FINAL CA – NOV 2018

ACCOUNTING STANDARDS (PART 1)

Test Code – CF1

Branch (MULTIPLE) (Date : 20.05.2018)

(50 Marks)

*Note: **All** questions are compulsory.*

Question 1 (5 marks)

As per AS 1 "Disclosure of Accounting Policies", any change in an accounting policy which has a material effect should be disclosed in the financial statements.

The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. **Thus Pioneer Ltd. should disclose the change in valuation method of inventory and its effect on financial statements.** The company may disclose the change in accounting policy in the following manner:

'**The company values its inventory at lower of cost and net realisable value**. Since net realisable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 2014-15 the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose.

The change in policy has reduced current profit and value of inventory by ` 16,000'

Question 2 (5 marks)

As per para 10 of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', **a contingent liability is: (a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; 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 ` 2.39 lakhs 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 ` 5.13 lakhs (` 7.52 lakhs less ` 2.39 lakhs) 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 recognised 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 lakhs in the books of account.
Regarding the balance amount of ` 5.13 lakhs (` 7.52 lakhs less ` 2.39 lakhs), 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, ` 5.13 lakhs may be disclosed as a contingent liability.**

Question 3 (5 marks)

As per para 26 of AS 27 **"Financial Reporting of Interests in Joint Ventures"**, in a venturer's separate financial statements, interest in a jointly controlled entity should be accounted for as an investment in accordance with AS 13 'Accounting for Investments'.

As per para 17 of **AS 13 "Accounting for Investments", long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long-term investment, the carrying amount is reduced to recognise the decline.**

Indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. The type and extent of the investor's stake in the investee are also taken into account. However, where there is a decline, other than temporary, in the carrying amounts of long-term investments, the resultant reduction in the carrying amount is charged to the profit and loss statement.

Since the investment was made in the year 2001-02, **it implies that the shares are held for more than a year and is a long term investment.**

In the given case, though the QSR Ltd. is in continuous losses for past 2 years, yet it has a futuristic and profitable business plans and projections for the coming years. Here, one of the indicators i.e. 'losses incurred to the company' may lead to diminution in the value of the shares while the other indicator that 'the company has positive expected cash flows from its business plans' does not lead to decline in the value of shares.

Considering both the facts, the decline in the value of shares of QSR Ltd. will be taken as other than temporary in nature. **Therefore, the investment in equity shares should be carried at cost only. Hence, the contention of JVR Ltd. to bring down the carrying amount of investment in QSR Ltd. is not in line with the provisions of AS 13.**

Question 4 (5 marks)

In the above case, the quarterly income has not been correctly stated. As per AS 25 "Interim Financial Reporting", the quarterly income should be adjusted and restated as follows:

Bad debts of ` 40,000 have been incurred during current quarter. Out of this, the company has deferred 50% (i.e.) ` 20,000 to the next quarter.

Therefore, ` 20,000 should be deducted from ` 7,20,000. The treatment of extra-ordinary loss of ` 35,000 being recognized in the same quarter is correct.

Recognising additional depreciation of ` 45,000 in the same quarter is in tune with AS 25 .Hence, no adjustments are required for these two items. Poonam Ltd should report quarterly income as ` **7,00,000** (` 7,20,000–` 20,000).

Question 5 (5 marks)

As per Schedule III, one of the criteria for classification of an asset as a current asset is that the asset is expected to be realised in the company's operating cycle or is intended for sale or consumption in the company's normal operating cycle.

Further, revised Schedule III defines that an operating cycle is the time between the acquisition of assets for processing and their realization in cash or cash equivalents.

However, when the normal operating cycle cannot be identified, it is assumed to have duration of 12 months.

