ACCOUNTING STANDARDS

I dedicate this book to **my grandfather Late Nagraj Ji Sancheti**, **my inspirational source - my father Mr. Rajendra Kumar Sancheti**, **my family**, **friends and students**. This book is designed in a way that **covers learning, understanding and problem solving** at **one place** with illustrations at the end of each concept. This book contains **all comprehensive problems on Accounting Standards** (from **ICAI study materials**, **Practice Manual**, **Past papers** and **other references**) and an illustrative text of each standard.

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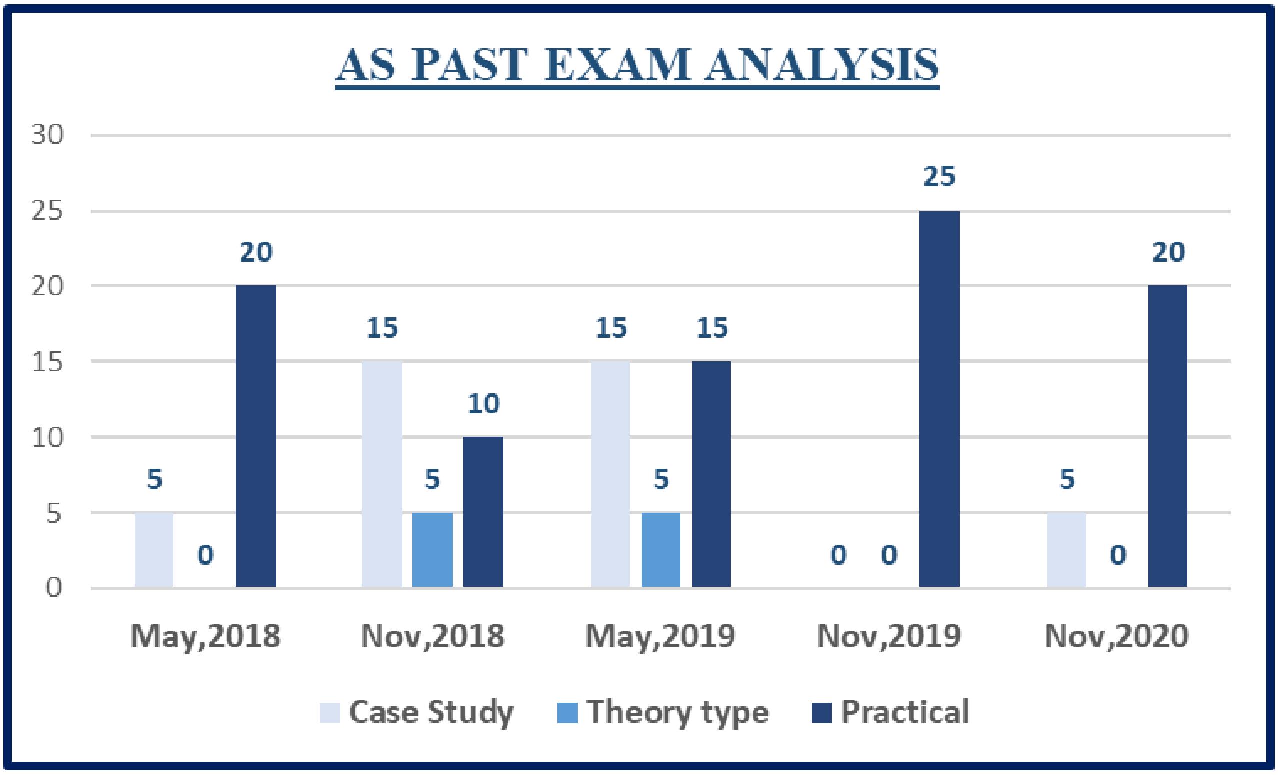

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INTRODUCTION TO ACCOUNTING STANDARDS

Meaning

Accounting Standards (AS) are **written policy documents** issued by expert accounting body or by government or other regulatory body **covering the aspects of recognition, measurement, presentation and disclosure of accounting transactions in the financial statements**.

