GROUP 1: ACCOUNTING STANDARDS

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AS-1: DISCLOSURE OF ACCOUNTING POLICIES

CA TEJAS SUCHAK
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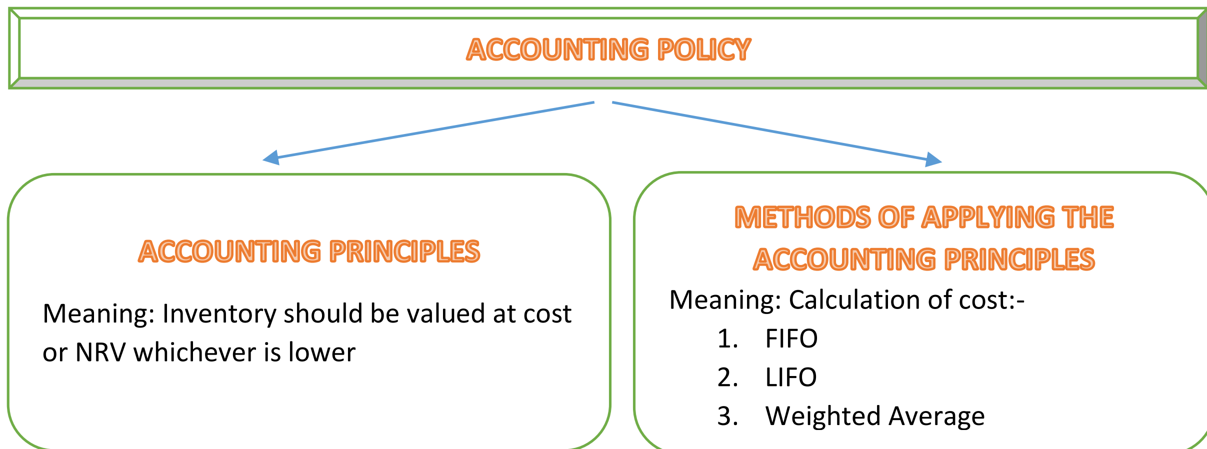

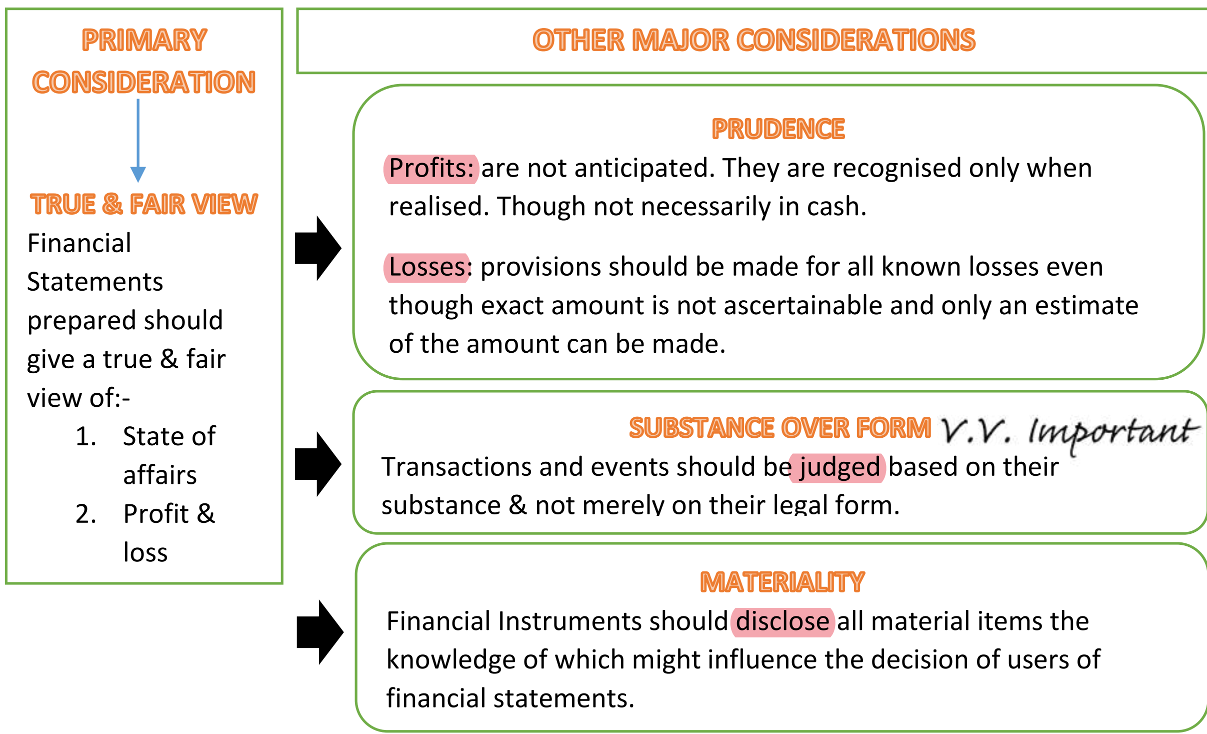

DISCLOSURE OF ACCOUNTING POLICIES

All significant accounting policies adopted in the preparation & presentation of the financial statements should be disclosed at one place to facilitate better understanding of the financial statements.

AS-1: DISCLOSURE OF ACCOUNTING POLICIES

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CHANGE IN ACCOUNTING POLICIES

MATERIAL EFFECT IN THE CURRENT PERIOD

1. Impact on P&L and B/S should be quantified.
2. If quantification is not possible then, fact that such change will have a material effect in the current period should be disclosed.

EXPECTED EFFECT IN LATER PERIODS

1. The fact of such change.
2. The fact that it will likely have an effect in the later periods, should be disclosed in the period in which change is adopted.

FUNDAMENTAL ACCOUNTING ASSUMPTIONS

GOING CONCERN

An enterprise is normally viewed as a going concern i.e. continuing its operations in the foreseeable future.

ASSUMPTION: Enterprise neither has the need nor the intention of liquidating its operations.

CONSISTENCY

Accounting policies should be consistently applied from one period to another.

ACCRUAL

Revenues & costs are accrued, i.e. recognised as they are earned or incurred and recorded in the financial statements of the periods to which they relate and not when the money is received or paid.

IF THE FUNDAMENTAL ACCOUNTING ASSUMPTIONS ARE FOLLOWED:-

No disclosure is required, since it is assumed that these assumptions are followed in the normal course of business.

IF THE FUNDAMENTAL ACCOUNTING ASSUMPTIONS ARE NOT FOLLOWED:-

Disclosure is necessary stating that the fundamental accounting assumptions are not followed.

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Question 1

When assets are purchased on hire purchase, the purchaser becomes the legal owner only after the payment of last instalment. But all risks and rewards related to the asset are with the purchaser right from the beginning and the hire purchaser gets all economic benefits from the asset.

Answer

As per the definition of "asset", Asset is the one which is controlled by the entity and expected future economic benefits inflow to the entity.

Irrespective of the legality, hire purchaser should record the asset in its books of account by considering the reality.

Question 2

Mr. A is a chief accountant of ABC Ltd. The company is capitalising the routine repair expenditure with the fixed asset and it is disclosing the same as it is the company's accounting policy. Comment please.

Answer

Routine repair expenditure is revenue expenditure and it does not increase the previously assessed level of capacity of the asset (Refer AS 10 for detailed discussion), hence such expenditure should be charged to P&L a/c as an expense. The current accounting treatment of the company is NOT correct and as it is said in the AS 1, disclosure is not a remedy for wrong accounting.

Question 3 Important

Can same type of inventory at two different factories be valued by applying two different accounting policies i.e. at one factory valuation of inventory by using FIFO method and at another factory Weighted average cost method?

Answer

The same type of inventory at two different factories cannot be valued by applying two different accounting policies as it doesn't give a true and fair view (The usage of inventory is same irrespective of location). The same has been clarified by Expert Advisory Committee of ICAI.

Question 4

Rama Ltd. follows the practice of disclosing accounting policies adopted in preparation of financial statements in the Directors report. Comment on this practice.

Answer

The practice followed by the company is not correct. It should be disclosed as part of the financial statements. (The directors' report is not part of financial statements)

Question 5 Most Important

Lakshman Ltd has disclosed accounting policies related to fixed assets in schedule E - Fixed assets, accounting policies relating to investments in schedule L - Investments, and accounting policies relating to inventories in schedule G - Current assets, loans and advances and so on. Comment on this practice.

Answer

As per AS-1, all significant accounting policies should be disclosed at one place and these should not be scattered over various schedules. The disclosure of policies of this company is NOT in

accordance with AS- 1. It should change the disclosure as required by the AS.

Question 6

Bharat Ltd. has not complied AS-22 - "Taxes on Income" and the same is disclosed in the notes on accounts. Management of the entity says as non-compliance of AS is disclosed - Financial statements give a true and fair view? Comment

Answer

As per AS-1, Disclosure of accounting policies is NOT a remedy for wrong accounting. The FS does not give a true and fair view as they are not in compliance with AS.

Question 7

A & Co., a partnership firm has prepared its accounts on cash basis. Comment

Answer

Accrual is a fundamental accounting assumption. If it is not followed by the entity, the facts should be disclosed in accordance with AS-1. Hence the firm should disclose the fact that cash basis of accounting has been followed in the notes on accounts.

Question 8

Can different methods of depreciation be followed for the same class of assets used in different plants?

Answer

As per the opinion given by Expert Advisory Committee ICAI, different methods of depreciation for the same class of assets used in different plants of the company can be applied if the management considers it appropriate to do so, after taking into account the factors such as type of the assets, the nature of the use of such assets and the circumstances prevailing in the business.

Question 9 Most Important

Satrugna Ltd has taken a loan of Rs. 10 crore from ICICI Limited. Its bankers Canara Bank have given guarantee to ICICI on its behalf. Satrugna Ltd. has mortgaged its assets to Canara Bank. Satrugna Ltd. has disclosed this loan in its balance sheet as an unsecured loan on the grounds that no security has been given to the lender ICICI Ltd.

Answer

This disclosure of Satrugna Ltd is in accordance with the legal form of the transaction which is that no security has been given to the lender. As per AS-1 accounting treatment and presentation in the financial statements of transactions and events should be governed by their substance and not merely by the legal form. In view of this, the loan should be disclosed as a secured loan, since the property had to be given as a security. If not to the lender, the security has to be given to the guarantor. Since, the economic reality is that the entity had to give its property as security and the loan should be disclosed as a secured loan. However, in the notes on accounts, it should be clarified that security has been given to the guarantor and not to the lender.

Question 10 Most Important

A Partnership firm was formed to secure the tenders floated by BSNL for publication of telephone directories in 2013-14. It bagged the tender for publishing directory for Pune circle for 5 years. It has made a profit in the last 4 years. It bids in tenders for publication of directories for other circles - Nagpur, Nashik, Mumbai, Hyderabad but failed to bag any of these. Its only activity till date is publication of Pune directory. The contract is said to expire on 31-03-2018. You are

auditing the accounts of 2016-17. Is the going concern assumption appropriate for preparation of accounts for 2016-17?

Answer

As per AS 1, It is assumed that an entity continues its business in the foreseeable future. It means the entity has neither intention nor necessity of closing its operations or liquidating its assets in the near future. An entity is assumed to be a going concern in general unless there is significant information to the contrary. Going concern assumption validity should be considered for at least one year. The entity has to consider many things before taking a decision on going concern.

In the given situation, as on 31-3-2017, the entity doesn't have any business in hand after a year. If the entity is of the opinion that it can get any other work during the next year and if it has reasonable plans to continue its business - there is NO doubt on Going concern assumption as far as accounts for 2016-17 are concerned.

If the entity is of the opinion to close its operations after 31-3-2018, it is appropriate to present current year financial statements i.e. 2016-17 at NRV or liquidation basis and any loss arising should be transferred to P&L and the fact should be disclosed in the notes on accounts.

Question 11 Important

A Limited has sold its building for Rs. 50 lakh. The purchaser has paid the full price. The company has given possession to the purchaser. The book value of the building is Rs. 35 lakh. As at 31st March, 2018, documentation and legal formalities are pending. The company has not recorded the disposal. It has shown the amount received as an advance. Do you agree with this treatment?

Answer

Considering the substance over form as per AS-1, documentation and legal formalities represent the form of the transaction, although the legal title has not been transferred, the economic reality and substance is that the rights and beneficial interest in the immovable property have been transferred. Therefore, recording of acquisition/disposal (by the transferee and transferor respectively) would in substance represent the transaction entered into.

In view of this A Ltd should record the sales of asset and recognize the profit of Rs.15 lakh in its P&L. It should eliminate building from its balance sheet. In the notes on accounts it should disclose that building has been sold and full consideration has been received, possession has been handed over to the buyer and documentation and legal formalities are pending.

Question 12 Lecture 2 Youtube

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

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital	*50,000*	*Fixed Assets*	*69,000*
Profit and 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:

(i) Remaining life of fixed assets is 5 years with even use. The net realizable value of fixed assets as on 31 st March, 2018 was Rs. 64,000.

(ii) Firm's sales and purchases for the year 2017-18 amounted to Rs. 5 lakh and Rs. 4.50 lakh respectively.

(iii) The cost and net realizable value of the stock were Rs. 34,000 and Rs. 38,000 respectively.

(iv) General Expenses for the year 2017-18 were Rs. 16,500.

(v) Deferred Expenditure is normally amortised equally over 4 years starting from F.Y. 2016-17 i.e. Rs. 5,000 per year.

(vi) Out of debtors worth Rs. 10,000, collection ofRs. 4,000 depends on successful redesign of certain product already supplied to the customer.

(vii) Closing trade payable is Rs. 10,000, which is likely to be settled at 95%.

(viii) There is pre-payment penalty ofRs. 2,000 for Bank loan outstanding.

Prepare Profit & loss Account for the year ended 31st March, 2018 by assuming it is not a Going Concern.

Answer

When the entity does not have going concern assumption, the entity should prepare the financial statements on Net realizable value basis. The gain or loss on such accounting should be transferred to P&L. The following is prepared accordingly:

Profit and Loss Account of Anurag Trading Co. for the year ended 31st March, 2018

(Assuming business is not a going concern)

	Rs.		Rs.
To Opening Stock	36,000	By Sales	5,00,000
To Purchases	4,50,000	By Trade payables	500
To Expenses	16,500	By Closing Stock	38,000
To Depreciation (69,000-64,000)	5,000		
To Provision for doubtful debts	4,000		
To Deferred expenditure	15,000		
To Loan penalty	2,000		
To Net Profit	10,000		
	5,38,500		5,38,500

Question 13

ABC Financial Services Ltd. 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. ABC Financial Services Ltd. 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 from the due date to date of repayment was mentioned in 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 Account.

State whether the treatment done by the company is correct or not as per relevant AS. (IPCC-May 2017)

Answer

I think, you need to read the question twice or thrice to understand.

First let us try to understand the question. Say entity took a loan on 01-04-2018 and due date to pay 31- 12-2018 but the loan is NOT repaid till the Balance sheet date i.e. 31-03-2019. In this case, the entity is providing interest only till 31-12-2018 and NOT recognising the interest for last 3 months which is against the accrual concept, (hope you got it - if not go back to the question again)

As per AS 1, 'accrual' is one of the fundamental accounting assumptions. Irrespective of the terms of the contract, so long as the principal amount of a loan is not repaid, the company has an obligation to the overdue interest.

In this situation, the company should provide for the liability (since it is not waived by the lenders) at an amount estimated or on reasonable basis based on facts and circumstances of each case. However, in respect of the overdue interest amounts, which are settled, the liability should be accrued to the extent of amounts settled. Non-provision of the overdue interest liability amounts to violation of accrual basis of accounting. Therefore, the treatment, done by the company, of not providing the interest amount from due date to the date of repayment, is not correct.

Question 14

In the books of M/s Prashant Ltd., closing inventory as on 31.03.2018 amounts to Rs. 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 2017-18. On the basis of weighted average method, closing inventory as on 31.03.2018 amounts toRs. 1,47,000. Realisable value of the inventory as on 31.03.2018 amounts toRs. 1,95,000. Discuss disclosure requirement of change in accounting policy as per AS-1.

Answer

As per AS 1, any change in an accounting policy which has a material effect should be disclosed in the financial statements. The amount by which any item in the financial statements is affected

by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

Thus Prashant Ltd. should disclose the change in valuation method of inventory and its effect on financial statements. The company may disclose the change in accounting policy in the following manner:

"The company values its inventory at lower of cost and net realisable value. Since net realisable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 2017-18, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by Rs.16,000".

Question 15

HIL Ltd. was making provisions 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 Rs. 120 lakh.

Provision required based on technical evaluation Rs.3 lakh;

Provision required based on 12 months no issues Rs.4 lakh;

You are required to discuss the following points in the light of AS - 1;

(i) Does this amount to change in accounting policy?

(ii) Can the company change the method of accounting? (CA Inter - Nov 2018)

Answer

The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory from Rs.4 lakhs to Rs.3 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2017-18:

"The company has provided for non-moving inventories on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been lower by Rs.1 lakh."

AS-2: VALUATION OF INVENTORIES

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DEFINITION

Inventory includes:-

1. Goods held for sale.(finished goods)
2. Goods held in the process of production for sale.(work in progress)
3. Materials & supplies used in production. (RM, consumables, spares etc.) of goods or rendering services.
4. Consumables & spares(other than those covered in AS-10) consumed in production of goods or rendering of services.
5. Also includes; by products, packages & consumables(stock of non returnable containers or other packing materials.)

APPLICABILITY

Not applies to:-

1. Inventory of producers(farmers) of agricultural goods.
2. Extraction/ Exploration industry output.(guidance note available)
3. WIP of service provider(AS-9)
4. WIP of construction contracts(AS-7)
5. Traders/Dealers in shares, debentures, securities.

VALUATION OF INVENTORY

- Inventory to be valued at cost or NRV w.e.l.
- Valuation to be done inventory wise and not for group of inventories, unless it is of the same class.

COST OF INVENTORIES

PURCHASE COST

-Cost of purchase

-Excludes recoverable taxes & rebates, trade discount.

-Costs incidental to bring the inventory to its present location & condition.

CONVERSION COSTS

-Costs that could be avoided if production activity was not being undertaken.

-Includes direct costs(prime costs) as well as indirect costs(production overheads) related to production.

EXCLUSIONS

-Abnormal costs
-General administration overhead
-Selling & distribution overhead
-Finished goods storage cost
-Borrowing costs(included only if allowed by AS-16)
-Research & development costs(as per AS-26)

AS-2: VALUATION OF INVENTORIES

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COST FORMULA/METHOD

UNIQUE PRODUCTION METHOD

Specific identification method

INTERCHANGEABLE PRODUCTION METHOD

FIFO or Weighted Average Method whichever more closely approximates with the pattern of issue of inventories.

