1 Accounting Standards

BASIC CONCEPTS	
Accounting Standards (ASs)	**Accounting Standards (ASs)** are written policy documents issued by expert accounting body or by government or other regulatory body covering the aspects of recognition, measurement, presentation and disclosure of accounting transactions in the financial statements. Accounting Standards 1, 2, 3, 6, 7, 9, 10, 13 and 14 are covered in this paper.

Applicability of Accounting Standards

Question 1

What are the issues, with which Accounting Standards deal?

Answer

Accounting Standards deal with the issues of

(i) Recognition of events and transactions in the financial statements,

(ii) Measurement of these transactions and events,

(iii) Presentation of these transactions and events in the financial statements in a manner that is meaningful and understandable to the reader, and

(iv) Disclosure requirements which should be there to enable the public at large and the stakeholders and the potential investors in particular, to get an insight into what these financial statements are trying to reflect and thereby facilitating them to take prudent and informed business decisions.

Question 2

List the criteria to be applied for rating a non-corporate entity as Level-I entity for the purpose of compliance of Accounting Standards in India.

Answer

Non-corporate entities which fall in any one or more of the following categories, at the end of the relevant accounting period, are classified as Level I entities:

(i) Entities whose equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India.

(ii) Banks (including co-operative banks), financial institutions or entities carrying on insurance business.

(iii) All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees fifty crore in the immediately preceding accounting year.

(iv) All commercial, industrial and business reporting entities having borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year.

(v) Holding and subsidiary entities of any one of the above.

Question 3

List the criteria to be applied for rating a non-corporate entity as Level-II entity for the purpose of compliance of Accounting Standards in India.

Answer

Non-corporate entities which are not level I entities but fall in any one or more of the following categories are classified as level II entities:

(i) All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees one crore but does not exceed rupees fifty crore in the immediately preceding accounting year.

(ii) All commercial, industrial and business reporting entities having borrowings (including public deposits) in excess of rupees one crore but not in excess of rupees ten crore at any time during the immediately preceding accounting year.

(iii) Holding and subsidiary entities of any one of the above.

AS 1 "Disclosure of Accounting Policies"

Question 4

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

Answer

Accounting Standard (AS) 1 recognizes three fundamental accounting assumptions. These are as follows:

(i) Going Concern: The financial statements are normally prepared on the assumption that an enterprise will continue its operations in the foreseeable future and neither there is intention, nor there is need to materially curtail the scale of operations.

(ii) Consistency: The principle of consistency refers to the practice of using same accounting policies for similar transactions in all accounting periods unless the change is required (i) by a

statute, (ii) by an accounting standard or (iii) for more appropriate presentation of financial statements.

(iii) Accrual basis of accounting: Under this basis of accounting, transactions are recognised as soon as they occur, whether or not cash or cash equivalent is actually received or paid.

Question 5

Mention few areas in which different accounting policies are followed by companies.

Answer

Following are the examples of the areas in which different accounting policies may be adopted by different enterprises:

(i) Methods of depreciation, depletion and amortisation.

(ii) Valuation of inventories.

(iii) Methods of valuing goodwill.

(iv) Valuation of investments.

Question 6

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

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

Discuss disclosure requirement of change in accounting policy as per AS-1.

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.

AS 2 "Valuation of Inventories"

Question 7

"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.

Question 8

The company deals in three products, A, B and C, which are neither similar nor interchangeable. At the time of closing of its account for the year 2014-15, the Historical Cost and Net Realizable Value of the items of closing stock are determined as follows:

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

What will be the value of closing stock?

Answer

As per para 5 of AS 2 on 'Valuation of Inventories', inventories should be valued at the lower of cost and net realizable value. Inventories should be written down to net realizable value on an item-by-item basis in the given case.

Items	*Historical Cost (₹ in lakhs)*	*Net Realisable Value (₹ in lakhs)*	*Valuation of closing stock (₹ in lakhs)*
A	40	28	28
B	32	32	32

C	16 88	24 84	16 76

Hence, closing stock will be valued at ₹ 76 lakhs.

Question 9

X Co. Limited purchased goods at the cost of ₹ 40 lakhs in October, 2014. Till March, 2015, 75% of the stocks were sold. The company wants to disclose closing stock at ₹ 10 lakhs. The expected sale value is ₹ 11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct closing stock to be disclosed as at 31.3.2015.

Answer

As per para 5 of AS 2 "Valuation of Inventories", the inventories are to be valued at lower of cost or net realizable value.

In this case, the cost of inventory is ₹ 10 lakhs. The net realizable value is 11,00,000 × 90% = ₹ 9,90,000. So, the stock should be valued at ₹ 9,90,000.

Question 10

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

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 11

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 para 13 of AS 2 (Revised), 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.

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 inventry = 4,700 MT x ₹ 1,052.6315 = ₹ 49,47,368.

Question 12

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

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

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

Answer

In accordance with paras 8 & 9 of AS 2, the cost of conversion include a systematic allocation of fixed and variable overheads that are incurred in converting materials into finished goods. The allocation of fixed overheads for the purpose of their inclusion in the cost of conversion is based on normal capacity of the production facilities.

Cost per kg. of finished goods:

		₹
Material Cost		200
Direct Labour	40	
Direct Variable Production Overhead	20	
Fixed Production Overhead $\left(\frac{20,00,000}{2,00,000}\right)$	10	70
		270

Hence the value of 4,000 kgs. of finished goods = 4,000 kgs x ₹ 270 = ₹ 10,80,000

Question 13

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

Answer

Valuation of unfinished unit

	₹
Net selling price	750
Less: Estimated cost of completion	(310)
	440
Less: Brokerage (4% of 750)	(30)
Net Realisable Value	410
Cost of inventory	530
Value of inventory (Lower of cost and net realisable value)	410

Note: The above answer is given on the assumption that partly finished unit cannot be sold in semi finished form and its NRV is zero without processing it further.

Question 14

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

Raw material X	
Closing balance	*500 units*

	₹ per unit
Cost price including excise duty	*200*
Excise duty (Cenvat credit is receivable on the excise duty paid)	*10*
Freight inward	*20*
Unloading charges	*10*
Replacement cost	*150*
Finished goods Y	
Closing Balance	*1200 units*
	₹ per unit
Material consumed	*220*
Direct labour	*60*
Direct overhead	*40*

Total Fixed overhead for the year was ₹ 2,00,000 on normal capacity of 20,000 units.

Calculate the value of the closing stock, when

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

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

Answer

Situation (i)

When Net Realisable Value of the Finished Goods Y is ₹ 400

NRV is greater than the cost of Finished Goods Y i.e. ₹ 330

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

Value of Closing Stock:

	Qty	*Rate*	*Amount (₹)*
Raw Material X	500	220	1,10,000
Finished Goods Y	1,200	330	3,96,000
Total Cost of Closing Stock			5,06,000

Situation (ii)

When Net Realisable Value of the Finished Goods Y is ₹ 300

NRV is less than the cost of Finished Goods Y i.e. ₹ 330

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	500	150	75,000
Finished Goods Y	1,200	300	3,60,000
Total Cost of Closing Stock			4,35,000

Working Notes:

Raw Material X	₹
Cost Price	200
Less: Cenvat Credit	(10)
	190
Add: Freight Inward	20
Unloading charges	10
Cost	220

Finished goods Y	₹
Materials consumed	220
Direct Labour	60
Direct overhead	40
Fixed overheads (₹ 2,00,000/20,000 units)	10
Cost	330

Note: It has been considered that Raw Material X is used for the production of Finished Goods Y.

