

CONTINGENCIES AND EVENTS OCCURRING AFTER BALANCE SHEET DATE

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CONTINGENCY	
Meaning	Contingency is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events
Contingent Losses	The accounting treatment of a contingent loss is determined by the expected outcome of the contingency. If it is likely that a contingency will result in a loss to the enterprise, then it is prudent to provide for that loss in the financial statements. The estimation of the amount of a contingent loss to be provided for in the financial statements, may be based on judgement made, by management
Contingent Gains	Contingent gains are not recognised in financial statements since their recognition may result in the recognition of revenue which may never be realised. However, when the realisation of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate.

EVENTS OCCURRING AFTER BALANCE SHEET DATE

Meaning	These are those significant events, both favorable and unfavorable 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 company, and the corresponding approving authority, in case of any other entity.
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TYPES OF EVENTS (PARA 8)

Adjusting events	Non-Adjusting events
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Those which provide further/additional evidence to assist estimation of amounts relating to <u>conditions that existed at the balance sheet date</u>	Those which are indicative of conditions that arose subsequent to balance sheet date or events which <u>do not relate to conditions existing at balance sheet date</u>
Require adjustments to assets and liabilities as at balance sheet date	No accounting treatment: No adjustment of assets & liabilities (<u>Refer note</u>)
<u>Example:</u> an adjustment may be made for loss on trade receivable account which is confirmed by insolvency of customer which occurs after the b/sheet date	<u>Example:</u> Ordinary decline in market value of investments between the balance sheet date and date on which financial statements are approved does not require any adjustment.

Note: Non adjusting events may be of such significance that they may require a disclosure in the report of approving authority i.e. report of BOD to enable users of financial statements to make proper evaluations and decisions.

Example: Material changes and commitments affecting the financial position of enterprise.

EXCEPTION TO THE RULE OF “NO ACCOUNTING TREATMENT FOR NON ADJUSTING EVENTS”

Fundamental accounting assumption of GOING CONCERN is not appropriate

Deterioration in operating results and financial position

Unusual changes affecting the existing or sub-stratum of the enterprise after the balance sheet date (eg. Destruction of major production plant by fire after the balance date)

Assets and liabilities should be adjusted i.e. financial statements should be prepared by not following fundamental accounting assumption of GOING CONCERN

In case the going concern assumption is not valid (based on events occurring after the balance sheet date), the financial statements are prepared on a liquidation basis.

SPECIAL CASE: PROPOSED DIVIDEND

There are events which, although they take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature.

For example, if dividends are declared after the balance sheet date but before the financial statements are approved for issue, the dividends are not recognized as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise. No liability for proposed dividends must be created now. Such proposed dividends are to be disclosed in the notes.

DISCLOSURE REQUIREMENTS

Disclosure of events occurring after the balance sheet date requires the following information should be provided:

- The nature of the event;
- An estimate of the financial effect, or a statement that such an estimate cannot be made.

ASSIGNMENT QUESTIONS**Question 1**

MEC Limited could not recover an amount of ₹ 8 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company for the year ended 31-3-2020 were finalized by making a provision @ 25% of the amount due from that debtor. In May 2020, the debtor became bankrupt and nothing is recoverable from him. Do you advise the company to provide for the entire loss of ₹ 8 lakhs in books of account for the year ended 31-3-2020?

Solution

As per para 8 of AS 4, adjustments to assets and liabilities are required for events occurring after the balance sheet date if such event provides/relates to additional information to the conditions existing at the balance sheet date and is also materially affecting the valuation of assets and liabilities on the balance sheet date.

As per the information given in the question, the company was aware that the debtor was already in a great financial difficulty at the time of closing of accounts. Bankruptcy of the debtor in May 2020 is only an additional information to the condition existing on the balance sheet date. Also the effect of a debtor becoming bankrupt is material as total amount of ₹ 8 lakhs will be a loss to the company. Therefore, the company is advised to provide for the entire amount of ₹ 8 lakhs in the books of account for the year ended 31st March, 2020.

