

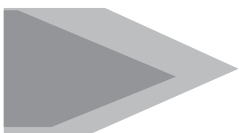


AVINASH LALA CLASSES

CMA INTER FINANCIAL ACCOUNTING AS Question Bank

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List of Important Links for CMA Inter Students

1. FA Marathon

https://youtube.com/playlist?list=PLCfhRcWosrzY5Z_Xmn4RARfPmpVEwILnj&si=tA0A5zKF57XSPrDe

2. FA MQP June 24 Set 1 Solution

<https://youtu.be/000r2BolQbA?si=SK3u-ya09bQx2ev1>

3. FA Dec-23 Paper Solution Video

https://youtu.be/UTRib65IW_4?si=ijWQXnqmK5n1rWmM

4. FA Dec-23 Paper Solution PDF

https://t.me/Intermediate_Accounts_and_Tax/22

5. FA Detailed Chapter wise Detailed Revision

<https://www.youtube.com/playlist?list=PLCfhRcWosrzbwh6JUgctNOq3tn7kWXN43>

6. FA Handwritten Notes

<https://www.avinashlalaclasses.com/product/cma-inter-financial-account-handwritten-notes>

7. Corporate Accounting Handwritten Notes

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AS-1: DISCLOSURE OF ACCOUNTING POLICIES

Question-1

Explain in short, the relevant disclosure of Accounting Policies as per AS-1.

(2022 Syllabus June-23, 3 Marks)

Solution

As per AS1, the disclosure of Accounting policies, all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

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. Any change in the accounting policies which has a material effect in the current periods should be disclosed. 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. 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 to be disclosed.

Question-2

State whether the following statements are 'True' or 'False'. Also give reason for your answer.

- Certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.
- If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.
- All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.
- Any change in an accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need not to be indicated.
- There is no single list of accounting policies which are applicable to all Circumstances.

(2016 Syllabus Dec-21 and Dec-22, 5 Marks)

Solution

- False;** As per AS 1 "Disclosure of Accounting Policies", certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.



- b. **False;** As per AS 1, 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.
- c. **True;** To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed in one place.
- d. **False;** 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. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.
- e. **True;** As per AS1, there is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable.

Question-3

Jivandeep Ltd. had made a right issue in 2020. In the offer document to its members, it had projected a surplus of ₹ 40 crores during the accounting year to be ended on 31st March 2022. The draft results for the year prepared on the hitherto followed accounting policies and presented for perusal of the Board of Directors showed a deficit of ₹ 10 crores. The Board, in consultation with the Managing Director, decided on the following:

- a. **Value year-end inventory at works cost (₹50 crores) instead of the hitherto method of valuation of inventory at Prime Cost (₹ 30 crores).**
- b. **Provide depreciation for the year on straight line basis or account of substantial additions in gross block during the year, instead of on the Reducing Balance Method, which had been hitherto adopted. As a consequence, the charge for depreciation at ₹ 27 crores is lower than the amount of ₹ 45 crores -which would have been provided had the old method been followed-by ₹ 18 crores.**
- c. **Not to provide for “after-sales expenses” during the warranty period. Till the last year, provision at 2% on sales used to be made under the concept of “matching of cost against revenue” and actual expenses used to be charged against the provision. The Board now decided to account for expenses as and when actually incurred. Sales during the year total to ₹ 600 crores.**
- d. **Provide for permanent fall in the value of investment-which fall had taken place over the past 5 years-the provision being ₹ 10 crores. As chief accountant of the company, you are asked by the Managing Director to draft the Notes on Accounts for inclusion in the annual report for 2021-2022.**

Solution

According to AS 1: “in the case of a change in accounting policies which has a material effect in the current period should be disclosed, 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.” Naturally, the Notes on Accounts must disclose the change.

Notes on Accounts

- Till last year, it was the practice of valuing inventory at prime cost but during the year the same was valued at works cost. Due to this change the closing inventory was valued at ₹ 50 crores and, accordingly, profit was increased by ₹ 20 crores (i.e. ₹ 50 crores - ₹ 30 crores) due to the change of the method of valuation.
- During the year the company decided to change the method of providing for depreciation from reducing balance method to straight line method. Due to this change, the amount of depreciation was undercharged i.e., instead of charging ₹ 45 crores it was charged by ₹ 27 crores and, as a consequence, the profit was increased by ₹ 18 crores (i.e., ₹ 45 crores minus ₹ 27 crores).
- It was the practice of the company to make provision of @ 2% on sales for ‘After-Sales expenses’ during the warranty period. It may be assumed that as a result of improved techniques and methods in production the possibility of defects became very rare. Consequently, the company took decision not to make any provision for after -sales expense’ during warranty period. As a result of this change, the profit would be increased by ₹ 12 crores.
- As a result of permanent fall in the value of investments which took place over the last 5 years the company decided to make provision to the extent of ₹ 10 crores. Due to this effect the profit would be reduced by ₹ 10 crores.

Question-4

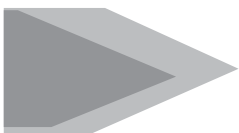
ABC Ltd. was making provision for non-moving inventories based on no issues for the last 12 months up to 31.3.2019.

The company wants to provide during the year ending 31.3.2020 based on technical evaluation:

Particulars	Amount (₹)
Total value of inventory	100 lakhs
Provision required based on 12 months issue	3.5 lakhs
Provision required based on technical evaluation	2.5 lakhs

Does this amount to change in Accounting Policy? Can the company change the method of provision?

Solution



The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting Policy. Accounting policy of a company may require that provision for non-moving inventories should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made. In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory 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 ABC Ltd. for the year 2019-20:

“The company has provided for non-moving inventories 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 lower by ₹ 1 lakh.”

AS-10: PROOPERTY PLANT AND EQUIPMENT

Question-1

A Ltd. has incurred the following costs. Determine if the following costs can be added to the invoiced purchase price and included in the initial recognition of the cost of the item of property, plant and equipment:

1. Import duties paid
2. Shipping costs and cost of road transport for taking the machinery to factory
3. Insurance for the shipping
4. Inauguration costs for the factory
5. Professional fees charged by consulting engineer for the installation process
6. Costs of advertising and promotional activities
7. Administration and other general overhead costs
8. Cost of site preparation.

Solution

Included in Cost: Point no. 1,2,3,5,8

Excluded from Cost: Point no. 4,6,7

Question-2

A Ltd. is installing a new plant at its production facility. It has incurred these costs:

Particulars	Amount (₹)
Cost of the plant (cost per supplier's invoice plus taxes)	50,00,000
Initial delivery and handling costs	4,00,000
Cost of site preparation	12,00,000
Consultants used for advice on the acquisition of the plant	14,00,000
Interest charges paid to supplier of plant for deferred credit	4,00,000
Estimated dismantling costs to be incurred after 7 years (PV)	6,00,000
Operating losses before commercial production	8,00,000

Advise A Ltd. on the costs that can be capitalized in accordance with AS – 10.

Solution

According to AS-10, these costs can be capitalized:

Particulars	Amount (₹)
Cost of the plant	50,00,000
Initial delivery and handling costs	4,00,000
Cost of site preparation	12,00,000

Consultants' fees	14,00,000
Estimated dismantling costs to be incurred after 7 years	6,00,000
	86,00,000

Note: Interest charges paid on "deferred credit terms" to the supplier of the plant (is not a qualifying asset) of ₹ 4,00,000 and operating losses before commercial production amounting to ₹ 8,00,000 are not regarded as directly attributable costs and thus cannot be capitalized. They should be written off to the income statement in the period in which they are incurred. The current Standard applies the two basic recognition criteria referred to above to all expenditures. If the two basic criteria are satisfied, then the cost should be recognized as an asset. If the cost of the replaced asset was not separately identifiable, then the cost of the replacement can be used as an indication of the cost of the replaced item, which should be removed from the asset record.