NET REALISABLE VALUE

FINISHED GOODS

-Selling price

-Less: direct selling cost

WORK IN PROGRESS

-Selling Price

-Less: direct selling cost

-Less: cost incurred to complete production.

RAW MATERIAL

-Replacement cost.

-VALUATION OF RAW MATERIALS.

-Used in production of finished goods

-Finished goods expected to be sold below cost: raw materials valued at cost/ NRV w.e.l.

-Finished goods expected to be sold at cost or above cost: raw materials valued at COST.

VALUATION OF JOINT PRODUCTS & BY PRODUCTS

JOINT PRODUCT

-Costs to be apportioned between the joint products on a reasonable basis at split off point.

-Eg: sales value at split off point.

BY PRODUCT

-Output of manufacturing process with immaterial value

-To be valued at NRV.

-Such value to be reduced from the cost of the main product.

Question 1

A Ltd. is into real estate industry. It purchases lands, develops them and sells them in small plots. The accountant of the company has grouped the cost of land and cost of development under fixed assets. Do you agree with this accounting treatment? Answer with reasons.

Answer

As per AS-2 Inventory is an asset which is held for sale in the ordinary course of business. Since land is being held by the company for sale in the ordinary course of business, it becomes an inventory to the company and therefore it should be classified as inventory under the head CURRENT ASSETS.

(For information - As per AS 10 - Fixed asset is an asset held to produce or provide services but not held for sale in the ordinary course of business; Refer AS 10 for further discussion on Fixed assets)

Question 2

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

Answer

When actual production is 1,00,000 units

When actual production is equal to normal capacity, fixed overheads should be absorbed by 1,00,000 units i.e. fixed overheads recovery rate = 5,00,000 / 1,00,000 = Rs.5 per unit.

Overheads absorbed = actual capacity x per unit rate = 1,00,000 x 5 = Rs.5,00,000;

Actual overheads incurred = Rs.5,00,000; So unabsorbed amount = Nil

When actual production is 80,000 units

When actual production is less than normal capacity, fixed overheads should be absorbed by using normal capacity (i.e. 1,00,000 units) i.e. fixed overheads recovery rate = 5,00,000 / 1,00,000 = Rs.5 per unit.

Overheads absorbed = actual capacity x per unit rate = 80,000 x 5 = Rs.4,00,000;

Actual overheads incurred = Rs.5,00,000; So unabsorbed amount = Rs.1,00,000

When actual production is 1,20,000 units

When actual production is more than normal capacity, fixed overheads should be absorbed by using actual capacity (i.e. 1,20,000 units) i.e. fixed overheads recovery rate = 5,00,000/1,20,000 = Rs.4.17 per unit. Overheads absorbed = actual capacity x per unit rate = 1,20,000 x 4.17 = Rs.5,00,000;

Actual overheads incurred = Rs.5,00,000; So unabsorbed amount = Nil

Question 3

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

1. *Trade discounts on purchase*
2. *Handling costs relating to imports*
3. *Salaries of accounting department*

4. *Sales commission paid to sales agents*
5. *After sales warranty costs*
6. *Import duties*
7. *Costs of purchases (based on supplier's invoices)*
8. *Freight expense*
9. *Insurance of purchases*
10. *Brokerage commission paid to indenting agents*

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

Answer

Items number 1,2, 6, 7, 8, 9, 10 are allowed by Ind AS 2 for the calculation of cost of inventories.

Salaries of accounts department, sales commission, and after sale warranty costs are not considered to be the cost of inventory therefore they are not allowed by Ind AS 2 for inclusion in cost of inventory and are expensed off in the profit and loss account.

Question 4

In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in a wastage of 300 MT. cost per MT of input is Rs.1,000. The entire quantity of waste is on stock at the year end. If waste has NO realizable value, what is the cost per unit? (IPCC May 2008 & Nov 2014)

Answer

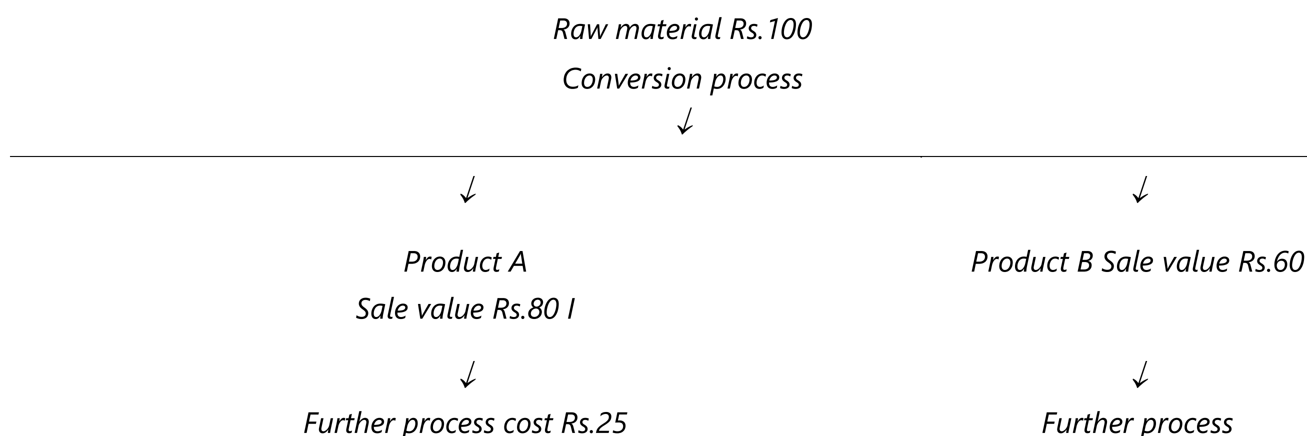
As per AS-2, Abnormal amount of waste materials, labour or other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred.

In this case, normal waste is 250 MT (5,000 MT x 5%) and Actual waste is 300 MT; hence abnormal waste is 50 MT (300 MT-250MT).

The cost of normal waste 250 MT will be included in determining the cost of inventories (finished goods) at the year end.

The cost of abnormal waste amounting to Rs.52,632 (50 MT x Rs. 1,052.63) will be charged to P&L statement. Cost per unit=5,000 x 1,000 / 4,750 = 1,052.63.

Question 5



cost Rs. 20 1

In the above example, the Raw material is used in conversion process and it is separated into Products A & B and both the products are material and important hence we can call them Joint products. The Sale value at the time of separation is Rs.80 and Rs.60 respectively and the company did further process of each and incurred a cost of Rs.25 & Rs.20 respectively and after the completion of the process the sale value is Rs.120 and Rs.90 respectively.

The question is how do you allocate the Rs. 100 of raw material between A&B?

Answer

The Raw material cost of Rs. 100 can be absorbed between A & B in the following ways - which the entity feels rational and systematic - it depends on the situation and circumstances.

(a) Sale value when they are separated i.e. in the ratio of 80:60

(b) Sale value of final products i.e. 120:90

(c) Sale value of final product Less further processing cost i.e. (120-25) 95 : 70 (90-20).

10. Allocation of cost in case of by-products

Question 6

During the production of main product Bomex, a by-product Brucil is also produced. Total cost of conversion is Rs.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 Rs.5 per unit (does not require any further process). Calculate the cost of conversion of Bomex and Brucil?

Answer

As per AS 2, we need to find out the cost of Main product in the following manner.

Joint costs of Bomex & Brucil (as given)	*Rs.3,85,000*
NRV of By-product (Brucil) (7,000 5)*	*Rs. 35,000*

Net costs of Main product = (3,85,000 - 35,000) = Rs.3,50,000

Cost of conversion of Main product Bomex per unit = (Rs.3,50,000 / 1,25,000 units) = Rs.2.80 per unit.

Question 7

During the production of main product Bomex, a by-product Brucil is also produced. Total cost of conversion is Rs. 3,88,500 and 1,25,000 units of Bomex and 7,000 units of Brucil arise from the process. Brucil CANNOT be sold at the time of split off. It can be sold after further process. Further process costs '0.50 per unit. After further process, by-product can be sold for per unit. Calculate the cost of conversion of Bomex (Main product)?

Answer

As per AS 2, we need to find out the cost of Main product in the following manner:

Joint costs of Bomex & Brucil (as given)	*Rs. 3,88,500*
NRV of By-product at the time of split off (Brucil) [7,000 x (Rs.6 - Rs.0.50)]	*Rs. 38,500*

Net costs of Main product = (3,88,500 - 38,500) = Rs.3,50,000

Cost of conversion of Main product Bomex per unit = (Rs.3,50,000 / 1,25,000 units) = Rs.2.80 per unit.

Question 8

On 31-3-2018, there is work in progress of product A. It is estimated that the finished product can be sold at Rs. 1,000. Estimated cost of completion is Rs.200. Brokerage is @10% on selling price. Calculate the NRV of WIP?

Answer

	Rs.
Estimated selling price of finished product	*1,000*
Less: Estimated cost to sell (1000 x 10%)	*(100)*
Less: Estimated cost of completion	*(200)*
NRV	*700*

Question 9

Mr. Mehul gives the following information relating to items forming part of inventory as on 31-3-2018. His factory produces Product X using Raw material A.

(i) 600 units of Raw material A (purchased @ Rs. 120). Replacement cost of raw material A as on 31-3- 2018 is Rs. 90 per unit.

(ii) 500 units of partly finished goods in the process of producing X and cost incurred till date Rs.260 per unit. These units can be finished next year by incurring additional cost ofRs. 60 per unit.

(iii) 1500 units of finished Product X and total cost incurred Rs. 320 per unit.

Expected selling price of Product X is Rs. 300 per unit.

Determine how each item of inventory will be valued as on 31-3-2018. Also calculate the value of total inventory as on 31 -3-2018.

Answer

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

Hence the valuation will be done as under.-

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

(ii) 500 units of partly finished goods will be valued at 240 per unit i.e. lower of cost Rs. 320

(Rs. 260 + additional cost Rs. 60) or Net estimated selling price Rs. 240 (Estimated selling price Rs. 300 per unit less additional cost ofRs. 60).

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

Valuation of Total Inventory as on 31.03.2018:

	Units	Cost (Rs.)	NRV/ Replace-ment cost	Value = units x cost or NRV whichever is less (Rs.)
Raw material A	600	120	90	54,000
Partly finished goods	500	260	240	1,20,000
Finished goods X	1,500	320	300	4.50.000
Value of Inventory				6.24.000

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

Question 10

Let us assume that a manufacturing company manufactures products X, Y & Z. At the year end the unsold amounts of X, Y& Z are 5,000, 8,000 and 2,000 respectively. Their NRV are 4,500, 7,800 and 2,500 respectively. Calculate the closing amount of inventory.(IPCC - May 2011 - Modified)

Answer

- *Here cost and NRV of each product is compared.*
- *In the balance sheet the net amount i.e. 14,300 should be carried.*

Product	Cost (Rs.)	NRV(Rs.)	Inventory value (Rs.)
X	5,000	4,500	4,500
Y	8,000	7,800	7,800
Z	2,000	2,500	2,000
Total Value of Inventory			14,300

Question 11

Inventories of a Car Mfg Co. include, the items required for manufacturing of a model which was removed from the production line 5 years back, valued at Cost price. Comment. (CA- Inter - Nov, 2002)

Answer

As per AS-2, inventories should be valued at Cost or NRV whichever is lower. Here, as the product

was removed from production line, its NRV seems lower than its cost. Therefore, it should be valued at NRV.

Question 12

X Ltd purchased goods at the cost of Rs.40 lakh in October, 2017. Till March 2018, 75% of the stock was sold. The company wants to disclose closing stock at Rs. 10 lakh (40 lakh x 25%). The expected sales value is Rs.11 lakh and a commission of 10% is payable to the agent. Advise, whether the inventory valuation is correct.

(PCC -May 2006)

Answer

AS-2 states that Inventory should be valued at lower of cost or NRV.

Here, Cost of inventory = (Rs.40 lakh x 25%) = 10 lakh

NRV = General selling price - Selling costs = 11 lakh -1.1 lakh (11 lakh x 10%) = 9.9 lakh Therefore, Inventory should be valued at Rs.9.9 lakh, being lower of cost and NRV.

Question 13

HP Ltd 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 June the following information is available:

Sales	*Rs.47,25,000*
General overheads cost	*Rs. 1,25,000*
Inventory at the beginning	*1,00,000 litres @ 15 per litre*

Purchases

- *June, 1st - two lakh litres @ 14.25*
- *June, 30th - one lakh litres @ 15.15 Closing inventory 1.30 lakh litres*

Compute the following by the FIFO method as per AS-2:

1. *Value of inventory on June, 30th*
2. *Amount of cost of goods sold for June*
3. *Profit/Loss for the month of June*

Answer

(1) Cost of closing inventory for 1,30,000 litres as on 30th June

1,00,000 litres @15.15	*15,15,000*
30,000 litres @ 14.25	*4,27,500*
Total cost in FIFO method	*19,42,500*

(2) Calculation of Cost of goods sold

Opening inventories (llakh litres @ 15)	*15,00,000*
Add: Purchases [(2lakh lts x 14.25) + (1 lakh lts x15.15)]	*43,65,000*
Less: closing inventory	*-19,42,500*
Cost of goods sold of June	*39,22,500*

(3) Calculation of Profit

Sales	*47,25,000*
Less: Cost of goods sold	*-39,22,500*
Less: General overheads	*- 1,25,000*
Profit	*6,77,500*

Question 14

Raw materials inventory of a company includes certain materials purchased at Rs. 100 per kg. The price of the material is on the decline & replacement cost of the inventory at the year end is Rs.75 per kg. It is possible to convert the material into finished product at a conversion cost of Rs. 125 per kg. Decide whether to produce the product or not, if selling price is (i) Rs.175 and (ii) Rs.225. Also find out the value of inventory in each case.

(IPCC May 2010, May 2013- modified)

Answer

As per AS-2, if finished goods are sold at or above cost, then Raw materials should be valued at cost only. If finished goods are sold at less than cost, then Raw materials should be valued at Replacement price.

(i) When Selling Price is Rs.175 Incremental profit = Rs.175 - 125 = Rs.50 Current price of material = Rs.75

As the incremental profit on sale is LESS than replacement cost, it is better to NOT produce the product. The entity can get better amount on sale of raw material as it is in the market.

Value of inventory = Rs.75 [because FG is sold at less than cost i.e., 225 (100 + 125)]

(ii) When Selling Price is Rs.225 Incremental profit = Rs.225-125 = Rs. 100 Current price of Raw material = Rs.75 Therefore, it is better to make the product.

Value of inventory = Rs.100 (because FG is sold at price equal to cost i.e. 225)

Question 15

An enterprise ordered 13,000 kg of certain material at Rs.90 per unit. The purchase price includes excise duty of Rs.5 per kg in respect of which full CENVAT credit is admissible. Freight incurred amounted to Rs.80,600. Normal transit loss is 4%. The enterprise actually received 12,400 kg and consumed 10,000 kg. Calculate cost of closing inventory. (PCC June 2009, Nov 2011 - modified)

Answer

Calculation of Material Cost:

PARTICULARS	*Amt in Rs.*
Purchase price (13,000 x 90)	*11,70,000*
Less: CENVAT credit (13,000 x 5)	*(65,000)*
Add: Freight inwards	*80.600*

Total material cost for 12,400 k.g.	*11.85.600*

Closing stock = 2,400 k.g.

Value of closing stock = (11,85,600 /12,480) x 2,400 = Rs.2,28,000.

Question 16

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

Raw material X	
Closing balance	*500 units*
	Rs. Per unit
Cost price including excise duty	*200*
Excise duty (Cenvat credit is receivable on the excise duty paid)	*10*
Freight inward	*20*
Unloading charges	*10*
Replacement cost	*150*
Finished goods Y	
Closing Balance	*1200 units*
	Rs. Per unit
Material consumed	*220*
Direct labour	*60*
Direct overhead	*40*

Total Fixed overhead for the year was Rs. 2,00,000 on normal capacity of 20,000 units. Calculate the value of the closing stock, when

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

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

(IPCC May 2014 & Nov. 2017)

Answer

Working Notes:

Raw Material X	*Rs.*

Cost Price	*200*
Less\ Cenvat Credit	*10*
	190
Add: Freight Inward	*20*
Unloading charges	*10*
Cost	*220*

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

Situation (i)

When Net Realisable Value of the Finished Goods Y is Rs. 400 NRV is greater than the cost of Finished Goods Y i.e. Rs. 330

Hence, as the costs of raw material can be recovered by selling the finished goods, RM and FG are to be valued at cost:

Value of Closing Stock:

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

Situation (ii)

When Net Realisable Value of the Finished Goods Y is Rs. 300 NRV is less than the cost of Finished Goods Y i.e. Rs. 330

As the the cost of RM cannot be recovered, Raw Material should be valued at replacement cost and Finished Goods are to be valued at NRV since NRV is less than the cost.

Value of Closing Stock:

	Qty	Rate	Amount
Raw Material X	*500*	*150*	*75,000*
Finished Goods Y	*1,200*	*300*	*3,60,000*
Total Cost of Closing Stock			*4,35,000*

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

Question 17

The company X Ltd., has to pay for delay in cotton clearing charges. The company up to 31.3.2017 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 2017-18. This would result in decrease in profit by Rs. 5 lakh. Comment.

Answer

As per AS 2, interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are therefore, usually not included in the cost of inventories.

However, X Ltd. was in practice to charge the cost for delay in cotton clearing in the closing stock. As X Ltd. decided to change this valuation procedure of closing stock, this treatment will be considered as a change in accounting policy and such fact to be disclosed as per AS 1. Therefore, any change in amount

mentioned in financial statement, which will affect the financial position of the company should be disclosed properly as per AS 1, AS 2 and AS 5.

Also a note should be given in the annual accounts that, had the company followed earlier system of valuation of closing stock, the profit before tax would have been higher by Rs. 5 lakh.

AS-10: PROPERTY, PLANT & EQUIPMENT

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ACCOUNTANCY ACE

NON APPLICABILITY

- Biological assets:- meaning assets which are consumed. Eg:- Plants, Animals.
- Wasting assets:- meaning mines.

DEFINITION: PROPERTY, PLANT & EQUIPMENT

Means Tangible Items which are held for

- Use in the production or supply of goods or services
- Rental to others
- Administrative Purposes

AND

are expected to be used for more than 12 Months.

NOTE: Items such as Spare Parts, Stand-By &Servicing Equipment are treated as **PPE,** if they meet the definition above. Otherwise, they are treated as Inventory.

RECOGNITION PRINCIPLE

PPE should be recognised only if following conditions are satisfied:-

- Future economic benefits flow to the entity.
- Costs can be reliably measured.

