Z Ltd, a subsidiary of AQ Ltd, has declared dividend for the year ended 31.03.2013 on 25th May 2013 the AGM for which is to be held on September 2013.

Solution

Revenue Recognition Principle:

As per AS-9, Dividend from Investments in Shares are not recognised in the Statement of Profit and Loss until a right to receive payment is established.

Based on above, the recognition will be as under:-

Case 1: Since, Interim Dividend is declared before the financial year ending 31.3.2013.

Case 2: In this case also, AQ Ltd should recognize the Dividend in the financial year 2013-14 and not in the year ending 31.3.2013, since the right to receive dividend did not exist at the Balance Sheet date, i.e. as at 31.3.2013 but existed only when Annual General Meeting of Y Ltd approved the dividend on 30th June 2013.

Case 3: AQ Ltd will recognize the Dividend in the financial year 2013-14, for the same reason mentioned in Case 2.

Question 7

A Company sells the goods with right to return. The following pattern has been observed

Time frame of Return from date of purchase	% of Cumulative Sales
Within 10 days	5%
Between 11 days and 20 days	7%
Between 21 days and 30 days	8%
Between 31 days and 45 days	9%

The company has made sales of Rs. 30 lakhs in the moth of February 2015 and of Rs. 36 lakhs in the month of March 2015. The total sales for the Financial year have been Rs. 450 lakhs and the cost of sales was Rs. 360 lakhs. Determine the amount of provision to be made and Revenue to be recognized in accordance with AS-9. A year may be considered of 360 days.

Solution

Accounting treatment for recognition of revenue.

Revenue in respect of sale of goods is recognized fully at the time of sale itself assumed that the company has complied with the conditions stated in AS 9 relating to recognition of revenue in the case of sale of goods. AS 9 also provides that in case of retail sales offering a guarantee of ‘money back, if not completely satisfied, it may be appropriate to recognize the sale but to make a suitable provisions for returns based on previous experiences.

Therefore, sale of Rs. 30,00,000 and Rs. 36,00,000 made in the month of February and March, 2015 will be recognized at full value.

Amount of provision

The goods are sold with a right to return. The existence of such right gives rise to a present obligation on the company as per AS 29, ‘ Provisions, Contingent Liabilities and Contingent Assets.’ According to the standard, a provision should be created on the Balance sheet date, for sales returns after the Balance sheet date, at the best estimate of the loss expected, along with any estimated incremental cost that would be necessary to resell the goods expected to be returned.

It is assumed that the sales has been made evenly throughout the month and every month is of 30 days based on the information given in the question i.e. a year is of 360 days.

Sales during	Sales value (Rs. In lakhs)	Sales value (cumulative) (Rs. In lacs)	Likely returns (%)	Likely returns (Rs. In lacs)	Provision @ 20% (Rs. In lacs) (refer W.N)
Last 10 days of March	36/3 or 12	12	5%	0.600	0.120
Previous 10 Days of March	36/3 or 12	24	7%	1.680	0.336
Previous 10 Days of March	36/3 or 12	36	8%	2.880	0.576
Last 15 days of February	30/2 or 15	51	9%	4.590	0.918
Total				**9.75**	**1.950**

Working Note:

Calculation of Profit % on sales

	(Rs. In lacs)
Sales for the year	450
Less : cost of sales	(360)
Profit Profit mark up on sales (90/450) × 100 = 20 %	90

Note : The above solution is on the basis of the facts given in the question.

The heading of Column 1 is " the time frame of sales return from the date of purchase." However, the time ranges given in three out of four rows in column 1 is not reckoned from the date of purchase but from the date after the close of the previous range. Further, the heading of column 2 is % of cumulative sales." However, they are standalone range commencing from the date after the close of the previous range. The two sets of data which are not exactly in line with each other may give rise to alternative computation of amount of provision.

Question 8

A Ltd entered into a contract with B Ltd. To dispatch goods valuing Rs. 25,000 every month for 4 months upon receipt of entire payment. B Ltd. Accordingly made the payment of Rs. 1,00,000 and A Ltd. Started dispatching the goods. In third month, due to a natural calamity, B Ltd. Requested A Ltd. Not to dispatch goods until further notice through A Ltd. Is holding the remaining goods worth Rs. 50,000 ready for dispatch. A Ltd. Accounted Rs. 50,000 as sales and transfected the balance to advance Received against Sales. Comment upon the treatment of balance amount with reference to the provisions of Accounting Standard 9.

Solution

As per Para 11 of 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 trains 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.

In the given case, transfer of property in goods results in or coincides with the transfer of significant risks and rewards and ownership to the buyer. Also, the sale price has been recovered by the seller. Hence, the sale is complete. However, delivery has been postponed at buyer's request. Merely postponement of delivery at buyers request shall not postpone the recognition of sale. Therefore, A Ltd. Should recognize the entire sale of Rs.1,00,000 (Rs.25,000 X 4) and no part of the same should be treated as Advance Receipt against Sales.

Question 9

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

Solution

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

Treat the discount as an expense but not as a deduction from sales.

Question 10

New Spice Ltd. sells male groaning products to various dealers situated in different states in India. It allows normal credit period of 45 days to its dealers to mace payment. Interest at the rate of 2% per month is charged on the dealers for delayed payments. The interest recovery on such overdue outstanding amounts from dealers is only 10%, due to various reasons. During the year 2014-15, the company vents to recognize only the interest received and not the balance 90% of interest receivable on overdue outstanding. Do you agree?

Solution

As per AS 9 on Revenue Recognition, where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g. for escalation of price, export incentive, interest, etc., revenue recognition is postponed to the extent of uncertainty invoked. In such cases, it may be appropriate to recognize revenue only when it is reasonable certain that the ultimate collection will be made. Were there is no uncertainty as to ultimate collection, revenue is recognized at the time of sale or rendering of service even though payments are made by installments.

Accordingly, New Spice Ltd. is correct in recognizing the interest on receipt basis i.e. 10% of interest recovered on overdue outstanding.

Question 11

X Limited sold goods worth Rs 13 lakhs to Y. Y asked for a trade discount amounting to Rs 1,06,000 and the same was agreed by X Limited. The sale was effected and goods were dispatched. On receipt of goods, Y has found that goods worth Rs 1,34,000 are defective. Y returned defective goods to X Limited and made payment amounting to Rs 10,60,000. The Accountant of X Limited booked the sale for Rs 10,60,000.

Discuss the contention of the Accountant with reference to relevant Accounting Standard.

Solution

As per AS 9, "Revenue Recognition", revenue is the gross inflow of cash, receivable or other consideration arising in the course of ordinary activities of an enterprise from the sale of goods. However, the above is subject to trade discount and volume rebates received in the course of carrying on business which shall be deducted in ascertaining revenue since they represent a reduction of cost.

Revenue is also subject to certain risks like damages on transfer of goods to the buyers' end.

In the given case, trade discount is to be deducted from Rs 13,00,000 and gross sale shall be recognized at (Rs 13,00,000 — Rs 1,06,000) = Rs 11,94,000 and goods returned for Rs 1,34,000 are to be recorded in the form of sales return.

Alternatively, if a trade discount is not allowed in the ordinary course of carrying on the business, X Limited should recognize the sale at Rs 13 lakhs only.

Discount of Rs 1,06,000 and return of goods worth Rs 1,34,000 are to be adjusted by suitable provisions.

In such a case, X limited shall send a credit note of Rs 2,40,000 to Y to account for these adjustments.

However, in both the cases contention of the Accountant to book sale of Rs 10,60,000 is not correct.

Question 1

Name two methods of accounting for amalgamations as contemplated by AS 14.

Answer

Two methods of accounting for amalgamation as contemplated by AS 14 are:

(a) The pooling of interests method and

(b) The purchase method

Question 2

X Co. Ltd. having share capital of Rs. 50 lakhs divided into equity shares of Rs. 10 each was taken over by Y Co. Ltd. X Co. Ltd. has General Reserve of Rs. 10,00,000 and Profit and Loss account Cr.Rs. 5,00,000. Y Co. Ltd. issued 11 equity shares of Rs. 10 each for every 10 shares of X Co. Ltd. How the Journal entry would be passed in the books of Y Co. Ltd. for the shares issued under the 'Pooling of interest method' of amalgamation.

Answer

In the books of Y Co. Ltd.

Journal Entries

	Rs.	***Rs.***
Business Purchase A/c Dr.	55,00,000	
To Liquidator of X Co. Ltd.		55,00,000
(Being business of X Co. Ltd. purchased)		
Assets A/c (Bal. Fig.)	65,00,000	
Dr.		55,00,000
To Business Purchase A/c		5,00,000
To General Reserve A/c∗(10,00,000 – 5,00,000)		5,00,000
To Profit and Loss A/c		

(Being assets and reserves and surplus taken over)		

Liquidator of X Co. Ltd. Dr.	55,00,000	
To Equity share capital A/c		55,00,000
(Being purchase consideration discharged through equity shares of Y Co. Ltd.)		

Purchase consideration	Rs. 55,00,000
Less: Share capital of X Co. Ltd.	Rs. 50,00,000
To be adjusted from general reserve	Rs. 5,00,000

Question 3

As per Accounting Standard-14, what are the conditions which must be satisfied for an amalgamation in the nature of merger?

Answer

According to AS 14 "Accounting for Amalgamations", Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

- All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.
- 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.
- 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.

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

Question 4

The abstract of the Balance Sheet of the AXE Ltd. as at 31st March 2010, are as follows:

Liabilities	Rs.
Equity share capital (Rs. 100 each)	15,00,000
12% Preference share capital (Rs. 100 each) 13% Debentures	8,00,000 3,00,000

On 31st March, 2010, BXE Ltd. agreed to take over AXE Ltd. on the following terms:

1. For each preference share in AXE Ltd., Rs. 10 in cash and one 9% preference share of Rs. 100 in BXE Ltd.
2. For each equity share AXE Ltd. Rs. 20 in cash and one equity share in BXE Ltd. Of Rs. 100 each. It was decided that the share in BXE Ltd. will be issued at market price Rs. 140 per share.
3. Liquidation expenses of AXE Ltd. are to be reimbursed by BXE Ltd. to the extent of Rs. 10,000. Actual expenses amounted to Rs. 12,500. You are required to compute the amount of purchase consideration.