Question 15

Capital Cables Ltd., has a normal wastage of 4% in the production process. During the year 2013-14 the Company used 12,000 MT of raw material costing ₹ 150 per MT. At the end of the year 630 MT of wastage was in stock. The accountant wants to know how this wastage is to be treated in the books. Explain in the context of AS 2 the treatment of normal loss and abnormal loss and also find out the amount of abnormal loss if any.

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.

Amount of Abnormal Loss:

Material used	12,000 MT @ ₹150 = ₹18,00,000
Normal Loss (4% of 12,000 MT)	480 MT
Net quantity of material	11,520 MT
Abnormal Loss in quantity	150 MT
Abnormal Loss	₹ 23,437.50

[150 units @ ₹ 156.25 (₹ 18,00,000/11,520)]

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

Question 16

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

As per AS 2 "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at 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 realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. 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 ₹ 320 (₹ 260 + additional cost ₹ 60) or Net estimated selling price ₹ 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 31.03.2015:

	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

AS 3 "Cash Flow Statements"

Question 17

What are the main features of the Cash Flow Statement? Explain with special reference to AS 3.

Answer

According to AS 3 (Revised) on "Cash Flow Statement", cash flow statement deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise

during the given period from operating, investing and financing activities. Cash flows from operating activities can be reported using either

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of 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 para 42 of AS 3 (Revised), an enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.

A cash flow statement when used in conjunction with the other financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency), and its ability to affect the amount and timing of cash flows in order to adapt to changing circumstances and opportunities. This statement also enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatments for the same transactions and events.

Question 18

X Ltd. purchased debentures of ₹ 10 lacs of Y Ltd., 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 on 31st March, 2015?

Answer

As per AS 3 on 'Cash flow Statement', cash and cash equivalents consists of cash in hand, balance with banks and short-term, highly liquid investments*. If investment, of ₹ 10 lacs, made in debentures is for short-term period then it is an item of 'cash equivalents'.

However, if investment of ₹ 10 lacs made in debentures is for long-term period then as per AS 3, it should be shown as cash flow from investing activities.

Question 19

Following is the cash flow abstract of Alpha Ltd. for the year ended 31st March, 2015:

Cash Flow (Abstract)

Inflows	*₹*	*Outflows*	*₹*
Opening balance:		*Payment for Account*	
Cash	*10,000*	*Payables*	*90,000*

* *As per para 6 of AS 3, 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.*

Bank	*70,000*	*Salaries and wages*	*25,000*
Share capital – shares issued	*5,00,000*	*Payment of overheads*	*15,000*
Collection on account Trade Receivables	*3,50,000*	*Fixed assets acquired*	*4,00,000*
		Debentures redeemed	*50,000*
Sale of fixed assets	*70,000*	*Bank loan repaid*	*2,50,000*
		Taxation	*55,000*
		Dividends	*1,00,000*
		Closing balance:	
		Cash	*5,000*
		bank	*10,000*
	10,00,000		*10,00,000*

Prepare Cash Flow Statement for the year ended 31st March, 2015 in accordance with Accounting standard 3.

Answer

Cash Flow Statement
for the year ended 31.3.2015

	₹	₹
Cash flow from operating activities		
Cash received on account of trade receivables	3,50,000	
Cash paid on account of trade payables	(90,000)	
Cash paid to employees (salaries and wages)	(25,000)	
Other cash payments (overheads)	(15,000)	
Cash generated from operations	2,20,000	
Income tax paid	(55,000)	
Net cash generated from operating activities		1,65,000
Cash flow from investing activities		
Payment for purchase of fixed assets	(4,00,000)	
Proceeds from sale of fixed assets	70,000	
Net cash used in investment activities		(3,30,000)
Cash flow from financing activities		
Proceeds from issue of share capital	5,00,000	
Bank loan repaid	(2,50,000)	
Debentures redeemed	(50,000)	

Dividends paid	(1,00,000)	
Net cash used in financing activities		1,00,000
Net decrease in cash and cash equivalents		(65,000)
Cash and cash equivalents at the beginning of the year		80,000
Cash and cash equivalents at the end of the year		15,000

Question 20

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 subsidiary 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*

Answer

Cash Flow Statement from Investing Activities of

M/s Creative Furnishings Limited for the year ended 31-03-2015

Cash generated from investing activities	₹	₹
Interest on loan received	82,500	
Pre-acquisition dividend received on investment made	62,400	
Unsecured loans given to subsidiaries	(4,85,000)	
Interest received on investments (gross value)	76,200	
TDS deducted on interest	(8,200)	
Sale of plant	74,400	
Cash used in investing activities (before extra ordinary item)		(1,97,700)
Extraordinary claim received for loss of plant		49,600
Net cash used in investing activities (after extra ordinary item)		(1,48,100)

Note:

1. Debenture interest paid and Term Loan repaid are financing activities and therefore not considered for preparing cash flow from investing activities.
2. Plant acquired by issue of 8% debentures does not amount to cash outflow, hence also not considered in the above cash flow statement.

AS 6 "Depreciation Accounting"

Question 21

What are depreciable assets as per Accounting Standard-6? Explain why AS 6 does not apply to Land.

Answer

As per AS 6 'Depreciation Accounting', depreciable assets are the assets which

(i) are expected to be used during more than one accounting period; and

(ii) have a limited useful life; and

(iii) are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business.

AS 6 does not apply to 'land' as land is considered to have unlimited useful life. Therefore, it is not appropriate to charge depreciation on land.

Question 22

X Co. Ltd. charged depreciation on its asset on SLM basis. For the year ended 31.3.2015 it changed to WDV basis. The impact of the change when computed from the date of the asset coming to use amounts to ₹ 20 lakhs being additional charge.

Decide how it must be disclosed in Profit and loss account. Also discuss, when such changes in method of depreciation can be adopted by an enterprise as per AS 6.

Answer

The company should disclose the change in method of depreciation adopted for the accounting year. The impact on depreciation charge due to change in method must be quantified and reported by the enterprise.

Following aspects may be noted in this regard as per AS 6 on Depreciation Accounting.

(a) The depreciation method selected should be applied consistently from period to period.

(b) A change from one method of providing depreciation to another should be made only if the adoption of the new method is required by statute or for compliance with an accounting standard if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise.

(c) When such a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed.

(d) In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged in the statement of profit and loss.

(e) In case the change in the method results in surplus, the surplus should be credited to the statement of profit and loss. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed.

Question 23

A Limited company charged depreciation on its assets on the basis of W.D.V. method from the date of assets coming to use till date amounts to ₹ 32.23 lakhs. Now the company decides to switch over to Straight Line method of providing for depreciation. The amount of depreciation computed on the basis of S.L.M. from the date of assets coming to use till the date of change of method amounts to ₹ 20 lakhs.

Discuss as per AS-6, when such changes in method of can be adopted by the company and what would be the accounting treatment and disclosure requirement.

Answer

Paragraph 21 of Accounting Standard 6 on Depreciation Accounting says, "The depreciation method selected should be applied consistently from period to period. A change from one method of providing depreciation to another should be made only if the adoption of the new method is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise."

The paragraph also mentions the procedure to be followed when such a change in the method of depreciation is made by an enterprise. As per the said paragraph, depreciation should be recalculated in accordance with the new method from the date of the asset coming to use. The difference in the amount, being deficiency or surplus from retrospective re-computation should be adjusted in the profit and loss account in the year such change is affected. Since such a change amounts to a change in the accounting policy, it should be properly quantified and disclosed. In the question given, the surplus arising out of retrospective re-computation of depreciation as per the straight line method is ₹ 12.23 lakhs (₹ 32.23 lakhs – ₹ 20 lakhs). This should be written back to Profit and Loss Account and should be disclosed accordingly.

Question 24

A plant was depreciated under two different methods as under:

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

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

Answer

As per para 21 of AS 6 on Depreciation Accounting, when a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective re-computation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. In the given case, there is a surplus of ₹ 26.30 lakhs on account of change in method of depreciation, which will be credited to Profit and Loss Account. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed.

