ACCOUNTING STANDARDS (PART 1)

Test Code – F1
Branch (MULTIPLE) (Date : 03.12.2017)

(50 Marks)

Note: All questions are compulsory.

Question 1 (5 marks)
As per para 10 of AS 2 'Valuation of Inventories', most by-products as well as scrap and waste materials, by their nature, are immaterial. They are often measured at net realizable value and this value is often deducted from the cost of the main product.

Determination of value of closing inventory of Main Products (1 Mark)

	Main Product ABC	*Main Product XYZ*
Closing inventory in units	16,000 units	4,000 units
Cost per unit (W.N.3)	` 31.68	` 19.80
Value of closing inventory	` 5,06,880	` 79,200

Working note:
(1) Calculation of net realizable value of by-product (1 Mark)

	`
Selling price of by-product (32,000 units x ` 25)	8,00,000
Less: Separate processing charges of by-product	(80,000)
Special packing charges	(1,20,000)
Net realizable value of by-product	6,00,000

(2) Calculation of cost of conversion for allocation between joint product ABC and XYZ (2 Mark)

		`
Raw Material		30,00,000
Wages		16,40,000
Fixed production overhead		11,60,000
Variable overhead		8,00,000
		66,00,000
Less: NRV of by-product	6,00,000	
Sales value of scrap	60,000	(6,60,000)
Joint cost to be allocated between ABC and XYZ		59,40,000

(3) Determination of basis of allocation and allocation of joint cost to main product ABC and XYZ (1 Mark)

	Main Product ABC	*Main Product XYZ*
Output in units (a)	1,25,000	1,00,000
Sales price per unit (b)	` 80	` 50
Sales Value (a × b)	` 1,00,00,000	` 50,00,00
Ratio of allocation	2	1
Joint cost ` 59,40,000 allocated in the ratio of 2:1 (c)	` 39,60,000	` 19,80,000

Cost per unit (c/a)	` 31.68	` 19.80

Question 2 (5 marks)

Gross investment = Minimum lease payments + Unguaranteed residual value

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

= [(` 1,00,000 × 5 years) + ` 20,000] + ` 20,000

= ` 5,40,000 (a)

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

Year	*M.L.P. inclusive of URV (`)*	*Discount factor @ 15%*	*Present Value (`)*
1	1,00,000	0.8696	86,960
2	1,00,000	0.7561	75,610
3	1,00,000	0.6575	65,750
4	1,00,000	0.5718	57,180
5	1,00,000	0.4972	49,720
	20,000 (GRV)	0.4972	9,944
	5,20,000		3,45,164 (i)
	20,000 (URV)	0.4972	9,944 (ii)
	5,40,000	(i) + (ii)	3,55,108 (b)

Unearned Finance Income = (a) – (b)

= ` 5,40,000 – ` 3,55,108

= ` 1,84,892 (2 marks)

Journal Entries in the books of SB Ltd. (3 marks)

		Dr.	Cr.
At the inception of lease			
Machinery account	Dr.	3,45,164*	
To XY Ltd.'s account			3,45,164*
(Being lease of machinery recorded at present value of minimum lease payments)			
At the end of the first year of lease			
Finance charges account (Refer Working Note)	Dr.	51,775	
To XY Ltd.'s account			51,775
(Being the finance charges for first year due)			
XY Ltd.'s account	Dr.	1,00,000	
To Bank account			1,00,000
(Being the lease rent paid to the lessor which includes outstanding liability of ` 48,225			

and finance charge of ` 51,775)		
Depreciation account£ Dr.	34,516	
To Machinery account		34,516
(Being the depreciation provided @ 10% p.a. on straight line method)		
Profit and loss account Dr.	86,291	
To Depreciation account		34,516
To Finance charges account		51,775
(Being the depreciation and finance charges transferred to profit and loss account)		

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*
	`	`	`	`	`
1	3,45,164	1,00,000	51,775	48,225	2,96,939
2	2,96,939	1,00,000	44,541	55,459	2,41,480
3	2,41,480	1,00,000	36,222	63,778	1,77,702
4	1,77,702	1,00,000	26,655	73,345	1,04,357
5	1,04,357	1,00,000	15,654	84,346	20,011

- As per para 11 of AS 19, the lessee should recognize the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payments from the standpoint of lessee, the amount recorded should be the present value of these minimum lease payments. Therefore, in this case, as the fair value of ` 4,00,000 is more than the present value amounting ` 3,45,164, the machinery has been recorded at ` 3,45,164 in the books of SB Ltd. (the lessee) at the inception of the lease. According to para 13 of the standard, at the inception of the lease, the asset and liability for the future lease payments are recognised in the balance sheet at the same amounts.
- Depreciation has been provided on the basis that the machine has been leased at the beginning of the year.
- The difference between this figure and guaranteed residual value (` 20,000) is due to approximation in computing the interest rate implicit in the lease.

Question 3 (5 marks)

Accounting treatment for recognition of revenue

Revenue in respect of sale of goods is recognised 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 previ ous experiences.

Therefore, sale of ` 30,00,000 and ` 36,00,000 made in the month of February and March, 2015 will be recognized at full value. (1 mark)

Amount of provision (4 marks)

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 (` in lacs)	Sales value (cumulative) (` in lacs)	Likely returns (%)	Likely returns (` in lacs)	Provision @ 20% (` 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

	(` in lacs)
Sales for the year	450
Less: Cost of sales	(360)
Profit	90
Profit mark up on sales (90/450) x 100 = 20%	

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 stand-alone ranges 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.

