DISCLOSURE OF ACCOUNTING POLICIES

ACCOUNTING STANDARD 1

Meaning of Accounting Policies:
The accounting policies are specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.

Need for Accounting Policies:
There is no single list of accounting policies. The different circumstances in which enterprise operate, i.e., in a situation of diverse and complex economic activity, make alternate principles and methods of applying those principles acceptable.
Since accounting policies vary from enterprise to enterprise, disclosure of the accounting policies would facilitate a meaningful comparison between financial statements of different enterprises.

Areas in which different accounting policies are encountered:

- Treatment of expenditure during construction
- Conversion or translation of foreign currency items
- Valuation of inventories
- Treatment of goodwill
- Valuation of investments
- Treatment of retirement benefits
- Recognition of profit on long term contracts
- Recognition of PPE
- Treatment of contingent liabilities

(The above list of examples is not intended to be exhaustive)

For example:

Items to be disclosed	Method of disclosure or valuation
Inventories	FIFO, Weighted Average etc.
Cash Flow Statement	Direct Method, Indirect Method
PPE	Cost Model, Revaluation Model

Selection of an Accounting Policy:
While selecting an accounting policy, the primary consideration is that the financial statements prepared and presented on the basis of such policies should represent a true and fair view of the financial statements.
For this purpose, major considerations are concept of prudence, substance over form and materiality.

a) Prudence:
There is always an uncertainty attached to future events. Therefore, profits are not anticipated but recognised only when realised though not necessarily in cash.
Whereas, provision is made for all known liabilities and losses even though the amount cannot be determined with certainty. The amount of provision represents an estimate of probable liability or loss. The exercise of prudence in selection of accounting policies ensure that (i) profits are not overstated (ii) losses are not understated (iii) assets are not overstated and (iv) 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
= Sale – Cost of goods sold = (400 x ₹ 15) – (500 x ₹ 10 – 100 x ₹ 10) = ₹ 2,000

Profit of the trader if net realisable value of unsold article is ₹ 8
= Sale – Cost of goods sold = (400 x ₹ 15) – (500 x ₹ 10 – 100 x ₹ 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.

b) Substance over Form:

The accounting treatment and presentation in financial statements of transactions and events should be according to their substance and not merely by legal form.

c) Materiality:

Financial statements should disclose all "material" items, i.e. items the knowledge of which may influence the decisions of the user of the financial statements.

Fundamental Accounting Assumptions:

1) **Going Concern:** Going Concern means continuity of operations for the foreseeable future. The enterprise has neither the intention nor the necessity of liquidation or reducing the scale of the operations.
2) **Consistency:** Consistency means that same accounting policies are followed by an enterprises in all the periods unless the change is required (i) by a statute, (ii) by a accounting standard or (iii) for more appropriate presentation of financial statements.
3) **Accrual:** Accrual means that revenues are recognised when these are earned and costs are recognised when these are incurred. Timing of actual receipt of revenue or payment of expenditure are irrelevant. These are recorded in the financial statements of the periods to which they relate.

Disclosure Requirements:

1. All significant accounting policies are to be disclosed.
2. These should form integral part of the financial statements.
3. These should be disclosed at one place.
4. If there is any change in accounting policy having material impact in the current year or likely impact in future, the fact is to be disclosed.
5. The impact on financial statements of the current year due to change in policy should be disclosed (amount).
6. In case the impact on current year due to change in policy is not ascertainable, the fact is to be disclosed*.
7. Going Concern/Consistency/Accrual - If followed, no need to disclose. (These are fundamental accounting assumptions and their acceptance and use is assumed in all financial statements)
8. Going Concern/Consistency/Accrual - If not followed, disclose the fact.

*The above requirement ensures that all important changes in accounting policies are actually disclosed. Suppose a company makes provision for warranty claims based on estimated costs of materials and labour. The company changed the policy in 2014- 15 to include overheads in estimating costs for servicing warranty claims. If value of warranty sales in 2014-15 is not significant, the change in policy will not have any material effect on financial statements of 2014-15. Yet, the company must disclose the change in accounting policy in 2014-15 because the change can affect future accounting periods when value of warranty sales may rise to a significant level. If the disclosure is not made in 2014-15, then no disclosure in future years will be required. This is because an enterprise has to disclose changes in accounting policies in the year of change only

Note: Disclosure of accounting policies cannot remedy a wrong or inappropriate treatment in the accounts.

QUESTION 1

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?

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 acquisition/disposal (by the transferee and transferor respectively) would, in substance, represent the purchase/sale. In view of this A Ltd., should record the sales and recognize the profit of ₹ 15 lakhs in its profit and loss account. It should eliminate building from its balance sheet. In notes to accounts, it should disclose that building has been sold, full consideration has been received, possession has been handed over to the buyer and documentation and legal formalities are pending.

The buyer should recognize the building as an asset in his balance sheet and charge depreciation on it. The buyer should disclose in his notes to account that possession has been received however documentation and legal formalities are pending.

QUESTION 2

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-I.

ANSWER

As per para 22 of 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'.

QUESTION 3

ABC Ltd. was making provision for non-moving stocks based on no issues for the last 12 months up to 31.3.2015.

The company wants to provide during the year ending 31.3.2015 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?

ANSWER

The decision of making provision for non-moving stocks on the basis of technical evaluation does not amount to change in accounting policy. Requirement to provide for non-moving stocks may be said as accounting policy but the basis for making provision will not constitute accounting policy. It will be considered as an accounting estimate. Further, 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 stock, the change in the amount of required provision of non-moving stock 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 2014-15:

"The company has provided for non-moving stocks 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 higher by ₹ 1 lakh."

QUESTION 4

Jagannath Ltd. had made a rights issue of shares in 2012. In the offer document to its members, it had projected a surplus of ₹ 40 crores during the accounting year to end on 31st March, 2014. 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) 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 2013-2014.

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) 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 5

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

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 nonpayment 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 6

Om Limited purchases goods on behalf of its customers for execution of 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.

QUESTION 7

(a)	Loan o/s in the books of the company. Due to trading losses, the company has not recognized accrued interest in the books of accounts treating it as contingent liability. Comment. [ANSWER: Treatment is wrong. Going by accrual concept and adopting prudence principle as per AS 1, accrued interest must be recognized in the books of the company.]
(b)	The company entered into 'agreement to sell' for sale of building costing 30 lakhs for 50 lakhs and received advance ₹ 5 lakhs as at book closure date. Comment. [ANSWER: Record the advance received as a liability.]
(c)	What are the three fundamental accounting assumptions recognised by AS 1?
(d)	Mention few areas in which different accounting policies are followed by companies.

QUESTION 8

State whether the following statements are 'True' or 'False'. Also give reason for your answer.
1. Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.
2. If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.
3. All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.
4. Any change in an accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need not to be indicated.

Answer
1. False; As per AS 1 “Disclosure of Accounting Policies”, certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.
2. False; As per AS 1, 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.
3. True; To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed in one place.
4. False; 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. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

VALUATION OF INVENTORIES

ACCOUNTING STANDARD 2 (REVISED)

Inventories are assets held for sale in the ordinary course of business; in the process of production for such sale; or in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Measurement of Inventories:
Inventories are to be valued at lower of cost and net realisable value.

Cost :
It comprises of following:
(a) Cost of Purchase
(b) Cost of Conversion
(c) Other costs incurred in bringing the inventories to their present location and condition.

Cost of Purchase:
It comprises of following:
(a) Purchase Price (Net of Input tax credit)
(b) Duty/Taxes (except recoverable in nature)
(c) Freight Inward
(d) Other Directly attributable expenses.
(Trade discount / rebate / duty drawbacks etc. are to be deducted).

Conversion Cost:
It comprises of following:
(a) Direct Labour
(b) Fixed Production Overhead (based on normal capacity)
(in case of abnormally high production -- use actual production)
(c) Variable Production Overhead (as per actual use)
(indirect material, indirect labour etc)

Other Costs:
Other Costs include cost specifically incurred and directly related to a product. e.g. Designing of specific product.

Net Realisable Value : Net Realisable value is determined as under:
Estimated Selling price
(less) Estimated cost of completion
(less) Estimated cost necessary to make sale

- Assessment of net realisable value is to be made at each Balance Sheet date.
- Inventories are written down on item by item basis.
  (Except if relating to same product line and not practicable to evaluate separately.)
- Consider events occurring after Balance Sheet date, but event must confirm to conditions existing at Balance Sheet date.
- Purpose of stock: Contract Sales
  (a) Then, record such inventory at cost or contract price, whichever is lower.
  (b) Excess stock than contract, if any, at cost or NRV, whichever is lower.
- Raw Material -- If finished goods are expected to be sold at cost / above cost
  (a) Then, record Raw Materials at cost.
  (b) Otherwise record at net realisable value. Best alternate of net realizable value is to record raw material at replacement value.

Following are excluded from cost:

- Abnormal wastage of material, labour or other costs
- Storage cost not related to production process.
- Administrative expenses not connected with bringing inventories to their present location and condition.
- Selling & distribution expenses
- *Interest expenses are usually not related to bringing inventories to their present location and condition.
  [* Exception : In case of wine etc.…..]

Cost Formulas:

In case goods can be specifically identified, apply specific identification method.
In other cases, apply First in first out method or Weighted Average Cost method. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the enterprise.
Standard cost method can be used for convenience if result approx. actual cost. Retail inventory method can be applied in case of very large variety of inventory is required to be maintained.

Disclosure Requirements

(a) Accounting policy and cost Formula used
(b) Carrying amount of inventories and its classification

Common Classification:

a) Raw Materials and components
b) Work in Progress
c) Finished Goods
d) Stock in trade (in respect of goods acquired for trading)
e) Stores and Spares
f) Loose Tools
g) Others (specify nature)

Exclusions:

This Accounting Standard does not apply to following:

- Work in progress under Construction Contract (These are dealt in AS 7)
- Work in progress in ordinary course of business of service provider
- Shares, debentures and other financial instruments held as stock in trade
- Producer's inventories of live stock, agricultural and forest products and mineral oils, ores and gases to the extent they are measured at net realisable value as per well established practice in those industries
- Inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of property, plant and equipment as per AS 10, property, plant and equipment. Such items are accounted for in accordance with AS 10, property, plant and equipment.

QUESTION 1

M/s Aspects Limited manufactures motor cars. During the year ended 31.03. 2010, the company manufactured 800 motor cars. It had closing stock of 30 motor cars as on 31.03. 2010. The detail of the cost is as under:

	(₹ in Lacs)
Raw material consumed	650
Direct labour	175
Variable production overheads	180
Fixed production overheads (Including interest of ₹ 50 Lakhs)	240

Compute:
(a) Cost per motor car ; (b) Value of closing stock as on 31.03. 2010.

ANSWER

TOTAL PRODUCTION COST/ FACTORY COST

	(₹in Lacs)
Raw material consumed	650
Direct labour	175
Variable production overheads	180
Fixed Production overheads (excluding interest)	190
	1195

Total units (cars) produced = 800

a) Cost per car = ₹ 1,49,375 (11,95,00,000 ÷ 800)

b) Value / carrying amount of closing stock as 31.3. 2010 = ₹ 44,81,250 (1,49,375 X 30)

QUESTION 2

The production details of M/s Aspects Ltd. are given below:

Normal Production 2,50,000 units
Fixed Production overheads ₹ 10,00,000
Actual Production
(a) When Actual production is 2,50,000 units
(b) When Actual production is 2,00,000 units
(c) When Actual production is 3,00,000 units

Decide the allocation of fixed production overheads to inventory in above situations.

ANSWER

Answer to Point A & point B will be based on normal production capacity.
Thus, fixed production overhead per unit will be

a) $\frac{\text{Total fixed Production Overheads}}{\text{Normal production capacity}}$

$= \frac{10,00,000}{2,50,000} = ₹\ 4$

b) $\frac{\text{Total fixed Production Overheads}}{\text{Normal production capacity}}$

$= \frac{10,00,000}{2,50,000} = ₹\ 4$

c) In case of abnormally high production, fixed production overhead allocated on basis of actual production.

Fixed production overhead per unit will be

$= \frac{\text{Total fixed Production Overheads}}{\text{Actual Production}}$

$= \frac{10,00,000}{3,00,000} = ₹\ 3.33$

QUESTION 3

M/s Aspects Ltd., a dealer in motor cars has purchased 100 Motor Cars at a cost of ₹ 2,00,000 each in the last week of March, 2010. The inventory as on 31.03.2010 comprises these 100 motor cars only. Of these 20 are earmarked against a sales contract at a price of ₹ 1,95,000 each against an earlier contract.. The general sale price of this brand has increased to ₹ 2,10,000. Sales contract is committed by both the parties. You are required to value stock of motor cars as on 31.03. 2010.

ANSWER

Closing inventory to be valued at cost or net realisable value (or contract price), whichever is less. Thus carrying amount of stock as on 31.3. 2010 will be

=(20 X 195000) + (80 X 200000) = 3900000 + 16000000 = ₹ 1,99,00,000

QUESTION 4

M/s Aspects Ltd.has 100 computers in stock as on 31st, March 2010. The computers are valued at net realisable value since their cost of manufacturing is very high. Of the 100 computers, 75 were sold at ₹ 25,000 each in April, 2010, i.e, before signing the accounts as against estimated sale price of ₹ 24,000 as on balance sheet date.. Of the balance 25 computers, 10 were under a contract at ₹ 22,000 each and the other 15 were to be sold in May, 2010, i.e., after signing of balance sheet, when the price is expected to be at ₹ 24,000 each. Determine the value of stock on 31 March, 2010.

ANSWER

As per AS-2 read with AS-4, the carrying amount of stock will be

=(75 X 25000) + (10 X 22000)+ (15 X 24000) = 1875000 + 220000+360000 = ₹ 24,55,000

QUESTION 5

M/s Aspects Ltd. has outstanding contract for supply of 500 computers for ₹ 30,000 each. The computers are being manufactured by the company in one of its factories and the cost incurred till the balance sheet date is ₹ 20,650 per unit. The total number of units under production as on 31.03. 2010 are 700 units. The company expects that it will have to incur another ₹ 8,000 per unit to complete the manufacture and a further sum of ₹ 800per unit for delivering the computers to the location of the customer. Ascertain the per unit value of stock in hand as on 31.03. 2010.

ANSWER

Closing stock should be carried at cost or net realisable value whichever is less.

Cost per unit = 20650

Net realisable value per unit = 21200 (i.e.30000 – 8000-800)

Thus, carrying amount per unit will be = 20650

QUESTION 6

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

(i) 600 units of Raw material A (purchased @ ₹ 120). Replacement cost of raw material A as on 31-3-2017 is ₹ 90 per unit.

(ii) 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.

(iii) 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 31-3-2017. Also calculate the value of total inventory as on 31-3-2017.

ANSWER

As per AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value. In the given case, selling price of product X is ₹ 300 and total cost per unit for production is ₹ 320.

Hence the valuation will be done as under:

(i) 600 units of raw material will be written down to replacement cost as market value of finished product is less than its cost, hence valued at ₹ 90 per unit.

(ii) 500 units of partly finished goods will be valued at 240 per unit i.e. lower of cost (₹ 260) or Net realisable value ₹ 240 (Estimated selling price ₹ 300 per unit less additional cost of ₹ 60).

(iii) 1,500 units of finished product X will be valued at NRV of ₹ 300 per unit since it is lower than cost ₹ 320 of product X.

Valuation of Total Inventory as on 31.03.2017:

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

QUESTION 7

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.

	₹ Per unit
Raw Material X	
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

(a) Net realizable value of Chemical Y is ₹ 800 per unit

(b) Net realizable value of Chemical Y is ₹ 600 per unit

ANSWER

(a) 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

(b) 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

QUESTION 8

Z Limited ordered 13,000 kg. of chemicals at ₹ 92.50 per kg. The purchase price includes GST of ₹ 7.50 per kg, in respect of which full ITC is admissible. Freight incurred amounted to ₹ 34,180. Normal transit loss is 4%. The company actually received 12,400 kg and consumed 10,000 kg. The company has received trade discount in the form of cash amounting to ₹ 1 per kg. The chemicals were delivered in containers. The containers were not reusable, hence sold for ₹ 500. The administrative expenses incurred to bring the chemicals were ₹ 10,000.
Compute the value of inventory and allocate the material cost as per AS-2.

ANSWER

Normal Cost per unit

	₹
Purchase price (Net of discount and ITC) [13000 X (92.5 – 1 – 7.5)]	10,92,000
Add: Freight	34,180
Add: Allocated administrative expenses	10,000
Less: Realisable value of empties	(500)
Total material cost	11,35,680
Number of units to be normally received [96% of 13000]	12,480
Normal cost per kg [1135680 / 12480]	91

Allocation of material cost

	Kg	₹ Per Kg	₹
Material consumed	10,000	91	9,10,000
Cost of closing inventory of material	2,400	91	2,18,400
Abnormal Loss (To be transferred to P & L)	80	91	7,280
Total material cost	12,480		11,35,680

QUESTION 9

Raw material inventory of a company includes 1 kg. of 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 ₹ 80 per kg. It is possible to corporate the material in a finished product. The conversion cost (wages and overheads) is ₹ 120.Inventory values for expected selling prices of the finished product (a) ₹ 195 b) ₹ 230 and (c) ₹ 210 are shown below. Find the carrying amount of inventory.

ANSWER

In all cases ,current price of material (₹ 80) is less than material cost ₹ 100

Case (a):

Selling price = ₹ 195
Incremental revenue =₹ 195 – ₹ 120 = ₹ 75
Current price of material = ₹ 80
<u>It is better to not to make the product</u>
Net realisable value (Replacement cost) ₹ 80 Vs Cost of material ₹ 100
Thus, carrying amount of inventory will be = ₹ 80

Case (b):

Selling price = ₹ 230
Incremental revenue =₹ 230 – ₹ 120 = ₹ 110
Current price of material = ₹ 80
<u>It is better to make the product</u>
Net realisable value ₹ 110 Vs Cost of material ₹ 100
Thus, carrying amount of inventory will be = ₹ 100

Case (c):

Selling price = ₹ 210
Incremental revenue =₹ 210 – ₹ 120 = ₹ 90
Current price of material = ₹ 80
<u>It is better to make the product</u>
Net realisable value ₹ 90 Vs Cost of material ₹ 100
Thus, carrying amount of inventory will be = ₹ 90

QUESTION 10

M/s Aspects 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.

ANSWER

Cost of inventories : 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, 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, interest on bank draft cannot be included in the cost of production.

QUESTION 11

Comment on following accounting treatment :
Inventories of a motor car manufacturing company include the items valued at cost price, which are required for the manufacturing of a motor car model which was discontinued two years back.

ANSWER

Treatment is incorrect. These are required to be valued at Net realisable value.

QUESTION 12

Cost of closing inventory ₹ 2,84,700. Besides other items, it also includes :

(i) 400 coats costing ₹ 80 each. Expected selling price ₹ 75 per coat. Selling expenses estimated to be 5% of sale proceeds.

(ii) 800 skirts costing ₹ 20 each. These were found defective and thus expected that remedial work will cost ₹ 5 per skirt. Expected selling price ₹ 28 per skirt. Selling expenses estimated to be ₹ 800 in total.

Find carrying amount of closing inventory.

ANSWER

	₹	₹
Cost of total inventory		2,84,700
(i) @ Coats		
Cost [400 X 80]	32000	
NRV [400 X (75 -5%)]	28500	
Diminution in the value of said coats (32000 – 28500)		(3,500)
(ii) @ Skirts		
Cost [800 X 20]	16000	
NRV [(800 X 28) – (800 X 5) – 800]	17600	
No diminution in the value of said skirts		-
Carrying value of inventories		2,81,200

QUESTION 13

The Company 'X Ltd.' has to pay for delay in cotton clearing charges. The company upto last year 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 from the current year onwards. This will result in decrease in profit by ₹ 5,00,000. Is it change in accounting policy or change in accounting estimate.

ANSWER

As per para 12 of AS 2 (revised), 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. However, X Ltd. was in practice to charge the cost for delay in cotton clearing in the closing stock. As X Ltd. decided to change this valuation procedure of closing stock, this treatment will be considered as a change in accounting policy and such fact to be disclosed as per AS 1. Therefore, any change in amount mentioned in financial statement, which will affect the financial position of the company should be disclosed properly as per AS 1, AS 2 and AS 5.
Also a note should be given in the annual accounts that, had the company followed earlier system of valuation of closing stock, the profit before tax would have been higher by ₹ 5 lakhs.

QUESTION 14

Till last year, the Company 'X Ltd.' used to estimate net realisable value on the basis of assessment made by internal staff. However, now onwards it has hired professional valuers for this job. Is it change in accounting policy or change in accounting estimate.

ANSWER

Its change in accounting estimate

QUESTION 15

Give your comments regarding valuation of inventory in the following cases:

a.	Inventory of harvested crops
b.	Inventory of live stock
c.	Inventory of towels. Export order received. But title not yet transferred to the buyer.
d.	Petroleum stock in pipelines and dead stock in tanks
e.	Containers / empties / huge quantity of empty beer bottles with the restaurant.

ANSWER

(a) NRV ; (b) NRV ; (c) Cost or NRV, whichever is lower ; (d) Cost or NRV, whichever is lower & (e) It will be considered as inventory of the restaurant. Its stock in trade and not merely a scrap.

QUESTION 16

M/s Aspects Ltd. is engaged in the production of pharmaceuticals. It produces the main products P and Q and one by-product R emerges from the production process apart from residual. Cost of the production is given below:

Expenditure during 2009-10	Units	₹
Raw material	10,000	2,50,000
Wages		85,000
Fixed overheads		90,000
Variable overheads		50,000

Output during 2009-10	Closing stock as on 31.03.2010
P=4500 units	1,000 units
Q=3600 units	500 units
R=1600 units	---

Following further information is given:

(a) Scrap realization is ₹ 5,000.
(b) By-product (R) is sold @ ₹ 23.25 per unit.
(c) There is separate processing charge of ₹ 4,500 on by-product.
(d) Packing of by product costs ₹ 4,000.
(e) Reasonable profit on by product after separate processing is ₹ 1,200.
(f) Average market price of P and Q is ₹ 90 per unit and ₹ 30 per unit, respectably.

Calculate the closing stock of P and Q products.

ANSWER

PRODUCTION COST

Raw material	250000
Add : Wages	85000
Add: Fixed overheads	90000
Add: Variable overheads	50000
Less: Scrap Realisation	(5000)
Total production cost(₹)	470000
B-Product Cost included in above [(1600 X23.25) - 4500-4000]	28700
Production cost of product P & Product Q(₹)	441300
Equivalent unit of product P & Product Q 4500 + (3600 X 30 / 90) = 4500+1200	5700 units
Cost per unit of product P (441300 / 5700)	₹ 77.421
Cost per unit of product Q (77.421 X 30 / 90)	₹ 25.807
Carrying amount of closing stock :	
Product P (1000 X 77.421)	₹ 77,421
Product Q (500 X25.807)	₹ 12,904

QUESTION 17

"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'.

ANSWER

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

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

ASSIGNMENT 'A'

Compute value of finished goods inventory of M/s Aspects Ltd. as on 31.03. 2010 from the following data:

Material cost	₹ 96.00 per kg.
Direct labour cost	₹ 28.00 per kg.
Variable production overhead	₹ 18.50 per kg.

Fixed production charges for the year on normal capacity of 2,00,000 kgs. is ₹ 15,00,000.
850 kgs. of finished goods inventory are in hand as on 31.03. 2010.

ANSWER

Cost per unit of finished Goods

	₹
Material Cost	96
Direct labour Cost	28
Variable production overheads	18.50
Fixed Production overheads (15,00,000/2,00,000)	7.50
	150

Value/ Carrying amount of finished goods inventory on 31.3.2010 = 150 X 850 = ₹ 1,27,500

A-2

Aspects Ltd. purchased raw materials at ₹ 118 per kg. The price of raw material is on the decline. The finished goods in which the raw material is used are expected to be sold below cost. 6,500 kgs. of raw material is in stock as on 31.03. 2010. The replacement cost of raw material as on 31.03. 2010 is ₹ 90 per kg. Compute: Value of raw materials as on 31.03. 2010

ANSWER

Carrying amount of raw material stock as on 31.3. 2010 will be = ₹ 5,85,000 (6,500 X 90)

A-3

M/s Aspects Ltd. is selling televisions. The purchase price of television is ₹ 22,000 as per the terms of sales. The television is to be delivered and installed at customer's house free of cost. Aspects Ltd. has hired Right Angle Ltd.. for the purpose and being paid ₹ 500 per television for delivery and installation.
At on 31.03. 2010, 30 televisions were in stock. The market price of the television is ₹ 22,400.
Calculate the value of closing stock as per AS-2.

ANSWER

Thus, carrying amount on closing stock as on 31.3. 2010 will be = ₹ 6,57,000 (30 X 21,900)

A-4

Aspects Ltd. deals in manufacturing of children footwear. The cost of production is given below:

Raw material per unit	₹ 250
Wages per unit	₹ 100
Overhead per unit	₹ 50
	₹ 400

As on 31.03. 2010, the replacement cost of raw material is ₹ 240 per unit. There were 1,500 units of raw material on balance sheet date.
Calculate the value of closing stock of raw material in each of the following cases:
(a) If finished product is sold at the rate of ₹ 425 per unit, what will be value of closing stock of raw material.
(b) If finished product is sold at the rate of ₹ 385 per unit, what will be value of closing stock of raw material.

ANSWER

a) When market value of finished goods is equal to or more than its cost, then raw material to be carried at cost. Therefore, carrying amount of raw material will be
= 250 X 1,500 =₹ 3,75,000

b) When market value of finished goods is less than its cost, then raw material to be carried at acquisition cost or replacement cost, whichever is less.
Acquisition /Historical cost per unit = ₹ 250
Replacement cost per unit = ₹ 240
Thus carrying amount of closing raw material will be
= 240 X 1,500 = ₹ 3,60,000

A-5

M/s Aspects Ltd., a retail trader gives below the information for the year ended 31st March, 2010:

	At Cost	At Mkt. Value
Opening Stock	45,000	60,000
Paints Purchased	1,55,000	2,40,000
Less: Sales for the year		2,25,000

Closing Stock 75,000

Ascertain value of inventory as on 31st March, 2010 using retail method.

ANSWER

	₹
Cost of total goods available for sale (45000 + 155000)	2,00,000
Sale value of total goods available for sale	3,00,000
Margin in total goods available for sale	1,00,000
Percentage margin	33 $^{1}/_{3}$% on sales

Thus, carrying amount of closing inventory as on 31.3. 2010 will be

= 75000 – 33 1/3 % =₹ 50,000

A-6

In a production process product P and Q are jointly produced. A total expenditure of ₹ 40,00,000 is incurred on production of joint products. P and Q. A total of 80,000 units of P and 60,000 units of Q are produced till split off point. The sale value per unit of product P and Q at split off point is ₹ 100 and ₹ 80 respectively. Compute allocation of cost of production to per unit of product P and Q.

ANSWER

Total Equivalent units = 80000 + (60000 X 80/100) = 80000 + 48000 = 1,28,000

Cost price per unit of product P = 40,00,000 / 128000 = ₹ 31.25

Cost price per unit of product Q = 31.25 X 80 /100 =₹ 25

A-7

X co. Limited purchased goods at the cost of ₹ 40 Lakhs in October,2008.Till March ,2009 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 sales is payable to the agent .Advise ,what is the correct closing stock to be disclosed as at 31.3.2009

ANSWER

Closing stock should be carried at cost or net realisable value whichever is less.

Thus, carrying amount of closing stock will be:

Cost of unsold stock = ₹ 10,00,000

Net realisable value of unsold stock = ₹ 9,90,000 (11,00,000 -10%)

Thus, carrying amount on closing stock as on 31.3.2010 will be ₹ 9,90,000.

ASSIGNMENT 'B'

B-1

(i) Cost of a semi finished unit at the end of 2009-2010 is ₹ 300 (Net realisable value being nil).The unit can be finished next year by a further expenditure of ₹ 100.The finished unit can be sold ₹ 250,subject to payment of 4% brokerage on selling price. Find carrying amount of inventory.

(ii) In part (i) ,suppose cost to complete the unit is ₹ 245 instead of ₹ 100 . Find carrying amount of inventory.

ANSWER

(i)

Net selling price	250
Less: Estimated cost of completion	100
	150
Less: Brokerage (4% of 250)	10
Net Realisable Value	140
Cost of inventory	300
Carrying value of inventory	140
(Lower of cost and net realisable value)	

Note : Incremental cost ₹ 100 (cost of complete) is less than incremental revenue ₹ 240 (₹ 250 – ₹ 10).The enterprise will therefore decided to finish the unit for sale at ₹ 250

(ii) The enterprise will be better off by not finishing the unit as shown below:

Incremental cost ₹ 245 (cost to complete) is more than incremental revenue ₹ 240 (₹ 250-₹ 10).The enterprise will be therefore prefer not to finish the unit

Net Realisable Value = Nil

Cost =₹ 300

Value of inventory (Lower of cost and net realisable value) = Nil

B-2

Opening stock ₹ 15,000. Gross purchases during the period ₹ 94,000. Purchase return ₹ 5,000. Gross sales during the period ₹ 1,20,000. Sales Return ₹ 15,000. Freight inwards ₹ 4,000. Freight outwards ₹ 5,400. Gross profit margin is 20%. Find closing stock.

ANSWER

₹ 24,000

B-3

M/s Aspects Ltd. deals in sale / purchase of second hand vehicles. During the period, the company purchased below mentioned vehicles

Items	Acquired Price (₹)
Maruti 800	50,000
Santro	70,000
Indigo	1,50,000
Honda City	5,00,000
Innova	6,00,000
Nano	60,000

Later the company sold Honda city and innova at good profit margin. Find the carrying amount of closing stock (i.e. cost of remaining cars).

ANSWER

₹ 3,30,000

B-4

Calculate the value of raw materials and finished goods :

	Closing bal.	Cost (per unit)	NRV (per unit)
Raw Material	500 units	₹ 220	₹ 150
Finished Goods	1200 units	₹ 330	Case (i) ₹ 400 Case (ii) ₹ 300

ANSWER

Case (i) RM ₹ 500 x 220 ; FG 1200 x 330 ; Case (ii) RM ₹ 500 x 150 ; FG 1200 x 300.

B-5

Capital Cables Ltd., has a normal wastage of 4% in the production process. During the year 201314 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.

ANSWER

As per para 13 of AS 2 (Revised) 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.
Normal Loss 480 m.t. ; Abnormal Loss 150 m.t. ; Abnormal Loss ₹ 23,437.50 will be charged to P & L a/c.

B-6

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.

(i) 600 units of Raw material A (purchased @ ₹ 120). Replacement cost of raw material A as on 31-3-2015 is ₹ 90 per unit.

(ii) 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.

(iii) 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.

ANSWER

54000 + 120000 + 450000 = 624000

B-7

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 Net Realizable Value of the Finished Goods Y is ₹ 400.

ANSWER

110000 + 396000 = 506000

B-8

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?

ANSWER

As per AS 2 (Revised), abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred. In this case, normal waste is 250 MT and abnormal waste is 50 MT. The cost of 250 MT will be included in determining the cost of inventories (finished goods) at the year end.
The cost of abnormal waste (50 MT x 1,052.6315 = ₹ 52,632) will be charged to the profit and loss statement.
Cost per MT (Normal Quantity of 4,750 MT) = 50,00,000 / 4,750 = ₹ 1,052.6315
Total value of inventory = 4,700 MT x ₹ 1,052.6315 = ₹ 49,47,368.

B-9

On 31st March 2017, a business firm finds that cost of a partly finished unit on that date is ₹ 530. The unit can be finished in 2017-18 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, 2017 for preparation of final accounts. Assume that the partly finished unit cannot be sold in semi finished form and its NRV is zero without processing it further.

ANSWER
₹ 410

B-10

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
₹ 4,95,000

B-11

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
₹ 59,000

Below given are few selected questions from CA Foundation Notes.
The numbering of these questions is kept same as it was in CA Foundation Notes.

FIFO Method / LIFO Method / Simple Average Method / Weighted Average Method

QUESTION 1

The following are the details of stock in trade of Sriram Wholesalers:

Date (March 2017)	Transaction	Units	Purchase Price (per unit) ₹
1	Purchased	400	10

3	Purchased	200	12
7	Purchased	500	11
11	Sold	300	-
16	Sold	200	-
18	Purchased	300	14
24	Sold	400	-
26	Purchased	250	15
30	Purchased	200	16
31	Sold	300	-

Find out the value of Inventory as on 31-3-2017 adopting perpetual inventory system, if the company follows: (i) First in first out method (FIFO); (ii) Last in first out method (LIFO) & (iii) Weighted average method.

What will be the answer, if periodic inventory system has been followed.
Further find answer by periodic approach using simple average method.

ANSWER
Closing inventory (in Rs.) 650 units

Case	If Perpetual Inventory System is followed	If Periodic Inventory System is followed
(i)	9,750	9,750
(ii)	7,450	6,950
(iii)	8,817	8,099
(iv)	--	8,450

QUESTION 2

The following are the raw material details of a manufacturing unit:

Date (March 2017)	**Transaction**	**Units**	**Purchase Price (per unit) ₹**
1	Purchased	600	18
5	Purchased	200	20
7	Issued for consumption	200	-
9	Purchased	500	23
14	Issued for consumption	300	-
17	Purchased	300	24
19	Issued for consumption	400	-
24	Issued for consumption	250	-
27	Purchased	200	25
31	Issued for consumption	300	-

Find out the value of Inventory as on 31-3-2017 adopting perpetual inventory system, if the company follows: (i) First in first out method (FIFO); (ii) Last in first out method (LIFO) & (iii) Weighted average method.

What will be the answer, if periodic inventory system has been followed.
Further find answer by periodic approach using simple average method.
ANSWER
Closing inventory (in Rs.) 350 units

Case	If Perpetual Inventory System is followed	If Periodic Inventory System is followed
(i)	8,600	8,600
(ii)	6,300	6,300
(iii)	7,898	7,487
(iv)	--	7,700

Adjusted Selling Price Method / Retail Inventory Method

QUESTION 11

		Case (i)	Case (ii)	Case (iii)	Case (iv)	Case (v)	Case (vi)
Opening stock	₹	10560	4835	18000	8000	12500	80000
Purchases	₹	215500	88000	335000	269000	105000	800000
Sales	₹	260000	120000	510000	285000	200000	980000
Closing stock at selling price	₹	22575	3780	19500	47400	35000	120000

Find:							
(i) GP Rate on sales							
(ii) Closing stock at cost	₹						

ANSWER

		Case (i)	Case (ii)	Case (iii)	Case (iv)	Case (v)	Case (vi)
Opening stock	₹	10560	4835	18000	8000	12500	80000
Purchases	₹	215500	88000	335000	269000	105000	800000
Cost of Total Goods (A)	₹	226060	92835	353000	277000	117500	880000
Sales	₹	260000	120000	510000	285000	200000	980000
Closing stock at selling price (S)	₹	22575	3780	19500	47400	35000	120000
Selling price of Total Goods (B)	₹	282575	123780	529500	332400	235000	1100000
Profit Margin in Total Goods (C) [i.e. B-A]	₹	56515	30945	176500	55400	117500	230000
GP Rate (%age of sales) (G) i.e. (C / B) x 100		20%	25%	$33^1/_3$%	$16^2/_3$%	50%	20%
Closing stock at cost i.e. [S – G]	₹	18060	2835	13000	39500	17500	96000

QUESTION 16

From the following information, ascertain the value of stock as on 31.3.2017:

	₹
Value of stock on 1.4.2016	7,00,000
Purchases during the period from 1.4.2016 to 31.3.2017	34,60,000
Manufacturing expenses during the above period	7,00,000
Sales during the same period	52,20,000

At the time of valuing stock on 31.3.2016, a sum of ₹ 60,000 was written off a particular item which was originally purchased for ₹ 2,00,000 and was sold for ₹ 1,60,000. But for the above transaction the gross profit earned during the year was 25% on cost.

ANSWER

Statement of Valuation of Stock as on 31st March, 2017

	₹	₹
Value of stock as on 1st April, 2016		7,00,000
Add: Purchases during the period from 1.4.2016 to 31.3.2017		34,60,000
Add: Manufacturing expenses during the above period		7,00,000
		48,60,000
Less: Cost of sales during the period:		
Sales	52,20,000	
Less: Gross profit	10,32,000	41,88,000
Value of stock as on 31.3.2017		6,72,000

Working Note:

	₹
Calculation of gross profit:	
Gross profit on normal sales 20/100 × (52,20,000 – 1,60,000)	10,12,000
Gross profit on the particular (abnormal) item 1,60,000 – (2,00,000 - 60,000)	20,000
	10,32,000

QUESTION 17

From the following information ascertain the value of stock as on 31st March, 2016 and also the profit for the year:

	₹
Stock as on 1.4.2015	1,42,500
Purchases	7,62,500
Manufacturing expenses	1,50,000
Selling expenses	60,500
Administrative expenses	30,000

Financial charges Sales	21,500 12,45,000

At the time of valuing stock as on 31st March, 2015, a sum of ₹ 17,500 was written off on a particular item, which was originally purchased for ₹ 50,000 and was sold during the year at ₹ 45,000. Barring the transaction relating to this item, the gross profit earned during the year was 20% on sales.

ANSWER

Statement of Valuation of Stock on 31st March, 2016

	₹	₹
Stock as on 31st March, 2015	1,42,500	
Less: Book value of abnormal stock (₹ 50,000 – ₹ 17,500)	32,500	1,10,000
Add: Purchases		7,62,500
Manufacturing expenses		1,50,000
		10,22,500
Less: Cost of sales:		
Sales as per book	12,45,000	
Less: Sales of abnormal item	45,000	
	12,00,000	
Less: Gross profit @ 20% stock as on 31st March, 2016	2,40,000	9,60,000
		62,500

Statement showing Profit for the year ended 31st March, 2016

	₹	₹
Gross profit on normal sales:		2,40,000
Add: Profit on abnormal item:		
Sales value	45,000	
Less: Book value on 31st March, 2015	32,500	12,500
		2,52,500
Less : Overhead expenses:		
Selling expenses	60,500	
Administrative expenses	30,000	
Financial charges	21,500	1,12,000
Net profit		1,40,500

Specific Identification Method

QUESTION 19

A dealer of second hand cars purchased and sold following cars during the period: (Assume opening balance Nil)

	Model	Purchase Price / Cost (₹)	Sold for (₹)	Balance Status
1	Honda City	5,50,000	6,20,000	
2	Maruti Swift	2,70,000		Not yet sold
3	Maruti Dsire	3,20,000	3,15,000	
4	Hyundai I-10	1,90,000		Not yet sold
5	Tata Indica	1,20,000		Not yet sold
6	Hyundai I-20	4,10,000	4,50,000	
7	Toyata Innova	7,80,000	8,25,000	

Find carrying value of closing inventory at the end of the period.

ANSWER

Model	Carrying Amt. (₹)
Maruti Swift	2,70,000
Hyundai I-10	1,90,000
Tata Indica	1,20,000
	5,80,000

--xxx--

QUESTION 21

The details regarding closing inventory of dealer of second hand cars are as under:

	Model	Purchase Price / Cost (₹)	Net Realizable Value (NRV) (₹)
1	Honda City	5,50,000	6,20,000
2	Maruti Swift	2,70,000	2,85,000
3	Maruti Dsire	3,20,000	3,15,000
4	Hyundai I-10	1,90,000	2,25,000
5	Tata Indica	1,20,000	1,10,000
6	Hyundai I-20	4,10,000	4,50,000
7	Toyata Innova	7,80,000	8,25,000

Find carrying value of closing inventory at the end of the period.

ANSWER Closing inventory is carried at lower of lower of cost and NRV (Item wise)

Model	Carrying Amt. (₹)
Honda City	5,50,000
Maruti Swift	2,70,000
Maruti Dsire	3,15,000
Hyundai I-10	1,90,000
Tata Indica	1,10,000
Hyundai I-20	4,10,000
Toyata Innova	7,80,000
	26,25,000

QUESTION 23

Find carrying value of closing stock (in unpacked condition), from the following information:

Figures in ₹

	(i)	(ii)	(iii)
Closing stock at cost (In unpacked condition)	92,000	5,00,000	5,20,000
Market value of such goods in packed condition	1,00,000	5,40,000	5,40,000
Estimated packing cost	500	3,000	3,000
Estimated selling expenses to be incurred to effect sales	10% of selling price	5% of selling price	5% of selling price
Find carrying value of closing stock			

ANSWER. (₹) (i) 89,500 ; (ii) 5,00,000 ; (iii) 5,10,000

QUESTION 24

Physical stock-taking was done on 25.03.2017.

		₹
Stock as on 25.03.2017		8,50,000
Purchases	(From 26.03.2017 to 31.03.2017)	70,000
Purchase Return	(From 26.03.2017 to 31.03.2017)	8,000
Sales	(From 26.03.2017 to 31.03.2017)	90,000
Sales Return	(From 26.03.2017 to 31.03.2017)	15,000
GP Margin (%age of sales)		25%

Find carrying value of closing inventory as on 31.03.2017.

ANSWER

		₹
Stock as per physical stock taking as on 25.03.2017		8,50,000
Add: Net Purchases (From 26.03.2017 to 31.03.2017)	[70,000 – 8,000]	62,000
Less: Cost of goods sold (From 26.03.2017 to 31.03.2017)	[90,000 – 15,000] - 25%	56,250
Value of stock as on 31.03.2017		8,55,750

QUESTION 26

Physical stock-taking was done on 07.04.2017.

₹

Stock as on 07.04.2017		2,20,000
Purchases	(From 31.03.2017 to 07.04.2017)	60,000
Purchase Return	(From 31.03.2017 to 07.04.2017)	5,000
Sales	(From 31.03.2017 to 07.04.2017)	48,000
Sales Return	(From 31.03.2017 to 07.04.2017)	3,000
GP Margin (%age of sales)		20%

Find carrying value of closing inventory as on 31.03.2017.

ANSWER

		₹
Stock as per physical stock taking as on 07.04.2017		2,20,000
Less: Net Purchases (From 31.03.2017 to 07.04.2017)	[60,000 – 5,000]	55,000
Add: Cost of goods sold (From 31.03.2017 to 07.04.2017)	[48,000 – 3,000] -20%	36,000
Value of stock as on 31.03.2017		2,01,000

QUESTION 30

X who was closing his books on 31.3.2016 failed to take the actual stock which he did only on 9th April, 2016, when it was ascertained by him to be worth ₹ 2,50,000.
It was found that sales are entered in the sales book on the same day of dispatch and return inwards in the returns book as and when the goods are received back. Purchases are entered in the purchases day book once the invoices are received.
It was found that sales between 31.3.2016 and 9.4.2016 as per the sales day book are ₹ 17,200. Purchases between 31.3.2016 and 9.4.2016 as per purchases day book are ₹ 1,200, out of these goods amounting to ₹ 500 were not received until after the stock was taken.
Goods invoiced during the month of March, 2016 but goods received only on 4th April, 2016 amounted to ₹ 1,000. Rate of gross profit is 33-1/3% on cost.
Ascertain the value of physical stock as on 31.3.2016.

ANSWER

Statement of Valuation of Physical Stock as on 31st March, 2016

		₹	₹
Value of stock as on 9th April, 2016			2,50,000
Add:	Cost of sales during the intervening period		
	Sales made between 31.3.2016 and 9.4.2016	17,200	
Less:	Gross profit @ 25% on sales	(4,300)	12,900
			2,62,900
Less:	Purchases actually received during the intervening period:		
	Purchases from 1.4.2016 to 9.4.2016	1,200	
Less:	Goods not received upto 9.4.2016	(500)	700
			2,62,200
Less:	Purchases during March, 2016 received on 4.4.2016		1,000
Value of physical stock as on 31.3.2016			2,61,200

QUESTION 31

The Profit and loss account of Hanuman showed a net profit of ₹ 6,00,000, after considering the closing stock of ₹ 3,75,000 on 31st March, 2016. Subsequently the following information was obtained from scrutiny of the books:

(i) Purchases for the year included ₹ 15,000 paid for new electric fittings for the shop.

(ii) Hanuman gave away goods valued at ₹ 40,000 as free samples for which no entry was made in the books of accounts.

(iii) Invoices for goods amounting to ₹ 2,50,000 have been entered on 27th March, 2016, but the goods were not included in stock.

(iv) In March, 2016 goods of ₹ 2,00,000 sold and delivered were taken in the sales for April, 2016.

(v) Goods costing ₹ 75,000 were sent on sale or return in March, 2016 at a margin of profit of $33^{1}/_{3}\%$ on cost. Though approval was given in April, 2016 these were taken as sales for March, 2016.

Calculate the value of stock on 31st March, 2016 and the adjusted net profit for the year ended on that date.

ANSWER

Profit and Loss Adjustment Account

	Dr.		Cr.
	₹		₹
To Advertisement (samples)	40,000	By Net profit	6,00,000
To Sales (goods approved in April to be taken as April sales: 7,500 + 2,500)	1,00,000	By Electric fittings	15,000
		By Samples	40,000
		By Stock (purchases of March not included in stock)	2,50,000
To Adjusted net profit	10,40,000	By Sales (goods sold in March wrongly taken as April sales)	2,00,000
		By Stock (goods sent on approval basis not included in stock)	75,000
	11,80,000		11,80,000

Calculation of value of inventory on 31st March, 2016

	₹
Stock on 31st March, 2016 (given)	3,75,000
Add: Purchases of March, 2016 not included in the stock	2,50,000
Goods lying with customers on approval basis	75,000
	7,00,000

QUESTION 32

Physical verification of stock in a business was done on 23rd June, 2016. The value of the stock was ₹ 48,00,000. The following transactions took place between 23rd June to 30th June, 2016:

(i) Out of the goods sent on consignment on 22nd June 2016, goods at cost worth ₹ 2,40,000 were unsold.