Issues dealt with by AS

1) **recognition of events and transactions** in the financial statements,
2) **measurement of these transactions and events**,
3) **presentation of these transactions and events** in the financial statements in a manner that is meaningful and understandable to the reader, and
4) **the disclosure requirements** which should be there to enable the public at large and the stakeholders and the potential investors in particular, to get an insight into what these financial statements are trying to reflect and thereby facilitating them to take prudent and informed business decisions.

Benefits of AS

I. **Standardisation of alternative accounting treatments**: Standards reduce to a reasonable extent or eliminate altogether confusing variations in the accounting treatments used to prepare financial statements.

II. **Requirements for additional disclosures**: There are certain areas where important information are not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.

III. **Comparability of financial statements**: The application of accounting standards would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country.

Limitations of AS

I. **Difficulties in making choice between different treatments**: Alternative solutions to certain accounting problems may each have arguments to recommend them. Therefore, the choice between different alternative accounting treatments may become difficult.

II. **Lack of flexibilities**: There may be a trend towards rigidity and away from flexibility in applying the accounting standards.

III. **Restricted scope**: Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.

Standard Setting Process

Identification of Area by ASB(ICAI)

↓

Constitution of study group

↓

Preparation of draft and its circulation

↓

Ascertainment of views of different bodies on draft

↓

Finalisation of exposure draft

↓

Comments received on Exposure draft

↓

Modification of draft

↓

Issue of AS

Applicability of AS on various entities

Corporate Entities	
SMCs	**Non - SMCs**
1) whose **equity or debt securities are not listed or are not in the process of listing** on any stock exchange, whether in India or outside India; **2)** which is **not a bank, financial institution or an insurance company;** **3)** whose **turnover** (excluding other income) **does not exceed rupees fifty crores in the immediately preceding accounting year**; **4)** which **does not have borrowings** (including public deposits) **in excess of rupees ten crores at any time during the immediately preceding accounting y**ear; and **5)** which is **not a holding or subsidiary company of a company which is not a small and medium-sized company**.	**Companies not falling within the definition of SMC**.
Applicability: 1) **Entirety - AS – 1, 2, 4, 5, 7, 9, 10, 11, 12, 13, 14, 16, 18, 22, 24, 26** 2) **Subject to relaxations - AS – 15, 19, 20, 28, 29** 3) **Non – applicable - AS – 3, 17**	**All AS are applicable in entirety**

Non - Corporate Entities		
Level I	**Level II**	**Level III**
1) whose **equity or debt securities are listed or in the process of listing** on any stock exchange, whether in India or outside India; **2)** which is **a bank, financial institution or an insurance company;** **3)** whose **turnover** (excluding other income) **exceed rupees fifty crorein the immediately preceding accounting year**; **4)** which have **borrowings** (including public deposits) **in excess of rupees ten crore at any time during the immediately preceding accounting year**; and **5)** which is **a holding or subsidiary of any of the above entities**.	**1) Entities other than Level I entities** **2)** All commercial, industrial and business reporting entities, **whose turnover (excluding other income) exceeds rupees one crore but does not exceed rupees fifty crore in the immediately preceding accounting year;** **3)** All commercial, industrial and business reporting entities **having borrowings (including public deposits) in excess of rupees one crore but not in excess of rupees ten crore at any time during the immediately preceding accounting year;** **4) Holding and subsidiary entities of any one of the above**.	**Entities which are not covered under Level I or Level II category**.
All AS are applicable in entirety.	**Applicability:** **1) Entirety - AS – 1, 2, 4, 5, 7, 9, 10, 11, 12, 13, 14, 16, 18, 22, 24, 26** **2) Subject to relaxations - AS – 15, 19, 20, 28, 29** **3) Non – applicable - AS – 3, 17**	**Applicability:** **1) Entirety - AS – 1, 2, 4, 5, 7, 9, 10, 11, 12, 13, 14, 16, 22, 26** **2) Subject to relaxations - AS – 15, 19, 20, 28, 29** **3) Non – applicable - AS – 3, 17, 18, 24**

IND-AS

Indian Accounting Standards (Ind AS) are **IFRS converged standards issued by** the **Central Government of India** under the **supervision and control of Accounting Standards Board (ASB) of ICAI** and in consultation with National Advisory Committeeon Accounting Standards (NACAS).

