

Chapter 2

Accounting Standards

Question 1

(i) In X Co. Ltd., theft of cash of Rs.5 lakhs by the cashier in January, 2007 was detected only in May, 2007. The accounts of the company were not yet approved by the Board of Directors of the company.

Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.2007. Decide.

(ii) A machinery costing Rs.10 lakhs has useful life of 5 years. After the end of 5 years, its scrap value would be Rs.1 lakh. How much depreciation is to be charged in the books of the company as per Accounting Standard-6?

(iii) Garden Ltd. acquired fixed assets viz. plant and machinery for Rs.20 lakhs. During the same year it sold its furniture and fixtures for Rs.5 lakhs. Can the company disclose, net cash outflow towards purchase of fixed assets in the cash flow statement as per AS-3?

(iv) ABC Ltd. gave 50,000 equity shares of Rs.10 each (fully paid up) in consideration for supply of certain machinery by X & Co. The shares exchanged for machinery are quoted on Bombay Stock Exchange (BSE) at Rs.15 per share, at the time of transaction. In the absence of fair market value of the machinery acquired, how the value of machinery would be recorded in the books of the company?

(v) A company took a construction contract for Rs.100 lakhs in January, 2006. It was found that 80% of the contract was completed at a cost of Rs.92 lakhs on the closing date i.e. on 31.3.2007. The company estimates further expenditure of Rs.23 lakhs for completing the contract. The expected loss would be Rs.15 lakhs. Can the company recognise the loss in the financial statements prepared for the year ended 31.3.2007?

(2 Marks each) (May, 2007)

Answer

(i) As per paragraph 13 of AS 4 (revised) 'Contingencies and Events occurring after the Balance Sheet Date', an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes.

If a fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognize the loss amounting Rs. 5,00,000 and adjust the accounts of the company for the year ended 31st March, 2007.

(ii) As per paragraph 20 of AS 6 'Depreciation Accounting', the depreciable amount of a depreciable asset should be allocated on a systematic basis to each accounting period during the useful life of the asset. In the given case, the depreciation amount can be calculated as follows:

	Rs.
Cost of machinery	10,00,000
Less: Scrap value at the end of useful life	<u>1,00,000</u>
Amount to be written off during useful life of machinery	<u>9,00,000</u>
Useful life of the asset	5 years
Depreciation to be provided each year (Rs.9,00,000 / 5 years)	Rs.1,80,000

(iii) According to Para 21 of AS 3 (Revised) 'Cash Flow Statements', an enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22 and 24 are reported on a net basis. Acquisition and disposal of fixed assets is not prescribed in para 22 and 24 of the standard.

Hence, the company cannot disclose net cash flow in respect of acquisition of plant and machinery and disposal of furnitures and fixtures.

(iv) As per paragraph 22 of AS 10 'Accounting for Fixed Assets', fixed asset acquired in exchange for shares or other securities in the enterprise should be recorded at its fair market value, or the fair market value of the securities issued, whichever is more clearly evident. Since, the market value of the shares exchanged for the asset is more clearly evident, the company should record the value of machinery at Rs.7,50,000. (i.e., 50,000 shares × Rs.15 per share being the market price)

(v) As per paragraphs 31 and 35 of AS 7 on Construction Contracts, an expected loss on the construction contract should be recognized as an expense immediately irrespective of (i) whether or not the work has commenced on the contract; or (ii) the stage of completion of the contract; or (iii) the amount of profits expected to arise in other contracts.

Hence, the company must recognize the loss immediately.

Question 2

How Government grant relating to specific fixed asset is treated in the books as per AS-12?

(4 Marks) (May, 2007)

Answer

In accordance with AS 12, government grants related to specific fixed assets should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value. Where the grant related to a specific fixed asset equals the whole, or virtually the whole, of the cost of the asset, the asset should be shown in the balance sheet at a nominal value. Alternatively, government grants related to depreciable fixed assets may be treated as deferred income which should be recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset, i.e., such grants should be allocated to income over the periods and in the proportions in which depreciation on those assets is charged. Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income is suitably disclosed in the balance sheet pending its apportionment to profit and loss account.

Question 3

A company lodged a claim to insurance company for Rs. 5,00,000 in September, 2006. The claim was settled in February, 2007 for Rs. 3,50,000. How will you record the short fall in claim settlement in the books of the company.

(2 Marks) (November, 2007)

Answer

Journal Entry

Rs. Rs.

