CHAPTER 1

ACCOUNTING STANDARDS

AS – 2 VALUATION OF INVENTORIES

Question – 1.

Venus Trading Company purchases cars from several countries and sells them to Asian countries. During the current year, this company has incurred following expenses:

1. Trade discounts on purchase
2. Handling costs relating to imports
3. Salaries of accounting department
4. Sales commission paid to sales agents
5. After sales warranty costs
6. Import duties
7. Costs of purchases (based on supplier's invoices)
8. Freight expense
9. Insurance of purchases
10. Brokerage commission paid to indenting agents

Evaluate which costs are allowed by AS 2 for inclusion in the cost of inventory in the books of Venus.

Solution

Items number 1, 2, 6, 7, 8, 9, 10 are allowed by AS 2 for the Calculation of cost of inventories. Salaries of accounts department, sales commission, and after sale warranty costs are not considered to be the cost of inventory therefore they are not allowed by AS 2 for inclusion in cost of inventory and are expensed off in the profit and loss account.

Question – 2.

In a manufacturing process of Mars ltd, one by-product BP emerges besides two main products MP1 and MP2 apart from scrap. Details of cost of production process are here under:

Item	Unit	Amount	Output	Closing Stock 31-3-20X1
Raw material	14,500	1,50,000	MP I-5,000 units	250
Wages	-	90,000	MP II - 4,000 units	100
Fixed overhead	-	65,000	BP- 2,000 units	-
Variable overhead	-	50,000	-	-

Average market price of MP1 and MP2 is ₹60 per unit and ₹50 per unit respectively, by-product is sold @ ₹20 per unit. There is a profit of ₹5,000 on sale of by-product after incurring separate processing charges of ₹8,000 and packing charges of ₹2,000, ₹5,000 was realised from sale of scrap.

Required:

Calculate the value of closing stock of MP1 and MP2 as on 31-03-20X1.

Solution:

As per Ind 2 'Inventories', most by-products as well as scrap or waste materials, by their nature, are immaterial. They are often measured at net realizable value and this value is deducted from the cost of the main product.

1) Calculation of NRV of By-product BP

Selling price of by-product Less: Separate processing charges of by- product BP Packing charges	2,000 units x 20 per unit	40,000 (8,000) (2,000)
Net realizable value of by-product BP		**30,000**

2) Calculation of cost of conversion for allocation between joint products MP1 and MP2

Raw material		1,50,000
Wages		90,000
Fixed overhead		65,000
Variable overhead		50,000
Less: NRV of by-product BP (See Calculation 1)	30,000	
Sale value of scrap	5,000	(35,000)
Joint cost to be allocated between MP1 and MP2		**3,20,000**

3) Determination of "basis for allocation" and allocation of joint cost to MP1 and MP2

	MP I	**MP 2**
Output in units (a)	5,000	4,000
Sales price per unit (b)	60	50
Sales value (a x b)	3,00,000	2,00,000
Ratio of allocation	3	2
Joint cost of ₹ 3,20,000 allocated in the ratio of 3:2 (c)	1,92,000	1,28,000
Cost per unit [c/a]	**38.4**	**32**

4) Determination of Value of Closing stock of MP 1 & MP 2

Particulars	**MP 1**	**MP 2**
Closing stock in units	250 units	100 units
Cost per unit	38.4	32
Value of closing stock	9,600	3,200

Question – 3. (RTP May 19)

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.

Solution

Net Selling Price	750
Less – Estimated Cost of Completion	(310)
Less – Brokerage (4% of 750)	(30)
NRV	**410**

Cost of Inventory	530
Valuation of Inventory (Lower of above)	410

AS – 3 CASH FLOW STATEMENT

Question – 4.

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 its subsidiaries companies

(ii) Investment made in subsidiary Smart Ltd. and dividend received

(iii) Dividend paid for the year

(iv) TDS on interest income earned on investments made

(v) TDS on interest earned on advance given to suppliers

(vi) Insurance claim received against loss of fixed asset by fire

Discuss in the context of AS 3 Cash Flow Statement.

Solution:

(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 Operating activities'.