Answer

Calculation of purchase consideration

		Rs.	*Rs.*

I	Payment made to shareholders of		
	8,000preference shares of AXE Ltd. :		
	Cash @ Rs. 10 per share (8,000 preference shares x Rs.	80,000	8,80,000
II	10) 9% Preference shares in BXE Ltd. @ Rs. 100 each	8,00,000	
	Payment made to Equity shareholders of 15,000equity		
	shares of AXE Ltd. :		
	Cash @ Rs. 20 per share (15,000 shares x Rs.	3,00,000	24,00,000
	20) Equity shares in BXE Ltd. issued at market		32,80,000
	price Rs. 140 each (15,000 shares x Rs. 140)	21,00,000	
	Total purchase consideration		

Note: Re-imbursement of liquidation expenses of AXE Ltd. to the extent of Rs. 10,000, will not be included in the calculation of purchase consideration.

$$\left(\frac{8,00,000}{100}\right) = 8,000 \text{ preference shares}$$

$$\left(\frac{15,00,000}{100}\right) = 15,000 \text{ preference shares}$$

Question 5

What disclosures should be made in the first financial statements following the amalgamation?

Answer

Para 24 of AS 14 'Accounting for Amalgamations' states that for all amalgamations (whether for amalgamations accounted for under the pooling of interests method or amalgamations accounted for under the purchase method), the following disclosures are considered appropriate in the first financial statements following the amalgamation:

a) Names and general nature of business of the amalgamating companies;
b) Effective date of amalgamation for accounting purposes;
c) The method of accounting used to reflect the amalgamation; and
d) Particulars of the scheme sanctioned under a statute.

Question 6

Briefly explain the types of Amalgamations?

Answer

As per AS 14, 'Accounting for Amalgamations' there are two types of amalgamation. In first type of amalgamation there is a genuine pooling not merely of assets and liabilities of the amalgamating companies but also of the shareholders' interests and of the businesses of the companies. Such amalgamations are amalgamations which are in the nature of 'merger' and the accounting treatment of such amalgamations should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the relevant figures of the amalgamating companies. In the second category are those amalgamations which are in effect a mode by which one company acquires another company and, as a consequence, the share holders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company, or the business of the company which is acquired is not intended to be continued. Such amalgamations are amalgamations in the nature of 'purchase'.

Note: It is possible to answer this question by specifying all the conditions to be satisfied for an amalgamation to be an amalgamation in the nature of merger. The amalgamation would to be an amalgamation in the nature of purchase if any one or more of the said conditions are not satisfied.

Question 7

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.

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.

However, 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.

<u>Question 8</u>

Briefly describe the disclosure requirements for amalgamation including additional disclosure, if any, for different methods of amalgamation as per AS 14.

Or

What disclosures should be made in the first financial statements following the amalgamation?

<u>Answer</u>

The disclosure requirements for amalgamations have been prescribed in paragraphs 43 to 46 of AS 14 on Accounting for Amalgamation.

For all amalgamations, the following disclosures should be made in the first financial statements following the amalgamation:

a) names and general nature of business of the amalgamating companies;
b) the effective date of amalgamation for accounting purpose;
c) the method of accounting used to reflect the amalgamation; and
d) particulars of the scheme sanctioned under a statute.

For amalgamations accounted under the pooling of interests method, the following additional disclosures should be made in the first financial statements following the amalgamation:

a) description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation; and
b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

For amalgamations, accounted under the purchase method, the following additional disclosures should be made in the first financial statements following the amalgamation;

a) consideration for the amalgamation and a description of the consideration paid or contingently payable; and
b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortization of any goodwill arising on amalgamation.

Question 9

Briefly explain the methods of accounting for amalgamation as per Accounting Standard- 14.

Answer

As per AS 14 on 'Accounting for Amalgamations', there are two main methods of accounting for amalgamations:

i. The Pooling of Interest Method: Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (after making the necessary adjustments).

   If at the time of amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

ii. The Purchase Method: Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company. Where assets and liabilities are restated on the basis of their fair values, the determination of fair values may be influenced by the intentions of the transferee company.

Question 10

List the conditions to be fulfilled as per Accounting Standard 14 for an amalgamation to be in the nature of merger, in the case of companies.

Answer

An amalgamation should be considered to be an amalgamation in the nature of merger if the following conditions are satisfied:

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.

AS 17 - Segment Reporting

Question 1

Microtech Ltd, produces batteries for scooters, cars, trucks, and specialized batteries, for invertors and UPS. How many segments should it have and why?

Solution

As per para 5 of AS 17 'segment reporting', a business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:

i. the nature of the products or services ;
ii. the nature of the production processes ;
iii. the type or class of customers for the products or services ;
iv. the methods used to distribute the products or provide the services; and
v. if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.

In case of microtech Ltd., the basic product is the batteries, but the risk and returns of the batteries for automobiles (scoters, cars and trucks) and batteries for invertors and UPS are affected by different set of factors. In case of automobiles batteries, the risks and returns are affected by the government policy, road conditions, quality of automobiles, etc. whereas in case of batteries for invertors and UPS the risks and returns are affected by power conditions standards of living, etc. therefore, it can be said that Micretech Ltd. Has two business segments viz- 'Automobiles batteries' and 'batteries for invertors and UPS'.

Question 2

Vintage Ltd has been in the business of sale of Vintage Wines for the last 12 years and is an extremely cash rich company. In FY 2011-12 the Board of the company decided to venture into new areas of business and identified the activity of acquiring Vintage Priorities such as old Bungalows, Heritage buildings and the like at prime location and after carrying out renovation and refurbishment of the same to let out these properties on lease to willing parties. The new business was commenced as a separate division of the company in FY 2012-13 during which the company managed to identify 19 and properties of which 17 were acquired and 9 given on lease. Being the initial year of operations and also since some of the lease arrangements were entered into at the fag end of the year the income from leasing was only a partly amount. After the acquisition of the properties as aforesaid very attractive offers for sale of 14 of the properties were received. Vintage Ltd. after negotiation accepted 12 of the offers and sold these 12 properties making large profits in the bargain. The accountant of Vintage Ltd. has accounted the acquisition and disposal of properties as 'Purchases' and 'sales' in the Profit & Loss account of the Property Division and treated the lease incomes as part of the other income of the company. The contention of the accountant of vintage Ltd., was that since a majority of the properties were disposed off within a short span of time, the properties are to be considered as stock in trade only . Further since the lease income and hence considered as part of of other income . You are required to examine the correctness of the accountant of Vintage Ltd., considering the relevant Accounting Standards and provision of Revised Schedule III of Companies Act, 2013.

Solution

First of all Vintage Ltd should get ready for disclosure for AS-17 also i.e. (i) Wines; (ii) Leasing activities. As clearly mentioned that V Ltd has ventured into leasing activities so leasing is the 'Revenue from operations. But fortunately leasing of properties are covered by Indian GAAP. However property leases are generally considered as operating lease. Such income should be recorded on SLM or any systematic basis. As far as sale/purchase of Land is considered it is not a stock in trade. It can be other income but not main operating income.

Question 3

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

Solution

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

i. the portion of enterprise revenue that is directly attributable to a segment,
ii. the relevant portion of enterprise revenue that can be allocated on a reasonable basis to a segment, and
iii. revenue from transactions with other segments of the enterprise.

Further as per the definition segment revenue excludes :

a) extraordinary items as defined in AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies :
b) interest or dividend income, including interest earned on advances or loans to other segments unless the operations of the segment are primarily of a financial nature ; and
c) gains on sales of investments or on extinguishment of debt unless the operations of the segment are primarily of a financial nature.

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

Non-operating interest should be excluded from segment revenue. However, interest received from customers due to delay in making payment is an operating income. Segment assets are those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Since receivables are part of the segment asset. The related income should be included in segment revenue.

Question 4

Following details are given for Sunder Ltd. For the year ended 31st March, 2013:

	(Rs. In lakhs)	**(Rs. In lakhs)**
Sales (including inter-segment sales): Food Products	10,000	
Plastic and Packaging	1240	
Health and Scientific	690	
Others	364	12,294
Expenses:		
Food products	7,170	
Plastic and Packaging	800	
Health and Scientific	444	
Others	400	8,814
Other items		
General corporate expenses		1,096
Income from investments		252
Interest expenses		126
Identifiable assets:		
Foods products	15,096	
Plastic and Packaging	4,000	
Health and Scientific	1,400	
Others	1,364	21,860

General corporate assets		1,664

Other information:

	(Rs. Rs.000)
Inter-segment sales are as below	
Food Products	120
Plastic and Packaging	168
Health and Scientific	36
Others	10

Operating profit includes Rs.(Rs.000) 66 on inter-segment sales.

You are required to identify reporting segments.

Solution

As per 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 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

- The combined result of all segments in profit; or
- The combined result of all segments in loss,

  Whichever is greater in absolute amount ; or

i. Its segment assets are 10% or more of the total assets of all segments.

Further, if the total external revenue attributable to reportable segments constitutes less than 75% of total enterprises revenue, additional segments should be identified as reportable segments, even if they do not meet the 10% threshold until at least 75% of total enterprises revenue is included in reportable segments.

