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Sample Notes

Curated By:-

CA, CPA

Vinod Kumar Agarwal

(AIR 2 - CA Foundation, AIR 4 - CA Inter, AIR 24 - CA Final)

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A. S. Foundation's VKNOW Victory of Knowledge

ABOUT

CA VINOD KUMAR AGARWAL
(AIR-2nd, 4th & 24th IN FOUNDATION, INTER & FINAL RESPECTIVELY)

SUMMARY

Founder Member of A.S. Foundation, India's Leading Academy for C.A. Course, CA Vinod Kumar Agarwal is a fellow member of ICAI and a past member of the Board of Studies, ICAI. With a teaching experience of twenty years, he has guided more than 1,00,000 students and is ranked as one of the best teachers for Accounts and Financial Management at Intermediate level and Financial Reporting and SFM at Final Level.

He has authored books on Accounts, Advanced Auditing for CA Final, Auditing for Intermediate, Accounting Standards, Ind AS, Costing and Financial Management, and his books have sold more than 2,00,000 copies.

PUBLICATIONS AND ACHIEVEMENTS

- A merit holder in all the three levels of exams conducted by ICAI (2nd rank, 4th rank, and 24th rank in CA Foundation, CA Intermediate an CA Final respectively).
- Scored 99 marks in Accountancy in CA Foundation.
- Authored books on Accounts, Advanced Auditing for CA Final, Auditing for Intermediate, Accounting Standards, Ind AS, Costing and Financial Management.
- Complied a book "No Truth, Only Interpretations", a book on motivation, inspiration and guidance.
- Compiled a book, "Mind Candy", a book on motivation.
- Compiled a book, "Sweet Voice", a book on inspirational quotes.
- Working experience with India's top firms Firms like M/s. S.B. Billimoria and A.F. Ferguson (both member firm of Deloitte).
- Published article in the Students Newsletter of ICAI on "Valuation of Equity Shares" and "Stock Market Index".
- Presented a paper on "Corporate Governance and Role of Auditor" in National Students Conference held in Goa.

EDUCATION

- Passed the Certified Public Accountant (CPA) (USA) exam in 2007.
- Post-graduation from Pune University with First Class.
- Graduation from B.M.C.C, Pune with distinction.
- Passed the Diploma in Business Finance Conducted by ICFAI, Hyderabad.
- Passed the Derivative Module test conducted by National Stock Exchange.
- Also appeared for UPSC exam and cleared Mains twice.

TEACHING EXPERIENCE

- Teaches Accounts, Advanced Accountancy, Financial management and Economics for Finance at CA Intermediate Level and Financial Reporting and Advanced Financial Management (AFM) at CA Final level.
- Pioneer of creating and distributing video tutorials in pen drives/google drive among students.
- Produced All India Toppers (1st Rank) in CPT examination and final examination apart from more than 250 all India merit- holders.
- More than 30000 Facebook subscribers, more than 42000 YouTube subscribers.
- Sold more than 40000 video lectures in pen-drive and google-drive mode.
- In 2019, launched a brand VKNOW, to become a national brand for digital learning.

TEACHING APPROACH

- Simple and effective way of teaching through concept building, class-room practice, home-exercise, and power-point presentation.
- A large variety of problems are solved in the class to meet the examination requirements.
- Notes are updated frequently covering amendments and exam problems.

QUESTION : 1

Provision for product warranty ***: A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within a specified period from the date of sale. Is provision required ?*** ***(Source: Study material)***

SOLUTION : 1

Present obligation as a result of a past obligating event- *the obligating event is the sale of the product with a warranty, which gives rise to a legal obligation.*

An outflow of resources embodying economic benefits *in settlement is probable for the warranties as a whole.*

Reliable estimate *of the provision can be made.*

Conclusion : *The company is required to recognise provision.*

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QUESTION : 2

A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale, the manufacturer undertakes to remedy, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. As this is the first year that the warranty has been available, there is no data from the firm to indicate whether there will be claim under the warranties. However, industry research suggests that it is likely that such claims will be forthcoming. Should the manufacturer recognize a provision in accordance with the requirements of Ind AS 37. Why or why not? ***(Source: Study material)***

SOLUTION : 2

For a provision to be recognized, Ind as 37 requires that:

a) an entity has a present obligation (legal or constructive) as a result of a past event;

b) it is probable that an outflow of resources embodying economic benefits will required to settle the obligation, and

c) a reliable estimate can be made of the amount of the obligation.

Here, the manufacturer has a present legal obligation. The obligation event is the sale of the product with a warranty.

Ind AS 37 outlines that the future sacrifice of economic benefits is probable when it is more likely than less likely that the future sacrifice of economic benefits will required. The probability that settlement will be required will be determined by considering the class of obligation (warranties) as a whole. In accordance with para 24 of Ind AS 37, it is more likely than less likely that a future sacrifice of economic benefits will be required to settle the class of obligations as a whole.

If a reliable estimate can be made the provision can be measured reliably. Past data can provide reliable measures, even if the data is not firm specific but rather industry based. Ind AS 37 notes that only in extremely rare cases, a reliable measure of a provision cannot be obtained. Difficulty in estimating the amount of a provision under conditions of significant uncertainty does not justify non-recognition of the provision.

Here, the manufacturer should recognize a provision based on the best estimate of the consideration required to settle the present obligation as at the reporting date.

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QUESTION : 3

Assume that the firm has not been operating its warranty for five years, and reliable data exists to suggest the following:

- ***If minor defects occur in all products sold, repair costs of ` 20,00,000 would result.***
- ***If major defects are detected in all products, costs of ` 50,00,000 would result.***
- ***The manufacturer's past experience and future expectations indicate that each year 80% of the goods sold will have no defects. 15% of the goods sold will have minor defects, and 5% of the goods sold will have major defects.***

Calculate the expected value of the cost of repairs in accordance with the requirements of Ind AS 37, if any. Ignore both income tax and the effect of discounting. ***(Reference Book)***

SOLUTION : 3

The expected value of cost of repairs in accordance with Ind as 37 is:

(80% x nil) + (15% x Rs 20,00,000) + (5% x Rs 50,00,000) = 3,00,000 + 2,50,000 = 5,50,000

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QUESTION : 4

A company offers product warranty. Past experience shows that the company had to expend 6% of sales value of the last accounting year during the current accounting period to fulfil the warranty obligation. Should the company recognise any provision for warranty against sales of the current accounting year? ***(ICAI – MTP – 5 Marks)***

SOLUTION : 4

Company should make a provision for warranty based on 6% of sales as there is a present obligation arising out of past events.

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QUESTION : 5

X Chemicals Ltd. engaged in the chemical industry causes environmental damage by dumping waste in the river near its factory. It does not clean up because there is no environmental legislation requiring cleaning up and X Chemicals Ltd. is causing damage for last 40 years. As at March 31, 20X2, the State Legislature has passed a path breaking legislation requiring all polluting factories to clean-up the river water already contaminated. The formal Gazette notification of the law is pending. How should X Chemicals Ltd. deal with this situation? ***(Source: Study material)***

SOLUTION : 5

The obligating event is the contamination of water and because of the virtually certainty of legislation requiring cleaning up, an outflow of resources is certain. It is possible to arrive at best estimated cost for the cleanup activity. So, a provision should be recognised in the books of X Chemicals Ltd. for 20X1-20X2.

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QUESTION : 6 :

Marico has an obligation to restore environmental damage in the area surrounding its factory. Expert advice indicates that the restoration will be carried out in two distinct phases; the first phase requiring expenditure of ` 2 million to remove the contaminated soil from the area and the second phase, commencing three years later from the end of first phase, to replant thearea with suitable trees and vegetation. The estimated cost of replanting is ` 3.5 million. Marico uses a cost of capital (before taxation) of 10% and the expenditure, when incurred, will attract tax relief at the company's marginal tax rate of 30%. Marico has not recognised any provision for such costs in the past and today's date is 31 March 20X2. The first phase of the clean up will commence in a few months time and will be completed on 31 March 20X3 when the first payment of ` 2 million will be made. Phase 2 costs will be paid three years later from the end of first phase. Calculate the amount to be provided at 31 March 20X2 for the restoration costs. ***(Source: Study material)***

SOLUTION : 6

Year	Cash Flow	10% Discount factor	Present Value
20X2-20X3	20,00,000	0.909	18,18,000
20X5-20X6	35,00,000	0.683	23,90,500
Provision required at 31 March 20X2			**42,08,500**

The provision is calculated using the pre-tax costs and a pre-tax cost of capital. The fact that the eventual payment will attract tax relief will be reflected in the recognition of a deferred tax asset for the deductible temporary difference (assuming that the recognition criteria for deferred tax assets are met.)

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QUESTION : 7

ABC Ltd. has an obligation to restore the seabed for the damage it has caused in the past. It has to pay ` 10,00,000 cash on 31st March 20X3 relating to this liability. ABC Ltd.'s management considers that 5% is an appropriate discount rate. The time value of money is considered to be material.

