## ACCOUNTING STANDARDS BASED QUESTIONS

<table>
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<tr>
<th>AS-1</th>
<th>QUESTION</th>
<th>Explain the areas in which different accounting policies may be followed?</th>
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<tbody>
<tr>
<td></td>
<td>ANSWER</td>
<td>The following are examples of the areas in which different accounting policies may be adopted by different enterprises.</td>
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<tr>
<td></td>
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<td>- Methods of depreciation, depletion and amortisation</td>
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<td>- Treatment of expenditure during construction</td>
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<td>- Conversion or translation of foreign currency items</td>
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<td>- Valuation of inventories</td>
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<td>- Treatment of goodwill</td>
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<td>- Valuation of investments</td>
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<td>- Treatment of retirement benefits</td>
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<td>- Recognition of profit on long-term contracts</td>
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<td>- Valuation of fixed assets</td>
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<td>- Treatment of contingent liabilities</td>
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<table>
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<tr>
<th>QUESTION</th>
<th>Explain the disclosure requirements of AS-1?</th>
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<tbody>
<tr>
<td>ANSWER</td>
<td>All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.</td>
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<td>The disclosure of the significant accounting policies as such should form part of the financial statements and the significant accounting policies should normally be disclosed in one place.</td>
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<td></td>
<td>Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed.</td>
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<td>In the case of a change in accounting policies which has a material effect in the current period, 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.</td>
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<td></td>
<td>If the fundamental accounting assumptions, viz. Going concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.</td>
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</table>
**AS-2**

**QUESTION**
The company deals in three products, A, B and C, which are neither similar nor interchangeable. At the time of closing of its account for the year 2002-03. The Historical Cost and Net Realizable Value of the items of closing stock are determined as follows:

<table>
<thead>
<tr>
<th>Items</th>
<th>Historical Cost (Rs. in lakhs)</th>
<th>Net Realisable Value (Rs. in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>40</td>
<td>28</td>
</tr>
<tr>
<td>B</td>
<td>32</td>
<td>32</td>
</tr>
<tr>
<td>C</td>
<td>16</td>
<td>24</td>
</tr>
</tbody>
</table>

What will be the value of Closing Stock?

**ANSWER**

<table>
<thead>
<tr>
<th>Items</th>
<th>Historical Cost (Rs. in lakhs)</th>
<th>Net Realisable Value (Rs. in lakhs)</th>
<th>Valuation of closing stock (Rs. in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>40</td>
<td>28</td>
<td>28</td>
</tr>
<tr>
<td>B</td>
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<td>32</td>
<td>32</td>
</tr>
<tr>
<td>C</td>
<td>16</td>
<td>24</td>
<td>16</td>
</tr>
</tbody>
</table>

88
84
76

Hence, closing stock will be valued at Rs. 76 lakhs.

**QUESTION**
The Company X Ltd., has to pay for delay in cotton clearing charges. The company up to 31.3.2006 has included such charges in the valuation of closing stock. This being in the nature of interest, X Ltd. decided to exclude such charges from closing stock for the year 2006-07. This would result in decrease in profit by Rs.5 lakhs. Comment.

**ANSWER**

As per para 12 of AS 2 (revised), interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are therefore, usually not included in the cost of inventories. However, X Ltd. was in practice to charge the cost for delay in cotton clearing in the closing stock. As X Ltd. decided to change this valuation procedure of closing stock, this treatment will be considered as a change in accounting policy and such fact to be disclosed as per AS 1. Therefore, any change in amount mentioned in financial statement, which will affect the financial position of the company should be disclosed properly as per AS 1, AS 2 and AS 5.

Also a note should be given in the annual accounts that, had the company followed earlier system of valuation of closing stock, the profit before tax would have been higher by Rs. 5 lakhs.

**QUESTION**

In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input is Rs.1,000. The entire quantity of waste is on stock at the year end. State with reference to Accounting Standard, how will you value the inventories in this case?

**ANSWER**

As per para 13 of AS 2 (Revised), abnormal amounts of wasted materials, labour and
other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred. In this case, normal waste is 250 MT and abnormal waste is 50 MT. The cost of 250 MT will be included in determining the cost of inventories (finished goods) at the year end. The cost of abnormal waste amounting to Rs.50,000 (50 MT × Rs.1,000) will be charged to the profit and loss statement.

AS-3

QUESTION
What are the main features of the Cash Flow Statement? Explain with special reference to AS 3?

ANSWER
According to AS 3 (Revised) on “Cash Flow Statements”, cash flow statement deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise during the given period from operating, investing and financing activities. Cash flows from operating activities can be reported using either:

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of non–cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows. As per para 42 of AS 3 (Revised), an enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.

A cash flow statement when used in combination with the other financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency), and its ability to affect the amount and timing of cash flows in order to adapt to changing circumstances and opportunities. AS 3 (revised) is recommendatory at present but for companies listed on stock exchanges, its compliance is mandatory due to the listing agreement which provides for the listed companies to furnish cash flow statement in their Annual Reports.

QUESTION
Explain the treatment of foreign exchange losses while preparing the Cash Flow Statement?

ANSWER
Unrealised gains and losses arising from changes in foreign exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in foreign currency is reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at the end-of-period exchange rates.

AS-4

QUESTION
Events Occurring after the Balance Sheet Date and their disclosure requirements.

ANSWER
Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, 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 and in the case of any other entity by the corresponding approving authority.
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 or that indicate that the fundamental accounting assumption of going concern (i.e., the continuance of existence or substratum of the enterprise) is not appropriate. However, assets and liabilities should not be adjusted for but disclosure should be made in the report of the approving authority of events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise.

