

The following further information is given:

(a) Fixed assets are to be depreciated @ 10% p.a. on straight line basis.

(b) On 31<sup>st</sup> March, 2009:

Expenses outstanding	£400
Prepaid expenses	£200
Closing stock	£8,000

(c) Rate of Exchange:

1 <sup>st</sup> April, 2005	₹ 70 to £1
1 <sup>st</sup> April, 2008	₹ 76 to £1
31 <sup>st</sup> March, 2009	₹ 75 to £1

You are required to prepare:

- (1) Trail Balance, incorporating adjustments of outstanding and prepaid expenses, conversing U.K. pound into Indian rupees.
- (2) Trading and Profit and Loss A/c for the year ended 31<sup>st</sup> March, 2009 and the Balance Sheet as on that date of London branch as would appear in the books of Delhi head Office of DM Ltd.

**Solution:**

**Trial Balance for the year ended 31-03-2009**

	Rates	£		₹	
	₹/\$	Dr.	Cr.	Dr.	Cr.
Fixed Assets	70	24,000	--	16,80,000	--
Opening Stock	76	11,200	--	8,51,200	--
Goods From H.O.	Actual	64,000	--	49,26,000	--
Expenses (4800 + 400 - 200)	75.5	5,000	--	3,77,500	--
Outstanding Expenses	75	--	400	--	30,000
Prepaid Expenses	75	200	--	15,000	--
Debtors	75	4,800	--	3,60,000	--
Creditors	75	--	3,200	--	2,40,000
Cash at Bank	75	1,200	--	90,000	--
H.O. a/c	Actual	--	22,800	--	17,20,000
Purchase	75.5	12,000	--	9,06,000	--
Sales	75.5	--	96,000	--	72,48,000
Exchange Difference	(b/f)	--	--	32,300	--
		<b>1,22,400</b>	<b>1,22,400</b>	<b>92,38,000</b>	<b>92,38,000</b>

**Branch Trading and Profit & Loss Account (in Rupees)**

Particulars	₹	Particulars	₹
To Opening Stock	8,51,200	By Sales	72,48,000
To Purchase	9,06,000	By Closing Stock (8,000 x 75)	6,00,000
To Goods from H.O.	49,26,000		
To Gross Profit	11,64,800		
	<b>78,48,000</b>		<b>78,48,000</b>
To Expenses	3,62,400	By Gross Profit	11,64,800
To Depreciation (16,80,000 x 10/70)	2,40,000		
To Exchange Difference	32,400		
To Net Profit	5,30,000		
	<b>11,64,800</b>		<b>11,64,800</b>

## Balance Sheet as at 31-03-2009

Liabilities		₹	Assets		₹
Head office	17,20,000		Fixed Assets		14,40,000
Add: Profit	<u>5,30,000</u>	22,50,000	Stock		6,00,000
Sundry Creditors		2,40,000	Debtors		3,60,000
			Cash at Bank		90,000
		<b>24,90,000</b>			<b>24,90,000</b>

**QUESTION 5.**

The Washington branch of XYZ Ltd., Mumbai sent the following trail balance as on 31<sup>st</sup> December, 2007:-

	\$	\$
Head Office A/c	---	22,800
Sales	---	84,000
Debtors and Creditors	4,800	3,400
Machinery	24,000	---
Cash at Bank	1,200	---
Stock 1 January, 2007	11,200	---
Goods from H.O.	64,000	---
Expenses	5,000	---
	<b><u>1,10,200</u></b>	<b><u>1,10,200</u></b>

In the books of head office, the Branch A/c stood as follows:

Washington Branch A/c			
₹		₹	
To Balance b/d	80,000	By cash	28,76,000
To goods sent to branch	29,26,000	By Balance c/d	8,60,000
	<b><u>37,36,000</u></b>		<b><u>37,36,000</u></b>

Goods are sent to the branch at cost plus 10% and the branch sell goods at Invoice price plus 25%. Machinery was acquired on 31<sup>st</sup> January, 2002.

When \$ 1.00 = ₹ 40.

Rates of Exchange were:

1 <sup>st</sup> January 2007	\$ 1.00 = ₹ 46
31 <sup>st</sup> December, 2007	41.00 – ₹ 48
Average	\$1.00 = ₹ 47

Machinery is depreciated @ 10% and the branch manager is entitled to a commission of 5% on the profit of the branch.

You are required to:

- Prepare the branch Trading & Profit & Loss /c in Dollars.
- Covert the trail balance a/c in the books of head office.

**QUESTION 6.**

Carlin & Co. had head office at New York (U.S.A) and branch at Mumbai furnishes you with its trial balance as on 31<sup>st</sup> March, 2016 and the additional information given thereafter.

	Rupees in thousands	
	Dr.	Cr.
Stock on 1 <sup>st</sup> April, 1998	300	---
Purchases and sales	800	1200
Sundry debtors and creditors	400	300
Bills of exchange	120	240
Wages and salaries	960	---
Rent, rates and taxes	360	---
Sundry charges	160	---
Computers	240	---
Bank balance	420	---
New York office A/c	---	1,620
	<b>3,360</b>	<b>3,360</b>

**Additional Information:-**

- (a) Computers were acquired from a remittance of US \$ 6,000 received from New York head office and paid to the supplier. Depreciate computers at 60% for the year.
- (b) Unsold stock of Mumbai branch was worth ₹ 4,20,000, on 31 March, 2016.
- (c) The rates of exchange may be taken as follows:-
  - (i) On 1.4.2015 @ ₹ 40 per US \$
  - (ii) On 31.3.2016 @ ₹ 42 per US \$
  - (iii) Average exchange rate for the year @ ₹ 41 per US \$
  - (iv) Conversion in \$ shall be made up to two decimal accuracy.

You are asked to prepare in US dollars the revenue statement for the year ended 31<sup>st</sup> March, 2016 and the balance sheet as on that date of Mumbai branch as would appear in the books of New York head office of Carlin & Co. You are informed the Mumbai branch showed a debit balance of US \$ 39,609.18 on 31.3.2016 in New York books and there were no items pending reconciliation.

**Ans.:- Net Loss – 17,685; Total of Balance Sheet – 34,780.95.**

**QUESTION 7.**

An Indian Company has a branch at Washington. Its Trial Balance as at 30<sup>th</sup> September, 1998 is as follows:-

	Dr. US \$U	Cr. S \$
Plant and machinery	1,20,000	----
Furniture and fixtures	8,000	----
Stock, Oct. 1997	56,000	----
Purchases	2,40,000	----
Sales	----	4,16,000
Goods from Indian Co. (H.O.)	80,000	----
Wages	2,000	----
Carriage inward	1,000	----
Salaries	6,000	----
Rent, Rates and taxes	2,000	----
Insurance	1,000	----
Trade expenses	1,000	----
Head Office A/c	----	1,14,000
Trade debtors	24,000	----
Trade creditors	----	17,000
Cash at bank	5,000	----
Cash in hand	1,000	----
	<b><u>US \$ 5,47,000</u></b>	<b><u>US \$ 5,47,000</u></b>

The following further information is given:-

- (1) Wages outstanding - \$ 1,000.
- (2) Depreciate Plant and Machinery and Furniture and Fixtures @ 10 per cent p.a.
- (3) The Head office has sent goods to Branch for ₹ 39,40,000.
- (4) The Head Office shows as amount of ₹ 43,00,000 due from Branch.
- (5) Stock on 30<sup>th</sup> September, 1998 - \$ 52,000.
- (6) There were no in transit items either at the start or at the end of the year.
- (7) On September 1, 1996, when the fixed assets were purchased, the rate of exchange was ₹ 38 to one \$.  
On October 1, 1997, the rate was ₹ 39 to one \$.  
On September 30, 1998, the rate was ₹ 41 to one \$.  
Average rate during the year was ₹ 40 to one \$.

You are asked to prepare:

- (a) Trial balance incorporating adjustments given under 1 to 4 above, converting dollars into rupees.
- (b) Trading and profit and loss account for the year ended 30<sup>th</sup> September, 1998 and Balance Sheet as on that date depicting the profitability and net position of the branch as would appear in India for the purpose of incorporating in the main Balance Sheet.

**Ans.:- Net Profit – ₹ 27,01,600; Balance Sheet – ₹ 77,39,600; G.P. – ₹ 28,88,000.**

# **CHAPTER 13**

# **ACCOUNTING**

# **STANDARDS**

<b>AS 1</b>	<b>(13.01</b>	<b>–</b>	<b>13.11)</b>
<b>AS 2</b>	<b>(13.12</b>	<b>–</b>	<b>13.23)</b>
<b>AS 10</b>	<b>(13.24</b>	<b>–</b>	<b>13.42)</b>
<b>AS 11</b>	<b>(13.43</b>	<b>–</b>	<b>13.56)</b>
<b>AS 12</b>	<b>(13.57</b>	<b>–</b>	<b>13.66)</b>
<b>AS 16</b>	<b>(13.66</b>	<b>–</b>	<b>13.80)</b>

# **AS-1**

# **DISCLOSURE**

# **OF**

# **ACCOUNTING**

# **POLICIES**

## INTRODUCTION

Irrespective of extent of standardisation, diversity in accounting policies is unavoidable for two reasons. First, accounting standards cannot and do not cover all possible areas of accounting and enterprises have the freedom of adopting any reasonable accounting policy in areas not covered by a standard.

Second, since enterprises operate in diverse situations, it is impossible to develop a single set of policies applicable to all enterprises for all time.

The accounting standards therefore permit more than one policy even in areas covered by it. Differences in accounting policies lead to differences in reported information even if underlying transactions are same. The qualitative characteristic of comparability of financial statements therefore suffers due to diversity of accounting policies. Since uniformity is impossible, and accounting standards permit more than one alternative in many cases, it is not enough to say that all standards have been complied with. For these reasons, accounting standard 1 requires enterprises to disclose significant accounting policies actually adopted by them in preparation of their financial statements. Such disclosures allow the users of financial statements to take the differences in accounting policies into consideration and to make necessary adjustments in their analysis of such statements.