Calculate the amount to be provided for at 31st March 20X1 for the costs of restoring the seabed ***(Source: Study material)***

SOLUTION : 7

Discounting factor of 5% for 2nd year as on 31st March 20X1 = (1/1.05)2 = 0.907

The present value of the provision as on 31st March 20X1 is

= ` 10,00,000 x 0.907 = ` 9,07,000

The amount of increase in the provision resulting from unwinding of discounting to reflect the passage of time should be included as an element of borrowing cost in determining the profit or loss for the year.

The provision should be initially recognised at ` 9,07,000 which is the present value of ` 10,00,000 discounted at 5% for two years. At the end of year 1 i.e. 31st March 20X2, the provision increases to ` 9,52,350, and the difference of ` 45,350 is recognised as borrowing cost. Similarly, for the year ending 31st March 20X3, the provision will increase to 10,00,000 and the increase being recognised as borrowing cost. Consequently, at the end of year 2 the amount of provision will be equal to the amount due, i.e., ` 10,00,000.

Note: *There may be some difference in amount due to approximation (limiting discounting factor to 3 place decimal), which can be overcome either by full scale calculation or adjustment at the end.*

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QUESTION : 8

X Shipping Ltd. is required by law to overhaul its shipping fleet once in every 3 years. The company's finance team was of the view that recognising the costs only when paid would prevent matching of revenue earned all the time with certain costs of

large amounts which are incurred occasional. Thereby, it has formulated an accounting policy of providing in its books of account for the future cost of maintenance (overhauls, annual inspection etc.) by calculating a rate per hours sailed on sea and accumulating a provision over time. The provision is adjusted when the expenditure is actually incurred. Is the accounting policy of X Shipping Ltd. correct? ***(Source: Study material)***

SOLUTION : 8

A provision is made for a present obligation arising out of a past event. Overhauling does not arise out of past event. Even a legal requirement to overhaul does not make the cost of overhaul a liability, because no obligation exists to overhaul the ships independently of the company's future actions - the company could avoid the future expenditure by its future actions for example by selling the ships. So there is no present obligation.

As per the standard, financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an entity's balance sheet are those that exist at the end of the reporting period.

Therefore, the accounting policy of X Shipping Ltd. is not correct. The company should adopt the component approach in Ind AS 16, Property, Plant and Equipment, for accounting for the refurbishment cost.

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QUESTION : 9

On 1st October, 2017, A Ltd. completed the construction of a power generating facility. The total construction cost was ` 2,00,00,000. The facility was capable of being used from 1st October, 2017 but A Ltd. did not bring the facility into use until 1st January, 2018. The estimated useful life of the facility at 1st October, 2017 was 40 years. Legally there are no requirements to restore the land on which power generating facilities stand to its original state at the end of the useful life of the facility. However, A Ltd. has a reputation for conducting its business in an environmentally friendly way and has previously chosen to restore similar land even in the absence of such legal requirements. The directors of A Ltd. estimated that the cost of restoring the land in 40 years' time (based on prices prevailing at that time) would be ` 1,00,00,000. A relevant annual discount rate to use in any discounting calculations is 5%. When the annual discount rate is 5%, the present value of ` 1 receivable in 40 years' time is approximately 0.142.

Analyse and present how the above events would be reported in the financial statements of A Ltd. for the year ended 31st March, 2018 as per Ind AS. ***(Nov. 2018 - RTP)***

SOLUTION : 9

All figures are ` in '000.

The power generating facility should be depreciated from the date it is ready for use, rather than when it would actually start being used. In this case, then, the facility should be depreciated from 1st October, 2017.

Although A Ltd. has no legal obligation to restore the piece of land, it does have a constructive obligation, based on its past practice and policies.

The amount of the obligation will be 1,420, being the present value of the anticipated future restoration expenditure (10,000 x 0.142).

This will be recognised as a provision under non-current liabilities in the Balance Sheet of A Ltd. at 31st March, 2018.

As time passes the discounted amount unwinds. The unwinding of the discount for the year ended 31st March, 2018 will be 35.5 (1,420 x 5% x 6/12).

The unwinding of the discount will be shown as a finance cost in the statement of profit or loss and the closing provision will be 1,455.50 (1,420 + 35.5).

The initial amount of the provision is included in the carrying amount of the non-current asset, which becomes 21,420 (20,000 + 1,420).

The depreciation charge in profit or loss for the year ended 31st March, 2018 is 267.75 (21,420 x 1/40 x 6/12).

The closing balance included in non-current assets will be 21,152.25 (21,420 – 267.75).

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QUESTION : 10

Entity XYZ entered into a contract to supply 1000 television sets for ` 2 million. An increase in the cost of inputs has resulted into an increase in the cost of sales to ` 2.5 million. The penalty for non- performance of the contract is expected to be ` 0.25 million. Is the contract onerous and how much provision in this regard is required? ***(Source: Study material)***

SOLUTION : 10

Ind AS 37 "Provisions, Contingent Liabilities and Contingent Assets" defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

Paragraph 68 of Ind AS 37 states that the unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it.

In the instant case, cost of fulfilling the contract is ` 0.5 million (` 2.5 million – ` 2 million) and cost of exiting from the contract by paying penalty is ` 0.25 million.

In accordance with the above reproduced paragraph, it is an onerous contract as cost of meeting the contract exceeds the economic benefits.

Therefore, the provision should be recognised at the best estimate of the unavoidable cost, which is lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it, i.e., at ` 0.25 million (lower of ` 0.25 million and ` 0.5 million).

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QUESTION : 11

X Metals Ltd. had entered into a non-cancellable contract with Y Ltd. to purchase 10,000 units of raw material at ` 50 per unit at a contract price of ` 5,00,000. As per the terms of contract, X Metals Ltd. would have to pay ` 60,000 to exit the said contract. X Metals Ltd. has discontinued manufacturing the product that would use the said raw material. For that X Metals Ltd. has identified a third party to whom it can sell the said raw material at ` 45 per unit.

How should X Metals Ltd. account for this transaction in its books of account in respect of the above contract?

(Source: Study material)

SOLUTION : 11

These circumstances do indicate an onerous contract. The only benefit to be derived from the purchase contract costing ` 5,00,000 are the proceeds from the sale contact, which are ` 4,50,000. Therefore, a provision should be made for the onerous element of ` 50,000, being the lower of cost of fulfilling the contract and the penal cost of cancellation of ` 60,000.

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QUESTION : 12

Sun Limited has entered into a binding agreement with Moon Limitedto buy a custom- made machine for ` 4,00,000. At the end of 2017-18, before delivery of the machine, Sun Limited had to change its method of production. The new method will not require the machine ordered which is to be scrapped after delivery. The expected scrap value is nil. Given that the asset is yet to be delivered, should any liability be recognized for the potential loss? If so, give reasons for the same, the amount of liability as well as the accountingentry. ***(Nov. 2018 – Exam - 4 Marks)***

SOLUTION : 12

As per IndAS 37, Executory contracts are contracts underwhich

- *neither party has performed any of its obligations; or*
- *both parties have partially performed their obligations to an equalextent.*

The contract entered by Sun Ltd. is an executory contract, since the delivery has not yet taken place.

Ind AS 37 is applied to executory contracts only if they are onerous.

Ind AS 37 defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

As per the facts given in the question, Sun Ltd. will not require the machine ordered. However, since it is a binding agreement, the entity cannot exit / cancel the agreement. Further, Sun Ltd. has to scrap the machine after delivery at nil scrapvalue.

These circumstances do indicate that the agreement/contract is an onerous contract. Therefore, a provision should be made for the onerous element of ` 4,00,000ie the full cost of themachine.

		`	`
Onerous Contract Provision Expense A/c	*Dr.*	*4,00,000*	
To Provision for Onerous Contract Liability A/c			*4,00,000*
(Being asset to be received due to binding agreement recognized)			
Profit and Loss Account (Loss due to onerous contract)	*Dr.*	*4,00,000*	
To Onerous Contract Provision Expense A/c			*4,00,000*
(Being loss due to onerous contract recognized and assetderecognsied)			

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QUESTION : 13

ABC Limited is an automobile component manufacturer. The automobile manufacturer has specified a delivery schedule, non-adherence to which will entail a penalty. As on 31st March, 20X1, the reporting date, the manufacturer has a delivery scheduled for June 20X2. However, the manufacturer is aware that he will not be able to meet the delivery schedule in June 20X2.

Determine whether the entity has a present obligation as at 31st March, 20X1, requiring recognition of provision.

(Source: Study material)

SOLUTION : 13

In this case, there is no present obligation arising out of a past event as the goods are scheduled for delivery in June 20X2 and there is no delay as at 31st March, 20X1. Hence, there is no present obligation to pay the penalty in the current year. Therefore, there is no present obligation to recognise the provision.