Question – 5. (RTP – MAY18)

A company provides you the following information:

- ***Total sales for the year were Rs. 398 crores out of which cash sales amounted to ` 262 crores.***
- ***Receipts from credit customers during the year, aggregated Rs. 134 crores.***
- ***Purchases for the year amounted to ` 220 crores out of which credit purchase was 80%.***
- ***Balance in creditors as on***
  - ***1.4.2016 Rs. 84 crores***
  - ***31.3.2017 Rs. 92 crores***
- ***Suppliers of other consumables and services were paid Rs. 19 crores in cash.***
- ***Employees of the enterprises were paid 20 crores in cash.***

- ***Fully paid preference shares of the face value of Rs. 32 crores were redeemed. Equity shares of the face value of Rs. 20 crores were allotted as fully paid up at premium of 20%.***
- ***Debentures of Rs. 20 crores at a premium of 10% were redeemed. Debenture holders were issued equity shares in lieu of their debentures.***
- ***Rs. 26 crores were paid by way of income tax.***
- ***A new machinery costing Rs. 25 crores was purchased in part exchange of an old machinery. The book value of the old machinery was Rs. 13 crores. Through the negotiations, the vendor agreed to take over the old machinery at a higher value of Rs. 15 crores. The balance was paid in cash to the vendor.***
- ***Investment costing Rs. 18 cores were sold at a loss of Rs. 2 crores.***
- ***Dividends amounting Rs. 15 crores (including dividend distribution tax of Rs. 2.7 crores) was also paid.***
- ***Debenture interest amounting Rs. 2 crore was paid.***
- ***On 31st March 2016, Balance with Bank and Cash on hand was Rs. 2 crores.***

On the basis of the above information, you are required to prepare a Cash Flow Statement for the year ended 31st March, 2017 (Using direct method).

Solution:

Cash flow statement (using direct method) for the year ended 31st March, 2017

Cash flow from operating activities -		
Cash sales	262	
Cash collected from credit customers	134	
Less: Cash paid to suppliers for goods & services and to employees (Refer Working Note)	(251)	
Cash from operations	**145**	
Less: Income tax paid	(26)	
Net cash generated from operating activities		119
Cash flow from investing activities -		
Net Payment for purchase of Machine (25 – 15)	(10)	
Proceeds from sale of investments	16	
Net cash used in investing activities		6
Cash flow from financing activities -		
Redemption of Preference shares	(32)	
Proceeds from issue of Equity shares	24	
Debenture interest paid	(2)	
Dividend Paid	(15)	
Net Cash used in Financing activities		**(25)**
Net Increase in Cash & Cash Equivalents		**100**
Add – Cash & Cash equivalents as on 01.04.2016		**2**
Cash & Cash Equivalents as on 31.03.2017		**102**

Working Note:

Calculation of cash paid to suppliers of goods and services and to employees

Opening Balance in creditors Account	84
Add: Purchases (220x .8)	176
Total	**260**
Less: Closing balance in Creditors Account	92
Cash paid to suppliers of goods	**168**
Add: Cash purchases (220x .2)	44
Total cash paid for purchases to suppliers (a)	**212**
Add: Cash paid to suppliers of other consumables and services (b)	19

Add: Payment to employees (c)	20
Total cash paid to suppliers of goods & services and to employees [(a)+ (b) + (c)]	**251**

AS – 10 PROPERTY, PLANT AND EQUIPMENTS

Question – 6. Change in Depreciation Method

An entity acquired an asset 3 years ago at a cost of Rs 5 million. The depreciation method adopted for the asset was 10 percent reducing balance method.

At the end of Year 3, the entity estimates that the remaining useful life of the asset is 8 years and determines to adopt straight –line method from that date so as to reflect the revised estimated pattern of recovery of economic benefits.

Show the necessary treatment in accordance of AS 16.

Solution:

Change in Depreciation Method shall be accounted for as a change in an accounting estimate in accordance of AS 8 and hence will have a prospective effect

Depreciation Charges for year 1 to 11 will be as follows:

Year 1	Rs 500,000
Year 2	Rs 450,000
Year 3	Rs 405,000
Year 4 to Year 11	Rs 455,625 p.a.