The purpose of Accounting Standard 1, Disclosure of Accounting Policies, is to promote better understanding of financial statements by requiring disclosure of significant accounting policies in orderly manner. As explained in the preceding paragraph, such disclosures facilitate more meaningful comparison between financial statements of different enterprises for same accounting periods. The standard also requires disclosure of changes in accounting policies such that the users can compare financial statements of same enterprise for different accounting periods.

The standard applies to all enterprises.

## ACCOUNTING POLICIES

**Accounting policies refer to**

- **Specific accounting principles** (e.g. lower of cost and NRV as the basis of valuation of Inventories) **as well as**
- **Methods of applying those principles**( e.g. FIFO applied in calculating cost of Inventories)
- Adopted by an enterprise in the preparation and presentation of financial statements.

There are many areas in which different accounting policies may be adopted by different enterprises such as:

Methods of **Depreciation** e.g. WDV, SLM method

Methods of **Conversion of foreign currency** e.g. Average rate, buying rate

Valuation of **Inventories** e.g. FIFO, LIFO, Weight Average

Valuation of **Investments** e.g. Lower of Cost and Fair Value

Treatment of **Goodwill** e.g. Capitalization method, Super profit method

Treatment of **Contingent liabilities** e.g. Make provision, Disclosure

Valuation of **Fixed Assets** e.g. Historical Cost, Revalued amount

Hence, Accounting policies contain the information about the method adopted for the preparation of financial statements

## DISCLOSURE OF ACCOUNTING POLICIES

- **All significant accounting policies** should be disclosed.
- Such disclosure should **form part of financial statements**.
- All disclosure should be made **at one place**.
- **Any change** in accounting policies which has a material effect in the **current period** or which is reasonably expected to have material effect in **later periods** should be disclosed.
- **In the case of a change** in accounting policies, which has a material effect **in the current period**, the **amount** by which any item in the financial statements is affected by such change should also be disclosed **to the extent ascertainable**. Where such amount is **not ascertainable**, the **fact** should be indicated.
- If **fundamental accounting assumptions**(GCA) are **not followed**, the fact should be disclosed.
- **Disclosure** of accounting policies **cannot remedy** a wrong or inappropriate treatment of the item in the financial statements.

## FUNDAMENTAL ACCOUNTING ASSUMPTION (GCA)

### GOING CONCERN

The financial statements are normally prepared on the assumption that an **enterprise will continue in operation in the foreseeable future**. Foreseeable future means coming one or two years. Neither there is intention of discontinuance of business, nor there need of liquidation of organization.

### CONSISTENCY

**Same accounting policies** are followed from one period to another.

### ACCRUAL

**Transactions are recognized as and when they occur**, whether or not cash is actually received or paid. They are recorded in the accounting period to which they relate.

## DISCLOSURE OF DEVIATIONS FROM FUNDAMENTAL ACCOUNTING ASSUMPTIONS

If the fundamental accounting assumptions, viz. Going concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed. The principle of consistency refers to the practice of using same accounting policies for similar transactions in all accounting periods.

### EXAMPLE 1.

In the books of M/s Prashant Ltd., closing inventory as on 31.03.2015 amounts to ₹ 1,63,000 (on the basis of FIFO method).

The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 2014-15. On the basis of weighted average method, closing inventory as on 31.03.2015 amounts to ₹ 1,47,000. Realisable value of the inventory as on 31.03.2015 amounts to ₹ 1,95,000. Discuss disclosure requirement of change in accounting policy as per AS-1.



**Ans.**

As per AS 1 “Disclosure of Accounting Policies”, any change in an accounting policy which has a material effect should be disclosed in the financial statements. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Thus Prashant Ltd. should disclose the change in valuation method of inventory and its effect on financial statements. The company may disclose the change in accounting policy in the following manner:

‘The company values its inventory at lower of cost and net realisable value. Since net realisable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 2014-15,

the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by ₹ 16,000.

## MAJOR CONSIDERATIONS GOVERNING THE SELECTION OF ACCOUNTING POLICIES

### PRIMARY CONSIDERATIONS

By selection of such accounting policies, **Financial Statements give true & fair view** of performance and state of affairs of an enterprises.

### SECONDARY CONSIDERATIONS

#### PRUDENCE

In view of uncertainty associated with future events, profits are not anticipated, but losses are provided for as a matter of conservatism. **Provision should be created** for all known liabilities and losses even though the amount cannot be determined with certainty. It should be **ensured** that Profits & Assets are not overstated and Losses & Liabilities are not understated.

#### EXAMPLE 1.

The most common example of exercise of prudence in selection of accounting policy is the policy of valuing inventory at lower of cost and net realisable value.

Suppose a trader has purchased 500 units of certain article @ ₹ 10 per unit. He sold 400 articles @ ₹ 15 per unit. If the net realisable value per unit of the unsold article is ₹ 15, the trader should value his stock at ₹ 10 per unit and thus ignoring the profit ₹ 500 that he may earn in next accounting period by selling 100 units of unsold articles. If the net realisable value per unit of the unsold article is ₹ 8, the trader should value his stock at ₹ 8 per unit and thus recognising possible loss ₹ 200 that he may incur in next accounting period by selling 100 units of unsold articles.

Profit of the trader if net realisable value of unsold article is ₹ 15

$$= \text{Sale} - \text{Cost of goods sold} = (400 \times ₹ 15) - (500 \times ₹ 10 - 100 \times ₹ 10) = ₹ 2,000$$

Profit of the trader if net realisable value of unsold article is ₹ 8

$$= \text{Sale} - \text{Cost of goods sold} = (400 \times ₹ 15) - (500 \times ₹ 10 - 100 \times ₹ 8) = ₹ 1,800$$

**EXAMPLE 2.**

Exercise of prudence does not permit creation of hidden reserve by understating profits and assets or by overstating liabilities and losses. Suppose a company is facing a damage suit. No provision for damages should be recognised by a charge against profit, unless the probability of losing the suit is more than the probability of not losing it.

**SUBSTANCE OVER FORM**

Transactions should be **accounted for** in accordance **with their substance** and financial reality and not by its legal form. e.g. in Hire purchase, assets are shown in the books of Hire Purchaser inspite of the fact that He is not the legal owner of the assets. Under Hire purchase, purchaser becomes the owner only on the payment of last installment.

**MATERIALITY**

Financial statements should **disclose all material items**.

Material items mean “the items” knowledge of which might influence the decisions of the user of the financial statements. Materiality is not always a matter of relative size. For example a small amount lost by fraudulent practices of certain employees can indicate a serious flaw in the enterprise’s internal control system requiring immediate attention to avoid greater losses in future.

In certain cases quantitative limits of materiality is specified. A few of such cases are given below:

- (a) A company should disclose by way of notes additional information regarding any item of income or expenditure which exceeds 1% of the revenue from operations or ₹ 1,00,000 whichever is higher (Refer general Instructions for preparation of Statement of Profit and Loss in Schedule III to the Companies Act, 2013).
- (b) A company should disclose in Notes to Accounts, shares in the company held by each shareholder holding more than 5 per cent shares specifying the number of shares held. (Refer general Instructions for Balance Sheet in Schedule III to the Companies Act, 2013).

**CHANGES IN ACCOUNTING POLICIES**

Changes should be made in following conditions:

- Required by **Law**, or
- For compliance of **AS**, or
- Change would result in **better presentation** of financial statements.

**Whenever there is change** in accounting policies, following points should be disclosed

- Old policy
- New policy
- Reasons of changing policy
- Impact of such change on Financial Statements.

**Example 1**

A simple disclosure that an accounting policy has been changed is not of much use for a reader of a financial statement. The effect of change should therefore be disclosed wherever ascertainable. Suppose a company has switched over to weighted average formula for ascertaining cost of inventory, from the earlier practice of using FIFO. If the closing inventory by FIFO is ₹ 2 lakh and that by weighted average formula is ₹ 1.8 lakh, the change in accounting policy pulls down profit and value of inventory

by ₹ 20,000. The company may disclose the change in accounting policy in the following manner :  
 'The company values its inventory at lower of cost and net realisable value. Since net realisable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year the company has changed to weighted average formula, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced profit and value of inventory by ₹ 20,000'.

### Example 2

ABC Ltd. was making provision for non-moving inventories based on issues for the last 12 months up to 31.3.2016.

The company wants to provide during the year ending 31.3.2017 based on technical evaluation:

Total value of inventory	₹ 100 lakhs
Provision required based on 12 months issue	₹ 3.5 lakhs
Provision required based on technical evaluation	₹ 2.5 lakhs

Does this amount to change in Accounting Policy? Can the company change the method of provision?

**Ans.**

The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory from ₹ 3.5 lakhs to ₹ 2.5 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2016-17:

"The company has provided for non-moving inventories on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been lower by ₹ 1 lakh."

## PROBLEMS

### QUESTION 1.

Under what circumstances can an enterprise change its accounting policy? **[Nov-2005]**

**Ans.** Change in accounting policy made in the light of AS-5 is not in contravention of the fundamental accounting assumption, as given in AS-1:-

- Accounts are prepared on a fundamental accounting assumption 'consistency'. But it does not mean that the accounting policy once adopted cannot be changed.
- It can be changed on the following conditions;-
- If adoption of different accounting policies is required by statute/law: or
- For compliance of Accounting Standards; or
- If it is considered that change would result in more appropriate and clear presentation of financial statement.

OR

**Ans.** An accounting policy can be changed only when at least one of the following conditions can be satisfied:-

1. When change is required by law (statute).
2. When change is required for compliance with an Accounting Standard.
3. When it is considered that the change would result in a more appropriate presentation of the financial statement of the enterprise.

**Example of change in accounting policy:-**

Depreciation method changed from WDV to SLM.

For accounting of construction contract enterprise change their method for revenue recognition i.e. From complete contract method to percentage to completion

It is necessary to qualify the effect of change on financial statement items.