Alternatively, AS 9 provides that Revenue should not be recognized until the goods have formally been accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has been elapsed. Based on this, an alternative view can be taken whereby the revenue shall not be recognized in full. In such a case, the revised sales will be as follows:

		(` in lacs)
Revised Sales when estimated sales return is 9.75 lacs	450 – 9.75	440.25
Revised Cost of Sales	440.25 x 80%	352.20
Revised Gross Profit		88.05
Given Gross Profit		90
Reduction in Gross Profit		1.95
Reduction in receivables and sales		9.75
Inventory will stand increased by		7.80

Question 4 (5 marks)

M Ltd.

Cash Flow Statement for the year ended 31st March, 2015

	` in lakhs	` in lakhs
Cash Flows from operating activities (2 marks)		
Net Income	8.30	
Add: Depreciation	5.75	
Amortisation of preliminary expenses	5.00	
Loss on sale of asset	6.20	
Less: Increase in account receivables	(11.50)	
Net cash generated from operating activities		13.75
Cash Flows from investing activities(1 mark)		
Capital expenditure	(19.90)	
Proceeds from sale of fixed assets	11.60	
Net cash used in investing activities		(8.30)

Cash Flows from financing activities(1 mark)		
Proceeds from issue of additional shares	16.50	
Dividend declared	(10.50)	
Redemption of 9% debentures	(12.50)	
Net cash generated from financing activities		(6.50)
Net decrease in cash(1/2 mark)`		(1.05)
Cash at the beginning of the period		11.55
Cash at the end of the period (balancing figure) (1/2 mark)		10.50

Question 5 (5 marks)

As per AS 12 'Government Grants', grants meant to subsidize or reduce expenses is taken to the Statement of Profit and loss in proportion to the savings and where the grant is related to fixed assets, the value of the fixed asset is stated net of grant and depreciation is provided accordingly. Government Grants in the nature of promoters contribution is however taken to Capital reserves. (2 marks)

In the given case, the Company has received an amount from a research company in USA to acquire equipment's to be used in research in India which is to be owned by the Indian Company only. The same can be considered as private grant and AS 12 do not apply to private grants. Since the amount received is towards capital items, therefore it is not possible that credit arising out of a grant can be taken to statement of profit and loss. If such grant received is credited to profit and loss, profit or loss position could be easily manipulated through such private grants.

However, in the present case, grant should either be shown as Capital Reserve (not revenue reserves) with proper disclosures or credited to Equipment Account. (3 marks)

Question 6 (5 marks)

Joint ventures take many different forms and structures. AS 27, 'Financial Reporting of Interests in Joint Venturtes' identifies three broad types of joint ventures– jointly controlled operations, jointly controlled assets and jointly controlled entities. The following characteristics are common to all joint ventures:

(a) two or more venturers are bound by a contractual arrangement; and

(b) the contractual arrangement establishes joint control. (2 marks)

In its separate financial statements as well as in consolidated financial statements, a venturer should disclose the aggregate amount of the following contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities:

(c) any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities which have been incurred jointly with other venturers;

- its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and
- those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture. (1 mark)

A venturer should also disclose the aggregate amount of the following commitments in respect of its interests in joint ventures separately from other commitments:

- any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and
- its share of the capital commitments of the joint ventures themselves. (1 mark)

A venturer should disclose a list of all joint ventures and description of interests in significant joint ventures. In respect of jointly controlled entities, the venturer should also disclose the proportion of ownership interest, name and country of incorporation or residence. (1/2 mark)

A venturer should disclose, in its separate financial statements only, the aggregate amounts of each of the assets, liabilities, income and expenses related to its interests in the jointly controlled entities. (1/2 mark)

Question 7 (5 marks)

As per para 66 of AS 28 'Impairment of Assets, the cash-generating unit is smallest group of asset that includes the asset and that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets. (2 marks)

In the instant case the primary purpose of the building is to serve as a corporate office of Light Ltd., which is engaged in multi product manufacturing activities. Therefore, the building as a whole cannot be considered to generate cash inflows which are largely independent of the cash flows for the company as a whole. The building is not held as an investment; therefore, it would be inappropriate to determine 'value in use' of the building based on future market rent.

Hence, building is not a cash generating unit; the cash-generating unit for the building is Light Ltd., the company as a whole. (3 marks)

Question 8 (5 marks)

As per AS 13 "Accounting for Investments" long-term investments are usually of individual importance to the investing enterprise. The carrying amount of long-term investments is therefore determined on an individual investment basis. Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. (3 marks)

Keeping in view the above, K Ltd should provide for the decline in the value of investments in two subsidiaries despite the fact that the overall investment portfolio in subsidiaries did not suffer any decline. (2 marks)

Question 9 (5 marks)
(i) According 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 assist the estimation of amounts relating to conditions existing at the balance sheet date. (1 mark)

In the given case, sale of 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 Pradeep Ltd. for the year ended 31st March, 2013. (1 ½ marks)

(ii)AS 4 (Revised) defines "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 required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 2013. (1 mark)

Applying provisions of the standard which clearly state that disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ` 40 lakhs in April, 2013 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions. (1 ½ marks)

Question 10 (5 marks)
Para 87, 88 and 89 of AS 26 ‘Intangible Assets’ states that an intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal. (1 mark)

Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss. (2 marks)

An intangible asset that is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use. At least at each financial year end, an enterprise tests the asset for impairment under Accounting Standard on Impairment of Assets, and recognises any impairment loss accordingly. (2 mark)

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