COSTS FOR SELF CONSTRUCTED PPE

1.Purchase price(after rebates & discounts)
Add:
2. Non recoverable taxes.
3. Directly attributable expenses.
- Installation expenses
- Trial run expenses
- Other expenses to make the assets ready for its intended use.

4. borrowing costs (date of borrowing - till - the asset is ready to use)
5. Initial estimate of decommissioning or dismantling costs.

COST OF SELF CONSTRUCTED PPE

1. Actual cost incurred on construction
2. Allocated overhead.

NOTE: internal profits cannot be recognised.

COST OF PPE ACQUIRED IN EXCHANGE OF OTHER ASSETS

Recorded at

1. Fair value of asset given up.
2. Fair value of asset acquired.

NOTE: consider the fair value whichever is more reliably measurable.

CONDITION:- The above criteria is followed only if the transaction has a commercial substance.

➢ If there is no commercial substance or the fair value cannot be reliably measured then the cost should be measured at the carrying amount of the asset given up.

COMMERCIAL SUBSTANCE

Exchange transaction has a commercial substance if:-

1. Risk, timings and amount of cash flows of the asset received are significantly different from the cash flows of the asset transferred.
2. There is a significant effect on the present value of after tax cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life due to the exchange transaction.

COMPONENT ACCOUNTING

If an asset comprises of two or more significant components with substantially different useful lives, usage or flow of economic benefits; then each component should be recognised and depreciated separately over its individual useful life.

SUBSEQUENT EXPENDITURE ON PPE

-If any subsequent expenditure is done on improvement of PPE such subsequent expenditure should be capitalised provided it improves efficiency of PPE i.e. it improves future economic benefits that can be derived from the asset.

-If such expenditure does not satisfy the above recognition criteria it will be charged to P&L.

DEPRECIATION ON PPE

-Depreciation is charged each year.

-Depreciation should be charged using systematic method:- SLM,WDV or any other method.

-Depreciation is charged from the date on which asset is ready to use.

-Depreciation should be charged for components separately.

-Method of depreciation, useful life, residual value should be reviewed at each balance sheet date. A change is in any of the above will be given effect to prospectively i.e. treated as a change in accounting estimate as per AS-5.

SUBSEQUENT MEASUREMENT OF PPE

- PPE can be subsequently measured under any of the two given models:-
  1. COST MODEL
  2. REVALUATION MODEL
- Revaluation model is an option given to a PPE, based on management's decision.
- Revaluation model should be selected when there is material difference between --carrying amount OR --fair value as on the balance sheet date.
- Revaluation model should be followed for an entire class of PPE such as P&M, L&B i.e. if an entity has taken a decision to revalue its buildings then it should revalue all the buildings of the entity.
- Revaluation of selective assets within a class is not permitted.
- Entity can follow Revaluation model for a particular class of assets and cost model for the remaining class of assets.

REVALUATION ACCOUNTING

FIRST TIME REVALUATION

UPWARD REVALUATION

PPE a/c Dr.
To, Revaluation Surplus a/c

DOWNWARD REVALUATION

P&L a/c Dr.
To, PPE a/c

SUBSEQUENT REVALUATION - UPWARD

FIRST REVALUATION-UPWARD

PPE a/c Dr.
To, Revaluation Surplus a/c

FIRST REVALUATION-DOWNWARD

PPE Dr.
To, Revaluation Surplus a/c (bal.fig)
To.P&L a/c

SUBSEQUENT REVALUATION - DOWNWARD

FIRST REVALUATION-UPWARD

Revaluation Surplus a/c
P&L a/c Dr. (bal.fig)
To, PPE a/c Dr.

FIRST REVALUATION-DOWNWARD

P&L a/c Dr.
To, PPE a/c

DISCLOSURE REQUIRMENTS

1. Gross book value of PPE.
2. Accumulated depreciation.
3. Addition to PPE.
4. Deletion to PPE.
5. Method of depreciation.
6. Useful life of PPE.
7. If company is following revaluation model such fact should be disclosed.

QUESTION 1

A Publishing Company undertook repair and overhauling of its Machinery at a cost of Rs. 2.50 Lakhs to maintain them in good condition and capitalized the amount as it is more than 25% of the Original Cost of the Machinery. Give your views on the above treatment.

Hint Answer: *Cost of Repairs and Maintenance are day-to-day servicing costs, and should be recognised as Expense in Profit and Loss. The percentage of such costs to the Carrying Amount of PPE is not relevant.*

QUESTION 2

Entity A, a Supermarket Chain, is renovating one of its major Stores. The Store will have more available space for In-Store Promotion Outlets after the renovation and will include a Restaurant. Management is preparing the budgets for the year after the Store re-opens, which include the Cost of Re-Modelling and the expectation of a 15% increase in sales resulting from the Store Renovations, which will attract new customers. State whether the Re-Modeling Cost can be capitalized.

In this case, Re-Modelling Expenditure will create future economic benefits (in the form of 15% of increase in sales) and the cost of re-modelling can be measured reliably. So, it should be capitalised.

QUESTION 3

An Amusement Park has a 'soft' opening to the public, to trial run its attractions. Tickets are sold at a 50% Discount during this period and the Operating Capacity is 80%. The official opening day of the Amusement Park is 3 Months later. Management claims that the soft opening is a trial run necessary for the Amusement Park to be in the condition capable of operating in the intended manner. So, the Net Operating Costs incurred should be capitalised. Comment on the above.

1. Even though it is running at less than full Operating Capacity (in this case 80%), there is sufficient evidence that the Amusement Park is capable of operating in the manner intended by the Management. Therefore, these costs are specific to the start-up and, therefore, should be expensed as incurred.

2. So, the Net Operating Costs should ***not*** *be capitalised, but should be recognised in the Statement of Profit and Loss.*

QUESTION 4

Sri Limited is a Manufacturing Company engaged in manufacture of cement. It had three Plants already commissioned in its Site at Chennai. The Company expanded its plant capacity by contracting with a Supplier for the purchase and installation of one additional Plant. The Project was commenced on 1st July 2018 and the new Plant commenced commercial operations on 1st January 2018. The New Plant was capitalized and shown as a PPE as on 31st March 2018 at Cost which included, besides other things, the following:

(1) Contract Price of Plant and Equipment and Installation Costs.

(2) Interest due for the period till 31st March 2018, for the Term Loan taken from a Scheduled Bank for financing the project which is repayable over 5 years commencing from 1st July 2018.

(3) Salaries, Welfare Expenses of the Plant Engineers of the Company for the period from 1st July 2018 to 31st December 2018 who supervised the contract work.

Item	***Treatment***

Contract Price of Plant and Equipment, and Installation Costs	*Should be included as part of Cost of PPE.*
Interest on Specific Term Loan	*To be capitalised only upto date of commencement of commercial operations, i.e. upto 1st January 2018.* ***[Refer AS-16 also]***
Salaries, Welfare Expenses, etc.	*Can be capitalized only if they are "directly" attributable. General Administrative Costs should not be included in the cost of PPE.*

QUESTION 5

In the Notes to Accounts of Chandrasekar Co. Ltd as on 31.03.2018, Note No.7 states that -

"Certain Machinery items are lying at Customs Warehouses and Company has paid Rs. 900 Lakhs up to 30.06.2018 as Detention Charges, out of which a sum of Rs. 580 Lakhs is written back during the year 2018-2018, based on settlement with the concerned authorities in respect of a major spares of Machinery. For the remaining Machinery items, negotiations are pending and a provision of Rs. 44 Lakhs is made.

As such, total amount of Rs. 364 Lakhs paid f provided on account of Detention Charges have been capitalized and included in the Fixed Assets f Capital Work in Progress. The Management is of the view that these expenses are directly attributable to the acquisition of the related Fixed Asset."

Comment on the appropriateness of the above accounting policy.

1. Detention Charges are not cost incurred directly or indirectly on the asset.

2. They are ***penal*** *in nature, and not attributable to the Asset, but attributable to certain statutory non-compliance.*

3. Such costs neither add value nor increase the functionality to the Asset under consideration.

4. Therefore, such costs ***should not be capitalized,*** *and should be expensed off.*

5. The Company's accounting policy is inappropriate.

QUESTION 6

On 1st April, an Enterprise acquired a machine under the following terms -

Particulars	***Rs.***
List Price of Machine	***80,00,000***
Import Duty	***5,00,000***
Delivery Fees	***1,00,000***
Electrical Installation Costs	***10,00,000***
Pre-Production Testing	***4,00,000***
Purchase of a 5-year Maintenance Contract with the Vendor	***7,00,000***

The Enterprise was granted a Trade Discount of 10% on the initial List Price of the Asset and a settlement discount of 5%, if payment for the Machine was received within 1 month of purchase. The Enterprise paid for the Plant on 20th April. At what Cost the Asset will be recognised?

Hint Answer: Refer Principles above.

Particulars	***Rs.***
List Price 80,00,000 Less: Trade Discount (10%)	*72,00,000*
Import Duty (non-refundable)	*5,00,000*
Delivery Fees	*1,00,000*
Electrical Installation Costs	*10,00,000*
Pre-Production Testing	*4,00,000*
Cost of PPE at Initial Recognition	***92,00,000***

Notes: *(1) Maintenance Contract is a* ***separate contract*** *to get service, so, the Maintenance Contract Cost of Rs. 7,00,000 should be taken as a Prepaid Expense and charged to the Profit or Loss over a period of 5 years. (2) Settlement Discount Received of (Rs. 72,00,000 x 5%) = Rs. 3,60,000 is to be shown as Other Income in the Profit or Loss.*

QUESTION 7

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

The Machine was purchased at Rs. 52,78,000 including GST. Rs. 18,590 Transportation Charges were incurred to bring the Machine to the Factory. An Architect was engaged at a fee of Rs. 10,000 to supervise machinery installation at the Factory Premises. Also, payment under the invoice was due in 3 months. However, the Company made the payment in the 2nd month. The Company operates on Bank Overdraft @ 11%.

Ascertain the amount at which the Asset should be recognised as PPE under AS 10.

Cost of PPE (i.e. Machine) is calculated as under -

Particulars			***Rs.***
	Purchase Price	*Given*	*52,78,000*
Less:	*GST*	*Not adjusted since Rate & Input Tax Credit availability not given.*	*Nil*
Add:	*Site Preparation Cost*	*Given*	*47,290*

Add:	*Technician's Salary*	*Specific / Attributable Cost for 2 months, w/o Profits* ***(Note 2)***	*30,000*
Add:	*Initial Delivery Cost*	*Transportation*	*18,590*
Add:	*Professional Fees for Installation*	*Architect's Fees*	*10,000*
Total Cost of Asset			***53,83,880***

Note: *1. If GST Rate is given and Input Tax Credit is available, it should* ***not*** *be included in Cost of PPE.*

2. Internally Booked Profits should be eliminated in arriving at the Cost of PPE.

3. Interest on Bank Overdraft for earlier payment of Invoice is not relevant under AS-10 or AS-16.

QUESTION 8

Versatile Limited purchased Machinery for Rs. 4,80,000 (inclusive of GST of Rs. 40,000). input Tax Credit is available for the GST paid. The Company incurred the following other expenses for installation.

Particulars	***Rs.***
Cost of Preparation of Site for Installation	***21,000***
Total Labour Charges (200 out of the total 600 man hours worked, were spent for installation of the Machinery)	***66,000***
Spare Parts and Tools consumed in Installation	***6,000***
Total Salary of Supervisor (time spent for installation was 25% of the total time worked)	***24,000***
Total Administrative Expenses (1/10 relates to the Plant Installation)	***32,000***
Test Run and Experimental Production Expenses	***23,000***
Consultancy Charges to Architect for Plant Setup	***9,000***
Depreciation on Assets used for the installation	***12,000***

The Machine was ready for use on 15th January but was used from 1st February. Due to this delay further costs Rs. 19,000 were incurred. Calculate the value at which the Plant should be capitalized.

Cost of PPE (i.e. Machine) is calculated as under -

	Particulars	***Rs.***
	Purchase Price (Rs. 4,80,000 less GST for which Credit is available 40,000)	*4,40,000*
Add:	*Site Preparation Cost*	*21,000*

Labour Charges Rs. 66,000 × $\frac{200}{600}$	*22,000*
Spares and Tools in Installation	*6,000*
Salary of Supervisor (24,000 × 25%)	*6,000*
Admin Expense attributable to Installation (Attributable Costs are included) l/10th of 32,000	*3,200*
Test Run & Experimental Production (Indirect Element)	*23,000*
Consultancy Charges to Architect for Plant setup	*9,000*
Depreciation on Asset used for Installation	*12,000*
Expenses due to delay in use (Excluded as it is abnormal)	*Nil*
Total Capitalized Cost of Asset	***5,42,200***

QUESTION 9

Bhargav Ltd has made additions to its factory by using its own workforce, at a cost of Rs. 4,50,000 as Wages and Materials. The lowest estimate from an outside Contractor to carry out the same work was Rs. 6,00,000. The Directors contend that, since they were fully entitled to employ an outside contractor, it is reasonable to debit the Factory Building Account with Rs. 6,00,000. Comment.

Hint: Refer Principles relating to Self-Constructed PPE above. *The Company should capitalise only Rs. 4,50,000, since*

Rs. 6,00,000 is only notional and not incurred by the Company. Also, Internal Profits, should be eliminated, as per AS 10.

QUESTION 10

Shankar Ltd is constructing a Fixed Asset, on which following expenses are incurred -

	Rs.
Material	***16,00,000***
Direct Expenses	***3,00,000***
Total Direct Labour (1f15th of total labour time was chargeable to construction)	***6,00,000***
Total Office & Administrative Expenses (4% is chargeable to the construction)	***9,00,000***
Depreciation on the assets used for the construction of this assets	***15,000***

Calculate the cost of Fixed Assets.

Particulars	***Rs.***
Direct Materials (Given)	*16,00,000*

Direct Labour (l/15th of Total Labour Rs. 5,00,000)	*40,000*
Direct Expenses (Given)	*3,00,000*
Office & Administrative Expenses (4% is only apportionment charge, not attributable specifically)	*Nil*
Depreciation Expense on other Assets used in construction (Given)	*15,000*
Cost of Self-Constructed Fixed Asset	***19,55/000***

Note: *Office and Administrative Expenses are general in nature, and not directly / specifically attributable to the asset.*

QUESTION 11

Sasidhar Ltd has constructed a new Plant and was ready to launch commercial production on 1st July. However, due to certain reasons, the Company could commence the commercial production only on 31st August. The startup and commissioning costs, test runs and sample production costs upto 31st August were accumulated in the Commissioning Costs Account and totaled Rs. 1,87,600. *The* ***Accountant gives the break up of the above as - (a) Upto 30th June - Rs. 49,200, (b) 1st July to 31st August - Rs. 1,38,400. Since the amount incurred after the date of commercial production is about 77% of the total amount, he argues that all the amounts should be capitalised. Comment.***

Principle: *Recognition of Costs in the Carrying Amount of an item of PPE* ***ceases*** *when the item is in the* ***location*** *&* ***condition*** *necessary for it to be capable of operating in the manner intended by Management.*

1. In the above case, the effective cut-off date for capitalisation as per above principle is ***1st July,*** *and not 31st August.*

2. The sum of Rs. ***49,200*** *should be* ***added to the Cost of the Plant.*** *The amount of Rs.* ***1,38,400*** *should be treated as an* ***Expense*** *for the year.*

3. The percentage of amount incurred before and after the date of commercial production is ***irrelevant*** *for this purpose.*

QUESTION 12

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

1. Purpose of Trial Run: *Generally, the purpose of Trial Production is to find out whether the Plant & Machinery and other facilities as installed, give the intended output in terms of quality and quantity. If during such trial run, the production standards are not met, normally the production is stopped, and necessary alterations / modifications are made to Production Lines, Machinery, etc. Additional Trial Runs may be required in such case.*

2. ***Analysis:*** *In the above case, the Company has opted to manufacture and sell the sub-standard product, due to financial investment and other commercial factors.*

3. ***Conclusion:*** *Hence, Trial Run is effectively complete, and capitalization should cease at the end of the Trial Run. The cut-off date would be the date on which the Trial Run was completed.*

QUESTION 13

An Entity has a Factory located in an industrial area which is fully operational. The Entity is required to relocate the Factory to the outskirts of the city on account of the new legislation for polluting industries. The Government allocates a Greenfield site in exchange for acquiring the Factory of the Entity and the Fair Value of the new site is Rs. 10,00,000. The WDV for the Plant in the Company's is Rs. 2,00,000. The Comapny is unable to work out the Fair Value of the Factory. Whether the transaction has commercial substance? At what value would the Entity recognise the transaction?

1. Here, the Cash Flows from the operational assets of the Factory given up are quite different in configuration from those of the Greenfield site. So, the transaction has commercial substance.

2. The Company should recognise the transaction at Fair Value of the Greenfield site (i.e. Asset Received) = Rs. 10,00,000 since that is more clearly evident.

QUESTION 14

A customer from whom Rs. 5 Lakhs is recoverable for Credit Sales, gives a Motor Car in full settlement of the dues. The Directors estimate that the Fair Value of the Motor Car transferred to it is Rs. 5.25 Lakhs and have debited Rs. 5.25 Lakhs to the Motor Car A/c. As on the date of Balance Sheet, the Car has not been registered in the name of the Entity. Comment on the above situation.

*1. **Cost of PPE under AS 10:** Here, the Value of the Asset given up i.e. Receivable / Debtors is Rs. 5,00,000 is **more clearly evident.** Hence, the Asset should be recorded at Rs. 5,00,000 only.*

*2. **Substance over Form:***

*(a) The accounting treatment and presentation in Financial Statements of transactions and events should be **governed by their substance** and not merely by the legal form.*

(b) Registration under the Motor Vehicles Act is a procedural legal formality to be complied with. But, the significant risk of ownership has passed to the Company.

(c) Hence, inspite of the non-registration of the Car in the Company's name as at the Balance Sheet Date, the Car should be recorded in the books at Rs. 5,00,000.

QUESTION 15

An Entity acquires an item of PPE for Rs. 50,000, which is depreciated over 20 years. Three years later, the asset is revalued to Rs. 60,000. Compute the amount of Revaluation Surplus.

Particulars		**Rs.**
	Revaluation Amount	*60,000*
Less:	*Carrying Amount = Cost Rs. 50,000 - 3 Years Depreciation Rs. 7,500 i.e. (Rs. 50,000 / 20) x 3 Yrs*	*(42,500)*
	Revalue Surplus at the end of 3rd Year	***17,500***

QUESTION 16

An Entity decides to revalue its Building on 1st April. On the date of revaluation, the Building stand at a cost of Rs. 100 Lakhs and Accumulated Depreciation is Rs. 40 Lakhs. The Building are now revalued at Rs. 150 Lakhs. How should the Entity account for the Revalued Building in its books of account?

