

However, if the cost of salaries, utilities and storage of goods are in the nature of operating expenditure that would be incurred if the supermarket was open, then these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management and should be expensed.

QUESTION 23 (STUDY MATERIAL)

An amusement park has a 'soft' opening to the public, to trial run its attractions. Tickets are sold at a 50% discount during this period and the operating capacity is 80%. The official opening day of the amusement park is three months later. Management claim that the soft opening is a trial run necessary for the amusement park to be in the condition capable of operating in the intended manner. Accordingly, the net operating costs incurred should be capitalised. Comment.

Answer

The net operating costs should not be capitalized, but should be recognized in the Statement of Profit and Loss.

Even though it is running at less than full operating capacity (in this case 80% of operating capacity), there is sufficient evidence that the amusement park is capable of operating in the manner intended by management. Therefore, these costs are specific to the start-up and, therefore, should be expensed as incurred.

QUESTION 24 (STUDY MATERIAL)

Entity A exchanges surplus land with a book value of Rs. 10,00,000 for cash of Rs. 20,00,000 and plant and machinery valued at Rs. 25,00,000. What will be the measurement cost of the assets received?

Answer

Since the transaction has commercial substance. The plant and machinery would be recorded at Rs.25,00,000, which is equivalent to the fair value of the land of Rs.45,00,000 less the cash received of Rs.20,00,000.

QUESTION 25 (STUDY MATERIAL)

Entity A exchanges car X with a book value of Rs. 13,00,000 and a fair value of

Rs.13,25,000 for cash of Rs.15,000 and car Y which has a fair value of Rs.13,10,000. The transaction lacks commercial substance as the company's cash flows are not expected to change as a result of the exchange. It is in the same position as it was before the transaction. What will be the measurement cost of the assets received?

Answer

The entity recognises the assets received at the book value of car X. Therefore, it recognises cash of Rs. 15,000 and car Y as PPE with a carrying value of Rs. 12,85,000.

QUESTION 26 (STUDY MATERIAL)

Entity A is a large manufacturing group. It owns a number of industrial buildings, such as factories and warehouses and office buildings in several capital cities. The industrial buildings are located in industrial zones, whereas the office buildings are in central business districts of the cities. Entity A's management want to apply the revaluation model as per AS 10 (Revised) to the subsequent measurement of the office buildings but continue to apply the historical cost model to the industrial buildings.

State whether this is acceptable under AS 10 (Revised) or not with reasons?

Answer

Entity A's management can apply the revaluation model only to the office buildings. The office buildings can be clearly distinguished from the industrial buildings in terms of their function, their nature and their general location. AS 10 (Revised) permits assets to be revalued on a class by class basis.

The different characteristics of the buildings enable them to be classified as different PPE classes. The different measurement models can, therefore, be applied to these classes for subsequent measurement.

However, all properties within the class of office buildings must be carried at revalued amount.

QUESTION 27 (STUDY MATERIAL)

Entity A has a policy of not providing for depreciation on PPE capitalised in the year until the following year, but provides for a full year's depreciation in the year of disposal of an asset. Is this acceptable?

Answer

The depreciable amount of a tangible fixed asset should be allocated on a systematic basis over its useful life. The depreciation method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

Useful life means the period over which the asset is expected to be available for use by the entity. Depreciation should commence as soon as the asset is acquired and is available for use. Thus, the policy of Entity A is not acceptable.

QUESTION 28 (STUDY MATERIAL)

Entity A purchased an asset on 1st January 2013 for Rs. 1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil.

On 1st January 2017, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years.

Calculate the amount of depreciation for each year, if company charges depreciation on Straight Line basis.

Answer

The entity has charged depreciation using the straight-line method at Rs.10,000 per annum i.e (1,00,000/10years).

On 1st January 2017, the asset's net book value is $[1,00,000 - (10,000 \times 4)]$ Rs.60,000.

The remaining useful life is 4 years. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of four years. Consequently, it should charge depreciation for the next 4 years at Rs. 15,000 per annum i.e. (60,000 / 4 years).

QUESTION 29 (STUDY MATERIAL)

Entity B constructs a machine for its own use. Construction is completed on 1st November 2016 but the company does not begin using the machine until 1st March 2017. Comment.

Answer

The entity should begin charging depreciation from the date the machine is ready for use – that is, 1st November 2016. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.

QUESTION 30 (STUDY MATERIAL)

A property costing Rs.10,00,000 is bought in 2016. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 20 years.

The estimated residual value in 20 years' time, based on 2016 prices, is:

Case (a) Rs. 10,00,000

Case (b) Rs. 9,00,000.

Calculate the amount of depreciation

Answer**Case (a)**

The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost.

There is, therefore, no depreciable amount and depreciation is correctly zero.

Case (b)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will be Rs. 9,00,000 and the depreciable amount is, therefore, Rs. 1,00,000.

Annual depreciation (on a straight line basis) will be Rs.5,000 $[(10,00,000 - 9,00,000) \div 20]$.

QUESTION 31 (STUDY MATERIAL)

Entity B manufactures industrial chemicals and uses blending machines in the production process. The output of the blending machines is consistent from year to year and they can be used for different products.

However, maintenance costs increase from year to year and a new generation of machines with significant improvements over existing machines is available every 5 years. Suggest the depreciation method to the management

Answer

The straight-line depreciation method should be adopted, because the production output is consistent from year to year.

Factors such as maintenance costs or technical obsolescence should be considered in determining the blending machines' useful life.

QUESTION 32 (STUDY MATERIAL)

Entity A carried plant and machinery in its books at Rs. 2,00,000. These were destroyed in a fire. The assets were insured 'New for old' and were replaced by the insurance company with new machines that cost Rs. 20,00,000. The machines were acquired by the insurance company and the company did not receive the Rs. 20,00,000 as cash compensation. State, how Entity A should account for the same?

Answer

Entity A should account for a loss in the Statement of Profit and Loss on de-recognition of the carrying value of plant and machinery in accordance with AS 10 (Revised).

Entity A should separately recognize a receivable and a gain in the income statement resulting from the insurance proceeds under AS 29 (Revised)* once receipt is virtually certain. The receivable should be measured at the fair value of assets that will be provided by the insurer.

QUESTION 33 (STUDY MATERIAL)

Kalim Ltd. borrowed US\$ 4,50,000 on 01/01/2016, which will be repaid as on 31/07/2016. Kalim Ltd. prepares financial statement ending on 31/03/2016. Rate of exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/2016	1 US\$ = Rs. 48.00
31/03/2016	1 US\$ = Rs. 49.00
31/07/2016	1 US\$ = Rs. 49.50

Answer

Journal Entries in the Books of Kalim Ltd

Date	Particulars	Rs. (Dr.)	Rs. (Cr.)
Jan. 01, 2016	Bank Account (4,50,000x48) Dr.	216,00,000	
	To Foreign Loan Account		216,00,000
Mar. 31, 2016	Foreign Exchange Difference Account Dr.	4,50,000	
	To Foreign Loan Account [4,50,000 x (49-48)]		4,50,000
Jul. 01, 2016	Foreign Exchange Difference Account Dr. [4,50,000 x (49.5-49)]	2,25,000	
	Foreign Loan Account Dr.	220,50,000	
	To Bank Account		2,22,75,000

QUESTION 34 (STUDY MATERIAL)

Opportunity Ltd. purchased an equipment costing Rs.24,00,000 on 1.4.2015 and the same was fully financed by foreign currency loan (US Dollars) payable in four annual equal instalments. Exchange rates were 1 Dollar = Rs.60.00 and Rs.62.50 as on 1.4.2015 and 31.3.2016 respectively. First installment was paid on 31.3.2016. The entire difference in foreign exchange has been capitalised. You are required to state that how these transactions would be accounted for.

Answer

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, should be recognised as income or expenses in the period in which they arise. Thus, exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets will be recognised as income or expense.

Calculation of Exchange Difference:

Foreign currency loan =	Rs. 24,00,000/60 = 40,000 US Dollars
Exchange difference =	40,000 US Dollars × (62.50-60.00) = Rs. 1,00,000
(including exchange loss on payment of first instalment)	

Therefore, entire loss due to exchange differences amounting Rs.1,00,000 should be charged to profit and loss account for the year.