Question 25

A machinery costing ₹ 20 lakhs has useful life for 5 years. At the end of 5 years its scrap value would be ₹ 2 lakhs. How much depreciation is to be charged in the books of the company as per Accounting Standard 6?

Answer

Calculation of depreciation as per Straight Line Method

	₹
Cost of machinery	20,00,000
Less: Scrap value at the end of its useful life (i.e. after 5 years)	(2,00,000)
Amount to be written off during the useful life of the machinery	18,00,000
Useful life of the machinery	5 years
Depreciation to be provided each year (₹ 18,00,000 / 5 years)	₹ 3,60,000

Question 26

MIs Progressive Company Limited has not charged depreciation for the year ended on 31st March, 2015, in respect of a spare bus purchased during the financial year 2014-15 and kept ready by the company for use as a stand-by, on the ground that, it was not actually used during the year. State your views with reference to Accounting Standard 6 "Depreciation Accounting".

Answer

According to AS 6, 'Depreciation Accounting', depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable assets arising from use, effluxion of time or obsolescence through technology and market changes. Accordingly, depreciation may arise even the asset is not used in the current year but was ready for use in that year.

The need for using the stand by bus may not have arisen during the year but that does not imply that the useful life of the bus has not been affected. Therefore, non-provision of depreciation on the ground that the bus was not used during the year is not tenable. So, depreciation should be changed on Spare Parts.

Question 27

A computer costing ₹ 60,000 is depreciated on straight line basis, assuming 10 years working life and Nil residual value, for three years. The estimate of remaining useful life after third year was reassessed at 5 years. Calculate depreciation as per the provisions of Accounting Standard 6 "Depreciation Accounting".

Answer

Depreciation per year = ₹ 60,000 / 10 = ₹ 6,000

Depreciation on SLM charged for three years = ₹ 6,000 x 3 years = ₹ 18,000

Book value of the computer at the end of third year = ₹ 60,000 – ₹ 18,000 = ₹ 42,000.

Remaining useful life as per previous estimate = 7 years

Remaining useful life as per revised estimate = 5 years

Depreciation from the fourth year onwards = ₹ 42,000 / 5 = ₹ 8,400 per annum

Question 28

In the Trial Balance of M/s. Sun Ltd. as on 31-3-2014, balance of machinery appears ₹ 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

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

	₹
Depreciation on old machinery in use [10% of (5,60,000-1,60,000)]	40,000
Add: Depreciation on new machine @ 10% for six months $\left(1,50,000 \times 10\% \times \frac{6}{12}\right)$	7,500
Total depreciation on machinery in use	47,500
Add: Depreciation on machine disposed of (10% for 6 months) $\left(1,60,000 \times 10\% \times \frac{6}{12}\right)$	8,000
So, total depreciation to be charged in Profit and Loss A/c	55,500

(ii) Loss on Exchange of Machine

	₹
Book value of machine as on 1.4.2014	1,60,000
Less: Depreciation for 6 months @ 10%	(8,000)
Written Down Value as on 30.9.2014	1,52,000
Less: Exchange value	(1,35,000)
Loss on exchange of machine	17,000

(iii) Book Value of Machinery in the Balance Sheet as on 31.03.2015

	₹
Balance as per trial balance	5,60,000
Less: Book value of machine sold	(1,60,000)
	4,00,000
Add: Purchase of new machine	1,50,000
	5,50,000
Less: Depreciation on machinery in use	(47,500)
	5,02,500

Question 29

Narmada Ltd. purchased an existing bottling unit from Kaveri Ltd. Kaveri Ltd. followed straight line method of charging depreciation on machinery of the sold unit whereas Narmada Ltd. followed written down value method in its other units. The directors of Narmada Ltd. want to continue to charge depreciation for the acquired unit in Straight Line Method which is not consistent with the WDV method followed in other units. Discuss the contention of the directors with reference to the Accounting Standard 6. Further during the year, Narmada Ltd. set up a new plant on coastal land. In view of the corrosive climate, the Company felt that its machine life is reducing faster. Can the Company charge a higher rate of depreciation?

Answer

According to para 12 of AS 6 'Deprecation Accounting', there are several methods of allocating depreciation over the useful life of the assets. The management of a business selects the most appropriate method(s) based on various important factors e.g., (i) type of asset, (ii) the nature of the use of such asset and (iii) circumstances prevailing in the business. A combination of more than one method is sometimes used. A company may adopt different methods of depreciation for different types of assets, provided the same methods are followed consistently. Thus Narmada Ltd. can continue to charge depreciation for the acquired unit as per straight line method. The statute governing an enterprise may provide the basis for computation of the depreciation. For example, the Companies Act lays down the rates of depreciation in respect of various assets. Where the management's estimate of the useful life of an asset of the enterprise is shorter than that envisaged under the provisions of the relevant statute, the depreciation provision is appropriately computed by applying a higher rate. Therefore, in the given case, the Company can charge higher rates of depreciation based on its estimate of the useful life of machinery, provided that such estimate is not less than the rate prescribed by the Companies Act, for that class of assets. However, such higher depreciation rates and/or the reduced useful lives of the assets should be disclosed by way of notes to the accounts in the Financial Statements.

Question 30

On 01.04.2010 a machine was acquired at ₹ 4,00,000. The machine was expected to have a useful life of 10 years. The residual value was estimated at 10% of the original cost. At the beginning of the 4th year, an attachment was made to the machine at a cost of ₹ 1,80,000 to enhance its capacity. The attachment was expected to have a useful life of 10 years and zero terminal value. During the same time the original machine was revalued upwards by ₹ 90,000 and remaining useful life was reassessed at 9 years and residual value was reassessed at NIL.

Find depreciation for the fourth year, if

(i) attachment retains its separate identity.

(ii) attachment becomes integral part of the machine

Answer

Depreciation of Original Machine

		₹
Original cost of Machine as on 01.04.2010		4,00,000
Less: Residual Value 10%		(40,000)
Depreciable Value		3,60,000
Useful life	10 Years	
Depreciation per year		36,000
Depreciation for 3 Years		1,08,000
Written down value at the beginning of 4th year (as on 1.04.2013) (4,00,000 – 1,08,000)		2,92,000
Add: Revaluation		90,000
Total Book Value after revaluation		3,82,000
Reassessed remaining useful life	9 Years	
Depreciation per year from 2013-14		42,444

Depreciation of Attachment

		₹
Original cost of Attachment as on 01.04.2013		1,80,000
Useful life	10 Years	
Depreciation per year from 2013-14		18,000

Depreciation for the year 2013-14

(i) If Attachment retains its separate identity:

Depreciation of Original Machine	₹ 42,444
Depreciation of Attachment	₹ 18,000
Total Depreciation for 2013-14	₹ 60,444

(ii) If Attachment becomes integral part of the Machine:

Total value of Machine as on 01.04.2013	
Original Machine at revalued cost (W.N.1)	₹ 3,82,000
Cost of attachment	₹ 1,80,000
	₹ 5,62,000
Useful life	9 Years
Depreciation for 2013-14	₹ 62,444

Question 31

In the books of Optic Fiber Ltd., plant and machinery stood at ₹ 6,32,000 on 1.4.2013. However on scrutiny it was found that machinery worth ₹ 1,20,000 was included in the purchases on 1.6.2013. On 30.6.2013 the company disposed a machine having book value of ₹ 1,89,000 on 1.4.2013 at ₹ 1,75,000 in part exchange of a new machine costing ₹ 2,56,000. The company charges depreciation @ 20% per annum WDV on plant and machinery.

