IPCC – November 2017

ACCOUNTING STANDARDS

Test Code – 8089

Branch (MULTIPLE) (Date : 27.08.2017)

(50 Marks)

Note: All questions are compulsory.

Question 1 (5 marks)

As per AS 13 'Accounting for Investments', the accounting standard is not applicable to Bank, Insurance Company, Mutual Funds. In this case Z Bank is a bank, therefore, AS 13 does not apply to it. **(2 ½ marks)**

For banks, the RBI has issued guidelines for classification and valuation of its investment and Z Bank should comply with those RBI Guidelines/Norms. Therefore, though Z Bank has not followed the provisions of AS13, yet it would not be said as non-compliance since, it is complying with the norms stipulated by the RBI**(2 ½ marks)**

Question 2 (5 marks)

The decision of making provision for non-moving stocks on the basis of technical evaluation does not amount to change in accounting policy. Requirement to provide for non-moving stocks may be said as accounting policy but the basis for making provision will not constitute accounting policy. It will be considered as an accounting estimate. Further, the method of estimating the amount of provision may be changed in case a more prudent estimate can be made**. (2 marks)**

In the given case, considering the total value of stock, the change in the amount of required provision of non-moving stock from ` 3.5 lakhs to ` 2.5 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of Mini Ltd. for the year 2015-16:

"The company has provided for non-moving stocks on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been higher by ` 1 lakh."**(3 marks)**

Question 3 (5 marks)

As per para 11 of AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods. **(2 marks)**

In the given case, transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. Also, the sale price has been recovered by the seller. Hence, the sale is complete but delivery has been postponed at buyer's request. A

Ltd. should recognize the entire sale of ` 1,00,000 (` 25,000 x 4) and no part of the same is to be treated as Advance Receipt against Sales. **(3 marks)**

Question 4 (5 marks)

An amalgamation may be either – an amalgamation in the nature of merger, or an amalgamation in the nature of purchase. The selection of method of accounting for amalgamation (pooling of interests or purchase method) is to be judged after considering the intentions of the both the companies. **(1 mark)**

If genuine pooling of all assets, liabilities, shareholders' interest is intended; separate businesses of both the companies are continued and their amalgamation scheme satisfies all the conditions necessary for merger as specified in AS 14 Accounting for Amalgamations, pooling of interests method is adopted . **(1 mark)**

However, if B Ltd. or A Ltd. wants to acquire the other company, then purchase method needs to be adopted. In that case, the shareholders of the acquired company don't continue to have proportional share in equity of the combined company and the business of the acquired company is not intended to be continued. The object of the purchase method is to account for the amalgamation by applying the same principles as are applied in the normal purchase of assets.

Thus choice of accounting method depends on the fact whether B Ltd. wants to continue its business or not. **(3 marks)**

Question 5 (5 marks)

As per AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares for calculation of diluted earnings per share. Hence, "in calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period." **(2 marks)**

Computation of diluted earnings per share = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity share}}$

Adjusted net profit for the current year. **(1 mark)**

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Net profit for the current year (after tax)	1,00,00,000
Add: Interest expense for the current year	5,00,000
Less: Tax relating to interest expense (30% of `5,00,000)	(1,50,000)
Adjusted net profit for the current year	1,03,50,000

Weighted average number of equity shares

Number of equity shares resulting from conversion of debentures

(1,00,000 x 100)/10 = 10,00,000 Equity shares

Weighted average number of equity shares used to compute diluted earnings per share. **(2 marks)**

= [(10,00,000 x 12) + (10,00,000 x 6)]/12 = 15,00,000 equity shares

Diluted earnings per share = ` 1,03,50,000 / 15,00,000 shares = ` 6.90 per share

Note: Interest on debentures for full year amounts to ` 10,00,000 (i.e. 10% of ` 1,00,00,000). However, interest expense amounting `5,00,000 has been given in the question. It may be concluded that debentures have been issued at the mid of the year and interest has been provided for 6 months.

Question 6 (5 marks)

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use. 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 ` in crores*	*Interest to be charged to Profit & Loss A/c ` 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.

Question 7 (5 marks)

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognized. Alpha Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Alpha Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Alpha Ltd. should provide for the contingency amounting ` 2 crores as per AS 29.

Question 8 (5 marks)

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:

Annuity Factor (Year 1 to Year 5) Present Value of minimum lease payments (`3 lakhs each year)	3.36 (approx.) `10.08 lakhs (approx.)

Thus present value of minimum lease payments is `10.08 lakhs and the fair value of the machine is ` 30 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.

Question 9 (5 marks)

As per para 13 of AS 11 (Revised 2003) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognized as income or expense.**(2 marks)**

Calculation of Exchange Difference:

$$\text{Foreign currency loan} = \frac{\text{` 3,000 lakhs}}{\text{` 40}} = \text{75 lakhs US Dollars}$$

Exchange difference = 75 lakhs US Dollars × (42.50 – 40.00) = `187.50 lakhs

(including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting ` 187.50 lakhs should be charged to profit and loss account for the year. . **(3 marks)**

Note: The above answer has been given on the basis that the company has not exercised the option of capitalization available under para 46 of AS 11. The answer will change if the company exercises the option of capitalization.

Question 10 (5 marks)

This event occurred after March 31, 2016 but before September 04, 2016 is an event occurring after the balance sheet date. But this event is not affecting financial position on the date of balance sheet therefore it should be disclosed in the directors' report.

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