QUESTION 35 (STUDY MATERIAL)

A business having the Head Office in Kolkata has a branch in UK. The following is the trial balance of Branch as at 31.03.2016:

Account Name	Amount in £	
	Dr.	Cr.
Fixed Assets (Purchased on 01.04.2013)	5,000	
Debtors	1,600	
Opening Stock	400	
		20,000
Goods received from Head Office Account (Recorded in HO books as Rs.4,02,000)	6,100	
Sales		
Purchases	10,000	
Wages	1,000	
Salaries	1,200	
Cash	3,200	
Remittances to Head Office (Recorded in HO books as Rs. 1,91,000)	2,900	
Head Office Account (Recorded in HO books as Rs. 4,90,000)		7,400
Creditors		4,000

- Closing stock at branch is £ 700 on 31.03.2016.
- Depreciation @ 10% p.a. is to be charged on fixed assets.
- Prepare the trial balance after been converted in Indian Rupees.
- Exchange rates of Pounds on different dates are as follow:
01.04.2013– Rs.61; 01.04.2015– Rs. 63 & 31.03.2016 – Rs.67

Answer

Trial Balance of the Foreign Branch converted into Indian Rupees as on March 31, 2016

Particulars	£ (Dr.)	£ (Cr.)	Conversion Basis	Rs. (Dr.)	Rs. (Cr.)
Fixed Assets	5,000		Transaction Date Rate	3,05,000	
Debtors	1,600		Closing Rate	1,07,200	
Opening Stock	400		Opening Rate	25,200	
Goods Received from HO	6,100		Actuals	4,02,000	
Sales		20,000	Average Rate		13,00,000
Purchases	10,000		Average Rate	6,50,000	
Wages	1,000		Average Rate	65,000	
Salaries	1,200		Average Rate	78,000	
Cash	3,200		Closing Rate	2,14,400	
Remittance to HO	2,900		Actuals	1,91,000	
HO Account		7,400	Actuals		4,90,000
Creditors		4,000	Closing Rate		2,68,000
Exchange Rate Difference			Balancing Figure	20,200	
	31,400	31,400		20,58,000	20,58,000
Closing Stock	700		Closing Rate	46,900	
Depreciation	500		Fixed Asset Rate	30,500	

QUESTION 36 (STUDY MATERIAL)

Rau Ltd. purchased a plant for US\$ 1,00,000 on 01st February 2016, payable after three months. Company entered into a forward contract for three months @ Rs. 49.15 per dollar.

Exchange rate per dollar on 01st Feb. was Rs. 48.85. How will you recognise the profit or loss on forward contract in the books of Rau Ltd.?

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Answer

Forward Rate	Rs.49.15
Less: Spot Rate	(Rs.48.85)
Premium on Contract	<u>Rs.0.30</u>
Contract Amount	US\$ 1,00,000
Total Loss (1,00,000x0.30)	Rs.30,000

Contract period 3 months

Two falling the year 2016-17; therefore loss to be recognised $(30,000/3) \times 2 =$
 Rs. 20,000. Rest Rs. 10,000 will be recognised in the following year.

QUESTION 37 (STUDY MATERIAL)

Mr. A bought a forward contract for three months of US\$ 1,00,000 on 1st December at 1 US\$ = Rs.47.10 when exchange rate was US\$ 1 = Rs.47.02. On 31st December when he closed his books exchange rate was US\$ 1 = Rs.47.15. On 31st January, he decided to sell the contract at Rs.47.18 per dollar. Show how the profits from contract will be recognised in the books.

Answer

Since the forward contract was for speculation purpose the premium on contract i.e. the difference between the spot rate and contract rate will not be recorded in the books. Only when the contract is sold the difference between the contract rate and sale rate will be recorded in the Profit & Loss Account.

Sale Rate	Rs. 47.18
Less: Contract Rate	(Rs. 47.10)
Premium on Contract	<u>Rs. 0.08</u>
Contract Amount	US\$ 1,00,000
Total Profit (1,00,000 x 0.08)	Rs. 8,000

QUESTION 38 (STUDY MATERIAL)

A Ltd. purchased fixed assets costing Rs.3,000 lakhs on 1.1.2016 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = Rs.40.00 and Rs.42.50 as on 1.1.2016 and 31.12.2016 respectively. First instalment was paid on 31.12.2016. The entire difference in foreign exchange has been capitalised.

You are required to state, how these transactions would be accounted for.

Answer

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognised as income or expense.

Calculation of Exchange Difference:

Foreign currency loan $\frac{\text{Rs.3,000 lakhs}}{\text{Rs.40}} = 75 \text{ lakhs US Dollars}$

Exchange difference = 75 lakhs US Dollars $\times (42.50 - 40.00) = \text{Rs.187.50 lakhs}$ (including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting Rs.187.50 lakhs should be charged to profit and loss account for the year.

QUESTION 39 (STUDY MATERIAL)

Assets and liabilities and income and expenditure items in respect of foreign branches (integral foreign operations) are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to revenue. Comment.

Answer

The financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures described in AS 11. The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself.

Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. For practical reasons, a rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of transaction.

Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realisable value is translated applying exchange rate when realisable value is determined which is generally closing rate.

Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account. Exchange difference arising on the translation of the financial statement of foreign operation may have tax effect which should be dealt as per AS 22 'Accounting for Taxes on Income'.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS11.

QUESTION 40 (STUDY MATERIAL)

Z Ltd. purchased a fixed asset for Rs. 50 lakhs, which has the estimated useful life of 5 years with the salvage value of Rs.5,00,000. On purchase of the assets government granted it a grant for Rs. 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant amount is deducted from the value of fixed asset.

Answer

Journal in the books of Z Ltd.

Year	Particulars	Rs. (Dr.)	Rs. (Cr.)
1st	Fixed Assets Account Dr.	50,00,000	
	To Bank Account		50,00,000

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2nd	(Being Fixed Assets purchased)			
	Bank Account Dr.	10,00,000		
	To Fixed Assets Account		10,00,000	
	(Being grant received from the government)			
	Depreciation Account Dr.	7,00,000		
	To Fixed Assets Account		7,00,000	
	(Being Depreciation charged on SLM)			
	Profit & Loss Account Dr.	7,00,000		
	To Depreciation Account		7,00,000	
	(Being Depreciation transferred to P/L Account)			
	Depreciation Account Dr.	7,00,000		
	To Fixed Assets Account		7,00,000	
	(Being Depreciation charged on SLM)			
	Profit & Loss Account Dr.	7,00,000		
	To Depreciation Account		7,00,000	
	(Being Depreciation transferred to P/L Account)			

QUESTION 41 (STUDY MATERIAL)

Z Ltd. purchased a fixed asset for Rs. 50 lakhs, which has the estimated useful life of 5 years with the salvage value of Rs.5,00,000. On purchase of the assets government granted it a grant for Rs. 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant is treated as deferred income.

Answer

Journal in the books of Z Ltd.

Year	Particulars	Rs. (Dr.)	Rs. (Cr.)
1st	Fixed Assets Account Dr.	50,00,000	
	To Bank Account		50,00,000
	(Being fixed assets purchased)		
	Bank Account Dr.	10,00,000	
	To Deferred Government Grant Account		10,00,000
	(Being grant received from the government)		
	Depreciation Account Dr.	9,00,000	

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2nd	To Fixed Assets Account (Being depreciation charged on SLM)		9,00,000
	Profit & Loss Account Dr.	9,00,000	
	To Depreciation Account (Being depreciation transferred to P/L Account)		9,00,000
	Deferred Government Grants Account Dr.	2,00,000	
	To Profit & Loss Account (Being proportionate government grant taken to P/L Account)		2,00,000
	Depreciation Account Dr.	9,00,000	
	To Fixed Assets Account (Being depreciation charged on SLM)		9,00,000
	Profit & Loss Account Dr.	9,00,000	
	To Depreciation Account (Being depreciation transferred to P/L Account)		9,00,000
	Deferred Government Grant Account Dr.	2,00,000	
	To Profit & Loss Account (Being proportionate government grant taken to P/L Account)		2,00,000

QUESTION 42 (STUDY MATERIAL)

Santosh Ltd. has received a grant of Rs.8 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed Rs.2 crores as dividend. Also, Santosh Ltd. received land free of cost from the State Government but it has not recorded it at all in the books as no money has been spent. In the light of AS 12 examine, whether the treatment of both the grants is correct.