(ii) Purchases of ₹ 4,00,000 were made out of which goods worth ₹ 1,60,000 were delivered on 5th July, 2016.

(iii) Sales were ₹ 13,60,000, which include goods worth ₹ 3,20,000 sent on approval. Half of these goods were returned before 30th June, 2016, but no information is available regarding the remaining goods.

(iv) Goods are sold at cost plus 25%. However goods costing ₹ 2,40,000 had been sold for ₹ 1,20,000.

Determine the value of stock on 30th June, 2016.

ANSWER

Statement of Valuation of Stock on 30th June, 2016

	₹	₹
Value of stock as on 23rd June, 2016		48,00,000
Add: Unsold stock out of the goods sent on consignment	2,40,000	
Purchases during the period from 23rd June, 2016 to 30th June, 2016	2,40,000	
Goods in transit on 30th June, 2016	1,60,000	
Cost of goods sent on approval basis (80% of ₹ 1,60,000)	1,28,000	7,68,000
		55,68,000
Less: Cost of sales during the period from 23rd June, 2016 to 30th June, 2016		
Sales (₹ 13,60,000 – ₹ 1,60,000)	12,00,000	
Less: Gross profit	96,000	
		11,04,000
Value of stock as on 30th June, 2016		44,64,000

Working Notes:

1.	**Calculation of normal sales:**		
	Actual sales		13,60,000
	Less: Abnormal sales	1,20,000	
	Return of goods sent on approval	1,60,000	2,80,000
			10,80,000
2.	**Calculation of gross profit:**		
	Gross profit or normal sales 20/100 × ₹ 10,80,000		2,16,000
	Less: Loss on sale of particular (abnormal) goods (₹ 2,40,000 - ₹ 1,20,000)		1,20,000
	Gross profit		96,000

QUESTION 33

Inventory taking for the year ended 31st March, 2016 was completed by 10th April, 2016, the valuation of which showed a inventory figure of ₹ 16,75,000 at cost as on the completion date. After the end of the accounting year and till the date of completion of inventory taking, sales for the next year were made for ₹ 68,750, profit margin being $33^1/_3$ % on cost. Purchases for the next year included in the inventory amounted to ₹ 90,000 at cost less trade discount 10%. During this period, goods were added to inventory at the mark up price of ₹ 3,000 in respect of sales returns. After inventory taking it was found that there were certain very old slow moving items costing ₹ 11,250, which should be taken at ₹ 5,250 to ensure disposal to an interested customer. Due to heavy flood, certain goods costing ₹ 15,500 were received from the supplier beyond the delivery date of customer. As a result, the customer refused to take delivery and net realizable value of the goods was estimated to be ₹ 12,500 on 31st March. Compute the value of inventory for inclusion in the final accounts for the year ended 30th March, 2016.

ANSWER

Statement showing the valuation of Inventory as on 31st March, 2016

	₹
Value of Inventory as on 10th April	16,75,000
Add: Cost of goods sold after 31st March till Inventory taking	51,560
(₹ 68,750 - ₹ 17,190)	
Less: Purchases for the next period (net)	(81,000)
Less: Cost of Sales Returns	(2,250)
Less: Loss on revaluation of slow moving inventories	(6,000)
Less: Reduction in value on account of default	(3,000)
Value of Inventory on March 31	16,34,310

Note: Profit margin of $33^1/_3$ % on cost means 25% on sales price.

PROPERTY, PLANT AND EQUIPMENT (PPE)

ACCOUNTING STANDARD 10 (REVISED)

Objective: To prescribe Accounting treatment for Property, Plant and Equipment.

Principle issues involved:
- the recognition of the assets,
- the determination of their carrying amounts
- and the depreciation charges and impairment losses to be recognised in relation to them.

This Standard does not apply to:
- Biological Assets (other than Bearer Plants) related to agricultural activity
- Wasting Assets including Mineral rights, Expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources

Notes:
1. AS 10 applies to PPE used to develop or maintain the assets described above.
2. AS 10 applies to Bearer Plants but it does not apply to the produce on Bearer Plants.
3. **Biological Asset:** An Accounting Standard on "Agriculture" is under formulation, which **w**ill, inter alia, cover accounting for livestock.Till the time, the Accounting Standard on "Agriculture" is issued, accounting for livestock meeting the definition of PPE, will be covered as per AS 10 (Revised).
   [Means, AS 10 generally not meant to apply to biological asset like living animals]
4. **Bearer Plant:** Is a plant that (satisfies all 3 conditions):
   - Produce '<u>Agricultural produce</u>'
   - Is expected to bear produce for more than 12 months
   - Has a remote likelihood of being sold as agriculture produce, except for incidental scrap sales

   <u>Agricultural Produce</u> is the harvested product of Biological Assets

   The following are not Bearer Plants:

   (a) Plants cultivated to be harvested as Agricultural produce.
   Example: Trees grown for use as lumber

   (b) Plants cultivated to produce Agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales
   Example: Trees which are cultivated both for their fruit and their lumber

   (c) Annual crops. Example: Maize and wheat

Definition of PPE / Conditions to be satisfied for a TANGIBLE item to be called PPE:
1. Held for
   - Use in production / Supply to goods or services
   - Rentals to others
   - <u>Administrative purposes</u>*
2. Expected to be used for more than 12 months

'<u>Administrative purposes'</u> has been used in wider sense to include all business purposes i.e. Selling and distribution, Finance and accounting & Personnel and other functions. It also includes assets acquired for safety or environmental reasons.

The acquisition of such PPE, although not directly increasing the future economic benefits of a nparticular existing item of PPE, may be necessary for an enterprise to obtain the future economic benef its
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 bee n
acquired.

<u>Example</u>: A chemical manufacturer may install new chemical handling processes to comply wit h
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.

Recognition criteria for PPE

The cost of an item of PPE should be recognised as an asset if, and only if:
(a) It is probable that future economic benefits associated with the item will flow to the enterprise, and
(b) The cost of the item can be measured reliably.

Notes:
1. It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies and to apply the criteria to the aggregate value.
2. 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.

Treatment of (i) Spare parts; (ii) Stand-by equipment; and (iii) Servicing Equipment
Case I If they meet the definition of PPE as per AS 10: Recognise as PPE as per AS 10
Case II If they do not meet the definition of PPE as per AS 10: Such items are classified as inventory as per AS 2

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.
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.

Replacement of Parts of PPE
Parts of some items of PPE may require replacement at regular intervals.
Examples:
1. A furnace may require relining after a specified number of hours of use.
2. Aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe.
3. Major parts of conveyor system, such as, conveyor belts, wire ropes, etc., may require replacement several times during the life of the conveyor system.
4. 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 must be derecognised.

Regular Major Inspection: 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.

Measurement of PPE
- At Recognition – At 'Cost Model'
- After Recognition – At 'Cost Model' **OR** At 'Revaluation Model'

Cost Model: Cost comprises of
- **Purchase price (Including / Deducting):**
  - Including import duties and other non-refundable purchase taxes
  - Deduct Trade discounts and rebates
- **Directly attributable costs:** Any cost 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.
  Examples of directly attributable costs are:
  1. Costs of employee benefits (as defined in AS 15) arising directly from the construction or acquisition of the item of PPE
  2. Costs of site preparation
  3. Initial delivery and handling costs
  4. Installation and assembly costs
  5. 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)
  6. Professional fees

The following costs are not included in the carrying amount of an item of PPE:
1. Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity;

2. Initial operating losses, such as those incurred while demand for the output of an item builds up; and
3. Costs of relocating or reorganising part or all of the operations of an enterprise.

Note: Some operations occurs in connection with the construction or development of an item of PPE, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities.

Example: Income may be earned through using a building site as a car park until construction starts because incidental operations are not necessary to brings an item to location and condition necessary for it be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in the statement of profits and loss and included in their respective classification of income and expense.

Further, the following costs will not form part of cost of an item of PPE:

- Costs of opening a new facility or business, such as 'Inauguration cost'.
- Costs of introducing a new product of 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.

➢ **Decommissioning, Restoration and similar Liabilities:**
Initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as 'Decommissioning, Restoration and similar Liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Self Constructed Asset: The cost comprises purchase price of various materials, consumables and other directly attributable expenses incurred in connection with the construction of an asset, incurred till an asset is ready to put to use.
Internal notional profits to be ignored / Eliminated.
Loss due to abnormal wastage is to be eliminated and to be treated as period cost.

Asset acquired in exchange of another asset : To be recorded at Fair Market Value of Asset given up OR Fair Market Value of Asset acquired (whichever is more clearly evident).

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.

Aggregating insignificant items: In some cases, it may be appropriate to aggregate individually insignificant items and to apply the criteria to classify fixed asset to the aggregate value.

Note: Investment property (defined in AS 13), should be accounted for only in accordance with the Cost model prescribed in this standard.

Revaluation Model

An enterprise may present their gross block of fixed assets at a revalued amount. Following should be considered for the recognition of revaluation.

a) Entire class of assets should be revalued OR Selection should be on systematic basis.
 ➔ The basis is required to be disclosed
b) Recognition of Increase or decrease on revaluation :-
 Revaluation – First time
 i) Increase on Revaluation : Credit to Revaluation Reserve
 ii) Decrease on Revaluation : Charge to Profit & Loss Account
 Subsequent revaluation
 i) If Increase is due to earlier revaluation decrease, then amount to that extent be reversed to Profit & Loss Account. Any amount beyond that should be credited to Revaluation Reserve Account.
 ii) If Decrease is due to earlier revaluation increase (transferred to Revaluation Reserve Account), then amount to that extent be reversed to Revaluation Reserve Account (If

still available in Revaluation Reserve Account). Any amount beyond that should be charged to Profit & Loss Account.

Frequency of revaluation:-

Items of PPE experience significant and volatile changes in Fair value: Annual revaluation shall be done.
Items of PPE with only insignificant changes in Fair value:
Revaluation shall be done at an interval of 3 to 5 yrs.

Examples of separate classes:

(a) Land [Freehold land is non-depreciable asset]
(b) Buildings
(c) Machinery
(d) Ships
(e) Aircraft
(f) Motor Vehicles
(g) Furniture and Fixtures
(h) Office Equipment
(i) Bearer plants

Depreciation Methods allowed:

- Straight line method
- Written down value method
- Production unit method

The standard permits use of more than one method of depreciation within the same entity for different class of assets having special nature of usage.

Depreciable Amount:

Original Cost or Amount subsituted for original cost Less Estimated scrap value. The depreciable amount of an asset should be allocated on a systematic basic over its useful life.
Useful life can be measured in years or units the machine can produce.

Commencement of period for charging Depreciation

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

Cessation of Depreciation

Depreciation ceases to be charged when asset's residual value exceeds its carrying amount
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 usage methods of depreciation, the depreciation charge can be zero while there is no production.

Change in estimate: The entity can change the method / rate of depreciation due to change in valuation of the asset or change in estimated useful life or change in estimated residual value, with prospective effect only.

Carrying Value of PPE:

Cost Model

After recognition as an asset, an item of PPE should be carried at:
Cost - Any Accumulated Depreciation - Any Accumulated Impairment losses

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.

Fair value at the date of the revaluation		xxx
Less: Any subsequent accumulated depreciation	(-)	xxx
Less: Any subsequent accumulated impairment losses	(-)	xxx
Carrying value		xxx

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 based on

- Discounted cash flow projections, Or
- A depreciated replacement cost approach

Asset held for disposal:

- State such assets at the lower of their Net Book Value and Net Realisable Value.
- Show such assets separately.

Eliminate of asset from accounts:

- Eliminate assets from accounts on disposal or
- When no future benefit expected from its use and subsequent disposal

Gain on disposal: Credit to Profit & Loss Account.
(whether carrying amount of asset is historical cost or at a revalued amount)
Loss on disposal / retirement: It should be debited to Profit & Loss Account (Except if loss is due to earlier revaluation increase credited to revaluation reserve, Debit amount to that extent to revaluation reserve (if still available), excess should be recognised in Profit & Loss Account.

Note: On the disposal of asset, amount standing to the credit of Revaluation reserve Account may be transferred to General Reserve.

Few Main Disclosure Requirements:
The financial statements should disclose, for each class of PPE:
(a) The measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount;
(b) The depreciation methods used;
(c) 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;
(d) The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and
The financial statements should also disclose:
(a) The existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;
(b) The amount of expenditure recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;
(c) The amount of contractual commitments for the acquisition of property, plant and equipment;
(d) If it is not disclosed separately on the face of the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in the statement of profit and loss; and
(e) The amount of assets retired from active use and held for disposal
Disclosures related to Revalued Assets:
If items of property, plant and equipment are stated at revalued amounts, the following should be disclosed:
(a) The effective date of the revaluation;
(b) Whether an independent valuer was involved;
(c) The methods and significant assumptions applied in estimating fair values of the items;
(d) The extent to which fair values of the items were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques; and
(e) The revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

QUESTION 1

Entity A, a supermarket chain, is renovating on 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 remodeling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers. State whether the remodeling cost will be capitalized or not.

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

QUESTION 2

(a) What happens if the cost of the previous part/inspection was/was not identified in the transaction in which the item was acquired or constructed?
(b) What will be your answer in the above question, if it is not practicable for an enterprise to determine the carrying amount of the replaced part/inspection?

ANSWER

(a) De-recognition of the carrying amount occurs regardless of whether the cost of the previous part/inspecting was identified in the transaction in which the item was acquired or constructed.
(b) It may use the cost of the replacement or the estimates cost of a future similar inspection as an indication of what cost of the replaced part/existing inspection component was then the item was acquired or constructed

QUESTION 3

Entity A has an existing freedom 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 of ₹ 3,00,000 to transport the machinery from the old location the temporary location.

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

ANSWER

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 do not meet the requirement of AS 10 and therefore, cannot be capitalised.

QUESTION 4

Entity A is a large manufacturing groups. It owns a number of industrial building, 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 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 or not with reasons?

ANSWER

Entity A's management can apply the revaluation model only the office buildings. The office buildings can be clearly distinguished from the industrial building in terms of their function, their nature and their general location. AS 10 permits assets to be revalued on a class by class basic.
The different characteristics of the buildings enable them to be classified as different PPE classes. The different measurement model can, therefore, be applied to these classes for subsequent measurement.
All properties within the class office buildings must, therefore , be carried at revalued amount.

QUESTION 5

Carrying amount of the part of the machinery to be replaced, ₹ 2,00,000. Today's cost of replacing the same said part ₹ 3,25,000. Scrapped part realised ₹ 15,000.
Record the transaction (without narration).

ANSWER

Machinery a/c Dr.	3,25,000	
To bank a/c		3,25,000
Bank a/c Dr.	15,000	
Loss on disposal of machinery part Dr.	1,85,000	
To Machinery a/c		2,00,000

QUESTION 6

Gross book value of the Machinery, ₹ 10,00,000. Accumulated Depreciation till date, ₹ 4,00,000. Today's market value of such machinery in new condition and depreciated condition, ₹ 25,00,000 and ₹ 15,00,000 respectively.
Record accounting entries (without narration)in case revaluation method is to be adopted.

ANSWER

Machinery a/c Dr.	15,00,000	
To accumulated depreciation a/c		6,00,000

To revaluation reserve a/c		9,00,000

Alternatively,

Accumulated depreciation a/c Dr.	4,00,000	
To machinery a/c		4,00,000
Machinery a/c Dr.	9,00,000	
To revaluation reserve a/c		9,00,000

QUESTION 7

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?

ANSWER

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 8

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

ANSWER

The net operating costs should not be 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 9

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?

ANSWER

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 10

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?

ANSWER

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.

QUESTION 11

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

ANSWER

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

Depreciation should commence as soon as the asset is acquired and is available for use. Thus, the policy of Entity A is not acceptable.

QUESTION 12

Entity A purchased an asset on 1st January 2013 for ₹ 1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil.
On 1st January 2017, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years.
Calculate the amount of depreciation for each year, if company charges depreciation on Straight Line basis.

ANSWER

The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e (1,00,000/10 years).
On 1st January 2017, the asset's net book value is [1,00,000 – (10,000 x 4)] ₹ 60,000. The remaining useful life is 4 years.
The company should amend the annual provision for depreciation to charge the unamortised cost over the revised remaining life of four years.
Consequently, it should charge depreciation for the next 4 years at ₹ 15,000 per annum i.e. (60,000 / 4 years).

QUESTION 13

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

ANSWER

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

QUESTION 14

A property costing ₹ 10,00,000 is bought in 2016. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 20 years. The estimated residual value in 20 years' time, based on 2016 prices, is:
Case (a) ₹ 10,00,000
Case (b) ₹ 9,00,000.
Calculate the amount of depreciation.

ANSWER

Case (a) The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost. There is, therefore, no depreciable amount and depreciation is correctly zero.
Case (b) The company considers that the residual value, based on prices prevailing at the balance sheet date, will be ₹ 9,00,000 and the depreciable amount is, therefore, ₹ 1,00,000.

QUESTION 15

Entity B manufactures industrial chemicals and uses blending machines in the production process. The output of the blending machines is consistent from year to year and they can be used for different products.
However, maintenance costs increase from year to year and a new generation of machines with significant improvements over existing machines is available every 5 years. Suggest the depreciation method to the management.

ANSWER

The straight-line depreciation method should be adopted, because the production output is consistent from year to year. Factors such as maintenance costs or technical obsolescence should be considered in determining the blending machines' useful life.

QUESTION 16

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

ANSWER

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

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

QUESTION 17

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

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

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

ANSWER

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

		₹
1	Cost of the plant	25,00,000
2	Initial delivery and handling costs	2,00,000
3	Cost of site preparation	6,00,000
4	Consultants used for advice on the acquisition of the plant	7,00,000
5	Estimated dismantling costs to be incurred after 7 years	3,00,000
		43,00,000

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

QUESTION 18

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

Component	Useful life (Years)	Cost (₹)
Land	Infinite	20,00,000
Roof	25	10,00,000
Lifts	20	5,00,000
Fixtures	10	5,00,000
Remaining building	50	50,00,000
		90,00,000

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

ANSWER

Statement showing amount of depreciation as per Componentization Method

Component	Depreciation p.a. (₹)
Land	Nil
Roof	40,000
Lifts	25,000
Fixtures	50,000
Remaining building	1,00,000
	2,15,000

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

QUESTION 19

A Ltd. purchased some Property, Plant and Equipment on 1 st April, 20X1, and estimated their useful lives for the purpose of financial statements prepared on the basis of AS 10 . Following were the original cost, and useful life of the various components of property, plant, and equipment assessed on 1st April, 20X1:

Property, Plant and Equipment	Original Cost	Estimated useful life
Buildings	₹ 15,000,000	15 years
Plant and machinery	₹ 10,000,000	10 years
Furniture and fixtures	₹ 3,500,000	7 years

A Ltd. uses the straight-line method of depreciation.

On 1 st April, 20X4, the entity reviewed the following useful lives of the property, plant, and equipment through an external valuation expert:

Property, Plant and Equipment	Estimated remaining useful life
Buildings	10 years
Plant and machinery	7 years
Furniture and fixtures	5 years

There were no salvage values for the three components of the property, plant, and equipment either initially or at the time the useful lives were revised.
Compute the impact of revaluation of useful life on the Statement of Profit and Loss for the year ending 31st March, 20X5.

ANSWER
The annual depreciation charges prior to the change in useful life were:
Buildings ₹ 1,50,00,000/15 = ₹ 10,00,000
Plant and machinery ₹ 1,00,00,000/10 = ₹ 10,00,000
Furniture and fixtures ₹ 35,00,000/7 = ₹ 5,00,000
Total = ₹ 25,00,000 (A)
The revised annual depreciation for the year ending 31st March, 20X5, would be:
Buildings [₹ 1,50,00,000 – (₹ 10,00,000 × 3)] / 10 = ₹ 12,00,000
Plant and machinery [₹ 1,00,00,000 – (₹ 10,00,000 × 3)] / 7 = ₹ 10,00,000
Furniture and fixtures [₹ 35,00,000 – (₹ 5,00,000 × 3)] / 5 = ₹ 4,00,000
Total ₹ 26,00,000 (B)
The impact on Statement of Profit and Loss for the year ending 31st March, 20X5 = ₹ 26,00,000 – ₹ 25,00,000 = ₹ 1,00,000.
This is a change in accounting estimate which is adjusted prospectively in the period in which the estimate is amended and, if relevant, to future periods if they are also affected. Accordingly, from 20X4-20X5 onward, excess of ₹ 1,00,000 will be charged in the Statement of Profit and Loss every year till the time there is any further revision.

QUESTION 20

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

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

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

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

		₹
1	Cost of the plant (cost per supplier's invoice plus taxes)	31,25,000
2	Initial delivery and handling costs	1,85,000
3	Cost of site preparation	4,50,000
4	Consultants used for advice on the acquisition of the plant	6,50,000
5	Estimated dismantling costs to be incurred after 5 years	2,50,000
		46,60,000

Note : Operating losses before commercial production amounting to ₹ 3,75,000 is not regarded as directly attributable costs and thus cannot be capitalised. It should be written off to the Statement of Profit and Loss in the period it is incurred.

QUESTION 21

XYZ Ltd. has acquired a heavy road transporter at a cost of ₹ 1,00,000 (with no breakdown of the component parts). The estimated useful life is 10 years. At the end of the sixth year, the power train (one of its component) requires replacement, as further maintenance is uneconomical due to the off-road time required. The remainder of the vehicle is perfectly roadworthy and is expected to last for the next four years. The cost of a new power train is ₹ 45,000.
Can the cost of the new power train be recognized as an asset, and, if so, what treatment should be used? Take suitable assumption about discount rate.

ANSWER
The new power train will produce economic benefits to XYZ Ltd., and the cost is measurable. Hence the item should be recognized as an asset as per AS 10 (Revised) as the recognition criteria is satisfied.
The original invoice for the transporter did not specify the cost of the power train. However, its cost of the replacement is ₹ 45,000 which can be used as an indication (usually by discounting factor) of the likely cost, six years previously.

If an appropriate discount rate is 5% per annum, ₹ 45,000 discounted back six years amounts to ₹ 33,570 (45,000 x 0.746), which would be written out of the asset records.
The cost of the new power train, ₹ 45,000, would be added to the asset record, resulting in revised book value of the total asset to be ₹ 71,572 [(₹ 1,00,000 X 40%) + ₹ 45,000 –(33,570 X 40%)].

QUESTION 22

A Ltd. has an item of plant with an initial cost of ₹ 1,00,000. At the date of revaluation, accumulated depreciation amounted to ₹ 55,000. The fair value of the asset, by reference to transactions in similar assets, is assessed to be ₹ 65,000. Pass Journal Entries with regard to Revaluation?

ANSWER

The entries to be passed would be:

Accumulated depreciation Dr. 55,000 To Asset A/c 55,000 (Being elimination of accumulated depreciation against the cost of the asset)	Asset A/c Dr 20,000 To Revaluation Surplus 20,000 (Being increase of net asset value to Fair value)

Note: The net result is that the asset has a carrying amount of ₹ 65,000 [1,00,000 – 55,000 + 20,000.]

QUESTION 23

B Ltd. owns an asset with an original cost of ₹ 2,00,000. On acquisition, management determined that the useful life was 10 years and the residual value would be ₹ 20,000. The asset is now 8 years old, and during this time there have been no revisions to the assessed residual value.
At the end of year 8, management has reviewed the useful life and residual value and has determined that the useful life can be extended to 12 years in view of the maintenance program adopted by the company. As a result, the residual value will reduce to ₹ 10,000.
How would the above changes in estimates be made by B Ltd.?

ANSWER

The above changes in estimates would be effected in the following manner:
The asset has a carrying amount of ₹ 56,000 at the end of year 8 [₹ 2,00,000 – ₹ 1,44,000] i.e. Accumulated Depreciation.
Accumulated depreciation is calculated as Depreciable amount {Cost less residual value} = ₹ 2,00,000 – ₹ 20,000 = ₹ 1,80,000.
Annual depreciation = Depreciable amount / Useful life = 1,80,000 / 10 = ₹ 18,000.
Accumulated depreciation = 18,000 × No. of years (8) = ₹ 1,44,000.
Revision of the useful life to 12 years results in a remaining useful life of 4 years (12 – 8).
The revised depreciable amount is ₹ 46,000. (56,000 – 10,000)
Thus, depreciation should be charged in future at ₹ 11,500 per annum (₹ 46,000/4 years).

QUESTION 24

Determine if the following costs can be added/subtracted to the invoiced purchase price for the initial recognition of the cost of the asset:

1. Consultants fees for choosing the new asset 2. A trade discount received of 5% of the purchase price of the asset 3. A discount received for paying the invoice within 90 days 4. Interest paid on a short term loan taken to provide the necessary cash for payment of the purchase price 5. Import duties paid 6. Shipping costs and cost of road transport 7. Insurance for the shipping 8. An economic development rebate from the state 9. GST paid on the purchase -- ITC available 10. Cost of laying a new concrete slab and installing special rubber mounted footings for the new press in order to reduce vibration during use 11. Hire of a crane to transfer the press from the vehicles into the factory	12. Costs associated with removing a section of the factory roof to allow the machine to be dropped into place and subsequently refitting the roof 13. Cost of installing soundproofing in the roof at the same time in order to provide protection for workers in other parts of the factory building 14. Professional fees charged by consulting engineer for overseeing the installation process 15. Electricians fees for connecting the press to the power supply 16. A portion of the operating costs (salaries, office expenses) of the purchasing department 17. Costs of materials (papers and inks) used in calibrating the machine and setting it up for operation 18. Costs of training the operators of the new machine 19. A portion of the inefficiencies in production for the first month of use while the operators became comfortable with using the machine

ANSWER

Included in Cost: Point no. 1,2,5,6,7,8,10,11,12,14,15 and 17
Excluded from Cost: Point no. 3,4,9,13,16,18 and 19

QUESTION 25

A Ltd. has carried out certain works on various machines in their engineering plant, which manufactures high quality metal patterns and templates for use in industry. Determine in each case whether the costs of the improvements can be added to the existing carrying value of the assets concerned?

1. The cost of an annual machine overhaul which will maintain the originally assessed standard of performance of the machine for the coming 12 months.

2. The cost of repairs to a press machine, which was damaged by the emergency services while trying to extricate the arm of a worker who had become trapped in the press.
3. Modifications to a cutting machine which will increase its rate of output from 500 to 560 patterns per shift.
4. Modifications to a lathe which will replace the current water cooling system with an oilbased system, thereby extending the life of the lathe by a forecast 2 years.
5. The upgrading of a cutting machine with new software which will improve the accuracy of its measurement and cutting tolerances by a number of microns, thereby raising the quality of output.
6. Alterations to a production line which will allow automatic feeding from a machine to the next one in the production process, thereby removing the need for an employee to manually load the second machine.

ANSWER

Point 1: No. This may not be capitalized as subsequent expenditure, since it merely maintains the originally assessed standard of performance of the asset.

Point 2: No

> (As per ICAI)
> Yes. An impairment loss should have been recognized when the damage occurred and any insurance payment received as compensation should have been recognized as income in the Statement of Profit and Loss when received.
> When expenditure is incurred to restore the asset, such expenditure is added to the carrying amount of the asset to the extent that it is probable that future economic benefits will flow to the enterprise.

Point 3: Yes. The cost of such modifications may be added to the carrying amount of the asset.

Point 4 to 6: Yes. Such costs may be capitalized.

QUESTION 26

An entity bought a plot of land for development of office buildings. Development of the land was scheduled into six phases. The land scheduled for development in phases five and six was leased to another entity on a short-term basis as a parking lot for heavy vehicles.

What is the treatment of rental income from car parking lot?

ANSWER

Rental income from the car park lease is recognized in the Statement of Profit and Loss for the period.

The car park activity is incidental to the entity's principal activity of property development. Operations that are incidental to the construction or development of property, plant and equipment are not necessary to bring the asset to its working condition for its intended use.

The income and related expenses of incidental operations are recognized in the Statement of Profit and Loss for the period.

QUESTION 27

An entity acquires the right to use an underground cave for gas storage purposes for a period of 50 years. The cave is filled with gas, but a substantial part of that gas will only be used to keep the cave under pressure in order to be able to get gas out of the cave. It is not possible to distinguish the gas that will be used to keep the cave under pressure and the rest of the gas. Evaluate whether AS 10 would apply or AS 2?

ANSWER

The total volume of gas must be virtually split into

(i) Gas held for sale, and

(ii) Gas held to keep the cave under pressure.

The former must be accounted for under AS 2 as Inventories. The latter must be accounted for as PPE under AS 10 and depreciated over the period the cave is expected to be used.

QUESTION 28

An entity operates an oil refining plant. For the refining process to take place, the plant must contain a certain minimum quantity of oil. This can only be taken out once the plant is abandoned and would then be polluted to such an extent that the plant's value is significantly reduced.

Evaluate whether AS 10 would apply or AS 2?

ANSWER

The part of the crude that is necessary to operate the plant and cannot be recouped (or can be recouped but would then be significantly impaired), even when the plant is abandoned, should be considered as an item of PPE under AS 10 and amortized over the life of the plant.

QUESTION 29

Neon Enterprise operates a major chain of restaurants located in different cities. The company has acquired a new restaurant located at Chandigarh. The new-restaurant requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the restaurant will be closed. Management has prepared the following budget for this period –

Salaries of the staff engaged in preparation of restaurant before its opening	₹ 7,50,000
Construction and remodelling cost of restaurant	₹ 30,00,000

Explain the treatment of these expenditures as per the provisions of AS 10 "Property, Plant and Equipment".

ANSWER

As per provisions of AS 10, any cost directly attributable to bring the assets to the location and conditions necessary for it to be capable of operating in the manner indicated by the management are called directly attributable costs and would be included in the costs of an item of PPE.

Management of Neon Enterprise should capitalize the costs of construction and remodelling the restaurant, because they are necessary to bring the restaurant to the condition necessary for it to be capable of operating in the manner intended by management. The restaurant cannot be opened without incurring the construction and remodelling expenditure amounting ₹ 30,00,000 and thus the expenditure should be considered part of the asset.
However, the cost of salaries of staff engaged in preparation of restaurant ₹ 7,50,000 before its opening are in the nature of operating expenditure that would be incurred if the restaurant was open and these costs are not necessary to bring the restaurant to the conditions necessary for it to be capable of operating in the manner intended by management. Hence, ₹ 7,50,000 should be expensed.

QUESTION 30

The following items are given to you:
ITEMS
(1) 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);
(2) Costs of conducting business in a new location or with a new class of customer (including costs of staff training);
(3) Any costs 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
(4) Costs of opening a new facility or business, such as, inauguration costs;
(5) Purchase price, including import duties and non–refundable purchase taxes, after deducting trade discounts and rebates.
With reference to AS 10 "Property, Plant and Equipment", classify the above items under the following heads:
HEADS
(i) Purchase Price of PPE
(ii) Directly attributable cost of PPE or
(iii) Cost not included in determining the carrying amount of an item of PPE.

ANSWER
(1) 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) will be classified as "Directly attributable cost of PPE".
(2) Costs of conducting business in a new location or with a new class of customer (including costs of staff training) will be classified under head (iii)as it will not be included in determining the carrying amount of an item of PPE.
(3) Any costs 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 will be included in determination of Purchase Price of PPE
(4) Costs of opening a new facility or business, such as, inauguration costs will be classified under head (iii) as it will not be included in determining the carrying amount of an item of PPE.
(5) Purchase price, including import duties and non–refundable purchase taxes, after deducting trade discounts and rebates will be included in determination of Purchase Price of PPE.

QUESTION 31

Shrishti Ltd. contracted with a supplier to purchase machinery which is to be installed in its Department A in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 1,41,870.
These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month. The technician's services were given by Department B to Department A, which billed the services at ₹ 49,500 per month after adding 10% profit margin. The machine was purchased at ₹ 1,58,34,000 inclusive of IGST @ 12% for which input credit is available to Shrishti Ltd. ₹ 55,770 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹ 30,000 to supervise machinery installation at the factory site.
Ascertain the amount at which the Machinery should be capitalized under AS 10 considering that IGST credit is availed by the Shristhi Limited. Internally booked profits should be eliminated in arriving at the cost of machine.

ANSWER
₹ 1,45,00,140

Additional Questions

AQ 1

ABC Ltd. purchased machinery from XYZ Ltd on 01.04.2017. The price was ₹ 92,34,400 after charging 12% GST and giving a trade discount of 3% on the quoted price. Transport charges were 0.40% on the quoted price and installation charges come to 1% on the quoted price.
Expenditure incurred on the trial run was: Material ₹ 75,000 Wages ₹ 53,000 and Overheads ₹ 32,000. Machinery was ready for use on 01.06.2017. Find out the cost of the machine.
Note: Input Tax Credit is available regard with to GST charged on said machinery.

ANSWER
₹ 85,24,000

AQ 2

ABC Ltd. is constructing a building for its factory. The cost of project is given below:

Materials	₹ 18,25,000
Direct Expenses	₹ 6,40,000
Total Wages of the company during the year	₹ 3,18,000 (50% is chargeable to Project)
Total Administrative expenses of the company during the year	₹ 9,00,000 (7% is chargeable to Project)
Depreciation on asset used for the project	₹ 20,000

Calculate the cost of building.

ANSWER

₹ 27,07,000

AQ 3

ABC Ltd. has a machinery having gross value of ₹ 24,00,000 appearing in the books of accounts. ABC Ltd. has charged depreciation on straight line basis over a period of 10 years based on estimated life and estimated scrap value of 5%. At the end of 8th year the machinery has been assessed as useless. Its estimated net realizable value is ₹ 4,65,000. Determine the loss or gain on retirement of machinery.

ANSWER

Loss : ₹ 1,11,000

AQ 4

On April 1, 2017, ABC Ltd. purchased Land & Factory Building thereon for Lump Sum amount of ₹ 81,00,000. The following data is available:

	Current Appraised Value (₹)	Seller's original Cost (₹)
Land	30,00,000	2,88,000
Factory Building	60,00,000	4,10,000
	90,00,000	6,98,000

Find the cost of Land to be recorded in the books of accounts of ABC Ltd.

ANSWER

₹ 27,00,000

AQ 5

(a)	Asset ready for use on 1st July, 2017. Total cost ₹ 1,20,000 (including installation charges ₹ 5,000). However, the asset was actually put into use on 1st October, 2017. Depreciation rate – 10% p.a.. Find depreciation expense for the year ending 31st March, 2018.
(b)	Total expenditure incurred in creating self generated fixed asset ₹ 2,60,000. The same asset would have cost the company ₹ 3,00,000 if purchased ready made from the market. Tell at what valuation we will record such self generated asset.

ANSWER

(a) ₹ 9,000; (b) ₹ 2,60,000

AQ 6

In the Trial Balance of M/s. Sun Ltd. as on 31-3-2014, balance of machinery appeared at ₹ 5,60,000. The company follows rate of depreciation on machinery @ 10% p.a. on Written Down Value Method. On scrutiny it was found that a machine appearing in the books on 1-4-2014 at ₹ 1,60,000 was disposed of on 30-9-2014 at ₹ 1,35,000 in part exchange of a new machine costing ₹ 1,50,000.

You are required to calculate:

(i) Total depreciation to be charged in the Profit and Loss Account.

(ii) Loss on exchange of machine.

(iii) Book value of machinery in the Balance Sheet as on 31.3.2015.

ANSWER

Annual depreciation ₹ 55,500; Loss on disposal of machinery ₹ 17,000 & c/d value of machinery ₹ 5,02,500

AQ 7

The Company purchased plant for ₹ 35 Lakhs on 1st April, 2010 paying 10 lakhs immediately and the balance to be paid along with interest over next few years. Useful life estimated ₹ 8 years. Scrap value estimated ₹ 3 Lakhs. On 1st April 2013 principal amount of loan outstanding was ₹ 6 Lakhs. On this date (i.e. 1/4/13) said outstanding loan amount was waived by the lender. Find Depreciation expense for 2013-14.

ANSWER

₹ 2,80,000

AQ 8

Factory plant purchased for ₹ 20 Lakhs. Another 3 Lakhs were spent as pre-operative expenses. The said fixed asset qualified as 'Qualifying Asset' under AS-16. Total borrowing cost incurred during the period ₹ 2,00,000 (including 80,000 for the period after qualifying asset was ready to put into use). Find gross book value of said factory plant.

ANSWER
₹ 24,20,000

AQ 9

A company is in the process of setting up a production line for manufacturing a new product. Based on trial runs conducted by the company, it was noticed that the production lines output was not of the desired quality. However, company has taken a decision to manufacture and sell the sub-standard product over the next one year due to the huge investment involved. What will be cut-off date for capitalization of the project cost.

ANSWER
Cut-off date is when trial run gets completed. Expenditure incurred after trial-run cannot be capitalized.

AQ 10

ABC Ltd. purchased a machine costing ₹ 80,000 for its manufacturing operations and paid transportation costs of ₹ 11,000. It further spent an amount of ₹ 6,000 for installation and testing of machine being pre-operative cost. What amount should ABC Ltd. record as the cost of the machine?

ANSWER
₹ 97,000

AQ 11

Meena Ltd. has an equipment purchased 2 year ago for ₹ 1,90,000. The residual value of the asset was estimated to be ₹ 10,000. The total useful life of the asset when purchased was 12 years. The company charges Depreciation as per Straight Line Method. Due to price adjustment, the cost of the asset is now increased by ₹ 15,000. What is the treatment for the increase in historical cost? Comment and calculate the revised depreciation for the current year.

ANSWER

Depreciation amount [(1,90,000-10,000) / 12 years]	= ₹ 15,000 p.a.
Present book value of the equipment after two years [₹ 1,90,000-(₹ 15,000×2 years)]	= ₹ 1,60,000
Revised depreciable value after price adjustment (₹ 1,60,000 + ₹ 15,000 – ₹ 10,000)	= ₹ 1,65,000
Revised depreciation amount [₹ 1,65,000 / 10 years]	= ₹ 16,500 p.a.

Increase in historical cost will be considered as revaluation of the book value of the asset. This revaluation of the book value of the asset is change in accounting estimate and hence depreciation on the same has been calculated prospectively.

AQ 12

Fire Ltd. purchased equipment for its power plant from Urja Ltd. during the year 2013-14 at a cost of ₹ 100 lacs. Fire Ltd. had paid only 90% and balance 10% was to be paid after one year on satisfactory performance of the equipment. During the Financial year 2014-15, Urja Ltd. waived off the balance 10% amount which was credited to Profit and Loss account by Fire Ltd. as discount received. Is this accounting treatment correct ? State in line with Accounting Standards.

ANSWER
According to AS 10 on Accounting for Fixed Assets, the cost of an asset may undergo changes subsequent to its acquisition on account of exchange fluctuation, price adjustment, changes in duty or similar factors. Such changes in price/cost needs to be adjusted with the cost of the asset. In the give case, Fire Ltd., initially accounted for 100% amount i.e., ₹ 100 lacs as cost of fixed asset although they paid only ₹ 90 lacs and kept ₹ 10 lacs as payable to the credit of Urja Ltd. Now since the supplier has waived off the balance amount of ₹ 10 lacs, this should be treated as change in price and needs to be adjusted with the cost of asset as per AS 10.Therefore, the treatment given by Fire Ltd., in crediting ₹ 10 lacs as discount to Profit & Loss Account is completely wrong and needs to be corrected.

AQ 13

Argon Ltd. purchased a shop on 1st January, 2001 at a cost of ₹ 8,50,000. The useful life of the shop is estimated as 30 years with residual value of ₹ 25,000 and depreciation is provided on a straight line basis. The shop was revalued on 30th June, 2015 for ₹ 19,50,000 and the revaluation was incorporated in the accounts.
Calculate: (i) The surplus on revaluation; (ii) Depreciation to be charged in the Profit and Loss account for the year ended on 31st December, 2015.

ANSWER
₹ 14,98,750; ₹ 75,847

AQ 14

Hema Ltd. purchased a machinery on 1.04.2008 for ₹ 15,00,000. The company charged straight line depreciation based on 15 years working life estimate and residual value ₹ 3,00,000. At the beginning of the 4th year, the company by way of systematic evaluation revalued the machinery upward by 20% of net book value as on date and also re-estimated the remaining useful life as 7 years and scrap value as nil. The increase in net book value was credited directly to revaluation reserves. Depreciation (on SLM basis) later on was charged to Profit & Loss Account. At the beginning of 8th year the company decided to dispose off the machinery and estimated the realizable value to ₹ 2,00,000.

You are required to ascertain the amount to be charged to Profit & Loss Account at the beginning of 8th year with reference to AS-10.

ANSWER

₹ 196000

AQ 15

An asset with an initial useful life of 10 years was acquired at cost of ₹ 16,00,000 on 01.04.2005 by Aspects Ltd. The scrap value was estimated at ₹ 70,000. During the year 2008-09, the Company re-estimated scrap value at ₹ 98,000. Compute the depreciation to be charged in each year; considering straight line method.

ANSWER

Annual dep. (first 3 yrs) ₹ 1,53,000 p.a. & thereafter ₹ 1,49,000 p.a.

AQ 16

Original cost of machine ₹ 1,26,000. Estimated useful life 10 years. Estimated scrap value ₹ 6,000. The estimate of remaining useful life after third year was re-estimated at 5 years. Find annual depreciation for fourth year. Further, in the fifth year the scrap value re-estimated at ₹ 1,000. What will be the annual depreciation for the 5th Year.

ANSWER

Annual dep. (4th yr) ₹ 16,800 & Annual dep. (5th yr) ₹ 18,050

AQ 17

The cost of the main machine ₹ 60,000. The cost of attachments ₹ 6,000. Estimated useful life 6 years and 10 years respectively. The terminal value / residual value / scrap value is zero for both. Assume fixed installment method / Original cost method of depreciation. Find annual depreciation in case:

(i) If attachment becomes integral part of the machine.

(ii) If attachment retains its separate identity and is capable of being used after the main machine is disposed off.

ANSWER

Annual dep. (i) ₹ 11,000 ; (ii) ₹ 10,600

AQ 18

Original cost of machine ₹ 1,20,000. Estimated useful life 10 years. Estimated scrap value NIL. The machine was revalued upwards by ₹ 6,000 at the beginning of 4th year and the remaining useful life was also re-estimated at 9 years. Find annual depreciation for fourth year.

ANSWER

Annual dep. (4th yr) ₹ 10,000

THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES
ACCOUNTING STANDARD 11 (REVISED)

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

I	II	III
In accounting for transactions in foreign currencies.	In translating the financial statements of foreign operations.	This Statement also deals with accounting for foreign currency transactions in the nature of forward exchange contracts.

Few Definitions

Monetary items	Monetary items 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	Non-monetary items are assets and liabilities other than monetary items. For example, fixed assets, inventories and investments in equity shares.
Foreign currency	Foreign currency is a currency other than the reporting currency of an enterprise

I. Transactions in Foreign Currencies

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.

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.

***For* Monetary Item**	***For* Non-monetary Item**
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. 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.* The contingent liability denominated in foreign currency at the balance sheet date is disclosed by using the closing rate.	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. Non-monetary items which are carried at fair value should be reported using the exchange rates that existed when the values were determined.

Recognition of Exchange Differences:

Main Rule	**Option: In case of Long-term foreign currency loan (Para 46 & 46A for Companies /**

	Para 46 for non-corporate entities)
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. An exchange difference results when there is a change in the exchange rate between the transaction date and the date of settlement of any monetary items arising from a foreign currency transaction. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognised in each intervening period up to the period of settlement is determined by the change in exchange rates during that period.	Exchange differences arising on reporting of long term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, insofar as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and should be depreciated over the balance life of the asset, and in other cases, can be accumulated in the Foreign Currency Monetary Item Translation Difference (FCMITD) Account and should be written off over the life of the liability. Such option is irrevocable and should be applied to all such foreign currency monetary items. A liability should be designated as a long-term foreign currency monetary item, if the asset is expressed in a foreign currency and has a term of 12 months or more at the date of origination of the said liability. The enterprise exercising such option should disclose the fact of such option and of the amount remaining to be amortised in the financial statements of the period in which such option is exercised and in every subsequent period so long as any exchange difference remains unamortised.

II. Foreign Operations

Few More Definitions

Foreign operation	Foreign operation is a subsidiary, associate, joint venture or branch of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise.
Integral foreign operation	Integral foreign operation is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations.
Non-integral foreign operation	Non-integral foreign operation is a foreign operation that is not an integral foreign operation. When there is a change in the exchange rate between the reporting currency and the local currency, there is little or no direct effect on the present and future cash flows from operations of either the non-integral foreign operation or the reporting enterprise. The change in the exchange rate affects the reporting enterprise's net investment in the non-integral foreign operation rather than the individual monetary and non-monetary items held by the non-integral foreign operation.

