

## Accounting Standard - 1

# Disclosure of Accounting Policies



### Objective of AS 1



- ✓ To facilitate better understanding of financial statements.
- ✓ To facilitate meaningful comparison between financial statements of different enterprises

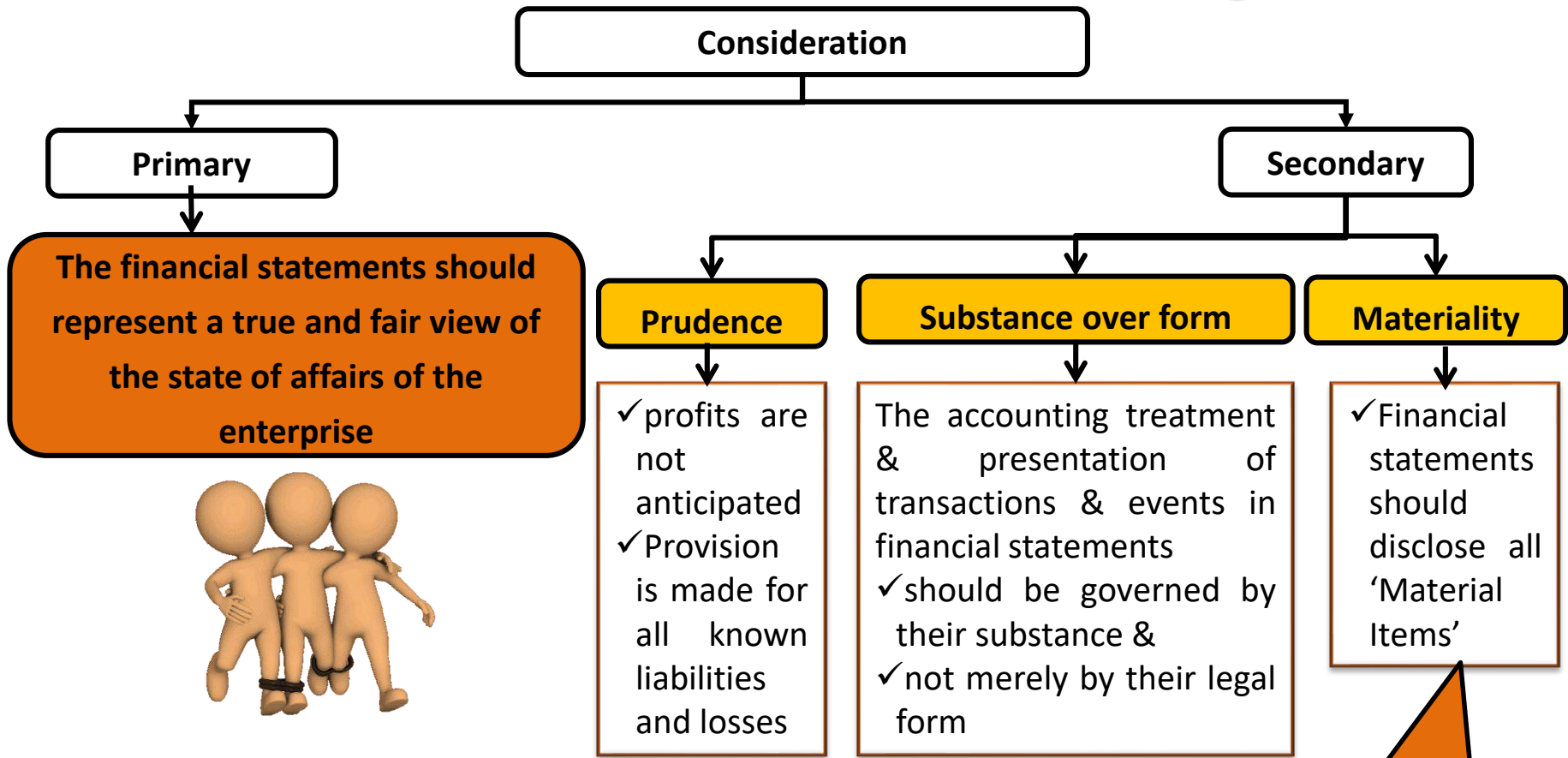
### Meaning of Accounting Policies

- ✓ Specific accounting principles &
- ✓ Methods of applying those principles adopted by the enterprise
- ✓ In preparation of financial statements

Valuation of Fixed Assets, Methods of Depreciation, Valuation of Inventories are the different areas where different accounting policies can be used.

AS 1 is **mandatory** in nature for  
**ALL ENTERPRISE**

# Considerations in the Selection of Accounting Policies



## Fundamental Accounting Assumption

- 1) Going Concern
- 2) Consistency
- 3) Accrual

If they are not followed, disclosure is required in financial statements

The items the knowledge of which might influence the decisions of the user of the financial statement.

# Going Concern Concept

- ✓ Enterprise has neither the intention nor the need to liquidate or curtail materially the scale of its operations.
- ✓ Assets are shown at books values (i.e. On cost less depreciation basis).
- ✓ Expenses and incomes related to future period are carried forward and only the incomes or expenses related to current year are considered while calculating profit and loss.



## Consistency

- ✓ The accounting policies are followed consistently from one period to another.
- ✓ Improves comparability of financial statements through time.



Any change in the accounting policy which has

- material effect in the current period or in the subsequent period - disclosed to the extent it is ascertainable.
- If the amount is not ascertainable - the fact should be disclosed.

## Accruals

- ✓ Accrual means recognition of revenue and costs as they are earned or incurred and not as money is received or paid.
- ✓ The actual **date of payment of cash is immaterial** for the purpose of recognition

# Disclosures of Accounting Policies

- All significant accounting policies adopted should be disclosed
- The disclosure should form part of the financial statements
- Any change in the accounting policies which has a material effect in the current period should be disclosed along with amount of effect
- If fundamental accounting assumptions is not followed, the fact should be disclosed
- Disclosure of accounting policies, or changes therein cannot rectify wrong or inappropriate accounting policies followed.



1. Balance sheet of a trader on 31st March, 20X1 is given below:

Liabilities	Rs.	Assets	Rs.
Capital	60,000	Fixed Assets	65,000
Profit and Loss Account	25,000	Stock	30,000
10% Loan	35,000	Trade receivables	20,000
Trade payables	10,000	Deferred costs	10,000
		Bank	5,000
	<b>1,30,000</b>		<b>1,30,000</b>

**Additional information:**

- a) The remaining life of fixed assets is 5 years. The pattern of use of the asset is even. The net realisable value of fixed assets on 31.03.X2 was Rs. 60,000.
  - (b) The trader's purchases and sales in 20X1-X2 amounted to Rs. 4 lakh and Rs. 4.5 lakh respectively.
  - (c) The cost and net realisable value of stock on 31.03.X2 were Rs. 32,000 and Rs. 40,000 respectively.
  - (d) Expenses for the year amounted to Rs. 14,900.
  - (e) Deferred cost is amortised equally over 4 years.
  - (f) Debtors on 31.03.X2 is Rs. 25,000, of which Rs. 2,000 is doubtful. Collection of another Rs. 4,000 depends on successful re-installation of certain product supplied to the customer.
  - (g) Closing trade payable is Rs. 12,000, which is likely to be settled at 5% discount.
  - (h) Cash balance on 31.03.X2 is Rs. 37,100.
  - (i) There is an early repayment penalty for the loan Rs. 2,500.
- The Profit and Loss Accounts and Balance Sheets of the trader are shown below in two cases  
 (i) assuming going concern (ii) not assuming going concern.

**Solution:****Profit and Loss Account for the year ended 31st March, 20X2**

		Case (i)	Case (ii)			Case (i)	Case (ii)
		Rs.	Rs.			Rs.	Rs.
<b>To</b>	Opening Stock	30,000	30,000	By	Sales	4,50,000	<b>4,50,000</b>
<b>To</b>	Purchases	4,00,000	4,00,000	By	Closing Stock	32,000	<b>40,000</b>
<b>To</b>	Expenses	14,900	14,900	By	Trade payables	-	<b>600</b>
<b>To</b>	Depreciation	13,000	5,000				
<b>To</b>	Provision for doubtful debts	2,000	6,000				
<b>To</b>	Deferred cost	2,500	10,000				
<b>To</b>	Loan penalty		2,500				
<b>To</b>	Net Profit (b.f.)	19,600	22,200				
		<b>4,82,000</b>	<b>4,90,600</b>			<b>4,82,000</b>	<b>4,90,600</b>

**Balance Sheet as at 31st March, 20X2**

Liabilities	Case (i)	Case (ii)	Assets	Case (i)	Case (ii)
	Rs.	Rs.		Rs.	Rs.
<b>Capital</b>	60,000	60,000	Fixed Assets	52,000	<b>60,000</b>
<b>Profit &amp; Loss A/c</b>	44,600	47,200	Stock	32,000	<b>40,000</b>
<b>10% Loan</b>	35,000	37,500	Trade receivables (less provision)	23,000	<b>19,000</b>
<b>Trade payables</b>	12,000	11,400	Deferred costs	7,500	<b>Nil</b>
			Bank	37,100	<b>37,100</b>
	<b>1,51,600</b>	<b>1,56,100</b>		<b>1,51,600</b>	<b>1,56,100</b>

2. What do you mean by 'Accrual' in reference to AS-1? Also, specify any three reasons for 'Accrual Basis of Accounting'.

**(QP Nov 2019 )(Group 2)**

**Answer**

The term “Accrual” has been explained in the AS 1 on Disclosure of Accounting Policies, as “Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate”

**Reasons for Accrual Basis of Accounting**

1. Accrual basis of accounting, attempts to record the financial effects of the transactions, events, and circumstances of an enterprises in the period in which they occur rather than recording them in the period(s) in which cash is received or paid by the enterprise.
2. Receipts and payments of the period will not coincide with the buying producing or selling events and other economic events that affect entity performance.
3. The goal of Accrual basis of accounting is to follow the matching concept of income and expenditure so that reported net income measures an enterprise’s performance during a period instead of merely listing its cash receipts and payments.
4. Accrual basis of accounting recognizes assets, liabilities or components of revenues and expenses for amounts received or paid in cash in past, and amounts expected to be received or paid in cash in the future.
5. Important point of difference between accrual and accounting based on cash receipts and outlay is in timing of recognition of revenues, expenses, gains and losses.

# Valuation of Inventories



## Objective of AS 2

- ✓ Specifies the principals for valuing the inventory
- ✓ Disclosure of the specific policies adopted by the management for the valuation of inventory



## Applicability

This statement should be applied in accounting for inventories other than

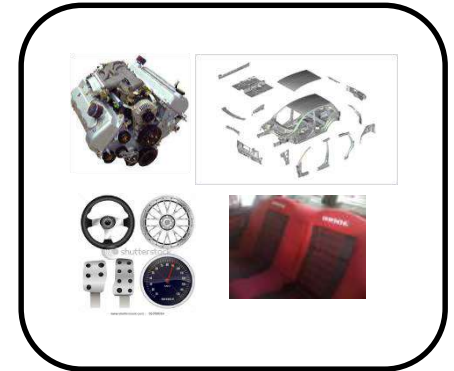
- ✓ WIP under construction contract
- ✓ WIP arising in case of service providers.
- ✓ Shares, debentures and other financial instruments held as stock-in-trade;
- ✓ inventories of livestock, agricultural and forest products, and mineral oils, ores and gases ( valued at net realisable value)



# According to AS - 2

Inventories are assets

- **Held for sale** in the ordinary course of business (**Finished Goods**)
- Used in the **process of production** for such sale (**WIP**)
- Used **in the form of materials** or supplies to be consumed in the production process or in the rendering of services (**Raw Material**)



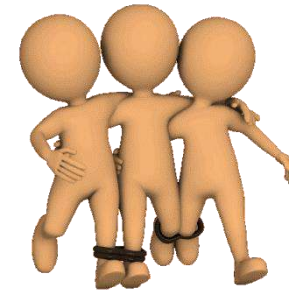
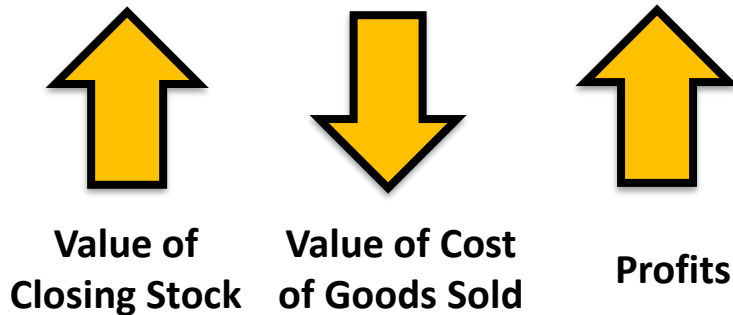
The valuation of inventory is crucial because of its **direct impact on profit/loss for an accounting period**

Inventory should be valued **at lower of**

Cost

Net Realisable Value

To ignore the anticipated profit



# Measurement of Inventories

Cost of Inventory

Raw Materials

Finished Goods and Work in progress

At Cost (If finished goods are sold at or above cost), otherwise at replacement cost

Lower of following

Cost

Net Realizable Value

Cost of purchase

Cost of conversion

Other costs

- Purchase price
- Import duty & tax
- freight inwards and other expenditure directly attributable to the acquisition

• Refer Chart below

- Tax payable on manufacturing of goods, if any
- Customs duties on imported goods lying in bonded warehouse
- Cost of designing product for specific customers

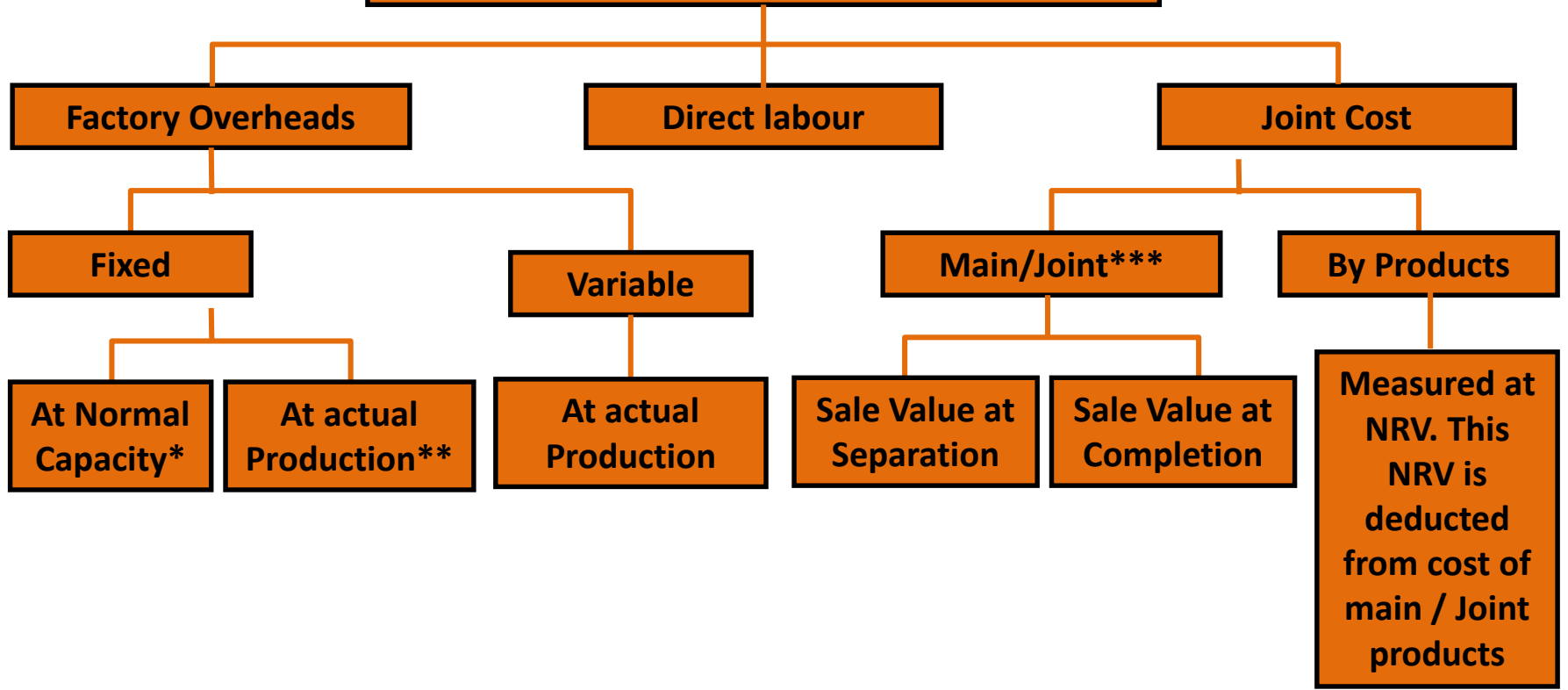
Realizable value less Selling Expenses less estimated cost of completion

Cost excluded from the valuation of inventories

- Abnormal costs
- Storage costs
- Administrative costs
- Selling & distribution costs
- Borrowing costs
- Exchange Differences.