Question 2 (ICAI Study Material)

In X Co. Ltd., theft of cash of ₹ 5 lakhs by the cashier in January, 2020 was detected in May, 2020. 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 31.3.2020. Decide.

Solution

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 amounts 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 ₹ 5,00,000 and adjust the accounts of the company for the year ended 31st March, 2020.

Question 3

State with reasons, how the following events would be dealt with in the financial statements of Pradeep Ltd. for the year ended 31st March, 2020:

- (i) An agreement to sell a land for ₹ 30 lakh to another company was entered into on 1st March, 2020. The value of land is shown at ₹ 20 lakh in the Balance Sheet. However, the Sale Deed was registered on 15th April, 2020.
- (ii) The negotiation with another company for acquisition of its business was started on 2nd February, 2020. Pradeep Ltd. invested ₹ 40 lakh on 12th April, 2020.

Solution

- (1) According to AS 4, 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, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 1st March, 2020 i.e. before the balance sheet date. Registration of the sale deed on 15th April, 2020, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of land is necessary in the financial statements of Pradeep Ltd. for the year ended 31st March, 2020.

- (2) AS 4 defines "Events occurring after the balance sheet date" as those significant events, both favorable and unfavorable, 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. 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 31st March, 2020. Applying provisions of the standard which clearly state that/disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 40 lakhs in April, 2020 in the acquisition of another company should be disclosed in report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

Question 4 *(RTP Nov 2019) / (ICAI Study Material) (Similar)*

An earthquake destroyed a major warehouse of PQR Ltd. on 30.4.2020. The accounting year of the company ended on 31.3.2020. The accounts were approved on 30.6.2020. The loss from earthquake is estimated at ₹ 25 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.

Solution

Para 8 of AS 4, 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. 31.3.2020.

However, according to standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of 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.

Case 1: If going concern assumption is not Valid

Since the fire occurred after 31/03/20, the loss on fire is not a result of any condition existing on 31/03/20. 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 warehouse on 30th April, 2020 which has made impossible for the enterprise to start operations again. Therefore, the financial statements have been prepared on liquidation basis."

Case 2: If going concern assumption is still Valid

The fact of earthquake together with an estimated loss of ₹ 25 lakhs should be disclosed in Report of Directors for the financial year 2019-2020 to enable users of financial statements to make proper evaluations and decisions.

Question 5

Neel Limited has its corporate office in Mumbai and sells its products to stockists all over India. On 31st March, 2020 the company wants to recognize receipt of cheques bearing date 31st March, 2020 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 cheques are presented to the bank in the month of April 2020 and are also realized in the same month in normal course after deposit in the bank.

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

- (i) Cheques collected by the marketing personnel of the company from the stockists on or before 31st March, 2020.
- (ii) Cheques sent by the stockists through courier on or before 31st March, 2020.

Solution

- (1) 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 31st March, 2020 require adjustment from the stockists' accounts i.e. from 'Trade Receivables A/c' even though these cheques (dated on or before 31st March, 2020) are presented in the bank in the month of April, 2020 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.
- (2) Even if the cheques bear the date 31st March or before and are sent by the stockists through courier on or before 31st March, 2020, it is presumed that the cheques will be received after 31st March. Collection of cheques after 31st March, 2020 does not represent any condition existing on the balance sheet date i.e. 31st 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 31st 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.

Question 6 *(ICAI Study Material)*

A company has filed a legal suit against the debtor from whom ₹ 15 lakh is recoverable as on 31.3.2020. The chances of recovery by way of legal suit are not good as per legal opinion given by the counsel in April, 2020. Can the company provide for full amount of ₹ 15 lakhs as provision for doubtful debts?

Solution

As per AS 4, 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, 2020 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 ended on 31st March, 2020.

Question 7 *(ICAI Study Material)*

During the year 2019-2020, Raj Ltd. was sued by a competitor for ₹ 15 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Raj Ltd. provided for a sum of ₹ 10 lakhs in its financial statements for the year ended 31st March, 2020. On 18th May, 2020, the Court decided in favour of the party alleging infringement of the trademark and ordered Raj Ltd. to pay the aggrieved party a sum of ₹ 14 lakhs. The financial statements were prepared by the company's management on 30th April, 2020, and approved by the board on 30th May, 2020.