Ind AS are named and numbered in the same way as the corresponding International Financial Reporting Standards (IFRS).

Benefits of convergence to IND-AS			
Globalization & Liberalization	**Transparency of Financial Statements**	**Comparability of Financial Statements**	**Enhanced DisclosureS**

Convergence & Carve-outs

The **Government of India in consultation with the ICAI decided to converge and not to adopt IFRS issued by the IASB**. The decision of convergence rather than adoption was taken after the detailed analysis of IFRS requirements and extensive discussion with various stakeholders.

Accordingly, while formulating IFRS converged Indian Accounting Standards (Ind AS), efforts have been made to keep these Standards, as far as possible, in line with the corresponding IAS/IFRS and departures have been made where considered absolutely essential. These changes have been made considering various factors, such as

- **Various terminology related changes have been made to make it consistent with the terminology used in law,** e.g., 'statement of profit and loss' in place of 'statement of comprehensive income' and 'balance sheet' in place of 'statement of financial position'.
- **Removal of options in accounting principles and practices in Ind AS vis-à-vis IFRS,** have been made to maintain consistency and comparability of the financial statements to be prepared by following Ind AS. However, these changes will not result into carve outs.
- **Certain changes have been made considering the economic environment of the country, which is different as compared to the economic environment presumed to be in existence by IFRS.** These differences are due to differences in economic conditions prevailing in India. These differences which are in deviation to the accounting principles and practices stated in IFRS, are commonly known as 'Carve-outs'.

Roadmap for Implementation of IND-AS

For Companies other than NBFCs, Banks & Insurance Cos		
1st April, 2015	1st April, 2016	1st April, 2017
Voluntary Basis	Mandatory Basis	Mandatory Basis
Any Company	Listed Cos or Cos in process of listing having Net worth > ₹500 crores Unlisted Cos having Net worth > ₹500 crores Parent, Subsidiary, Associate & JV of above	All Listed Cos or Cos in process of listing Unlisted Cos having Net worth > ₹250 crores Parent, Subsidiary, Associate & JV of above

Note:
1) Cos listed on SME Exchange are not required to apply Ind AS.
2) Once Ind AS are applicable, entity shall follow the Ind AS for all subsequent Financial Statements.
3) Companies not covered under this roadmap shall continue to apply Accounting Standards.

For NBFCs	
1st April, 2018	1st April, 2019
Mandatory Basis	Mandatory Basis
Listed Cos or Cos in process of listing having Net worth > ₹500 crores Unlisted Cos having Net worth > ₹500 crores Parent, Subsidiary, Associate & JV of above	All Listed Cos or Cos in process of listing Unlisted Cos having Net worth > ₹250 crores Parent, Subsidiary, Associate & JV of above

Note:
1) Companies not covered under this roadmap shall continue to apply Accounting Standards.
2) Voluntary adoption of Ind AS is not allowed.

For Scheduled Commercial Banks & Insurance Cos
1st April, 2018
Mandatory Basis
All Banks & Insurance Cos Parent, Subsidiary, Associate & JV of above

Note: Urban Cooperative Banks & Regional Rural Banks are not required to apply Ind AS.

SELF TEST QUESTIONS

Question 1

What are the issues, with which Accounting Standards deal?

Question 2

What are the benefits and limitations of Accounting Standards?

Question 3

"Accounting standards standardize diverse accounting policies with aview to eliminate the non-comparability of financial statements and improve the reliability of financial statements." Discuss and explain the benefits of Accounting standards?

Question 4

What are the main reasons for adoption of Ind AS in India?

AS-1 DISCLOSURE OF ACCOUNTING POLICIES

Applicability

This Accounting standard is applicable to **all entities**.

Accounting Policy

The accounting policies refer to the **specific accounting principles and the methods of applying those principles** adopted by the enterprise **in the preparation and presentation of financial statements.**

EXPLANATION

Areas where different accounting policies can be adopted

1) **Valuation of Inventories** – FIFO, Weighted Average etc.
2) **Valuation of Investments**
3) Determination of **Carrying amount of Property, Plant & Equipment**
4) **Valuation of Goodwill**
5) **Treatment of Foreign exchange fluctuation gain\loss** etc.