Calculation of Segment Result

	Sales (Rs. In lakhs)	Expenses (Rs. In Lakhs)	Segment result (Rs. In lakhs)

Food products	10,000	7,170	2,830
Plastic & packaging	1,240	800	440
Health & scientific	690	444	246
Other	364	400	(36)

Sunder Ltd. Operate through four segments, namely, 'Food Products', ;Plastic and Packaging', 'Health and Scientific' and 'Others'. The relevant information about these segments is given in the following table;

		Food Products	**Plastic and Packaging**	**Health and Scientific**	**Others**	**Total**
1.	Segment Assets	15,096	4,000	1,400	1,364	21,860
2.	Segment assets as a percentage of total assets of all segments	69.06%	18.3%	6.4%	6.24%	
3.	Segment Results	2,830	440	246	(36)	3,480
4.	Combined Result of all Segment in Profits	2,830	440	246		3,516
5.	Combined Result of all Segments in loss				(36)	
6.	Segment Result as a percentage of the greater of the totals arrived at 4 and 5 above in absolute amount (i.e. 3516)	80.49%	12.51%	7%	1.02%	
7.	Segment Revenue	10,000	1,240	690	364	12,294

8.	Total Revenue of each segment as a percentage of total revenue of all segments	81.34%	10.09%	5.61%	2.96%	

a) On the basis of 'Revenue' criteria segments Food Products' and 'Plastic and Packaging' are reportable segments.

b) On the basis of 'Result" criteria, segments 'Food Products' and 'Plastic and Packaging' are reportable segments (since their results in absolute amount is 10% or more of Rs. 3516 lakhs).

c) On the basis of 'Asset' criteria, 'Food Products' and 'Plastic and Packaging are reportable segments

Question 5

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

* LIBOR — London Inter bank Offered Rate (LIBOR) is the world's most widely used benchmark for short-term interest rate.

Segments	A	B	C	Total
Directly attributed revenue	500000	300000	100000	900000
Enterprise revenue (allocated in 5 : 4 : 2 basis)				110000
Revenue from transactions with other segments				
Transaction from B	100000		50000	150000

Transaction from C	10000	50000		60000
Transaction from A		25000	100000	125000
Other Income				
Revenue from extra ordinary items	5000	10000	15000	30000
Dividend Income	20000	15000	10000	45000
Interest earned on advances and loan	30000	40000	50000	120000
Gain on sale of investments	1000	5000	3000	9000
Operating expense	300000	150000	75000	525000
Enterprise expenses (allocated in 5 : 4 : 2 basis)				
Expenses on transactions with other segments				
Transaction from B	75000		30000	
Transaction from C	6000	40000		
Transaction from A		18000	82000	
Other Expenses				
Expense on extra ordinary items	3000	7000	11000	21000
Interest on bank overdraft	30000	28000	12000	50000
Income tax	60000	55000	50000	165000

Solution

(a) Calculation of segment result

Segments	A	B	C	Total
Directly attributed revenue	500000	300000	100000	900000
Enterprise revenue (allocated in 5 : 4 : 2 basis)	50000	40000	20000	110000
Revenue from transactions with other segments				
Transaction from B	100000		50000	150000
Transaction from C	10000	50000		60000
Transaction from A		25000	100000	125000
Total segment revenue as per AS 17 (A)	660000	415000	270000	1345000
Operating expense	300000	150000	75000	525000
Enterprise expenses (allocated in 5 : 4 : 2 basis)	35000	28000	14000	77000
Expenses on transactions with other segments				
Transaction from B	75000		30000	
Transaction from C	6000	40000		
Transaction from A		18000	82000	

Total segment revenue as per AS 17 (B)	416000	236000	201000	853000
SEGMETN RESULT (A - B)	244000	179000	69000	492000

Note: As per para 5.5 and 5.6 of AS 17 "Segment Reporting", following revenues and expenses are not considered for calculation of segment revenue and segment expenses:

Other Income

Revenue from extra-ordinary items

Dividend income

Interest earned on advances and loan

Gain on sale of investments

Other Expenses:

Expenses on extra-ordinary items

Interest on bank overdraft

Income-tax

AS 18 - Related Party Disclosures

Question 1

Ganga Ltd. sold goods for 90 lakhs to Yamuna Ltd. during financial year ended 31.3.2012. the Managing Director of Ganga Ltd. own 100% of Yamuna Ltd. The sales were made to Yamuna Ltd. at normal selling prices followed by Ganga Ltd. The Chief accountant of Ganga Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. Is the Chief Accountant correct?

Solution

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

In the given case, Ganga Ltd. and Yamuna 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 Ganga Ltd is wrong.

Question 2

P Ltd. Has 60% voting right in Q Ltd has 20% voting rights in R Ltd. Also P Ltd. Directly enjoys voting right of 14% in R Ltd. R Ltd. Is a listed company and regular supplies goods to P Ltd. R Ltd has not disclosed its relationship with P Ltd

However would you assess the situation from the view point of AS-18 on related party discloser?

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

Solution

P Ltd has direct economic interest in R Ltd to the extent of 14T 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.

Here, control is defined as ownership directly or indirectly of more than one-half of the voting power if an enterprises; and significant influence is defined as participation in the financial and/or operating policy decision of an enterprises by not control of these polices.

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

The obligating event is the contamination of the land because of the virtual certainty of legislation recuing cleaning up. A provision is recognized for the best estimate of the costs of the clean-up. As outflow of resources, embodying economic benefits is probable.

Question 3

Kismis Lid, is a 100% subsidiary of kaju Ltd. Which of the followings are related party transactions for the purpose of consolidated financial statements?

i. Salary paid to employees of Kismis Ltd.
ii. Loans given to employees of Kaju Ltd.
iii. Inter-comppany sales between Kaju Ltd. And Kismis Ltd.
iv. Loan given by Kismiss Ltd. To managing director of Kaju Ltd.
v. Transfer of Asset by Kaju Ltd, to Kismis Ltd.

Solution

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

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

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

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

Question 4

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

Solution

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

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

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

Question 5

ABC Limited has three segments viz. A, B and C. the total assets of the company is Rs.15 crores. The assets of Segment A is 1.85 cores, Segment B is 6.15 Crores and Segment C is Rs.7.00 Crores. Assets of each segment include deferred tax assets of Rs.0.50 Crores in A, Rs.0.40 Crores in B and Rs.0.30 Cores 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.

Solution

According to AS 17 "Segment Reporting", segment assets do not include income tax assets. Segment assets should be net off DTA. Segment A holds assets of 1.35 crores (1.85 – 0.5 crores); Segment B holds 5.75 crores (6.15 crores – 0.4 crores); and Segment C holds 6.7 Crores (7 Crores – 0.3 Crores). Therefore, the revised total assets are 13.8 crores [1.35 + 5.75 + 6.70] crores.

Segment A holds = 9.78% of total segment asset < 10%

Segment B holds = 41.67% of total segment assets < 10%

Segment C holds = 48.55% of total segment assets < 10%

Only segment A is not reportable but the other Segment viz B and C are reportable. B and C's assets exceeds more than 10% of the total assets of all the segments.

AS – 19 - Accounting for lease

Question 1

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

i. State with reason whether the lease constitutes finance lease.
ii. Calculate unearned finance income.

Solution

i. Present Value of residual value = Rs.40,000 x 0.7513 = Rs.30,052

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

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

ii. Calculation of unearned finance income

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

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

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

Question 2

Prakash Ltd. Leased a machine to Badal Ltd. On the following terms:

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

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

Ascertain Unearned Financial Income.

Solution

Calculation of unearned finance income

Year	MLP	Discount Rate	PV
1	800000	0.8696	695680

2	800000	0.7561	604880
3	800000	0.6575	526000
4	800000	0.5718	457440
5	1100000	0.4972	546920
	4300000		2830920

Note:

It has been assumed that the lease rent is paid at the end of the year

Unearned Finance Income – 4300000 – 2830920=R. 1469080

Question 3

Annual Lease rent= Rs 40,000at the end of each year

Lease period = 5 years

Guaranteed residual valule = Rs 14,000

Fair valule at the inception (beginning) of lease = Rs 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 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.

Solution

In books of Lessee

Journal Entry

	Rs.	Rs.
Asset A/c Dr. To lessor (Being recognition of finance lease as asset and liability)	1,49,888	 1,49,888

Working note:

Year	Lease payments Rs.	DF (12.6%)	PV Rs.
1	40,000	0.89	35,600
2	40,000	0.79	31,600
3	40,000	0.70	28,000
4	40,000	0.6222	24,880
5	40,000	0.552	22,080
5	14,000	0.552	7,728
			1,49,888

Question 4

On 1st January 2011 Santa Ltd sold equipment for Rs 6,14,460. The carrying amount of the equipment on the date was Rs 1,00,000. The sale was part of the package under which Banta Ltd leased the asset to Santa Ltd for 10 year term. The economic life of the asset is estimated at 10 years. The Minimum Lease Rents payable by the Lesser has been fixed at Rs 1,00,000 payable annually beginning 31st December, 2011. The incremental borrowing Interest Rate of Santa Ltd is estimated at 10% p.a. Calculate the net effect on the Profit and Loss Account.

Solution

Profit on sale lease is to be deferred over lease period in the ratio of depreciation (SLM). SP - BV = 614460 - 100000 = Rs 5,14,460.

Present Value of MLP = 6.1446 x 100000 = Rs 6,14,460, Also leased asset has the FV at 6,14,460.

Lessee will record the asset @ 6,14,460.

As per AS-19 para…. the profit/loss on sale under the Sale and Lease Back method should be deferred in the ratio of depreciation

Net amount charged to P/L is as follows: (Books of Lessee)

Depreciation Dr	**Interest Charge Dr.**	**Deferment Cr**	**Net Charge Dr.**
61,446	61,446	51446	71,446

61,446	57,591	51446	67,591
61,446	53,350	51446	63,350
61,446	48,685	51446	58,685
61,446	43,533	51446	53,553
61,446	37,908	51446	47,908
61,446	31,699	51446	41,699
61,446	24,869	51446	34,869
61,446	17,356	51446	27,356
61,446	9,092	51446	19,092

For the calculation of interest please refer interest table from AS-19.

Question 5

Classify the following into either operating or finance leases.

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

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

iii. Economic life of the asset is 5 years, lease term is 41/2 years, but asset is not acquired at the end of lease term

iv. PV pf MLP = "X", Fair Value of the asset is Y.

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

Solution

i. Finance Lease.

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

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

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

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

Question 6

WIN Ltd. has entered in to three year lease arrangement with Tanya sports club in respect of Fitness Equipment costing Rs 16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Value of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be Rs 1,33,500. The assets would revert to the lessor at the end of the lease. Implicit rate of interest is 10%. You are required to compute the amount of the annual lease and the unearned finance income discounting factor at 10% for years 1,2 and 3 are 0.909, 0.826, 0.751 respectively.