Question – 7. (Exam Nov. 2018 – 8 Marks)

On 1st April, 2017 Good Time Limited purchased some land for Rs 1.5 crore (including legal cost of Rs 10 lakhs) for the purpose of constructing a new factory. Construction work commenced on 1st May, 2017. Good Time Limited incurred the following costs in relation to its construction

	Rs
Preparation and levelling of the land	***4,40,000***
Purchase of materials for the construction	***92,00,000***
Employment costs of the construction workers (per month)	***1,45,000***
Overhead costs incurred directly on the construction of the factory (per month)	***1,25,000***
Ongoing overhead costs allocated to the construction project (using the company's normal overhead allocation model) per month	***75,000***
Costs of relocating employees to work at new factory	***3,25,000***
Costs of the opening ceremony on 1st January, 2018	***2,50,000***
Income received during the temporary use of the factory premises as a store during the construction period.	***60,000***

The construction of the factory was completed on 31st December, 2017 and production began on 1st February, 2018. The overall useful life of the factory building was estimated at 40 years from the date of completion. However, it is estimated that the roof will need to be replaced 20 years after the date of completion and that the cost of replacing the roof at current prices would be 25% of the total cost of the building.

At the end of the 40 years period, Good Time Limited has a legally enforceable obligation to demolish the factory and restore the site to its original condition. The company estimates that the cost of demolition in 40 year's time (based on price

prevailing at that time) will be Rs 3 crore. The annual risk adjusted discount rate which is appropriate to this project is 8%. The present value of Rs 1 payable in 40 years time at an annual discount rate of 8% is 0.046.

The construction of the factory was partly financed. by a loan of Rs 1.4 crore taken out on 1st April, 2017. The loan was at an annual rate of interest of 9%. During the period 1st April, 2017 to 30th September, 2017 (when the loan proceeds had been fully utilized to finance the construction), Good Time Limited received investment income of Rs 1,25,000 on the temporary investment of the proceeds.

You are required to compute the cost of the factory and the carrying amount of the factory in the Balance Sheet of Good Time Limited as at 31st March, 2018.

Solution:

Computation of the cost of the factory

	Rs
Purchase of land	1,50,00,000
Preparation and levelling	4,40,000
Materials	92,00,000
Employment costs of construction workers (1,45,000 x 8 months)	11,60,000
Direct overhead costs (1,25,000 x 8 months)	10,00,000
Allocated overhead costs	Nil
Income from use of a factory as a store	Nil
Relocation costs	Nil
Cost of the opening ceremony	Nil
Finance costs	9,45,000
Investment income on temporary investment of the loan proceeds	(1,25,000)
Demolition cost recognised as a provision (3,00,00,000 x 0.046)	13,80,000
Total	**2,90,00,000**

Computation of carrying amount of the factory as at 31st March, 2018

		Land (Non-depreciable asset)	Factory (Depreciable asset)
Cost of the asset (Total cost 2,90,00,000)		1,50,00,000	1,40,00,000
Less: Depreciation			
On Land		Nil	
On Factory			
Depreciation on roof component (1,40,00,000 × 25% × 1/20 x 3/12)	43,750		
Depreciation on remaining factory (1,40,00,000 × 75% × 1/40 × 3/12)	65,625		(1,09,375)
Carrying amount of depreciable asset i.e factory		1,50,00,000	1,38,90,625
Total cost			**2,88,90,625**

Note:

1. Interest cost has been capitalised based on nine month period. This is because; purchase of land would trigger off capitalisation.

2. All of the net finance cost of Rs 8,20,000 (Rs 9,45,000 - Rs 1,25,000) has been allocated to the depreciable asset i.e. Factory. Alternatively, it can be allocated proportionately between land and factory.

AS – 11 EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Question – 8.

Sunshine company Ltd. imported Raw Materials worth US Dollars 9,000 on 25th Feb, 2011, when the exchange rate was 44/- per US Dollars. 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 Dollars. At the yearend 31st March, 2011, the rate of exchange was 49/- per US Dollar.

The Chief Accountant of 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).

Solution:

Question – 9.

Patidar Ltd. borrowed US $ 5,00,000 on 31.12.2010 which will be repaid (settled) as on 30.06.11. Patidar Ltd. prepares its financial statements ending on 31.3.11. Rate of exchange between reporting currency (rupees) and foreign currency ($) on different dates are as under:

31.12.2010	***1 US $ = Rs. 44.00***
31.03.2011	***1 US $ = Rs. 44.50***
30.06.2011	***1 US $ = Rs. 44.75.***

(i) Calculate borrowings in reporting currency to be recognized in the books on above mentioned dates & also show journal entries for the same.

