Question No. 5 — RTP May 2016

Samrat Limited has set up its business in a designated backward area which entitles the company for subsidy of 25% of the total investment from Government of India. The company has invested ₹ 80 crores in the eligible investments. The company is eligible for the subsidy and has received ₹ 20 crores from the government in February 2014. The company wants to recognize the said subsidy as its income to improve the bottom line of the company.
Do you approve the action of the company in accordance with the Accounting Standard?

Answer

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

The subsidy received by Samrat Ltd. for setting up its business in a designated backward area will be treated as grant by the government in the nature of promoters contribution as the grant is given with reference to the total investment in an undertaking i.e. subsidy is 25% of the eligible investment and also no repayment is apparently expected in respect thereof.

Since the subsidy received is neither in relation to specific fixed assets nor in relation to revenue. Thus, the company cannot recognize the said subsidy as income in its financial statements in the given case. It should be recognized as capital reserve which can be neither distributed as dividend nor considered as deferred income.

Question No. 6 — RTP Nov. 2016

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

Particulars	₹
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation (from 2012-13- to 2014- 15 on Straight Line Method)	12 00 000
	8,00,000
Less: Grant received	(16,00,000)
Balance	(8,00,000)

How should the company deal with this asset in its accounts for 2015-16? Can it charge depreciation or negative depreciation for 2015-16? Can it credit ₹ 8,00,000 to Capital Reserve?

Answer

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

The balance ₹ 8,00,000 may be credited to P&L A/c, since already the cost of the asset to the tune of 2,00,000 had been debited to P&L A/c in the earlier years by way of depreciation charge, and ₹ 8,00,000 transferred to P&L A/c now would be partial recovery of that cost.

There is no need to provide depreciation for 2015-16 or 2016-17 as the depreciable amount is now Nil.
In respect of Depreciable Assets, AS-12 does not permit the crediting of the grant or any part thereof to Capital Reserve A/c.

Question No. 7 **RTP May 2017,2018**

P Limited belongs to the engineering industry. The Chief Accountant has prepared the draft accounts for the year ended 31.03.2016. You are required to advise the company on the following item from the viewpoint of finalisation of accounts, taking note of the mandatory accounting standards:

The company purchased on 01.04.2015 special purpose machinery for ₹ 25 lakhs. It received a Central Government Grant for 20% of the price. The machine has an effective life of 10 years.

Answer

AS 12 'Accounting for Government Grants' regards two methods of presentation, of grants related to specific fixed assets, in financial statements as acceptable alternatives. Under the first method, the grant of ₹ 5,00,000 can be shown as a deduction from the gross book value of the machinery in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge.

Under the second method, it can be treated as deferred income which should be recognised in the profit and loss statement over the useful life of 10 years in the proportions in which depreciation on machinery will be charged. The deferred income pending its apportionment to profit and loss account should be disclosed in the balance sheet with a suitable description e.g., 'Deferred government grants' to be shown after 'Reserves and Surplus' but before 'Secured Loans'.

The following should also be disclosed:

(i) the accounting policy adopted for government grants, including the methods of presentation in the financial statements;

(ii) the nature and extent of government grants recognised in the financial statement of ₹5 lakhs is required to be credited to the profit and loss statement of the current year.

Question No. 8 **RTP Nov. 2018**

A specific government grant of ₹ 15 lakhs was received by USB Ltd. for acquiring the Hi-Tech Diary plant of ₹ 95 lakhs during the year 2014-15. Plant has useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2017-18, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 10.50 lakhs and written down value of plant was ₹ 66.50 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of plant and the amount of depreciation to be charged during the year 2017-18 in profit and loss account?

(ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2014-15 assuming plant account showed the balance of ₹ 56 lakhs as on 1.4.2017?

You are required to explain in the line with provisions of AS 12.

Answer

As per para 21 of AS 12, 'Accounting for Government Grants', the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

(i) In this case the grant refunded is ₹ 15 lakhs and balance in deferred income is ₹ 10.50 lakhs, ₹ 4.50 lakhs shall be charged to the profit and loss account for the year 2017-18. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

(ii) If the grant was deducted from the cost of the plant in the year 2014-15 then, para 21 of AS 12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by ₹ 15 lakhs. The increased cost of ₹ 15 lakhs of the plant should be amortized over 7 years (residual life).

Depreciation charged during the year 2017-18 shall be (56+15)/7 years = ₹ 10.14 lakhs presuming the depreciation is charged on SLM.

Concept No. 1 - Accounting policies means

- Specific accounting principles

- Methods of applying such principles

- Adopted in preparation and presentation of financial statement.

Definition: - Accounting Policies are Specific accounting principles & Methods of applying such principles adopted in preparation and presentation of financial statements.

Financial Statements Means

Income statement

Cash flow statement

Balance Sheet

Examples of Accounting Policies

Purpose/Principle	Methods for applying Principles
Providing Depreciation	Straight Line method, Written down value method etc.
Valuation of Inventory	FIFO, Weighted Average and Standard Cost method etc.
Valuation of Fixed Assets	Cost model, Revaluation model
Treatment of Government grants	Recognising as Income or reduction from cost of asset

Concept No. 2 - Conditions to be satisfied for adopting accounting policy

"Policies selected should give true and fair view of business through Financial Statements" therefore following points becomes important for selection of accounting policies.

1. Prudence

1. Prudence means Caution and this means management should be cautious (careful) while selecting accounting policies.
2. Wrong selection of Accounting Policies may lead to excessive Profits, overvaluation or undervaluation of Assets and liabilities.
3. As per prudence / conservatism, Probable loss is to be recognised but probable income is not to be recognised unless it is virtually certain.
4. In other words, expect and record all future losses and don't expect and record future gains.

Example: Inventories are valued at cost or net realisable value whichever is lower.
Probable losses shall be provided immediately.

2. Substance Over Form

1. Reality is more important than legal form.
2. Transactions and other events should be accounted for and presented in accordance with their substance and financial reality not merely with their legal form.
3. Example: In case of hire purchase, the hire vendor is owner till the payment of last installment. Irrespective of this, Hire purchaser records the asset in his books and hire vendor records hire purchase transaction as sale as the final intention of hire purchase is to sale goods.