**For which following disclosures are required:-**

- (i) Any change in all accounting policy which has a material effect is to be disclosed;
- (ii) When the impact of such change is material it should be shown in the financial statements of the period in which such change has been made if the impact is not ascertainable, the fact thereof is to be disclosed;
- (iii) When a change does not have a material effect on the financial statements of the current period but is reasonably expected to have a material effect subsequently, the fact of change is to be appropriately disclosed in the period in which such change has been adopted

### QUESTION 2.

List the criteria to be applied for rating an enterprise as Level-I enterprise for the purpose of Compliance of Accounting Standards in India. [Nov-2007]

**Ans.** Enterprise which fall any one or more of following categories are classified as level I Enterprise-

1. Enterprise whose equity or debt are listed or in the process are listing (in India/or outside India).
2. Bank including co-operative banks
3. Financial institution.
4. Enterprise carrying on insurance business.
5. All commercial or business enterprise whose turnover exceeds ₹50 crore immediately financial years.
6. All commercial, business enterprise having borrowing including public deposit exceeding 10 crore at any time during the accounting period.
7. Holding or subsidiary at any one of the above at any time during the accounting period.

### QUESTION 3.

Mention six areas in which different accounting policies are followed by Companies. [Nov-2007]

**Ans.** Area in which different accounting policy can be adopted

- (a) Method of depreciation, depletion and amortization.
- (b) Valuation of investment.
- (c) Valuation of fixed asset.
- (d) Treatment of goodwill.

- (e) Treatment of retirement benefit.
- (f) Conversion of foreign currency.

**QUESTION 4.**

Year to year results of a company were not found comparable on the basis of gross profit margin.

List out the probable reasons.

**Ans.** The probable reasons could be the change in the accounting policy viz.

- (a) Change in method of recording of sales revenue from cash basis to accrual basis or vice versa; or
- (b) Change in valuation in closing inventory by adopting different methods year to year such as LIFO to FIFO to weighted average of vice versa.

**QUESTION 5.**

What are financial indicators to be considered for evaluating the assumption of going concern?

**Ans.**

1. Negative Net Worth or Negative working without realistic prospect.
2. Fixed term borrowing approaching maturity without realistic prospect.
3. Adverse key financial ratios.
4. Substantial operating losses.
5. Substantial negative cash flows from operation.
6. Arrear of discontinuance of dividend.
7. Inability to pay creditors on due date.
8. Difficulty in complying with terms of loan agreement.
9. Entering into a arrangement with the creditors to reduce the liability.
10. Destruction of major assets of enterprise.

**QUESTION 6.**

Ram Ltd. Sold its machinery to Shyam Ltd. For ₹ 50 lakhs on 30-09-2013 and gave possession of machinery to shyam Ltd. However, documents and legal formalities are pending. Due to this, Ram Ltd. has not recorded sales and has shown the amount received as an advance. The book value of machinery is ₹ 30 lakhs on 31-03-2014. Do you agree with this treatment? If you do not agree, explain the reason with reference to accounting standard. **(Nov. 2010 modified)**

**Ans.**

As per AS 1, principal of prudence, substance over form and materiality should be taken into, to ensure true and fair consideration in a transaction.

The economic reality and substance of transaction is that the right and beneficial interest in property has been transferred although legal title has not been transferred. Hence, Ram Ltd. should record the sale and recognize profit of ₹ 20 lakhs in its financial statements for the year ended 31<sup>st</sup> March, 2014. Value of machinery should be removed from the balance sheet. Therefore the treatment given by the company is not correct.

**QUESTION 7.**

Jagannath Ltd. had made a rights issue of shares in 2017. In the offer document to its members, it had projected a surplus of ₹ 40 crores during the accounting year to end on 31st March, 2017. The draft results for the year, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of ₹ 10 crores. The board in consultation with the managing director, decided on the following:

- (i) Value year-end inventory at works cost (₹ 50 crores) instead of the hitherto method of valuation of inventory at prime cost (₹ 30 crores).
- (ii) Provide depreciation for the year on straight line basis on account of substantial additions in gross block during the year, instead of on the reducing balance method, which was hitherto adopted. As a consequence, the charge for depreciation at ₹ 27 crores is lower than the amount of ₹ 45 crores which would have been provided had the old method been followed, by ₹ 18 crores.
- (iii) Not to provide for “after sales expenses” during the warranty period. Till the last year, provision at 2% of sales used to be made under the concept of “matching of costs against revenue” and actual expenses used to be charged against the provision. The board now decided to account for expenses as and when actually incurred. Sales during the year total to ₹ 600 crores.
- (iv) Provide for permanent fall in the value of investments - which fall had taken place over the past five years - the provision being ₹ 10 crores.

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2016-2017.

**Ans**

As per AS 1, any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

Accordingly, the notes on accounts should properly disclose the change and its effect.

**Notes on Accounts:**

- (i) During the year inventory has been valued at factory cost, against the practice of valuing it at prime cost as was the practice till last year. This has been done to take cognisance of the more capital intensive method of production on account of heavy capital expenditure during the year. As a result of this change, the year-end inventory has been valued at ₹ 50 crores and the profit for the year is increased by ₹ 20 crores.
- (ii) In view of the heavy capital intensive method of production introduced during the year, the company has decided to change the method of providing depreciation from reducing balance method to straight line method. As a result of this change, depreciation has been provided at ₹ 27 crores which is lower than the charge which would have been made had the old method and the old rates been applied, by ₹ 18 crores. To that extent, the profit for the year is increased.
- (iii) So far, the company has been providing 2% of sales for meeting “after sales expenses during the warranty period. With the improved method of production, the probability of defects occurring in the products has reduced considerably.

Hence, the company has decided not to make provision for such expenses but to account for the same as and when expenses are incurred. Due to this change, the profit for the year is increased by ₹ 12 crores than would have been the case if the old policy were to continue.

- (iv) The company has decided to provide ₹ 10 crores for the permanent fall in the value of investments which has taken place over the period of past five years. The provision so made has reduced the profit disclosed in the accounts by ₹ 10 crores.

**QUESTION 8.**

XYZ Company is engaged in the business of financial services and is undergoing tight liquidity position, since most of the assets of the company are blocked in various claims/ petitions in a Special Court. XYZ has accepted Inter-Corporate Deposits (ICDs) and, it is making its best efforts to settle the dues. There were claims at varied rates of interest, from lenders, from the due date of ICDs to the date of repayment. The company has provided interest, as per the terms of the contract till the due date and a note for non-provision of interest on the due date to date of repayment was affected in the financial statements. On account of uncertainties existing regarding the determination of the amount and in the absence of any specific legal obligation at present as per the terms of contracts, the company considers that these claims are in the nature of "claims against the company not acknowledged as debt", and the same has been disclosed by way of a note in the accounts instead of making a provision in the profit and loss accounts. State whether the treatment done by the Company is correct or not.

**Ans.**

AS 1 'Disclosure of Accounting Policies' recognises 'prudence' as one of the major considerations governing the selection and application of accounting policies. In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

Also as per AS 1, 'accrual' is one of the fundamental accounting assumptions. Irrespective of the terms of the contract, so long as the principal amount of a loan is not repaid, the lender cannot be replaced in a disadvantageous position for non-payment of interest in respect of overdue amount. From the aforesaid, it is apparent that the company has an obligation on account of the overdue interest. In this situation, the company should provide for the liability (since it is not waived by the lenders) at an amount estimated or on reasonable basis based on facts and circumstances of each case. However, in respect of the overdue interest amounts, which are settled,

the liability should be accrued to the extent of amounts settled. Non-provision of the overdue interest liability amounts to violation of accrual basis of accounting. Therefore, the treatment, done by the company, of not providing the interest amount from due date to the date of repayment is not correct.

# **AS-2**

# **VALUATION OF INVENTORIES**



## INTRODUCTION

The accounting treatment for inventories is prescribed in AS 2 (Revised) 'Valuation of Inventories', which provides guidance for determining the value at which inventories, are carried in the financial statements until related revenues are recognized. It also provides guidance on the cost formulas that are used to assign costs to inventories and any write-down thereof to net realizable value.

## INVENTORIES

Inventories are assets which are:

- (a) held for sale in the ordinary course of business (**Finished Goods**); or
- (b) in the process of production of such sale (**WIP**); or
- (c) for consumption in the production of goods or services for sale, including maintenance supplies and consumables other than machinery spares, servicing equipment and standby equipment meeting the definition of Property, plant and equipment.

**However, this standard does not apply to the valuation of following inventories:**

- (a) **WIP** arising under **construction contract** (Refer AS – 7);
- (b) **WIP** arising in the ordinary course of business of **service providers**;
- (c) **Shares, debentures** and other financial instruments **held as stock in trade**; and
- (d) Producers' inventories of **livestock, agricultural and forest products**, mineral oils, ores and gases. Such inventories are measured at net realizable value.

## VALUATION OF INVENTORIES

Inventories should be valued at the **lower of cost and net realizable value**

The **Cost of Inventories** includes:

- (a) All **costs of purchase**
- (b) Cost of **conversion**
- (c) **Other costs** (incurred in bringing the inventories to their present location and condition).

Cost of inventory **does not include**.

- (a) **Abnormal Loss** (waste of 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, Selling and Distribution** costs.
- (d) **Interest** and other **borrowing costs**

The **costs of purchase** consist of

- (a) the purchase price
- (b) duties and taxes ( **other than** those subsequently recoverable by the enterprise from the taxing authorities like CENVAT credit)
- (c) Freight inwards and other expenditure **directly attributable** to the acquisition.

**Trade discounts** (but not cash discounts), rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase.

The **costs of conversion** include **direct costs** (Direct Material, Direct Labour & Direct Exps.) and systematic allocation of fixed and variable **production overhead**.

**Allocation of overheads**

Overhead Recovery Rate = 
$$\frac{\text{Production Overhead}}{\text{Normal/Actual Production (whichever is higher)}}$$

**JOINT OR BY PRODUCTS**

In case of **joint products**, the costs incurred up to the stage of split off should be allocated on a rational and consistent basis. The basis of allocation may be sale value at split off point or sale value at the completion of production.

In case of the **by products, scrap or waste material**, they are valued at net realizable value. The **cost of main product** is then **joint cost minus NRV** of by product or waste.

**COST FORMULA**

**Specific identification method** for determining cost of inventories

Specific identification method means **directly linking the cost with specific item** of inventories.

