

## TOPIC - 12

### ACCOUNTING STANDARD - 4

### CONTINGENCIES & EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

#### TOTAL NO. OF QUESTIONS - 15

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#### SERIES 100 – ICAI STUDY MODULE QUESTIONS

##### Q.AS4.SM.101:

*In a company theft of cash of Rs. 5 lacs by the cashier in January 20X1, was detected in May 20X1. The accounts of the company were not yet approved by the Board of Directors of the company. Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.03.20X1. Decide whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.03.X1.*



##### Q.AS4.SM.102: (SIMILAR IN MTP M23)

*An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.2019. The accounting year of the company ended on 31.3.2019. The accounts were approved on 30.6.2019. The loss from earthquake is estimated at Rs. 30 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company.*



**Q.AS4.SM.103:**

A company has filled a legal suit against the debtor from whom Rs. 15 lakh is recoverable as on 31.03.2019. The chances of recovery by way of legal suit are not good as per the legal opinion by the counsel in April, 2019. Can the company provide for full amount of Rs. 15 lakh as provision for doubtful debts? Discuss in brief.

**Q.AS4.SM.104:**

In preparing the financial statements of R Ltd. for the year ended 31<sup>st</sup> March, 20X1, you come across the following information. State with reasons, how you would deal with this in the financial statements:

The company invested 100 lakhs in April, 20X1 before approval of Financial Statements by the Board of directors in the acquisition of another company doing similar business, the negotiations for which had started during the year.

**Q.AS4.SM.105:**

A Limited Company closed its accounting year on 30.6.20X1 and the accounts for that period were considered and approved by the board of directors on 20th August, 20X1. The company was engaged in laying pipeline for an oil company deep beneath the earth. While doing the boring work on 1.9.20X1 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of Rs.80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.20X1.

**Q.AS4.SM.106**

Y Ltd. has book debts and has a doubt over recoverability of some of the book debts. The amount that cannot be recovered is not quantifiable. Thus, Y Ltd. is of the opinion that provision for doubtful debts should not be created. Y Ltd. creates provision for certain other expenses on estimated basis. Whether contention of Y Ltd. is correct?

**Q.AS4.SM.107**

A Ltd. has sold its building for ₹ 50 lakhs to B Ltd. and has also given possession to B Ltd. The book value of the building is ₹ 30 lakhs. As on 31<sup>st</sup> March, 20X1, the documentation and legal formalities are pending. The company has not recorded the sale and has shown the amount received as advance. Do you agree with this treatment?

**Q.AS4.SM.108:**

During the year 20X1-20X2, Raj Ltd. Was sued by a competitor for Rs. 15 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Raj Ltd. Provided for a sum of Rs. 10 lakhs in its financial statements for the year ended 31<sup>st</sup> March, 20X2. On 18<sup>th</sup> May, 20X2, the Court decided in favor of the party alleging infringement of the trademark and ordered Raj Ltd. To pay the aggrieved party a sum of Rs.14 lakhs. The financial statements were prepared by the company's management on 30<sup>th</sup> April, 20X2, and approved by the board on 30<sup>th</sup> May, 20X2.

**SOLUTIONS OF ABOVE QUESTIONS OF SERIES 100****ANSWER Q101**

As per AS 4 (Revised) 'Contingencies and Events occurring after the Balance Sheet Date', an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes.

If a fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognise the loss amounting Rs. 5,00,000 and adjust the accounts of the company for the year ended 31st March, 20X1.

### **ANSWER Q102**

1) AS 4 (Revised) "Contingencies and Events Occurring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. **The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.3.2019. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 2018-2019.**

2) If there are significant changes that could affect the company's ability to continue operating after the balance sheet date, it may be necessary to evaluate whether the company can still be considered a "going concern" when preparing the financial statements.

As per the information given in the question, the earthquake has caused major destruction; therefore, fundamental accounting assumption of going concern is called upon. Considering that the going concern assumption is still valid, the fact of earthquake together with an estimated loss of Rs.30 lakhs should be disclosed in the financial statements for the financial year 2018-2019.