Raw materials and WIP are not for sale and hence the NRV cannot be estimated. They need to be valued at cost.

# Conversion Cost



- \* When actual production is almost equal or lower than normal capacity.
- \*\* When actual production is higher than normal capacity.
- \*\*\* Allocation at reasonable and consistent basis.

# Borrowing Cost

Interest and other borrowing costs are not usually considered as part of inventories. Except

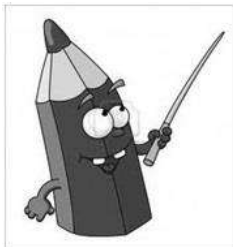
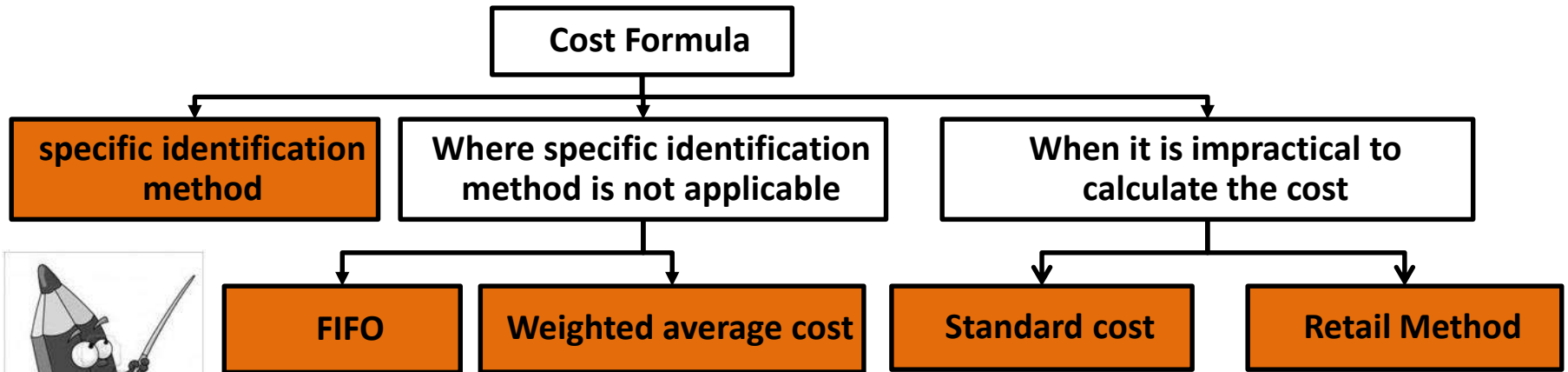
As per AS 16, for inventories that are qualifying assets, any directly attributable borrowing costs (for acquisition, construction or production) should be capitalized as part of their cost

# Net Realisable Value

***Net Realisable Value = Estimated selling price in the ordinary course of business - estimated costs of completion - the estimated costs necessary to make the sale.***



# Cost Formula



# Disclosures

- Accounting policies adopting measuring inventories
- Cost formula used
- Total carrying amount of inventories
- Classification of the inventories into raw materials and components, work in progress, finished goods, stores and spares, and loose tools



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

**(RTP Nov 19)**

**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 Rs. 5 lakhs. The net realizable value is Rs. 4.95 lakhs (Rs. 5.5 lakhs less cost to make the sale @ 10% of Rs. 5.5 lakhs). So, the closing stock should be valued at Rs. 4.95 lakhs.

2. Wooden Plywood Limited has a normal wastage of 5% in the production process. During the year 2017-18, the Company used 16,000 MT of Raw material costing Rs. 190 per MT. At the end of the year, 950 MT of wastage was in stock. The accountant wants to know how this wastage is to be treated in the books.

You are required to :

- i. Calculate the amount of abnormal loss.
- ii. Explain the treatment of normal loss and abnormal loss. [In the context of AS-2 (Revised)]

**(QP May 19)**

**Answer:**

As per 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 recognised 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 16,000 MT @ Rs. 190	30,40,000
Normal Loss (5% of 16,000 MT)	800 MT
<b>Net quantity of material</b>	<b>15,200 MT</b>
Abnormal Loss in quantity (950 - 800)	150 MT
Abnormal Loss [150 units @ Rs. 200 (Rs. 30,40,000/15,200)]	<b>Rs. 30,000</b>
<b>Amount of Rs. 30,000 (Abnormal loss) will be charged to the Profit and Loss statement.</b>	

**3.** On 31st March 2017, a business firm finds that cost of a partly finished unit on that date is Rs. 530. The unit can be finished in 2017-18 by an additional expenditure of Rs. 310. The finished unit can be sold for Rs. 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 further.

**(RTP May 19)**

**Solution:**

**Valuation of unfinished unit**

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



## Accounting Standard - 3

# Cash Flow Statement



### Objective of AS 3

- ✓ Cash flow statement exhibits the flow of incoming and outgoing cash
- ✓ Assess the ability of enterprise to generate cash and to utilize the cash
- ✓ Tool for assessing the liquidity and solvency of the enterprise



### Applicability

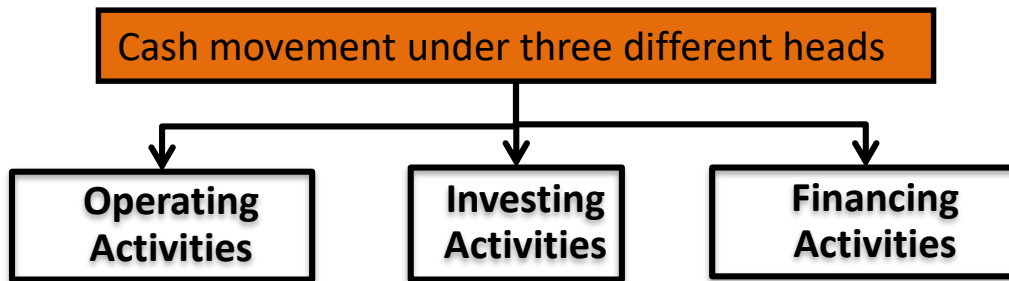
This standard applies to the following entities

- ✓ Which have a turnover of more than Rs. 50 crores in a preceding financial year
- ✓ Borrowing more than Rs. 10 crores at any time during the immediately preceding accounting period.
- ✓ Financial institution
- ✓ Banks including co-operative banks
- ✓ Insurance companies
- ✓ Holding and subsidiary enterprises of any of the above at any time during the accounting period.

# Cash and Cash Equivalents

- Held for the purpose of meeting short-term cash commitments
- Readily convertible in cash and be subject to an insignificant risk of changes in value.
- Investments in shares are excluded unless they are, in substance, cash equivalents

## Presentation of Cash Flow Statements



- ✓ An enterprise presents its cash flows from operating, Investing and financing activities in a manner which is most appropriate to its business
- ✓ A single transaction may include cash flows that are classified differently.

# Operating activity

- The principal revenue producing activities of the enterprise
- Result from the transactions and other events that enter into the determination of net profit or loss.
- A key indicator of the extent to which the operations of the enterprise have generated sufficient cash flows

## Elements of Operating Activity

Cash receipts from sale of goods and rendering services.

Cash receipts from royalty, fees, commissions and other revenue.

Cash payments to suppliers for goods and services.

Cash payments to and on behalf of employees.

Cash receipts & payments by an insurance enterprise for premiums ,claims, annuities etc.

Cash payments and refunds of income taxes

Cash receipts and payments relating to contracts held for dealing or trading purposes.

Cash flow from dealing in securities when enterprise holds securities for such purpose.



# Investment activity

- Acquisition and disposal of long-term assets and other investments not included in cash equivalents

## Elements of Investing Activity

Cash payments for acquisition of fixed assets including intangibles.

Cash receipts from disposal of fixed assets.

Cash payments to acquire shares, warrants or debt instruments of other enterprise.

Cash receipts from disposal of shares, warrants or debt instruments of other enterprise.

Cash advances and loans made to third parties.

Cash receipts from repayments of advances and loans made to third parties.

Cash payments for future, forward, option and swap contracts.

Cash receipts from future, forward, option and swap contracts.



# Financing Activity

- Activities which results in changes in the size and composition of the owners capital and borrowing of organization.

## Elements of Financing Activity

Cash proceeds from issuing shares or other equity instruments.

Cash payments to owners to acquire or redeem the enterprise's shares.

Cash proceeds from issuing debentures, & other short & long term borrowings.

Cash repayments of amounts borrowed.

Cash payments by a lease for the reduction of the outstanding liability relating to a finance lease.

**Investing and financing transactions that do not require the use of cash equivalents should be excluded from a cash flow statement.**



## **Foreign currency cash flows**

- ✓ Transactions in a foreign currency should be recorded in an enterprise's reporting currency.
- ✓ A rate that approximates the actual rate may be used if the result is substantially the same.
- ✓ The effect of changes in exchange rates on cash and cash equivalents held in a foreign currency should be reported as a separate part of the reconciliation of the changes in cash and cash equivalents during the period.

## **Extraordinary Item**

classified in operating, investing and financing activity. If such categorization is not possible then show it in operating activity.

## **Income taxes**

Operating activities unless they can be specifically identified with financing & investing activity.

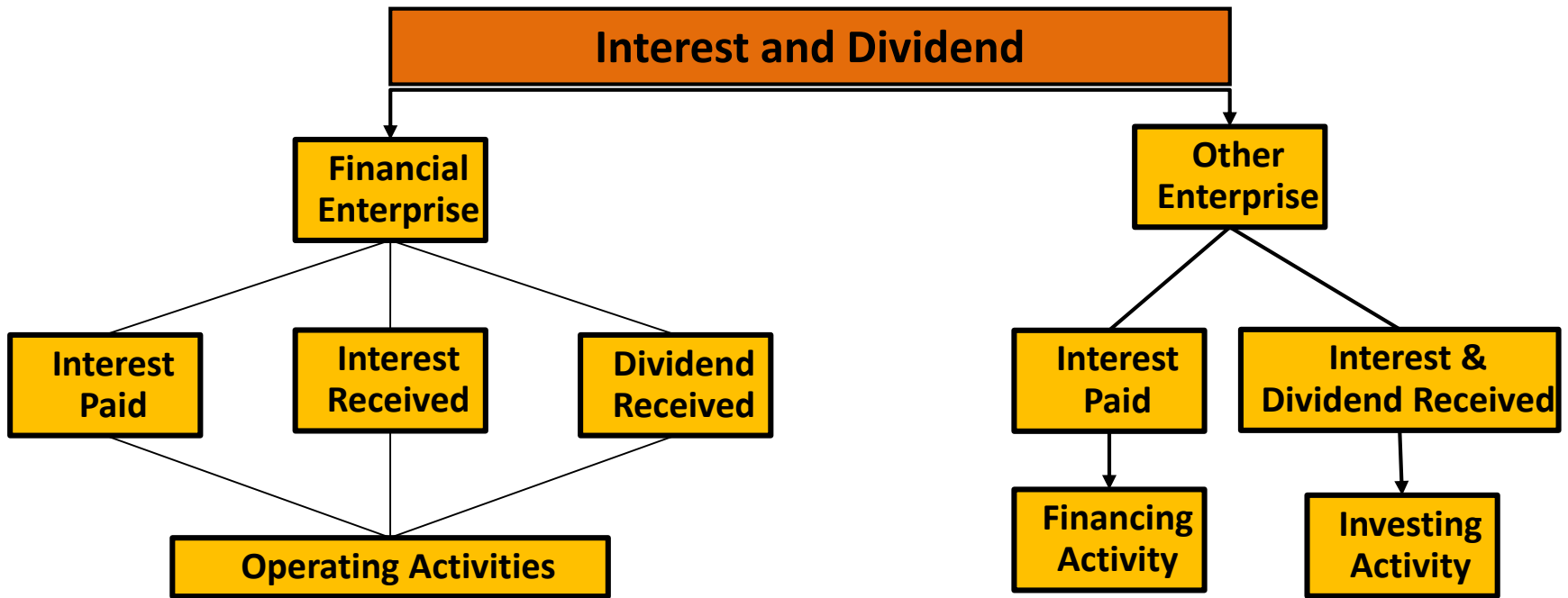
## **Sale of non – current asset**

Investing activity.

## **Acquisitions and disposal of subsidiaries and other business units:**

Presented separately and classified as investing activities.





- Dividend paid should be classified as cash flow from financing activities

## Disclosures

- An enterprise should disclose the component of cash and cash equivalent and should present a reconciliation of the amount in the cash flow statement with the equivalent items reported.
- An enterprise should disclose amount of significant cash and cash equivalent balance held by enterprise that are not available for use by it with explanation of management

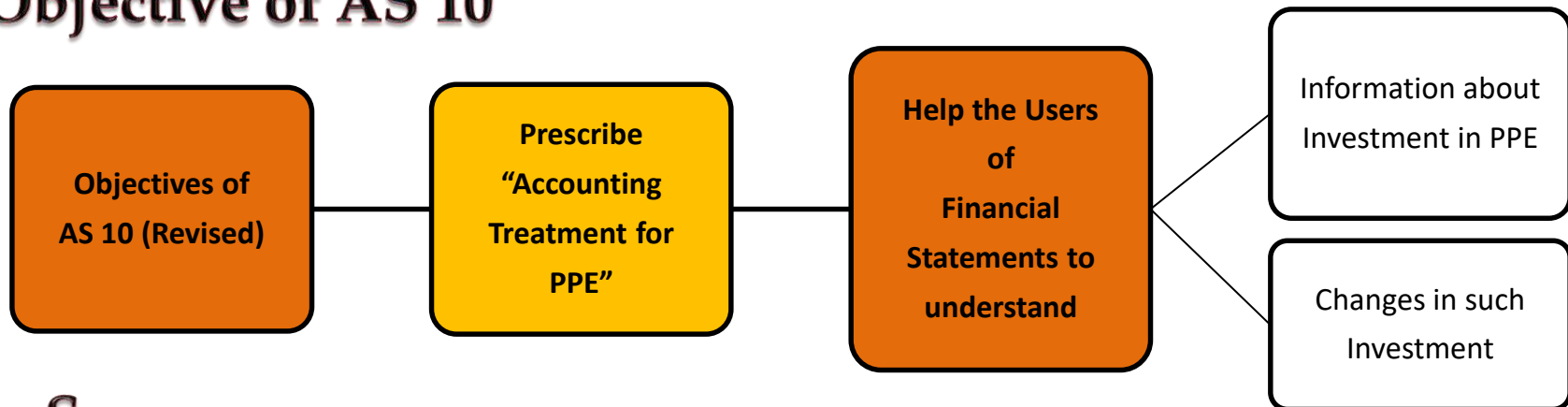


## Accounting Standard - 10

# Property Plant and Equipment



## Objective of AS 10



## Scope

- ❖ This Standard should be applied in accounting for property, plant and equipment except when another Accounting Standard requires or permits a different accounting treatment.