**Where Specific Identification method is not applicable:**

The cost of inventories is valued by the following methods;

- FIFO ( First In First Out) Method
- Weighted Average Cost

**Net Realisable Value** means the **estimated selling price less** estimated cost of completion and estimated cost necessary to make the sale. (e.g. selling exps)

**NRV is estimated** on the basis of most reliable evidence at the time of valuation. (e.g Firm Contracts )

**COMPARISON BETWEEN NRV AND COST OF INVENTORY**

The **comparison** between cost and net realizable value **should be made on item-by-item** basis. (In some cases, it may be appropriate to group **similar or related item**)

**VALUATION OF RAW MATERIAL**

Raw material is valued at Cost. But when Finished Product in which such Raw Material is incorporated is expected to be sold at below its cost, then Raw Material is valued at **Cost or Net Replacement value** whichever is lower.

**DISCLOSURE REQUIREMENTS**

- Inventory valuation policy
- Basis of valuation (FIFO, Weighted Average)
- Classification of inventories:
  - (1) raw materials and components,
  - (2) work in progress,
  - (3) finished goods,
  - (4) Stock-in-trade (in respect of goods acquired for trading),
  - (5) stores and spares,
  - (6) loose tools, and
  - (7) Others (specify nature).

## PRACTICAL PROBLEMS

### VALUATION QUESTIONS

#### QUESTION 1.

Historical cost and net realizable value to five inventory items are given below:

	Historical cost	Net realizable value
A	20,000	30,000
B	12,000	10,000
C	12,000	18,000
D	32,100	26,000
E	28,000	26,000
	<b>1, 04,000</b>	<b>1, 10,000</b>

Advice valued inventory for Balance Sheet?

#### QUESTION 2.

The company deals in three products, A, B and C, which are neither similar nor interchangeable. At the time of closing of its account for the year 2002-03. The Historical Cost and net realizable value of the items of closing stock are determined as following:

Items	Historical Cost (₹ in lakhs)	Net Realizable Value (₹ in lakhs)
A	40	28
B	32	32
C	16	24

What will be the value of Closing Stock?

[May 2004]

Ans. ₹ 76

#### QUESTION 3.

The total stock of A Ltd. as on 31.3.2012 was ₹ 5,00,000 of which stock amounting to ₹ 31,000 were not ascertained as per AS 2. Compute the value of the said stocks as per AS 2 for inclusion in financial statements as on that date.

Type of Product	Cost of Materials	Productive Expenses incurred	Selling and Distribution expense to be incurred	Estimated Selling Price
P	10,000	2,000	1,000	15,000
S	5,000	--	500	4,500
T	12,000	3,000	2,000	18,000
	<b>27,000</b>	<b>5,000</b>	<b>3,500</b>	<b>37,500</b>

**Solution:**

As per para 21, AS 2, inventories are usually written-down to net realisable value on item-by-item basis. Thus, value of stock will be computed as:

Type of Product	Cost Price (including Production Exp.)	Net Realisable Value (excluding Selling & Distribution Expenses from Selling Price)	Value of Stock to be taken (lower of Cost Price & Net Realisable Value)
P	12,000 (₹ 10,000 + ₹ 2,000)	14,000 (₹15,000 – ₹ 1,000)	12,000
S	5,000	4,000 (₹ 4,500 – ₹ 500)	4,000
T	15,000 (₹ 12,000 + ₹ 3,000)	16,000 (₹18,000 – ₹ 2,000)	15,000
			<b>31,000</b>

So, Value of Stock will be ₹ 31,000 for inclusion in financial statements as per AS 2.

**QUESTION 4.**

‘Sonar Bhandar deals in old colour TVs. It has 4 TVs the particulars of which are given below : You are asked to compute the value of stock to be included, in Balance Sheet for the year ended 31st March 2009:

TV	Onida	Philips	EC	Sony	Total
Cost Price	10,000	20,000	35,000	50,000	1,15,000
Expenses incurred to bring into saleable conditions	3,000	2,000	5,000	--	10,000
Net Realisable Value (₹)	18,000	30,000	36,000	55,000	1,39,000

**Solution:**

As per para 5, AS 2 Valuation of Inventories, inventories should be valued at the lower of cost or net realisable value, which are:

TV	Onida	Philips	EC	Sony	Total
Cost Price (Including Expenses incurred to bring into saleable conditions)	13,000	22,000	40,000	50,000	1,25,000
Net Realisable Value (₹)	18,000	30,000	36,000	55,000	1,39,000
Valuation (₹) (Lower)	<b>13,000</b>	<b>22,000</b>	<b>36,000</b>	<b>50,000</b>	<b>1,21,000</b>

Value of Stock to be included in Balance Sheet will be ₹ 1,21,000 (i.e. lower of Cost (₹ 1,25,000) and net realisable value ₹ 1,21,000).

**QUESTION 5.**

An enterprise has in its stock 10000 bags of cement purchased at a cost of ₹ 180 per bag. The terms of Trades are that the cement is delivered at the buyer's door and the cost of delivery of ₹ 10 per bag is Paid by the seller. The selling price of cement is ₹ 187 per bag. Find out the value of closing stock.

**Ans.** Value of stock ₹ 17,70,000

**QUESTION 6.**

On 31.3.2012, the closing stock of Gourav Ltd. includes 10,000 units costing @ ₹ 10 i.e., ₹ 1,00,000. But the current market price as on that date was @ ₹ 9 i.e., ₹ 90,000.

**Solution:** According to AS 2, Valuation of Inventories, an assessment is made of net realisable value as at each Balance Sheet date. Hence, the value of stock should be ₹ 90,000 (i.e. @ ₹ 9 per unit).

**QUESTION 7.**

X Co. Limited purchased goods at the cost of ₹ 40 lakhs in October 2005. Till March, 2006 75% of the Stocks were sold. The company wants to disclose closing stock at ₹ 10 lakhs. The expected sale value is ₹ 11 lakhs and a commission at 10% on sale is payable to the agent. Advice, what is the correct closing Stock to be disclosed as at 31.3.2006. [May-2006]

**Ans. Value of Stock ₹ 9.90 lakhs**

**QUESTION 8.**

A has purchased 10000 TV's at the cost of ₹ 8,000/- each. On Balance Sheet date there were 2000 TV'S In stock. Of these 500 were enmarked against a sales contract at a price of ₹ 9,000/- each. The general Price of this brand has dropped to ₹ 7,500/- Sales contract is committed by both parties. You are Required to value stock

**Ans. Value of Stock ₹ 1,52,50,000**

**RETAIL METHOD****QUESTION 9.**

Given below is the accounting data of a retail business in paints for the year ended 31<sup>st</sup> December, 2003

	At Cost	At Retail
Opening Stock	20,000	30,000
Paint Purchased	1,00,000	1,70,000
Less : Sales for the year		1,60,000
Closing Stock		40,000

You are required to estimate cost of inventories on 31<sup>st</sup> December, 2003 using retail methods.

**Ans. Value of Stock ₹ 24,000**

**QUESTION 10.**

From the following information calculate inventories using retail methods

Opening Stock	400 items @ 19.50 (retail price ₹ 30/-)
Purchase	1200 items @ ₹ 25/- (retail price ₹ 35/-)
Net Sales	₹ 45,000

**Ans. Value of Stock ₹ 6300**

## ACTUAL COST METHOD

### QUESTION 11.

Normal Production	1, 00,000 Units
Fixed Production overheads	₹ 5, 00,000
Actual Production	
Case I	1, 00,000
Case II	80,000
Case III	1, 25,000

Discuss how the fixed production overheads will be allocated to inventories

**Ans.** Fixed production overhead per unit Case I- ₹ 5, Case II- ₹ 5, Case III- ₹ 4

### QUESTION 12.

Sony Pharma ordered 12,000 kg of certain material at ₹80 per unit. The purchase price included Excise duty ₹4 per kg in respect of which full CENVAT credit is admissible. Freight incurred amounted To ₹ 77,400. Normal transit loss is 3%. The company actually received 11,600 kg and consumed 10,100 Kg of material. Compute cost of inventory under AS-2 and abnormal loss. [May-2009]

**Ans.** Cost of stock ₹ 1,27,500, abnormal loss ₹ 3400

### QUESTION 13.

Anil Pharma Ltd. Ordered 16,000 kg of certain material at ₹ 160 per unit. The purchase price Includes Excise duty ₹ 10 per kg in respect of which full CENVAT credit is admissible. Freight incurred Amounted To ₹1,40,160. Normal transit loss is 2%. The company actually received 15,500 kg and Consumed 13,600 kg of material. Compute cost of inventory under AS-2 and amount of abnormal loss. [May-2011]-4 Marks

**Ans.** Cost of stock ₹ 3,07,800 , abnormal loss ₹ 29,160

### QUESTION 14.

Capital Cables Ltd., has a normal wastage (of A% in, the production process. During the year 2013-14 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 accountant to know how this wastage is to be treated in the books. Explain in the context of AS 2 the: treatment of normal loss and amount of abnormal loss if any.

#### Solution:

As per AS-2, Normal loss is part of cost, but abnormal loss is not part of cost.

Particulars	Units	₹
Purchase cost @ 150	12,000	18,00,000
Less: Normal loss (12,000 × 4%)	480	-
	11,520	18,00,000
Less: Abnormal loss (630-480)	150	23,438
Cost of material consumed	11,370	17,76,562

**QUESTION 15.**

From the following data, find out value of inventory as on 30.04.2009 using (a) LIFO method, and (b) FIFO method:

[Nov-2009]

(1)	01.04,2009 Purchased	10 units @ ₹70 per unit
(2)	06.04.2009 Sold	6 units @ ₹90 per unit
(3)	09.04.2009 Purchased	20 units @ ₹75 per unit
(4)	18.04.2009 Sold	14 units @ ₹100 per unit.

**Ans. (a) ₹ 730 (b) ₹ 750**

**QUESTION 16.**

In a production process, normal waste is 5% of input, 5,000 MT of input was put in process resulting In Wastage of 300 MT. Cost per MT of input is ₹ 1,000. The entire quantity of waste is on stock at The Year end. If waste has nil realizable value. What is the cost of stock and cost of abnormal loss?

**Ans. Cost of stock ₹ 49,47,361, abnormal loss ₹ 52,631.50**

## COST OF JOINT PRODUCTS

**QUESTION 17.**

A Ltd. Produce four products L, M, N and P from a joint process, Incurring a cost ₹ 5,71,200. Allocate the joint cost with the following information:

Particulars	L	M	N	P
Quantity produced (in'000)	10,000 kgs.	12,000 kgs.	14,000 kgs.	16,000 kgs.
Sale price per kg	₹ 13	₹ 17	₹ 19	₹ 22
Stock Quantity at the end of the year (kgs)	1625	400	Nil	1550

Also calculate value of stock in respect of the above products.