Answer

As per AS 12 'Accounting for Government Grants', when government grant is received for a specific purpose, it should be utilised for the same. So the grant received for setting up a factory is not available for distribution of dividend.

In the second case, even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value. The treatment of both the elements of the grant is incorrect as per AS12.

QUESTION 43 (STUDY MATERIAL)

Top & Top Limited has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment. Having fulfilled all the conditions under the scheme, the company on its investment of Rs. 50 crore in capital assets received Rs. 10 crore from the Government in January, 2017 (accounting period being 2016-2017). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 2017.

Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.

Answer

As per para 10 of AS 12 'Accounting for Government Grants', where the government grants are of the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus it is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs. The correct treatment is to credit the subsidy to capital reserve. Therefore, the accounting treatment desired by the company is not proper.

QUESTION 44 (STUDY MATERIAL)

Z Ltd. purchased a fixed asset for Rs.50 lakhs, which has the estimated useful life of 5 years with the salvage value of Rs.5,00,000. On purchase of the assets government granted it a grant for Rs.10 lakhs (This amount was reduced from the cost of fixed asset). Grant was considered as refundable in the end of 2nd year to the extent of

Rs.7,00,000. Pass the journal entry for refund of the grant as per the first method.

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Answer

Fixed Assets Account	Dr.	Rs.7,00,000
To Bank Account		Rs.7,00,000
(Being government grant on asset refunded)		

QUESTION 45 (STUDY MATERIAL)

A fixed asset is purchased for Rs. 20 lakhs. Government grant received towards it is Rs. 8 lakhs. Residual Value is Rs. 4 lakhs and useful life is 4 years. Assume depreciation on the basis of Straight Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of Rs. 5 lakhs due to non-compliance with certain conditions.

Pass journal entries for first two years**Answer****Journal Entries**

Year	Particulars	Rs.in lakhs (Dr.)	Rs.in lakhs (Cr.)
1	Fixed Asset Account Dr. To Bank Account (Being fixed asset purchased)	20	20
	Bank Account Dr. To Fixed Asset Account (Being grant received from the government reduced the cost of fixed asset)	8	8
2	Depreciation Account (W.N.1) Dr. To Fixed Asset Account (Being depreciation charged on Straight Line method (SLM))	2	2
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 1)	2	2
		5	

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Fixed Asset Account To Bank Account (Being government grant on asset partly refunded which increased the cost of fixed asset)	Dr.		5
		3.67	3.67
Depreciation Account(W.N.2) To Fixed Asset Account (Being depreciation charged on SLM on revised value of fixed asset prospectively)	Dr.	3.67	
			3.67
Profit & Loss Account To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 2)	Dr.		

Working Notes:**1. Depreciation for Year1**

	₹ in lakhs
Cost of the Asset	20
Less: Government grant received	<u>(8)</u>
Depreciation	2

2. Depreciation for Year2

	Rs.in lakhs
Cost of the Asset	20
Less: Government grant received	<u>(8)</u>
	12
Less: Depreciation for the first year	<u>2</u>
	10
Add: Government grant refundable	<u>5</u>
	<u>15</u>
Depreciation for the second year	3.67

QUESTION 46 (STUDY MATERIAL)

On 1.4.2014, ABC Ltd. received Government grant of Rs.300 lakhs for acquisition of machinery costing Rs.1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 2017 due to non-fulfilment of certain conditions.

How you would deal with the refund of grant in the books of ABC Ltd. assuming that the company did not charge any depreciation for year 2017?

Answer

According to para 21 of AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing deferred income balance, as appropriate, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

		(Rs.in lakhs)
1st April, 2014	Acquisition cost of machinery (Rs.1,500 – Rs.300)	1,200.00
31st March, 2015	Less: Depreciation @ 20%	(240.00)
	Book value	960.00
31st March, 2016	Less: Depreciation @ 20%	(192.00)
	Book value	768.00
31st March, 2017	Less: Depreciation @ 20%	(153.60)
1st April, 2017	Book value	614.40
May, 2017	Add: Refund of grant	300.00
	Revised book value	914.40

Depreciation @ 20% on the revised book value amounting Rs.914.40 lakhs is to be provided prospectively over the residual useful life of the asset.

QUESTION 47 (STUDY MATERIAL)

A Ltd. purchased a machinery for Rs.40 lakhs. (Useful life 4 years and residual value Rs.8 lakhs) Government grant received is Rs.16lakhs.

Show the Journal Entry to be passed at the time of refund of grant in the third year and the value of the fixed assets, if:

- (1) the grant is credited to Fixed Assets A/c.
- (2) the grant is credited to Deferred Grant A/c.

Answer

In the books of A Ltd.
Journal Entries (at the time of refund of grant)

- (1) If the grant is credited to Fixed Assets Account:

		Rs.	Rs.
I	Fixed Assets A/c Dr. To Bank A/c (Being grant refunded)The amount of refund should be Rs.16 Lakhs	16 lakhs	16 lakhs

II The balance of fixed assets after two years depreciation will be Rs.16 lakhs (W.N.1) and after refund of grant it will become (Rs.16 lakhs + Rs.16 lakhs) = Rs.32 lakhs on which depreciation will be charged for remaining two years. Depreciation = $(32-8)/2 = \text{Rs.12 lakhs p.a.}$ will be charged for next two years.

- (2) If the grant is credited to Deferred Grant Account:

As per para 14 of AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years $(\text{Rs.16 lakhs} / 4 \text{ years}) = \text{Rs.4 lakhs p.a.}$ x 2 years = Rs.8 lakhs were credited to Profit and Loss Account and Rs.8 lakhs was the balance of Deferred Grant Account after two years.

Therefore, on refund in the 3rd year, following entry will be passed:

		Rs.	Rs.
I	Deferred Grant A/c Dr.	8 lakhs	
	Profit & Loss A/c Dr.	8 lakhs	16 lakhs
	To Bank A/c		
	(Being Government grant refunded)		

- II Deferred grant account will become Nil. The fixed assets will continue to be shown in the books at Rs.24 lakhs (W.N.2) and depreciation will continue to be charged at Rs.8 lakhs per annum for the remaining two years.

Working Notes:

1. Balance of Fixed Assets after two years but before refund (under first alternative)

Fixed assets initially recorded in the books = Rs.40 lakhs – Rs.16 lakhs = Rs.24 lakhs

Depreciation p.a. = (Rs.24 lakhs – Rs.8 lakhs)/4 years = Rs.4 lakhs per year

Value of fixed assets after two years but before refund of grant

= Rs.24 lakhs – (Rs.4 lakhs x 2 years) = Rs.16 lakhs

2. Balance of Fixed Assets after two years but before refund (under second alternative)

Fixed assets initially recorded in the books = Rs.40 lakhs

Depreciation p.a. = (Rs.40 lakhs – Rs.8 lakhs)/4 years = Rs.8 lakhs per year Book

value of fixed assets after two years = Rs.40 lakhs – (Rs.8 lakhs x 2 years)

= Rs.24 lakhs

Note : It is assumed that the question requires the value of fixed assets is to be given after refund of government grant.

QUESTION 48 (STUDY MATERIAL)

An unquoted long term investment is carried in the books at a cost of Rs.2 lakhs. The published accounts of the unlisted company received in May, 2017 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than Rs.20,000. How will you deal with this in preparing the financial statements of R Ltd. for the year ended 31st March, 2017?

Answer

As it is stated in the question that financial statements for the year ended 31st March, 2017 are under preparation, the views have been given on the basis that the financial statements are yet to be completed and approved by the Board of Directors. Also, the fall in value of investments has been considered on account of conditions existing on the balance sheet date.

Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution should be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

AS 13 (Revised) 'Accounting for Investments' states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. On these bases, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to Rs.20,000 in the financial statements for the year ended 31st March, 2017.

