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ACCOUNTING STANDARDS

BASIC CONCEPTS

CHAPTER 1 : ACCOUNTING STANDARDS

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

Question 1

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

(November, 1999)

Answer

According to AS 3 (Revised) on "Cash Flow Statements", cash flow statement deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise during the given period from operating, investing and financing activities. Cash flows from operating activities can be reported using either

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

(b) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of non–cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

As per para 42 of AS 3 (Revised), an enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.

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

AS 3 (revised) is recommendatory at present but for companies listed on stock exchanges, its compliance is mandatory due to the listing agreement which provides for the listed companies to furnish cash flow statement in their Annual Reports.

Question 2

Media Advertisers obtained advertisement rights for One Day World Cup Cricket Tournament to be held in May/June, 2011 for Rs. 250 lakhs.

By 31st March, 2011 they have paid Rs. 150 lakhs to secure these advertisement rights. The balance Rs. 100 lakhs was paid in April, 2011.

By 31st March, 2011 they procured advertisement for 70% of the available time for Rs. 350 lakhs. The advertisers paid 60% of the amount by that date. The balance 40% was received in April, 2011.

Advertisements for the balance 30% time were procured in April, 2011 for Rs. 150 lakhs. The advertisers paid the full amount while booking the advertisement.

25% of the advertisement time is expected to be available in May, 2011 and the balance 75% in June, 2011.

You are asked to :

(i) Pass journal entries in relation to the above.

(ii) Show in columnar form as to how the items will appear in the monthly financial statements for March, April, May and June 2011.

Give reasons for your treatment. ***(May, 1999)***

Answer

(i) **In the books of Media Advertisers**

Journal Entries

			Dr. *Rs. in lakhs*	*Cr.* *Rs. in lakhs*
2011				
March	Advance for advertisement rights (purchase) A/c	Dr.	150.00	
	To Bank A/c			150.00
	(Being advance paid for obtaining advertisement rights)			
	Bank A/c	Dr.	210.00	
	To Advance for advertisement time (sale) A/c			210.00
	(Being advance received from advertisers amounting to 60% of Rs. 350 lakhs for booking 70% advertisement time)			

April	Advance for advertisement rights (purchase) A/c	Dr.	100.00	
	To Bank A/c			100.00
	(Being balance advance i.e., Rs. 250 lakhs less Rs. 150 lakhs paid)			
	Bank A/c	Dr.	140.00	
	To Advance for advertisement time (sale) A/c			140.00
	(Being balance advance i.e., Rs. 350 lakhs less Rs. 210 lakhs received from advertisers)			
	Bank A/c	Dr.	150.00	
	To Advance for advertisement time (sale) A/c			150.00
	(Being advance received from advertisers in respect of booking of balance 30% time)			
May	Advertisement rights (purchase) A/c	Dr.	62.50	
	To Advance for advertisement rights (purchase) A/c			62.50
	(Being cost of advertisement rights used in May i.e., 25% of Rs. 250 lakhs, adjusted against advance paid)			
	Advance for advertisement time (sale) A/c	Dr.	125.00	
	To Advertisement time (sale) A/c			125.00
	(Being sale price of advertisement time in May i.e., 25% of Rs. 500 lakhs adjusted, against advance received from advertisers)			
	Profit and Loss A/c	Dr.	62.50	
	To Advertisement rights (purchase) A/c			62.50
	(Being cost of advertisement rights debited to Profit and Loss Account in May)			
	Advertisement time (sale) A/c	Dr.	125.00	
	To Profit and Loss A/c			125.00
	(Being revenue recognised in Profit and Loss Account in May)			
June	Advertisement rights (purchase) A/c	Dr.	187.50	
	To Advance for advertisement rights (purchase) A/c			187.50
	(Being cost of advertisement rights used in June, i.e., 75% of Rs. 250 lakhs, adjusted against advance paid)			

	Advance for advertisement time (sale) A/c	Dr.	375.00	
	To Advertisement time (sale) A/c			375.00
	(Being sale price of advertisement time availed in June i.e., 75% of Rs. 500 lakhs, adjusted against advance received from advertisers)			
June	Profit and Loss A/c	Dr.	187.50	
	To Advertisement rights (purchase) A/c			187.50
	(Being cost of advertisement rights used in June, debited to Profit and Loss Account in June)			
	Advertisement time (sale) A/c	Dr.	375.00	
	To Profit and Loss Account			375.00
	(Being revenue recognised in June)			

(ii) **Monthly financial statements**

(1) Revenue statement (Rs. in lakhs)

