

CHAPTER 16 - SM QUESTIONS

Illustration

Illustration 1

Question Analysis:

Info star Ltd. is a listed company engaged in the provision of IT services in India. The directors are paid a bonus based on the profits achieved by the company during the year as per the bonus table given below:

Range of Profit after tax	Bonus to Directors
Less than ₹ 1 crore	NIL
₹ 1 crore to < ₹ 5 crores	2% of Net Profit after tax
₹ 5 crores to < ₹ 10 crores	4% of Net Profit after tax
₹ 10 crores to < ₹ 20 crores	6% of Net Profit after tax
₹ 20 crores to < ₹ 30 crores	8% of Net Profit after tax
₹ 30 crores and above	10% of Net Profit after ta

The draft Statement of Profit and Loss for the year ended 31 March 20X2 currently shows a profit of ₹ 2 crores.

Transaction Date: Info star Ltd. sold land on 25 March 20X2.

Buyback Option: Option to repurchase on 25 May 20X2.

Buyback price: ₹ 40 crores + 6% premium.

Financial Impact: Eliminated bank overdraft of Infostar Ltd. as of 31 March 20X2.

Accounting Treatment: Treated as a sale.

Profit included in the Statement of Profit and Loss for the year ending 31 March 20X2.

CFO's Role: CFO, a chartered accountant, instructed the accounting treatment.

Required: Discuss ethical and accounting implications, referring to relevant Ind AS.

Answer Analysis:

Accounting Treatment

Repurchase Agreement: The sale of land qualifies as a repurchase agreement under Ind AS 115 as Infostar Ltd. has a buyback option.

Control Not Transferred: Zest Ltd.'s ability to benefit from the land is restricted; hence, control isn't transferred.

Financing Arrangement: Infostar Ltd. should treat the transaction as a financing arrangement, recording both the asset (land) and the financial liability.

Derecognition Error: The land shouldn't have been derecognized from the financial statements due to non-transfer of risks and rewards.

Substance Over Form: The transaction's essence is a ₹ 40 crores loan with the 6% premium reflecting interest. Recording it as a sale manipulates financial statements.

Ethical Issues

Integrity Breach: The CFO's integrity is questionable for recording the transaction as a sale instead of a loan.

Window Dressing: Accounting it as a sale is a form of 'window dressing' to falsely enhance the financial position.

Objectivity Compromised: Accountants must act without bias. The drive to show profits and achieve bonuses indicates a conflict of interest.

Professional Behaviour: The accounting treatment doesn't align with Ind AS, violating the principles of professional behaviour.

Professional Competence: If the CFO is unaware of the correct treatment, it indicates a lack of updated knowledge and skills.

Professional Misconduct: The CFO might be guilty of professional misconduct under the Chartered Accountants Act, 1949, if he contravenes its provisions or guidelines.

Legal Implications

Chartered Accountants Act: As per Clause 1 of Part II of the Second Schedule, any contravention of the Act, regulations, or guidelines results in professional misconduct.

Illustration 2

Question Analysis:

Company Obligation

Oil Rig Dismantling: Rustom Ltd. has a duty to dismantle the oil rig after its 10-year useful life.

Inescapable Obligation: This obligation cannot be cancelled or transferred by Rustom Ltd.

Dismantling Cost: The estimated cost for dismantling at the end of 10 years is ₹100 crores.

Accounting Standards

Awareness of Ind AS: The directors are knowledgeable about Ind AS 37 and Ind AS 16 requirements.

Proposed Treatment: They plan to record the dismantling costs only when incurred, without any current entries or disclosures.

Judgment in Ind AS: The directors believe that applying Ind AS involves judgment, and prudence is just one way to ensure faithful representation.

Ethical Consideration

Ethical Dilemma: Is the directors' approach to the dismantling costs unethical?

Chartered Accountant's Role

CA's Action: What should the practising Chartered Accountant do in this situation?

