AS-3 (REVISED): CASH FLOW STATEMENT

Illustration 1.

Oriental Bank of Commerce, received a gross ₹4,500 crores demand deposits from customers and customers withdrawn ₹4,000 crores of demand deposits during the financial year 2017-18. How would you classify such cash flows?

Solution:

It will be treated as an Operating activity, on net basis ₹500 crores, inflow.

AS-7 (REVISED): ACCOUNTING FOR CONSTRUCTION CONTRACTS

Illustration 2.

A Company undertook to pay contract for a building for ₹40 lakhs. As on 31.3.2017, it incurred a cost of ₹6 lakhs and expects that there will be ₹36 lakhs more for completing the building. It has received ₹4 lakhs as progress payment. What is the degree of completion?

Solution:

$$\text{Percentage of Completion} = \frac{\text{Cost to date}}{\text{Cumulative cost incurred + Estimated cost to complete}} \times 100 = \frac{6}{6+36} = 14.28\%$$

AS-9 REVENUE RECOGNITION

Illustration 3.

AB Ltd. seeks your advise about the treatment of the following in the final statement of accounts for the year ended 31st March 2017:

“As a result of a recent announced price revision, granted by the Government of India with effect from 1st July, 2014, the company stands to receive ₹ 6 lakhs from its customers in respect of sales made in 2016-17”

Solution:

The company is preparing the financial statements for the year ended 31.3.17. Due to price revision granted by the Government of India, the company has to receive an additional sales revenue of ₹ 6 lakhs in respect of sales made during the year 2016-17.

As per AS-9, where uncertainty exists in collection of revenue, its recognition is postponed to the extent of uncertainty involved and it should be recognized as revenue only when it is reasonably certain about its collection.

In view of the above statement, if there is no uncertainty exists as to the collect ability of ₹ 6 lakhs, it should be recognized as revenue in the financial statements for the year ended 31.3.17.

Illustration 4.

Advise D Ltd.about the treatment of the following in the final statement of accounts for the year ended 31st March, 2017.

A claim lodged with the Railways in March, 2015 for loss of goods of ₹ 5 lakhs had been passed for payment in March, 2017 for ₹ 4 lakhs. No entry was passed in the books of the company, when the claim was lodged.

Solution:

The financial statements of the company are prepared for the year ended 31.3.17.

There was a loss of goods of ₹ 5 lakhs in 2014-15 and the claim was lodged in March 2015 with the Railway authorities. No entry was passed in the books of the company when the claim was lodged and the said treatment was correct in view of AS-9, which states that if uncertainty exists as to collectability, the revenue recognition should be postponed.

Since, the claim is passed for payment of ₹ 4 lakhs in March, 2017, it should be recognized as revenue in the financial statements prepared for the year ended 31.3.17.

As per AS-5 Revised, the claim amount received will not be treated as extraordinary item. AS-5 Revised further states that when items of income and expense within profit 0r loss from ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately.

Illustration 5.

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

Solution:

Accounting Standard 2 "Valuation of Inventories" states that inventories should be valued at lower of historical cost and net realisable value. AS 9 on "Revenue Recognition" states, "at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases, when sale is assured under forward contract or a government guarantee or when market exists and there is a negligible risk of failure to sell, the goods invoiced are often valued at Net-realisable value."

Terry Towels do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing stock of finished goods (Fancy terry towel) should have been valued at lower of cost and net-realisable value and not at net realisable value. Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing stock of inventories of finished goods is not correct.

AS-11: THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Illustration 6.

	Exchange Rate
Goods purchased on 24.3.16 of US $1,00,000	₹64.60
Exchange rate on 31.3.2016	₹65.00
Date of actual payment 5.6.2017	₹65.50

Calculate the loss/gain for the financial years 2015-16 and 2016-17.

Solution:

As per AS-11, all foreign currency transactions should be recorded by applying the exchange rate at the date of transaction. Therefore, goods purchased on 24.03.2016 and cores sponding creditor would be recorded at ₹64.60

= 1,00,000 x 64.60 = ₹64,60,000

As per AS-11, at the balance sheet date all monetary items should be reported using the closing rate. Therefore, the creditors of US $1,00,000 outstanding on 31.3.2016 will be reported as:

1,00,000 x 65.00 = ₹65,00,000.

Exchange loss ₹40,000 (= 65,00,000 – 64,60,000) should be debited in Profit and Loss Account for 2016-17.

As per AS-11, exchange difference on settlement on monetary items should be transferred to Profit and Loss Account as gain or loss thereof:

1,00,000 x 65.50 = ₹65,50,000 – 65,00,000 = ₹50,000 should be debited to profit or loss for the year 2016-17.

Illustration 7.

Z Ltd. acquired a machine on 1.4.2016 costing US $ 1,00,000. The suppliers agreed to the following terms of payment:

1.4.2016:	down payment 50%
1.4.2017:	25%
1.4.2018:	25%

The company depreciates machinery @ 10% on the Straight Line Method. The rate of exchange is steady at US 1 = ₹60 upto 30.9.2017. On 1.10.2017, due to an official revaluation of rates, the exchange rate is adjusted to US $ 1= ₹68.

Show the extracts of the relevant entries in the Profit and Loss Account for the year ending 31st March, 2016 and the Balance Sheet as on that date, showing such workings as necessary.

Working Notes:

2016-17:

1. Original Cost of the machine = $1,00,000 x ₹60 = ₹60,00,000

2. Depreciation (SLM) @ 10% = ₹6,00,000

2017-18:

1. Original Cost of the machine upto 30.9.2017 = ₹60,00,000

2. Revised cost of the machine as on 1.10.2017

Due to official revaluation of exchange rates, the US $ 1 = ₹68. There is a foreign exchange loss of ₹8 for each dollar liability. The total loss on foreign currency fluctuation was $25,000 x ₹8 = ₹2,00,000. This has to be added to the original cost of the machine. Therefore, revised cost of the machine as on 1.10.2017 is ₹62,00,000 (i.e. ₹60,00,000 + ₹2,00,000)

The revised cost of the machine as on 1.10.2017:		₹
Original Cost on 1.4.2016		60,00,000
Less: Depreciation:		
01.4.2016 to 31.3.2017	6,00,000	
01.4.2017 to 30.9.2017	3,00,000	9,00,000
		51,00,000
Add: Loss on foreign exchange fluctuation as on 1.10.2017		2,00,000
		53,00,000
Depreciation:		
1.4.2017 to 30.9.2017 (60,00,000 x 10/100 x 6/12)		3,00,000
1.10.2017 to 31.3.2018 $\left(\frac{53,00,000 \times 6}{8.5 \times 12}\right)$		3,11,765
Total Depreciation for the year 2017-18		6,11,765

Note: As per AS-6 Revised, 'Depreciation Accounting', in case of change in historical cost due to foreign exchange fluctuation, depreciation on the revised unamortized depreciable amount should be provided prospectively over the residual life of the asset. In this case, the residual life is 8.5 years.

Profit and Loss Account (extract)
for the year ended 31st March, 2018

Particulars	₹	**Particulars**	₹
To Depreciation on Machinery	6,11,765		

Balance Sheet (extract) as at 31st March, 2018

Liabilities	₹	**Assets**		₹
Current Liabilities	12,00,000	Fixed Assets		
Creditors for Supply of Machinery		Machinery (at cost)	60,00,000	
		Add: Adj. for foreign Exchange fluctuation	2,00,000	
			62,00,000	
		Less: Accumulated Depreciation	6,11,765	55,88,235

AS -12: ACCOUNTING FOR GOVERNMENT GRANTS

Illustration 8.

Z Ltd. has set up its business in designated backward area which entitles it to receive as per a public scheme announced by the Government of India, a subsidy of 25% of the cost of investment. Having fulfilled the conditions laid down under the scheme, the company on its investment of ₹100 lakhs in capital assets during its accounting year ending on 31st March, 2017, received a subsidy of ₹25 lakhs in January, 2017 from the Government of India. The Accountant of the company would like to record the receipt as an item of revenue and to reduce the losses on the Profit and Loss Account for the year ended 31st March, 2017. Is his action justified?