Classification of Foreign Operations as Integral or Non-Integral

Integral foreign operation	Non-integral foreign operation
An integral foreign operation carries on its business as if it were an extension of the reporting enterprise's operations. For example, such an operation might only sell goods imported from the	A non-integral foreign operation accumulates cash and other monetary items, incurs expenses, generates income and perhaps arranges borrowings, all substantially in its local currency. When there is a change in the exchange rate between the reporting currency and the local currency, there is little or no direct effect on the present and future cash flows from operations of either the non-integral foreign operation or the reporting enterprise. The change in the exchange rate affects the reporting enterprise's net

reporting enterprise and remits the proceeds to the reporting enterprise.	investment in the non-integral foreign operation rather than the individual monetary and non- monetary items held by the non-integral foreign operation.
The individual items in the financial statements of the foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself. The cost and depreciation of tangible fixed assets is translated using the exchange rate at the date of purchase of the asset or, if the asset is carried at fair value, using the rate that existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when those costs were incurred.	The translation of the financial statements of a non-integral foreign operation is done using the following procedures: (a) The assets and liabilities, both monetary and non-monetary, of the non-integral foreign operation should be translated at the closing rate; (b) Income and expense items of the non-integral foreign operation should be translated at exchange rates at the dates of the transactions; (c) All resulting exchange differences should be accumulated in a foreign currency translation reserve until the disposal of the net investment. In the case of a partial disposal, only the proportionate share of the related accumulated exchange differences is included in the gain or loss; (d) For practical reasons, a rate that approximates the actual exchange rates, for example an average rate for the period is often used to translate income and expense items of a foreign operation; (e) A contingent liability disclosed in the financial statements of a non-integral foreign operation is translated at the closing rate for its disclosure in the financial statements of the reporting enterprise.

Change in the classification of a foreign operation

IFO to NFO	NFO to IFO
When a foreign operation that is integral to the operations of the reporting enterprise is reclassified as a non-integral foreign operation, exchange differences arising on the translation of non-monetary assets at the date of the reclassification are accumulated in a foreign currency translation reserve.	When a non-integral foreign operation is reclassified as an integral foreign operation, the translated amounts for non-monetary items at the date of the change are treated as the historical cost for those items in the period of change and subsequent periods. Exchange differences which have been deferred are not recognised as income or expenses until the disposal of the operation.

III. Forward Exchange Contract

Few More Definitions

Forward exchange contract	Forward exchange contract means an agreement to exchange different currencies at a forward rate.
Forward rate	Forward rate is the specified exchange rate for exchange of two currencies at a specified future date.

Forward Exchange Contract:

For Hedging Purpose	For Trading or Speculation purpose
The premium or discount arising at the inception of such a forward exchange contract should be amortised as expense or income over the life of the contract.	In forward contract for trading or speculation purpose, the premium on contract i.e. the difference between the spot rate and contract rate will not be recorded in the books. Only when the contract is sold the difference between the contract rate and sale rate will be recorded in the Profit & Loss Account.

This Standard does not:

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	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	Deal with exchange differences arising from foreign currency borrowings to the extent that they	Deal with the restatement of an enterprise's financial statements from its reporting currency into another currency for the convenience of

using that currency. The Standard also requires disclosure of the reason for any change in the reporting currency.	are addressed in AS 3 'Cash flow statement'.	are regarded as an adjustment to interest costs.	users accustomed to that currency or for similar purposes.

Tax effects of exchange differences: Gains and losses on foreign currency transactions and exchange differences arising on the translation of the financial statements of foreign operations may have associated tax effects which are accounted for in accordance with AS 22.

QUESTION 1

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

01/01/2016	1 US$ = ₹ 48.00
31/03/2016	1 US$ = ₹ 49.00
31/07/2016	1 US$ = ₹ 49.50

ANSWER

Journal Entries in the Books of Kalim Ltd.

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

QUESTION 2

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

ANSWER

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

Calculation of Exchange Difference:

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

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

Note : The above answer has been given on the basis that the company has not availed the option for capitalisation of exchange difference as per paragraph 46/ 46A of AS 11.

However, as per paragraph 46A of the standard, the exchange differences arising on reporting of long term foreign currency monetary items at rates different from those at which they were initially recorded during the period, in so far as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and should be depreciated over the balance life of the asset.
Accordingly, in case Opportunity Ltd. opts for capitalising the exchange difference, then the entire amount of exchange difference of ₹ 1,00,000 will be capitalised to 'Equipment account'. This capitalised exchange difference will be depreciated over the useful life of the asset.
Cost of the asset on the reporting date

Initial cost of Equipment	₹ 24,00,000
Add: Exchange difference	₹ 1,00,000

Total cost on the reporting date ₹ 25,00,000

QUESTION 3

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

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

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

ANSWER

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

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

QUESTION 4

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 2016, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st Feb. was ₹ 48.85. How will you recognise the profit or loss on forward contract in the books of Rau Ltd?

ANSWER

Forward Rate ₹ 49.15
Less: Spot Rate (₹ 48.85)

Premium on Contract	₹ 0.30
Contract Amount	US$ 1,00,000
Total Loss (1,00,000 x 0.30)	₹ 30,000
Contract period 3 months	

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

QUESTION 5

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

ANSWER

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

Sale Rate	₹ 47.18
Less: Contract Rate	(₹ 47.10)
Premium on Contract	₹ 0.08
Contract Amount	US$ 1,00,000
Total Profit (1,00,000 x 0.08)	₹ 8,000

QUESTION 6

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

ANSWER

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

Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. For practical reasons, a rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non- monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realisable value is translated applying exchange rate when realisable value is determined which is generally closing rate.

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

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11.

QUESTION 7

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3.2015.
Sundry Debtors include amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at 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.

ANSWER

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

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

	Foreign Currency Rate	₹
Debtors		
Initial recognition US $8,547 (5,00,000/58.50)	1 US $ = ₹ 58.50	5,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Gain US $ 8,547 X (61.20-58.50)		23,077
Treatment: Credit Profit and Loss A/c by ₹ 23,077		
Long term Loan		
Initial recognition US $ 1,07,913.67 (60,00,000/55.60)	1 US $ = ₹ 55.60	60,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Loss US $ 1,07,913.67 X (61.20 – 55.60)		6,04,317
Treatment: Credit Loan A/c And Debit FCMITD A/C or Profit and Loss A/c by ₹ 6,04,317		

Thus Exchange Difference on Long term loan amounting ₹ 6,04,317 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting ₹ 23,077 is required to be transferred to Profit and Loss A/c.

QUESTION 8

	Exchange Rate per $
Goods purchased on 1.1.2007 of US $ 10,000	₹ 45
Exchange rate on 31.3.2007	₹ 44
Date of actual payment 7.7.2007	₹ 43

Ascertain the loss/gain for financial years 2006-07 and 2007-08, also give their treatment as per AS 11.

ANSWER

As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2007 and corresponding creditor would be recorded at ₹ 4,50,000 (i.e. $10,000 × ₹ 45)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditor of US $10,000 on 31.3.2007 will be reported at ₹ 4,40,000 (i.e. $10,000 × ₹ 44) and exchange profit of ₹ 10,000 (i.e. 4,50,000 – 4,40,000) should be credited to Profit and Loss account in the year 2006-07.

On 7.7.2007, trade payables of $10,000 is paid at the rate of ₹ 43. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 10,000 (i.e. 4,40,000 – 4,30,000) will be credited to Profit and Loss account in the year 2007-08.

QUESTION 9

Sunshine Company Limited imported raw materials worth US Dollars 9,000 on 25th February, 2011, when the exchange rate was ₹ 44 per US Dollar. The transaction was recorded in the books at the above mentioned rate. The payment for the transaction was made on 10th April, 2011, when the exchange rate was ₹ 48 per US Dollar. At the year end 31st March, 2011, the rate of exchange was ₹ 49 per US Dollar.

The Chief Accountant of the company passed an entry on 31st March, 2011 adjusting the cost of raw material consumed for the difference between ₹ 48 and ₹ 44 per US Dollar. Discuss whether this treatment is justified as per the provisions of AS-11 (Revised).

ANSWER

As per para 9 of AS 11, 'The Effects of Changes in Foreign Exchange Rates', initial recognition of a foreign currency transaction is done in the reporting currency by applying the exchange rate at the date of the transaction. Accordingly, on 25th February 2011, the raw material purchased and its creditors will be recorded at US dollar 9,000 × ₹ 44 = ₹ 3,96,000.

Also, as per para 11 of the standard, on balance sheet date such transaction is reported at closing rate of exchange, hence it will be valued at the closing rate i.e. ₹ 49 per US dollar (USD 9,000 x ₹ 49 = ₹ 4,41,000) at 31st March, 2011, irrespective of the payment made for the same subsequently at lower rate in the next financial year.
The difference of ₹ 5 (49 – 44) per US dollar i.e. ₹ 45,000 (USD 9,000 x ₹ 5) will be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2011 and will not be adjusted against the cost of raw materials.
In the subsequent year on settlement date, the company would recognize or provide in the Profit and Loss account an exchange gain of ₹ 1 per US dollar, i.e. the difference from balance sheet date to the date of settlement between ₹ 49 and ₹ 48 per US dollar i.e. ₹ 9,000. Hence, the accounting treatment adopted by the Chief Accountant of the company is incorrect i.e. it is not in accordance with the provisions of AS 11.

QUESTION 10

Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date? Classify the following as monetary or non-monetary item: (i) Share Capital ; (ii) Trade Receivables; (iii) Investments ; & (iv) Fixed Assets.

ANSWER
As per AS 11' The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.
Foreign currency monetary items should be reported using the closing rate at each balance sheet date. 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. 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.

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

QUESTION 11

Deekay Ltd. purchased fixed assets costing ₹ 5,000 lakh on 01.04.2012 payable in foreign currency (US$) on 05.04.2013. Exchange rate of 1 US$ = ₹ 50.00 and ₹ 54.98 as on 01.04.2012 and 31.03.2013 respectively.
The company also obtained a soft loan of US$ 1 lakh on 01.04.2012 payable in three annual equal instalments. First instalment was due on 01.05.2013.
You are required to state, how these transactions would be accounted for in the books of accounts ending 31st March, 2013.

ANSWER
As per AS 11 (Revised) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as an expense in the period in which they arise. However, Ministry of Corporate Affairs has recently amended AS 11 through a notification. As per the notification, exchange difference arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to requisition of depreciable capital asset, can be added to or deducted from cost of asset. The MCA has given an option for the enterprises to capitalize the exchange differences arising on reporting of long term foreign currency monetary items till 31st March, 2020. Thus the company can capitalize the exchange differences arising due to long term loans linked with the acquisition of fixed assets.
Transaction 1: Calculation of exchange difference on fixed assets Foreign Exchange Liability
= 5,000 lakhs / 50 = US $ 100 lakhs
Exchange Difference = US $ 100 lakhs x (₹ 54.98 – ₹ 50) = ₹ 498 lakhs.
Loss due to exchange difference amounting ₹ 498 lakhs will be capitalised and added in the carrying value of fixed assets. Depreciation on the unamortised amount will be provided in the remaining years.
Transaction 2: Soft loan exchange difference (US $ 1 lakh i.e ₹ 50 lakhs)
Value of loan 31.3.13 → US $ 1 lakh x 54.98 = ₹ 54,98,000
AS 11 also provides that in case of liability designated as long-term foreign currency monetary item (having a term of 12 months or more at the time of origination) the exchange difference is to be accumulated in the

Foreign Currency Monetary Item Translation Difference (FCMITD) and should be written off over the useful life of such long-term liability, by recognition as income or expenses in each of such periods.
Exchange difference between reporting currency (INR) and foreign currency (USD) as on 31.03.2013 = US$1.00 lakh X ₹ (54.98 – 50) = ₹ 4.98 lakh.
Loan account is to be increased to 54.98 lakh and FCMITD account is to be debited by 4.98 lakh. Since loan is repayable in 3 equal annual instalments, ₹ 4.98 lakh/3 = ₹ 1.66 lakh is to be charged in Profit and Loss Account for the year ended 31st March, 2013 and balance in FCMITD A/c ₹ (4.98 lakh – 1.66 lakh) = ₹ 3.32 lakh is to be shown on the 'Equity & Liabilities' side of the Balance Sheet as a negative figure under the head 'Reserve and Surplus' as a separate line item.
Note: The above answer is given on the basis that the company has availed the option under para 46A of AS 11

QUESTION 12

"The company had a engineering contract with a foreign government, work to be carried out in foreign country and payments to be received in dollars. The work was completed in the year 2015, and the entire contracted amount was duly recorded in the books of the company at the prevalent exchange rate on the date of completion of the work. However, payments to the extent of ₹ 40 crores could not be released by the Foreign Government because of temporary foreign exchange crisis in that country. This ₹ 40 crores unrealized at the end, if converted at the year end rate would amount to ₹ 40.50 croes. The Company has adopted and follows the following accounting policy:
"In respect of foreign currency transactions, current assets and current liabilities are revalued at year end rates. However, if there is a net loss, due to exchange difference, the same is charged off to the P&L account, but if there is a net gain, the same is ignored in view of the prudent accounting policies of not recording unrealized gains due to exchange rate fluctuations".
Comment on the appropriateness of the above.

ANSWER

In given case the recoverability of ₹ 40 Crores is not doubtful or uncertain but just deferred temporarily hence it should be translated using exchange rates at the close of the year. Further AS-11 clearly mentions that net difference shall be transferred to profit and loss account. Hence, we can say that exchange difference favourable or unfavorable both shall be considered at the year end rather to ignore the gains and recording just losses.

QUESTION 13

On 31st March, 2012, the following ledger balances have been extracted from the books of Washington branch office of A Ltd. whose Head Office is in Mumbai.

Ledger Accounts	**$**
Building	180
Stock as on 1.4.2011	26
Cash and Bank Balances	57
Purchases	96
Sales	110
Commission receipts	28
Debtors	46
Creditors	65

You are required to convert above Ledger balances into Indian Rupees.
Use the following rates of exchange:

	₹ per $
Opening rate	46
Closing rate	50
Average rate	48
For fixed assets	42

May 2010

ANSWER

Conversion of ledger balances (in Dollars) into Rupees

	$	**Rate per $**	**Amount in ₹**
Building	180	42	7,560
Stock as on 01.04.2011	26	46	1,196
Cash and bank balances	57	50	2,850
Purchases	96	48	4,608
Sales	110	48	5,280

Commission receipts	28	48	1,344
Debtors	46	50	2,300
Creditors	65	50	3,250

Assumption: The branch is a integral foreign operation of A Limited.

QUESTION 14

Omega has a branch at Washington. Its Trial Balance as at 30th September, 2012 is as follows:

	Dr. US $	Cr. US $
Plant and machinery	1,20,000	-
Furniture and fixtures	8,000	-
Stock, Oct. 1, 2011	56,000	-
Purchases	2,40,000	-
Sales	-	4,16,000
Goods from Omega (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	-
	5,47,000	**5,47,000**

The following further information is given:
(1) Wages outstanding - $ 1,000.
(2) Depreciate Plant and Machinery and Furniture and Fixtures @ 10% p.a.
(3) The Head Office sent goods to Branch for ₹ 39,40,000.
(4) The Head Office shows an amount of ₹ 43,00,000 due from Branch.
(5) Stock on 30th September, 2012 - $ 52,000.
(6) There were no in transit items either at the start or at the end of the year.
(7) On September 1, 2010, when the fixed assets were purchased, the rate of exchange was ₹ 38 to one $.

On October 1, 2011, the rate was ₹ 39 to one $.
On September 30, 2012, 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 30th September, 2012 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.

Assume: The branch is a non-integral foreign operation of Omega.

ANSWER

In the books of Omega
Washington Branch Trial Balance (in Rupees)
as on 30th September, 2012

	Dr. US $	Cr. US $	Conversion Rate	Dr. (₹ '000')	Cr. (₹ '000')
Plant and Machinery	1,08,000		41	44,28,000	
Depreciation on plant and machinery	12,000		41	4,92,000	
Furniture and fixtures	7,200		41	2,95,200	
Depreciation on furniture and fixtures	800		41	32,800	
Stock, Oct. 1, 2011	56,000		39	21,84,000	
Purchases	2,40,000		40	96,00,000	
Sales		4,16,000	40		1,66,40,000
Goods from Omega (H.O.)	80,000			39,40,000	
Wages	3,000		40	1,20,000	
Outstanding wages		1,000	41		41,000
Carriage inward	1,000		40	40,000	

Salaries	6,000		40	2,40,000	
Rent, rates and taxes	2,000		40	80,000	
Insurance	1,000		40	40,000	
Trade expenses	1,000		40	40,000	
Head Office A/c		1,14,000			43,00,000
Trade debtors	24,000		41	9,84,000	
Trade creditors		17,000	41		6,97,000
Cash at bank	5,000		41	2,05,000	
Cash in hand	1,000		41	41,000	
Exchange gain (bal. fig.)					10,84,000
	5,48,000	**5,48,000**		**2,27,62,000**	**2,27,62,000**

(b) **Washington Branch Trading and Profit and Loss Account for the year ended 30th September, 2012**

	₹		₹
To Opening stock	21,84,000	By Sales	1,66,40,000
To Purchases	96,00,000	By Closing stock (52,000 US $ 41)	21,32,000
To Goods from Head Office	39,40,000		
To Wages	1,20,000		
To Carriage inward	40,000		
To Gross profit c/d	28,88,000		
	1,87,72,000		**1,87,72,000**
To Salaries	2,40,000	By Gross profit b/d	28,88,000
To Rent, rates and taxes	80,000		
To Insurance	40,000		
To Trade expenses	40,000		
To Depreciation on plant and machinery	4,92,000		
To Depreciation on furniture and fixtures	32,800		
To Net Profit c/d	19,63,200		
	28,88,000		**28,88,000**

Balance Sheet of Washington Branch as on 30th September, 2012

Liabilities	₹	₹	**Asses**	₹	₹
Head Office A/c	43,00,000		Plant and machinery	49,20,000	
Add: Net profit	19,63,200	6,263,200	Less: Depreciation	(4,92,000)	44,28,000
Foreign currency			Furniture and fixtures	3,28,000	
Translation reserve		10,84,000	Less: Depreciation	(32,800)	2,95,200
Trade creditors		6,97,000	Closing stock		21,32,000
Outstanding wages		41,000	Trade debtors		9,84,000
			Cash in hand		41,000
			Cash at bank		2,05,000
		80,85,200			**80,85,200**

Note: Depreciation has been calculated at the given depreciation rate of 10% on WDV basis.

QUESTION 15

The Washington branch of XYZ Mumbai sent the following trial balance as on 31st December, 2012:

	$	**$**
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, 2012	11,200	-
Goods from H.O.	64,000	-
Expenses	5,000	
	1,10,200	**1,10,200**

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

Washington Branch A/c

	₹		₹
To Balance b/d	8,10,000	By Cash	28,76,000
To Goods sent to branch	29,26,000	By Balance c/d	8,60,000
	37,36,000		**37,36,000**

Goods are sent to the branch at cost plus 10% and the branch sells goods at invoice price plus 25%. Machinery was acquired on 31st January, 2007, when $ 1.00 = ₹ 40.
Rates of exchange were:

1st January, 2012	$ 1.00	=	₹ 46
31st December, 2012	$ 1.00	=	₹ 48
Average	$ 1.00	=	₹ 47

Machinery is depreciated @ 10% and the branch manager is entitled to a commission of 5% on the profits of the branch.
You are required to:

(i) Prepare the Branch Trading & Profit & Loss A/c in dollars.

(ii) Convert the Trial Balance of branch into Indian currency and prepare Branch Trading & Profit and Loss A/c and the Branch A/c in the books of head office.

Note: Ignore stock reserve calculations.

ANSWER

(i) **In the Books of Head Office**
Branch Trading and Profit & Loss A/c (in Dollars)
for the year ended 31st December, 2012

Particulars	**$**	**Particulars**	**$**
To Opening stock	11,200	By Sales	84,000
To Goods from H.O.	64,000	By Closing stock (W.N.2)	8,000
To Gross profit c/d	16,800		
	92,000		92,000
To Expenses	5,000	By Gross profit b/d	16,800
To Depreciation	2,400		
To Manager's commission (W.N.1)	470		
To Net profit c/d	8,930		
	16,800		16,800

(ii) (a) Converted Branch Trial Balance (into Indian Currency)

Particulars	**Rate per $**	**Dr. (₹)**	**Cr.(Rs.)**
Machinery	40	9,60,000	-
Stock January 1, 2012	46	5,15,200	-
Goods from head office	Actual	29,26,000	-
Sales	47	-	39,48,000
Expenses	47	2,35,000	-
Debtors & creditors	48	2,30,400	1,63,200
Cash at bank	48	57,600	-
Head office A/c	Actual	-	8,60,000
Difference in exchange rate		47,000	
		49,71,200	49,71,200
Closing stock $ 8,000 (W.N.2)	48		₹ 3,84,000

(b) Branch Trading and Profit & Loss A/c for the year ended 31st December, 2012

Particulars	**₹**	**Particulars**	**₹**
To Opening stock	5,15,200	By Sales	39,48,000
To Goods from Head office	29,26,000	By Closing stock (W.N.2)	3,84,000
To Gross profit c/d	8,90,800		
	43,32,000		43,32,000
To Expenses	2,35,000	By Gross profit b/d	8,90,800
To Depreciation @ 10% on ₹ 9,60,000	96,000		
To Exchange difference	47,000		
To Manager's commission (W.N.1)	22,560		
To Net Profit c/d	4,90,240		
	8,90,800		**8,90,800**

Branch Account

	₹			₹
To Balance b/d	8,60,000	By Machinery	9,60,000	
To Net profit	4,90,240	Less: Depreciation	(96,000)	8,64,000
To Creditors	1,63,200	By Closing stock		3,84,000
To Outstanding commission	22,560	By Debtors		2,30,400
		By Cash at bank		57,600
	15,36,000			**15,36,000**

Working Notes:

1. Calculation of manager's commission @ 5% on profit

5% of $ [16,800 – (5,000 + 2,400)] = 5% × $9,400 = $ 470

Manager's commission in Rupees = $ 470 × ₹ 48 = ₹ 22,560

2. Calculation of closing stock

Opening stock		11,200
Add: Goods from head office		64,000
		75,200
Less: Cost of goods sold (at invoice price) i.e. 100/125×84,000		(67,200)
Closing stock		8,000

Closing stock in Rupees = $8,000×₹ 48=₹ 3,84,000.

Assumption: The branch is a integral foreign operation of XYZ Mumbai.

QUESTION 16

DM Delhi has a branch in London which is an integral foreign operation of DM. At the end of the year 1st March, 2011, the branch furnishers the following trial balance in U.K. Pound:

Particulars	£ Dr.	£ C.
Fixed assets (Acquired on 1st April, 2007)	24,000	
Stock as on 1st April, 2010	11,200	
Goods from head office	64,000	
Expenses	4,800	
Debtors	4,800	
Creditors		3,200
Cash at bank	1,200	
Head Office Account		22,800
Purchases	12,000	
Sales		96,000
	1,22,000	1,22,000

In head office books, the branch account stood as shown below:

London Branch A/c

Particulars	Amount ₹	Particulars	Amount ₹
To Balance B/d	20,10,000	By Bank A/c	52,16,000
To Goods sent to branch	49,26,000	By Balance C/d	17,20,000
	69,36,000		**69,36,000**

The following further information is given:

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

(b) On 31st March, 2010:

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

(c) Rate of Exchange:

1st April, 2007	-	₹ 70 to £ 1
1st April, 2010	-	₹ 76 to £ 1
31st March, 2011	-	₹ 77 to £ 1
Average	-	₹ 75 to £ 1

You are required to prepare:

(1) Trial balance, incorporating adjustments of outstanding and prepaid expenses, converting U.K. pound into Indian rupees.

(2) Trading and profit and loss account for the year ended 31st March, 2011 and the Balance Sheet as on that date of London branch as would appear in the books of Delhi head office of DM.

ANSWER

Trial Balance of London Branch as on 31st March, 2011

Particulars	U.K. Pound	Rate Per U.K. Pound	Dr. (₹)	Cr.(Rs.)
Fixed Assets	24,000	70	16,80,000	
Stock (as on 1st April, 2010)	11,200	76	8,51,200	
Goods from Head Office	64,000	-	49,26,000	
Sales	96,000	75		72,00,000
Purchases	12,000	75	9,00,000	
Expenses (4,800 + 400 – 200)	5,000	75	3,75,000	
Debtors	4,800	77	3,69,600	
Creditors	3,200	77		2,46,400
Outstanding Expenses	400	77		30,800

Prepaid expenses	200	77	15,400	
Cash at Bank	1,200	77	92,400	
Head office Account		-		17,20,000
Difference in Exchange				12,400
			92,09,600	**92,09,600**

Closing stock will be (8,000 × 77) = ₹ 6,16,000

Trading and Profit & Loss A/c
for the year ended 31st March, 2011

Particulars	**Amount (₹)**	**Particulars**	**Amount (₹)**
To Opening Stock	8,51,200	By Sales	72,00,000
To Purchases	9,00,000	By Closing Stock	6,16,000
To Goods from H.O.	49,26,000		
To Gross Profit	11,38,800		
	78,16,000		78,16,000
To Expenses	3,75,000	By Gross Profit	11,38,800
To Depreciation	1,68,000	By Profit due to Exchange difference	12,400
To Net Profit	6,08,200		
	11,51,200		**11,51,200**

Balance Sheet as on 31st March, 2011

Liabilities	**₹**	**₹**	**Assets**	**₹**	**₹**
Head office Balance	17,20,000		Fixed Assets Less: Depreciation	16,80,000 (1,68,000)	15,12,000
Add: Net Profit	6,08,200	23,28,200	Debtors		3,69,600
Outstanding expenses		30,800	Cash at bank		92,400
Creditors		2,46,400	Prepaid expenses		15,400
			Closing stock		6,16,000
		26,05,400			**26,05,400**

QUESTION 17

Moon Star has a branch at Virginia (USA). The Branch is a non-integral foreign operation of the Moon Star. The trial balance of the Branch as at 31st March, 2012 is as follows:

Particulars	**US $ Dr.**	**Cr.**
Office equipments	48,000	
Furniture and Fixtures	3,200	
Stock (April 1, 2011)	22,400	
Purchases	96,000	
Sales	---	1,66,400
Goods sent from H.O.	32,000	
Salaries	3,200	
Carriage inward	400	
Rent, Rates & Taxes	800	
Insurance	400	
Trade Expenses	400	
Head Office Account	---	45,600
Sundry Debtors	9,600	
Sundry Creditors	---	6,800
Cash at Bank	2,000	
Cash in Hand	400	
	2,18,800	**2,18,800**

The following further information's are given:
(1) Salaries outstanding $ 400.
(2) Depreciate office equipment and furniture & fixtures @ 10% p.a. at written down value.
(3) The Head Office sent goods to Branch for ₹ 15,80,000.
(4) The Head Office shows an amount of ₹ 20,50,000 due from Branch.
(5) Stock on 31st March, 2012-$21,500.
(6) There were no transit items either at the start or at the end of the year.
(7) On April 1, 2010 when the fixed assets were purchased the rate of exchange was ₹ 43 to one $. On April 1, 2011, the rate was 47 per $. On March 31, 2012 the rate was ₹ 50 per $. Average rate during the year was ₹ 45 to one $.

Prepare:
(a) Trial balance incorporating adjustments given converting dollars into rupees.

(b) Trading, Profit and Loss Account for the year ended 31st March, 2012 and Balance Sheet as on date depicting the profitability and net position of the Branch as would appear in the books of Moon Star for the purpose of incorporating in the main Balance Sheet.

ANSWER

In the Books of Moon Star
Trial Balance (in Rupees) of Virginia (USA) Branch
as on 31st March, 2012

	Dr.	Cr.	Conversion	Dr.	Cr.
	US $	**US $**	**Rate**	**₹**	**₹**
Office Equipment	43,200		50	21,60,000	
Depreciation on Office Equipment	4,800		50	2,40,000	
Furniture and fixtures	2,880		50	1,44,000	
Depreciation on furniture & fixtures	320		50	16,000	
Stock (1st April, 2011)	22,400		47	10,52,800	
Purchases	96,000		45	43,20,000	
Sales		1,66,400	45		74,88,000
Goods sent from H.O.	32,000		15,80,000		
Carriage inward	400		45	18,000	
Salaries (3,200+400)	3,600		45	1,62,000	
Outstanding salaries		400	50		20,000
Rent, rates and taxes	800		45	36,000	
Insurance	400		45	18,000	
Trade expenses	400		45	18,000	
Head Office A/c		45,600			20,50,000
Trade debtors	9,600		50	4,80,000	
Trade creditors		6,800	50		3,40,000
Cash at bank	2,000		50	1,00,000	
Cash in hand	400		50	20,000	
Exchange gain (bal. fig.)					4,66,800
	2,19,200	2,19,200		1,03,64,800	1,03,64,800

(b) **Trading and Profit and Loss Account of Virginia Branch**
for the year ended 31st March, 2012

			₹
To Opening stock	10,52,800	By Sales	74,88,000
To Purchases	43,20,000	By Closing stock	10,75,000
To Goods from Head Office	15,80,000	(2,500 US $ × 50)	
To Carriage inward	18,000		
To Gross profit c/d	15,92,200		
	85,63,000		85,63,000
To Salaries	1,62,000	By Gross profit b/d	15,92,200
To Rent, rates and taxes	36,000		
To Insurance	18,000		
To Trade expenses	18,000		
To Depreciation on office equipment	2,40,000		
To Depreciation on furniture and fixtures	16,000		
To Net Profit c/d	11,02,200		
	15,92,200		**15,92,200**

Balance Sheet of Virginia Branch
as on 31st March, 2012

Liabilities	₹	₹	**Assets**	₹	₹
Head office A/c	20,50,000		Office Equipment	24,00,000	
Add: Net Profit	11,02,200	31,52,200	Less: Depreciation	(2,40,000)	21,60,000
Foreign Currency Translation		4,66,800	Furniture and fixtures	1,60,000	
Trade creditors		3,40,000	Less: Depreciation	(16,000)	1,44,000
Outstanding salaries		20,000	Closing stock		10,75,000
			Trade debtors		4,80,000
			Cash in hand		20,000
			Cash at bank		1,00,000
		39,79,000			**39,79,000**

QUESTION 18

ABCD Ltd., Delhi has a branch in New York, USA, which is an integral foreign operation of the company. At the end of 31st March, 2013, the following ledger balances have been extracted from the books of the Delhi office and the New York Branch:

Particulars	Delhi (₹ thousands)		New York ($ thousands)	
	Debit	Credit	Debit	Credit
Share Capital		1,250		
Reserves and Surplus		940		
Land	475			
Building (cost)	1,000			
Building Depreciation Reserve		200		
Plant & Machinery (cost)	2,000		100	
Plant & Machinery Depreciation Reserve		500		20
Trade receivables/payables	500	270	60	20
Stock (01-04-2012)	250		25	
Branch Stock Reserve		65		
Cash & Bank Balances	125		4	
Purchases/Sales	275	600	25	125
Goods sent to Branch		1,500	30	
Managing Director's salary	50			
Wages & Salaries	100		18	
Rent			6	
Office Expenses	25		12	
Commission receipts		275		100
Branch/H.O. Current A/c	800			15
	5,600	**5,600**	**280**	**280**

The following information is also available:

(1) Stock as at 31-03-2013

Delhi – ₹ 2,00,000

New York - $ 10 (all stock received from Delhi)

(2) Head Office always sent goods to the Branch at cost plus 25%.

(3) Provision is to be made for doubtful debts at 5%.

(4) Depreciation is to be provided on Buildings at 10% and on Plant and Machinery at 20% on written down values.

You are required:

(a) To convert the branch Trial Balance into rupees, using the following rates of exchange:

Exchange:

Opening rate 1 \$ = ₹ 50

Closing rate 1 \$ = ₹ 55

Average rate 1 \$ = ₹ 52

For fixed assets 1 \$ = ₹ 45

(b) To prepare the Trading and Profit & Loss Account for the year ended 31st March, 2013, showing to the extent possible, Head Office results and Branch results separately.

ANSWER

ABCD Ltd.
New York Branch Trial Balance
as on 31st March 2013

	($ '000)			(₹ '000)	
	Dr.	**Cr.**	**Conversion rate per $**	**Dr.**	**Cr.**
Plant & Machinery (cost)	100		₹ 45	4,500	
Plant & Machinery Dep. Reserve		20	₹ 45		900
Trade receivables/payable	60	20	₹ 55	3,300	1,100
Stock (1.4.2012)	25		₹ 50	1,250	
Cash & Bank Balances	4		₹ 55	220	
Purchase / Sales	25	125	₹ 52	1,300	6,500

Goods received from H.O.	30		Actual	1,500	
Wages & Salaries	18		₹ 52	936	
Rent	6		₹ 52	312	
Office expenses	12		₹ 52	624	
Commission Receipts		100	₹ 52		5,200
H.O. Current A/c		15	Actual		800
				13,942	14,500
Exchange loss (bal. fig.)				558	
	280	280		14,500	14,500
Closing stock	.010		₹ 55	0.55	

Trading and Profit & Loss Account
for the year ended 31st March, 2013

					(₹ 000)		
	H.O.	**Branch**	**Total**		**H.O.**	**Branch**	**Total**
To Opening Stock	250	1,250.00	1,500.00	By Sales	600	6,500.00	7,100.00
To Purchases	275	1,300.00	1,575.00	By Goods sent to Branch	1,500	-	1,500.00
To Goods received from Head Office	-	1,500.00	1,500.00	By Closing Stock	200	0.55	200.55
To Wages & Salaries	100	936.00	1,036.00				
To Gross profit c/d	1,675	1,514.55	3,189.55				
	2,300	6,500.55	8,800.55		2,300	6,500.55	8,800.55
To Rent	-	312.00	312.00	By Gross profit b/d	1,675	1,514.55	3,189.55
To Office expenses	25	624.00	649.00	By Commission receipts	275	5,200.00	5,475.00
To Provision for doubtful debts @ 5%	25	165.00	190.00				
To Depreciation (W.N.1)	380	720.00	1,100.00				
To Balance c/d	1,520	4,893.55	6,413.55				
	1,950	6,714.55	8,664.55		1,950	6,714.55	8,664.55
To Exchange loss			558.00	By Balance b/d			6,413.55
To Managing Director's Salary			50.00	By Branch Stock Reserve (W.N.2)			64.89
To Balance c/d			5,870.44				
			6,478.44				**6,478.44**

Working Notes:

(1) Calculation of Depreciation

	H.O ₹ 000	**Branch ₹ 000**
Building – Cost	1,000	
Less: Dep. Reserve	(200)	
	800	
Depreciation @ 10% (A)	80	
Plant & Machinery Cost	2,000	4,500
Less: Dep. Reserve	(500)	(900)
	1,500	3,600
Depreciation @ 20% (B)	300	720
Total Depreciation (A+B)	380	720

(2) Calculation of Additional Branch Stock Reserve

	(₹'000)
Closing stock of Branch	0.55
Reserve on closing stock (0.55 × 1/5)	0.11
Less : Branch Stock Reserve (as on 1.4.2012)	(65)
Reversal of Stock Reserve	(64.89)

ACCOUNTING FOR GOVERNMENT GRANTS

ACCOUNTING STANDARD 12

Government :
Government refers to government, government agencies, and similar bodies whether local, national or international

Government Grants :
Government Grants are assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions. Grant includes subsidies, cash incentives, duty drawbacks etc.

Recognition of Government Grants :
Recognise Government Grants when both the following conditions are fulfilled:
(i) It is expected that enterprise will comply with the conditions attached to the grant
(ii) Expected that the grants will be received

Where to recognise Government Grants :

(1) Grants related to Fixed Assets (non-depreciable asset)

- Deduct grant from gross value of asset, or
- Amount of grant may be credited to capital reserve.

  (However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income is suitably disclosed in the balance sheet pending its apportionment to profit and loss account)

  However, when grant equals whole or virtually the whole cost of Fixed Asset, then show Fixed Asset at nominal value.

(2) Grants related to Fixed Assets (depreciable asset)

- Deduct grant from gross value of asset)0r
- Amount of grant may be treated as Deferred Income. Recognise in P/L on rational & systematic basis over useful life

  (However, when grant equals whole or virtually the whole cost of Fixed Asset, then show Fixed Asset at nominal value.)

(3) Grants related to Revenue

- These are to be recognised in Profit & Loss Account on systematic basis over period to match related costs
- Show under Other Income or Deduct from related expense

(4) Grants in the nature of Promoter Contribution

- These are to be credited to Capital Reserve
- These are treated as a part of shareholders fund

  (Can be neither distributed as dividend nor considered as deferred income)

(5) Grants in the form of non-monetary asset given at concessional rate

- Record asset at acquisition cost

(6) Grants in the form of non-monetary asset given free of cost

- Record asset at nominal value

(7) Grants that are receivable as compensation for expenses or losses incurred in previous accounting period or for the purpose of giving immediate financial support with no further related costs

- These should be recognised in Profit & Loss account of the period in which they are receivable.
- Show as Extraordinary item, if appropriate as per AS 5

Treatment of Grants Refundable:
(Treat these as Extra-ordinary items)

(1) Related to Revenue
- Reverse the deferred credit, if any. The shortfall should be charged to Profit & Loss Account.

(2) Related to specific Fixed Asset
- Increase Book Value of Asset
  (in this case, depreciation prospectively in residual life), or
- Reduce Capital Reserve, or
- Deferred Income Balance
  (as appropriate)

(3) In the Nature of Promoter Contribution
- Reduce Capital Reserve

Exclusions from Standard :
- Accounting for government grants in financial statements reflecting the effects of changing prices
- Government assistance other than in the form of government grants
- Government participation in the ownership of the enterprise.

Disclosure
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 statements, including grants of non-monetary assets given at a concessional rate or free of cost.

Capital Approach versus Income Approach

Two broad approaches may be followed for the accounting treatment of government grants:
Capital approach:- Under which a grant is treated as part of shareholders' funds.
Income approach:- Under which a grant is taken to income over one or more periods.

Those in support of the 'capital approach' argue as follows:
(i) Many 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 and no repayment is ordinarily expected in the case of such grants. These should, therefore, be credited directly to shareholders' funds.
(ii) It is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs.

Arguments in support of the 'income approach' are as follows:
(i) Government grants are rarely gratuitous. The enterprise earns them through compliance with their conditions and meeting the envisaged obligations. They should therefore be taken to income and matched with the associated costs which the grant is intended to compensate.
(ii) As income tax and other taxes are charges against income, it is logical to deal also with government grants, which are an extension of fiscal policies, in the profit and loss statement. (iii) In case grants are credited to shareholders' funds, no correlation is done between the accounting treatment of the grant and the accounting treatment of the expenditure to which the grant relates.

It is generally considered appropriate that accounting for government grant should be based on the nature of the relevant grant. Grants which have the characteristics similar to those of promoters' contribution should be treated as part of shareholders' funds. Income approach may be more appropriate in the case of other grants.

It is fundamental to the 'income approach' that government grants be recognised in the profit and loss statement on a systematic and rational basis over the periods necessary to match them with the related costs. Income recognition of government grants on a receipts basis is not in accordance with the accrual accounting assumption.

BASE QUESTIONS

1.	ABC (P) Limited sold solar panels for ₹ 20,00,000 during the period. It earned and received Government Grant of ₹ 3,00,000 i.e. 15% of sales achieved. Record the transaction.
2.	M/S ABC Electro manufactured and sold solar panels. The cost of basic raw materials consumed amounted to ₹ 15,00,000 during the period. It earned and received Government Grant of ₹ 3,00,000 i.e. 20% of cost of principal raw materials consumed. Record the transaction.
3.	ABC (P) Limited purchased land for the factory for ₹ 10,00,000 and received ₹ 2,00,000 as Government Grant against the same. Record the transactions using both methods.
4.	ABC (P) Limited purchased plant and machinery for the factory for ₹ 10,00,000 and received ₹ 2,00,000 as Government Grant against the same. The useful life of the plant and machinery estimated as 4 years with estimated scrap value of ₹ 1,00,000. The followed wanted to follow SLM method of depreciation. Record the transactions using both methods.
5.	ABC (P) Limited purchased plant and machinery for the factory for ₹ 10,00,000 and received ₹ 2,00,000 as Government Grant against the same. The useful life of the plant and machinery estimated as 4 years with estimated scrap value of ₹ 1,00,000. The followed wanted to follow WDV method of depreciation. Record the transactions using both methods. Note: The rate of depreciation comes to 40.539% p.a. under method 1 and 43.765% p.a. under method 2.
6	ABC (P) Limited invested ₹ 40,00,000 in the project located in the backward area and received ₹ 10,00,000 as Government Grant against the same. Record the transaction.
7.	Intelligent Public School got land for the school from the Government at concessional value of ₹ 80,00,000. The market value of land would be ₹ 2,00,00,000. Record the transaction.
8.	Intelligent Public School got land for the school from the Government, for free. The market value of land would be ₹ 50,00,000. Record the transaction.
9.	XYZ (P) Limited was incurring losses for the last four years and was on the verge of closure. Its closure may cause employment loss for at-least 200 families. Taking the facts of the matter into consideration, the Government gave financial aid of ₹ 1,00,00,000 to the ailing company, to enable the company to continue with its operations.

MAIN QUESTIONS

QUESTION 1

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

Case (ii): Pass the necessary journal entries in the books of the company for first two years if the grant is treated as deferred income.

ANSWER

Case (i)

Journal in the books of Z Ltd.

Year	*Particulars*		*₹ (Dr.)*	*₹ (Cr.)*
1st	Fixed Assets Account	Dr.		50,00,000
	To Bank Account		50,00,000	
	(Being Fixed Assets purchased)			

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

Case (ii)

Journal in the books of Z Ltd.

Year	Particulars		₹ (Dr.)	₹ (Cr.)
1st	Fixed Assets Account	Dr.		50,00,000
	To Bank Account		50,00,000	
	(Being fixed assets purchased)			
	Bank Account	Dr.		10,00,000
	To Deferred Government Grant Account		10,00,000	
	(Being grant received from the government)			
	Depreciation Account	Dr.		9,00,000
	To Fixed Assets Account		9,00,000	
	(Being depreciation charged on SLM)			
	Profit & Loss Account	Dr.		9,00,000
	To Depreciation Account		9,00,000	
	(Being depreciation transferred to P/L Account)			
	Deferred Government Grants Account	Dr.		2,00,000
	To Profit & Loss Account		2,00,000	
	(Being proportionate government grant taken to P/L Account)			
2nd	Depreciation Account	Dr.		9,00,000
	To Fixed Assets Account		9,00,000	
	(Being depreciation charged on SLM)			
	Profit & Loss Account	Dr.		9,00,000
	To Depreciation Account		9,00,000	
	(Being depreciation transferred to P/L Account)			
	Deferred Government Grant Account	Dr.		2,00,000
	To Profit & Loss Account		2,00,000	
	(Being proportionate government grant taken to P/L Account)			

QUESTION 2

M/s Aspects Ltd. purchased fixed assets for ₹ 25 Lakhs for which it got grants from an international agency (which comes within the definition of government as mentioned in AS 12) ₹ 15 Lakhs. Aspects Ltd. decides to treat the grant as deferred income. Suggest appropriate basis for taking credit of the grant to Profit and Loss A/c. Take estimated useful life of the assets as 5 years. The company followed W.D.V. method of depreciation. Depreciation rate 20% p.a.. Estimated Scrap value ₹ 8,19,200 Lakhs.

ANSWER

₹

Year	Depreciation @ 20% WDV Method	Income from grant	
Year 1	500000	1500000 X 500000 / 1680800 =	446216
Year 2	400000	1500000 X 400000 / 1680800 =	356973
Year 3	320000	1500000 X 320000 / 1680800 =	285578
Year 4	256000	1500000 X 256000 / 1680800 =	228463
Year 5	204800	1500000 X 204800 / 1680800 =	182770
	(Total)1680800		15,00,000

QUESTION 3

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 ₹ 12,00,000 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 4

How Government grant relating to specific fixed asset is treated in the books as per AS-12?

ANSWER

In accordance with AS 12, government grants related to specific fixed assets should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value. Where the grant related to a specific fixed asset equals the whole, or virtually the whole, of the cost of the asset, the asset should be shown in the balance sheet at a nominal value.

Alternatively, government grants related to depreciable fixed assets may be treated as deferred income which should be recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset, i.e., such grants should be allocated to income over the periods and in the proportions in which depreciation on those assets is charged. Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income is suitably disclosed in the balance sheet pending its apportionment to profit and loss account.

QUESTION 5

How would you record a non-monetary grant received from the Government as per AS 12?

ANSWER

According to para 7.1 of AS 12 'Accounting for Government Grants', Government grants may take the form of non-monetary assets such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary grants given free of cost are recorded at a nominal value.

QUESTION 6

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

ANSWER

As per AS 12 'Accounting for Government Grants', when government grant is received for a specific purpose, it should be utilised for the same. So the grant received for setting up a factory is not available for distribution of dividend. In the second case, even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value. The treatment of both the elements of the grant is incorrect as per AS 12.

QUESTION 7

Top & Top Limited has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment. Having fulfilled all the conditions under the scheme, the company on its investment of ₹ 50 crore in capital assets received ₹ 10 crore from the Government in January, 2017 (accounting period being 2016-2017). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 2017. Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.

ANSWER

As per para 10 of AS 12 'Accounting for Government Grants', where the government grants are of the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus it is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs. The correct treatment is to credit the subsidy to capital reserve. Therefore, the accounting treatment desired by the company is not proper.

QUESTION 8

A Ltd. purchased a machinery for ₹ 40 lakhs. (Useful life 4 years and residual value ₹ 8 lakhs) Government grant received is ₹ 16 lakhs.
Show the Journal Entry to be passed at the time of refund of grant in the third year and the value of the fixed assets, if:
(1) the grant is credited to Fixed Assets A/c
(2) the grant is credited to Deferred Grant A/c

ANSWER

In the books of A Ltd.