You are required to calculate:

(i) Depreciation to be charged to P/L

(ii) Book value of Plant and Machinery A/c as on 31.3.2014

(iii) Loss on exchange of machinery.

Answer

(i) Depreciation to be charged to the Profit and Loss Account

	(₹)
Depreciation on old Machinery [20% on ₹6,32,000 for 3 months(01.4.13 to 30.6.13)]	31,600
Add: Depreciation machinery acquired on 01.06.2013 (₹ 1,20,000 x 20% x 10/12)	20,000
Depreciation on Machinery after adjustment of exchange [20% of ₹(6,32,000 -1,89,000+2,56,000) for 9 months]	1,04,850
Total Depreciation to be charged to Profit and Loss A/c	1,56,450

(ii) Book Value of Plant and Machinery as on 31.03.2014

	₹	₹
Balance as per books on 01.04.2013		6,32,000
Add: Included in purchases on 01.06.2013	1,20,000	
Add: Purchase on 30.06.2013	2,56,000	3,76,000
		10,08,000
Less: Book value of Machine sold on 30.06.2013		(1,89,000)
		8,19,000
Less: Depreciation on machinery in use (1,56,450 - 9,450)		(1,47,000)
Book Value as on 31.03.2014		6,72,000

(iii) Loss on exchange of Machinery

Book value of machinery as on 01.04.2013	1,89,000
Less: Depreciation for 3 months	9,450
WDV as on 30.06.2013	1,79,550
Less: Exchange value	1,75,000
Loss on exchange of machinery	4,550

Question 32

M/s. Laghu Udyog Limited has been charging depreciation on an item of Plant and Machinery on straight line basis. The machine was purchased on 1-4-2012 at ₹ 3,25,000. It is expected to have a total useful life of 5 years from the date of purchase and residual value of ₹ 25,000. Calculate the book value of the machine as on 1-4-2014 and the total depreciation charged till 31-3-2014 under SLM. The company wants to change the method of depreciation and charge depreciation @ 20% on WDV from 2014-15.

Is it valid to change the method of depreciation? Explain the treatment required to be done in the books of accounts in the context of AS-6.

Ascertain the amount of depreciation to be charged for 2014-15 and the net book value of the machine as on 31-3-2015 after giving effect of the above change.

Answer

As per AS 6 "Depreciation Accounting", a change from one method of providing depreciation to another should be made only if the adoption of the new method is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise

When a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use.

The deficiency or surplus arising from retrospective re-computation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged in the statement of profit and loss. In case the change in the method results in surplus, the surplus should be credited to the statement of profit and loss.

Such a change should be treated as change in accounting policy and its effect should be quantified and disclosed.

In the given case, the company cannot change the method of depreciation from year 2014-15 without making re-computations for the previous year also according to the new method.

Depreciation for year 2014-15 and net book value of Machine as on 31.3.15 after effect of the change	₹
Purchase value of Machinery as on 01.04.2012	3,25,000
Depreciation for 2 years under WDV @ 20% (₹ 65,000 + ₹ 52,000)	1,17,000
Book value as on 01.04.2014 under WDV (i)	2,08,000
Book value as on 01.04.2014 under SLM (Working Note) (ii)	2,05,000
Excess depreciation credited to Statement of Profit and Loss (i-ii)	3,000
Current year depreciation as per new method (WDV) (2,08,000 X 20%)	41,600
Net Book value as on 31.03.2015 (2,08,000 – 41,600)	1,66,400

Working Note:

Book Value of Machinery and Depreciation under SLM as on 01-04-2014

	₹
Cost of Machine purchased on 01.04.2012	3,25,000
Less: Residual Value	25,000
Depreciable amount	3,00,000
Useful life of Machine	5 Years
Depreciation for 2 Years (₹3,00,000 x 2/5)	1,20,000
Book value as on 01.04.2014	2,05,000

Question 33

A machinery with a useful life of 6 years was purchased on 1st April, 2012 for ₹ 1,50,000. Depreciation was provided on straight line method for first three years considering a residual value of 10% of cost.

In the beginning of fourth year the company reassessed the remaining useful life of the machinery at 4 years and residual value was estimated at 5% of original cost.

The accountant recalculated the revised depreciation historically and charged the difference to profit and loss account. You are required to comment on the treatment by accountant and calculate the depreciation to be charged for the fourth year.

Answer

As per AS 6 "Depreciation Accounting", when there is a revision of the estimated useful life of an asset, the unamortized depreciable amount should be charged over the revised remaining useful life. Accordingly revised depreciation shall be calculated prospectively. Thus, the treatment done by the accountant regarding recalculating the revised depreciation historically i.e. retrospectively is incorrect. As per para 18 of AS 6, if the depreciable assets are revalued, the provision for depreciation should be based on the revalued amount and on

the estimate of the remaining useful lives of such assets. In case the revaluation has a material effect on the amount of depreciation, the same should be disclosed separately in the year in which revaluation is carried out.

Calculation of Depreciation

Depreciation per year charged for first three years	***= ₹ (1,50,000 - 15,000) / 6***
	= ₹ 22,500
WDV of the machine at the beginning of the fourth year	***= ₹ 1,50,000 – (₹ 22,500× 3)***
	= ₹ 82,500
Depreciable amount after reassessment of residual vale	***= ₹ 82,500 – (1,50,000 x 5%)***
	= ₹ 75,000

Remaining useful life as per revised estimate = 4 years

Depreciation from the fourth year onwards = ₹ 75,000 / 4 = ₹ 18,750

AS7 "Construction Contracts"

Question 34

What are the disclosure requirements of AS-7 (Revised)?

Answer

According to paragraphs 38, 39 and 41 of AS 7, an enterprise should disclose:

(a) the amount of contract revenue recognized as revenue in the period;

(b) the methods used to determine the contract revenue recognized in the period; and

(c) the methods used to determine the stage of completion of contracts in progress.

In case of contract still in progress the following disclosures are required at the reporting date:

(a) the aggregate amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;

(b) the amount of advances received; and

(c) the amount of retentions.

An enterprise should also present:

(a) the gross amount due from customers for contract work as an asset; and

(b) the gross amount due to customers for contract work as a liability.

Question 35

B Ltd. undertook a construction contract for ₹ 50 crores in April, 2014. The cost of construction was initially estimated at ₹ 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated the cost of completion of the contract at ₹ 53 crores.

Can the company provide for the expected loss in the book of account for the year ended 31st March, 2015?

Answer

As per para 35 of AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Therefore, The foreseeable loss of ₹ 3 crores (₹ 53 crores less ₹ 50 crores) should be recognised as an expense immediately in the year ended 31st March, 2015. The amount of loss is determined irrespective of

(i) Whether or not work has commenced on the contract;

(ii) Stage of completion of contract activity; or

(iii) The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance with para 8 of AS 7.

Question 36

M/s Excellent Construction Company Limited undertook a contract to construct a building for ₹ 3 crore on 1st September, 2014. On 31st March, 2015 the company found that it had already spent ₹ 1 crore 80 lakhs on the construction. Prudent estimate of additional cost for completion was ₹ 1 crore 40 lakhs. What amount should be charged, to revenue in the final accounts for the year ended on 31st March, 2015, as per the provisions of Accounting Standard 7 "Construction Contracts (Revised)"?

Answer

	₹ in crores
Cost of construction incurred till date	1.80
Add: Estimated future cost	1.40
Total estimated cost of construction	3.20

Percentage of completion till date to total estimated cost of construction

= (1.80/3.20)×100 = 56.25%

Proportion of total contract value recognised as revenue as per AS 7 (Revised)

= Contract price x percentage of completion

= ₹ 3 crores x 56.25% = ₹ 1.6875 crores

Amount of foreseeable loss	*(₹ in crores)*
Total cost of construction	3.20
Less: Total contract price	(3.00)
Total foreseeable loss to be recognized as expense	0.20

According to of AS 7 (Revised 2002), when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

Question 37

M/s Highway .Constructions undertook the construction of a highway on 01.04.2013. The contract was to be completed in 2 years. The contract price was estimated at ₹ 150 crores. Up to 31.03.2014 the company incurred ₹ 120 crores on the construction. The engineers involved in the project estimated that a further ₹ 45 crores would be incurred for completing the work.