**Ans. Value of stock ₹ 12,675, ₹ 4,080, Nil, ₹ 20,460.**

**QUESTION 18.**

In a Manufacturing process of ISL Ltd, one by-product BP emerges besides two main products MP1 and MP2 apart from scrap. Details of cost of production process is here under-

Items	Units	Amounts (₹)	Outputs(units)	Closing stock on 31 <sup>st</sup> March
Raw material	15,000	1,60,000	MP1- 6,250	800 units
Wages	-	82,000	MP2- 5,000	200 units
Fixed Overhead	-	58,000	BP-1,600	-
Variable Overhead	-	40,000	-	-

Average Market Price of MP1 and MP2 is ₹ 80 per unit and ₹ 50 per unit respectively. By- Product is sold at ₹ 25 per unit. There is a profit of ₹ 5,000 on sale of By-product after incurring separate processing charges of ₹ 4,000 and packing charges of ₹ 6,000. ₹ 6,000 were realized from sale of scrape. Calculate of value of closing stock of MP1 and MP2 on 31<sup>st</sup> March.

**Ans. Value of stock – MP1- ₹ 25,944, MP2- ₹ 4,054.**

## VALUATION OF RAW MATERIALS

### QUESTION 19.

Raw materials inventory of a company includes certain material purchased at ₹ 100 per kg. The price of the material is on decline and replacement cost of the inventory at the year end is ₹ 75 per kg. It is possible to convert the material into finished product at conversion cost of ₹ 125.

Decide whether to make the product or not to make the product, if selling price is (i) ₹ 175 and (ii) ₹ 225. Also find out the value of inventory in each case. **[May-2010]**

### QUESTION 20.

X Ltd. presented the following particular as on 31.3.2012: Compute the value of stock as on 31.3.2012. The total cost of product:

	Cost per unit ₹
Cost of materials (₹ 12 each)	50
Manufacturing inputs	30
Total Cost	80
Profit	20
Selling Price	100

On 31.3.2012, selling price has gone down suddenly from ₹ 100 to ₹ 70. Price of raw material has also gone down to ₹ 8 each. X Ltd. had in its stock 6,000, units of materials which was bought as per the above rate on the same date.

#### Solution:

according to para 24, AS 2, when there has been a decline in the price of materials and it is estimated that the cost of the 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 this case, the total cost of ₹ 80 exceeds the net realisable value, i.e., selling price, of ₹ 70 (as the price of raw materials had gone down from ₹ 12 to ₹ 8). So, inventories should be valued @ ₹ 8 each and, as such, the total value of stock would be ₹ 48,000 (i.e., ₹ 6,000 units x ₹ 8).

### QUESTION 21.

A Ltd. uses a single raw material that converts that into finish product. During the current period the Cost of production and sales are as follows:

Raw material 3 units at ₹ 8 each	₹ 24.00
Cost of conversion	₹ 26.00
Selling price	₹ 75.00

On the balance sheet date there is a steep fall in the price of production to ₹ 45/- because of competition and a steep fall in material price. Currently material can be purchased at ₹ 4 per unit.

On the balance sheet date there are 1,00,000 units of raw material in stock purchased on 31.3.2004 at cost of ₹ 5 per unit. You are required to value inventories as on the balance sheet.



## MISCELLANEOUS QUESTIONS

**QUESTION 22.**

State with reference to A.S., how you will value the inventories in the following cases:

- (a) Raw material was purchased at ₹ 100 per kilo. Price of raw materials is on the decline. The finished goods in which the raw material is incorporated is expected to be sold at below cost, 10,000 kgs of raw material is on stock. At the year-end, Replacement cost is ₹ 80 per kg.
- (b) In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. The entire quality of waste is on stock at the year end.  
Per kg. Of finished goods consisted of:
- |                                     |               |
|-------------------------------------|---------------|
| Material cost                       | ₹ 100 per kg. |
| Direct labour cost                  | ₹ 20 per kg.  |
| Direct variable production overhead | ₹ 10 per kg.  |
- Fixed production charges for the year on normal capacity of one lakh kg is ₹ 10 lakhs. 2,000 kgs. Of finished goods are on stock at the year-end. **[C.A. Final Nov.-2000]**

**Ans.** Value of stock (a) ₹ 8,00,000 (b) ₹ 2,90,526

**QUESTION 23.**

Raw Material X is applied in finished product A and raw material Y in finished product B

	Stock	Cost	NRV	Replacement Cost
A	20,000	30	32	33
B	10,000	16	14	14.30
C	5,000	8	7	7.15
X	4,000	2	1.80	1.85
Y	10,000	22	20	21

B has pending defence supply at price of 23 for a quantity of 8000 units. Price of C has declined due to adverse media coverage which is ordinarily releasable at ₹ 25. It has been expected that its NRV will become normal after 2 months.

**QUESTION 24.**

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 31<sup>st</sup> March, 2017.

<u>Raw Material</u>	₹ per unite
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 ₹ 4,00,000 on normal capacity of 20,000 units.
- ii. Closing balance of Raw Material X was 1,000 units and Chemical Y was ₹ 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

- a) Net realizable value of Chemical Y is ₹ 800 per unit
- b) Net realizable value of Chemical Y is ₹ 600 per unit

(Nov- 2017, 5 Marks)

**Situation (i)**

**When Net Realisable Value of the Finished Goods Y is ₹ 800:** NRV is greater than the cost of Finished Goods Y i.e. ₹ 660 Hence, Raw Material and Finished Goods are to be valued at cost Value of Closing Stock:

	Qty	Rate	Amounts (₹)
Raw Material X	1,000	440	4,40,000
Finished Goods Y	2,400	660	15,84,000
<b>Total Cost of Closing Stock</b>			<b>20,24,000</b>

**Situation (ii) When Net Realisable Value of the Finished Goods Y is ₹ 600 :** NRV is less than the cost of Finished Goods Y i.e. ₹ 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	Amounts (₹)
Raw Material X	1,000	300	3,00,000
Finished Goods Y	2,400	600	14,40,000
<b>Total Cost of Closing Stock</b>			<b>17,40,000</b>

**Working notes:**

<b>Raw Material X</b>		₹
Cost Price		380
Add: freight inward		40
Add: unloading Charges		20
<b>Cost</b>		<b>440</b>

<b>Finished goods Y</b>		₹
Materials consumed		440
Direct Labour		120
Direct overhead		80
Fixed overheads (₹ 4,00,000/20,000 units)		20
<b>Cost</b>		

**QUESTION 24.**

How would you deal with the following in the annual accounts of a company for the year ended 31.3.2012?  
 “The company has to pay delayed cotton clearing charges over and above the negotiated price for asking delayed delivery of cotton from the supplier’s godown. Up to 2010-11, the company has regularly included such charges in the valuation of closing stock. This being in the nature of interest the company has decided to exclude it from closing stock valuation for the year 2011-12. This would result into decrease in profit by ₹ 7.60 lakhs.”

**Solution:**

As per para 12, AS 2, **Valuation of Inventories**, interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are, therefore, usually not included in the cost of inventories. Thus, it becomes quite clear that delayed cotton clearing charges which were treated in the nature of interest must not be included while valuing closing stock as per the provision of AS 2 and it is not in compliance with AS 2 which was done up to 2010-11.

But from year 2011-12, the company decided to change the earlier view i.e. they decided to exclude the same from the valuation of closing stock which is, no doubt, in compliance with AS 2.

As a result of change in accounting policy regarding valuation of stock the profit was reduced by is. 7.60 lakhs which must be disclosed in the financial statement or per AS 1 as Notes to Account.

**QUESTION 27.**

How will you deal with the following situation?

“A company deals in purchase and sale of timber and has included notional interest charges calculated (on the paid-up share capital and free reserves) in the value of stock of timber as at the Balance Sheet date as part of cost of holding the timber”.

**Solution:**

According to para 12 of AS 2, **Valuation of Inventories**, interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are, therefore, usually not included in the cost of inventories. Hence, the valuation of closing stock of timber cannot be considered as it is not in conformity with AS 2.

**AS 10**  
**(REVISED)**  
**PROPERTY,**  
**PLANT AND**  
**EQUIPMENT**

## INTRODUCTION

The objective of this Standard is to prescribe accounting treatment for Property, Plant and Equipment (PPE) are:

- Prescribed Accounting Treatment of PPE
- Help the user of financial statement to understand :
  - The investment in PPE
  - Changes in investment
- The principal issues in Accounting for PPE are:
  - Determination of carrying amount of PPE
  - Recognition of PPE
  - Depreciation charge on PPE
  - Impairment losses to be recognized in relation to PPE

## MEANING OF PROPERT, PLANT AND EQUIPMENT (PPE)

PPE are tangible items which are held:

- For production of goods
- Rendering of services
- For rental to others
- For administrative purpose
- Expected to be used for more than one accounting period
- Which are not held for sale in the ordinary course of buisness.

**Note: This standard prescribed accounting treatment for PPE except when another AS permit different accounting treatment (for example- AS-19)**

- **This standard does not apply to:**
  - **Biological assets for agricultural activity such as Living animals and Living plants other than Bearer Plants**
  - **Wasting Assets such as Mines, Mineral Rights**

**Note: Bearer plant means a plant:**

- That is used in the production or supply of agricultural produce
- Expected to bear produce for more than 12 months
- Has a remote likelihood of being sold as agricultural produce except for incidental scrap sale

**Example of Bearer plants are: Orange tree, Apple Tree and Mango Tree**

**AS 10 is applicable on bearer plants but not applicable on its produce. For Example: AS 10 is applicable on apple tree but not on apple produce. Following are not bearer plants:**

- Plants cultivated to be harvested as agricultural produce(tree grown for use as lumber)
- Annual crops (such as maize and wheat)

## INVESTMENT PROPERTY

Investment property is an investment in land or building that is not intended to be occupied substantially for use in the operation of the investing enterprise. The investment property is not PPE but should be accounted for only in accordance with the cost model prescribed in this standard.