1. Buildings are revalued to Rs. 150 Lakhs, i.e. a 150% increase from its Original Cost of Rs. 100 Lakhs.

2. So, applying that ratio of 150%, the Gross Carrying Amount will be 100 + 150% = Rs. 250 Lakhs and Accumulated Depreciation will be 40 + 150% = Rs. 60 Lakhs.

QUESTION 17

In the year 2016-17, an Entity has acquired a New Freehold Building with a useful life of 50 years for Rs. 70,00,000. The Entity desires to calculate the Depreciation charge per annum using a Straight-Line Method. It has identified the following components (with no Residual Value of Lifts & Fixtures at the end of their useful life) as follows -

Component	Land	Roof	Lifts	Fixtures	Remainder of building
Cost	Rs. 20,00,000	Rs. 10,00,000	Rs. 5,00,000	Rs. 5,00,000	Rs. 30,00,000
Useful life (Years)	Infinite	25	20	10	50

Calculate Depreciation for the Year 2016-2017.

Computation of Depreciation as per Componentisation Method (Rs.) *[Depreciation = $\frac{Cost}{Life}$]*

Component	Land	Roof	Lifts	Fixtures	Remainder of Building
Depreciation	Since life is infinite, No Deprn.	40,000	25,000	50,000	60,000

Total Depreciation for the Year 2016-2017 *= Rs. 40,000 + Rs. 25,000 + Rs. 50,000 + Rs. 60,000 = Rs.* ***1,75,000***

Note: *When the Roof requires replacement at the end of its useful life the Carrying Amount will be Nil. The Cost of replacing the Roof should be recognised as a New Component.*

QUESTION 18

Sthaanu Ltd purchased Machinery for Rs. 300 Lakhs. Depreciation was charged at 10% on SLM basis, for a useful life of 10 years. At the end of 4th year, the Company revalued the Machinery to Rs. 270 Lakhs and the same was adopted. What will be the Carrying Amount of the Asset at the end of Year 5 and Year 6? Assume no change in the Useful Life.

Particulars		Rs. Lakhs
	Original Cost of the Asset	300.00
Less:	Depreciation for 4 years (Rs. 300 Lakhs × 10% × 4 years)	(120.00)
	Book Value at the end of 4th year	180.00
Add:	Revaluation Surplus, so as to adjust / increase Book Value to Rs. 270 Lakhs	90.00
	Revalued Amount = Revised Depreciable Value for balance 6 years	270.00
Less:	Depreciation for Year 5 (Rs. 270 Lakhs ÷ 6 years)	(45.00)

	Carrying Amount at the end of 5th year	*225.00*
Less:	*Depredation for Year 5 (Rs. 270 Lakhs ∈- 6 years)*	*(45.00)*
	Carrying Amount at the end of 6th year	*180.00*

AS-11: ACCOUNTING FOR EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

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EXHANGE RATE
It is the ratio of exchange between two currencies.
Ex: 1$= Rs. 65.

REPORTING CURRENCY
Currency of the country in which the enterprise is domiciled.

FOREIGN CURRENCY
Currency other than reporting currency.

SPOT RATE
Rate prevailing on the date of exchange.

CLOSING RATE
Rate prevailing on the B/S date.

FORWARD EXCHANGE CONTRACT
Agreement to exchange different currencies at a forward date using a forward rate. (i.e. rate of a future date.)

MONETARY ITEMS
- Money held,
- Assets & Liabilities to be received or paid in fixed or determinable amounts of money.

Ex: Debtors, Creditors, Cash etc.

NON-MONETARY ITEMS
Assets & Liability other than monetary items.

Ex: Inventory, Fixed Assets etc.

FOREIGN CURRENCY TRANSACTION
- A transaction denominated in foreign currency or
- that requires settlement in foreign currency.

Ex: 1. Buying or selling of goods or services whose price is denominated in foreign currency.
2. Borrowing or lending of funds where the amount is denominated in foreign currency.
3. Forward exchange contract.

RECOGNITION OF FOREIGN CURRENCY TRANSACTIONS

TYPE OF TRANSACTION	INITIAL RECOGNITION	SUBSEQUENT RECOGNITION AT B/S DATE	RECOGNITION OF DIFFERENCE
1.MONETARY TRANSACTIONS	SPOT RATE	Closing Rate on B/S Date.	Exchange difference- in P&L.
2.NON-MONETARY TRANS.:-			
a) CARRIED AT HISTORICAL COST	SPOT RATE	SPOT RATE (i.e. rate on the date of transaction)	No Exchange Difference.
b) CARRIED AT FAIR VALUE	SPOT RATE	Rate on the date of valuation	Valuation diff.- In P&L.

EXCHANGE DIFFERENCE
It is a difference that arises as a result of reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.

NOTE: When number of units of foreign currency changes, any difference that arises will be treated a VALUATION DIFFERENCE.

NOTE: Rather than using spot rate, the weekly or monthly average of spot rates can be used.

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FOREIGN OPERATION

- Is a subsidiary, associate, joint venture, branch of the reporting enterprise
- the activities of which are based in a country other than the country of the reporting enterprise.

INTEGRAL FOREIGN OPERATION

Is a foreign operation, the activities of which are an integral part of the activities of the reporting enterprise.

NON-INTEGRAL FOREIGN OPERATION

Is a foreign operation, that is not an Integral foreign operation.

TRANSLATION OF FINANCIAL STATEMENTS OF FOREIGN OPERATIONS

TYPE OF OPERATION	INITIAL RECOGNITION	SUBSEQUENT RECOGNITION AT B/S DATE	RECOGNITION OF DIFFERENCE
INTEGRAL OPERATION			
1.MONETARY ITEMS	SPOT RATE	Closing Rate at B/S date	Exchange difference- in P&L.
2.NON-MONETARY ITEMS			
a)Carried at Historical cost	SPOT RATE	SPOT RATE (i.e. rate on the date of transaction)	No Exchange Difference.
b)carried at Fair Value	SPOT RATE	Rate on the date of valuation	Valuation diff.- In P&L.
NON-INTEGRAL OPERATION			
1.All Assets & Liabilities (includes monetary & non-monetary)	SPOT RATE	Closing rate at B/S date.	Exchange difference accumulated in **Foreign Currency Translation Reserve(FCTR).**
2.All Incomes & Expenses.	SPOT RATE	SPOT RATE (i.e. rate on the date of transaction)	No Exchange Difference.

FOREIGN CURRENCY TRANSLATION RESERVE

- FCTR can have a credit as well as a debit balance.
- When the net investment in such non-integral foreign operation is disposed off(in part), then such reserve will be recognised(proportionately) in P&L.

INDICATORS OF NON-INTEGRAL FOREIGN OPERATION

- Activities are significantly autonomous form the reporting enterprise.
- Transactions with reporting enterprise are not a high proportion of its activities.
- Its activities are financed mainly from its own operations/local borrowings.
- Costs of its products/services settled/paid in local currency of the foreign country.
- It sales mainly in local currency other than reporting currency.
- Cash flows of reporting enterprise are not dependent on the day-to-day activities of foreign operation.
- Active local sales market for its products.

NET INVESTMENT IN A NON-INTEGRAL FOREIGN OPERATION

- Is the reporting enterprise's share in the net assets of the non-integral foreign operation.

CHANGE IN CLASSIFICATION OF A FOREIGN OPERATION

CHANGE FROM	CHANGE TO	EFFECT
INTEGRAL	NON-INTEGRAL	EXCHANGE DIFFERENCE ACCUMULATED IN **FCTR.**
NON-INTEGRAL	INTEGRAL	1.TRANSLATED AMOUNTS OF NON-MONETARY ITEMS AT THE DATE OF CHANGE WILL BE TREATED AS ITS HISTORICAL COST. 2.EXCHANGE DIFFERENCES IN FCTR WILL NOT BE RECOGNISED IN P&L UNTIL DISPOSAL OF OPERATION.

FORWARD EXCHANGE CONTRACT

HEDGING PURPOSE

-premium/discount amortised over the life of the contract.
-Difference between:

- Contract rate or the rate at previous reporting date &
- Rate on settlement date or current reporting date

should be recognised in P&L.

NOTE: Premium/Discount= Difference between spot rate and forward rate.

SPECULATION PURPOSE

-No premium/discount to be recognised.
-Difference between:

- Contract rate or the rate at previous reporting date &
- forward rate available at the end of the current year

should be recognised in P&L.

NOTE: Premium/Discount= Difference between spot rate and forward rate.

PARA 46 AND 46A

DEPRECIABLE FIXED ASSET

- Exchange difference related to Long Term Foreign Currency Monetary Item (eg: long term foreign currency loan)
- to acquire a Depreciable Fixed Asset
  - Can be adjusted(debited/Credited) to cost of the Fixed Asset and be depreciated over its remaining useful life. or
  - Difference can be charged to P&L.

OTHER CASES

- Exchange difference related to Long Term Foreign Currency Monetary item (eg: long term foreign currency loan)
- in other cases
  - Will be taken to foreign currency monetary item translation difference account & amortised over the balance period of such long term asset/liability. or
  - Difference can be charged to P&L.

1. Long term = term of 12months or more.
2. The option to adjust against the cost of asset/ transfer to FCMITDA/C or charge to P&L should be taken irrevocably, retrospectively & be applied to all foreign currency monetary items.
3. Applicable to both corporate as well as non-corporate entities.

QUESTION 1

(a) Sterling Ltd. purchased a plant for US $ 20,000 on 31st December, 2011 payable after 4 months. The company entered into a forward contract for 4 months @ Rs. 48.85 per dollar. On 31st December, 2011, the exchange rate was Rs. 47.50 per dollar.

How will you recognize the profit or loss on forward contract in the books of Sterling Limited for the year ended 31st March, 2012.

(b)

	Exchange Rate per $
Goods purchased on 1.1.2011 of US $ 10,000	**Rs. 45**
Exchange rate on 31.3.2011	**Rs. 44**
Date of actual payment 7.7.2011	**Rs. 43**

Ascertain the loss/gain for financial years 2010-11 and 2011-12, also give their treatment as per AS 11.

Answer

(a) Calculation of profit or loss to be recognized in the books of Sterling Limited

	Rs.
Forward contract rate	*48.85*
Less: Spot rate	*(47.50)*
Loss	*1.35*
Forward Contract Amount	*$20,000*
Total loss on entering into forward contract = ($20,000 × Rs. 1.35)	*Rs. 27,000*
Contract period	*4 months*
Loss for the period 1st January, 2012 to 31st March, 2012 i.e. 3 months falling in the year 2011-2012 will be Rs. 27,000 $\times \frac{3}{4}$ *=*	*Rs. 20,250*

Balance loss of Rs. 6,750 (i.e. Rs. 27,000 – Rs. 20,250) for the month of April, 2012 will be recognized in the financial year 2012-2013.

(b) *As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2011 and corresponding creditor would be recorded at Rs. 4,50,000 (i.e. $10,000 × Rs. 45)*

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditor of US $10,000 on 31.3.2011 will be reported at Rs. 4,40,000 (i.e. $10,000 × Rs. 44) and exchange profit of Rs. 10,000 (i.e. 4,50,000 – 4,40,000) should be credited to Profit and Loss account in the year 2010-11.

On 7.7.2011, creditor of $10,000 is paid at the rate of Rs. 43. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, Rs. 10,000 (i.e. 4,40,000 – 4,30,000) will be credited to Profit and Loss account in the year 2011-12.

QUESTION 2

Sunshine Company Limited imported raw materials worth US Dollars 9,000 on 25th February, 2011, when the exchange rate was Rs. 44 per US Dollar. The transaction was

recorded in the books at the above mentioned rate. The payment for the transaction was made on 10th April, 2011, when the exchange rate was Rs. 48 per US Dollar. At the year end 31st March, 2011, the rate of exchange was Rs. 49 per US Dollar.

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

Answer

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

Also, as per para 11 of the standard, on balance sheet date such transaction is reported at closing rate of exchange, hence it will be valued at the closing rate i.e. Rs. 49 per US dollar (USD 9,000 x Rs. 49 = Rs. 4,41,000) at 31st March, 2011, irrespective of the payment made for the same subsequently at lower rate in the next financial year.

The difference of Rs. 5 (49 – 44) per US dollar i.e. Rs. 45,000 (USD 9,000 x Rs. 5) will be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2011 and will not be adjusted against the cost of raw materials.

*In the subsequent year on settlement date, the company would recognize or provide in the Profit and Loss account an exchange gain of Rs. 1 per US dollar, i.e. the difference from balance sheet date to the date of settlement between Rs. 49 and Rs. 48 per US dollar i.e. Rs. 9,000. Hence, the accounting treatment adopted by the Chief Accountant of the company is incorrect
i.e. it is not in accordance with the provisions of AS 11.*

QUESTION 3

Mr. Y bought a forward contract for three months of US $ 2,00,000 on 1st December 2010 at 1 US $ = Rs. 44.10 when the exchange rate was 1 US $ = Rs. 43.90. On 31-12-2010, when he closed his books, exchange rate was 1 US $ = Rs. 44.20. On31st January, 2011 he decided to sell the contract at Rs. 44.30 per Dollar. Show how the profits from the contract will be recognized in the books of Mr. Y.

Answer

As per para 39 of AS 11 'Changes in Foreign Exchange Rates", in recording a forward exchange contract intended for trading or speculation purpose, the premium or discount on the contract is ignored and at each balance sheet date, the value of contract is marked to its current market value and the gain or loss on the contract is recognised. Since the forward contract was for speculation purposes the premium on forward contract i.e. the difference between the spot rate and the forward contract rate will not be recorded in the books. Only when the forward contract is sold the difference between the forward contract rate and sale rate will be recorded in the Profit & Loss Account.

	Rs.
Sale rate	*44.30*
Less: Contract rate	*(44.10)*
Profit on sale of contract per US$	*00.20*

Contract Amount US $ 2,00,000 Total profit (2,00,000 x 0.20) Rs. 40,000

QUESTION 4

Beekay Ltd purchased Fixed Assets costing to Rs. 5,000 Lakhs on 01.04.2017 payable in Foreign Currency (US$) on 05.04.2018. Exchange Rate of 1 US$ = Rs. 50.00 and Rs. 54.98 as on 01.04.2017 and 31.03.2018 respectively.

The Company also obtained a Soft Loan of US$ 1 Lakh on 01.04.2017 payable in three annual equal instalments. First instalment was due on 01.05.2018. You are required to state, how these transactions would be accounted for in the books of accounts ending 31st March 2018.

The accounting treatment relating to P&L and B/s Items is as under -

Date	***Transaction***	***Treatment***	***Amount***
01.04.2017	*Purchase of Fixed Asset*	*At Initial Recognition, Fixed Assets are recorded at Spot Rate, i.e. Rate on the date of transaction.*	*Given Rs. 5,000 Lakhs*
01.04.2017	*Soft Loan taken*	*At Initial Recognition, Loan obtained is recorded at Spot Rate, i.e. USD 1 Lakh × Rs. 50*	*Rs. 50 Lakhs*
31.03.2018	*Reporting Difference on Fixed Assets*	*Fixed Assets, being Non-Monetary Items carried at Historical Cost, are to be reported using the Exchange Rate at the date of transaction only.*	*No further adjustment is required.*
31.03.2018	*Reporting Difference on Soft Loan*	*Soft Loan, being Monetary Item, should be reported at Closing Rate, and the Exchange Loss or Gain in reporting is transferred to P&L Account. USD 1 Lakh × [Rs. 54.98 - Rs. 50.00]*	*Rs. 4.98 Lakhs Exchange Loss is written off to P&L.*

Note: *It is assumed that the Soft Loan is not related to purchase of Fixed Asset, and hence, the Company cannot adjust the reporting difference on Soft Loan towards Cost of Fixed Asset, as per option available to Companies under MCA Notification.*

QUESTION 5

Sekar Ltd purchased a Machinery from a foreign country on 1st April, at a price of USD 1,50,000, upon terms of credit that

price should be settled within six months from the date of purchase. The Company capitalized the asset and created liability for the Capital Goods, converting the Foreign Currency Liability in terms of Indian Rupees at a rate of exchange prevailing as on date of purchase. When the Company settled the liability on 18th July, it had to incur an additional amount of Rs. 6,75,000 due to change in foreign exchange rate on the date of settlement. The Company added the additional amount of exchange variation, in the Capital Cost of the Asset, and charged depreciation on the enhanced amount from 18th July. Comment. [P (Aud) - M 08]

*1. **Issue 1:** Capitalising the Asset at the rate as on transaction date is correct.*

*2. **Issue 2:** Debiting additional amount to Asset Cost is incorrect as per AS-11. It should be debited to P&L A/c.*

QUESTION 6

Compute the Loss / Gain for the financial years ending 31st March 2017 and 2018 from the following -

Raw Materials imported on 1st January 2017 USD 10,000	***Rate of Exchange Rs. 55 per USD***
Financial Year ending on 31st March 2017	***Rate of Exchange Rs. 54 per USD***
Date of Actual Payment 7th July 2017	***Rate of Exchange Rs. 53 per USD***

Chief Accountant passed an entry on 31.03.2017, adjusting the cost of Raw Material consumed for the difference between Rs. 55 and Rs. 53 per USD. Discuss whether this treatment is justified.

The Raw Material Purchase should be recorded at the Transaction Rate, i.e. USD = Rs. 55 = Rs. 5,50,000. The treatment of Exchange Differences will be as under -

Purchase of Goods for 10,000 USD	***Financial Year Ending***	***Payment to Supplier***
Transaction Date = 1st Jan 2017	*Balance Sheet Date = 31st March 2017*	*Settlement Date = 7th July 2017*
USD = Rs. 55	*USD = Rs. 54*	*USD = Rs. 53*
*Exchange Difference = Rs. 1 per USD **(Gain)***		*Exchange Difference = Rs. 1 per USD **(Gain)***
*(due to **Reporting)** i.e. Rs. 10,000*		*(due to **Settlement)** i.e. Rs. 10,000*
Credited to P&L A/c for year ending 31st March 2017.		*Credited to P&L A/c in next FY, i.e. after 31st March 2017.*

Conclusion: *For the year ended 31st March 2017, the gain of Rs. 10,000 should be separately credited to P&L A/c as an Exchange Difference and disclosed as required under AS-11, and Schedule III which requires specific disclosure of Net Gain / Loss on Foreign Currency Transaction and Translation. It should **not** be adjusted to the Cost of Materials Consumed.*

QUESTION 7

Explain the accounting treatment needed in the following cases as per AS-11 as on 31st March. US $ 1 = Rs. 61.20 on 31st March.

(a) Sundry Debtors include amount receivable from UmeshRs. 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $ 1 = Rs. 58.50.