QUESTION 49 (STUDY MATERIAL)

X Ltd. on 1-1-2017 had made an investment of Rs.600 lakhs in the equity shares of Y Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realisable value of all such investment on 31-3-2017 became Rs.200 lakhs as Y Ltd. lost a case of copyright. From the given market conditions, it is apparent that the reduction in the value is not temporary in nature. How will you recognise the reduction in financial statements for the year ended on 31-3-2017?

Answer

X Ltd. invested Rs.600 lakhs in the equity shares of Y Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. Rs.300 lakhs and remaining as temporary (current) investment i.e. Rs.300 lakhs. Irrespective of the fact that investment has been held by X Ltd. Only for 3 months (from 1.1.2017 to 31.3.2017), AS 13 (Revised) lays emphasis on intention of the investor to classify the investment as current or long term even though the long term investment may be readily marketable.

In the given situation, the realisable value of all such investments on 31.3.2017 became Rs.200 lakhs i.e. Rs.100 lakhs in respect of current investment and Rs.100 lakhs in respect of long term investment.

As per AS 13 (Revised), 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value.

Accordingly, the carrying value of investment held as temporary investment should be shown at realisable value i.e. at Rs.100 lakhs. The reduction of Rs.200 lakhs in the carrying value of current investment will be charged to the profit and loss account.

Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long term investment, the carrying amount is reduced to recognise the decline.

Here, Y Ltd. lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quite a substantial figure. Losing the case of copyright may affect the business and the performance of the company in long run. Accordingly, it will be appropriate to reduce the carrying amount of long term investment by Rs.200 lakhs and show the investments at Rs.100 lakhs, since the downfall in the value of shares is other than temporary. The reduction of Rs.200 lakhs in the carrying value of long term investment will also be charged to the Statement of profit and loss.

QUESTION 50 (STUDY MATERIAL)

M/s Innovative Garments Manufacturing Company Limited invested in the shares of another company on 1st October, 2016 at a cost of Rs.2,50,000. It also earlier purchased Gold of Rs.4,00,000 and Silver of Rs.2,00,000 on 1st March, 2014. Market value as on 31st March, 2017 of above investments are as follows:

	Rs.
Shares	2,25,000
Gold	6,00,000
Silver	3,50,000

How above investments will be shown in the books of accounts of M/s Innovative Garments Manufacturing Company Limited for the year ending 31st March, 2017 as per the provisions of Accounting Standard 13 "Accounting for Investments"?

Answer

As per AS 13 (Revised) 'Accounting for Investments', for investment in shares - if the investment is purchased with an intention to hold for short-term period (less than one year), then it will be classified as current investment and to be carried at lower of cost and fair value, i.e., in case of shares, at lower of cost (Rs. 2,50,000) and market value (Rs. 2,25,000) as on 31 March 2017, i.e., Rs.2,25,000.

If equity shares are acquired with an intention to hold for long term period (more than one year), then should be considered as long-term investment to be shown at cost in the Balance Sheet of the company. However, provision for diminution should be made to recognize a decline, if other than temporary, in the value of the investments.

Gold and silver are generally purchased with an intention to hold it for long term period (more than one year) until and unless given otherwise. Hence, the investment in Gold and Silver (purchased on 1st March, 2014) should continue to be shown at cost (since there is no 'other than temporary' diminution) as on 31st March, 2017, i.e., Rs.4,00,000 and Rs.2,00,000 respectively, though their market values have been increased.

QUESTION 51 (STUDY MATERIAL)

ABC Ltd. wants to re-classify its investments in accordance with AS 13 (Revised). Decide and state on the amount of transfer, based on the following information:

- (1) A portion of current investments purchased for Rs.20 lakhs, to be reclassified as long term investment, as the company has decided to retain them. The market value as on the date of Balance Sheet was Rs.25 lakhs.
- (2) Another portion of current investments purchased for Rs.15 lakhs, to be reclassified as long term investments. The market value of these investments as on the date of balance sheet was Rs.6.5 lakhs.

- (3) Certain long term investments no longer considered for holding purposes, to be reclassified as current investments. The original cost of these was Rs.18 lakhs but had been written down to Rs.12 lakhs to recognise other than temporary decline as per AS 13(Revised).

Answer

As per AS 13 (Revised), where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer.

- (1) In the first case, the market value of the investment is Rs.25 lakhs, which is higher than its cost i.e. Rs.20 lakhs. Therefore, the transfer to long term investments should be carried at cost i.e. Rs.20lakhs.
- (2) In the second case, the market value of the investment is Rs.6.5 lakhs, which is lower than its cost i.e. Rs.15 lakhs. Therefore, the transfer to long term investments should be carried in the books at the market value i.e. Rs.6.5 lakhs. The loss of Rs.8.5 lakhs should be charged to profit and loss account.

As per AS 13 (Revised), where long-term investments are re-classified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

In the third case, the book value of the investment is Rs.12 lakhs, which is lower than its cost i.e. Rs.18 lakhs. Here, the transfer should be at carrying amount and hence this re-classified current investment should be carried at Rs.12 lakhs.

QUESTION 52 (STUDY MATERIAL)

X Ltd. began construction of a new building on 1st January, 2016. It obtained Rs.1 lakh special loan to finance the construction of the building on 1st January, 2016 at an interest rate of 10%. The company's other outstanding two non-specific loans were:

Amount	Rate of Interest
Rs.5,00,000	11%
Rs.9,00,000	13%

The expenditures that were made on the building project were as follows:

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	Rs.
January 2016	2,00,000
April 2016	2,50,000
July 2016	4,50,000
December 2016	1,20,000

Building was completed by 31st December, 2016. Following the principles prescribed in AS 16 'Borrowing Cost,' calculate the amount of interest to be capitalised and pass one Journal Entry for capitalising the cost and borrowing cost in respect of the building

Answer

(i) Computation of average accumulated expenses

	Rs.
Rs.2,00,000 x 12 / 12	= 2,00,000
Rs.2,50,000 x 9 / 12	= 1,87,500
Rs.4,50,000 x 6 / 12	= 2,25,000
Rs.1,20,000 x 1 / 12	= <u>10,000</u>
	<u>6,22,500</u>

(ii) Calculation of average interest rate other than for specific borrowings

Amount of loan (Rs.)	Rate of interest	Amount of interest (Rs.)
5,00,000	11%	= 55,000
<u>9,00,000</u>	13%	= <u>1,17,000</u>
14,00,000		<u>1,72,000</u>
Weighted average rate of interest		= 12.285% (approx)

(iii) Interest on average accumulated expenses

		Rs.
Specific borrowings (Rs.1,00,000 x 10%)	=	10,000
Non-specific borrowings (Rs. 5,22,500 x 12.285%)	=	64,189
Amount of interest to be capitalised	=	74,189

(iv) Total expenses to be capitalised for building

	Rs.
Cost of building Rs.(2,00,000 + 2,50,000 + 4,50,000 +1,20,000)	10,20,000
Add: Amount of interest to be capitalised	74,189
	10,94,189

(v) Journal Entry

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
31.12.2016	Building account	Dr.	10,94,189	
	To Bank account			10,94,189
	(Being amount of cost of building and borrowing cost there on capitalised)			

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QUESTION 53 (STUDY MATERIAL)

PRM Ltd. obtained a loan from a bank for Rs.50 lakhs on 30-04-2016. It was utilised as follows:

Particulars	Amount (Rs.in lakhs)
Construction of a shed	50
Purchase of a machinery	40
Working Capital	20
Advance for purchase of truck	10

Construction of shed was completed in March 2017. The machinery was installed on the date of acquisition. Delivery of truck was not received. Total interest charged by the bank for the year ending 31-03-2017 was Rs.18 lakhs. Show the treatment of interest.