### **ANSWER: Q103**

As per AS 4 (Revised) "Contingencies and Events Occurring After the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

**In the given case, company should make the provision for doubtful debts, as legal suit has been filed on 31st March, 2019 and the chances of recovery from the suit are not good. Though, the actual result of legal suit will be known in future yet situation of non-recovery from the debtors exists before finalisation of financial statements. Therefore, provision for doubtful debts should be made for the year ending on 31<sup>st</sup> March, 2019.**

### **ANSWER Q104**

AS 4 (Revised) defines "Events Occurring after the Balance Sheet Date" as 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 Approving Authority in the case of a company.

Accordingly, **the acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31<sup>st</sup> March, 20X1.**

The disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represents material changes and commitments affecting the financial position of the enterprise, the investment of Rs. 100 lakhs in April, 20X1 for the acquisition of another company should be disclosed in the report of the Approving Authority to enable users of financial statements to make proper evaluations and decisions.

### **ANSWER Q105**

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 AS 4 (Revised).

**In this case the incidence, which was expected to push up cost, became evident after the date of approval of the accounts. So it is not an 'event occurring after the balance sheet date'. However, this may be mentioned in the Report of Approving Authority.**

**Solution Q106**

As per AS 4, "Contingencies and Events Occurring After the Balance Sheet Date" if it is likely that a contingency will result in a loss to an entity then it should create provision for that contingency on the estimated basis.

Based on the above, the contention that provision for doubtful debt is not created merely because the amount is not quantifiable is not correct. Hence Y Ltd. should make provision in the books based on estimation.

**SOLUTION Q107**

The economic reality and substance of the transaction is that the rights and beneficial interest in the property has been transferred although legal title has not been transferred. A Ltd. should record the sale and recognise the gain of ₹ 20 lakhs in its profit and loss account. The building should be derecognized in the financial statements.

**ANSWER: Q108**

1) As per AS 4 (Revised), 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, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 20X1-X2 for which the provision was also made by it, the decision of the Court on 18<sup>th</sup> May, 20X2, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Raj Ltd. should adjust the provision upward by Rs. 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

2) Had the judgment of the Court been delivered on 1<sup>st</sup> June, 20X2, it would be considered as an event occurring after the approval of the financial statements which is not covered by AS 4 (Revised). In that case, no adjustment in the financial statements of 20X1-X2 would have been required.

**SERIES 200 – QUESTIONS OF RTPs/MTPs/PAST EXAMS****Q.AS4.RMP.201: (Exam Nov18)**

The accounting year of Dee Limited ended on 31st March, 2018 but the accounts were approved on 30th April, 2018. On 15th April, 2018 a fire occurred in the factory and office premises. The loss by fire is of such a magnitude that it was not possible to expect the enterprise Dee Limited to start operation again. State with reasons, whether the loss due to fire is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company in the context of the provisions of AS-4 (Revised).

**Q.AS4.RMP.202: (RTP May21)**

A case is going on between ABC Ltd. and Tax department on claiming the exemption for certain items, for the year 2019-2020. The court has issued the order on 15th April and rejected the claim of the company. Accordingly, company is liable to pay the additional tax. The financial statements



were approved on 31st May, 2020. Shall company account for such tax in the year 2019-2020 or shall it account for in the year 2020-2021?

### Q.AS4.OM.203: (Old Course)

Neel Limited has its corporate office in Mumbai and sells its products to its stockists all over India. On 31<sup>st</sup> March, 20X1, the company wants to recognize receipts of cheques bearing date 31<sup>st</sup> March, 20X1 or before, as "Cheques in Hand" by reducing "Trade Receivables". The Cheques in Hand is shown in the Balance sheet as an item of Cash and Cash Equivalents. All the cheques are presented to the bank in the month of April 20X1 and are also realized in the same month in normal course. State with reasons, whether each of the following is an adjusting event and how this fact is to be disclosed by the company, with reference to the relevant accounting standard:



- (a) Cheques collected by marketing personnel of the company from stockists on or before 31<sup>st</sup> March, 20X1.  
 (b) Cheques sent by the stockists through courier on or before 31<sup>st</sup> March, 20X1.