## RECOGNITION OF PPE

The cost of an item of PPE should be recognised as an asset if, and only if:

- It is probable that future economic benefits associated with the item will flow to the enterprise, and
- The cost of the item can be measured reliably.

### Notes:

- It may be appropriate to aggregate individually insignificant items, such as moulds, tools and to apply the criteria to the aggregate value.
- An enterprise may decide to expense an item which could otherwise have been included as PPE, because the amount of the expenditure is not material.

### Example:

Entity A, a supermarket chain, is renovating one of its major stores. The store will have more available space for in store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers. State whether the remodelling cost will be capitalised or not.

### Solution

The expenditure in remodelling the store will create future economic benefits (in the form of 15% of increase in sales) and the cost of remodelling can be measured reliably, therefore, it should be capitalised.

## MEASUREMENT OF PPE

- **Measurement on initial Recognition - This will be using Cost Model**
- **Measurement after initial recognition (subsequent recognition) - This will be using either cost model or using revaluation model**

## INITIAL RECOGNITION

When an item of PPE that qualifies for recognition as an asset, it should be measured at its cost as per cost model

### What is Cost

- For purchased PPE
- For self-constructed PPE
- For exchange PPE

## COST FOR PURCHASE PPE

Purchase price (less trade discount and rebate)	xxx
Add: import duty	xxx
Add: Non-refundable taxes	xxx
Add: cost directly attributable to bringing the assets to the present location and conditions	xxx
Add: initial cost of dismantling /decommissioning, removing and site restoration at present value	<u>xxx</u>
<b>Total Cost</b>	<b><u>xxx</u></b>

**Examples of directly attributable costs are:**

- Costs of site preparation
- Initial delivery and handling costs
- Installation and assembly costs
- Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment)
- Professional fees

**Example on Decommissioning and Restoration:**

Ram Ltd. has put plant in 2016 on Leasehold land. The lease period is 15 years. Ram has to dismantle the plant removing from leasehold land and restore the leasehold land at the same position at the time of inception of lease. The estimated cost of dismantling the plant after 15 years will be ₹ 50 crores.

The pretax rate of time value of money is 10%. The PV factor after 15 years at 10% is 0.239

**Calculate restoration cost to be capitalized.**

**Cost which are not included in cost of PPE**

- Costs of opening a new facility or business (such as, inauguration costs)
- Costs of introducing a new product or service (including costs of advertising and promotional activities)
- Costs of conducting business in a new location or with a new class of customer (including costs of staff training)
- Administration and other general overhead costs

**COST FOR SELF CONSTRUCTED PPE**

Cost of material consumed	xxx
Cost of labour	xxx
Direct expenses on assets	xxx
Administrative expenses allocated to assets	
Depreciation on assets used for construction	<u>xxx</u>
<b>TOTAL COST</b>	<b><u>xxx</u></b>

**Note:**

- Cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset.
- Any internal profit will not be included in cost of self-constructed assets

**EXCHANGE OF ASSETS**

- Cost of such an item of PPE is measured at fair value
- If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

**Example 1**

A Ltd acquired a machinery in exchange of building. The fair value of machine acquired is ₹ 5,00,000 and book value of building given up is ₹ 4,50,000. Pass journal entry.

**Example 2.**

What is your answer if fair value of machine is not available?

## TREATMENT OF SPARE PARTS, STAND BY EQUIPMENT AND SERVICING EQUIPMENT

- Spare parts and servicing equipment are usually treated as inventory and recognized in the profit or loss as and when consumed.
- Major spare part and stand by equipment are treated as PPE when they are expected to be used over more than one accounting period. It means those which can be used exclusively with an item of PPE are accounted for as PPE. They are included in non-current assets from the date the cost is incurred.

## TREATMENT OF SUBSEQUENT COSTS

### COST OF DAY-TO-DAY SERVICING

- Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of such expenditures is often described as for the **'Repairs and Maintenance' of the item of PPE.**
- Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of such expenditures is often described as for the **'Repairs and Maintenance' of the item of PPE.**

### ACCOUNTING TREATMENT

- An enterprise does not recognise in the carrying amount of an item of PPE the costs of the day-to-day servicing of the item. Rather, these costs are recognised in the statement of profit and loss as incurred.
- But if subsequent expenditure on PPE increases the performance of an item of PPE beyond the standards previously assessed, then such expenditure qualify for capitalization.

## REPLACEMENT OF PART OF PPE

Parts of some items of PPE may require replacement at regular intervals.

### Examples:

- Aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe.
- Replacing the interior walls of a building, or to make a non-recurring replacement.

### ACCOUNTING TREATMENT

An enterprise recognises in the carrying amount of an item of PPE the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met.

**Note:** The carrying amount of those parts that are replaced is derecognised in accordance with the de-recognition provisions of this standard.



## REGULAR MAJOR INSPECTIONS

### ACCOUNTING TREATMENT

- When each major inspection is performed, its cost is recognised in the carrying amount of the item of PPE as a replacement, if the recognition criteria are satisfied.
- Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised.

## ITEMS OF PPE ACQUIRED FOR SAFETY OR ENVIRONMENTAL REASONS

- The acquisition of such PPE, although not directly increasing the future economic benefits of any particular existing item of PPE, may be necessary for an enterprise to obtain the future economic benefits from its other assets.
- Such items of PPE qualify for recognition as assets because they enable an enterprise to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired.

**Example:** A chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the enterprise is unable to manufacture and sell chemicals.

## MEASUREMENT AFTER INITIAL RECOGNITION

### (SUBSEQUENT RECOGNITION)

An enterprise should choose

- Either cost model, or
- revaluation model

As its accounting policy and should apply that policy to an entire class of **PPE**.

## CLASS OF PPE

A class of PPE is a grouping of assets of a similar nature and use in operations of an enterprise.

Examples of separate classes:

- Land
- Land and buildings
- Machinery
- Ships
- Aircraft
- Motor vehicles
- Furniture and fixtures
- Office equipment
- Bearer plants

## SUBSEQUENT RECOGNITION AT COST MODEL

After recognition as an asset, an item of PPE should be carried at:

Cost - any accumulated depreciation - any accumulated impairment losses

## SUBSEQUENT RECOGNITION AT REVALUATION MODEL

- After recognition as an asset, an item of PPE whose fair value can be measured reliably should be carried at a revalued amount:

<b>Fair value at the date of the revaluation</b>	<b>xxx</b>
<b>Less: any subsequent accumulated depreciation</b>	<b>xxx</b>
<b>Less: any subsequent accumulated impairment losses</b>	<b><u>xxx</u></b>
<b>Carrying value</b>	<b>xxxx</b>

- If an item of PPE is revalued, the entire class of PPE to which that asset belongs should be revalued.
- The items within a class of PPE are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the Financial Statements that are a mixture of costs and values as at different dates.

### Example:

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?

### Solution:

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.

## FREQUENCY OF REVALUATIONS

Revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using Fair value at the Balance Sheet date.

The frequency of revaluations depends upon the changes in fair values of the items of PPE being revalued.

When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required.

- Items of PPE experience significant and volatile changes in Fair value  
Annual revaluation should be done.
- Items of PPE with only insignificant changes in Fair value  
Revaluation should be done at an interval of 3 or 5 years.

## DETERMINATION OF FAIR VALUE

- Fair value of items of PPE is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers.
- If there is no market-based evidence of fair value because of the specialised nature of the item of PPE and the item is rarely sold, except as part of a continuing business, an enterprise may need to estimate fair value using an income approach.

## ACCOUNTING TREATMENT OF REVALUATIONS

When an item of PPE is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:

- A. Technique 1:** Gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset.

### Gross carrying amount

- May be restated by reference to observable market data, or
- May be restated proportionately to the change in the carrying amount.

### Accumulated depreciation at the date of the revaluation is

- Adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses

### Case Study on Technique I

PPE is revalued to ₹ 1,500 consisting of ₹ 2,500 Gross cost and ₹ 1,000 Depreciation based on observable market data.

Details of the PPE before and after revaluation are as follows:

Particulars	Cost/ Revalued Amt	Accumulated Dep.	Net Book Value
PPE before revaluation (assumed)	5,000	2,000	3,000
Fair Value			7,500
Revaluation Gain			4,500
Gain allocated proportionately to cost and Depreciation	7,500	3,000	4,500
PPE after Revaluation	12,500	5,000	7,500

The increase on revaluation is ₹ 4,500 (i.e., ₹ 7,500 – ₹ 3,000).

- B. Technique 2 :** Accumulated depreciation is eliminated against the Gross Carrying amount of the asset

### Case Study on Technique II

(Taking the information given in the above Example)

Details of the PPE before and after revaluation are as follows :

Particulars	Cost/ Revalued Amt	Accumulated Dep.	Net Book Value
PPE before revaluation (assumed)	5,000	2,000	3,000
PPE after Revaluation	7,500	-	7,500
Revaluation Gain	2,500	2,000	-

The increase on revaluation is ₹ 4,500 (i.e., ₹ 2,500 + ₹ 2,000).

## TREATMENT OF REVALUATIONS SURPLUS /LOSS

- **When there is upward revaluation:**
  - Profit on Revaluation will be credited to Revaluation Reserve/ surplus.
  - When upward revaluation made subsequently (initially decrease), then surplus to the extent loss earlier charged to statement of profit & Loss is recognized in statement of profit & Loss and Balance surplus (if any) is credited to revaluation reserve/surplus
- **When there is Downward revaluation:**
  - Loss on Revaluation will be charged to statement of Profit & Loss.
  - When Downward revaluation made subsequently (initially increase), then Loss to the extent Surplus earlier credited to revaluation reserve is debited directly to revaluation reserve and Balance Loss (if any) is charged to statement of Profit & Loss.

## DEPRECIATION

### Meaning:

- Depreciation is a systematic allocation of depreciable amount of assets over the useful life of assets
- **Depreciable amount** = cost – residual value
- **Accounting treatment:**  
Depreciation charge for each period should be recognised in the statement of profit and loss unless it is included in the carrying amount of another asset.

### Example:

#### Crane used for construction of building

In this case depreciation of crane will be added to cost of building

## REVIEW OF RESIDUAL VALUE AND USEFUL LIFE OF AN ASSET

- Residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change should be accounted for as a change in an accounting estimate.