Solution

i. Computation of annual rent =

PV of Residual value = 1,33,500 x 0.751 = 1,00,259

PV of lease payments = 16,99,999 - 1,00,259 = 15,99,740

Annual payments = 15,99,740 / 2.4869 = 6,43,267

ii. Calculation of UFI:

Gross investments = (3 x 6,43,267) +1,33,500 = 20,63,300

Less: Cost of property = (17,00,000)

Unearned Finance Income = Rs 3,63,300

Question 7

Naveen Ltd. Has initiated a lease for three years in respect of an equipment costing Rs. 3,00,000 with expected useful life of 4 years. The asset would revert to Naveen Ltd. Under the lease agreement. The other information available in respect of lease agreement is:

The unguaranteed residual value of the equipment after the expiry of the lease term is estimated at Rs. 40,000

Ascertain in the hands of Naveen Ltd.

i. The annual lease payment.
ii. The unearned finance income.
iii. The segregation of finance income.

Solution

i. Calculation of Annual Lease Payment'

	Rs
Cost of the equipment Unguaranteed Residual Value	3,00,000 40,000
PV of residual value for 3 years @ 10% (Rs 40,000 X 0.751) Fair value to be recovered from Lease Payment (Rs. 3,00,000 – Rs. 30,040) PV Factor for 3 years @ 10% Annual Lease Payment (Rs. 2,69,960/ PV Factor for 3 years @ 10% i.e. 2.487	30,040 2,69,960 2.487 1,08,550 (Approx)

The implicit rate of interest is 10% Present value factor at 10% are 0.909, 0.827 and 0.751 at the end of first, second and third years respectively.

ii. Unearned Finance Income

	Rs
Total lease Payments(Rs. 1,08,550 X3)	3,25,650
Add: Residual value	40,000
Gross Investments	3,65,650
Less: Present value of investments(Rs. 2,69,96. + Rs. 30,040	3,00,000

Unearned Finance Income	65,650

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

iii. Segregation of Finance Income

Year	Lease Rentals Rs.	Finance Charges @ 10% on outstanding amount of the year Rs.	Repayment Rs.	Outstanding Amount Rs.
0	-	-	-	3,00,000
1	1,08,550	30,000	78,550	2,21,450
2	1,08,550	22,145	86,405	1,35,045
3	1,48,550	13,505	1,35,045	-
	3,65,650	65,650	3,00,000	

Question 8

X Ltd has leased an equipment over its useful life that costs Rs.7,46,55,100 for a three year lease period. After the lease term, the asset would revert to the Lessor. You are informed that –

i. The estimated Unguaranteed residual Value would be Rs.1 Lakh Only.

ii. The Annual Lease Payments have been structured in such a way that the sum of their Present Values together with that of the Residual Value of the asset will equal the cost thereof.

iii. Implicit interest rate is 10%.

You are required to ascertain the Annual Lease Payment and the Unearned Finance Income. PV Factor @ 10% for year 1 to 3 are 0.909, 0.826 and 0.751 respectively.

Solution

Calculation of PV of MLP + UGRV:

Let MLP every year be Rs.X.

Year	MLP	PVF @ 10%	PV (MLP)
0	-	-	-
1	X	0.909	0.909X
2	X	0.826	0.826X
3	X + 100000 (Rent + UGRV)	0.751	0.751 + 75100
Total	3X + 100000		2.487X + 75100

As per the data given in the problem PV of MLP + RV = Cost of Asset

Therefore, 7,46,55,100 = 2.487X + 75100

X = Rs.2,99,87,937.

i. Annual Lease Payment = Rs.2,99,87,937.

ii. UFI = Gross Investments – Net Investments

= (3X + 100000) – 74655100

= 3 x 2,99,87,937 + 100000 – 74655100

= 90063811 – 74655100

= Rs.1,54,08,711

Question 9

Lease Ltd. Has initiated a leased for four years in respect of a vehicle costing Rs. 20,00,000 with expected useful life of 5 years. The asset would revert to the company under the lease agreement. The other information available in respect of lease agreement is:

i. The unguaranteed residual value of the equipment after the expiry of the lease term is estimated at Rs. 2,50,000.

ii. The implicit rate of interest is 10%

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

Ascertain in the hand of Lease Ltd.

Solution

i. The annual lease payment.

Calculation of annual lease payment

Cost of equipment	20,00,000
Unguaranteed residual value	2,50,000
PV of residual value for 4th year @ 10% (Rs.2,50,000 X 0.683)	1,70,750
Fair value to be recovered from lease payment	
(Rs.20,00.000 – Rs. 1,70,750)	18,29,250
PV factor for 4 years @10%	23,16987
Annual lease payment (Rs.18,29,250/3.16987)	5,77,074

ii. The unearned finance income.

Total lease payments (Rs.5,77,074X4)	23,08,296
Add: Residual Value	2,50,000
Gross Investment	25,58,296
Less : Present value of investment	
(Rs.18,29,250 +1,70,750)	(20,00,000)
Unearned Finance Income	5,58,296

iii. The segregation of finance income

Year	Lease rentals(Rs.)	Finance charge @ 10% on outstanding amount of the year(Rs.)	Repayment (Rs.)	Outstanding Amount(Rs.)
1	-	-	-	20,00,000
2	5,77,074	2,00,000	3,77,074	16,22,926
3	5,77,074	1,62,293	4,14,781	12,08,145

4	5,77,074	1,20,814	4,56,260	7,51,885
	8,27,074*	75,189	7,51,885	-
	25,58,296	5,58,296	20,00,000	

* 5,77,074 + Rs.2,50,00 = Rs.8,27.074

Note:

a) PV of residual value for 4th year @ 10% is 0.683

b) PV factor for 4 years @ 10% is 3.16987.

Question 10

XY Ltd. leased a machine to SB Ltd. on the following terms:

	(in lakhs)
Fair value of the machine	4.00
Lease term	5 years
Lease rental per annum	1.00
Guaranteed residual value	0.20
Expected residual value	0.40
Internal rate of return	15%

Depreciation is provided on straight line method at 10% per annum. Ascertain Unearned Finance Income. Also pass necessary journal entries in the books of the Lessee in the first year of lease.

Solution

Gross Investments = Minimum lease payments + Unguaranteed residual value

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

= [(Rs 100000 x 5 years)] + Rs 20000] + Rs 20000

= Rs 540000

Table showing present value of Minimum lease payments (MLP) and Unguaranteed residual value (URV)

Year	M.L.P inclusive of URV (Rs)	Discount factor @ 15%	Present Value (Rs)
1	100000	0.8696	86960
2	100000	0.7561	75610
3	100000	0.6575	65750
4	100000	0.5718	57180
5	100000	0.4972	49720
	20000 (GRV)	0.4972	9944
	520000		345164 (i)
	20000 (URV)	0.4972	9944 (ii)
	540000	+ (ii)	355108 (b)

Unearned Finance Income = (a) – (b)

= Rs 540000 - Rs 355108

= Rs 184892

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	₹	Rs
At the inception of lease		
Machinery account Dr. To XY Ltd's account (Being lease of machinery recorded at present value of minimum lease payments)	345164	 345164
At the end of the first year of lease Finance charges account Dr. (Refer Working Note) TO XY Ltd's account	51775	51775

XY Ltd's account Dr. To Bank account (Being the lease rent paid to the lessor which includes outstanding liability of Rs 48225 and finance charge of Rs 51775)	100000	 100000
Depreciation account Dr. To Machinery account (Being the depreciation provided @ 10% p.a. on straight line method)	34516	 34516
Profit and loss account Dr. To Depreciation account To Finance charges account (Being the depreciation and finance charges transferred to profit and loss account)	86291	 34516 51775

Working Note:

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

Year	Outstanding liability (opening balance)	Minimum lease payments	Finance charges	Reduction in principal amount	Outstanding liability (closing balance)
	Rs	Rs	Rs	Rs	Rs
1	345164	100000	51775	48225	296939
2	296939	100000	44541	55459	241480
3	241480	100000	36222	63778	177702
4	177702	100000	26655	73345	104357
5	104357	100000	15654	84346	20011

AS 20 – EPS

Question 1

Determine the order to include dilutive securities in the computation of weighted average number of shares and calculate the diluted earnings per share on the basis of the following information pertaining to financial year ended 31st March, 2012:

Earnings i.e., Net profit attributable to equity shareholders	Rs. 1,00,00,000
No. of equity shares outstanding	20,00,000
Average fair value of one equity share during the year	Rs. 75.00

Details of Potential Equity Shares:

Options	1,00,000 with exercise price of Rs.60
Convertible preferences shares	8,00,000 shares entitled to a cumulative dividend of Rs. 8 per share. Each preference share is convertible into 2 equity shares.
Attributable tax, e.g., dividend distribution tax (DDT)	16.2225%
12% convertible debentures of Rs.100 each	Nominal amount Rs.10,00,00,000. Each debenture is convertible into 4 equity shares.
Tax rate	30%

Manner of determining the order in which dilutive securities should be included in computation of Weighted Average Number of Shares

Solution

As per para 42 of AS 20 'earning Per Share', in order to maximize the dilution of basic earnings per share, each issue or series of potential equity shares is considered in sequence from the most dilutive to the least dilutive. For purpose of determine the sequence from most dilutive to least dilutive potential equity shares, the earning's per incremental potential equity share is calculated. Where the earnings per incremental shares is the least, the potential equity shares is considered most dilutive and vice-versa.

Increase in Earning Attributable to Equity Shareholders on Conversion of Potential Equity Shares

	Increase in earnings	Increase in no. of equity shares	Earnings per incremental shares
Options Increase in earnings No. of incremental shares Issued for no consideration {1,00,000*(75-60)/75}	Nil	20,000	nil
Convertible preferences shares Increase in net profit attributable to equity shareholders as adjusted by attributable tax (DDT) [Rs. 8 * 8,00,000) +16.2225% of (8*8,00,000)] No of incremental share's {2*8,00,000}	Rs.74,38,240	16,00,000	Rs. 4.6489
12% convertible debentures Increase in net profit {Rs 10,00,00,000*0.12* (1-0.30)} No. of incremental shares {10,00,000*4}	Rs.84,00,000	40,00,000	Rs. 2.10

It may be noted from the above that options are most dilutive earnings per incremental shares is nil. Hence, for purpose of computation of diluted earnings per share, options will be considered first. 12% convertible debenture being second most dilutive will be considered next and convertible preferences share will be considered at the end.