### Q.AS4.RMP.204: (RTP May19)

The Board of Directors of New Graphics Ltd. in its Board Meeting held on 18th April, 2017. Considered and approved the Audited Financial results along with Auditors Report for the Financial Year ended 31st March, 2017 and recommended a dividend of Rs.2 per equity share (on 2 crore fully paid up equity shares of Rs. 10 each) for the year ended 31<sup>st</sup> March, 2017 and if approved by the members at the forthcoming Annual General Meeting of the company on 18th June, 2017, the same will be paid to all the eligible shareholders.



Discuss on the accounting treatment and presentation of the said proposed dividend in the annual accounts of the company for the year ended 31st March, 2017 as per the applicable Accounting Standard and other Statutory Requirements.

**Q.AS4.RMP.205: (RTP May22)**

Smart Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31st March, 2024 are to be approved by the approving authority on 30th June 2024. During the first quarter of 2024-2025, the following events / transactions has taken place. The accountant of the company seeks your guidance for the following:

- (i) Smart Ltd. has an inventory of 50 stitching machines costing at ₹ 5,500 per machine as on 31st March, 2024. The company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realisable value, whichever is lower. During the month of April 2024, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during this month at a price of ₹ 4,000 per machine.
- (ii) A fire has broken out in the company's godown on 15th April, 2024. The company has estimated a loss of ₹ 25 lakhs of which 75% is recoverable from the Insurance company.
- (iii) The company has entered into a sale agreement on 30th March, 2024 to sell a property for a consideration of ₹ 7,50,000 which is being carried in the books at ₹ 5,50,000 at the year end. The transfer of risk and reward and sale is complete in the month of May 2024 when conveyance and possession get completed.
- (iv) The company has received, during the year 2022-2023, a government grant of ₹ 15 lakhs for purchase of a machine. The company has received a notice for refund of the said grant on 15th June, 2024 due to violation of some of the conditions of grant during the year 2023-2024.

You are required to state with reasons, how the above transactions will be dealt with in the financial statement for the year ended 31st March 2024.

**Q.AS4.RMP.206: (RTP May22 & May'25)**

Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31st March 2020 are to be approved by the approving authority on 30th June 2020. During the first quarter of 2020-2021, the following events / transactions has taken place. The accountant of the company seeks your guidance for the following:

- (i) Tee Ltd. has an inventory of 50 stitching machines costing at Rs. 5,500 per machine as on 31st March 2020. **The company is expecting a heavy decline in the demand in next year.** The inventories are valued at cost or net realizable value, whichever is lower. During the month of April 2020, **due to fall in demand, the prices have gone down drastically.** The company has sold 5 machines during April, 2020 at a price of Rs. 4,000 per machine.
- (ii) A fire has broken out in the company's godown on 15th April 2020. The company has estimated a loss of Rs. 25 lakhs of which 75% is recoverable from the Insurance company.
- (iii) **A suit against the company's advertisement was filed by a party on 10<sup>th</sup> April, 2020 10 days after the year end claiming damages of Rs. 20 lakhs.**

You are required to state with reasons, how the above transactions will be dealt with in the financial statements for the year ended 31 March 2020.

**Q.AS4.RMP.207: (RTP Sep'24)**

For five companies whose financial year ended on 31<sup>st</sup> March, 2023, the financial statements were approved by their approving authority on 15<sup>th</sup> June, 2023.