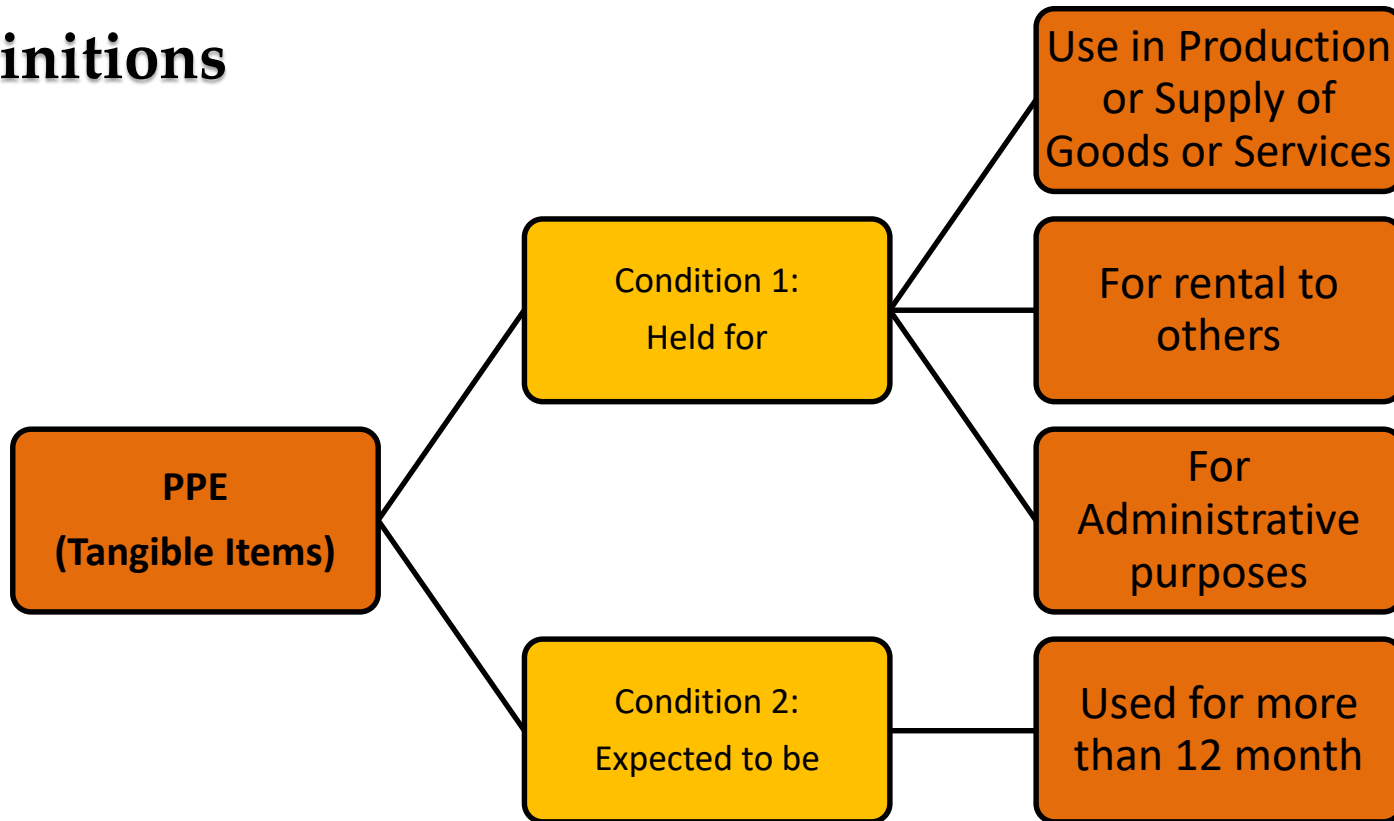


# Scope of Standard

## This standard does not apply to:

- Biological assets related to agricultural activity other than bearer plants.
- Wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oils, natural gas and similar non-regenerative resources.

## Definitions



# Recognition Criteria

The cost of an item of property, plant and equipment should be recognised as an asset if, and only if:

- it is probable that future economic benefits associated with the item will flow to the enterprise and
- Cost of the item can be measured reliably.

## Recognition of Spare parts and stand-by equipment

**If the recognition criteria is met**  
Accounted as per AS 10 (Revised)

**If recognition criteria is not satisfied**  
Accounted as per AS 2 'Valuation for Inventories'

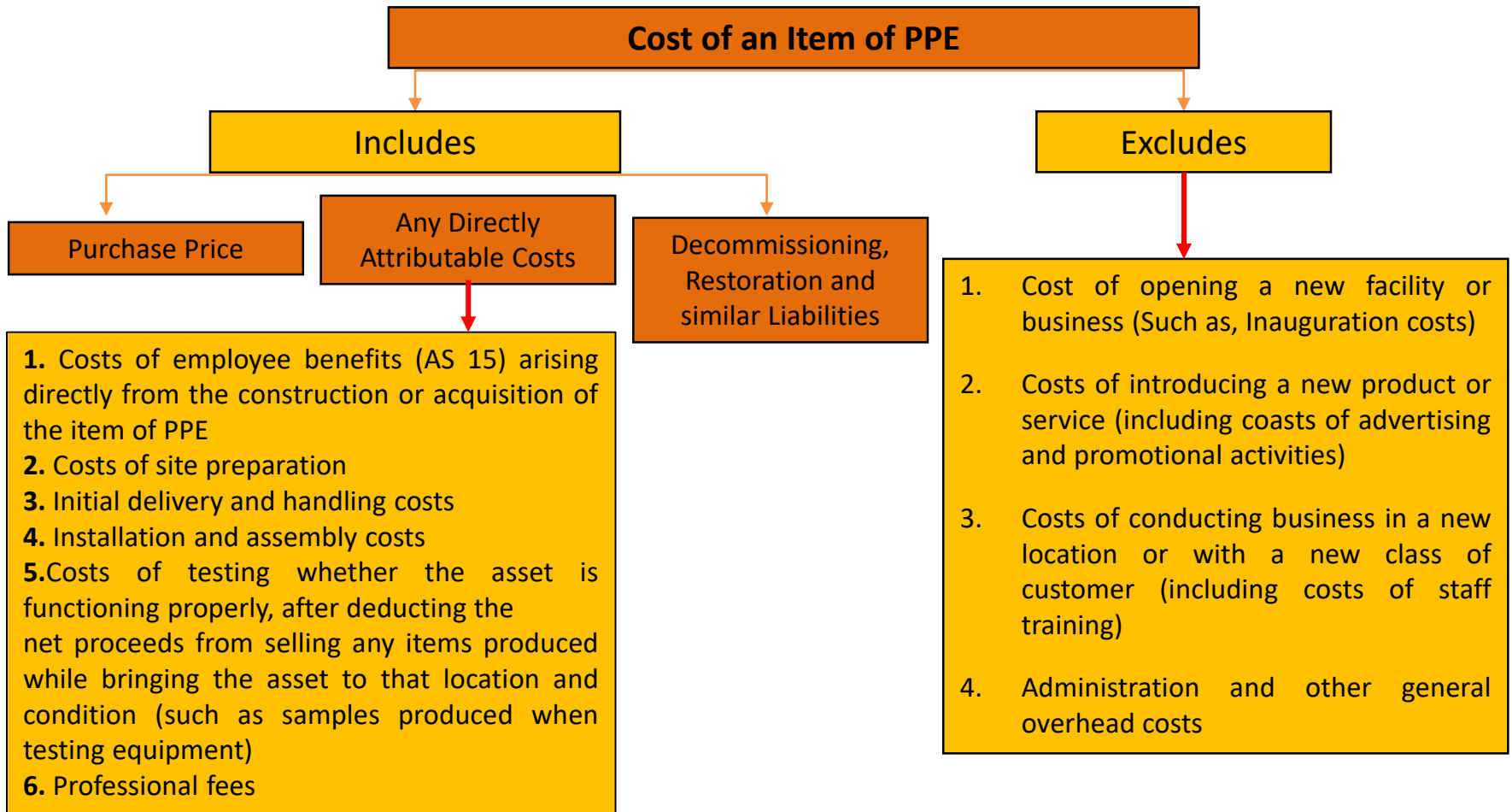
# Measurement at Recognition

An item of property, plant and equipment that qualifies for recognition as an asset should be measured at its cost.

## The cost of PPE includes;

Initial Cost: cost incurred initially to acquire or construct the PPE

Subsequent Cost: costs incurred subsequently to add to, replace part of, or service it.



# Self Constructed Assets

- Same principles as for an acquired asset.
- The cost of the asset is usually the same as the cost of constructing an asset for sale.
- Any internal profits are eliminated in arriving at such costs.
- The cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost
- Any borrowing cost which can be capitalized can be included in the cost of PPE.
- Bearer plants are accounted for in the same way as self-constructed items of PPE before they are in the location and condition necessary to be capable of operating in the manner intended by management.

## Measurement of cost

- **If payment is deferred beyond normal credit terms:**

Total payment minus Cash price equivalent

- is recognised as an interest expense over the period of credit
- unless such interest is capitalised in accordance with AS 16

- **PPE acquired in Exchange for a Non-monetary Asset or Assets or A combination of Monetary and Non-monetary Assets:**

Cost of such an item of PPE is measured at fair value unless:

- Exchange transaction lacks commercial substance; Or
- Fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable

# Measurement after Recognition

**Cost Model**

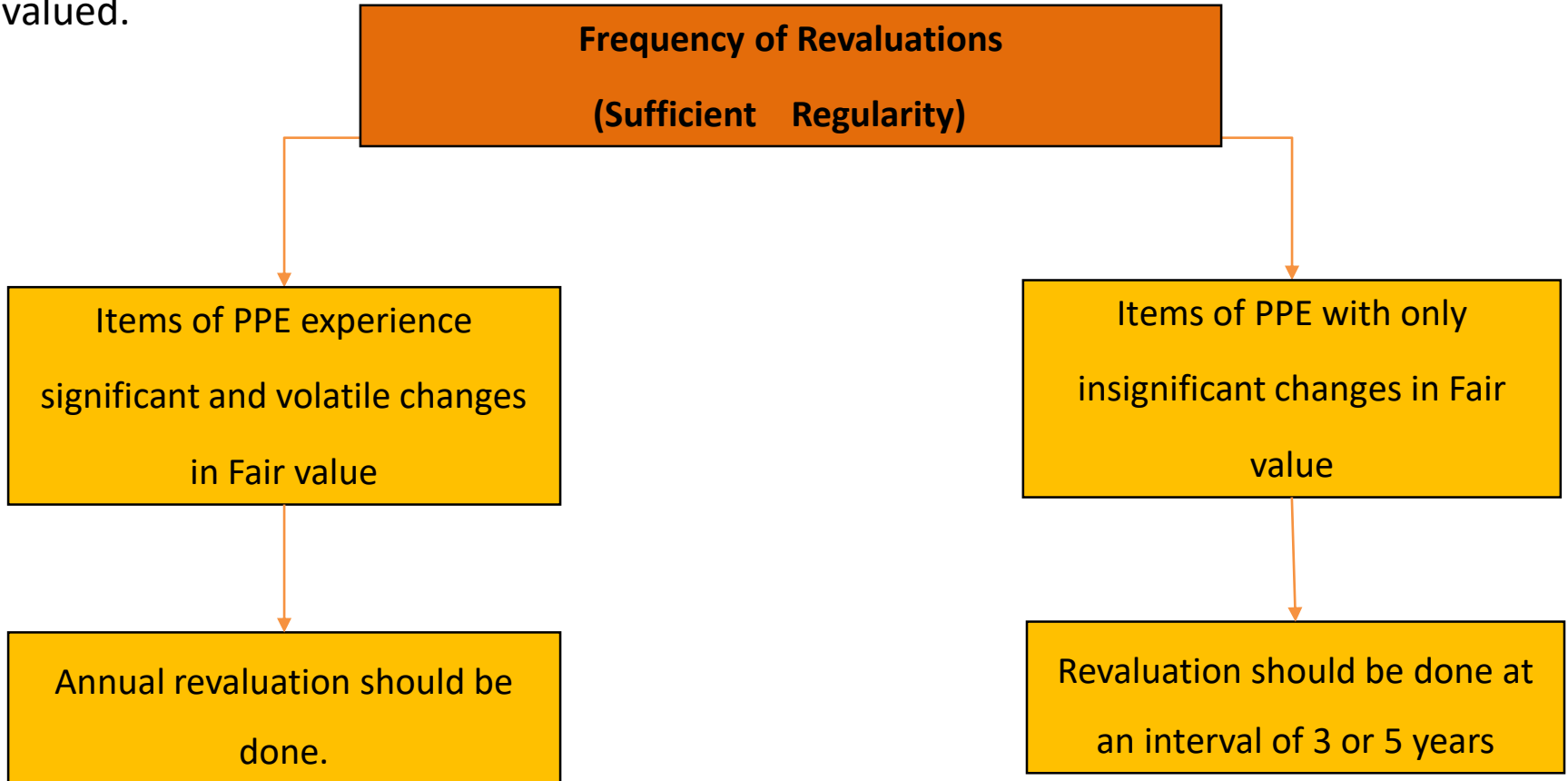
**Cost- Any Accumulated Depreciation-  
Any Accumulated Impairment losses**

**Revaluation Model**

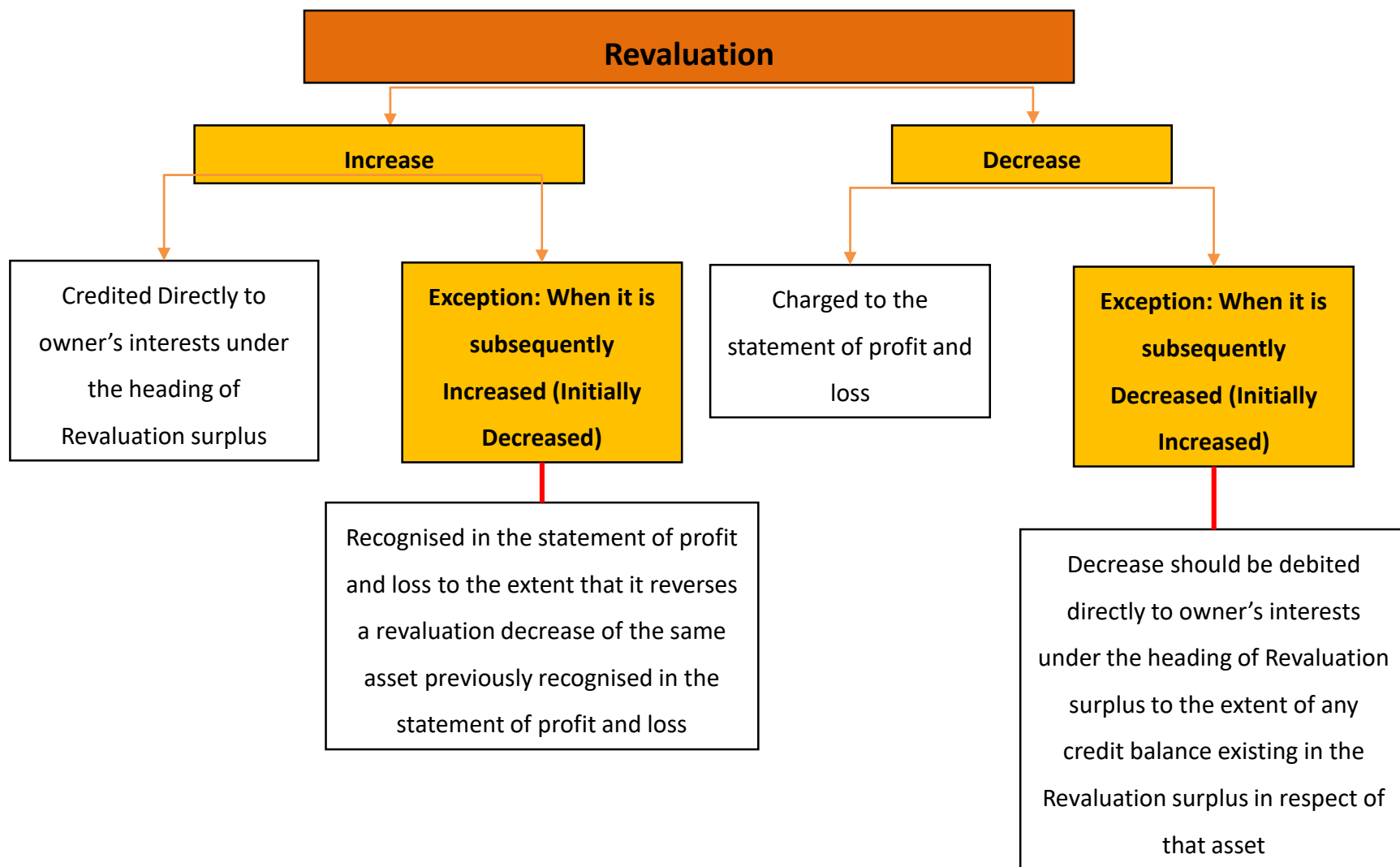
Fair value at the date of the revaluation	XXX
Less: Any subsequent accumulated depreciation	(XXX)
Less: Any subsequent accumulated impairment losses	(XXX)
<b>Carrying value</b>	<b>XXX</b>

## Revaluation

If an item of PPE is revalued the entire class of PPE to which this asset belongs should be revalued.