Answer Analysis:

Contravention of Standards

Ind AS Violation: The directors' proposed treatment contravenes Ind AS 37.

Standard Requirements: As per Ind AS 16 and 37, at asset's initial recognition, the present value of dismantling cost should be capitalized, creating a provision simultaneously.

Deliberate Action: The non-compliance seems intentional, not a mere oversight.

Chartered Accountant's Responsibility

Integrity and Unbiased: Despite potential undue influence, the chartered accountant must act with integrity and recommend compliance with Ind AS 16 and 37.

Communication: The chartered accountant should discuss the issue with non-executive directors, ensuring financial statements are accurate and compliant.

Professional Behaviour: The accountant must inform directors about corrective measures, upholding the principle of professional behaviour and compliance with laws.

Potential Consequences

Breach of Principle: Not communicating corrective measures breaches the principle of professional behavior.

Non-Compliance Implications: Ignoring the Ind AS requirements means the Chartered Accountant isn't acting diligently or demonstrating professional competence and due care.

Legal Implications

Professional Misconduct: The accountant may face professional misconduct under Clauses 5, 6, and 7 of Part I of the Second Schedule of the Chartered Accountants Act, 1949.

Clause 5: Failing to disclose a known material fact necessary for a financial statement.

Clause 6: Not reporting a known material misstatement in a financial statement.

Clause 7: Not exercising due diligence or being grossly negligent in professional duties.

Illustration 3

Question Analysis:

Company's Financial Need

Capital Requirement: Alaap Ltd. needs significant capital to upgrade its plant and equipment.

Order Promise: The company has potential orders if it can produce internationally standard goods.

Bank's Lending Criteria

Cash Flow Projection: Banks require strong projected cash flows for lending.

Debt Service Coverage Ratio: The required ratio exceeds 10, but Alaap Ltd.'s current projections don't meet this.

Directors' Assurance

Financial Position Claim: Directors have assured the bank of the company's excellent financial health.

Accountant's Report: They've told the bank that the chartered accountant will soon provide a report confirming the financial position.

Chartered Accountant's Dilemma

New Joiner: The chartered accountant has recently joined Alaap Ltd.

Job Security Concern: He has expressed that he cannot afford to lose his job due to personal financial commitments.

Ethical Consideration

Potential Conflicts: What are the ethical conflicts that might arise in this scenario?

Guiding Principles: What ethical principles should guide the chartered accountant's response to the situation?

Answer Analysis:

Conflict of Interest

Pressure vs. Personal Circumstances: The chartered accountant faces pressure to provide favorable cash flow statements due to his personal financial situation.

Duty to Stakeholders: Directors have obligations towards shareholders, employees, and the bank. Misleading information can harm the company's long-term reputation.

Ethical Principles at Stake

Compromised Objectivity: The accountant's potential bias, due to job security concerns, challenges his objectivity.

Integrity in Question: Presenting misleading information breaches the principle of integrity.

Professional Competence: The accountant should prepare cash flow projections using his best professional judgment, which may be compromised here.

Recommended Action

Ethical Dilemma: The accountant must prioritize professional ethics over personal pressures.

Honest Reporting: The accountant should insist on presenting an accurate reflection of the company's financial position to the bank.

Resisting Undue Influence: The accountant shouldn't let the directors' pressures override his professional judgment.

Communication: The accountant should advise the directors to submit an honest projected statement of cash flows to the bank.

Consequences of Misconduct

Professional Misconduct: Knowingly providing incorrect information is a breach of professional conduct.

Maintaining Integrity: By adhering to ethical principles, the accountant upholds his professional integrity and the trust placed in his work.

Legal Implications: If the accountant submits misleading projections, he may face professional misconduct charges under the Chartered Accountants Act, 1949.

Illustration 4

Question Analysis:

Company's Financial Situation

Debt Covenants: Sunshine Ltd. has borrowings with attached covenants, listed under Financial Liabilities in the Balance Sheet.

Covenant Conditions: The company must repay the debt if it doesn't maintain a specified liquidity ratio and operating margin.