Since, diluted earnings per share is increased while taking the convertible preference shares into account (from Rs. 3.06 to Rs. 3.39), the convertible preference shares are anti-[diluted earnings per share is Rs. 3.06.

Question 2

From the following information relating to W Ltd, calculate diluted Earnings Per Share as per AS - 20. 1.

- Net Profit for the Current Year - Rs 5,00,00,000
- Number of Equity Shares outstanding - Rs 1,00,00,000
- 11% convertible Debentures of Rs 100 each (Nos.) - 1,25,000
- Interest Expenses for current year - Rs 13,75,000 5.
- Tax saving relating to interest expense - 30%
- Each Debenture is convertible into eight Equity Shares.

Solution

Basic EPS = 500 lakhs / 100 lakhs =Rs 5/- (Assuming NP is after tax)

Diluted EPS = 500 lakhs + Interest savings after tax / (WANES + Addln shares on conversion)

= (500 + 9.63)/ (100+10)= Rs 4 AR (Diluted FPS disclosure is mandatory)

Question 3

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

Net profit for year ended 31-03-2012	Rs 75,50,000
Net profit for year ended 31-03-2013	Rs 1,00,25,000

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

Solution

Number of Bonus shares issued as on 1.1.2013

On existing shares (50,00,250 × 1/2) 25,00,125 shares

On convertible debentures as per SEBI Guidelines on Bonus Issue

(1,00,000 debentures × 10 shares × 1/2) 5,00,000 shares

Basic Earnings per shares for the year 2012-13

$$\frac{\text{Net profit for the year ended 31.3.2013}}{\text{Weighted average number of equity shares as on 31.3.2013}}$$

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

Adjusted earnings per share for the year 2011-12

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

Diluted Earning Per Share for the year 2012-13

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

Tax relating to interest expenses (30%) = Rs 3,60,000

Adjusted net profit for the current year

= [RS 1,00,25,000 + {(12,00,000 – 3,60,000) × 3/12}]

= Rs 1,02,35,000

Number of equity shares resulting from conversion of debentures

= 1,00,000 × 10 shares = 10,00,000

Number of equity shares used to compute diluted earnings per shares

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

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

= 82,50,375 shares

Diluted earnings per shares = 1,02,35,000 / 82,50,375 = Rs 1.24

Note: As per AS 20, bonus shares issued to existing shareholders and to convertible debenture holders (on conversion of debentures into shares) are an issue without consideration. Therefore, it is treated as if it had occurred prior to the beginning of the year 2011-12, the earliest period reported.

Question 4

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

Net profit for	**Rs.**
Year 2012 -13	25,00,000
Year 2013-14	40,00,000

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

Right issue	:	One new share for each three outstanding I.e. 4,00,000 shares
	:	Right issue price Rs.22
	:	Last date to exercise rights 30.06.2013

Fair value of one equity share immediately prior to exercise of rights on 03.06.2013 =Rs. 28

You are required to computed the earnings per share for the year 2012 and 2013 - 2014.

Solution

Computation of earnings per share (EPS)

	Year 2012-13 (Rs.)	Year 2013-14 (Rs.)
EPS for the year 2012-13 as originally reported $= \frac{\text{Net profit for the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during t}}$ $= \frac{25,00,000}{12,00,000\ shares}$	2.08	
EPS for the Year 2012 -13 restated for rights issue $= \frac{25,00,000}{12,00,000\ shares \times 1.06}$	1.97 (approx.)	
EPS for the Year 2012 -13 including effects of right issue $= \frac{25,00,000}{[12,00,000 \times 1.06 \times 3/12] + \{16,00,000 \times 9/12\}}$		2.64 (approx.)

Question 5

Compute Basic and Adjusted EPS from the following information. All workings may be rounded off to two decimals.

Net Profit for 2012-2013	Rs.22 Lakhs
Net Profit for 2013-14	Rs.33 Lakhs
No. of shares before Rights Issue	110,000
Rights Issue Ratio one of Every Four Held	
Rights Issue Price	Rs.180

Date of Exercising Rights option 31.7.2013 (fully subscribed on this date)

Fair Value of Share before Rights Issue Rs.270

Solution

Calculation of WANES:

Particulars	No of Shares	Weight	Product
Original shares	1,10,000	1	1,10,000
Right Issue: Shares Issued for consideration Bonus element	 19,643 7,857	 8/12 1	 13,095 7,857
			1,30,952

$$\text{Theoretical Ex} - \text{right MP} = \frac{\text{Original shares} \times \text{cum market price} + \text{RI} \times \text{Subscription price}}{\text{Total Shares}}$$

$$= \frac{110000 \times 270 + 27500 \times 180}{137500} = \text{Rs. } 252$$

Total Right Shares Issued	27,500
Less: Shares for which proceeds are received (275000 x 180/252)	19,643
Bonus element or proceeds not recd	7,857

Calculation of EPS:

Basic EPS 2013-14 (Reported) = Net Profit/ WANES = 33,00,000/1,30,952 = Rs.25.20

Adjusted EPS 2012-13 = 22,00,000/1,17,857 = Rs.18.67

Question 6

The following information is available in respect of Rise Ltd. For the accounting year 2012-13 and 2013-14:

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

Number 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 Rs. 25

: Last date to exercise right 31st July, 2013.

Fair value of one equity shares immediately prior to exercise of rights on 31.07.2013 is Rs. 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 tight issue.

iii. Basic earnings per share for the year 2013-14.

<u>Solution</u>

Computation of basic earnings per share

	Year 2012-2013(Rs.)	Year 2013-14 (Rs.)
EPS for the year 2012-13 as originally reported		
=Net profit for the year attributable to equity share holders/weighted average number of equity shares outstanding during the year = 22,00,000/10,00,000 shares	2.20	
EPs for the year 2012-13 restated or the right issue = 22,00,000/(10,00,000 X 1.04)	2.12	
= Rs.30,00,000/{10,00,000 X1.04X4/12)+ (12,00,000 X8/12)}		2.62

Working Notes:

i. Computation of theoretical ex-right fair value per share =(fair value of all outstanding shares immediately prior to exercise of rights +Total value received from exercise of rights) /(number of shares outstanding prior to exercise +number of shares issued on the exercise)

=(Rs.32 X10,00,000 +Rs.25x2,00,000)/(10,00,000,000 +2,00,000)

=30.83

ii. Computation of adjustment factor

=Fair value per share prior to exercise of right /Theoretical ex-right value per share

=32/ 30.83

=1.04 (approx.)

Question 7

A Ltd. had 8,00,000 equity shares outstanding as on 1st April, 2013. The company earned a profit of " 20,00,000 during the year 2014.15. The average fair value per share during 2014-15 was Rs. 40. The company has given share option to its employees of 1,00,000 equity shares at the option price of 20.

Calculate Basic EPS and Diluted EPS.

Solution

Computation of Earnings per Share

	Earnings	**Shares**	**Earnings per share**
	Rs		**Rs**
Net profit for the year 2014-15	2000000		
Number of shares outstanding during the year 2014 -15		800000	
Basic Earnings Per Share 2000000 ------------- 800000			2.50

Number of shares under option		100000	
Number of shares that would have been issued at fair value (Refer Note) [100000 x 20/40]		(50000)	
Diluted Earnings Per Share 2000000			
850000	2000000	850000	2.35

Note: The earnings have not been increase as the total number of shares has been increased only by the number of shares (50000) deemed for the purpose of the computation to have been issued for no consideration.

Question 8

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 (on month basis) in the following case:

		No. of shares
1st April , 2014	Balance of Equity Shares	500000
30th June , 2014	Equity shares issued for cash	100000
15th January , 2015	Equity shares bought back	50000
31st March , 2015	Balance of equity shares	550000

Solution

As per AS 20, "Earnings Per Share", the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or lesser number of shares outstanding at any time. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Computation of weighted average number of shares outstanding during the period

Date	**No. of equity shares**	**Period outstanding**	**Weights (months)**	**Weighted average number of shares**
1	2	3	4	5= 2x 4
1stApril 2014	500000 (Opening)	12 months	12/12	500000
30th June 2014	100000 (Additional issue)	9 months	9/12	75000
15th Jan 2014	50000 (Buy back)	2.5 months	2.5/12	(10417)
31st March 2015	550000 (Balance)	0/12	0/12	-
Total				564583

AS 22 - Accounting for Taxes on Income

Question 1

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

Solution

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

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

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

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

Question 2

Goodwill Ltd. Is a full tax free enterprises for the first 12 years of its existence and is in third year of operation. Deprecation timing difference resulting in a deferred tax liability in 1st, 2nd and 3rd year is Rs.200 lakhs, 300 lakhs and 400 lakhs respectively. From the 4th year onward, it is expected that the timing difference would reverse each year by Rs. 10 lakhs. Assuming tax rate @ 35% find out the deferred tax liability at the end of 3rd year and any charge to the profit and loss account.

Solution

As per AS-22 |Accounting for Taxes on Income"-

- The deferred tax in respect of timing difference which originate during the tax holiday period, and reverse during the tax holiday period, should not be recognized to the extent the gross total income of the enterprises is subject to such deductions.
- The deferred tax in respect of timing difference which originate during the tax holiday period, but reverse after the tax holiday period, should be recognized in the years in which the timing difference originate, subject to consideration of purchase.
- Timing differences, which originate first, should be recognized as reversing first.

  In this case, the Milton Ltd is a full tax free enterprises of the first 12 years of its existence and therefore, as per the above interpretation the depreciation deferred tax liability arose in year 1 of Rs. 200 lakhs will be reversed first from 4 onwards to the extent of Rs. 90 lakhs, the balance Rs. 110 lakhs is not reversed during tax holiday period and Rs.300 lakhs which resulted in year 2 is also not reversed during the tax holiday period further 1400 lakhs of 3rd year is not reversed during tax holiday period further 400 lakhs of 3rd year is not reversed during tax holiday period. Therefore, deferred tax liability own account of deprecation timing difference of Rs. 283.5 lakhs should be recognized at the end of the 3rd year and charged to profit and loss account.