Manner of Disclosure

All significant accounting policies adopted in the preparation and presentation of financial statements **should be disclosed**. The **disclosure** of the significant accounting policies as such **should form part of the financial statements** and the significant accounting policies should normally be **disclosed in one place**.

EXPLANATION

Selection of Accounting Policies

1) **True & Fair view** – Accounting policies shall be selected in a manner that it present a true and fair view of the financial performance and position of business entity.
2) **Prudence** - In view of uncertainty associated with future events, profits are not anticipated, but losses are provided for as a matter of conservatism. The exercise of prudence in selection of accounting policies ensure that (i) profits are not overstated (ii) losses are not understated (iii) assets are not overstated and (iv) liabilities are not understated.
3) **Substance over form** - Transactions and other events should be accounted for and presented in accordance with their substance and financial reality and not merely with their legal form.
4) **Materiality** - Financial statements should disclose all 'material items, i.e. the items the knowledge of which might influence the decisions of the user of the financial statement.

EXPLANATION

Question 1

V Ltd. purchases goods on behalf of its customers for execution of work under a Works contract against which it receives full payment and necessary declaration form under GST Act to be passed on to the supplier. The Company follows the practise of treating the same as its Purchases and accordingly debits it to Profit & Loss A/c. Give your views on the above.

ANSWER

Fundamental Accounting Assumptions

Going Concern	Consistency	Accrual
Enterprise will continue its operations in the foreseeable future and neither there is intention, nor there is need to materially curtail the scale of operations.	It refers to the **practice of using same accounting policies for similar transactions in all accounting periods**.	Under this basis of accounting, **transactions are recognised as soon as they occur**, whether or not cash or cash equivalent is actually received or paid.
The above three concepts are fundamental assumptions of Accounting i.e. they are being followed by every accountant while preparing financial statements. If the above **assumptions are followed**, **no separate disclosure** is required but if the above assumptions are **not followed**, the **fact must be disclosed** in the financial statement.		
EXPLANATION		

Disclosure of changes in accounting policy

Accounting policies once adopted must be **followed consistently** over various accounting periods and shall not be changed **unless the change is required due to**: a) **Change in statute**; b) **Change in accounting standard** and c) for **better presentation of accounting information**.

Any change in the accounting policies **which has a material effect** in the **current period** or which is reasonably expected to have a material effect in a **later period** should be **disclosed**. In the case of a change in accounting policies, which has a material effect in the current period, the **amount by which any item in the financial statements is affected** by such change should also be **disclosed** to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

EXPLANATION

Question 2

In the books of M/s Prashant Ltd., closing inventory as on 31.03.2015 amounts to ₹1,63,000 (on the basis of FIFO method). The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 2014-15. On the basis of weighted average method, closing inventory as on 31.03.2015 amounts to ₹1,47,000. Realisable value of the inventory as on 31.03.2015 amounts to ₹1,95,000.

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

ANSWER

Question 3

Jagannath Ltd. had made a rights issue of shares in 2017. In the offer document to its members, it had projected a surplus of ₹40 crores during the accounting year to end on 31st March, 2017. The draft results for the year, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of ₹10 crores. The board in consultation with the managing director, decided on the following:

- Value year-end inventory at works cost (₹50 crores) instead of the hitherto method of valuation of inventory at prime cost (₹30 crores).
- Not to provide for "after sales expenses" during the warranty period. Till the last year, provision at 2% of sales used to be made under the concept of "matching of costs against revenue" and actual expenses used to be charged against the provision. The board now decided to account for expenses as and when actually incurred. Sales during the year total to ₹600 crores.
- Provide for permanent fall in the value of investments - which fall had taken place over the past five years - the provision being ₹10 crores.

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2016-2017.