Leasing Strategy

Lease Concern: The directors and CFO are wary of how a new five-year lease might impact the debt covenants.

Alternative Proposal: They suggest structuring the lease as six ten-month leases to benefit from the short-term lease exemption under Ind AS 116.

Accounting Implication: This approach would allow the leases to be accounted for in their legal form, potentially bypassing the accounting standards.

Ethical and Accounting Implications

Ethical Dilemma: The CFO, being a chartered accountant, must weigh the ethical implications of potentially manipulating the lease structure.

Accounting Standards: The proposed treatment might be contrary to the accounting standards, even if it meets the debt covenant requirements.

CFO's Responsibility: The CFO should consider the long-term implications and potential risks of such a strategy on the company's financial health and reputation.

Guiding Principles

Integrity: The CFO must act with honesty, ensuring that financial statements provide a true and fair view.

Professional Competence: The CFO should adhere to accounting standards and best practices, even if they conflict with short-term objectives.

Objectivity: The CFO must not let personal bias or external pressures compromise his professional judgment.

Answer Analysis:

Financial Statement Reliability

Stakeholder Decisions: Stakeholders rely on financial statements for informed decisions, emphasizing the need for accuracy and reliability.

Ethical Responsibility: Directors of Sunshine Ltd. must ensure compliance with Ind AS, producing transparent and error-free financial statements.

Debt Covenants and Stakeholder Interests

Lender Protection: Covenants in lending agreements safeguard lenders' interests.

Investor Assessment: Potential investors evaluate risks and returns based on covenants and financial statements.

Proposed Lease Agreement Strategy

Covenant Circumvention: Sunshine Ltd.'s proposal seems to bypass covenant terms deliberately.

Off-Balance Sheet Finance: The proposed short-term leases would not reflect true assets and obligations, misrepresenting liquidity ratios.

Operating Profit Impact: The proposed treatment might negatively affect operating profit margins.

Ethical and Professional Implications

Breach of Principles: The proposal violates the fundamental principles of objectivity and integrity in the Code of Ethics.

Professional Behaviour: Chartered accountants must consistently exhibit professional behaviour and due care.

Misleading Stakeholders: Sunshine Ltd.'s proposals could deceive stakeholders, potentially damaging the profession's reputation.

Directors' Ethical Duties: Directors should be reminded of their ethical obligations and the need for full compliance with Ind AS.

Legal Consequences for Non-Compliance

12. Professional Misconduct: The CFO risks facing professional misconduct under the Chartered Accountants Act, 1949, if he fails in his duties.

Clause 1 Implications: This clause states that any contravention of the Act, regulations, or guidelines results in professional misconduct. The CFO must exercise due diligence and avoid negligence.

Illustration 5

Question Analysis:

Company Overview

Business Nature: Agastya Ltd. is a listed company manufacturing automotive spare parts.

Financial Statement Preparation: The company is preparing its financial statements for the year ended 31 March 20X3.

Director Incentives: Directors' incentives are based on the company's operating profit margin.
Pension Scheme Amendment

Amendment Date: The pension scheme was amended on 1 April 20X2.

Entitlement Increase: Pension entitlement was raised from 12% to 18.5% of final salary due to pandemic-induced salary cuts.

Accounting Treatment: The chartered accountant recorded the increase (₹ 85 crores) under 'Employee Benefits' within operating profit.

Directors' Concern and Proposal

Presentation Disagreement: Directors believe the pension scheme, being post-retirement, isn't integral to operations and its current presentation could mislead operating profit calculations.

Proposed Accounting Policy: Directors suggest recognizing gains or losses on the pension scheme under Other Comprehensive Income for consistency and understandability.

Pension Scheme Status: The company's pension scheme is currently in deficit.

Ethical and Accounting Implications

Fair Presentation: Directors justify their proposal based on the fair presentation principle in the Framework.

Relevant Ind AS: The consultant should refer to Ind AS related to employee benefits and other comprehensive income to assess the appropriateness of the proposed change.