Solution:

As per AS-12, the Government grants related to depreciable fixed assets to be treated as deferred income which should be recognized in the Profit and Loss Account on a systematic and rational basis over the useful life of the asset. Such grants should be allocated to income over the periods and in proportions in which depreciation on those assets is charged.

The company has received ₹25 lakhs subsidy for investment in capital assets which are depreciable in nature. In view of the provisions under AS-12, the subsidy amount ₹25 lakhs received should not be credited to the Profit and Loss Account for the year ended 31st March, 2017. the subsidy should be recognized and credited to the Profit and Loss Account in the proportion of depreciation charge over the life of the subsidized assets.

Illustration 9.

Hero Ltd. belongs to the engineering industry. The Chief Accountant has prepared the draft accounts, taking note of the mandatory accounting standards.

"The company purchased on 1.4.2017 a special purpose machinery for ₹50 lakhs. It received a Central Government grant for 20% of the price. The machine has an effective life of 5 years". Discuss how to treat the Government Grant in Accounts.

Solution:

AS-12 prescribes two methods in accounting treatment of Government grants for specific fixed assets.

Method I: Government grants related to depreciable fixed assets to be treated as deferred income which is to be recognized in the Profit and Loss Account in proportion in which depreciation on those assets is charged over the useful life of the asset. Method II. The deferred income pending its apportionment to Profit and Loss Account to be disclosed in the balance sheet separately with a suitable description, e.g. Deferred Government Grants, to be shown after "Reserves & Surplus" but before " Secured Loans".

AS -14: ACCOUNTING FOR AMALGAMATIONS (Revised)

Illustration 10.

X Ltd. having a share capital of ₹20 lakhs and Y Ltd.having a share capital of ₹30 lakhs. Z Ltd. was formed to take over the business of X Ltd and Y Ltd. at a purchase consideration of ₹25 lakhs and ₹28 lakhs, payable in shares of Z Ltd. The assets and liabilities were taken at their carrying amounts. Compute the Goodwill or Capital Reserve.

Solution:

Since the purchase consideration is payable in shares of the transferee company and all the assets and liabilities are taken over at their carrying amounts, the amalgamation is in the nature of merger, i.e. pooling of interests method.

For X Ltd. Purchase consideration = ₹25 lakhs

Less: Share capital of X Ltd = ₹20 lakhs

Excess of purchase consideration = ₹5 lakhs. This shall have to be adjusted against the Reserves of Z Ltd.

For Y Ltd. Purchase Consideration = ₹28 lakhs

Less: Share Capital of Y Ltd = ₹30 lakhs

since purchase consideration is less than share capital of the transferor company, ₹2 lakhs shall be treated as Capital Reserve.

Note: In case of amalgamation in the nature of purchase, goodwill shall have to be shown in the Balance Sheet of the Transferee company. Such goodwill shall have to be written off over a maximum period of 5 years.

Illustration 11.

Net Assets of the Transferor Company : ₹20 lakhs. If Purchase Consideration is (i) ₹18 lakhs (ii) ₹23 lakhs & amalgamation is in the nature of purchase. Compute the Goodwill or Capital Reserve.

Solution:

(i) Net Assets ₹20 lakhs > Purchase Consideration ₹18 lakhs. So, ₹2 lakhs will be treated as Capital Reserve.

(ii) Net Assets ₹20 lakhs < Purchase Consideration ₹23 lakhs. So, ₹3 lakhs will be treated as Goodwill.

AS-15: EMPLOYEE BENEFITS

Illustration 12.

ZERO Bank has followed the policies for retirement benefits as under:

(a) contribution to pension fund is made based on actuarial valuation at the year end. In respect of employees who have opted for pension scheme.

(b) Contribution to the gratuity fund is made based on actuarial valuation at the year end.

(c) Leave encashment is accounted for on "PAY-AS-YOU-GO" method.

Comment whether the policy is in accordance with AS-15.

Solution:

(a) As the contribution to Pension Fund is made on actuarial basis every year, there fore the policy is as per AS-15, which is based on actuarial basis of a counting.

(b) As the contribution is being made on annual basis to gratuity fund on actuarial basis, the policy is in accordance with AS-15.

(c) As regard leave encashment, which is accounted for on PAY-AS-YOU-GO basis, it is not in accordance with AS-15. It should be accounted for on accrual basis.

Illustration 13.

In the context of relevant Accounting Standards, give your comment on the following matter for the financial year ending 31st March, 2017:

"Increase in pension liability on account of wage revision in 2016-17 is being provided for in 5 instalments commencing from that year. The remaining liability of ₹300 lakhs as re-determined in actuarial valuation will be provided for in the next 2 years"

Solution:

As per AS-15, the costs arising from an alteration in the retirement benefits to employees should be treated as follows:

(i) The cost may relate to the current year of service or to the past years of service.

(ii) In case of costs relating to the current year, the same may be charged to Profit and Loss Account

(iii) Where the cost relates to the past years of service these should be charged to Profit and Loss Account as 'prior period' items in accordance with AS-5.

(iv) Where retirement benefit scheme is amended in a manner which results in additional benefits being provided to retired employees, the cost of the additional benefits should be taken as " Prior Period and Extraordinary Items" as per AS-5.

In view of the above, the method adopted for accounting the increase in pension liability is not in consonance to the provisions mentioned in AS-15.

AS-16: BORROWING COST

Illustration 14.

A company capitalizes interest cost of holding investments and adds to cost of investment every year, thereby understating interest cost in profit and loss account. Whether it leads to unusual accounting?

Solution:

The Accounting Standard Board (ASB) has opined that investments other than investment properties are not qualifying assets as per AS-16, Borrowing Costs. Therefore, interest cost of holding such investments cannot be capitalized. Further, even interest in respect of investment properties can only be capitalized if such properties meet the definition of qualifying assets, namely, that it necessarily takes a substantial period of time to get ready for its intended use or sale, even where the investment properties meet the definition of "qualifying asset", for the capitalization of borrowing costs the other requirements of the standard such as that borrowing costs should be directly attributable to the acquisition or construction of the investment property and suspension of capitalization as per paragraphs 17 and 18 of AS-16 have to be complied with.

Illustration 15.

X Ltd. has obtained an institutional loan of ₹800 lakhs for modernization and renovation of its machinery. Machinery acquired under the modernization scheme and installation completed on 31.3.17 amounts to ₹600 lakhs. ₹80 lakhs has been advanced to suppliers for additional assets and balance loan of ₹120 lakhs has been utilized for working capital purpose. The total interest paid for the above loan amounted to ₹80 lakhs during 2016-17.

You are required to state how the interest on the institutional loan is to be accounted in the year 2016-17.

Solution:

The total interest of ₹80 lakhs is related to two periods. Upto the date of installation of the machinery, amount disbursed is ₹680 lakhs ₹ (600 + 80). Interest on such amounting to ₹68 lakhs should be capitalized and the balance of the interest ₹12 lakhs ₹ (i.e. 80-68) should be treated as an expense.

Illustration 16.

Happy Ltd. has taken a loan of US $10 lakhs on 1st April, 2016, for a specific project at an interest rate of 10% p.a., payable annually. On 1st April, 2016, the exchange rate between the currencies was ₹65 per US $. The exchange rate, as at 31st March, 2017, is ₹ 68 per US $. The corresponding amount could have been borrowed by Happy Ltd. in local currency at an interest rate of 15% p.a. as on 1st April, 2016. Show the treatment of borrowing costs as per AS-16.

Solution:

The following computation would be made to determine the amount of borrowing costs for the purposes of paragraph 4(e) of AS-16.

(a) Interest for the period = US $10,00,000 x 10% x ₹68 per US $ = ₹68,00,000

(b) Increase in the liability towards the principal amount = US $ 10,00,000 x (68 - 65)= ₹30,00,000.