Question-3

JIMIRA LTD. bought a machine on 30.09.2014 at a price of ₹ 248 Lakh after charging 6% GST and giving a trade discount of 1.3% on the quoted price. Transport charges and installation charges were 0.30% and 0.75% respectively on the quoted price. To meet machine, purchase a loan of ₹ 240 lakh was taken from the bank on which interest at 12% P.A. was to be paid. Expenditure incurred on trial run was materials, wages and overheads ₹ 24,000, ₹ 18,000 and ₹ 11,000 respectively. Machine was ready for use on 01.12.2014. However, it was actually put to use only on 01.05.2015. Entire loan amount remains unpaid on 01.05.2015. Required:

Find the cost of machine as per AS – 10.

(June-15, 4 Marks)

Solution

Calculation of Cost of machine (As per AS – 10)

Particulars	Amount (₹)
Machine cost price $(2,48,00,000 \times 100/106 \times 100/98.70)$ (Given price related after charging sales tax and trade discount)	2,37,04,383
Less: Trade discount $(2,37,04,383 \times 1.3/100)$	3,08,157
	2,33,96,226
Add: GST $(2,33,96,226 \times 6/100)$	14,03,774
	2,48,00,000
Transport charges (0.30% on ₹ 2,37,04,383)	71,113
	2,48,71,113
Installation charges (0.75% on 2,37,04,383)	1,77,783



Add: Incurred Expenses for trial run		
Materials	24,000	
Wages	18,000	
Overheads	11,000	53,000
Borrowings costs (Interest) (240 lakh × 0.12 × 2/12)	4,80,000	5,33,000
Total Cost		2,55,81,896

Alternative Solution:

If the student considers the definition of Qualifying Asset as per AS – 16 while considering the Borrowing Cost (as in the question given the asset gets ready for its intended use only within 2 months i.e. 30.09.2014 to 30.11.2014)

Calculation of Cost of machine (As per – AS – 10)

Particulars	Amount (₹)
Machine cost price (2,48,00,000 × 100/106 × 100/98.70) (Given price related after charging sales tax and trade discount)	2,37,04,383
Less: Trade discount (2,37,04,383 × 1.3/100)	3,08,157
	2,33,96,226
Add: GST (2,33,96,226 × 6/100)	14,03,774
	2,48,00,000
Transport charges (0.30% on ₹ 2,37,04,383)	71,113
	2,48,71,113
Installation charges (0.75% on 2,37,04,383)	1,77,783
	2,50,48,896
Add: Incurred Expenses for trial run	
Materials	24,000
Wages	18,000
Overheads	11,000
	53,000
Total Cost	2,51,01,896

Note:

As per Accounting Standard – 16 (Borrowing Costs) borrowing cost, which is directly related to the acquisition, construction or production of qualifying asset should be capitalized.

[Qualifying Asset is an asset which takes substantial period of time to get ready for its intended use or sale, is called qualifying asset. The “substantial period” of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of 12

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.]

Question-4

Alex. Ltd. intends to set up a solar plant. Alex Ltd. has acquired a dilapidated factory, having an area of 7500 acres at a cost of ₹ 70,000 per acre. Alex Ltd. has incurred ₹ 50,00,000 on demolishing the old factory building thereon. A sum of ₹ 43,57,500 (including 5% Sales Tax) was realized from sale of material salvaged from the site.

Alex Ltd. also incurred Stamp Duty and Registration Charges of 5% of Land Value, paid Legal and Consultancy Charges ₹ 5,00,000 for land acquisition and incurred ₹ 2,00,000 on Title Guarantee Insurance. Compute the value of land acquired.

(June-17, 6 Marks)

Solution

Computation of value of land acquired

Particulars	(₹ in lakhs)
Purchase price @ ₹ 70,000 per acre for 7,500 acres	5,250.00
Stamp duty & registration charges @ 5%	262.50
Legal fees	5.00
Title guarantee insurance	2.00
Demolition expenses	50.00
Less: Sale of salvaged materials (net of tax) (43,57,500×100/105)	(41.50)
Value of land	5,528

Question-5

Star Limited purchased machinery for ₹ 6,80,000 (inclusive of GST of ₹ 40,000). Input credit is available for entire amount of GST paid. The company incurred the following other expense for installation.

Particulars	Amount (₹)
Cost of preparation of site for installation	21,200
Total Labour charges	56,000
(200 out of the total of 500 men hours worked, were spent on installation of the machinery)	
Spare parts and tools consumed in installation	5,000
Total salary of supervisor	26,000
(Time spent for installation was 25% of the total time worked)	
Total administrative expense	34,000

(1/10 relates to the plant installation)	
Test run and experimental production expenses	18,000
Consultancy charges to architect for plant set up	11,000
Depreciation on assets used for installation	12,000

The machine was ready for use on 15.01.2021 but was used from 01.02.2021. Due to this delay further expenses of ₹ 8,900 were incurred.

Calculate the value at which the plant should be capitalized in the books of Star Limited.

Solution

Calculation of Cost of Plant

Particulars		Amount (₹)
Purchase Price	Given	6,80,000
Add: Site Preparation Cost	Given	21,200
Labour charges	(56,000×200/500) Given	22,400
Spare parts		5,000
Supervisor's Salary	25% of ₹ 26,000	6,500
Administrative costs	1/10 of ₹ 34,000	3,400
Test run and experimental production charges	Given	18,000
Architect Fees for set up	Given	11,000
Depreciation on assets used for installation	Given	12,000
Total Cost of Asset		7,79,500
Less: GST credit receivable		(40,000)
Value to be capitalized		7,39,500

Note: Further Expenses of ₹ 8,900 from 15.01.2021 to 01.02.2021 to be charged to profit and loss A/c as plant was ready for production on 15.01.2021.

Question-6

Jay Ltd., a chemical producing company changed a semi-automatic component in an existing machine with a fully-automatic component incurring ₹ 85,000. This new component would result in increasing the output by 150%. The component changing exercise required the company to dismantle a part of the machine and also re-erect the same for which the company incurred ₹ 38,000. How should the costs be treated as per AS 10?

Solution

Cost of new component: As the new component results in increased output, it would result in increasing the future benefits from the machine. So, the cost incurred ₹ 85,000 should be capitalised.

Cost of dismantling and re-erection: ₹ 38,000 incurred towards dismantling and re-erection should be charged to the Statement of Profit and Loss.

Question-7

A Ltd. had following assets. Calculate depreciation for the year ended 31st March, 2020 for each asset as per AS 10 (Revised):

- i. Machinery purchased for ₹10 lakhs on 1st April, 2015 and residual value after useful life of 5 years, based on 2015 prices is ₹10 lakhs.
- ii. Land for ₹50 lakhs.
- iii. A Machinery is constructed for ₹5,00,000 for its own use (useful life is 10 years). Construction is completed on 1st April, 2019, but the company does not begin using the machine until 31st March, 2020.
- iv. Machinery purchased on 1st April, 2017 for ₹50,000 with useful life of 5 years and residual value is NIL. On 1st April, 2019, management decided to use this asset for further 2 years only.