# Accounting treatment Revaluation



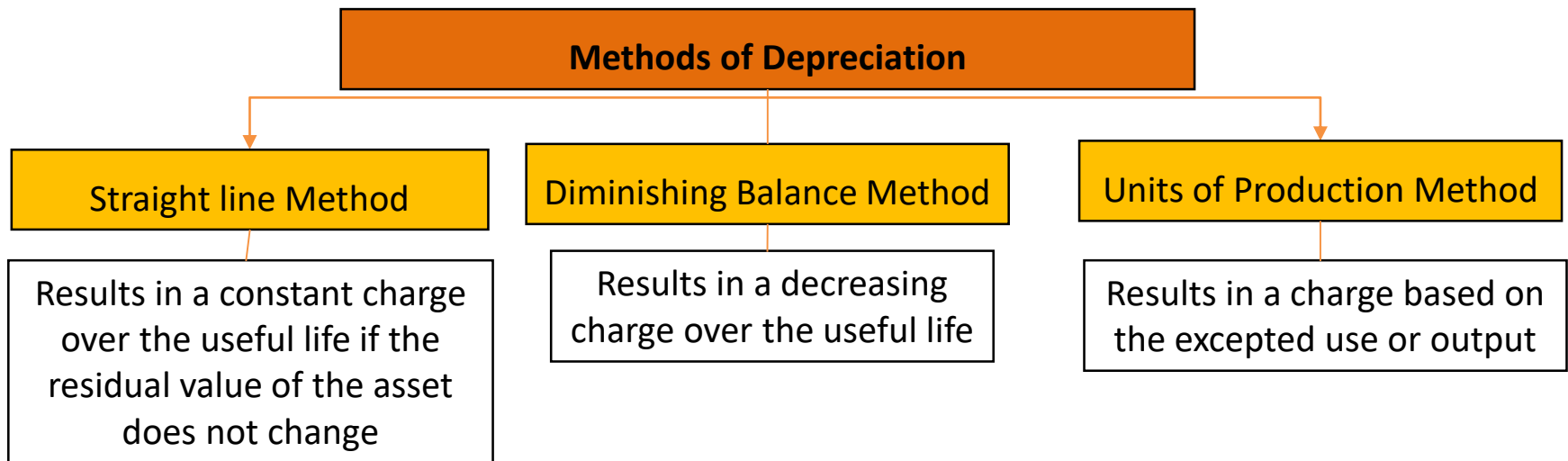
# DEPRECIATION

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. **Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.**

**Component cost approach is to be followed - i.e., Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately.**

## Methods of Depreciation

- The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.





# Review of Residual Value, Useful life & Method of Depreciation

- AS 10 (Revised) required that the residual value, useful life and method of depreciation used **should be reviewed at least at each financial year.**
- In case of **method of depreciation**, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Such a change should be accounted for as a **change in an accounting estimate** in accordance with AS 5.
- In case of residual value and useful life, , if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with AS 5.

## Commencement of period for charging Depreciation

**Depreciation of an asset begins when it is available for use**

## Cessation of Depreciation

1. Depreciation ceases to be charged when asset's residual value exceeds its carrying amount
2. Depreciation of an asset ceases at the earlier of:
  - The date that the asset is retired from active use and is held for disposal, and
  - The date that the asset is derecognised

# IMPAIRMENT

An **impairment loss** is the amount by which the carrying amount of an asset exceeds its recoverable amount.

To determine whether an item of property, plant and equipment is impaired, an enterprise **applies AS 28, Impairment of Assets.**

Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up should be included in the statement of profit and loss when the compensation becomes receivable.

# RETIREMENTS

- Items of PPE retired from active use and held for disposal should be stated at the lower of their carrying amount and net realisable value.
- Any write-down in this regard should be recognised immediately in the statement of profit and loss.

## De-Recognition

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

- On disposal
  - \* By sale
  - \* By entering into a finance lease, or
  - \* By donation, Or
- When no future economic benefits are expected from its use or disposal

## Accounting Treatment:

Gain or loss arising from de-recognition of an item of PPE should be included in the Statement of Profit and Loss.

## Gain or loss arising from de-recognition of an item of PPE

= Net disposal proceeds (if any) - Carrying Amount of the item

**Note:** Gains should not be classified as revenue, as defined in **AS 9 'Revenue Recognition'**

# Important Disclosure Requirements

- **The financial statements should disclose, for each class of property, plant and equipment:**
  - The measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount.
  - The depreciation methods used.
  - The useful lives or the depreciation rates used.
  - The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.
  
- **A reconciliation of the carrying amount at the beginning and end of the period showing:**
  - i. additions;
  - ii. assets retired from active use and held for disposal;
  - iii. acquisitions through business combinations ;
  - iv. increases or decreases resulting from revaluations and from impairment losses recognised or reversed directly in revaluation surplus in accordance with AS 28;
  - v. impairment losses recognised in the statement of profit and loss in accordance with AS 28;
  - vi. impairment losses reversed in the statement of profit and loss in accordance with AS 28;
  - vii. depreciation;
  - viii. the net exchange differences arising on the translation of the financial statements of a non-integral foreign operation in accordance with AS 11, The Effects of Changes in Foreign Exchange Rates; and
  - ix. other changes.

**Continues.....**

## Continues.....

- **The financial statements should also disclose:**
  - the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;
  - the amount of expenditure recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;
  - the amount of contractual commitments for the acquisition of property, plant and equipment;
  - if it is not disclosed separately on the face of the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in the statement of profit and loss; and
  - the amount of assets retired from active use and held for disposal.
- **If items of property, plant and equipment are stated at revalued amounts, the following should be disclosed:**
  - the effective date of the revaluation;
  - whether an independent valuer was involved;
  - the methods and significant assumptions applied in estimating fair values of the items;
  - the extent to which fair values of the items were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques; and
  - the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

1. Shrishti Ltd. contracted with a supplier to purchase machinery which is to be installed in its Department A in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were Rs. 1,41,870. These activities were supervised by a technician during the entire period, who is employed for this purpose of Rs. 45,000 per month. The technician's services were given by Department B to Department A, which billed the services at Rs. 49,500 per month after adding 10% profit margin.

The machine was purchased at Rs. 1,58,34,000 inclusive of IGST @ 12% for which input credit is available to Shrishti Ltd. Rs. 55,770 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of Rs. 30,000 to supervise machinery installation at the factory site.

Ascertain the amount at which the Machinery should be capitalized under AS 10 considering that IGST credit is availed by the Shristhi Limited. Internally booked profits should be eliminated in arriving at the cost of machine.

(RTP Nov 19)

**Solution:**

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

Particulars			Rs.
<b>Purchase Price</b>		Given (Rs. 158,34,000 x 100/112)	<b>1,41,37,500</b>
<b>Add:</b>	Site Preparation Cost	Given	<b>1,41,870</b>
	Technician's Salary	Specific/Attributable overheads for 3 months (See Note) (45,000 x3)	<b>1,35,000</b>
	Initial Delivery Cost	Transportation	<b>55,770</b>
	Professional Fees for Installation	Architect's Fees	<b>30,000</b>
<b>Total Cost of Asset</b>			<b>1,45,00,140</b>

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

1.	<b>Cost of the plant (cost per supplier's invoice plus taxes)</b>	<b>Rs. 50,00,000</b>
2.	Initial delivery and handling costs	<b>Rs. 4,00,000</b>
3.	Cost of site preparation	<b>Rs. 12,00,000</b>
4.	Consultants used for advice on the acquisition of the plant	<b>Rs. 14,00,000</b>
5.	Interest charges paid to supplier of plant for deferred credit	<b>Rs. 4,00,000</b>
6.	Estimated dismantling costs to be incurred after 7 years	<b>Rs. 6,00,000</b>
7.	<b>Operating losses before commercial production</b>	<b>Rs. 8,00,000</b>

Please advise Preet Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised). **(RTP May 19)**

**Solution:**

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

1.	<b>Cost of the plant</b>	<b>Rs. 50,00,000</b>
2.	Initial delivery and handling costs	<b>Rs. 4,00,000</b>
3.	Cost of site preparation	<b>Rs. 12,00,000</b>
	Consultants' fees	<b>Rs. 14,00,000</b>
	Estimated dismantling costs to be incurred after 7 years	<b>Rs. 6,00,000</b>
		<b>Rs. 86,00,000</b>

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of Rs. 4,00,000 and operating losses before commercial production amounting to Rs. 8,00,000 are not regarded as directly attributable costs and thus cannot be capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

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

Management has prepared the following budget for this period –

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

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

**Solution:**

**(QP Nov 18)**

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

Management of Neon Enterprise should capitalize the costs of construction and remodelling the restaurant, because they are necessary to bring the restaurant to the condition necessary for it to be capable of operating in the manner intended by management. The restaurant cannot be opened without incurring the construction and remodelling expenditure amounting Rs. 30,00,000 and thus the expenditure should be considered part of the asset.

However, the cost of salaries of staff engaged in preparation of restaurant Rs. 7,50,000 before its opening are in the nature of operating expenditure that would be incurred if the restaurant was open and these costs are not necessary to bring the restaurant to the conditions necessary for it to be capable of operating in the manner intended by management. Hence, Rs. 7,50,000 should be expensed.



## Accounting Standard - 11

# The Effect of Changes in Foreign Exchange Rate



## Objective of AS 11

- ✓ To Prescribe the selection of exchange rate for foreign currency transaction and operations
- ✓ To Prescribe the treatment of effect of change in exchange rates.

### Applies to.....

- ✓ In accounting for transaction in foreign currency.
- ✓ In translating the financial statement of foreign operations – Integral as well as non-integral.
- ✓ Forward exchange contracts.



### Not applies to.....

- ✓ Re- statement of enterprise financial statements from its reporting currency into another currency
- ✓ The presentation in cash flow statement
- ✓ Exchange differences arising from foreign currency borrowings to the extent of adjustment to interest cost.

## Important Definitions

<b>Reporting Currency</b>	Reporting currency is the currency used in presenting the financial statements.
<b>Foreign Currency</b>	Currency other than reporting Currency is called foreign currency
<b>Exchange Rate</b>	The rate at which foreign currency is converted into reporting currency or vice versa.
<b>Average Rate</b>	It is the mean of exchange rate in force during the period. Period may be week, fortnight, months, etc.
<b>Forward Rate</b>	Agreed Exchange rate between two parties for exchange of two currencies at a specified future date.
<b>Closing Rate</b>	Exchange rate at the balance sheet date.
<b>Foreign Operations</b>	Operational activities conducted in a country other than the country of the reporting enterprises by the reporting enterprises.
<b>Monetary Items</b>	Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amount of money. For example -cash, receivable and payable.
<b>Non-Monetary Items</b>	Non-monetary items are assets and liabilities other than monetary items. For example, fixed assets, inventories, and investment in equity shares.
<b>Foreign Currency Transactions</b>	Transactions denominated in a foreign currency or require settlement in foreign currency are called as Foreign Currency Transactions

## Transactions are classified as....

### Foreign Currency Transactions

- ✓ Buying or selling the goods or services.
- ✓ Lending & borrowing in foreign currency.
- ✓ Acquisition & disposition of asset in foreign currency.

### Foreign Operations

- ✓ Foreign branch
- ✓ An associate
- ✓ Joint venture
- ✓ Foreign subsidiary

### Forward Exchange Contract

- ✓ For managing risk/hedging.
- ✓ For trading and speculation

## Initial Recognition of Foreign Currency Transactions

Alternatively average rate for a week or a month can be used if there is no significant fluctuation in the exchange rate.

Transactions are recorded by applying an exchange rate between the reporting currency and the foreign currency at the date of transaction.



# Valuation at the Balance Sheet Date



## Foreign currency transactions

### Monetary items

- Monetary items are Debtors, Creditors, Cash, Loans etc.
- These are converted at closing exchange difference rate. i.e. exchange rates on balance sheet date.
- There can be exchange fluctuation gain or loss, which is the difference of the closing exchange rate and exchange rate used for initial recognition.

### Non-Monetary items

#### Items Carried at Historical Cost

Fixed assets, long term investments for which transactions are made in foreign currency are reported at the actual rate used for initial recognition.

#### Items Carried at Fair Value

Non-monetary items such as inventory, current investment for which transactions are made in foreign currency which are carried at fair value.

Generally fair value is determined at the balance sheet date. Therefore conversion is made using exchange rate of balance sheet date.

# Treatment of Exchange difference



## Reasons for exchange difference

Reported at different rate from the rate at which it is initially recorded.

**Transactions are settled at a rate different** from the one taken for the reporting in the last financial statement

Transaction, monetary or non-monetary item being settled at a rate different from the rate at which it is initially recorded

## Accounting Treatment of Contingent Liability

### Contingent Liability

These liabilities are reported at the exchange rate of the balance sheet date.



## Foreign currency transactions

### Integral Foreign Operations

A foreign operation which are carried out as if it were extension of the reporting enterprise.

#### Activities

- Dependent Branches
- Sales Depot
- Foreign arm which produces raw material and transfers it to head office
- Foreign operations only raises finance to help reporting enterprise

#### Translation of accounts

Transactions of foreign branch are translated as if all these transactions had been entered into by the reporting enterprise.