3. Materiality

1. Facts which are not of material nature need not be disclosed separately.
2. Material items are those items which affects decision making of users.
3. Materiality depends on Size and nature of business.

Concept No. 3 - Disclosure of Accounting Policy

All Accounting Policies shall be disclosed at one place

Accounting Policies shall be selected after complying with above conditions because just disclosure is not remedy for wrong selection of accounting Policy

Why disclosure of Accounting Policy is required?

It helps users of accounting information:

- In better understanding of financial information.
- For comparison of financial statements with other entities.

Concept No. 4_Fundamental Accounting Assumptions (F.A.A.)

Fundamental Accounting Assumption

- **Going concern**

- **Consistency**

- **Accrual Assumption**

Explanation of Fundamental Accounting Assumption.

Going concern

- It is assumed that business would continue for foreseeable period.
- There is no necessity or decision to curtail/close down of entity.
- Entity is assumed to be a going concern unless there is clear situation of winding up of business.
- **Example -** Plant 1,00,000 life 10 years, scrap 10,000. Calculate Depreciation for first year. **Solution -** 9,000 on the assumption that business would continue for 10 year.

Consistency

- It means it is always assumed that same accounting policies would be followed every year.
- **Example: -** plant 1,00,000 life 10 years, scrap 10,000 Calculate Depreciation for second year. Solution: - 9,000 every year on the assumption of going concern and consistency.

Accrual Assumption

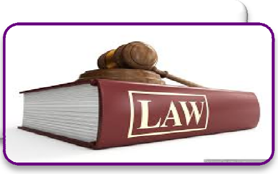
- It is assumed that entity record all income & exp. on period basis. They are not recorded on payment basis.
- As per accrual, all expenses shall be recorded when it is incurred and all incomes shall be recorded when it is earned,
- This concept helps in calculation of true income of business for each accounting period.
- Even section 128 of Companies Act, 2013 requires that Accounts of companies shall be maintained on accrual basis,
- **In Trial Balance following balance are shown.**
- Salary 1,00,000. Outstanding salary 10,000.
- **Solution: -** In P&L salary 1,00,000 Add:- Outstanding salary (it is added because it is related to current period even though it is not paid in current year) and shown on liability side of Balance Sheet .

Concept No. 5_Change in Accounting Policy

As per consistency, entity shall follow same accounting policy year by year but entity may change accounting policy in following cases:

Entity may change accounting policy

- **If change in accounting policies is required to comply with**
  - **Statute (Law)**



  - **Accounting Standards.**

- **If it is considered That change in Accounting Policy results in appropriate presentation of Financial Statements.**

Additional Points on Change in Accounting Policies:

-Any change in accounting policy should be disclosed.
-The effect of such a change should be quantified.
-If quantification is not possible the facts should be disclosed.
-The change is to be disclosed in the year or years in which it has an impact on financial statements.

Example:
1. Change in method of depreciation.
2. Change in the method of valuation of inventories.

Chart AS 1 "Disclosure of Accounting Policies"

1.

Accounting Policies Means

Specific accounting principles & Methods of applying such principles adopted in preparation and presentation of financial statements.

Selection of accounting policies is the responsibility of the management.

In selection of accounting policies, management should consider the following:

Primary consideration

Financial statements should give True & Fair view after applying selected policies

Other Major consideration

Prudence

- It means management should be careful while selecting accounting policies.
- Management should apply knowledge i.e. nature of business, legal requirements, accounting standards, etc. in the selection of policies.

Substance over

- It is Reality over Legality.
- Management should select the accounting policies which help to present a accurate picture of financial statements rather than legality

Materiality

- Financial Statement should disclose all material Items i.e. those items which affect decision making of users

2.

Fundamental Accounting Assumption in preparation of financial statements

Going concern

It is assumed that business would continue for foreseeable period.

Consistency

it is always assumed that same accounting policies would be followed every year.

Accrual Assumption

It is assumed that entity record all income & exp. on period basis. They are not recorded on payment basis

Questions

Question No. 1 — RTP May 2017

Mini Ltd. was making provision for non-moving stocks based on no issues for the last 12 months up to 31.3.2016.

The company wants to provide during the year ending 31.3.2016 based on technical evaluation:

Total value of stock	₹ 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?

Question No. 2 — RTP Nov 2017

A limited has sold its building for ₹ 50 lakhs and the purchaser has paid the full price. The Company has given possession to the purchaser. The book value of the building is ₹ 35 lakhs. As at 31st March 2017, documentation and legal formalities are pending. The company has not recorded the sale. It has shown the amount received as advance. Do you agree with this treatment?

What accounting treatment should the buyer give in its financial statements?

Question No. 3 — RTP May 2018

J Ltd. had made a rights issue of shares in 2016. 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 for permanent fall in the value of investments - this 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.

Additional Questions with Answers

Question No. 1 **RTP May 2012**

X Ltd. sold its building to Mini Ltd. for ₹ 60 lakhs on 30.09.2010 and gave possession of the property to Mini Ltd. However, documentation and legal formalities are pending. Due to this, the company has not recorded the sale and has shown the amount received as an advance. The book value of the building is ₹ 25 lakhs as on 31st March, 2011. Do you agree with this treatment? If you do not agree, explain the reasons with reference to the accounting standard.

Answer

As per para 16 & 17 of AS 1, "Disclosure of Accounting Policies", the main consideration in selection of accounting policy is the presentation of a true and fair picture of the state of affairs & performance of the enterprise. To ensure true and fair consideration, principles of prudence, substance over form and materiality should be looked into.

In this case, the economic reality and substance of the transaction is that the rights and beneficial interest in the property has been transferred although legal title has not been transferred. Hence, X Ltd. in its financial statements for the year ended 31.3.2011, should record the sale and recognize the profit of ₹ 35 lakhs in its Profit & Loss Account and building should be removed from the balance sheet of X Ltd. **Therefore, the treatment given by the company is not correct.**

Question No. 2 **RTP Nov 2012**

Explain the concept of 'materiality' in brief.