Should Raj Ltd. adjust its financial statements for the year ended 31st March, 2020?

Solution

As per para 8 of AS 4, 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 2019-20 for which the provision was also made by it, the decision of the Court on 18th May, 2020, 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 ₹ 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

Had the judgment of the Court been delivered on 1st June, 2020, it would be considered as post reporting period i.e. event occurred after the approval of the financial statements. In that case, no adjustment in the financial statements of 2019-20 would have been required.

Question 8 *(ICAI Study Material)*

A Limited Company closed its accounting year on 30.6.20 and the accounts for that period were considered and approved by the board of directors on 20th August, 2020. The company was engaged in laying pipe line for an oil company deep beneath the earth. While doing the boring work on 1.9.2020 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of ₹ 80 lakhs.

You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.20.

Solution

AS 4 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 above mentioned definition and requirements given in AS 4.

In this case the incidence, which was expected to push up cost became evident after the date of approval of the accounts. So that was not an 'event occurring after the balance sheet date'.

Question 9

A company deals in petroleum products. The sale price of petrol is fixed by the government. After the Balance Sheet date, but before the finalisation of the company's accounts, the government unexpectedly increased the price retrospectively.

Can the company account for additional revenue at the close of the year? Discuss in line with provisions of AS 4.

Solution

According to para 8 of AS 4, the unexpected increase in sale price of petrol by the government after the balance sheet date cannot be regarded as an event occurring after the Balance Sheet date, which requires an adjustment at the Balance Sheet date, since it does not represent a condition present at the balance sheet date. The revenue should be recognized only in the subsequent year with proper disclosures.

Question 10

F Ltd. has finalized their financial statements for the year ending 31st March, 2020 and approved by their approving authority on 30th June, 2020.

- (a) A major fire broke out in the night of 31st May, 2020 destroying factory premises. Loss of property estimated to be ₹ 25 lakhs.
- (b) Negotiations with another company started in April 2020 for acquisition of two manufacturing units which may involve additional investments of ₹ 50 lakhs.
- (c) Foreign exchange loss during the period 1st April, 2020 and 1st June 2020 has resulted that assets being reduced by ₹ 30 lakhs.

You are requested to state how to deal with the above information's in the annual accounts.

Solution

For the information given, the following will be recommended treatment with reference to the provisions of AS 4: Contingencies and Events Occurring After the Balance Sheet Date.

- a. 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, the event would appear to be of such significance as to require a disclosure in the report of the approving authority to enable users of the financial statements to make proper evaluation and decision, hence, such disclosure is recommended.
- b. AS 4 defines events occurring after the balance sheet date as those significant event- both favorable and unfavorable – that occur between the balance sheet date and the date on which the financial statements are approved by the approving authority. Accordingly, negotiation for acquisitions of two manufacturing units which started on 30th April, 2020 should be disclosed in the Board's Report. No adjustments of assets and liabilities are required, as the negotiation does not affect the determination and the conditions of the amounts stated in the financial statements for the year ended 31st March, 2020.
- c. The foreign exchange loss due to changes in exchange rates during the period 1st April 2020 and 1st June 2020, is a non adjusting event since it does not relate to the conditions existing at the balance sheet date. The amount of loss appears material and may be of such significance that requires disclosure in the report of the approving authority

Question 11 *(RTP May 2018 / RTP May 2020) (Similar)*

With reference to AS 4 "Contingencies and events occurring after the balance sheet date", state whether the following events will be treated as contingencies, adjusting events or non-adjusting events occurring after balance sheet in case of a company which follows April to March as its financial year.

