# FINAL CA – May 2018
## ACCOUNTING STANDARDS

**Test Code – F8**
**Branch (MULTIPLE) (Date : 17.12.2017)**

**(50 Marks)**

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

**Question 1 (5 marks)**

As per para 9 of AS 2 'Valuation of Inventories', for inclusion in the cost of inventory, allocation of fixed production overheads is based on the normal capacity of the production facilities. **(1 mark)**

In this, case finished stock has been valued at a standard cost of ` 1.8 lakhs per computer which incidentally synchronizes with the value computed on the basis of absorption costing as under:

| | | (` *in lakhs)* |
|---|---|---|
| Materials | | 400 |
| Direct Labour | | 250 |
| Variable production overheads | | 150 |
| Fixed production overheads | 290 | |
| Less: Interest | (100) | 190 |
| Total cost | | 990 |

Number of computers produced = 550 computers (Assumed to be normal production)

Cost per computer ` 990 lakhs/550 computers = ` 1.80 lakhs **(3 marks)**

Policy of the company to value closing stock on the basis of standard costing is not as per AS 2. As per para 18 of AS 2, the techniques of standard cost method may be used for convenience if the result approximates to the actual cost. However, standard cost should be regularly reviewed, if necessary, and be revised in the light of the current conditions. In the instant case, the cost of inventory can be conveniently calculated as per absorption costing. Therefore, there is no reason to adopt standard costing method. **(1 mark)**

**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)

| *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)

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

= ` 5,40,000 – ` 3,55,108

= ` 1,84,892 **(2 marks)**

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

***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* | *Minimum lease* | *Finance charges* | *Reduction in principal* | *Outstanding liability (closing* |
|---|---|---|---|---|---|

| | (opening balance) | payments | | amount | 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 |

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- 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)**

As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method as the service is performed, whichever relates the revenue to the work accomplished. **(1 mark)**

In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is published and hence revenue is recognized on that date. In this case, 15.03.2015 is the date of publication of the magazine. **(1 mark)**

Hence, ` 3,00,000 (` 2,40,000 + ` 60,000) is recognized as income in March, 2015. The terms of payment are not relevant for considering the date on which revenue is to be recognized. Since, the revenue of ` 3,00,000 will be recognised in the March, 2015, ` 60,000 will be treated as amount due from advertisers as on 31.03.2015 and ` 2,40,000 will be treated as payment received against the sale. **(1 mark)**

However, if the publication is delayed till 02.04.2015 revenue recognition will also be delayed till the advertisements get published in the magazine. In that case revenue of ` 3,00,000 will be recognized in the year ended 31.03.2016 after the magazine is published on 02.04.2015**.** The amount received from sale of advertising space on 10.03.2015 of ` 2,40,000 will be considered as an advance from advertisers as on 31.03.2015. **(2 marks)**

**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)**

(i) Whether a subsidy applied is to be classified as prior period item as per AS 5, depends upon whether the company has committed an error in 2013-14 by not recognising the subsidy? The answer is in para 13 of AS 12 "Accounting for Government Grants" which permits recognition of grant only when there is reasonable assurance that (i) the enterprise will comply with the conditions attached to them and (ii) the subsidy will be received. Mere making of an application does not provide the reasonable assurance that the subsidy will be received. Letter of sanction from IREDA is required to provide this assurance. Since, the subsidy was granted in June, 2014 after approval of accounts, non-recognition of grant in 2013-14 will not be considered as an error. Hence, this is not a prior period item. Therefore, the company was right in not recognizing the grant.

Further, AS 4 requires adjustment of events occurring after the balance sheet date only upto the date of approval of accounts by the Board of Directors. In view of this, the company is correct in not adjusting the same in the accounts in the year 2013-14. **(2 marks)**

(ii) The subsidy should be deducted from the cost of the generator. The revised unamortised amount of generator should be written off over the remaining useful life.

Alternatively, the same may be treated as Deferred Income and allocated over the remaining useful life in the proportion in which depreciation is charged. **(1** mark)

(iii) Here in this case, the opinion given in (i) and (ii) above would change. AS 4 requires the value of assets and liabilities to be adjusted for events occurring after the balance sheet date which occur upto the date of approval of accounts by the Board of Directors if they confirm the conditions existing at the balance sheet date. Since, in this case books of account have not been approved, grant of subsidy will be considered as an adjusting event. Hence, the accounts should be adjusted for the subsidy in 2013-14. The subsidy should be credited to the cost of the generator.

Alternatively, the subsidy may be treated as deferred income to be written off over the useful life in proportion in which depreciation is written off. **(1 mark)**

(iv) As per the past experience of the company wherein similar applications were made and subsidy was granted on all occasion, one can conclude that the reasonable assurance that subsidy will be received, as envisaged in Para 13, is there in the form of past record. If there are no changes in the subsidy scheme and the application is submitted in the same manner as in the past, then subsidy should have been accounted in 2013-14 itself. The opinion in (i) and (ii) would change. The opinion in (iii) above will hold good in this case also. **(1 mark)**

**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)**

The contention of the Big Publisher Limited is not acceptable.

As per para 4 of AS 28 "Impairment of Assets", A cash generating unit is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets. **(1 mark)**

It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other titles in the customer segment, cash inflows from direct sales and advertising are identifiable for each title. **(1 mark)**

In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis. Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent one from another and that each magazine title is a separate cash-generating unit (CGU). **(1 mark)**

Therefore, the decision of the Big Publisher Limited to treat all magazine titles as one cash- generating unit is wrong. In this case each individual magazine title generates cash flow and the same is independent from another magazine hence each individual magazine is a separate cash generating unit. Besides, as per AS 28, an impairment loss should be recognised for a cash generating unit if, and only if, its recoverable amount is less than its carrying amount. The impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order: **(2 marks)**

(a) first, to goodwill allocated to the cash-generating unit (if any); and

(b) then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.

These reductions in carrying amounts should be treated losses on individual assets and recognised in accordance with para 58 of AS 28. The Impairment testing as per AS 28 would be done for each cash generating unit as explained above.

**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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