	March *Rs.*	*April* *Rs.*	*May* *Rs.*	*June* *Rs.*
Sale of advertisement time	–	–	125.00	375.00
Less: Purchase of advertisement rights	–	–	62.50	187.50
Netprofit	–	–	62.50	187.50

(2) Balance sheet as at	*31.3.2011*	*30.4.2011*	*31.5.2011*	*30.6.2011*
Sources of funds:				
Net profit	–	–	62.50	250.00
Application of funds:				
Current assets, loans and advances:				
Advance for advertisement rights	150.00	250.00	187.50	–
Bank Balance	60.00	250.00	250.00	250.00
	210.00	500.00	437.50	250.00
Less: Current liabilities				
Advance for advertisement time				
(received from advertisers)	(210.00)	(500.00)	(375.00)	–
Net current assets	–	–	62.50	250.00

As per para 7.1 of AS 9 on Revenue Recognition, under proportionate completion method, revenue from service transactions is recognised proportionately by reference to the performance of each act where performance consists of the execution of more than one act. Therefore, income from advertisement is recognised in May, 2011 (25%) and June, 2011 (75%) in the proportion of availability of the advertisement time.

Question 3

(a) *X Co. Ltd. charged depreciation on its asset on SLM basis. For the year ended 31.3.2011 it changed to WDV basis. The impact of the change when computed from the date of the asset coming to use amounts to Rs. 20 lakhs being additional charge.*

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

(b) *Briefly describe the disclosure requirements for amalgamation including additional disclosure, if any, for different methods of amalgamation as per AS 14.* ***(May, 2003)***

Answer

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Question 4

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

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

(b) X Limited has recognized Rs. 10 lakhs on accrual basis income from dividend on units of mutual funds of the face value of Rs. 50 lakhs held by it as at the end of the financial year 31st March, 2011. The dividends on mutual funds were declared at the rate of 20% on 15th June, 2011. The dividend was proposed on 10th April, 2011 by the declaring company. Whether the treatment is as per the relevant Accounting Standard? You are asked to answer with reference to provisions of Accounting Standard. ***(November, 2003 & May, 2004)***

Answer

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

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

(b) Paragraph 8.4 and 13 of Accounting Standard 9 on Revenue Recognition states that dividends from investments in shares are not recognised in the statement of profit and loss until a right to receive payment is established.

In the given case, the dividend is proposed on 10th April, 2011, while it is declared on 15th June, 2011. Hence, the right to receive payment is established on 15th June, 2011. As per the above mentioned paragraphs, income from dividend on units of mutual funds should be recognised by X Ltd. in the financial year ended 31st March, 2012.

The recognition of Rs. 10 lakhs on accrual basis in the financial year 2010-2011 is not as per AS 9 'Revenue Recognition'.

(i) Acting as a banker in respect of funds of local bodies, Zilla Parishads, Panchayat Institutions etc. who keep their funds with the treasuries.

(ii) Custody of opium and other valuables because of the strong room facility provided at the treasury.

(iii) Custody of cash balances of the State Government and conducting cash business of Government at non-banking treasuries.

Question 5

(a) The company deals in three products, A, B and C, which are neither similar nor interchangeable. At the time of closing of its account for the year 2010-11. The Historical Cost and Net Realizable Value of the items of closing stock are determined as follows:

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

What will be the value of Closing Stock?

(b) During the current year 2010-11, X Limited made the following expenditure relating to its plant building:

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

What amount should be capitalized?

(c) *A plant was depreciated under two different methods as under:*

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

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

(d) *Briefly explain the methods of accounting for amalgamation as per Accounting Standard-14.*

(May, 2004)

Answer

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

Items	*Historical Cost (Rs. in lakhs)*	*Net Realisable Value (Rs. in lakhs)*	*Valuation of closing stock (Rs. in lakhs)*
A	40	28	28
B	32	32	32
C	16	24	16
	88	84	76

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

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

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

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

(i) The Pooling of Interest Method

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

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

(ii) The Purchase Method

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

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

Question 6

(a) X Co. Limited purchased goods at the cost of Rs.40 lakhs in October, 2010. Till March, 2011, 75% of the stocks were sold. The company wants to disclose closing stock at Rs.10 lakhs. The expected sale value is Rs.11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct closing stock to be disclosed as at 31.3.2011.

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

(c) Arjun Ltd. sold farm equipments through its dealers. One of the conditions at the time of sale is, payment of consideration in 14 days and in the event of delay interest is chargeable @ 15% per annum. The Company has not realized interest from the dealers in the past. However, for the year ended 31.3.2011, it wants to recognise interest due on the balances due from dealers. The amount is ascertained at Rs.9 lakhs. Decide, whether the income by way of interest from dealers is eligible for recognition as per AS 9? ***(May, 2006)***

Answer

(a) As per Para 5 of AS 2 "Valuation of Inventories", the inventories are to be valued at lower of cost and net realizable value.