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QUESTION : 14

X Ltd. has entered into an agreement with its selling agent Y, in accordance with which X Ltd. has to pay a base percentage of commission on export sales and an additional commission is to be paid if the export incentives are received. As per the accounting policy of X Ltd., it recognises export incentives when actually realised, on account of the uncertainty in realising such incentives. Export incentives have not been received for the year 20X1-20X2, however X Ltd. is hopeful of receiving the export incentives in the year 20X2-20X3. In the financial statements for 20X1-20X2, should X Ltd. provide for both base commission and additional commission? (Source: Study material)

SOLUTION : 14

So far as the base percentage of sales commission is concerned, it is a present obligation arising out of past events. The obligating event takes place when the sales are made and also since commission is based on percentage of sale, reliable estimation can also be made. Therefore, the base percentage of sales commission should be provided.

However, in respect of additional commission, it is to be paid when the export incentives are recognised and export incentives are recognised only when it is received. Therefore, the obligating event will arise only when export incentives are received. Hence, no provision for additional commission is to be made in financial year 20X1-20X2. The expectation of X Ltd. to receive the export incentives in next year would not make any difference as on 31 March 20X2.

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QUESTION : 15

X Cements Ltd. has three manufacturing units situated in three different states of India. The board of directors of X Cements Ltd., in their meeting held on January 10, 20X1, decided to close down its operations in one particular state on account of environmental reasons. A detailed formal plan for shutting down the above unit was also formalised and agreed by the board of directors in that meeting, which specifies the approximate number of employees who will be compensated and expenditure expected to be incurred. Date of implementation of plan has also been mentioned. Meetings were also held with customers, suppliers, and workers to communicate the features of the formal plan to close down the operations in the said state, and representatives of all interested parties were present in those meetings. Do the actions of the board of directors create a constructive obligation that needs a provision for restructuring? (Source: Study material)

SOLUTION : 15

As per Ind AS 37, the conditions prescribed are:

(a) *there should be detailed formal plan of restructuring;*

(b) *which should have raised valid expectations in the minds of those affected that the entity would carry out the restructuring by announcing the main features of its plans to restructure.*

The board of directors did discuss and formalise a formal plan of winding up the operation in the above said state. This plan was communicated to the parties affected and created a valid expectation in their minds that X Cements Ltd. would go ahead with its plans to close down operations in that state. Thus, there is a constructive obligation that needs to be provided at year-end.

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QUESTION : 16

X Packaging Ltd. has two segments, packaging division and paper division. In March 20X1, the board of directors approved and announced a formal plan to sell the paper division in June 20X1. Operating losses of the paper division are estimated to be approximately ` 50,00,000 during the period from April 1, 20X1 to the expected date of disposal. Management of X Packaging Ltd. wants to include the future operating loss of ` 50,00,000 in a provision for restructuring in the financial statements for the period ended March 31, 20X1. Can X Packaging Ltd. include these operating losses in a provision for restructuring?

(Source: Study material)

SOLUTION : 16

Standard states that provision should not be made for future operating losses. Since Ind AS 37 prohibits the recognition of future operating losses, so X Packaging Ltd. should

not include these future operating losses in a provision for restructuring even though these losses relate to the disposal group.

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QUESTION : 17

U Ltd. is a large conglomerate with a number of subsidiaries. It is preparing consolidated financial statements as on 31st March 2018 as per the notified Ind AS. The financial statements are due to be authorised for issue on 15th May 2018. It is seeking your assistance for some transactions that have taken place in some of its subsidiaries during the year.

G Ltd. is a wholly owned subsidiary of U Ltd. engaged in management consultancy services. On 31st January 2018, the board of directors of U Ltd. decided to discontinue the business of G Ltd. from 30th April 2018. They made a public announcement of their decision on 15th February 2018.

G Ltd. does not have many assets or liabilities and it is estimated that the outstanding trade receivables and payables would be settled by 31st May 2018. U Ltd. would collect any amounts still owed by G Ltd's customers after 31st May 2018. They have offered the employees of G Ltd. termination payments or alternative employment opportunities.

Following are some of the details relating to G Ltd.:

⇒ ***On the date of public announcement, it is estimated by G Ltd. that it would have to pay 540 lakhs as termination payments to employees and the costs for relocation of employees who would remain with the Group would be ` 60 lakhs. The actual termination payments totalling to ` 520 lakhs were made in full on 15th May 2018. As per latest estimates made on 15th May 2018, the total relocation cost is ` 63 lakhs.***

⇒ ***G Ltd. had taken a property on operating lease, which was expiring on 31st March 2022. The present value of the future lease rentals (using an appropriate discount rate) is ` 430 lakhs. On 15th May 2018, G Ltd. made a payment to the lessor of ` 410 lakhs in return for early termination of the lease.***

The loss after tax of G Ltd. for the year ended 31st March 2018 was ` 400 lakhs. G Ltd. made further operating losses totalling ` 60 lakhs till 30th April 2018.

How should U Ltd. present the decision to discontinue the business of G Ltd. in its consolidated statement of comprehensive income as per Ind AS?

What are the provisions that the Company is required to make as per lnd AS 37? ***(Source: Study material)***

SOLUTION : 17

A discontinued operation is one that is discontinued in the period or classified as held for sale at the year end. The operations of G Ltd were discontinued on 30th April 2018 and therefore, would be treated as discontinued operation for the year ending 31st March 2019. It does not meet the criteria for held for sale since the company is terminating its business and does not hold these for sale.

Accordingly, the results of G Ltd will be included on a line-by-line basis in the consolidated statement of comprehensive income as part of the profit from continuing operations of U Ltd for the year ending 31st March 2018.

As per para 72 of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', restructuring includes sale or termination of a line of business. A constructive obligation to restructure arises when:

a) an entity has a detailed formal plan for the restructuring

b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

The Board of directors of U Ltd have decided to terminate the operations of G Ltd. from 30th April 2018. They have made a formal announcement on 15th February 2018, thus creating a valid expectation that the termination will be implemented. This creates a constructive obligation on the company and requires provisions for restructuring.

A restructuring provision includes only the direct expenditures arising from the restructuring that are necessarily entailed by the restructuring and are not associated with the ongoing activities of the entity.

The termination payments fulfil the above condition. As per Ind AS 10 'Events after Reporting Date', events that provide additional evidence of conditions existing at the reporting date should be reflected in the financial statements. Therefore, the company should make a provision for ` 520 lakhs in this respect.

The relocation costs relate to the future conduct of the business and are not liabilities for restructuring at the end of the reporting period. Hence, these would be recognised on the same basis as if they arose independently of a restructuring.

The operating lease would be regarded as an onerous contract. A provision would be made at the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. Hence, a provision shall be made for ` 410 lakhs.

Further operating losses relate to future events and do not form a part of the closure provision.

Therefore, the total provision required = ` 520 lakhs + ` 410 lakhs = ` 930 lakhs

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QUESTION : 18

X Telecom Ltd. has income tax litigation pending before appellate authorities. Legal advisor's opinion is that X Telecom Ltd. will lose the case and estimated that liability of ` 1,00,00,000 may arise in two years. The liability is recognised on a discounted basis. The discount rate at which the liability has been discounted is 10% and it is assumed that discount rate does not change over the period of 2 years. How should X Telecom Ltd. calculate the amount of borrowing cost?

(Source: Study material)

SOLUTION : 18

The discount factor of 10% for 2 years is 0.827. X Telecom Ltd. will initially recognise provision for ` 82,70,000 (` 1,00,00,000 x 0.827).

The discount factor of 10% at the end of year 1 is 0.909. At the end of year 1, provision amount would be ` 90,90,000 (` 1,00,00,000 x 0.909).

As per the standard, the difference between the two present values i.e., ` 8,20,000 is recognised as a borrowing cost in year 1.

At the end of the Year 2, the liability would be ` 1,00,00,000.

The difference between the two present values i.e., ` 9,10,000 (` 1,00,00,000 - ` 90,90,000) is recognised as borrowing cost in year 2.

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QUESTION : 19

X Beauty Solutions Ltd. is selling cosmetic products under its brand name 'B', but it is getting its product manufactured from Y Ltd. It has an understanding with Y Ltd. that if the company becomes liable for any damage claims, due to any injury or harm to the customer of the cosmetic products, 30% will be reimbursed to it by Y Ltd. During the financial year 20X1-20X2, a claim of Rs 30,00,000 becomes payable to customers by X Beauty Solutions Ltd. How should X Beauty Solutions Ltd. account for the claim that becomes payable? ***(Source: Study material)***

SOLUTION : 19

X Beauty Solutions Ltd. will get reimbursement of Rs 9,00,000 (i.e 30,00,000 x 30%) from Y Ltd. So, X Beauty Solutions Ltd. should make a provision of Rs 21,00,000 (30,00,000 - 9,00,000) in financial year 20X1-20X2 and disclose a contingent liability of Rs 9,00,000. The contingent liability is recognised keeping in view the fact that in case Y Ltd. does not pay, then X Beauty Solutions Ltd. will be liable for the whole claim.