- (a) A major fire has damaged the assets in a factory on 5th April, 5 days after the year end. However, the assets are fully insured and the books have not been approved by the Directors.
- (b) A suit against the company's advertisement was filed by a party on 10th April, 10 days after the year end claiming damages of ₹ 20 lakhs.
- (c) It sends a proposal to purchase an immovable property for ₹ 30 lakhs in March. The book value of the property is ₹ 20 lakhs as on year end date. However, the deed was registered as on 15th April.
- (d) The terms and conditions for acquisition of business of another company have been decided by March end. But the financial resources were arranged in April and amount invested was ₹ 40 lakhs.
- (e) Theft of cash of ₹ 2 lakhs by the cashier on 31st March but was detected the next day after the financial statements have been approved by the Directors.

Solution

According to AS 4 on 'Contingencies and Events Occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. However, 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. "Contingencies" used in the Standard is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur.

- (i) Fire has occurred after the balance sheet date and also the loss is totally insured. Therefore, the event becomes immaterial and the event is non-adjusting in nature.
- (ii) 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 ₹ 20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a non-adjusting event.
- (iii) In the given case, proposal for deal of immovable property was sent before the closure of the books of accounts. This is a non-adjusting event as only the proposal was sent and no agreement was effected in the month of March i.e. before the balance sheet date.
- (iv) As the term and conditions of acquisition of business of another company had been decided by the end of March, acquisition of business is an adjusting event occurring after the balance sheet date. Adjustment to assets and liabilities is required since the event affects the determination and the condition of the amounts stated in the financial statements for the financial year ended on 31st March.
- (v) Since the financial statements have been approved before detection of theft by the cashier of ₹ 2,00,000, it becomes a non-adjusting event and no disclosure is required in the report of the Approving Authority.

Question 12 (RTP May 2019)

The Board of Directors of M/s. New Graphics Ltd. in its Board Meeting held on 18th April, 2020, considered and approved the Audited Financial results along with Auditors Report for the Financial Year ended 31st March, 2020 and recommended a dividend of ₹ 2 per equity share (on 2 crore fully paid up equity shares of ₹ 10 each) for the year ended 31st March, 2020 and if approved by the members at the forthcoming Annual General Meeting of the company on 18th June, 2020, 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, 2020 as per the applicable Accounting Standard and other Statutory Requirements

Solution

As per the amendment in AS 4 “Contingencies and Events Occurring After the Balance Sheet Date” vide Companies (Accounting Standards) Amendments Rules, 2016 dated 30th March, 2016, 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.

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 ₹ 4 crores recommended by New Graphics Ltd. in its Board meeting on 18th April, 2020 shall not be accounted for in the books for the year 2019-20 irrespective of the fact that it pertains to the year 2019-20 and will be paid after approval in the Annual General Meeting of the members / shareholders

Question 13 *(RTP May 2022) (Similar)*

Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31 March 2020 are to be approved by the approving authority on 30 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 ₹ 5,500 per machine as on 31 March 2020. On 31 March 2020 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 2020, 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 15 April 2020. 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 30 March 2020 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 2020 when conveyance and possession get completed.
- (iv) The company has received, during the year 2018-2019, a government grant of ₹ 15 lakhs for purchase of a machine. The company has received a notice for refund of the said grant on 15 June, 2020 due to violation of some of the conditions of grant during the year 2019-2020.
- (v) A suit against the company's advertisement was filed by a party on 10th April, 2020 10 days after the year end claiming damages of ₹ 20 lakhs.

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 2020

Solution

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:

- (a) 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 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.
- (b) A fire took place after the balance sheet date i.e. during 2020-2021 financial year. Hence, corresponding financials of 2019-2020 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.
- (c) Since the transfer of risk and reward and sale was complete in the month of May, 2020 when conveyance and possession got complete, no revenue should be recognised with respect to it in the financial statements of 2019-2020. However, a disclosure for the same should be given by the entity.
- (d) Since the notice has been received after 31 March but before 30 June 2020 (approval date), the said grant shall be adjusted in the financial statements for financial year 2019-2020 because the violation of the conditions took place in the financial year 2019-2020 and the company must be aware of it.
- (e) 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 ₹ 20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a non-adjusting event.

Question 14 (ICAI Study Material)

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?