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

Journal Entries (at the time of refund of grant)

		₹	₹
Fixed Assets a/c	Dr.	16,00,000	
To Bank a/c			16,00,000
(Being grant refunded)			

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

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

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

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

		₹	₹
Deferred grant a/c Dr.		8,00,000	
P & L a/c	Dr.	8,00,000	
To Bank a/c			16,00,000
(Being grant refunded)			

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

Working Notes:

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

Fixed assets initially recorded in the books = ₹ 40 lakhs – ₹ 16 lakhs = ₹ 24 lakhs
Depreciation p.a. = (₹ 24 lakhs – ₹ 8 lakhs)/4 years = ₹ 4 lakhs per year
Value of fixed assets after two years but before refund of grant = ₹ 24 lakhs – (₹ 4 lakhs x 2 years) = ₹ 16 lakhs.

2. Balance of Fixed Assets after two years but before refund (under second alternative)
Fixed assets initially recorded in the books = ₹ 40 lakhs
Depreciation p.a. = (₹ 40 lakhs – ₹ 8 lakhs)/4 years = ₹ 8 lakhs per year
Book value of fixed assets after two years = ₹ 40 lakhs – (₹ 8 lakhs x 2 years) = ₹ 24 lakhs

QUESTION 9

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

ANSWER

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

The amount refundable in respect of a government grant related to revenue is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement. In the present case, the amount of refund of government grant should be shown in the profit & loss account of the company as an extraordinary item during the year.

QUESTION 10

Explain the treatment of refund of Government Grants as per Accounting Standard 12.

ANSWER

Para 11 of AS 12, "Accounting for Government Grants", explains treatment of government grants in following situations:

(i) When government grant is related to revenue
- (a) When deferred credit account has a balance: The amount of government grant refundable will be adjusted against unamortized deferred credit balance remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit the amount is immediately charged to profit and loss account.
- (b) Where no deferred credit account balance exists: The amount of government grant refundable will be charged to profit and Loss account.

(ii) When government grant is related to specific fixed assets
- (a) Where at the time of receipt, the amount of government grant reduced the cost of asset: The amount of government grant refundable will increase the book value of the asset.
- (b) Where at the time of receipt, the amount of government grant was credited to "Deferred Grant Account": The amount of government grant refundable will reduce the capital reserve or unamortized balance of deferred grant account as appropriate.

(iii) When government grant is in the nature of Promoter's contribution The amount of government grant refundable in part or in full on non-fulfilment of specific conditions, the relevant amount recoverable by the government will be reduced from capital reserve.

A government grant that becomes refundable is treated as an extra-ordinary item.

QUESTION 11

How refund of revenue grant received from the Government is disclosed in the Financial Statements?

ANSWER

The amount refundable in respect of a grant related to revenue should be applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount should be charged to profit and loss statement. The amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., 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.

QUESTION 12

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

ANSWER

Journal Entries

Year	Particulars		₹ in lakhs (Dr.)	₹ in lakhs (Cr.)
1	Fixed Asset Account	Dr.	20	
	To Bank Account			20
	(Being fixed asset purchased)			
	Bank Account	Dr.	8	
	To Fixed Asset Account			8
	(Being grant received from the government reduced the cost of fixed asset)			
	Depreciation Account (W.N.1)	Dr.	2	
	To Fixed Asset Account			2
	(Being depreciation charged on Straight Line method (SLM))			
	Profit & Loss Account	Dr.	2	
	To Depreciation Account			2
	(Being depreciation transferred to Profit and Loss Account at the end of year 1)			
2	Fixed Asset Account	Dr.	5	
	To Bank Account			5
	(Being government grant on asset partly refunded which increased the cost of fixed asset)			
	Depreciation Account (W.N.2)	Dr.	3.67	
	To Fixed Asset Account			3.67
	(Being depreciation charged on SLM on revised value of fixed asset prospectively)			
	Profit & Loss Account	Dr.	3.67	
	To Depreciation Account			3.67
	(Being depreciation transferred to Profit and Loss Account at the end of year 2)			

Working Notes :

1. Depreciation of Year 1

	₹ in lakhs
Cost of the Asset	20
Less : Government grant received	(8)
	12
Depreciation $\frac{12-4}{4}$	2

2. Depraciation for Year 2

	₹ in lakhs
Cost of the Asset	20
Less : Government grant received	(8)
	12
Less : Depraciation for the firs year $\frac{12-4}{4}$	2
	10
Add : Government grant refundable	5
	15
Depraciation for the second year $\frac{15-4}{3}$	3.67

QUESTION 13

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2014- 15 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet and was not deducted from the cost of plant. 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 ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2017-18 in profit and loss account? AS 13 Accounting for Investments.

ANSWER

As per 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. In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 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.

QUESTION 14

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.

QUESTION 15

How would you treat the following in the accounts in accordance with AS 12 'Government Grants'?

(i) ₹ 35 Lakhs received from the Local Authority for providing Medical facilities to the employees.

(ii) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in a notified backward area.

(iii) ₹ 10 Lakhs Grant received from the Central Government on installation of antipollution equipment.

ANSWER

(i) ₹ 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in the nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, ₹ 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

(ii) 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 and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of ₹ 100 lakhs should be credited to capital reserve.

(iii) ₹ 10 lakhs grant received for installation anti-pollution equipment is a grant related to specific fixed asset. Two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives. Under first method, the grant is shown as a deduction from the gross value of the asset concerned 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, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

Thus, ₹ 10 lakhs may either be deducted from the cost of equipment or treated as deferred income to be recognized on a systematic basis in profit & Loss A/c over the useful life of equipment.

QUESTION 16

Darshan Ltd. purchased a Machinery on 1st April, 2016 for ₹ 130 lakhs (Useful life is 4 Years). Government grant received is ₹ 40 lakhs for the purchase of above Machinery. Salvage value at the end of useful life is estimated at ₹ 60 lakhs. Darshan Ltd. decides to treat the grant as deferred income. You are required to calculate the amount of depreciation and grant to be recognized in profit & loss account for the year ending 31st

March, 2017,31st March, 2018, 31st March, 2019& 31st March, 2020. Darshan Ltd. follows straight line method for charging depreciation.

ANSWER

As per 12 “Accounting for government grants”, grants related to depreciable assets, if treated as deferred income are recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Amount of depreciation and grant to be recognized in the profit and loss account each year Depreciation per year:

		₹ in lakhs
Cost of the Asset		130
Less: Salvage value		(60)
		70
Depreciation per year	(70 lakhs / 4)	17.50

₹ 17.50 Lakhs depreciation will be recognized for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

Amount of grant recognized in Profit and Loss account each year: 40 lakhs /4 years = ₹ 10 Lakhs for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

QUESTION 17

On 1st April, 2016, Mac Ltd. received a Government Grant of ₹ 60 lakhs for acquisition of machinery costing ₹300 lakhs. The grant was credited to the cost of the asset. The estimated useful life of the machinery is 10 years. The machinery is depreciated @ 10% on WDV basis. The company had to refund the grant in June 2019 due to noncompliance of certain conditions. How the refund of the grant is dealt with in the books of Mac Ltd. assuming that the company did not charge any depreciation for the year 2019-20.

Pass necessary Journal Entries for the year 2019-20.

ANSWER (As per ICAI)

Journal Entries

Machinery Account To Bank Account (Being government grant on asset partly refunded which increased the cost of fixed asset)	Dr.	60	60
Depreciation Account To Machinery Account (Being depreciation charged on revised value of fixed asset prospectively for 10 months)	Dr.	19.337	19.337
Profit & Loss Account To Depreciation Account (Being depreciation transferred to Profit and Loss Account amounting to ₹ (2.916 + 19.337= 22.253)	Dr.	22.253	22.253

Working Notes:

		(₹ in lakhs)
1st April, 2016	Acquisition cost of machinery	300.00
	Less: Government Grant	60.00
		240.00
31st March, 2017	Less: Depreciation @ 10%	(24.00)
1st April, 2017	Book value	216.00
31st March, 2018	Less: Depreciation @ 10%	(21.60)
1st April, 2018	Book value	194.40
31st March, 2019	Less: Depreciation @ 10%	(19.44)
1st April, 2019	Book value	174.96
	Less: Depreciation @10% for 2 months	(2.916)
1st June, 2019	Book value	172.044
June 2019	Add: Refund of grant*	60.00
	Revised book value	232.044

Depreciation @10% on the revised book value amounting to ₹ 232.044 lakhs is to be provided prospectively over the residual useful life of the machinery.

**considered refund of grant at beginning of June month and depreciation for two months already charged. Alternative answer considering otherwise also possible.*

ASSIGNMENT

A-1

X Ltd. received a grant of ₹ 2 crores from the Central Government for the purpose of a special Machinery during 1998 -99. The cost of Machinery was ₹ 20 crores and had a useful life of 9 years. During 2002-03, the grant has become refundable due to non-fulfillment of certain conditions attached to it. Assuming the entire grant was deducted from the cost of Machinery in the year of acquisition. State with reasons, the accounting treatment to be followed in the year 2002-03.

ANSWER

As per AS 12 on Accounting for Government Grants, the amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset. Depreciation on the revised book value is provided prospectively over the residual useful life of the asset. In the given case, book value of machinery will be increased by ₹ 2 crores in the year 2002-2003. The computations for the depreciation on machinery can be given as:

Cost of machinery			₹ 20 crores
Less:	Grant received		₹ 2 crores
	Cost of machinery		₹ 18 crores
Useful life of machinery			9 years
Depreciation per year as per straight line method			₹ 18 crores/9
	(assuming residual value to be zero)	=	₹ 2 crores
Total depreciation for 4 years (1998- 99 to 2001-2002)			₹ 8 crores
Book value (in year 2002-2003)			₹ 10 crores
Add: Grant refunded			₹ 2 crores
Revised book value			₹ 12 crores
Remaining useful life			5 years
Revised annual depreciation			₹ 12 crores/5
		=	₹ 2.4 crores

Thus, book value of machinery will be ₹ 12 crores in the year 2002-2003 and the depreciation amounting ₹ 2.4 crores will be charged on machinery. Annual depreciation of ₹ 2.4 crores will be charged in the next four years.

A-2

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs (This amount was reduced from the cost of fixed asset). Grant was considered as refundable in the end of 2nd year to the extent of ₹ 7,00,000. Pass the journal entry for refund of the grant as per the first method.

ANSWER

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

A-3

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

ANSWER

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

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

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

ASSIGNMENT A-4

On 01.04.2014, XYZ Ltd. received Government grant of ₹ 100 Lakhs for an acquisition of new machinery costing ₹ 500 lakhs. The grant was received and credited to the cost of the assets. The life span of the machinery is 5 years. The machinery is depreciated at 20% on WDV method.
The company had to refund the entire grant in 2nd April, 2017 due to non-fulfilment of certain conditions which was imposed by the government at the time of approval of grant.
How do you deal with the refund of grant to the Government in the books of XYZ Ltd., as per AS 12?

ANSWER

Value of machinery as at 02.04.2017 = ₹ 304.80 Lakhs. Depreciation at applicable rate on the revised book value amounting ₹ 304.80 lakhs is to be provided prospectively over the residual useful life of the asset.

ACCOUNTING FOR INVESTMENTS (AS 13)

Purpose: This Standard deals with accounting for investments in the financial statements of enterprises and related disclosure requirements.

Investments: Are assets held by an enterprise for earning income by way of dividends, interest & rentals, for capital appreciation, or for other benefits to the investing enterprise.
Assets held as stock in trade are not investments.

Current investment: Is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made.

Long-term investment: Is an investment other than a current investment.

Investment property: An investment property is an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise.
The cost of any shares in a co-operative society or a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property.
Treat investment property as long term investment.

Cost of investments: The cost of an investment includes acquisition charges such as brokerage, fees and duties.
If an investment is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost is the fair value of the securities issued. The fair value may not necessarily be equal to the nominal or par value of the securities issued.
If an investment is acquired in exchange, or part exchange, for another asset, the acquisition cost of the investment is determined by reference to the fair value of the asset given up. It may be appropriate to consider the fair value of the investment acquired if it is more clearly evident.

Fair value: Is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.
Under appropriate circumstances, market value or net realisable value provides an evidence of fair value.

Market value: is the amount obtainable from the sale of an investment in an open market, net of expenses necessarily to be incurred on or before disposal.

'Interest, dividends and rentals receivable' treated as income: Interest, dividends and rentals receivable in connection with an investment are generally regarded as income, being the return on the investment.
However, in some circumstances, such inflows represent a recovery of cost and do not form part of income, for example, when unpaid interest has accrued before the acquisition of an interest-bearing investment and is therefore included in the price paid for the investment, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; the pre-acquisition portion is deducted from cost.
When dividends on equity are declared from pre-acquisition profits, a similar treatment may apply. If it is difficult to make such an allocation except on an arbitrary basis, the cost of investment is normally reduced by dividends receivable only if they clearly represent a recovery of a part of the cost.

Right share: When rights share offered are subscribed for, the cost of the rights shares is added to the carrying amount of the original holding.
If rights are not subscribed for but sold in the market, the sale proceeds are taken to the profit and loss statement. **However**, where the investments are acquired on cum right basis and the market value of investments immediately after their becoming ex right is lower than the cost for which they

were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value.

Carrying amount of Current Investments: The carrying amount for current investments is the lower of cost and fair value.
In respect of investments for which an active market exists, market value generally provides the best evidence of fair value.
The valuation of current investments at lower of cost and fair value provides a prudent method of determining the carrying amount to be stated in the balance sheet.
Valuation of current investments on overall basis is not considered appropriate.
The more prudent and appropriate method is to carry investments individually at the lower of cost and fair value.
For current investments, any reduction to fair value and any reversals of such reductions are included in the profit and loss statement.

Carrying amount of Long Term Investments: The carrying amount for long term investments is usually carried at cost.
However, when there is a decline, other than temporary, in the value of a long-term investment, the carrying amount is reduced to recognise the decline.
Where there is a decline, other than temporary, in the carrying amounts of long term investments, the resultant reduction in the carrying amount is charged to the profit and loss statement and provision for diminution shall be made.
The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.
The carrying amount of long term investments is determined on an individual investment basis.

Carrying amount of Investments in 'Investment Property': An investment property is accounted for in accordance with cost model as prescribed in Accounting Standard (AS) 10, Property, Plant and Equipment.

An enterprise should disclose current investments and long term investments distinctly in its financial statements.

<u>Disposal of investment</u>: On disposal of an investment, the difference between the carrying amount and the disposal proceeds, net of expenses, is recognised in the P&L statement. When disposing of a part of the holding of an individual investment, the carrying amount to be allocated to that part is to be determined on the <u>basis of the average carrying amount of total holding of the investment</u>.

<u>Re-classification of investments:</u>

(i) **If long term investments are re-classified as current investments:** The transfer should be made at the lower of cost and carrying amount at the date of transfer.
(ii) **If current investments are re-classified as long-term investments:** The transfer should be made at the lower of cost and fair value at the date of transfer.

This accounting standard does not deal with:

(a) The bases of recognition of interest, dividends and rentals earned on investments which are covered by AS 9.
(b) Operating and finance leases.
(c) Investments of retirement benefit plans and life insurance enterprises.
(d) Mutual funds / asset management companies, banks and financial institutions as governed by RBI or other statutory bodies.

Disclosure in notes to accounts:

a) The accounting policy adopted for the determination of carrying amount of investments.
b) Separately details for dividends and interest received from subsidiary companies.
c) Separate details for dividend and interest from current investments and long-term investments.

d) Profit and loss on disposal of current investments and changes in carrying amount of balance investments.
e) Profit and loss on disposal of long term investments and changes in carrying amount of balance investments.
f) Significant restrictions on the right of ownership, realisability of investments or remittance of income and proceeds of disposal.
g) The aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments.
h) Other disclosures as specifically required by the relevant statute governing the enterprise.

Additional Points

1. A separate investment account should be made for each scrip purchased.
2. If pre-dividend amount cannot be quantified exactly, treat total dividend as revenue income and transfer the same to the credit side of P & L account.
3. In case year ending of dividend paying company is not given, then also consider total dividend received of shares held (including bonus shares) as revenue income and transfer the same to the credit side of P & L account.
4. *In the absence of a statutory requirement, such further classification should disclose, where applicable, investments in:*
   (a) Government or Trust securities
   (b) Shares, debentures or bonds
   (c) Investment properties
   (d) Others—specifying nature.
5. Shares, debentures and other securities held as stock-in-trade (i.e., for sale in the ordinary course of business) are not 'investments' as defined in this Standard. However, the manner in which they are accounted for and disclosed in the financial statements is quite similar to that applicable in respect of current investments. Accordingly, the provisions of this Standard, to the extent that they relate to current investments, are also applicable to shares, debentures and other securities held as stock-in-trade, with suitable modifications as specified in this Standard.

MAIN QUESTIONS

QUESTION 1

Mr. Chatur had 12% Debentures of Face Value ₹ 100 of M/s. Unnati Ltd. as current investments. He provides the following details relating to the investments.

1-4-2014 Opening balance 4000 debentures costing ₹ 98 each
1-6-2014 Purchased 2000 debentures @ ₹ 120 cum interest
1-9-2014 Sold 3000 debentures @ ₹ 110 cum interest
1-12-2014 Sold 2000 debentures @ ₹ 105 ex interest
31-1-2015 Purchased 3000 debentures @ ₹ 100 ex interest
31-3-2015 Market value of the investments ₹ 105 each
Interest due dates are : 30th June and 31st December.
Mr. Chatur closes his books on 31-3-2015. He incurred 2% brokerage for all his transactions.
Show investment account in the books of Mr. Chatur assuming FIFO method is followed

ANSWER

Investment A/c of Mr. Chatur
For the year ending on 31-3-2015
(Scrip: 12% Debentures of Unnati Limited)
(Interest Payable on 30th June and 31st December)

Date	Particulars	Nominal Value	Interest	Amount	Date	Particulars	Nominal Value	Interest	Amount
1.4.2014	To Balance b/d	4,00,000	12,000 (WN 1)	3,92,000	30.6.2014	By Bank (WN 3)	-	36,000	-

1.6.2014	To Bank (WN 2)	2,00,000	10,000	2,34,800	1.9.2014	By Bank (WN 4)	3,00,000	6,000	3,17,400
1.9.2014	To Profit on sale of investments (WN 5)			23,400	1,12,2014	By Bank (WN 6)	2,00,000	10,000	2,05,800
31.1.2015	To Bank (WN 9)	3,00,000	3,000	3,06,000	1.12.2014	By loss on sale of investments (WN 7)	-	-	9,600
31.3.2015	To Profit & Loss A/c (Balancing figure)		45,000		31.12.14	By Bank (WN 8)	-	6,000	-
					31.3.2015	By loss on revaluation of investments (WN 10)	-	-	3,400
					31.3.2015	By Balance c/d	4,00,000	12,000 (WN 11)	4,20,000 (WN 10)
		9,00,000	70,000	9,56,200			9,00,000	70,000	9,56,200

WORKING NOTES

WN 1	400000 X 12% X 3 /12 = 12000
WN 2	Cum interest price = 2000 X 120 = 240000 Brokerage = 240000 X 2% = 4800 Interest = (2000 X 100) X 12% X 5/12 = 10000 Cost of investments = (240000 – 10000) + 4800 = 234800
WN 3	600000 X 12% X 6 / 12 = 36000
WN 4	Cum interest price = 3000 X 110 = 330000 Brokerage = 330000 X 2% = 6600 Interest = (3000 X 100) X 12% X 2/12 = 6000 Investments realised = 330000 – 6000 – 6600 = 317400 (Net)
WN 5	Cost of investments sold = 392000 X 300000 / 400000 = 294000 Investments sold for = 317400 Profit on sale = 317400 – 294000 = 23400
WN 6	Ex interest price = 2000 X 105 = 210000 Brokerage = 210000 X 2% = 4200 Investments realised = 210000 – 4200 = 205800 (Net) Interest = (2000 X 100) X 12% X 5/12 = 10000
WN 7	Cost of investments sold = (392000 X 100000 / 400000) + (234800 X 100000 / 200000) = 215400 Investments sold for = 205800 Loss on sale = 215400 – 2058000 = 9600

WN 8	100000 X 12% X 6 /12 = 6000
WN 9	Ex interest price = 3000 X 100 = 300000 Brokerage = 300000 X 2% = 6000 Cost of investments = 300000 + 6000 = 306000 Interest = (3000 X 100) X 12% X 1/12 = 3000
WN 10	Investments c/d At cost: 392000 + 234800 + 306000 – 294000 – 215400 = 423400 At fair value: 4000 X 105 = 420000 Loss on revaluation = 3400 Current investments to be carried at lower of cost or fair value
WN 11	400000 X 12% X 3 /12 =12000

QUESTION 2

A Pvt. Ltd. follows the calendar year for accounting purposes. The company purchased 5,000 nos, of 13.5% Convertible Debentures of Face Value of ₹ 100 each of P Ltd, on 1st May 2014 @ ₹ 105 on cum interest basis. The interest on these instruments is payable on 31st March & 30th September respectively. On August 1st 2014 the company again purchased 2,500 of such debentures @ ₹ 102.50 each on cum interest basis. On October 1st, 2014 the company sold 2,000 Debentures @ ₹ 103 each. On 31st December, 2014 the company received 10,000 equity shares of ₹ 10 each in P Ltd, on conversion of 20% of its holdings. The market value of the debentures and equity shares as at the close of the year were ₹ 106 and ₹ 9 respectively. Prepare the Debenture Investment Account & Equity Shares Investment Account in the books of A Pvt. Ltd. for the year 2014 on Average Cost Basis.

ANSWER

Books of A Pvt. Ltd.
Investment in 13.5% Convertible Debentures in Pergot Ltd. Account
(Interest payable 31st Marc & 30th September)

Date	Particulars	Nominal Value	Interest	Amount	Date	Particulars	Nominal Value	Interest	Amount
2014 May 1	To Bank	5,00,000	5,625	5,19,375	2014 Sept.30	By Bank (6 months int.)		50,625	
Aug. 1	To Bank	2,50,000	11,250	2,45,000	Oct. 1	By Bank	2,00,000		2,06,000
Oct.1	To P&L A/c			2,167	Dec. 31	By Bank (See note 1)		3,7,13	
Dec.31	To P&L A/c		52,313		Dec.31	By Equity share	1,10,000		1,12,108
					Dec.31	By Balance c/d	4,40,000	14,850	4,48,434
		7,50,000	69,188	7,66,542			7,50,000	69,188	7,66,542

Note 1: ₹ 3,713 received on 31.12.2014 represents interest on the debentures converted till date of conversion.
Note 2: Cost being lower than Market Value the debentures are carried forward at Cost.

Investment in Equity shares in P Ltd. Account

Date	Particulars	Nominal	Amount	Date	Particulars	Nominal	Amount
		₹	₹			₹	₹
2014 Dec.31	To 13.5% Deb.	1,00,000	1,12,108	2014 Dec.31	By P&L A/c		22,108

				Dec.31	By Bal. c/d	1,00,000	90,000
		1,00,000	1,12,108			1,00,000	1,12,108

Note 3: Cost being higher than Market Value the shares are carried forward at Market Value.

Working Notes:

1	Interest @ transaction dt. 1.5.14	(5000 X 100) X 13.5% X 1/12 = 5625
2	Investments purchased dt. 1.5.14	5000 X 105 (cum interest) Less 5625 (Interest) = 519375
3	Interest @ transaction dt. 1.8.14	(2500 X 100) X 13.5% X 4/12 = 11250
4	Investments purchased dt. 1.8.14	2500 X 102.50 (cum interest) Less 11250 (Interest) = 245000
5	Interest 30.9.14	(7500 X 100) X 13.5% X 6/12 = 50625
6	Investments sold dt. 1.10.14	2000 X 103 (ex interest) = 206000
7	Profit on sale of investments	Cost of investment sold = (519375 + 245000) X $\frac{2000}{7500}$ = 203833 Sold for = 206000 Profit on sale = 2167
8	Debentures converted into equity shares	Nominal value of debentures converted into shares (500000 + 250000 – 2000000) X 20% =₹ 110000 Cost of converted portion of debentures = (519375 + 245000) X $\frac{1100}{7500}$ = 112108 Interest on converted portion = 110000 X 13.5% X 3/12 = 3713
9	Carried down value of debenture investments	(At cost) (519375 + 245000) X $\frac{4400}{7500}$ = 448433 [Market value 4400 X 106 = 466400 is higher than cost and thus ignored]
10	Carried down value of investments in equity shares	Cost = 112108 Market value (10000 X 9) = 90000 It will be carried at market value (being lower) and loss of revaluation will be 22108.

QUESTION 3

On 1-4-2014, Sundar had 25,000 equity shares of XYZ Ltd. at a book value of ₹ 15 per share (Face value ₹ 10).

On 20-6-2014, he purchased another 5,000 shares of the company at ₹ 16 per share.

The directors of XYZ Ltd. announced a bonus and rights issue. The terms of the issue are as follows:

Bonus basis 1 : 6 (Date 16-8-2014)

Rights basis 3 : 7 (Date 31-8-2014) Price ₹ 15 per share. Due date for payment 30-9-2014.

Shareholders can transfer their rights in full or in part. Accordingly, Sundar sold $33^1/_3$% of his entitlement to Shekhar for a consideration of ₹ 2 per share.

Dividend for the year ended 31-3-2014 at the rate of 20% were declared by XYZ Ltd. and received by Sundar on 31-10-2014.

On 15-11-2014, Sundar sold 25,000 equity shares at a premium of ₹ 5 per share.

You are required to prepare Investment Account & Abstract / Extract of P & L Account in the books of Sundar. Prepare account as on 31-12-2014.

ANSWER

Books of Sundar

Investment Account (Scrip: Equity Shares in X Ltd.)

		No.	Income	Amount			No.	Income	Amount
				₹					₹
1.4.2014	To Bal b/d	25,000		3,75,000	31.10.2014	By Bank	--	50,000	*10,000

20.6.2014	To Bank	5,000		80,000		(25000 X 10 X 20%) (5000 X 10 X 20%)			
16.8.2014	To Bonus shares (1:6) [(25000 + 5000) / 6]	5,000		--					
30.9.2014	To Bank (Rights Shares) {[(25000 + 5000+ 5000) X 3/7)] X 2/3}	10,000		1,50,000	15.11.2014	By Bank (Sale of shares)	25,000		3,75,000
15.11.2014	To Profit on sale of investments			44,444	31.12.2014	By Bal. c/d	20,000		2,64,444
31.12.2014	To P & L		50,000						
		45,000	50,000	6,49,444			45,000	50,000	6,49,444

* Pre-dividend received -- Dividend on shares acquired on 20/6/2014

Profit and Loss Account (Extract)

		By profit from sale of rights (5000 X 2)	10,000
		By dividend received	50,000
		By profit on sale of investments	44,444

Working Notes:

WN 1: Profit on sale of investments

Cost of investments sold = (375000 + 80000 + nil + 150000 – 10000) X 25000 / 45000 = 330556

Sold for = 375000

Profit on sale 44444

WN 2: Investments c/d

(375000 + 80000 + nil + 150000 – 10000) X 20000 / 45000 = 264444

OR

(375000 + 80000 + nil + 150000 – 10000) – 330556 = 264444

QUESTION 4

Meera Investments carried out the following transactions in the shares of Kumar Ltd..

a) On 1st April, 2013 Meera Investments purchased 40,000 equity shares of Re. 1 each fully paid for ₹ 60,000.

b) On 15th May, 2013, Meera Investments sold 8,000 shares for ₹ 15,200.

c) At a meeting on 15th June 2013, the company decided :

   i. to make a bonus issue of one fully paid share for every four shares held on 1st June 2013, and

   ii. to give its members the right to apply for one share for every five shares held on 1st June, 2013 at a price of ₹ 1.50 per share of which 75 paise is payable on or before 15th July, 2013, and the balance, 75 paise per share, on or before 15th September, 2013.

   The shares issued under (i) and (ii) were not to rank for dividend for the year ending 31st Dec., 2013.

d) Meera Investments received his bonus shares and took up 4,000 shares under the rights issue, paying the sums thereon when due and selling the rights to the remaining shares at 40 paise per share; the proceeds were received on 30th September, 2013.

e) On 15th March, 2014, Meera Investments received a dividend from Kumar Ltd. of 15 per cent in respect of the year ended 31st December, 2013.

f) On 30th March, Meera Investments received ₹ 28,000 for the sale of 20,000 shares.

You are required to record these transactions in the Investments Account in Meera Investment's books for the year ended 31st March 2014, transferring any profits or losses on these transactions.

ANSWER

In the books of Meera
Investment Account (Shares in Kumar Limited)

Date	Particulars	No. of shares	Income	Amount	Date	Particulars	No. of shares	Income	Amount
2013			₹	₹				₹	₹
April 1	To Bank	40,000	-	60,000	May 15	By Bank(Sale)	8,000	-	15,200
May 15	To Profit & Loss A/c	-	-	3,200					
June 15	To Bonus issue	8,000	-	Nil	2014				
July 15	To Bank @ 75 p. paid on 4,000 shares)	4,000	-	3,000	Mar.15	By Bank (Dividend @ 15% on ₹ 32,000)		4,800	
Sept. 15	To Bank @ 75 p. paid on 4,000 shares)	-	-	3,000	Mar.30	By Bank (Sale)	20,000	-	28,000
2014 March 30	To Profit & Loss A/c			3,455	Mar.31	By Balance c/d (24,000/44,000×54,000)	24,000	-	29,455
31.3.14	To Profit & Loss A/c	-	4,800						
		52,000	4,800	72,655			52,000	4,800	72,655

QUESTION 5

On 1-4-2009, XY Ltd had 15,000 equity shares of ABC Ltd. at a book value of ₹ 15 per share (Face value ₹ 10). On 01-6-2009, XY Ltd purchased another 5,000 shares of the same company at ₹ 20 per share. The directors of ABC Ltd. announced a bonus and rights issue. The terms of the issue are as follows:

Bonus basis 1 : 5 (Date 01-7-2009)

Rights basis 1 : 6 (Date 01-9-2009) at 20% premium.

Right shares are to be issued to be existing shareholders on 1st Sept. 2009. No dividend was payable on these shares.

Shareholders can transfer their rights in full or in part. Accordingly, XY Ltd sold 50% of its entitlement to Shekhar for a consideration of ₹ 8 per share.

Dividend for the year ended 31-3-2009 at the rate of 20% were declared by ABC Ltd. and received by XY Ltd. on 31-10-2009.

On 01-01-2010, XY Ltd sold half of its holdings at ₹ 16.50 per share. Brokerage being 1%.

You are required to prepare Investment Account.

ANSWER

In the books of XY Ltd.
Investment in equity shares of ABC Ltd.
for the year ended 31st March, 2010

Date	Particulars	No.	Income	Amount	Date	Particulars	No.	Income	Amount

			₹	₹				₹	₹
2009 April 1	To Balance b/d	15,000	-	2,25,000	2009 Oct.31	By Bank A/c	-	30,000	10,000
June 1	To Bank A/c	5,000	-	1,00,000	2010 Jan.1	By Bank A/c	13,000	-	2,12,355
July 1	To Bonus issue	4,000	-	-	March 31	By Balance c/d	13,000	-	1,69,500
Sept.1	To Bank A/c	2,000	-	24,000					
1.1.10	To P & L A/c	-	-	42,855					
31.3.10	To P&L A/c	-	30,000	-					
		26,000	**30,000**	**3,91,855**			**26,000**	**30,000**	**3,91,855**

QUESTION 6

On 1st April 2011 Mr. Shekharan purchased 5000 equity shares of ₹ 100 each in the V Ltd., @ ₹ 120 each from a broker, who charged 2% brokerage. He also incurred 50 paisa per ₹ 100 as stamp duty (i.e. 0.5% as cost of shares transfer stamps) . A year later the company resolved to capitalise its profit and to issue to the holders of equity shares, one equity share as bonus for every two shares held by them. Prior to the capitalisation , the shares of V Ltd., were quoted at ₹ 175 per share. After the capitalisation, the shares were quoted at ₹ 90 per share. Mr. Shekharan sold the bonus shares and paid brokerage 2% . Show the Investment Account in books of Mr. Shekharan.

ANSWER

In the books of T.Shekharan

Investment Account For the year ended 31st March, 2012 (Script: Equity Shares of V. Ltd.)

Date	**Particulars**	**Nominal Value (₹)**	**Cost (₹)**	**Date**	**Particulars**	**Nominal Value (₹)**	**Cost (₹)**
1.4.2011	To Bank A/c (W.N.1)	5,00,000	6,15,000	31.3.2012	By Bank A/c (W.No.2)	2,50,000	2,20,500
31.1.2012	To Bonus shares	2,50,000	-	31.3.2012	By Balance c/d (W.N. 4)	5,00,000	4,10,000
31.3.2012	To Profit and Loss A/c (W.N.3)		15,500				
		7,50,000	6,30,500			7,50,000	6,30,500

Working Notes:

1. **Cost of equity shares purchased on 1st April, 2011**
   = Cost +Brokerage + Cost of transfer stamps
   = 5,000 × ₹ 120 + 2% of ₹ 6,00,000 + ½% of ₹ 6,00,000
   = ₹ 6,15,000
2. Sale proceeds of equity shares sold on 31st March, 2012
   = Sale price – Brokerage
   = 2,500 × ₹ 90 – 2% of ₹ 2,25,000
   = ₹ 2,20,500
3. Profit on sale of bonus shares on 31st March, 2012
   = Sales proceeds = ₹ 2,20,500
   Average cost = Rs.[6,15,000×2,50,000/7,50,000]
   = ₹ 2,05,000
   Profit = ₹ 2,20,000 – ₹ 2,05,000=₹ 15,500
4. Valuation of equity shares on 31st March, 2012
   Cost = Rs.[6,15,000×5,00,000/7,50,000]= ₹ 4,10,000 i.e. ₹ 82 per share
   Market Value = 5,000 shares × ₹ 90 = ₹ 4,50,000
   Closing stock of equity shares has been valued at ₹ 4,10,000 i.e. cost being lower than the market value.

QUESTION 7

X purchased 500 ordinary shares of ₹ 100 each in the Omega Co. Ltd., for ₹ 62,500 inclusive of brokerage and stamp duty. Some years later the company resolved to capitalise its profit and to issue to the holders of ordinary shares, one ordinary shares as bonus for every share held by them. Prior to the capitalisation , the shares of Omega Co. Ltd., were quoted at ₹ 175 per share. After the capitalisation, the shares were quoted at ₹ 92.50 per share. X sold the bonus shares and received at ₹ 90 per share. Show the Investment Account in X's books.

ANSWER

In the books of Mr. A
Investment Account
[Scrip: Equity Shares in Omega Co. Ltd.]

Particulars	Nominal Value (₹)	Amount (₹)	Particulars	Nominal Value (₹)	Amount (₹)
To Bank	50,000	62,500	By Bank A/c	50,000	45,000
To Bonus shares	50,000	-			
To P & L A/c	-	13,750	By Balance c/d	50,000	31,250
	1,00,000	76,250		1,00,000	76,250

QUESTION 8

On 1.4.2014 Mr. Krishna Murty purchased 1000 equity shares of ₹ 100 each in TELCO Ltd. @ ₹ 120 each from a broker, who charged 2% brokerage. He incurred 50 paisa per ₹ 100 as share transfer stamps . On 31.3.2015, the company declared bonus shares in the ration of 1 : 2. Before and after the record date of bonus shares, the shares were quoted at ₹ 175 per share and ₹ 90 per share respectively. On 31.3.2015, Mr. Murty sold bonus shares through a broker, who charged 2% brokerage. Show the Investment Account in Krishna Murty's books.

ANSWER

In the books of Mr. Krishna Murty
Investment Account for the year ended 31st March, 2015
(Script: Equity Shares of TELCO Ltd.)

Date	Particulars	Nominal Value(₹)	Cost (₹)	Date	Particulars	Nominal Value(₹)	Cost (₹)
1.4.2014	To Bank A/c	1,00,000	1,23,000	31.3.2015	By Bank A/c	50,000	44,100
31.3.2015	To Bonus shares	50,000	-	31.3.2015	By Balance c/d	1,00,000	82,000
31.3.2015	To Profit and Loss A/c(W.N.(iii)	-	3,100				
		1,50,000	1,26,100			1,50,000	1,26,100

QUESTION 9

The following transactions of Nidhi took place during the year ended 31st March, 2014:

1st April, 2013 Purchased ₹ 12,00,000 8% bonds at ₹ 80.50 cum-interest. Interest is payable on 1st November and 1st May.
12th April Purchased 1,00,000 equity shares of ₹ 10 each in X Ltd. for ₹ 40,00,000.
1st May Received half year's interest on 8% bonds
15th May X Ltd. made a bonus issue of three equity shares for every two held. Investor Ltd. sold 1,25,000 bonus shares for ₹ 20 each.
1st October Sold ₹ 3,00,000 8% bonds at ₹ 81 ex-interest.
1st November Received half year's interest on 8% bonds.
1st December Received 18% dividend on equity shares in X Ltd.

Prepare the relevant investments accounts in the books of Nidhi for the year ended 31st March, 2014.

ANSWER

In the books of Nidhi
8% Bonds Account
[Interest Payable: 1st November & 1st May]

Date	Particulars	Nominal	Interest	Cost	Date	Particulars	Nominal	Interest	Cost
		Value (₹)	(₹)	(₹)			Value (₹)	(₹)	(₹)
1.4.13	To Bank A/c (W.N.1)	12,00,000	40,000	9,26,000	1.5.13	By Bank A/c	-	48,000	-
1.10.13	To Profit & Loss A/c			11,500	1.10.13	By Bank A/c (W.N.2)	3,00,000	10,000	2,43,000
31.3.14	To Profit & Loss A/c (W.N.6)		84,000		1.11.13	By Bank A/c(W.N.3)	-	36,000	-
					31.3.14	By Balance c/d(W.N.4)	9,00,000	30,000	6,94,500
		12,00,000	1,24,000	9,37,500			12,00,000	1,24,000	9,37,500

Investment in Equity Shares of X Ltd. Account

Date	Particulars	No.	Dividend	Cost	Date	Particulars	No.	Dividend	Cost
			(₹)	(₹)				(₹)	(₹)
12.4.13	To Bank A/c	1,00,000		40,00,000	15.5.13	By Bank A/c	1,25,000		25,00,000
15.5.13	To Bonus Issue	1,50,000			1.12.13	By Bank A/c		2,25,000	
15.5.14	To profit & Loss A/c			5,00,000	31.3.14	By Balance c/d	1,25,000		20,00,000
31.3.14	To profit & Loss A/c (W.N.5)		2,25,000						
		2,50,000	2,25,000	45,00,000			2,50,000	2,25,000	45,00,000

QUESTION 10

Mr. Shape had purchased and sold certain investments. He furnished the following data:
Investments in hand as at July 1, 2012
300 --- 3% Conversion Loan of ₹ 100 each purchased at ₹ 60.
250 --- Equity Shares of ₹ 10 each of Everlite Limited at ₹ 18 per share.
1000 --- 9% Preference shares of ₹ 100 each of Prosperous Limited at ₹ 95.
Transactions during the year :
Purchases: 750 Equity Shares of ₹ 10 each of Everlite Limited at ₹ 23.
250 Equity Shares of ₹ 10 each of Small Limited at ₹ 9.
125 Equity Shares of ₹ 10 each of Bright Shipping Limited at ₹ 12.
Sold: 100 --- 3% conversion loan at ₹ 65.
100 --- 9% Preference shares of Prosperous Limited at ₹ 99.
Interest/Dividends Received :

3% Conversion Loan ---Interest received ₹ 900.
9% Preference Shares of Prosperous Limited at ₹ 9,000.
Everlite Limited --- Dividend at 20% on 1000 Shares --- ₹ 2,000.

Everlite Limited issued Bonus Shares and Mr. Shape received 1000 Equity Shares of the Company as Bonus Shares.
You are required to show the Investment Account in the Books of Mr. Shape for the year ending 30th June, 2013.

ANSWER

Investment in 3% conversion loan

	b/d	30000	--	18000		By bank	10000	---	6500
	To profit.....	--	--	500		By bank	--	900	--
	To P & L	--	900	--		By bal c/d	20000	--	12000
		30000	**900**	**18500**			**30000**	**900**	**18500**

Investment in equity shares of Everlite Ltd.

	b/d	250	--	4500		By bank	--	2000	--
	To bank	750	--	17250					
	To bonus	1000	--						
	To P & L	--	**2000**	--		By bal c/d	2000	--	21750
		2000	**2000**	**21750**			**2000**	**2000**	**21750**

Investment in 9% pref. shares of Prosperous Ltd.

	b/d	100000	--	95000		By bank	10000	---	9900
	To profit.....	--	--	400		By bank	--	9000	--
	To P & L	--	9000	--		By bal c/d	90000	--	85500
		100000	**9000**	**95400**			**100000**	**9000**	**95400**

Investment in equity shares of Small Ltd.

	To bank	2500	2250				
					By bal c/d	2500	2250
		2500	**2250**			**2500**	**2250**

Investment in equity shares of Bright Shipping Ltd.

	To bank	1250	1500				
					By bal c/d	1250	1500
		1250	**1500**			**1250**	**1500**

QUESTION 11

The following transactions of Mr. Brown took place during the year ended 31st March, 2012:

01.05.2011 Purchased 24,000 12% Bonds of ₹ 100 each at ₹ 84 cum-interest. Interest is payable on 30th Sept. and 31st March every year.

15.06.2011 Purchased 1,50,000 equity shares of ₹ 10 each in Alpha Ltd. for ₹ 25 each. Brokerage paid 2%.

10.07.2011 Purchased 60,000 equity shares of ₹ 10 each in Betta Ltd. for ₹ 44 each. Brokerage paid 2%.

14.10.2011 Alpha Ltd. made a bonus issue of two equity shares for every three held.

31.10.2011 Sold 80,000 shares of Alpha Ltd. for ₹ 22 each.

01.01.2012 Received 15% interim dividend on equity shares in Alpha Ltd.

15.01.2012 Beeta Ltd. made a rights issue of one equity share for every four held at premium of ₹ 5 per share.
Mr. Brown exercised his option for 40% of his entitlement and sold the balance rights in the market at ₹ 2.25 per share.

01.03.2012 Sold 15,000 12% Bonds for ₹ 90 each (ex-interest).
15.03.2012 Received 18% interim dividend on equity shares in Beeta Ltd.
Interest on 12% Bonds was duly received on due dates.

Prepare the relevant investments accounts in the books of Mr. Brown for the year ended 31st March, 2012.

ANSWER

In the books of Mr. Brown
12% Bonds for the year ended 31st March, 2012

Date	Particulars	No.	Income	Amount	Date	Particulars	No.	Income	Amount
			(₹)	(₹)				(₹)	(₹)
2011 May 1	To Bank A/c	24,000	24,000	19,92,000	2011 Sept. 30	By Bank Interest	-	1,44,000	
2012 March 1	To profit on sale			1,05,000	2012 Mar. 1	By Bank A/c	15,000	75,000	13,50,000
2012 March 31	To P & L A/c (W.No.1) To P & L A/c		2,49,000		2012 Mar.31	By Bank-Interest		54,000	
					2012 Mar.31	By Balance c/d (W.N.2)	9,000	-	7,47,000
		24,000	2,73,000	20,97,000			24,000	2,73,000	20,97,000

Investment in Equity shares of Alpha Ltd. for the year ended 31st March, 2012

Date	Particulars	No.	Income	Amount	Date	Particulars	No.	Income	Amount
			(₹)	(₹)				(₹)	(₹)
2011 June 15	To Bank A/c	1,50,000	-	38,25,000	2011 Oct. 31	By Bank A/c	80,000	-	17,60,000
Oct. 14	To Bonus Issue (1,50,000/3×2)	1,00,000	-	-	2012 Jan.1	By Bank A/c-dividend		2,55,000	
2011 Oct..31	To P & L A/c			5,36,000	March 31	By Balance c/d	1,70,000	-	26,01,000
2012 Mar.31	To P & L A/c		2,55,000						
		2,50,000	2,55,000	43,61,000			2,50,000	2,55,000	43,61,000

Investment in Equity shares of Beeta Ltd. for the year ended 31st March, 2012

Date	Particulars	No.	Income	Amount	Date	Particulars	No.	Income	Amount
			(₹)	(₹)				(₹)	(₹)
2011 July 10	To Bank A/c	60,000	-	26,92,800	2012 Mar. 15	By Bank dividend	-	1,18,800	
2012 Jan. 15	To Bank A/c (W.N.5)	6,000	-	90,000	March 31	By Balance c/d(bal.fig.)	66,000	-	27,82,800
March 31	To P & L A/c	-	1,18,800	-					
		66,000	1,18,800	27,82,800			66,000	1,18,800	27,82,800

QUESTION 12

Smart Investments made the following investment in the year 2013-14:
12% State Government Bonds having face value ₹ 100

Date	Particulars
01.04.2013	Opening Balance (1200 Bonds) book value of ₹ 1,26,000
02.05.2013	Purchased 2,000 bonds @ ₹ 100 cum interest
30.09.2013	Sold 1,500 bonds at ₹ 105 ex interest

Interest on the bonds is received on 30th June and 31st Dec. each year

Equity Shares of X Ltd.	
15.04.2013	Purchased 5,000 equity shares @ ₹ 200 Brokerage of 1% was paid in addition (face Value of shares ₹ 10).
03.06.2013	The company announced a bonus issue of 2 shares for every 5 shares held
16.08.2013	The company made a rights issue of 1 share for every 7 shares held at ₹ 250 per share. The entire money was payable by 31.08.2013.
22.08.2013	Rights to the extent of 20% was sold @ ₹ 60. The remaining rights were subscribed.
02.09.2013	Dividend @ 15% of the year ended 31.03.2013 was received on 16.09.2013
15.12.2013	Sold 3,000 shares @ ₹ 300. Brokerage of 1% was incurred extra.
15.01.2014	Received interim dividend @ 10% for the year 2013-14
31.03.2014	The shares were quoted in the stock exchange @ ₹ 220

ANSWER

Investment A/c
(Scrip: 12% GB)

Date	Particulars	Nominal Value	Interest	Cost	Date	Particulars	Nominal Value	Interest	Cost
1.4.13	To Balance b/d	120000	3600	126000	30.6.13	By Bank		19200	
2.5.13	To Bank	200000	8000	192000	30.9.13	By Bank	150000	4500	157500
30.9.13	To profit on sale of investments			8438	31.12.13	By Bank		10200	
31.3.14	To Profit & Loss A/c (Balancing figure)		27400		31.3.14	By Balance c/d	170000	5100	168938
		320000	39000	326438			320000	39000	326438

Investment in Equity shares ….