Question 3

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

Company X has a block of assets with a written down value of Rs 1,00,000 on 1st April, 2011 for tax purpose. The book value of the assets for accounting purposes is also Rs 1,00,000. The assets are depreciated on written down value basis at 25 per cent per annum for both accounting and tax purposes. Of the entire block, assets costing Rs 5000 on April, 2011, were sold for Rs 10,000 on 31st March,2013. Compute the deferred tax asset/ liability assuming tax rate of 40 percent.

Solution

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

2011-12

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

2012-13

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

i. Depreciation for tax purposes is Rs 16,250 and for accounting purposes Rs 18,750 giving rise to a timing difference of Rs 2,500.
ii. Profit on sale of fixed asset amounting to Rs 7,188 (Rs 10,000 – Rs 2,812 being the WDV of the asset as on 31st March, 2013) is recognized for accounting purpose. However, for tax purposes this income is not considered. This will result in a timing difference of Rs 7,188.

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

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

Question 4

To comply with listing requirements and other statutory obligations Quaker Ltd. prepares interim financial reports at the end of each quarter. The company has brought forward losses of Rs 700 lakhs under Income Tax Law, of which 90% is eligible for set off as per the recent verdict of the Court, that has attained finality. No deferred Tax Asset has been recognized on such losses in view of the uncertainty over its eligibility for set off, The company has reported quarterly earnings of Rs 700 lakhs Rs 300 lakhs respectively for the first two quarters of financial year 2013-14 and anticipates a net earning of Rs 800 lakhs in the coming half year ended March 2014 of which Rs 100 lakh will be the loss in the quarter ended Dec, 2013. The tax rate for the company is 30% with a 10% surcharge. You are required to calculate the amount of Tax Expense to be reported for each quarter of financial year 2013-14 .

Solution

As per para 29 (c) - Treatment of Taxes: Income Tax Expense is recognized in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

a) Estimated Total Income for the year 2013-14: 700 + 300 + 800 = Rs 1800 lakhs
b) Estimated Total Tax Liability: 1800 - 700 x 90% = Rs 1170 lakhs
c) Average Annual Tax = 1170 x 33% = Rs 386.1
d) Average Annual Tax Rate: = Z 386.1 / 1800 = 21.45%
e) Quarterly Tax Expense: —Q1, Q2, Q3, Q4 = 700x 21.45% = = Rs 150.15 Lakhs, 300x 21.45% = Rs 64.35 Lakhs (100)x 2.45% = Rs (21.45), Lakhs 900x 21.45%= Rs 193.05 Lakhs

Question 5

Alpha Ltd prepares its accounts annually on 31st March. The company has incurred a loss of Rs.1,00,000 in the year 2010 and made profits or Rs. 50,000 and Rs. 60,000 in year 2011 and year 2012 respectively. It is assumed that under the tax laws, loss can be carried forward for 8 years and tax trade is 40% and at the end of year 2010. It was virtually certain, supported by convincing evidence, that the company would have sufficient taxable income in the future years against which unabsorbed deprecation and carry forward if losses can be set-off. It is also assumed that there is no difference between taxable income and accounting income except that set off of loss is allowed in years 2011 and 2012 for tax purpose. Calculated profit (loss) after tax effect as per AS 22, in all the three years.

Solution

Statement of profit and Loss

(for the three years ending 31stg March, 2010, 2011, 2012)

(Rs. Thousands)

	2010	2011	2012
Profit (loss)	(100)	50	60
Less: Current tax (Refer W.N.	-	-	(4)
	----	----	------
	(100)	50	56
Adjustment of Deferred tax:			
Tax effect of timing differences originating during the year	40		
Tax effect of timing differences reversing during the year	--	(20)	(20)
		---	----
Profit (loss) after tax effect	(60)	30	36
	----	-----	-----

Working Note:

Loss of the year 2010 Rs. 100 thousands is set off from the profits of the year 2011 and 2012. After set-off of loss, remaining profit of the year 2012 to the extent of Rs. 10 thousands is taxable @ 40%

Question 6

Quick Ltd. is a Company engaged in the trading of spare parts used in the repair of automobiles. The company has been regular in depositing the tax, as such there is no liability of Income Tax, etc. for the financial Year 2012-2013. The figures for the year are as under:

Income chargeable to Tax	Rs.211.64 Lakhs
Total Income after Adjustments	Rs.228.48 Lakhs
Tax thereon	Rs.74.13 Lakhs
TDS deducted during the year	Rs.30.45 Lakhs
Tax paid for the year	Rs.43.68 Lakhs

The company has prepared its Balance Sheet as per above figures. However, during the assessment proceeding held before the finalization of the Balance Sheet, the Income Tax Officer has issued demand of Rs.7.52 Lakhs, insisting that this amount of TDS has not been uploaded online and thus is not acceptable as deduction.

The company has in reply to the same filed a rectification with the Assessing Officer. The Company is trying to collect the TDS Certificates, but Rs.2.39 Lakhs deducted by XY Ltd, is not traceable. The rectification is lying pending with the Assessing Officer. Please suggest the treatment of Rs.2.35 Lakhs and Rs.7.52 Lakhs in Balance Sheet.

Solution

There are 2 things in the problem (1) TDS of Rs.2.39 lakhs which is not traceable, (2) TDS of Rs.5.13 lakhs which is being traced. However in this case the ITO should accept the TDS evidence: Under the Income Tax Act, the credit for TDS cannot be denied on the ground that it is not reflected online in Form 26AS. In such cases, the TDS Credit can be given on the strength of other evidences available with the Assessee.

Accounting Treatment:

For TDS of Rs.2.39 lakhs which is not traceable: It may or may not be traceable, in future. This means it is not a real but possible obligation which means it is contingent liability. It should be disclosed in the notes to accounts.

For TDS of Rs.5.13 lakhs which is traceable: As the occurrence of the liability is remote no disclosure is required either as a contingent liability nor it is a provision.

Question 7

What are Timing Differences and Permanent Differences as per Accounting Standard - 22? Explain with example.

Solution

Timing Differences	Permanent Difference
Differences in accounting income and taxable income which arises in one year and is capable of reversal in the subsequent years is known as timing Differences.	These are the differences in the Accounting income and Taxable income which arises in one year and is not capable of reversal in the subsequent years.
Deferred taxes are created on TDS	No deferred taxes are created on PDs.
Ex. Borrowing Costs, Finance lease, Depreciation, Section 43B expenses	Ex. Penalty, Donations disallowed, Agricultural income.

Question 8

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

A company has a block of assets with a written done value of Rs. 1,00,000 on April1, 2012 for tax purposes. The book value of the assets for accounting purposes is also Rs. 1,00,000. The assets are depreciated on written down value basis at 25 percent per annum for both accounting and tax purpose. Of the entire block, assets costing Rs. 5,000 on April, 1, 2012, were sold for Rs. 10,000 on March 31, 2014. Compute the deferred tax asset/liability assuming tax rate of 40 per cent.

Solution

In the case of a company, the following computations will be made: 2012-13

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

2013-14

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

- Depreciation for tax purpose is Rs.16,250 and for accounting purposes Rs.18,750 giving rise to a timing difference of Rs. 2,500.
- Profit on sale of fixed asset amounting to Rs.7,188 (Rs.10,000-Rs.2,812 being the WDV of the asset as on 31st March, 2014) is recognized for accounting purposes. However, for tax purpose this income is not considered. This will result in a timing difference of Rs. 7,188.

The net timing difference would be Rs. 4,688 (Rs.7,188 – Rs.2,500) by which the accounting purposes would be higher as compared to depreciation for tax purposes because depreciation for accounting purposes would be computed on higher carrying amount of fixed assets as compared to carrying amount of those assets for tax purposes.

<u>Question 9</u>

From the given information, you are required to compute the deferred tax assets and deferred tax liability for Ramanujam Limited as on 31st March 2014. The tax rate applicable is 35%.

i. The company has charged depreciation of (7,42,900/- in its books of accounts while as per income-tax computation, the depreciation available to the company is Rs.8,65,400
ii. The company has made provision for doubtful debts for Rs.54,300/- during the year.
iii. The company has debited share issue expenses of Rs.6,23,500/- which will be available for deduction under the Income-tax act from the next year.

iv. The expense of Rs.7,84,5001- has been charged to profit and loss account which are disallowed under the Income-tax Act.

v. The company has made donation of Rs.2,00,000/- which has been debited to profit and loss account and only 50% thereof win be allowed as deduction as per Income-tax law

Solution

Particulars	**Timing Diff**	**Net**	**Deferred tax @35%**
Depreciation	(865400 – 7,42,900)	1,22,500	42,875
Provision for DD	(54300 – 0)	54300	19,005
Share issue exp	(623500 – 0)	623500	2,18,225
		Net DTA	2,80,105

Note:

(1) Item no (iv) Rs.7,84,500 disallowed under IT Act is a permanent difference.

(2) Item No (v) Rs.2,00,000 whereby 50% is allowed by IT Act and 50% is disallowed under IT Act hence it is a permanent difference.

AS 24 - Discontinuing Operations

Question 1

A cosmetic goods producer has changed the product line as follows:

	Day Cream	**Night Cream**
January, 2011 – September, 2011 per month	2,00,000	2,00,000
October, 2011 – December, 2011 per month	1,00,000	3,00,000
January, 2012 – March, 2012 per month	0	4,00,000

The company has enforced a gradual enforcement of change in product line on the basis of an overall plant capacity. The Board of Directors of the Company has passed a resolution in March, 2011 to this effect. The Company follows calendar year as its accounting year. Should it be treated as discontinuing operation?

Solution

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

Question 2

A cosmetic items producing company provides the following information.

