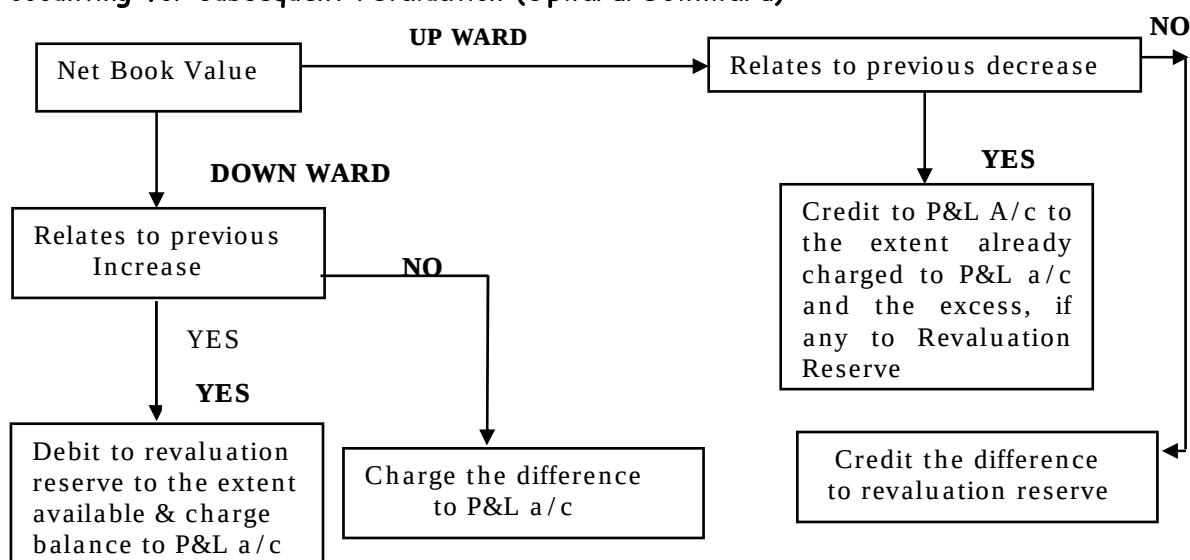


ACCOUNTING FOR FIXED ASSETS (AS-10)

1. Fixed assets shall be shown in financial statements at historical cost less depreciation.
2. **What is Historical cost:** The historical cost consists of the following:
 - a. Purchase price.
 - b. Import duties and other non-refundable taxes.
 - c. Cost of bringing the asset to the working condition like: Site preparation, Delivery cost, Installation cost, Expenditure incurred on test runs less income by sale of products, Administrative overheads specifically attributable for construction/acquisition/installation.
 - d. Reduce Govt. grants received/receivable against fixed assets.
 - e. Price adjustments, changes in duties etc.
3. **Self - Constructed Assets:** Cost of self-constructed assets shall not include any internal profit.
4. **Accounting treatment of first time Revaluation:**
 - a. **Upward:** Increase in net book value is credited to 'Revaluation Reserve'.
 - b. **Downward:** Decrease in net book value is charged to the profit & loss account.
5. **Accounting for subsequent revaluation (Upward/Downward):**



Note: “No” means first time revaluation. “Yes” means second and subsequent revaluations.

6. **Valuation of fixed assets in special cases:**
 - a. **Assets acquired on hire purchase terms:** Such assets are recorded at their cash price. Further, Shown in Balance Sheet - indicating full ownership does not exist.
 - b. **Cost of jointly held assets:** The original cost, accumulated depreciation, and written down value should be stated in the b/s in the proportion of entities ownership.
 - c. **Fixed assets acquired at consolidated price:** Cost of each fixed asset should be determined on a fair basis as per valuation by competent valuer's.
 - d. **Cost of assets acquired in exchange of assets:** Assets acquired should be recorded either at fair market value of asset given up or book value of asset given up, whichever is lower. ADD/LESS: Any additional payment or receipt.
 - e. **Fixed Assets acquired in exchange of shares or other securities:** When payment of fixed assets is made in shares or securities, assets should be recorded either at Fair market value of asset acquired or Fair market value of shares or securities issued, whichever is clearer.

7. Goodwill: Is recorded

- a. Only when consideration is paid, or when excess is paid over net assets acquired.
- b. Is written-off over a period as a matter of financial prudence.

8. Patents:

- a. On purchase, recorded at - At Purchase price, Incidental expenses, Stamp cost, etc.
- b. On in house development, recorded at - All Related expenses.
- c. Written - off over their legal life or useful life whichever is less.

9. Known-how:

- g. On purchase, recorded at - At Purchase price, Incidental expenses, Stamp cost, etc.
- h. On in house development, recorded at - All Related expenses
- i. To be written off:
 - i. Relating to manufacturing process - in the year in which it is incurred.
 - ii. Relating to Plans, designs & drawings of buildings or plant & machinery - To be capitalised & depreciated.

Note: Composite payments (manufacturing process & plans, designs etc.) are to be apportioned.

10. Addition or extension to an existing asset:

- a. **If integral part of existing asset:** Added to gross book value of existing assets.
- b. **If having separate identity** and capable to be used after the disposal of existing asset - it is accounted for separately.

11. Disposals:

- a. F.A's are deleted from the F.S. either on disposal or on expiry of expected benefit's.
- b. Gains or losses arising on disposal are generally recognised in profit & loss account.