Date	Particulars	No. of shares	Income	Amount	Date	Particulars	No. of shares	Income	Amount
			(₹)	(₹)				(₹)	(₹)
15.4.13	To Bank A/c	5000		1010000	16.9.13	By Bank			7500
3.6.13	To Bonus Issue	2000			15.12.13	By Bank	3000		891000
31.8.13	To Bank A/c	800		200000	15.1.14	By Bank		4800	
15.12.13	To profit on sale			428500					
31.3.14	To P & L A/c		4800		31.3.14	By Bal c/d	4800		740000
		7800	4800	1638500			7800	4800	1638500

QUESTION 13

Bonanzaa Ltd. held on 1st April,2012 ₹ 2,00,000 of 9% Govt. Loan at ₹ 1,90,000. (F.V. ₹ 100 each). On 31st May, 2012 the company purchased the same Govt. Loan of the face value of ₹ 80,000 at ₹ 95 (net) cum-interest.

On 1st June, 2012, ₹ 60,000 face value of the Loan was sold at ₹ 94 (net) ex-interest.
Interest on the loan is to be paid each year on 30th June and 31st December and to be credited by the bank on the same date.
On 30th November, 2012, ₹ 40,000 face value of the loan was sold at ₹ 97 (net) cum-interest.
On 1st December, 2012 the company purchased the same loan ₹ 10,000 ex-interest at par.
On 1st March, 2013 the company sold ₹ 10,000 face value of the loan at ₹ 95 ex-interest.
The market price of the loan on 31st March, 2013 was ₹ 94.
Draw up the said Loan A/c in the books of Bonanzaa Limited.
Calculation shall be made to the nearest rupee or multiple thereof.

ANSWER

Investment Account…

1/4/12	To balance b/d	200000	4500	190000	1/6/12	By bank	60000	2250	56400
31/5/12	To bank	80000	3000	73000	30/6/12	By bank	------	9900	---------
1/6/12	To profit on sale			43	30/11/12	By bank	40000	1500	37300
					30/11/12	By loss on sale			271
1/12/12	To bank	10000	375	10000	31/12/12	By bank	-----	8550	------
1/3/13	To profit on sale			75	1/3/13	By bank	10000	150	9500
31 /3/13	To P &L		18525		31/3/13	By loss on reval.			447
					31/3/13	By balance c/d	180000	4050	169200
		290000	**26400**	**273118**			**290000**	**26400**	**273118**

Working Notes:

1	200000 X 9% X 3/12 = 4500
2	80000 X 9% X 5/12 = 3000 800 X 95 = 76000 cum interest 76000 – 3000 = 73000 ex-interest
3	60000 X 9% X 5/12 = 2250 600 X 94 = 56400 Cost of investments sold (Applying average cost basis) = (190000 + 73000) X 600 / 2800 = 56357 Profit on sale = 56400 – 56357 = 43
4	[(2000 + 800 – 600) X 100] X 9% X 6/12 = 9900
5	40000 X 9% X 5/12 = 1500 400 X 97 = 38800 cum-interest 38800 – 1500 = 37300 Cost of investments sold (Applying average cost basis) = (190000 + 73000) X 400 / 2800 = 37571 Loss on sale = 37571 – 37300= 271
6	10000 X 9% X 5/12 = 375 100 X 100 = 10000 ex-interest
7	[(2000 + 800 – 600 – 400 + 100) X 100] X 9% X 6/12 = 8550
8	10000 X 9% X 2/12 = 150 100 X 95 = 9500 ex-interest

	Cost of investments sold (Applying average cost basis) = (190000 + 73000 – 56357 – 37571 + 10000) X 100 / 1900 = 9425 Profit on sale = 9500 – 9425 = 75
9	Balance 1800 units of Govt. Loan: At cost (190000 + 73000 – 56357 – 37571 + 10000 - 9425) = 169647 Market value (1800 X 94) = 169200 It will be carried at market value (being lower) and loss of revaluation will be 447. Interest accrued on investments = 180000 X 9% X 3/12 = 4050

QUESTION 14

Investors Ltd. held on 1-1-2012, ₹ 60,000 of 12% Govt. securities of ₹ 100 each of ₹ 56,500.
On 1.6.2012, the company purchased a further of ₹ 40,000 of the security at 96.5 cum-interest, brokerage being 1/2%.
On 31.7.2012, ₹ 50,000 of the security was sold at 94.5 ex-interest, brokerage being 1/2%.
On 1.12.2012, ₹ 20,000 of the security was again sold at ₹ 96 cum-interest.
Interest on the security was paid each year on 31st March and 30th September and was credited by the bank on 3rd April and 4th October respectively.
The price of the security on 31.12.2012, was 96. Investors Ltd. closes its books on 31st December each year. Draw up the Investment Account in the books of Investors Ltd.

ANSWER

Investment Account

1/1/12	To bal b/d	60000	1800	56500	3/4/12	By bank	-	3600	-
1/6/12	To bank	40000	800	37993	31/7/12	By bank	50000	2000	47014
					31/7/12	By loss on sale of....	-	-	233
					4/10/12	By bank	-	3000	-
					1/12/12	By bank	20000	400	18800
31/12/12	To P &L		7300		1/12/12	By loss on sale of....	-	-	98
					31/12/12	By balance c/d	30000	900	28348
		100000	**9900**	**94493**			**100000**	**9900**	**94493**

Working Notes:

1	60000 X 12% X 3/12 = 1800
2	60000 X 12% X 6/12 = 3600
3	Interest = 40000 X 12% X 2/12 = 800 Brokerage = 0.5% of transaction value = (400 X 96.50) X 0.5% = 193 Cost of investments = [(400 X 96.50) – interest] + brokerage = 38600 -800 + 193 = 37993
4	Interest = 50000 X 12% X 4/12 = 2000 Brokerage = 0.5% of transaction value = (500 X 94.50) X 0.5% = 236 Investments sold for = (500 X 94.50) – brokerage = 47250 – 236 = 47014 Cost of investments sold (Applying average cost basis) = (56500 + 37993) X 500 / 1000 = 47247 Loss on sale = 47247 – 47014 = 233
5	(60000 + 40000 – 50000) X 12% X 6/12 = 3000
6	Interest = 20000 X 12% X 2/12 = 400 Investments sold for = (200 X 96) – interest = 19200 – 400 = 18800 Cost of investments sold (Applying average cost basis) = (56500 + 37993) X 200 / 1000 = 18898 OR = (56500 + 37993 - 47247) X 200 / 500 = 18898 Loss on sale = 18898– 18800 = 98

7	Balance 300 Units of Govt Securities At cost (56500 + 37993 – 47247 - 18898) = 28348 Market value (300 X 96) = 28800 (Ignore, being higher than cost) Interest accrued on investments = 30000 X 12% X 3/12 = 900

QUESTION 15

A purchased on 1st March, ₹ 24,000 5% Bharat Debenture Stock at 90 cum-interest, interest being payable on 31st March and 30th September each year. Stamp and expenses on purchase amounted to ₹ 20 and brokerage at 2% was charged on cost; interest for the half year was received on the due date. On 1st Sept. ₹ 10,000 of the stock was sold at 92 ex-interest less brokerage at 2%. On 30th Sept., ₹ 8,000 stock was purchased at 91 ex-interest plus brokerage at 2% and charges ₹ 10. On 1st Dec., ₹ 6,000 stock was sold at 94 cum interest less brokerage 2%. The market price of stock on 31st Dec. was ₹ .91. Show the investment A/c for the year ended 31st Dec. marking all calculation in months.

ANSWER

Investment Account

1/3	To bank	24000	500	21552	31/3	By bank	-	600	-
1/9	To profit on sale of...	-	-	36	1/9	By bank	10000	208	9016
30/9	To bank	8000	-	7436	30/9	By bank	-	350	-
1/9	To profit on sale of...	-	-	20	1/12	By bank	6000	50	5477
31/12	To P & L		908		31/12	By bal c/d	16000	200	14551
		32000	**1408**	**29044**			**32000**	**1408**	**29044**

QUESTION 16

Bombay Investments Corporation has done the following transactions in 6% State Government Stock between 1st September 2010 and 31st July 2012 and all these transactions are Cum-interest excepting those marked Ex-interest. Interest is payable half - yearly on 1st February and 1st August. The accounting period ends on 30th June every year.

1st Sept 2010 - Purchased ₹ 10,000 stock @ 101.50.
1st Oct. 2010 - Purchased ₹ 25,000 stock @ 101.
1st Nov. 2010 - Sold ₹ 15,000 stock @ 103.25.
1st Nov. 2010 - Purchased ₹ 5,000 stock @ 103.
15th Jan. 2011 - sold ₹ 10,000 stock @ 105 Ex-interest
1st March 2011 - sold ₹ 4,000 stock @ 102..50
15th July 2011 - purchased ₹ 5,000 stock @ 101.25 Ex- interest
1st Nov. 2011 - Purchased ₹ 5,000 stock @ 102.
15th Jan. 2012 - sold ₹ 15,000 stock @ 103.

Write up the Investment Account in the books of the Corporation.

ANSWER

Investment Account

01/09/2010	To bank	10000	50	10100	01/11/2010	By bank	15000	225	15263
01/10/2010	To bank	25000	250	25000	15/01/2011	By bank	10000	275	10500
01/11/2010	To profit on sale.....	-	-	220	01/02/2011	By bank	-	450	-

01/11/2010	To bank	5000	75	5075	01/03/2011	By bank	4000	20	4080
15/01/2011	To Profit on sale.....	-	-	447					
01/03/2011	To Profit on sale....	-	-	59					
	To P & L	-	870	-	30/06/2011	By bal c/d	11000	275	11058
		40000	**1245**	**40901**			**40000**	**1245**	**40901**
01/07/2011	b/d	11000	275	11058	01/08/2011	By bank	-	480	-
15/07/2011	To bank	5000	138	5062	15/01/2012	By bank	15000	413	15037
01/11/2011	To bank	5000	75	5025	15/01/2012	By loss on sale....	-	-	67
					01/02/2012	By bank	-	180	-
30/6/2012	To P & L	-	735	-	30/06/2012	By bal c/d	6000	150	6041
		21000	**1223**	**21145**			**21000**	**1223**	**21145**

(As given in a specific order, it is assumed that on 01/11/2010, first sale occurred and thereafter purchase……..)

QUESTION 17

Kamani purchased on 1st May, 2011 15% Convertible Debentures of ₹ 100 each in XY Ltd., of the face value of ₹ 1,00,000 @ ₹ 105; interest on the debentures is payable each year on 30th June and 31st December. Kamani closes his books of account every year on 31st March. The following other transactions were entered into in the year ended 31st March, 2012 in regard to these debentures:---

2011

Aug. 1 Purchase of ₹ 60,000 Debentures @ ₹ 109 cum-interest.

Aug. 31 Sale of ₹ 50,000 Debentures @ ₹ 104.

Oct. 31 Purchase of ₹ 40,000 Debentures @ ₹ 102 ex-interest.

2012

March 31 Receipt of 3,000 Equity Shares in XY Ltd., of ₹ 10 each in conversion of 40% of the Debentures held.

The market value of the debentures and the equity shares in XY Ltd., on 31st March, 2012 were ₹ 103 cum-interest and ₹ 15 respectively. Prepare the Debenture Investment Account in the books of Kamani on average cost basis.

ANSWER

Investment Account

1/5/11	To bank	100000	5000	105000	30/6/11	By bank	---	7500	-
1/8/11	To bank	60000	750	64650	31/8/11	By bank	50000	1250	52000
31/10/11	To bank	40000	2000	40800	31/8/11	By loss on sale....	-	---	1016
					31/12/11	By bank	--	11250	--
					31/03/12	By bank	----	2250	----
31/03/12	To P & L	---	17875	----	31/03/12	By Investment in eq sh of...	60000	---	62974
					31/03/12	By loss on revaluation…	---	----	5135

					31/03/12	By bal c/d	90000	3375	89325
		200000	**25625**	**210450**			**200000**	**25625**	**210450**

QUESTION 18

X Ltd. on 1-1-2015 had made an investment of ₹ 600 lakhs in the equity shares of Y Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realizable value of all such investment on 31-3-2015 became ₹ 200 lakes as Y Ltd. lost a case of copyright. How will you recognize the reduction in financial statements for the year ended on 31-3-2015.

ANSWER

X limited invested ₹ 600 Lakhs in the equity shares of Y Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. ₹ 300 Lakhs and remaining as temporary (current) investment i.e. ₹ 300 Lakhs. Irrespective of the fact that investment has been held by X Limited only for 3 months (from 1.1.2015 to 31.3.2015), AS 13 lays emphasis on intention of the investor to classify the investment as current or long term even though the long term investment may be readily marketable.

In the given situation, the realizable value of all such investments on 31.3.2015 became ₹ 200 Lakhs i.e. ₹ 100 Lakhs in respect of current investment and ₹ 100 Lakhs in respect of long term investment.

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

Accordingly, the carrying value of investment held as temporary investment should be shown at realizable value i.e. at ₹ 100 Lakhs. The reduction of ₹ 200 Lakhs in the carrying value of current investment will be included in the profit and loss account.

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

Here, Y Limited lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quiet a substantial figure. Losing the case of copyright may affect the business and the performance of the company in long run. Accordingly, it will be appropriate to reduce the carrying amount of long term investment by ₹ 200 Lakhs and shown the investments at ₹ 100 Lakhs, considering the downfall in the value of shares as decline other than temporary. The reduction of ₹ 200 lakhs' in the carrying value of long term investment will be included in the profit and loss account.

* If one assumes that the decline in the value of long term investment is temporary and Y Limited will overcome this downfall in short period by filing a case against this decision of government, with strong arguments. In such a case, long term investment will be shown at cost.

QUESTION 19

Albert Ltd. has made the following investments:

(i) Purchased the following equity shares from stock exchange on 1st June, 2013:

	Cost (Rs.)
Scrip X	1,80,000
Scrip Y	50,000
Scrip Z	1,70,000
	4,00,000

(ii) Purchased government securities at a cost of ₹ 5,00,000 on 1st April, 2013.

How will you treat these investments as per applicable AS in the books of the company for the year ended on 3lst March, 2014, if the values of these investments are as follows:

Scrip X	1,90,000	
Scrip Y	40,000	
Scrip Z	70,000	3,00,000
Government securities		7,00,000

ANSWER

As per para 14 and 15 of AS 13 accounting for Investments', current investments should be carried at lower of cost and fair value determined either on an individual investment basis or by category of investment, but not on an overall (or global) basis. Also as per para 17 of the standard, long-term investments are carried at cost except when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognise the decline.

(i) If the investment in shares is intended to be held as current investment then scrip X should be valued at cost i.e. ₹ 1,80,000 (lower of cost and fair value), scrip Y should be valued at fair value i.e. ₹ 40,000 (lower of cost and fair value) and scrip Z should be valued at fair value i.e. ₹ 70,000 (lower of cost and fair value). The total loss of ₹ 1,10,000 (₹ 4,00,000 - ₹ 2,90,000) on scrip's purchased on Ist June, 2013 is to be charged to profit and loss account for the year ended 3lst March, 2014.

If investment is intended to be held as long term investment then it will continue to be shown at cost in the balance sheet of the company. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of investments, such reduction being determined and made for each investment individually.

(ii) Value of government securities (purchased on Ist April, 2013) is to be shown at cost of ₹ 5,00,000 in the balance sheet as on 31.3.2014.

QUESTION 20

Blue-chip Equity Investments Ltd., wants to re-classify its investments in accordance with AS 13.

(i) Long term investments in Company A, costing ₹ 8.5 lakhs are to be re-classified as current. The company had reduced the value of these investments to ₹ 6.5 lakhs to recognize a permanent decline in value. The fair value on date of transfer is ₹ 6.8 lakhs.

(ii) Long term investments in Company B, costing ₹ 7 lakhs are to be re-classified as current. The fair value on date of transfer is ₹ 8 lakhs and book value is ₹ 7 lakhs.

(iii) Current investment in Company C, costing ₹ 10 lakhs are to be re-classified as long term as the company wants to retain them. The market value on date of transfer is ₹ 12 lakhs.

(iv) Current investment in Company D, costing ₹ 15 lakhs are to be re-classified as long term. The market value on date of transfer is ₹ 14 lakhs.

ANSWER

As per AS 13 accounting for Investments', where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer. And where investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer. Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹ 6.5 lakhs in the books.

(ii) The carrying / book value of the long term investment is same as cost i.e. ₹ 7 lakhs. Hence this long term investment will be reclassified as current investment at book value of ₹ 7 lakhs only.

(iii) In this case, reclassification of current investment into long-term investments will be made at ₹ 10 lakhs as cost is less than its market value of ₹ 12 lakhs.

(iv) In this case, market value is ₹ 14 lakhs which is lower than the cost of ₹ 15 lakhs. The reclassification of current investment as long-term investments will be made at ₹ 14 lakhs.

QUESTION 21

a) Rose Ltd. had made an investment of ₹ 500 lakhs in the equity shares of Nose Ltd. on 10.01.2009, the realizable value of such investment on 31.03.2009 became ₹ 200 lakhs as Nose Ltd. lost a case of patent rights. Rose Ltd. follows financial year as accounting year. How will you recognize this reduction in Financial statements for the year ending 2009.

b) An unquoted long term investment is carried in the books at cost of ₹ 2 lac. The published accounts of unlisted company received in May, 2009 showed that the company has incurred cash losses with decline market share and the long term investment may not fetch more than ₹ 20,000. How you will deal with it in the financial statement of investing company for the year ended 31.3.2009.

c) Investments details are as under :

Invested into	Date of Purchase	Acquired Price (₹)	Market Price as on 31.03.2012 (Rs.)
Shares	01.10.2011	2,50,000	2,25,000
Gold	01.03.2009	4,00,000	6,00,000
Silver	01.03.2009	2,00,000	3,50,000

Show at what value these investments will be carried in the balance sheet as on 31.03.2012.

ANSWER

(a)

Recognition of reduction in value of investment would depend upon the nature of investment and nature of decline as per AS 13. If the investments were acquired for long term and decline is temporary in nature, reduction in value will not be recognized and investments would be carried at cost. If the decline is of permanent nature, it will be charged to profit and loss account. If the investments are current investments, the reduction should be recognized and charged to Profit and Loss Account as the current investments are carried at cost or fair value which ever is less.

(b)

As it is stated in the question that financial statements for the year ended 31st March, 2009 are under preparation, the views have been given on the basis that the financial statements are yet to be completed and approved by the Board of Directors.

Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. Para 17 of AS 13 accounting for Investments' states that indicators of the value of an investment are obtained by reference to its market value, the investor's assets and results and the expected cash flows from the investment. On these bases, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to ₹ 20,000 in the financial statements for the year ended 31st March, 2009.

(c)

As per para 32 of AS 13 on accounting for investments, any investment of long term period is shown at cost. Hence, the investment in Gold and Silver shall continue to be shown at cost i.e., ₹ 4,00,000 and ₹ 2,00,000 respectively as their value have increased.

Also as per AS 13, for investment in shares - if the investment is for short-term period then the loss of ₹ 25,000 is to be charged to profit & loss account for the year ended 31st March, 2012. If investment is of long term period then it will continue to be shown at cost in the Balance Sheet of the company. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

QUESTION 22

Z Bank has classified its total investment on 31-3-2016 into three categories (a) held to maturity (b) available for sale (c) held for trading, as per the RBI Guidelines.

'Held to maturity' investments are carried at acquisition cost less amortised amount. 'Available for sale' investments are carried at market to market. 'Held for trading' investments are valued at weekly intervals at market rates. Net depreciation, if any, is charged to revenue and net appreciation, if any, is ignored. Comment whether the policy of the bank is in accordance with AS 13?

ANSWER

As per AS 13 'Accounting for Investments', the accounting standard is not applicable to Bank, Insurance Company, Mutual Funds. In this case Z Bank is a bank, therefore, AS 13 does not apply to it. For banks, the RBI has issued guidelines for classification and valuation of its investment and Z Bank should comply with those RBI Guidelines/Norms. Therefore, though Z Bank has not followed the provisions of AS 13, yet it would not be said as non-compliance since, it is complying with the norms stipulated by the RBI.

QUESTION 23

Mr. Investor purchased 1000 shares of X Ltd. otherwise than on cum-right basis @ ₹ 600 per share on 1.4.2013. There was right issue in June, 2013 at one share for every two shares held at a price of ₹ 400 per share. (a) If Mr. Investor subscribed to the rights what would be the carrying cost of 1500 shares ? (b) If he sold the rights in the market at ₹ 120 a share what would be the carrying cost of the original shares.

ANSWER

(a) [(1000 X 600) + (500 X 400)] = ₹ 8,00,000

(b) [(1000 X 600) = 600000. Profit on sale of rights ₹ 60,000 [i.e. 500 X 120] will be credited to P& L a/c.

QUESTION 24

Mr. Investor purchased 1000 shares of X Ltd. on cum-right basis @ ₹ 600 per share on 1.4.2013. There was right issue in June, 2013 at one share for every two shares held at a price of ₹ 400 per share. Mr. Investor sold the rights in the market at ₹ 120 per share.

What would be the carrying amount of investments after the sale of rights if :(a) After the right issue, the ex-right share price fell from ₹ 600 to ₹ 530 per share ; (b) After the right issue, the ex-right share price fell from ₹ 600 to ₹ 560 per share.

ANSWER

(a) [(1000 X 600) - 60000)] = ₹ 5,40,000

(b) [(1000 X 600) - 40000 = 5,60,000. Remaining portion of profit on sale of rights ₹ 20,000 [i.e. 60,000 – 40,000] will be credited to P& L a/c.

QUESTION 25

Mr. Vijay entered into the following transactions of purchase and sale of equity shares of JP Power Ltd. The shares have paid up value of ₹ 10 per share.

Date	No. of Shares	Terms
01.01.2016	600	Buy @ ₹ 20 per share
15.03.2016	900	Buy @ ₹ 25 per share
20.05.2016	1000	Buy @ ₹ 23 per share
25.07.2016	2500	Bonus Shares received
20.12.2016	1500	Sale @ ₹ 22 per share
01.02.2017	1000	Sale @ ₹ 24 per share

Addition information:

(1) On 15.09.2016 dividend @ ₹ 3 per share was received for the year ended 31.03.2016.

(2) On 12.11.2016 company made a right issue of equity shares in the ratio of one share for five shares held on payment of ₹ 20 per share. He subscribed to 60% of the shares and renounced the remaining shares on receipt of the premium of ₹ 3 per share.

(3) Shares are to be valued on weighted average cost basis.

You are required to prepare Investment Account for the year ended 31.03.2016 and 31.03.2017.

ANSWER

Investment in Equity shares of JP Power Ltd.

Date	Particulars	No.	Dividend ₹	Amount ₹	Date	Particulars	No.	Dividend ₹	Amount ₹
1.1.16	To Bank A/c	600		12,000	31.3.16	By Balance c/d	1,500		34,500
15.3.16	To Bank A/c	900		22,500					
		1,500		34,500			1,500		34,500
1.4.16	To Balance b/d	1,500		34,500	15.9.16	By Bank-dividend		4,500	3,000
20.5.16	To Bank A/c	1,000		23,000	20.12.16	By Bank	1,500		33,000
25.7.16	To Bonus shares	2,500			1.2.17	By Bank	1,000		24,000
12.11.16	To Bank A/c	600		12,000	31.3.17	By Balance c/d	3,100		36,812.50*
20.12.16	To P & L A/c (Profit on sale)			15,187.50*					
1.2.17	To P & L A/c (Profit on sale)			12,125					
31.3.17	To P & L A/c (dividend)		4,500						
		5,600	4,500	96,812.50			5,600	4,500	96,812.50

Working Notes:

1. **Calculation of Weighted average cost of equity shares**

   600 shares purchased at ₹ 12,000

   900 shares purchased at ₹ 22,500

   1,000 shares purchased at ₹ 23,000

   2,500 shares at nil cost

   600 right shares purchased at ₹ 12,000

   Total cost of 5,600 shares is ₹ 66,500 [₹ 69,500 less ₹ 3,000 (pre-acquisition dividend received on 1,000 shares purchased on 20.5.17].

   Hence, weighted average cost per share will be considered as ₹ 11.875 per share (66,500/5,600).

2. It has been considered that no dividend was received on bonus shares as the dividend pertains to the year ended 31^{st} March, 2016.

3. **Calculation of right shares subscribed by Vijay**

Right Shares (considering that right shares have been granted on Bonus shares also) = 5,000/5×1 = 1,000 shares

Shares subscribed = 1,000 ×60% = 600 shares

Value of right shares subscribed = 600 shares @ ₹ 20 per share = ₹ 12,000

Calculation of sale of right renouncement

No. of right shares sold = 1,000 × 40% = 400 shares

Sale value of right = 400 shares × 3 per share = ₹ 1,200

Note: As per para 13 of AS 13, sale proceeds of rights is to be credited to P & L A/c.

4. Profit on sale of equity shares

As on 20.12.16

Sales price (1,500 shares at ₹ 22)	33,000.00
Less: Cost of shares sold (1,500 × 11.875)	(17,812.50)
Profit on sale	15,187.50
As on 1.2.17	
Sales price (1,000 shares at ₹ 24)	24,000
Less: Cost of shares sold (1,000 × 11.875)	(11,875)
Profit on sale	12,125

Balance of 3,100 shares as on 31.3.17 will be valued at ₹ 36,812.50 (at rate of ₹ 11.875 per share)

QUESTION 26

A Limited purchased 5,000 Equity Shares (Face Value ₹ 100 each) of Allianz Limited for ₹ 105 each on 1st April 2014. The Shares were quoted cum dividend. On 15th May 2014, Allianz Limited declared & paid Dividend of 2% for year ended 31st March 2014. On 30th June 2014, Allianz Limited issued Bonus Shares in ratio of 1:5. On 1st October 2014, Allianz Limited issued Rights Share in the ratio of 1:12 at ₹ 45 per Share. A Limited subscribed to half of the rights issue and the balance was sold at ₹ 5 per Right Entitlement. The Company declared interim Dividend of 1% on 30th November 2014, Right Shares were not entitled to Dividend. The Company sold 3,000 Shares on 31st December 2014 at ₹ 95 per Share. The Company A Ltd. incurred 2% as Brokerage while buying and selling Shares.

You are required to prepare investments Account in books of A Ltd.

ANSWER: Bal c/d ₹ 279110; Profit ₹ 21,660; Dividend Income ₹ 6,000.

QUESTION 27

Following transactions of Nisha took place during the financial year 2017-18:

1st April, 2017	Purchased 9,000 8% bonds of ₹ 100 each at ₹ 80.50 cum-interest. Interest is payable on 1st November and 1st May.
1st May, 2017	Received half year's interest on 8% bonds.
10th July, 2017	Purchased 12,000 equity shares of ₹ 10 each in Moon Limited for ₹ 44 each through a broker, who charged brokerage @ 2%.
1st October, 2017	Sold 2,250 8% bonds at ₹ 81 Ex-interest.
1st November, 2017	Received half year's interest on 8% bonds.
15th January, 2018	Moon Limited made a rights issue of one equity share for every four Equity shares held at premium of ₹ 5 per share. Nisha exercised the option for 40% of her entitlements and sold the balance rights in the market at ₹ 2.25 per share.
15th March, 2018	Received 18% interim dividend on equity shares of Moon Limited.

Prepare separate investment account for 8% bonds and equity shares of Moon Limited in the books of Nisha for the year ended on 31st March, 2018. Assume that the average cost method is followed.

ANSWER

Interest Income ₹ 63,000; Dividend Income ₹ 23,760; Profit on sale of investments ₹ 8,625; Investments c/d ₹ 5,20,875 and ₹ 5,56,560.

QUESTION 28

How will you classify the investments as per AS 13? Explain in Brief

Answer

The investments are classified into two categories as per AS 13, viz., Current Investments and Long-term Investments. A current Investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost and fair value. Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss. A long-term investment is an investment other than a current investment. Long term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognise the decline. The reduction in carrying amount is charged to the statement of profit and loss.

QUESTION 29 (MCQ Based)

Choose the most appropriate option as the answer:

(i) The cost of Right shares is:
(a) added to the cost of investments (b) subtracted from the cost of investments
(c) no treatment is required

(ii) Long term investments are carried at:
(a) cost less 'other than temporary' decline (b) fair value
(c) Cost and market value whichever is less

(iii) Current investments are carried at:
(a) Fair value (b) cost (c) Cost and fair value, whichever is less

(iv) A Ltd. acquired 2,000 equity shares of Omega Limited on cum-right basis at ₹ 75 per share. Subsequently, omega Limited made a right issue of 1:1 at ₹ 60 per share, which was subscribed for by A. Total cost of investments at the year-end will be (₹):
(a) 2,70,000 (b) 1,50,000 (c) 1,20,000

(v) Cost of investment includes:
(a) Purchase costs (b) Brokerage and Stamp duty paid (c) Both (a) and (b)

(vi) A current investment is an investment:
(a) That is intended to be held for not more than one year from the date on which such investment is made (b) That is readily realisable (c) Both (a) and (b)

(vii) All the following are fixed income bearing securities except:
(a) Debentures (b) Equity shares (c) Govt. Bonds

(viii) If there is 'other than temporary' decline in the value of a long term investment then:
(a) Carrying amount is reduced to recognise the decline
(b) The reduction in carrying amount is charged to profit and loss account
(c) Both (a) and (b)

(ix) If investment is acquired by issue of shares, the acquisition cost of investment is:
(a) Amount paid for acquisition (b) Fair value of securities issued
(c) Market price of securities.

(x) When long-term investments are reclassified as current investments, current investments are valued at:
(a) Cost (b) Carrying amount (c) Lower of Cost and Carrying amount

Answer

(i)	(ii)	(iii)	(iv)	(v)	(vi)	(vii)	(viii)	(ix)	(x)
(a)	(a)	(c)	(a)	(c)	(c)	(b)	(c)	(b)	(c)

QUESTION 30(a)

(i)	Violet Ltd. held shares in Omega Co. from 01.04.20X1 onwards as investment for long term purpose. Now it wants to reclassify investment of cost of ₹ 50,000 out of these shares as current investments having carrying value of ₹ 45000. The fair value on date of transfer is ₹ 48,000. These reclassified shares would be valued on date of transfer at (a) ₹ 50000 (b) ₹ 48000 (c) ₹ 45000.
(ii)	Mr. X acquires 200 shares of a company on cum-right basis for ₹ 60,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at ₹ 105 each. He does not subscribe but sells the rights for ₹ 5,000. The market value of the shares after their becoming ex-rights has also gone down. It would be appropriate to (a) Credit ₹ 5,000 to Profit and Loss account. (b) Reduce the carrying amount of investment by ₹ 5,000. (c) Add ₹ 5,000 to the carrying amount of investment.

Answer: c; b

QUESTION 30(b)

Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without providing for any diminution in value is correct and in accordance with the provisions of AS 13.

If not, what should have been the accounting treatment in such a situation? Explain in brief.

Answer

The accounting treatment 'at cost' under the head 'Long Term Investment' in the financial statements of the company without providing for any diminution in value is correct and is in accordance with the provisions of AS 13 provided that there is no decline, other than temporary, in the value of investment. If the decline in the value of investment is, other than temporary, compared to the time when the shares were purchased, provision is required to be made.

QUESTION 30(c)

Mr. X acquires 200 shares of a company on cum-right basis for ₹ 70,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at ₹ 107 each. He does not subscribe but sells all the rights for ₹ 12,000. The market value of the shares after their becoming ex-rights has also gone down to ₹ 60,000. What should be the accounting treatment in this case?

Answer

As per AS 13, where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value. In this case, the amount of the ex-right market value of 200 shares bought by X immediately after the declaration of rights falls to ₹ 60,000. In this case, out of sale proceeds of ₹ 12,000, ₹ 10,000 may be applied to reduce the carrying amount to bring it to the market value and ₹ 2,000 would be credited to the profit and loss account.

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ASSIGNMENT 'A'

A - 1

On 1st Jan., 2014, Singh had 20,000 equity shares in X Ltd. Face value of the shares was ₹ 10 each but their book value was ₹ 16 per share.
On 1st June 2014, Singh purchased 5,000 more equity shares in the company at a premium of ₹ 4 per share.
On 30th June, 2014, the Directors of X Ltd. announced a bonus and rights issue. Bonus was declared at the rate of one equity share for every five shares held and these shares were received on 2nd August, 2014.
The terms of the rights issue were:

a) Rights shares to be issued to the existing holders on 10th August 2014.
b) Rights issue would entitle the holders to subscribe to additional equity shares in the Company at the rate of one share per every three held at ₹ 15 per share --the whole sum being payable by 30th September, 2014.
c) Existing shareholders may, to the extent of their entitlement, either wholly or in part, transfer their rights to outsiders.
d) Singh exercised his option under the issue for 50% of his entitlements and the balance of rights he sold to Ananth for a consideration of ₹ 1.50 per share.
e) Dividends for the year ended 31st March, 2014, at the rate of 15% were declared by the Company and received by Singh on 20th October, 2014.
f) On 1st Nov., 2014, Singh sold 20,000 equity shares at a premium of ₹ 3 per share.

The market price of share on 31-12-2104 was ₹ 14. Show the Investment A/c as it would appear in Singh's books as on 31-12-2014 and the value of shares held on that date.

ANSWER

Investment Account

Date	Particulars	No.	Div. income	Amount	Date	Particulars	No.	Div. income	Amount
1.1.14	b/d	20000		320000	20.10.14	bank		30000	7500
1.6.14	bank	5000		70000	1.11.14	bank	20000		260000

2.8.14	bonus	5000			1.11.14	Loss on sale			1429
30.9.14	bank	5000		75000					
31.12.14	P & L		30000		31.12.14	c/d	15000		196071
		35000	**30000**	**465000**			**35000**	**30000**	**465000**

Profit from sale of rights = 5000 X 1.50 = 7500

A - 2

Tee Ltd. purchased on 1st May, 2002 13.5% Convertible Debentures in Dee Ltd. of face value of ₹ 5,00,000 @ 105 ; Interest on the debentures is payable each year on 31st March and 30 Sept. The accounting year adopted by Tee Ltd. is the calendar year. The following other transactions were entered into in 2000 by Tee Ltd. in regard to these debentures.

Aug. 1	Purchased ₹ 2,50,000 Deb. @ 107 cum interest.
Oct 1	Sale of ₹ 2,00,000 Deb. @ 103
Dec. 31	Receipt of 10,000 Equity Shares in Dee Ltd. of ₹ 10 each in conversion of 20 % of the Debentures held.

The market value of the Debentures and Equity shares in Dee Ltd. at the end of 2002 was ₹ 106 and ₹ 15 respectively. Prepare the Debenture Investment Account in the books of Tee Ltd.

ANSWER

Investment Account

Date	Particulars	NV	Interest	Amount	Date	Particulars	NV	Interest	Amount
1.5.2002	Bank	500000	5625	525000	30.9.2002	bank		50625	
1.8.2002	Bank	250000	11250	256250	1.10.2002	bank	200000		206000
					1.10.2002	Loss on sale			2333
					31.12.2002	bank		3713	
					31.12.2002	Investment in…	110000		114583
31.12.2002	P & L		52313		31.12.2002	c/d	440000	14850	458334
		750000	**69188**	**781250**			**750000**	**69188**	**781250**

A - 3

Gamma Investment Company furnishes the following details relating to its holding in 15% Debentures of Beta Industries Ltd. (Face Value per debenture - ₹ 100) :

Opening Balance as on 1.4.2009 face value ₹ 1,00,000, Cost ₹ 1,05,000.

01.05.09 500 debentures purchased cum-interest for ₹ 53,500

01.11.09 Sold 600 debentures ex-interest for ₹ 57,300

30.11.09 Purchased 400 debentures for ₹ 38,400 (ex- interest)

31.12.09 Sold 400 debentures cum-interest for ₹ 55,000

Interest dates are 30th June and 31st December.

Prepare the Investment account showing value of holding on 31/3/2010 at cost, using FIFO mehod.

ANSWER

Investment Account

Date	Particulars	NV	Interest	Amount	Date	Particulars	NV	Interest	Amount

1.4.2009	b/d	100000	3750	105000	30.6.2009	bank		11250	
1.5.2009	Bank	50000	2500	51000	1.11.2009	bank	60000	3000	57300
30.11.2009	Bank	40000	2500	38400	1.11.2009	Loss on sale			5700
31.12.2009	Profit (sale)			10000	31.12.2009	bank	40000	3000	52000
					31.12.2009	bank		6750	
31.3.2010	P & L		18625		31.3.2010	c/d	90000	3375	89400
		190000	**27375**	**204400**			**190000**	**27375**	**204400**

A - 4

Investors Ltd. held on 1-1-2002, ₹ 80,000 of 9% Govt. securities of ₹ 100 each of ₹ 76,500.
On 1.5.2002, the company purchased a further of ₹ 60,000 of the security at 96.5, brokerage being 1/2% of nominal value.
On 30.6.2002, ₹ 40,000 of the security was sold at 94.5 cum-interest, brokerage being 1/2% of nominal value .
On 1.11.2002, ₹ 30,000 of the security was again sold at ₹ 96.5. Brokerage being same as above.
Interest on the security was paid each year on 31st March and 30th September.
The price of the security on 31.12.2002, was 88. Investors Ltd. closes its books on 31st December each year. Draw up the Investment Account in the books of Investors Ltd.

ANSWER

Investment Account

Date	Particulars	NV	Interest	Amount	Date	Particulars	NV	Interest	Amount
1.1.2002	b/d	80000	1800	76500	31.3.2002	bank		3600	
1.5.2002	bank	60000	450	58200	30.6.2002	bank	40000	900	36700
					30.6.2002	Loss on sale			1786
					30.9.2002	bank		4500	
					1.11.2002	bank	30000	225	28800
					1.11.2002	Loss on sale			64
					31.12.2002	Loss on reval			5750
31.12.2002	P & L		8550		31.12.2002	c/d	70000	1575	61600
		140000	**10800**	**134700**			**140000**	**10800**	**134700**

A - 5

Mr. Z furnishes the following details relating to its holding in 9% Government Bonds:
Opening Balance as on 1.1.2008 face value ₹ 1,20,000, Cost ₹ 1,18,000.
01.03.08 200 units purchased ex-interest at ₹ 98.
01.07.08 Sold 500 units (out of original holding) ex-interest at ₹ 100.
01.10.08 Purchased 150 units at ₹ 98, cum interest.
01.11.08 Sold 300 units (out of original holding) ex-interest at ₹ 99.
Interest dates are 30th September and 31st March.
Mr. Z closes his books every 31st December. Show the Investment account as it would appear in his books.

ANSWER

Investment Account

Date	Particulars	NV	Interest	Amount	Date	Particulars	NV	Interest	Amount

1.1.2008	b/d	120000	2700	118000	31.3.2008	bank		6300	
1.3.2008	bank	20000	750	19600	1.7.2008	bank	50000	1125	50000
1.7.2008	Profit on sale			833	30.9.2008	bank		4050	
1.10.2008	bank	15000		14700	1.11.2008	bank	30000	225	29700
1.11.2008	Profit on sale			200					
31.12.2008	P & L		9938		31.12.2008	c/d	75000	1688	73633
		155000	**13388**	**153333**			**155000**	**13388**	**153333**

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ASSIGNMENT 'B'

B - 1

Mr. Purofit furnishes the following details relating to its holding in 8% Debentures of P Ltd.
Opening Balance as on 1.4.2009 face value ₹ 1,20,000, Cost ₹ 1,18,000.

01.07.09 100 units purchased ex-interest at ₹ 98.
01.10.09 Sold 200 units ex-interest at ₹ 100.
01.01.10 Purchased 50 units at ₹ 98, cum interest.
01.02.10 Sold 200 units ex-interest at ₹ 99.

Interest dates are 30th September and 31st March.
Mr. Purofit closes his books on 31.03.2010. Brokerage 1% is paid on each transaction. Show the Investment account as it would appear in his books. Adopt FIFO Method. Market value of 8% Debentures of P Ltd on 31.03.2010 is ₹ 99.

B - 2

a) MY Ltd . had acquired 200 equity shares of YZ Ltd. at ₹ 105 per share on 01.01.2009 and paid ₹ 200 towards brokerage, stamp duty and STT. On 31st March, 2009 shares of YZ Ltd. were traded at ₹ 110 per share . At what value investment is to be shown in the Balance Sheet of MY Ltd. as at 31st March,2009.

b) Mr X purchased 1,000, 6% government bonds of ₹ 100 each on 31st January, 2009 at ₹ 95 each. Interest is payable on 30th June and 31st December. The price quoted is cum interest. Journalise the transaction.

c) Mr. T purchased 1,000 nos. of 10% debentures of ₹ 100 each on 1/4/2009 @ ₹ 96 cum interest, the previous interest date being 31/12/2008. Compute cost of investment.

d) Dua Ltd. acquired 2000 debentures in Kundra Ltd. by issue of 10000 equity shares having a face value of ₹ 100 each, whose market value is ₹ 150 per share . The debentures of kundra Ltd, were listed at ₹ 800 (Face value being ₹ 500 per debenture) . What should be the cost of investment ? Ignore pre-acquisition interest.

B - 3

Alpha Ltd. purchased 5,000, 13.5% Debentures of Face Value of ₹ 100 each of Pergot Ltd. on 1st May 2013 @ ₹ 105 on cum interest basis. The interest on these instruments is payable on 31st & 30th of March & September respectively. On 1st August 2013, the company again purchased 2,500 of such debentures @ ₹ 102.50 each on cum interest basis. On 1st October, 2013 the company sold 2,000 Debentures @ ₹ 103 each. The market value of the debentures as at the close of the year was ₹ 106. Prepare the Debenture Investment Account in the books of Alpha Ltd. for the year ended 3lst Dec. 2013.

B - 4

On 1st April 2014, Hasan has 20,000 equity shares of Vayu Ltd., at a book value of ₹ 20 per share (face value of ₹ 10 each). He provides the following information:

(i) On 10th June 2014, he purchased another 5,000 shares in Vayu Ltd., @ ₹ 15 per share.
(ii) On 1st August 2014 Vayu Ltd., issued one bonus share for every five shares held by the shareholders.
(iii) On 31st August 2014, the directors of Vayu Ltd. announced a rights issue which entitle the shareholders to subscribe two shares for every six shares held @ of ₹ 15 per share. The shareholders can transfer their rights in full or in part Hasan sold 1/4th of his right shares holding to Harsh for a consideration of ₹ 3 per share and subscribed the rest on 31st of October 2014.

Prepare Investment A/c in the books of Hasan as on 31st October. 2014

B - 5

Chandigarh Investments carried out the following transactions in the shares of Bright Ltd..

a. On 1st April, 2012 Chandigarh Investments purchased 20,000 equity shares of Re. 1 each fully paid for ₹ 30,000.

b) On 15th May, 2012, Chandigarh Investments sold 4,000 shares for ₹ 7,600.

c) At a meeting on 15th June 2012, the company decided :

   (i) to make a bonus issue of one fully paid share for every four shares held on 1st June 2012, and

   (ii) to give its members the right to apply for one share for every five shares held on 1st June, 2012 at a price of ₹ 1.50 per share of which 75 paise is payable on or before 15th July, 2012, and the balance, 75 paise per share, on or before 15th September, 2012.

   The shares issued under (i) and (ii) were not to rank for dividend for the year ending 31st Dec., 2012.

d) Chandigarh Investments received his bonus shares and took up 2,000 shares under the rights issue, paying the sums thereon when due and selling the rights to the remaining shares at 40 paise per share; the proceeds were received on 30th September, 2012.

e) On 15th March, 2013, Chandigarh Investments received a dividend from Bright Ltd. of 15 per cent in respect of the year ended 31st December, 2012.

f) On 30th March, Chandigarh Investments received ₹ 14,000 for the sale of 10,000 shares.

You are required to record these transactions is the Investments Account in Chandigarh Investment's books for the year ended 31st March 2013, transferring any profits or losses on these transactions.

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ASSIGNMENT 'C'

C - 1

PAC furnishes the following details relating to its holding in 6% Government Bonds:

Opening Balance as on 1.1.2012 face value ₹ 60,000, Cost ₹ 59,000.