Solution

Computation of amount of depreciation as per AS 10

	Particulars	Amount (₹)
(i)	Machinery purchased on 1/4/15 for ₹10 lakhs (having residual value of ₹10 lakhs) Reason: The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost. Therefore, there is no depreciable amount and depreciation is correctly zero.	Nil
(ii)	Land (50 lakhs) (considered freehold) Reason: Land has an unlimited useful life and therefore, it is not depreciated.	Nil
(iii)	Machinery constructed for own use (₹5,00,000/10) Reason: The entity should begin charging depreciation from the date the machine is ready for use i.e. 1st April, 2019. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.	50,000
(iv)	Machinery having revised useful life Reason: The entity has charged depreciation using the straight-line method at ₹10,000 per annum i.e., (50,000/5 years). On 1st April, 2019	15,000

<p>the asset's net book value is $[50,000 - (10,000 \times 2)]$ i.e., ₹30,000. The remaining useful life is 2 years as per revised estimate. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of 2 years. Consequently, it should charge depreciation for the next 2 years at ₹15,000 per annum i.e. $(30,000 / 2)$ years).</p>	
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Question-8

Machineries which appeared in the books of Dee Ltd. at ₹ 86,00,000 has been revalued at ₹ 90,00,000. The accumulated depreciation associated was ₹ 28,00,000. The accountant suggested that revaluation should be accounted for by adjusting accumulated depreciation account. You are required to discuss the treatment as per AS 10.

Solution

The suggestion of the accountant of Dee Ltd. is incorrect. As per AS 10, when fixed assets are revalued upwards, the increase on account of revaluation should be credited to Revaluation Surplus Account.

Question-9

XYZ Limited provided you the following information for the year ended 31 st March, 2022.

- The carrying amount of a property at the end of the year amounted to ₹ 2,16,000 (cost/value ₹ 2,50,000 and accumulated depreciation ₹ 34,000). On this date the property was revalued and was deemed to have a fair value of ₹ 1,90,000. The balance in the revaluation surplus relating to a previous revaluation gain for this property was ₹ 20,000.

You are required to calculate the revaluation loss as per AS 10 (Revised) and give its treatment in the books of accounts.

- An asset that originally cost ₹ 76,000 and had accumulated depreciation of ₹ 62,000 was disposed of during the year for ₹ 4,000 cash.

You are required to explain how the disposal should be accounted for in the financial statements as per AS 10 (Revised).

Solution

- As per AS 10, a decrease in the carrying amount of an asset arising on revaluation should be charged to the statement of profit and loss. However, the decrease should be debited directly to owners' interests under the heading of revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

Calculation of revaluation loss and its accounting treatment

Particulars		Amount (₹)
Carrying value of the asset as on 31st March, 2022	A	2,16,000
Revalued amount of the asset	B	(1,90,000)

Total revaluation loss on asset	c=a-b	26,000
Adjustment of previous revaluation reserve	D	(20,000)
Net revaluation loss to be charged to the Profit and loss account	e=c-d	6,000

- ii. AS 10 states that the carrying amount of an item of property, plant and equipment is derecognized on disposal of the asset. It further states that the gain or loss arising from the derecognition of an item of property, plant and equipment should be included in the statement of profit and loss when the item is derecognized. Gains should also not be classified as revenue.

Calculation of loss on disposal of the asset and its accounting treatment

Particulars		Amount (₹)
Original cost of the asset	A	76,000
Accumulated depreciation till date	B	62,000
Carrying value of the asset as on 31st March, 2022	c=a-b	14,000
Cash received on disposal of the asset	D	4,000
Loss on disposal of asset charged to the Profit and loss account	e=c-d	10,000

AS-11: THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATE

Question-1

Pass journal entries for initial recognition of following transactions:

Date	Transaction	Amount (\$)	Rate of \$ on transaction date
10-04-2022	Goods sold for cash	10,000	72
28-04-2022	Goods sold on credit	6,000	74.5
25-05-2022	Good purchased on credit	8,000	75
20-06-2022	Salary paid	500	77
15-07-2022	Rent paid	300	78
10-10-2022	Bank loan taken	5,000	80

Question-2

State whether following items are monetary or non-monetary

- a. Inventory
- b. Plant and Machinery
- c. Trade Receivables
- d. Furniture
- e. Bank Loan
- f. Creditors

Question-3

ABC Ltd. borrowed US \$ 5,00,000 on 01/01/2017, which was repaid as on 31/07/2017. ABC Ltd. prepares financial statement ending on 31/03/2017. Rate of Exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

Date	Rate	
01/01/2017	1 US\$	₹68.50
31/03/2017	1 US \$	₹69.50
31/07/2017	1 US \$	₹70.00

You are required to pass necessary journal entries in the books of ABC Ltd. as per AS 11.

Solution**Journal Entries in the Books of ABC Ltd.**

Date	Particulars		₹(Dr.)	₹(Cr.)
2017				
Jan. 01	Bank A/c (5,00,000 x 68.50)	Dr.	3,42,50,000	
	To Foreign Loan A/c			3,42,50,000
Mar. 31	Foreign Exchange Difference A/c	Dr.	5,00,000	
	To Foreign Loan Account [5,00,000 x (69.50-68.50)]			5,00,000
Jul. 31	Foreign Exchange Difference A/c [5,00,000 x (70-69.5)]	Dr.	2,50,000	
	Foreign Loan A/c	Dr.	3,47,50,000	
	To Bank A/c			3,50,00,000

Question-4

M Ltd. sold goods to a US Company for US \$ 1,00,000 on 10.01.2022 and realized the due on 30.06.2022. Y Ltd. closes the books of accounts on 31st March every year. Exchange rates were as follows:

Date	Rate (₹)
10.01.2022	79.20
31.03.2022	86.10
30.06.2022	84.30

Analyse the impact of change in the exchange rate on the reporting date and on the settlement date and comment on their treatment as per AS 11.

Question-5

During the financial year 2021-22, Zeds Ltd., an e-commerce firm entered into a foreign currency transaction relating to fees for technical services paid to a Lucas Ltd., an Atlanta based organisation in the USA. The transaction was for \$24,000, which was entered into on 07.12.2021. The payment for the same was made on 20.05.2022.

Given that the exchange rates are: on 07.12.2021: \$1 = ₹ 68.80; on 01.01.2021: \$1 = ₹ 68.95; on 31.03.2022: \$1 = ₹ 70.45; on 20.05.2022: \$1 = ₹ 71.50.

You are required to:

- ascertain the amount at which the transaction would get recognised in the books; and
- calculate amount of foreign exchange gain/ loss to be recorded in the financial statement for the years 2021-22 and 2022-23.

Solution

- a. As per AS 11, a foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.

∴ Fees for technical services \$24,000 would be recorded on 07.12.2021 applying the exchange rate existing on that date = $24,000 \times ₹ 68.80 = ₹ 16,51,200$.

b. For 2021-22:

On 31.03.2022, Outstanding fees for technical services should be reflected in the balance sheet using the closing rate (\$1 = ₹ 70.45) i.e. $24,000 \times ₹ 70.45 = ₹ 16,90,800$.

∴ Exchange loss to be charged to the Statement of Profit and Loss = ₹ (16,90,800 – 16,51,200) = ₹ 39,600.

For 2022-23:

On 20.05.2022, Outstanding fees for technical services paid should be recognised using the existing rate (\$1 = ₹ 71.50) i.e., $24,000 \times ₹ 71.50 = ₹ 17,16,000$.

∴ Exchange loss on settlement to be charged to the Statement of Profit and Loss = ₹ (17,16,000 – 16,90,800) = ₹ 25,200.

Question-6

- i. ABC Ltd. an Indian Company obtained long term loan from WWW private Ltd., a U.S. company amounting to ₹ 30,00,000. It was recorded at US \$1 = ₹ 60.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2018) was US \$1 = ₹ 62.00.
- ii. Trade receivable includes amount receivable from Preksha Ltd., ₹ 10,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US \$1 = ₹ 59.00. The exchange rate on balance sheet date (31.03.2018) was US \$1 = ₹ 62.00.