12. Disposal of previously revalued fixed assets:

- a. If there is profit, then it is credited to P & L a/c.
- b. The revaluation reserve relating to the disposed assets may be transferred to general reserve.
- c. If there is a loss & if any revaluation reserve is in existence relating to that particular asset, loss is first adjusted against that reserve & balance loss is transferred to P&L a/c.

13. Retirement: When Fixed assets are retired from active use and held for disposal:

- a. Stated at the lower of net book value & NRV.
- b. The revaluation reserve relating to the retired assets may be transferred to general reserve.
- c. Expected loss is taken immediately to P&L a/c after adjusting the revaluation reserve, if any.

ILLUSTRATIONS

Q.No.1: A company has constructed buildings itself, at a cost of 4,50,000. The lowest estimate from an outside contractor to carry out the same work was for 6,00,000. The directors argue that as they were fully entitled to employ an outside contractor, it is reasonable to debit the factory building account with 6,00,000.

Ans: The contention of the board is incorrect. As per AS 10 cost of self-constructed assets shall not include any internal profit.

Q.No.2: Wipro Ltd. has purchased a plant in the year 2006-07 for Rs.45 lakhs. A balance of Rs.5 lakhs is still payable to the sellers and is waived off by the seller in the current year. The company credited this to P&L a/c. Whether the company is correct?

Ans: As per AS-10 the cost of fixed assets may undergo changes subsequent to its acquisition on account of price adjustments etc. The treatment done by the company is not correct. Rs.5 lakhs should be deducted from the cost of fixed assets.

Q.No.3: A Ltd. decided to retire a plant. The gross book value is Rs.100 lacs. The company charged depreciation over a period of 10 years (estimated life) at an estimated scrap value of 3% (Under SLM). At the end of 7th year the plant has been decided to be retired and its NRV is Rs.31,10,000.

Ans: When an asset is retired, it is to be stated at the lower of net book value & NRV and expected loss is taken immediately to P&L a/c.

Loss/Profit:

Depreciable amount (100 - 3)	97
Depreciation charge per annum on SLM Basis	9.70
Total depreciation charged (9.7 X 7 years)	67.90
Net book value (a)	32.10
Net realisable value (b)	31.10
Loss (a) - (b) (Debited to P&L a/c)	1.00

Q.No.4: On March 31, 2007, Joy Ltd. exchanged an old machine having a WDV of Rs. 16,800, and paid the cash difference of Rs. 6,000 for a new machine having a total cash price of Rs. 20,500. On March 31, 2007, what amount of loss should company recognise on this exchange?

Ans: When a fixed asset is acquired in exchange, asset acquired should be recorded either at fair market value of asset given up or book value of asset given up, which ever is lower. ADD/LESS: Any additional payment or receipt. The cash price of the new machine represents its FMV. The FMV of the old machine can be determined by subtracting the cash paid towards the exchange (Rs. 6,000) from the cost of the new machine i.e. Rs. 20,500 - Rs. 6,000 = Rs.14,500. Since the book value of the old machine (Rs. 16,800) exceeds its FMV on the date of its exchange (Rs. 14,500), the difference of Rs. 2,300 must be recognised as loss.

Q.No.5: Xerox Ltd. purchased know-how for both manufacturing process & design, drawing of the factory at a cost of Rs.10 crores. 75% is towards design and drawings. X Ltd capitalised the cost of drawings, etc. with factory building and cost of manufacturing process with the cost of machinery.

Ans: As per AS-10, X Ltd. should have capitalised know-how related to plans, design etc. of factory building with the cost of building and know how expenses relating to manufacturing process should be debited to profit and loss a/c.

Q.No.6: Karjai Ltd. being a manufacturer of pollution control equipments entered into collaboration agreements for the supply of drawings and designs for manufacture of pollution control equipments. The consideration is Rs.100 lakhs. The co. has shown the cost of technical know-how as an asset.

Ans: As per As-10, know- how is generally of two types viz., (i) relating to manufacturing process; and (ii) relating to plans, designs and drawings of buildings or plant & machinery. As per AS-10 know how related to manufacturing processes is to be debited to the profit and loss account. The amount in question is not related to plans, designs and drawings of buildings or plant or machinery but in relation to manufacturing process and therefore such expenditure is to be debited to the profit and loss account instead of treating as an asset.

Q.No.7: A public company whose main object is to buy large lands, develop them and sell them in small plots. Land purchased by the company and the cost of development has been consistently grouped under fixed assets in its balance sheet Comment.

Ans: It is not a fixed asset, since land is being held by the company for sale in the normal course of business. Therefore, as it is an inventory, should be classified under current assets.

Q.No.8: On 1-4-2001 Induga Ltd. had sold some of its fixed assets for Rs.100 lakhs written down value Rs.250 lakhs, these assets were revalued earlier. As on 1-4-2001 the revaluation reserve corresponding to these assets stood at Rs.200lakhs. The profit on sale of property Rs.200 lakhs shown in the profit and loss statement represented the transfer of this amount. Loss on sale of asset was included in the cost of goods sold. Comment.

Ans: As per AS-10, on accounting for fixed assets. On disposal of a previously revalued item of fixed assets, the difference between net disposal proceeds and the net book value is normally charged or credited to the profit and loss statement except that to the extent such a loss 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 is charged directly to that account. The amount standing in revaluation reserve following the retirement or disposal of an asset, which relates to that asset, may be transferred to general reserve. Accordingly, the following journal entries are to be passed.