What amount should be charged to revenue for the year 2013-14 as per the provisions of Accounting Standard 7 "Construction Contracts"? Show the extract of the Profit & Loss A/c in the books of M/s. Highway Constructions.

Answer

Statement showing the amount to be charged to Revenue as per AS 7

		₹ in crores
	Cost of construction incurred upto 31.03.2014	120
Add:	Estimated future cost	45
	Total estimated cost of construction	165
	Degree of completion (120/165 x 100)	72.73%
	Revenue recognized (72.73% of 150)	109 (approx)
	Total foreseeable loss (165 – 150)	15
Less:	Loss for the current year (120 – 109)	11
	Loss to be provided for	4

Profit and Loss Account (Extract)

		₹ in crores			*₹ in crores*
To	Construction Costs	120	By	Contract Price	109
To	Provision for loss	4	By	Net loss	15
		124			124

Question 38

A construction contractor has a fixed price contract for ₹ 9,000 lacs to build a bridge in 3 years time frame. A summary of some of the financial data is as under:

	(Amount ₹ in lacs)		
	Year 1	*Year 2*	*Year 3*
Initial Amount for revenue agreed in contract	*9,000*	*9,000*	*9,000*
Variation in Revenue (+)	*-*	*200*	*200*

Contracts costs incurred up to the reporting date	*2,093*	*6,168**	*8,100***
Estimated profit for whole contract	*950*	*1,000*	*1,000*

**Includes ₹ 100 lacs for standard materials stored at the site to be used in year 3 to complete the work.*

***Excludes ₹ 100 lacs for standard material brought forward from year 2.*

The variation in cost and revenue in year 2 has been approved by customer.

Compute year wise amount of revenue, expenses, contract cost to complete and profit or loss to be recognized in the Statement of Profit and Loss as per AS-7 (revised).

Answer

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are computed below:

(Amount in ₹ lakhs)

	Up to the reporting date	*Recognized in previous years*	*Recognized in current year*
Year 1			
Revenue (9,000 x 26%)	2,340	-	2,340
Expenses (8,050 x 26%)	2,093	-	2,093
Profit	247	-	247
Year 2			
Revenue (9,200 x 74%)	6,808	2,340	4,468
Expenses (8,200 x 74%)	6,068	2,093	3,975
Profit	740	247	493
Year 3			
Revenue (9,200 x 100%)	9,200	6,808	2,392
Expenses (8,200 x 100%)	8,200	6,068	2,132
Profit	1,000	740	260

Working Note:

	Year 1	*Year 2*	*Year 3*
Revenue after consider variations	9,000	9,200	9,200
Less: Estimated profit for whole contract	950	1,000	1,000
Estimated total cost of the contract (A)	8,050	8,200	8,200
Actual cost incurred upto the reporting date (B)	2,093	6,068 (6,168-100)	8,200 (8,100+100)
Degree of completion (B/A)	26%	74%	100%

AS 9 "Revenue Recognition"

Question 39

Arjun Ltd. sold farm equipments through its dealers. One of the conditions at the time of sale is payment of consideration in 14 days and in the event of delay interest is chargeable @ 15% per annum. The Company has not realized interest from the dealers in the past. However, for the year ended 31.3.2015, it wants to recognise interest due on the balances due from dealers. The amount is ascertained at ₹ 9 lakhs. Decide, whether the income by way of interest from dealers is eligible for recognition as per AS 9?

Answer

As per AS 9 "Revenue Recognition", where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty inverted. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made.

In this case, the company never realized interest for the delayed payments make by the dealers. Hence, it has to recognize the interest only if the ultimate collection is certain. The interest income hence is not to be recognized.

Question 40

The Board of Directors of X Ltd. decided on 31.3.2015 to increase sale price of certain items of goods sold retrospectively from 1st January, 2015. As a result of this decision the company has to receive ₹ 5 lakhs from its customers in respect of sales made from 1.1.2015 to 31.3.2015. But the Company's Accountant was reluctant to make-up his mind. You are asked to offer your suggestion.

Answer

As per para 10 of AS 9 'Revenue Recognition', the additional revenue on account of increase in sales price with retrospective effect, as decided by Board of Directors of X Ltd., of ₹ 5 lakhs to be recognised as income for financial year 2014-15, only if the company is able to assess the ultimate collection with reasonable certainty. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

Question 41

A Ltd. entered into a contract with B Ltd. to despatch goods valuing ₹ 25,000 every month for 4 months upon receipt of entire payment. B Ltd. accordingly made the payment of ₹ 1,00,000 and A Ltd. started despatching the goods. In third month, due to a natural calamity, B Ltd. requested A Ltd. not to despatch goods until further notice though A Ltd. is holding the remaining goods worth ₹ 50,000 ready for despatch. A Ltd. accounted ₹ 50,000 as sales and transferred the balance to Advance Received against Sales. Comment upon the treatment of balance amount with reference to the provisions of Accounting Standard 9.

Answer

As per para 11 of AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

In the given case, transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. Also, the sale price has been recovered by the seller. Hence, the sale is complete but delivery has been postponed at buyer's request. A Ltd. should recognize the entire sale of ₹ 1,00,000 (₹ 25,000 x 4) and no part of the same is to be treated as Advance Receipt against Sales.

Question 42

M/s. Moon Ltd. sold goods worth ₹ 6,50,000 to Mr. Star. Mr. Star asked for a trade discount amounting to ₹ 53,000 and same was agreed to by M/s. Moon Ltd. The sale was effected and goods were dispatched. On receipt of goods, Mr. Star has found that goods worth ₹ 67,000 are defective. Mr. Star returned defective goods to M/s. Moon Ltd. and made payment due amounting to ₹ 5,30,000. The accountant of M/s. Moon Ltd. booked the sale for ₹ 5,30,000. Discuss the contention of the accountant with reference to Accounting Standard (AS) 9.

Answer

As per AS 9 'Revenue Recognition', revenue is the gross inflow of cash, receivable or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods. However, trade discounts and volume rebates given in the ordinary course of business should be deducted in determining revenue. Revenue from sales should be recognized at the time of transfer of significant risks and rewards. If the delivery of the sales is not subject to approval from customers, then the transfer of significant risks and rewards would take place when the sale is affected and goods are dispatched.

In the given case, if trade discounts allowed by M/s. Moon Ltd. are given in the ordinary course of business, M/s. Moon Ltd. should record the sales at ₹ 5,97,000 (i.e. ₹ 6,50,000 – ₹ 53,000) and goods returned worth ₹ 67,000 are to be recorded in the form of sales return. However, when trade discount allowed by M/s. Moon Ltd. is not in the ordinary course of business, M/s. Moon Ltd. should record the sales at gross value of ₹ 6,50,000. Discount of ₹ 53,000 in price and return of goods worth ₹ 67,000 are to be adjusted by suitable provisions. M/s Moon Ltd. might have sent the credit note of ₹ 1,20,000 to Mr. Star to account for these adjustments. In both the cases, the contention of the accountant to book the sales for ₹ 5,30,000 is not correct.

Question 43

Sarita Publications publishes a monthly magazine on the 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The sale of space for the March 2014 issue was made in February 2014. The magazine was published on its scheduled date. It received ₹ 2,40,000 on 10.3.2014 and ₹ 60,000 on 10.4.2014 for the March 2014 issue. Discuss in the context of AS 9 the amount of revenue to be recognized and the treatment of the amount received from advertisers for the year ending 31.3.2014. What will be the treatment if the publication is delayed till 2.4.2014 ?