(c) Interest that would have resulted if the loan was taken in Indian currency = US $ 10,00,000 x 65 x 15% = ₹97,50,000

(d) Difference between interest on local currency borrowing and foreign currency borrowing = ₹97,50,000 – ₹68,00,000 = ₹29,50,000

Therefore, out of ₹30,00,000 increase in the liability towards principal amount, only ₹29,50,000 will be considered as the borrowing cost. Thus, total borrowing cost would be ₹97,50,000 being the aggregate of interest of ₹68,00,000 on foreign currency borrowings (as per Para 4(a) of AS-16) plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹29,50,000. Thus, ₹97,50,000 would be considered as the borrowing cost to be accounted for as per AS-16 and the remaining ₹50,000 would be considered as the exchange difference to be accounted for as per AS-11 "The Effects of Changes in Foreign Exchange Rates".

Illustration 17.

On 30.4.2017 MNC Ltd.obtained a loan from the bank for ₹5 crores to be utilized as under:

(i)	Construction of a factory shed	₹2 crores.
(ii)	Purchase of Machinery	₹1.5 crores.
(iii)	Working Capital	₹1 crore.
(iv)	Advance for Purchase of truck	₹50 lakhs.

In March 2011, construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ended 31.3.17 was ₹90 lakhs. Show the treatment of interest as per AS-16.

Solution:

As per AS-16, borrowing cost (interest) should be capitalized if borrowing cost is directly attributable to the acquisition, construction or production of qualifying asset. ₹5 crores borrowed from Bank was utilized for four different purposes, only construction of factory shed is a qualifying asset as per AS-16, while the other three payments are not for the qualifying asset. Therefore, borrowing cost attributable to the construction of a factory shed should only be capitalized which will be equal to ₹ 90 lakhs x 2/5 = ₹36 lakhs.

The balance of ₹ 54 lakhs (₹90 lakhs – ₹36 lakhs) should be treated as an expense and debited to Profit and Loss Account.

AS 17: SEGMENT REPORTING

Illustration 18.

M/S ABC Ltd. Has three segments namely A, B, C. The total assets of the company are ₹10.00 crs. Segment A has ₹2.00 crs. Segment B has ₹3.00 crs and Segment C has ₹5.00 crs. Deferred tax assets included in the assets of each segments are A – ₹0.50 crs. B- ₹0.40 crs. C- ₹0.30 crs. The accountant contends that al the three segments are reportable segments. Comment.

Solution:

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

Segment A = 2.00 – 0.50 =	₹1.50 crs.
Segment B = 3.00 – 0.40 =	₹2.60 crs.
Segment C = 5.00 – 0.30 =	₹4.70 crs.
Total Segment Assets	₹8.80 crs.

Since each segment's assets is more than 10% of total segment assets (i.e. ₹0.88 crs.) all segments are reportable segments.

Illustration 19.

M Ltd. Group has three divisions A, B and C. Details of their turnover, results and net assets are given below:

	₹ ('000)
Division A	
Sales to B	9,150
Other Sales (Home)	180
Export Sales	12,270
	21,600
Division B	
Sales to C	90
Exports Sales to Europe	600
	690
Division C	
Export Sales to America	540

	Head Office ₹ ('000)	**A ₹ ('000)**	**B ₹ ('000)**	**C ₹ ('000)**
Operating Profit or Loss before tax		480	60	(24)
Re-allocated cost from Head Office		144	72	72
Interest cost		12	15	3
Fixed assets	150	600	120	360
Net current assets	144	360	120	270
Long-term liabilities	114	60	30	360

Prepare a Segmental Report for publication in M Ltd. Group.

Solution:

M Ltd. Segmental Report					
					(₹ in '000)
	Division				
Segment Revenue	**A**	**B**	**C**	**Inter segment Eliminations**	**Consolidated Total**
Sales:					
Domestic	180				180
Export	12,270	600	540		13,410
External Sales	12,450	600	540		13,590
Inter-segment Sales	9,150	90		9,240	
Total Revenue	21,600	690	540	9,240	13,590
Segment result (given)	480	60	(24)		516
Head office expenses					(288)
Operating profit					228
Interest expenses					(30)
Profit before tax					198
Other information:					
Fixed assets	600	120	360		1,080
Net current assets	360	120	270		750
Segment assets	960	240	630		1,830
Unallocated corporate assets					294
Segment liabilities	60	30	360		450
Unallocated corporate liabilities					114

Sales Revenue by Geographical Market

					(₹ in '000)
	Home Sales	Export Sales (by division A)	Export to Europe	Export to America	Consolidated Total
External Sales	180	12,270	600	540	13,590

Illustration 20.

Identify the reportable segment by profitability test is demonstrated as follows for XYZ Ltd.

Segment	**Prof it (Loss)**
A	450
B	50
C	(350)
D	(40)
E	(210)

Solution:

First, the operating segments are grouped according to whether they incurred a profit or loss, as follows:

Segments Incurring Profits		**Segments Incurring Losses**	
Segment	**Profit (₹)**	**Segment**	**Loss (₹)**
A	450	C	(350)
B	50	D	(40)
	-	E	(210)
	500		600

From this point on the profitability test, only absolute amounts are used. The combined total of those segments incurring a loss is larger than the combined total of those segments incurring a profit. Therefore, any segment for which the absolute amount of its operating profit or loss equals or exceeds ₹60 (i.e., 10% of ₹600) meets the profitability test and is therefore a reportable segment. Segments A, C and E meet the profitability test, summarized as follows:

Operating Segment	Absolute amount of Profit or loss	₹60	
A	450	Yes	(reportable segment)
B	50	No	
C	350	Yes	(reportable segment)
D	40	No	
E	210	Yes	(reportable segment)

If the total external reven ue (i.e., sales to unaffiliated customers) of the reportable segments is less than 75% of total consolidated revenue, additional operating segments must be identified as reportable segments (even if they do not otherwise qualify as a reportable segment) until at least 75% of total consolidated revenue is included in reportable segments.

Information about all operating segments that did not qualify as reportable segments must be combined and disclosed in an “all other” category.

If an operating segment was identified in the immediately preceding prior period as a reportable segment and management deems that segment to be of continuing significance, information about that segment should continue to be reported separately in the current period even if that segment does not otherwise qualify as a reportable segment in the current period.

If an operating segment qualifies in the current period as a reportable segment but did not qualify as a reportable segment in the prior period(s), prior-period segment data presented for comparative purposes should be restated as if the segment qualified as a reportable segment in the prior period(s).

Illustration 21.

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

Particulars	M	N	O	P	Q	R	Total
Segment Assets	40	80	30	20	20	10	200
Segment Result	50	- 190	10	10	-10	30	-100
Segment Revenue	300	620	80	60	80	60	1200

The Chief Accountant is of the opinion that segments “M” and “N” alone should be reported. Is he justified in his view? Discuss.

Solution:

No, he is not justified in his view, because as per Para 27 of AS-17 “Segment Reporting”, Business Segment or geographical segment which has been identified as reportable segment shall be further divided to include sub-segments based on the following conditions:

+ Segment revenue from sales to external customers and internal transfer is

10% or more than total external and internal revenue of all segments.

Or

+ 10% or more of segment result

+ (Segment result means: if some segments are in loss then total loss of all loss making segments or if some segments are profit, total profit of all profit making segments. Whichever is higher i.e., total profit or total loss figure in absolute term.)

Or

+ Segment asset is 10% or more than total assets of all segments.

+ Ensure whether at least 75% of total external revenue should be in the reportable segments.

In the question, the segments “M” and “N” are reportable segments on the basis of 10% of more segment revenue other two criteria should also be applied to make reportable segment as per AS-17. I0% of segment result which is 20 or more (loss) (190+10) × 10%. By these criteria "R" is also reportable segment. As per the 1096 or more asset criteria "0", "P" and "Q" also becomes the reportable segments; therefore all the 6 segments should be reportable segments.

AS -19: LEASES

Example 1 –

H Ltd. Sells machinery, WDV of which was ₹400 lakhs for ₹500 lakhs to B Ltd. The same machinery was leased back to H Ltd. by BLtd. for 10 years resulting in finance lease. What should be the treatment of profit in the books of seller lessee (H Ltd.)?

Answer:

The profit of ₹100 lakhs on sale of machinery by H Ltd. (seller lessee) should not be immediately recognized in books rather it should be deferred and amortized over 10 years in proportion of the depreciation amount to be charged by the H Ltd. on the machinery.