(b) Long-Term Loan taken from a US Company, amounting to Rs. 60,00,000. It was recorded at US $ 1 = Rs. 55.60, taking the

exchange rate prevailing at the date of transaction. [P (A/c) - N 15]

Solution:

1. Computation of Gain / (Loss) on Foreign Exchange

Sundry Debtors= Receivable	***Long-Term Loan = Payable***

Transaction Date USD = Rs. 58.50	Balance Sheet Date 31st March USD = Rs. 61.20	Transaction Date USD = Rs. 55.60	Balance Sheet Date 31st March USD = Rs. 61.20
⟵⟶		⟵⟶	
Exchange Difference = Rs. 2.7 per USD ***(Gain)***		*Exchange Differences 5.6 per USD* ***(Loss)***	

Sundry Debtors= Receivable	***Long-Term Loan = Payable***
(due to ***Reporting)*** *i.e.* $\frac{5,00,000}{58.50} \times 2.7$ *= Rs.* ***23,077***	*(due to* ***Reporting)*** *i.e.* $\frac{60,00,000}{55.60} \times 5.6$ *= Rs.* ***6,04,317***
Credited to P&L A/c for the year ending 31st March.	*Debited to P&L A/c for year ending 31st March.*

2. Disclosure in Balance Sheet: *Sundry Debtors & Long Term Loan taken are Monetary Items as per AS-11. At each Balance Sheet date, they should be reported using the* ***Closing Rate.*** *The difference in reporting should be recognized in the Statement of Profit and Loss for the current year. The Balances to be shown in the Balance Sheet are -*

Sundry Debtors = $\frac{5,00,000}{58.50} \times 61.20$ *=* ***Rs.5,23,077,*** *and Long-Term Loan =* $\frac{60,00,000}{55.60} \times 61.20$ *=* ***Rs.66,04,317.***

QUESTION 8

Ambikapati Ltd imported certain stock worth USD 60,000 on 30th June when 1 USD = Rs. 54.00. The payment is made on 31st December when 1 USD = Rs. 55.40. The Stock is in hand and lying unsold as on 30th September when the Company closes its accounts. Give Journal Entries under AS -11, if the rate on the Balance Sheet date was 1 USD = Rs. 53.85.

Date	***Particulars***	***Dr.(Rs.)***	***Cr.(Rs.)***
30th June	*Purchases A/c Dr.*	*32,40,000*	
(Transaction	*To Vendor / Foreign Supplier A/c*		*32,40,000*
Date)	*(Being import of raw materials, recorded at spot rate, i.e. USD 60,000 × Rs. 54.00)*		
	Vendor / Foreign Supplier A/c Dr.	*9,000*	
30th Sept.	*To Profit and Loss A/c (Exchange Rate Difference)*		*9,000*
(FY end)	*(Being translation of payable, i.e. monetary item at the Closing Rate and*		
	recognition of gain due to exchange difference [60,000 × (54.00 - 53.85)])		

30th Sept. (FY end)	*Closing Stock A/c* *To Trading A/c* *(Being Stock, non-monetary item, carried at Fair Value, presumed equal to Rs. 32.40 Lakhs, i.e. cost)*	*Dr.*	*32,40,000*	*32,40,000*
Next FY 31st Dec. (Settlement Date)	*Vendor / Foreign Supplier A/c* *Profit and Loss A/c (Exch.Rate Difference)* *To Bank A/c* *(Being payment made to Vendor at Rs. 55.40 × USD 60,000, the difference due to settlement (Rs. 53.85 - Rs. 55.40) × USD 60,000, being loss transferred to P&L A/c)*	*Dr.* *Dr.*	*32,31,000* *93,000*	*33,24,000*

QUESTION 9

S Ltd acquired 70% stake in a US Subsidiary P Ltd on 31st March 2017 when the rate was 1 USD = Rs. 53.00, the consideration paid was Rs. 20,000. The Balance Sheet of P Ltd on 31st March 2017 showed the following items (in USD):

Assets -1,000, External Liabilities - 400, Reserves - 200, Capital - 400. Average Rate during 2017-16 was Rs. 54.50 per USD.

On 31st March 2018 (when Exchange Rate = Rs. 48.00), the items in P Ltd's Balance Sheet were (in USD): Assets - 1,500, External Liabilities - 600, Reserves - 500, Capital - 400.

Show how will the above items be reflected in S Ltd's Balance Sheet on the two dates, as per AS - 11. What will be the treatment if S Ltd sells its holding in P Ltd - (a) in full, or (b) to an extent of 15% only and holding the balance 55% stake?

1. Translation of Subsidiary's Balance Sheet for Consolidation Purposes:

Particulars	***As on 31st March 2017***		***As on 31st March 2018***		
	USD	***(at Rs. 53) INR***	***USD***		***INR***
Share Capital	*400*	*21,200*	*400*	*(at Rs. 53)*	*21,200*
Reserves and Surplus	*200*	*10,600*	*500*	*(See **Note 1)***	*26,950*
Net Worth	***600***	***31,800***	***900***		***48,150***
External Liabilities	*400*	*21,200*	*600*	*(at Rs. 56)*	*33,600*
*Foreign Currency Translation Reserve **(bal. fig.)***	*Nil*	*Nil*	*Nil*	*(See **Note 2)***	*2,250*
Total Funds employed	***1,000***	***53,000***	***1,500***		***84,000***

Represented by: Assets	*1,000*	*53,000*	*1,500*	*(at Rs. 56)*	*84,000*

Note 1: *Reserves at the end of the year = 500 USD = Opening Balance 200 + Current Year Profit 300. The Opening Balance shall be considered at the Original Rate of Rate of Rs. 53. Current Year's Profit (i.e. Income less Expenses) shall be translated using the Average Rate, i.e. Rs. 54.50 per USD. Hence, Reserves at year end = (200 × 53) + (300 × 54.50) = 10,600 + 16,350 = Rs. 26,950*

Note 2: *Foreign Currency Translation Reserve is the Balancing Figure after translating all other items in the manner specified in AS - 11. Alternatively, it may be calculated as under -*

Exchange Difference on Current Year's Profit 300 USD × (Rs. 56.00 - Rs. 54.50)	*Rs. 450*
Exchange Difference on Assets at year beginning 1,000 USD × (Rs. 56.00 - Rs. 53.00)	*Rs. 3,000*
Exchange Difference on Liabilities at year beginning 400 USD × (Rs. 56.00 - Rs. 53.00)	*(Rs. 1,200)*
Net Exchange Difference taken to Foreign Currency Translation Reserve	***Rs. 2,250***

2. ***Entries in the Holding Company's Balance Sheet (upon Consolidation):***

Particulars	***As on 31st March 2017***	***As on 31st March 2018***
Minority Interest (30%)	*Rs. 31,800 × 30% = Rs. 9,450*	*Rs. 48,150 × 30% = Rs. 14,445*
	70% Share of Share Capital and Preacquisition Reserves, i.e.	
Goodwill on Consolidation		***Goodwill*** *- Rs.* ***2,260*** *(as calculated in previous column)*

QUESTION 10

X Limited, a newly incorporated Company in India commenced its business from 1st April 2017. The Company purchased Fixed Assets costing Rs. 4,000 Lakhs on 01.04.2017 and the same was fully financed by Foreign Currency Loan (U.S. Dollars) payable in three annual equal installments. Exchange Rates were 1 Dollar = Rs. 40.00 and Rs. 42.50 as on 01.04.2017 & 31.03.2018 respectively. The Company worked out Foreign Exchange Loss as per AS 11 at Rs. 250 Lakhs and expensed the entire amount in the Profit and Loss Account. The Managing Director of the Company was worried about this heavy revenue loss and asked the Accountant not to follow AS 11 issued by the ICAI for this particular transaction. The Accountant of the Company, followed the instruction of the Managing Director and removed Exchange Loss from the Profit and Loss Account but then he added the entire Exchange Loss to the value of Fixed Asset and computed the depreciation thereon. As an Auditor of X Limited how you would you deal with this particular transaction?

Conclusion: *If the above option is exercised by the Company, then the fact that it is exercised shall be disclosed in the Notes on Accounts. In such case, the Auditor can issue a Clean Opinion on the Financial Statements.*

CA TEJAS SUCHAK
ACCOUNTANCY ACE

GOVERNMENT GRANTS

Government Grants are-

- Assistance by government
- In cash or kind to an enterprise
- For past or future compliance with certain conditions.

It excludes-

- Govt. assistance which cannot reasonably have a value placed upon them.
- Transactions with govt. which cannot be distinguished from normal trading transactions.

RECOGNITION OF GOVERNMENT GRANTS

Should not be recognised until there is REASONABLE ASSURANCE that-

1. The enterprise will comply with conditions attached to the grant AND
2. The grant will be received.

NOTE:

a. Mere receipt of grant is not a conclusive evidence that the conditions attached to it have been or will be fulfilled.
b. When grant is received and there is no reasonable assurance that the conditions attached to it will be fulfilled, such grant should be recognised as a LIABILITY.

ACCOUNTING FOR GOVERNMENT GRANTS

RELATED TO DEPRECIABLE FIXED ASSETS

INITIAL RECOGNITION

1.Credit to Fixed Asset a/c.

Bank/Grant receivable a/c Dr.

To, Fixed Asset a/c

2. Credit to govt. grant a/c.

Bank/Grant receivable a/c Dr.

To, Deferred Govt. Grant a/c

(write off to P&L in proportion of depn.)

REFUND OF GRANT

1.Debit to Fixed Asset a/c

Fixed Asset a/c Dr.

To, Bank/Grant Payable a/c

(depn. on revised value prospectively)

2.Debit to D.G.G a/c & P&L a/c

D.G.G. a/c Dr.(to extent of bal.)

P&L a/c Dr.(excess if any)

To, Bank/Grant payable a/c

RELATED TO NON-DEPRECCIABLE FIXED ASSETS

INITIAL RECOGNITION

1.Credit to Fixed Asset a/c.

Same as above

2.Credit to govt. grant a/c.

Same as above

(this is applicable if certain costs need to be incurred in respect of such grant, then recognise it over the period when such costs will be incurred.)

REFUND OF GRANT

1.Debit to Fixed Asset a/c

Same as above.

2.Debit to D.G.G a/c & P&L a/c

Same as above.

3.Debit to Capital Reserve & P&L

Capital Res.a/c Dr.(extent of bal.)

P&L a/c Dr.(excess if any)

3.Credit to Capital Reserve

Bank/Grant Receivable a/c Dr.

To, Capital reserve a/c

RELATED TO PROMOTERS CONTRIBUTION

INITIAL RECOGNITION

1.Credited to Capital Reserve

Bank/grant receivable a/c Dr.

To, Capital reserve a/c

REFUND OF GRANT

1.Debited to Capital Reserve & P&L

Capital Reserve a/c Dr.

P&L a/c Dr.

To, Bank/grant payable a/c

GRANTS RELATED TO PROMOTERS CONTRIBUTION

- Such grants are given with respect to TOTAL INVESTMENT IN AN UNDERTAKING or by way of CONTRIBUTION TOWARDS ITS TOTAL OUTLAY and no repayment is ordinarily expected with respect to such grants.

RELATED TO REVENUE

INITIAL RECOGNITION

1.Credit to P&L a/c

Bank a/c Dr.

To, P&L a/c

(Alternatively, it can be reduced from its related expenditure.)

2. Credit to D.G.G a/c

Bank a/c Dr.

To, D.G.G a/c

(Write off to P&L in the period over which such costs are incurred.)

REFUND OF GRANT

1.Debit to P&L.

P&L a/c Dr.

To, Bank a/c

2.Debit to D.G.G a/c & P&L a/c

D.G.G a/c Dr.(extent of bal.)

P&L a/c Dr.(excess if any)

To, Bank/Grant Payable.

RELATED TO COST INCURRED IN PREVIOUS PERIOD/NO CORRESPONDING CURRENT/FUTURE COST TO BE INCURRED

INITIAL RECOGNITION

1.Credit to P&L a/c

Bank a/c Dr.

To, P&L a/c

REFUND OF GRANT

1.Debit to P&L a/c

P&L a/c Dr.

To, Bank a/c

NON-MONETARY GRANT: ASSET GIVEN AT CONCESSIONAL RATE

INITIAL RECOGNITION

1.Record asset at actual cost incurred.

Fixed Asset a/c Dr.
To, Bank a/c.

REFUND OF GRANT

1.If Asset is taken over.

P&L a/c Dr.
To, Fixed Asset a/c.

2.If concession amount required to be paid.

Fixed Asset a/c Dr.
To, Bank/Grant Payable a/c.

NON-MONETARY GRANT: GIVEN FREE OF COST

INITIAL RECOGNITION

1.Record at token value (eg: Rs.100).

Fixed Asset a/c Dr.
To, Bank a/c.

REFUND OF GRANT

1.If Asset is taken over.

P&L a/c Dr.
To, Fixed Asset a/c.

2.If concession amount required to be paid.

Fixed Asset a/c Dr.
To, Bank/Grant Payable a/c.

QUESTION 1

A Ltd. purchased a machinery for Rs. 40 lakhs. (Useful life 4 years and residual value Rs. 8 lakhs) Government grant received is Rs. 16 lakhs.

Show the Journal Entry to be passed at the time of refund of grant in the third year and the value of the fixed assets, if:

(1) the grant is credited to Fixed Assets A/c.

(2) the grant is credited to Deferred Grant A/c.

Answer

In the books of A Ltd.

Journal Entries (at the time of refund of grant)

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

		Rs.	Rs.
I	*Fixed Assets A/c Dr.* *To Bank A/c* *(Being grant refunded) The amount of refund should be Rs. 16 Lakhs*	*16 lakhs*	*16lakhs*

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

If the grant is credited to Deferred Grant Account:

As per para 14 of AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first

two years (Rs. 16 lakhs /4 years) = Rs. 4 lakhs p.a. x 2 years = Rs. 8 lakhs were credited to Profit and Loss Account and Rs. 8 lakhs was the balance of Deferred Grant Account after two years.

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

		Rs.	Rs.
I	*Deferred Grant A/c Dr.* *Profit & Loss A/c Dr.* *To Bank A/c* *(Being Government grant refunded)*	*8 lakhs* *8 lakhs*	*16 lakhs*

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

Working Notes:

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

Fixed assets initially recorded in the books = Rs. 40 lakhs – Rs. 16 lakhs = Rs. 24 lakhs Depreciation p.a.

= (Rs. 24 lakhs – Rs. 8 lakhs)/4 years = Rs. 4 lakhs per year

Value of fixed assets after two years but before refund of grant

= Rs. 24 lakhs – (Rs. 4 lakhs x 2 years) = Rs. 16 lakhs

Balance of Fixed Assets after two years but before refund (under second alternative)

Fixed assets initially recorded in the books = Rs. 40 lakhs

Depreciation p.a. = (Rs. 40 lakhs – Rs. 8 lakhs)/4 years = Rs. 8 lakhs per year Book value of fixed assets after two years = Rs. 40 lakhs – (Rs. 8 lakhs x 2 years)

= Rs. 24 lakhs

Note : *It is assumed that the question requires the value of fixed assets is to be given after refund of government grant.*

QUESTION 2

Viva Ltd. received a specific grant of Rs. 30 lakhs for acquiring the plant of Rs. 150 lakhs during 2007-08 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2010-11, 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.

(i) 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 2010-11 in profit and loss account?

(ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2007-08 assuming plant account showed the balance of Rs. 84 lakhs as on 1.4.2010?

Answer

As per para 21 of AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

(i) *In this case the grant refunded is 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 2010-11. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.*

(ii) *If the grant was deducted from the cost of the plant in the year 2007-08 then, para 21 of AS-12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by Rs. 30 lakhs. The increased cost of Rs. 30 lakhs of the plant should be amortized over 7 years (residual life).*

Depreciation charged during the year 2010-11 shall be (84 + 30)/7 years = Rs. 16.286 lakhs presuming the depreciation is charged on SLM.

QUESTION 3

M/s A Ltd. has set up its business in a designated backward area with an investment of

Rs. 200 Lakhs. The Company is eligible for 25% subsidy and has received Rs. 50 Lakhs from the Government.

Explain the treatment of the Capital Subsidy received from the Government in the Books of the Company.

Answer

As per para 10 of AS 12 "Accounting for Govt. Grants", Where the government grants are of the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve.

Subsidy received by A Ltd. is in the nature of promoter's contribution, since this grant is given with reference to the total investment in an undertaking and by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof. Therefore, this grant should be treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

1. Krithivasa Ltd received an area of Land, free of cost, from the Government. This amount is not recorded at all. The Company argues that - (a) No money has been spent by the Company on its acquisition, and (b) Land is not a depreciable asset. Comment.

*1. **Principle:** Non-Monetary Grants / Assets received free of cost, are recorded at a **Nominal Value** (say Rs. 100) for the purposes of identification and control). Whether it is depreciable or non-depreciable is not relevant in this regard.*

*2. **Conclusion:** As per AS - 12, the above Land should be recorded at a Nominal Value (say Rs. 100), for identification and control purposes. Hence, the Company's stand is not in accordance with AS - 12.*

QUESTION 4

Gowripathi set up a new factory in the backward area and purchased Plant for Rs. 500 Lakhs for the purpose. Purchases were entitled for the CENVAT Credit of Rs. 10 Lakhs and also the Government agreed to extend 20% Subsidy for Backward Area Development. Determine the Depreciable Value of the Asset.

	Particulars	***Rs. Lakhs***
	Cost of the Plant	*500*
Less:	*CENVAT Credit available*	*(10)*
	Balance	*490*
Less:	*Subsidy at 20% of Rs. 490 Lakhs*	*(98)*

Depreciable Value of the Plant	***392***

Note: *Asset Cost Reduction Method has been adopted in the above case.*

QUESTION 5

Kripanidhi Ltd purchased a Fixed Asset for Rs. 75 Lakhs, which has an estimated useful life of 5 years, with the Salvage Value of Rs. 7,50,000. On purchase of the Asset, the Government gave the Company a grant of Rs. 15 Lakhs. Pass the necessary journal entries in the books of the Company for the first two years.