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of ABC Ltd.

Solution

Amount of Exchange difference and its Accounting Treatment

	Particulars	Foreign Currency Rate	Amount (₹)
	Long term Loan		
(i)	Initial Recognition (30,00,000/60) = US \$ 50,000	1 US \$ = ₹ 60	30,00,000
	Rate on Balance sheet date	1 US \$ = ₹ 62	
	Exchange Difference Loss US \$ 50,000 x ₹ (62 – 60)		1,00,000

	Treatment: Credit Loan A/c and Debit Profit and Loss A/c by ₹ 1,00,000		
	Trade receivables		
(ii)	Initial Recognition (₹10,00,000/59) US \$ 16,949.152*	1 US \$ = ₹ 59	10,00,000
	Rate on Balance sheet date	1 US \$ = ₹ 62	
	Exchange Difference Gain US \$ 16,949.152* x ₹ (62-59)		50,847.456*
	Treatment: Credit Profit and Loss A/c by ₹ 50,847.456* And Debit Trade Receivables		

Question-7

Subhash Ltd. purchased a machine costing ₹ 216 lakhs on 1.4.2021 and the same was fully financed by foreign currency loan (US \$) payable in three annual equal instalments. Exchange rates were \$1 = ₹ 67.50 and ₹ 70.45 as on 1.4.2021 and 31.03.2022 respectively. First instalment was paid on 31.03.2022. The entire difference in foreign exchange has been capitalized. Advice how the exchange gain/ loss should be accounted for by the company.

Solution

Cost of machine (in US\$) = ₹ 2,16,00,000/ 67.50 = \$3,20,000.

∴ Exchange loss on payment of first instalment = 3,20,000 × ₹ (70.45 – 67.50) = ₹ 9,44,000.

This entire loss due to exchange differences amounting ₹ 9,44,000 should be charged to the Statement of Profit and Loss.

Question-8

AXE Limited purchased fixed assets costing \$ 5,00,000 on 1st Jan. 2018 from an American company M/s M&M Limited. The amount was payable after 6 months. The company entered into a forward contract on 1st January 2018 for five months @ ₹ 62.50 per dollar. The exchange rate per dollar was as follows:

On 1st January, 2018 ₹ 60.75 per dollar

On 31st March, 2018 ₹ 63.00 per dollar

You are required to state how the profit or loss on forward contract would be recognized in the books of AXE Limited for the year ending 2017-18, as per the provisions of AS 11.

Solution

As per AS 11 “The Effects of Changes in Foreign Exchange Rates”, an enterprise may enter into a forward exchange contract to establish the amount of the reporting currency required, the premium or discount arising at the inception of such a forward exchange contract should be amortized as expenses or income over the life of the contract.

Forward Rate ₹ 62.50

Less: Spot Rate (₹ 60.75)

Premium on Contract ₹ 1.75



Contract Amount US\$ 5,00,000

Total Loss (5,00,000 x 1.75) ₹ 8,75,000

Contract period 5 months

3 months falling in the year 2017-18; therefore, loss to be recognized in 2017-18 $(8,75,000/5) \times 3 = ₹ 5,25,000$. Rest ₹ 3,50,000 will be recognized in the following year 2018-19.

AS-12: ACCOUNTING FOR GOVERNMENT GRANT

Question-1

Suggest two approaches of accounting for government grant.

Solution

There are two broad approaches which can be adopted for the accounting treatment of Government grants. They are:

- a. Capital approach; and
- b. Income approach.

It is generally considered appropriate that accounting for Government grant should be based on the nature of the relevant grant. Grants which have the characteristics similar to those of promoters' contribution should be treated under Capital approach, whereas Income approach is considered more appropriate in the case of other grants.

Capital approach: Under this approach, a grant is treated as part of shareholders' funds. This is credited directly to shareholders' funds.

Income approach: Under this approach, a grant is considered to be an item of income over one or more periods. It should therefore be taken to income and matched with the associated costs which the grant is intended to compensate.

Question-2

Alps Limited has received the following Grants from the Government during the year ended 31st March, 2021:

- i. ₹ 120 Lacs received as Subsidy from the Central Government for setting up an Industrial undertaking in Medak, a notified backward area.
- ii. ₹ 15 Lacs Grant received from the Central Government on installation of Effluent Treatment Plant.
- iii. ₹ 25 Lacs received from State Government for providing medical facilities to its workmen during the pandemic.

Advise Alps Limited on the treatment of the above Grants in its books of Account in accordance with AS-12 "Government Grants".

Solution

- i. As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the central government for setting up an industrial undertaking in Medak is neither in relation to specific fixed asset nor in relation in revenue. Thus, the amount of ₹ 120 Lacs should be credited to capital reserve.



(Note: Subsidy for setting up an industrial undertaking is considered to be in the nature of promoter's contribution)

- ii. As per AS 12 'Accounting for Government Grants', two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives –
 - a. The grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.
 - b. Grants related to depreciable asset are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

In the given case, ₹ 15 Lacs was received as grant from the Central Government for installation of Effluent Treatment Plant. Since the grant was received for a fixed asset, either of the above methods can be adopted.

- iii. ₹ 25 lacs received from State Government for providing medical facilities to its workmen during the pandemic is a grant received in nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as "Other Income". Alternatively, ₹ 25 lacs may be deducted in reporting the related expense i.e., employee benefit expense.

Question-3

Suraj Limited provides you the following information:

- i. It received a Government Grant @40% towards the acquisition of Machinery worth ₹ 25 Crores.
- ii. It received a Capital Subsidy of ₹ 150 Lakhs from Government for setting up a Plant costing ₹ 300 Lakhs in a notified backward region.
- iii. It received ₹ 50 Lakhs from Government for setting up a project for supply of arsenic free water in a notified area.
- iv. It received ₹ 5 Lakhs from the Local Authority for providing Corona Vaccine free of charge to its employees and their families.
- v. It also received a performance award of ₹ 500 Lakhs from Government with a condition of major renovation in the Power Plant within 3 years. Suraj Limited incurred 90% of amount towards Capital expenditure and balance for Revenue Expenditure.

State, how you will treat the above in the books of Suraj Limited.

Solution

- i. As per AS 12 "Accounting for Govt. Grants", two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable

alternatives. Under the first alternative, the grant of ₹ 10 crores (40% of 25 crores) is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognized the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Under second alternative method, grant amounting ₹ 10 crores is treated as deferred income which is recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

- ii. In the given case, the grant amounting ₹ 150 lakhs received from the Central Government for setting up a plant in notified backward area may be considered as in the nature of promoters' contribution. Thus, amount of ₹ 150 lakhs should be credited to capital reserve and the plant will be shown at ₹ 300 lakhs.
- iii. ₹ 50 lakhs received from Govt. for setting up a project for supply of arsenic free water in notified area should be credited to capital reserve.

Alternatively, if it is assumed that the project consists of capital asset only, then the amount of ₹ 50 lakhs received from Govt. for setting up a project for supply of arsenic free water should either be deducted from cost of asset of the project concerned in the balance sheet or treated as deferred income which is recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

- iv. ₹ 5 lakhs received from the local authority for providing corona vaccine to the employees is a grant received in nature of revenue grant. Such grants are generally presented as a credit in the profit and loss account, either separately or under a general heading 'Other Income'. Alternatively, ₹ 5 lakhs may be deducted in reporting the related expense i.e., employee benefit expenses.
- v. ₹ 500 Lakhs will be reduced from the renovation cost of power plant or will be treated as deferred income irrespective of the expenditure done by the entity out of it as it was specifically received for the purpose major renovation of power plant. However, it may be, later on, decided by the Govt. whether the grant will have to be refunded or not due to non-compliance of conditions attached to the grant.