	(Rs. in lakhs)
Profit on sale of property A/c	200
To Cost of goods sold A/c	150
To General Reserve A/c	50

Q.No.9: AD Softex (India) Ltd. expects that a plant has become useless which is appearing in the books at Rs.10 lakhs gross value. The company charges SLM depreciation on a period of 10 years estimated life and estimated scrap value of 3%. At the end of 7th year the plant has been assessed as useless. Its estimated net realizable value is Rs.3,10,000. Determine the loss /gain on retirement of the fixed assets.

Ans: Cost of the plant Rs.10,00,000

Estimated realizable value Rs.30,000.

Depreciable amount Rs.9,70,000

Depreciation per year Rs.97,000

Written down value at the end of 7th year = 10,00,000 – (97,000 x 7) = Rs.3,21,000.

As per AS - 10, items of fixed assets that have been retired from active use and are held for disposal are stated at the lower of their net book value and net realizable value and are shown separately in the financial statements. Any expected loss is recognized immediately in the profit and loss statement. Accordingly, the loss of Rs.11,000 (3,21,000 – 3,10,000) to be shown in the profit and loss account and asset of Rs.3,10,000 to be shown in the balance sheet separately.

Q.No.10: NDA Co. purchased a machine costing Rs.1,25,000 for its manufacturing operations and paid shipping costs of Rs.20,000. NDA spent an additional amount of Rs. 10,000 for testing and preparing the machine for use. What amount should NDA record as the cost of the machines?

Ans: As per AS – 10, the cost of fixed asset should comprise its purchase price and any attributable cost of bringing the asset to its working condition for its intended use. In this case the cost of machinery includes all expenditures incurred in acquiring the asset and preparing it for use. Cost includes the purchase price, freight and handling charges, insurance cost on the machine while in transit, cost of special foundations, and cost of assembling, installation and testing. Therefore the cost to be recorded is Rs.1,55,000 (Rs.1,25,000 + Rs.20,000 + Rs.10,000).

Q.No.11: On December 1, 2001, Induga Co. purchased Rs.4,00,000 worth of land for a factory site. Induga razed an old building on the property and sold the materials it salvaged from the demolition. Induga incurred additional costs and realized salvage proceeds during December 2001 as follows:

Demolition of old building	Rs.50,000
Legal fees for purchase contract and recording ownership	Rs.10,000
Title guarantee insurance	Rs. 12,000
Proceeds from sale of salvaged materials	Rs.8,000

In its December 31, 2001 Balance Sheet, Induga Co. should report a balance in the land account.

Ans: As per AS – 10, the cost of land should include all expenditure incurred preparing it for its ultimate use (such as factory site) is considered part of the cost of land. Before the land can be used as a building site, it must be purchased (involving costs such as purchase price, legal fees, and title insurance) and the old building must be razed (cost of demolition less proceeds from sale of scrap). The total balance in the land account should be Rs.4,64,000.

Purchase price	Rs. 4,00,000
Legal Fees	Rs.10,000
Title Insurance	Rs. 12,000
Net cost of demolition (Rs.50,000 – Rs.8,000)	<u>Rs.42,000</u>
	<u>Rs. 4,64,000</u>

Q.No.12: A building suffered uninsured fire damage. The damaged portion of the building was refurbished with higher quality materials. The cost and related accumulated depreciation of the damaged portion are identifiable. To account for these events, the owner should

- Reduce accumulated depreciation equal to the cost of refurbishing.
- Record a loss in the current period equal to the sum of the cost of refurbishing and the carrying amount of the damaged portion of the building.
- Capitalize the cost refurbishing and record a loss in the current period equal to the carrying amount of the damaged portion of the building.
- Capitalize the cost of refurbishing by adding the cost to the carrying amount of the building.

Ans: When an entity suffers a casualty loss to an asset; the accounting loss is recorded at the net carrying value of the damaged asset, if known. In this case, the cost and related accumulated depreciation are identifiable. The entity should therefore recognize a loss in the current period equal to the carrying amount of the damaged portion of the building. The refurbishing of the building, which is an economic event separate from the fire damage, should be treated similarly as the purchase of other assets or betterments. The cost of refurbishing the building should therefore be capitalized and depreciated over the shorter of the refurbishment's useful lives or the useful life of the building.

i. Loss A/c	Dr.		
Acc. Depreciation A/c	Dr.		
To Building A/c			
ii. Space Building A/c	Dr.		
To Cash A/c			

Therefore, answer (c) is correct and answer (b) is incorrect. Answer (a) is incorrect because in order to reduce the accumulated depreciation account, the useful life of the asset must be extended. In this case, there is no mention of this fact. Answer (d) is incorrect because it fails to recognize the casualty loss and properly remove the cost and accumulated depreciation on the damaged portion of the building from the accounting records.

Note: If the components of the damaged portion were not identifiable, the following entry would be made:

Loss A/c	Dr.		
To Cash A/c			

Q.No.13: Rawat & Co. Ltd. incurred costs to modify its building and to rearrange its production line. As a result, an overall reduction in production costs is expected. However, the modifications did not increase the building's market value, and the rearrangement did not extend the production line's life. Should the building modification costs and the production line rearrangement costs be capitalized?