01.03.12 100 units purchased ex-interest at ₹ 98.

01.07.12 Sold 200 ex-interest at ₹ 100.

01.10.12 Purchased 50 units at ₹ 98

01.11.12 Sold 200 units ex-interest at ₹ 99.

Interest dates are 30th September and 31st March. Mr. Investor closes his books every 31st December. Show the Investment account as it would appear in his books.

Case(i) – Adopt Average Cost Method; Case(ii) – Adopt FIFO Method

C - 2

Calcutta Investments held 400, 12% debentures of ₹ 100 each in Acme Ltd. as on 1st April, 2012 at a cost of ₹ 50,000. Interest is payable on 30th June and 31st December, each year. On 1st June 2012, 200 debentures are purchased cum-interest at ₹ 21,400. On 1st November, 2012, 300 debentures are sold ex-interest at ₹ 28,650. On 30th November, 2012, 200 debentures are purchased ex-interest at ₹ 19,200. On 31st December, 2012, 300 debentures are sold cum-interest for ₹ 32,250. Prepare investment account for the year ending 31st March 2013. The debentures were quoted at par on 31st March, 2013. [Case(i) – Adopt Average Cost Method; Case(ii) – Adopt FIFO Method]

C - 3

M/S Bull and Bear provides the following details relating to the investment in 12% Debentures of Wye Ltd.:

1-12-2012 Purchased 10,000 debentures @ ₹ 101 cum interest. Brokerage paid 1%.

1-3-2013 Sold 10,000 debentures @ ₹ 106 cum interest. . Brokerage paid 1%.

Interest dates being : 31st March and 30th September.

Show investment account in the books of M/S Bull and Bear from 1-12-2012 to 1-3-2013.

C - 4

On 1-4-2011, Rajat had 50,000 equity shares of P Ltd. at a book value of ₹ 15 per share (Face value ₹ 10). On 20-6-2011, Rajat purchased another 10,000 shares of the same company at ₹ 16 per share. The directors of P Ltd. announced a bonus and rights issue. The terms of the issue are as follows:

Bonus basis 1 : 6 (Date 01-8-20011)

Rights basis 3 : 7 (Date 31-10-2011) @ ₹ 15 per share.

Shareholders can transfer their rights in full or in part. Accordingly, Rajat sold 1/3rd of its entitlement to Umang for a consideration of ₹ 2 per share and subscribed the rest on 5th Nov. 2011.You are required to prepare Investment Account.

C - 5

The following information is presented by Mr. Akash relating to his holding in 9% Government Bonds:
Opening Balance as on 01-01-2014 (Face Value) ₹ 60,000, Cost ₹ 59,000 (Face value of each unit is ₹ 100)
01-03-2014 purchased 100 units, ex-interest at ₹ 100
01-07-2014 sold 250 units, ex-interest out of original holding at ₹ 100
01-10-2014 Purchased 75 units at ₹ 98 cum interest.
01-11-2014 sold 150 units ex-interest at ₹ 99 out of original holdings.
Interest due dates are 30th September and 31st March, Mr. Akash closes his books every year by 31st December. Show the Investment A/c as it would appear in his books. Mr. Akash was following FIFO Method.

C - 6

On 1st April, 20X1, Mr. Vijay had 30,000 Equity shares in X Ltd. at a book value of ₹ 4,50,000 (Face Value ₹ 10 per share).
On 22nd June, 20X1, he purchased another 5000 shares of the same company for ₹ 80,000.
The Directors of X Ltd. announced a bonus of equity shares in the ratio of one share for seven shares held on 10th August, 20X1.
On 31st August, 20X1 the Company made a right issue in the ratio of three shares for every eight shares held, on payment of ₹ 15 per share.
Due date for the payment was 30th September, 20X1, Mr. Vijay subscribed to 2/3rd of the right shares and sold the remaining of his entitlement to Viru for a consideration of ₹ 2 per share.
On 31st October, 20X1, Vijay received dividends from X Ltd. @ 20% for the year ended 31st March, 20X1. Dividend for the shares acquired by him on 22nd June, 20X1 to be adjusted against the cost of purchase.
On 15th November, 20X1 Vijay sold 20,000 Equity shares at a premium of ₹ 5 per share.
You are required to prepare Investment Account in the books of Mr. Vijay for the year ended 31st March, 20X2 assuming the shares are being valued at average cost.

Answers

B-1	Interest income 9,233; Profit on sale 133; Loss on sale 64; c/d 93,414
B-2	A: c/d 21,200 B: Investment Dr. 94,500; Interest Dr. 500; To bank 95,000 C: Cost of investment D: 15,00,000
B-3	Interest income 52,313; Profit on sale 2,167; c/d 5,60,542
B-4	c/d 5,87,500
B-5	Profit on sale ₹ 1,600 & ₹ 1,727; c/d balance – ₹ 14,727; Dividend Income ₹ 2400 Profit from sale of rights ₹ 480, will get transferred to the credit of P & L account.
C-1	(i) Interest income 3,375; Profit on sale 343 & 148; Balance c/d 34,391 (ii) Interest income 3,375; Profit on sale 333 & 134; Balance c/d 34,367
C-2	(i) Interest income 5200; Loss on sale 6550 & 2190 ; Loss on revaluation 1760; Bal c/d 20000 (ii) Interest income 5200 ; Loss on sale 8850 & 2450 ; Balance c/d 19200
C-3	Interest income 30000 ; Loss on sale 700
C-4	Balance c/d 1210000 ; Profit from sale of rights ₹ 20000, will be transferred to the credit of P & L account.
C-5	Bal c/d (Nominal Value ₹ 37500) 37017 ; Profit on sale 417 & 100 ; Interest income 4969
C-6	Profit on sale ₹ 32,000; c/d balance – ₹ 4,02,000; Dividend Income ₹ 60,000 Profit from sale of rights to be transferred to the credit of P & L account ₹ 10,000.

CASH FLOW STATEMENTS [CFS]
(AS 3)

Mandatory for Level I enterprises. Not mandatory for Level II & III enterprises. Made mandatory for all companies except few, vide Companies Act, 2013. To be discussed under the chapter 'Accounting Standards'.

Information about the cash flows of an enterprise is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilise those cash flows. An enterprise should prepare a cash flow statement and should present it for each period for which financial statements are presented.

Cash flows are inflows and outflows of **cash and cash equivalents**	
Cash comprises cash on hand and demand deposits with banks.	**Cash equivalents** are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

***Cash equivalents** are held for the purpose of meeting short term cash commitments rather than for investment or other purposes. Cash equivalent includes Fixed Deposits with banks and very short term and highly liquid investments. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition.

The cash flow statement should report cash flows during the period classified by operating, investing and financing activities**.**

Operating activities	Investing activities	Financing activities
are the principal revenue producing activities of the enterprise and other activities that are not investing or financing activities.	are the acquisition and disposal of long term assets and other investments not included in cash equivalents.	are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.

<u>Operating activities</u>: The amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the enterprise have generated sufficient cash flows to maintain the operating capability of the enterprise, pay dividends, repay loans, and make new investments without recourse to external sources of financing.
Examples of cash flows from operating activities are:

a) Cash receipts from the sale of goods and the rendering of services
b) Cash receipts from royalties, fees, commissions, and other revenue
c) cash payments to suppliers for goods and services
d) cash payments to and on behalf of employees
e) Cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits
f) Cash payments or refunds of income tax unless they can be specifically identified with financing and investing activities.

<u>Investing activities</u>: The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditure have been made for resources intended to generate future income and cash flows.
Examples of cash flows arising from investing activities are:

a) Cash payments to acquire fixed assets (including intangibles). These payments include those relating to capitalised research & development costs and self constructed fixed assets
b) Cash receipts from disposal of fixed assets (including intangibles)
c) Cash payments to acquire shares, warrants, or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered to be cash equivalents and those held for dealing or trading purposes)

d) Cash receipts from disposal of shares, warrants, or debt instruments of other enterprises and interests in joint ventures (other than payments from those instruments considered to be cash equivalents and those held for dealing or trading purposes)
e) Cash advances and loans made to third parties (other than advances and loans made by a financial enterprise)
f) Cash receipts from the repayment of advances and loans made to third parties (other than advances and loans of a financial enterprise).

Financing activities: The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of funds (both capital and borrowings) to the enterprise.
Examples of cash flows arising from financing activities are:
a) Cash proceeds from issuing shares or other similar instruments;
b) Cash proceeds from issuing debentures, loans, notes, bonds, and other short or long term borrowings and
c) Cash repayments of amounts borrowed.

Reporting cash flows from operating activities -- An enterprise should report cash flows operating activities using either:

the **direct method**, whereby major classes of gross cash receipts and gross cash payments are disclosed.	**OR**	the **indirect method**, whereby net profit or loss is adjusted for the effects of transactions of a non cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

*As per SEBI guidelines and Clause 32 of the listing agreement, all widely held public companies are compulsorily required to adopt indirect method.

The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method and is, therefore, considered more appropriate than the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either a) from the accounting records of the enterprise or b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial enterprise) and other items in the statement of profit and loss for i. Changes during the period in inventories and operating receivables and payables ii. other non cash items and iii. other items for which the cash effects are investing or financing cash flows.	**Under the indirect method,** the net cash flow from operating activities is determined by adjusting net profit or loss for the effect of a) Changes during the period in inventories and operating receivables and payables b) non cash items such as depreciation, provisions, deferred taxes, and unrealised foreign exchange gains and losses; and c) all other items for which the cash effects are investing or financing cash flows.

Loans / Advances Given and Interests earned:
(a) Loans and advances given and interests earned on them in the ordinary course of business are operating cash flows for financial enterprises.
(b) Loans and advances given and interests earned on them are investing cash flows for non-financial enterprises.
(c) Loans and advances given to subsidiaries and interests earned on them are investing cash flows for all enterprises.
(d) Loans and advances given to employees and interests earned on them are operating cash flows for all enterprises.
(e) Advance payments to suppliers and interests earned on them are operating cash flows for all enterprises.
(f) Interests earned from customers for late payments are operating cash flows for all enterprises.

Loans / Advances taken and interests paid:
(a) Loans and advances taken and interests paid on them in the ordinary course of business are operating cash flows for financial enterprises.
(b) Loans and advances taken and interests paid on them are financing cash flows for non

financial enterprises.
(c) Advance taken from customers and interests paid on them are operating cash flows for all enterprises.
(d) Interests paid to suppliers for late payments are operating cash flows for all enterprises.
(e) Interests taken as part of inventory costs in accordance with AS 16 are operating cash flows.

Investments made and dividends earned:
(a) Investments made and dividends earned on them in the ordinary course of business are operating cash flows for financial enterprises.
(b) Investments made and dividends earned on them are investing cash flows for non financial enterprises.
(c) Investments in subsidiaries and dividends earned on them are investing cash flows for all enterprises.

Dividends Paid: Dividends paid are financing cash outflows for all enterprises.

Taxes on Income: Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.
(a) Tax paid on operating income is operating cash outflows for all enterprises
(b) Tax deducted at source against income are operating cash outflows if concerned incomes are operating incomes and investing cash outflows if the concerned incomes are investment incomes, e.g. interest earned.
(c) Capital gain tax paid on sale of land will classify as cash used in investing activities.

Insurance claims received:
(a) Insurance claims received against loss of stock or loss of profits are extraordinary operating cash inflows for all enterprises.
(b) Insurance claims received against loss of fixed assets are extraordinary investing cash inflows for all enterprises.

AS 3 requires separate disclosure of **extraordinary cash flows**, classifying them as cash flows from operating, investing or financing activities, as may be appropriate.

Reporting Cash Flows on Net Basis:
Paragraph 21 forbids netting of receipts and payments from investing and financing activities. Thus, cash paid on purchase of fixed assets should not be shown net of cash realised from sale of fixed assets. For example, if an enterprise pays ₹ 50,000 in acquisition of machinery and realises ₹ 10,000 on disposal of furniture, it is not right to show net cash outflow of As. 40,000. The exceptions to this rule are stated in paragraphs 22 and 24.

As per paragraph 22, cash flows from the following operating, investing or financing activities may be reported on a net basis. (a) Cash receipts and payments on behalf of customers, e.g. cash received and paid by a bank against acceptances and repayment of demand deposits. (b) Cash receipts and payments for items in which the turnover is quick, the amounts are large and the maturities are short, e.g. purchase and sale of investments by an investment company.	Paragraph 24 permits financial enterprises to report cash flows on a net basis in the following three circumstances. (a) Cash flows on acceptance and repayment of fixed deposits (b) Cash flows on placement and withdrawal deposits from other financial enterprises (c) Cash flows on advances/loans given to customers and repayments received therefrom.

Foreign Currency Factor:
It is important to note that a change in cash does not necessarily imply cash flow. For example: suppose an enterprise has a bank balance of USD 10,000, stated in books at ₹ 7,40,000 using the rate of exchange ₹ 74 / 1 USD prevailing on date of receipt of dollars. If the closing rate of exchange is ₹ 76 / 1 USD, the bank balance will be restated at ₹ 7,60,000 on the balance sheet date. The increase is however not a cash flow because neither there is any cash inflow nor there is any cash outflow.

Notes:

(1) A single transaction may include cash flows that are classified differently. For example, when the installment paid in respect of a fixed asset acquired on deferred payment basis includes both interest and loan, the interest element is classified under financing activities and the loan element is classified under investing activities.

(2) Where the amount of significant cash and cash equivalent balances held by an enterprise are not available for use by the enterprise, the same should be disclosed separately together with a commentary by the management. This may happen for example, in case of bank balances held in other countries subject to such exchange control or other regulations that the fund is practically of no use.

(3) While preparing cash flow statement, conversion of debentures into equity share capital should not be shown as it is a non-cash transaction.

(4) Onedha, a stock broking firm, received ₹ 1,00,000 as premium for forward contracts entered for purchase of equity shares. The firm will classify this amount in the cash flow statement as Operating Activity.

(5) Advantages (to mention a few):
- (a) To access (i) ability of an enterprise to generate cash flows and (ii) their timings, (iii) certainty of cash generation, & (iv) needs of the enterprise to utilize such resources.
- (b) To make economic decisions based on such an assessment.
- (c) To measure the quality of profits and assess adverse cash positions if any. Since reported income is determined on accrual basis (involving estimates), cash flow statement assist users in assessment of the reliability of income figures.

(6) Drawbacks (to mention a few)
- (a) CFS is based on historical data. Users prefer forecast of cash flows.
- (b) Timings of presentation of CFS is at least five or six months after the end of accounting period, rendering the information of little use.
- **(c)** CFS gives information of changes in working capital but it does not indicate how efficient is the working capital.

ILLUSTRATION 1

From the below given information, prepare financial statements as per Schedule III of Companies Act, 2013 and Cash Flow Statement as per Accounting Standard 3

Pioneer Limited

Summarized Trading Account for the year ending 31.3.2020

Particulars		Amount	Particulars		Amount
To opening inventory:			By revenue from Operations		16,10,000
Raw material	10,000				
Work in progress	12,000				
Finished goods	19,000				
Stock in trade	11,000	52,000			
To raw material purchased		3,00,000			
To purchases of stock in trade		4,00,000			
To carriage inwards		21,000			
To wages:			By closing inventory:		
Paid	1,50,000		Raw material	13,000	
Add: outstanding wages	14,000	1,64,000	Work in progress	21,000	
To other manufacturing expenses		1,00,000	Finished goods	23,000	
To gross profit		6,36,000	Stock in trade	6,000	63,000
		16,73,000			16,73,000

Summarized Profit and Loss Account for the year ending 31.3.2020

Particulars		Amount	Particulars		Amount
To administrative expenses:		1,32,000	By gross profit b/d		6,36,000
To selling and distribution expenses		1,48,000	By profit on sale of Furniture		6,000
To debenture interest paid	39,000		By interest on Investments:		
Add: O/S at the end	9,000		Received	47,500	
Less: O/S at the beg.	(6,000)	42,000	Add: Accrued (End)	14,500	
To depreciation & amortization:			Less: Accrued (Beg.)	(18,000)	44,000
Plant and machinery	1,42,000				
Furniture	15,000	1,57,000			
To loss on sale of machine		7,000			
To profit before tax (PBT)		2,00,000			
		6,86,000			6,86,000
To provision for income tax		50,000			
To profit after tax (PAT)		1,50,000			

Surplus Account / Profit and Loss Appropriation Account

To general reserve	16,000	By balance b/d	85,000
To preference dividend	36,000	By profit after tax	1,50,000
To equity dividend	90,000		
To balance c/d	93,000		
	2,35,000		2,35,000

Summarized Balance Sheet In ₹

Liabilities	As on 31.3.2020	As on 31.3.2019	Assets	As on 31.3.2020	As on 31.3.2019
Equity share capital	7,00,000	4,00,000	Plant & Machinery	5,36,000	4,00,000
9% Pref. share Capital	1,50,000	4,00,000	Furniture	85,000	1,60,000
Surplus Account	93,000	85,000	Long term Investments	6,15,000	3,35,000
General reserve	56,000	40,000	(In Government Bonds)		
			Inventories	63,000	52,000
12% Debentures	3,50,000	1,00,000	Trade debtors	86,000	77,000
Trade creditors	55,500	66,000	Accrued interest on		
Outstanding wages	14,000	Nil	Investments	14,500	18,000
O/S Debenture interest	9,000	6,000	Bank	44,000	47,000
Provision for tax	25,000	5,000	Cash	9,000	13,000
	14,52,500	11,02,000		14,52,500	11,02,000

Additional information:

1	₹ 2,00,000, 12% Debentures issued at par to vendors on April 1, 2019 against machine purchased.
2	On April 1, 2019, ₹ 50,000, 12% Debentures raised against cash.
3	On April 1, 2019, a machine costing ₹ 1,50,000 was purchased against cash payment.
4	Machine having book value ₹ 80,000 as on April 1, 2019 was sold on Oct. 1, 2019 for ₹ 65,000.
5	Furniture having book value ₹ 60,000 was sold on April 1, 2019 for ₹ 66,000.
6	Depreciation on plant and machinery @ 20% p.a. & Furniture @ 15% p.a., adopting WDV method.
7	Cash sales were ₹ 4,00,000 and cash purchases ₹ 2,00,000.
10	Administrative expenses include staff salaries ₹ 80,000.

Answer ……

ILLUSTRATION 2

Prepare cash flow statement of Pioneer Limited for the year ending 31st March, 2019.

Pioneer Limited
Balance Sheet

	Particulars	Note No.	As at 31.3.2019 (In Rupees)	As at 31.3.2018 (In Rupees)
I.	Equity and Liabilities			
(1)	Shareholders' funds			
	a Share capital	1	7,50,000	7,00,000
	b Reserves and Surplus	2	2,10,000	1,12,000
(2)	Non-current liabilities			
	a Long-term borrowings (10% Deb.)		3,00,000	2,00,000
(3)	Current liabilities			
	a Short-term borrowings (Bank o/d)		52,000	40,000
	b Trade Payables		15,000	23,000
	c Other current liabilities	3	5,000	Nil
	d Short-term provisions (Pro. for tax)		19,000	7,000
	Total		13,51,000	10,82,000
II.	Assets			
(1)	Non-current assets			
	a Property, Plant and Equipment			
	(i) Tangible assets	4	2,97,500	1,75,000
	(ii) Intangible assets (Goodwill)		76,000	95,000
	b Non-current investments	5	8,40,000	6,90,000
(2)	Current assets			
	a Inventories (Stock in trade)		18,000	10,000
	b Trade receivables		11,000	18,000
	c Cash and cash equivalents	6	1,02,500	94,000
	d Other current assets (Accrued interest on investments)		6,000	Nil
	Total		13,51,000	10,82,000

Statement of Profit and Loss for the year ended 31st March, 2019

Particulars		Note No.	₹
I	Revenue from operations		8,00,000
II	Other income	7	59,500
III	Total Revenue [I + II]		8,59,500
IV	Expenses:		
	Cost of material consumed		Nil
	Purchase of stock in trade		6,08,000
	Changes in inventories of stock-in-trade (18,000 – 10,000)		(8,000)
	Employee Benefit Expense		17,500
	Financial Costs		20,000
	Depreciation and Amortization Expense	8	71,500
	Other Expenses	9	37,000
	Total Expenses		7,46,000
V	Profit before Tax and extra-ordinary item (III-IV)		1,13,500
VI.	Add: Insurance proceeds from earthquake disaster settlement		1,00,000
VII.	Profit before Tax		2,13,500
VIII.	Tax Expense		50,000
IX.	Profit for the period		1,63,500

Notes to accounts:

		As at 31.3.2019 (₹)	As at 31.3.2018 (₹)
1	Share Capital		
	Authorised Share Capital:		
	Equity Share Capital	7,50,000	7,50,000
	9% Preference Share Capital	5,00,000	5,00,000
		12,50,000	12,50,000
	Issued & Paid-up Share Capital:		
	Equity Share Capital	5,50,000	4,00,000
	9% Preference Share Capital	2,00,000	3,00,000
	Total	7,50,000	7,00,000
2	Reserves and Surplus		
	General Reserve	45,000	35,000
	Surplus i.e. Balance in Statement of Profit & Loss:	1,55,500	77,000
	Opening Balance 77,000		
	Add: Profit for the year 1,63,500		
	Less: Transfer to general reserve (10,000)		
	Less: Preference Dividend (27,000)		
	Less: Equity Dividend (48,000)		
	Security Premium Reserve	9,500	--
	Total	2,10,000	1,12,000
3.	Other current liabilities		
	Outstanding office expenses	2,000	Nil
	Outstanding debenture interest	3,000	Nil
	Total	5,000	Nil
4.	Tangible assets		
	Plant & Machinery	4,60,000	3,00,000
	Less: Accumulated depreciation	1,62,500	1,25,000
		2,97,500	1,75,000
5.	Non-current investments		
	Property Investments	3,40,000	3,40,000
	Investment in 12% Bonds of ABC Limited	4,25,000	2,00,000
	Investment in Shares of XYZ Limited	75,000	1,50,000
		8,40,000	6,90,000
6.	Cash and cash equivalents		
	Cash at bank in current accounts	32,000	20,000
	Cash in hand	4,500	9,000
	Fixed Deposit with Bank	66,000	65,000
	Total	1,02,500	94,000

	Other incomes	
7.	Interest income	24,000
	Dividend received	12,000
	Rent received	16,000
	Profit on sale of investments	7,500
	Total	59,500
8.	Depreciation and amortization expense	
	Depreciation on plant and machinery	52,500
	Goodwill written off	19,000
	Total	71,500
9.	Other expenses	
	Other office expenses	30,000
	Loss on sale on machinery	7,000
	Total	37,000

Additional information:

1	Equity shares and debentures issued at premium of 5% and 2%, respectively.
2	Machinery costing ₹ 60,000 on which accumulated depreciation was ₹ 15,000, sold for ₹ 38,000.
3	50% of the investments in shares sold at a profit of 10%.

ILLUSTRATION 2 (Repeat)

Prepare cash flow statement of Pioneer Limited for the year ending 31st March, 2019.

Pioneer Limited
Balance Sheet

	Particulars	Note No.	As at 31.3.2019 (In Rupees)	As at 31.3.2018 (In Rupees)
I.	Equity and Liabilities			
(1)	Shareholders' funds			
	a Share capital	1	7,50,000	7,00,000
	b Reserves and Surplus	2	2,10,000	1,12,000
(2)	Non-current liabilities			
	a Long-term borrowings (10% Deb.)		3,00,000	2,00,000
(3)	Current liabilities			
	a Short-term borrowings (Bank o/d)		52,000	40,000
	b Trade Payables		15,000	23,000
	c Other current liabilities	3	5,000	Nil
	d Short-term provisions (Pro. for tax)		19,000	7,000
	Total		13,51,000	10,82,000
II.	Assets			
(1)	Non-current assets			
	a Property, Plant and Equipment			
	(i) Tangible assets	4	2,97,500	1,75,000
	(ii) Intangible assets (Goodwill)		76,000	95,000
	b Non-current investments	5	8,40,000	6,90,000
(2)	Current assets			
	a Inventories (Stock in trade)		18,000	10,000
	b Trade receivables		11,000	18,000
	c Cash and cash equivalents	6	1,02,500	94,000
	d Other current assets (Accrued interest on investments)		6,000	Nil
	Total		13,51,000	10,82,000

Notes to accounts:

			As at 31.3.2019 (₹)	As at 31.3.2018 (₹)
1	Share Capital			
	Authorised Share Capital:			
	Equity Share Capital		7,50,000	7,50,000
	9% Preference Share Capital		5,00,000	5,00,000
			12,50,000	12,50,000
	Issued & Paid-up Share Capital:			
	Equity Share Capital		5,50,000	4,00,000
	9% Preference Share Capital		2,00,000	3,00,000
	Total		7,50,000	7,00,000
2	Reserves and Surplus			
	General Reserve		45,000	35,000
	Surplus i.e. Balance in Statement of Profit & Loss:		1,55,500	77,000
	Opening Balance	77,000		
	Add: Profit for the year	1,63,500		

	Less: Transfer to general reserve	(10,000)		
	Less: Preference Dividend	(27,000)		
	Less: Equity Dividend	(48,000)		
	Security Premium Reserve		9,500	--
		Total	2,10,000	1,12,000
3.	Other current liabilities			
	Outstanding office expenses		2,000	Nil
	Outstanding debenture interest		3,000	Nil
		Total	5,000	Nil
4.	Tangible assets			
	Plant & Machinery		4,60,000	3,00,000
	Less: Accumulated depreciation		1,62,500	1,25,000
			2,97,500	1,75,000
5.	Non-current investments			
	Property Investments		3,40,000	3,40,000
	Investment in 12% Bonds of ABC Limited		4,25,000	2,00,000
	Investment in Shares of XYZ Limited		75,000	1,50,000
			8,40,000	6,90,000
6.	Cash and cash equivalents			
	Cash at bank in current accounts		32,000	20,000
	Cash in hand		4,500	9,000
	Fixed Deposit with Bank		66,000	65,000
		Total	1,02,500	94,000

Additional information:

1	Equity shares and debentures issued at premium of 5% and 2%, respectively.
2	Machinery costing ₹ 60,000 on which accumulated depreciation was ₹ 15,000, sold for ₹ 38,000.
3	50% of the investments in shares sold at a profit of 10%.
4	(i) Dividend received ₹ 12,000; & (ii) Rent received ₹ 16,000.
5	Income tax paid ₹ 38,000
6	Got 'Insurance proceeds from earthquake disaster settlement' ₹ 1,00,000.
7	The new debentures were issued on 31.03.2019 and the additional investment in Bonds of ABC Limited was also made on 31.03.2019.

ILLUSTRATION 2 [Part – Operating Activities] (Repeat)

Calculate Cash Flows from Operating Activities (using indirect method) for the year ending 31st March, 2019. Some details for the period are:

Particulars		₹
Net profit after tax and extra-ordinary item		1,63,500
Provision for tax		50,000
Insurance proceeds from earthquake disaster settlement		1,00,000
Revenue from operations		8,00,000
Gross profit margin		25%
Salaries		17,500
Other office expenses: Paid	28,000	
Add: Outstanding	2,000	30,000
Depreciation on plant and machinery		52,500
Goodwill written off		19,000
Loss on sale of machine		7,000
Profit on sale of investments		7,500
Debenture interest: Paid	17,000	
Add: Outstanding	3,000	20,000
Interest on investments: Received	18,000	
Add: Accrued Interest	6,000	24,000
Rent received		16,000
Dividend received		12,000
Equity dividend paid		48,000
Preference dividend paid		27,000
Income tax paid		38,000

Additional information:

Balances as on	31.03.2019	31.03.2018
Trade receivables	11,000	18,000
Trade payables	15,000	23,000
Inventories	18,000	10,000
Provision for taxation	19,000	7,000

ILLUSTRATION 2 [Part – Investing Activities] (Repeat)

Presentation 1

Calculate Cash Flows from Investing Activities for the year ending 31st March, 2019. Some details for the period are:

Particulars	31st March, 2019 (Rs.)	31st March, 2018 (Rs.)
Property Investment	3,40,000	3,40,000
Investment in 12% Bonds	4,25,000	2,00,000
Investment in shares	75,000	1,50,000
Plant and Machinery	4,60,000	3,00,000
Provision for depreciation (P & M)	1,62,500	1,25,000
Goodwill	76,000	95,000

Additional Information:
Machinery costing ₹ 60,000 on which accumulated depreciation was ₹ 15,000, sold for ₹ 38,000.
50% of the investments in shares sold at a profit of 10%.
Additional investment was made in 12% Bonds on 31.3.2019.
Rent received ₹ 16,000. Dividend received ₹ 12,000. Accrued interest on investments ₹ 6,000.

Presentation 2

Calculate Cash Flows from Investing Activities for the year ending 31st March, 2019. Some details for the period are:

Particulars	31st March, 2019 (Rs.)	31st March, 2018 (Rs.)
Property Investment	3,40,000	3,40,000
Investment in 12% Bonds	4,25,000	2,00,000
Investment in shares	75,000	1,50,000
Plant and Machinery	2,97,500	1,75,000
Goodwill	76,000	95,000

Additional Information:
A machine having book value ₹ 45,000 was sold for ₹ 38,000. Depreciation on machinery charged during the year was ₹ 52,500.
50% of the investments in shares sold at a profit of 10%.
Additional investment was made in 12% Bonds on 31.3.2019.
Rent received ₹ 16,000. Dividend received ₹ 12,000. Accrued interest on investments ₹ 6,000.

Presentation 3

Calculate Cash Flows from Investing Activities for the year ending 31st March, 2019. Some details for the period are:

Particulars	₹
Plant and machinery purchased	2,20,000
Proceeds from sale of machine (Book Value ₹ 45,000)	38,000
Invested in bonds of some listed company	2,25,000
Proceeds from sale of investment in shares (cost price ₹ 75,000)	82,500
Rent from investment property received	16,000
Interest received	18,000
Dividend received	12,000
Depreciation & Amortization expense	71,500

ILLUSTRATION 2 [Part – Financing Activities] (Repeat)

Calculate Cash Flows from Financing Activities for the year ending 31st March, 2019. Some details for the period are:

Particulars	31st March, 2019 (Rs.)	31st March, 2018 (Rs.)
Equity Share Capital	5,50,000	4,00,000
9% Preference Share Capital	2,00,000	3,00,000
10% Debentures	3,00,000	2,00,000
Bank Overdraft	52,000	40,000

Additional Information: Preference Dividend paid ₹ 27,000. Equity dividend paid ₹ 48,000. Debenture interest outstanding ₹ 3,000. Equity shares and debentures issued at premium of 5% and 2%, respectively. New Debentures were issued on 31.03.2019

MAIN QUESTIONS

QUESTION 1

The following data were provided by the accounting records of Ryan Ltd. at year–end, March 31, 2015

Income Statement

Sales		6,98,000
Cost of goods sold		(5,20,000)
Gross margin		1,78,000
Operating expenses		
(including depreciation expenses of ₹ 37,000)		(1,47,000)
		31,000
Other Income / (expenses):		
Interest expense paid	(23,000)	
Interest income received	6,000	
Gain on sale of investments	12,000	
Loss on sale of Plant	(3,000)	
		(8,000)
		23,000
Income tax		(7,000)
		16,000

Comparative Balance Sheet

	31.3.2015	31.3.2014
Assets		
Plant Assets	7,15,000	5,05,000
Less: Accumulated Depreciation	(1,03,000)	(68,000)
	6,12,000	4,37,000
Investments (long term)	1,15,000	1,27,000
Current Assets:		
Inventory	1,44,000	1,10,000
Accounts Receivable	47,000	55,000
Cash	46,000	15,000
Prepaid Expenses	1,000	5,000
	9,65,000	7,49,000
Liabilities		
Share Capital	4,65,000	3,15,000
Reserves and surplus	1,40,000	1,32,000
Bonds	2,95,000	2,45,000
Current Liabilities:		
Accounts Payable	50,000	43,000
Accrued Liabilities	12,000	9,000
Income taxes Payable	3,000	5,000
	9,65,000	7,49,000

Analysis of selected accounts and transactions during 2014-2015:

1. Purchased investments for ₹ 78,000.
2. Sold investment for ₹ 1,02,000. These investments cost ₹ 90,000.
3. Purchased plant assets for ₹ 1,20,000.
4. Sold plant assets that cost ₹ 10,000 with accumulated dep. of ₹ 2,000 for ₹ 5,000.
5. Issued ₹ 1,00,000 of bonds at face value in an exchange for plant assets on 31st March,2015.
6. Repaid ₹ 50,000 of bonds at face value at maturity.
7. Issued 15,000 shares of ₹ 10 each.
8. Paid cash dividend ₹ 8,000.

Prepare Cash Flow Statement as per AS-3 (Revised),using indirect method.

QUESTION 2

The balance sheets (Extract) of Sun Ltd. for the years ended 31st March 2015 and 2014 were summarized thus:

	2015	2014
Equity share Capital	60,000	50,000
Reserves:		
Profit and loss account	5,000	4,000
Current liabilities:		
Creditors	4,000	2,500
Taxation	1,500	1,000
Dividend payable	Nil	1,000
	70,500	58,500
Fixed Assets (at W.D.V)		
Premises	10,000	10,000
Fixtures	17,000	11,000
Vehicles	12,500	8,000
Current Assets:		
Current investments	2,000	1,000
Stock	17,000	14,000
Debtors	8,000	6,000
Cash and cash equivalents	4,000	8,500
	70,500	58,500

And the profit and loss account for the year ended 31st March, 2015 disclosed

Profit before tax	4,500
Taxation	(1,500)
Profit after tax	3,000
Dividend declared	(2,000)
Retained profit	1,000

Further information is available :

	Fixtures	Vehicles
Depreciation for year	1,000	2,500
Disposals:		
Proceeds on disposal	---	1,700
Written down value	---	(1,000)
Profit on disposal		700

Prepare Cash Flow Statement for the year ended 31st March, 2015

QUESTION 3

Ms. Jyoti of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year 2015 :

	(₹ in Lakhs)
Net Profit	25,000
Dividend paid	8,535
Provision for Income tax	5,000
Income tax paid during the year	4,248
Loss on sale of assets (net)	40
Book value of the assets sold	185
Depreciation charged to Profit & Loss Account	20,000
Profit on sale of Investments	100
Carrying amount of Investment sold	27,765
Interest income on investments	2,506
Interest expense	10,000
Interest paid during the year	10,520
Increase in Working Capital (excluding Cash & Bank Balance)	56,081
Purchase of fixed assets	14,560
Investment in joint venture	3,850
Expenditure on construction work in progress	34,740
Proceeds from calls in arrear	2
Receipt of grant for capital projects	12
Proceeds from long-term borrowings	25,980
Proceeds from short-term borrowings	20,575
Opening cash and Bank balance	5,003
Closing cash and Bank balance	6,988

Required:

Prepare the Cash Flow Statement for the year 2015 in accordance with AS 3. (make necessary assumptions).

QUESTION 4

Given below Profit and loss account of ABC Ltd. and relevant balance sheet information:

Profit and loss account (Extract) **of ABC Ltd.**
For the year ended 31st December,2015

	(Rs .in lakhs)
Revenue:	
Sales	4,150
Interest and dividend	100
Stock adjustment	20
Total (A)	4270
Expenditure:	
Purchases	2400
Wages and salaries	800
Other expenses	200
Interest	60
Depreciation	100
Total (B)	3560
Profit before tax (A-B)	710
Tax provision	200
Profit after tax	510
Balance of profit and loss account brought forward	50
Profit available for distribution (C)	560
Appropriations:	
Transfer to general reserve	200
Declared Dividend (including CDT)	330
Total (D)	530
Balance (C-D)	30

Relevant balance sheet information	31.12.2015 (₹ in lakhs)	31.12.2014 (₹ in lakhs)
Trade receivables	400	250
Inventories	200	180
Trade payables	250	230
Outstanding wages	50	40
Outstanding expenses	20	10
Advance tax	195	180
Tax provision	200	180
Assessed tax liability		

Compute cash flow operating activities using both direct and indirect method.

QUESTION 5

Prepare Cash Flow for Gamma Ltd., for the year ending 31.3.2015 from the following information:

(1) Sales for the year amounted to ₹ 135 crores out of which 60% was cash sales.
(2) Purchases for the year amounted to ₹ 55 crores out of which credit purchase was 80%.
(3) Administrative and selling expenses amounted to ₹ 18 crores and salary paid amounted to ₹ 22 crores.
(4) The Company redeemed debentures of ₹ 20 crores at a premium of 10%. Debenture holders were issued equity shares of ₹ 15 crores towards redemption and the balance was paid in cash. Debenture interest paid during the year was ₹ 1.5 crores.
(5) Dividend paid during the year amounted to ₹ 11.7 crores.
(6) Investment costing ₹ 12 crores were sold at a profit of ₹ 2.4 crores.
(7) ₹ 8 crores was paid towards income tax during the year.
(8) A new plant costing ₹ 21 crores was purchased in part exchange of an old plant. The book value of the old plant was ₹ 12 crores but the vendor took over the old plant at a value of ₹ 10 crores only. The balance was paid in cash to the vendor.
(9) The following balances are also provided.

	(₹ in crores) 1.4.2014	**(₹ in crores) 31.3.2015**
Debtors	45	50
Creditors	21	23
Bank	6	

QUESTION 6

From the following information, calculate cash flow from operating activities:

Summary of Cash Account
For the year ended March 31, 2015

Particulars	₹	Particulars	₹
To Balance b/d	1,00,000	By Cash Purchases	1,20,000
To Cash sales	1,40,000	By Trade payables	1,57,000
To Trade receivables	1,75,000	By Office & Selling Expenses	75,000
To Trade Commission	50,000	By Income Tax	30,000
To Sale of Investment	30,000	By Investment	25,000
To Loan from Bank	1,00,000	By Repay of Loan	75,000
To Interest & Dividend	1,000	By Interest on loan	10,000
		By Balance c/d	1,04,000
	5,96,000		5,96,000

QUESTION 7

The following cash account has been extracted from the company's accounting records:

Summary Cash A/c

(₹'000)

Balance at 1.1.2014		35
Receipts from customers		2,783
Issue of shares		300
Sale of fixed assets		128
		3,246
Payments to suppliers	2,047	
Payments for fixed assets	230	
Payments for overheads	115	
Wages & Salaries	69	
Taxation	243	
Dividends	80	
Repayments of bank loan	250	(3,034)
Balance at 31.12.2014		212

Prepare cash flow statement of this company hills Ltd. for the year ended 31st December 2015 in accordance with AS-3 (Revised). The company does not have any cash equivalents.

QUESTION 8

Following are the extracts of Balance Sheet of Ajay Ltd.:

Liabilities	31.3.2014	31.3.2015	Assets	31.3.2014	31.3.2015
	Rs.	Rs.		Rs.	Rs.
Share Capital	5,00,000	5,00,000	Discount on issue	90,000	1,15,000
15% Debentures	5,00,000	7,50,000	Of Debentures		
Unpaid Interest	--	5,000			
Profit & Loss A/c	50,000	90,000			

You are required to show the related items in Cash Flow Statement, If Discount on issue of Debentures amounting to Rs.10,000 has been written off during the year.

QUESTION 9

From the following Balance Sheets of Mr. Zen, prepare a Cash flow statement as per AS-3 for the year ended 31.3.2015:

Balance Sheets of Mr. Zen

Liabilities	As on 1.4.2014 ₹	As on 1.4.2015 ₹
Zen's Capital A/c	10,00,000	12,24,000
Trade payables	3,20,000	3,52,000
Mrs. Zen's loan	2,00,000	--
Loan from Bank	3,20,000	4,00,000
	18,40,000	19,76,000
Assets	**As on 1.4.2014 ₹**	**As on 1.4.2015 ₹**
Land	6,00,000	8,80,000
Plant and Machinery	6,40,000	4,40,000
Inventories	2,80,000	2,00,000
Trade receivables	2,40,000	4,00,000
Cash	80,000	56,000

	18,40,000	19,76,000

Additional information:
A machine costing ₹ 80,000 (accumulated depreciation there on ₹ 24,000) was sold for ₹ 40,000. The provision for depreciation on 1.4.2014 was ₹ 2,00,000 and 31.3.2015 was ₹ 3,20,000. The net profit for the year ended on 31.3.2015 was ₹ 3,60,000.

QUESTION 10

From the following Balance Sheet (Extract) and information, prepare Cash Flow Statement of Ryan Ltd. for the year ended 31st March, 2015:

Balance Sheet

Liabilities	**31st March, 2015** ₹	**31st March, 2014** ₹
Equity Share Capital	6,00,000	5,00,000
10% Redeemable Preference Capital	–	2,00,000
Capital Redemption Reserve	1,00,000	–
Capital Reserve	70,000	–
General Reserve	1,50,000	2,50,000
Profit and Loss Account	1,00,000	50,000
9% Debentures	2,00,000	–
Trade Payables	1,15,000	1,10,000
Liabilities for Expenses	30,000	20,000
Provision for Taxation	95,000	60,000
Dividend Payable	Nil	60,000
	14,60,000	12,50,000

Assets	**31st March, 2015** ₹	**31st March, 2014** ₹
Land and Building	1,50,000	2,00,000
Plant and Machinery	7,65,000	5,00,000
Investments	50,000	80,000
Inventory	95,000	90,000
Trade Receivable	2,50,000	2,25,000
Cash and Bank	50,000	90,000
Other current assets	1,00,000	65,000
	14,60,000	12,50,000

Additional Information:
(i) A piece of land has been sold out for ₹ 1,50,000 (Cost – ₹ 1,20,000) and the balance land was revalued. Capital Reserve consisted of profit on revaluation.
(ii) On 1st April, 2014 a plant was sold for ₹ 90,000 (Original Cost – ₹ 70,000 and W.D.V. – ₹ 50,000) and Debentures worth ₹ 1 lakh was issued at par as part consideration for plant of ₹ 4.5 lakhs acquired.
(iii) Part of the investments (Cost – ₹ 50,000) was sold for ₹ 70,000.
(iv) Pre-acquisition dividend received ₹ 5,000 was adjusted against cost of investment.
(v) The company declared and paid 15% interim dividend during the current year.
(vi) Income-tax liability for the current year was estimated at ₹ 1,35,000.
(vii) Depreciation @ 15% has been written off from Plant account but no depreciation has been charged on Land and Building.

QUESTION 11

The Balance Sheet (Extract) of New Light Ltd. for the years ended 31st March, 2014 and 2015 are as follows:

Liabilities	**31.03.2014 (Rs.)**	**31.03. 2015 (Rs.)**	**Assets**	**31.03.2014 (Rs.)**	**31.03.2015 (Rs.)**
Eq. share capital	12,00,000	16,00,000	Fixed Assets	32,00,000	38,00,000
10% Preference			Less: Depreciation	9,20,000	11,60,000
share capital	4,00,000	2,80,000		22,80,000	26,40,000
			Investment	4,00,000	3,20,000
General Reserve	6,00,000	7,60,000	Cash	10,000	10,000
P & Loss A/c	2,40,000	3,40,000	Inventories	2,16,000	3,00,000
9% Debentures	4,00,000	2,80,000	Other current assets	8,94,000	8,50,000
Current liabilities	4,80,000	5,20,000			
Dividend payable	1,20,000	Nil			
Provision for Tax	3,60,000	3,40,000			
	38,00,000	41,20,000		38,00,000	41,20,000

Additional information:

(i) The company sold one fixed asset for ₹ 1,00,000, the cost of which was ₹ 2,00,000 and the depreciation provided on it was ₹ 80,000.

(ii) The company also decided to write off another fixed asset costing ₹ 56,000 on which depreciation amounting to ₹ 40,000 has been provided.

(iii) Depreciation on fixed assets provided ₹ 3,60,000.

(iv) Company sold some investment at a profit of ₹ 40,000.

(v) Debentures and preference share capital redeemed at 5% premium. Debentures were redeemed at the end of the year.

(vi) Company decided to value stock at cost, whereas previously the practice was to value stock at cost less 10%. The stock according to books on 31.3.2014 was ₹ 2,16,000. The stock on 31.3.2015 was correctly valued at ₹ 3,00,000.

Prepare Cash Flow Statement as per revised Accounting Standard 3 by indirect method.

QUESTION 12

ABC Ltd. gives you the following information. You are required to prepare Cash Flow Statement by using indirect methods as per AS 3 for the year ended 31.03.2015:

Balance Sheet (Extract) **as on**

Liabilities	31st March 2014 ₹	31st March 2015 ₹	Assets	31st March 2014 ₹	31st March 2015 ₹
Capital	50,00,000	50,00,000	Plant & Machinery	27,30,000	40,70,000
Retained Earnings	26,50,000	36,90,000	Less: Depreciation	6,10,000	7,90,000
9% Debentures	—	9,00,000		21,20,000	32,80,000
Current Liabilities:			**Current Assets**		
Trade payables	8,80,000	8,20,000	Trade receivables	23,90,000	28,30,000
Short term borrowings	1,50,000	3,00,000	Less: Provision	1,50,000	1,90,000
Liability for expenses	3,30,000	2,70,000		22,40,000	26,40,000
Dividend payable	1,50,000	Nil	Cash	15,20,000	15,20,000
			Current investments	11,80,000	15,00,000
			Inventories	20,10,000	19,20,000
			Prepaid Expenses	90,000	1,20,000
	91,60,000	1,09,80,000		91,60,000	1,09,80,000

Additional Information:

(i) Net profit for the year ended 31st March, 2015, after charging depreciation ₹ 1,80,000 is ₹ 10,40,000.