### Non- Integral Foreign Operations

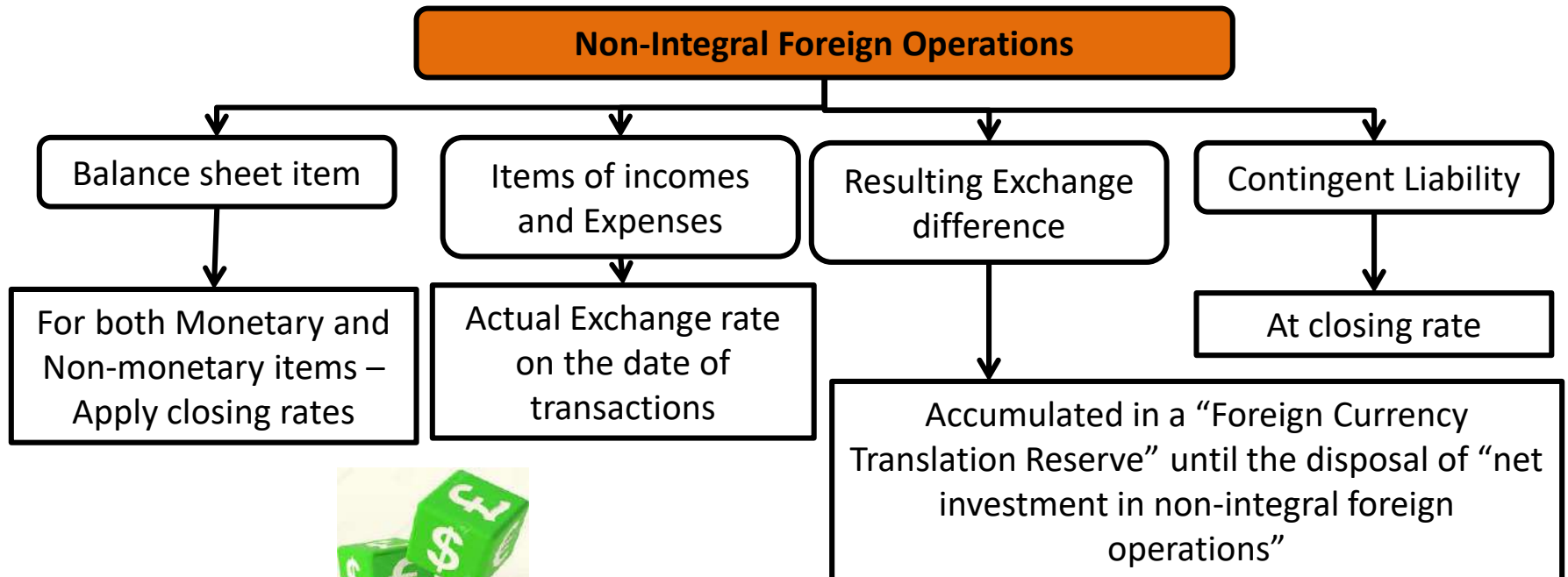
The operations which are not “integral foreign operations”

- ✓ Foreign operation activities are carried independently.
- ✓ Transactions with the reporting enterprise are not a high proportion of the foreign operation's activities.
- ✓ The activities of the foreign operation are financed mainly from its own operations or local borrowings.
- ✓ Costs of labour, material and other components of the foreign operation's products or services are primarily paid or settled in the local currency.
- ✓ The foreign operation's sales are mainly in currencies other than the reporting currency.
- ✓ Cash flows of the reporting enterprise are insulated from the day-to-day activities of the foreign operation.
- ✓ There is an active local sales market for the foreign operation's products.
- ✓ Sales prices for the foreign operation's products are not responsive to changes in exchange rates.

# Translation of Financial Statement Non Integral Foreign

- ✓ The assets and liabilities, both monetary and non-monetary, of the non-integral foreign operation should be translated at the closing rate;
- ✓ Income and expense items of the non-integral foreign operation should be translated at exchange rates at the dates of the transactions, and
- ✓ All resulting exchange differences should be accumulated in a foreign currency translation reserve until the disposal of the net investment.

## Translation of accounts of Non-Integral Foreign operations



# Disposal of non-integral foreign operations



## Disposal includes:

- ✓ Sales ,Liquidation
- ✓ Repayment of its share capital by non-integral foreign operation
- ✓ Abandonment of all or part of the foreign operation by reporting enterprise
- ✓ Payment of dividend by the non-integral foreign operation if it is treated as return on investment by the reporting enterprise.

## Treatment of foreign currency translation reserve:

- On partial disposal, proportionate foreign currency translation reserve is recognized as income or expenses.
- On full disposal, whole foreign currency translation reserve is recognized as income or expenses.

when non-integral foreign subsidiary is consolidated with the reporting enterprise

## Consolidation Procedure

- ✓ Goodwill/capital reserve arising on the acquisition, as a result of consolidation is translated using closing rate.
- ✓ Intra-group transactions are eliminated as per AS-21 and AS-27.
- ✓ Exchange difference arising on intra-group monetary item - recognize as income or expense in consolidated financial statements. If exchange difference arising on monetary items that in substance form part of net investment in non-integral foreign operation, it should be accumulated in currency translation reserve.



# Change in Classification

Change in classification from....

Integral to Non-integral

- ✓ Translation procedure applicable to non-integral shall be followed from the date of change.
- ✓ Exchange difference arising on the translation of non-monetary assets at the date of re-classification is accumulated in foreign currency translation reserve.

From non-integral to integral

- ✓ Translation procedure as applicable to integral should be applied from the date of change.
- ✓ Translated amount of non-monetary items at the date of change is treated as historical cost.
- ✓ Exchange difference lying in foreign currency translation reserve is not to be recognized as income or expense till the disposal of the operation even if the foreign operation becomes integral.



# Forward Exchange Contract

A forward contract is an agreement between two parties whereby one party agrees to buy from or sell to the other party an asset at future date for an agreed price. In case of foreign exchange contract the assets is foreign currency.

## Accounting Treatment of Forward Exchange Contract

Forward Exchange contract entered for Managing Risk/hedging

- ❖ The premium or discount that arises on entering into the contract is measured by the difference between the exchange rate at the date of the inception of the forward
- ❖ If forward exchange contract is cancelled/renewed the profit or loss arising on cancellation/ renewal is recognised in P & L a/c for the period.
- ❖ To minimize the risk due to fluctuation in exchange on the date of the settlement of the transaction is the contract for managing the risk.

Forward Exchange contract entered for Trading/speculation

- ❖ To earn profit by trading or speculation in foreign exchange.
- ❖ As per the accounting standard premium or discount on such forward contract is not to be recognized, in other words, is to be ignored.
- ❖ At each balance sheet date the value of contract is marked, so its current market value, gains or loss on the contract is recognized.



# Disclosure



- An enterprise should disclose-
- Amount of exchange difference included in the net profit or loss.
- Amount accumulated in foreign exchange translation reserve.
- Reconciliation of opening and closing balance of foreign exchange translation reserve.
- If the reporting currency is different from the currency of the country in which entity is domiciled, the reason for such difference.
- **A change in classification of signification of foreign operation needs following disclosures-**
  - Nature of change in classification
  - The reason for the change
  - Effect of such change on shareholders fund
  - Impact on change in net profit or loss for each prior period presented
  - The disclosure is also encouraged of an enterprise's foreign currency risk management policy.

1. (i) Trade receivables as on 31.3.2019 in the books of XYZ Ltd. include an amount receivable from Umesh Rs. 5,00,000 recorded at the prevailing exchange rate on the date of sales, i.e. at US \$ 1= Rs. 58.50. US \$ 1 = Rs. 61.20 on 31.3.2019.

Explain briefly the accounting treatment needed in this case as per AS 11 as on 31.3.2019.

(ii) Power Track Ltd. purchased a plant for US\$ 50,000 on 31st October, 2018 payable after 6 months. The company entered into a forward contract for 6 months @Rs. 64.25 per Dollar. On 31st October, 2018, the exchange rate was Rs. 61.50 per Dollar.

You are required to recognise the profit or loss on forward contract in the books of the company for the year ended 31st March, 2019

**(RTP Nov 19)**

**Solution:**

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

Accordingly, exchange difference on trade receivables amounting Rs. 23,076

{Rs. 5,23,076(US \$ 8547 $\frac{1}{2}$  x Rs. 61.20) less Rs. 5,00,000} should be charged to profit & Loss account.

(ii) Calculation of profit or loss to be recognized in the books of Power Track Limited

	<b>Rs.</b>
<b>Forward contract rate</b>	<b>64.25</b>
<b>Less: Spot rate</b>	<b>(61.50)</b>
<b>Loss on forward contract</b>	<b>2.75</b>
<b>Forward Contract Amount</b>	<b>\$ 50,000</b>
<b>Total loss on entering into forward contract = (\$ 50,000 × Rs. 2.75)</b>	<b>Rs.1,37,500</b>
<b>Contract period</b>	<b>6 months</b>
<b>Loss for the period 1st November, 2018 to 31st March, 2019 i.e. 5 months falling in the year 2018-2019</b>	<b>5 months</b>
<b>Hence, Loss for 5 months will be Rs. 1,37,500 X 5/6 =</b>	<b>Rs. 1,14,583</b>

Thus, the loss amounting to Rs. 1,14,583 for the period is to be recognized in the year ended 31st March, 2019.

2. 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 @ Rs. 49.15 per dollar. Exchange rate per dollar on 01st Feb. was Rs. 48.85. How will you recognise the profit or loss on forward contract in the books of Rau Ltd.?

**(RTP May 19)**

**Solution:**

<b>Forward Rate</b>	<b>Rs.49.15</b>
Less : Spot Rate	(Rs.48.85)
Premium on Contract	Rs. 0.30
Contract Amount	US \$ 1,00,000
Total Loss (1,00,000 x 0.30)	Rs.30,000
Contract period 3 months	

**Two falling the year 2016-17; therefore loss to be recognised  $(30,000/3) \times 2 = \text{Rs. } 20,000$ . Rest Rs. 10,000 will be recognised in the following year.**

3. (i) ABC Ltd. a Indian Company obtained long term loan from WWW private Ltd., a U.S. company amounting to Rs. 30,00,000. It was recorded at US \$1 = Rs. 60.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2018) was US \$1 = Rs. 62.00.

(ii) Trade receivable includes amount receivable from Preksha Ltd.,Rs. 10,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US \$1 = Rs. 59.00. The exchange rate on balance sheet date (31.03.2018) was US\$1 = Rs. 62.00.

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of ABC Ltd

**(QP Nov 18)**

**Solution:****Amount of Exchange difference and its Accounting Treatment**

Long term Loan			Foreign Currency Rate	Rs.
(i)	Initial recognition Rs. (30,00,000/60)	US	\$ 50,000	1 US \$ = Rs. 60 <b>30,00,000</b>
	Rate on Balance sheet date			1 US \$ = Rs. 62
	Exchange Difference Loss US \$ 50,000 x Rs. (62 – 60)			<b>1,00,000</b>
	Treatment: Credit Loan A/c and Debit FCMITD A/c or Profit and Loss A/c by Rs. 1,00,000			
	Trade receivables			
(ii)	Initial recognition (Rs.10,00,000/59)	US	\$ 16,949.152*	1 US \$ = Rs. 59 <b>10,00,000</b>
	Rate on Balance sheet date			1 US \$ = Rs. 62
	Exchange Difference Gain US \$ 16,949.152* x Rs. (62-59)			<b>50,847.456*</b>
	<b>Treatment: Credit Profit and Loss A/c by Rs. 50,847.456* And Debit Trade Receivables</b>			

Thus, Exchange Difference on Long term loan amounting Rs. 1,00,000 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on trade receivables amounting Rs. 50,847.456 is required to be transferred to Profit and Loss A/c.



4. AXE Limited purchased fixed assets costing \$ 5,00,000 on 1st Jan. 2018 from an American company M/s M&M Limited. The amount was payable after 6 months. The company entered into a forward contract on 1st January 2018 for five months @ Rs. 62.50 per dollar. The exchange rate per dollar was as follows :

On 1st January, 2018                      Rs. 60.75 per dollar

On 31st March, 2018                      Rs. 63.00 per dollar

You are required to state how the profit or loss on forward contract would be recognized in the books of AXE Limited for the year ending 2017-18, as per the provisions of AS 11. **(QP Nov 18)**

**Solution:**

As per AS 11 “The Effects of Changes in Foreign Exchange Rates”, an enterprise may enter into a forward exchange contract to establish the amount of the reporting currency required, the premium or discount arising at the inception of such a forward exchange contract should be amortized as expenses or income over the life of the contract.

<b>Forward Rate</b>	<b>Rs.62.50</b>
Less : Spot Rate	(Rs.60.75)
Premium on Contract	Rs. 1.75
Contract Amount	US \$ 5,00,000
Total Loss (5,00,000 x 1.75)	Rs.8,75,000
Contract period 5 months	

**3 months falling in the year 2017-18; therefore loss to be recognized in 2017-18  $(8,75,000/5) \times 3 = \text{Rs. } 5,25,000$ . Rest Rs. 3,50,000 will be recognized in the following year 2018-19.**

## Accounting Standard - 12

# Accounting for Government Grants



### Objective of AS 12

- ✓ To provide the guidelines for classification of Government Grant
- ✓ To prescribe the accounting treatment of Government Grant

### Government Grant

It is assistance by the government **in the form of cash / kind** to an enterprise in return for past or future compliance with certain condition.

AS – 12 does not apply to

Government assistance

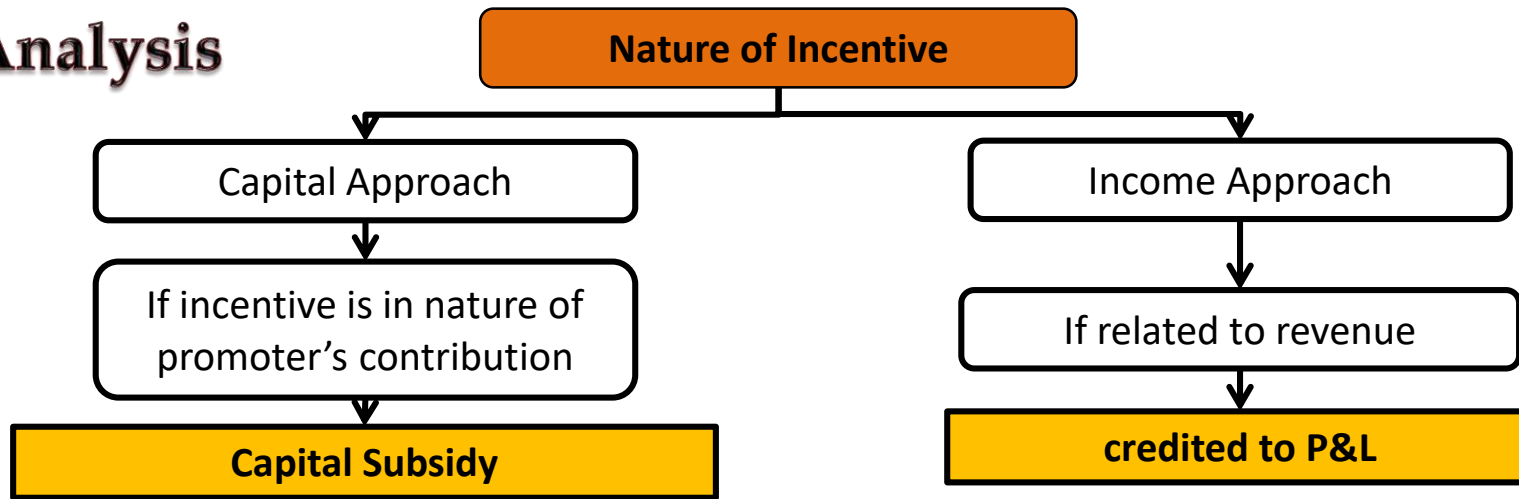
Which cannot be measured reasonably  
i.e. Tax holiday, Tax exemption.