	Building modification costs	Production line rearrangement costs
(a)	Yes	No
(b)	Yes	Yes
(c)	No	No
(d)	No	Yes

Ans: As per AS – 10,– Only 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. In this case future benefits from the existing asset appear to have increased beyond its previously assessed standard of performance as there is over all reduction in production cost which is expected. Therefore both the building modification and production line rearrangement contributed to the improved efficiency in the production process. Therefore, both costs should be capitalized and answer (b) is correct.

Q.No.14: A conveyor system was capitalized on 01-01-97 with value of Rs.41.37crores. The break – up of the capital cost was as follows:

Civil & Mechanical structure	11.72
Driving units and plumbing	05.40
Rope	02.83
Belt	11.17
Safety and electrical equipments	06.15
Other accessories	<u>04.10</u>
	41.37

During the financial year 2000-2001 due to wear and tear, the rope used in the conveyor system was replaced by a new one at cost of Rs.8 crores. As new rope did not increase the capacity and is a component of the total assets. The company charged the full costs of the new rope to repairs and maintenance. Old rope continues to appear in the books of account and is charged with depreciation every year.

Whether the above accounting treatment is correct. If not, give the correct accounting treatment with explanation.

Ans: As per AS – 10– Subsequent expenditure relating to an item of fixed asset should be added to its book value only if it increases the future benefits from the existing asset beyond its previously assessed standard of performance. In the instant case, the new replaced rope does not increase the future benefits from the assets beyond their previously assessed performance, therefore the cost of replacement of rope should be charged to revenue, however in doing so the estimated scrap value of the old rope should be deducted from the cost of new rope.

Q.No.15: One customer from whom Rs.5 lakhs are recoverable for credit sales given a motor car in full settlement of dues. The directors estimate that the market value of the motor car transferred is Rs.5.25 lakhs. As on the date of the balance sheet the car has not been registered in the name of the auditee. As an auditor, what would you do in the following situations?

Ans: The motor car has been acquired in exchange for another assets i.e. receivables. The fair value of motor car is Rs.5.25 lakhs and that of receivable Rs.5 lakhs. As per AS – 10 the asset acquired in an exchange of assets should be valued at the fair market value of assets acquired or the asset given up, whichever is more clearly evident. Here fair market value of the asset given up obviously more clearly evident. Hence, the motor car should be valued at Rs.5 lakhs. Also the motor car should be recognized as an asset even though it is not yet registered in auditee's name. This is because legal title is not necessary for an asset to exist. What is necessary is control as per the framework for preparation and presentation of financial statements. Applying substance over form we find since price has been settled, the auditee has control, hence it should be reflected as an asset along with a note to the effect that the registration in auditee name is pending.

Q.No.16: 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. As an auditor, what you do in this situation?

Ans: Size of the expenditure is not the criteria to decide whether subsequent expenditure should be capitalized. The important question is whether the expenditure increases the expected future benefits from the asset beyond its pre-assessed standard of performance as per AS – 10. Only then it should capitalize. Since in this case, only the benefits are maintained at existing level, the expenditure should not be capitalized. If under the circumstances the amount is material the auditor should qualify his report.

Q.No.17: A company has scrapped a semi-automatic part of a machine (not written – off) and replaced with a more expensive fully automatic part, which has doubled the output of the machine. At the same time the machine was moved to more suitable place in the factory, which involved the building of new foundation in addition to the cost of dismantling and re-erection. The company wants to charge the whole expenditure to revenue. As an auditor, what would you do in this situation?

Ans: If the subsequent expenditure increases the expected future benefits from the asset beyond its pre-assessed standard of performance then as per AS – 10 it should be capitalized. Otherwise it should be expensed. In this case, the replacement of semi-automatic part with fully automatic part has doubled the output of the machine thus, it has increased future benefits beyond the machines pre-assessed standard performance, hence this expenditure should be capitalized as part of cost of the machine. However, the expenses for shifting the machine and building of a new foundation in addition to the cost of dismantling and re-erection do not contribute to any new future benefits from the existing asset. They only serve to maintain performance of the machine. Hence, this cost should be charged to revenue.

Q.No.18: NDA Limited purchased a machine of Rs.20 lakhs including excise duty of Rs.4 lakhs. The excise duty is Cenvatable under the excise laws. The enterprise intends to avail CENVAT credit and it is reasonably certain to utilize the same within reasonable time. How should the excise duty of Rs.4 lakhs be treated?

Ans:		(Rs. in lakhs)
Year of acquisition:		
Machine Account	Dr.	16
CENVAT Credit Receivable Account	Dr.	2
CENVAT Credit Deferred Account	Dr.	2
To Supplier's Account		20
Next Year		
CENVAT credit receivable Account	Dr.	2
To CENVAT credit deferred Account		2

Q.No.19: Is Project under sale fixed or current asset?

Ans: According to AS – 10, Accounting for Fixed Assets. Material items retired from active use and held for disposal should be stated at the lower of their net book value and net realizable value and shown separately in the financial statements.

In view of the above, the ASB opined that project under sale, which was originally treated, as fixed asset would continue to be a fixed asset even if it is under sale and will not, therefore, be classified as a current asset. However, if an enterprise were a dealer of projects, then the project under sale would be an inventory and will be classified as a current asset.

Q.No.20: ABC Ltd. imported a machine from Germany at a cost of Euros Rs.1,50,000. The exchange rate at the time of import was Rs.55 for 1 Euro. Customs duty was paid at 25% on its cost. The customs department applied a standard exchange rate of Rs.52 for 1 Euro for the purpose of computation. Other port charges, inward transport and octroi amounted to Rs.2 lakhs.