Answer

Qualifying Asset as per AS 16 = Rs.50 lakhs (construction of a shed) Borrowing cost to be capitalised = $18 \times 50/120 = \text{Rs.7.5 lakhs}$ Interest to be debited to Profit or Loss account = $\text{Rs.}(18 - 7.5)\text{lakhs}$
 $= \text{Rs.10.5 lakhs}$

QUESTION 54 (STUDY MATERIAL)

The company has obtained Institutional Term Loan of Rs.580 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 2017 amounted to Rs.406 lakhs, Rs.58 lakhs has been advanced to suppliers for additional assets and the balance loan of Rs.116 lakhs has been utilised for working capital purpose. The Accountant is on a dilemma as to how to account for the total interest of Rs.52.20 lakhs incurred during 2016-2017 on the entire Institutional Term Loan of Rs.580 lakhs.

Answer

As per para 6 of AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred.

A qualifying asset is an asset that necessary takes a substantial period of time* to get ready for its intended use or sale.

The treatment for total interest amount of Rs.52.20 lakhs can be given as:

Purpose	Nature	Interest to be capitalized	Interest to be charged to profit and loss account
		Rs.in lakhs	Rs.in lakhs
Modernization and renovation of plant and machinery	Qualifying asset	580	
Advance to supplies for additional assets	Qualifying asset	580	580
Working Capital	Not a qualifying asset		
		41.76	10.44

QUESTION 55 (STUDY MATERIAL)

Take Ltd. has borrowed Rs.30 lakhs from State Bank of India during the financial year 2016-2017. The borrowings are used to invest in shares of Give Ltd., a subsidiary company of Take Ltd., which is implementing a new project, estimated to cost Rs.50 lakhs. As on 31st March, 2017, since the said project was not complete, the directors of Take Ltd. resolved to capitalise the interest accruing on borrowings amounting to Rs.4 lakhs and add it to the cost of investments. Comment.

Answer

As per AS 13 (Revised) "Accounting for Investments", the cost of investment includes acquisition charges such as brokerage, fees and duties. In the present case, Take Ltd. has used borrowed funds for purchasing shares of its subsidiary company Give Ltd. Rs.4 lakhs interest payable by Take Ltd. to State Bank of India cannot be called as acquisition charges, therefore, cannot be constituted as cost of investment.

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Further, as per para 3 of AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Since, shares are ready for its intended use at the time of sale, it cannot be considered as qualifying asset that can enable a company to add the borrowing cost to investments. Therefore, the directors of Take Ltd. cannot capitalise the borrowing cost as part of cost of investment. Rather, it has to be charged to the Statement of Profit and Loss for the year ended 31st March, 2017.

QUESTION 56 (STUDY MATERIAL)

Which item of inventory is under the scope of AS2 (Revised)?

- (a) WIP arising under construction contracts
- (b) Raw materials
- (c) Shares, Debentures held as stock in trade.

Answer: b) Raw Materials

QUESTION 57 (STUDY MATERIAL)

Crown Ltd. wants to prepare its cash flow statement. It sold equipment of book value of Rs.60,000 at a gain of Rs.8,000. The amount to be reported in its cash flow statement under operating activities is

- (a) Nil
- (b) Rs.8,000
- (c) 68,000

Answer: a) Nil

QUESTION 58 (STUDY MATERIAL)

While preparing cash flow statement, an entity (other than a financial institution) should disclose the dividends received from its investment in shares as

- (a) operating cash inflow
- (b) investing cash inflow
- (c) financing cash inflow

Answer: b) investing cash inflow

QUESTION 59 (STUDY MATERIAL)

As per AS 10 'Property, plant and equipment', which costs is not included in the carrying amount of an item of PPE

- (a) Costs of site preparation
- (b) Costs of relocating
- (c) Installation and assembly costs.

Answer: b) Costs of relocating

QUESTION 60 (STUDY MATERIAL)

As per AS 10 (Revised) 'Property, Plant and Equipment', an enterprise holding investment properties should value Investment property

- (a) as per fair value
- (b) under discounted cash flow model.
- (c) under cost model

Answer: c) under cost model

QUESTION 61 (STUDY MATERIAL)

As per AS 11 assets and liabilities of non-integral foreign operations should be converted rate.

- (a) Opening
- (b) Average
- (c) Closing

Answer: c) Closing

QUESTION 62 (STUDY MATERIAL)

The debit or credit balance of "Foreign Currency Monetary Item Translation Difference account".

- (a) Is shown as "Miscellaneous Expenditure " in the Balance Sheet.
- (b) Is shown under "Reserve & Surplus" as a separate line item.
- (c) Is shown as "other Non-current /Current Assets" in the Balance sheet.

Answer: b) Is shown under "Reserve & Surplus" as a separate line item.

CA Ravi Agarwal's
CA INTER ACCOUNTING COMPILER 4.0**QUESTION 63 (STUDY MATERIAL)**

If asset of an integral foreign operation is carried at cost, cost and depreciation of tangible fixed asset is translated at

- (a) Average exchange rate
- (b) Closing exchange rate
- (c) Exchange rate at the date of purchase of asset

Answer: c) Exchange rate at the date of purchase of asset

QUESTION 64 (STUDY MATERIAL)

To encourage industrial promotion, IDCI offers subsidy worth Rs. 50 lakhs to all new industries set up in the specified industrial areas. This grant is in the nature of promoter's contribution. How such subsidy should be accounted in the books?

- (a) Credit it to capital reserve
- (b) Credit it as 'other income' in the profit and loss account in the year of commencement of commercial operations
- (c) Both (a) and (b) are permitted

Answer: a) Credit it to capital reserve

QUESTION 65 (STUDY MATERIAL)

As per AS 16, all of the following are qualifying assets except

- (a) Manufacturing plants and Power generation facilities
- (b) Inventories that require substantial period of time
- (c) Assets those are ready for sale

Answer: c) Assets those are ready for sale

QUESTION 66 (STUDY MATERIAL)

Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be

- (a) sold above cost.

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- (b) sold less than cost.
- (c) sold at or above cost.

Answer: c)

QUESTION 67 (STUDY MATERIAL)

All of the following costs are excluded while computing value of inventories except?

- (a) Selling and Distribution costs
- (b) Allocated fixed production overheads based on normal capacity.
- (c) Abnormal wastage

Answer: b)

QUESTION 68 (STUDY MATERIAL)

If an investment is acquired in exchange for another asset, it will be valued at

- (a) Fair value of the asset given up.
- (b) Fair value of the investment acquired.
- (c) Either (a) or (b), whichever is more clearly evident.

Answer: c)

QUESTION 69 (STUDY MATERIAL)

XYZ Co. is a financial enterprise. In its cash flow statement, interest paid and dividends received should be

- (a) classified as operating cash flows.
- (b) classified as financing cash flows.
- (c) Not shown in cash flow statement.

Answer: a)

QUESTION 70 (STUDY MATERIAL)

Government grants that are receivable as compensation for expenses or losses incurred in a previous accounting period or for the purpose of giving immediate financial support to the enterprise with no further related costs, should be

- (a) recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable as an ordinary item.
- (b) recognised and disclosed in the Statement of Profit and Loss of the period in which the losses or expenses were incurred.
- (c) recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable, as an extraordinary item if appropriate as per AS 5.

Answer: c)

QUESTION 71 (STUDY MATERIAL)

What are the issues, with which Accounting Standards deal?

Answer: Accounting standards deal with the issues of (i) Recognition of events and transactions in the financial statements ,(ii) Measurement of these transaction and events ,(iii) Presentation of these transaction and events in the financial statements in the manner that is meaningful and understandable to the reader and (iv) Discloser requirements.

QUESTION 72 (STUDY MATERIAL)

What are the three fundamental accounting assumptions recognised by Accounting Standard(AS)1? Briefly describe each one of them.

Answer: Accounting Standard (AS) 1 recognises three fundamental accounting assumptions. These are:(i) Going Concern;(ii) Consistency; (iii) Accrual basis of accounting

QUESTION 73 (STUDY MATERIAL)

In determining the cost of inventories, it is appropriate to exclude certain cost and recognise them as expenses in the period in which they are incurred. Provide examples of such costs as per AS 2 (Revised) Valuation of Inventories”

Answer:

As per AS 2 (Revised) 'Valuation of Inventories', certain costs are excluded from the cost of the inventories and are recognised as expenses in the period in which incurred. Examples of such costs are:

- (a) abnormal amount of wasted materials, labour, or other production costs;
- (b) storage costs, unless those costs are necessary in the production process prior to a further production stage;
- (c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
- (d) selling and distribution costs.