Answer

Para 17 of AS 1 'Disclosure of Accounting Policies', states that financial statements should disclose all material items, i.e., items the knowledge of which might influence the decisions of the user of the financial statements. Materiality depends on the size of item or error judged in the particular circumstances of its omission or misstatement. From a positive perspective, materiality has to do with the significance of an item or event to warrant attention in the accounting process.

From a negative view point, materiality is critical because otherwise a great deal of time might be spent on trivial matters in the accounting process. Individual judgments are required to assess materiality, or to decide what the appropriate minimum quantitative criteria are to be set for given situations. What is material to one organization, may not be material for another organization.

For example, a long term investor is interested in the current value of fixed asset like building, while the banker may not consider it significant for a short-term loan. Similarly a pair of scissors, ball pens, sharpeners, waste-paper baskets could be used for a number of years but still it is treated as an expense and not an asset. The omission of "paise" in the financial statements is also due to their insignificant effect to the users of the financial statement in making a decision.

Question No. 3 **RTP May 2013**

FINMIN Ltd. 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 claim/petitions in a Special Court. FINMIN Ltd. has accepted Inter-Corporate Deposits (ICDs) and 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 from 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 statement of profits and loss. Comment on the correctness of the treatment for such claims as done by the company.

Answer

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 recognized only when realized 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.

Further, 'accrual' is one of the fundamental accounting assumptions as per AS 1. Irrespective of the terms of the contract, so long as the principal amount of a loan is not repaid, the lender cannot be placed in a disadvantageous position for non payment of interest in respect of claim for interest from the due date to date of repayment of loan.

From the aforesaid, it is apparent that 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. Non-provision of the interest from the due date to the date of repayment of loan amounts to violation of accrual basis of accounting.

Question No. 4 **RTP Nov 2013**

X Limited has sold its building for ₹ 50 lakhs to the purchaser who has paid the full price. Company has given possession to the purchaser. The book value of the building is ₹ 35 lakhs. As at 31st March, 2013, documentation and legal formalities are pending. The company has not recorded the sale. It has shown the amount received as advance. Do you agree with this accounting treatment done by X Ltd.? If not, then suggest the correct accounting treatment in this regard.

Answer

Although legal title has not been transferred, the economic reality and substance is that the rights and beneficial interest in the immovable property have been transferred. Therefore, recording of disposal by the transferor would in substance represent the transaction entered into.
In view of this, X Ltd. should record the sales and recognize the profit of ₹ 15 lakhs in its Statement of Profit and Loss. It should remove building account from its balance sheet. Further, in its 'Notes to Accounts', X Ltd. should disclose the following:
"Building has been sold and full consideration has been received and possession of the same has been handed over to the buyer. However, documentation and legal formalities are pending as on 31.3.2013."

Question No. 5 **RTP May 2014**

Omega Ltd. projected a surplus of ₹ 40 crores during the accounting year to end on 31st March, 2013. 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) 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 cores.)
(ii) 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 2012-2013.

Answer

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) 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.

(ii) 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 No. 6 | **RTP Nov 2015, May 2018**

Jagannath Ltd. had made a rights issue of shares in 2014. In the offer document to its members, it had projected a surplus of ₹ 40 crores during the accounting year to end on 31st March, 2015. 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 cores.

(iii) 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 2014-2015.

Answer

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 cognizance 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) 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 No. 7 **RTP May 2016**

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.

Answer

Para 17 of AS 1 'Disclosure of Accounting Policies' recognizes '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 recognized only when realized 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 para 10 of the 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.

Question No. 8 **RTP Nov 2016**

Om Ltd. purchases goods on behalf of its customers for execution of work under a works contract against which it receives full payment and necessary declaration form under Central Sales Tax Act to be passed on to the supplier. The company follows the practice of treating the same as its purchases and accordingly debits to its Profit and Loss Account. Give your views on the above.

Answer

AS-1 "Disclosures of Accounting Policies", states that the accounting treatment and presentation in Financial Statements of transactions should be governed by their substance and not merely by the legal form. The treatment in the given case would depend on the terms of the Works Contract and also the substance of the agreement.
Accordingly, there can be two possibilities in the instant case, viz.

Situation 1
The Company acts as the agent of the customer.
Disclosure should be made to this effect that the material purchased belongs to the customer.

Where ownership of goods vests with the customers and the company merely purchases goods on behalf of its customers, it acts in the capacity of an agent for execution of works under a works contract for which it receives full payment. Hence, these purchases cannot be treated as the purchases of the Company and so, the debit to its P&L A/c is not correct

Situation 2
The Company is the owner of the materials purchased in substance and has the right, (though a restricted one) to use the materials, for all practical purposes.
If the terms of Works Contract provide for factor linked payment by customer and in substance the materials acquired by the Company belongs to the company only, irrespective of the legal form of ownership, the Company is justified in debiting its P&L A/c.

AS – 2 Valuation of Inventories

Concept No. 1 - Objetives of AS Valuation of Inventories

1. To formulate the method of calculation of Inventories/Stock
2. To determine the carrying amount of inventories in Financial Statements (FSs). This includes determination of cost of inventory and any amount to be written off to bring it to Net Realisable Value (NRV).

This Standard is very important as it impacts both P&L as well as Balance sheet i.e. if closing stock is overvalued/ undervalued; it impacts CY profits as well as asset value in the Balance sheet.

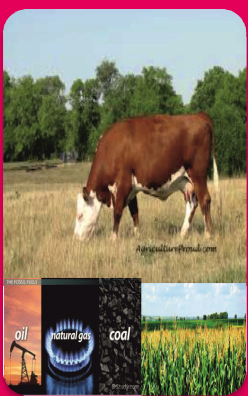
Concept No. 2 - Applicability of AS - Inventory Valuation

This standard is not applicable to the following.

WIP of service provider

If the entity holds shares, debentures and other financial instruments as stock-in-trade ; (It is discussed in AS 13.)

Work-in-progress (WIP) arising under construction contracts; (It is discussed in AS 7)



1. Inventories of livestock,

2. Agricultural and forest products,

3. Mineral oils, ores and gases to the extent that they are measured at NRV in accordance with well established practices in those industries.