(ii) Trade receivables of ₹ 2,30,000 were determined to be worthless and were written off against the provisions for doubtful debts account during the year.

(ii) Debentures were issued at the end of the year.

QUESTION 13

The following figures have been extracted from the Books of X Limited for the year ended on 31.3.2015. You are required to prepare a cash flow statement.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 19.25 lakhs:

(a) Depreciation on Fixed Assets ₹ 5 lakhs.

(b) Discount on issue of Debentures written off ₹ 30,000.

(c) Interest on Debentures paid ₹ 3,50,000.

(d) Book value of investments ₹ 3 lakhs (Sale of Investments for ₹ 3,20,000).

(e) Interest received on investments ₹ 60,000.

(f) Premium on redemption of preference shares.

(ii) Compensation received ₹ 90,000 by the company in a suit filed.

(iii) Income tax paid during the year ₹ 10,50,000.

(iv) 15,000, 10% preference shares of ₹ 100 each were redeemed on 31.3.2015 at a premium of 5%. Further the company issued 50,000 equity shares of ₹ 10 each at a premium of 20% on 2.4.2014. Dividend on preference shares were paid at the time of redemption.

(v) Dividends paid for the year 2013-2014 ₹ 5 lakhs and interim dividend paid ₹ 3 lakhs for the year 2014-2015.

(vi) Land was purchased on 2.4.2014 for ₹ 2,40,000 for which the company issued 20,000 equity shares of ₹ 10 each at a premium of 20% to the land owner as consideration.

(vii) Current assets and current liabilities in the beginning and at the end of the years were as detailed below:

	As on 31.3.2014 ₹	As on 31.3.2015 ₹

Stock	12,00,000	13,18,000
Cash in hand	1,96,300	35,300
Trade receivables	2,58,000	2,53,100
Trade payables	2,11,000	2,11,300
Outstanding expenses	75,000	81,800

QUESTION 14

Surya Ltd. has provided you the following particulars. Prepare Cash Flow from Operating Activities by Indirect Method in accordance with AS 3:

Profit & Loss Account (Extract) **of Surya Ltd. for the year ended 31st March, 2015**

Particulars	**₹**	**Particulars**	**₹**
To Depreciation	86,700	By Operating Profit before depreciation	11,01,600
To Patents written off	35,000	By Profit on Sale on Investments	10,000
To Provision for Tax	1,25,000	By Refund of Tax	3,000
To dividend payable	72,000	By Insurance Claim-Major Fire Settlement	1,00,000
To Transfer to Reserve	87,000		
To Net Profit	8,08,900		
	12,14,600		12,14,600

Additional information: **in ₹**

	31.3.2014	**31.3.2015**
Inventory	1,20,000	1,60,000
Trade Receivables	7,500	75,000
Trade Payables	23,735	87,525
Provision for Tax	1,18,775	1,25,000
Prepaid Expenses	15,325	12,475
Marketable Securities	11,775	29,325
Cash Balance	25,325	35,340

QUESTION 15

Prepare Cash Flow from Investing Activities of M/s. Creative Furnishings Limited for the year ended 31-3-2015

Particulars	**₹**
Plant acquired by the issue of 8% Debentures	1,56,000
Claim received for loss of plant in fire	49,600
Unsecured loans given to subsidiaries	4,85,000
Interest on loan received from subsidiaries companies	82,500
Pre-acquisition dividend received on investment made	62,400
Debenture interest paid	1,16,000
Term loan repaid	4,25,000
Interest received on investment	68,000
(TDS of ₹ 8,200 was deducted on the above interest)	
Book value of plant sold (loss incurred ₹ 9,600)	84,000

QUESTION 16

The following are the changes in the account balances taken from the Balance Sheets (Extract) of PQ Ltd. as at the beginning and end of the year. :

Changes in Rupees in	Debit or[Credit]
Equity share capital 30,000 shares of ₹ 10 each issued and fully paid	0
Capital reserve	[49,200]
8% debentures	[50,000]
Debenture discount	1,000
Freehold property at cost/revaluation	43,000
Plant and machinery at cost	60,000
Depreciation on plant and machinery	[14,400]
Trade receivables	50,000
Inventory and work-in-progress	38,500
Trade payables	[11,800]
Net profit for the year	[76,500]
Dividend paid in respect of earlier year	30,000
Provision for doubtful debts	[3,300]

Trade investments at cost Bank	47,000 [64,300]

You are informed that

(a) Capital reserve as at the end of the year represented realised profits on sale of one freehold property together with surplus arising on the revaluation of balance of freehold properties.

(b) During the year plant costing ₹ 18,000 against which depreciation provision of ₹ 13,500 was lying, was sold for ₹ 7,000.

(c) During the middle of the year ₹ 50,000 debentures were issued for cash at a discount of ₹ 1,000.

(d) The net profit for the year was after crediting the profit on sale of plant and charging debenture interest.

You are required to prepare a statement which will explain why bank balance had decreased by ₹ 64,300 during the year end. Ignore taxation.

QUESTION 17

From the following information prepare a Cash Flow Statement according to (a) Direct Method (b) Indirect Method as per AS 3 (Revised). Working notes would form part of your answer

		2013 (₹ In '000)		2012(₹ In '000)
Assets				
Cash on hand and balances with banks		200		25
Short term investments		670		135
Sundry debtors		1,700		1,200
Interest receivable		100		--
Inventories		900		1,950
Long term investments		2,500		2,500
Fixed assets at cost	2,180		1,910	
Less: Accumulated depreciation	(1,450)		(1,060)	
Fixed assets (net)		730		850
Total Assets		6,800		6,660
		2013(₹ In '000)		2012(₹ In '000)
Liabilities				
Sundry creditors		150		1,890
Interest payable		230		100
Income taxes payable		400		1,000
Long term debt		1,110		1,040
Total liabilities		1,890		4,030
Shareholders' funds				
Share capital		1,500		1,250
Reserves		3,410		1,380
Total shareholders' funds		4,910		2,630
Total liabilities and shareholders' funds		6,800		6,660

(2) STATEMENT OF PROFIT AND LOSS for the period ended 31.12.2013

	(₹ In '000)
Sales	30,650
Cost of sales	(26,000)
Gross profit	4,650
Depreciation	(450)
Administrative and selling expenses	(910)
Interest expense	(400)
interest income	300
Dividend income	200
Foreign exchange loss	(40)
Net profit before taxation and extraordinary item	3,350
Extraordinary item-	
Insurance proceeds from earthquake disaster settlement	180
Net profit from extraordinary item	3,530
Income tax	(300)
Net profit	3,230

Additional Information: (Figures in ₹ '000)

(a) An amount of 250 was raised from the issue of share capital and a further 250 was raised from long-term borrowings.

(b) Interest expense was 400 of which 170 was paid during the period. 100 relating to interest expense of the prior period was also paid during the period.
(c) Dividends paid were 1,200.
(d) Tax deducted at source on dividends received (included in the tax expense of 300 for the year) amounted to 40.
(e) During the period, the enterprise acquired fixed assets for 350. The payment was made in cash.
(f) Plant with original cost of 80 and accumulated depreciation of 60 was sold for 20.
(g) Foreign exchange loss of 40 represents the reduction in the carrying amount of a short term investment in foreign currency designated bonds arising out of a change in exchange rate between the date of acquisition of the investment and the balance sheet date.
(h) Sundry debtors and sundry creditors include amounts relating to credit sales and credit purchases only.

QUESTION 18

Given below are the condensed Balance Sheets (Extract) of Lambakadi Ltd. for two years and the statement of Profit and Loss for one year:

		(Figures ₹ in lakhs)
As at 31st March	2015	2014
Share Capital		
In equity shares of ₹ 100 each	150	110
10% redeemable preference shares of ₹ 100 each	10	40
Capital redemption reserve	10	---
General reserve	15	10
Profit and loss account balance	30	20
8% debentures with convertible option	20	40
Other term loans	15	30
	250	250
Fixed assets less depreciation	130	100
Long term investments	40	50
Working capital	80	100
	250	250

Statement of Profit and Loss (Extract) **for the year ended 31st March, 2015**

		(Figures ₹ In lakhs)
Sales		600
Less : Cost of sales		400
		200
Establishment charges	30	
Selling and distribution expenses	60	
Interest expenses	5	
Loss on sale of equipment (Book value ₹ 40 lakhs)	15	110
		90
Interest income	4	
Dividend income	2	
Foreign exchange gain	10	
Damages received for loss of reputation	14	30
		120
Depreciation		50
		70
Taxes		30
		40
Dividends		15
Net profit carried to Balance Sheet		25

You are informed by the accountant that ledgers relating to trade receivables, trade payables and inventory for both the years were seized by the income-tax authorities and it would take atleast two months to obtain copies of the same. However, he is able to furnish the following data:

		(Figures ₹ in lakhs)
	2015	2014
Dividend receivable	2	4
Interest receivable	3	2
Cash on hand and with bank	7	10
Investment maturing within two months	3	2
	15	18
Interest payable	4	5
Taxes payable	6	3
	10	8

Current ratio	1.5	1.4
Acid test ratio	1.1	0.8

It is also gathered that debenture holders owning 50% of the debentures outstanding as on 31.3.2014 exercised the option for conversion into equity shares during the financial year and the same was put through.

You are required to prepare a direct method cash flow statement for the financial year, 2015 in accordance with para 18(a) of Accounting Standard (AS) 3 revised.

QUESTION 19

Write short notes on '*Cash Flow Statement'.*

ANSWER

Cash flow statement is a statement of inflows and outflows of cash and cash equivalents. It starts with the opening balance of cash and cash equivalents at the start of the accounting period. It then gives in a summary form, the inflows and outflows relating to the following three classifications of activities:

(i) Operating activities: They are the principal revenue producing activities of the enterprise.

(ii) Investing activities: They deal with the acquisition and disposal of long-term assets and long term investments.

(iii) Financing activities: They reflect changes in the size and composition of capital in the case of a company this would preference capital and borrowings of the enterprise.

The cash flows arising from extraordinary items are disclosed separately under each of the above three classifications.

Likewise where the amount of significant cash and cash equivalent balances held by an enterprise are not available for use by the enterprise, the same should be disclosed separately together with a commentary by the management. This may happen for example, in case of bank balances held in other countries subject to such exchange control or other regulations that the fund is practically of no use.

As per para 18 of AS 3 (Revised) on Cash Flow Statements, an enterprise should report cash flows from operating activities using either :

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby net profit or loss in adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

QUESTION 20

In the case of manufacturing company:

(i) List the items of 'inflows' of cash receipts from operating activities;

(ii) List the items of "outflows" of investing activities.

ANSWER

(i) Inflows of cash receipts from operating activities:

(a) Cash receipts from the sales of goods;

(b) Royalties, fees, commission and other revenue;

(c) Refunds of income-tax.

(ii) Outflows of investing activities:

(a) Cash payments for acquisition of fixed assets;

(b) Cash payments for acquisition of shares, warrants or debts instruments of other enterprises and interests in joint ventures (other than payments for instruments considered to cash equivalents and those for dealing or trading purposes);

(c) Cash advances and loans to third parties.

QUESTION 21

Classification of activities (with two examples) as suggested in AS 3, to be used for preparing a cash flow statements.

ANSWER

AS 3 (Revised) on Cash Flow Statements requires that the cash flow statement should report cash flows by operating, investing and financing activities.

(i) Operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities. Cash receipts from sale of goods and cash payments to suppliers of goods are two examples of operating activities.

(ii) Investing activities are acquisition and disposal of long-term assets and other investments not included in cash equivalents. Payment made to acquire machinery and cash received for sale of furniture are examples of investing activities.

(iii) Financial activities are those activities that result in changes in the size and composition of the owner's capital (including preference share capital in the case of a company) and borrowings of the enterprise. Cash proceeds from issue of shares and cash paid to redeem debentures are two examples of financing activities.

QUESTION 22

Explain the difference between direct and indirect methods of reporting cash flows from operating activities with reference to Accounting Standard 3.

ANSWER

As per para 18 of AS 3 (Revised) on Cash Flow Statements, an enterprise should report cash flows from operating activities using either :

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby net profit or loss in adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method and is, therefore, considered more appropriate than the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:

(a) from the accounting records of the enterprise; or

(b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial enterprise) and other items in the statement of profit and loss for :
  (i) changes during the period in inventories and operating receivables and payables;
  (ii) other non-cash items; and
  (iii) other items for which the cash effects are investing or financing cash flows.

Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of:

(a) changes during the period in inventories and operating receivables and payables;

(b) non-cash items such as depreciation, provisions, deferred taxes and unrealised foreign exchange gains and losses; and

(c) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the operating revenues and expenses, excluding non-cash items disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

QUESTION 23

What is meant by Cash and Cash Equivalent as per AS 13?

ANSWER

As per AS 3 'Cash Flow Statements', the term 'Cash' and 'Cash equivalents' mean the following:

Cash : It includes cash on hand and demand deposits with banks.

Cash Equivalents: It means short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to insignificant risk of changes in value. Cash equivalents are held for the purpose of meeting short -term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent, it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition.

QUESTION 24

Garden Ltd. acquired fixed assets viz. plant and machinery for ₹ 20 lakhs. During the same year it sold its furniture and fixtures for ₹ 5 lakhs. Can the company disclose, net cash outflow towards purchase of fixed assets in the cash flow statement as per AS -3?

ANSWER

According to Para 21 of AS 3 (Revised) 'Cash Flow Statements', an enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22 and 24 are reported on a net basis. Acquisition and

disposal of fixed assets is not prescribed in para 22 and 24 of the standard.
Hence, the company cannot disclose net cash flow in respect of acquisition of plant and machinery and disposal of furniture and fixtures.

QUESTION 25

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

(i) Loans and Advances given to the following and interest earned on them:
  (1) to suppliers
  (2) to employees
  (3) to subsidiaries companies
(ii) Investment made in subsidiary Smart Ltd. and dividend received
(iii) Dividend paid for the year
(iv) TDS on interest income earned on investments made
(v) TDS on interest earned on advance given to suppliers
(vi) Insurance claim received against loss of fixed asset by fire

Discuss in the context of AS 3 Cash Flow Statement

ANSWER

(i) Loans and advances given and interest earned

(1)	to suppliers	Operating Cash flow
(2)	to employees	Operating Cash flow
(3)	to its subsidiary companies	Investing Cash flow

(ii) Investment made in subsidiary company and dividend received
Investing Cash flow
(iii) Dividend paid for the year
Financing Cash outflow
(iv) TDS on interest income earned on investments made
Investing Cash Outflow
(v) TDS on Interest earned on advance given to suppliers
Operating Cash Outflow
(vi) Insurance claim received of amount loss of fixed asset by fire
Extraordinary item to be shown under a separate heading as 'Cash inflow from investing activities'.

QUESTION 26

X Limited purchases debentures of ₹ 10,00,000 of Y Limited which are redeemable within three months. How will you show this item as per AS 3 while preparing cash flow statement for the year ended 31st March, 2015 ?

Hint Answer : As Cash equivalent

QUESTION 27

Classify the following activities as (1) Operating activities, (2) Investing activities, (3) Financing activities:
(a) Purchase of machinery
(b) Proceeds from issuance of equity share capital
(c) Cash sales
(d) Proceeds from short term and long term borrowings
(e) Proceeds collected from debtors
(f) Brokerage paid on purchase of investments

Hint Answer : (1) c & e ; (2) a & f ; (3) b & d

QUESTION 28

"Withdrawal of demand deposits has been classified by State Bank Of India as an operating activity". Whether the classification is in consonance with AS 3.

Hint Answer : The classification is correct.

QUESTION 29

Explain the meaning of the terms 'cash' and 'cash equivalent' for the purpose of Cash Flow Statement as per AS-3.
Ruby Exports had a bank balance of USD 25,000, stated in books at ₹ 16,76,250 using the rate of exchange ₹ 67.05 per USD prevailing on the date of receipt of dollars. However, on the balance sheet date, the closing rate of exchange was ₹ 67.80 and the bank balance had to be restated at ₹ 16,95,000.

Comment on the effect of change in bank balance due to exchange rate fluctuation and also discuss how it will be disclosed in Cash Flow Statement of Ruby Exports with reference to AS 3.

ANSWER
Cash flow statement consists of:
(a) Cash in hand and deposits repayable on demand with any bank or other financial institutions and
(b) Cash equivalents, which are short term, highly liquid investments that are readily convertible into known amounts of cash and are subject to insignificant risk or change in value.
Cash flows are inflows (i.e. receipts) and outflows (i.e. payments) of cash and cash equivalents. Any transaction, which does not result in cash flow, should not be reported in the cash flow statement. Movements within cash or cash equivalents are not cash flows because they do not change cash as defined by AS 3 "Cash Flow Statements" which is sum of cash, bank and cash equivalents.
In the given case, due to increase in rate of foreign exchange by 75 paise, there is increase (change) in bank balance. This increase of ₹ 18,750 (25,000 x 0.75) is not a cash flow because neither there is any cash inflow nor there is any cash outflow. Therefore, this change in bank balance amounting ₹ 18,750 need not be disclosed in Cash Flow Statement of Ruby exports.
The net increase/decrease in Cash/Cash equivalents in the Cash Flow Statements are stated exclusive of exchange gains and losses. The resultant difference between Cash and Cash Equivalents as per the Cash flow statement and that recognized in the balance sheet is reconciled in the note on cash flow statements.

QUESTION 30

Classify the following activities as per AS 3 Cash Flow Statement:
(i) Interest paid by financial enterprise
(ii) Dividend paid
(iii) Tax deducted at source on interest received from subsidiary company
(iv) Deposit with Bank for a term of two years
(v) Insurance claim received towards loss of machinery by fire
(vi) Bad debts written off
Which activity does the purchase of business falls under and whether netting off of aggregate cash flows from disposal and acquisition of business units is possible?

ANSWER
(i) Interest paid by financial enterprise -- Cash flows from operating activities
(ii) Dividend paid -- Cash flows from financing activities
(iii) TDS on interest received from subsidiary company -- Cash flows from investing activities
(iv) Deposit with bank for a term of two years -- Cash flows from investing activities
(v) Insurance claim received against loss of fixed asset by fire -- Extraordinary item to be shown as a separate heading under "Cash flow from investing activities"
(vi) Bad debts written off -- It is a non-cash item which is adjusted from net profit/loss under indirect method, to arrive at net cash flow from operating activity.

Purchase of business falls under Investing Activities as per AS 3 "Cash Flow Statement". The aggregate cash flows arising from acquisitions and from disposals of other business units should be presented separately and classified as investing activities. Thus netting of aggregate cash flows from disposal and acquisition of business units is not possible.

QUESTION 31

The following information was provided by PQR Ltd. for the year ended 31st March, 2019:
(1) Gross Profit Ratio was 25% for the year, which amounts to ₹ 3,75,000.
(2) Company sold goods for cash only.
(3) Opening inventory was lesser than closing inventory by ₹ 25,000.
(4) Wages paid during the year ₹ 5,55,000.
(5) Office expenses paid during the year ₹ 35,000.
(6) Selling expenses paid during the year ₹ 15,000.
(7) Dividend paid during the year ₹ 40,000.
(8) Bank Loan repaid during the year ₹ 2,05,000 (included interest ₹ 5,000)
(9) Trade Payables on 31st March, 2018 were ₹ 50,000 and on 31st March, 2019 were ₹ 35,000.
(10) Amount paid to Trade payables during the year ₹ 6,10,000
(11) Income Tax paid during the year amounts to ₹ 55,000 (Provision for taxation as on 31st March, 2019 ₹ 30,000).
(12) Investments of ₹ 8,20,000 sold during the year at a profit of ₹ 20,000.

(13) Depreciation on furniture amounts to ₹ 40,000.
(14) Depreciation on other tangible assets amounts to ₹ 20,000.
(15) Plant and Machinery purchased on 15th November, 2018 for ₹ 3,50,000.
(16) On 31st March, 2019 ₹ 2,00,000, 7% Debentures were issued at face value in an exchange for a plant.
(17) Cash and Cash equivalents on 31st March, 2018 ₹ 2,25,000.
(A) Prepare cash flow statement for the year ended 31st March, 2019, using direct method.
(B) Calculate cash flow from operating activities, using indirect method.

QUESTION 32(a)

Prepare cash flow from investing activities as per AS 3 of M/s Subham Creative Limited for year ended 31.3.2019:

(i) Machinery acquired by issue of shares at face value ₹ 2,00,000
(ii) Claim received for loss of machinery in earthquake ₹ 55,000
(iii) Unsecured loans given to associates ₹ 5,00,000
(iv) Interest on loan received from associate company ₹ 70,000
(v) Pre-acquisition dividend received on investment made ₹ 52,600
(vi) Debenture interest paid ₹ 1,45,200
(vii) Term loan repaid ₹ 4,50,000
(viii) Interest received on investment (TDS of ₹ 8,200 was deducted on the above interest) ₹ 73,800
(ix) Purchased debentures of X Ltd., on. 1st December, 2018 which are redeemable within 3 months ₹ 3,00,000
(x) Book value of plant & machinery sold (loss incurred ₹ 9,600) ₹ 90,000

QUESTION 32(b)

The following are the extracts of Balance Sheet and Statement of Profit and Loss of Supriya Ltd.:

Extract of Balance Sheet

		Particulars	***Notes***	***2021 (₹000)***	***2020 (₹000)***
		Equity and Liabilities			
1		**Shareholder's funds**			
	(a)	Share capital	1	500	200
2		**Non- current liabilities**			
	(a)	Long term loan from bank		---	250
3		**Current liabilities**			
	(a)	Trade Payables		1,000	3,047
		Assets			
1		**Non-current assets**			
	(a)	Property, Plant and Equipment		230	128
2		**Current assets**			
	(a)	Trade receivables		2,000	4,783
	(b)	Cash & cash equivalents (Cash balance)		212	35

Extract of Statement of Profit and Loss

	Particulars	Notes	2021 (₹000)	2020 (₹000)
I	Expenses:			
	Employee benefits expense		69	25
	Other expenses	2	115	110
II	Tax expense:			
	Current tax (paid during year)		243	140

Notes to accounts

		2021 (₹000)	2020 (₹000)
1	**Share Capital**		
	Equity Shares of ₹10 each, fully paid up	500	200
2	**Other expenses**		
	Overheads	115	110

Prepare Cash Flow Statement of Supriya Ltd. for the year ended 31st March, 2021 in accordance with AS-3 (Revised) using direct method. All transactions were done in cash only. There were no outstanding/prepaid expenses as on 31st March, 2020 and on 31st March, 2021. Ignore deprecation. Dividend amounting ₹ 80,000 was paid during the year ended 31st March, 2021.

QUESTION 33

1. While preparing cash flow statement, conversion of debt to equity
(a) Should be shown as a financing activity.
(b) Should be shown as an investing activity.
(c) Should not be shown as it is a non-cash transaction.
2. Which of the following would be considered a ‘cash-flow item from an “investing" activity’?
(a) Cash outflow to the government for taxes.
(b) Cash outflow to purchase bonds issued by another company.
(c) Cash outflow to shareholders as dividends.
3. All of the following would be included in a company’s operating activities except:
(a) Income tax payments
(b) Collections from customers or Cash payments to suppliers
(c) Dividend payments.
4. Hari Uttam, a stock broking firm, received ₹ 1,50,000 as premium for forward contracts entered for purchase of equity shares. How will you classify this amount in the cash flow statement of the firm?
(a) Operating Activities. (b) Investing Activities. (c) Financing Activities.
5. As per AS 3 on Cash Flow Statements, cash received by a manufacturing company from sale of shares of ABC Company Ltd. should be classified as
(a) Operating activity. (b) Financing activity. (c) Investing activity.
6. Which of the following activities would generally be regarded as a financing activity in preparing a cash flow statement?
(a) Dividend distribution.
(b) Proceeds from the sale of shares of other companies.
(c) Loans made by the financial enterprise to other businesses entities.
7. All of the following are examples of cash flows arising from investing activities except
(a) Cash payments to acquire fixed assets.
(b) Cash receipts from disposal of fixed assets.
(c) Cash payments to suppliers for goods and services.
8. Cash repayments of amounts borrowed will be disclosed in the cash flow statement as
(a) An operating activity. (b) A financing activity (c) An investing activity.
9. In the cash flow statement, ‘cash and cash equivalents’ include
(a) Bank balances and Cash balances.
(b) Short-term investments readily convertible into Cash are subject to an insignificant risk of changes in value.
(c) Both (a) and (b).

10. While preparing a Cash Flow Statement using the Indirect method as required under AS 3, which of the following will be deducted from the Net Profit to arrive at the "Cash flow from Operating activities"? (a) Interest income (b) Gain on sale of a Fixed asset.. (c) Both (a) and (b)
11. XYZ Co. Ltd is a financial Institute and has given loans and advances to its subsidiary and earned interest of ₹ 5 lacs on that loan. Interest earned by XYZ Co. Ltd is shown as
(a) Operating Cash Flow. (b) Investing Cash Flow. (c) Financing Cash Flow.

ANSWER

1. (c); 2. (b); 3. (c); 4. (a); 5. (c); 6. (a); 7. (c); 8. (b); 9. (c); 10. (c); 11. (a)

QUESTION 34

Classify the following activities as (1) Operating activities, (2) Investing activities (3) Financing activities (4) Cash equivalents with reference to AS 3 (Revised).
(a) Brokerage paid on purchase of investments
(b) Underwriting commission paid
(c) Trading commission received
(d) Proceeds from sale of investment
(e) Purchase of goodwill
(f) Redemption of preference shares
(g) Rent received from property held as investment
(h) Interest paid on long-term borrowings
(i) Marketable securities (having risk of change in value)
(j) Refund of income tax received.

ANSWER

(1) c & j
(2) a, d, e & g
(3) b, f & h
(4) i

QUESTION 35

How will you disclose following items while preparing Cash Flow Statement of Gagan Ltd. as per AS-3 for the year ended 31st March, 20X2?
(i) 10% Debentures issued:
As on 01-04-20X1 ₹ 1,10,000
As on 31-03-20X2 ₹ 77,000
(ii) Debentures were redeemed at 5% premium at the end of the year. Premium was charged to the Profit & Loss Account for the year.
(iii) Unpaid Interest on Debentures:
As on 01-04-20X1 ₹ 275
(iv) Debtors of ₹ 36,000 were written off against the Provision for Doubtful Debts A/c during the year.
(v) 10% Bonds (Investments):
As on 01-04-20X1 ₹ 3,50,000
As on 31-03-20X2 ₹ 3,50,000
(vi) Accrued Interest on Investments:
As on 31-03-20X2 ₹ 10,500

Self Assessment Test 1

QUESTION 1

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 2015 in accordance with AS using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31.3.2015

	₹ '000		₹ '000
Balance on 1.4.2014	50	Payment to Suppliers	2,000
Issue of Equity Shares	300	Purchase of Fixed Assets	200
Receipts from Customers	2,800	Overhead expense	200
Sale of Fixed Assets	100	Wages and Salaries	100
		Taxation	250
		Dividend	50
		Repayment of Bank Loan	300
		Balance on 31.3.2015	150
	3,250		3,250

QUESTION 2

From the following details relating to the Accounts of Grow More Ltd. prepare Cash Flow Statement:

Liabilities	**31.03.2015 (Rs.)**	**31.03.2014 (Rs.)**

Share Capital	10,00,000	8,00,000
Reserve	2,00,000	1,50,000
Profit and Loss Account	1,00,000	60,000
Debentures	2,00,000	–
Provision for taxation	1,00,000	70,000
Dividend payable	Nil	1,00,000
Trade payables	7,00,000	8,20,000
	23,00,000	20,00,000
Assets		
Plant and Machinery	7,00,000	5,00,000
Land and Building	6,00,000	4,00,000
Investments	1,00,000	–
Trade receivables	5,00,000	7,00,000
Stock	4,00,000	2,00,000
Cash on hand/Bank	Nil	2,00,000
	23,00,000	20,00,000

(i) Depreciation @ 25% was charged on the opening value of Plant and Machinery.
(ii) During the year one old machine costing 50,000 (WDV 20,000) was sold for ₹ 35,000.
(iii) ₹ 50,000 was paid towards Income tax during the year.
(iv) Building under construction was not subject to any depreciation.

Prepare Cash flow Statement.

QUESTION 3

Raj Ltd. gives you the following information for the year ended 31st March, 2015:

(i) Sales for the year ₹ 48,00,000. The Company sold goods for cash only.
(ii) Cost of goods sold was 75% of sales.
(iii) Closing inventory was higher than opening inventory by ₹ 50,000.
(iv) Trade creditors on 31.3.2015 exceed the outstanding on 31.3.2014 by ₹ 1,00,000.
(v) Tax paid during the year amounts to ₹ 1,50,000.
(vi) Amounts paid to Trade creditors during the year ₹ 35,50,000.
(vii) Administrative and Selling expenses paid ₹ 3,60,000.
(viii) One new machinery was acquired in December, 2014 for ₹ 6,00,000.
(ix) Dividend paid during the year ₹ 1,20,000.
(x) Cash in hand and at Bank on 31.3.2015 ₹ 70,000.
(xi) Cash in hand and at Bank on 1.4.2014 ₹ 50,000.

Prepare Cash Flow Statement for the year ended 31.3.2015 as per the prescribed Accounting standard.

Self Assessment Test 2

QUESTION 1

From the following information, prepare cash flow statement of A (P) Ltd. as at 31st March, 2015 by using indirect method:

Balance Sheet (Extract)

	2014 ₹	**2015** ₹
Liabilities:		
Share capital	12,00,000	12,00,000
Profit and loss account	8,50,000	10,00,000
Long term loans	10,00,000	10,60,000
Trade payables	3,50,000	4,00,000
	34,00,000	36,60,000
Assets:		
Fixed assets	17,00,000	20,00,000
Investment in shares	2,00,000	2,00,000
Inventory	6,80,000	7,00,000
Trade receivables	7,60,000	6,90,000
Cash	60,000	70,000
	34,00,000	36,60,000

Income Statement (Extract) **for the year ended 31st March, 2015**

		₹
Sales		40,80,000
Less: Cost of sales		(27,20,000)
Gross Profit		13,60,000
Less: Operating expenses:		
Administrative expenses	4,60,000	
Depreciation	2,20,000	(6,80,000)
Operating profit		6,80,000
Add: Non-operating incomes (dividend received)		50,000
		7,30,000
Less: Interest paid		(1,40,000)
Profit before tax		5,90,000
Less: Income-tax		(2,60,000)
Profit after tax		3,30,000

Statement of Retained Earnings

	₹
Opening balance	8,50,000
Add: Profit	3,30,000
	11,80,000
Less: Dividend paid	1,80,000
Closing balance	10,00,000

QUESTION 2

The Balance Sheets (Extract) of 'X' Ltd. as on 31st March, 2015 are as follows:

Liabilities	**2014 Amount (Rs.)**	**2015 Amount (Rs.)**	**Assets**	**2014 Amount (Rs.)**	**2015 Amount (Rs.)**
Share Capital	5,00,000	7,00,000	Land and Buildings	80,000	1,20,000
General Reserve	50,000	70,000	Plant and Machinery	5,00,000	8,00,000
Profit and Loss A/c	1,00,000	1,60,000	Inventory	1,00,000	75,000
Trade payables	1,93,000	2,40,000	Trade receivables	1,50,000	1,60,000
Outstanding Expenses	7,000	5,000	Cash	20,000	20,000
	8,50,000	11,75,000		8,50,000	11,75,000

Additional information:

(a) ₹ 50,000 depreciation has been charged to Plant and Machinery during the year 2015.

(b) A piece of Machinery costing ₹ 12,000 (Depreciation provided there on ₹ 7,000) was sold at 60% profit on book value.

You are required to prepare Cash flow statement for the year ended 31st March 2015 as per AS 3 (revised), using indirect method.

Self Assessment Test 3

QUESTION 1

On the basis of the following information prepare a Cash Flow Statement for the year ended 31st March, 2015:

(i) Total sales for the year were ₹ 199 crore out of which cash sales amounted to ₹ 131 crore.

(ii) Cash collections from credit customers during the year, totalled ₹ 67 crore.

(iii) Cash paid to suppliers of goods and services and to the employees of the enterprise amounted to ₹ 159 crore.

(iv) Fully paid preference shares of the face value of ₹ 16 crore were redeemed and equity shares of the face value of ₹ 16 crore were allotted as fully paid up at a premium of 25%.

(v) ₹ 13 crore were paid by way of income tax.

(vi) Machine of the book value of ₹ 21 crore was sold at a loss of ₹ 30 lakhs and a new machine was installed at a total cost of ₹ 40 crore.

(vii) Debenture interest amounting ₹ 1 crore was paid.

(viii) Dividends totalling ₹ 11.70 crore was paid on equity and preference shares.

(ix) On 31st March, 2014 balance with bank and cash on hand totalled ₹ 9 crore.

QUESTION 2

Prepare Cash Flow Statement of MNT Ltd. for the year ended 31st March 2015 with the help of the following information:

1. Company sold goods for cash only.
2. Gross Profit Ratio was 30% for the year, Gross Profit amounts to ₹ 3,82,500.
3. Opening Inventory was lesser than Closing Inventory by ₹ 35,000.
4. Wages paid during the year ₹ 4,92,500.
5. Office and Selling Expenses paid during the year ₹ 75,000.
6. Dividend paid during the year ₹ 30,000.
7. Bank Loan repaid during the year ₹ 2,15,000 (including Interest ₹ 15,000).
8. Trade Payables on 31st March 2014 exceed the balance on 31st March 2015 by ₹ 25,000.
9. Amount paid to Trade Payables during the year ₹ 4,60,000.
10. Tax paid during the year amounts to ₹ 65,000 (Provision for Taxation as on 31.03.2015 ₹ 45,000).
11. Investments of ₹ 7,00,000 sold during the year at a profit of ₹ 20,000.
12. Depreciation on Fixed Assets amounts to ₹ 85,000.
13. Plant and Machinery purchased on 15th November 2014 for ₹ 2,50,000.
14. Cash and Cash Equivalents on 31st March 2014 ₹ 2,00,000
15. Cash and Cash Equivalents on 31st March 2015 ₹ 6,07,500.

QUESTION 3

On the basis of the following information prepare a Cash Flow Statement for the year ended 31st March, 2016 (Using direct method):

(i) Total sales for the year were ₹ 398 crores out of which cash sales amounted to ₹ 262 crores.
(ii) Receipts from credit customers during the year, totalled ₹ 134 crores.
(iii) Purchases for the year amounted to ₹ 220 crores out of which credit purchase was 80%.
Balance in creditors as on
1.4.2015 ₹ 84 crores
31.3.2016 ₹ 92 crores
(iv) Suppliers of other consumables and services were paid ₹ 19 crores in cash.
(v) Employees of the enterprises were paid 20 crores in cash.
(vi) Fully paid preference share of the face value of ₹ 32 crores were redeemed. Equity shares of the face value of ₹ 20 crores were allotted as fully up at premium of 20%.
(vii) Debentures of ₹ 20 crores at a premium of 10% were redeemed. Debenture holders were issued equity shares in lieu of their debentures.
(viii) ₹ 26 crores were paid by way of income tax.
(ix) A new machinery costing ₹ 25 crores was purchased in part exchange of an old machinery. The book value of the old machinery was ₹ 13 crores. Through the negotiations, the vendor agreed to take over the old machinery at a higher value of ₹ 15 crores. The balance was paid in cash to the vendor.
(x) Investment costing ₹ 18 crores were sold at a loss of ₹ 2 crores.
(xi) Dividends totally ₹ 15 crores was also paid.
(xii) Debenture interest amounting ₹ 2 crores was paid.
(xiii) On 31st March 2015, Balance with Bank and Cash on hand totalled ₹ 2 crores.

Self Assessment Test 4

QUESTION 1

Ms. Joyti of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year 2009 :

	(₹ in Lakhs)
Net Profit before tax provision	36,000
Dividend paid	10,202
Income tax paid during the year	5,100
Loss on sale of assets (net)	48
Book value of the assets sold	222
Depreciation charged to Profit & Loss Account	24,000
Amortisation of Capital grant	10
Profit on sale of Investments	120
Book value of Investment sold	33,318
Interest income on investments	3,000
Interest expenses	12,000
Interest paid during the year	13,042

Increase in Working Capital (excluding Cash & Bank Balance)	67,290
Purchase of fixed assets	22,092
Expenditure on construction work in progress	41,688
Receipt of grant for capital projects	18
Proceeds from long-term borrowings	55,866
Provision for Income Tax debited to P & L a/c	6,000
Opening cash and Bank balance	4,000
Closing cash and Bank balance	6,000

Required :

Prepare the Cash Flow Statement for the year 2009 in accordance with AS 3. (make necessary assumptions).

QUESTION 2

The summarized Balance Sheets (Extract) of Z Ltd. as on 31st March, 2013 and 31st March, 2014 are as under:

Liabilities	**2012-13**	**2013-14**	**Assets**	**2012-13**	**2013-14**
	₹	₹		₹	₹
Equity share capital	15,00,000	20,00,000	Goodwill	5,75,000	4,50,000
12% Redeemable Pref. share capital	7,50,000	5,00,000	Land & Building	10,00,000	8,50,000
			Plant & Machinery	4,00,000	10,00,000
General Reserve	2,00,000	3,50,000	Trade receivables	8,00,000	12,60,000
Profit & Loss A/c	1,50,000	2,40,000	Inventory	4,85,000	4,35,000
Trade Payables	2,75,000	4,15,000	Cash and Bank	1,25,000	90,000
Outstanding Expenses	1,00,000	80,000			
Provision for Tax	2,00,000	2,50,000			
Dividend Payable	2,10,000	2,50,000			
	33,85,000	**40,85,000**		**33,85,000**	**40,85,000**

Additional information:

(i) Depreciation charged on Plant & Machinery and Land & Building during the year was ₹ 50,000 and ₹ 1,00,000 respectively.

(ii) Income-tax ₹ 1,75,000 was paid during the year 2013-14.

Prepare Cash Flow Statement as per AS 3(Revised), using indirect method.

Self Assessment Test 5

QUESTION 1

The following particulars relate to Bee Ltd., for the year ended 31st March, 2010 :

(i) Furniture of book value of ₹ 15,500 was disposed off for ₹ 12,000.

(ii) Machinery costing ₹ 3,10,000 was purchased and ₹ 20,000 were spent on its erection.

(iii) Fully paid 8% preference shares of the face value of ₹ 10,00,000 were redeemed at a premium of 3%. In this connection 60,000 equity shares of ₹ 10 each were issued at a premium of ₹ 2 per share. The entire money being received with applications.

(iv) Dividend was paid as follows:

On 8% preference shares	₹ 40,000
On equity shares for the year 2009-10	₹ 1,32,500

(v) Total sales were ₹ 32,00,000 out of which cash sales were ₹ 11,50,000.

(vi) Total purchases were ₹ 8,00,000 including cash purchase of ₹ 60,000.

(vii) Total expenses were ₹ 12,40,000 charged to Profit and Loss A/c.

(viii) Taxes paid ₹ 3,07,500.

(ix) Cash and cash equivalents as on 31st March, 2010 were ₹ 1,25,000.

You are requested to prepare Cash Flow Statement as per AS 3 for the year ended 31st March, 2010 after taking into consideration the following also:

	On 31st March, 2009 (Rs.)	On 31st March, 2010 (Rs.)
Sundry debtors	1,50,000	1,47,000
Sundry creditors	78,000	83,000
Unpaid expenses	63,000	55,000

QUESTION 2

The following are the summarized Balance Sheets of Lotus Ltd. as on 31st March 2014 and 2015:

Liabilities	**31-3-2014 ₹**	**31-3-2015 ₹**
Equity share capital (₹ 10 each)	10,00,000	12,50,000
Capital reserve		10,000
Profit and loss A/c	4,00,000	4,80,000
Long term loan from the bank	5,00,000	4,00,000
Trade payables	5,00,000	4,00,000
Provision for taxation	50,000	60,000
	24,50,000	26,00,000
Assets	₹	₹
Land and building	4,00,000	3,80,000
Machinery	7,50,000	9,20,000
Investment	1,00,000	50,000
Inventory	3,00,000	2,80,000
Trade receivables	4,00,000	4,20,000
Cash in hand	2,00,000	1,40,000
Cash at bank	3,00,000	4,10,000
	24,50,000	26,00,000

Additional information:

(1) Depreciation written off on land and building ₹ 20,000.
(2) The company sold some investment at a profit of ₹ 10,000, which was credited to Capital Reserve.
(3) Income-tax paid during the year ₹ 55,000.
(4) During the year, the company purchased a machinery for ₹ 2,25,000. They paid ₹ 1,25,000 in cash and issued 10,000 equity shares of ₹ 10 each at par.

You are required to prepare a cash flow statement for the year ended 31st March 2015 as per AS 3 by using indirect method.

Self Assessment Test 6

QUESTION

From the following information, prepare a Cash Flow Statement for the year ended 31st March, 2016.

Balance Sheets as on..........

	Particulars	**Note**	**31.03.2016 (Rs.)**	**31.03.215 (Rs.)**
I	EQUITY AND LIABILITIES			
	(1) Shareholders' Funds			
	(a) Share Capital	1	3,50,000	3,00,000
	(b) Reserves and Surplus	2	82,000	38,000
	(2) Non-Current Liabilities			
	(3) Current Liabilities			
	Trade Payables		65,000	44,000
	Other Current Liabilities	3	37,000	27,000
	Short term Provisions (provision for tax)		32,000	28,000
	Total		5,66,000	4,37,000
II	ASSETS			

(1) Non current Assets			
Tangible Fixed Assets	4	2,66,000	1,90,000
Intangible Assets (Goodwill)		47,000	60,000
Non-Current Investments		35,000	10,000
(2) Current Assets			
Inventories		78,000	85,000
Trade Receivables		1,08,000	75,000
Cash & Cash Equivalents		32,000	17,000
Total		5,66,000	4,37,000

Note 1: Share Capital

Particulars	31.03.2016 (Rs.)	31.03.2015 (Rs.)
Equity Share Capital	2,50,000	1,50,000
8% Preference Share Capital	1,00,000	1,50,000
Total	3,50,000	3,00,000

Note 2: Reserves and Surplus

Particulars	31.03.2016 (Rs.)	31.03.2015 (Rs.)
General Reserve	30,000	20,000
Profit and Loss A/c	27,000	18,000
Capital Reserve	25,000	
Total	82,000	38,000

Note 3: Current Liabilities

Particulars	31.03.2016 (Rs.)	31.03.2015 (Rs.)
Dividend declared	37,000	27,000

Note 4: Tangible Fixed Assets

Particulars	31.03.2016 (Rs.)	31.03.2015 (Rs.)
Land & Building	75,000	1,00,000
Machinery	1,91,000	90,000
Total	2,66,000	1,90,000

Additional Information:

(i) ₹ 18,000 depreciation for the year has been written off on Plant and Machinery and no depreciation has been charged on land and building.

(ii) A piece of land has been sold out for ₹ 50,000 and the balance has been revalued, profit on such sale and revaluation being transferred to capital reserve. There is no other entry in Capital Reserve Account.

(iii) A plant was sold for ₹ 12,000 (WDV being ₹ 15,000).

(iv) Dividend received amounted to ₹ 2,100 which included pre acquisition dividend of ₹ 600.

(v) An interim dividend of ₹ 10,000 has been paid.

(vi) Non-current investments given in the balance sheet represents investment in shares of other companies.

Self Assessment Test 7

QUESTION 1

Balance Sheet (Extract) of Raman Ltd. is given below:

					(₹ in '000)
Liabilities	31.3.08	31.3.09	Assets	31.3.08	31.3.09
Share capital	500	500	Land & Building	300	300
9% Debentures	200	160	Machinery	164	180
Sundry creditors	230	216	Stock-in-trade	200	228
Profit and Loss A/c	40	54	Sundry debtors	170	162
Depreciation fund	80	88	Cash and bank balances	120	110
Contingency reserve	140	110	Current Investment	262	190
Outstanding expenses	30	48	Pre-paid expenses	4	6
	1,220	1,176		1,220	1,176

The following information is furnished:

(i) One old machinery which has original cost of ₹ 30,000 was sold for ₹ 10,000. The accumulated depreciation in respect of the said machinery amounts to ₹ 16,000.
(ii) One new machinery was acquired for ₹ 46,000.
(iii) 9% Debentures were redeemed at a discount at 4% of their face value.
(iv) Dividend at 12% was declared and paid in cash.
(v) Income-tax liability of ₹ 30,000 paid was debited to contingency reserve.

You are required to prepare Cash Flow Statement in accordance with the Accounting Standard 3.

QUESTION 2

The following are the summarized Balance Sheets of 'X' Ltd. as on March 31, 2014 and 2015:

Liabilities	**As on 31.3.2014 (Rs.)**	**As on 31.3.2015 (Rs.)**
Equity share capital	15,00,000	16,50,000
Capital Reserve	--	10,000
General Reserve	2,50,000	3,00,000
Profit and Loss A/c	1,50,000	1,80,000
Trade payables	5,00,000	4,00,000
Provision for Taxation	50,000	60,000
Dividend payable	1,00,000	1,25,000
	25,50,000	27,25,000
Assets	**Year 2014 (Rs.)**	**Year 2015 (Rs.)**
Land and Building	5,00,000	4,80,000
Machinery	7,50,000	9,20,000
Investment	1,00,000	50,000
Inventory	3,00,000	2,80,000
Trade receivables	4,00,000	4,20,000
Cash in Hand	2,00,000	1,65,000
Cash at Bank	3,00,000	4,10,000
	25,50,000	27,25,000

Additional information:
(i) Dividend of ₹ 1,00,000 was paid during the year ended March 31, 2015.
(ii) Machinery during the year purchased for ₹ 1,25,000.
(iii) Machinery of another company was purchased for a consideration of ₹ 1,00,000 payable in equity shares.
(iv) Income-tax provided during the year ₹ 55,000.
(v) Company sold some investment at a profit of ₹ 10,000, which was credited to Capital reserve.
(vi) There was no sale of machinery during the year.
(vii) Depreciation written off on Land and Building ₹ 20,000.