(ii) Disclosure regarding events occurring after the balance sheet date:
(a) The nature of the event;
(b) An estimate of the financial effect, or a statement that such an estimate cannot be made.

**QUESTION**

You are an accountant preparing accounts of A Ltd. as on 31.3.2003. After year end the following events have taken place in April, 2003:
(i) A fire broke out in the premises damaging, uninsured stock worth Rs. 10 lakhs (Salvage value Rs. 2 lakhs).
(ii) A suit against the company’s advertisement was filed by a party claiming damage of Rs. 20 lakhs.
(iii) Dividend proposed @ 20% on share capital of Rs. 100 lakhs.

Describe, how above will be dealt with in the account of the company for the year ended on 31.3.2003

**ANSWER**

Events occurring after the Balance Sheet date that represent material changes and commitments affecting the financial position of the enterprise must be disclosed according to para 15 of AS 4 on Contingencies and Events occurring after the Balance Sheet date. Hence, fire accident and loss thereof must be disclosed.

Suit filed against the company being a contingent liability must be disclosed with the nature of contingency, an estimate of the financial effect and uncertainties which may affect the future outcome must be disclosed as per para 16 of AS 4.

There are events which, although take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. Such items include the amount of dividend proposed or declared by the enterprise after the balance sheet date in respect of the period covered by the financial statements. Thus, dividends which are proposed or declared by the enterprise after the balance sheet date but before approval of the financial statements, should be adjusted as per para 14 of AS 4.

**QUESTION**

A major fire has damaged the assets in a factory of a limited company on 2nd April - two days after the year end closure of account. The loss is estimated at Rs. 20 crores out of which Rs. 12 crores will be recoverable from the insurers. Explain briefly how the loss should be treated in the final accounts for the previous year.

**ANSWER**

The loss due to break out of fire is an example of event occurring after the balance sheet date that does not relate to conditions existing at the balance sheet date. It has not affected the financial position as on the date of the balance sheet and therefore requires no specific adjustments in the financial statements. However, paragraph 8.6 of AS-4
states that disclosure is generally made of events in subsequent periods that represent unusual changes affecting the existence or substratum of the enterprise at the balance sheet date. In the given case, the loss of assets in a factory is considered to be an event affecting the substratum of the enterprise after the balance sheet date. Hence, as recommended in paragraph 15 of AS-4, disclosure of the event should be made in the report of the approving authority that represent material changes and commitments affecting the financial position of the enterprise.

**QUESTION**
A major fire has damaged assets in a factory of X Co. Ltd. on 8.4.2004, 8 days after the year end closing of accounts. The loss is estimated to be Rs. 16 crores (after estimating the recoverable amount of Rs. 24 crores from the Insurance Company). If the company had no insurance cover, the loss due to fire would be Rs. 40 crores. Explain, how the loss should be treated in the Final accounts of the year ended 31.3.2004.

**ANSWER**
The present event does not relate to conditions existing at the balance sheet date. Hence, no specific adjustment is required in the financial statements for the year ending on 31.3.2004. But if the event occurring after balance sheet date gives an indication that the enterprise may cease to be a going concern, then the assets and liabilities are required to be adjusted for the financial year ended 31st March, 2004. AS 4 (Revised) requires disclosure in respect of events occurring after the balance sheet date representing unusual changes affecting the existence or substratum of the enterprise after the date of the Balance Sheet.
In the present event, the loss of assets in a factory can be considered to be an event affecting the substratum of the enterprise. Hence, an appropriate disclosure should be made in the report of the approving authority.

**QUESTION**
ABC Ltd. could not recover Rs. 10 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company were finalized for the year ended 31.3.2005 by making a provision @ 20% of the amount due from the said debtor. The debtor became bankrupt in April, 2005 and nothing is recoverable from him. Do you advise the company to provide for the entire loss of Rs. 10 lakhs in the books of account for the year ended 31st March, 2005?

**ANSWER**
As per AS 4 ‘Contingencies and Events occurring after the Balance Sheet Date’, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.
In the given case, bankruptcy of the debtor in April, 2005 and consequent non-recovery of debt is an event occurring after the balance sheet date which materially affects the determination of profits for the year ended 31.3.2005. Therefore, the company should be advised to provide for the entire amount of Rs. 10 lakhs according to para 8 of AS 4.

**QUESTION**
A Limited Company closed its accounting year on 30.6.10 and the accounts for that period were considered and approved by the board of directors on 20th August, 2010. The company was engaged in laying pipe line for an oil company deep beneath the earth. While doing the boring work on 1.9.2010 it had met a rocky surface for which it
was estimated that there would be an extra cost to the tune of `80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.10.

**ANSWER**
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 by `80 lakhs 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.

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**AS-5**

**QUESTION**
*Prior-Period items*

**ANSWER**
When income or expenses arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods, the said incomes or expenses have to be classified as prior period items. The errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts or oversight.

**QUESTION**
The difference between actual expense or income and the estimated expense or income as accounted for in earlier years’ accounts, does not necessarily constitute the item to be a prior period item comment.

**ANSWER**
The statement given in the question is correct and is in accordance with the Accounting Standard (AS) 5 (Revised) “Net Profit or Loss for the Period. Prior Period Items and Changes in Accounting Policies”.
The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. An estimate may have to be revised if changes occur regarding the circumstances on which the estimate was based, or as a result of new information or subsequent developments. The revision of the estimate, by its nature, does not bring the adjustments within the definition of an extraordinary item or a prior period item.