An engineer was invited from Germany for installation. His fees and expenses came to Rs.3 lakhs in rupees plus 10,000 Euros. This was remitted at Rs.56 for 1 Euro.

A loan of Rs.50 lakhs was taken for the acquisition of the machine at an interest of 8% per annum.

The loan was disbursed on 1st September, 2003. The exchange rate was Rs.55.80 for 1 Euro on this date.

The machine was installed and put to commercial use on 1st February, 2004.

Depreciation is charged on straight – line basis in the books of account at 13.91% per annum.

The exchange rate on 31st March, 2004 was Rs.57 for 1 Euro. The exchange rate on 31st March, 2005 was Rs.59 for 1 Euro.

10% of the loan was repaid on 1st October, 2004. The exchange rate was Rs.57.75 on this day.

From the above information work out the following.

- a. Original cost of the machine in the books of account;
- b. Depreciation for the financial year ended 31st March, 2004;
- c. Book value as on 31st March, 2004;
- d. Exchange rate differences if any charged to profit and loss for the financial year ended 31st March, 2004;
- e. Depreciation for the financial year ended on 31st March, 2005;
- f. Book value as on 31st March, 2005;
- g. Exchange rate differences if any to be charged to profit and loss for the financial year to ended 31st March, 2004.

Note: Apply the revised and latest accounting standards as applicable in India.

Ans:

- a. Original cost of machine in the books of account:

Purchase Price	Euro 1,50,000	@ Rs.55	82,50,000
Custom Duty	Euro 37,500	@ Rs.52	19,50,000
Other Charges			2,00,000
Engineer's Rupee Payments			3,00,000
Engineer's Euro Payments	Euro 10,000	@ Rs. 56	5,60,000
Interest on Loan	Rs.50,00,000	8%	1,66,667
Total Cost:			1,14,26,667

- b. Depreciation for the financial year ended 31-03-2004: (Rs.)
 @ 13.91% per annum on Rs.1,14,26,667 for two months = 2,64,908
- c. Book value as on 31-03-2004: (Rs.1,14,26,667 – 2,64,908) = 1,11,61,759
- d. Exchange fluctuation expense for the financial year ended 31-03-2004 is NIL, as the loan was denominated in rupees.
 Hence, no fluctuation is applicable.
- e. Depreciation for the year to end 31-03-2005: @ 13.91% per annum. = 15, 89,499
- f. Book Value as on 31-03-2005: (Rs.1,11,61,759 – 15,89,49) = 95,72,310
- g. Exchange fluctuation expense for financial year ended 31-03-2005 is NIL, as the loan was denominated in rupees.
 Hence, no fluctuation is applicable.

Q.No.21: Discuss the following as an element of cost of a fixed asset:

- a. General Administration expenses.
- b. Wages payable for the erection of a machinery.
- c. Conveyance expenses paid for the purchase of plant.
- d. Interest paid on loan taken to purchase the asset.
- e. Cost of design or machinery.
- f. Interest payable on a Hire Purchase agreement.
- g. Penalty payable to a supplier of machine for delayed payment.
- h. Overheads of the company.
- i. Cost of removing the encroachment from a land acquired earlier.
- j. Non technical staff's salary during the installation period.

Ans:

- a. General administrative expenses are normally not capitalised unless the cost is incurred to bring the asset to its present location and working condition.
- b. It should be capitalised being a direct cost.
- c. It should be capitalised.
- d. If interest relates to qualifying assets as per AS-16, then, interest can be capitalised.
- e. Cost of design of machine should be capitalised being a direct cost.
- f. If it relates to a qualifying asset interest can be capitalised.
- g. Penalty should not be capitalised. It is not related to bringing the assets to its present locations and conditions.
- h. Overheads are generally not capitalised.
- i. Cost of removing the encroachment of a land acquired earlier should normally not be capitalised unless it relates to increasing the capacity of land beyond its previously assessed standard of performance.
- j. Non-technical staff salary should not be capitalised being an item of general overhead.

Q.No.22: PQR Ltd. purchased a machine for Rs. 1,50,000 a few years ago. It was revalued two years ago by adding Rs. 75,000 to the carrying cost and the revaluation reserve. The present carrying amount of the asset is Rs. 95,000. It has been sold for Rs. 1,05,000 now. Find out the amount of profit on sale to be recognized in the Profit & Loss A/c.

Ans:

Calculation of Profit	Rs.
Sale value	1,05,000
Book value	95,000
Profit	10,000

Therefore amount to be recognised in profit and loss is Rs. 10,000. Balance of Rs. 7,500/- in revaluation Reserve account will be transferred to general reserve account.

Q.No.23: RST Ltd. has an asset at the net written down value of Rs. 50 lacs. It had been revalued upward by creating a revaluation reserve to the extent of Rs. 30 lacs. This balance still appears in the revaluation reserve. Now, the asset has been sold for of Rs. 15 lacs. Find out the amount to be taken to Profit & Loss A/c.

Ans: Calculation of loss on sale of asset:

	Rs. in lakhs
Book value	50
Less: sale value	<u>15</u>
	<u>35</u>

As there is a balance in Revaluation Reserve of Rs.30 lakhs in respect of these assets, the loss of Rs. 30 lakhs should be written off against Revaluation Reserve and the balance loss of Rs. 5 lakhs should be debited to profit and loss account.