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

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

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

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

Question 7

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

(b) What are the information that are to be disclosed in the financial statements as per AS-10? ***(May, 2007)***

Answer

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

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

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

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

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

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

(b) the amount of advances received; and

(c) the amount of retentions.

An enterprise should also present:

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

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

(b) As per AS 10, the following information should be disclosed in the financial statements:

(i) gross and net book values of fixed assets at the beginning and end of an accounting period showing additions, disposals, acquisitions and other movements ;

(ii) expenditure incurred on account of fixed assets in the course of construction or acquisition ; and

(iii) revalued amount substituted for historical costs of fixed assets, the method adopted to compute the revalued amounts, the nature of indices used, the year of any appraisal made, and whether an external valuer was involved, in case where fixed assets are stated at revalued amounts.

Question 8

(a) The Company X Ltd., has to pay for delay in cotton clearing charges. The company up to 31.3.2010 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 2010-11. This would result in decrease in profit by Rs.5 lakhs. Comment.

(b) The Board of Directors of X Ltd. decided on 31.3.2011 to increase sale price of certain items of goods sold retrospectively from 1st January, 2011. As a result of this decision the company has to receive Rs.5 lakhs from its customers in respect of sales made from 1.1.2011 to 31.3.2011. But the Company's Accountant was reluctant to make-up his mind. You are asked to offer your suggestion.

(c) Briefly explain disclosure requirements for Investments as per AS-13. ***(November, 2007)***

Answer

(a) As per para 12 of AS 2 (revised), interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are therefore, usually not included in the cost of inventories. However, X Ltd. was in practice to charge the cost for delay in cotton clearing in the closing stock. As X Ltd. decided to change this valuation procedure of closing stock, this treatment will be considered as a change in accounting policy and such fact to be disclosed as per AS 1. Therefore, any change in amount mentioned in financial statement, which will affect the financial position of the company should be disclosed properly as per AS 1, AS 2 and AS 5.

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

(b) As per para 10 of AS 9 'Revenue Recognition', the additional revenue on account of increase in sales price with retrospective effect, as decided by Board of Directors of X Ltd., of Rs.5 lakhs to be recognised as income for financial year 2010-11, only if the company is able to assess the ultimate collection with reasonable certainty. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

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

(i) Accounting policies followed for valuation of investments.

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

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

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

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

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

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

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

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

Question 9

X Ltd. purchased debentures of Rs.10 lacs of Y Ltd., which are traded in stock exchange. How will you show this item as per AS 3 while preparing cash flow statement for the year ended on 31st March, 2011? ***(May, 2008)***

Answer

As per AS 3 on 'Cash flow Statement', cash and cash equivalents consists of cash in hand, balance with banks and short-term, highly liquid investments[1]. If investment, of Rs.10 lacs, made in debentures is for short-term period then it is an item of 'cash equivalents'.

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

Question 10

(i) *A manufacturing company purchased shares of another company from stock exchange on 1st May, 2010 at a cost of Rs.5,00,000. It also purchased Gold of Rs.2,00,000 and Silver of Rs.1,50,000 on 1st April, 2008. How will you treat these investments as per the applicable AS in the books of the company for the year ended on 31st March, 2011, if the values of these investments are as follows:*

	Rs.
Shares	*2,00,000*
Gold	*4,00,000*
Silver	*2,50,000*

(ii) *In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input is Rs.1,000. The entire quantity of waste is on stock at the year end. State with reference to Accounting Standard, how will you value the inventories in this case?* ***(May, 2008)***

Answer

(i) As per para 32 of AS 13 on 'Accounting for Investments', any investment of long term period is shown at cost. Hence, the investment in Gold and Silver (purchased on 1st April 2008) shall continue to be shown at cost i.e., Rs.2,00,000 and Rs.1,50,000 respectively as their value have increased.

Also as per AS 13, for investment in shares - if the investment is for short-term period then the loss of Rs.3,00,000 is to be charged to profit & loss account for the year ended 31st March, 2011. If investment is of long term period then it will continue to be shown at cost in the Balance Sheet of the company. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

(ii) As per para 13 of AS 2 (Revised), abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred.

In this case, normal waste is 250 MT and abnormal waste is 50 MT.

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[1] As per para 6 of AS 3, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say three months or less from the date of acquisition.