QUESTION 74 (STUDY MATERIAL)**What are the main features of the cash flow statement?**

Answer: According to AS 3 on "Cash Flow Statement", cash flow statement deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise during the given period from operating, investing and financing activities. Cash flows from operating activities can be reported using either (a) the direct method, or (b) the indirect method. A cash flow statement when used in conjunction with the other financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency), and its ability to affect the amount and timing of cash flows in order to adapt to changing circumstances and opportunities.

QUESTION 75 (STUDY MATERIAL)**When can a company change its accounting policy?****Answer:**

A change in accounting policy should be made in the following conditions:

- (i) If the change is required by some statute or
- (ii) for compliance with an Accounting Standard or
- (iii) Change would result in more appropriate presentation of financial statement.

QUESTION 76 (STUDY MATERIAL)

Explain “monetary item” as per Accounting Standard 11. How are foreign currency monetary items to be recognised at each Balance Sheet date? Classify the following as monetary or non-monetary item:

- (i) Share Capital
- (ii) Trade Receivables
- (iii) Investments
- (iv) Fixed Assets.

Answer:

Share capital	Non-monetary
Trade receivables	Monetary
Investments	Non-monetary
Fixed assets	Non-monetary

QUESTION 77 (STUDY MATERIAL)

Briefly explain disclosure requirements for Investments as per AS-13.

Answer: The disclosure requirements as per AS 13 (Revised) are as follows:

- (i) Accounting policies followed for valuation of investments.
- (ii) Classification of investment into current and long term.
- (iii) The amount included in profit and loss statements for
 - (a) Interest, dividends and rentals for long term and current investments, disclosing therein gross income and tax deducted at source thereon;
 - (b) Profits and losses on disposal of current investment and changes in carrying amount of such investments;
 - (c) Profits and losses and disposal of long term investments and changes in carrying amount of investments.
- (iv) Aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments;
- (v) Any significant restrictions on investments like minimum holding period for sale/disposal, utilisation of sale proceeds or non-remittance of sale proceeds of investment held outside India.
- (vi) Other disclosures required by the relevant statute governing the enterprise.

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CA INTER ACCOUNTING COMPILER 4.0**QUESTION 78 (STUDY MATERIAL)**

When capitalisation of borrowing cost should cease as per Accounting Standard 16?

Answer

Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

QUESTION 79 (STUDY MATERIAL)

Explain 'Bearer Plant' and 'Biological Asset' as per Accounting Standard 10.

ANSWER 75

As per AS 10 Property, Plant and Equipment, biological asset is a living animal or plant. Bearer plant is a plant that (a) is used in the production or supply of agricultural produce; (b) is expected to bear produce for more than a period of twelve months; and (c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales. Plants cultivated to be harvested as agricultural produce (for example, trees grown for use as lumber); plants cultivated to produce agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales (for example, trees that are cultivated both for their fruit and their lumber); and annual crops (for example, maize and wheat) are not bearer plants.

QUESTION 80 (STUDY MATERIAL)

Distinguish Non-Integral Foreign Operation (NFO) with Integral Foreign Operation (IFO) as per AS 11.

ANSWER

As per AS 11, Integral foreign operation (IFO) is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations. In contrast, a non-integral foreign operation (NFO) is a foreign operation that is not an integral operation. For details, refer para 2.5 of chapter.

QUESTION 81 (STUDY MATERIAL)

XYZ Ltd., with a turnover of Rs.35 lakhs and borrowings of Rs.10 lakhs during any time in the previous year, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3.2017. Advise the management on the exemptions that are available as per the Companies (AS) Rules, 2006. If XYZ is a partnership firm is there any other exemptions additionally available.

Answer

The question deals with the issue of Applicability of Accounting Standards for corporate & non-corporate entities .

The companies can be classified under two categories viz SMCs and Non SMCs under the Companies (AS) Rules, 2006.

As per the Companies (AS) Rules, 2006, criteria for above classification as SMCs, are: "Small and Medium Sized Company" (SMC) means, a company-

whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;

which is not a bank, financial institution or an insurance company;

whose turnover (excluding other income) does not exceed rupees fifty crore in the immediately preceding accounting year;

which does not have borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year; and

which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Since, XYZ Ltd.'s turnover of Rs.35 lakhs does not exceed Rs.50 crores & borrowings of Rs.10 lakhs is less than Rs.10 crores, it is a small and medium sized company

The following relaxation and exemptions are available to XYZ Ltd:

1. Cash flow statement is not mandatory
2. "AS 17 Segment Reporting " is not mandatory.
3. SME are exempt from some paragraphs of AS 19 "leases".

4. SME are exempt from disclosures of diluted EPS (both including and excluding extraordinary items)
5. SMEs are allowed to measure the 'value in use' on the basis of reasonable estimate thereof instead of computing the value in use by present value technique under AS 28 "Impairment of Assets".
6. SMEs are exempt from certain disclosure requirements of AS 29 (Revised) "Provisions, Contingent Liabilities and Contingent Assets".
7. SMEs are exempt from certain requirements of AS 15 "Employee Benefits".
8. Accounting Standards 21, 23, 27 are not applicable to SMEs.

However, if XYZ is a partnership firm and not a corporate, then its classification will be done on the basis of the classification of non-corporate entities as prescribed by the ICAI. Accordingly, to ICAI, non-corporate entities can be classified under 3 levels viz Level I, Level II (SMEs) and Level III (SMEs).

Since, turnover of XYZ, a partnership firm is less than Rs.1 crore & borrowings of Rs.10 lakhs is less than Rs.1 crore, therefore, it will be classified as Level III SME. In this case, AS3, AS17, AS18, AS21(Revised), AS23, AS24, AS27 will not be applicable to XYZ a partnership firm. Relaxations from certain requirements in respect of AS 15, AS 19, AS 20, AS 25, AS 28 and AS 29 (Revised) are also available to XYZ a partnership firm.

QUESTION 82 (STUDY MATERIAL)

A company was classified as Non-SMC in 2015-2016. In 2016-2017 it has been classified as SMC. The management desires to avail the exemption or relaxations available for SMCs in 2016-2017. However, the accountant of the company does not agree with the same. Comment.

Answer

As per Rule 5 of the Companies (Accounting Standards) Rules, 2006, an existing company, which was previously not an SMC and subsequently becomes an SMC, should not be qualified for exemption or relaxation in respect of accounting standards available to an SMC until the company remains an SMC for two consecutive accounting periods. Therefore, the management of the company cannot avail the exemptions available with the SMCs for the year ended 31st March, 2017.

QUESTION 83 (STUDY MATERIAL)

Capital Cables Ltd., has a normal wastage of 4% in the production process. During the year 2016-17 the company used 12,000 MT of raw material costing 150 per MT. At the end of the year 630 MT of wastage was in stock. The accountants want to know how this wastage is to be treated in the books. Explain in the context of AS 2 (Revised) the treatment of normal loss and abnormal loss and also find out the amount of abnormal loss if any.

Answer

Amount of Abnormal Loss:

Material used

Normal Loss (4% of 12,000 MT)

Net quantity of material 11,520 MT

Abnormal Loss in quantity 150 MT

Abnormal Loss Rs.23,437.50 [150

units @ Rs.156.25 (Rs.18,00,000/11,520)]

Amount Rs.23,437.50 will be charged to the Profit and Loss statement.

QUESTION 84 (STUDY MATERIAL) (PAST PAPER JAN 21)

Mr. Mehul gives the following information relating to items forming part of inventory as on 31-3-2017. His factory produces Product X using Raw Material A .

- (i) 600 units of Raw material A (purchased @ Rs.120). Replacement cost of raw material A as on 31-3-2017 is Rs.90 per unit.
- (ii) 500 units of partly finished goods in the process of producing X and cost incurred till date Rs.260 per unit. These units can be finished next year by incurring additional cost of Rs.60 per unit.
- (iii) 1500 units of finished Product X and total cost incurred Rs.320 per unit.

Expected selling price of Product X is Rs.300 per unit.

Determine how each item of inventory will be valued as on 31-3-2017. Also calculate the value of total inventory as on 31-3-2017.