**QUESTION**
A limited company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2003-2004. Subsequently on a review of the credit period allowed and financial capacity of the customers, the company decided to increase the provision to 8% on debtors as on 31.3.2004. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard can this revision be considered as an extraordinary item or prior period item?
**ANSWER**
The preparation of financial statements involve making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revise an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate, by its nature, does not bring the adjustment within the definitions of a prior period item or an extraordinary item [para 21 of AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies].

In the given case, a limited company created 2.5% provision for doubtful debts for the year 2003-2004. Subsequently in 2004 they revised the estimates based on the changed circumstances and wants to create 8% provision. As per AS-5 (Revised), this change in estimate is neither a prior period item nor an extraordinary item. However, as per para 27 of AS 5 (Revised), a change in accounting estimate which has material effect in the current period, should be disclosed and quantified. Any change in the accounting estimate which is expected to have a material effect in later periods should also be disclosed.

**QUESTION**

X Co. Ltd. signed an agreement with its employees union for revision of wages in June, 2004. The wage revision is with retrospective effect from 1.4.2000. The arrear wages upto 31.3.2004 amounts to Rs. 80 lakhs. Arrear wages for the period from 1.4.2004 to 30.06.2004 (being the date of agreement) amounts to Rs. 7 lakhs.

Decide whether a separate disclosure of arrear wages is required.

**ANSWER**

It is given that revision of wages took place in June, 2004 with retrospective effect from 1.4.2000. The arrear wages payable for the period from 1.4.2000 to 30.6.2004 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. Additional wages liability of Rs. 87 lakhs (from 1.4.2000 to 30.6.2004) should be included in current year’s wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per Para 12 of AS 5 (Revised),’ Net Profit or loss for the Period, Prior Period Items and Changes in the Accounting Policies’, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. However, wages payable for the current year (from 1.4.2004 to 30.6.2004) amounting Rs. 7 lakhs is not a prior period item, hence need not be disclosed separately. This may be shown as current year wages.
QUESTION

X Co. Ltd. charged depreciation on its asset on SLM basis. For the year ended 31.3.2003 it changed to WDV basis. The impact of the change when computed from the date of the asset coming to use amounts to Rs. 20 lakhs being additional charge.

Decide how it must be disclosed in Profit and loss account. Also, discuss, when such changes in method of depreciation can be adopted by an enterprise as per AS–6.

(24 marks) (PE-II – May 2003)

ANSWER

The company should disclose the change in method of depreciation adopted for the accounting year. The impact on depreciation charge due to change in method must be quantified and reported by the enterprise.

Following aspects may be noted in this regard as per AS 6 on Depreciation Accounting.

(a) The depreciation method selected should be applied consistently from period to period.
(b) A change from one method of providing depreciation to another should be made only if the adoption of the new method is required by statute or for compliance with an accounting standard if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise.
(c) When such a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed.
(d) In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged in the statement of profit and loss.
(e) In case the change in the method results in surplus, the surplus should be credited to the statement of profit and loss. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed.

QUESTION

Limited company charged depreciation on its assets on the basis of W.D.V. method from the date of assets coming to use till date amounts to Rs. 32.23 lakhs. Now the company decides to switch over to Straight Line method of providing for depreciation. The amount of depreciation computed on the basis of S.L.M. from the date of assets coming to use till the date of change of method amounts to Rs. 20 lakhs.

Discuss as per AS-6, when such changes in method of can be adopted by the company and what would be the accounting treatment and disclosure requirement.

ANSWER

Paragraph 21 of Accounting Standard 6 on Depreciation Accounting says, "The depreciation method selected should be applied consistently from period to period. A change from one method of providing depreciation to another should be made only if the adoption of the new method is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise."

The paragraph also mentions the procedure to be followed when such a change in the method of depreciation is made by an enterprise. As per the said paragraph, depreciation should be recalculated in accordance with the new method from the date of the asset coming to use. The difference in the amount, being deficiency or surplus from retrospective recomputation should be adjusted in the profit and loss account in
the year such change is effected. Since such a change amounts to a change in the accounting policy, it should be **properly quantified and disclosed**. In the question given, the surplus arising out of retrospective recomputation of depreciation as per the straight line method is Rs.12.23 lakhs (Rs. 32.23 lakhs – Rs. 20 lakhs). This should be written back to Profit and Loss Account and should be disclosed accordingly.

**QUESTION**  
Explain the following statement:  
“AS-6 has limited applicability”.

**ANSWER**  
AS-6 has limited applicability in the sense that it does not apply to the following items:  
(i) forests, plantations and similar regenerative natural resources;  
(ii) wasting assets including expenditure on the exploration for and extraction of minerals;  
(iii) natural gas and similar non-regenerative resources;  
(iv) expenditure on research and development;  
(v) goodwill;  
(v) livestock.  
This statement also does not apply to land unless it has a limited useful life for the enterprise.

**AS-7**  
**QUESTION**  
B Ltd. undertook a construction contract for Rs. 50 crores in April, 2007. The cost of construction was initially estimated at Rs. 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated the cost of completion of the contract at Rs. 53 crores.  
Can the company provide for the expected loss in the book of account for the year ended 31st March, 2008?  

**ANSWER**  
As per para 35 of AS 7 “Construction Contracts”, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Therefore, The foreseeable loss of Rs.3 crores (Rs. 53 crores less Rs. 50 crores) should be recognised as an expense immediately in the year ended 31st march, 2008.

**QUESTION**  
Explain the difference between the fixed price and cost plus contracts?  

**ANSWER**  
A **fixed price contract** is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.  
A **cost plus contract** is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus percentage of these costs or a fixed fee.
When can revenue be recognised in the case of transaction of sale of goods?