Question-4

Darshan Ltd. purchased a Machinery on 1st April, 2016 for ₹130 lakhs (Useful life is 4Years). Government grant received is ₹40 lakhs for the purchase of above Machinery.

Salvage value at the end of useful life is estimated at ₹60 lakhs. Darshan Ltd. decides to treat the grant as deferred income.

You are required to calculate the amount of depreciation and grant to be recognized in profit & loss account for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 & 31st March, 2020.

Darshan Ltd. follows straight line method for charging depreciation.

Solution

As per 12 “Accounting for government grants”, grants related to depreciable assets, if treated as deferred income are recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

Amount of depreciation and grant to be recognized in the profit and loss account each year

Depreciation per year

	₹ in lakhs
Cost of the Asset	130
Less: Salvage value	(60)
	70
Depreciation per year(70lakhs/4)	17.50

₹17.50 Lakhs depreciation will be recognized for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

Amount of grant recognized in Profit and Loss account each year:

40 lakhs /4 years = ₹10 Lakhs for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

Question-5

Big Box Ltd., a start-up purchased on April 1, 2020, a machine worth ₹ 44,85,000 in relation to which it received ₹ 7,35,000 as grant from Government of India. The company decided to treat this grant as a capital receipt. It is estimated that the realizable value of the machine at the end of its useful life of 4 years will be ₹ 15,36,000. During the financial year 2022-23, the grant became refundable as the start-up company failed to comply with the necessary terms and conditions of the grant.

You are required to calculate the amount of depreciation that is to be charged to the statement of profit and loss for the years 2022-23 and 2023-24 given that the company follows straight line method of charging depreciation.

Solution

Calculation of Depreciation for the years 2022-23 and 2023-24

	₹ in '000'
Cost of machine on 01.01.2020	4,485
Less: Grant from Government of India	735
Net cost of machine	3,750
Estimated useful life	4 years
Depreciation p.a. under straight line method (3,750 – 1,536) / 4	
Depreciation charged during 2020-21 and 2021-22 [553.5 × 2]	1,107

Book value of machine on 01.04.2022 [3,750 – 1,107]	2,643
Add: Refund of government grant during 2022-23	735
Revised Book value of machine	3,378
Remaining useful life of machine	2 years
Revised depreciation p.a. (3,378 – 1,536) / 2	921

Question-6

X Ltd. received a grant of ₹ 2 crores from the Central Government for the purpose of a special Machinery during 2018-19. The cost of Machinery was ₹ 20 crores and had a useful life of 9 years. During 2022-23, the grant has become refundable due to non-fulfilment of certain conditions attached to it. Assuming the entire grant was deducted from the cost of Machinery in the year of acquisition. Recommend the accounting treatment to be followed in the year 2022-23.

Solution

As per 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 ₹ 2 crores in the year 2022-2023. The computations for the depreciation on machinery can be given as:

Particulars	(₹ in Crores)
Cost of machinery	20
Less: Grant received	2
Cost of machinery	18
Useful life of machinery 9 years	
Depreciation per year as per straight line method = 18/9 (Assuming, residual value to be zero)	2
Total depreciation for 4 years (2018-19 to 2021-2022)	8
Book value (in year 2022-2023)	10
Add: Grant refunded	2
Revised book value	12
Remaining useful life 5 years	
Revised annual depreciation = 12/5	2.4



Thus, book value of machinery will be ₹ 12 crores in the year 2022-2023 and the depreciation amounting ₹ 2.4 crores will be charged on machinery. Annual depreciation of ₹ 2.4 crores will be charged in the next four years.

Question-7

On 1st April 2019 Hero Limited received Government grant of ₹ 300 lakhs for acquisition of a machinery costing ₹ 1,500 lacs.

The grant was credited to the cost of the asset.

The life of the machinery is 5 years. The machinery is depreciated at 20% on w.d.v. basis.

The company had to refund the grant in May 2022 due to non-fulfillment of certain conditions.

Suggest how the management should with the refund of grant in the books of Hero Limited.

Solution

Date	Particulars	(₹ in lakhs)
01.04.2019	Cost of machine (adjusting grant) = (1,500-300)	1,200
31.03.2020	Depreciation	240
	WDV	960
31.03.2021	Depreciation	192
	WDV	768
31.03.2022	Depreciation	153.60
	WDV	614.40
	Add: Govt. grant	300.00
	Revised book value	914.40

Note 1: Depreciation on revised book value will be provided prospectively over the residual life of the asset.

Note 2: The company can also debit the refund amount of ₹ 300 lakhs to DGG A/c if the same account was credited at the time of receipt of the grant.

Question-8

On 1st April, 2016, Mac Ltd. received a Government Grant of ₹60 lakhs for acquisition of machinery costing ₹300 lakhs. The grant was credited to the cost of the asset. The estimated useful life of the machinery is 10 years. The machinery is depreciated @ 10% on WDV basis. The company had to refund the grant in June 2019 due to non-compliance of certain conditions.

How the refund of the grant is dealt with in the books of Mac Ltd. assuming that the company did not charge any depreciation for the year 2019-20.

Pass necessary Journal Entries for the year 2019-20.

Solution

Date	Particulars	(₹in lakhs)
1st April, 2016	Acquisition cost of machinery	300.00
	Less: Government Grant	60.00
		240
31st March, 2017	Less: Depreciation @ 10%	(24.00)
1st April, 2017	Book value	216.00
31st March, 2018	Less: Depreciation @ 10%	(21.60)
1st April, 2018	Book value	194.40
31st March, 2019	Less: Depreciation @ 10%	(19.44)
1st April, 2019	Book value	174.96
	Less: Depreciation @10% for 2 months	(2.916)
1st June, 2019	Book value	172.044
June 2019	Add: Refund of grant*	60.00
	Revised book value	232.044

Depreciation @10% on the revised book value amounting to ₹232.044 lakhs is to be provided prospectively over the residual useful life of the machinery.

*considered refund of grant at beginning of June month and depreciation for two months already charged. Alternative answer considering otherwise also possible.

Journal Entries

Machinery Account	Dr.	60	
To Bank Account			60
(Being government grant on asset partly refunded which increased the cost of fixed asset)			
Depreciation Account	Dr.	19.337	
To Machinery Account			19.337
(Being depreciation charged on revised value of fixed asset prospectively for 10 months)			
Profit & Loss Account	Dr.	22.253	
To Depreciation Account			22.253
(Being depreciation transferred to Profit and Loss Account amounting to ₹ (2.916 + 19.337= 22.253)			

AS-16: BORROWING COST

Question-1

On 14.08.2021, Pushkar Ltd. obtained a loan from RBC Bank of ₹ 65 lakhs to be utilised as under:

Purchase of equipment: ₹ 19,50,000;

Construction of factory shed: ₹ 26,00,000;

Advance for purchase of delivery vehicle: ₹ 6,50,000;

Working capital: ₹ 13,00,000.

In March, 2022 installation of the machinery was completed and also construction of factory shed was completed and the machinery installed. However, the truck was not delivered within 31.03.2022. Total interest charged by the bank for the year ending 31.3.2022 was ₹ 11.70 lakhs. Discuss how the interest amount would be treated in the financial statements of the company as per AS 16.