Concept No. 3 - Definitions

Finished goods (FG) -
Held for sale in the Ordinary course of business

Raw Material, WIP -
Used in the process of production for such sale

Consumables & Loose tools, etc..
To be consumed in the process of production or in rendering the services

Chart Presentation Inventories includes

Inventories consist of

- **Held for sale in the Ordinary course of business i.e. Finished goods (FG).**
- **Used in the process of production for such sale i.e. raw material, WIP etc.**
- **To be consumed in the process of production or in rendering the services e.g. consumables and loose tools, etc.**

Concept No. 4 Measurement of Inventories

Major points for valuation of Inventories

1. Determination cost of Inventories → **2. Determination Net Realisable Value of Inventories** → **3. Comparison between the Cost and Net Realisable Value**

Inventory is valued at COST (or) NRV Whichever is LOWER

Concept No. 5 What is Cost of Inventories

Chart Presentation Cost of Inventories includes

Cost of Inventories Includes

- **Cost of purchase**
- **Cost of Conversion**
- **Other costs incurred to bring the inventory to present location and condition.**

5. (1) Cost Of Purchase

Cost of purchase includes all costs incurred to purchase the material.

The following items are directly related to the purchase of material.

Particulars	Amount
Purchase price i.e. Basic price of material	xxx
Add	
NON refundable taxes & duties	xxx
Carrying Cost i.e. inward freight cost	xxx
Inward Insurance cost	xxx
All other costs incurred directly related to acquisition and bringing it to warehouse.	xxx
Less	
Trade discounts Quantity discounts	xxx
Duty drawbacks & other similar items	xxx
Cost or Purchase Price	XXX

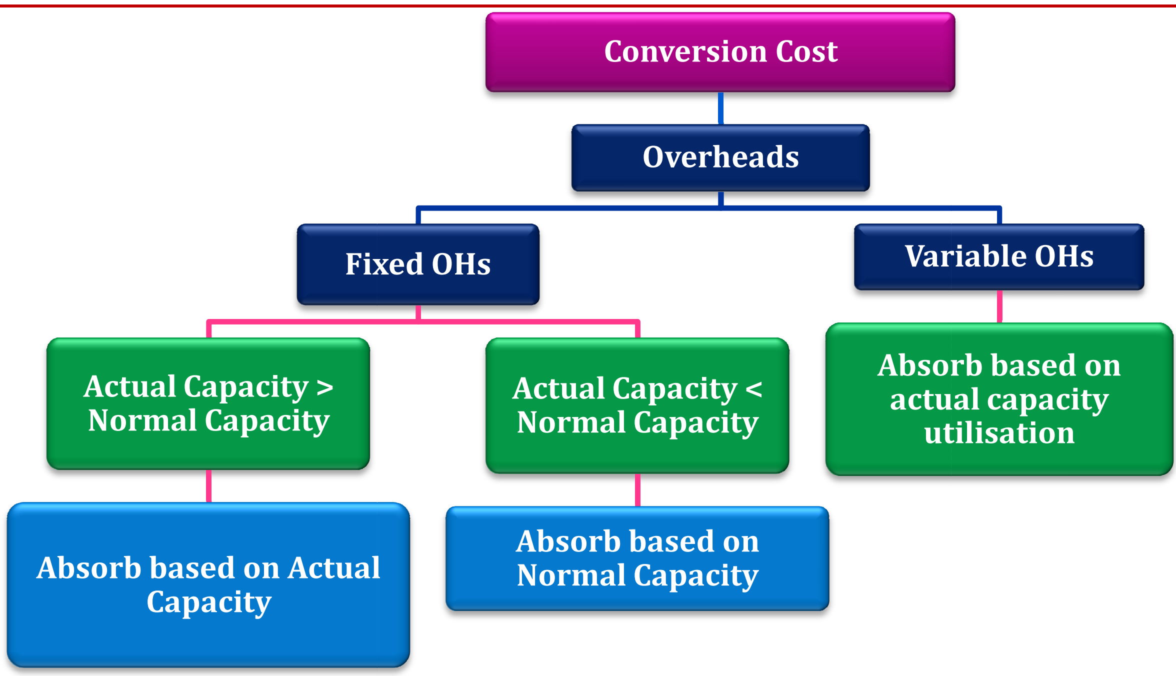
5 (2) Cost of Conversion

This includes the costs incurred to convert the raw materials into finished goods.

For example major costs like Labour, Factory rent, fuel costs, power expenses (factory overheads) and other items.
The overheads (OH) should be absorbed in the following manner:
Factory overheads can be divided into two types based on its nature i.e. variable overheads and fixed OH.

Variable expenses – which vary (change) along with the volume of production;
Fixed expenses – which do not vary with volume of production.

Chart Presentation



Normal Capacity (Meaning)

Normal Capacity is the number of units of production on an average over a period under normal Circumstances after considering loss of capacity under normal circumstances.
(Normal capacity = Total capacity Less planned maintenance)

Actual capacity (Meaning)

Actual capacity is **actual production** of goods.

1. Fixed Production Overhead will be taken in actual cost on recovery basis

$$\text{Overhead Recovery Rate} = \frac{\text{Production Overhead}}{\text{Normal Production}}$$

Overhead Recovered = Rate X Units Produced

2. If Actual production is very high, then take the actual production as denominator.

$$\text{Overhead Recovery Rate} = \frac{\text{Production Overhead}}{\text{Actual Production}}$$

Overhead Recovered = Rate X Units Produced

Examples of factory cost and these should be absorbed in the calculation of per unit cost.

1. Consumable stores and spares;
2. Depreciation of plant and machinery, factory building etc…
3. Lease rent of production assets;
4. Repair and maintenance of plant and machinery, factory building etc...
5. Indirect employees cost connected with production activities;
6. Drawing and Designing department cost;
7. Insurance of plant and machinery, factory building, stock of RM & WIP etc.
8. Amortized cost of jigs, fixtures, tooling etc.
9. Service department cost such as Tool Room, Engineering & Maintenance etc.

5 (3) Other Costs

All other costs incurred to bring the inventory to the present location and condition. Examples:

1. Quality control cost - quality control employee cost and other costs of that dept;
2. R&D cost incurred for the development and improvement of the process or product;
3. Administration OHs in relation to production activities; (General admin OHs should NOT be included);
4. Packaging cost - primary and secondary package cost should be included, etc.