Journal Entries under Asset Cost Reduction Method (Rs. in Lakhs)

Year	***Particulars***	***Dr.***	***Cr.***
1	*Machinery A/c Dr.* *To Bank A/c* *(Being Machinery purchased)*	*75.00*	*75.00*
	Bank A/c Dr. *To Machinery A/c* *(Being Government Grant received and credited to Fixed Asset A/c)*	*15.00*	*15.00*
	Depreciation A/c [Cost 75 (-) Grant 15 (-) Salvage Value 7.5] ÷ 5 years Dr. *To Machinery A/c* *(Being Depreciation charged on Straight Line Method on Cost net of Grant & SV)*	*10.50*	*10.50*
	Profit & Loss A/c Dr. *To Depreciation A/c* *(Being Depreciation transferred to P&L A/c)*	*10.50*	*10.50*
2	*Depreciation A/c Dr.* *To Machinery A/c* *(Being Depreciation charged on Straight line method)*	*10.50*	*10.50*
	Profit & Loss A/c Dr. *To Depreciation A/c* *(Being Depreciation transferred to P&L A/c)*	*10.50*	*10.50*

Journal Entries under Deferred Income Method

(Rs. in Lakhs)

Year	Particulars		Dr.	Cr.
1	Machinery A/c	Dr.	75.00	
	To Bank A/c			75.00
	(Being Machinery purchased)			
	Bank A/c	Dr.	15.00	
	To Government Grants Deferred Income A/c			15.00
	(Being Government Grant received and retained as Deferred Income)			
	Government Grants Deferred Income A/c [15 Lakhs ÷ 5 years]	Dr.	3.00	
	To Profit & Loss A/c			3.00
	(Being Grant portion for this year, considered as Income in P&L A/c)			
	Depreciation A/c [Cost 75 (-) Salvage Value 7.5] ÷ 5 years	Dr.	13.50	
	To Machinery A/c			13.50
	(Being Depreciation charged on Straight Line Method on Cost net of Salvage Value)			
	Profit & Loss A/c	Dr.	13.50	13.50
	To Depreciation A/c			
	(Being Depreciation transferred to P&L A/c)			
2	Government Grants Deferred Income A/c [15 Lakhs ÷ 5 years]	Dr.	3.00	
	To Profit & Loss A/c			3.00
	(Being Grant portion for this year, considered as Income in P&L A/c)			
	Depreciation A/c	Dr.	13.50	
	To Machinery A/c			13.50
	(Being Depreciation charged on Straight line method)			
	Profit & Loss A/c	Dr.	13.50	
	To Depreciation A/c			13.50
	(Being Depreciation transferred to P&L A/c)			

QUESTION 6

Nalanda University has received the following Grants during a year -

(a) From Ministry of Human Resources to be used for AIDS Research - Rs. 45,00,000, which includes Rs. 3,00,000 to cover Indirect Expenses incurred in administering the Grant.

(b) From a Reputed Trust to be used to set up a Centre to conduct seminars on AIDS related matters from time to time - Rs. 35,00,000.

(c) Donations from a well-wisher - Rs. 5,00,000 worth of equipments to be used for AIDS Research.

During the year, the University spent Rs. 32,25,000 of the Government Grant and incurred Rs. 3,00,000 as Overhead Expenses. Rs. 28,00,000 were spent from the Grant received from the Trust. Show the necessary Journal Entries.

	Particulars	***Dr. (Rs.)***	***Cr. (Rs.)***
1.	*Bank A/c Dr.*	*45,00,000*	
	To Government Grants A/c		*45,00,000*
	(Being Govt Grant for AIDS Research including Rs. 3 Lakhs for indirect expenses thereof)		
2.	*Bank A/c Dr.*	*35,00,000*	
	To Grants From Trusts A/c		*35,00,000*
	(Being Grant received to set up a Centre to conduct seminars on AIDS related matters)		
3.	*Fixed Assets (AIDS related) A/c Dr.*	*100*	
	To Capital Reserve A/c		*100*
	(Being equipment worth Rs. 5 Lakhs donated by .... Recorded at nominal value for control)		
4.	*AIDS Related Expenses A/c Dr.*	*35,25,000*	
	Seminar / Centre Related Expenses A/c Dr.	*28,00,000*	
	To Bank A/c		*63,25,000*
	(Being AIDS / Grant related expenditure incurred including OH Expenses)		
5.	*Government Grants A/c Dr.*	*35,25,000*	
	Grants from Trusts A/c Dr.	*28,00,000*	
	To Profit & Loss A/c		*63,25,000*

	(Being Grants transferred to P&L Account to the extent of expenditure incurred thereto)		

Note: *In the P&L A/c, the credit of Rs. 63,25,000 may be shown generally as Other Income or specifically as "Grant*

Income". Alternatively, the expenses could be netted off against the Grants transferred to P&L A/c.

QUESTION 7

Sambhu Ltd has set up its business in a designated backward area, which entitles if to receive, as per a public scheme announced by Government, a subsidy of 15% of Cost of Investment. Having fulfilled all the conditions laid down under the Scheme, the Company on its investment of Rs. 100 Lakhs in capital assets, received in January, during the accounting year ending 31st March, Rs. 15 Lakhs from Government. The Accountant of the Company would like to treat the receipt as an item of revenue and to reduce the losses on P & L Account for that year. Is his action justified? Discuss.

Kapali Ltd received Rs. 50 Lakhs from the Central Government as Subsidy for setting up an industry in backward area. How will you treat it in accounts?

A Ltd has set up its business in a designated backward area with an investment of Rs. 200 Lakhs. The Company is eligible for 25% Subsidy and has received Rs. 50 Lakhs from the Government. Explain the treatment of the Capital Subsidy received from the Government in the books of the Company.

Here, the Subsidy received is ***not*** *in relation to specific Fixed Asset or in relation to revenue. Hence, treatment as Deferred Income or as an item of Revenue violates AS - 12. The correct treatment is to credit the Subsidy to* ***Capital Reserve.***

QUESTION 8

Santosh Ltd has received a Grant of Rs. 8 Crores from the Government, for setting up a Factory in a backward area. Out of this Grant, the Company distributed Rs. 2 Crores as Dividend. Also, Santosh Ltd received land free of cost from the State Government but it has not recorded at all in the books as no money has been spent. In the light of AS - 12, examine, whether the treatment of both the Grants is correct.

1. Rs. 8 Crores is in the nature of Promoter's Contribution, and hence should be transferred to Capital Reserve. Its distribution as Dividend is inappropriate.

2. Land received free of cost, being Non-Monetary Grant, should be recorded at Nominal Value (Rs. 100 or Rs. 1,000).

QUESTION 9

Supriya Ltd received a grant of Rs. 2,500 Lakhs from the Government during the last accounting year for welfare activities to be carried on by the Company for its Employees. The Grant prescribed conditions for its utilization. However, during the current year, it was found that the conditions of Grants were not complied with and the Grant had to be refunded to the Government in full. Explain the accounting treatment, under AS - 12.

1. The above Grant is in the nature of Revenue Grant, since it is for welfare activities for its Employees. Therefore, when received, it should have been credited to P&L Account.

2. Therefore, in the event of refund, the amount refunded should be debited to P&L Account.

3. Such debit should be shown as an Extra Ordinary item in the P&L Statement.

QUESTION 10

Neelakanta Ltd purchased a Machinery for Rs. 40 Lakhs (Useful Life 4 years and Residual Value Rs. 8 Lakhs). Government Grant received is Rs. 16 Lakhs. Due to non-compliance of certain condition, the Grant becomes refundable in 3rd year to the extent of Rs. 12 Lakhs. Show the Journal Entry to be passed at the time of refund of Grant and the value of the Fixed Assets, if: (a) the Grant is credited to Fixed Assets, (b) the Grant is credited to Deferred Grant A/c.

A. If Grant is credited to Fixed Assets (i.e. Asset Cost Reduction Method)

Particulars		***Dr. (Rs.)***	***Cr. (Rs.)***
Fixed Assets A/c	*Dr.*	*12,00,000*	
To Bank A/c			*12,00,000*
(Being Grant refunded to the Government on non-compliance of related conditions, and Cost			
of the Asset thereby increased) ***[See Note below]***			

• *Depreciation p.a.* = $\frac{Cost\ 40\ Lakhs - Grant\ 16\ Lakhs - Residual\ Value\ 8\ Lakhs}{4\ years\ Useful\ Life}$ = *Rs. 4,00,000 p.a.*

• *WDV of Asset before the above Journal Entry = Cost Rs. 40,00,000* ***less*** *Grant Credited at inception Rs. 16,00,000* ***less*** *Depreciation of Rs. 4,00,000 for 2 years = Rs. 16,00,000*

• *Carrying Book Value of Asset after above Journal Entry = Rs. 16,00,000 + Rs. 12,00,000 = Rs. 28,00,000*

B. If Grant is credited to Deferred Grant A/c (i.e. Deferred Income Method)

Particulars		***Dr. (Rs.)***	***Cr. (Rs.)***
Deferred Government Grant A/c	*Dr.*	*8,00,000*	
Profit and Loss A/c	*Dr.*	*4,00,000*	
To Bank A/c			*12,00,000*
(Being Grant refunded to Government, and excess provided from Profit & Loss A/c)			

• *Depreciation p.a. under Deferred Income Method* = $\frac{Cost\ 40\ Lakhs - Residual\ Value\ 8\ Lakhs}{4\ years\ Useful\ Life}$ = *Rs. 8,00,000 p.a.*

• *WDV of Asset at beginning of Year 3 = Cost Rs. 40,00,000* ***less*** *Depreciation of Rs. 8,00,000 for 2 years = Rs. 24,00,000.*

• *Balance of Deferred Grant at the end of 2 years is Rs. 16,00,000 - (Rs. 4,00,000 × 2 Years) = Rs. 8,00,000*

• *There will not be any change in the Carrying Amount of the Asset.*

QUESTION 11

Markandeya Ltd applied for a Government Grant for purchase of a special machinery. The machinery costs Rs. 80 Lakhs and the Grant was Rs. 30 Lakhs. The Machinery has a useful life of 10 years and the Company follows SLM Depreciation. The Grant was promptly received but certain conditions regarding production were attached to it. Four years later, an amount of Rs. 4 Lakhs

become refundable to the Government since the Company did not adhere to the conditions imposed earlier. Explain the accounting treatment.

*1. Where **Asset Cost Reduction Method** is followed:*

(a) Original Cost of the Machinery	*Rs. 80 Lakhs*
(b) Government Grant reduced from Cost	*Rs. 30 Lakhs*
(c) Depreciable Amount of Machinery (a - b)	*Rs. 50 Lakhs*
(d) Useful Life	*10 years*
(e) Depreciation per annum (c h- d)	*Rs. 5 Lakhs*
(f) Accumulated Depreciation for four years	*Rs. 20 Lakhs (Rs. 5 Lakhs × 4 years)*
(g) Book Value of the asset in fourth year	*Rs. 30 Lakhs (Rs. 50 Lakhs - Rs. 20 Lakhs)*
(h) Add back: Amount of Refundable Grant	*Rs. 4 Lakhs*
(i) Revised Book Value of Machinery (g + h)	*Rs. 34 Lakhs*
(i) Balance Useful Life	*10 - 4 = 6 years*
(k) Depreciation to be provided for next 6 years	*34 => 6 = Rs. 5.67 Lakhs per annum.*

*2. Where **Deferred Income Method** is followed:*

(a) Original Cost of the Machinery	*Rs. 80 Lakhs*
(b) Useful Life	*10 years*
(c) Depreciation per annum	*Rs. 8 Lakhs*
(d) Government Grant treated as Deferred Income	*Rs. 30 Lakhs*
(e) Amount allocated / credited to P & L A/c every year	*Rs. 3 Lakhs (Rs. 30 Lakhs => 10 years)*
(f) Total Amount credited to P&L for four years	*Rs. 12 Lakhs*
(g) Balance in Deferred Income Account for 4th year	*Rs. 18 Lakhs (Rs. 30 Lakhs - Rs. 12 Lakhs)*
(h) Less: Grant Refundable - now adjusted	*Rs. 4 Lakhs*
(i) Revised Balance in Deferred Income Account	*Rs. 12 Lakhs*
(j) Amount to be credited to P&L for next 6 years	*Rs. 2 Lakhs (Rs. 12 Lakhs => 6 years)*

***Note:** Depreciation amount for the next 6 years will not be affected in this case.*

QUESTION 12

Six years earlier, Mrithyunjaya Ltd had received a Grant of Rs. 50 Lakhs from a State Government towards installation of Pollution Control Machinery on fulfillment of certain conditions. The Company, however, failed to comply with the said conditions and consequently was required to refund the said amount during the current year. The Company debited the said amount to its Machinery in the current year on payment of the same, it also re-worked the depreciation for the said machinery from the date of its purchase and passed necessary adjusting entries in the current year to incorporate the retrospective impact of the same. Comment on the above.

*1. **Principle:** AS- 12 requires that the amount refundable in respect of a Government Grant related to a specific Fixed Asset is recorded - (a) by increasing the Book Value of the Asset, or (b) by reducing the Capital Reserve or the Deferred Income balance, as appropriate, by the amount refundable.*

*2. **Analysis & Conclusion:** If the Book Value of the asset is increased, depreciation on the Revised Book Value of the Plant and Machinery is proper. However, the adjustment of depreciation with retrospective effect is improper, and violates both AS - 6 and AS - 12.*

QUESTION 13

A Steel Manufacturing Company has a turnover of Rs. 45 Crores and Net Pre-Tax Profit of Rs. 6 Crores. The Company's financial year ends on 31st March. The Company's policy is to treat Grants received in respect of Fixed Assets as Deferred Income and to deduct all Grants identified as relating to specific revenue expenditure against that expenditure. All other Grants recognized are credited to P & L Account. Answer the following questions -

A. During the year, the Company received a Grant from the Defence Department of Government of India for Rs. 3,00,000 towards the cost of new equipment. The equipment has an estimated useful economic life of 10 years and cost Rs. 7,00,000. The Company policy is to depreciate all depreciable Fixed Assets by the Straight Line Method.

B. During the year, the Company spent Rs. 70,000 on training, in respect of which it is due to receive Government Grant of 50%. The Grant formalities have been completed but payment is not expected until mid-June of the next year.

C. In October, a Grant of Rs. 40,000 was received from the Government in recognition of the high quality that the Company's production had maintained over 5 years, which had ended on 31st March, the previous accounting year.

***Situation A:** The Government Grant has been received relating to specific Fixed Assets. There are two methods for dealing with the Grant in the books -*

Particulars	***Asset Cost Reduction Method***	***Deferred Income Method***
1. Original Cost of Equipment	*Rs. 7,00,000*	*Rs. 7,00,000*
2. Specific Grant Received	*Rs. 3,00,000* *(reduced from Cost)*	*Rs. 3,00,000* *(treated as Deferred Income)*
3. Depreciable Value (1) - (2)	*Rs. 4,00,000*	*Rs. 7,00,000*
4. Useful Life of Machinery	*10 year*	*10 year*

	s	*s*
5. Depreciation provided p.a. (3) => (4)	*Rs. 40,000*	*Rs. 70,000*
6. Other Income credited to P&L A/c every year	*Not Applicable*	*(2) => (4) Rs. 30,000*

Note: *The balance in the Deferred Income Account shall be shown in the Balance Sheet separately with a description, as 'Deferred Government Grants', under the appropriate head.*

Situation B: *The Government Grant to be received can be shown either as income or as deduction from Training Expense. As the Grant has not been received till the year end, it has to be shown as* ***Receivable.***

Situation C: *This is not a Grant related to specific Fixed Asset or for conditions to be complied in future. This Grant should be credited to P & L Account in the year of receipt only.*

AS-13: ACCOUNTING FOR INVESTMENTS

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ACCOUNTANCY ACE

INVESTMENTS

Assets held for earning

- Interest
- Rent
- Dividend
- Capital Appreciation

CLASSIFICATION OF INVESTMENTS

LONG TERM INVESTMENTS

-Investments intended to be held for more than 12months from acquisition date.

-Valued at COST.

CURRENT INVESTMENTS

-Investments intended to be held for upto 12 months from acquisition date.

-Valued at COST/FMV whichever is lower.

COST OF INVESTMENTS

- RECOGNITION: All investments to be initially recorded at cost.
- INCLUDES: brokerage, stamp duty.
- EXCLUDES:

1. Cum interest price: Interest paid on acquisition of investments included in the cost of purchase. Such interest should be debited separately to P&L.

2. Cum Dividend: When investments are acquired cum dividend, the dividend later received will be reduced from the cost of the investments.

3. Cum Rights: when investments are acquired cum rights and the rights are sold, then the sale proceeds to the extent of reduction in FMV after right issue(cost – ex-right FMV) will be reduced from the cost of the investment. Excess sale proceeds if any will be credited to P&L as a profit on sale of rights.

- BONUS SHARES: Not recognised separately. Only reduces average price per share.

FAIR MARKET VALUE

- FMV is the selling price – direct selling cost (i.e. incurred as a result of sale)
- Active market price unless binding sale agreements are made.
- If active market price not available then last transaction price.

COST OF INVESTMENT IN DIFFERENT CASES

ACQUIRED BY PAYMENT OF CASH/CREDIT

Cost of investment = amount paid/payable.

ACQUIRED BY ISSUE OF SHARES OR OTHER SECURITIES

Cost of investment= fair value of shares or other securities on the date of acquisition.

ACQUIRED BY EXCHANGE OF ANOTHER ASSET OF ENTITY

Cost of investment=
1.F.V. of asset given up. OR
2.F.V. of investment acquired.
w.e. is more clearly evident

VALUATION OF INVESTMENTS

- CURRENT INVESTMENTS:

1. To be valued security wise.
2. However group wise valuation is also permissible if the entity has a history of managing investments as a portfolio.

- LONG TERM INVESTMENTS: valued security wise and not group wise.

SALE OF INVESTMENTS

- Profit/loss on sale of investments is computed by deducting average cost of investment from the selling price net of direct costs.
- Profit/loss to be credited/debited to P&L a/c.

RECLASSIFICATION

CURRENT TO LONG TERM: Cost/FMV w.e.l.

LONG TERM TO CURRENT: At carrying amount

Investment in gold converted into stock: Value at FMV but no profit recognised unless realised.

Profit if any deferred till sale.

Question 1

X Ltd. acquired 1,000 shares in Tata Ltd. at Rs.55 each on 31-5-2018 and it paid 2% brokerage fee and stamp duty ofRs.50. Nominal value of Tata Ltd. share is Rs.10. How do you recognise this in the books of accounts of X Ltd.? Discuss.

Answer

As per AS 13 - Investments should be recognised initially at Cost. Cost of investment includes all direct costs incurred for acquisition. Hence the total cost of investment in Tata Ltd. is computed as follows:

	Rs.
Basic cost of investment (1,000 x 55)	*55,000*
Brokerage fee (it is always paid on the basic cost) (Rs.55,000 x 2%)	*1,100*
Stamp duty (directly related to acquisition)	*50*
Total cost of investment	*56,150*

So X Ltd. should recognise the investment at Rs.56,150 on 31-5-2012 by recording the following entry:

31 -5-2018 Investment in Tata Ltd. a/c Dr 56,150

To Cash/ Bank a/c 56,150

Question 2

Rama Ltd. purchased a HIG flat in the Ayodhya co-operative society for Rs.25 lakh. Intention of acquisition is to earn rental income and capital appreciation. However, for purchasing the flat, it was necessary to obtain membership of the society priced at lakh. The company charged off Rs.2 lakh to P&L a/c in the year in which flat was purchased. Discuss

Answer

As per AS 13 - Investments should be recognised initially at Cost. Cost of investment includes all direct costs incurred for acquisition. In the given case, the membership fee (Rs.2 lakh) is paid only to purchase the flat. Hence it is treated as direct cost incurred to acquire the flat and it will be capitalised along with the flat. Hence total cost of flat = 25 + 2 = Rs.27 lakh. Charging Rs.2 lakh to P&L is incorrect.