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QUESTION : 20

Shyam Ltd. (a Public Sector Company) provides consultancy and engineering services to its clients. In the year 2020-21, the Government has set up a commission to decide about the pay revision. The pay will be revised with respect from 1-1-2016 based on the recommendations of the commission. The company makes the provision of Rs. 680 lakhs for pay revision in the financial year 2020-21 on the estimated basis as the report of the commission is yet to come. As per the contracts with the client on cost plus job, the billing is done on the actual payment made to the employees and allocated to jobs based on hours booked by these employees on each job.

The company discloses through notes to accounts

"Salaries and benefits include the provision of Rs. 680 lakhs in respect of pay revision. The amount chargeable from reimbursable jobs will be billed as per the contract when the actual payment is made".

The accountant feels that the company should also book/recognise the income by Rs. 680 lakhs in Profit and Loss Account as per the terms of the contract. Otherwise, it will be the violation of matching concept & understatement of profit.

(Source: Study material)

SOLUTION : 20

Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.

Accordingly, potential loss to an enterprise may be reduced or avoided because a contingent liability is matched by a related counter-claim or claim against a third party. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim if no significant uncertainty as to its measurability or collectability exists.

In this case, the provision of salary to employees of Rs. 680 lakhs will be ultimately collected from the client, as per the terms of the contract. Therefore, the liability of Rs. 680 lakhs is matched by the counter claim from the client. Hence, the provision for salary of employees should be made reducing the claim to be made from the client. It appears that the whole amount of Rs. 680 lakhs is recoverable from client and there is no significant uncertainty about the collection. Hence, the net charge to profit and loss account should be nil.

The opinion of the accountant regarding non-recognition of income of Rs. 680 lakhs is not as per Ind AS 37. However, the concept of prudence will not be followed if Rs.680 lakhs is simultaneously recognized as income. Rs. 680 lakhs is not the revenue at present but only reimbursement of claim. However the accountant is correct to the extent as that non- recognition of Rs. 680 lakhs as income will result in the understatement of profit.

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QUESTION : 21 ***A COURT CASE***

A Company has at its financial year ended 31st March, 2024 fifteen law suits outstanding, none of which has been settled by the time the accounts are approved by the directors. The directors have estimated that the possible out-comes are as below:

Result	Probability	Amount of loss
For first ten cases:		***Rs.***
Win	***0.6***	***--***
Lose-low damages	***0.3***	***90,000***
Lose-high damages	***0.1***	***1,60,000***
For remaining five cases:		
Win	***0.5***	***--***
Lose-low damages	***0.3***	***60,000***
Lose-high damages	***0.2***	***95,000***

The directors believe that the outcome of each case is independent of the outcome of all the others.

Estimate the amount of contingent loss and state the accounting treatment of such contingent loss. ***(Reference Book)***

SOLUTION : 21

Contingent liability should be disclosed in financial statements if following conditions are satisfied:-

- *There should be present obligation arising out of past event but not recognized as provision.*
- *It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.*
- *The possibility of an outflow of resources embodying economic benefits is not remote.*
- *The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.*

In this case, the probability of winning of first 10 cases is 60% and for remaining, five cases 50%. In other words, the probability of losing is 40% or 50% respectively. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in first ten cases	=	*Rs. 90,000 x 0.3 + Rs. 1,60,000 x 0.1*
	=	*Rs. 43,000 x 10*
	=	*Rs. 4,30,000*
Expected loss in remaining five cases	=	*Rs. 60,000 x 0.3 + Rs. 95,000 x 0.2*
	=	*Rs. 37,000 x 5*
	=	*Rs. 1,85,000*
Total Contingent Liability	=	*Rs. 4,30,000 + Rs. 1,85,000 = Rs. 6,15,000*

*****

QUESTION : 22

X Chemical Ltd. is operating in the vicinity of a river since 20 years. A community living near X Chemical Ltd. claims that its operations has caused contamination of drinking water. X Chemical Ltd. has received notice from the governmental environmental agency that official investigations will be made into claims of pollution caused by the entity. If it is found that X Chemical Ltd. has caused contamination, then penalties and fine would be levied on it.

X Chemical Ltd. believes that it has implemented all environmental safety measures to an extent that it is unlikely to cause pollution. Management is not sure whether it has all the information about the entire 20 years. Therefore, neither management nor external experts are able to assess X Chemical Ltd.'s responsibility until the investigation has completed.

In such situation, how should management of X Chemical Ltd. account for a liability? ***(Source: Study material)***

SOLUTION : 22

As per the standard, in the present case, the available evidence does not support a conclusion that a present obligation exists. However, there is a possible obligation which exists and will be confirmed upon completion of investigations. Therefore, management should disclose the contingent liability for potential penalties and fines that may be imposed if contamination is proved.

*****

QUESTION : 23

During the year, QA Ltd. delivered manufactured products to customer K. The products were faulty and on 1st October, 2016 customer K commenced legal action against the Company claiming damages in respect of losses due to the supply of faulty product. Upon investigating the matter, QA Ltd. discovered that the products were faulty due to defective raw material procured from supplier F. Therefore, on 1st December, 2016, the Company commenced legal action against F claiming damages in respect of the supply of defec tive raw materials.

QA Ltd. has estimated that it's probability of success of both legal actions, the action of K against QA Ltd. and action of QA Ltd. against F, is very high.

On 1st October, 2016, QA Ltd. has estimated that the damages it would have to pay K would be Rs. 5 crores. This estimate was revised to Rs. 5.2 crores as on 31st March, 2017 and Rs. 5.25 crores as at 15th May, 2017. This case was eventually settled on 1st June, 2017, when the Company paid damages of Rs. 5.3 crores to K.

On 1st December, 2016, QA Ltd. had estimated that it would receive damages of Rs. 3.5 crores from F. This estimate was revised to Rs. 3.6 crores as at 31st March, 2017 and Rs. 3.7 crores as on 15th May, 2017. This case was eventually settled on 1st June, 2017 when F paid Rs. 3.75 crores to QA Ltd. QA Ltd. had, in its financial statements for the year ended 31 st March, 2017, provided Rs. 3.6 crores as the financial statements were approved by the Board of Directors on 26th April, 2017.

(i) ***Whether the Company is required to make provision for the claim from customer K as per applicable Ind AS? If yes, please give the rationale for the same.***

(ii) ***If the answer to (a) above is yes, what is the entry to be passed in the books of account as on 31st March, 2017? Give brief reasoning for your choice.***

(A)	***Statement of Profit and Loss A/c***	***Dr.***	***Rs. 5.2 crores***	***Rs. 5.2 crores***
	To Current Liability A/c			***Rs. 5.2 crores***
(B)	***Statement of Profit and Loss A/c***	***Dr.***	***Rs. 5.3 crores***	
	To Non-Current Liability A/c			***Rs. 5.3 crores***
(C)	***Statement of Profit and Loss A/c***	***Dr.***	***Rs. 5.25 crores***	
	To Current Liability A/c			***Rs. 5.25 crores***

What will the accounting treatment of the action of QA Ltd. against supplier F as per applicable Ind AS?

(Nov. 2018 Exam - 6 Marks)

SOLUTION : 23

(i) Yes, QA Ltd. is required to make provision for the claim from customer K as per Ind AS 37 since the claim is a present obligation as a result of delivery of faulty goods manufactured. Also, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations. Further, a reliable estimate of Rs. 5.2 crore can be made of the amount of the obligation while preparing the financial statements as on 31st March, 2017.

(ii) *Option (A) : Statement of Profit and Loss A/c Dr. Rs. 5.2 crore*

To Current Liability A/c Rs. 5.2 crore

(iii) As per para 31 of Ind AS 37, QA Ltd. shall not recognise a contingent asset. Here the probability of success of legal action is very high but there is no concrete evidence which makes the inflow virtually certain. Hence, it will be considered as contingent asset only and shall not be recognized.

*****

QUESTION : 24

A company manufacturing and supplying process control equipment is entitled to duty draw back if it exceeds its turnover above a specified limit. To claim duty drawback, the company needs to file application within 15 days of meeting the specified turnover. If application is not filed within stipulated time, the Department has discretionary power of giving duty draw back credit. For the year 20X1-20X2 the company has exceeded the specified limit of turnover by the end of the reporting period. However, duty drawback can be claimed on filing of application within the stipulated time or on discretion of the Department if filing of application is late. The application for duty drawback is filed on April 20, 20X2, which is after the stipulated time of 15 days of meeting the turnover condition. Duty drawback has been credited by the Department on June 28, 20X2 and financial statements have been approved by the Board of Directors of the company on July 26, 20X2. What would be the treatment of duty drawback credit as per the given information? (Source: Study material)

SOLUTION : 24

In the instant case, the condition of exceeding the specified turnover was met at the end of the reporting period and the company was entitled for the duty drawback. However, the application for the same has been filed after the stipulated time. Therefore, credit of duty drawback was discretionary in the hands of the Department. Since the claim was to be accrued only after filing of application, its accrual will be considered in the year 20X2-20X3 only.

Accordingly, the duty drawback credit is a contingent asset as at the end of the reporting period 20X1-20X2, which will be realised when the Department credits the same.