Answer

As per para 12 of AS 9 'Revenue Recognition', 'In a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished'.

In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is seen by public and hence revenue is recognized on that date. In this case, it is 15.03.2014, the date of publication of the magazine.

Hence, ₹ 3,00,000 (₹ 2,40,000 + ₹ 60,000) is recognized as income in March, 2014. The terms of payment are not relevant for considering the date on which revenue is to be recognized. ₹ 60,000 is treated as amount due from advertisers as on 31.03.2014 and ₹ 2,40,000 will be treated as payment received against the sale.

However, if the publication is delayed till 02.04.2014 revenue recognition will also be delayed till the advertisements get published in the magazine. In that case revenue of ₹ 3,00,000 will be recognized for the year ended 31.03.2015 after the magazine is published on 02.04.2014**.** The amount received from sale of advertising space on 10.03.2014 of ₹ 2,40,000 will be considered as an advance from advertisers for the year ended 31st March, 2014.

Question 44

Given the following information of M/s. Paper Products Ltd.

(i) Goods of ₹ 60,000 were sold on 20-3-2015 but at the request of the buyer these were delivered on 10-4-2015.

(ii) On 15-1-2015 goods of ₹ 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-2015.

(iii) ₹ 1,20,000 worth of goods were sold on approval basis on 1-12-2014. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-2015 and no approval or disapproval received for the remaining goods till 31-3-2015.

(iv) Apart from the above, the company has made cash sales of ₹ 7,80,000 (gross). Trade discount of 5% was allowed on the cash sales.

You are required to advise the accountant of M/s. Paper Products Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS-9 and also determine the total revenue to be recognized for the year ending 31-3-2015.

Answer

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i)

The sale is complete but delivery has been postponed at buyer's request. M/s Paper Products Ltd. should recognize the entire sale of ₹ 60,000 for the year ended 31st March, 2015.

Case (ii)

20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 1,20,000 (80% of ₹ 1,50,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Case (iii)

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹ 1,20,000 as the time period for rejecting the goods had expired.

Case (iv)

Trade discounts given should be deducted in determining revenue. Thus ₹ 39,000 should be deducted from the amount of turnover of ₹ 7,80,000 for the purpose of recognition of revenue. Thus, revenue should be ₹ 7,41,000.

Thus total revenue amounting ₹ 10,41,000 (60,000 + 1,20,000+ 1,20,000+7,41,000) will be recognized for the year ended 31st March, 2015 in the books of M/s Paper Products Ltd.

Question 45

M/s Umang Ltd. sold goods through its agent. As per terms of sales, consideration is payable within one month. In the event of delay in payment, interest is chargeable @ 12% p.a. from the agent. The company has not realized interest from the agent in the past. For the year ended 31st March, 2015 interest due from agent (because of delay in payment) amounts to ₹ 1,72,000. The accountant of M/s Umang Ltd. booked ₹ 1,72,000 as interest income in the year ended 31st March, 2015. Discuss the contention of the accountant with reference to Accounting Standard-9.

Answer

As per para 9.2 of AS 9 "Revenue Recognition", "where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty involved. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made". In this case, the company never realized interest for the delayed payments made by the agent. Hence, based on the past experience, the realization of interest for the delayed payments by the agent is very much uncertain. The interest should be recognized only if the ultimate collection is certain. Therefore, the interest income of ₹ 1,72,000 should not be recognized in the books for the year ended 31st March, 2015. Thus the contention of accountant is incorrect. However, if the agents have agreed to pay the amount of interest and there is an element of certainty associated with these receipts, the accountant is correct regarding booking of ₹ 1,72,000 as interest amount.

AS 10 "Accounting for Fixed Assets"

Question 46

(a) Explain the 'Accounting of Revaluation of Assets' with reference to AS 10.

(b) Explain the disclosure requirement for fixed assets as per AS 10.

Answer

(a) As per Para 30 of AS 10 "Accounting for Fixed Assets", an increase in net book value arising on revaluation of fixed assets should be credited to owner's interests under the head of 'revaluation reserve, except that, to the extent that such increase is related to and not greater than a decrease arising on revaluation previously recorded as a charge to the profit and loss statement, it may be credited to the profit and loss statement. A decrease in net book value arising on revaluation of fixed assets is charged directly to profit and loss statement except that to the extent such a decrease is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilized , it may be charged directly to that account.

(b) As per para 39 of AS 10 "Accounting for Fixed Assets", following information should be disclosed in the financial statements:

1. Gross and net book values of fixed assets at the beginning and at the end of an accounting period showing additions, disposals, acquisitions and other movements.
2. Expenditure incurred on account of fixed assets in the course of construction or acquisition; and
3. Revalued amounts substituted for historical costs of fixed assets, the method adopted to compute the revalued amounts, the nature of indices used, the year of any appraisal made, and whether an external valuer was involved, in case where fixed assets are stated at revalued amounts.

Question 47

During the current year 2014-15, X Limited made the following expenditure relating to its plant building:

	₹ in lakhs
Routine Repairs	*4*
Repairing	*1*
Partial replacement of roof tiles	*0.5*
Substantial improvements to the electrical wiring system which will increase efficiency	*10*

What amount should be capitalized?

Answer

As per para 12.1 of AS 10 'Accounting for Fixed Assets', expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value, e.g., an increase in capacity. Hence, in the given case, Repairs amounting ₹ 5 lakhs and Partial replacement of roof tiles should be charged to profit and loss statement. ₹ 10 lakhs incurred for substantial improvement to the electrical writing system which will increase efficiency should be capitalized.

Question 48

During the year 2014-15, P Limited incurred the following expenses on machinery:

₹ 2.50 lacs as routine repairs and ₹ 75,000 on partial replacement of a part. ₹ 7 lacs on replacement of part of a machinery which will improve the efficiency of the machine. Which amount should be capitalized as per AS 10?

Answer

As per para 12.1 of AS 10 "Accounting for Fixed Assets", only those expenditures that increase the future benefits from the existing assets, is to be included in the gross book value. Example: Increase in capacity.

Hence, in the given case, amount of ₹ 3.25 lacs spent on repairs and partial replacement of a part of the machinery should be charged to Profit and Loss Account as they will help in maintaining the capacity but will not improve the efficiency of the machine. However, ₹ 7 lacs incurred on replacement of a part of the machinery, which will increase the efficiency, should be capitalized by inclusion in the gross book value of assets.

Question 49

During the year MIs Progressive Company Limited made additions to its factory by using its own workforce, at a cost of ₹ 4,50,000 as wages and materials. The lowest estimate from an outside contractor to carry out the same work was ₹ 6,00,000. The directors contend that, since they are fully entitled to employ an outside contractor, it is reasonable to debit the Factory Building Account with ₹ 6,00,000. Comment whether the directors' contention is right in view of the provisions of Accounting Standard 10 "Accounting for Fixed Assets"?

Answer

AS 10, 'Accounting for Fixed Assets', clearly states that the gross book value of the self constructed fixed asset includes the cost of construction that relate directly to the specific asset and the costs that are attributable to the construction activity in general can be allocated to the specific asset. If any internal profit is there it should be eliminated. Thus, only ₹ 4,50,000 should be debited to the factory building account and not ₹ 6,00,000. Hence, the contention of the directors of the company to capitalize ₹ 6,00,000 as cost of factory building, on the ground that the company is fully entitled to employ an outside contractor is not justifiable.