Example:

H Ltd. sold machinery having WDV of ₹400 Lakhs to B Ltd. for ₹500 Lakhs and the same machinery was leased back by B Ltd. to H Ltd. The Lease back is operating lease.

Comment if –

(a) Sale price of ₹500 lakhs is equal to fair value

(b) Fair value is ₹600 lakhs

(c) Fair value is ₹450 lakhs and sale price is ₹380 lakhs

(d) Fair value is ₹400 lakhs and sale price is ₹500 lakhs

(e) Fair value is ₹460 lakhs and sale price is ₹500 lakhs

(f) Fair value is ₹350 lakhs and sale price is ₹390 lakhs

Answer:

(a) H ltd. should immediately recognize the profit of ₹100 lakhs in its books.

(b) Profit ₹100 lakhs should be immediately recognized by H Ltd.

(c) Loss of ₹20 lakhs to be immediately recognized by H Ltd. in its books provided loss is not compensated by future lease payment.

(d) Profit of ₹100 lakhs is to be amortized over the lease period.

(e) Profit of ₹60 lakhs (460-400) to be immediately recognized in its books and balance profit of ₹40 lakhs (500- 460) is to be amortized / deferred over lease period.

(f) Loss of ₹50 lakhs (400-350) to be immediately recognized by H Ltd. in its books and profit of ₹40 lakhs (390-350) should be amortized / deferred over lease period.

Illustration 22.

Viraj Limited wishes to obtain a machine costing ₹45 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 5 years. It enters into an agreement with Jhalak Ltd., for a lease rental for ₹4.5 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Viraj Limited is not sure about the treatment of these lease rentals and seeks your advise.

Solution:

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

Annuity Factor (Year 1 to Year 5) 3.36 (approx.)

Present value of minimum lease payments (for ₹4.5 lakhs each year) ₹15.12lakhs (approx.)

Thus, present value of minimum lease payments is ₹15.12 lakhs and the fair value of the machine is ₹45 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for five years.

Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Illustration 23.

Milind Softex Ltd. has taken the assets on lease from ABC Impex Ltd. The following information is given below:

Lease Term =	4 years
Fair value at inception of lease =	₹16,00,000
Lease Rent =	₹5,00,000 p.a. at the end of year
Guaranteed Residual Value =	₹1,00,000
Expected Residual Value =	₹2,00,000
Implicit Interest Rate =	14.97%

Do the accounting in the book of lease?

Solution:

Present value of minimum lease payment

Year	MLP ₹	Discount rate 14.97%	PV ₹
1	5,00,000	0.8698	4,34,900
2	5,00,000	0.7565	3,78,250
3	5,00,000	0.6580	3,29,000
4	6,00,000 (including 1,00,000)	0.5724	3,43,440
	21,00,000		14,85,590

Present value of minimum lease payment (₹14,85,590) is less than Fair value at the inception of lease (₹16,00,000) so the leased asset and liability should be recognized at ₹ 14,85,590.

Apportionment of finance lease: Rate of Interest 14.97%

Year	Liability ₹	MLP ₹	Finance Charge ₹	Principal Amount of reduction ₹
0	14,85,590	-	-	-
1	12,07,983	5,00,000	2,22,393	2,77,607
2	8,88,818	5,00,000	1,80,835	3,19,165
3	5,21,874	5,00,000	1,33,056	3,66,944
4	-	6,00,000	78,1245	5,21,875

Books of Milind Softex
Lease Rent Account

Year	Particulars	Amount ₹	Particulars	Amount ₹
1st year	To, Bank A/c	5,00,000	By, Finance Charges A/c	2,22,393
			By, Lease liability A/c	2,77,607
		5,00,000		5,00,000
2nd year	To, Bank A/c	5,00,000	By, Finance Charges A/c	1,80,835
			By, Lease liability A/c	3,19,165
		5,00,000		5,00,000
3rd year	To, Bank A/c	5,00,000	By, Finance Charges A/c	1,33,056
			By, Lease liability A/c	3,66,944
		5,00,000		5,00,000
4th year	To, Bank A/c	5,00,000	By, Finance Charges A/c	78,126
			By, Lease liability A/c	5,21,874
		5,00,000		5,00,000

Lease Liability Account (Lessor)				
Year	**Particulars**	**Amount ₹**	**Particulars**	**Amount ₹**
1st year	To, Lease Rent A/c	2,77,607	By, Balance b/d	14,85,590
	To, Balance c/d	12,07,983		
		14,85,590		14,85,590
2nd year	To, Lease Rent A/c	3,19,165	By, Balance b/d	12,07,903
	To, Balance c/d	8,88,818		
		12,07,903		12,07,903
3rd year	To, Lease Rent A/c	3,66,944	By, Balance b/d	8,88,818
	To, Balance c/d	5,21,874		
		8,88,818		8,88,818
4th year	To, Lease Rent A/c	5,21,874	By, Balance b/d	5,21,874
		5,21,874		5,21,874

Extract of Profit and Loss Account		
Year	**Particulars**	**Amount ₹**
1st year	To, Finance Charge	2,22,393
	To Depreciation on leased Asset under SLM	3,71,397
2nd year	To, Finance Charge	1,80,835
	To Depreciation on leased Asset under SLM	3,71,397
3rd year	To, Finance Charge	1,33,056
	To Depreciation on leased Asset under SLM	3,71,397
4th year	To, Finance Charge	78,125
	To Depreciation on leased Asset under SLM	3,71,397

Extract balance Sheet				
Year	**Particulars**	**Amount ₹**	**Particulars**	**Amount ₹**
1st year	Lease Liability A/c	12,07,983	Fixed Asset under Finance Lease	14,85,590
			Less: Depreciation	3,71,397
				11,41,193
2nd year	Lease Liability A/c	8,88,818	Fixed Asset under Finance Lease	14,85,590
			Less: Depreciation	7,42,794
				7,42,796
3rd year	Lease Liability A/c	5,21,874	Fixed Asset under Finance Lease	14,85,590
			Less: Depreciation	11,14,191
				3,71,399
4th year	Lease Liability A/c	NIL	Fixed Asset under Finance Lease	14,85,590
			Less: Depreciation	14,85,590
				NIL

Illustration 24.

Milind Softex Ltd. has taken the assets on lease from ABC Impex Ltd. The following information is given below:

Lease Term =	4 years
Fair value at inception of lease =	₹16,00,000
Lease Rent =	₹5,00,000 p.a. at the end of year
Guaranteed Residual Value =	₹1,00,000
Expected Residual Value =	₹2,00,000
Implicit Interest Rate =	14.97%

How the accounting is done in the book of lessor?

Solution:

Lessor should recognize asset given under lease at net investment in lease.

Net investment in lease = Gross investment – unearned finance income

Gross Investment = MLP + Guaranteed residual value + Unguaranteed residual value

= ₹20,00,000 + ₹1,00,000 + ₹1,00,000 = ₹22,00,000

Unearned Finance Income = Gross Investment – present value of gross investment

Year	Value of MLP ₹	Gross investment discount factor	Present Value ₹
1	5,00,000	0.8698	4,34,900
2	5,00,000	0.7565	3,78,250
3	5,00,000	0.6580	3,29,000
4	7,00,000	0.5724	4,00,680
	22,00,000		15,42,830

Unearned Finance Income = ₹22,00,000 - ₹15,42,830 = ₹6,57,170

Apportionment of MLP into Capital recovery & Finance income

Year	Balance of lease receivable	Cash receipts	Finance	Capital recovery reduced from receivable
0	15,42,830	-	-	-
1	12,73,792	5,00,000	2,30,962	2,69,038
2	9,64,479	5,00,000	1,90,687	3,09,313
3	6,08,862	5,00,000	1,44,383	3,55,617
4		7,00,000	91,147	6,08,853
			6,57,179	15,42,821

The lease receivable account shown in the books of lessor will not tally with the lease liability account as shown by the leasee in his book. Difference will remain because of guaranteed residual value from the third party or/ and unguaranteed residual value from the leasee point of view.

Illustration 25.