So X Ltd. should recognise the investment in flat at Rs.27 lakh by recording the following entry:

Investment in flat a/c Dr Rs.27 lakh

To Cash/ Bank a/c Rs.27 lakh

Question 3

X Ltd. acquired Land & building from Mr. A on 21-03-2018. As per the agreement between the parties, X Ltd. allotted 5,000 equity shares of Rs.10 each on the same date to Mr. A. Land and building is an investment. Market value of equity shares of X Ltd. is Rs. 120 on the date of allotment. Discuss accounting treatment as per AS 13.

Answer

As per AS 13 - If investments are acquired by issue of shares or other securities, the cost of

investment is the fair value of the shares (Not nominal/face value). So the fair value of the shares = 5,000 x 120 = Rs.6,00,000. X Ltd. should record the following JE:

21-03-2018 Investment in land and building a/c Rs.6,00,000	*Dr*
To Equity share capital a/c (5,000 x 10)	*Rs.50,000*
To Security premium a/c (5,000 x 110)	*Rs.5,50,000*

Investment can be acquired

↓	↓	↓
Payment of cash/credit 1 *Cost of investment = Amount paid/payable*	*By issue of shares or other securities* *Cost of investment =* ↓ *Fair value tFVl of shares / other securities on the date of acquisition*	*By exchange of another asset of the entity (Barter)* *Cost of investment =* ↓ *1. FV of asset given up Or* *2. FV of Investment acquired* *Whichever is clearly evident Refer Note below*

Question 4

X Ltd. acquired 10,000 shares of Infosys company from Mr. Y. As per the agreement, X Ltd. should give its car to Y as consideration. Book value of the car in X Ltd's books is Rs.10 lakh and the fair value of Infosys company shares is Rs. 120 on the date of transaction. Fair value of the car cannot be determined very clearly. How to account for this transaction in accordance with AS-13?

Answer

As per AS 13- when investment is acquired by exchange of assets, cost of investment is fair value of the asset given up (Car) or the fair value of the investment received (Infosys shares), whichever is clearly evident.

In the given situation, fair value of the asset given up (i.e. Car value) cannot be determined clearly and hence we have to consider the fair value of the investment received (shares), as fair value of it can be determined clearly. The difference between the fair value of investment and book value of asset given up should be transferred to P&L a/c. So the entity should record the following JE:

Investment in equity shares a/c Dr (10,000 x 120)	*Rs. 12,00,000*
To Car (Book value)	*Rs. 10,00,000*
To Profit on asset exchange (P&L a/c)	*Rs.2,00,000*

(Being investment acquired by exchange of an asset and accounted for accordingly)

Question 5

On 1-4-2018, X Ltd. purchased 500 equity shares of Y Ltd. @ 35 each. Face value of shares is Rs.10. X Ltd. has received a dividend of Rs.5,000 on 31-8-2018 for the financial year 2017-18. The accountant of X Ltd. has considered it as dividend income and transferred it to P&L. Is it a correct accounting treatment as per AS 13?

Answer

X Ltd. has acquired the shares on 1-4-2018 and it was not a member during the FY 2017-18.

Therefore dividend received is an income related to pre-acquisition period (i.e. 2017-18). So dividend received should be deducted from the cost of investment. (As the entity doesn't know how much dividend is receivable from Y Ltd. they should follow 1st method - which is discussed above). On receipt of dividend, X Ltd. should record the following JE:

31-8-2018 Casha/c Dr 5,000

To Investment in shares of Y Ltd. a/c 5,000

(Being pre-acquisition income deducted from cost of investment)

Question 6

Mr. A has 1,000 equity shares in Alfa Ltd. As on 30-09-2018, Alfa Ltd. issued one right for every two shares held in the company as on that day. The company offered shares at a discounted price of Rs.50,

whereas the market value of a share is Rs.65. So Mr. A received 500 rights as part of rights issue.

Record necessary journal entries in the books of Mr. A & Mr. B for the following situations:

1. *A subscribed for all 500 rights.*
2. *A sold all rights to B @ 10 each and B exercised the rights.*
3. *A subscribed for 250 rights and sold the remaining rights to B @ 10 each.*

Answer

Situation 1: A subscribed for all 500 rights.

Investment in Alfa Ltd. a/c Dr (500 x 50) 25,000

To Bank a/c 25,000

(Being rights exercised)

Situation 2: A sold all rights to B @ 10 each. (Mr. A's Books)

Bank a/c Dr (500 x 10) 5,000

To Income from rights sale a/c 5,000

(Being rights sale proceeds taken to P&L a/c)

In the books of Mr. B

Investment in Alfa Ltd. a/c Dr [(500 x 50) + (500 x 10)] 30,000

To Bank a/c 30,000

(Amount paid to Alfa Ltd is Rs.25,000(500 x 50) and amount paid to Mr. A is Rs.5,000 (500 x10).

Amount paid to Mr. A for rights is a direct cost incurred to acquire shares in Alfa, hence it is capitalised along with the investment)

Situation 3: A subscribed for 250 rights and sold the remaining rights to B @ 10 each.! Mr. A's Books):

1. *Bank a/c Dr (250 x 10) 2,500*

To Rights sale income a/c 2,500

(Being rights sale proceeds taken to P&L a/c)

2. *Investment in Alfa Ltd. a/c Dr (250 x 50) 12,500*

To Bank a/c 12,500

(Being 250 rights exercised)

In the books of Mr. B

Investment in Alfa Ltd. a/c Dr (250 x 50) + (250 x 10) 15,000

To Bank a/c 15,000

(Amount paid to Alfa Ltd is Rs. 12,500 (250 x 50) and amount paid to Mr. A is Rs.2,500 (250 x 10)

Question 7

On 1-04-2018. Alfa Ltd. issued one right for every two shares held in the company and rights can be exercised by the members on or before 30-06-2018. The company offered shares at a discounted price of Rs.50. Mr. X has 1,000 shares in Alfa Ltd. and on 30-04-2018. Mr. X sold the equity shares @ 60 each along with 500 rights (i.e. on cum right basis) to Mr. A. On 30-05-2018, Mr. A sold all rights for Rs.6,000. Record necessary journal entries in the books of Mr. A, if the market value of Alfa Ltd. shares after right shares issue (i.e. after 30-06-2018) is Rs.55 or Rs.53 or Rs.60.

Answer

As per AS 13, if shares are acquired on cum right basis and if market value of shares comes down below the cost of investment, the sale proceeds of rights should be adjusted to cost of investment appropriately.

	Rs.
Cost of investment along with rights (1,000 x 60)	*60,000*
Sale proceeds of rights	*6,000*

Market value of the shares after right shares are issued:

↓		
↓ *Rs.55.000 155 x 1.000) 1*	↓ *Rs.53,000 (53 x 1,000) 1*	↓ *Rs.60,000 (60 x 1,000) 1*
Value reduced compared to cost = 60,000 - 55,000 = 5,000	*Value reduced compared to cost = 60,000 - 53,000 = 7,000*	*Value reduced compared to cost = 60,000 - 60,000 = Nil*
To the extent of value reduced proceeds is adjusted to cost and balance is treated	*To the extent of sales proceeds of rights received, adjust the cost.*	*Entire proceeds are treated as income.*
as income. *Cash a/c Dr 6,000* *To Investment 5,000* *ToP&La/c 1,000*	*Cash a/c Dr 6,000* *To Investment 6,000*	*Cash a/c Dr 6,000* *To P&L a/c 6,000*

Question 8

A Ltd. is engaged in speculation business. It mainly deals with equity market. So it purchases and sells investments with a transaction gap of one week. At the end of the FY, it has 1,000 equity shares in Satyam Ltd.; Cost of acquisition of those shares is Rs.15 lakh. Due to unexpected market

conditions on 31st March, 2018, the market value of those is Rs.13 lakh. Discuss.

Answer

The investment can be classified as current investment as it is

1. *By its nature readily realisable; and*
2. *Intention to hold for not more than a year.*

As per the AS 13, current investment will be subsequently measured at lower of cost and fair value.

The cost of investment is Rs.15 lakh and fair value is Rs.13 lakh, as fair value is less than the cost, the investment should be stated at fair value i.e. 13 lakh. The resultant difference of Rs.2 lakh is transferred to P&L a/c. The company should record the following journal entry in its books of accounts

31-03-18 P&L a/c Dr	*2,00,000*	
To Investment a/c		*2,00,000*

(Being current investment value reduced to fair value as per AS 13)

Question 9

H Ltd. holds 1,000 shares out of 2,500 shares in S Ltd. The intention of the company is to gradually get the control on S Ltd. by purchasing majority shares in that company. Cost of investment is Rs.20 crore and due to temporary fluctuation of the market as on the balance sheet date market value is Rs.19 lakh. Discuss.

Answer

In the given situation, the investment doesn't satisfy both the conditions of a current investment. The shares may be readily realisable but the intention is to own S Ltd. i.e., there is no intention of selling within one year. So investment can be classified as a long-term investment.

Long-term investments are stated at cost on the balance sheet date irrespective of temporary market fluctuations. If the decline in value is other than temporary in nature, carrying amount should be reduced. In the given case the fluctuation is temporary so no need to consider the market value. Hence H Ltd. should state the investment at cost i.e. at Rs.20 crore only. It need not record any JE.

Question 10

X Ltd. holds the following current investments as on the balance sheet date. It has shares in A Ltd., B Ltd, C Ltd. and its costs of investments are 15 lakh, 10 lakh and 12 lakh respectively (Total cost = 37 lakh). Fair value of the shares on the balance sheet date are 14 lakh, 15 lakh and 9 lakh respectively (Total fair value = 38 lakh). The accountant is of the feeling that total cost is less than the total fair value and there is NO need to record any journal entry to reduce the value of investments. Do you agree with the contention of the accountant and why?

Answer

As per AS 13, current investments are measured at cost or fair value whichever is lower and it should be computed on individual investment basis but not on a group basis.

It should be computed in the following manner:

Company	*Cost (Tin lakh)*	*FV (Tin lakh)*	*Value on BS date*

A	*15*	*14*	*14*
B	*10*	*15*	*10*
C	*12*	*9*	*9*
Total			*33*

Hence the investments should be stated at Rs.33 lakh as on the balance sheet date. The resultant difference of Rs.4 lakh (37-33) should be transferred to P&L a/c.

Question 11

X Ltd., acquired 7,000 equity investments in R Ltd., on the following dates for Rs.6,30,000

Date	*Qty*	*Amount (Rs.)*
08.08.2017	*3,000*	*3,00,000*
16.12.2017	*2,200*	*1,30,000*
02.01.2018	*1,800*	*2,00,000*
Total	*7,000*	*6,30,000*

On 13.05.2018, X Ltd. sold 4,000 shares of R Ltd., at Rs.85 per share. Determine profit or loss on sale of investment as per AS 13.

Answer

As per AS 13, while disposing a part of investment, the carrying amount is to be determined on the basis of the average carrying amount of the total holding of the investment.

So the carrying amount of the investments sold = 6,30,000/7,000 x 4,000 = Rs.3,60,000 (A)

Sale proceeds received (4,000 x 85) = Rs.3,40,000 (B)

Loss on sale of investment (to be taken to P&L a/c) = Rs.20,000 (A-B)

Remaining carrying amount of investment (6,30,000 - 3,60,000) = Rs.2,70,000 X Ltd. should record the following journal entry.

13-05-18 Cash a/c Dr	*3,40,000*	
Loss on sale of investment a/c Dr	*20,000*	
To Investment a/c		*3,60,000*

(Being investments disposed off and loss on disposal transferred to P&L a/c)

Question 12

X Ltd., has the following investment transactions:

Date	*Activity*	*Qty*	*Amount (Rs.)*

08.08.2018	*Purchase*	*3,000*	*3,00,000*
16.09.2018	*Purchase*	*2,200*	*1,16,000*
02.10.2018	*Sale*	*(1,200)*	*1,00,000*
02.11.2018	*Bonus shares received*	*1,000*	*Nil*
02.12.2018	*Sale*	*1,000*	*60,000*
Closing balance of shares		*4,000*	

Determine profit or loss on sale of investments.

Answer

As per AS 13, while disposing a part of the investment, the carrying amount is to be determined on the basis of the average carrying amount of the total holding of the investment. Average carrying amount is deducted from the investment a/c accordingly.

Calculation of profit/ Loss on sale as on 02.10.2018:

Carrying amount of 1,200 shares sold on 02.10.2018 = 3,00,000+ 1,16,000 /(3,000 + 2,200) x 1,200 = Rs. 96,000

Sale proceeds	*= Rs. 1,00,000*	
Profit =(1,00,000-96,000)	*= Rs. 4,000*	
02.10.2018 Cash a/c	*Dr 1,00,000*	
To Investment a/c		*96,000*
To Profit on sale of investment		*4,000*

(Being investments disposed off and profit on disposal transferred to P&L a/c)

Calculation of profit/ Loss on sale as on 02.12.2018

Carrying amount of 1,000 shares sold on 02.12.2018

=3,00,000 + 1,16,000 - 96,000 + Nil /(3,000 + 2,200 - 1,200 + 1,000) x 1,000 = Rs.64,000

Sale proceeds	*= Rs.60,000*	
Loss = (60,000 -64,000)	*= Rs. 4,000*	
02.12.2018 Cash a/c	*Dr 60,000*	
Loss on sale of investment a/c	*Dr 4,000*	
To Investment a/c		*64,000*

(Being investments disposed off and loss on disposal transferred to P&L a/c)

Question 13

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

(1) A portion of Current Investments purchased for Rs.20 lakh, to be reclassified as Long Term Investment, as the company has decided to retain them. The market value as on the date of BS was Rs.25 lakh.

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

(3) Certain long-term investments no longer considered for holding purposes, to be reclassified as current investments. The original cost of these was Rs.18 lakh but had been written down to Rs. 12 lakh to recognize permanent decline as per AS 13.(IPCCMay 2012, 2018, Nov 2014 & 2016)

Answer

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

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

(2) In the second case, the market value of the investment is Rs.6.5 lakh, which is lower than its cost i.e. Rs.15 lakh. Therefore, the transfer to long-term investments should be carried in the books at the market value i.e. Rs.6.5 lakh. The difference loss of Rs.8.5 lakh should be recognised as loss in P&L.

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

(3) In the third case, the book value of the investment is Rs.12 lakh, which is lower than its cost i.e. Rs.18 lakh. Here, the transfer to current investment should be at carrying amount.

Question 14

M/s Innovative Garments Manufacturing Company Limited invested in the shares of another company on 1st October, 2017 at a cost of Rs.2,50,000. It also earlier purchased Gold of Rs.4,00,000 and Silver of Rs.2,00,000 on 1st March, 2015. Market value as on 31st March, 2018 of above investments are as follows:

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

How above investments will be shown in the books of accounts of M/s Innovative Garments Manufacturing Company Limited for the year ending 31st March, 2018 as per AS 13? (IPCC May 2012 & May 2016)

Answer

As per AS 13 Accounting for Investments', for investment in shares - if shares are purchased with an intention to hold for short-term period then it will be shown at the realizable value of Rs.2,25,000 as on 31st March, 2018.

However, if equity shares are acquired with an intention to hold for long-term period then it will be shown at cost of Rs.2,50,000 in the Balance Sheet of the company. However, provision for

diminution shall be made to recognize a decline, if other than temporary, in the value of shares.

As per the standard, investment acquired for long-term period shall be shown at cost. Gold and silver are generally purchased with an intention to hold it for long-term period until and unless given otherwise. Hence, the investment in Gold and Silver (purchased on 1st March, 2015) shall continue to be shown at cost as on 31st March, 2018 i.e., Rs.4,00,000 and Rs.2,00,000 respectively, though their realizable values have been increased.

Question 15

Comment on the following practices of Pankaj Ltd., relating to its investments:

(i) Current investments are valued at lower of cost and fair value. Valuation is being done on a global basis.

(ii) Permanent diminution in the value of long-term investment is being adjusted against credit balance in the capital reserve.

Answer

(i) Valuation should not be done on global basis. Investments should be valued on an individual basis or category-wise. Practice of valuing at lower of cost and fair value is in consonance with AS 13.

(ii) Treatment is not correct, diminution to be charged in the profit and loss statement.

Question 16

An unquoted long-term investment is carried in the books at cost of 72 lacs. The published accounts of unlisted company received in May, 2018 showed that the company has incurred cash losses with decline market share and the long-term investment may not fetch more than 720,000. How you will deal with it in the financial statement of investing company for the year ended 31.3.2018?

(IPCC - Nov 2016, May 2010, PCC May 2011)

Answer

As per AS 13, investment classified as long-term investments should be carried at cost. However, provision for diminution shall be made to recognise a permanent decline in the value of the investments, such reduction being determined and made for each investment individually. As per the standard, 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. The facts of given case clearly suggest that there is decline in the market share of the company and the investment will not fetch more than 720,000. Therefore, the provision of Rs.1,80,000 should be made to reduce the carrying amount of long-term investment to 720,000 in the financial statements for the year ended 31st March, 2018.

AS-16: BORROWING COSTS

CA TEJAS SUCHAK
ACCOUNTANCY ACE

Preference shares and Equity are not borrowings.

Borrowing costs that are directly attributable to acquisition, construction or production of a qualifying asset should be capitalised as cost of that asset.

BORROWING COSTS

- Interest & other costs incurred by an enterprise in connection with the borrowing of funds.

Imp NOTE: interest paid to a supplier due to delay in payment are not borrowing costs.

OTHER COSTS

- Commitment charges on borrowings.
- Amortisation of discounts & premiums & also ancillary costs related to borrowings.
- Finance charges in respect of finance leases.

NOTE: Discount & premium related to preference shares is not covered by this AS. IMP

- Exchange differences arising on foreign currency borrowings to the extent they are an adjustment to interest costs.

QUALIFYING ASSET

- Asset that takes a substantial period of time to get ready for its intended use or sale. Examples:
1. Power generating facility.
2. manufacture of plants.
3.Inventories that take a substantial period of time to bring them to saleable condition(Liquor).

NOTE: Qualifying assets include both current as well as Fixed assets.