Concept No. 6 Following cost should be excluded From "COST"

1. **Abnormal Loss** (Loss due to Fire, waste of materials, labour or other production costs)

2. Storage costs, unless those costs are necessary in the production process prior to a further production stage. (E.g. Electricity used for cold storage)	
3. Administrative, Selling and Distribution costs. (Expenses such as rent, staff salary, Electricity Bill)	
4. Borrowing costs (Interest)	

Concept No. 7 Allocation of costs in special situations:

Points	Joint Products	By Products
Meaning	Two or more outputs generated simultaneously, by a single manufacturing process using common input, and being substantially equal in value.	It is a secondary or incidental product in a process of manufacture and generally it has insignificant value.
Example	(1) Butter, cheese, and cream from milk, (2) Fuel oil, gasoline, and kerosene from crude oil.	In manufacture of Sugar - Sugar is main product and molasses is by product.
Allocation of Cost	In this case, the joint costs (common costs) are allocated between the products on a rational and consistent basis. a) On the Sales value of each product when the products become separately identifiable; (b) On the sale value after completion of production;	1. Find out the joint costs of main product & by products. 2. Compute Net realisable value of by product at the time of separation. 3. Cost of main product = total joint costs of main product & by product Less NRV of by product.

What Is Joint Product & By Product

Raw Material

Product A

Product B Is it Significant

Yes

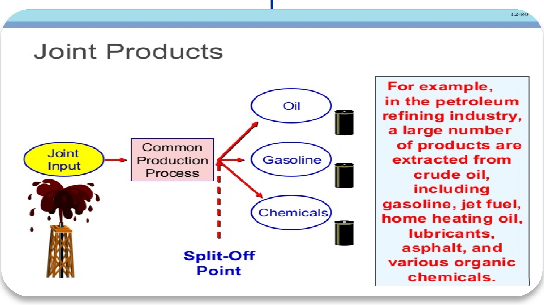
No

Joint Product

By Product

Two or more outputs generated simultaneously, by a single manufacturing process using common input, and being substantially equal in value.

It is a secondary or incidental product in a process of manufacture and generally it has insignificant value.



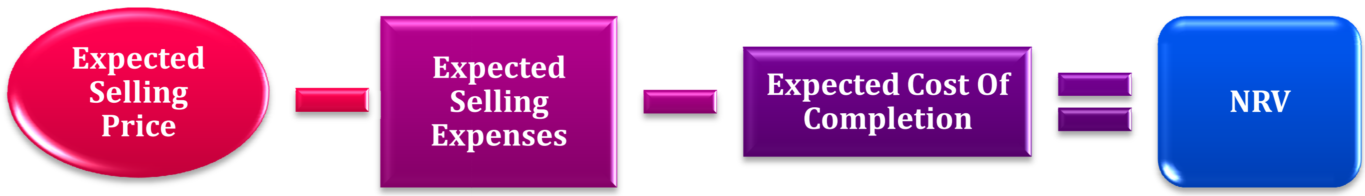
Concept No. 8 -_Methods of Ascertaining of Cost of Inventories

Cost of inventory should be ascertained in following manner

1. If stock in hand is unique not similar to each other, use Specific Identification Method.
2. If stock in hand is similar to each other, then use following two methods of stock valuation
   a) FIFO Method
   b) Weighted Average Method

Concept No. 9 – Net Realisable Value

Calculation of NRV



Expected Selling Price in ordinary course of business	xxx
Less:- Expected Selling Expenses	xxx
Less:- Expected Cost Of Completion	xxx
Net Realisable Value	**xxx**

Expected means management estimated, can be made due to contract received. It can be general price also.

Diagrammatical Presentation

9.1 NRV Of Work – In - Progress

WIP is the one which is not completed or partially completed. Finding out expected selling price for WIP is not possible as nobody purchases the WIP product. It is meant to be converted into FG and to sell as FG. Hence we start computing the NRV of WIP with Expected selling price of FG and deduct the costs to be incurred to complete it as FG & Costs incurred to sell.

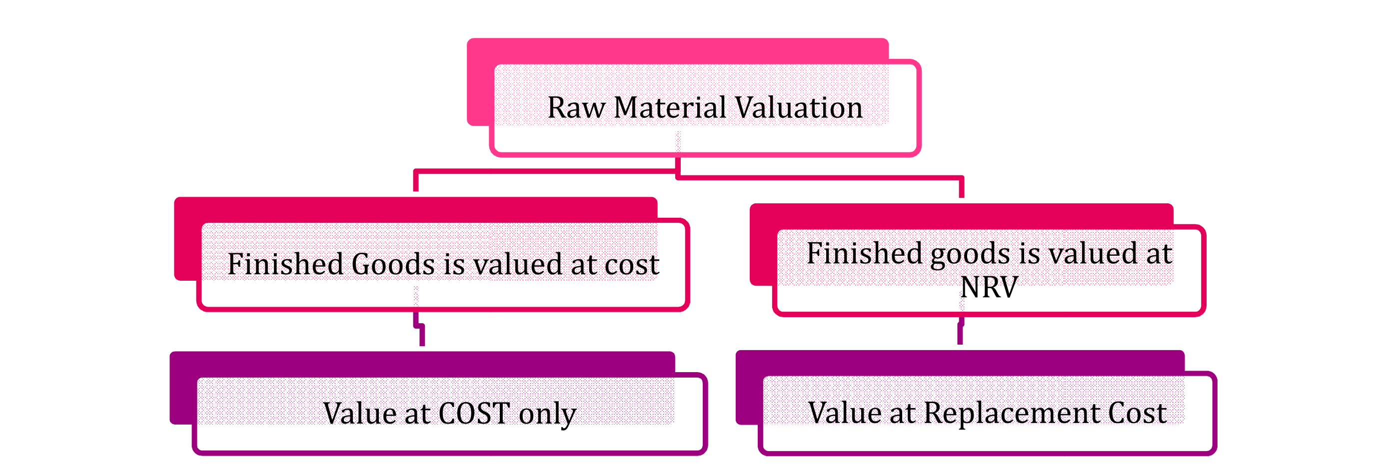
9.(2) Valuation of Raw Material Stock

Valuation of Raw Material is **NOT based on Cost (or) NRV whichever is less.**

Its valuation is fully based on the valuation of finished goods as the entity is purchasing raw material not to sell in the ordinary course of business as raw material BUT to use it for producing the finished goods.