ANSWER

Question 4

XYZ Company is engaged in the business of financial services and is undergoing tight liquidity position, since most of the assets of the company are blocked in various claims/ petitions in a Special Court. XYZ has accepted Inter-Corporate Deposits (ICDs) and, it is making its best efforts to settle the dues. There were claims at varied rates of interest, from lenders, from the due date of ICDs to the date of repayment. The company has provided interest, as per the terms of the contract till the due date and a note for non provision of interest on the due date to date of repayment was affected in the financial

statements. On account of uncertainties existing regarding the determination of the amount and in the absence of any specific legal obligation at present as per the terms of contracts, the company considers that these claims are in the nature of "claims against the company not acknowledged as debt", and the same has been disclosed by way of a note in the accounts instead of making a provision in the profit and loss accounts. State whether the treatment done by the Company is correct or not.

ANSWER

Question 5

State whether the following statements are 'True' or 'False'. Also give reason for your answer:

a) Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.

b) If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.

c) All significant accounting policies adopted in the preparation and presentation of financial statements should form part of financial statements.

d) Any change in accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need not to be indicated.

ANSWER

Question 6

Balance Sheet of Anurag Trading Co. on 31st March, 2017 is given below:

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital	50,000	Fixed Assets	69,000
Profit & Loss A\c	22,000	Stock in trade	36,000
10% Loan	43,000	Trade Receivables	10,000
Trade Payables	18,000	Deferred Expenditure	15,000
		Bank	3,000
	1,33,000		**1,33,000**

Additional Information:

1. Remaining life of fixed assets is 5 years with even use. The net realisable value of fixed assets as on 31st March, 2018 was ₹64,000.
2. Firm's Sales and purchases for the year 2017-18 amounted to ₹5 lakhs and ₹4.50 lakhs respectively.
3. The cost and NRV of stock were ₹34,000 and ₹38,000 respectively.
4. General expenses for the year amounted to ₹16,500.
5. Deferred Expenditure is normally amortised equally over 4 years starting from F.Y. 2016-17 i.e. ₹5,000 p.a.
6. Out of debtors worth ₹10,000, collection of ₹4,000 depend on successful redesign of certain product already supplied to customer.
7. Closing trade payable is ₹10,000, which is likely to be settled at 95%.
8. There is pre-payment penalty of ₹2,000 for Bank loan outstanding.

Prepare Profit & Loss A\c for the year ended 31st March, 2018 under the two cases:

a) **Firm is a going concern**

b) **Firm is not a going concern.**

ANSWER

Question 7

HIL Ltd. was making provision for non-moving stocks based on no issues having occurred for the last 12 months upto 31.03.2017. The Company now wants to make provision based on technical evaluation during the year ending 31.03.2018.

Total value of stock ₹120 lakhs

Provision required based on technical evaluation ₹3 lakhs

Provision required based on 12 months no issue ₹4 lakhs

You are requested to discuss the following points in the light of AS-1:

a) Does this amount to change in accounting policy?

b) Can the company change the method of accounting?

ANSWER

Concept	Summary
AS-1 deals with	
Accounting Policy	
Areas where different accounting policies can be adopted	
Selection of Accounting policies	
Disclosure of Accounting policies	
Changes in Accouting policies	

Fundamental Accounting Assumption	

SELF TEST QUESTIONS

Question 1

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

Question 2

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

Question 3

Under what circumstances can an enterprise change its accounting policy?

Space for Self Notes

AS – 2 VALUATION OF INVENTORIES

Applicability

This Accounting standard is **applicable to all entities**.

Objective of AS – 2

A primary issue in accounting for inventories is the determination of the value at which inventories are carried in the financial statements until the related revenues are recognised. This standard deals with:

a) **Determination of Value of Inventory**;
b) **Ascertainment of Cost** of Inventory; and
c) **Writing down to Net Realisable Value**.

Meaning of Inventory

Inventories are assets:

a) **held for sale in the ordinary course of business;** (Finished Goods purchased by retailer for resale)
b) **in the process of production** for such sale; or (Raw materials & Work-in-progress)
c) **in the form of materials or supplies to be consumed in the production process or in the rendering of services**.(loose tools, maintenance supplies etc.)