Solution

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 be created merely because the amount is not quantifiable is not correct. Hence Y Ltd. should make provision in the books on the basis of estimation.

PRACTICE QUESTIONS**Question 1** *(RTP Nov 2018) / (ICAI Study Material)*

While preparing its final accounts for the year ended 31st March, 2020, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2020 a debtor for ₹ 20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2020 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2020?

Solution

As per AS 4, Assets and Liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist estimation of amounts relating to conditions existing at the balance sheet date.

A debtor for ₹ 20,00,000 suffered heavy loss due to earthquake in the last week of February, 2020 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in April, 2020 (after the balance sheet date) is only an additional information related to the condition existing on the balance sheet date. However, bankruptcy of debtors is an adjusting event

Accordingly, full provision for bad debts amounting ₹ 20,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2020. Since the company has already made 5% provision of its total debtors, additional provision amounting ₹ 19,00,000 shall be made (20,00,000 x 95%).

Question 2

A Company entered into an agreement to sell its immovable property to another company for ₹ 35 lakhs. The property was shown in the Balance Sheet at ₹ 7 lakhs. The agreement to sell was concluded on 15th February, 2020 and sale deed was registered on 30th April, 2020. You are required to state, with reasons, how this event would be dealt with in the financial statements for the year ended 31st March, 2020.

Solution

According to AS 4, 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, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 15th February 2020 i.e. before the balance sheet date. Registration of the sale deed on 30th April, 2020, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of immovable property is necessary in the financial statements for the year ended 31st March, 2020.

Question 3 *(ICAI Study Material)*

In preparing the financial statements of R Limited for the year ended 31st March, 2020 you come across the following information. How you would deal with this in the financial statements?

The company invested ₹ 100 lakhs in April, 2020 before approval of financial statements by Board of Directors in the acquisition of another company doing similar business, negotiations for which had just started.

Solution

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 31st March, 2020.

The disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 100 lakhs in April, 2020 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.

Question 4

A major fire has damaged the assets in a factory of a Limited Company on 5th April – five days after the year end and closure of accounts. The loss is estimated at ₹ 10 crores out of which ₹ 7 crores will be recoverable from the insurers.

Explain briefly how the loss should be treated in the final accounts for the previous year.

Solution

The loss due to break out of fire is an example of event occurring after the balance sheet date. The event being in the nature of a fire which is unpredictable does not relate to conditions existing at the balance sheet date. It has not affected the financial position as on the date of balance sheet and therefore requires no specific adjustments in the financial statements.

However, AS 4 states that disclosure is generally made of events occurring after balance sheet date i.e. in subsequent periods that represent unusual changes affecting the existence or substratum of the enterprise after the balance sheet date. 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 going concern assumption is still valid, the fact of earthquake together with an estimated loss should be disclosed.

Question 5 *(Inter Nov 2018) (5 Marks)*

The accounting year of Dee Limited ended on 31st March, 2020 but the accounts were approved on 30th April, 2020. On 15th April, 2020 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).

Solution

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, 2020 but before approval of financial statement of 30.4.2020. 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 31/03/20, the loss on fire

is not a result of any condition existing on 31/03/20. 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, 2020 which has made impossible for the enterprise to start operations again. Therefore, the financial statements have been prepared on liquidation basis.”

Question 6 *(RTP Nov 2020)*

A fire on 2nd April 2020 completely destroyed a manufacturing plant of Omega Ltd. whose financial year ended on 31st March 2020. The financial statements were approved by their approving authority on 15th June 2020. It was expected that loss of ₹ 10 million would be fully covered by the insurance company. How will you disclose it in the financial statements of Omega Ltd. for the year ended 31st March, 2020

Solution

The event is a non adjusting event since it occurred after the year end & does not relate to the conditions existing at the year end. However it is necessary to consider the validity of 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 note to the financial statements.