The cost of 250 MT will be included in determining the cost of inventories (finished goods) at the year end. The cost of abnormal waste amounting to Rs.50,000 (50 MT × Rs.1,000) will be charged to the profit and loss statement.

Question 11

Following is the cash flow abstract of Alpha Ltd. for the year ended 31st March, 2011:

Cash Flow Abstract

Inflows	*Rs.*	*Outflows*	*Rs.*
Opening balance:		*Payment to creditors*	*90,000*
Cash	*10,000*	*Salaries and wages*	*25,000*
Bank	*70,000*	*Payment of overheads*	*15,000*
Share capital – shares issued	*5,00,000*	*Fixed assets acquired*	*4,00,000*
Collection from Debtors	*3,50,000*	*Debentures redeemed*	*50,000*
Sale of fixed assets	*70,000*	*Bank loan repaid*	*2,50,000*
		Taxation	*55,000*
		Dividends	*1,00,000*
		Closing balance:	
		Cash	*5,000*
		bank	*10,000*
	10,00,000		*10,00,000*

Prepare Cash Flow Statement for the year ended 31st March, 2011 in accordance with Accounting standard 3. ***(November, 2008)***

Answer

Cash Flow Statement

for the year ended 31.3.2011

	Rs.	*Rs.*
Cash flow from operating activities		
Cash received from customers	3,50,000	
Cash paid to suppliers	(90,000)	
Cash paid to employees (salaries and wages)	(25,000)	
Other cash payments (overheads)	(15,000)	
Cash generated from operations	2,20,000	
Income tax paid	(55,000)	
Net cash from operating activities		1,65,000

Cash flow from investing activities		
Payment for purchase of fixed assets	(4,00,000)	
Proceeds from sale of fixed assets	70,000	
Net cash used in investment activities		(3,30,000)
Cash flow from financing activities		
Proceeds from issue of share capital	5,00,000	
Bank loan repaid	(2,50,000)	
Debentures redeemed	(50,000)	
Dividends paid	(1,00,000)	
Net cash from financing activities		1,00,000
Net decrease in cash and cash equivalents		(65,000)
Cash and cash equivalents at the beginning of the year		80,000
Cash and cash equivalents at the end of the year		15,000

Question 12

(a) B Ltd. undertook a construction contract for Rs. 50 crores in April, 2010. The cost of construction was initially estimated at Rs. 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated the cost of completion of the contract at Rs. 53 crores.

Can the company provide for the expected loss in the book of account for the year ended 31st March, 2011?

(b) List the conditions to be fulfilled as per Accounting Standard 14 for an amalgamation to be in the nature of merger, in the case of companies. ***(November, 2008)***

Answer

(a) As per para 35 of AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Therefore, The foreseeable loss of Rs.3 crores (Rs. 53 crores less Rs. 50 crores) should be recognised as an expense immediately in the year ended 31st march, 2008. The amount of loss is determined irrespective of

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

(ii) Stage of completion of contract activity; or

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

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

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

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

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

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

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

Question 13

A machinery costing Rs.20 lakhs has useful life for 5 years. At the end of 5 years its scrap value would be Rs.2 lakhs. How much depreciation is to be charged in the books of the company as per Accounting Standard 6? ***(May, 2010)***

Answer

Calculation of depreciation as per Straight Line Method

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

Question 14

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

(ii) During the year 2010-11, P Limited incurred the following expenses on machinery:

Rs.2.50 lacs as routine repairs and Rs.75,000 on partial replacement of a part. Rs.7 lacs on replacement of part of a machinery which will improve the efficiency of the machine. Which amount should be capitalized as per AS 10? ***(November, 2009)***

Answer

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

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

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

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

Question 15

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

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

Fixed production charges for the year on normal working capacity of 2 lakh kgs is Rs.20 lakhs. 4,000 kgs of finished goods are in stock at the year end. ***(May, 2010)***

Answer

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

Cost per kg. of finished goods:

		Rs.
Material Cost		200
Direct Labour	40	
Direct Variable Production Overhead	20	

Fixed Production Overhead $\left(\frac{20,00,000}{2,00,000}\right)$	<u>10</u>	<u>70</u>
		<u>270</u>

Hence the value of 4,000 kgs. of finished goods = 4,000 kgs x Rs. 270

= Rs. 10,80,000

Question 16

When can a company change its accounting policy? ***(May, 2007)***

Answer

A change in accounting policy should be made in the following conditions:

(i) If the change is required by some statute or for compliance with an Accounting Standard.

(ii) Change would result in more appropriate presentation of the financial statement.