EXPLANATION

Measurement of Inventories

W.I.P & Finished Goods

Inventories should be **valued at Cost or Net Realisable Value** (NRV); **whichever is lower**.

Inventories are usually **written down to net realisable value** on an **item-by-item basis.**It is **not** appropriate to write down inventories based on a classification of inventory **(Global basis)**, for example, finished goods, or all the inventories in a particular business segment.

EXPLANATION

Question 1

Best Ltd. deals in five products, P, Q, R, S, and T which are neither similar nor interchangeable. At the time of closing of its accounts for the year ending 31st March 2010, the historical cost and net realizable value of the items of the closing stock are determined as follows:

Items	Historical Cost (₹)	Net Realisable Value (₹)
P	5,70,000	4,75,000
Q	9,80,000	10,32,000
R	3,16,000	2,89,000
S	4,25,000	4,25,000
T	1,60,000	2,15,000

What will be the value of closing stock for the year ending 31st March, 2012 as per AS 2 "Valuation of Inventories"?

ANSWER

Raw Material

Materials and other supplies held for use in the production of inventories are **valued at cost**. However, **when there has been a decline in the price of materials** and **it is estimated that the cost of the finished products will exceed net realisable value**, the **materials are written down to net realisable value**. In such circumstances, the **replacement cost of the materials** may be the best available measure of their **net realisable value**.

EXPLANATION

Cost of Inventories

The **cost of inventories** should comprise **all costs of purchase**, **costs of conversion** and **other costs** incurred in bringing the inventories to their **present location and condition**.

Cost of Purchase

It includes:

a) **Purchase price**;

b) **Duties and taxes** (other than those subsequently recoverable);

c) **Freight and other expenses** directly **attributable to acquisition**.

Note: Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase.

Cost of Conversion

It includes:

a) **Cost directly related to production** (like Direct labour, cost of design etc.)
b) **Variable Overhead** - assigned to each unit of production **on the basis of the actual use** of the production facilities.
c) **Fixed Overhead** - **absorbed** systematically to units of production over **normal capacity**.

Note:
The amount of fixed production overheads allocated to each unit of production should not be increased as a consequence of low production or idle plant. Unallocated overheads (i.e. under recovery) are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed production overheads allocated to each unit of production is decreased so that inventories are not measured above cost.

Other costs

These are included in cost of inventory to the extent they are directly attributable\related to bring the inventory to its present location and condition.

Exclusion from Cost

In determining the cost of inventories, it is appropriate to exclude certain costs and recognise them as expenses in the period in which they are incurred. Examples of such costs are:

a) **Abnormal amounts of wasted materials, labour, or other production costs**;
b) **Storage costs**, unless the production process requires such storage;
c) **Administrative overheads** that do not contribute to bringing the inventories to their present location and condition;
d) **Selling and distributions costs**;
e) **Interest and other borrowing costs.**

Note: Normal Loss shall always will included in computation of cost of inventory.

EXPLANATION

Question 2

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

Item of Cost	₹ per kg
Material	200
Labour	40
Direct variable overhead	20

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

ANSWER

Question 3

An enterprise ordered 13,000 Kg. of certain material at ₹90 per unit. The purchase price includes excise duty ₹5 per Kg., in respect of which full CENVAT credit is admissible. Freight incurred amounted to ₹80,600. Normal transit loss is 4%. The enterprise actually received 12,400 Kg and consumed 10,000 Kg. Determine the cost of Inventory and its allocation into Materials consumed, Closing inventory and Abnormal loss?

ANSWER

Question 4

Normal production volume of Rama Ltd. Is 1,00,000 units. Estimated fixed overheads are ₹5,00,000. Calculate fixed overhead per unit to be absorbed when actual production is (i) 1,00,000 units; (ii) 80,000 units and (iii) 1,20,000 units and find out unabsorbed amount to be transferred to P&L in all the situations?

ANSWER

Question 5

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

ANSWER

Joint Products & By-Products

A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production.

Most by-products as well as scrap or waste materials, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

EXPLANATION

Question 6

During the production of main product Bomex, a by-product Brucil is also produced. Total cost of conversion is ₹3,85,000 and 1,25,000 units of Bomex and 7,000 units of Brucil arise from the process. Brucil can be sold for ₹5 per unit. Calculate the cost of conversion of Bomex?