(ii) if borrowing was repaid on 28.02.11 on which date exchange rate was 1US $ = Rs. 44.20 than what entry should be passed?

Solution:

Question – 10.

S Ltd. purchased fixed assets costing Rs. 3,000 lacs on 01.01.2010 and the same was fully financed by foreign currency loan ($) payable in three equal installments. Exchange rates were 1US $ = Rs. 40.00 and 42.50 as on 01.01.2010 and 31.12.2010. First installment was paid on 31.12.2010. The entire difference in foreign exchange has been capitalized. You are required to state, whether the treatment made by S Ltd. is correct or not?

Solution:

Question – 11.

The following is the Trial Balance of TATA Ltd. as on 31st March, 2011 before subsequent recognition:

Particulars	*Dr. Amt.*	*Cr. Amt.*
Purchases	80,000	-
Debtors (Foreign currency) $ 2,000	60,000	-
Debtors (Indian currency)	25,000	-
Loan (long term F.C.) for financing Machine $ 3,000	-	1,00,000
Loan (long term F.C.) others $ 4,000	-	1,40,000
Machine	2,00,000	-
Sales		1,25,000
	3,65,000	3,65,000

Exchange rate as on 31.03.2011 is Rs. 50/- per US $. Apply Para 46 and Prepare Trial Balance thereafter.

Solution:

Question – 12.

A Ltd. has following information

Year	Exchange Diff on Short Term Foreign Currency Monetary Item	Exchange Diff on Long Term Foreign Currency Monetary Item Monetary Item (Dep Assets)	Exchange Diff on Long Term Foreign Currency Monetary Item Monetary Item (Other Items)
05-06	10,000	18,000	26,000
06-07	11,000	19,000	27,000
07-08	12,000	20,000	28,000
08-09	13,000	21,000	29,000
09-10	14,000	22,000	30,000
10-11	15,000	23,000	31,000
11-12	16,000	24,000	32,000
12-13	17,000	25,000	33,000

Apply Para 46. Depreciation rate 10%. WDV of Asset on 01/04/2006 is Rs. 10,00,000.

Solution:

Question – 13.

"Assets and Liabilities and Income and Expenditure items in respect of dependent foreign branches are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange difference in the case of profit, is carried to other Liabilities accounts and the loss, if any, is charged to revenue". Comment.

Solution:

***Question – 14.** (May 19 – RTP)*

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.?

Solution:

Forward Rate	49.15
Less – Spot Rate	48.85
Premium on Contract (Forward Premium)	0.30
Contract Value	$ 1,00,000
Total Loss (1,00,000 x 0.30)	Rs. 30,000

Contract period of 3 months, out of which two months falling in the year 2016-17, therefore loss to be recognised (30000x3) x 2 = 20000. Rest Rs. 10000 will be recognised in the following year.

AS – 12 ACCOUNTING FOR GOVT. GRANTS

Question – 15. (MAY 19 – RTP)

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?

Solution:

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 Rs.30 lakhs and balance in deferred income is Rs. 21 lakhs, Rs. 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 – 16.

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

Solution:

AS – 16 BORROWING COSTS

Question – 17.
ABC Ltd. has taken a loan of USD 20,000 on April 1, 20X1 for constructing a plant at an interest rate of 5% per annum payable on annual basis.
On April 1, 20X1, the exchange rate between the currencies i.e USD Vs INR was Rs45 per USD. The exchange rate on the reporting date i.e March 31, 20X2 is Rs48 per USD. The corresponding amount could have been borrowed by ABC Ltd from State bank of India in local currency at an interest rate of 11% per annum as on April 1, 20X1.
Compute the borrowing cost to be capitalized for the construction of plant by ABC Ltd.

Solution:

In the above situation, the Borrowing cost needs to determine for interest cost on such foreign currency loan and eligible exchange loss difference if any.