Government participation

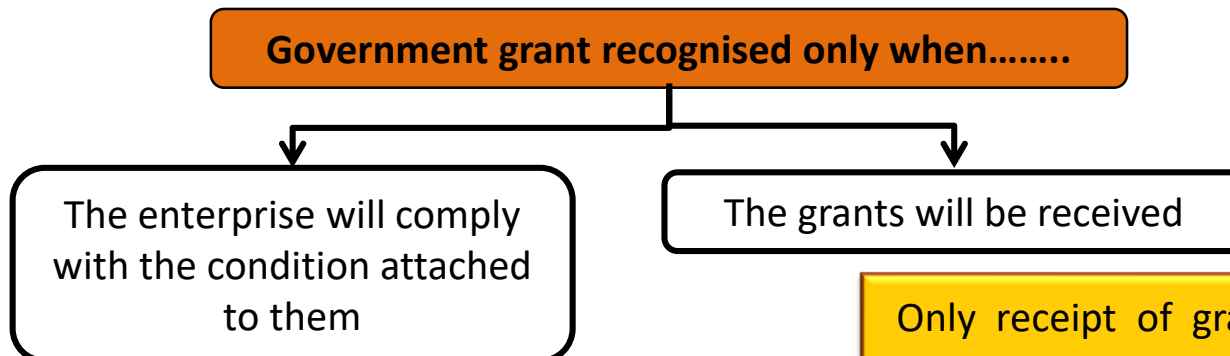
Investment by Government as  
equity in the enterprise

# Analysis



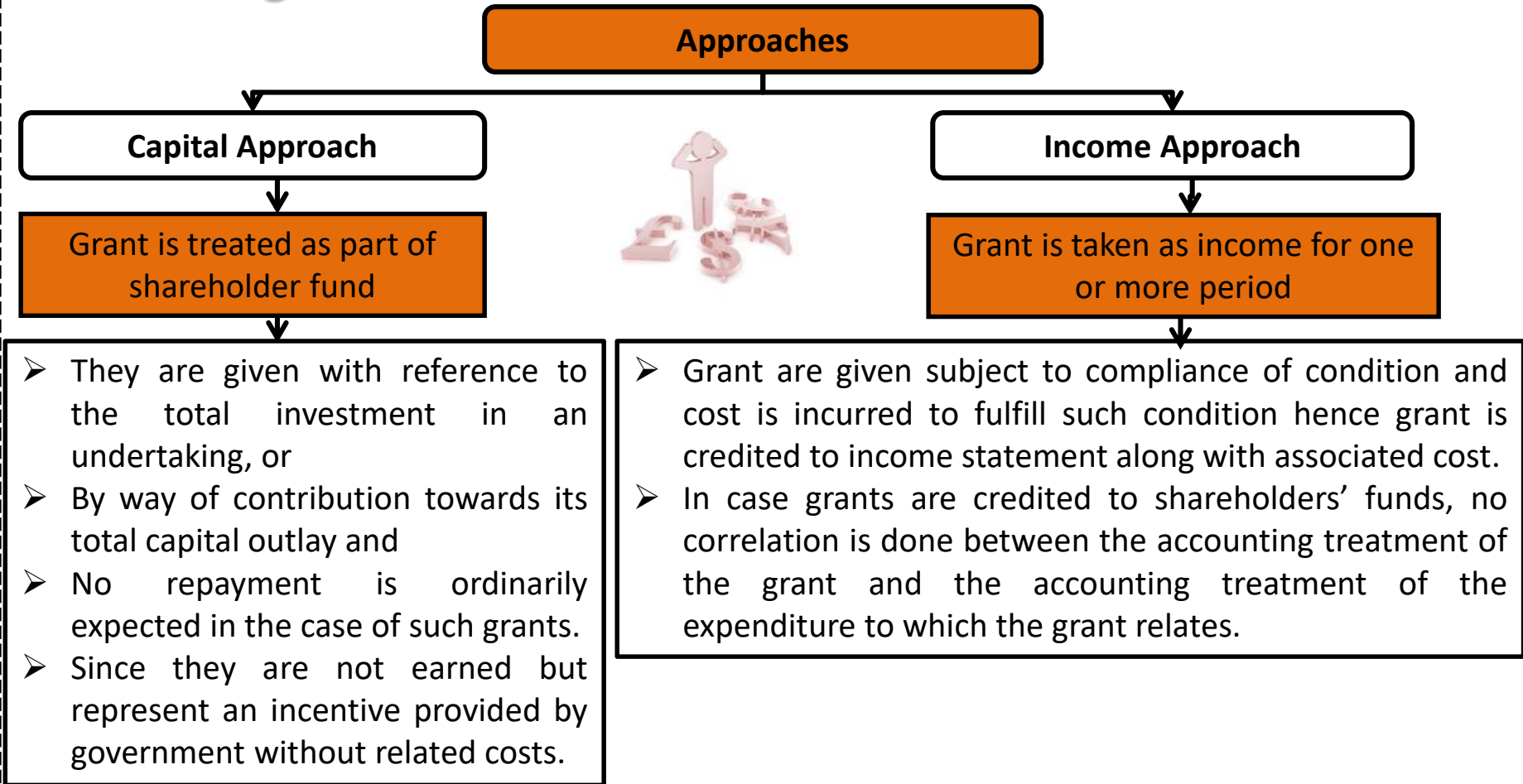
sales-tax exemption available to the unit is not an assistance in cash or kind and is therefore not a government grant

# Recognition of Government Grant



Only receipt of grant is not conclusive evidence that condition attaching to the grant have been or will be fulfilled.

# Accounting for Government Grant

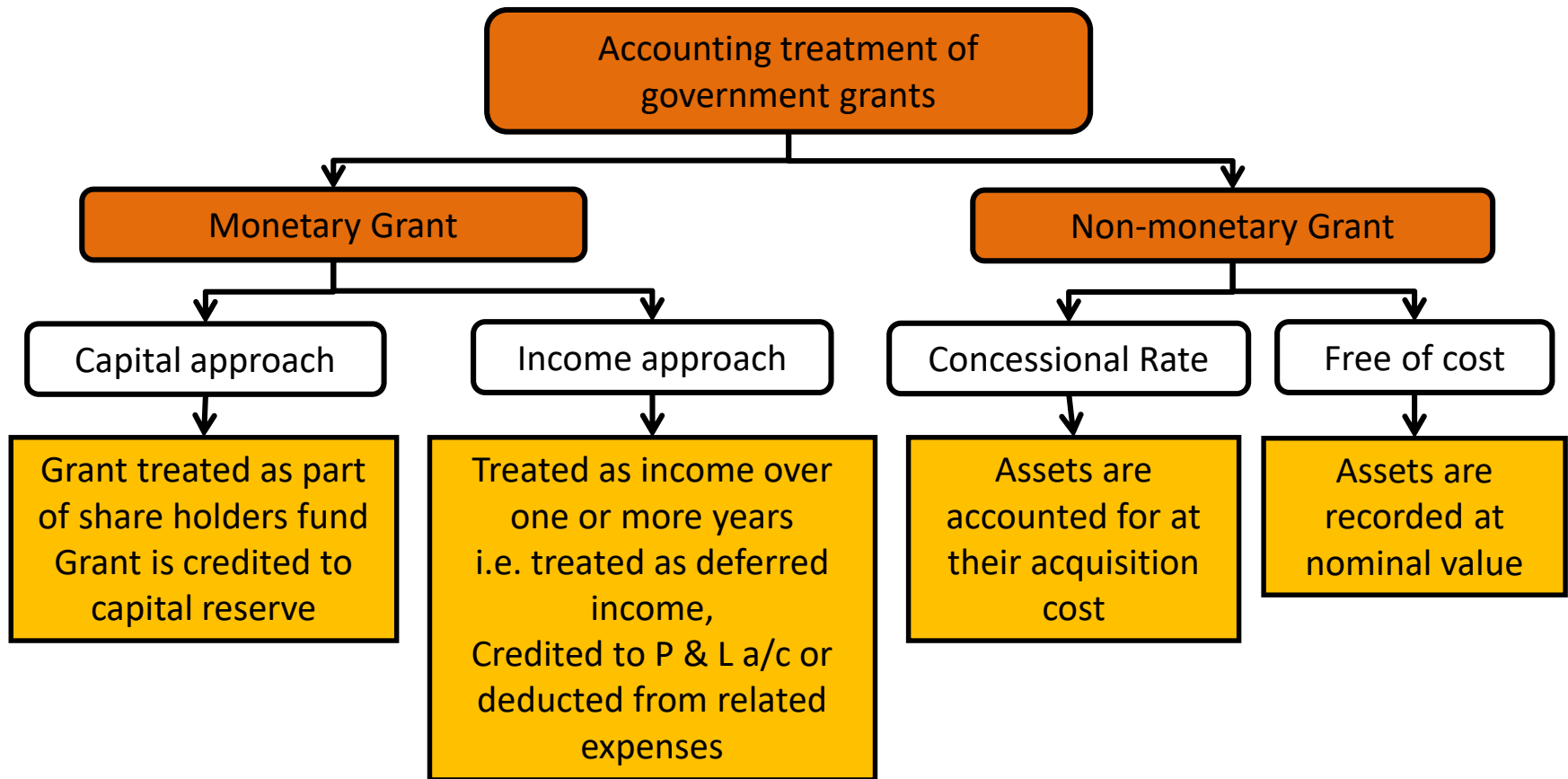


Accounting of grant should be on the basis of nature of relevant grant.

Grant having characteristic of promoter should be transferred to shareholder fund.

Other grants are transferred to income statement.

# Monetary and Non Monetary Grant



# Grant related to Specific Fixed Assets

## Grant related to Specific Fixed Assets

### Primary Conditions

- ❖ Purchase
- ❖ Construct or
- ❖ Otherwise acquire such assets.

### Other Conditions

- ❖ Type of Asset
- ❖ Location of Assets
- ❖ Period during which they are acquired

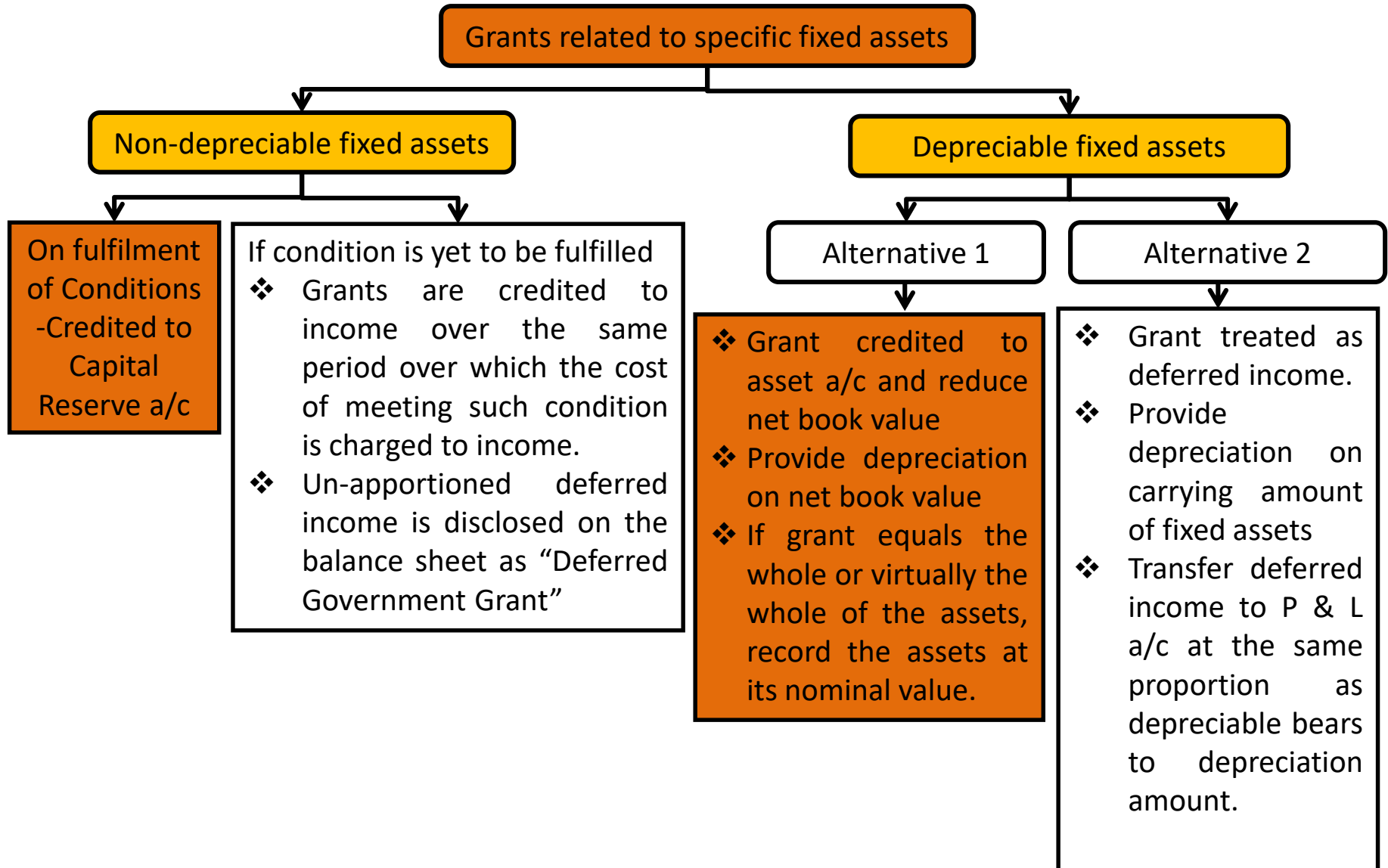
## Presentations in Financial Statements

### Deductive Approach

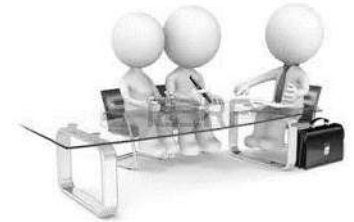
- ✓ When the grant is lower than the cost of assets, then it is shown at reduction from the cost of such assets.
- ✓ When grant is equal to the value of assets then it is shown at Nominal Value.

### Deferred Income Approach

# Accounting Treatment



# Presentation of Grant Related to Revenue



Grant Related to Revenue

Presented as a credit in the  
profit and loss statement

Grant is deducted in reporting  
the related expenses

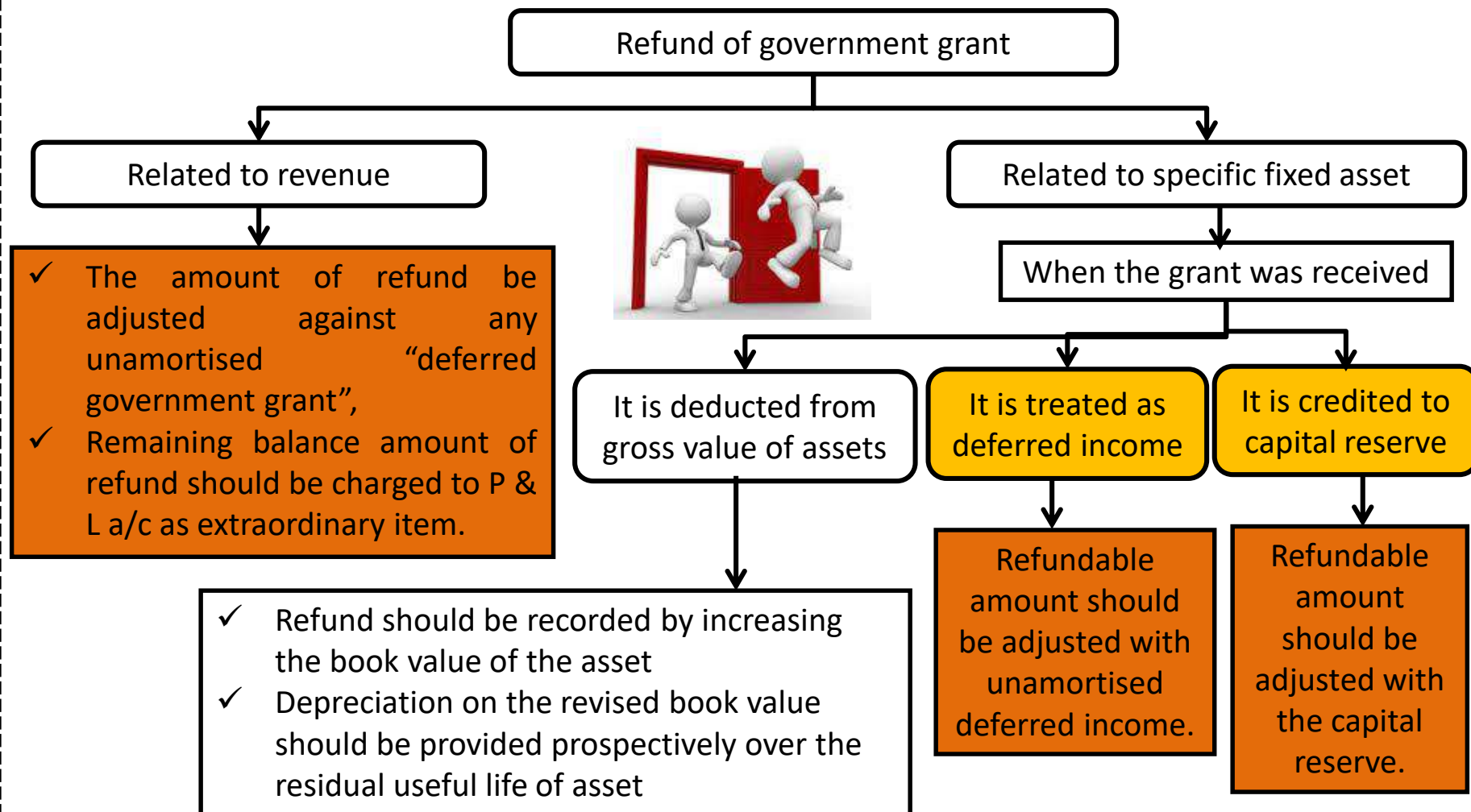
Separately

Under General Heading like Other Income



# Refund of Government Grants

- ❖ Government grant become refundable due to **non-fulfilment of condition** attached to the grant.
- ❖ A government grant that become refundable is treated as **an extraordinary item under AS 5**.