Q.No.24: The net written down value of an asset to Rs.8,50,000 as on 1/1/03. During the year, the asset has been discarded as it has been found to be of no use to the firm. The annual depreciation charge of this asset for the year 2003 is Rs. 1,30,000. However, on 31-12-03, the net realizable value of the discarded asset has been estimated to be Rs. 3,50,000 only. Show the presentation of this asset in the financial statements for the year 2003.

Ans: The asset has been discarded during the year. So the depreciation for the year 2002-03 need not be provided for. The W.D.V of the asset is Rs. 8,50,000 and the N.R.V is Rs. 3,50,000. Therefore loss of Rs. 5,00,000 will be recognised in the profit and loss account. The asset will be shown in the balance sheet at Rs. 3,50,000. The details of the fact should be disclosed in the notes to accounts.

Q.No.25: Academy Ltd. purchased a computer for Rs. 1,50,000 to be paid in two instalments of Rs.1,00,000 and Rs. 50,000 payable on 1-12-03 and 31-1-04 respectively. The acquisition of

asset at Rs. 1,50,000 was duly recorded and the supplier was shown as a creditor for Rs.50,000 in the balance sheet as on 31-12-03. The account of the creditor however was settled by paying Rs. 40,000 only on 31-1-04. The rebate of Rs. 10,000 has been considered as income of the year 2004. Comment.

Ans: The accounting policy followed by the company is wrong. The company should not recognise Rs. 10,000 as the income of the year, rather it should be reduced from the carrying amount of the fixed asset. As per AS-10 the cost of the fixed asset may undergo changes subsequent to its acquisition on account of price adjustment. Therefore Rs. 10,000 should be deducted from the cost of the asset.

Q.No.26: The carrying amount of an asset is Rs. 5,60,000 and its net realizable value is Rs.4,20,000. It has been replaced by a new machine for which an amount of Rs. 2,30,000 has been paid besides handing over the old asset in an exchange offer. The market price of the new asset is Rs. 7,15,000. Find out the amount at which the new asset be shown in the balance sheet, and the amount to be charged to the Profit & Loss A/c.

Ans: The new asset PV should be taken at its market price i.e. Rs. 7,15,000. Out of Rs.7,15,000; Rs. 2,30,000 has been paid in cash. It means the old asset has been exchanged for Rs. (7,15,000 - 2,30,000) i.e. 4,85,000. The book value of old asset is Rs. 5,60,000. Therefore Loss of Rs. 75,000 (5,60,000 - 4,85,000) should be recognised in the profit and loss account for the year.

Q.No.27: In a major fire a portion of the factory was destroyed. The cost of the damaged portion and the written down value, both can be determined and are identifiable. The damaged portion was reconstructed at a cost higher than 'the WDV of the damaged portion. What should be the accounting treatment of related figures in the financial statements of the firm, given that after repairs, the performance of the factory will improve.

Ans: As the standard of the performance of the factory is expected to improve after the reconstruction of the damaged portion the cost of reconstruction should be capitalised.

However, the W.D.V of the damaged portion should be determined and charged to profit and loss account. A detail explanation should be given in the notes to account regarding the damage and reconstruction.

Q.No.28: Patalganga Ltd. purchased a factory (including the land) building at a cost of Rs. 8,60,000. The separate valuation of Land and Building was made at Rs. 2,50,000 and Rs. 5,30,000 respectively. Show the assets of Land and building in the balance sheet of the firm.

Ans: Fair value of the Land & Building is 2,50,000 and 5,30,00 respectively. Total cost paid i.e. Rs. 8,60,000 should be apportioned between Land & Building in the ratio 2,50,000 : 5,30,000.

Capitalised value of land = $\frac{250}{780} \times 8,60,000 = \text{Rs. } 2,75,641.$

Capitalised value of Bldg = $\frac{530}{780} \times 8,60,000 = \text{Rs. } 5,84,359.$

Q.No.29: As an auditor, state your views on the following situation A computerized machinery was purchased by two companies jointly. The price was shared equally. It was also agreed that they would use the machinery equally and show in their Balance Sheets, 50% of the value of the machinery and charge 50% of the depreciation in their respective books of account.

Ans: The accounting policy followed by the company is right. As per AS-10 where an enterprise owns fixed assets jointly with others the extent of its share in such assets and the proportion in the original cost, accumulated depreciation and W.D.V are stated in the balance sheet. Alternatively, the pro-rata cost of such jointly owned asset can be grouped together with similar fully owned asset. Therefore the accounting policy is in accordance with AS-10.

Q.No.30: Your client is purchasing its fixed assets from indigenous and overseas sources. On these fixed assets, rebates and discounts are sometimes allowed by the supplier. In other situations, the client deducts at the time of payment, liquidated damages because of late delivery of the machines. Advise your client on accounting for rebates, discount and liquidated damages.

Ans: Liquidated damages or penalties received from the suppliers are not price adjustment. Hence, such liquidate damages should not be adjusted against the cost of the asset but should be shown as other income in the profit and loss account. The rebates and discounts are regarded as price adjustment and should be deducted from the cost of the asset.

Q.No.31: During the current year 2002-03, Parul Ltd. made the following expenditure relating to its plant building:

	Rs. Lakhs
Routine repairs	2
Repainting	0.5
Partial replacement of roof tiles	1.5
Substantial improvements to the electrical wiring system	5
What amount should be capitalized?	