As per the facts given in the question, the process of manufacturing of lotus wine takes around 18 months; therefore, its realisation into cash and cash equivalents will be done only when it is ready for sale i.e. after 18 months. This means that normal operating cycle of the product is 18 months. **Therefore, the contention of the company's management that the operating cycle of the product lotus wine is 18 months and not 12 months is correct. H. Ltd. will classify the raw material purchased and held in stock as current asset in its Balance Sheet.**

Question 6 (5 marks)

Calculation of Revised Book Value of Machine as on 1st April, 2016

Particulars	(`)
Acquisition of 40 Doppler Scan machines [US $ 165,100 x ` 50 x 40 machines]	33,02,00,000
Add: Bank charges paid ($ 4,000 x ` 50)	2,00,000
Add: Sea Freight on the above machines (` 7,500 per unit x 40 machines)	3,00,000
Total landed cost as on 1st April, 2013	33,07,00,000
Less: Government grant	(5,00,00,000)
Value of 40 Doppler Scan machines	28,07,00,000
Less: Depreciation @ 20% for 3 years on SLM basis (i.e ` 28,07,00,000 x 20% x 3 years)	(16,84,20,000)
WDV at the beginning of the year 2015-16	11,22,80,000

Add: Refund of government grant on 1st April, 2016	5,00,00,000
Revised book value of machine as on 1st April, 2016	**16,22,80,000**

Note: As per para 16 of AS 6 'Depreciation Accounting', where the historical cost of a depreciable asset has undergone a change due to increase or decrease in long term liability on account of exchange fluctuations, price adjustments, changes in duties or similar factors, the depreciation on the revised unamortized depreciable amount should be provided prospectively over the residual useful life of the asset. In this case, on 1st April, 2016, the remaining useful life is only two years i.e. 2016-17 & 2017-18. Hence, the WDV of ` 16,22,80,000 is to be written off under SLM @ 50% each year i.e. ` 8,11,40,000 per year.

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

Question 7 (5 marks)

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

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

Therefore, in the case of XYZ, even though AS 22 has come into effect from 1.4.2001, the transitional provisions permit adjustment of deferred tax liability/asset upto the previous year to be adjusted from opening reserve. In other words, the deferred taxes not provided for alone can be adjusted against opening reserves.

Provision for deferred tax asset/liability for the current year should be routed through profit and loss account like normal provision.

Question 8 (5 marks)

Mere gradual phasing is not considered as discontinuing operation as defined under para 3 of AS 24, 'Discontinuing Operation'.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

(1) **Gradual or evolutionary phasing out** of a product line or class of service.

(2) **Shifting** of some production or marketing activities for a particular line of business from one location to another and

(3) Closing of a facility to achieve productivity **improvements or other cost savings.**

A Reportable business segment or geographical segment as defined in AS 17, would normally satisfy criteria (b) of the definition.

In view of the above the answers are:

(i) No. The companys' strategic plan has no final approval from the board through a resolution and no specific time bound activities like shifting of Assets and employees and above all the **new segment commercial vehicle production line and factory has started.**

(ii) No. The resolution is salient about stoppage of the Car segment in definite time period. Though, some assets sales and transfer proposal was passed through a resolution to the new factory, closure road map and **new segment starting road map is missing. Hence, AS-24 will not be applicable.**

Yes. Phased and time bound programme resolved in the board clearly indicates the closure of the passenger car segment in a definite **time frame and clear road map. Hence, this action will attract AS-24 compliance.**

Question 9 (5 marks)

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

The given case is discussed in the light of the above mentioned definition and requirements given in paras 13-15 of the said AS 4 (Revised).

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

Question 10 (5 marks)

As per para 12 of AS 15 on **'Accounting for Retirement Benefits in the Financial Statements of Employers', the cost of retirement benefits to an employer results from receiving services from the employees who are entitled to receive such benefits.**

Consequently, the cost of retirement benefits is accounted for in the period during which these services are rendered. Accounting for retirement benefit cost only when employees retire or receive benefits payments (i.e. as per pay as you go method) does not achieve the objective of allocation of those costs to the periods in which the services were rendered.

Hence, the treatment of leave encashment benefit by the management is not in consonance with AS 15.

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