During 2023-2024, the following material events took place:

- (a) A Ltd. sold a major property which was included in the balance sheet at ₹ 1,00,000 and for which contracts had been exchanged on 15<sup>th</sup> March, 2023. The sale was completed on 15<sup>th</sup> May, 2023 at a price of ₹ 2,50,000.
- (b) On 30<sup>th</sup> April, 2023, a 100% subsidiary of B Ltd. declared a dividend of ₹3,00,000 in respect of its own shares for the year ended on 31<sup>st</sup> March, 2023.
- (c) On 31<sup>st</sup> May, 2023, the mail order activities of C Ltd. (a retail trading group) were shut down with closure costs amounting to ₹ 2.5 million.
- (d) On 1<sup>st</sup> July, 2023 the discovery of sand under D Ltd.'s major civil engineering contract site causes the cost of the contract to increase by 25% for which there would be no corresponding recovery from the customer.
- (e) A fire, on 2<sup>nd</sup> April, 2023, completely destroyed a manufacturing plant of E Ltd. It was expected that the loss of ₹ 10 million would be fully covered by the insurance company

You are required to state with reasons, how each of the above items numbered (a) to (e) should be dealt with in the financial statement of the various companies for the year ended 31<sup>st</sup> March, 2023.

## SOLUTIONS OF ABOVE QUESTIONS OF SERIES 200

**SOLUTION: Q201**

As per AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date", an event occurring after the balance sheet date should be an adjusting event even if it does not reflect any condition existing on the balance sheet date, if the event is such as to indicate that the fundamental accounting assumption of going concern is no longer appropriate.

The fire occurred in the factory and office premises of an enterprise after 31 March, 2018 but before approval of financial statement of 30.4.18. The loss by fire is of such a magnitude that it is not reasonable to expect the Dee Ltd. to start operations again, i.e., the going concern assumption is not valid. Since the fire occurred after 31/03/18, the loss on fire is not a result of any condition existing on 31/03/18. But **the**

*loss due to fire is an adjusting event* the entire accounts need to be prepared on a liquidation basis with adequate disclosures by the company by way of note in its financial statements in the following manner: "Major fire occurred in the factory and office premises on 15th April, 2018 which has made impossible for the enterprise to start operations again. Therefore, the financial statements have been prepared on liquidation basis."

### **SOLUTION: Q202**

To decide whether, the event is adjusting or not adjusting two conditions need to be satisfied,

(a) There has to be evidence

(b) The event must have been related to period ending on reporting date.

Here both the conditions are satisfied. Court order is conclusive evidence which has been received before approval of the financial statements since the liability is related to earlier year. **The event will be considered as an adjusting event** and accordingly the amount will be adjusted in accounts of 2019-2020.

### **SOLUTION: Q203**

(a) Cheques collected by the marketing personnel of the company is an adjusting event as the marketing personnels are employees of the company and therefore, are representatives of the company. Handing over of cheques by the stockist to the marketing employees discharges the liability of the stockist. Therefore, cheques collected by the marketing personnel of the company on or before 31<sup>st</sup> March, 20X1 require adjustment from the stockists' accounts i.e. from 'Trade Receivables A/c' even though these cheques (dated on or before 31<sup>st</sup> March, 20X1) are presented in the bank in the month of April, 20X1 in the normal course. **Hence, collection of cheques by the marketing personnel is an adjusting event as per AS 4 'Contingencies and Events Occurring after the Balance Sheet Date'**. Such 'cheques in hand' will be shown in the Balance Sheet as 'Cash and Cash equivalents' with a disclosure in the Notes to accounts about the accounting policy followed by the company for such cheques.

(b) Even if the cheques bear the date 31<sup>st</sup> March or before and are sent by the stockists through courier on or before 31<sup>st</sup> March, 20X1, it is presumed that the cheques will be received after 31<sup>st</sup> March. Collection of cheques after 31<sup>st</sup> March, 20X1 does not represent any condition existing on the balance sheet date i.e. 31<sup>st</sup> March. **Thus, the collection of cheques after balance sheet date is not an adjusting event.** Cheques that are received after the balance sheet date should be accounted for in the period in which they are received even though the same may be dated 31<sup>st</sup> March or before as per AS 4. Moreover, the collection of cheques after balance sheet date does not represent any material change affecting financial position of the enterprise, so no disclosure in the Director's Report is necessary.

### **SOLUTION: Q204**

As per AS 4 "Contingencies and Events Occurring After the Balance Sheet Date", the events which take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature.