Ethical Consideration: The consultant must ensure that the financial statements provide a true and fair view, without being influenced by the directors' personal interests in their incentives.

Accounting Consistency: While consistency is important, any change in accounting policy must genuinely reflect the economic reality of transactions and not just serve to enhance reported profits.

Answer Analysis:

Accounting Standards and Policy Change

Ind AS 8 Requirements: Change in accounting policy is permitted if mandated by an Ind AS or if it provides more reliable and relevant information. Retrospective adjustments are typically required.

Rare Override: Departing from Ind AS is allowed in extremely rare circumstances where compliance would be misleading.

Employee Benefits and Pension Scheme

Ind AS 19 Provisions: All gains and losses on a defined benefit pension scheme should be recognized in profit or loss, except for remeasurements which go to Other Comprehensive Income.

Past Service Cost: Amendments to pension schemes, like the one made by Agastya Ltd., should be expensed immediately in the profit or loss.

Directors' Ethical and Financial Considerations

Fair Presentation: The directors' proposal to change the accounting policy cannot be justified on the grounds of fair presentation as per Ind AS.

Self-Interest: Directors' potential bonus might be influencing their decision to maximize profits by changing the accounting policy.

Misleading Presentation: The proposed treatment would not comply with Ind AS, making the financial statements less comparable and reliable.

Ethical Responsibilities and Alternatives

Ethical Principles: The proposed change would violate the principles of objectivity, integrity, and professional behaviour in the Code of Ethics.

Alternative Measures: Directors can use other indicators like EBITDA or cash generated from operations to explain the company's results.

Chartered Accountant's Role and Responsibilities

Reporting Misstatements: If a Chartered Accountant identifies misstatements, they can report non-compliance or consider withdrawing from the engagement.

Potential Misconduct: If influenced by the directors, the Chartered Accountant risks professional misconduct under Clauses 5, 7, and 8 of the Chartered Accountants Act, 1949.

Legal Implications for Non-Compliance

Clause 5: A Chartered Accountant must disclose material facts known to them in financial statements.

Clause 7: Chartered Accountants must exercise due diligence and avoid gross negligence.

Clause 8: Chartered Accountants must obtain sufficient information to express an opinion or highlight material exceptions.

Illustration 6

Question Analysis:

Director's Incentive and Company's Performance

Incentive Structure: Directors' incentive is based on 'Cash Generated from Operations' as per Ind AS 7.

Pandemic Impact: The company experienced negative cash flow from operations due to the pandemic's adverse effects.

Proposed Treatment of Asset Disposal

Asset Disposal: Directors plan to sell under-utilized equipment and investments to generate cash.

Cash Flow Presentation: Directors suggest presenting the inflow from these sales under 'Cash from Operations' in the Statement of Cash Flows.

Motive: The proposed treatment aims to make the 'Cash from Operations' figure positive, ensuring directors meet their targets and secure their jobs.

Ethical Responsibility of the Chartered Accountant

Ind AS 7 Compliance: Cash inflows from the sale of equipment and investments should typically be classified under 'Cash from Investing Activities'.

Manipulation Concern: Presenting these inflows under 'Cash from Operations' would be a misrepresentation and not in line with Ind AS 7.

Ethical Duty: The Chartered Accountant, as an employee, has an ethical responsibility to ensure accurate and fair presentation of financial statements.

Integrity and Objectivity: The Chartered Accountant should prioritize integrity and objectivity over any undue influence or pressure from the directors.

Professional Misconduct: Knowingly allowing or participating in such manipulation could lead to professional misconduct charges against the Chartered Accountant.

Communication: The Chartered Accountant should communicate the correct accounting treatment to the directors and emphasize the importance of adhering to Ind AS 7.

Stakeholder Trust: Manipulating the Statement of Cash Flows could mislead stakeholders, affecting their trust in the company's financial reporting.