As per AS 9 Revenue Recognition, revenue from sales transactions should be recognised when the following requirements as to performance are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection:

(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 goods.

X Limited has recognized Rs. 10 lakhs on accrual basis income from dividend on units of mutual funds of the face value of Rs. 50 lakhs held by it as at the end of the financial year 31st March, 2003. The dividends on mutual funds were declared at the rate of 20% on 15th June, 2003. The dividend was proposed on 10th April, 2003 by the declaring company. Whether the treatment is as per the relevant Accounting Standard?

As per paragraphs 8.4 and 13 of Accounting Standard 9 on Revenue Recognition, dividends from investments in shares are not recognised in the statement of profit and loss until a right to receive payment is established. In the given case, the dividend is proposed on 10th April, 2003, while it is declared on 15th June, 2003. Hence, the right to receive payment is established on 15th June, 2003. As per the above mentioned paragraphs, income from dividend on units of mutual funds should be recognised by X Ltd. in the financial year ended 31st March, 2004.

The recognition of Rs. 10 lakhs on accrual basis in the financial year 2002-2003 is not as per AS 9 'Revenue Recognition'.

The Board of Directors of X Ltd. decided on 31.3.2007 to increase sale price of certain items of goods sold retrospectively from 1st January, 2007. As a result of this decision the company has to receive Rs.5 lakhs from its customers in respect of sales made from 1.1.2007 to 31.3.2007. But the Company’s Accountant was reluctant to make-up his mind. You are asked to offer your suggestion.

As per para 10 of AS 9 ‘Revenue Recognition’, the additional revenue on account of increase in sales price with retrospective effect, as decided by Board of Directors of X Ltd., of Rs.5 lakhs to be recognised as income for financial year 2006-07, only if the company is able to assess the ultimate collection with reasonable certainty. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.
QUESTION
Enumerate any three main items of revenue on which AS-9 does not apply?

ANSWER
This Statement does not deal with the following aspects of revenue recognition to which special considerations apply:
(i) Revenue arising from construction contracts;
(ii) Revenue arising from hire-purchase, lease agreements;
(iii) Revenue arising from government grants and other similar subsidies;
(iv) Revenue of insurance companies arising from insurance contracts.

QUESTION
Explain the conditions of recognition of revenue as per AS-9 for following:

ANSWER
(i) Interest: on a time proportion basis taking into account the amount outstanding and the rate applicable;
(ii) Royalties: on an accrual basis in accordance with the terms of the relevant agreement; and
(iii) Dividends from: when the owner’s right to receive payment is Investments in shares established.

AS-10
QUESTION
Provisions contained in the Accounting Standard in respect of Revaluation of fixed assets.

ANSWER
(i) Revaluation of fixed Assets
According to Accounting Standard 10 on “Accounting for Fixed Assets”
(a) When fixed assets are revalued in financial statements, the basis of selection should be an entire class of assets or the selection should be done on a systematic basis. The basis of selection should be disclosed.
(b) The revaluation of any class of assets should not result in the net book value of that class being greater than the recoverable amount of that class of assets.
(c) The accumulated depreciation should not be credited to profit and loss account.
(d) The net increase in book value should be credited to a revaluation reserve account.
(e) On disposal of a previously revalued item of fixed asset, the difference between net disposal proceeds and the net book value should be charged or credited to the profit and loss account except that to the extent to which such a loss is related to an increase and which has not been subsequently reversed or utilised may be charged directly to that account.

QUESTION
Valuation of fixed assets in special cases.

ANSWER
Para 15 of Accounting Standard 10 on “Accounting for Fixed Assets” states the following provisions regarding valuation of fixed assets in special cases:
1. In the case of fixed assets acquired on hire purchase terms, although legal ownership does not vest in the enterprise, such assets are recorded at their cash value, which if not readily available, is calculated by assuming an appropriate rate of interest. They are shown in the balance sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof.
2. Where an enterprise owns fixed assets jointly with others (otherwise than as a partner in a firm), the extent of its share in such assets, and the proportion in the original cost, accumulated depreciation and written down value are stated in the balance sheet. Alternatively, the pro rata cost of such jointly owned assets is grouped together with similar fully owned assets. Details of such jointly owned assets are indicated separately in the fixed assets register.

3. Where several assets are purchased for a consolidated price, the consideration is apportioned to the various assets on a fair basis as determined by competent valuers.

**QUESTION**
Ram Co. (P) Ltd. furnishes you the following information for the year ended 31.3.2005:
- Depreciation for the year ended 31.3.2005 (under straight line method) Rs. 100 lakhs
- Depreciation for the year ended 31.3.2005 (under written down value method) Rs. 200 lakhs
- Excess of depreciation for the earlier years calculated under written down value method over straight line method Rs. 500 lakhs

The Company wants to change its method of claiming depreciation from straight line method to written down value method. Decide, how the depreciation should be disclosed in the Financial Statement for the year ended 31.3.2005.

**ANSWER**
The deficiency or surplus arising from retrospective recomputation should be adjusted in the accounts in the year in which the method of depreciation is changed. The deficiency should be charged to profit and loss account. Similarly, any surplus should be credited in the statement of profit and loss. Such change is a change in the accounting policy, and its effect should be quantified and disclosed.

In the given case, the deficiency of Rs. 500 lakhs would be charged to the profit and loss account of 31.3.2005. In the notes to account, the fact of change in method of depreciation should be elaborated along with the effect of Rs. 500 lakhs. The current depreciation charge of 200 lakhs determined in accordance with the written down value method should be debited to the profit and loss account.