Question 7

X Oil Ltd. closed the books of accounts on March 31, 2020 for which financial statement was finalized by the Board of Directors on September 04, 2020. During the month of December 2019, company undertook the project of laying a pipeline across the country and during May 2020 engineers realized that due to unexpected heavy rain, the total cost of the project will be inflated by ₹ 50 lakhs. How this should be provided for in the balance sheet of 2019-20 in accordance to AS 4?

Solution

This event occurred after March 31, 2020 but before September 04, 2020 is an event occurring after the balance sheet date. But this event is not affecting financial position on the date of balance sheet therefore it can be disclosed in the directors' report

Question 8 *(Inter May 2019) (5 Marks)*

The financial statements of PQ Ltd. for the year 2019-20 approved by the Board of Directors on 15th July, 2020. The following information was provided:

- A suit against the company's advertisement was filed by a party on 20th April, 2020, claiming damages of ₹ 25 lakhs.
- The terms and conditions for acquisition of business of another company have been decided by March, 2020. But the financial resources were arranged in April, 2020 and amount invested was ₹ 50 lakhs.
- Theft of cash of ₹ 5 lakhs by the cashier on 31st March, 2020 but was detected on 16th July, 2020.
- Company sent a proposal to sell an immovable property for ₹ 40 lakhs in March, 2020. The book value of the property was ₹ 30 lakhs on 31st March, 2020. However, the deed was registered on 15th April, 2020.
- A major fire has damaged the assets in a factory on 5th April, 2020. However, the assets are fully insured.

With reference to AS-4 "Contingencies and events occurring after the balance sheet date", state whether the above mentioned events will be treated as contingencies, adjusting events or non-adjusting events occurring after the balance sheet date.

Solution

- (a) Suit filed against the company is a contingent liability but it was not existing as on balance sheet date as the suit was filed on 20th April after the balance Sheet date. As per AS 4, 'Contingencies' used in the Standard is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur. Hence, it will have no effect on financial statements and will be a non-adjusting event.
- (b) In the given case, terms and conditions for acquisition of business were finalised and carried out before the closure of the books of accounts but transaction for payment of financial resources was effected in April, 2020. This is clearly an event occurring after the balance sheet date. Hence, necessary adjustment to assets and liabilities for acquisition of business is necessary in the financial statements for the year ended 31st March 2020.
- (c) Only those significant events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustment to assets and liabilities existing on the balance sheet date or may require disclosure. In the given case, theft of cash was detected on 16th July, 2020 after approval of financial statements by the Board of Directors, hence no treatment is required.
- (d) 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. In the given case, sale of immovable property was under proposal stage (negotiations also not started) on the balance sheet date. Therefore, no adjustment to assets for sale of immovable property is required in the financial statements for the year ended 31st March, 2020.
- (e) The condition of fire occurrence was not existing on the balance sheet date. Only the disclosure regarding event of fire and loss being completely insured may be given in the report of approving authority.

Question 9

State with reasons, how the following events would be dealt with in the financial statements of Hari Ltd. for the year ended 31st March, 2019 (accounts were approved on 25th July, 2019):

- (1) Negotiations with another company for acquisition of its business was started on 21st January, 2019. Hari Ltd. invested ₹ 40 lakh on 22nd April, 2019.
- (2) The company made a provision for bad debts @ 4% of its total debtors (as per trend followed from the previous years). In the second week of March 2019, a debtor for ₹ 2,50,000 had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In May, 2019 the debtor became bankrupt.
- (3) During the year 2018-2019, Hari Ltd. was sued by a competitor for ₹ 13 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Hari Ltd. provided for a sum of ₹ 8 lakhs in its financial statements for the year ended 31st March, 2019. On 26th May, 2019, the Court decided in favour of the party alleging infringement of the trademark and ordered Hari Ltd. to pay the aggrieved party a sum of ₹ 12 lakhs.
- (4) Cashier of Hari Ltd. embezzled cash amounting to ₹ 3,00,000 during March, 2019. However the same comes to the notice of Company management during August, 2019.
- (5) Cheques dated 31st March, 2019 collected in the month of April, 2019. All cheques are presented to the bank in the month of April, 2019 and are also realized in the same month in the normal course after deposit in the bank.