Answer Analysis:

Creative Accounting and Misclassification

Favourable Presentation: Management may use creative accounting techniques, like window dressing, to present results favourably.

Inaccurate Classification: The case highlights the misclassification of cash flows to achieve a specific presentation objective.

Ind AS 7 and Cash Flow Classification

Investing Activities: As per Ind AS 7, investing activities include cash flows from the sale of long-term assets like property, plant, and equipment.

Misleading Presentation: Classifying proceeds from the sale of investments and equipment under 'Cash from Operations' is misleading.

Implications of Misclassification

Operating Cash Flows: These are crucial for long-term survival and are recurring. A negative figure can indicate potential cash shortage.

One-off Cash Flows: Proceeds from the sale of assets are non-recurring and cannot be repeated regularly.

Ethical Concern: Misclassification can be seen as an attempt to mislead stakeholders, which is unethical.

Chartered Accountant's Responsibility

Duty to Stakeholders: Chartered Accountants owe a duty to the company, their professional body, and the company's stakeholders.

Correct Classification: Proceeds from asset sales should be presented under 'Cash Flows from Investing Activities' as per Ind AS 7.

Professional Competence: Allowing the proposed treatment by management would breach the principle of professional competence and due care.

Course of Action for Chartered Accountant

Prevent Misclassification: The Chartered Accountant should advise against the proposed treatment that violates Ind AS 7.

Inform Auditors: If management insists on the proposed treatment, the Chartered Accountant should notify the auditors.

Professional Misconduct: Non-compliance could lead to charges of professional misconduct under the Chartered Accountants Act, 1949.

Illustration 7

Question Analysis:

Infostar Ltd. is a listed company engaged in the provision of IT services in India. The directors are paid a bonus based on the profits achieved by the company during the year as per the bonus table given below:

Profit Range	Bonus to Directors
NIL < Profit < ₹ 1 crore	NIL
₹ 1 crore < Profit < ₹ 5 crores	2% of Net Profit
₹ 5 crores < Profit < ₹ 10 crores	4% of Net Profit
₹ 10 crores < Profit < ₹ 20 crores	6% of Net Profit
₹ 20 crores < Profit < ₹ 30 crores	8% of Net Profit
Profit > ₹ 30 crores	10% of Net Profit

The draft Statement of Profit and Loss for the year ended 31 March 20X2 currently shows a profit of ₹ 2 crores.

Historical Incentive Practice

Discretionary Incentive: Info star Ltd. has a 15-year history of paying individual-performance-based discretionary incentives to employees.

Expected Bonus: For the year 20X1-20X2, the anticipated bonus amount is ₹ 3 crores.

CFO's Suggestion

Avoiding Incentive: Due to the company's poor performance and potential non-payment of directors' bonuses, the CFO suggests skipping the employees' discretionary incentive.

Impact on Profits: By not paying the incentive, the company would report profits.

Non-Financial Performance Measures

Annual Report Metrics: Infostar Ltd. includes non-financial performance measures in its annual report, such as employee satisfaction scores, attrition rates, gender equality, and absenteeism rates.

CFO's Perspective: The CFO believes stakeholders don't pay attention to non-financial information, implying that not paying the incentive won't have significant repercussions.

Ethical Implications

Employee Expectations: Withholding a historically given incentive could demotivate employees and affect their morale.

Transparency: The CFO's suggestion lacks transparency and could be seen as manipulating financial statements to present a favourable picture.

Stakeholder Trust: Disregarding non-financial metrics undermines the trust stakeholders place in the company's comprehensive reporting.

Accounting Implications

Bonus Provision: As per Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, if the company has a present obligation (legal or constructive) arising from past events, a provision should be recognized. Given the historical trend, there might be an expectation of bonus payment.

Fair Presentation: Ind AS 1, Presentation of Financial Statements, emphasizes the fair presentation of financial statements. Avoiding the incentive to artificially boost profits goes against this principle.

CA Sushil Bhupathy's Perspective

Professional Integrity: As a Chartered Accountant, Sushil Bhupathy should uphold the principles of integrity, objectivity, and professional competence.