As per para 35 of Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an entity discloses the contingent asset.

In accordance with the above, the duty drawback credit which was contingent asset for the F.Y. 20X1 -20X2 should be recognised as asset and related income should be recognized in the reporting period in which the change occurs. i.e., in the period in which realisation becomes virtually certain, i.e., F.Y. 20X2 - 20X3

*****

QUESTION : 25

X Sugars Ltd. has entered into a sale contract of ` 3,00,00,000 with Y Choclates Ltd. for the supply of sugar during 20X1-20X2. As per the contract the delivery is to be made within 2 months from the date of contract. In case of failure to deliver within the schedule, X Sugars Ltd. has to pay a compensation of ` 30,00,000 to Y Chocolates Ltd.

During the transit, the vehicle carrying the sugar met accident and X Sugar Ltd. lost the entire consignment. It is, however covered by an insurance policy. According to the report of the surveyor, the amount is collectible, subject to the deductible clause [i.e., 15% of the claim] in the insurance policy. The cost of goods lost was ` 2,50,00,000.

Before the financial year end, X Sugars Ltd. received informal information from the insurance company that their claim had been processed and the payment had been dispatched for 85% of the claim amount. Meanwhile Y Chocolates Ltd. has made demand of ` 30,00,000 since the goods were not delivered on time.

What provision or disclosure would X Ltd. need to make at year end? ***(Source: Study material)***

SOLUTION : 25

As per the standard, where an inflow of economic benefits is probable, an entity should disclose a brief description of the nature of the contingent assets at the end of the reporting period, and, where practicable, an estimate of their financial effect, measured using the principles set out in Ind AS 37.

So X Sugars Ltd. would need to disclose the contingent asset of ` 2,12,50,000 (` 2,50,00,000 x 85%) at the end of the financial year 20X1-20X2.

It would also need to make a provision of ` 30,00,000 towards the claim of Y Chocolates Ltd.

*****

QUESTION : 26

Raghav Ltd. had a major break down in its plant in the month of February. In the month of March it entered into an agreement with an Engineering Firm for the purpose of repairing its plant for a consideration of Rs. 180 lakhs. The Engineering Firm started the repairing work in the month of April and completed it in the same month. Raghav Ltd. made the Provision for said expenditure on repairs in its books of account for the financial year ended 31st March on the plea that the event of break down leading to repair expenditure had taken place in that financial year, binding contract for repairs was entered into during the same financial year and repair work was also completed before the Financial Statements were approved by the Company's Board of Directors. Comment. ***(Source: Study material)***

SOLUTION : 26

1. ***Recognition :*** *Provision should be recognized if the following conditions for satisfied –*

Condition (1)	***Condition (2)***	***Condition (3)***
Present *obligation as a result of past event.*	***Outflow of resources*** *to settle the obligation is probable.*	*Reliable* ***estimate*** *of the amount.*
Break down of the plant and binding contract for repairs is entered into, during the financial year ending 31st March but the Engineering Firm has ***not started*** *performing the work of repair until the date of Balance Sheet. Hence, there is* ***nopresent obligation****.*	*Payment should be made to the Engineering Firm as per the Binding Contract on completion of the repairs and hence outflow of resources is probable.*	*Sum payable on account of repairs is Rs. 180 lakhs.*

2. ***Treatment and Conclusion :***
   a. *Since all the conditions for recognition of a Provision are not satisfied, a Provision should* ***not*** *be recognized for the year ending 31st March.*
   b. *Hence, Provision made by Raghav Ltd. for expenditure on repairs in its books of account for repair work to be done in the next Financial Year is wrong, as there was no obligation.*

*****

QUESTION : 27

Rajeev Ltd. was under audit for the year-ended 31st March. An appeal filed by Rajeev Ltd. against the demand of Excise Duty of Rs. 26 Crores was pending before the Supreme Court for which neither Provision was made nor was disclosed in the Notes to the Financial Statements. On 12th July (i.e. subsequent to the Balance sheet date), the Auditor came to know through paper reports that the point involved in the appeal of Rajeev Ltd. was adjudicated by the Supreme Court in the case of some other assessee, which is in favour of the Department of Excise Duty. The Auditor insisted that Provisions be made of Rs. 26 Crores in the Financial Statements. The Management was of the view that since its own case is still pending, no Provision is called for. It was also of the view that the event does not have any effect on the financial position of the Company on the Balance sheet date. Is the Management's view correct? ***(Source: Study material)***

SOLUTION : 27

1. ***Recognition :*** *Provision should be recognized if the following conditions for satisfied –*

Condition (1)	Condition (2)	Condition (3)
***Present** obligation as a result of past event.*	***Outflow of resources** to settle the obligation is **probable**.*	***Reliableestimate** of the amount.*
Excise Duty demand is already made on the Company. Hence present obligation exists at the Balance Sheet date.	*Additional evidence arising after Balance Sheet date lead to the conclusion that the outflow is probable i.e. more likely than not.*	*Rs. 26 crores is the amount of the liability. (Given)*

2. ***Treatment and Conclusion :**Since all the conditions for recognition of a Provision are satisfied, the Provision should be recognized for the year ending 31st March. If the amount is material, separate disclosure is also required. The Management's contention is not tenable.*

*****

QUESTION : 28

X Solar Power Ltd., a power company, has a present obligation to dismantle its plant after 35 years of useful life. X Solar Power Ltd. cannot cancel this obligation or transfer to third party. X Solar Power Ltd. has estimated the total cost of dismantling at ` 50,00,000, the present value of which is ` 30,00,000. Based on the facts and circumstances, X Solar Power Ltd. considers the risk factor of 5% i.e., the risk that the actual outflows would be more from the expected present value. How should X Solar Power Ltd. account for the obligation? (Source: Study material)

SOLUTION : 28

The obligation should be measured at the present value of outflows i.e., ` 30,00,000. Further a risk adjustment of 5% i.e., ` 1,50,000 (` 30,00,000 x 5%) would be made.

So, the liability will be recognised at = ` 30,00,000 + `1,50,000 = ` 31,50,000.

*****

QUESTION : 29

A manufacturer gives warranties at the time of sale to purchasers of its three product lines. Under the terms of the warranty, the manufacturer undertakes to repair or replace items that fail to perform satisfactorily for two years from the date of sale. At the end of the reporting period, a provision of ` 60,000 has been recognised. The provision has not been discounted as the effect of discounting is not material. Draft the Note. (Source: Study material)

SOLUTION : 29

A provision of ` 60,000 has been recognised for expected warranty claims on products sold during the last three financial years. It is expected that the majority of this expenditure will be incurred in the next financial year, and all will be incurred within two years after the reporting period.

*****

QUESTION : 30

X Ltd. is operating in the telecom industry. During the Financial Year 20X1-20X2, the Income Tax authorities sent a scrutiny assessment notice under Section 143(2) of the Income-tax Act, 1961, in respect to return filed under Section 139 of this Act for Previous Year 20X0-20X1 (Assessment Year 20X1-20X2) and initiated assessment proceedings on account of a deduction claimed by the company which in the view of the authorities was inadmissible.

During the financial year 20X1-20X2 itself, the assessment proceedings were completed and the assessing officer did not allow the deduction and raised a demand of ` 1,00,00,000 against the company. The company contested such levy and filed an appeal with the Appellate authority. At the end of the financial year 20X1-20X2, the appeal had not been heard. The company is not confident whether that the company would win the appeal. However, the company was advised by its legal counsel that on a similar matter, two appellate authorities of different jurisdictions had given conflicting judgements, one in favour of the assessee and one against the assessee. The legal counsel further stated it had more than 50% chance of winning the appeal. Please advise how the company should account for these transactions in the financial year 20X1-20X2.

The information usually required by Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, is not disclosed on the grounds that it can be expected to prejudice seriously the outcome of the litigation. The directors are of the opinion that the claim can be successfully resisted by the company. (Source: Study material)

SOLUTION : 30

Ind AS 37 provides that in rare cases it not clear whether there is a present obligation, for example, in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an entity should determine whether a present obligation exits at the end of the reporting period by taking account of all available evidence, for example, the opinion of experts.

In the present case, the company is not confident that whether it would win the appeal. By taking into account the opinion of the legal counsel, it is not sure that whether the company would win the appeal. On the basis of such evidence, it is more likely than not that a present obligation exists at the end of the reporting period. Therefore, the entity should recognise a provision. The company should provide for a liability of ` 1,00,00,000.

*****

QUESTION : 31

What is the accounting treatment for recognising the impact of unwinding of discounting?

The amount of increase in the provision resulting from unwinding of discounting to reflect the passage of time should be included as an element of borrowing cost in determining the profit or loss for the year.