Solution

- (1) As per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 40 lakhs in April, 2019 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.
- (2) As per AS 4, adjustment 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. A debtor for ₹ 2,50,000 suffered heavy loss due to earthquake in the second week of March, 2019 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in May, 2019 (after the balance sheet date) is only an additional information related to the existing condition on the balance sheet date. Accordingly, full provision for bad debts amounting ₹ 2,50,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2019.
- (3) As per AS 4, 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 Hari Ltd. was sued by a competitor for infringement of a trademark during the year 2018-19 for which the provision was also made by it, the decision of the Court on 26th May, 2019, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Hari Ltd. should adjust the provision upward by ₹ 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.
- (4) As the embezzlement of cash comes to the notice of company management only after approval of financial statements by board of directors of the company, then the treatment will be done as per the provisions of AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" and the same will not be adjusted in the financial statements for the year ended 31st March, 2019. This being an extra-ordinary item should be disclosed in the statement of profit and loss as a part of loss for the year ending March 2020, in a manner, that its impact on current profit or loss can be perceived.
- (5) Collection of cheques after balance sheet date is not an adjusting event even if the cheques bear the date of 31st March. Recognition of cheques in hand is therefore not consistent with requirements of AS 4. Moreover, the collection of cheques after balance sheet date does not represent any material change or commitments affecting financial position of the enterprise and no disclosure of such collections in the Directors' Report is necessary.

Question 10 *(RTP May 2021)*

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?

Solution

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 a 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.

Question 11 *(RTP Nov 2021)*

XYZ Ltd. operates its business into various segments. Its financial year ended on 31st March, 2020 and the financial statements were approved by their approving authority on 15th June, 2020. The following material events took place:

- A major property was sold (it was included in the balance sheet at ₹ 25,00,000) for which contracts had been exchanged on 15th March, 2020. The sale was completed on 15th May, 2020 at a price of ₹ 26,50,000.
- On 2nd April, 2020, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of ₹ 10 million would be fully covered by the insurance company.
- A claim for damage amounting to ₹ 8 million for breach of patent had been received by the entity prior to the year-end. It is the director's opinion, backed by legal advice that the claim will ultimately prove to be baseless. But it is still estimated that it would involve a considerable expenditure on legal fees.

You are required to state with reasons, how each of the above items should be dealt with in the financial statements of XYZ Ltd. for the year ended 31st March, 2020.

Solution

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

- 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 should be reflected in the financial statements ended on 31.3.2020 and the profit on sale of property ₹ 1,50,000 would be considered.
- 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.
- On the basis of evidence provided, the claim against the company will not succeed. Thus, ₹ 8 million should not be provided in the account, but should be disclosed by means of a contingent liability with full details of the facts. Provision should be made for legal fee expected to be incurred to the extent that they are not expected to be recovered

Question 12 *(Inter July 2021) (5 Marks)*

Surya Limited follows the financial year from April to March. It has provided the following information.

- A suit against the Company's Advertisement was filed by a party on 5th April, 2021, claiming damages of ₹ 5 lakhs.
- Company sends a proposal to sell an immovable property for ₹ 45 lakhs in March 2021. The book value of the property is ₹ 30 lakhs as on year end date. However, the Deed was registered on 15th April, 2021.
- The terms and conditions for acquisition of business of another company have been decided by the end of March 2021, but the financial resources were arranged in April 2021. The amount invested was ₹ 50 lakhs.
- Theft of cash amounting to ₹ 4 lakhs was done by the Cashier in the month of March 2021 but was detected on the next day after the Financial Statements have been approved by the Directors.

Keeping in view the provisions of AS-4, state with reasons whether the above events are to be treated as Contingencies, Adjusting Events or Non-Adjusting Events occurring after Balance Sheet date.