### Example:

Entity a purchased an asset on 1st January 2013 for ₹ 3,00,000 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.

## COMMENCEMENT OF PERIOD FOR CHARGING DEPRECIATION

Depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management.

### Example:

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?

### Solution

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.

## COMPONENT METHOD OF DEPRECIATION

- Each part of an item of PPE with a cost that is significant in relation to the total cost of the item should be depreciated separately.

**Example:** it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.

## GROUPING OF COMPONENT

- A significant part of an item of PPE which may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

## CESSEATION OF DEPRECIATION

- Depreciation ceases to be charged when asset's residual value exceeds its carrying amount
- The residual value of an asset may increase to an amount equal to or greater than its carrying amount.
- If it does, depreciation charge of the asset is zero unless and until its residual value subsequently decreases to an amount below its carrying amount.

### Example:

A property costing ₹ 50,00,000 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) ₹ 50,00,000

Case (b) ₹ 45,00,000.

Calculate the amount of depreciation.

**Solution****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 ₹ 45,00,000 and the depreciable amount is, therefore, ₹ 5,00,000.

Annual depreciation (on a straight line basis) will be ₹ 25,000  $[(50,00,000 - 45,00,000) \div 20]$ .

**DEPRECIATION OF AN ASSET CEASES AT THE EARLIER OF:**

- The date that the asset is retired from active use and is held for disposal, and
- The date that the asset is derecognized

Therefore, depreciation does not cease when the asset becomes idle or is retired from active use (but not held for disposal) unless the asset is fully depreciated.

**However**, under production methods of depreciation, the depreciation charge can be zero while there is no production.

**LAND AND BUILDINGS**

- Land and buildings are separable assets and are accounted for separately, even when they are acquired together.

**Land:** land has an unlimited useful life and therefore is not depreciated.

**Exceptions:** depreciation is charged on Leasehold land over the period of lease

**Buildings:** buildings have a limited useful life and therefore are depreciable assets.

- An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.

**DEPRECIATION METHOD**

- The depreciation method used should to reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.
- **The method selected is applied consistently from period to period unless:**
  - there is a change in the expected pattern of consumption of those future economic benefits; or
  - That the method is changed in accordance with the statute to best reflect the way the asset is consumed.
- **Method of depreciation includes**
  - **Straight line method (SLM):** Results in a constant charge over the useful life if the residual value of the asset does not change
  - **Written Down Value Method (WDV):** Results in a decreasing charge over the useful life
  - **Production Method:** Results in a charge based on the expected use or output

**REVIEW DEPRECIATION METHOD**

- The depreciation method applied to an asset should be reviewed at least at each financial year-end
- And, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset
- The method should be changed to reflect the changed pattern.

Such a change should be accounted for as a change in an accounting estimate and applied prospectively.

## RETIREMENTS OF PPE

Items of PPE retired from active use and held for disposal should be stated at the lower of:

- Carrying amount, and
- Net realizable value

**Note: any write-down in this regard should be recognised immediately in the statement of profit and loss.**

**Example:**

A machinery with carrying amount of ₹ 2,00,000 is held for disposal. The realisable value of machine is ₹ 1,80,000.

**Answer:**

In the given case, machinery is shown in balance sheet at NRV ₹ 1,80,000 and ₹ 20,000 is recognised in statement of profit & loss immediately as loss.

## DEROGATION

The carrying amount of an item of PPE should be derecognised:

- on disposal or by sale
- Or by entering into a finance lease, or
- Or by donation, or
- When no future economic benefits are expected from its use or disposal

## ACCOUNTING TREATMENT

- Gain or loss arising from de-recognition of an item of PPE should be included in the statement of profit and loss
- When the item is derecognized unless other standards require otherwise.
- Where, gain or loss arising from de-recognition of an item of PPE =  
**Net disposal proceeds (if any) - carrying amount of the item**

**Note: gains should not be classified as revenue, as defined in as 9 'revenue recognition'.**

## EXCEPTION

- If an enterprise that in the course of its ordinary activities, routinely sells items of PPE that it had held for rental to others, Transfer such assets to inventories at their carrying amount when they cease to be rented and become held for sale.

The proceeds from the sale of such assets

- should be recognised in revenue
- In accordance with as 9 on revenue recognition.

## DISCLOSURE REQUIREMENT

The financial statements should disclose, for each class of PPE:

- The measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount;
- The depreciation methods used;
- The useful lives or the depreciation rates used.

In case the useful lives or the depreciation rates used are different from those specified in the statute governing the enterprise, it should make a specific mention of that fact;

- the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and
- A reconciliation of the carrying amount at the beginning and end of the period
- 

## PRACTICAL QUESTIONS

### QUESTION 1.

Amna Ltd. Contracted with a supplier to purchase a specific machinery to be installed in Department A in two months' time. Special foundations were required for the plant, which were to be prepared within this supply lead time. The cost of site preparation and laying foundation were ₹ 47,290. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 15,000 per month. The technician's services were given to Department A by Department B, which billed the services at ₹ 16,500 per month after adding 10% profit margin. The machine was purchased at ₹ 52,78,000. Sales tax was charged at 4% on the invoice ₹ 18,590 transportation charges were incurred to bring the machine to the factory. An architect was engaged at a fee of ₹ 10,000 to supervise machinery installation at the factory premises. Also, payment under the invoice was due in 3 months. However, the company made the payment in 2<sup>nd</sup> month. The company operates on Bank Overdraft @ 11%.

Ascertain the amount at which the asset should be capitalized under AS 10. [NOV 2013, 5 Marks]

**Ans. Total cost to be capitalized ₹ 55,95,000**

### QUESTION 2.

JIMIRA Ltd. Bought machinery on 30.09.2014. The price was ₹ 248 lakhs after charging 6% Sales-tax and giving a trade discount of 1.3% on the quoted price. Transport charges were 0.30% on the quoted price and installation charges come to 0.75 % on the quoted price. To meet machine, a loan of ₹ 240 Lakhs was taken from the bank on which interest at 12% per annum was to be paid. Expenditure incurred on the trial run was Materials ₹ 24,000, Wages ₹ 18,000 and Overheads ₹ 11,000. Machinery was ready for use on 1.12.2014. However, it was actually put to use only on 1.5.2015. The entire loan amount remained unpaid on 1.5.2015. Find out the cost of the machine as per AS-10.

**Ans. Total Cost of Machine ₹ 255.82**



**QUESTION 3.**

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

Cost of new plant of ABC Ltd. as per AS 10 PPE:-

Cost of Plant	₹31,25,000
Estimated cost of dismantling	₹2,50,000
Initial operational losses	₹4,75,000
Initial Delivery & Handling Cost	₹1,85,000
Cost of site preparation	₹4,50,000
Consultant Fee	₹6,50,000

Please Advise ABC Ltd to capitalize the cost of plant as per AS 10- Property, Plant and Equipment.

**Ans. ₹ 46,60,000**

**QUESTION 4.**

BHVP is constructing a seamless steel tube plant at Goindwal near Amritsar. Given below are the details of the project cost:

Material	₹ 35,00,000
Direct Expenses	5,00,000
Total Wages of the company during the year (1/10 <sup>th</sup> is chargeable to project)	60,00,000
Total Administration Expenses (2% to project)	40,00,000
Depreciation on assets used for project	60,000

**Ans.**

**Value of Capital Work-in-Progress As on 31-3-2003**

items	₹
Materials	35,00,000
Direct Expenses	5,00,000
Proportionate Wages	6,00,000
Proportionate Administrative Exp.	80,000
Depreciation on Fixed asset used in the project	60,000
<b>Cost of capitalization</b>	<b>47,40,000</b>

**QUESTION 5.**

MALIK Ltd. is constructing a bridge near Bareilly. Given below are the details of the project cost:

Material	₹ 25, 00,000
Direct Expenses	5, 00,000
Total Wages of the company during the year (1/4 <sup>th</sup> is chargeable to project)	10, 00,000
Total Administration Expenses (8% to project)	5, 00,000
Depreciation on assets used for project	60,000

Calculate cost of capitalization.

**Ans. ₹ 33, 50,000**

**QUESTION 6.**

A Ltd. is constructing a building near Delhi. Given below are the details of the project cost:

Material	₹ 55, 00,000
Direct Expenses	15, 00,000
Total Wages of the company during the year (1/5 <sup>th</sup> is chargeable to project)	30, 00,000
Total Administration Expenses (4% to project)	25, 00,000
Depreciation on assets used for project	1, 60,000

Calculate cost of capitalization.

**Ans. ₹ 78, 60,000**

**QUESTION 7.**

A company has made additions to its factory buildings by its own workmen, at a cost of ₹ 4, 50,000 for wages and materials. The lowest estimate from an outside contractor to carry out the same work was for ₹ 6, 00,000. The directors contend that as they were fully entitled to employ an outside contractor, it is reasonable to debit the Factory Building Account with ₹ 6, 00,000. [Nov. 2001]

**[Ans. ₹ 4, 50,000 shall be debited]**

**QUESTION 8.**

What is the accounting entry to be passed as per AS-10 for the following situations?

- Increase in value of fixed asset by ₹ 50, 00,000 on account of revaluation.
- Decrease in the value of fixed asset by ₹ 30, 00,000 on account of revaluation.

[May-2008]

**Ans.**

**Journal Entries**

	Particulars	L/F	Dr. (₹)	Cr. (₹)
a.	Fixed Asset A/c Dr. To Revaluation Reserve A/c (being the increase in value of fixed asset due to upward revaluation)		50,00,000	50,00,000
b.	Profit and Loss A/c Dr. To Fixed Asset A/c (Being the decrease in net book value of fixed asset due to downward revaluation)		30,00,000	30,00,000

**Note:** It has been assumed that both the above instances are independent each other and revaluation is done for first time.

**QUESTION 9.**

A Ltd. Purchased an aircraft for ₹ 50,00,000. The cost of Aircraft is divided as under:

- Airframe ₹ 30,00,000 (Useful life 12 years)
- Seats ₹ 8,00,000 (Useful life 8 years)
- Engine ₹ 12,00,000 (Useful life 6 years)

Calculate Depreciation on above Aircraft.