**QUESTION**
AS-10 excludes certain items from its ambit. In the light of above statement mention any 3 items on which AS-10 is not applicable?

**ANSWER**
This AS does not deal with accounting for the following items to which special considerations apply:
(i) forests, plantations and similar regenerative natural resources;
(ii) wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources;
(iii) expenditure on real estate development; and
(iv) livestock.
### QUESTION
What is the cost of self generated asset as per AS-10?

**ANSWER**
The cost of a self-constructed fixed asset should comprise those costs that relate directly to the specific asset and those that are attributable to the construction activity in general and can be allocated to the specific asset.

### QUESTION
At what value should the assets acquired in exchange or for consideration in kind should be recorded in books as per AS-10?

**ANSWER**
When a fixed asset is acquired in exchange or in part exchange for another asset, the cost of the asset acquired should be recorded either at fair market value or at the net book value of the asset given up, adjusted for any balancing payment or receipt of cash or other consideration. For these purposes fair market value may be determined by reference either to the asset given up or to the asset acquired, whichever is more clearly evident. Fixed asset acquired in exchange for shares or other securities in the enterprise should be recorded at its fair market value, or the fair market value of the securities issued, whichever is more clearly evident.

### QUESTION
Explain the accounting treatment on revaluation of fixed assets?

**ANSWER**
An increase in net book value arising on revaluation of fixed assets should be credited directly to owner's interests under the head of revaluation reserve, except that, to the extent that such increase is related to and not greater than a decrease arising on revaluation previously recorded as a charge to the profit and loss statement, it may be credited to the profit and loss statement. A decrease in net book value arising on revaluation of fixed asset should be charged directly to the profit and loss statement except that to the extent that such a decrease is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilised, it may be charged directly to that account.

### AS-11 QUESTION
Discuss the treatment of exchange loss relating to fixed assets as per AS 11 vis – a – vis the Schedule VI disclosure under the Companies Act, 1956.

**ANSWER**
Schedule VI to The Companies Act, 1956 provides that any increase or decrease in liability due to change in the rate of exchange relating to any fixed asset should be added to or deducted from the cost of the asset. The amount arrived at should be taken to be the cost of the fixed asset. AS 11 (revised), however, does not require adjustment of exchange difference in the carrying amount of fixed assets. The exchange difference is required to be recognised in the statement of profit or loss since it is felt that this treatment is conceptually preferable to that required in Schedule VI and is in consonance with the international position in this regard.
The provisions of AS 11 will prevail over Schedule VI of the Companies Act. National Advisory Committee on Accounting Standards (NACAS) has notified AS 11 for preparation of financial statements of companies. ICAI has come up with the
announcement in this regard, stating that after the notification of AS 11 by NACAS, AS 11 will overrule Schedule VI of the Companies Act.

**QUESTION**

S Ltd. purchased fixed assets costing `3,000 lakhs on 1.1.2010 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = `40.00 and `42.50 as on 1.1.2010 and 31.12.2010 respectively. First instalment was paid on 31.12.2010. The entire difference in foreign exchange has been capitalized.

You are required to state, how these transactions would be accounted for.

**ANSWER**

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.

Calculation of Exchange Difference:

Foreign currency loan = 

\[
\frac{3,000 \text{ lakhs}}{75 \text{ lakhs}} = 40 \text{ US Dollars}
\]

Exchange difference = 75 lakhs US Dollars \((42.50 - 40.00)\)

\[= `187.50 \text{ lakhs}\]

(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.

**AS-12**

**QUESTION**

How the government grants related to specific fixed assets should be presented in the Balance Sheet as per AS–12?

**ANSWER**

Paragraphs 8 and 14 of AS 12 on Accounting for Government Grants deal with presentation of government grants relates to specific fixed assets. Government grants related to specific fixed assets should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value. Where the grant related to a specific fixed asset equals the whole, or virtually the whole, of the cost of the asset, the asset should be shown in the balance sheet at a nominal value. Alternatively, government grants related to depreciable fixed assets may be treated as deferred income which should be recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset, i.e., such grants should be allocated to income over the periods and in proportion in which depreciation on those assets is charged. Grants related to non-depreciable assets should be credited to capital reserve under this method. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations,
the grant should be credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income balance should be separately disclosed in the financial statements.

**QUESTION**

*X Ltd.* received a grant of Rs. 2 crores from the Central Government for the purpose of a special Machinery during 1998-99. The cost of Machinery was Rs. 20 crores and had a useful life of 9 years. During 2002-03, the grant has become refundable due to non-fulfillment of certain conditions attached to it. Assuming the entire grant was deducted from the cost of Machinery in the year of acquisition.

State with reasons, the accounting treatment to be followed in the year 2002-03.

**ANSWER**

As per para 11.3 of AS 12 on Accounting for Government Grants, the amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset. Depreciation on the revised book value is provided prospectively over the residual useful life of the asset. In the given case, book value of machinery will be increased by Rs. 2 crores in the year 2002-2003.

The computations for the depreciation on machinery can be given as:

- Cost of machinery Rs. 20 crores
- Less: Grant received Rs. 2 crores
- Cost of machinery Rs. 18 crores
- Useless life of machinery 9 years
- Depreciation per year as per straight line method Rs. 18 crores/9 (assuming residual value to be zero) = Rs. 2 crores
- Total depreciation for 4 years (1998-99 to 2001-2002) Rs. 8 crores
- Book value (in year 2002-2003) Rs. 10 crores
- Add: Grant refunded Rs. 2 crores
- Revised book value Rs. 12 crores
- Remaining useful life 5 years
- Revised annual depreciation Rs. 12 crores/5 = 2.4 crores

Thus, book value of machinery will be Rs. 12 crores in the year 2002-2003 and the depreciation amounting Rs. 2.4 crores will be charged on machinery. **Annual depreciation of Rs. 2.4 crores will be charged in the next four years.**

**QUESTION**

How refund of revenue grant received from the Government is disclosed in the Financial Statements?