# Disclosures

- The accounting policy adopted for government grants including the method of presentation in the financial statement.
- The nature and extent of government grant recognised in the financial statement including grants of non-monetary assets given at a concessional rate or free of cost.



1. Samrat Limited has set up its business in a designated backward area which entitles the company for subsidy of 25% of the total investment from Government of India. The company has invested Rs. 80 crores in the eligible investments. The company is eligible for the subsidy and has received Rs. 20 crores from the government in February 2019. The company wants to recognize the said subsidy as its income to improve the bottom line of the company.

Do you approve the action of the company in accordance with the Accounting Standard?

**(RTP Nov 19)**

**Solution:**

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

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

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

2. Viva Ltd. received a specific grant of Rs. 30 lakhs for acquiring the plant of Rs. 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 Rs. 21 lakhs and written down value of plant was Rs. 105 lakhs. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2017-18 in profit and loss account? AS 13 Accounting for Investments. **(RTP May 19)**

**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.

## Accounting Standard - 13

# Accounting for Investments



## Objective of AS 13

- ✓ Every organization makes some investments either for short duration or long term purpose.
- ✓ It is very important component of balance sheet
- ✓ Income on it shall be correctly recorded to have correct calculation of profit.

- Assets held as a stock in trade is not Investment.
- Shares, debentures and other securities held as stock in trade, are accounted for & disclosed in Financial Statement in a manner that is applicable to Current Investments.

Investments are asset held by enterprise for earning income by the way of Dividend, Interest, Rental, Capital Appreciation, for Other Benefits



# Applicability

Not applies to

- ✓ Mutual funds, venture capital fund and/ or the related asset management companies, banks and public financial Institutions (Guidance note by ICAI)
- ✓ The basis for Recognition of Interest, dividend & rentals earned on Investment ( AS – 9)
- ✓ Operating or finance Leases (AS – 19)
- ✓ Investment of Retirement benefit plans and life insurance enterprise (AS - 15)

## Classification of Investment

Current Investment

- Readily realisable
- Intended to be held for not more than one year

Long term Investment

Investment **other than**  
current investment



Investment Property

Investment in land or building that is not intended to be occupied for use in their operation

Valued at cost as per **AS 10**

# Cost of Investment = Purchase Price + Acquisition charges

Brokerage, Fees & Duties payable

Finance & Borrowing cost is part of cost of Investment Property subject to AS 16

## Other Important Point

Investment acquired in exchange of another asset

Cost of Investment = Fair value of asset given up or fair value of investment acquired whichever is more clearly evident

Investment acquired by issue of shares or other securities

Cost of Investment = Fair value of securities issued



Pre-acquisition interest

Interest accrued in pre-acquisition period & was included in cost of investment at the time of acquisition (cum – interest price) then subsequent receipt of such pre acquisition interest is deducted from the cost of Investment

Dividend

Dividend declared from Pre- acquisition profits & Later on received by the purchaser of investment, then such amount of dividend is deducted from The cost of investment

# Carrying Amount of Investments:

**Current Investment**

Carried at lower of

Cost

Fair Value

Determined on individual basis or by category of investment

1. Reduction in realisable value - Dr. to P & L A/c
2. Increase in realisable value – Upto Cost of investment - Cr. to P & L A/c & excess portion ignored.

**Long Term Investment**

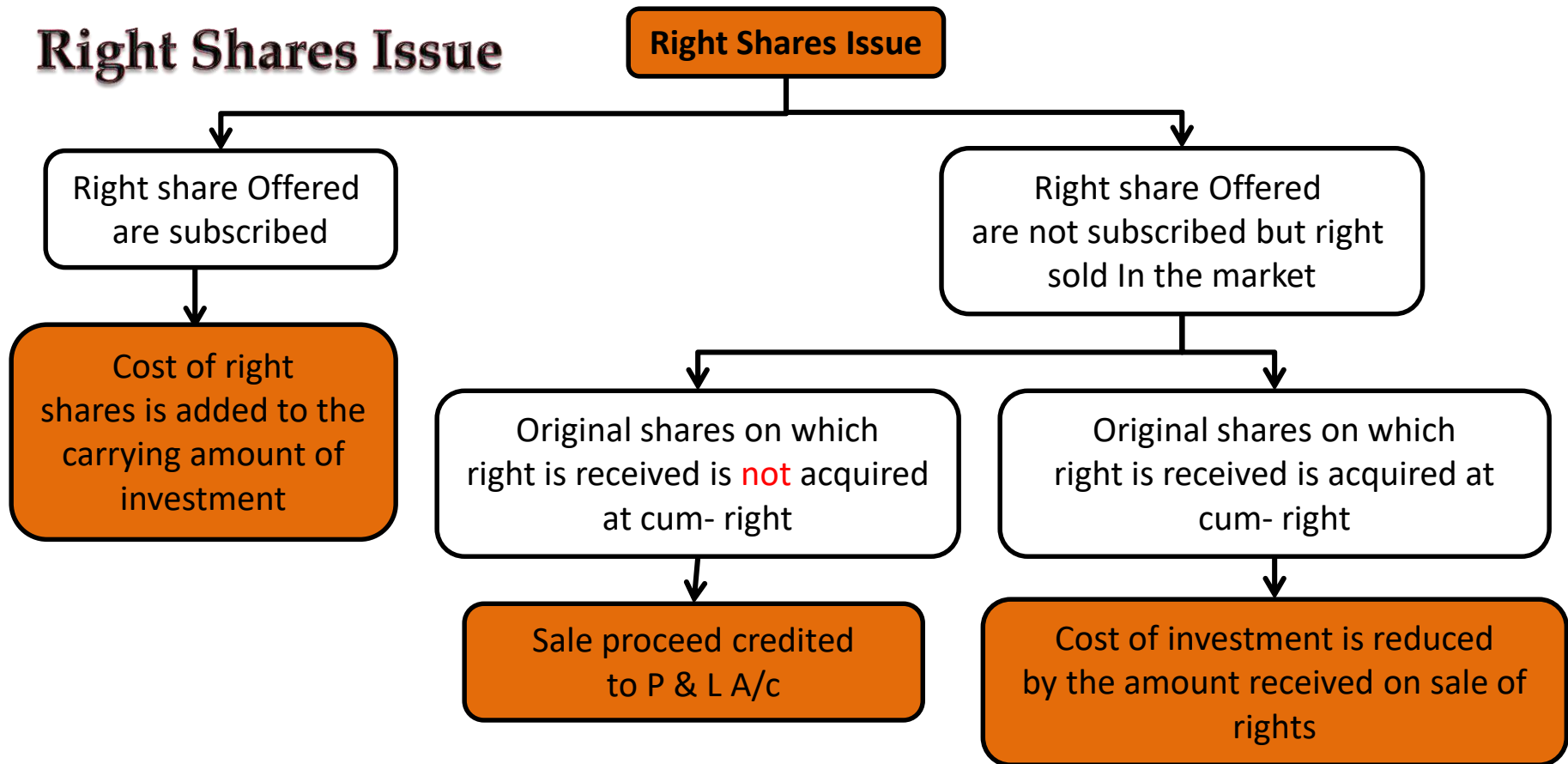
At cost

Provision for permanent diminution shall be made to recognize the decline, other than temporary.

- ✓ Usually valued at cost
- ✓ Temporary increase / decrease in value of investment is not recognised
- ✓ Permanent change in value is charged /credited to P & L a/c



# Right Shares Issue



## Earning From Investments

- ✓ Interest and dividends on investment are to be treated as income.
- ✓ when the purchase is made on cum-interest or cum-dividend terms, interest or dividend received need to be allocated between capital and revenue as appropriate.



# Disposal of Investment

## Disposal of Investment

Complete investment is disposed

Only part of total investment is disposal off

Difference between carrying amount & net sale proceed is recognised in Profit & Loss Account



- ✓ Calculate carrying amount of part of investment
- ✓ Difference in Carrying amount & net sale proceed is recognised in P & L a/c

## Reclassification

Long term to current	Current to Long term
Take date of transfer as base	Take date of transfer as base
Determine carrying amount on such date	Determine fair value on such date
Determine cost	Determine cost
Apply lower of cost & carrying amount	Apply lower of cost & fair value

# Disclosure



- **The following information should be disclosed in the financial statements:**
- (a) the accounting policies for determination of carrying amount of investments;
- (b) classification of investments.
- (c) the amounts included in profit and loss statement for:
  - (i) interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long term and current investments. Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes Paid;
  - (ii) profits and losses on disposal of **current investments** and changes in the carrying amount of such investments; and
  - (iii) profits and losses on disposal of **long term investments** and changes in the carrying amount of such investments;
- (d) significant restrictions on the right of ownership, realisability of investments or the remittance of income and proceeds of disposal;
- (e) other disclosures as specifically required by the relevant statute governing the enterprise.

1. An unquoted long term investment is carried in the books at a cost of ` 2 lakhs. The published accounts of the unlisted company received in May, 2017 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than ` 20,000. How will you deal with this in preparing the financial statements of R Ltd. for the year ended 31st March, 2017 ?

### **Solution**

As it is stated in the question that financial statements for the year ended 31st March, 2017 are under preparation, the views have been given on the basis that the financial statements are yet to be completed and approved by the Board of Directors. Also, the fall in value of investments has been considered on account of conditions existing on the balance sheet date.

Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution should be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. AS 13 (Revised) 'Accounting for Investments' states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. On these bases, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to ` 20,000 in the financial statements for the year ended 31<sup>st</sup> March, 2017.

2. X Ltd. on 1-1-2017 had made an investment of ` 600 lakhs in the equity shares of Y Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realisable value of all such investment on 31-3-2017 became ` 200 lakhs as Y Ltd. lost a case of copyright. From the given market conditions, it is apparent that the reduction in the value is not temporary in nature. How will you recognise the reduction in financial statements for the year ended on 31-3-2017 ?

**Solution**

X Ltd. invested ` 600 lakhs in the equity shares of Y Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. ` 300 lakhs and remaining as temporary (current) investment i.e. ` 300 lakhs. Irrespective of the fact that investment has been held by X Ltd. only for 3 months (from 1.1.2017 to 31.3.2017), AS 13 (Revised) lays emphasis on intention of the investor to classify the investment as current or long term even though the long term investment may be readily marketable.

In the given situation, the realisable value of all such investments on 31.3.2017 became ` 200 lakhs i.e. ` 100 lakhs in respect of current investment and ` 100 lakhs in respect of long term investment. As per AS 13 (Revised), 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value. Accordingly, the carrying value of investment held as temporary investment should be shown at realisable value i.e. at ` 100 lakhs. The reduction of ` 200 lakhs in the carrying value of current investment will be charged to the profit and loss account. Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long term investment, the carrying amount is reduced to recognise the decline.

Here, Y Ltd. lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quite a substantial figure. Losing the case of copyright may affect the business and the performance of the company in long run. Accordingly, it will be appropriate to reduce the carrying amount of long term investment by ` 200 lakhs and show the investments at ` 100 lakhs, since the downfall in the value of shares is other than temporary. The reduction of ` 200 lakhs in the carrying value of long term investment will also be charged to the Statement of profit and loss.

3. Z Bank has classified its total investment on 31-3-2018 into three categories (a) held to maturity (b) available for sale (c) held for trading as per the RBI Guidelines.

'Held to maturity' investments are carried at acquisition cost less amortized amount.

'Available for sale' investments are carried at marked to market. 'Held for trading' investments are valued at weekly intervals at market rates. Net depreciation, if any, is charged to revenue and net appreciation, if any, is ignored.

You are required to comment whether the policy of the bank is in accordance with AS 13?

**(RTP Nov 19)**

**Solution:**

As per AS 13 'Accounting for Investments', the accounting standard is not applicable to Bank, Insurance Company, Mutual Funds. In this case Z Bank is a bank, therefore, AS 13 does not apply to it. For banks, the RBI has issued separate guidelines for classification and valuation of its investment and Z Bank should comply with those RBI Guidelines/Norms. Therefore, though Z Bank has not followed the provisions of AS 13, yet it would not be said as non-compliance since, it is complying with the norms stipulated by the RBI.

4. On 15th June, 2018, Y limited wants to re-classify its investments in accordance with AS 13 (revised).

Decide and state the amount of transfer, based on the following information:

- (1) A portion of long term investments purchased on 1st March, 2017 are to be re-classified as current investments. The original cost of these investments was Rs. 14 lakhs but had been written down by Rs. 2 lakhs (to recognise 'other than temporary' decline in value). The market value of these investments on 15th June, 2018 was Rs. 11 lakhs.
- (2) Another portion of long term investments purchased on 15th January, 2017 are to be re-classified as current investments. The original cost of these investments was Rs. 7 lakhs but had been written down to Rs. 5 lakhs (to recognize 'other than temporary' decline in value). The fair value of these investments on 15th June, 2018 was Rs. 4.5 lakhs.
- (3) A portion of current investments purchased on 15th March, 2018 for Rs. 7 lakhs are to be re-classified as long term investments, as the company has decided to retain them. The market value of these investments on 31st March, 2018 was Rs. 6 lakhs and fair value on 15th June 2018 was Rs. 8.5 lakhs,
- (4) Another portion of current investments purchased on 7th December, 2017 for Rs. 4 lakhs are to be re-classified as long term investments. The market value of these investments was:

on 31st March, 2018   Rs. 3.5 lakhs

on 15th June, 2018    Rs. 3.8 lakhs

**(QP May 19)**

**Solution:**

As per AS 13 (Revised) '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 Rs. 12 lakhs in the books.
- (ii) In this case also, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at Rs. 5 lakhs in the books.
- (iii) In this case, reclassification of current investment into long-term investments will be made at Rs. 7 lakhs as cost is less than its fair value of Rs. 8.5 lakhs on the date of transfer.
- (iv) In this case, market value (considered as fair value) is Rs. 3.8 lakhs on the date of transfer which is lower than the cost of Rs. 4 lakhs. The reclassification of current investment into long-term investments will be made at Rs. 3.8 lakhs.



5. Paridhi Electronics Ltd. has current investment (X Ltd.'s shares) purchased for Rs. 5 lakhs, which the company want to reclassify as long term investment on 31.3.2018. The market value of these investments as on date of Balance Sheet was Rs. 2.5 lakhs. How will you deal with this as on 31.3.18 with reference to AS-13?

**(RTP May 19)**

**Solution:**

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

In the given case, the market value of the investment (X Ltd. shares) is Rs. 2.50 lakhs, which is lower than its cost i.e. Rs. 5 lakhs. Therefore, the transfer to long term investments should be made at cost of Rs. 2.50 lakhs. The loss of Rs. 2.50 lakhs should be charged to profit and loss account.