Solution

In this case, only the factory shed is a Qualifying Asset (QA) as per AS 16. The amount of interest on borrowings and its treatment is presented below:

Particulars	Nature of asset	Interest capitalised	Interest charged to Income Statement
Purchase of equipment	Not a QA		3,51,000 [11.7 × 19.5/65]
Construction of factory shed	QA	4,68,000 [11.7 × 26/65]	
Advance for purchase of delivery vehicle	Not a QA		1,17,000 [11.7 × 6.5/65]
Working capital	Not a QA		2,34,000 [11.7 × 13/65]
Total		4,68,000	7,02,000

Question-2

Zebra Limited began construction of a new plant on 1st April, 2021 and obtained a special loan of ₹ 20,00,000 to finance the construction of the plant. The rate of interest on loan was 10%.

The expenditure that was incurred on the construction of plant was as follows:

	Amount (₹)
1st April, 2021	10,00,000



1st August,2021	24,00,000
1st January,2022	4,00,000

The company's other outstanding non-specific loan was ₹ 46,00,000 at an interest rate of 12%.

The construction of the plant completed on 31st March,2022.

You are required to:

- Calculate the amount of interest to be capitalized as per the provisions of AS 16 "Borrowing Cost".
- Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant.

Solution

Total expenses to be capitalized for borrowings as per AS 16 "Borrowing Costs":

Particulars	Amount (₹)
Cost of Plant (10,00,000 + 24,00,000 + 4,00,000)	38,00,000
Add: Amount of interest to be capitalized (W.N.)	2,84,000
	40,84,000

Journal Entry

Date	Particulars		Amount (₹)	Amount (₹)
31-03-22	Plant A/c	Dr.	40,84,000	
	To Bank A/c			40,84,000
	[Being amount of cost of plant and borrowing cost thereon capitalized]			

Working Note:

Computation of Average Accumulated Expenses:

1st April, 2021	$10,00,000 \times 12/12$	10,00,000
1st August, 2021	$24,00,000 \times 8/12$	16,00,000
1st January, 2022	$4,00,000 \times 3/12$	1,00,000
		27,00,000

Computation of interest to be capitalized:

		Amount (₹)
On specific borrowing	$20,00,000 \times 10\%$	2,00,000
On non-specific borrowing	$(27,00,000 - 20,00,000) \times 12\%$	84,000

		2,84,000
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Question-3

First Ltd. began construction of a new factory building on 1st April, 2017. It obtained ₹ 2,00,000 as a special loan to finance the construction of the factory building on 1st April, 2017 at an interest rate of 8% per annum. Further, expenditure on construction of the factory building was financed through other non-specific loans. Details of other outstanding non-specific loans were:

Amount (₹)	Rate of Interest per annum
4,00,000	9%
5,00,000	12%
3,00,000	14%

The expenditures that were made on the factory building construction were as follows:

Date	Amount (₹)
1st April, 2017	3,00,000
31st May, 2017	2,40,000
1st August, 2017	4,00,000
31st December, 2017	3,60,000

The construction of factory building was completed by 31st March, 2018. As per the provisions of AS 16, you are required to:

- Calculate the amount of interest to be capitalized.
- Pass Journal entry for capitalizing the cost and borrowing cost in respect of the factory building.

Solution

Computation of average accumulated expenses

	Amount (₹)
$3,00,000 \times 12 / 12$	3,00,000
$2,40,000 \times 10 / 12$	2,00,000
$4,00,000 \times 8 / 12$	2,66,667
$3,60,000 \times 3 / 12$	90,000
	8,56,667

Calculation of average interest rate other than for specific borrowings

Amount of loan (₹)	Rate of interest	Amount of interest (₹)
4,00,000	9%	36,000

5,00,000	12%	60,000
3,00,000	14%	42,000
		1,38,000
Weighted average rate of interest (1,38,000/12,00,000) x 100		11.5%

Amount of interest to be capitalized

	Amount (₹)
Interest on average accumulated expenses:	
Specific borrowings (₹2,00,000 x 8%)	16,000
Non-specific borrowings (₹6,56,667* x 11.5%)	75,517
Amount of interest to be capitalised	91,517

Total expenses to be capitalised for building

	Amount (₹)
Cost of building ₹ (3,00,000 + 2,40,000 + 4,00,000 + 3,60,000)	13,00,000
Add: Amount of interest to be capitalized	91,517
	13,91,517

Journal Entry

Date	Particulars		Dr. (₹)	Cr. (₹)
31.3.2018	Building A/c	Dr.	13,91,517	
	To Building WIP A/c			13,00,000
	To Borrowing costs A/c			91,517
	(Being amount of cost of building and borrowing cost thereon capitalised)			

Question-4

Advise the management on the amount of borrowing cost to be capitalized as per AS 16 based on the following information.

Particulars	Amount (₹)
Expenditure incurred till 31.03.2021	5,00,000
Interest cost capitalized for the financial year 2020-21@ 13%	26,000
Amount borrowed till 31.03.2021	2,00,000
Assets transferred to construction during 2021-22	1,00,000
Cash payment during 2021-22	75,000

Progress payment received	3,50,000
New borrowing during 2021-22 @ 13%	2,00,000

(Dec-22, 4 Marks)

Solution

Total borrowing cost – $(2,00,000+2,00,000) \times 13/100 = ₹ 52,000$

Particulars	Amount (₹)
Expenditure incurred including previously capitalized borrowing cost (5,00,000 + 26,000)	5,26,000
Cash payment during 2021-22	75,000
Asset transferred during 2021-22	1,00,000
	7,01,000
Less: Progress payment received	3,50,000
	3,51,000

Money borrowed including previously capitalized interest cost

= $(2,00,000+2,00,000+26,000) = 4,26,000$

Borrowing cost to be capitalized = $3,51,000/4,26,000 * 52,000 = ₹ 42,845$

Question-5

T&L Ltd. is a large construction company which is presently involved in the construction of a railway bridge over the Ganga River at Patna. The project cost is ₹ 125 crores, 40% of which is financed by borrowing from Asian Development Bank at an interest of 3%. There has been a delay in the completion of the project, and the project manager of the railway bridge construction site has identified that delay construction of the railway bridge has happened due to high water levels during the monsoon months of July to September. Ms. Sonali Mathur, the accountant of T&L Co. has not suspended the capitalisation of the borrowing cost and reflected the same in the cost of the qualifying asset.

You are required to comment on the treatment

Solution

In this case, the work got suspended due to temporary delay which is a necessary part of the construction process. Capitalisation of borrowing cost would continue during the extended period during which high water levels delay construction of the railway bridge, as such high-water levels are common during the monsoon period in the geographic region involved. So, the treatment done by Ms. Mathur, the company accountant is correct.

Question-6

XYZ Ltd. has taken a loan of USD 10,000 on April 1, 2023, for a specific project at an interest rate of 5% p.a., payable annually. On April 1, 2023, the exchange rate between the

currencies was ₹ 45 per USD. The exchange rate, as at March 31, 2024, is ₹ 48 per USD. The corresponding amount could have been borrowed by XYZ Ltd. in local currency at an interest rate of 11 per cent per annum as on April 1, 2023.

What would be the answer if interest rate was 13% instead of 11%.

Solution

The following computation would be made to determine the amount of borrowing costs for the purposes of AS 16:

- a. Interest for the period = USD 10,000 x 5% x ₹ 48/USD = ₹ 24,000
- b. Increase in the liability towards the principal amount = USD 10,000 x (48 - 45) = ₹ 30,000
- c. Interest that would have resulted if the loan was taken in Indian currency = USD 10,000 x 45 x 11% = ₹ 49,500
- d. Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 49,500 – ₹ 24,000 = ₹ 25,500

Therefore, out of ₹ 30,000 increase in the liability towards principal amount, only ₹ 25,500 will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 49,500 being the aggregate of interest of ₹ 24,000 on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 25,500.