Example: An entity has a legal claim that is likely to be settled at the end of two years for an amount of Rs. 100 million. Assuming a discounting rate of 4.5%, the accounting will be as follows: ***(Reference Book)***

SOLUTION : 31

	Discounting factor @ 4.5%	NPV (Rs. in Million)	Borrowing cost (Rs. in Million)
	0.9157	91.57	
End of Year 1	0.9569	95.69	4.12
End of Year 2	1	100	4.31

The provision should be initially recognised at Rs. 91.57 million which is the present value of Rs. 100 million discounted at 4.5% for two years. At the end of year 1, the provision increases to Rs. 95.69 million, and the difference of Rs. 4.12 million is recognised as borrowing cost. In year 2, the provision will increase by Rs. 4.31 million, the increase being recognised as borrowing cost. Consequently, at the end of year 2 the amount of provision will be equal to the amount due, i.e., Rs. 100 million.

*****

QUESTION : 32

XYZ Ltd. offers a six-month warranty on its small to medium sized equipment, which can be put to use by the customer with no installation support. The warranty comes with the equipment and the customer cannot purchase it separately. This equipment is typically sold at a gross margin of 40%. XYZ Ltd. has made a provision of ` 30,000 during the year ended 31st March, 20X2, which is approximately 1% of its gross margin on the sale of these equipment. Based on past experience, it is expected that 1 % of equi pment sold have been returned as faulty within the warranty period. Faulty equipment returned to XYZ Ltd. during the warranty period are scrapped and the sale value is fully refunded to the customer.

Assuming that sales occurred evenly during the year, how should XYZ Ltd. evaluate whether any additional warranty provision is required on equipment sold in the past as at 31st March, 20X2? Had the warranty period been 2 years instead of six months, what additional criteria would XYZ Ltd. need to consider? ***(RTP – May 2022)***

SOLUTION : 32

Calculation of additional warranty provisions:

Warranty claim covers 1% of gross margin, whereas customers are refunded the full selling price. As the goods are scrapped it is assumed XYZ Ltd has no potential for reimbursement from its supplier regarding the faulty goods.

A calculation of warranty provision is set out below:

1% of annual gross margin is ` 30,000 therefore 100% of annual gross margin must be ` 30,00,000. Since gross margin is 40%, sales should be ` 75,00,000. As provide in the question that the sales are evenly spread during the year and given the six month warranty, half of the sales occurred in the second half of the year is still covered within the warranty period as follows.

	% age	Annual sales	Product under warranty at 31st March, 20X2	Percentage expected to be returned	Warranty provision
		`	`	`	`
Gross margin Selling price	40% 100%	30,00,000 50,00,000	37,50,000	1%	37,500

The warranty provision should therefore be increased by ` 7,500 (` 37,500 - ` 30,000). As the provision is expected to be used in the next 6 months no discounting is required.

If the warranty period is 2 years:

Since the outstanding period of warranties is 6 months (i.e. less than a year), no discounting is required. However, if a longer warranty period is to be given, the entity will have to take into account the effect of the time value of money. The amount of provision shall be the present value of the expenditures expected to be required to settle the warranty obligation. (Refer Para 45 of Ind AS 37)

The discount rate shall be a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The discount rate shall not reflect risks for which future cash flow estimates have been adjusted. (Refer Para 47 of Ind AS 37)

	% age	Annual sales	Product under warranty at 31st March, 20X2	Percentage expected to be returned	Warranty provision

		`	`	`	`
Gross margin	40%	30,00,000			
Selling price	100%	75,00,000	75,00,000	1%	75,000

The warranty provision should therefore be increased by ` 45,000 (` 75,000 - ` 30,000). Further discounting of provision would be required.

*****

QUESTION : 33

TCO Limited is a telecom operator. Laying of cables across the world is a requirement to enable the entity to run its business. Cables are also laid under the sea and contracts are entered into for the same. By virtue of laws of the countries through which the cable passes, the entity is required to restore the sea bed at the end of the contract period. Discuss the nature of obligation that TCO Limited has in such a case. ***(May 2023 Exam - 4 Marks)***

SOLUTION : 33

Paragraph 14 of Ind AS 37 states that a provision shall be recognised when:

a) an entity has a present obligation (legal or constructive) as a result of a past event;

b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision shall be recognised.

Further, with regard to past event paragraph 17 of Ind AS 37 states that a past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only:

a) where the settlement of the obligation can be enforced by law; or

b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation.

Applying the above guidance in the given scenario, provision should be recognised as soon as the obligating event takes place because the entity is under legal obligation to restore the seabed, provided the other recognition criteria stated in paragraph 14 reproduced above are met. Moreover, the amount of the provision would depend on the extent of the obligation arising from the obligating event. In the instant case, an obligating event is the laying of cables under the sea. To the extent the cables hav e been laid down under the sea, a legal obligation has arisen and to that extent provision for restoration of seabed should be recognised.

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PROBLEM :- 34

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

SOLUTION: 34

A provision should be recognised only when an enterprise has a present obligation as a result of a past event. In the given case, there is no present obligation, therefore no provision is recognized as per IND AS 37.

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

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PROBLEM :- 35

Refunds Policy : A company follows a policy of refunding money to the dissatisfied customers if they claim within thirty days from the date of purchase and return the goods. It appears from the past experience that in a month only 0.25% of the customers claim refunds. The company sold goods amounting to Rs. 10 lacs during the last month of the financial year. Should the entity create provision?

SOLUTION : 35

Present obligation as a result of a past obligating event - *The obligating event is the sale of the product, which gives rise to an obligation because obligations also arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner.*

An outflow of resources embodying economic benefits in settlement- *Probable, a proportion of goods are returned for refund.*

Conclusion - *A provision is recognised for the best estimate of the costs of refunds. Company should make a provision of 10,00,000 x 0.25% = Rs. 2500*

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PROBLEM :- 36

Sun Ltd. has entered into a sale contract of Rs.5 crores with X Ltd. during 2019-20 financial year. The profit on this transaction is Rs.1 crore. The delivery of goods to take place during the first month of 2020-21 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of Rs.1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 2019-20 financial year. As on *reporting* ***date (31.3.2020), the goods were not manufactured and it was unlikely that Sun Ltd. will be in a position to meet the contractual obligation.***

i. Should Sun Ltd. create provision under Ind AS 37?

ii. Should provision be measured as the excess of compensation to be paid over the profit?

SOLUTION : 36

(i) When an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Sun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for Rs.1.5 crores as per Ind AS 37.

(ii) Provision should not be measured as the excess of compensation to be paid over the profit. The goods were not manufactured before 31st March, 2010 and no profit had accrued for the financial year 2009-2010. Therefore, provision should be made for the full amount of compensation amounting Rs.1.50 crores.

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PROBLEM :- 37

As on 31st March, there was a claim for damage from one of the customers against the Company engaged in selling of accounting software for an alleged failure to provide satisfactory after-sales services in relation to the software purchased from it. Before finalization of the accounts for the year ended 31st March (the accounts were finalized on 14th June), the Company won the case and had no liability whatsoever in this regard. The Company has made a Provision for this Contingent Liability in its accounts for the year ended 31st March, which, it says, will be reversed in the next year. Comment.

SOLUTION : 37

1. ***Post B/S events :*** *As per facts of the case, on the Balance Sheet date, there was a claim against the Company for damages by a customer for not providing after sales service. The winning of the case by the Company in its favour (before the accounts were approved) after the Balance Sheet date, constitutes additional evidence that will help in deciding the treatment of the matter in the accounts .*
2. ***Nature of Liability :*** *As on the B/S date, the Company may have provided for the Contingent Liability perhaps in view of expectation that such a claim may crystallize as liability against it. However, no Provision would be required as the case had been won by the Company, confirmed by the event happening after the Balance Sheet date.*
3. ***Treatment :*** *The provisioning for non-existent liability is not proper. However, disclosure of facts of the case is, necessary with a view to keeping users of Financial Statements informed about the nature of event as well as the fact that no Provision is necessary.*

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PROBLEM :- 38

Twenty people died possibly as a result of food poisoning from product sold by the entity in a conference. Legal proceeding has been initiated seeking damages from the entity but it disputes liability. Up to the date of approval of the financial statements for the year to 31 March 2024 for issue. The entity's lawyer advised that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to 31 March 2025, its lawyer advised that, owing to developments in the case, it is probable that the entity will be found liable.

Should the entity create provision in 2023-24 & 2024-25?

SOLUTION : 38

<u>For the year ended 31 March 2024</u>

There is no present obligation. The company should not make a provision but should disclose it as a contingent liability unless the probability of any outflow is regarded as remote.

<u>For the year ended 31 March 2025</u>

However, by virtue of Ind AS 37, a past event is deemed to give rise to a present obligation if, taking into account of all available evidence, it is more likely than not that a present obligation exists at the end of the reporting period 31 March 2025. So there is an obligation event and the provision shall be created for the best estimate of amount to settle the obligation.

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PROBLEM :- 39

In 2017, an entity involved in nuclear activities recognises a provision for decommissioning costs of ` 300 million. The provision is estimated using the assumption that decommissioning will take place in 60–70 years' time. However, there is a possibility that it will not take place until 100–110 years' time, in which case the present value of the costs will be significantly reduced. Draft the note.