Advise Against Manipulation: Sushil Bhupathy should advise against the CFO's suggestion, emphasizing the importance of ethical practices and transparent reporting.

Stakeholder Consideration: Sushil Bhupathy should highlight the importance of both financial and non-financial metrics in providing a holistic view to stakeholders.

Answer Analysis:

Employee Treatment and Ethical Behaviour

Organizational Success: Ethical behaviour and fair treatment of employees are crucial for long-term organizational success.

CFO's Suggestion: The CFO proposes not paying the discretionary bonus to employees, which would lead to a profit of ₹ 2 crores, enabling a bonus for the directors.

Legal vs. Ethical: While legally permissible, the non-payment of bonuses raises ethical concerns due to the underlying motive.

Impact on Employee Morale

Employee Dissatisfaction: Withholding the bonus could lead to employee dissatisfaction, especially if directors receive bonuses from the saved costs.

Wage Gap Concern: The decision might exacerbate the wage disparity between management and employees.

Non-Financial Metrics: The CFO's belief that non-financial metrics are overlooked is misleading, as these metrics are increasingly significant to stakeholders.

Chartered Accountant's Responsibility

Due Diligence: Chartered accountants must consider both financial and non-financial information and act ethically.

Public Interest: Accountants have a duty to act in the public interest, not just to serve individual clients or employers.

Code of Ethics: Chartered accountants must adhere to the Code of Ethics, which emphasizes acting in the public interest (Refer Section 100.1 A1, Code of Ethics issued by ICAI).

Conclusion

Upholding Standards: It's vital for chartered accountants to maintain professional standards, ensuring transparency and accuracy in financial reporting while considering the broader ethical implications of decisions.

Illustration 8

Question Analysis:

Background and Context

Company Profile: Agastya Ltd. is a listed entity in the automotive spare parts manufacturing sector.

Financial Preparation: The company is in the process of finalizing its financial statements for the year ending 31 March 20X3.

Director Incentive: Directors' incentives are linked to the company's operating profit margin.

Identified Issue

Director's Loan: The draft financial statements show a loan of ₹ 75 lakhs given to a director.

Repayment Terms: The loan lacks specific repayment terms and is repayable on demand.

Classification: Directors have categorized this loan under 'Cash and Cash Equivalents', justifying it as being readily convertible to cash due to its on-demand nature.

Directors' Reasoning

Policy Choice: Directors argue that financial statements are prepared based on the company's chosen accounting policies. In this instance, Agastya Ltd. has opted to treat such a loan as a cash equivalent.

Ethical and Accounting Implications

Ind AS Framework: The classification of the loan under 'Cash and Cash Equivalents' needs to be evaluated against the Ind AS framework.

Loan Classification: The decision to categorize the loan as a cash equivalent might not align with the standard definitions and criteria set by Ind AS.

Transparency and Integrity: Ethical concerns arise when financial statements potentially mislead stakeholders, especially if the classification serves to inflate certain financial metrics.

Conclusion

Consultant's Role: As a consultant, it's crucial to ensure that the company's financial statements adhere to the Ind AS framework and uphold the principles of transparency, accuracy, and ethical reporting.

Answer Analysis:

Misclassification

Issue Identified: The directors classified a loan made to a director as part of 'Cash and Cash Equivalents'.

Ind AS 7 Definition: Cash equivalents are short-term, highly liquid investments convertible to known cash amounts with minimal risk.

Inappropriateness: The loan doesn't fit the criteria for cash equivalents due to its purpose, lack of fixed repayment, and unknown default risk.

Correct Classification

Financial Asset: The loan should be treated as a financial asset as per Ind AS 109, Financial Instruments.

Further Analysis Needed: Determination of the loan's fair value and potential treatment as director's remuneration.

Related Party Disclosures: Given the director's status, disclosures under Ind AS 24, Related Party Disclosures, may be necessary.