	Fairness Cream	**Vanishing Cream**
January, 2012 – September, 2012 per month	2,00,000	2,00,000
October, 2012 – December, 2012 per month	2,00,000	3,00,000
January, 2012 – March, 2013 per month	0	4,00,000

The company has enforced a gradual change in product- line on the basis of an overall plan. The Board of Directors of the Company has passed a resolution in March, 2012 to this effect. The company follows calendar year as its accounting year. Should this be treated as a discontinuing operation? Give reasons in support of your answer.

Solution

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

Question 3

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:

1. You are required of comment if mere gradual phasing out in itself can be considered as a "Discontinuing Operation' within the meaning of AS-24.
2. 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 factory, does this trigger the application of AS-24?
3. 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?

Solution

1. Mere gradual phasing out in itself cannot be considered as a Discontinuing Operation (DO). Gradual or evolutionary phasing out of a product line or class of service is not DO para 9
2. Passing of 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 factory, does not trigger the application of AS-24. It is sale in its entirety remember and not some of the assets. Also starting the operations in the New Factory is altogether a new business and has nothing to do with old business.

3. Resolution to sell assets of the Passenger Car Division in a phased but time bound manner will lead to identification of a Discontinuing Operation as per AS-24. It means there is a single plan to discontinue the operation. The manner of discontinuance seems to be piecemeal distribution.

Question 4

A cosmetic item producing company provides the following information:

	Famines Cream	Vanishing Cream
January, 2012- September, 2012 per month	2,00,000	2,00,000
October, 2012-December, 2012 per month	2,00,000	3,00,000
January, 2013- March, 2013 per month	0	4,00,000

The company has enforced a gradual change in product-line on the basis of an overall plan. The Board of directors of the Company has passed a resolution in March, 2012 to this effect. The company follows calendar year as its accounting year. Should this be treated as a discounting operation? Give reasons in support of your answer.

Solution

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

AS 26: Intangible Assets

Question 1

London International Ltd. is developing a new production process. During the financial year ending 31st March, 2011, the total expenditure incurred was 50 lakhs. This process met the criteria for recognition as an intangible asset on 1st December, 2010. Expenditure incurred till this date was 22 lakhs. Further expenditure incurred on the process for the financial year ending 31st March 2012 was 80 lakhs. As at 31st March, 2012, the recoverable amount of know-how embodied in the process is estimated to be 72 lakhs. This includes estimates of future cash outflows as well as inflows.

You are required to calculate:

I. Amount to be charged to Profit and Loss A/c for the year ending 31st March, 2011 and carrying value of intangible as on that date.

II. Amount to be charged to Profit and Loss A/c and carrying value of intangible as on 31st March, 2012.

Ignore depreciation.

Solution

As per AS 26 'Intangible Assets'

- For the year ending 31.03.2011

1. Carrying value of intangible as on 31.03.2011:

At the end of financial year 31st March, 2011, the production process will be (expenditure incurred since the date the recognition criteria were met, i.e. on 1st December, 2010)

2. Expenditure to be charged to Profit and Loss account:

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

- For the year ending 31.03.2012

1. Expenditure to be charged to Profit and Loss account:

	(Rs. In lakhs)
Carrying amount as on 31.03.2011	28
Expenditure during 2011-2012	80
Total book cost	108
Recoverable Amount	72
Impairment loss	36

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

2. Carrying value of intangible as on 31.03.2012:

	(Rs. In lakhs)
Total Book Cost	108
Less: Impairment Loss	36
Carrying amount as on 31.03.2012	72

Question 2

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

i. import duty : 20%
ii. purchase Tax : 10%
iii. entry tax : 5% (recoverable later from tax department)
iv. installation expense : Rs. 25,000
v. professional fees for clearance from customs : Rs. 20,000.

Compute the cost of software to be capitalized.

Solution

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

Purchase cost of the software	$1,00,000
Less: trade discount @5%	$5,000
	$95,000
Cost in Rs. (US $ 95,000*Rs. 52)	49,40,000
Add: import duty on cost @ 20% (Rs.)	9,88,000
	59,28,000
Add: purchase tax @ 10% (Rs.)	5,92,800
Installation expense (Rs.)	25,000
Professional fee for clearances from customs (Rs.)	20,000
Cost of the software to be capitalized (Rs.)	65,65,800

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

Question 3

X Ltd is engaged in the business of Newspaper and Radio Broadcasting. It operates through different brand names. During Financial Year 2012-2013, it incurred substantial amounts on external trade, business communication and branding expenses by participation in various Corporate Social Responsibility initiatives. The Company expects to benefit by this expenditure by attracting new customers over a period of time and accordingly it has capitalized the same under Brand Development Expenses and intends to amortize the same over the period in which it expects the benefits to flow. As the Statutory Auditor of the Company, do you concur? Give reasons.

Solution

Assumption 1:

All the Broadcasting Brands are purchased one: Yes the Brands are Intangible assets as per AS-26. Purchased Brands are intangible assets.

Assumption 2:

All the Broadcasting Brands are internally generated: As per AS-26 internally generated brand's, goodwill, publishing titles and mastheads are not intangible assets ……….para 50

Now let's talk about the expenses on promotion and branding development.

Whether the brands are purchased one or internally generated in all such cases expenses on brand building has to be charged to profit/loss account.

AS-26 has prohibited Selling and Advertisement expenses to be either deferred or capitalized. The company is incorrect in its contention.

Question 4

Religare Ltd. Acquired a patent of a drug at a cost of Rs. 20,00,000 for a period of 4 years and the product life-cycle is also 4 years. The company capitalized the cost and started amortizing the asset at Rs. 5,00,000 per annum.

After one year, it was found that the product life-cycle may continue for another 5 years from then. The net cash flow form then. The net cash flows from the product during theses 5 years were expected to be Rs. 8,00,000, Rs. 132,00,000 Rs, 10,00,000, Rs. 12,50,000 and Rs. 7,50,00.

Find out the amortization of the patent for each of the years?

Solution

As per Para 48 of AS 26' Intangibles Assets', the amortization period and the amortization method should be reviewed at lease at each financial year end. If the expected useful life of the asset is significantly different from previous estimates, the amortization period should be changed accordingly. If there has been a significant change in the expected pattern of economic benefits from the asset, the amortization method should be changed to reflect the changed pattern.

Accordingly, Relegate Ltd. Amortized Ltd. Amortized Rs. 5,00,000 per annum for the first year. The remaining carrying cost of Rs. 15,00,000(Rs.20,00,000 - Rs.5,00,000) will be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortization may be calculated as follows;

Year	Net Cash flows(Rs.)	Amortization basis	Amortization Amount (Rs.)
1	-	Rs.20,00,000/4 Years	5,00,000
2	8,00,00	0.160	2,40,000
3	12,00,000	0.240	3,60,000
4	10,00,000	0.200	3,00,000
5	12,50,000	0.250	3,75,000
6	7,50,000	0.150	2,25,000
	50,00,000	**1.000**	**20,00,000**

Question 5

Sunny Limited is developing a new production process. During the financial year ended 31st March 2013, the company has incurred total expenditure of Rs.40 lacs on the process. On 1st December, 2012, the process has met the norms to be recognized as 'intangible assets' and the expenditure incurred till that date is Rs.16 lakhs. During the financial year ending on 31st March 2014, the company has further incurred 70 lacs. The recoverable amount as on 31st March 2014 of the process is estimated to be Rs.62 lacs. You are required to work out:

i. Expenditure to be charged to profit and loss account for the financial year ending on 31st March 2013 and 31st March 2014. (ignore depreciation)
ii. Carrying amount of the 'intangible asset' as at 31st March 2013 and 31st March 2014

Solution

Expenditure charged to P&L A/c for 2013-13: Rs.16 lakhs will be recognized 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 recognized in the balance sheet. Carrying value of intangible as on 31.03.2013 will be Rs.24 lakhs.

i. Expenditure charged to P&L A/c for 2013-13 will be Rs.16 lakhs.
   Carrying amount as on 31/3/2013 = 24 lakhs
ii. Next year:

Particulars	Rs.Lakhs
Development cost as on 31/3/2014 (24 lakhs + 70 lakhs) Less: recoverable amount	94 62
Impairment loss to be charged to P&L A/c	32

Carrying value of Intangible as on 31.03.2014: 62 lakhs and the Amount charged to P/L will be 32 lakhs

SUMMARY:

	31/3/2013	31/3/2014
Amount charged to P/L A/c	16,00,000	32,00,000
Carrying amount of asset	24,00,000	62,00,000

AS 29 - Provisions, Contingent Liabilities and Contingent Assets

Question 1

Ram Company has at its financial year ended 31st March, 2012 fifteen law suits outstanding none of which has been settled by the time the accounts are approved by the directors. The directors have estimated that the possible outcomes as below:

Result	Probability	Amount of loss
For first ten cases:		
Win	0.6	-
Lose-low damages	0.3	90,000
Lose-high damages	0.1	1,60,000
For remaining five cases:		
Win	0.5	-
Lose-low damages	0.3	60,000

Lose-high damages	0.2	95,000

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

Estimated the amount of contingent loss and state the accounting treatment of such contingent loss.

Solution

As per AS 29, Contingent liability should be disclosed in financial statements if following conditions are satisfied:-

- There should be present obligation arising out of past event but not recognized as provision.
- It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- The possibility of an outflow of resources embodying economic benefits is not remote.
- The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first 10 cases is 60% and for remaining, five cases 50%. In other words, the probability of losing is 40% or 50% respectively. As per the AS-29, we make a provision if the loss is probable. As the loss does not appear to be probable and the 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 should be made. For the purpose of the disclosure of contingent liability by way of note amount may be calculated as under.

Expected loss in first ten cases	= Rs.90,000 x 0.3 + Rs.1,60,000 x 0.1 = Rs.43,000 x 10 = Rs.4,30,000
Expected loss in remaining five cases	= Rs.60,000 x 0.3 + Rs.95,000 x 0.2 = Rs.37,000 x 5 = Rs.1,85,000

Total Contingent Liability	= Rs.4,30,000 + Rs.1,85,000 = Rs.6,15,000

Question 2

Vishnu Company has at its financial year ended 31st March, 2013 fifteen law suits outstanding, none of which has been settled by the time the accounts are approved by the directors.