(a) Interest on Foreign currency loan for the period:
USD 20,000 x 5% = USD 1,000
Converted in Rs: USD 1,000 x Rs 48/USD = Rs 48,000

Increase in liability due to change in exchange difference: USD 20,000 x (48 - 45) = Rs 60,000

(b) Interest that would have resulted if the loan was taken in Indian Currency:
USD 20,000 x Rs 45/USD x 11% = Rs 99,000

(c) Difference between Interest on Foreign Currency borrowing and local Currency borrowing:
Rs 99,000 - 48,000 = Rs 51,000

Hence, out of Exchange loss of Rs 60,000 on principal amount of foreign currency loan, only exchange loss to the extent of Rs 51,000 is considered as borrowing costs.

Total borrowing cost to be capitalized is as under:

(a) Interest cost on borrowing	Rs 48,000
(b) Ex. Dif. to the extent considered to be an adjustment to Interest cost	Rs 51,000
Total	**Rs 99,000**

The exchange difference of Rs 51,000 has been capitalized as borrowing cost and the remaining Rs 9,000 will be expensed off in the Statement of Profit and loss.

Question – 18.
Beta Ltd had the following loans in place at the end of 31st March 20X2:

(Amounts in Rs. 000s)

Loan	*1st April 20X1*	*31st March 20X2*

18% Bank Loan	*1,000*	*1,000*
16% Term Loan	*3,000*	*3,000*
14% Debentures	*-*	*2,000*

14% debenture was issued to fund the construction of Office building on 1st July 20X1 but the development activities has yet to be started.

On 1st April 20X1, Beta ltd began the construction of a Plant being qualifying asset using the existing borrowings. Expenditure drawn down for the construction was: Rs 500,000 on 1st April 20X1 and Rs 2,500,000 on 1st January 20X2.

Required

Calculate the borrowing cost that can be capitalised for the plant.

Solution:

Capitalisation rate	(18% x 1000)/1000+3000 + (16% x 3000)/1000+3000	16.5%
Borrowing Costs	(500,000 x 16.5%)+(2,500,000 x16.5% x 3/12)	Rs. 1,85,625

Question – 19.

X Limited has a treasury department that arranges funds for all the requirements of the Company including funds for working capital and expansion programs. During the year ended March 31, 20X2, the Company commenced the construction of a qualifying asset and incurred the following expenses:

Date Amount	***(Rs)***
July 1, 20X1	***2,50,000***
December 1, 20X1	***3,00,000***

The details of borrowings and interest thereon are as under:

Particulars	***Average Balance (Rs)***	***Interest (Rs)***
Long term loan @ 10%	*10,00,000*	*1,00,000*
Working capital loan	*5,00,000*	*65,000*
	15,00,000	*1,65,000*

Compute the borrowing costs that need to be capitalised.

Solution:

The capitalisation rate is:

Total borrowing costs / Weighted average total borrowings: 1,65,000/15,00,000 = 11% Interest will be capitalised as under:

— On Rs 2,50,000 @ 11% p.a. for 9 months = Rs 20,625

— On Rs₹ 3,00,000 @ 11% p.a. for 4 months = Rs11,000

Question – 20.

XYZ Ltd. acquired a bank loan of Rs. 40 lakhs on interest rate of 20% per annum on 1 July, 2013. The said loan was utilized by the company for three transactions as under:

(i) ***Construction of factory Shed*** ***Rs. 10,00,000***

(ii) ***Purchase of Plant & Machinery*** ***Rs. 25,00,000***

(iii) ***Balance Loan was unallocated and used generally for the purpose of***

business.
The accountant of the company has charged the total interest to Profit and Loss account. Comment in view of the provisions of AS 23.

Solution:

Question – 21. (May 19 – RTP)
Zen Bridge Construction Limited obtained a loan of Rs. 64 crores to be utilized as under:

1	*Construction of hill link road in kedarnath*	*50 cr.*
2	*Purchase of equipment and machinaries*	*6 cr.*
3	*Working capital*	*4 cr.*
4	*Purchase of vehicles*	*1 cr.*
5	*Purchase of Technical know how*	*2 cr*
6	*Advance for tools/ cranes etc*	*1 cr.*
7	*Total Interest Charged by the bank for the year ending 31st March*	*1.6 cr.*

Show the treatment of Interest according to Accounting Standard by Zen Bridge Construction Limited.

Solution:

COVID 19

Student Notes:-

COVID-19