Thus, ₹ 49,500 would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 4,500 would be considered as the exchange difference to be accounted for as per Accounting Standard (AS) 11, The Effects of Changes in Foreign Exchange Rates.

In the above question, if the interest rate on local currency borrowings is assumed to be 13% instead of 11%, the entire exchange difference of ₹ 30,000 would be considered as borrowing costs, since in that case the difference between the interest on local currency borrowings and foreign currency borrowings [i.e., ₹ 34,500 (₹ 58,500 – ₹ 24,000)] is more than the exchange difference of ₹ 30,000.

Therefore, in such a case, the total borrowing cost would be ₹ 54,000 (₹ 24,000 + ₹ 30,000) which would be accounted for under AS 16 and there would be no exchange difference to be accounted for under AS 11 'The Effects of Changes in Foreign Exchange Rates'.

AS-19: ACCOUNTING FOR LEASES

Question-1

Vishnu Ltd. leased a printing machine from GF Ltd. for a period of 3 years. The useful life of the printing machine is known to be of 5 years. It was agreed between the lessor and lessee that the amount will be paid in 3 instalments and at the termination of the lessee, GF Ltd. will take back the said machine.

The following details are available in respect of the machine lessee:

- a. Cost of the printing machine is ₹ 15,00,000;
- b. Unguaranteed residual value at the end of the lease period is ₹ 2,00,000;
- c. Fair value of the machine is ₹ 15,00,000;
- d. The internal rate of return of the investment is 10%.

You are required to:

1. Analyse whether the lease is a finance lease or an operating lease?
2. Ascertain the amount of unearned finance income.

Given: PVF10%, 3 = 0.7513; PVAF10%, 3 = 2.4868.

Solution

Present value of unguaranteed residual value = ₹ 2,00,000 × 0.7513 = ₹ 1,50,260

∴ Present value of lease payments = ₹ (15,00,000 – 1,50,260) = ₹ 13,49,740

Present value of lease payments as percentage of Fair value

= 13,49,740/15,00,000 = 90% (approx.)

As the 'Present value of lease payments' makes a substantial portion of the 'Fair value', the machine lease by VK Ltd. from GF Ltd. is a finance lease by nature.

Annual lease payments

= Present value of lease payments/ PVAF10%, 3

= 13,49,740/2.4868

= ₹ 5,42,762 (approx.)

Gross investment in lease

= ₹ [(₹ 5,42,762 × 3) + 2,00,000] = ₹ 18,28,286

Unearned finance income

= Excess of 'Gross investment in lease' over 'Cost of the printing machine'

= ₹ (18,28,286 – 15,00,000)

= ₹ 3,28,286

Question-2

A Ltd. has taken the assets on lease from X Ltd. The following information is given below:

Lease Term = 3 years

Fair value at inception of lease = ₹ 14,00,000

Lease Rent = ₹ 6,00,000 p.a. at the end of each year

Guaranteed Residual Value = ₹ 44,000

Implicit Interest Rate = 15% p.a.

Calculate the value of the asset to be considered by A Ltd. and the interest (finance charges) in each year.

Present value of ₹1.00 at 15% is given below:

Year	1	2	3
PVIF (15%)	0.869	0.756	0.657

(June-19, 5 Marks)

Solution

Calculation of Present value of Minimum Lease Payments

Year (end)	MLP (₹)	PVIF at 15%	Present Value (₹)
1	6,00,000	0.869	5,21,400
2	6,00,000	0.756	4,53,600
3	6,44,000(6,00,000+44,000)	0.657	4,23,108
			13,98,108

Value of the asset will be the lower of fair value at the inception of lease and present value of MLP plus residual value. Therefore, the value of the asset will be ₹ 13,98,108.

Calculation for Interest (Finance Charge)

Year	Liability (₹)	MLP (₹)	Finance Charge (₹)	Principle Amt. of reduction (₹)
1	13,98,108	—	—	—
2	10,07,824	6,00,000	2,09,716	3,90,284
3	5,58,998	6,00,000	1,51,174	4,48,826
4	—	6,44,000	83,850	5,60,150

Note: The difference between this figure and the guaranteed residual value (as per the problem) is due to approximation.

Question-3

Kovid Limited has taken a Machinery on Lease from Krishna Limited. The following information are provided by Kovid Limited:

Particulars	Details
Lease Term	5 years
Fair value at inception of Lease	₹ 20 Lakhs
Lease Rent	₹ 5 Lakhs per annum payable at the end of the year



Expected Residual value	₹ 3 Lakhs
Guaranteed Residual value	₹ 2 Lakhs
Implicit Interest rate	15.5% per annum

You are required to prepare Lease Rent Account and Lease Liability Account in the Books of Kovid Limited.

(The present value of ₹ 1 at Discount rate of 15.5% are 0.8658, 0.7496, 0.6490, 0.5619 and 0.4865 for year 1 to year 5 respectively.)

(Dec-13, 8 Marks)

Solution

Calculation of Present value of MLP

Year	MLP (₹)	Discount Rate 15.5%	Present Value (₹)
1	5,00,000	0.8658	4,32,900
2	5,00,000	0.7496	3,74,800
3	5,00,000	0.6490	3,24,500
4	5,00,000	0.5619	2,80,950
5	7,00,000 (5 Lakhs + 2 Lakhs)	0.4865	3,40,550
	27,00,000		17,53,700

Present Value of MLP ₹ 17,53,700 is less than fair value at the inception of lease ₹ 20,00,000, so the leased asset and liability should be recognized at ₹ 17,53,700 Apportionment of finance lease:

Year	Liability (₹)	MLP (₹)	Finance Charge (liability at beginning X interest rate) (₹)	Principal Amount of reduction (₹)	Closing Liability
0	17,53,700	-	-		
1	17,53,700	5,00,000	2,71,824	2,28,176	15,25,524
2	15,25,524	5,00,000	2,36,456	2,63,544	12,61,980
3	12,61,980	5,00,000	1,95,607	3,04,393	9,57,587
4	9,57,587	5,00,000	1,48,426	3,51,574	6,06,013
5	6,06,013	7,00,000	93,987	6,06,013	-

Books of Kovid Ltd.
Lease Rent Account

Particulars	Amount (₹)	Particulars	Amount (₹)
1st year			
To Bank A/c	5,00,000	By Finance Charge A/c	2,71,824
		By Lease Liability A/c	2,28,176
	5,00,000		5,00,000
2nd year			
To Bank A/c	5,00,000	By Finance Charge A/c	2,36,456
		By Lease Liability A/c	2,63,544
	5,00,000		5,00,000
3rd Year			
To Bank A/c	5,00,000	By Finance Charge A/c	1,95,607
		By Lease Liability A/c	3,04,393
	5,00,000		5,00,000
4th year			
To Bank A/c	5,00,000	By Finance Charge A/c	1,48,426
		By Lease Liability A/c	3,51,574
	5,00,000		5,00,000
5th year			
To Bank A/c	7,00,000	By Finance Charge A/c	93,932
		By Lease Liability A/c	6,06,068
	7,00,000		7,00,000

Lease Liability Account
Lease Rent Account

Particulars	Amount (₹)	Particulars	Amount (₹)
1st year			
To Lease Rent A/c	2,28,176	By Balance b/d	17,53,700
To Balance c/d	15,25,524		
	17,53,700		17,53,700
2nd year			
To Lease Rent A/c	2,63,544	By Balance b/d	15,25,524

To Balance c/d	12,61,980		
	15,25,524		15,25,524
3rd year			
To Lease Rent A/c	3,04,393	By Balance b/d	12,61,980
To Balance c/d	9,57,587		
	12,61,980		12,61,980
4th Year			
To Lease Rent A/c	3,51,574	By Balance b/d	9,57,587
To Balance c/d	6,06,013		
	9,57,587		9,57,587
5th Year			
To Lease Rent A/c	6,06,013	By Balance b/d	6,06,013
	6,06,013		6,06,013

Question-4

Arun Ltd. has taken an equipment on operating lease for the coming 5 years. As per the agreement with the lessor, it will not make any payment for lease rentals for the first 2 years, and will have to pay ₹ 21,00,000 in each of the following 3 years. Advise Arun Ltd. on accounting for the lease rentals in this case.