SUBSTANTIAL PEIOD OF TIME

Depends on the facts and circumstances of each case. Generally considered 12 months, unless a shorter/longer time can be justified.

DIRECTLY ATTRIBUTABLE

Borrowing costs that are directly attributable are those costs that would not have been incurred if the expenditure on qualifying asset had not been made.

EXAMPLE

USD LOAN= $10,000, INT.= 5% PAY. ANNUALLY.
DATE OF LOAN= 1ST APRIL 2013, EXC. RATE= 45/$
EXC. RATE ON 31ST MARCH 2014=48/$.
SIMILAR LOAN IN INDIA @ 11% p.a.

SOLUTION: 1. CALCULATE EXCHANGE DIFF.
=10,000*(48-45) = RS. 30,000.
2. CALCULATE INTEREST AMOUNT.
a) IF LOAN IS TAKEN IN USD
=10,000*48*5% = 24,000
b) IF LOAN IS TAKEN LOCALLY
=10,000*45*11%= 49,500
c) ADJUSTMENT TO INTEREST COSTS = a) -b) = 49500 – 24000 = 25,500.
3. EXCHANGE DIFF. THAT CAN BE CONSIDERED AS BORROWING COST AND CAPITALISED: LOWER OF
- 1. = 30,000
- 2.c) = 25,500

HENCE, 25,500 WILL BE CAPITALISED AND REMAINING 4,500 WILL BE TREATED AS PER AS-11.

CA TEJAS SUCHAK
ACCOUNTANCY ACE

CAPITALISATION OF BORROWING COSTS

SPECIFIC BORROWING

- Funds borrowed specifically for the Qualifying Asset.
- Specific interest rate of the borrowing should be used for capitalization.
- Income from temporary investments of borrowed funds should be deducted from the borrowing costs incurred.

GENERAL BORROWING

- Funds which have been borrowed generally and are being used for the purpose of the Qualifying Asset.
- Weighted average rate should be used for capitalization.
- Weighted average=summation of interest rate* amount of borrowing.

PERIOD OF CAPITALIZATION OF BORROWING COSTS

COMMENCEMENT

Capitalization should commence when all of the following conditions are satisfied:

- Expenditure on acquisition, construction& production of QA is being incurred.
- Borrowing costs are incurred.
- Activities necessary to prepare the QA for its intended use or sale are in progress.

SUSPENSION

- Capitalisation should be suspended when active development is interrupted.
- However, capitalisation is not normally suspended when substantial technical and administrative work is being carried out.
- Capitalization is also not suspended when the temporary delay is a necessary part of getting the asset ready for its intended use or sale. Eg: Delay because of high water levels during construction of a bridge.

CESSATION

- Capitalization should cease when substantially all the activities necessary to prepare the QA for its intended use or sale are complete.
- An asset is said to be ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue.
- **SUBSTANTIALLY COMPLETE** :- An asset is said to be substantially complete even though minor modifications might still be pending.

QUALIFYING ASSET COMPLETED IN PARTS (eg: housing society)

When construction of QA is completed in parts, and the completed part is capable of being used while construction continues for other parts, capitalization of BC should cease for such completed part when substantially all the activities necessary to prepare the QA are complete.

CA TEJAS SUCHAK
ACCOUNTANCY ACE

QUESTION 1

Lakshmipathi Ltd borrowed Rs. 40,00,000 for purchase of Machinery on 01.06.2017. Interest on Loan is 9% p.a. The Machinery was put to use from 01.01.2018. Pass Journal Entry for the year ended 31.03.2018 to record the Borrowing Cost of the Loan as per AS-16.

Notes and Assumptions:

*1. The Machinery purchased was not ready for its intended use on the date of acquisition. It was ready for intended use only on the date on which it was put to use. Hence, the Machinery is a **"Qualifying Asset"** for the period of 7 months from 01.06.2017 to 01.01.2018.*

*2. Six months is assumed to be **"substantial period of time"** for the asset under consideration.*

3. Hence, Interest Cost for the period of construction, i.e. from 01.06.2017 to 01.01.2018 is capitalized as part of the asset. The amount to be capitalized = Rs. 40,00,000 × 9% × 7/12 = Rs. 2,10,000.

Particulars		***Dr. (Rs.)***	***Cr. (Rs.)***
Interest A/c	*Dr.*	*3,00,000*	
To Interest Payable A/c			*3,00,000*
(Being total interest accrued for year, i.e. Rs. 40,00,000 × 9% × 10/12)			
Machinery A/c	*Dr.*	*2,10,000*	
To Interest A/c			*2,10,000*
(Being amount of interest capitalized as per AS - 16.)			
Interest Payable A/c	*Dr.*	*3,00,000*	
To Bank A/c			*3,00,000*
(Being Total Interest on Loan paid)			
Profit & Loss A/c	*Dr.*	*90,000*	
To Interest A/c			*90,000*
(Being balance amount of interest debited to Profit and Loss A/c)			

QUESTION 2

XYZ Limited acquired a Bank Loan of Rs. 40 Lakhs on interest rate of 20% per annum on 1st July 2017. The said loan was utilized by the Company for three transactions as under:

(a) Construction of Factory Shed Rs. 10,00,000

(b) Purchase of Plant and Machinery Rs. 25,00,000

(c) Balance Loan was unallocated and used generally for the purpose of business.

The Accountant has charged the total interest to the Profit and Loss Account. Comment.

Purpose / Utilisation	***Loan Amt.***	***Interest Amount***	***Accounting Treatment***
Construction of Factory Shed	*Rs. 10 Lakhs*	*Rs. 10 Lakhs × 20% × $\frac{9}{12}$ = Rs. 1,50,000*	*Added to Cost of Factory Shed as per AS-16.*
Purchase of Machinery	*Rs. 25 Lakhs*	*Rs. 25 Lakhs × 20% × $\frac{9}{12}$ = Rs. 3,75,000*	*Plant and Machinery, immediately available for use is not a Qualifying Asset. So, this is written off to P&L as **Expense.***
Other Purposes	*Rs. 5 Lakhs*	*Rs. 5 Lakhs × 20% × $\frac{9}{12}$ = Rs. 75,000*	*Written off to P&L A/c as **Expense,** as per AS-16.*
Total	***Rs. 40 Lakhs***	***Rs. 52.20 Lakhs***	

QUESTION 3

Harihara Limited obtained a Loan for Rs. 70 Lakhs on 15th April 2017 from a Nationalised Bank, to be utilized as under:

Particulars	***Rs.***
Construction of Factory Shed	***25,00,000***
Purchase of Machinery	***20,00,000***
Working Capital	***15,00,000***
Advance for Purchase of Truck	***10,00,000***

In March 2018, Construction of the Factory Shed was completed and Machinery which was ready for its intended use installed. Delivery of Truck was received in the next Financial Year. Total Interest Rs. 9,10,000 charged by the Bank for the Financial Year ending 31.03.2017. Show the treatment of Interest under AS-16.

Effective Interest Rate = $\frac{9.10\ Lakhs}{70.00\ Lakhs}$ *= 13%. The treatment for the Total Interest of Rs. 9.10 Lakhs is as under -*

Purpose / Utilisation	***Loan Amt.***	***Interest Amount***	***Accounting Treatment***
Construction of Factory Shed	*Rs. 25 Lakhs*	*Rs. 25 × 13% = Rs. 3.25 Lakhs*	*Added to Cost of Factory Shed as per AS - 16.*
Purchase of Machinery	*Rs. 20 Lakhs*	*Rs. 20 × 13% = Rs. 2.60 Lakhs*	*Added to Cost of Machinery as per AS - 16.*

Working Capital	*Rs. 15 Lakhs*	*Rs. 15 × 13% = Rs. 1.95 Lakhs*	*Written off to P&L A/c as* ***Expense,*** *as per AS - 16.*
Advance to Suppliers for Purchase of Truck	*Rs. 10 Lakhs*	*Rs. 10 × 13% = Rs. 1.30 Lakhs*	*Kept in Interest Suspense A/c (Capital WIP A/c) till the date of acquisition / installation of Truck & capitalised later on asset creation. [Assumed as Qualifying Asset]*
Total	***Rs. 70 Lakhs***	***Rs. 9.10 Lakhs***	

QUESTION 4

Hariram Iron and Steel Ltd is establishing an Integrated Steel Plant consisting of four phases. It is expected that the full Plant will be established over several years but Phase I and Phase II will be started as soon as they are completed.

Following are the details of work done on different phases of the Plant during the current year: (in Rs.)

Particulars	***Phase I***	***Phase II***	***Phase III***	***Phase IV***
Cash expenditure Plants purchased	***20,00,000 28,00,000***	***35,00,000 40,00,000***	***25,00,000 30,00,000***	***40,00,000 48,00,000***
Total Expenditure	***48,00,000***	***75,00,000***	***55,00,000***	***88,00,000***
Total Expenditure of all Phases				***2,66,00,000***
Loan taken at 16%				***2,40,00,000***

During the current year, Phases I and II have become operational. Find out the total amount to be capitalized and to be expensed during the year.

Particulars	***Rs.***
1. Interest Expense on Loan (Assuming that Loan is taken on the first day of the financial period concerned, and the work of asset creation had started on that date) = Rs. 2,40,00,000 at 16%	*38,40,000*
2. Total Cost of Phases I and II (Rs. 48,00,000 + Rs. 75,00,000)	*1,23,00,000*
3. Total Cost of Phases III and IV (Rs. 55,00,000 + Rs. 88,00,000)	*1,43,00,000*
4. Total Cost of all 4 Phases	*2,66,00,000*
5. Total Loan	*2,40,00,000*
6. Proportionate Loan used for Phases I and II: $\frac{2,40,00,000}{2,66,00,000} \times 1,23,00,000$	*1,10,97,744*
7. Proportionate Loan used for Phases III and IV = $\frac{2,40,00,000}{2,66,00,000} \times 1,43,00,000$	*1,29,02,256*

8. Interest on Loan used for Phases I & II, based on Proportionate Loan Amount = 1,10,97,744 at 16%	*17,75,639*
9. Interest on Loan used for Phases III & IV, based on Proportionate Loan Amount = 1,29,02,256 at 16%	*20,64,361*

Accounting Treatment: *Interest of Rs. 17,75,639 relating to Phases I and II should be capitalized (in the ratio of Asset Costs 48:75), and added to respective Assets in Phases I and II. Interest of Rs. 20,64,361 relating to Phases III and IV should be held in Capital Work in Progress till asset construction work is completed, and thereafter capitalized in the ratio of cost of assets. No part of the Interest Expense should be written off to P&L A/c during the year.*

Note: *Alternatively, it can be assumed that Phase I and II have become operational in the middle of the current year. In this case, only half of the Interest Rs. 8,87,820 (Rs. 17,75,639 + 2) relating to Phases I and II should be capitalized (in the ratio of Asset Costs 48:75), and remaining Interest Rs. 8,87,820 should be expensed off / charged to Profit & Loss A/c.*

QUESTION 5

Parasuram Ltd had the following borrowings during a year in respect of capital expansion.

Plant	***Cost of Asset***	***Remarks***
Plant P	***Rs. 100 Lakhs***	***No Specific Borrowings.***
Plant Q	***Rs. 125 Lakhs***	***Bank Loan of Rs. 65 Lakhs at 10%.***
Plant R	***Rs. 175 Lakhs***	***9% Debentures of Rs. 125 Lakhs were issued.***

In addition to the above specific borrowings, the Company had obtained Term Loans from two Banks - (1) Rs. 100 Lakhs at 10% from Corporation Bank and (2) Rs. 110 Lakhs at 11.50% from Canara Bank, to meet its capital expansion requirements. What is the amount of Borrowing Costs to be capitalised in each of the above Plants?

1. Computation of Actual Borrowing Costs incurred during the year:

Source	***Loan Amount***	***Interest Rate***	***Interest Amount***
Bank Loan	*Rs. 65.00 Lakhs*	*10.00%*	*Rs. 6.50 Lakhs*
9% Debentures	*Rs. 125.00 Lakhs*	*9.00%*	*Rs. 11.25 Lakhs*
Term Loan from Corporation Bank	*Rs. 100.00 Lakhs*	*10.00%*	*Rs. 10.00 Lakhs*
Term Loan from Canara Bank	*Rs. 110.00 Lakhs*	*11.50%*	*Rs. 12.65 Lakhs*
Total	***Rs. 400.00 Lakhs***		***Rs. 40.40 Lakhs***
Specific Borrowings included in above	***Rs. 190.00 Lakhs***		***Rs. 17.75 Lakhs***

2. Weighted Average Capitalisation Rate for General Borrowings =

$$\frac{\text{Total Interest } \textbf{Less} \text{ Interest on Specific Borrowings}}{\text{Total Borrowings } \textbf{Less} \text{ Specific Borrowings}}$$

$= \frac{40.40-17.75}{400-190} = \frac{22.65}{210}$ = ***10.79%***

3. Capitalisation of Borrowing Costs under AS - 16 will be as under -

Plant	***Borrowing***	***Loan Amount***	***Interest Rate***	***Interest Amt***	***Cost of Asset***
P	*General*	*Rs. 100 Lakhs*	*10.79%*	*Rs. 10.79 Lakhs*	*Rs. 110.79 Lakhs*
Q	*Specific* *General*	*Rs. 65 Lakhs* *Rs. 60 Lakhs*	*10.00%* *10.79%*	*Rs. 6.50 Lakhs* *Rs. 6.47 Lakhs*	 *Rs. 137.97 Lakhs*
R	*Specific* *General*	*Rs. 125 Lakhs* *Rs. 50 Lakhs*	*9.00%* *10.79%*	*Rs. 11.25 Lakhs* *Rs. 5.39 Lakhs*	 *Rs. 191.64 Lakhs*
Total		***Rs. 400 Lakhs***		***Rs. 40.40 Lakhs***	***Rs. 440.40 Lakhs***

Note: *The amount of Borrowing Costs capitalised should not exceed the actual interest cost.*

QUESTION 6

Ayush Ltd began construction of a Building on 1st January 2018. it obtained Rs. 3 Lakh Special Loan to finance the construction on 1st January 2018 @ interest rate of 12% p.a. Company's other outstanding two Non-Specific Loans were:

Amount	***Rate of Interest***
Rs. 6,00,000	***11% p.a.***
Rs. 11,00,000	***13% p.a.***

The Expenditure that were made on the Building Project were as follows:

January, 2018	***April, 2018***	***July, 2018***	***December, 2018***
Rs. 3,00,000	***Rs. 3,50,000***	***Rs. 5,50,000***	***Rs. 1,50,000***

The Building was completed on 31st December 2018. Following the principles prescribed in AS 16 'Borrowing Cost', calculate the amount of interest to be capitalized and pass one Journal Entry for capitalizing the cost and borrowing in respect of the Building.

1. Computation of Average Accumulated Expenses		***2. Computation of Average Interest Rate***
1. Rs. 3,00,000 × 12 / 12	*= Rs. 3,00,000*	*(a) Total Interest Expense =*
2. Rs. 3,50,000 × 9 / 12	*= Rs. 2,62,500*	*= (Rs. 6,00,000 × 11%) + (Rs. 11,00,000 × 13%)*
3. Rs. 5,50,000 × 6 / 12	*= Rs. 2,75,000*	*= Rs.* ***2,09,000.***
4. Rs. 1,50,000 × 1 / 12	*= Rs. 12.500*	*(b) Total Loan Amount = Rs. 17,00,000.*

Rs. 8.50,000	*(c) So, Average Interest Rate = (a ÷ b) =* ***12.294%***
Note: *Out of the above, Rs. 3,00,000 is from Specific Loan, and balance Rs. 5,50,000 is from Non-Specific Loans.*	

3. Computation of amount to be capitalised

Particulars	***Rs.***
Cost of Building Rs. (3,00,000 + 3,50,000 + 5,50,000 + 1,50,000)	*13,50,000*
Add: *Interest Cost to be capilised: Specific Borrowings (Rs. 3,00,000 × 10%)*	*30,000*
Non-Specific Borrowings (Rs. 5,50,000 × 12.294%)	*67,617*
Total Amount to be captilized for the Building	***14,47,617***

4. Journal Entry

Date	***Particulars***	***Dr. (Rs.)***	***Cr. (Rs.)***
31st Dec	*Building Account Dr.*	*14,47,617*	
	To Bank Account		*14,47,617*
	(Being amount of Cost of Building and Borrowing Cost capitalized thereon)		

QUESTION 7

In February, a Company took a Bank Loan to be used specifically for the construction of a new Factory Building. The construction was completed in September 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 December (end of accounting year) 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?

Interest on Loan borrowed to purchase a Machinery which has been installed two years back is still debited to Machinery Account. Comment on the above.

1. Interest can be capitalized only for the period up to September, i.e. Building put to use. Hence the Company should add Rs. 18 Lakhs to the cost of the Factory Building.

2. The balance interest of Rs. 7 Lakhs should be charged to P&L A/c for the year as an expense.

QUESTION 8

Shan Builders Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2017-2018 for its Residential Project at LIBOR + 3%. The interest is payable at the end of the Financial Year. At the time of the availment, the Exchange Rate was Rs. 56 per US $ and the rate as on 31st March 2018 was Rs. 62 per US $. If Shan Builders Limited borrowed the Loan in India in Indian Rupee equivalent, the pricing of Loan would have been 10.50%. Compute the Borrowing

Cost and Exchange Difference for the year ending 31st March 2018 as per applicable Accounting Standard. (Applicable LIBOR is 1%).

Particulars	*Result*
1. ***Interest Payable if Borrowed in INR*** = *(USD 10,00,000 x Opening Exchange Rate Rs. 56 x INR Loan Interest Rate 10.50%)*	*Rs. 58,80,000*
2. ***Interest Actually Paid in Foreign Currency*** = *Foreign Currency Loan USD 10,00,000 x Closing Exchange Rate Rs. 62 x USD Interest Rate 4%*	*Rs. 24,80,000*
3. ***Notional Savings in Interest due to Foreign Currency Borrowings*** = *(1 - 2)*	*Rs. 34,00,000*
4. ***Change in Carrying Amount of Principal due to Exchange Rate Difference*** = *(Closing Exchange Rate Rs. 62* ***less*** *Opening Exchange Rate Rs. 56) x USD 10,00,000* ***Note:*** *Since Closing Rate > Opening Rate, there is an Increase in Carrying Amount in this case.*	*Rs. 60,00,000*
5. ***Further Amount to be treated as Borrowing Cost*** = ***Least*** *of (3) and (4)*	*Rs. 34,00,000*
6. ***Aggregate Borrowing Cost*** *as per AS - 16 = Actual Interest as per (2) + Additional in (5)*	*Rs. 58,80,000*
7. ***Exchange Rate Loss to be Recognized in Statement of P&L*** = ***(4 - 5)***	***Rs. 26,00,000***