**ANSWER**

The amount refundable in respect of a grant related to revenue should be applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount should be charged to profit and loss statement. The amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value
should be provided prospectively over the residual useful life of the asset.

**QUESTION**
*Explain the treatment of Refund of Government Grants as per AS-12.*

**ANSWER**
As per para 11 of AS 12 ‘Accounting for Government Grants’, government grant that becomes refundable is treated as an extraordinary item. The amount refundable in respect of a government grant related to revenue is first applied against any unamortised deferred credit remaining in respect of the grant. The amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. Where a grant which is in the nature of promoters’ contribution becomes refundable, in part or in full, to the government on non-fulfillment of some specified conditions, the relevant amount recoverable by the government is reduced from the capital reserve.

**QUESTION**
Wye Ltd. received Rs.50 lacs from the Central Government as subsidy for setting up an industry in backward area. How will you treat it in accounts?

**ANSWER**
As per para 10 of AS 12 on ‘Accounting for Government Grants’, subsidy of Rs.50 lacs from the Central government, for setting up an industry in backward area is a government grant in the nature of promoter’s contribution. Such grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

**AS-13 QUESTION**
*Briefly explain disclosure requirements for Investments as per AS-13.*

**ANSWER**
The disclosure requirements as per para 35 of AS 13 are as follows:
(i) Accounting policies followed for valuation of investments.

(ii) Classification of investment into current and long term in addition to classification as per Schedule VI(revised) of Companies Act in case of company.

(iii) The amount included in profit and loss statements for:
(a) Interest, dividends and rentals for long term and current investments, disclosing therein gross income and tax deducted at source thereon;
(b) Profits and losses on disposal of current investment and changes in carrying amount of such investments;
(c) Profits and losses and disposal of long term investments and changes in carrying amount of investments.

(iv) Aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments;

(v) Any significant restrictions on investments like minimum holding period for sale/disposal, utilization of sale proceeds or non-remittance of sale proceeds of investment held outside India.
(vi) Other disclosures required by the relevant statute governing the enterprises.

**QUESTION**
A manufacturing company purchased shares of another company from stock exchange on 1st May, 2007 at a cost of Rs.5,00,000. It also purchased Gold of Rs.2,00,000 and Silver of Rs.1,50,000 on 1st April, 2005. How will you treat these investments as per the applicable AS in the books of the company for the year ended on 31st March, 2008, if the values of these investments are as follows:

<table>
<thead>
<tr>
<th>Item</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shares</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Gold</td>
<td>4,00,000</td>
</tr>
<tr>
<td>Silver</td>
<td>2,50,000</td>
</tr>
</tbody>
</table>

**ANSWER**
As per para 32 of AS 13 on ‘Accounting for Investments’, any investment of long term period is shown at cost. Hence, the investment in Gold and Silver (purchased on 1st April 2005) shall continue to be shown at cost i.e., Rs.2,00,000 and Rs.1,50,000 respectively as their value have increased.

Also as per AS 13, for investment in shares - if the investment is for short-term period then the loss of Rs.3,00,000 is to be charged to profit & loss account for the year ended 31st March, 2008. If investment is of long term period then it will continue to be shown at cost in the Balance Sheet of the company. 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.

**QUESTION**
Explain the classification of investments as per AS-13?

**ANSWER**
Investments are classified as Long Term Investments and Current Investments. Current investments are in the nature of current assets, although the common practice may be to include them in investments.

Investments other than current investments are classified as long-term investments, even though may be readily marketable.

**AS-14 QUESTION**
Briefly describe the disclosure requirements for amalgamation including additional disclosure, if any, for different methods of amalgamation as per AS–14.

**ANSWER**
The disclosure requirements for amalgamations have been prescribed in paragraphs 43 to 46 of AS 14 on Accounting for Amalgamation.

For all amalgamations, the following disclosures should be made in the first financial statements following the amalgamation:
(a) names and general nature of business of the amalgamating companies;
(b) the effective date of amalgamation for accounting purpose;
(c) the method of accounting used to reflect the amalgamation; and
(d) particulars of the scheme sanctioned under a statute.

For amalgamations accounted under the **pooling of interests method**, the following **additional disclosures** should be made in the first financial statements following the amalgamation:
(a) description and number of shares issued, together with the percentage of each
company’s equity shares exchanged to effect the amalgamation; and
(b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.
For amalgamations, accounted under the purchase method, the following additional disclosures should be made in the first financial statements following the amalgamation;
(a) consideration for the amalgamation and a description of the consideration paid or contingently payable; and
(b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortisation of any goodwill arising on amalgamation.

QUESTION
Briefly explain the methods of accounting for amalgamation as per Accounting Standard-14.

ANSWER
As per AS 14 on ‘Accounting for Amalgamations’, there are two main methods of accounting for amalgamations:
(i) *The Pooling of Interest Method*
Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (after making the necessary adjustments). If at the time of amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with AS 5 on ‘Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies’.
(ii) *The Purchase Method*
Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company. Where assets and liabilities are restated on the basis of their fair values, the determination of fair values may be influenced by the intentions of the transferee company.