Change in accounting policy may have a material effect on the items of financial statements. For example, if depreciation method is changed from straight-line method to written-down value method, or if cost formula used for inventory valuation is changed from weighted average to FIFO, or if interest is capitalized which was earlier not in practice, or if proportionate amount of interest is changed to inventory which was earlier not the practice, all these may increase or decrease the net profit. Unless the effect of such change in accounting policy is quantified, the financial statements may not help the users of accounts. Therefore, it is necessary to quantify the effect of change on financial statement items like assets, liabilities, profit / loss.

Question 17

What is meant by accounting estimate? Give two examples for accounting estimate.

(November, 2007)

Answer

As a result of the uncertainties in business activities, many financial statement items cannot be measured with precision but can only be estimated. These are called accounting estimates. Therefore, the management makes various estimates and assumptions of assets, liabilities, incomes and expenses as on the date of preparation of financial statements. This process of estimation involves judgements based on the latest information available.

Examples of estimation in some fields are:

(i) Estimation of useful life of depreciable assets.

(ii) Estimation of provision to be made for bad and doubtful debts.

Question 18

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

(November, 2007)

Answer

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

(i) Methods of depreciation, depletion and amortisation.

(ii) Treatment of expenditure during construction.

(iii) Valuation of inventories.

(iv) Treatment of goodwill.

(v) Valuation of investments.

(vi) Valuation of fixed assets.

Question 19

List the criteria to be applied for rating an enterprise as Level-I enterprise for the purpose of compliance of Accounting Standards in India. ***(November, 2007)***

Answer

Following are the criteria for classifying an enterprise as Level -I enterprise:

(i) Enterprises, whose equity or debt securities are listed or is in the process of being listed in India.

(ii) Banks (including co-operative banks), Insurance companies and Financial Institutions.

(iii) All commercial, industrial and other business reporting enterprises whose turnover during the previous year is in excess of Rs.50 crores. Here turnover does not include 'other income'.

(iv) All commercial, industrial and other business reporting enterprises whose total borrowings including public deposits during the accounting year exceeds Rs.10 crores.

(v) Holding and subsidiary companies of any of the above enterprises at any time during the accounting year.

EXERCISES

1. *Explain Provisions contained in the Accounting Standard in respect of Revaluation of fixed assets.*
2. *When can revenue be recognised in the case of transaction of sale of goods?*
3. *Write short note on valuation of fixed assets in special cases.*

4. *Jagannath Ltd. had made a rights issue of shares in 2009. In the offer document to its members, it had projected a surplus of Rs. 40 crores during the accounting year to end on 31st March, 2011. The draft results for the year, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of Rs. 10 crores. The board in consultation with the managing director, decided on the following:*

   (i) *Value year-end inventory at works cost (Rs. 50 crores) instead of the hitherto method of valuation of inventory at prime cost (Rs. 30 crores).*

   (ii) *Provide depreciation for the year on straight line basis on account of substantial additions in gross block during the year, instead of on the reducing balance method, which was hitherto adopted. As a consequence, the charge for depreciation at Rs. 27 crores is lower than the amount of Rs. 45 crores which would have been provided had the old method been followed, by Rs. 18 cores.*

   (iii) *Not to provide for "after sales expenses" during the warranty period. Till the last year, provision at 2% of sales used to be made under the concept of "matching of costs against revenue" and actual expenses used to be charged against the provision. The board now decided to account for expenses as and when actually incurred. Sales during the year total to Rs. 600 crores.*

   (iv) *Provide for permanent fall in the value of investments - which fall had taken place over the past five years - the provision being Rs. 10 crores.*

   As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2010-2011.

5. *On 25th September, 2011, Planet Advertising Limited obtained advertisement rights for World Cup Hockey Tournament to be held in Nov./Dec., 2011 for ₹ 520 lakhs.*

   They furnish the following information:

   (1) *The company obtained the advertisements for 70% of available time for ₹ 700 lakhs by 30th September, 11.*

   (2) *For the balance time they got bookings in October, 11 for ₹ 240 lakhs.*

   (3) *All the advertisers paid the full amount at the time of booking the advertisements.*

   (4) *40% of the advertisements appeared before the public in Nov. 11 and balance 60% appeared in the month of December, 11.*

   You are required to calculate the amount of profit/loss to be recognized for the month November and December, 2011 as per Accounting Standard 9. ***(November, 2010)***

   (Hints: Company should recognise ₹ 168 lakhs (i.e. ₹ 420 lakhs x 40%) in November, 2011 and rest ₹ 252 lakhs (i.e. ₹ 420 lakhs x 60%) in December, 2011.)