Raw Material	Finished Goods	Valuation of Raw Material
		1. Stock of Raw material (wool) is valued at cost price, if finished goods(Sweater) in which such raw material used is valued at cost price. 2. Stock of Raw material (wool) is valued at Replacement Cost, if a finished goods (Sweater) is valued at NRV.
		1. Stock of Raw material (Leather) is valued at cost price, if finished goods(Shoes)in which such raw material used is valued at cost price. 2. Stock of Raw material (Leather) is valued at Replacement Cost, if a finished goods (Shoes) is valued at NRV.

Chart Presentation of Raw Material Valuation

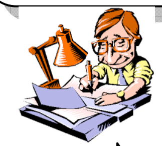


Disclosure Requirements Under AS - 2

Concept No. 10_Disclosure Requirements	
The financial statement should disclosed	
1. The accounting policies adopted in measuring inventories, including the cost formula used; 2. The total carrying amount of inventories and its classification appropriate to the enterprise.	

Chart AS – 2 Valuation of Inventories (Chart)

Inventory is an asset held for sale in the ordinary course of business (Finished goods), which is used in the process of production (Raw Material) or consumed in the process of production (Consumables and Loose tools)



Valuation of Inventory

1. ***Inventory is valued at COST (or) NRV whichever is LOWER***

Let us understand ***"What Cost of Inventory Includes"***

Cost of Purchase

Particulars	₹
Purchase price i.e. Basic price of material	--
Add	
NON refundable taxes & duties	--
Carrying Cost i.e. inward freight cost	--
Inward Insurance cost	--
All other costs incurred directly related to acquisition and bringing it to warehouse.	--
Less	
Trade discounts Quantity discounts	--
Duty drawbacks & other similar items	--
	--
Cost of Purchase	--

Cost of Conversion

This includes the costs incurred to convert the raw materials into finished goods. (I.e. Factory Overheads)

Absorption of Factory Overheads

- ***Fixed OHs***
  - *Actual Capacity > Normal Capacity* → *Absorb based on Actual Capacity*
  - *Actual Capacity < Normal* → *Absorb based on Normal Capacity*
- ***Variable OHs***
  - *Absorb based on actual capacity utilisation*

Example

Other Cost

All other costs incurred to bring the inventory to the present location and condition. E.g. R & D cost, Packaging cost, Administration OHs in relation to production activities

Cost of inventory should be ascertained in following manner

1. If stock in hand is unique not similar to each other, use Specific Identification Method.
2. If stock in hand is similar to each other, then use following two methods of stock valuation FIFO Method, Weighted Average Method

Following Cost should be Excluded from Cost – 1) Abnormal Loss 2) Storage Cost (Unless those cost are necessary for production process) 3) Administrative selling & distribution cost 4) Borrowing cost (Interest)

2. Let us see "How to Calculate Net Realisable Value

Net Realisable Value of

- ***Finished Goods*** – *Expected SP - Selling cost*
- ***Work in Progress*** – *Expected SP of FG - Expected cost to complete - Selling Cost*
- ***Raw Material*** – *Strictly, No need to determine NRV*

3. Valuation of Raw Material

Its valuation is fully based on the valuation of Finished Goods

- ***If finished goods is sold or expected to be sold at cost or above cost*** – ***Raw material should be valued at Cost***
- ***If finished goods is sold or expected to be sold below the cost*** – ***Raw material should be valued at Replacement Cost***

Examples

Or

4. *Disclosure Requirements –*
The financial statement should disclosed

1. ***The accounting policies adopted in measuring inventories, including the cost formula used. The accounting policies adopted in measuring inventories, including the cost formula used***
2. ***The total carrying amount of inventories and its classification appropriate to the enterprise.***

Question No. 1 **(PM)**

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

Question 2 **(PM)**

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 2014-15, the Historical Cost and Net Realizable Value of the items of closing stock are determined as follows:

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

What will be the value of closing stock?

Question 3 **(PM)**

X Co. Limited purchased goods at the cost of ₹ 40 lakhs in October, 2014. Till March, 2015, 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. Advise, what is the correct closing stock to be disclosed as at 31.3.2015.

Question 4 **(PM)**

The company X Ltd., has to pay for delay in cotton clearing charges. The company up to 31.3.2014 has included such charges in the valuation of closing stock. This being in the nature of interest, X Ltd. decided to exclude such charges from closing stock for the year 2014-15. This would result in decrease in profit by ₹ 5 lakhs. Comment

Question 5 **(PM)**

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. Cost per MT of input is ₹ 1,000. The entire quantity of waste is on stock at the year end. State with reference to Accounting Standard, how will you value the inventories in this case?

Question 6 **(Nov. 2012, 4 Marks)**

From the following information, ascertain the value of stock as on 31st March, 2012:

Particulars	₹
Stock as on 01-04-2011	28,500
Purchases	1,52,500
Manufacturing Expenses	30,000
Selling Expenses	12,100

Administration Expenses	6,000
Financial Expenses	4,300
Sales	2,49,000

At the time of valuing stock as on 31st March, 2011, a sum of ₹ 3,500 was written off on a particular item, which was originally purchased for ₹ 10,000 and was sold during the year for ₹ 9,000. Barring the transaction relating to this item, the gross profit earned during the year was 20% on sales

Question 7 **(PM)**

You are required to value the inventory per kg of finished goods consisting of:

	₹ per kg.
Material cost	200
Direct labour	40
Direct variable overhead	20

Fixed production charges for the year on normal working capacity of 2 lakh kgs is ₹ 20 lakhs. 4,000 kgs of finished goods are in stock at the year end

Question 8 **(PM) (May 2013, 4 Marks)**

On 31st March 2013 a business firm finds that cost of a partly finished unit on that date is ₹ 530. The unit can be finished in 2013-14 by an additional expenditure of ₹ 310. The finished unit can be sold for ₹ 750 subject to payment of 4% brokerage on selling price. The firm seeks your advice regarding the amount at which the unfinished unit should be valued as at 31st March, 2013 for preparation of final accounts.