## Accounting Standard - 16

# Borrowing Cost



## Objective of AS 16



## Applicability

- ✓ Appreciate the basis for recognising borrowing costs
- ✓ Identify the nature of specific and general borrowings, & treatment of related borrowing costs
- ✓ Ensure when to Commence capitalisation, Suspend capitalisation, Cease capitalisation

### Not Applicable to

- ✓ Actual cost of owners' equity - including preference share capital and
- ✓ Imputed cost of such equity
- ✓ And such other items forming part of equity and not classified as a liability

## Borrowing cost

Money borrowed by enterprise for

Purchasing fixed asset

Acquiring land

Working capital

Constructing Building

These assets take time to make them useable or saleable.  
Enterprise incur cost on borrowing i.e. interest and other cost  
Standard deals with accounting of borrowing cost.

## Borrowing cost

Interest

+

Other cost

=

Borrowing cost



### Other cost include –

- ✓ Commitment charges on borrowing.
- ✓ Amortization of discounts or provision relating to borrowing.
- ✓ Amortization of ancillary costs incurred in connection with arrangement of borrower.
- ✓ Finance charges when the asset acquired under finance leases.
- ✓ Exchange difference arising from foreign currency borrowing to the extent that they are regarded as an adjustment to interest costs.
- ✓ Amortisation means dividation of total ancillary expenses in the ratio of usage amount.

# Qualifying Asset

QA is an asset which takes substantial period of time to get ready for its

- ✓ intended use (Fixed assets or investment properties) or
- ✓ sale (Inventory)



## Examples

Any tangible fixed assets, which are in construction process or acquired tangible fixed assets, which are not ready for use or resale, such as plant and machinery.

Any intangible assets, which are in development phase or acquired but not ready for use or resale, such as patent.

Investment property.

Inventories that require a substantial period to bring them to a saleable value.

✓ Substantial Period of Time is the period of 12 month.

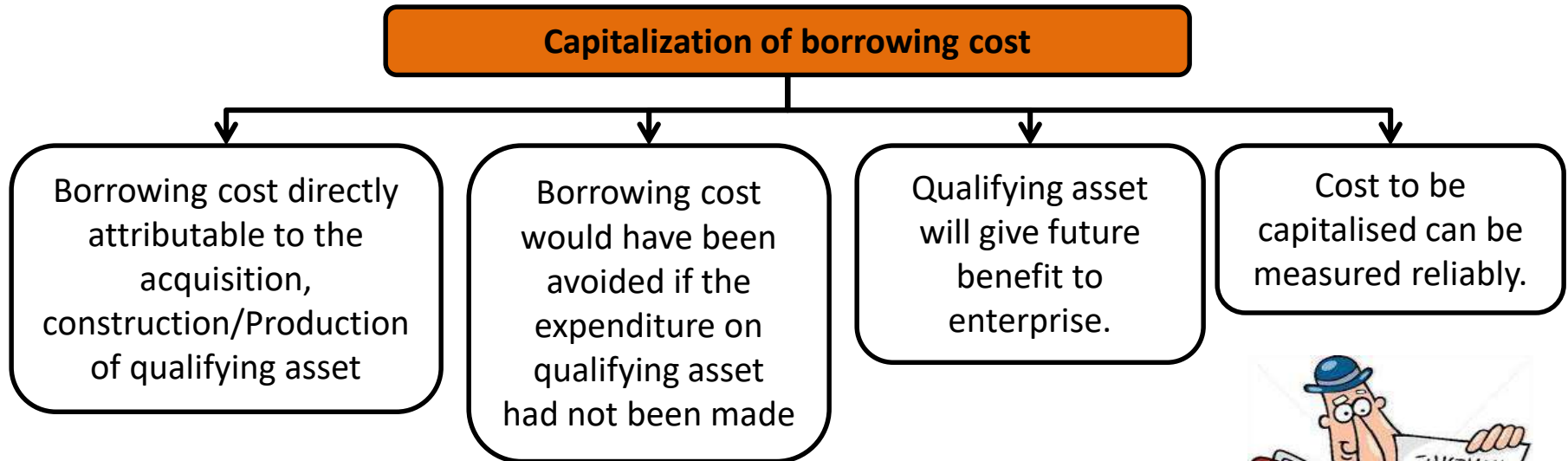
Longer or shorter period may also be justified based on the circumstances of the case

Following is not a QA

- Inventories routinely manufactured
- Inventories produced in large quantities on repetitive basis
- Assets ready for intended use at the time of acquisition

# Accounting treatment of Borrowing cost

As per AS – 16, borrowing cost, which is directly related to the acquisition, construction or production of qualifying asset should be capitalized.



- If any of the above conditions does not satisfy then it is charged to P & L A/c
- If all the conditions are satisfied, Capitalise the Borrowing cost.

# Types of Borrowing

## Types of Borrowing

### Specific Borrowing

Borrowed specifically for expenditure on qualifying asset.

Amount of borrowing cost to be capitalised = Actual borrowing cost – income on temporary investment

**Borrowing cost capitalised should not exceed actual cost incurred during the period.**

**When the carrying amount of qualifying assets exceeds its recoverable amount of NRV, the carrying amount is written down in accordance with requirement of other AS**

### General Borrowing

Borrowing is wholly or partly for expenditure incurred on qualifying asset

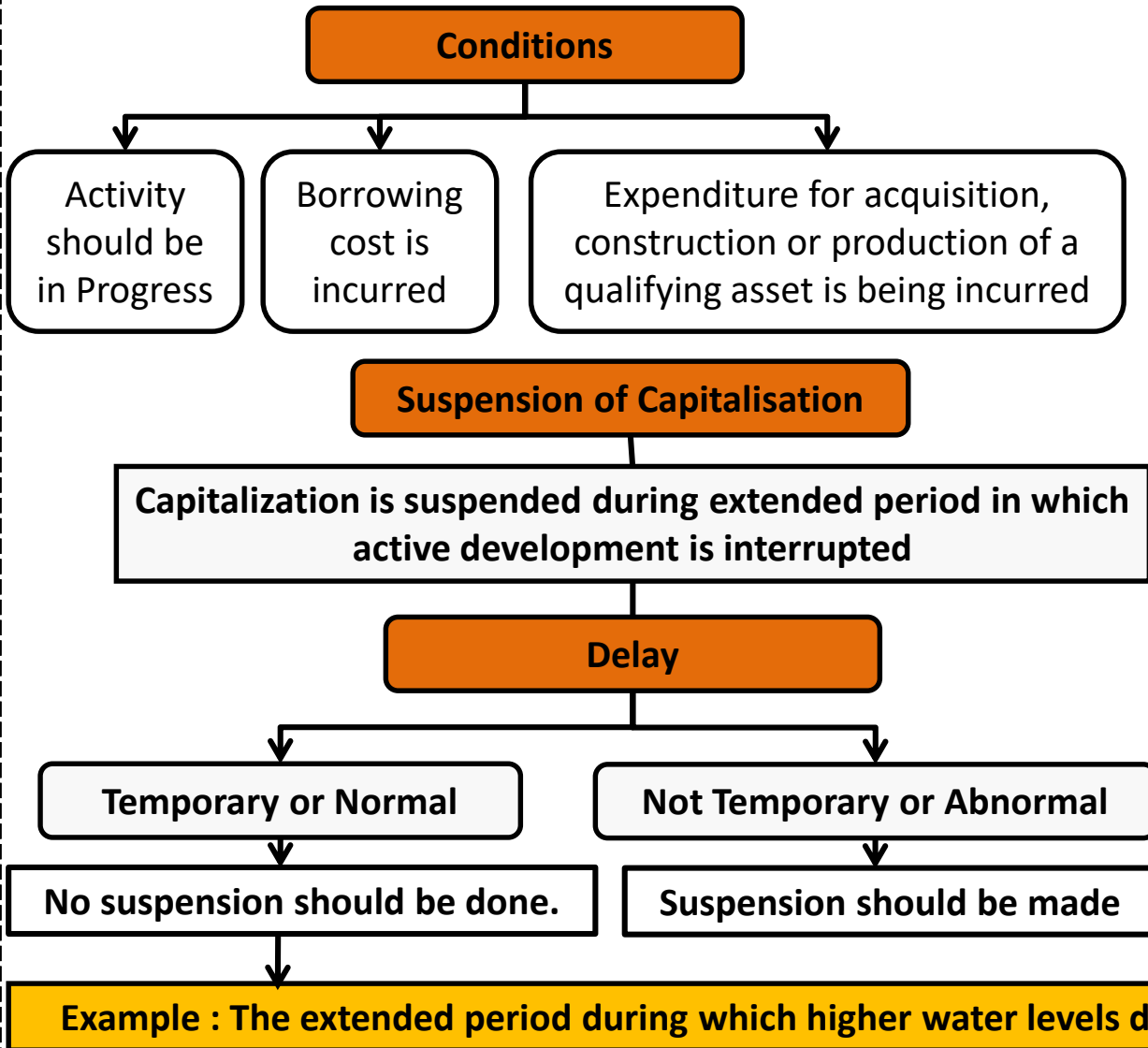
**Borrowing cost to be capitalised = Apply capitalisation rate to the expenditure on that asset**

**Capitalisation rate = Weighted average of borrowing cost**





# Commencement of Capitalization



**Expenditure on a qualifying asset includes:**

- Expenditure that has resulted in payment of cash
- Transfers of other assets or the assumption of interest bearing liabilities.

**Expenditure is reduced by:**

- Any progress payments received and
- Grants received in connection with the asset.





# Exception

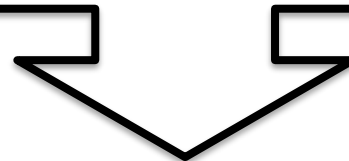
## Capitalization of borrowing cost is not suspended

- During a period when substantial technical and administrative work is being carried out
- When a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

**Example:** Capitalization should continue during the extended period needed for inventories to mature, or the extended period during which high water levels delay the construction of a bridge.

## Cessation of capitalization

- ✓ Capitalization of borrowing cost should cease when substantially all the activities necessary to prepare the qualifying assets for its intended use or sale are completed.
- ✓ Items of administrative work or finishing touches to be completed happen to be minor in nature
- ✓ Construction of the qualifying asset is carried out in parts / phase and each part / phase can be used independently, required activities are completed for such phase and it is ready for intended use or sale, capitalization of borrowing cost for such phase / part will cease.



## Divisible and Indivisible Indivisible Projects : These situations are analysed below :

Particulars	Asset completed in parts (i.e. Divisible Projects)	Assets completed in full (i.e. Indivisible Projects)
<b>(a)Description</b>	When construction of a Qualifying Asset is completed in parts and a completed part is capable of being used while construction continues for the other parts.	When the Qualifying Assets consists of a number of parts which can be used only in total, i.e. a completed part cannot be used until construction of all parts is complete.
<b>(b)Example</b>	A Business Park comprising several buildings, each of which can be used individually, is a Qualifying Asset for which each part is capable of being used while construction continues for the other parts.	An Industrial Plant involving several processes which are carried out in sequence at different parts of the plant within the same site, such as a Steel Mill, is a Qualifying Asset that needs to be complete in all respects before any part can be used.
<b>(c)Cessation of Capitalisation</b>	Capitalisation of Borrowing Costs in relation to a part should cease when substantially all the activities necessary to prepare that part of the asset for its intended use or sale are complete.	Capitalisation of Borrowing Costs should cease only when substantially all the activities necessary to complete the whole of the assets for its intended use or sale, is complete.

## Disclosures

- The accounting policy adopted for borrowing cost.
- The amount of borrowing cost capitalised during the period.



1. In May, 2018, Capacity Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2019 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was Rs. 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2019 amounted to Rs. 25 lakhs.

Can Rs. 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

**Solution:**

**(RTP Nov 19)**

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2019) i.e. Rs. 18 lakhs alone can be capitalized. It cannot be extended to Rs. 25 lakhs.

2. First Ltd. began construction of a new factory building on 1st April, 2017. It obtained Rs. 2,00,000 as a special loan to finance the construction of the factory building on 1st April, 2017 at an interest rate of 8% per annum. Further, expenditure on construction of the factory building was financed through other non-specific loans. Details of other outstanding non-specific loans were:

Amount (Rs.)	Rate of Interest per annum
4,00,000	9%
5,00,000	12%
3,00,000	14%

The expenditures that were made on the factory building construction were as follows:

Date	Amount (Rs.)
1st April, 2017	3,00,000
31st May, 2017	2,40,000
1st August, 2017	4,00,000
31st December, 2017	3,60,000

The construction of factory building was completed by 31st March, 2018. As per the provisions of AS 16, you are required to:

- (1) Calculate the amount of interest to be capitalized.
- (2) Pass Journal entry for capitalizing the cost and borrowing cost in respect of the factory building. **(QP May 19)**

## Solution:

(i) Computation of average accumulated expenses

		Rs.
Rs. 3,00,000 x 12 / 12	=	3,00,000
Rs. 2,40,000 x 10 / 12	=	2,00,000
Rs. 4,00,000 x 8 / 12	=	2,66,667
Rs. 3,60,000 x 3 / 12	=	<u>90,000</u>
		<u>8,56,667</u>

(ii) Calculation of average interest rate other than for specific borrowings

Amount of loan (Rs.)	Rate of interest		Amount of interest (Rs.)
4,00,000	9%	=	36,000
5,00,000	12%	=	60,000
3,00,000	14%	=	42,000
			1,38,000
<b>Weighted average rate of interest</b> $1,38,000/12,00,000 \times 100$		=	11.5%

(iii) Amount of interest to be capitalized

			Rs.
Interest on average accumulated expenses:			
Specific borrowings (Rs. 2,00,000 x 8%)	=		16,000
Non-specific borrowings (Rs. 6,56,667 x 11.5%)	=		75,517
Amount of interest to be capitalised	=		91,517

(iv) Total expenses to be capitalised for building

		Rs.
Cost of building Rs. (3,00,000 + 2,40,000 + 4,00,000 + 3,60,000)		13,00,000
Add: Amount of interest to be capitalized		91,517
		13,91,517

(v) Journal Entry

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
31.3.2018	Building A/c	Dr.	13,91,517	
	To Building WIP** A/c			13,00,000
	To Borrowing costs A/c			91,517
	(Being amount of cost of building and borrowing cost thereon capitalised)			

3. Zen Bridge Construction Limited obtained a loan of Rs. 64 crores to be utilized as under:

(i)	<b>Construction of Hill link road in Kedarnath</b>	<b>Rs. 50 crores</b>
(ii)	Purchase of Equipment and Machineries	<b>Rs. 6 crores</b>
(iii)	Working Capital	<b>Rs. 4 crores</b>
(iv)	Purchase of Vehicles	<b>Rs. 1crore</b>
(v)	Advances for tools/cranes etc.	<b>Rs. 1crore</b>
(vi)	Purchase of Technical Know how	<b>Rs. 2 crores</b>
(vii)	<b>Total Interest charged by the Bank for the year ending 31st March, 2018</b>	<b>Rs. 1.6 crores</b>

Show the treatment of Interest according to Accounting Standard by Zen Bridge Construction Limited. **(RTP May 19)**

**Solution:**

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use. As per the standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

The treatment of interest by Zen Bridge Construction Ltd. can be shown as:

	Qualifying Asset	Interest to be capitalized Rs. in crores	Interest to be charged to Profit & Loss A/c Rs. in crores	
Construction of hill road*	Yes	1.25		<b>1.6/64 x 50</b>
Purchase of equipment and machineries	No		0.15	<b>1.6/64 x 6</b>
Working capital	No		0.10	<b>1.6/64 x 4</b>
Purchase of vehicles	No		0.025	<b>1.6/64 x 1</b>
Advance for tools, cranes etc.	No		0.025	<b>1.6/64 x 1</b>
Purchase of technical know-how	No		<u>0.05</u>	<b>1.6/64 x 2</b>
<b>Total</b>		<b><u>1.25</u></b>	<b><u>0.35</u></b>	

\*Note: It is assumed that construction of hill road will normally take more than a year (substantial period of time), hence considered as qualifying asset.