Question 50

M/s. Tiger Ltd. allotted 7,500 equity shares of ₹ 100 each fully paid up to Lion Ltd. in consideration for supply of a special machinery. The shares exchanged for machinery are quoted at National Stock Exchange (NSE) at ₹ 95 per share, at the time of transaction. In the absence of fair market value of the machinery acquired, show how the value of the machinery would be recorded in the books of Tiger Ltd.?

Answer

As per para 11 of AS 10 "Accounting for Fixed Assets", fixed asset acquired in exchange for shares or other securities in the enterprise should be recorded at its fair market value, or the fair market value of the securities issued, whichever is more clearly evident. Since, in the given situation, the market value of the shares exchanged for the asset is more clearly evident, the company should record the value of machinery at ₹ 7,12,500 (i.e., 7,500 shares x ₹ 95 per share) being the market price of the shares issued in exchange.

Question 51

PQR Ltd. constructed a fixed asset and incurred the following expenses on its construction:

	₹
Materials	*16,00,000*

Direct Expenses	*3,00,000*
Total Direct Labour	*6,00,000*
(1/15th of the total labour time was chargeable to the construction)	
Total Office & Administrative Expenses	*9,00,000*
(4% of office and administrative expenses are specifically attributable to construction of a fixed asset)	
Depreciation on assets used for the construction of this asset	*15,000*

Calculate the cost of the fixed asset.

Answer

Calculation of cost of fixed asset

	₹
Materials	16,00,000
Direct expenses	3,00,000
Direct labour (1/15th of ₹ 6,00,000)	40,000
Office and administrative expenses (4% ₹ 9,00,000)	36,000
Depreciation on assets	15,000
Cost of fixed asset	19,91,000

Question 52

Amna Ltd. contracted with a supplier to purchase a specific machinery to be installed in Department A in two months time. Special foundations were required for the plant, which were to be prepared within this supply lead time. The cost of site preparation and laying foundations were ₹ 47,290. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 15,000 per month. The Technician's services were given to Department A by Department B, which billed the services at ₹ 16,500 per month after adding 10% profit margin.

The machine was purchased at ₹ 52,78,000. Sales Tax was charged at 4% on the invoice ₹ 18,590 transportation charges were incurred to bring the machine to the factory. An Architect was engaged at a fee of ₹ 10,000 to supervise machinery installation at the factory premises. Also, payment under the invoice was due in 3 months. However, the Company made the payment in 2nd month. The company operates on Bank Overdraft@ 11%.

Ascertain the amount at which the asset should be capitalized under AS 10.

Answer

Calculation of Cost of Fixed Asset (i.e. Machine)

Particulars		₹
Purchase Price	Given	52,78,000
Add: Sales Tax at 4%	₹ 52,78,000 x 4%	2,11,120
Site Preparation Cost	Given	47,290
Technician's Salary	Specific/Attributable overheads for 2 months (See Note)	30,000
Initial Delivery Cost	Transportation	18,590
Professional Fees for Installation	Architect's Fees	10,000
Total Cost of Asset		55,95,000

Note:

(i) Interest on Bank Overdraft for earlier payment of invoice is not relevant under AS 10.

(ii) Internally booked profits should be eliminated in arriving at the cost of Fixed Assets.

(iii) It has been assumed that the purchase price of ₹ 52,78,000 excludes amount of sales tax.

Question 53

Ascertain the value at which various items of Fixed Assets are to be shown in the Financial Statements of Velvet Ltd. and amount to be debited to the Profit and Loss Account in the context of the relevant Accounting Standard. Narrations for the adjustments made should form part of the answer:

(i) Goodwill was valued at ₹ 1,20,000 by independent valuers and no consideration was paid. The Company has not yet recorded the same.

(ii) Balance of Office Equipment as on 01.04.2013 is ₹ 1,20,000. On.1.04.2013, out of the above office equipment having book value ₹ 20,000 has been retired from use and held for disposal. The net realizable value of the same is ₹ 2,000. Rate of depreciation is 15% p.a. on WDV basis.

(iii) Book Value of Plant and Machinery as on 01.04.2013 was ₹ 7,20,000. On 01.08.2013 an item of machinery was purchased in exchange for 500 equity shares of face value ₹ 10. The Fair Market value of the equity shares on 01.08.2013 was ₹ 120. Rate of depreciation is 10% p.a. on WDV basis.

Answer

Statement showing treatment and value of various items of Fixed Assets

	Item of Fixed Assets	*Amount (₹)*	*Amount Debited to P& L in 2013-14*	*Narration*	*Book Value as on 31.3.2014 to be shown in the Financial Statements*
(i)	**Goodwill**				
	Book value as on 1.4.2013	0			
	Balance as on 31.3.2014 (See Note 1)				0
(ii)	**Office Equipment**				
	Balance as on 1.4.2013	1,20,000			
	Less: Retired from use (Book value on 1.4.2013)	20,000			
		1,00,000			
	Less: Depreciation for 2013-14 @ 15% WDV	15,000	15,000	Depreciation	
	Balance as on 31.3.2014	85,000			85,000
	Office Equipment (Retired from use)				
	Book Value as on 1.4.2013	20,000			
	Less: Book Value as on 31.3.2014 (at NRV)(See Note 2)	2,000			2,000
	Loss on retirement charged to P&L	18,000	18,000	Loss on retirement of asset	
(iii)	**Plant and Machinery**				
	Book Value as on 1.4.2013	7,20,000			
	Add: Machine purchased on 01.08.2013 (See Note 3)	60,000			
		7,80,000			
	Less: Depreciation				
	Original machine for whole year 72,000				
	New machine for 8 months 4,000	76,000	76,000	Depreciation	

	Balance as on 31.3.2014	7,04,000			7,04,000
			1,09,000		7,91,000

Note:

1. As per para 16 of AS 10 'Accounting for Fixed Assets' goodwill is to be recorded only when some consideration in money or money's worth has been paid for it. Since the goodwill is self generated and no money or money's worth has been paid for the same, therefore, it is not to be recorded in the books.
2. Office equipment having book value of ₹ 20,000 as on 1.4.2013 has been retired from use. It has been recorded at Net Realisable Value (NRV) as the NRV is lower than the book value and shown separately in the financial statements. This is in consonance with the provisions stated in para 14 of AS 10.
3. As per para 11 of the standard, the new machine has been recorded at the Fair Market Value of the securities issued as it is more clearly evident.

Question 54

M/s. Versatile Limited purchased machinery for ₹ 4,80,000 (inclusive of excise duty of ₹ 40,000). CENVAT credit is available for 50% of the duty paid. The company incurred the following other expenses for installation.

	₹
Cost of preparation of site for installation	*21,000*
Total labour charges .	*66,000*
(200 out of the total of 600 men hours worked, were spent for installation of the machinery)	
Spare parts and tools consumed in installation	*6,000*
Total salary of supervisor	*24,000*
(time spent for installation was 25% of the total time worked.)	
Total administrative expenses	*32,000*
(1/10 relates to the plant installation)	
Test run and experimental production expenses	*23,000*
Consultancy changes to architect for plant set up	*9,000*
Depreciation on assets used for the installation	*12,000*

The machine was ready for use on 15-1-2015 but was used from 1-2-2015. Due to this delay further expenses of ₹ 19,000 were incurred. Calculate the value at which the plant should be capitalized in the books of M/s. Versatile Limited.

Answer

Calculation of Cost of Fixed Asset (i.e. Machine)

Particulars		₹
Purchase Price	Given	4,80,000
Add:		
Site Preparation Cost	Given	21,000
Labour charges	(66,000/600x200)	22,000
Spare parts	Given	6,000
Supervisor's Salary	25% of ₹ 24,000	6,000
Administrative costs	1/10 of ₹ 32,000	3,200
Test run and experimental production charges	Given	23,000
Architect Fees for set up	Given	9,000
Depreciation on assets used for installation	Given	12,000
Total Cost of Asset		5,82,200
Less: Cenvat credit receivable	50% of ₹ 40,000	20,000
		5,62,200

Note: Expenses of ₹ 19,000 from 15.1.2015 to 1.2.2015 to be charged to profit and loss A/c as plant were ready for production on 15.1.2015.