Question 9 **(PM) (May 2014, 4 Marks)**

Calculate the value of raw materials and closing stock based on the following information:

Raw material X Closing balance	500 units

	₹ Per unit
Cost price including excise duty	200
Excise duty (Cenvat credit is receivable on the excise duty paid)	10
Freight inward	20
Unloading charges	10
Replacement cost	150

Finished goods Y Closing Balance	1200 units

	₹ per unit
Material consumed	220
Direct labour	60
Direct overhead	40

Total Fixed overhead for the year was ₹ 2,00,000 on normal capacity of 20,000 units. Calculate the value of the closing stock, when

(i) Net Realizable Value of the Finished Goods Y is ₹ 400.
(ii) Net Realizable Value of the Finished Goods Y is ₹ 300.

Question 10 **(PM) (Nov. 2014, 5 Marks)**

Capital Cables Ltd., has a normal wastage of 4% 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 wants 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 abnormal loss and also find out the amount of abnormal loss if any.

Question 11 **(May 2015, 5 marks)**

Mr. Mehul gives the following information relating to items forming part of inventory as on 31-3-2015. His factory produces Product X using Raw material A.

1) 600 units of Raw material A (purchased @ ₹ 120). Replacement cost of raw material A as on 31-3-2015 is ₹ 90 per unit.
2) 500 units of partly finished goods in the process of producing X and cost incurred till date ₹ 260 per unit. These units can be finished next year by incurring additional cost of ₹ 60 per unit.
3) 1500 units of finished Product X and total cost incurred ₹ 320 per unit.

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

Determine how each item of inventory will be valued as on 31-3-2015. Also calculate the value of total inventory as on 31-3-2015.

Additional Questions with Answer

Question No. 1 **RTP May 2012**

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.

Answer

Calculation of total cost of material as per AS-2

	₹
Purchase price (16,000 kg. x ₹ 160)	25,60,000
Less : CENVAT credit (16,000 kg. x ₹ 10)	(1,60,000)
	24,00,000
Add : Freight	1,40,160
Total material cost	25,40,160

Number of units after normal loss = 16,000 kg. x (100-2)% = 15,680 kg

Revised cost per kg. = $\frac{25,40,160}{15,680 \text{ kg}}$ = ₹ 162 per kg

Closing inventory = Material actually received - Material consumed
= 15,500 kg - 13,600 kg = 1,900 kg

Value of closing stock = 1,900 kg x ₹ 162 = ₹ 3,07,800

Abnormal loss in kg = Material after normal loss - Material actually received
=15,680 kg - 15,500 kg = 180 kg

Abnormal loss in value = 180 kg x ₹ 162 = ₹ 29,160

Question No. 2 **RTP May 2013**

The closing inventory at cost of XYZ Ltd. amounted to ₹ 9,56,700. 350 Shirts, which had cost ₹ 380 each and normally sold for ₹ 750 each are included in this amount of ₹ 9,56,700. Owing to a defect in manufacture, they were all sold after the Balance Sheet date at 50% of their normal price. Selling expenses amounted to 5% of the proceeds. What should be the closing inventory value?

Answer

Calculation of value of closing inventory

	₹
Value of closing inventory (given)	9,56,700
Less: Adjustment to bring the stock of shirts at NRV (W.N 1)	(8,313)
Revised value of closing inventory as per AS 2	9,48,387

Working Notes:

1. **Valuation of Shirts as per AS 2**

	₹
Cost price (per shirt)	380
NRV per shirt :	
Sale price (per shirt) ₹ 750 × 50% = 375.00	
Less : Selling expenses (5% of ₹ 375) = (18.75)	
NRV (per shirt) 356.25	
As per AS 2, inventories are valued at cost or NRV whichever is less	356.25
Difference of cost and NRV	23.75

Therefore, value of inventory of shirts to be reduced by ₹ 8,313 (approx) (₹ 23.75 x 350 shirts)

Question No. 3 — RTP Nov 2013

U.S.A Ltd. purchased raw material @ ₹ 400 per kg. Company does not sell raw material but uses it in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year, company is having 10,000 kg of raw material in stock. As the company never sells the raw material, it does not know the selling price of raw material and hence cannot calculate the realizable value of the raw material for valuation of inventories at the end of the year. However replacement cost of raw material is ₹ 300 per kg. How will you value the inventory of raw material?

Answer

As per AS 2 "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, 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 realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. Therefore, in this case, USA Ltd. will value the stock of raw material at ₹ 30,00,000 (10,000 kg. @ ₹ 300 per kg.).

Question No. 4 — RTP May 2014

Alpha Ltd. sells beer to customers; some of the customers consume the beer in the bars run by Alpha Limited. While leaving the bars, the consumers leave the empty bottles in the bars and the company takes possession of these empty bottles. The company has laid down a detailed internal record procedure for accounting for these empty bottles which are sold by the company by calling for tenders. Keeping this in view:

(i) Decide whether the inventory of empty bottles is an asset of the company;

(ii) If so, whether the inventory of empty bottles existing as on the date of Balance Sheet is to be considered as inventories of the company and valued as per AS 2 or to be treated as scrap and shown at realizable value with corresponding credit to 'Other Income'?

Answer

(i) Tangible objects or intangible rights carrying probable future benefits, owned by an enterprise are called assets. Alpha Ltd. sells these empty bottles by calling tenders. It means further benefits are accrued on its sale. Therefore, empty bottles are assets for the company.

(ii) As per AS 2 "Valuation of Inventories", inventories are assets held for sale in the ordinary course of business. Inventory of empty bottles existing on the Balance Sheet date is the inventory and Alpha Ltd. has detailed controlled recording and accounting procedure which duly signify its materiality. Hence inventory of empty bottles cannot be considered as scrap and should be valued as inventory in accordance with AS 2.

Question No. 5 — **RTP Nov 2014,2017**

A company had 5,000 units of stock"A", costing @ ₹ 50 each on 31.3.2014. Out of this stock, 3,000 units are to be supplied under a firm contract at ₹ 45 each. Show how the valuation will be done of such stock when

(i) The general selling price is ₹ 49 each.

(ii) The general selling price is ₹ 52 each.