However, **dividends declared after the balance sheet date but before approval of financial statements are not recognized as a liability at the balance sheet date because no statutory obligation exists at that time.** Hence such dividends are disclosed in the notes to financial statements.

**Conclusion** - No, provision for proposed dividends is not required to be made. Such proposed dividends are to be disclosed in the notes to financial statements. Accordingly, the dividend of Rs 4 crores recommended by New Graphics Ltd. in its Board meeting on 18th April, 2017 shall not be accounted for in the books for the year 2016-17 irrespective of the fact that it pertains to the year 2016-17 and will be paid after approval in the Annual General Meeting of the members / shareholders.

### **SOLUTION: Q205**

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, by the corresponding approving authority in the case of any other entity.

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 is not appropriate.

In the given case, financial statements are approved by the approving authority on 30th June 2024.

On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31st March 2024:

- (i) Since on 31st March 2024, Smart Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2024 will be considered as an adjusting event. Hence, Smart Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realisable value at the end of the reporting period. Accordingly, inventory should be written down to ₹ 4,000 per machine. Total value of inventory in the books will be 50 machines x ₹ 4,000 = ₹ 2,00,000.
- (ii) A fire took place after the balance sheet date i.e. during 2024-2025 financial year. Hence, corresponding financials of 2023-2024 financial year should not be adjusted for loss occurred due to fire. However, in this circumstance, the going concern assumption will be evaluated. In case the going concern assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements.
- (iii) Since the transfer of risk and reward and sale was complete in the month of May, 2024 when conveyance and possession got complete, no revenue should be recognised with respect to it in the financial statements of 2023-2024. However, a disclosure for the same should be given by the entity.
- (iv) Since the notice has been received after 31 March but before 30 June 2024 (approval date), the said grant shall be adjusted in the financial statements for financial year 2023-2024 because the violation of the conditions took place in the financial year 2023-2024 and the company must be aware of it.

### **SOLUTION: Q206**

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, by the corresponding approving authority in the case of any other entity. 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 is not appropriate. In the given case, financial statements are approved by the approving authority on 30 June 2020. On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:

- (i) Since on 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, **decline in the value during April, 2020 will be considered as an adjusting event.** Hence, Tee Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realizable value at the end of the reporting period. Accordingly, inventory should be written down to Rs. 4,000 per machine. Total value of inventory in the books will be 50 machines x Rs. 4,000 = Rs. 2,00,000.
- (ii) A fire took place after the balance sheet date i.e., during 2020-2021 financial year. **Hence, the financial statements for the year 2019-2020 should not be adjusted for loss occurred due to fire.** However, in this circumstance, the going concern assumption will be evaluated. In case the going concern, assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements.
- (iii) The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of Rs. 20 lakhs. **Therefore, it does not fit into the definition of a contingency and hence is a non-adjusting event.**

**SOLUTION: Q207**

Treatment as per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date

(a)	A Ltd.	The sale of property should be treated as an adjusting event since contracts had been exchanged prior to the year-end. The effect of the sale would be reflected in the financial statements ended on 31.3.2023 and the profit on sale of property ₹ 1,50,000 would be treated as an extraordinary item.
(b)	B Ltd.	The declaration of dividend on 30 <sup>th</sup> April, 2023 of ₹ 3,00,000 would be treated as a non-adjusting event in the financial statements of 2022-2023. This is because, the dividend has been declared after the balance sheet date and no conditions existed on the balance sheet date for such declaration of dividend. Further as per AS 9, right to receive dividend is established when it is declared and not before that.
(c)	C Ltd.	A closure not anticipated at the year-end would be treated as a non-adjusting event. Memorandum disclosure would be required for closure of mail order activities since non disclosure would affect user's understanding of the financial statements.
(d)	D Ltd.	The event took place after the financial statements were approved by the approving authority and is thus outside the purview of AS 4. However, in view of its significance of the transaction, the directors may consider publishing a separate financial statement/additional statement for the attention of the members in general meeting.
(e)	E Ltd.	The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover. Also, since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.



Student Notes: -