SOLUTION : 39

A provision of ` 300 million has been recognised for decommissioning costs. These costs are expected to be incurred between 2077 and 2087; however, there is a possibility that decommissioning will not take place until 2117–2127. If the costs were measured based upon the expectation that they would not be incurred until 2117–2127 the provision would be reduced to ` 136 million. The provision has been estimated using existing technology, at current prices, and discounted using a real discount rate of 2%.

*****

PROBLEM :- 40

Management is making an assessment of provision required for site cleanup cost. This provision reflects the reasonable expectation of technical experts about the technology that would be available at the time of the clean-up taking into account, all available evidence. Consequently, cost reduction is being recognised for:

⇒ ***increased experience in applying existing technology; and***

⇒ ***applying existing technology to a larger or more complex clean- up operation than has been carried out to date?***

Should an entity take into consideration the impact of future events while determining the amount of provision?

SOLUTION : 40

Paragraph 48 of Ind AS 37 requires that future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision when there is sufficient objective evidence that they will occur. Further, paragraph 49 of Ind AS 37 provides that the current provision should reflect the cost reduction arising from technology expected to be available at the time of the future clean-up.

In the instant case, since technical experts have reasonable expectation about the technology that will be available at the time of clean-up would result in cost reduction, the impact of the same should be taken into consideration while determining the amount of provision.

*****

PROBLEM :- 41

Entity A is in the process of finalising a restructuring plan. As a result it is likely that there will be closure of two units, a reduction in head count, potential new hires and additional training for developing new skills. Additionally, they are proposing hiring a new manager for whom the entity will have to bear relocation cost. The entity proposes to sell the assets at the unit on closure. Which of the following costs should be included while determining the provision for restructuring:

- ❖ ***Cost of employee termination***
- ❖ ***Staff training cost***
- ❖ ***Recruitment and relocation cost of new manager.***

Should the provision for restructuring be made net of expected gain on disposal of assets at units?

SOLUTION : 41

Paragraph 80 of Ind AS 37 provides "A restructuring provision shall include only the direct expenditures arising from the restructuring, which are those that are both:

(a) *necessarily entailed by the restructuring; and*

(b) *not associated with the ongoing activities of the entity."*

Paragraph 81 of Ind AS 37 provides "A restructuring provision does not include such costs as:

(a) *retraining or relocating continuing staff;*

(b) *marketing; or*

(c) *investment in new systems and distribution networks.*

These expenditures relate to the future conduct of the business and are not liabilities for restructuring at the end of the reporting period. Such expenditures are recognised on the same basis as if they arose independently of a restructuring."

In accordance with the above, cost of employee termination is an expenditure, which is necessarily entailed by restructuring. Therefore, it should be included in restructuring provision.

Staff training cost and recruitment cost and cost of new manager relates to future conduct of business, therefore should not be included.

Further, paragraph 83 clarifies that any gain on expected disposal of assets should not be taken into consideration while determining the cost of provision. Accordingly, provision for restructuring should not be made net of any expected gain on disposal of assets at units.

*****

PROBLEM :- 42

An entity has a contract to purchase one million units of gas at 23p per unit, giving a contract price of `2,30,000. The current market price for a similar contract is 16p per unit, giving a price of ` 1,60,000. All of the gas purchased by the entity is used to generate electricity using dedicated assets.

Determine in the following situations whether the contract is onerous and provision is to be made when:

(i) The electricity is sold at a profit. The electricity is sold to a wide range of customers.

(ii) The electricity is sold at a loss, and the entity makes an overall operating loss. The electricity is sold to a wide range of customers.

(iii) The entity sells the gas under contract, which it no longer needs, to a third party for 18p per unit (5p below cost). The entity determines that it would have to pay ` 55,000 to exit the purchase contract. ***(April 2024 MTP - 6 Marks***

SOLUTION : 42

(i) The gas will be used to generate electricity, which will be sold at a profit. The economic benefits from the contract include the benefits to the entity of using the gas in its business and, because the electricity will be sold at a profit, the contract is not onerous.

(ii) The electricity is sold to a wide range of customers. The entity first considers whether the assets used to generate electricity are impaired. To the extent that there is still a loss after the assets have been written down, a provision for an onerous contract should be recorded.

(iii) The only economic benefit from the purchase contract costing ` 2,30,000 are the proceeds from the sales contract, which are ` 1,80,000. Therefore, a provision should be made for the onerous element of ` 50,000, being the lower of the cost of fulfilling the contract and the penalty cost of cancellation(`55,000).

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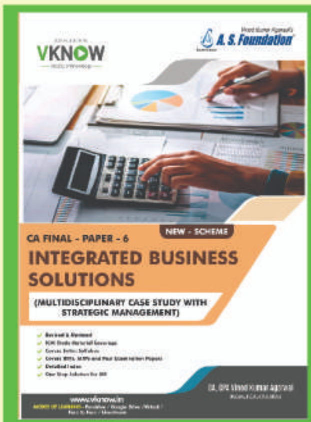

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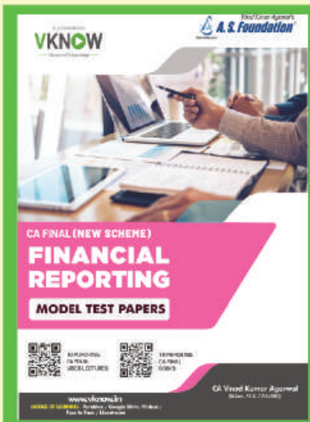

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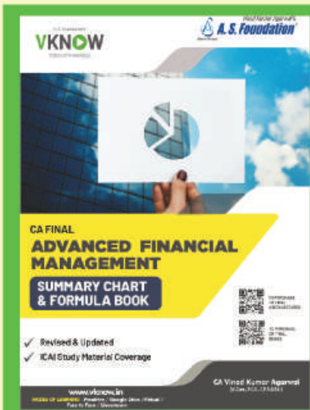

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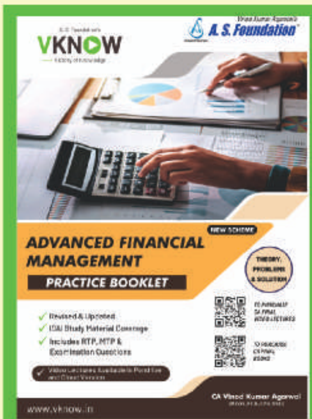

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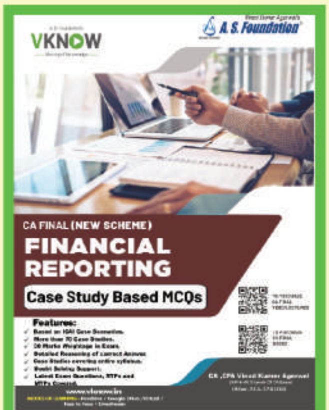

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CA VINOD KUMAR AGARWAL'S STUDENTS

FEEDBACK

Hello Sir,
After studying the first group of CA final in just four months, I passed in the first attempt and the feeling is amazing. Scored 53 in FR and 63 in SFM.. writing paper was so easy because I was familiar with every question and logic which was taught by you... Taking your class was my one of the best decision in my life..
Also I want to share that my financial condition is not good to purchase lectures of any faculty.. literally I decided to start with self study but You offered your lectures at very low price and it was golden opportunity for me..the tears of joy in my mother's eyes after hearing the result reminded me of you....
The amount of respect I have for you is not something I can put into words..
THANK YOU GURUJI...!

-Rushikesh Pokalekar

Hello, sir you are the best teacher. You are the best faculty for practical subject as well as theory subjects. I really enjoyed your class. Lots of questions like all past questions, RTP, MTP, study material question solved in classroom. It is very helpful for me because lot of practice is needed to tackle the exam. Sir, your theory subject Economics is very helpful for me because it solves practical approach in the classroom, lots of examples.
Thankyou so so so much sir.

- Payal Ramesh Mali

Hello, I am Rushikesh Shrihari Puri, studied the FM-ECO subject under the guidance of CA Vinod Kumar Agarwal sir. Sir won't speak much more about himself but his pervasive domain of knowledge regarding subject he teaches even Accounts can enlighten your brain with great thoughts & knowledge. Just last words to say, that please & a humble request to take real guidance under his roof of knowledge for becoming CA & human too. Yes, this institute is not on marketing basis, it is on the experience of student to student.
So, enjoy your CA inter journey as we all have enjoyed

- Rushikesh Shrihari Puri

Vinod sir teaches with utmost conceptual clarity which helped me retain concepts very easily, with logical explanation is at peaks which helps solve tricky question very easily. All RTP, MTP and past year questions were solved in class itself and sir teaches in a way that develops your thinking process which would eventually lead to solving of hard questions in very efficient and effective way.
Thankyou Vinod sir for everything.