Amit purchased a computer for ₹44,000 and leased out it to Sumit for four years on leases basis, after the lease period, value of the computer was estimated to be ₹3,000; whichhe realized after selling it in the second hand market. Lease amount payable at the beginning of each year is ₹22,000; ₹13,640; ₹6,820 & ₹3,410. Depreciation was charged @ 40% p.a. You are required to pass the necessary journal entries in the books of both Amit and Sumit.

Solution:

Journals

In the books of Amit

	Particulars		Dr. ₹	Cr. ₹
1st	**Purchase of Computers:**			
	Computer A/c	Dr.	44,000	
	To, Bank A/c			44,000
	Payment of first Year's Lease:			
	Bank A/c	Dr.	22,000	
	To, Lease Rent A/c			22,000
	Depreciation for First Year:			
	Depreciation A/c	Dr.	17,600	
	To, Computer A/c			17,600
	Transfer to Profit & Loss Account:			
	Profit & Loss A/c	Dr.	17,600	
	To, Depreciation A/c			17,600
	Lease Rent A/c	Dr.	22,000	
	To, Profit & Loss A/c			22,000
2nd	**Payment of Second Year's Lease:**			
	Bank A/c	Dr.	13,640	
	To, Lease Rent A/c			13,640
	Depreciation for Second Year:			

	Depreciation A/c	Dr.	10,560	
	To, Computer A/c			10,560
	Transfer to Profit & Loss Account:			
	Profit & Loss A/c	Dr.	10,560	
	To, Depreciation A/c			10,560
	Lease Rent A/c	Dr.	13,640	
	To, Profit & Loss A/c			13,640
3rd	**Payment of Third Year's Lease:**			
	Bank A/c	Dr.	6,820	
	To, Lease Rent A/c			6,820
	Depreciation for Third Year:			
	Depreciation A/c	Dr.	6,336	
	To, Computer A/c			6,336
	Transfer to Profit & Loss Account:			
	Profit & Loss A/c	Dr.	6,336	
	To, Depreciation A/c			6,336
	Lease Rent A/c	Dr.	6,820	
	To, Profit & Loss A/c			6,820
4th	**Payment of Fourth Year's Lease:**			
	Bank A/c	Dr.	3,410	
	To, Lease Rent A/c			3,410
	Depreciation for Fourth Year:			
	Depreciation A/c	Dr.	3,802	
	To, Computer A/c			3,802
	Transfer to Profit & Loss Account:			
	Profit & Loss A/c	Dr.	3,802	
	To, Depreciation A/c			3,802
	Lease Rent A/c	Dr.	3,410	
	To, Profit & Loss A/c			3,410
	Sale of Lease assets:			
	Bank A/c	Dr.	3,000	
	Loss on Sale A/c	Dr.	2,702	
	To, Computer A/c			5,702

In the books of Sumit

	Particulars		Dr. ₹	Cr. ₹
	Purchase of Computers:		**No Entry**	
	Payment of first Year's Lease:			
	Lease Rent A/c	Dr.	22,000	
	To, Bank A/c			22,000
	Depreciation for First Year:		**No Entry**	
	Transfer to Profit & Loss Account:			
	Profit & Loss A/c	Dr.	22,000	
	To, Lease Rent A/c			22,000
	Payment of Second Year's Lease:			
	Lease Rent A/c	Dr.	13,640	
	To, Bank A/c			13,640
	Depreciation for Second Year:		**No Entry**	
	Transfer to Profit & Loss Account:			
	Profit & Loss A/c	Dr.	13,640	
	To, Lease Rent A/c			13,640
	Payment of Third Year's Lease:			
	Lease Rent A/c	Dr.	6,820	
	To, Bank A/c			6,820

	Depreciation for Second Year:		**No Entry**	
	Transfer to Profit & Loss Account:			
	Profit & Loss A/c	Dr.	6,820	
	To, Lease Rent A/c			6,820
	Payment of Fourth Year's Lease:			
	Lease Rent A/c	Dr.	3,410	
	To, Bank A/c			3,410
	Depreciation for Second Year:		**No Entry**	
	Transfer to Profit & Loss Account:			
	Profit & Loss A/c	Dr.	3,410	
	To, Lease Rent A/c			3,410
	Sales of Lease Assets:		**No Entry**	

Illustration 26.

Weighted avg. number of equity shares has been illustrated in AS-20 in the following line:

Accounting year: 2016-17

Date	Description	Shares Issued (Nos)	Buyback (Nos)	O/S
01/04/2016	Op. Balance	1800	-	1800
30/09/2016	Issued for Cash	600	-	2400
29/02/2017	Buyback	-	300	2100
31/03/2017	Cl. Balance	2400	300	2100

Compute the weighted average number of shares.

Solution:

Weighted average number

(a) (1800 x 6/12) + (2400 x 5/12) + (2100 x 1/12) i.e. 2075 shares

or

(b) (1800 x 12/12) + (600 x 7/12) - (300 x 2/12) i.e. 2075 shares

= 1800 + 250 + 25

Illustration 27.

Net profit for 2014-15: ₹18,00,000; Net profit for 2015-16: ₹60,00,000; No. of equity shares as on 31.12.15: ₹20,00,000.

Bonus issued on 1-1-16 : 2 equity shares for each Equity Share outstanding at 31-12-16 i.e. ₹40,00,000.

Compute the EPS for 2015-16 and the Adjusted EPS of 2014-15.

Solution:

EPS for 2015-16: (₹ 60,00,000)/(20,00,000+40,00,000) = ₹1.00

Adjusted EPS for 2014-15: (earliest period reported) [₹18,00,000/60,00,000] = ₹ 0.30

Illustration 28.

Compute EPS:

(a) Net profit for 2014-15 ₹11,00,000

Net profit for 2015-16 ₹15,00,000

(b) Nos. of shares outstanding prior to Right Issue: 5,00,000 shares

(c) Right Issue: one new share for 5 outstanding i.e. 1,00,000 new shares

(d) Right price: ₹15

(e) Last date of right option: 1st March 2016

(f) Fair value prior to the right option on 1st march 2016: ₹21 per equity share

Solution:

Computation:

1) Theoretical ex-right fair value per share:

   [(₹21 x 5,00,000) + (₹15 x 1,00,000)] / (5,00,000+ 1,00,000)

   i.e. 1,20,00,000/6,00,000 = ₹20

2) Adjustment factor:- fair value prior to exercise of rights/theoretical ex-right value. i.e. 21/20=1.05

3) Computation of EPS:

Year 2014-15	
EPS as originally reported	
₹ 11,00,000/5,00,000 shares	₹2.20
EPS restated for right issue	
₹ 11,00,000/(5,00,000 x ₹ 1.05)	₹2.10
Year 2015-16	
EPS-for 2016 including rights	
₹ 15,00,000/(5,00,000 x 1.05 x 2/12) + (6,00,000 x 10/12)	₹2.25

Illustration 29.

From the following information for R Ltd. for the year ended 31st March, 2016, calculate the deferred tax asset/ liability as per AS-22

Accounting Profit	₹10,00,000
Book Profit as per MAT(Minimum Alternate Tax)	₹9,00,000
Profit as per Income Tax Act	₹1,00,000
Tax Rate	30%
MAT Rate	10%

Solution:

Tax as per accounting profit :	10,00,000 x 30% = 3,00,000
Tax as per Income Tax profit :	1,00,000 x 30% = 30,000
Tax as per MAT :	9,00,000 x 10% = 90,000

Tax expense = Current tax + Deferred tax

3,00,000 = 30,000 + Deferred tax

Therefore, Deferred Tax Liability as on 31.3.2016 = ₹3,00,000 – ₹30,000 = ₹2,70,000.

Amount of tax to be debited in Profit and Loss Account for the year 31.03.2016:

= Current tax + Deferred tax liability + Excess of MAT over current tax

= 30,000 + 2,70,000 + (90,000 – 30,000)

= 3,60,000

Illustration 30.

Z Ltd,has provided depreciation as per accounting records ₹40 lakhs but as per tax records ₹60 lakhs. Unamortized preliminary expenses, as per tax records is ₹20,000. there is adequate evidence of future profit sufficiency. How much deferred tax asset/liability should be recognized as transition adjustment? Tax rate 30%.