Breach of Fundamental Characteristics

Relevance: The loan's separate disclosure is crucial for users.

Faithful Representation: Information should be complete, neutral, and error-free.

Violations of Enhancing Qualitative Characteristics

Understandability: Masking the loan's nature reduces clarity for users.

Verifiability: The directors' treatment doesn't meet the benchmark of unbiased representation.

Comparability: Misclassification affects year-on-year and inter-company comparability.

Potential Conflicts and Legal Implications

Conflict of Interest: The director's interests may conflict with the company's, necessitating separate disclosure.

Legal Compliance: Issues with section 185 of the Companies Act, 2013 might arise.

Directors' Responsibility: Directors must correct errors to ensure compliance with Ind AS.

Ethical Concerns

Motivation: Directors might be acting in personal interest, compromising their ethical duty.

Credibility: One misleading transaction can cast doubt on the entire financial statements' credibility.

Consultant's Responsibility

Guidance: The consultant should rectify the financial statements and educate the directors on Ind AS principles.

Professional Misconduct: Failure to act appropriately could lead to charges under the Chartered Accountants Act, 1949, specifically Clauses 6 and 7.

Conclusion

Accountability: Both the directors and the consultant have a duty to ensure accurate and ethical financial reporting. Misclassifications and misleading transactions compromise the integrity of financial statements and can have legal and ethical repercussions.

Illustration 9

Question Analysis:

Disposal Plan

Plan Details: Mitra Ltd. intends to dispose of its 75% subsidiary, Dosti Ltd.

Approval & Communication: The board approved the plan, and it was reported to the media and the Stock Exchange.

Potential Buyer

Stakeholder Interest: Jaya Ltd., a non-controlling shareholder with a 25% stake in Dosti Ltd., is expected to acquire the remaining 75% equity interest.

Financial Implications

Trading Losses: Dosti Ltd. is anticipated to incur significant trading losses up to the sale date.

Accounting Treatment: Mr. X, a chartered accountant, wants to categorize Dosti Ltd. as "held for sale" and create a restructuring provision for disposal costs and future trading losses.

Management's Concerns

COO's Stance: The COO opposes the "held for sale" classification and doesn't want to provide for expected losses.

Motivation: Concerns about sales impact and unmet bonus targets.

Shareholder Return: The COO believes it's his duty to secure a high sales price for the benefit of Mitra Ltd.'s shareholders.

Job Threat: Mr. X's employment might be jeopardized if he insists on the provision in the financial statements.

Future Trading Losses:	₹ 20 crores
Various legal costs of sale	₹ 1.5 crores
Redundancy costs for Dosti Ltd.'s employees	₹ 4 crores
Impairment losses on Property, Plant and Equipment	₹ 7 crores

Accounting Treatment

Disposition Plan: How should Mitra Ltd. handle the accounting for the planned disposal of Dosti Ltd. in the financial statements?

Ethical Implications

Conflict & Pressure: What are the ethical challenges faced by Mr. X, especially in light of the COO's stance and the potential implications on his job?

Answer Analysis:

A. Classification Criteria

Held for Sale Definition: As per Ind AS 105, assets are classified as held for sale if they are primarily recoverable through sale rather than use.

Conditions: The asset must be available for immediate sale, the sale must be highly probable, and it should be actively marketed at a reasonable price. The sale should be expected to complete within a year.

Subsidiary Disposal

Loss of Control: If an entity plans to lose control of a subsidiary, all assets and liabilities of that subsidiary should be classified as held for sale.

Treatment: Dosti Ltd. meets the criteria for held for sale. If it's a major component, its losses should be presented separately as a discontinued operation.

Measurement

Valuation: Assets classified as held for sale should be measured at the lower of their carrying amount or fair value minus costs to sell.

Impairment Allocation: Any impairment loss should first be allocated to goodwill, then pro-rata across other non-current assets.

COO's Stance

Restructuring Provision: The COO's exclusion of a restructuring provision is incorrect. Since the disposal has been communicated, a constructive obligation exists.