QUESTION
When *Capitalisation of borrowing cost should cease as per Accounting Standard 16?*

ANSWER
Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user’s specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.
**QUESTION**

On 20.4.2003 JLC Ltd. obtained a loan from the Bank for Rs. 50 lakhs to be utilised as under:

- Construction of a shed 20 lakhs
- Purchase of machinery 15 lakhs
- Working capital 10 lakhs
- Advance for purchase of truck 5 lakhs

In March, 2004 construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ending 31.3.2004 was Rs. 9 lakhs. Show the treatment of interest under AS 16.

**ANSWER**

<table>
<thead>
<tr>
<th>PARTICULARS</th>
<th>NATURE</th>
<th>INTEREST CAPITALIZED</th>
<th>INTEREST CHARGED TO P &amp; L</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Construction of a shed</td>
<td>Q.A.</td>
<td>= Rs. 3.60 lakhs</td>
<td></td>
</tr>
<tr>
<td>2. Purchase of machinery</td>
<td>NOT Q.A.</td>
<td></td>
<td>Rs. 2.70 lakhs</td>
</tr>
<tr>
<td>3. Working capital</td>
<td>NOT Q.A.</td>
<td></td>
<td>Rs. 1.80 lakhs</td>
</tr>
<tr>
<td>4. Advance for purchase of truck</td>
<td>NOT Q.A.</td>
<td></td>
<td>Rs. 0.90 lakhs</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td><strong>Rs.3.60 lakhs</strong></td>
<td><strong>Rs.5.40 lakhs</strong></td>
</tr>
</tbody>
</table>

On the basis that machinery is ready for its intended use at the time of its acquisition/purchase.

**AS-19 QUESTION**

State the different types of Leases contemplated in Accounting Standard 19 and discuss briefly.

**ANSWER**

Accounting Standard 19 has divided the lease into two types viz.

(i) Finance Lease and
(ii) Operating Lease.

**Finance Lease**: A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. Title may or may not eventually be transferred. At the inception of a finance lease, the lessee should recognise the lease as an asset and a liability. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of the lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of the minimum lease payments from the standpoint of the lessee.

**Operating Lease**: A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership. Lease payments under an operating lease should be recognised 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**

S&P Ltd. availed a lease from N&S Ltd. The conditions of the lease terms are as under:

(i) Lease period is 3 years, in the beginning of the year 2009, for equipment costing `10,00,000 and has an expected useful life of 5 years.

(ii) The Fair market value is also `10,00,000.

(iii) The property reverts back to the lessor on termination of the lease.

(iv) The unguaranteed residual value is estimated at `1,00,000 at the end of the year 2011.

(v) 3 equal annual payments are made at the end of each year.

Consider IRR = 10%.

The present value of `1 due at the end of 3rd year at 10% rate of interest is `0.7513.

The present value of annuity of `1 due at the end of 3rd year at 10% IRR is `2.4868.

State whether the lease constitute finance lease and also calculate unearned finance income.

**ANSWER**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of equipment</td>
<td>`10,00,000</td>
</tr>
<tr>
<td>Unguaranteed residual value</td>
<td>`1,00,000</td>
</tr>
<tr>
<td>Present value of residual value after third year @ 10%</td>
<td>`75,130</td>
</tr>
<tr>
<td>Fair value to be recovered from lease payments</td>
<td>`9,24,870</td>
</tr>
<tr>
<td>Present value of annuity for three years is</td>
<td>`3,71,911.70</td>
</tr>
<tr>
<td>Annual lease payment</td>
<td>(`9,24,870/</td>
</tr>
<tr>
<td></td>
<td>`2.4868)</td>
</tr>
</tbody>
</table>

The present value of lease payment i.e., `9,24,870 equals 92.48% of the fair market value i.e., 10,00,000. As the present value of minimum lease payments substantially covers the initial fair value of the leased asset and lease term (i.e. 3 years) covers the major part of the life of asset (i.e. 5 years). Therefore, it constitutes a finance lease.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total lease payments (`3,71,911.70 x 3)</td>
<td>`11,15,735</td>
</tr>
<tr>
<td>Add: Unguaranteed residual value</td>
<td>`1,00,000</td>
</tr>
<tr>
<td>Gross investment in the lease</td>
<td>`12,15,735</td>
</tr>
<tr>
<td>Less: Present value of investment (lease payments and residual value) (<code>75,130 + </code>9,24,870)</td>
<td>(`10,00,000)</td>
</tr>
<tr>
<td>Unearned finance income</td>
<td>`2,15,735</td>
</tr>
</tbody>
</table>
**AS-20**

**QUESTION**
Briefly describe, how do you calculate "Diluted Earnings per Share" as per Accounting Standard 20.

**ANSWER**
For the purpose of calculating diluted 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.

The amount of net profit or loss for the period attributable to equity shareholders should be adjusted, after taking into account any attributable change in tax expense for the period.

The number of equity shares should be the aggregate of the weighted average number of equity shares (as per paragraphs 15 and 22 of AS 20) and the weighted average number of equity shares which would be issued on the conversion of all the dilutive potential equity shares into equity shares. Dilutive potential equity shares should be deemed to have been converted into equity shares at the beginning of the period or, if issued later, the date of the issue of the potential equity shares. An enterprise should assume the exercise of dilutive options and other dilutive potential equity shares of the enterprise. The assumed proceeds from these issues should be considered to have been received from the issue of shares at fair value. The difference between the number of shares issuable and the number of shares that would have been issued at fair value should be treated as an issue of equity shares for no consideration.