The directors have estimated that the possible outcomes as below:

RESULT	PROBABILITY	AMOUNT OF LOSS
For first ten cases :		
Win	0.6	-
Lose – low damages	0.3	90000
Lose – high damages	0.1	160000
For remaining five cases :		
Win	0.5	-
Lose – low damages	0.3	60000
Lose – high damages	0.2	95000

The directors believe that the outcome of each case is independent of the outcome of all the others. Estimate the amount of contingent loss and state the accounting treatment of such contingent loss.

Solution

As per AS-29 Contingent liability should be disclosed in financial statements if following conditions are satisfied:—

- There should be present obligation arising out of past event but not recognized as provision.
- It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- The possibility of an outflow of resources embodying economic benefits remote

- The amount of the obligation cannot be measured with sufficient re to be recognized as provision

In this case, the probability of winning of first 10 cases is 60%and for remaining, five cases 50%. In other words, the probability of losing is 40%or 50% respectively. As per the AS-29, we make a provision if the loss is probable. As the loss does not appear to be probable and the 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 should be made. For the purpose of the disclosure of contingent liability by way of note amount may be calculated as under:

Expected loss in first ten cases	= Rs 90,000 x 0.3 + Rs 1,60,000 x 0.1
	= Rs 43,000 x 10
	= Rs 4,30,000
Expected loss in remaining five cases	= Rs 60,000 x 0.3+ Rs 95,000 x 02
	= Rs 37,000 x 5= Rs 1,85,000
Total Contingent Liability	= Rs 4,30,000 + Rs 1,85,000
	= Rs 6,15,000

Question 3

Raja Ltd. had announced a Voluntary Retirement Scheme (VRS) for its employees on 1st January,2012. The scheme is scheduled to close on 30th June, 2012. The scheme envisaged an initial lump-sum payment of maximum of Rs 2 lakhs and monthly payments over the balance period of service of employees coming under the plan. 200 employees opted for the scheme as on 31st March, 2012. The total lump sum payment for these employees would be Rs 250 lakhs and the aggregate of future payments to them would amount to Rs 1500 lakhs.

However no payment had been made to the employees under the scheme up to 31st March, 2012. The Company had not made any provision in its accounts towards any liability under the scheme. Give your views on the above.

Solution

Recognition – As per AS 29 a provision should be recognized if the following conditions are satisfied.

Condition – 1	**Condition – 2**	**Condition – 3**
Present obligation is a result of past event	Outflow of the resources to settle the obligation is probable	Reliable estimate of the amount can be made
VRS started in January 2012 and existed on the balance sheet date. As on the balance sheet date, nearly 200 employees had opted for the scheme evidencing the existence of a liability on the balance sheet date.	As and when the employees' applications are accepted, the outflow of resources to settle the obligation is probable. Also it is probable that the liability will increase, if more people opt for VRS.	Lumpsum payment is Rs 250 lakhs and estimated payment is Rs 1,500 lakhs (given)

Treatment and Conclusion: Since all the conditions for recognition of a Provision are satisfied, a Provision should be recognized for the year ending 31st March, 2012. Hence, the treatment of the Company for not recognizing the provision violates AS 29 requirements.

Question 4

Raja Ltd. Had announced a Voluntary Retirement Scheme (VRS) for its employees on 1st January 2012. The scheme is scheduled to close on 30th June 2012. The scheme envisaged an initial lump-sum payment to maximum of Rs. 2 Lakhs and monthly payments over the balance period of service of employees coming under the plan. 200 employees opted for the scheme as on 31st March 2012. The total lump sum payment for these employees would be Rs. 250 Lakhs and the aggregated of future payments to them would amount to Rs. 1,500 Lakhs. However no payment has been made to the employees under the scheme up to 31st March 2012. The

Company had not made any provision in its accounts towards any liability under the scheme. Give your views on the above.

Solution

Recognition: - As per As 29 a provision should be recognized if the following conditions are satisfies.

Condition -1	**Condition -2**	**Condition -3**
Present obligation is a result of past event	Outflow of the resources to settle the obligation is portable	Reliable estimate of the amount can be made.
VRS started in January 2012 and existed on the balance sheet date. As on the balance sheet date, nearly 200 employees had opted for the scheme evidencing the existence of a ability on the balance sheet date.	As and when the employees' Applications are accepted, the outflow f resources to settle the obligation is probable. Also it is portable that the liability will increase, if more people opt for VRS.	Lump sum payment is Rs. 250 lakhs and estimated payment is Rs. 1,500 lakhs (given)

Treatment and Consultation: Since all the conditions for recognition of a Provision are satisfied, a Provision should be recognized for the year ending 31st March 2012. Hence, the treatment of the Company for not recognizing violates As 29 requirements

Question 5

Lucky P limited has been assessed to Income- Tax, in which a demand of Rs. 10 lakhs has been made. The company has gone in appeal. The company has deposited Rs. 6.00 lakhs against the demand, on being pursed by the Department. The company has been advised by its Counsel that there is 80% chance of losing in respect of one of the ground which may end up confirming the demand of Rs. 4.00 lakhs, while on other ground, there is fair chance of winning the appeal.

How the company should treat the same while preparing the Final Accounts for the year ending 31st March, 2015?

Solution

An enterprise should recognize a provision only when all of the following conditions met:

i. there is a present obligation as a result of a past event ;
ii. it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation : and
iii. reliable estimate can be made of the amount of the obligation.

Accounting treatment:

As there is 80% chance of losing the case it is highly probable that outflow of resources will be spent to settle the obligation. Hence Lucky Ltd should make a provision of Rs. 4,00,000. For the balance demand the company should make a disclosure as a Contingent Liability as there is a fair chance of winning the appeal.

Regarding Rs. 6,00,000 which is not a settlement of the liability, it should be disclosed under the head “Non-Current Assets” indicating that it is paid in relation to an appeal pending.

Question 6

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 Rs.1250 Iakhs 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 1250 laths in respect of pay revision. The amount chargeable from reimbursable jobs will be billed as per the contract Men the actual payment is made."

The Accountant feels that the company should also book/recognize the income by, 1250 lakh in profit& Loss Account as per the terms of the contract Otherwise it will be the violation of matching concept & understatement or profit

Comment on the opinion of the Accountant with reference to relevant Accounting Standards.

Corporate Financial Reporting

11. Max & Co. Ltd. Had the following items under Reserves& Surplus in the Balance Sheet as on 31st March, 2015

Securities Premium	50 lakhs
Capital Reserve	30 lakhs
General Reserve	21 lakhs

The company had annulated loss of Rs. 120 lakhs, on the same day, which it had disclosed utter the head 'Statement of Profit and Loss" as an 'Asset in its Balance Sheet.

Comment on the correctness of this twirled in line with Schedule III to the Companies Act, 2013.

Accounting for Corporate Restructuring

12. The following are the Balance Sheets of A Ltd. & B Ltd. as on 31s, Match, 2015:

Liabilities	A Ltd.	B Ltd.
Share Capital :		
Equity Shares of 10 each fully paid	4500000	1000000
8% Preference Shares of 1- each fully paid	-	500000
General Reserve	350000	310000
Profit and Loss Account	634000	60000
10% Debentures	-	800000
Current Liabilities	600000	380000
TOTAL	6084000	3050000

Question 7

Immediate Ltd. is a company engaged in the trading of spare parts used in the repair of automobiles. The company has been regular in depositing the tax, as such there is no liability of Income-tax etc. for the Financial Year 2012-13. The figures for the year are as under:

Income chargeable to tax	Rs 211.64 lakhs
Total income after adjustment	Rs 228.48 lakhs
Tax theoran TDS deducted during the year	Rs. 74.13 lakhs
Tax paid for the year	Rs 30.45 lakhs
Tax paid for the year	Rs 43.68 lakhs

The company has prepared its Balance Sheet as per above figures. However, during the assessment proceeding held before the finalization of the Balance Sheet the Income Tax Officer has issued demand of Rs 7.52 lakhs, insisting that this amount of TDS has not been uploaded online and thus is not acceptable as deduction.

The company has in reply to the same filed a rectification with the Assessing Officer. The company is trying to collect the TDS certificates, but Rs 2.39 lakhs deducted by XY Ltd., is not traceable. The rectification is lying pending with the Assessing Officer.

Please suggest the treatment of Rs 2.39 lakhs and Rs.7.52 lakhs in Balance Sheet.

Solution

As per para 10 of AS 29 Provisions , Liabilities and Contingent Assets', a contingent liability Is (a) a possible obligation that arises from past events and the existence of which will be occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or (b) a present obligation that arises from past events but is not recognized because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) a reliable estimate of the amount of the obligation cannot be made. An obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

In the given case, TDS shall be allowed by the IT department on submission of duplicate TDS certificates. Since the company is making efforts and is hopeful for its ultimate collection, contingent liability will be made for Rs 2.39 Iakhs in the books of account.

Further as per para 15 of the standard, where it is more likely that no present obligation exists at the balance sheet date and the possibility of an outflow of resources embodying economic benefits is remote, no contingent liability is disclosed.

TDS certificates for Rs.5.13 lakhs (Rs.7.52 Iakhs less Rs 2.39 Iakhs) have been submitted and the company has filed a rectification with the Assessing Officer. Therefore, the possibility of an outflow of resources embodying economic benefits is remote; the company shall not disclose it as contingent liability. This amount should be disclosed by way of a note to the accounts.

An alternative view can also be considered on the basis of the paragraph 14 of the standard which states that a provision should be recognized in the books when (a) an enterprise has a present obligation as a result of a past event; (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation.

Accordingly, in the given case, since there is a probability of outflow of resources and also the amount can be quantified on account of non-traceability of TDS certificates, a provision may be made for 2.39 Iakhs in the books of account.

Regarding the balance amount of Rs 5.13 lakhs (Rs 7.52 lakhs less Rs 2.39 Iakhs), since TDS certificated have been submitted, it is likely that the Income-tax Officer may accept the rectification filed by the assessee. However, since the TDS details have not been uploaded online because of which demand has been issued, there may be a possibility that the rectification may also not be accepted. Therefore, taking a conservative approach, Rs 5.13 lakhs may be disclosed as a contingent liability.