Answer

(i) Valuation of stock as on 31.3.2014 when general selling price is ₹ 49 each.

Value 3,000 units at ₹ 45 each (lower of cost and net realizable value). Value remaining 2,000 units at ₹ 49 each (lower of cost and net realizable value).

Units	*Cost*	*NRV*	*Lower of cost and NRV*	*Valuation*
1	*2*	*3*	*4*	*5 = 1x4*
3000	50	45	45	1,35,000
2000	50	49	49	98,000
				2,33,000

Valuation of stock should be ₹ 2,33,000.

(ii) Valuation of stock as on 31.3.2014 when general selling price is ₹ 52 each

Units	*Cost*	*NRV*	*Lower of cost and NRV*	*Valuation*
1	*2*	*3*	*4*	*5 = 1x4*
3000	50	45	45	1,35,000
2000	50	52	50	1,00,000
				2,35,000

Valuation of stock should be ₹ 2,35,000.

Question No. 6 — **RTP Nov 2015**

CC Ltd., a Pharmaceutical Company, while valuing its finished stock at the year end wants to include interest on Bank Overdraft as an element of cost, for the reason that overdraft has been taken specifically for the purpose of financing current assets like inventory and for meeting day to day working expenses". State your comments on this treatment.

Answer

As per Accounting Standard 2 "Valuation of Inventories", cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. However, it makes clear that interest and other borrowing costs are usually not included in the cost of inventories because generally such costs are not related in bringing the inventories to their present location and condition. Therefore, the proposal of CC Ltd. to include interest on bank overdraft as an element of cost is not acceptable because it does not form part of cost of production.

Question No. 7 **RTP May 2016**

On the basis of information given below, find the value of inventory (by periodic inventory method) as per AS 2, to be considered while preparing the Balance Sheet as on 31St March, 2015 on weighted Average Basis.

Details of Purchases:

Date of purchase	Unit (Nos.)	Purchase cost per unit (₹)
01-03-2015	20	108
08-03-2015	15	107
17-03-2015	30	109
25-03-2015	15	107

Details of issue of Inventory:

Date of Issue	Unit (Nos.)
03-03-2015	10
12-03-2015	20
18-03-2015	10
24-03-2015	20

Net realizable value of inventory as on 31st March, 2015 is ₹107.75 per unit. What will be the value of Inventory as per AS 2?

Answer

Net Realisable Value of Inventory as on 31st March, 2015

= ₹107.75 x 20 units = ₹ 2,155

Value of inventory as per Weighted Average basis

Total units purchased and total cost:

01.03.2015	₹ 108 x 20 units = 2160
08.3.2015	₹ 107 x 15 units =₹ 1605
17.03.2015	₹ 109 x 30 units = ₹ 3270
25.03.2015	₹ 107 x 15 units = ₹ 1605
Total	80 units = ₹ 8640

Weighted Average Cost = ₹ 8640180 units = ₹108
Total Value = ₹ 108 x 20 units = ₹ 2,160

Value of inventory to be considered while preparing Balance Sheet as on 31st March, 2015 is, Cost or Net Realisable value whichever is lower i.e. ₹ 2,155.

Question No. 8 — RTP Nov 2016, 2017

Hello Ltd. purchased goods at the cost of 20 lakhs in October. Till the end of the financial year, 75% of the stocks were sold. The Company wants to disclose closing stock at 5 lakhs. The expected sale value is ₹ 5.5 lakhs and a commission at 10% on sale is payable to the agent. What is the correct value of closing stock?

Answer

As per AS 2 "Valuation of Inventories", the inventories are to be valued at lower of cost or net realizable value.
In this case, the cost of inventory is ₹ 5 lakhs. The net realizable value is ₹ 4.95 lakhs (₹ 5.5 lakhs less cost to make the sale @ 10% of ₹ 5.5 lakhs). So, the closing stock should be valued at ₹ 4.95 lakhs.

Question No. 9 — RTP May 2017

Suraj Stores is a departmental store, which sell goods on retail basis. It makes a gross profit of 20% on net sales. The following figures for the year-end are available:
Opening Inventory ₹ 50,000; Purchases ₹ 3,60,000; Purchase Returns ₹ 10,000; Freight Inwards ₹ 10,000; Gross Sales ₹ 4,50,000; Sales Returns ₹ 11,250; Carriage Outwards ₹ 5,000.
Compute the estimated cost of the inventory on the closing date.

Answer

Calculation of cost of closing inventory

Particulars	**₹**
Opening Inventory	50,000
Purchases less returns (₹3,60,000 -₹ 10,000)	3,50,000
Freight Inwards	10,000
	4,10,000
Less: Net Sales (₹ 4,50,000 -₹ 11,250)	(4,38,750)
	(28,750)
Add: Gross Profits (₹ 4,38,750 x 20%)	87,750
Closing Inventory	**59,000**

Question No. 10 — RTP May 2018

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

Answer

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

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

Question No. 11 **RTP Nov. 2018**

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

Raw Material X	**₹ Per unit**
Cost price	380
Unloading Charges	20
Freight Inward	40
Replacement cost	300

Chemical Y

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

(i) Net realizable value of Chemical Y is ₹ 800 per unit
(ii) Net realizable value of Chemical Y is ₹ 600 per unit

Answer

(i) When Net Realizable Value of the Chemical Y is ₹ 800 per unit

NRV is greater than the cost of Finished Goods Y i.e. ₹ 660 (Refer W.N.)

Hence, Raw Material and Finished Goods are to be valued at cost.

Value of Closing Stock:

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

(ii) When Net Realizable Value of the Chemical Y is ₹ 600 per unit

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 (₹)*	*Amount (₹)*
Raw Material X	1,000	300	3,00,000
Finished Goods Y	2,400	600	14,40,000
Total Value of Closing Stock			17,40,000

Working Note:

Statement showing cost calculation of Raw material X and Chemical Y.

Raw Material X	₹
Cost Price	380
Add: Freight Inward	40
Unloading charges	20
Cost	**440**
Chemical Y	₹
Materials consumed	440
Direct Labour	120
Variable overheads	80
Fixed overheads (₹4,00,000/20,000 units)	20
Cost	**660**