Basic earnings per share (EPS) =
Weighted average number of equity shares outstanding during the year = Rs. 3 (i.e. 264000/88000 )
Net profit attributable to equity shareholders

**QUESTION**
A Ltd. had 6,00,000 equity shares on April 1, 2007. The company earned a profit of Rs.15,00,000 during the year 2007-08. The average fair value per share during 2007-08 was Rs.25. The company has given share option to its employees of 1,00,000 equity shares at option price of Rs.15. Calculate basic EPS and diluted EPS.

**ANSWER**
Rs. 2.34
(approx.)

**AS-26**

**QUESTION**
Decide when research and development cost of a project can be deferred to future periods as per AS 26.

**ANSWER**
As per para 41 of AS 26 ‘Intangible Assets’, no intangible asset arising from research should be recognized. The expenditure incurred on development phase can be deferred to the subsequent years if the company can demonstrate all of the following conditions (as specified in para 44 of AS 26 ‘Intangible Assets’):
(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;
(b) its intention to complete the intangible asset and use or sell it;
(c) its ability to use or sell the intangible asset;
(d) how the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;
(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
(f) its ability to measure the expenditure attributable to the intangible asset during its development reliably.

QUESTION

How is software acquired for internal use accounted for under AS-26?

ANSWER

Paragraphs 10 and 11 of Appendix A to the Accounting Standard 26 on Intangible Assets, lays down the following procedure for accounting of software acquired for internal use:-

- The cost of a software acquired for internal use should be recognised as an asset if it meets the recognition criteria prescribed in paragraphs 20 and 21 of this statement.
- The cost of a software purchased for internal use comprises its purchase price, including any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities) and any directly attributable expenditure on making the software ready for its use.

Any trade discounts and rebates are deducted in arriving at the cost.

QUESTION

A Company had deferred research and development cost of Rs. 150 lakhs. Sales expected in the subsequent years are as under:

<table>
<thead>
<tr>
<th>Years</th>
<th>Sales (Rs. in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>400</td>
</tr>
<tr>
<td>II</td>
<td>300</td>
</tr>
<tr>
<td>III</td>
<td>200</td>
</tr>
<tr>
<td>IV</td>
<td>100</td>
</tr>
</tbody>
</table>

You are asked to suggest how should Research and Development cost be charged to Profit and Loss account.

If at the end of the III year, it is felt that no further benefit will accrue in the IV year, how the unamortised expenditure would be dealt with in the accounts of the Company?

ANSWER

Based on sales, research and development cost to be allocated as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Research and Development cost allocation (Rs. in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>60</td>
</tr>
<tr>
<td>II</td>
<td>45</td>
</tr>
<tr>
<td>III</td>
<td>30</td>
</tr>
<tr>
<td>IV</td>
<td>15</td>
</tr>
</tbody>
</table>

(ii) If at the end of the III year, the circumstances do not justify that further benefit will accrue in IV year, then the company has to charge the unamortised amount i.e. remaining Rs. 45 lakhs [150 – (60 + 45)] as an expense immediately.
**QUESTION**

An intangible asset appears in Balance Sheet of A Co. Ltd. at Rs. 16 lakhs as on 31.3.2004. The asset was acquired for Rs. 40 lakhs in April, 1991. The Company has been amortising the asset value on straight line basis. The policy is to amortise for 20 years. Do you advise the Company to amortise the entire asset value in the books of the company as on 31.3.2004?

**ANSWER**

AS 26 ‘Intangible Assets’, came into effect for accounting periods commencing on or after 1.4.2003 and is mandatory in nature. Para 67 of the standard provides that if there is persuasive evidence that the life of the intangible asset is 20 years, then no adjustment is required at 1.4.2003. However, para 63 of the standard states that if it cannot be demonstrated that the life of the intangible asset is greater than 10 years, then AS 26 would require the asset to be amortised over not more than 10 years. Since, in the given case, the amortisation period determined by applying para 63 has already expired as on 1.4.2003, the carrying amount of Rs. 16 lakhs would be required to be eliminated with a corresponding adjustment to the opening balance of revenue reserves as on 1.4.2003.

**AS-29 QUESTION**

There is a sales tax demand of Rs. 2.50 crores against a company relating to prior years against which the company has gone on appeal to the appellate authority in the department. The grounds of appeal deal with points covering Rs. 2 crores of the demand. State how the matter will have to be dealt with in the final accounts for the year.

**ANSWER**

The undisputed part of sales tax liability of Rs. 0.50 crore should be considered as actual liability and adequately provided for. The Institute of Chartered Accountants of India has issued Accounting standard 29 on “Provisions Contingent Liabilities and Contingent Assets” (comes into effect in respect of accounting periods commencing on or after 1.4.2004). According to the standard, an enterprise should not recognise a contingent liability but should disclose it, as required by paragraph 68, unless the possibility of an outflow of resources embodying economic benefits is remote. Accordingly the company should disclose the disputed part of sales tax liability of Rs. 2 crore as contingent liability in their financial statements of the year. However, the above disclosed contingent liability should be reviewed continuously and if it becomes probable that an outflow of future economic benefit will be required, then recognise the contingent liability as a provision.

**QUESTION**

An airline is required by law to overhaul its aircraft once in every five years. A company which operates aircrafts does not provide any provision as required by law in its final account. Discuss with reference to relevant Accounting Standard.

**ANSWER**

A provision should be recognised only when an enterprise has a present obligation as a result of a past event. In the given case, there is no present obligation, therefore no provision is recognized as per AS 29 ‘Provisions, Contingent Liabilities and Contingent Assets’.

The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company’s decision to continue operating the aircrafts. Even a legal requirement to overhaul does not require
the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts. Further, the enterprises can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation after completion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime. A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than five years.