Solution:

As per Para 13 of AS-22, deferred tax should be recognized for all the timing differences. In this situation, the timing difference i.e. the difference between taxable income and accounting income is :

Excess depreciation as per tax ₹(60 – 40) lakhs =	₹20.00 lakhs
Less: Expenses provided in taxable income =	₹0.20 lakhs
Timing difference	₹19.80 lakhs

As tax expense is more than the current tax due to timing difference of ₹19.80 lakhs, therefore deferred tax liability = 30% of ₹19.80 lakhs = ₹5.94 lakhs.

Profit and Loss A/c…………	Dr.	5.94	
To Deferred Tax Liability A/c			5.94

Illustration 31.

Om Limited is working on different projects which are likely to be completed within 3 years period. It recognizes revenue from these contracts on percentage of completion method for financial statements during 2015, 2016 and 2017 for ₹11,00,000, ₹16,00,000 and ₹21,00,000 respectively. However, for income-tax purpose, it has adopted the completed contract method under which it has recognized revenue of ₹7,00,000, ₹18,00,000 and ₹23,00,000 for the years 2015, 2016 and 2017 respectively. Income-tax rate is 40%. Compute the amount of deferred tax asset/ liability for the years 2015, 2016 and 2017.

Solution:

Om Limited

Calculation of Deferred Tax Asset/Liability

Year	**Accounting Income**	**Taxable Income**	**Timing Difference (balance)**	**Deferred Tax Liability (balance)**
2015	11,00,000	7,00,000	4,00,000	1,40,000
2016	16,00,000	18,00,000	2,00,000	70,000
2017	21,00,000	23,00,000	NIL	NIL
	48,00,000	48,00,000		

Illustration 32.

X holds, 25% share in Y Ltd at a cost of ₹5 lakhs as on 31.03.2017. Out of Y's shares capital and reserve ₹20 Lakh each.

For the year ended 31.03.2017 Y made a profit of ₹80,000 and 50% distributed as dividend. Compute the value (carrying amount) as at 31.03.2017 to be shown in the CFS.

Solution:

	₹ in Lakhs
Cost of shares in Y Ltd.	5.00
Share of Reserve	5.00
Share of profit	0.20
	10.20
Less: dividend received	0.10
Value of investment as at 31.03.17	10.10

Illustration 33.

Style Ltd. acquired 30% of Ugly Ltd.'s shares on April 10,2017, the price paid was ₹20,00,000.

	₹
Equity shares (Paid up)	5,00,000
Securities Premium	15,00,000
Reserve	5,00,000
	25,00,000

Further, Ugly Ltd reported a net income of ₹3,00,000 and paid dividends of ₹1,00,000. Style Ltd. has subsidiary on 31.3.17. Calculate the amount at which the investment in Ugly Ltd should be shown in the consolidated Balance Sheet of Style Ltd. as on 31.3.17.

Solution:

As per AS-23, when the investor company prepares the consolidated Balance Sheet, the investment in associate i.e. Ugly Ltd. shall be carried by equity method and goodwill and capital reserve to be identified and disclosed separately.

Value of the investment as per equity method = 20,00,000 + 30% (3,00,000 – 1,00,000) = ₹20,40,000.

Goodwill identified = (20,00,000 – 30% of 25,00,000) = ₹ 12,50,000

Illustration 34.

A Company belonging to the process industry carries out three consecutive processes. The output of the first process is taken as input of the second process, and the output of the second process is taken as input of the third process. The final product emerges out of the third process. It is also possible to outsource the intermediate products. It has been found that over a period of time cost of production of the first process is 10% higher than the market price of the intermediate product, available freely in the market. The company has decided to close down the first process as a measure of cost saving (vertical spin off) and outsource. Should this event be treated as discontinuing operation?

Solution:

The change made by the company is focused on outsourcing of services, in respect of one single process – in a sequence of process. The net effect of this change is closure of facility relating to process.

This has been done by the company with a view to achieving productivity improvement and savings in costs.

Such a change does not meet definition criteria in paragraph 3(a) of AS-24 namely, disposing of substantially in its entirety, such as by selling a component of the enterprise in a single transaction. The change is merely a cost saving endeavor. Hence, this change over is not a discontinuing operation.

Illustration 35.

A FMCG company is manufacturing two brands of soap. Cinthol and Breeze. Company has gradually planned to shift all the manufacturing operation engaged in two soaps to manufacture only 'Breeze Soap' without closing the factory/plant producing the 'Cinthol Soap', rather utilizing the production facilities of 'Cinthol Soap' for producing the 'Breeze Soap'. Can we consider the operation to have been discontinued?

Solution:

Discontinuing operation is relatively large component of an enterprise which is major line of business or geographical segment, that is distinguishable operationally or for financial reporting such component of business is being disposed on the basis of an overall plan in its entirety or in piecemeal. Discontinuance will be carried either through demerger or spin-off, piecemeal disposal of assets and settling of liabilities or by abandonment.

In the given case, it is not a discontinuing operation.

Illustration 36.

B Ltd. is a software company, has subsidiary C Ltd. B Ltd.hold 70% shares in C Ltd. During 2016-17, B Ltd. sold its entire investment in C Ltd. Is it a discontinuing operation?

Solution:

As per the definition and scope of 'discontinuing operation', the sell of investments in subsidiary company does not attract the provisions of AS-24.

Hence, it is not a discontinuing operation.

Illustration 37.

C Ltd. has three major lines of business: steel, tea and power generation. It has decided to sell the tea division during the financial year 2016-17. A sale agreement has been entered into on 30th September 2016 with P Ltd. under which the tea division shall be transferred to P Ltd. on 31st March, 2015. Is it a discontinuing operation?

Solution:

This is a case of disposing of the tea division substantially and in its entirety. It will be considered as a discontinuing operation.

However, if a special resolution is passed for sale of various assets and to repay the various liabilities individually of the tea division, it is a case of "disposing by piecemeal" and not a "discontinuing operation".

Note: Any planned change in the product line may not be treated as a discontinuing operation.

Illustration 38.

S Ltd. presents interim financial report quarterly on 1.4.2017. S Ltd.has carried forward loss of ₹800 lakhs for income tax purpose for which deferred tax asset has not been recognized. S Ltd.earns ₹ 600 lakhs; ₹700 lakhs; ₹750 lakhs and

₹800 lakhs respectively in the subsequent quarters, excluding the carried forward losses. Income tax rate is 30%. Calculate the amount of tax expense to be reported in each quarter.

Solution:

The estimated payment of the annual tax on ₹2,850 lakhs earnings for the current year = ₹(2,850 – 800) lakhs = ₹2,050 lakhs.

Therefore, tax = 30% of ₹2,050 lakhs = ₹615 lakhs.

Average annual effective tax rate = (615/2,850) x 100 = 21.58%

Tax expense to be shown:	₹ lakhs
1st quarter = 600 x 21.58% =	129.48
2nd quarter = 700 x 21.58% =	151.06
3rd quarter = 750 x 21.58% =	161.85
4th quarter = 800 x 21.58% =	172.64

Illustration 39.

M Ltd. presents interim financial report(IFR) quarterly, earns ₹800 lakhs pre-tax profit in the first quarter ending 30.6.17 but expect to incur losses of ₹250 lakhs in each of the remaining three quarters. Effective income tax rate is 35%. Calculate the income-tax expense to be reported for each quarter as per AS-25.

Solution:

Tax expense to be reported in each of the quarters are:

1st quarter = 800 x 35% = ₹ 280.00 lakhs

2nd quarter = (250) x 35% = ₹ (87.5)lakhs

3rd quarter = (250) x 35% = ₹ (87.5)lakhs

4th quarter = (250) x 35% = ₹ (87.5) lakhs

Annual Tax Expense = ₹17.5 lakhs

Illustration 40.