ANSWER

Question 7

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

Item	Units	Amount (₹)	Output (unit)	Closing stock
Raw Material	15,000	1,60,000	MP1 – 6,250	800
Wages	-	82,000	MP2 – 5,000	200
Fixed Overhead	-	58,000	BP – 1,600	-
Variable overhead	-	40,000	-	-

Average market price of MP1 and MP2 is ₹80/unit and ₹50/unit respectively. By-product is sold at ₹25/unit. There is a profit of ₹5,000 on sale of by-product after incurring separate processing charges of ₹4,000 and packing charges of ₹6,000. ₹6,000 realised from sale of scrap. Calculate the value of Closing stock of MP1 and MP2?

ANSWER

Net Realisable Value

Net realisable value is the **estimated selling price** in the ordinary course of business **less the estimated costs of completion** and the **estimated costs necessary to make the sale**.

Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made as to the amount the inventories are expected to realise.

Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess inventory is based on general selling prices.

EXPLANATION

Question 8

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

a. 600 units of Raw material A (purchased @ ₹120). Replacement cost of raw material A as on 31-3-2015 is ₹90 per unit.
b. 500 units of partly finished goods in the process of producing X and cost incurred till date ₹260 per unit. These units can be finished next year by incurring additional cost of ₹60 per unit.
c. 1500 units of finished Product X and total cost incurred ₹320 per unit. Expected selling price of Product X is ₹300 per unit.

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

ANSWER

Question 9

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

Particulars	Amount (₹)
Raw Material X	
Closing Balance	500 units
	₹ per unit
Cost price including excise duty	200
Excise Duty (Cenvat credit is receivable)	10
Freight Inward	20
Unloading Charges	10
Replacement Cost	150
Finished Goods Y	
Closing Balance	1,200 units
	₹ per unit
Material Consumed	220
Direct Labour	60
Direct Overhead	40

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

Calculate the value of the closing stock, when:

1) Net Realizable Value of the Finished Goods Y is ₹400.
2) Net Realizable Value of the Finished Goods Y is ₹300.

ANSWER

Question 10

Item of Cost	Kg	₹
Opening Inventory:		
Finished Goods	1,000	25,000
Raw Materials	1,100	11,000
Purchases	10,000	1,00,000
Labour	-	76,500
Fixed overhead	-	75,000
Sales	10,000	2,80,000
Closing Inventory:		
Finished Goods	900	?
Raw Materials	1,200	?

The expected production for the year was 15,000 kg of the finished product. Due to fall in market demand the sales price for the finished goods was ₹20 per kg and the replacement cost for the raw material was ₹9.5 per kg on the closing day. You are required to calculate the value of closing stock?

ANSWER

Cost Formula

Mostly inventories are purchased / made in different lots and unit cost of each lot frequently differs. In all such circumstances, determination of closing inventory cost requires identification of units in stock to have come from a particular lot. This specific identification is best wherever possible. In all other cases, the cost of inventory should be determined by the First-In First-Out (FIFO), or Weighted Average cost formula. **The formula used should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition.**

Instead of actual, the standard costs may be taken as cost of inventory provided standards fairly approximate the actual.

In retail business, where a large number of rapidly changing items are traded, the actual costs of items may be difficult to determine. The units dealt by a retailer however, are usually sold for similar gross margins and a retail method to determine cost in such retail trades makes use of the fact. **By this method, cost of inventory is determined by reducing sale value of unsold stock by appropriate average percentage of gross margin.**

EXPLANATION

Question 11

HP is a leading distributor of petrol. A detail inventory of petrol in hand is taken when the books are closed at the end of each month. At the end of month following information is available:

Sales	₹47,25,000
General overheads cost	₹1,25,000
Inventory at beginning 1,00,000 litres @ 15 per litre	

Purchases:

June 1 - 2 lakh litres @ ₹ 14.25

June 30 - 1 lakh litres @ ₹ 15.15

Closing inventory 1.30 lakh litres

Compute the following by the FIFO as per AS 2:

a. Value of Inventory on June, 30.
b. Amount of cost of goods sold for June.
c. Profit/Loss for the month of June.