Question 55

Briefly explain the treatment of following items as per relevant accounting standards:

- ***The accountant of Star Limited valued the Goodwill of the company at ₹ 50 lakhs and showed the same as Fixed Asset in Balance Sheet. The corresponding credit was given to Reserves.***
- ***An expense of ₹ 5 crores was incurred on a Machine towards its Repairs and Maintenance. The accountant wants to capitalize the same considering the significance of amount spent.***
- ***A plant was ready for commercial production on 01.04.2014 but could commence actual production only on 01.06.2014. The company incurred ₹ 50 lakhs as administrative expenditure during the period of which 20% was allocable to the plant. The accountant added ₹ 10 lakhs to cost of plant.***

Answer

Treatment of given items

- ***As per AS 10 "Accounting for Fixed Assets", goodwill, in general, is recorded in the books only when some consideration in money or money's worth has been paid for it.***

In the given situation, the company has valued its goodwill which will be considered as earned over the years i.e. it is self-generated goodwill. Therefore, the same shall not be recorded in the books, as consideration in money or money's worth has not been paid for it. Thus raising goodwill by giving corresponding credit to Reserve is incorrect.

- ***Only expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value, e.g., an increase in capacity. The cost of an addition or extension to an existing asset which is of a capital nature and which becomes an integral part of the existing asset is usually added to its gross book value. Any other expenses incurred, though substantial, on machine towards its repairs and maintenance should not be capitalized but charged to profit and loss account since it does not increase capacity.***
- ***If the interval between the date a project is ready to commence commercial production and the date at which commercial production actually begins is prolonged, all expenses incurred during this period are charged to the profit and loss statement. However, the expenditure incurred during this period is also sometimes treated as deferred revenue expenditure, to be amortized over a period not exceeding 3 to 5 years, after the commencement of commercial production. Thus the amount of ₹ 10 lakh should either be charged to profit and loss statement in the year ended 31st March, 2015 or may be amortized for a future period not exceeding 3 to 5 years after the commencement of commercial production i.e. 1.6.2014.***

AS 13 "Accounting for Investments"

Question 56

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

Answer

The disclosure requirements as per para 35 of AS 13 are as follows:

(i) Accounting policies followed for valuation of investments.

(ii) Classification of investment into current and long term in addition to classification as per Schedule VI of Companies Act in case of company.

(iii) The amount included in profit and loss statements for

  (a) Interest, dividends and rentals for long term and current investments, disclosing therein gross income and tax deducted at source thereon;

  (b) Profits and losses on disposal of current investment and changes in carrying amount of such investments;

  (c) Profits and losses and disposal of long term investments and changes in carrying amount of investments.

(iv) Aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments;

(v) Any significant restrictions on investments like minimum holding period for sale/disposal, utilisation of sale proceeds or non-remittance of sale proceeds of investment held outside India.

(vi) Other disclosures required by the relevant statute governing the enterprises.

Question 57

M/s Innovative Garments Manufacturing Company Limited invested in the shares of another company on 1st October, 2014 at a cost of ₹ 2,50,000. It also earlier purchased Gold of ₹ 4,00,000 and Silver of ₹ 2,00,000 on 1st March, 2012. Market value as on 31st March, 2015 of above investments are as follows:

	₹
Shares	*2,25,000*
Gold	*6,00,000*
Silver	*3,50,000*

How above investments will be shown in the books of accounts of M/s Innovative Garments Manufacturing Company Limited for the year ending 31st March, 2015 as per the provisions of Accounting Standard 13 "Accounting for Investments"?

Answer

As per AS 13 'Accounting for Investments', for investment in shares - if the investment is purchased with an intention to hold for short-term period then it will be shown at the realizable value of ₹ 2,25,000 as on 31st March, 2015.

If equity shares are acquired with an intention to hold for 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, if other than temporary, in the value of the investments.

As per the standard, investment acquired for long term period shall be shown at cost. Gold and silver are generally purchased with an intention to hold it for long term period until and unless given otherwise. Hence, the investment in Gold and Silver (purchased on 1st March, 2009) shall continue to be shown at cost as on 31st March, 2015 i.e., ₹ 4,00,000 and ₹ 2,00,000 respectively, though their realizable values have been increased.

Question 58

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

(1) A portion of current investments purchased for ₹ 20 lakhs, to be reclassified as long term investment, as the company has decided to retain them. The market value as on the date of Balance Sheet was ₹ 25 lakhs.

(2) Another portion of current investments purchased for ₹ 15 lakhs, to be reclassified as long term investments. The market value of these investments as on the date of balance sheet was ₹ 6.5 lakhs.

(3) Certain long term investments no longer considered for holding purposes, to be reclassified as current investments. The original cost of these was ₹ 18 lakhs but had been written down to ₹ 12 lakhs to recognize permanent decline as per AS 13.

Answer

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

(1) In the first case, the market value of the investment is ₹ 25 lakhs, which is higher than its cost i.e. ₹ 20 lakhs. Therefore, the transfer to long term investments should be carried at cost i.e. ₹ 20 lakhs.

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

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

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

Question 59

Blue-chip Equity Investments Ltd., wants to re-classify its investments in accordance with AS 13. State the values, at which the investments have to be reclassified in the following cases:

(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.

AS 14 "Accounting for Amalgamations"

Question 60

Briefly describe the disclosure requirements for amalgamation including additional disclosure, if any, for different methods of amalgamation as per AS 14.

Or

What disclosures should be made in the first financial statements following the amalgamation?

Answer

The disclosure requirements for amalgamations have been prescribed in paragraphs 43 to 46 of AS 14 on Accounting for Amalgamation.

For all amalgamations, the following disclosures should be made in the first financial statements following the amalgamation:

(a) names and general nature of business of the amalgamating companies;

(b) the effective date of amalgamation for accounting purpose;

(c) the method of accounting used to reflect the amalgamation; and

(d) particulars of the scheme sanctioned under a statute.

For amalgamations accounted under the pooling of interests method, the following additional disclosures should be made in the first financial statements following the amalgamation:

(a) description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation; and

(b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

For amalgamations, accounted under the purchase method, the following additional disclosures should be made in the first financial statements following the amalgamation;

(a) consideration for the amalgamation and a description of the consideration paid or contingently payable; and

(b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortisation of any goodwill arising on amalgamation.

Question 61

Briefly explain the methods of accounting for amalgamation as per Accounting Standard-14.

Answer

As per AS 14 on 'Accounting for Amalgamations', there are two main methods of accounting for amalgamations:

(i) The Pooling of Interest Method: Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (after making the necessary adjustments).

If at the time of amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

(ii) The Purchase Method: Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

Where assets and liabilities are restated on the basis of their fair values, the determination of fair values may be influenced by the intentions of the transferee company.

Question 62

List the conditions to be fulfilled as per Accounting Standard 14 for an amalgamation to be in the nature of merger, in the case of companies.

Answer

An amalgamation should be considered to be an amalgamation in the nature of merger if the following conditions are satisfied:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

Exercise

1. *Explain provisions contained in the Accounting Standard in respect of Revaluation of fixed assets.*
2. *When can revenue be recognized in the case of transaction of sale of goods?*
3. *Write short note on valuation of fixed assets in special cases.*
4. *A Ltd. is amalgamating with B Ltd. They are undecided on the method of accounting to be followed. You are required to advice the management of B Ltd. on the method of accounting that can be adopted under AS-14.*