On February 2015, J Ltd.bought a trademark from I Ltd. for ₹50 lakhs. J Ltd. retained an independent consultant, who estimated the trademark's remaining life to be 14 years. Its unamortized cost on I ltd. records was ₹35 lakhs. J Ltd. decided to amortize the trademark over the maximum period allowed. In J Ltd.'s Balance Sheet as on 31st December 2015, what amount should be reported as accumulated amortization?

Solution:

As per para 23 of AS-26, intangible assets should be measured initially at cost therefore. J Ltd. should amortize the trademark at its cost of ₹50 lakhs. The unamortized cost on the seller's books ₹35 lakhs is irrelevant to the buyer. Although the trademark has a remaining useful life of 14 years, intangible assets are generally amortized over a maximum period of 10 years as per AS-26. Therefore, the maximum amortization expense and accumulated amortization is ₹5 lakhs (₹50 lakhs/10).

Illustration 41.

During 2016-17, A Ltd.incurred organization costs/preliminary expenses of ₹40,000. What portion of the organization costs will A Ltd. defer to years subsequent to the 2016-17?

Solution:

As per AS-26, organization costs /preliminary expenses are those incurred in the formation of a corporation. Since uncertainty exists concerning the future benefit of these costs in future years, they are properly recorded as an expense in 2016-17.

Illustration 42.

D Ltd. is developing a new distribution system of its material, following the costs incurred at different stages on research and development of the system:

Year ended 31.3	Phase/Expenses	Amount (₹ In lakhs)
2013	Research	8
2014	Research	10
2015	Development	30
2016	Development	36
2017	Development	50

On 31.3.13, D Ltd. identified the level of cost savings at ₹ 16 lakhs expected to be achieved by the new system over a period of 5 years, in addition this system developed can be marketed by way of consultancy which will earn cash flow of ₹10 lakhs per annum. D Ltd. demonstrated that new system meet the criteria of asset recognition as on 1.4.2015.

Determine the amount/cash which will be expensed and to be capitalized as intangible assets, presuming that no active market exist to determine the selling price of product i.e. system developed. System shall be available for use from 1.4.2013.

Solution:

As per AS-26, research cost of ₹18 lakhs to be treated as an expense in respective year ended 31st March 2013 and 2014 respectively.

The development expenses can be capitalized from the date the internally generated assets (new distribution system in this given case) meet the recognition criteria on and from 1.4.2013. Therefore, cost of ₹(30 + 36 + 50) = ₹116 lakhs is to be capitalized as an intangible asset.

However, as per para 62 of AS-26, the intangible asset should be carried at cost less accumulated amortization and accumulated impairment losses.

At the end of 31st March, 2017, D Ltd. should recognize impairment loss of ₹22.322 lakhs = (116 - 93.678) and carry the new distribution system at ₹ 93.678 lakhs in the Balance Sheet as per the calculation given below:

Impairment loss is excess of carrying amount of asset over recoverable amount. Recoverable amount is higher of two i.e. value in use (discounted future cash inflow) and market realizable value of asset.

The calculation of discounted future cash flow is as under assuming 12% discount rate.

					(₹ Lakhs)
Year	**Cost Savings**	**Inflow by introducing the system**	**Total cash inflow**	**Discounted at 12%**	**Discounted cash flow**
2018	16	10	26	0.893	23.218
2019	16	10	26	0.797	20.722
2020	16	10	26	0.711	18.486
2021	16	10	26	0.635	16.51
2022	16	10	26	0.567	14.742
					93.678

No amortization of asset shall be done in 2013 as amortization starts after use of asset which is during the year 2017-18.

Illustration 43.

M.S. International Ltd. is developing a new production process. During the financial year ending 31st March, 2017, the total expenditure incurred was ₹50 lakhs. This process met the criteria for recognition as an intangible asset on 1st December, 2016. Expenditure incurred till this date was ₹22 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2018 was ₹80 lakhs. As at 31st March, 2018, 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, 2017 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, 2018. Ignore depreciation.

Solution:

As per AS 26 'Intangible Assets'

(i) For the year ending 31.03.2017

(a) Carrying value of intangiblet as on 31.03.2017:

At the end of financial year 31st March 2017, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹28 lakhs (expenditure incurred since the date the recognition criteria were met, i.e., on 1st December 2016).

(b) Expenditure to be charged to Profit and Loss account: The ` 22 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2017. This expenditure will not form part of the cost of the production process recognized in the balance sheet.

(ii) For the year ending 31.03.2018

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

	(₹ in lakhs)
Carrying Amount as on 31.03.2017	28
Expenditure during 2017 – 2018	80
Total book cost	108
Recoverable Amount	72
Impairment loss	36

₹ 36 lakhs to be charged to Profit and loss account for the year ending 31.03.2018.

(b) Carrying value of intangible as on 31.03.2018:

	(₹ in lakhs)
Total Book Cost	108
Less: Impairment loss	36
Carrying amount as on 31.03.2018	72

Illustration 44.

N Ltd has 80% shares in a joint venture with Suzuki Ltd. N Ltd. sold a plant WDV ₹20 lakhs for ₹30 lakhs. Calculate how much profit N Ltd. should recognize in its book in case joint venture is:

(a) jointly controlled operation;

(b) jointly controlled asset;

(c) jointly controlled entity.

Solution:

As per AS-27, in case of jointly controlled operation and jointly controlled assets joint venture, the venture should recognize the profit to the extent of other venturer's interest.

In the given case, N Ltd. should recognize profit of:

= ₹(30 – 20)lakhs = ₹10 x 20%= ₹2 lakhs only.

However, in case of jointly controlled entities N Ltd. should recognize full profit of ₹10 lakhs in its separate financial statement. However, while preparing consolidated financial statement it should recognize the profit only to the extent of 20% i.e. ₹ 2 lakhs only.

Illustration 45.

X Ltd. purchased a machinery on 1.1.201 for ₹ 20 lakhs. WDV of the machine as on 31.3.17 ₹12 lakhs. The Recoverable amount of the machine is ₹11 lakhs. What is the impairment loss?

Solution:

Impairment Loss = Carrying amount – Recoverable Amount

= ₹12 lakhs – ₹11 lakhs = ₹ 1 lakh.

Illustration 46.

Carrying amount ₹200 lakhs. Net Selling Price ₹210 lakhs. Value in use ₹ 220 lakhs. What is the impairment loss?

Solution:

Carrying amount ₹200 lakhs

Recoverable amount ₹ 220 lakhs (being the higher of net selling price and value in use)

Since, recoverable amount is more than carrying amount of the asset, there will arise no impairment loss.

Illustration 47.

C Ltd. acquired a machine for ₹3.2 crores on 1.1.2014. It has a life of 5 years with a salvage value of ₹40 lakhs. Apply the test of impairment on 31.3.2017:

(a) Present value of future cash flow ₹ 1.3 crores

(b) Net selling price ₹ 1.2 crores

Solution:

Carrying amount of the asset: [3.2 – (3.2 – 0.4) x 39/60] = 1.38 crores.

Time period for use of the asset: 1.1.2014 to 31.3.2017 = 39 months

Total life period of the asset = 5 years = 60 months.

Recoverable amount: being the higher of present value and net selling price = ₹1.3 crores.

Impairment Loss = ₹(1.38 – 1.3) crores = ₹0.08 crores.

Example : 1

Is there any specific disclosure requirement as per Ind AS-1 for a Company in Liquidation?

Answer:

For a Company in liquidation, the fundamental accounting assumption of Going Concern is apparently not valid.

The Carrying Amounts of assets and liabilities would reflect the Realisable Value.

As per Ind AS-1, when an Entity does not prepare Financial Statements on a going concern basis, it shall disclose –

(a) that fact,

(b) the basis on which it prepared the Financial Statements, and

(c) the reason why the Entity is not regarded as a going concern.

Example: 2

Om Ltd has a vacant land measuring 10,000 sq.mts. which it had no intention to use in the future. The Board of Directors decided to sell the land to tide over its liquidity problems. The Company made a profit of ₹10 Lakhs by selling the said Land. There was a fire in the factory and a part of the unused factory valued at ₹8 Lakhs was destroyed. The Loss was setoff against the Profit from Sale of Land and a Profit of ₹2 Lakh was disclosed as Net Profit from Sale of Assets. Analyse.