Ans: Rs. 5 lakhs should be capitalized, being substantial improvement to the electrical wiring system. Other expenditures should be charged to 'Profit and Loss Account'.

Q.No.32: Abhayankar Ltd. an existing Company has undertaken a capital expansion programme, concurrently with normal production. The Company holds the view that since the expansion programme will be completed within the financial year, it need not capitalize the indirect expenditure incurred for this purpose. State your views on the above.

Ans:

a. Treatment: For Capital Expansion Programme, AS – 10 provides that the Company should capitalize:

- i. Costs of construction that relate directly to the specific asset; and
- ii. Costs that are attributable to the construction activity in general and can be allocated to the specific asset.

b. Indirect Expenses: If the indirect expenses incurred during the construction period are not related and incidental to the construction, such expenses need not be capitalized.

c. Invalid Arguments: The arguments of the Company that:

- i. Capital expansion programme was carried out concurrently with normal production and
- ii. The expansion programme will be completed during the financial year, are NOT valid in this regard.

Q.No.33: A Project intended to be sold is treated as Fixed Asset. Comment on the accounting treatment accorded by the Company.

Ans:

a. Project Under Sale: As per AS - 10 states that material items retired from active use and held for disposal should be stated at:

- i. Their Net Book Value; or
- ii. Their Net Realisable Value whichever is LOWER.

It shall be shown separately in the financial statements.

b. Analysis:

i. Project treated as Fixed Asset: If the project under sale was originally treated as a Fixed Asset, it will continue to be a Fixed Asset even if it is under sale and will not, therefore, be classified as a Current Asset. However this item should not be clubbed with other Fixed Assets and should be shown separately.

ii. Dealer in Projects: Where the enterprise is a dealer of projects, the Project under Sale would be an item of inventory and will be classified as a Current Asset. Hence, its treatment as a Fixed Asset is not proper.

Q.No.34: Ekambar Ltd. transferred Land from "Fixed Assets" to "Current Assets" at market price and adjusted the excess value under "Capital Reserve" instead of "Revaluation Reserve". In subsequent years, the value was written down gradually as "Decline in Market Value". Comment on the validity of this accounting treatment.

Ans:

a. Where the Company intends to deal in Land: If the intention of the Company is to become a dealer of, the asset which was hitherto treated as a Fixed Asset, it is permissible to transfer such assets to Current Asset. For accounting their valuation, the following alternatives are available:

Alternative 1	Alternative 2
Show Fixed Assets reclassified as Current Assets at their Carrying Amount (e.g. Cost) appearing in the Balance Sheet or at their Net Realisable Value, whichever is lower.	Show Fixed Assets reclassified at their Market Price on the date of re-classification, so as to determine the correct profit on sale of such assets in the ordinary course of business.
No appreciation in value would be recognised either in the Capital Reserve or the Revaluation Reserve, in such case.	If Market Value exceeds carrying amount (e.g. Cost), the date of reclassification, difference can be transferred to Revaluation Reserve/Capital Reserve

Revaluation Reserve Vs Capital Reserve:

- i. Revaluation Reserve arises in a situation where a Fixed Asset is revalued and continues to be a fixed asset. It does not apply to reclassification of assets from Fixed to Current Assets.
- ii. Hence, in case of reclassification of assets, the excess of Market Value over the carrying amount, can be transferred to a Capital Reserve instead of Revaluation Reserve.
- iii. Revaluation Reserve and Capital Reserve are primarily of the same nature and cannot be used for distribution as dividend.
- iv. Part III of Schedule VI to the Companies Act states that Capital Reserve shall not include any amount regarded as free for distribution through the P&L A/c; and Revenue Reserve shall mean any reserve other than a Capital Reserve.
- v. Thus Revaluation Reserve is covered by the definition of Capital Reserve.
- vi. Hence, the Company's treatment in transferring the difference between Market Value on date of reclassification and carrying amount (like cost of land) to the Capital Reserve is proper.

b. Where the Company does not intend to deal in Land:

- i. If the Company does not intend to deal in the assets which were hitherto treated as fixed assets, but such assets are retired from active use and held for disposal, these should continue to be classified as Fixed Assets and reported separately.
- ii. As per AS - 10 requires that material items retired from active use and held for disposal should be stated at Net Book Value or Net Realisable Value, whichever is lower and shown separately in the Financial Statements.

Q.No.35: In the recent past, many Companies have resorted to revaluation of Fixed Assets. According to one view, reserve created on revaluation of Fixed Asset represents a realised gain (as there is knowledge and evidence that the revalued amount is realisable), which can be used for writing off past losses or providing for current as well as arrears of depreciation. Another opinion is that such reserve is an unrealised gain and thus, cannot be used for writing off past losses or depreciation but may be used for adjusting additional depreciation provision required in consequence of revaluation. Which opinion you will uphold as an auditor and why?