Provision Calculation: Only directly attributable restructuring costs should be provided. Future operating losses and impairment losses of assets are excluded. A provision of ₹ 5.5 crores is required.

B. Accountant's Responsibility

Duty of Fairness: Accountants must ensure financial statements are transparent, fair, and compliant with accounting standards.

Mr. X's Mistakes: He was unaware of the correct costs for a restructuring provision and didn't recognize the absence of an obligating event for future losses.

Professional Competence: Mr. X should update his knowledge and adhere to ethical and professional standards. Ignorance breaches professional competence.

COO's Manipulation

Profit Manipulation: The COO aims to manipulate financial statements to meet bonus targets, avoiding profit reductions.

Misrepresentation: While the COO argues for maximizing shareholder returns, it shouldn't be at the expense of accurate financial representation. His motivations seem driven by personal gain.

Unethical Threats: The COO's threats to Mr. X are unethical and against professional principles, creating an ethical dilemma for Mr. X.

Ethical Stand

Addressing the COO: Mr. X should remind the COO of ethical principles and advocate for necessary adjustments to ensure fair financial statements.

Potential Misconduct: If Mr. X succumbs to the COO's influence and applies incorrect accounting treatments, he risks professional misconduct under the Chartered Accountants Act, 1949.

TYK 1**Question Analysis:****Lease Arrangement**

Desire for Upgrade: Shastra Ltd. wants to upgrade its production process through technology.

Lease for Tax Benefits: On 1 April 20X5, the company entered a property lease to obtain tax advantages.

Financial Statement Discrepancy: Draft financial statements don't reflect a lease asset or liability.

Differing Opinions

CA. Sunil Raghavan's View: The new financial controller believes the lease should be recognized in the Balance Sheet.

Ms. Anusha Shrivastava's Perspective: The Managing Director sees the lease as a monthly rental without an asset transfer, given there's no 'invoice'. She's concerned about the impact of showing a lease obligation on the company's gearing ratio and the upcoming loan application.

Ethical Dilemma

Pressure on CA. Sunil: Ms. Anusha implies that recognizing the lease could jeopardize the loan application and CA. Sunil's future at Shastra Ltd.

Required Discussion

Ethical Conflicts: The scenario presents potential ethical conflicts between accurate financial reporting and business interests.

Guiding Principles: The question seeks guidance on the ethical principles that should inform the financial controller's response.

Answer Analysis:**Lease Recognition**

Ind AS 116 Definition: A contract is a lease if it provides the right to control the use of an identified asset for a period in exchange for consideration.

Shastra Ltd.'s Obligation: Recognize a right-of-use asset for the property and a corresponding lease liability for lease payments.

Components of Right-of-Use Asset: Initial measurement of lease liability, initial direct costs, and costs for dismantling or restoring at lease end.

Lease Liability Measurement: Present value of future lease payments, including any residual value guarantee payments, discounted using the appropriate rate.

Invoice Not a Hindrance: Absence of an 'invoice' doesn't negate the need to recognize the right-to-use asset. The recognition is for the right to use, not ownership.

Ethical Concerns

MD's Threat: The Managing Director's threat to the financial controller creates an ethical dilemma, especially since the controller is new.

Intimidation Threat: The threat poses a challenge to the principles of objectivity and integrity.

Advocacy Threat: The MD's concern about loan acquisition creates a pressure to misrepresent financials, compromising the controller's objectivity.

Professional Competence: The financial controller must ensure compliance with Ind AS when preparing financial statements.

Correct Course of Action

Compliance with Ind AS 116: The lease arrangement meets the criteria, so the right-of-use asset and lease liability must be recognized.

ICAI Code of Ethics: The financial controller should disclose any non-compliance to the appropriate authority to ensure ethical actions.

Potential Misconduct: If the controller succumbs to pressure and misrepresents the lease, it would breach the Chartered Accountants Act, 1949, risking professional misconduct.