From the above particulars, prepare a cash flow statement for the year ended March, 2015 as per AS 3 (Indirect method).

Self Assessment Test 8

QUESTION 1

The following are the summarized Balance Sheet of Star Ltd. as on 31st March, 2014 and 2015:

		(₹'000)
	2014	**2015**
Equity share capital of ₹ 10 each	3,400	3,800
Profit and Loss A/c	400	540
Securities Premium	40	80
14% Debentures	800	900
Long term borrowings	180	240
Trade payables	360	440
Provision for Taxation	20	40
Dividend payable	300	480
	5,500	**6,520**

Sundry Fixed Assets:		
Gross Block	3,200	4,000
Less: Depreciation	(640)	(1,440)
Net Block	2,560	2,560
Investment	1,200	1,400
Inventories	1,000	1,400
Trade receivables	640	900
Cash and Bank Balance	100	260
	5,500	6,520

The Profit and Loss account for the year ended 31st March, 2015 disclosed:

	(₹'000)
Profit before tax	780
Less: Taxation	160
Profit after tax	620
Less: dividend payable	480
Retained Profit	**140**

The following information are also available:

(1) 40,000 equity shares issued at a premium of Re.1 per share.

(2) The Company paid taxes of ₹ 1,40,000 for the year 2014-2015.

(3) During the period, it discarded fixed assets costing ₹ 4 lacs, (accumulated depreciation ₹ 80,000) at ₹ 40,000 only.

You are required to prepare a cash flow statement as per AS 3 (Revised), using indirect method.

QUESTION 2

The following are the changes in the account balances taken from the balance sheets of Leela Ltd. as at the beginning and end of the year.

	Debit (Rs.)	Credit (Rs.)
8% Debentures		1,50,000
Debenture Discount	3,000	
Plant and Machinery at cost	1,80,000	
Depreciation on Plant and Machinery		43,200
Trade receivables	1,50,000	
Inventory including Work-in-Progress	1,15,500	
Trade payables		35,400
Net Profit for the year		2,29,500
Dividend paid in respect of earlier year	90,000	
Provision for Doubtful Debts		9,900
Trade Investments at cost	1,41,000	
Bank		2,11,500
Total	6,79,500	6,79,500

You are informed that:

- During the year Plant costing ₹ 54,000 against which Depreciation Provision of ₹ 40,500 was lying was sold for ₹ 21,000.
- During the middle of the year, ₹ 1,50,000 Debentures were issued for cash at a discount of ₹ 3,000.
- The net Profit for the year was after crediting the profit on sale plant and charging Debenture Interest.

Prepare a Cash Flow Statement which will explain why Bank balance has decreased by ₹ 2,11,500 during the year end, ignore taxation.

Self Assessment Test 9

QUESTION

From the following information, prepare a Cash Flow Statement as per AS-3 for Banjara Ltd., using direct method :

Balance Sheet (Extract) **as on March 31, 2010**

	(₹'000) 2010	(₹'000) 2009
Assets :		
Cash on hand and balances with bank	200	25
Marketable securities (having one month Maturity)	670	135
Sundry Debtors	1,700	1,200
Interest Receivable	100	—

Inventories	900	1.950
Investments	2,500	2.500
Fixed Assets at Cost	2,180	1.910
Accumulated Depreciation	(1,450)	(1,060)
Fixed Assets (net)	730	850
Total Assets	6800	6660
Liabilities:		
Sundry Creditors	150	1,890
Interest Payable	230	100
Income tax payable	400	1,000
Long term Debt	1,110	1,040
Total Liabilities	1,890	4,030
Shareholder's Fund		
Share Capital	1,500	1,250
Reserves	3,410	1,380
	4,910	2,630
Total Liabilities and Shareholders' Fund	6,800	6,660

Statement of Profit or Loss for the year ended 31.03.2010

	(₹'000)
Sales	30,650
Cost of sales	(26,000)
Gross profit	4,650
Depreciation	(450)
Administrative and Selling expenses	(910)
Interest expenses	(400)
Interest income	300
Dividend income	200
Net profit before taxation and extraordinary items	3,390
Extraordinary items :	
Insurance proceeds from earthquake disaster settlement	140
Net profit after extraordinary items	3,530
Income tax	(300)
Net Profit	**3,230**

Additional Information : (₹ '000)

(i) An amount of ₹ 250 was raised from the issue of share capital and a further ₹ 250 was raised from long-term borrowings.

(ii) Interest expense was ₹ 400 of which ₹ 170 was paid during the period ₹ 100 relating to interest expense of the prior period was also paid during the period.

(iii) Dividends paid were ₹ 1,200.

(iv) Tax deducted at source on dividends received (included in the tax expense of ₹ 300 for the year) amounted to ₹ 40.

(v) During the period the enterprise acquired Fixed Assets for ₹ 350. The payment was made in cash.

(vi) Plant with original cost of ₹ 80 and accumulated Depreciation of ₹ 60 was old for ₹ 20.

(vii) Sundry debtors and Sundry creditors include amounts relating to credit sales and credit purchase only.

Self Assessment Test 10

QUESTION 1 (January 2021)

Following information was extracted from the books of S Ltd. for the year ended 31st March,2020:

(1) Net profit before taking into account income tax and after taking into account the following items was ₹ 30 lakhs;

(i) Depreciation on Property, Plant & Equipment ₹ 7,00,000

(ii) Discount on issue of debentures written off ₹ 45,000.

(iii) Interest on debentures paid ₹ 4,35,000

(iv) Investment of Book value ₹3,50,000 sold for ₹3,75,000.

(v) Interest received on Investments ₹70,000

(2) Income tax paid during the year ₹ 12,80,000

(3) Company issued 60,000 Equity Shares of ₹ 10 each at a premium of 20% on 10th April,2019.

(4) 20,000,9% Preference Shares of ₹ 100 each were redeemed on 31st March, 2020 at a premium of 5%

(5) Dividend paid during the year amounted to ₹ 11 Lakhs.

(6) A new Plant costing ₹ 7 Lakhs was purchased in part exchange of an old plant on 1st January,2020. The book value of the old plant was ₹ 8 Lakhs but the vendor took over the old plant at a value of ₹ 6 Lakhs only. The balance amount was paid to vendor through cheque on 30th March,2020.

(7) Company decided to value inventory at cost, whereas previously the practice was to value inventory at cost less 10%. The inventory according to books on 31.03.2020 was ₹ 14,76,000.

The inventory on 31.03.2019 was correctly valued at ₹ 13,50,000.

(8) Current Assets and Current Liabilities in the beginning and at the end of year 2019-2020 were as:

	As on 1st April,2019 (₹)	As on 31st March,2020 (₹)
Inventory	13,50,000	14,76,000
Trade Receivables	3,27,000	3,13,200
Cash &Bank Balances	2,40,700	3,70,500
Trade Payables	2,84,700	2,87,300
Outstanding Expenses	97,000	1,01,400

You are required to prepare a Cash Flow Statement for the year ended 31st March, 2020 as per AS 3 (revised) using the indirect method.

QUESTION 2 (November 2020)

The following figures have been extracted from the books of Manan Jo Limited for the year ended on 31.3.2020. You are required to prepare the Cash Flow statement as per AS 3 using indirect method.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 30 lakhs:

(a) Depreciation on Property, Plant & Equipment ₹ 7.50 lakhs.

(b) Discount on issue of Debentures written off ₹ 45,000.

(c) Interest on Debentures paid ₹ 5,25,000.

(d) Book value of investments ₹ 4.50 lakhs (Sale of Investments for ₹ 4,80,000).

(e) Interest received on investments ₹ 90,000.

(ii) Compensation received ₹ 1,35,000 by the company in a suit filed.
(iii) Income tax paid during the year ₹ 15,75,000.
(iv) 22,500, 10% preference shares of ₹ 100 each were redeemed on 02-04-2019 at a premium of 5%.
(v) Further the company issued 75,000 equity shares of ₹ 10 each at a premium of 20% on 30.3.2020 (Out of 75,000 equity shares, 25,000 equity shares were issued to a supplier of machinery)
(vi) Dividend for FY 2018-19 on preference shares were paid at the time of redemption.
(vii) Dividend on Equity shares paid on 31.01.2020 for the year 2018-2019 ₹ 7.50 lakhs and interim dividend paid ₹ 2.50 lakhs for the year 2019-2020.
(viii) Land was purchased on 02.4.2019 for ₹ 3,00,000 for which the company issued 22,000 equity shares of ₹ 10 each at a premium of 20% to the land owner and balance in cash as consideration.
(ix) Current assets and current liabilities in the beginning and at the end of the years were as detailed below:

	As on 01.04.2019 ₹	As on 31.3.2020 ₹
Inventory	18,00,000	19,77,000
Trade receivables	3,87,000	3,79,650
Cash in hand	3,94,450	16,950
Trade payables	3,16,500	3,16,950
Outstanding expenses	1,12,500	1,22,700

Answers of main questions

		Net Cash Flows from or (used in) operating activities	Net Cash Flows from or (used in) investing activities	Net Cash Flows from or (used in) financing activities
1.	[₹]	47000	(85000)	69000
2.	[₹]	2800	(14300)	7000
3.	[₹ in Lakhs]	(2895)	(22622)	27502
4.	[₹ in Lakhs]	445		
5.	[₹ in Crores]	29	3.4	(20.2)
6.	[₹]	(17000)		

7.	[₹ in '000]	309	(102)	(30)
8.	[₹]	140000		180000
9.	[₹]	472000	(240000)	(256000)
10.	[₹]	188000	(60000)	(168000)
11.	[₹]	(644000)	(636000)	(8000)
12.	[₹]	760000	(1660000)	900000
13.	[₹]	1734000	380000	(2275000)
14.	[₹]	1044965		
15.	[₹]		(148100)	
16.	[₹]	30500	(111800)	17000
17.	[₹ in '000]	1870	30	(1150)
18.	[₹ in Lakhs]	112	(78)	(46)
31.	[₹]	230000	490000	(245000)
32(a)	[₹]		(168200)	
32(b)	[₹ in '000]	309	(102)	(30)
35.	[₹]	1650 | 11000 | -35000	24500	-10100 | -34650

Answers of test questions

		Net Cash Flows from or (used in) operating activities	Net Cash Flows from or (used in) investing activities	Net Cash Flows from or (used in) financing activities
1(1)	[₹ in '000]	250	(100)	(50)
1(2)	[₹]	110000	(610000)	300000
1(3)	[₹]	740000	(600000)	(120000)
2(1)	[₹]	740000	(470000)	(260000)
2(2)	[₹]	187000	(387000)	200000
3(1)	[₹ in Crores]	26	(19.30)	(8.70)
3(2)	[₹]	182500	470000	(245000)
3(3)	[₹]	119	6	(25)
4(1)	[₹ in Lakhs]	(3472)	(27150)	32622
4(2)	[₹]	525000	(600000)	40000
5(1)	[₹]	852500	(318000)	(482500)
5(2)	[₹]	65000	(65000)	50000
6	[₹]	97500	(95500)	13000
7(1)	[₹]	190000	(65000)	(50000)
7(2)	[₹]	138800	(36000)	(112800)
8(1)	[₹ in '000]	1346	(1360)	174
8(2)	[₹]	91500	(354000)	51000
9	[₹ in '000]	1830	30	(1150)
10(1)	[₹]	2699800	345000	(2915000)
10(2)	[₹]	2601000	534000	(3512500)

BORROWING COSTS

ACCOUNTING STANDARD – 16

Meaning of Borrowing Costs:

The Borrowing Costs are interest and other costs incurred in connection with borrowing of funds.
Examples:
- Interest & commitment charges on Borrowings
- Amortisation of Discount / Premium on Borrowings
- Amortisation of ancillary costs relating to Borrowings
- Finance charges for assets acquired on Finance Lease / Hire purchase
- Exchange Deference, to the extent they are regarded as an adjustment to interest cost

Meaning of Qualifying Asset:

Qualifying Asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.
Examples :
- manufacturing plants,
- inventories that require a substantial period of time to bring them to a saleable condition
- investment properties.

Other investments and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets.

Recognition of Borrowing Costs:

Borrowing costs attributable to:-

Acquisition, Construction or production of qualifying asset should be capitalised as a part of cost of that asset.
Other borrowing cost are considered as expense in the period in which these are incurred.

HOW TO RECOGNIZE?

In case of Specific borrowings:

(i) Actual borrowing cost of funds specifically borrowed for a particular qualifying asset. Income from temporary investment out of specific borrowed funds to be deducted from borrowing cost.

In case of General borrowings:

(i) In case single borrowing used for few qualifying assets, use weighted average, i.e., as per usage of funds by various assets. Income from temporary investment out of general borrowings to be deducted from borrowing cost

(ii) In case few borrowings at different rates of interest for few qualifying assets, use capitalization rate to expenditure on asset. (i.e., Use weighted average cost of borrowings, other than specific) Income from temporary investment out of general borrowings to be deducted from borrowing cost

WHEN TO RECOGNIZE?

Commencement of Capitalisation

Capitalisation of Borrowing costs should commence when **all** the following conditions are fulfilled:

(a) Expenses are being incurred on acquisition or construction or production of qualifying asset.
(b) Borrowing cost are being incurred.
(c) Activities, which are essential, are in progress for assets intended use or sale of qualifying asset.

The activities necessary to prepare the asset for its intended use or sale encompass more than the physical construction of the asset. They include technical and administrative work prior to the commencement of physical construction. However, such activities exclude the holding of an asset when no production or development that changes the asset’s condition is taking place. For example, borrowing costs incurred while land is under development are capitalised during the period in which activities related to the development are being undertaken. However, borrowing costs incurred while land acquired for building purposes is held without any associated development activity do not qualify for capitalisation.

Suspension of Capitalisation

Capitalization of borrowing costs should be suspended during extended periods when active development on qualifying asset is interrupted.

Capitalisation of borrowing costs is not suspended if the delay is a necessary part of the process of getting an asset ready for its intended use or sale.

Example:

- While constructing bridge over river, any suspension of work due to high water levels **which are common** in the geographic area, borrowing cost will continue to be capitalised.

Cessation of Capitalisation

Capitalisation of borrowing costs should cease when substantially all activities for qualifying asset intended use or sale are complete. Even in case of completion of 'Independent Portion' capitalisation on such portion should cease.

Exchange Differences on Foreign Currency Borrowings

Exchange differences arising from foreign currency borrowing and considered as borrowing costs are those exchange differences which arise on the amount of principal of the foreign currency borrowings to the extent of the difference between interest on local currency borrowings and interest on foreign currency borrowings. Thus, the amount of exchange difference not exceeding the difference between interest on local currency borrowings and interest on foreign currency borrowings is considered as borrowings cost to be accounted for under this Standard and the remaining exchange difference, if any, is accounted for under AS 11, 'The Effect of Changes in Foreign Exchange Rates'. For this purpose, the interest rate for the local currency borrowings is considered as that rate at which the enterprise would have raised the borrowings locally had the enterprise not decided to raise the foreign currency borrowings.

Disclosure

Following are required to be disclosed:

(i) Accounting Policy for Borrowing costs

(ii) Amount of borrowing cost capitalised during the period

OTHER IMPORTANT POINTS

Excess of the Carrying Amount of the Qualifying Asset over Recoverable Amount

When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount or net realisable value, the carrying amount is written down or written off in accordance with the requirements of other Accounting Standards. In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other Accounting Standards.

Cost of equity

Cost of equity capital or preference capital, whether actual or imputed is not considered as Borrowing Cost.

Forms of expenditure on qualifying asset

The expenditure incurred on qualifying asset includes **only** following::

- cash payments, or
- transfer of assets, or
- assumption of interest bearing liabilities

Expenditure is reduced by any Progress Payments Received and Government Grants received in connection with the asset.

Capitalisation of Borrowing Costs vs Actual Borrowing Cost

Borrowing cost capitalised during the period should not exceed borrowing cost incurred during the period

Meaning of Substantial period of time:

The "Substantial period of time" is to be fixed by a Company on case to case basis. Ordinarily, a period of twelve months is considered as substantial period of time, unless shorter or longer period can be justified on the facts and circumstances of the case. The time that an asset takes technologically and commercially to get ready for its intended use or sale should be considered in estimating the period. Primarily, it depends on the facts and circumstances of each case.

Specimen Accounting Policy:

"The Company capitalizes interest and other costs incurred by it in connection with funds borrowed for the acquisition of fixed assets. Where specific borrowings are identified to a fixed asset, the company uses the interest rates applicable to that specific borrowing as the capitalization rate. Where borrowings cannot be specifically identified to fixed assets, the capitalization rate applied is the weighted average of the interest rates. The capitalization ceases where all the activities necessary to prepare the fixed asset for their intended use are substantially complete."

QUESTION 1

Rainbow Limited borrowed an amount of ₹ 150 crores on 1.4.2016 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Rainbow Ltd. capitalized ₹ 19.50 crores for the accounting period ending on 31.3.2017. Due to surplus fund , out of ₹ 150 crores, an income of ₹ 3.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

ANSWER

AS 16 'Borrowing Costs' states , "to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings. " The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Rainbow Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2016-2017 should be calculated as follows:

Actual interest for 2016-2017 (11% of ₹ 150 crores)	₹ 16.50 crores
Less: Income on temporary investment from specific borrowings	₹ 3.50 crores
Borrowing costs to be capitalized during year 2016-2017	₹ 13.00 crores

QUESTION 2

M/s. Zen Bridge Construction Limited obtained a loan of ₹ 64 crores to be utilized as under:

(i)	Construction of Hill link road in Kedarnath: (work was held up totally for a month during the year due to heavy rain which are common in the geographic region involved)	:	₹	50 crores
(ii)	Purchase of equipments and machineries	:	₹	6 crores
(iii)	Working capital	:	₹	4 crores
(iv)	Purchase of vehicles	:	₹	1 crore
(v)	Advance for tools/ cranes etc.	:	₹	1 crore
(vi)	Purchase of technical know-how	:	₹	2 crores
(vii)	Total interest charged by the bank for the year ending 31.03.2016	:	₹	1.60 crores

Show the treatment of Interest according to Accounting Standard by M/s. Zen Bridge Construction Limited.

ANSWER

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use. As per the standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

The treatment of interest by Zen Bridge Construction Ltd. can be shown as:

		Qualifying Asset	Interest to be capitalized ₹ in crores	Interest to be charged to P & L A/c ₹ in crores	
(i)	Construction of Hill link road	YES	1.25		1.6 X (50 / 64)
(ii)	Purchase of equipments and machineries	NO		0.15	1.6 X (6 / 64)
(iii)	Working capital	NO		0.10	1.6 X (4 / 64)
(iv)	Purchase of vehicles	NO		0.025	1.6 X (1 / 64)
(v)	Advance for tools/ cranes etc.	NO		0.025	1.6 X (1 / 64)
(vi)	Purchase of technical know-how	NO		0.05	1.6 X (2 / 64)
			1.25	0.35	

*Note: It is assumed that construction of hill road will normally take more than a year (substantial period of time), hence considered as qualifying asset.

QUESTION 3

The following are the details regarding construction contract undertaken by M/s Aspects Ltd.:

	₹ Lakhs
Expenditure incurred till 31.03.2016	1350
Interest paid & capitalized for the year 2015-16 @12% p.a.	72
Amount specifically borrowed till 31.03.2016	600
Assets transferred to construction site during 2016-17	300
Cash expenditure incurred during 2016-17	234
Progress payment received during 2016-17	900
New borrowings during 2016-17 @ 12% p.a.	600

Compute the amount of borrowing cost to be capitalized during the year 2016-17.

ANSWER

		Amount (₹ in Lakhs)	*Amount (₹ in Lakhs)*
1.	Opening capital works in progress 01.04.2016		
	(a) Expenditure incurred	1350.00	
	(b) Borrowing cost capitalized	72.00	1422.00
2.	Current year expenditure		
	(a) Asset transferred to construction	300.00	
	(b) Cash payment	234.00	534.00
			1956.00
3.	Less : Progress payments received		900.00
4.	Total expenditure on Qualifying Asset		1056.00
5.	Total amount borrowed	600 + 600	1200.00
6.	Borrowing cost incurred in current year	12% p.a.	144.00
7.	Borrowing cost to be capitalised being 12% of 1056.00	Pro-rata restricted to expenditure incurred	126.72

QUESTION 4

Small Limited began construction of a building on 1st April, 2016 which is expected to cost ₹ 25,00,000. The construction of the building was financed through a special loan of ₹ 10,00,000 obtained at an interest rate of 10% per annum on 1st April, 2016. Further, expenditure on the building was financed through other non-specific finance arrangements of the company. Details of non-specific finance arrangements are as under:

Amount	Rate of Interest P.a.
₹ 30,00,000	12%
₹ 20,00,000	15%

Cumulative expenses incurred on the building were as follows:

Date	Amount
1 st April, 2016	₹ 5,00,000
1 st July 2016	₹ 13,00,000
1 st November, 2016	₹ 20,00,000
31st January, 2017	₹ 25,00,000

Construction of the building was completed on 31st March, 2017. Following the principles specified in AS 16 'Borrowing Cost', calculate the amount of interest to be capitalized and and pass one Journal Entry for capitalising the cost and borrowing cost in respect of the building.

ANSWER

Calculation of average interest rate other than for specific borrowings

Amount of loan (₹)	Rate of interest	Amount of interest (₹)
30,00,000	12%	3,60,000
20,00,000	15%	3,00,000
50,00,000		6,60,000
Weighted average rate of interest (6,60,000 / 50,00,000 x 100)		13.2%

Interest amount to be capitalized

	Amount	Rate of Interest	Interest to be capitalized
Specific borrowings			₹
₹ 5,00,000 x 3 / 12	1,25,000		
₹ 10,00,000 x 9 / 12	7,50,000		

Total of Specific borrowings	8,75,000	10%	87,500
Non-specific borrowings (₹ 13,00,000 -10,00,000) x 4 / 12 (₹ 20,00,000 -10,00,000) x 3 / 12 (₹ 25,00,000 -10,00,000) x 2 / 12	 1,00,000 2,50,000 2,50,000		
Total of Non-specific borrowings	6,00,000	13.20%	79,200
Amount of interest to be capitalized			1,66,700

Total expenses to be capitalised for building

	₹
Cost of building ₹	25,00,000
Add: Amount of interest to be capitalized	1,66,700
	26,66,700

Journal Entry

Date	Particulars		Dr. ₹	Cr. ₹
31.03.2017	Building account To Bank account (Being amount of cost of building and borrowing cost thereon capitalised)	Dr.	26,66,700	 26,66,700

QUESTION 5

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

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

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

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

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

ANSWER

(i) Computation of average accumulated expenditure

		₹
₹ 2,00,000 x 12 / 12	=	2,00,000
₹ 2,50,000 x 9 / 12	=	1,87,500
₹ 4,50,000 x 6 / 12	=	2,25,000
₹ 1,20,000 x 1 / 12	=	10,000
		6,22,500

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

Amount of loan (₹)	Rate of interest		Amount of interest (₹)
5,00,000	11%	=	55,000
9,00,000	13%	=	1,17,000
14,00,000			1,72,000
Weighted average rate of interest (1,72,000 / 14,00,000) X 100		=	12.2857 % (approx)

(iii) Interest on average accumulated expenditure

		₹
Specific borrowings (₹ 1,00,000 x 10%)	=	10,000
Non-specific borrowings (₹ 6,22,500 – 1,00,000) x 12.2857%	=	64,193
Amount of interest to be capitalized	=	74,193

(iv) Total expenses to be capitalised for building

	₹
Cost of building ₹ (2,00,000 + 2,50,000 + 4,50,000 + 1,20,000)	10,20,000
Add: Amount of interest to be capitalized	74,193
	10,94,193

(v) Journal Entry

Date	Particulars		Dr. ₹	Cr. ₹
31.12.2016	Building account To Bank account (Being amount of cost of building and borrowing cost thereon capitalised)	Dr.	10,94,193	10,94,193

QUESTION 6

An industry borrowed ₹ 40,00,000 for purchase of machinery on 1.6.2007. Interest on loan is 9% per annum. The machinery was put to use from 1.1.2008. Pass journal entry for the year ended 31.3.2008 to record the borrowing cost of loan as per AS 16.

ANSWER

₹ Interest upto 31.3.2008 (40,00,000 × 9% × 10 /12 months) = 3,00,000
Interest relating to pre-operative period 3,00,000 × 7 /10 = 2,10,000
Amount to be charged to P&L A/c = 90,000

Pre-operative interest to be capitalized = 2,10,000

Journal Entry:
Machinery A/c Dr. 2,10,000;
To Loan A/c 2,10,000
(Being interest on loan for pre-operative period capitalized)
Interest on loan A/c Dr. 90,000
To Loan A/c 90,000
(Being the interest on loan for the post-operative period)
Profit and Loss A/c Dr. 90,000
To Interest on loan A/c 90,000
(Being interest on loan transferred to P&L A/c)

QUESTION 7

XYZ Ltd. has taken a loan of USD 10,000 on April 1, 2X16, for a specific project at an interest rate of 5% p.a., payable annually. On April 1, 2X16, the exchange rate between the currencies was ₹ 45 per USD. The exchange rate, as at March 31, 2X17, is ₹ 48 per USD. The corresponding amount could have been borrowed by XYZ Ltd. in local currency at an interest rate of 11 per cent per annum as on April 1, 2X16.
Following the principles specified in AS 16 'Borrowing Cost', calculate the amount of interest to be capitalized. What will be the answer if interest rate on local currency borrowings is assumed to be 13% instead of 11%.

ANSWER

The following computation would be made to determine the amount of borrowing costs for the purposes of paragraph 4(e) of AS 16:
(i) Interest for the period = USD 10,000 x 5% x ₹ 48/USD = ₹ 24,000
(ii) Increase in the liability towards the principal amount = USD 10,000 x (48 – 45) = ₹ 30,000
(iii) Interest that would have resulted if the loan was taken in Indian currency
= USD 10,000 x 45 x 11% = ₹ 49,500
(iv) Difference between interest on local currency borrowing and foreign currency borrowing
= ₹ 49,500 – ₹ 24,000 = ₹ 25,500
Therefore, out of ₹ 30,000 increase in the liability towards principal amount, only ₹ 25,500 will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 49,500 being the aggregate of interest of ₹ 24,000 on foreign currency borrowings (covered by paragraph 4(a) of AS 16) plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 25,500.
Thus, ₹ 49,500 would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 4,500 would be considered as the exchange difference to be accounted for as per Accounting Standard (AS) 11, The Effects of Changes in Foreign Exchange Rates.

If the interest rate on local currency borrowings is assumed to be 13% instead of 11%, the entire exchange difference of ₹ 30,000 would be considered as borrowing costs, since in that case the difference between the interest on local currency borrowings and foreign currency borrowings (i.e., ₹ 34,500 (₹ 58,500 – ₹ 24,000)) is more than the exchange difference of ₹ 30,000. Therefore, in such a case, the total borrowing cost would be ₹ 54,000 (₹ 24,000 + ₹ 30,000) which would be accounted for under AS 16 and there would be no exchange difference to be accounted for under AS 11 'The Effects of Changes in Foreign Exchange Rates'.

QUESTION 8

Shan Builders Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2014-15 for its residential project at LIBOR + 3 %. The interest is payable at the end of the Financial Year. At the time of availment, exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2015 ₹ 62 per US $. If Shan Builders Limited borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%. Compute Borrowing Cost and exchange difference for the year ending 31st March, 2015 as per applicable Accounting Standards. (Applicable LIBOR is 1%).

ANSWER

(i) Interest for the period 2014-15 = US $ 10 lakhs x 4% × ₹ 62 per US $ = ₹ 24.80 lakhs
(ii) Increase in the liability towards the principal amount = US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs
(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs
(iv) Difference between interest on local currency borrowing and foreign currency borrowing
= ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

QUESTION 9

PRM Ltd. obtained a loan from a bank for ₹ 120 lakhs on 30-04-2016. It was utilised as follows:

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

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

ANSWER

Qualifying Asset as per AS 16 (Construction of a shed) = ₹ 50 lakhs
Borrowing cost to be capitalised = 18 x 50/120 = ₹ 7.5 lakhs
Interest to be debited to Profit or Loss account = ₹ (18 – 7.5) lakhs = ₹ 10.5 lakhs

QUESTION 10

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

ANSWER

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

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

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

Purpose	Nature	Interest to be capitalized	Interest to be charged to
		₹ in lakhs	₹ in lakhs
Modernisation and renovation of plant and machinery	Qualifying asset	**52.20 X 406/580 = 36.54	
Advance to supplies for additional assets	Qualifying asset	**52.20 X 58/580 = 5.22	
Working Capital	Not a qualifying asset		
		41.76	10.44

* A substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case.
** It is assumed in the above solution that the modernisation and renovation of plant and machinery will take substantial period of time (i.e. more than twelve months). Regarding purchase of additional assets, the nature of additional assets has also been considered as qualifying assets. Alternatively, the plant and machinery and additional assets may be assumed to be non-qualifying assets on the basis that the renovation and installation of additional assets will not take substantial period of time. In that case, the entire amount of interest, ₹ 52.20 lakhs will be recognised as expense in the profit and loss account for year ended 31st March, 2017.

QUESTION 11

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

ANSWER

As per AS 13 (Revised) "Accounting for Investments", the cost of investment includes acquisition charges such as brokerage, fees and duties. In the present case, Take Ltd. has used borrowed funds for purchasing shares of its subsidiary company Give Ltd. ₹ 4 lakhs interest payable by Take Ltd. to State Bank of India cannot be called as acquisition charges, therefore, cannot be constituted as cost of investment. Further, as per para 3 of AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Since, shares are ready for its intended use at the time of sale, it cannot be considered as qualifying asset that can enable a company to add the borrowing cost to investments. Therefore, the directors of Take Ltd. cannot capitalise the borrowing cost as part of cost of investment. Rather, it has to be charged to the Statement of Profit and Loss for the year ended 31st March, 2017.

QUESTION 12

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

ANSWER

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

QUESTION 13

Briefly indicate the items, which are included in the expression "borrowing cost" as explained in AS 16.

ANSWER

Borrowing costs : Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds.
As per AS 16 on Borrowing Costs, borrowing costs may include :

(a) interest and commitment charges on bank borrowings and other short-term and long-term borrowings;
(b) amortisation of discounts or premiums relating to borrowings ;
(c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;
(d) finance charges in respect of assets acquired under finance leases or under other similar arrangements; and
(e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

QUESTION 14

Write short note on "Treatment of borrowing costs".

ANSWER

According to AS 16, borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds. Borrowing costs may include: (i) interest and commitment charges on bank borrowings and other short-term and long-term borrowings; (ii) amortization of discounts or premiums relating to borrowings; (iii) amortization of ancillary costs incurred in connection with the arrangement of borrowings; (iv) finance charges in respect of assets acquired under finance leases or under other similar arrangements; and (v) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. The capitalization of borrowing costs as part of the cost of a qualifying asset should commence when the conditions specified in AS 16 are satisfied.
Note: A qualifying asset is an asset that necessarily takes a substantial period of time[1] to get ready for its intended use or sale

QUESTION 15

Enumerate two points which the financial statements should disclose in respect of Borrowing Costs as per AS 16.

ANSWER

As per AS 16, the Financial Statements should disclose the following:
(a) The accounting policy adopted for borrowing costs; and
(b) The amount of borrowing costs capitalized during the period.

QUESTION 16

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

ANSWER

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

QUESTION 17

M/s Aspects Ltd. has raised following borrowings during the year 2010-2011 for a new project:

Borrowings	*Date of Borrowings*	*Amount (₹Lakhs)*	Purpose	*Related Exp. (₹ Lakhs)*
14% Deposits	01.04.2010	1,500.00	General	2.50
16% Debentures	01.11.2010	1,200.00	General	3.25
11% Secured Loans	31.12.2010	600.00	Plant & Machinery	2.20

The qualifying assets are:

	₹ Lakhs
Building	800.00
Plant & Machinery	2,100.00
Other Fixed Assets	1,100.00
Total	4,000.00

The project is under construction on 31.03.2011. Compute the amount of interest to be capitalized as on 31.03.2011.

ANSWER

Computation of Borrowing Cost

Borrowings	*Amount (₹ in Lakhs)*	*Interest (₹ in Lakhs)*	*Related Expenses (₹ in Lakhs)*	*Total Borrowing Cost (₹ in Lakhs)*	*Purpose of Borrowing*
14% Deposits	1,500.00	210 (1500 × 14%)	2.50	212.50	General
16% Debentures	1,200.00	80 (1200 × 16% × 5/12)	3.25	83.25	General
11% Secured Loans	600.00	16.50 (600 × 11% × 3/12)	2.20	18.70	Specific

Computation of Weighted Average Borrowing Cost of General Borrowings

Borrowings	*Amount of Borrowings (₹ in Lakhs)*	*Weighted Average Borrowings (₹ in Lakhs)*	*Borrowing Cost (As Table-I) (₹ in Lakhs)*	*Weighted Average Borrowing cost (%age)*
14% Deposits	1,500.00	1,500.00	212.50	(295.75/2,000) × 100
16% Debentures	1,200.00	500.00 (1200 × 5/12)	83.25	= 14.7875%
	2,700.00	2,000.00	295.75	

Time factor Ratio for General Borrowing

= Weighted Average Borrowings / Actual Borrowings
= 2000.00 / 2700.00
= 20 / 27.

General Borrowing Vs. Utilization Ratio

General Borrowings (₹ in Lakhs) : 1,500.00 + 1,200.00 = 2,700.00
Utilization (₹ in Lakhs) : 800.00 + (2,100.00 – 600.00) + 1,100.00 = 3,400.00
Ratio : 2,700.00 / 3,400.00 = 27/34

Allocation of Borrowing Cost

Asset	*Allocated Borrowing Cost*		*(₹ in Lakhs)*
Building	[800 × 14.7875% × 20/27 × 27/34]	=	69.59
Plant & Machinery	[(18.70) + (1500 × 14.7875% × 20/27 × 27/34)	=	149.18
Other Fixed Assets	[1100 × 14.7875% × 20/27 × 27/34]	=	95.68

QUESTION 18

A company incorporated in June 2017, has setup a factory within a period of 8 months with borrowed funds. The construction period of the assets had reduced drastically due to usage of technical innovations by the company. Whether interest on borrowings for the period prior to the date of setting up the factory should be capitalized although it has taken less than 12 months for the assets to get ready for use. You are required to comment on the necessary treatment with reference to AS 16.

ANSWER

As per AS 16 'Borrowing Costs', a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.
Further, it states that what constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances

of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.
It may be implied that there is a rebuttable presumption that a 12 months period constitutes substantial period of time.
Under present circumstances where construction period has reduced drastically due to technical innovation, the 12 months period should at best be looked at as a benchmark and not as a conclusive yardstick. It may so happen that an asset under normal circumstances may take more than 12 months to complete. However, an enterprise that completes the asset in 8 months should not be penalized for its efficiency by denying it interest capitalization and vice versa.
The substantial period criteria ensures that enterprises do not spend a lot of time and effort capturing immaterial interest cost for purposes of capitalization.
Therefore, if the factory is constructed in 8 months then it shall be considered as a qualifying asset. The interest on borrowings for the same shall be capitalised although it has taken less than 12 months for the asset to get ready to use.

QUESTION 19

ABC Limited has started construction of an asset on 1st December, 2020, which continues till 31st March, 2021 (and is expected to go beyond a year). The entity has not taken any specific borrowings to finance the construction of the asset but has incurred finance costs on its general borrowings during the construction period. The directly attributable expenditure at the beginning of the month on this asset was ₹ 10 lakh in December 2020 and ₹ 4 lakh in each of the months of January to March 2021. At the beginning of the year, the entity had taken Inter Corporate Deposits of ₹ 20 lakh at 9% rate of interest and had an overdraft of ₹ 4 lakh, which increased to ₹ 8 lakh on 1st March, 2021. Interest was paid on the overdraft at 10% until 1st January, 2021 and then the rate was increased to 12%. You are required to calculate the annual capitalization rate for computation of borrowing cost in accordance with AS 16 'Borrowing Costs'.

ANSWER

Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	*Period of outstanding balance*	*Amount of loan (₹)*	*Rate of interest p.a.*	*Weighted average amount of interest (₹)*
	a	*b*	*c*	*d = [(b x c) x (a/12)]*
9% Debentures	12 months	20,00,000	9%	1,80,000
Bank overdraft	9 months	4,00,000	10%	30,000
	2 months	4,00,000	12%	8,000
	1 month	8,00,000	12%	8,000
		36,00,000		2,26,000

Weighted average cost of borrowings

= {20,00,000 x(12/12)} + {4,00,000 x (11/12)} + {8,00,000 x (1/12)} = 24,33,334

Capitalisation rate = [(Weighted average amount of interest / Weighted average of general borrowings) x 100] = [(2,26,000 / 24,33,334) x 100] = 9.29% p.a.

ASSIGNMENTS

A-1

In May, 2014 Speed Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2015 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2015 amounted to ₹ 25 lakhs.

Can ₹ 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building?

ANSWER

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building upto the date of completion (January, 2015) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

A-2

Ayush Ltd. began construction of a new building on 1st January, 2016. It obtained ₹ 3 lakhs special loan to finance the construction of the building on 1st January, 2016 at an interest rate of 12%. The company's other outstanding two non-specific loans were:

Amount	Rate of Interest
₹ 6,00,000	11%
₹ 11,00,000	13%

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

	₹
January 2016	3,00,000
April 2016	3,50,000
July 2016	5,50,000
December 2016	1,50,000

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

ANSWER

(i) Computation of average accumulated expenditure

		₹
₹ 3,00,000 x 12 / 12	=	3,00,000
₹ 3,50,000 x 9 / 12	=	2,62,500
₹ 5,50,000 x 6 / 12	=	2,75,000
₹ 1,50,000 x 1 / 12	=	12,500
		8,50,000

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

Amount of loan (₹)	Rate of interest		Amount of interest (₹)
6,00,000	11%	=	66,000
11,00,000	13%	=	1,43,000
17,00,000			2,09,000
Weighted average rate of interest (2,09,000 / 17,00,000) X 100		=	12.2941 % (approx)

(iii) Interest on average accumulated expenditure

		₹
Specific borrowings (₹ 3,00,000 x 12%)	=	36,000
Non-specific borrowings (₹ 8,50,000 – 3,00,000) x 12.2941%	=	67,618
Amount of interest to be capitalized	=	1,03,618

(iv) Total expenses to be capitalised for building

	₹
Cost of building ₹ (3,00,000 + 3,50,000 + 5,50,000 + 1,50,000)	13,50,000
Add: Amount of interest to be capitalized	1,03,618
	14,53,618

(v) Journal Entry

Date	Particulars		Dr. ₹	Cr. ₹
31.12.2016	Building account To Bank account (Being amount of cost of building and borrowing cost thereon capitalised)	Dr.	14,53,618	14,53,618

A-3

G Ltd. began construction of a new building on 1st January, 2016. It obtained ₹ 2 lakhs special loan to finance the construction of the building on 1st January, 2016 at an interest rate of 11%. The company's other outstanding two non-specific loans were:

Amount	Rate of Interest
₹ 3,00,000	12%
₹ 7,00,000	14%

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

	₹
January 2016	1,60,000
May 2016	2,70,000
August 2016	4,20,000
December 2016	1,50,000

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

ANSWER

Interest to be capitalized (20533 + 45672) = ₹ 66205

Journal Entry

Date	Particulars		Dr. ₹	Cr. ₹
31.12.2016	Building account To Bank account	Dr.	10,66,205	 10,66,205

A-4

Axe Limited began construction of a new plant on 1st April, 2016 and obtained a special loan of ₹ 4,00,000 to finance the construction of the plant. The rate of interest on loan was 10%.

The expenditure that were made on the project of plant were as follows:

	₹
1st April, 2016	5,00,000
1st August, 2016	12,00,000
1st January, 2017	2,00,000

The company's other outstanding non-specific loan was ₹ 23,00,000 at an interest rate of 12%.

The construction of the plant completed on 31st March, 2017.

You are required to:

(a) Calculate the amount of interest to be capitalized as per the provisions of AS 16 "Borrowing Cost".

(b) Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant.

ANSWER

Interest to be capitalized (40000 + 114000) = ₹ 154000

Journal Entry

Date	Particulars		Dr. ₹	Cr. ₹
31.03.2017	Plant account To Bank account	Dr.	20,54,000	 20,54,000

B-1

On 1st April 2016 amazing construction Ltd. obtained a loan of ₹ 32 crores to be utilized as under :

(i)	Construction of sea-link across two cities : (work was held up totally for a month during the year due to high water levels)	:	₹	25 crores
(ii)	Purchase of equipments and machineries	:	₹	3 crores
(iii)	Working capital	:	₹	2 crores
(iv)	Purchase of vehicles	:	₹	50,00,000

(v)	Advance for tools/ cranes etc.	:	₹	50,00,000
(vi)	Purchase of technical know-how	:	₹	1 crores
(vii)	Total interest charged by the bank for the year ending 31st March 2010	:	₹	80,00,000

Show the treatment of interest by Amazing Construction Ltd. for the year ending 31.03.2017.

ANSWER

Interest to be capitalized ₹ 62,50,000 ; Interest to be charged to P & L account ₹ 17,50,000.

B-2

Suhana Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.05.2016, to be utilized as under:

Construction of factory building	₹ 40,00,000
Purchase of Machinery	₹ 35,00,000
Working Capital	₹ 25,00,000

In March 2017, construction of the factory building was completed and machinery was installed and ready for it's intended use. Total interest on debentures for the financial year ended 31.03.2017 was ₹ 11,00,000. During the year 2016-17, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹ 2,00,000.

Show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

ANSWER

Interest to be capitalized ₹ 3,60,000 ; Interest to be charged to P & L account ₹ 5,40,000.

B-3

M/s Aspects Ltd. has obtained a foreign currency loan amounting to US $3,00,000 on 1st April, 2010, for a qualifying asset at an interest rate of 6% per annum, payable annually. On 1st April 2010, the exchange rate was ₹ 42 = 1 US $. The exchange rate, as at 31st March 2011 was ₹ 46 = 1 US $.

Compute borrowing cost in the following cases:

Case (a) : The equivalent loan could have been borrowed by M/s Aspects Ltd. in local currency at an interest of 13% per annum as on 1st April 2010..

Case (b) : The equivalent loan could have been borrowed by M/s Aspects Ltd. in local currency at an interest of 17% per annum as on 1st April 2010..

ANSWER

Amount of Loan as on 01.04.2010	=	US $ 3,00,000			
Amount of Loan (in Rupees)	=	US $ 3,00,000 × ₹ 42	=	₹	1,26,00,000
Interest for the year 2010-11	=	US $ 3,00,000 × 6%			
	=	US $ 18,000			
Interest (in Rs.)	=	US $ 18,000 × ₹ 46	=	₹	8,28,000
Increase in liability towards principal amount	=	US $ 3,00,000 × (₹ 46 – ₹ 42)	=	₹	12,00,000

Case (a)

Comparable Borrowing Cost in Indian currency	=	₹ 1,26,00,000 × 13%	=	₹	16,38,000
Difference in Interest of loan in Foreign currency Vs. Indian Currency	=	₹ 16,38,000 – ₹ 8,28,000	=	₹	8,10,000

Exchange difference to the extent of ₹ 8,10,000 to be considered as borrowing cost as per AS : 16. Excess exchange difference, if any, to be dealt as per AS : 11. Thus exchange difference of ₹ 3,90,000 (₹ 12,00,000 – ₹ 8,10,000) is to be dealt as per AS : 11.

Summary :

(i)	Interest	₹ 8,28,000	(Borrowing Cost as per AS : 16)
(ii)	Exchange Fluctuation	₹ 8,10,000	(Borrowing Cost as per AS : 16)
(iii)	Exchange Fluctuation	₹ 3,90,000	(Dealt as per AS : 11)
	Total Borrowing cost (i) + (ii) =		₹ 16,38,000.

Case (b)

Comparable Borrowing Cost in Indian currency	=	₹ 1,26,00,000 × 17%	=	₹	21,42,000

Difference in Interest of loan in Foreign currency Vs. Indian Currency	=	₹ 21,42,000 – ₹ 8,28,000	=	₹ 13,14,000

Exchange difference to the extent of ₹ 13,14,000 to be considered as borrowing cost as per AS : 16. However the actual exchange difference is ₹ 12,00,000 only. Thus, the whole amount of ₹ 12,00,000 will be dealt as per considered as borrowing cost as per AS : 16.

Summary :

(i)	Interest	₹ 8,28,000	(Borrowing Cost as per AS : 16)
(ii)	Exchange Fluctuation	₹ 12,00,000	(Borrowing Cost as per AS : 16)
(iii)	Exchange Fluctuation	Nil	(Dealt as per AS : 11)

Total Borrowing cost (i) + (ii) = ₹ 20,28,000.