Ans:

a. Nature of Revaluation Reserve:

- i. Fixed Assets are held for use in the business and not for sale in the normal course of business. Hence, the difference between the Market Value and the Book Value does not represent realised and cannot be treated as such in the books of accounts.
- ii. There is no justification for taking credit for unrealised gains because the increase in market value of the Fixed Assets may be due to various extraneous factors, e.g. fall in purchasing power of currency of other factors not related to operations of the company.
- iii. Revaluation Reserve has been created as a result of a book adjustment only and, therefore, such reserve is an unrealised reserve which is not available for distribution as dividends.

b. Utility of Revaluation Reserve:

i. Adjusting Past Losses & Arrears of Depreciation:

- Revaluation Reserves cannot be used for adjusting past accumulated losses as well as depreciation for the year or arrears of depreciation for earlier years, which are required to be provided u/s 205 of the Companies Act.
- If accumulated losses and depreciation (including arrears of depreciation) are adjusted against Revaluation Reserve, it will amount to setting off actual losses against unrealised gains.

ii. Declaration of Dividend:

- When dividend is declared out of the current profit that should have been utilised to set off past losses and arrears of depreciation, it will contravene Section 205 of the Companies Act.
- Effectively, the Company will be declaring dividend out of unrealised gains appearing in the accounts in the form of Revaluation Reserve.
- So, accumulated losses or arrears of depreciation should not be set off against Revaluation Reserve.
- This view is as per ICAI's Guidance Note for Treatment of Revaluation Reserves and the Companies (Declaration of Dividend out of Reserve) Rules, 1975.

iii. Adjustment of Additional Depreciation:

- Depreciation should be provided with reference to the total value of the Fixed Asset as appearing in the accounts after revaluation.
- For statutory purposes like dividends, managerial remuneration etc., only depreciation relatable to the historical cost of the Fixed Assets is to be provided out of current profits.
- Therefore, additional depreciation relatable to revaluation may be adjusted against Revaluation Reserve by transfer to P&L Account.

The Company should provide depreciation on the Total Book Value of the Fixed Assets (including the increased amount as a result of revaluation) in the P&L Account, and thereafter transfer an amount equivalent to the Additional Depreciation from the Revaluation Reserve, showing such transfer separately, with appropriate Notes on Accounts.

- c. Need for Retention of Funds for Replacement:** The above views are maintainable from the legal standpoint. Also, utilisation of the Revaluation Reserve for these purposes will not be sound from accounting point of view because fund retention for replacement of the assets is not possible.

Q.No.36: As at the beginning of the year, Mallikarjun Limited has a Capital of Rs.2.50 Crores, Free Reserves of Rs.0.50 Crores and Revaluation Reserve of Rs.4.50 Crores. During the year under audit, the Company has incurred a loss of Rs.4 Crores. The Company proposes to adjust the loss with the Revaluation Reserve. Comment on the above.

Ans: Analysis:

- a. Treatment of Increase:** AS - 10 states that an increase in Net Book Value arising on revaluation of fixed assets is normally credited directly to owner's interest under the heading "Revaluation Reserve" which is not available for distribution.
- b. Treatment of Decrease:** A decrease in Net Book Value arising on Fixed Asset revaluation is charged to Profit & Loss Statement.
- c. Set – off against previous increase:** To the extent that a decrease is considered as related to a previous increase on revaluation that is included in Revaluation Reserve, it is charged against that earlier increase.
- d. Reversal of previous decrease:** Where an increase to be recorded is a reversal of a previous decrease arising on revaluation which has been charged to Profit and Loss Statement, the increase is credited to the Profit and Loss Statement to the extent that it offsets the previously recorded decrease.
- e. Utilisation:** As per AS - 10 and also under ICAI's Guidance Note on "Treatment of Reserve created on Revaluation of Fixed Assets", Revaluation Reserve shall not be utilised for adjusting the current or past, accounted losses of the Company.

Conclusion: In view of the above provisions, the treatment accorded by the Company is NOT proper.

Q.No.37: An old car of a Company having a very nominal book value has impressed a buyer, who is willing to pay Rs.1 lakh for it. The Company proposes not to sell the car, but to neglect its valuation in its accounts at Rs.1 lakh. Can the Company do so?

Ans:

Car not intended to be sold	Car intended to be sold
a. A single item of Fixed Asset cannot be arbitrarily revalued at the price quoted by a potential buyer. b. Revaluation should be based on proper appraisal and undertaken by competent valuers. c. Hence, the Company's treatment to neglect the valuation of the car in the accounts is proper and in accordance with AS – 10.	a. As per AS - 10 applies, whereby the material items retired from active use and held for disposal should be stated at lower of (i) Net Book Value and (ii) Net Realisable Value. b. Since the Net Book Value is nominal and lower than the proposed price of Rs.1 lakh, the asset should be carried at the Nominal Book Value only. c. The Company's accounting treatment is correct.

Q.No.38: Viswa Ltd. awarded a turnkey contract to Nathan Contractors Ltd. for construction of its plant. Viswa Ltd. does not have any data regarding apportionment of the total contractual value between the various units of plants and assets. Accordingly, it wants to rely, for this purpose, on the data furnished by Nathan Contractors Ltd. State your views on the above.

Ans:

- a. Suitable Basis:** Where the detail regarding the total contract value of the various units of plants and assets are not known, the total consideration can be apportioned in any suitable manner.
- b. Contractors Data:** For Technical Know-how which is used for constructing the different units of plant, the data supplied by the contractors indicating a suitable basis of apportioning can be considered.
- c. Other Bases:** Where data supplied by the contractors are inadequate, apportionment can be based on:
 - i.** Value or cost of the different units, which are constructed; or
 - ii.** Approximate time spent by the contractors in designing the construction of each unit.
 AS - 10 states that apportionment can be done on a fair basis, as determined by competent valuers.

The End