SUGGESTED SOLUTION

CA INTERMEDIATE NOV'19

SUBJECT- ACCOUNTING STANDARDS

Test Code - CIM 8333

BRANCH - () (Date :)

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ANSWER-1

ANSWER-A

(i) In the given case, Mobile limited created 2% provision for doubtful debts till 31st March, 2016. Subsequently in2016 – 17, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex – gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in an accounting policy.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

(5*1 = 5 MARKS)

ANSWER-B

As per para 3.2 to **AS 16 'Borrowing Costs', a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale**.

Further, Explanation to the above para states that what constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

It may be implied that there is a rebuttable presumption that a 12 months period constitutes substantial period of time.

Under present circumstances where construction period has reduced drastically due to technical innovation, the 12 months period should at best be looked at as a benchmark and not as a conclusive yardstick. It may so happen that an asset under normal circumstances may take more than 12 months to complete. However, an enterprise that completes the asset in 8 months should not be penalized for its efficiency by denying it interest capitalization and vice versa.

The substantial period criteria ensures that enterprises do not spend a lot of time and effort capturing immaterial interest cost for purposes of capitalization.

Therefore, if the factory is constructed in 8 months then it shall be considered as a qualifying asset. The interest on borrowings for the same shall be capitalized although it has taken less than 12 months for the asset to get ready to use.

(5 MARKS)

ANSWER-2

ANSWER-A

Calculation of segment result

Segments	A	B	C	Total
	Rs.	Rs.	Rs.	Rs.
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5 : 4 : 2 basis)	50,000	40,000	20,000	1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Total segment revenue as per AS 17(A)	6,60,000	4,15,000	2,70,000	13,45,000
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in 5 : 4 : 2 basis)	35,000	28,000	14,000	77,000
Expenses on transactions with other segments				
Transaction from B	75,000		30,000	1,05,000
Transaction from C	6,000	40,000		46,000
Transaction from A		18,000	82,000	1,00,000
Total segment expenses as per AS 17(B)	4,16,000	2,36,000	2,01,000	8,53,000
Segment result (A – B)	2,44,000	1,79,000	69,000	4,92,000

(5 MARKS)

ANSWER-B

As per **para 13 of Accounting Standard (AS) 22, Accounting for Taxes on Income", deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognized to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income – tax Act.** Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognized in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of Rs. 1,000 lakhs depreciation, timing difference amounting Rs. 400 lakhs (Rs. 50 lakhs × 8 years) will reverse in the tax holiday period and therefore, should not be recognized. However, for Rs. 600 lakhs (Rs. 1,000 lakhs – Rs. 400 lakhs), deferred tax liability will be recognized for Rs. 240 lakhs (40% of Rs. 600 lakhs) in first year. In the second year, the entire amount of timing difference of Rs. 2,000 lakhs will reverse only after tax holiday period and hence, will be recognized in full. Deferred tax liability amounting Rs. 800 lakhs (40% of Rs. 2,000 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be Rs. 1,040 lakhs (240 lakhs + 800 lakhs).

(5 MARKS)

ANSWER-3

ANSWER-A

Determination of Nature of Lease

Present value of unguaranteed residual value at the end of 3 rd year

= Rs. 50,000 x 0.7513

= Rs. 37,565

Present value of lease payments = Rs. 5,00,000 – Rs. 37,565

= Rs. 4,62,435

The percentage of present value of lease payments to fair value of the equipment is (Rs. 4,62,435/ Rs. 5,00,000) x 100 = 92.487%.

Since, lease payments substantially covers the major portion of the fair value; the lease constitutes a finance lease.

Calculation of Unearned Finance Income

Annual lease payment = Rs. 4,62,435/ 2.4868 =Rs. 1,85,956 (approx.)

Gross investment in the lease = Total minimum lease payments + unguaranteed residual value

= (Rs. 1,85,956 × 3) + Rs. 50,000

= Rs. 5,57,868 + Rs. 50,000 = Rs. 6,07,868

Unearned finance income = Gross investment - Present value of minimum lease payments and unguaranteed residual value

= Rs. 6,07,868 – Rs. 5,00,000 = Rs. 1,07,868

(5 MARKS)

ANSWER-B

(i)	**Loss for the year ended, 31st March, 2018**	**(Rs. in Lakhs)**
	Amount of foreseeable loss	
	Total cost of construction (6,250 + 1,250 + 8,750)	16,250
	Less : Total contract price	(12,000)
	Total foreseeable loss to be recognised as expense	4,250

According to AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

Loss for the year ended, 31st March, 2018 amounting Rs. 4,250 will be recognized.

(ii)	**Contract work – in – progress as on 31.3.18**	**(Rs. in lakhs)**
	Contract work – in – Progress i.e. cost incurred to date are Rs. 7,500 lakhs :	
	Work certified	6,250
	Work not certified	1,250
		7,500

(iii) Proportion of total contract value recognized as revenue

Cost incurred till 31.3.18 is 46.15% (7,500/16,250 × 100) of total costs of construction.

Proportion of total contract value recognized as revenue :

46.15% of Rs. 12,000 lakhs = Rs. 5,538 lakhs

(iv) Amount due from / to customers at year end

(Contract costs + Recognized profits – Recognised Losses) – (Progress payments received + Progress payments to be received)

= (7,500 + Nil – 4,250) – (5,500 + 1,500) Rs. in lakhs

= [3,250 – 7,000] Rs. in lakhs

Amount due to customers = Rs. 3,750 lakhs

(5 MARKS)

ANSWER-4

ANSWER-A

Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations. According to Paragraph 9 of AS 24, examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include :

(i) Gradual or evolutionary phasing out of a product line or class of service ;
(ii) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
(iii) Shifting of some production or marketing activities for a particular line of business from one location to another; and
(iv) Closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

(5 MARKS)

ANSWER-B

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

In the given case, Sun Ltd. and Moon Ltd are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price.

Hence the contention of Chief Accountant of Sun Ltd. is wrong.

(5 MARKS)

ANSWER-5

ANSWER-A

As per **AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when**

(a) an **enterprise has a present obligation** as a result of a past event;
(b) it is probable that an **outflow of resource embodying economic benefits** will be required to settle the obligation; and
(c) a **reliable estimate can be made of the amount of the obligation**.

If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note :

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of Rs. 200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

(5 MARKS)

ANSWER-B

According to **<u>AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use</u>**. As per the standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

The treatment of interest by Zen Bridge Construction Ltd. can be shown as:

	Qualifying Asset	Interest to be capitalized Rs. in crores	Interest to be charged to Profit & Loss A/c Rs. in crores	
Construction of hill road*	Yes	1.25		1.6/64 x 50
Purchase of equipment and machineries	No		0.15	1.6/64 x 6
Working capital	No		0.10	1.6/64 x 4
Purchase of vehicles	No		0.025	1.6/64 x 1
Advance for tools, cranes etc.	No		0.025	1.6/64 x 1
Purchase of technical know-how	No		0.05	1.6/64 x 2
Total		1.25	0.35	

***Note:** It is assumed that construction of hill road will normally take more than a year (substantial period of time), hence considered as qualifying asset.

(5 MARKS)