-Sarthak Nalawade

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CA VINOD KUMAR AGARWAL'S STUDENTS

FEEDBACK

Sir,I have purchased your SFM class...and i have scored exemption in it! Just wanted to thank you for all the concept clarity and making the subject so easy...Your way of teaching was simply awesome because you have always given reason behind every concept...and hence we never have to mug up any concept. Thank u so much sir.
Regards,
Nishigandha R. Daulatkar

Hello sir Wanted to convey my thanks to you for your wonderful guidance in my SFM subject. Scored 72 marks I was not prepared for rest of the group so just jumped into SFM preparation and achieved exemption. It was just because of your wonderful conceptual clarity and guidance.
Regards,
Nishtha Chopra

Dear Sir,I am your virtual class student Mayuri Sutar. I have majorly done my CA Final classes with AS Foundation (FR, SFM, Audit and Costing) regular as well as revision classes.Your SFM revision lecture are really helping me to complete my syllabus in very short time.

Thnx for entire team for processing my order in a speedy way. Very happy to take classes from Vinod sir who has such a great heart in understanding the needs of students and providing classes at such affordable prices.I will repay my debt to Vinod sir by scoring Exemption in May 21 attempt and post the Mark sheet here itself...Once again thnx thnx thnx....a lot

Good morning,
I wrote only 2nd group in this May 2022 attempt and I cleared that group and I attended Risk Management class from Vinod sir and I got exemption in that and I got 60 marks in that subject.

-Sonia S

Hello sir you are really the best teacher forever for the chapter portfolio management even 1st standard student can understand the concepts thoroughly.thank you so much sir.
- Venkatalakshmi Lakshmi.

Respected Vinod Sir,
Sir your FR and SFM regular batch lectures really helped me in my interview . Received an internship offer from Tresvista for an Investment Research role . Thank you for all the classes.

Thanks & Regards, Joydeep Gorai

Hello.. I have taken FR
and SFM class from Vinod Sir.
I scored 62 in FR and 64 in SFM.
My registration no. is [redacted]
I cleared CA in this attempt.
- Diganta Chowdhury

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CA VINOD KUMAR AGARWAL'S STUDENTS FEEDBACK

Thank you so much VK sir,
Your teaching techniques helped me a lot to take 73 marks.

Regards,
Manjunath Doddamani

I scored 68 in SFM.. all thanks to you... From hating financial management in IPCC...to an exemption in CA final.. credits to you.

Thank you to Rakesh agrawal and VK sir.. I bought video lectures from A.S. Foundation. I got 59 marks in costing And 74 marks in FSCM. Thanks a lot

Regards,
Abarna J

Hello sir,Glad to share that I cleared CA final exam..Had cleared grp 2 in July attempt already..Scored exemption in FR & SFM..
Big big thanks to you !!
Thanks and regards,
CA Swapnil Kshirsagar

I took vinod sir's FR and SFM..scored exemption in both

Regards,
Shebin Sebastian

Sir today I cleared my CA final group 1 with exemption in all subjects I secured 63 in FR & 63 in SFM
Thanks a lot sir for your guidance :)

Please convey my message to Vinod Sir. Because of him I was able to pass when result is just 11%

I have done Vinod Sir's FR revision lecture's and able to score 55 Marks in FR. Thank you very much Vinod Sir. I cleared group 1

Regards,
Abhijit Mohan Lokhande

Hi Sir, I had secured exemptions in SFM(60) and FM(73) in previous attempts. SFM score helped me clear G1 this time.

Regards,
Kaushal

Sir, I cleared CA final in 1st attempt. Special thanks to VK Agarwal Sir for all his guidance and motivation 😊😊

Regards,
Siddhi Suman Parab

Hello sir I have taken CA final FR and SFM lectures from A.S Foundation. Now I have cleared both groups of CA Final

Regards,
Ashwani Kumar

I am very thankful to vinod sir. I cleared group 1 and scored 53 in SFM. Vinod sir's SFM class helps in clearing SFM.

Regards,
Ashutosh Kumar

I completed SFM revision it's good.
Sir covered all concepts.
- Srinath Y.C

Dear Vinod Sir, Very well explained. In first 30 minutes sir has built the base with help of various examples.
-Milan Jeswani.

Hi sir. Good evening. I have taken SFM from you. I have cleared group-1.
I am very thankful to you sir.
I really loved the way you teach sir.
Regards
Sai Eshwar

I am also purchasing this sfm lectures and I have also done the FR from vinod sir by virtual classes ,it's really helpful and having easy understanding methods.

Ye sir hai jinke wajah se CA intermediate students ko bahut help milti hai. Aur to aur maine Vinod sir ke classes kiye hai. Inke jaise padhanewale kash hi koi ho sakate hai.
- Laxman Patil

Dear Vinod Sir, I've attended your FR and SFM regular classes. I liked it very much and I've recommended the same to my friends too. Many of my friends have already watched your class. Thank you so much sir.
Regards,
Anu

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VK SIR STUDENT'S FEEDBACK

Vinod Kumar Agarwal sir-
• Teaches with 100% conceptual clarity,
• All of the queries are solved on emails within a day or two.
• Gives minimal homework,
• Almost all of the questions are solved in the class
• His lectures are effective
• The best thing is, in every chapter he teaches almost 60 questions whereas in ICAI material there are around 15 questions only
• Those questions includes ICAI material + Previous Exam questions + MTP RTP. So everything is covered
• He also, marks down the questions which seems to be important
• Although students of this generation tends more towards younger teachers maybe because they use humour, but the experience that VK sir has is exceptional!

-Saddab Idrisi

Hello Sir,
Bought your CA Inter Accounting Standards Group 2 book; I must say the book is so comprehensive that it covers everything in it.
I went through the lectures provided on YouTube, the way you covered the standards for examination purpose as well as for real life application was commendable.Thank you so much sir for all your efforts.

Regards,
Sakshi K

These is Unnat Chandak. I took CA Final FR classes from AS Foundation. Sir has taught us in very simple way and has covered all previous attempt paper questions in his book.His teaching techniques and practice questions helped me to get exemption in FR.

Respected Vinod Sir,
Good evening sir. Hope you are well . Sir I was from an engineering background enrolled in FR regular batch from Feb 2022 (online) . Sir, your teaching made me confident in FR.
Thank you for all the important lectures delivered by you. And books are very good for revision.
Will always be thankful to you for FR .

Thank & Regards
Name - Joydeep Gorai

Hi...i took risk management classes from Vinod sir...I cleared my 2nd grp of CA final.. scored good marks in Risk management...

Notes of risk management helped me a lot
-Supriya paygude

A. S. Foundation's VKNOW Victory of Knowledge

CA VINOD KUMAR AGARWAL'S STUDENTS

FEEDBACK

Subject : CA Final SFM Face-to-Face Batch

In the era of online/pen-drive lectures, it was great to have an opportunity to attend SFM classes face to face by VK Agarwal sir.
The portion was covered extensively & main focus was given on conceptual understanding. Face to Face batch helped me in covering full potion efficiently. Sir has taught SFM in such a way that now it feels easy & it has given me confidence that I can score marks in it & get exemption as well.
The class has been engaging & sir's enthusiasm to teach us is infectious & makes us excited to study more & love the subject.
He has covered all types of questions in the class not just from ICAI material but also from other reference material.

- Meenal Malpote

SFM Revision Batch

The batch was awesome & I got maximum out of it, that I could. Almost every concept was explained with detailed explanation, followed by solving problems in the class. Didn't have to mug up any rule or concept because it was explained thoroughly. Practice booklet provided by you have lots of problems that a student can do after chapters are over. The material was updated perfectly having latest types of sums asked by ICAI, even the RTP, MTP and exam questions of may 2023 were covered.
This batch was great covering huge syllabus in just 30 days. Thnakyou sir.

-Champak Dixit

Face to face batches are the essence of learning and I have rediscovered the joy of studying after doing this SFM fully exam oriented face to face batch.
Sir has covered all concepts and has made us solve all varieties of questions in this short amount of time. Doing video lectures was taking very long & was not as fun as doing face to face lectures. I was lucky to find this batch and I'm amazed how quickly we were able to cover all of SFM, this has saved me a lot of precious time & has opened the doors for considering giving both groups.
The way sir has taught us, it made me understand and grasp all chapters. The notes given are concise & precise & easy for revision. I'm very confident in this subject now & I have also joined the FR Fully exam oriented face to face batch.
Sir has brought back my joy of learning. He is one of the rare faculties who is less interested in marketing & strives to help students in every way possible.

-Ajit Pawar

Hello Sir,
I am Abhay Singh From Chhindwara .
I want to express my heartfelt gratitude to you Sir, for providing free of cost class. I'm fortunate for receiving knowledge from the very experienced teacher V.K Agarwal Sir.
When I started your lecture it seemed very easy from me to understand the concept because you are providing indepth knowledge about every concept.
Alongwith it, you tell us about which topic is important for exam and also the question which is frequently asked in the exam .
And the Advanced Accounts Book is so precise that I am getting all MTP, RTP, previous year questions in a single book which helps me to get more practice of a variety of question in single compact book.
Thank you so much sir!

-Abhay Singh