Answer

As per AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the

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finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value. In the given case, selling price of product X is Rs.300 and total cost per unit for production is Rs.320.

Hence the valuation will be done as under:

- (i) 600 units of raw material will be written down to replacement cost as market value of finished product is less than its cost, hence valued at Rs.90 per unit.
- (ii) 500 units of partly finished goods will be valued at 240 per unit i.e. lower of cost (Rs.260) or Net realisable value Rs.240 (Estimated selling price Rs.300 per unit less additional cost of Rs.60).
- (iii) 1,500 units of finished product X will be valued at NRV of Rs.300 per unit since it is lower than cost Rs.320 of product X.

Valuation of Total Inventory as on 31.03.2017:

	Units	Cost (₹)	NRV/Rep lacement cost	Value = units x cost or NRV whichever is less (₹)
Raw material A	600	120	90	54,000
Partly finished goods	500	260	240	1,20,000
Finished goods X	1,500	320	300	4,50,000
Value of Inventory				6,24,000

QUESTION 85 (STUDY MATERIAL)

Money Ltd., a non-financial company has the following entries in its Bank Account. It has sought your advice on the treatment of the same for preparing Cash Flow Statement.

- (i) Loans and Advances given to the following and interest earned on them:
 - (1) to suppliers
 - (2) to employees
 - (3) to its subsidiaries companies
- (ii) Investment made in subsidiary Smart Ltd. and dividend received
- (iii) Dividend paid for the year
- (iv) TDS on interest income earned on investments made
- (v) TDS on interest earned on advance given to suppliers Discuss in the context of AS 3 Cash Flow Statement.

Answer

Treatment as per AS 3 'Cash Flow Statement'

- (i) Loans and advances given and interest earned
 - (1) to suppliers Cash flows from operating activities
 - (2) to employees Cash flows from operating activities
 - (3) to its subsidiary companies Cash flows from investing activities
- (ii) Investment made in subsidiary company and dividend received Cash flows from investing activities
- (iii) Dividend paid for the year
Cash flows from financing activities
- (iv) TDS on interest income earned on investments made
Cash flows from investing activities
- (v) TDS on interest earned on advance given to suppliers Cash flows from operating activities

QUESTION 86 (STUDY MATERIAL)

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

1. Cost of the plant (Cost per Supplier's Invoice plus taxes) 25,00,000
2. Initial Delivery and handling cost 2,00,000.
3. Cost of Site Preparation 6,00,000
4. Consultants used for advice on the acquisition of the plant 7,00,000
5. Interest charges paid to supplier of plant for deferred credit 2,00,000
6. Estimated dismantling costs to be incurred after 7 years 3,00,000
7. Operating losses before commercial production 4,00,000.

Please advise ABC Ltd. on the costs that can be capitalised in accordance with AS 10(Revised).

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Answer

According to AS 10 (Revised), these costs can be capitalised

1. Cost of the plant	Rs.25,00,000
2. Initial delivery and handling costs	Rs.2,00,000
3. Cost of site preparation	Rs.6,00,000
4. Consultants' fees	Rs.7,00,000
5. Estimated dismantling costs to be incurred after 7 years	Rs.3,00,000
	Rs.43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 2,00,000 and operating losses before commercial production amounting to ₹ 4,00,000 are not regarded as directly attributable costs and thus cannot be capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

QUESTION 87 (STUDY MATERIAL) (PAST EXAM JAN 21)

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3.2017.

Trade receivables include amount receivable from Umesh Rs.5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US\$1 = Rs.58.50.

Long term loan taken from a U.S. Company, amounting to Rs.60,00,000. It was recorded at US\$1 = Rs.55.60, taking exchange rate prevailing at the date of transaction.

US\$1 = Rs.61.20 on 31.3.2017.

Answer

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortised over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

QUESTION 88 (STUDY MATERIAL)

Supriya Ltd. received a grant of Rs.2,500 lakhs during the accounting year 2015-16 from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilisation. However, during the year 2016-17, it was found that the conditions of grants were not complied with and the grant had to be refunded to the government in full. Elucidate the current accounting treatment, with reference to the provisions of AS-12

Answer

As per AS 12 'Accounting for Government Grants', Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extra ordinary item as per AS 5.

The amount refundable in respect of a government grant related to revenue is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

In the present case, the amount of refund of government grant should be shown in the profit & loss account of the company as an extraordinary item during the year.

QUESTION 89 (STUDY MATERIAL)

Blue chip Equity Investments wants to reclassify its investments in accordance with AS 13 (revised). State the values at which investments have to be classified in the following cases:

- i. Long term investments in company A, costing 8.5 lakhs are to be reclassified as current. The company had reduced the value of these investments to 6.5 lakhs to recognize "other than temporary" decline in value. The fair value on the date of transfer is 6.8 lakhs.
- ii. Long term investments in Company B, costing Rs.7 lakhs are to be re-classified as current. The fair value on date of transfer is Rs.8 lakhs and book value is Rs.7 lakhs.
- iii. Current investment in Company C, costing Rs.10 lakhs are to be re-classified as long term as the company wants to retain them. The market value on date of transfer is Rs.12 lakhs.

Answer

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As per AS 13 (Revised) 'Accounting for Investments', where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer. And where investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

- (i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹ 6.5 lakhs in the books.
- (ii) The carrying / book value of the long term investment is same as cost i.e. ₹ 7 lakhs. Hence this long term investment will be reclassified as current investment at book value of ₹ 7 lakhs only.
- (iii) In this case, reclassification of current investment into long term investment will be made at ₹ 10 lakhs as cost is less than its market value of ₹ 12 lakhs.

	Current account balance	Profit & loss		
G	600	(6,400)	5,800	Dr.
S	10,800	(4,800)	6,000	Cr.
J	(480)	(3,200)	3,680	Dr.

QUESTION 90 (RTP MAY 18)

A private limited company manufacturing fancy terry towels had valued its closing inventory of inventories of finished goods at the realizable value, inclusive of profit and the export cash incentives. Firm contracts had been received and goods were packed for export, but the ownership in these goods had not been transferred to the foreign buyers.

You are required to advise the company on the valuation of the inventories in line with the provisions of AS2.

ANSWER:

Accounting Standard 2 "Valuation of Inventories" states that inventories should be valued at lower of historical cost and net realizable value. The standard states, "at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases, when sale is assured under forward contract or government guarantee or when market exists and there is a negligible risk of failure to sell, the goods are often valued at net realizable value at certain

stages of production.”

Terry Towels do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing inventory of finished goods (Fancy terry towel) should have been valued at lower of cost and net realizable value and not at net realizable value. Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing inventory of inventories of finished goods is not correct.

QUESTION 91 (RTP MAY 18)

In the year 2016-17, an entity has acquired a new freehold building with a useful life of 50 years for Rs. 90,00,000. The entity desires to calculate the depreciation charge per annum using a straight-line method. It has identified the following components (with no residual value of lifts & fixtures at the end of their useful life) as follows:

Component	Useful life (Years)	Cost
Land	Infinite	Rs. 20,00,000
Roof	25	Rs. 10,00,000
Lifts	20	Rs. 5,00,000
Fixtures	10	Rs. 5,00,000
Remainder of building	50	Rs. 50,00,000
		<u>Rs. 90,00,000</u>

You are required to calculate depreciation for the year 2016-17 as per componentization method.

ANSWER:

Statement showing amount of depreciation as per Componentization Method

Component	Depreciation (Per annum) (Rs.)
Land	Nil
Roof	40,000
Lifts	25,000
Fixtures	50,000
Remainder of Building	<u>1,00,000</u>
	<u>2,15,000</u>

Note: When the roof requires replacement at the end of its useful life the carrying amount will be nil. The cost of replacing the roof should be recognized as a new component.

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QUESTION 92 (RTP MAY 18)

Power Track Ltd. purchased a plant for US\$ 50,000 on 31st October, 2016 payable after 6 months. The company entered into a forward contract for 6 months @Rs. 64.25 per Dollar. On 31st October, 2016, the exchange rate was Rs. 61.50 per Dollar.