Solution

As per AS-19, 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.

The pattern of payment, in this case, does not follow straight line basis, rather it is arising towards the end of the lease period. For accounting purpose, such effect should be neutralized i.e. the total payment of ₹ 63,00,000 in the last 3 years should be spread over the entire lease period of 5 years i.e. ₹ 12,60,000 should be charged to the statement of profit and loss for each year.

Question-5

A Ltd. sold machinery having WDV of ₹ 40 lakhs to B Ltd. for ₹ 50 lakhs and the same machinery was leased back by B Ltd. to A Ltd. The lease back is operating lease. Comment if –

- Sale price of ₹ 50 lakhs is equal to fair value.
- Fair value is ₹ 60 lakhs.
- Fair value is ₹ 45 lakhs and sale price is ₹ 38 lakhs.
- Fair value is ₹ 40 lakhs and sale price is ₹ 50 lakhs.

- e. Fair value is ₹ 46 lakhs and sale price is ₹ 50 lakhs
 f. Fair value is ₹ 35 lakhs and sale price is ₹ 39 lakhs.

Solution

Following will be the treatment in the given cases:

- When sales price of ₹ 50 lakhs is equal to fair value, A Ltd. should immediately recognise the profit of ₹ 10 lakhs (i.e. 50 – 40) in its books.
- When fair value is ₹ 60 lakhs then also profit of ₹ 10 lakhs should be immediately recognised by A Ltd.
- When fair value of leased machinery is ₹ 45 lakhs & sales price is ₹ 38 lakhs, then loss of ₹ 2 lakhs (40 – 38) to be immediately recognised by A Ltd. in its books provided loss is not compensated by future lease payment, otherwise defer and amortise the loss.
- When fair value is ₹ 40 lakhs & sales price is ₹ 50 lakhs then, profit of ₹ 10 lakhs is to be deferred and amortised over the lease period.
- When fair value is ₹ 46 lakhs & sales price is ₹ 50 lakhs, profit of ₹ 6 lakhs (46 - 40) to be immediately recognised in its books and balance profit of ₹ 4 lakhs (50-46) is to be amortised/deferred over lease period.
- When fair value is ₹ 35 lakhs & sales price is ₹ 39 lakhs, then the loss of ₹ 5 lakhs (40-35) to be immediately recognised by A Ltd. in its books and profit of ₹ 4 lakhs (39-35) should be amortised/deferred over lease period.

Question-6

M Ltd. sold machinery having WDV of ₹ 200 Lakhs to N Ltd. for ₹ 250 Lakhs and the same machinery was leased back by N Ltd. to M Ltd. The lease back is an operating lease. Comment on the accounting treatment as per AS 19 in the following circumstances:

- Fair value is ₹ 230 Lakhs and sale price is ₹ 250 Lakhs
- Fair value is ₹ 175 Lakhs and sale price is ₹ 195 Lakhs

(June-17, 4 Marks)

Solution

Here the leaseback is an operating lease.

- So, the treatment of the given circumstances will be as follows:
 Here, sale price > Fair value, so, profit of ₹ (230-200) = ₹30 Lakhs is to be immediately recognized by M Ltd in its books and balance profit of ₹ (250-230) i.e. ₹20 Lakhs is to be amortized over the lease period.
- Here, sale price > Fair value, so, loss of ₹ (200-175) = ₹25 Lakhs is to be immediately recognized by M Ltd in its books and balance profit of ₹ (195-175) i.e. ₹20 Lakhs is to be amortized over the lease period.

AS-22: ACCOUNTING FOR TAXES ON INCOME

Question-1

Write short note on Timing difference and Permanent Difference as per AS 22.

Solution

Matching of taxes against revenue for a period poses special problems arising from the fact that in number of cases, taxable income may be different from the accounting income. The divergence between taxable income may be different from the accounting income arises due to two main reasons: Firstly, there are differences between items of revenue and expenses as appearing in the statement of profit and loss and the items which are considered as revenue, expenses or deductions for tax purposes, known as Permanent Difference. Secondly, there are differences between the amount in respect of a particular item of revenue or expense as recognised in the statement of profit and loss and the corresponding amount which is recognised for the computation of taxable income, known as Timing Difference.

Permanent differences are the differences between taxable income and accounting income which arise in one accounting period and do not reverse subsequently. For example, an income exempts from tax or an expense that is not allowable as a deduction for tax purposes.

Timing differences are those differences between taxable income and accounting income which arise in one accounting period and are capable of reversal in one or more subsequent periods. For e.g., Depreciation, Bonus, etc.

Question-2

Classify the following as Timing Difference and Permanent Difference and also state whether they would result in Deferred Tax Asset or Deferred Tax Liability:

- Unabsorbed depreciation
- Income tax penalty
- Interest on loan taken from scheduled bank accounted in the books, but not paid till the date of filing Return of Income.

Solution:

Particulars	Nature of difference	DTA/ DTL
Unabsorbed depreciation	Timing Difference	DTA
Income tax penalty	Permanent Difference	Neither DTA nor DTL to be created
Interest on loan taken from scheduled bank accounted in the books, but not paid till the date of filing Return of Income.	Permanent Difference	Neither DTA nor DTL to be created

Question-3

Rohit Ltd. has provided the following information

Particulars	Amount (₹)
Depreciation as per accounting records	2,50,000
Depreciation as per tax records	5,50,000
Unamortised preliminary expenses as per tax record	40,000

There is adequate evidence of future profit sufficiency. How much deferred tax assets/liability should be recognized as transition adjustment when the tax rate is 50%?

Solution

Table showing calculation of deferred tax asset / liability

Particulars	Amount (₹)	Timing difference	Deferred tax	Amount @ 50% (₹)
Excess depreciation as per tax records (5,50,000 – 2,50,000)	3,00,000	Timing	Deferred tax liability	1,50,000
Unamortised preliminary expenses as per tax records	40,000	Timing	Deferred tax asset	(20,000)
Net deferred tax liability				1,30,000

Net deferred tax liability amounting ₹1,30,000 should be recognized as transition adjustment.

Question-4

Parshuram Ltd., which commenced its operations in 2018-19, provides the following details:

Financial year	Profit before tax (₹)	Timing Difference (₹)	Permanent Difference (₹)	Corporate tax rate	Remarks
2018-19	28,00,000	+ 3,15,000	+ 3,50,000	40%	Reversible in 2021-22
2019-20	31,50,000	+ 2,10,000	+ 2,80,000	38%	Reversible in 2020-21
2020-21	35,00,000	- 70,000	+ 3,15,000	35%	Reversible in 2021-22
2021-22	24,50,000	Nil	+ 4,20,000	30%	--

Solution

Calculation of Current Tax (in ₹ Lakhs)

Particulars	2018-19	2019-20	2020-21	2021-22
Profit before tax	28.00	31.5	35.00	24.50
Timing Differences	3.15	2.10	(0.70)	Nil



Permanent Differences	3.50	2.80	3.15	4.20
Taxable Income	34.65	36.40	37.45	28.70
Corporate tax rate	40%	38%	35%	30%
Current Tax (Taxable Income Tax rate)	13.86	13.832	13.1075	8.61