Solution

- (a) Suit filed against the company is a contingent liability but it was not existing as on date of balance sheet date as the suit was filed on 5th April after the balance sheet date. As per AS 4, 'Contingencies' is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur. However, it may be disclosed with the nature of contingency, being a contingent liability. This event does not pertain to conditions on the balance sheet date. Hence, it will have no effect on financial statement and will be a non-adjusting event.
- (b) In this case, 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 31st March, 2021. There was just a proposal before 31st March, 2021 and hence sale cannot be shown in the financial statements for the year ended 31st March, 2021. Sale of immovable property is an event occurring after the balance sheet date is a non-adjusting event.
- (c) In the given case, terms and conditions for acquisition of business were finalized before the balance sheet date and carried out before the closure of the books of accounts but transaction for payment of financial resources was effected in April, 2021. Hence, it is an adjusting event and necessary adjustment to assets and liabilities for acquisition of business is necessary in the financial statements for the year ended 31st March 2021.
- (d) Only those events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustments to assets and liabilities as at the balance sheet date or may require disclosure. In the given case, as the theft of cash was detected after approval of financial statements, no adjustment is required. Hence it is non-adjusting event.

Question 13 *(Inter Dec 2021) (5 Marks)*

As per the provision of AS 4, you are required to state with reason whether the following transactions are adjusting event or non-adjusting event for the year ended 31.03.2021 in the books of NEW Ltd. (accounts of company were approved by board of directors on 10.07.2021):

- a) Equity Dividend for the year 2020-21 was declared at the rate of 7% on 15.05.2021.
- b) On 05.03.2021, ₹ 53,000 cash was collected from a customer but not deposited by the cashier. This fraud was detected on 22.06.2021.
- c) One building got damaged due to occurrence of fire on 23.05.2021. Loss was estimated to be ₹ 81,00,000.

Solution

- a) If dividends are declared after the balance sheet date but before the financial statements are approved, the dividends are not recognized as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise. Such dividends are disclosed in the notes. Thus, no liability for dividends needs to be recognized in financial statements for financial year ended 31st March, 2021 and declaration of dividend is non-adjusting event.
- b) As per AS 4 '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 such events relate to conditions existing at the

balance sheet date. In the given case, fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognize the loss. Thus, loss amounting ₹ 53,000 should be adjusted in the accounts of the company for the year ended 31st March, 2021 as it is adjusting event.

- c) AS 4 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 damage of one building due to fire did not exist on the balance sheet date i.e. 31.3.2021. Therefore, loss occurred due to fire is not to be recognized in the financial year 2020-2021 as it is non-adjusting event. However, according to the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the fire has caused major destruction; therefore, fundamental accounting assumption of going concern would have to be evaluated. Considering that the going concern assumption is still valid, the fact of fire together with an estimated loss of ₹ 81 lakhs should be disclosed in the report of the approving authority for financial year 2020-21 to enable users of financial statements to make proper evaluations and decisions.

Question 14 *(Inter Nov 2022) (5 Marks)*

MN Limited operates its business into various segments. Its financial year ended on 31st March, 2022 and financial statements were approved by their approving authority on 15th June, 2022. The following material events took place:

- On 7th April, 2022, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of ₹ 15 crores would be fully covered by the insurance company.
- A claim for damage amounting to ₹ 12 crores for breach of patent had been received by the entity prior to the year end. It is the director's opinion, backed by legal advice that the claim will ultimately prove to be baseless. But it is still estimated that it would involve a considerable expenditure on legal fees.
- A major property was sold (it was included in the balance sheet at ₹ 37,50,000) for which contracts had been exchanged on 15th March, 2022. The sale was completed on 15th May, 2022 at a price of ₹ 39,75,000.

You are required to state with reasons, how each of the above items should be dealt with in the financial statements of MN Limited for the year ended 31st March, 2022 as per AS 4.

Solution:

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

- 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 note in the financial statements.
- On the basis of evidence provided, the claim against the company will not succeed. Thus, 12 crores should not be provided in the account but should be disclosed by means of a contingent liability with full details of the facts as per AS 29. Provision can be made for legal fee expected to be incurred to the extent that they are not expected to be recovered if the amount can be ascertained.
- 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 31.3.2022 and the profit on sale of property ₹ 2,25,000 would be considered.