Answer:

An Entity shall not offset Assets and Liabilities or Income and Expenses, unless required or permitted by an Ind AS.

When items of Income or Expense are material, an Entity shall disclose their nature and amount separately. Disposal of items of Property, Plant and Equipment is one example of such material item.

Disclosing Net Profits by setting off Fire Losses against Profit from Sale of Land is not correct. As per Ind AS-1, Profit on Sale of Land, and Loss due to Fire should be disclosed separately.

Example: 3

A loss of ₹8,00,000 on account of embezzlement of cash was suffered by the Company and it was debited to Salary Account, discuss.

Answer:

Embezzlement of Cash during the course of business is a Business Loss. It is a business hazard which can occur once in a while.

Loss due to embezzlement of Cash cannot be merged with any other head. Being a material item, it should to be disclosed under a distinct head in the P&L A/c and not under Salary A/c.

Example: 4

A Ltd as part of overall cost cutting measure, announced a Voluntary Retirement Scheme (VRS) to reduce its number of employee. During the first half year, the Company paid a compensation of ₹144 Lakhs to those who availed the scheme. The Chief Accountant has reflected this payment as part of regular Salaries & Wages paid by the Company. Is this correct?

Answer:

VRS Payments as an overall cost-cutting measure may be considered as a part of routine business activities.

The nature and the amount involved may make it a material item requiring separate disclosure.

The Entity shall present additional line Items, Headings and Sub-Totals in the Statement of Profit and Loss, when such presentation is relevant to an understanding of the Entity's financial performance.

VRS payments should not be reflected as Salaries and Wages paid since they do not form part of regular Salaries and Wages given to Employees. The treatment given by the Company is not proper.

Example: 1

Avishkar Ltd.'s normal production capacity is 1,00,000 units and the Fixed Overheads are estimated at ₹5,00,000. Give the treatment of Fixed Production Overhead under Ind AS – 2, if actual production during a period was –

(i) 84,000 unites;

(ii) 1,00,000 units;

(iii) 1,20,000 units.

Answer:

Fixed Production Overhead Rate (based on Normal Capacity) = ₹5,00,000/1,00,000 units = ₹5 p.u. Fixed Overhead is treated as under —

Particulars	Situation (i)	Situation (ii)	Situation (iii)
1. Normal Production	1,00,000 units	1,00,000 units	1,00,000 units
2. Actual Production	84,000 units	1,00,000 units	1,20,000 units
3. Difference in Production (1 – 2)	16,000 units (short)	Nil	20,000 units (Excess)
4. Recovery Rate to be used as per Ind AS – 2	Normal Rate = ₹5 per unit	Normal Rate = ₹5 per unit	Revised Rate = ₹5,00,000/1,20,000 units = ₹4.167 p.u.
5. Recovered Cost	84,000 × ₹5 = ₹4,20,000	1,00,000 units × ₹5 = ₹5,00,000	1,20,000 units × ₹4.167 p.u. = ₹5,00,000
6. Balance treated as Period Cost	₹80,000	Nil	Nil

Example: 2

In a production process, Normal Waste is 4% of input. 6,000 MT of input were put in process resulting in a wastage of 300 MT. Cost per MT of input is ₹1,250. The entire quantity of waste is on stock at the year-end. Compute the value of Inventory.

Answer:

Abnormal Amounts of Waste Materials, Labour or other Production Costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred.

Normal Waste is 4% of 6,000 MT i.e. 240 MT and Abnormal Waste is 300 MT – 240 MT = 60 MT.

Cost of Normal Waste 240 MT will be included in determining the cost of inventories at the year-end.

Cost of Abnormal Waste 60 MT 5 ₹1,250 i.e. ₹75,000 will be charged to Profit and Loss Account.

Ind AS 23, Borrowing Costs, identifies limited circumstances where borrowing costs are included in the cost of inventories.

Example: 3

A firm (dealer of T.V) has purchased 100 T.Vs on deferred payment basis for ₹5,000 per month per T.V. The amount is to be paid in twelve monthly equal instalments. The cash cost per unit of T.V. is ₹56,000. At the end of year, 25 T.Vs were in the stock. What should be the Cost of Inventories?

Answer:

Interest Expense = Deferred Payment Price (-) Cash Cast = (5,000 × 12 Months) – 56,000 = ₹4,000.

Inventory should be valued only at Cash ₹56,000 p.u. Interest Expense ₹4,000 should not be included in Valuation of Inventory.

Conclusion:

(i) Value of Inventory = ₹56,000 × 20 units = ₹14,00,000

(ii) Cost of Inventory sold to be recognised as Expense in the Statement of P&L = ₹56,000 × 75 units = ₹42,00,000

(iii) Interest Expense to be recognised as an Expense in the Statement of P&L = ₹4,000 × 100 units =₹4,00,000.

Example 1:

An entity sold a machinery (Book Value ₹1,00,000) for ₹72,000. The loss of ₹28,000 debited to the Profit & Loss Account. Is this transaction as Operating Activity?

Answer:

Operating Activities are the principal revenue generating activities. Investing Activities relate to the acquisition and disposal of long-term assets and other investments that are not Cash Equivalents. However, Cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale as per Para 68A of Ind AS 16, are Cash Flows from Operating Activities. Cash receipts from rents and subsequent sales of such assets are also Cash Flows from Operating Activities.

The amount of ₹72,000 i.e. the sale proceeds should be shown as an Inflow under Investing Activities. ₹28,000 i.e. loss on sale of asset should be added back to derive Operating Cash Flow, under Indirect Method.

Example 2:

Golden Ltd acquired Fixed Assets viz. Plant and Machinery for ₹60 Lakhs. During the same year, it also sold Furniture and Fixtures for ₹15 Lakhs. Can the Company disclose, Net Cash Outflow towards Purchase of Fixed Assets in the Statement of Cash Flows?

Answer:

Acquisition and Disposal of Fixed Assets is not prescribed for Net-Basis reporting.

The Company cannot disclose Net Cash Flow in respect of acquisition of Plant and Machinery and disposal of Furniture and Fixtures.

Example 1:

There was a Material Prior Period Error by way of understatement of Salary Expense ₹15 Lakhs. How will you disclose it in the Financial Statements for the Financial Year 2016-2017, if the Salary Expense related to - (a) Financial Year 2015-2016 or (b) Financial Year 2013-2014?

Answer:

Prior Period relating to 2015-16:

Treatment: Financial Statements of 2016-2017, which will have comparative figures of Financial Year 2015-2016 will re-state comparative amounts of Salary Expense correctly.

Prior Period relating to 2013-14:

Treatment: Since comparative figures of 2013-2014 are not presented as comparative figures now, the difference of ₹15 Lakhs will be shown by re-stating the Opening Balances of Equity, at reduced amount.

Financial statements of subsequent periods need not repeat these disclosures.

Example 1:

As at 31st March, Cost of Investments is ₹1,50,000, Market Value ₹1,80,000. Its value declines to ₹80,000 on 25th April.

How should the Entity consider the above in its Financial Statements?

Answer:

Decline in Fair Value of Investments does not normally relate to the condition of the Investments at the end of the reporting period, but reflects circumstances that have arisen subsequently.

The Entity does should not adjust the amounts recognised in its Financial Statements for the Investments, or Should not update the amounts disclosed for the Investments as at the end of the reporting period.

The Entity may need to give Additional Disclosure.

Example 2:

State the accounting requirements in case of Settlement after the Reporting Period, of a Court Case, that confirms that the Entity had a present obligation at the end of the Reporting Period.

Answer:

It is an Adjusting Event.

The Entity shall adjust any previously recognised provision related to this Court Case in accordance, or shall recognise a new provision.

The Entity does not merely disclose a Contingent Liability because the settlement provides additional evidence that would be considered accordingly.

Example 1:

Until 31st March, 2017 a Company had been preparing and presenting the financial statements in line with the Companies(AS) Rules. With effect from accounting year beginning on or after 1st April 2017, the company is required to prepare and present its Financial Statements in line with Ind AS. In this case the date of transition to Ind AS is — 1st April, 2016.