You are required to calculate the amount of the profit or loss on forward contract to be recognized in the books of the company for the year ended 31st March, 2017.

ANSWER:

Calculation of profit or loss to be recognized in the books of Power Track Limited

	Rs.
Forward contract rate	64.25
Less: Spot rate	(61.50)
Loss on forward contract	2.75
Forward Contract Amount	\$ 50,000
Total loss on entering into forward contract = (\$ 50,000 × Rs. 2.75)	Rs.1,37,500
Contract period	6 months
Loss for the period 1 st November, 2016 to 31 st March, 2017 i.e. 5 months falling in the year 2016-2017	5 months
Hence, Loss for 5 months will be	Rs. 1,14,583

Thus, the loss amounting to Rs. 1,14,583 for the period is to be recognized in the year ended 31st March, 2017.

QUESTION 93 (RTP MAY 18)

D Ltd. acquired a machine on 01-04-2012 for Rs. 20,00,000. The useful life is 5 years. The company had applied on 01-04-2012, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 2015. The Company's Fixed Assets Account for the financial year 2015-16 shows a credit balance as under:

Particulars	Rs.
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation (from 2012-13- to	

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2014-15 on Straight Line Method)	<u>12,00,000</u>
	8,00,000
Less: Grant received	<u>(16,00,000)</u>
Balance	<u>(8,00,000)</u>

You are required to explain how should the company deal with this asset in its accounts for 2015-16?

ANSWER:

From the above account, it is inferred that the Company follows Reduction Method for accounting of Government Grants. Accordingly, out of the Rs. 16,00,000 that has been received, Rs. 8,00,000 (being the balance in Machinery A/c) should be credited to the machinery A/c.

The balance Rs. 8,00,000 may be credited to P&L A/c, since already the cost of the asset to the tune of Rs. 12,00,000 had been debited to P&L A/c in the earlier years by way of depreciation charge, and Rs. 8,00,000 transferred to P&L A/c now would be partial recovery of that cost.

There is no need to provide depreciation for 2015-16 or 2016-17 as the depreciable amount is now Nil.

QUESTION 94 (RTP MAY 18)

Paridhi Electronics Ltd. invested in the shares of another unlisted company on 1st May 2012 at a cost of Rs. 3,00,000 with the intention of holding more than a year. The published accounts of unlisted company received in January, 2017 reveals that the company has incurred cash losses with decline in market share and investment of Paridhi Electronics Ltd. may not fetch more than Rs.45,000.

You are required to explain how you will deal with the above in the financial statements of the Paridhi Electronics Ltd. as on 31.3.17 with reference to AS 13?

ANSWER:

As per AS 13, "Accounting for Investments" Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. The standard also states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment.

On this basis, the facts of the case given in the question clearly suggest that the provision for

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diminution should be made to reduce the carrying amount of shares to Rs. 45,000 in the financial statements for the year ended 31st March, 2017 and charge the difference of loss of Rs. 2,55,000 to profit and loss account.

QUESTION 95 (RTP MAY 18)

In May, 2016, Capacity Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2017 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was Rs. 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2017 amounted to Rs. 25lakhs.

Can Rs. 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

ANSWER:

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2017) i.e. Rs.18 lakhs alone can be capitalized. It cannot be extended to Rs. 25lakhs.

QUESTION 96 (RTP NOVEMBER 18)

A Limited is engaged in manufacturing of Chemical Y for which Raw Material X is required. The company provides you following information for the year ended 31st March, 2017.

	Rs.Per unit
<u>Raw Material X</u>	
Cost price	380
Unloading Charges	20
Freight Inward	40
Replacement cost	300
<u>Chemical Y</u>	
Material consumed	440
Direct Labour	120
Variable Overheads	80

Additional Information:

- (i) Total fixed overhead for the year was Rs.4,00,000 on normal capacity of

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20,000 units.

- (ii) Closing balance of Raw Material X was 1,000 units and Chemical Y was Rs.2,400 units.

You are required to calculate the total value of closing stock of Raw Material X and Chemical Y according to AS 2, when

- (i) Net realizable value of Chemical Y is Rs.800 per unit
 (ii) Net realizable value of Chemical Y is Rs.600 per unit

ANSWER:

- (i) **When Net Realizable Value of the Chemical Y is Rs.800 per unit**

NRV is greater than the cost of Finished Goods Y i.e. Rs.660 (Refer W.N.) Hence, Raw Material and Finished Goods are to be valued at cost.

Value of Closing Stock:

	Qty.	Rate (Rs.)	Amount (Rs.)
Raw Material X	1,000	440	4,40,000
Finished Goods Y	2,400	660	15,84,000
Total Value of Closing Stock			20,24,000

- (ii) **When Net Realizable Value of the Chemical Y is Rs.600 per unit**

NRV is less than the cost of Finished Goods Y i.e. Rs.660. Hence, Raw Material is to be valued at replacement cost and Finished Goods are to be valued at NRV since NRV is less than the cost.

Value of Closing Stock:

	Qty.	Rate (Rs.)	Amount (Rs.)
Raw Material X	1,000	300	3,00,000
Finished Goods Y	2,400	600	<u>14,40,000</u>
Total Value of Closing Stock			<u>17,40,000</u>

Working Note:

Statement showing cost calculation of Raw material X and Chemical Y

Raw Material X	Rs.
Cost Price	380
Add: Freight Inward	40

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Unloading charges	<u>20</u>
Cost	<u>440</u>
Chemical Y	Rs.
Materials consumed	440
Direct Labour	120
Variable overheads	80
Fixed overheads (Rs.4,00,000/20,000 units)	<u>20</u>
Cost	<u>660</u>

QUESTION 97 (RTP NOVEMBER 18)

ABC Ltd. is installing a new plant at its production facility. It provides you the following information:

	Rs.
Cost of the plant (cost as per supplier's invoice)	31,25,000
Estimated dismantling costs to be incurred after 5 years	2,50,000
Initial Operating losses before commercial production	3,75,000
Initial delivery and handling costs	1,85,000
Cost of site preparation	4,50,000
Consultants used for advice on the acquisition of the plant	6,50,000

You are required to compute the costs that can be capitalised for plant by ABC Ltd., in accordance with AS 10: Property, Plant and Equipment.

ANSWER:

According to AS 10 on Property, Plant and Equipment, the costs which will be capitalized by ABC Ltd.:

	Rs.
Cost of the plant	31,25,000
Initial delivery and handling costs	1,85,000
Cost of site preparation	4,50,000
Consultants' fees	6,50,000
Estimated dismantling costs to be incurred after 5 years	<u>2,50,000</u>
Total cost of Plant	46,60,000

Note: Operating losses before commercial production amounting to Rs.3,75,000 will not be capitalized as per AS 10. They should be written off to the Statement of Profit and Loss in the period they are incurred.

QUESTION 98 (RTP NOVEMBER 18) (RTP NOVEMBER 20)

Classify the following items as monetary or non-monetary item:

Share Capital

Trade Receivables

Investment in Equity shares

Fixed Assets.

ANSWER:

Share capital	Non-monetary
Trade receivables	Monetary
Investment in equity shares	Non-monetary
Fixed assets	Non-monetary

QUESTION 99 (RTP NOVEMBER 18) (RTP NOVEMBER 20)

	Exchange Rate per \$
Goods purchased on 1.1.2017 for US \$ 15,000	₹ 75
Exchange rate on 31.3.2017	₹ 74
Date of actual payment 7.7.2017	₹ 73

You are required to ascertain the loss/gain for financial years 2016-17 and 2017- 18, also give their treatment as per AS 11.

ANSWER:

As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2017 and corresponding creditor would be recorded at Rs.11,25,000 (i.e. \$15,000 × Rs.75)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditors of US \$15,000 on 31.3.2017 will be reported at Rs.11,10,000 (i.e. \$15,000 × Rs.74) and exchange profit of Rs.15,000 (i.e. 11,25,000 – 11,10,000) should be credited to Profit and Loss account in the year 2016-17.

On 7.7.2017, creditors of \$15,000 is paid at the rate of Rs.73. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, Rs.15,000 (i.e. 11,10,000 – 10,95,000) will be credited to Profit and Loss account in the year 2017-18.