**QUESTION 10.**

A plant was depreciated under two different methods as under:

Year	SLM (₹ in lakhs)	W.D.V. (₹ in lakhs)
1	7.80	21.38
2	7.80	15.80
3	7.80	11.68
4	7.80	<u>8.64</u>
	31.20	<u>57.50</u>
5	<b>7.80</b>	<b>6.38</b>

What should be the amount of resultant surplus/deficiency, if the company decides to switch over from W.D.V. method to SLM method for first four year? Also state, how you will treat the same in Accounts. [2004-May]

**QUESTION 11.**

Entity A has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site. The following incremental costs will be incurred:

1. Setup costs of ₹ 5,00,000 to install machinery in the new location.
2. Rent of ₹ 15,00,000
3. Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.

Can these costs be capitalised into the cost of the new building?

**Solution**

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not to be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The costs to be incurred by the company are in the nature of costs of relocating or reorganising operations of the company and do not meet the requirement of AS 10 (Revised) and therefore, cannot be capitalised.

**QUESTION 12.****(Capitalisation of directly attributable costs)**

Entity A, which operates a major chain of supermarkets, has acquired a new store location. The new location requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the supermarket will be closed.

Management has prepared the budget for this period including expenditure related to construction and remodelling costs, salaries of staff who will be preparing the store before its opening and related utilities costs. What will be the treatment of such expenditures?

**Solution**

Management should capitalise the costs of construction and remodelling the supermarket, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management. The supermarket cannot be opened without incurring the remodelling expenditure, and thus the expenditure should be considered part of the asset.

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 13.****(Operating costs incurred in the start-up period)**

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.

**Solution**

The net operating costs should not be capitalised, but should be recognised 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 14.****(Consideration received comprising a combination of non-monetary and monetary assets)**

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

**Solution**

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

**QUESTION 15.****(Exchange of assets that lack commercial substance)**

Entity A exchanges car X with a book value of ₹ 13,00,000 and a fair value of ₹ 13,25,000 for cash of ₹ 15,000 and car Y which has a fair value of ₹ 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?

**Solution**

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

**C. PPE purchased for a Consolidated Price :**

Where several items of PPE are purchased for a consolidated price, the consideration is apportioned to the various items on the basis of their respective fair values at the date of acquisition.

**Note:** In case the fair values of the items acquired cannot be measured reliably, these values are estimated on a fair basis as determined by competent valuers.

**D. PPE held by a lessee under a Finance Lease:**

The cost of an item of PPE held by a lessee under a finance lease is determined in accordance with AS 19 (Leases).

**E. Government Grant related to PPE:**

The carrying amount of an item of PPE may be reduced by government grants in accordance with AS 12 (Accounting for Government Grants).

**QUESTION 16.****(Determination of appropriate Depreciation Method)**

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.

**Solution**

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 17.**

During the current year 2002-03, X Limited made the following expenditure relating to its plant building:

	₹ in lakhs
Routine Repairs	12
Repairing	3
Partial replacement of roof tiles	2
Substantial improvements to the electrical wiring	30
System which will increase efficiency	
What amount should be capitalized?	

**QUESTION 18.**

During the current year 2009-10 M/s L & C Ltd. made the following expenditure relating to its plant and Machinery:

	₹
General repairs	4,00,000
Repairing of Electric Motors	1,00,000
Partial Replacement of parts of Machinery	50,000
Substantial improvements to the electrical wiring system	
Which will increase efficiency of the plant and machinery	10, 00,000
What amount should be capitalized according to AS-10?	

[May-2010]

**Ans.** As per As 10, expenditure on improvements / repairs that increases the future benefits from the existing asset beyond its previously assessed standard of performance is capitalized other expenditures should be charged to the P & L account. The following is the breakup of revenue & capital expenditure in this case –

Particulars	Reasons / Explanations	Total	Revenue Exp.	Capital Exp.
(a) General Repairs	Maintenance of assets rather than increase in future benefits	4,00,000	4,00,000	NIL

(b)Repairing of Electric Motors	Maintenance of assets rather than increase in future benefits	1,00,000	1,00,000	NIL
(c)Partial Replacement of parts of Machinery	Replacement of defective parts, does not lead to increase in future benefits.	50,000	50,000	NIL
(d)Substantial improvement to the electrical wiring system which will increase efficiency	Improvement in asset functionality, which will create benefit of enduring nature	10,00,000	NIL	10,00,000

**AS-11**

**ACCOUNTING  
FOR EFFECTS  
OF CHANGES  
IN FOREIGN  
EXCHANGE  
RATES**

## INTRODUCTION

The standard deals with the issues involved in accounting for foreign currency transactions and foreign operations i.e., to decide which exchange rate to use and how to recognise the financial effects of changes in exchange rates in the financial statements

## SCOPE

This Standard should be applied:

- (a) In accounting for foreign exchange transactions.
- (b) In translating the financial statements of foreign operations.
- (c) Accounting for foreign currency transactions in the nature of forward exchange contracts.

**This Standard does not:**

- (a) Specify the currency in which an enterprise presents its financial statements.  
However, an enterprise normally uses the currency of the country in which it is domiciled. If it uses a different currency, the Standard requires disclosure of the reasons for using that currency. The Standard also requires disclosure of the reason for any change in the reporting currency.
- (b) Deal with the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation, which are addressed in AS 3 'Cash flow statement'.
- (c) Deal with exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.
- (d) Deal with the restatement of an enterprise's financial statements from its reporting currency into another currency for the convenience of users accustomed to that currency or for similar purposes.

## FOREIGN EXCHANGE TRANSACTIONS

### INITIAL RECOGNITION

A foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.

A rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable.

### REPORTING AT EACH BALANCE SHEET DATE

The treatment of foreign currency items at the balance sheet date depends on whether the item is:

- monetary or non-monetary; and
- Carried at historical cost or fair value (for non-monetary items).



## MONETARY ITEMS

They are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money. For example, cash, receivables and payables.

## NON MONETARY ITEMS

They are assets and liabilities other than monetary items. For example, fixed assets, inventories and investments in equity shares.

## REPORTING

- (a) Foreign currency monetary items should be reported using the closing rate. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date, e.g., where there are restrictions on remittances or where the closing rate is unrealistic and it is not possible to effect an exchange of currencies at that rate at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from or required to disburse, such item at the balance sheet date.
- (b) Non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction.
- (c) Non-monetary items which are carried at fair value or other similar valuation denominated in a foreign currency should be reported using the exchange rates that existed when the values were determined.
- (d) The contingent liability denominated in foreign currency at the balance sheet date is disclosed by using the closing rate.

## RECOGNITION OF EXCHANGE DIFFERENCES

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.

### QUESTION 1.

A company had imported raw material worth US dollars 250,000 on 15th January, 2002 when the exchange rate was ₹ 46 per US dollar. The company had recorded the transaction at that rate. The payment for the imports was made only on 15th April, 2002 when the exchange rate was ₹ 49 per US dollar. However on 31st March 2002, the rate of exchange was ₹ 50 per US dollar. The company passed an entry on 31st March, 2002 adjusting the cost of raw materials consumed for the difference between ₹ 49 and ₹ 46 per US dollar.  
**[May 2002]**

### Ans.

Sundry creditors should be valued at the closing rate, i.e. ₹ 50 at 31st March, 2002. The difference of ₹ 4 (50-46) per US dollar should be shown as an exchange loss in the profit and loss account. In the subsequent year, the company would record an exchange gain of ₹ 1 per US dollar.

### QUESTION 2.

A company had imported raw materials worth US Dollars 6,00,000 on 5<sup>th</sup> January, 2005, when the exchange rate was ₹ 43 per US Dollar. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transaction was made on 5th April, 2005 when the exchange rate was ₹ 47 per

US Dollar. However on 31<sup>st</sup> March 2005, the rate of exchange was ₹ 48 US Dollar. The company passed an entry on 31st March, 2005 adjusting the cost of raw materials consumed for the difference between ₹ 47 and ₹ 43 per US Dollar.

In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss.

[Nov-2006] -4 Marks

**Ans.**

As per AS 11 (AS revised in 2003), 'The Effects of Changes in Foreign Exchange Rates', monetary items denominated in a foreign currency should be reported, using the closing rate at each balance sheet date. The effect of exchange difference should be taken into profit and loss account. Sundry creditors is a monetary item hence should be valued at the closing rate i.e, ₹48 at 31<sup>st</sup> March, 2005 irrespective of the payment for the same subsequently at lower rate in the next financial year. The difference of ₹ 5 (48-43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31<sup>st</sup> March, 2005 and is not to be adjusted against the cost of raw-materials.

In the subsequent year, the company would record an exchange gain of ₹ 1 per US" dollar, i.e., the difference between ₹48 and ₹47 per Us dollar. Hence, the accounting treatment adopted by the company is not in consonance with the requirements of AS-11.

### QUESTION 3.

Hind Export Ltd. exported goods for \$ 2,00,000 in February (exchange rate ₹ 48.38). The amount was received in June (exchange rate ₹ 48.43). The company closes books of accounts on March 31 every year. The exchange rate on 31st March current year was ₹ 48.50. Find out the exchange fluctuation gain/loss on the balance sheet

[May – 06]

**Ans**

	₹
Debtors on the date of transaction (2,00,000 x ₹ 48.38)	96,76,000
Debtors on the balance sheet date (2,00,000 x ₹ 48.50)	<u>97,00,000</u>
Exchange difference gain on balance sheet date	<u>24,000</u>
Amount received on the due date (2,00,000 x ₹ 48.43)	96,86,000
Therefore exchange difference loss on the date of receipt (₹ 97,00,000 - ₹ 96,86,000)	<u>14,000</u>

date and on the date of receipt.

### QUESTION 4.

Explain briefly the accounting treatment needed in the following cases as per AS 11 AS ON 31.03.2015.

Sundry Debtors include amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transactions recorded as US \$1 = ₹ 58.50.

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

US \$ 1 = ₹ 61.20 on 31.3.2015

(Nov – 2015, Marks 5)

**Ans.** As per AS 11, all foreign currency monetary items should be subsequently recognized on each balance sheet date by taking the exchange rate prevailing on the date of Balance sheet. Any exchange difference on