ANSWER

Question 12

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

Particulars	₹
Stock as on 01-04-2011	28,500
Purchases	1,52,500
Manufacturing Expenses	30,000
Selling Expenses	12,100
Administration Expenses	6,000
Financial Expenses	4,300
Sales	2,49,000

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

ANSWER

Question 13

Shri Ganesh operates a retail business. For a financial year, the following data is given:

Particulars	Selling price	Cost price
Value of Opening Stock	₹80,000	₹60,000
Purchases	₹1,40,000	₹1,20,000

Calculate the cost of closing stock using Retail method, if Sales made during the year is ₹2,00,000.

ANSWER

Disclosure

The financial statements should disclose:

a) **the accounting policies adopted in measuring inventories, including the cost formula used**;

b) **the total carrying amount of inventories and its classification appropriate to the enterprise.**

Scope (Exclusions from AS – 2)

This Standard should be applied in accounting for inventories other than**:**

a) **work in progress arising under construction contracts**, including directly related service contracts (Accounting Standard (AS) 7, Construction Contracts);

b) **work in progress arising in the ordinary course of business of service providers**;

c) **shares, debentures and other financial instruments held as stock-in-trade**; and

d) **producers' inventories of livestock, agricultural and forest products, and mineral oils, ores and gases to the extent that they are measured at net realisable value** in accordance with well- established practices in those industries.

Concept	Summary
Inventory	
Accounting for Inventory	
Determination of Cost of inventory	
Cost of Joint products & By products	
Effect of Normal & Abnormal Loss	

Exclusions from Cost	
Valuation of Inventory	
Net realisable value	
Cost Formula	
Retail inventory method	
Exclusions from AS-2	

SELF TEST QUESTIONS

Question 1

Cost of a partly finished unit at the end of 2009-10 is ₹150. The unit can be finished next year by a further expenditure of ₹100. The finished unit can be sold at ₹250, subject to payment of 4% brokerage on selling price. Determine the value of Inventory?

Question 2

A trader purchased certain articles for ₹85,000. He sold some of articles for ₹1,05,000. The average percentage of gross margin is 25% on cost. Opening stock of inventory at cost was ₹15,000. Find the cost of closing Inventory?

Question 3

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

Question 4

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

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

What will be the value of Closing Stock?

Question 5

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

Question 6

In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input is ₹1,000. The entire quantity of waste is on stock at the year end. State with reference to Accounting Standard, how will you value the inventories in this case?

Question 7

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

Question 8

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

Question 9

Sony Pharma ordered 12,000 kg. of certain material at ₹80 per unit. The purchase price includes excise duty ₹4 per kg in respect of which full CENVAT credit is admissible. Freight incurred amounted to ₹77,400. Normal transit loss is 3%. The company actually received 11,600 kg. and consumed 10,100 kg. of material. Compute cost of inventory under AS 2 and abnormal loss.

Question 10

Raw materials inventory of a company includes certain material purchased at ₹100 per kg. The price of the material is on decline and replacement cost of the inventory at the year end is ₹75 per kg. It is possible to convert the material into finished product at conversion cost of ₹125. If selling price is (i) ₹175 and (ii) ₹225, find out the value of inventory in each case.

Question 11

On 31stMarch 2013 a business firm finds that cost of a partly finished unit on that date is ₹530. The unit can be finished in 2013-14 by an additional expenditure of ₹310. The finished unit can be sold for ₹750 subject to payment of 4% brokerage on selling price.

The firm seeks your advice regarding:-

a) the amount at which the unfinished unit should be valued as at 31st March, 2013 for preparation of final accounts; and
b) the desirability or otherwise of producing the finished unit.

Question 12

A private limited company manufacturing fancy terry towels had valued its closing stock at the realizable value, inclusive of profit and the export cash incentives. Firm contracts had been received and goods are packed for export, but the ownership in these goods had not been transferred to the foreign buyers.

You are required to advise the company on the valuation of inventories with the provisions of AS-2.