Profit and Loss A/c	Dr.	1,50,000	
To Insurance Company A/c			1,50,000

[Being the shortfall in insurance claim is the loss, transferred to Profit and Loss A/c]

Question 4

From the following information relating to Y Ltd. Calculate Earnings Per Share (EPS):

	Rs. in crores
Profit before V.R.S. payments but after depreciation	75.00
Depreciation	10.00
VRS payments	32.10
Provision for taxation	10.00
Fringe benefit tax	5.00
Paid up share capital (shares of Rs. 10 each fully paid)	93.00
(4 Marks) (November, 2007)	

Answer

	Rs. in crores
Profit after depreciation but before VRS Payment	75.00
Less: Depreciation – No. adjustment required	-
VRS payments	32.10
Provision for taxation	10.00
Fringe benefit tax	<u>5.00</u>
Net Profit	<u>47.10</u>
	<u>27.90</u>
No. of shares	9.30 crores

$$\begin{aligned}
 \text{EPS} &= \frac{\text{Net profit}}{\text{No. of shares}} \\
 &= \frac{27.90}{9.30} \\
 &= \text{Rs.3 per share.}
 \end{aligned}$$

Question 5

(i) How would you record a non-monetary grant received from the Government as per AS 12?

(ii) What is the accounting entry to be passed as per AS 10 for the following situations:

(a) Increase in value of fixed asset by Rs.50,00,000 on account of revaluation.

(b) Decrease in the value of fixed asset by Rs.30,00,000 on account of revaluation.

(iii) An industry borrowed Rs.40,00,000 for purchase of machinery on 1.6.2007. Interest on loan is 9% per annum. The machinery was put to use from 1.1.2008. Pass journal entry for the year ended 31.3.2008 to record the borrowing cost of loan as per AS 16.

(2 Marks each) (May, 2008)

Answer

(i) According to para 7.1 of AS 12 'Accounting for Government Grants', Government grants may take the form of non-monetary assets such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary grants given free of cost are recorded at a nominal value.

(ii) Journal entries*		Rs.	Rs.
(a)	Fixed asset A/c	Dr.	50,00,000
	To Revaluation reserve A/c		50,00,000
	(Being the increase in value of fixed asset due to upward revaluation)		
(b)	Profit and loss A/c	Dr.	30,00,000
	To Fixed asset A/c		30,00,000
	(Being the decrease in net book value of fixed asset due to downward revaluation)		
(iii)			Rs.
	Interest upto 31.3.2008 $(40,00,000 \times 9\% \times \frac{10}{12} \text{ months})$	=	3,00,000
	Less: Interest relating to pre-operative period $3,00,000 \times \frac{7}{10}$	=	<u>2,10,000</u>
	Amount to be charged to P&L A/c	=	<u>90,000</u>
	Pre-operative interest to be capitalized	=	<u>2,10,000</u>

Journal Entry			
Machinery A/c	Dr.	2,10,000	
To Loan A/c			2,10,000
(Being interest on loan for pre-operative period capitalized)			
Interest on loan A/c	Dr.	90,000	
To Loan A/c			90,000
(Being the interest on loan for the post-operative period)			
Profit and Loss A/c	Dr.	90,000	

* The journal entries given are on the assumption that the revaluation is done for the first time, for that particular fixed asset.

To Interest on loan A/c
(Being interest on loan transferred to P&L A/c)

90,000

Question 6

- (i) *When can an item qualify to be a prior period item as per AS 5?*
(ii) *What are the items that are to be excluded in determination of the cost of inventories as per AS-2?*

(4 Marks each) (May, 2008)

Answer

(i) According to para 16 of AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', prior period items refers to those income or expenses, which arise in the current period as a result of errors or omissions in the preparation of financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods, are determined in the current period e.g., arrears payable to workers in current period as a result of revision of wages with retrospective effect.

(ii) Items that are to be excluded in determination of the cost of inventories as per para 13 of AS 2 on 'Valuation of Inventories' are:

- (i) Abnormal amounts of wasted materials, labour or other production costs.
- (ii) Storage costs unless those costs are necessary in the production process prior to a further production stage.
- (iii) Administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
- (iv) Selling and distribution costs.

Question 7

(i) *The company finds that the stock sheets of 31.3.2007 did not include two pages containing details of inventory worth Rs. 20 lakhs. State, how will you deal with this matter in the accounts of A Ltd., for the year ended 31st March, 2008 with reference to AS 5.*

(ii) *Mention four assets, in respect of which AS 6 (revised) is not applicable.*

(iii) *Y Ltd. used certain resources of X Ltd. In return X Ltd. receives Rs. 10 lakhs and Rs. 15 lakhs as interest and royalties respectively, from Y Ltd. during the year 2007 –2008. State on what basis X Ltd. should recognize their revenue, as per AS 9.*

(iv) *Mention two categories of investments defined by AS 13 and also state their valuation principles.*

(v) *X Ltd. sold goods to its associate company for the 1st quarter ending 30.6.2007. After that, the related party relationship ceased to exist. However, goods were supplied as was supplied to any other ordinary customer. Decide whether transactions of the entire year have to be disclosed as related party transaction.*

(2 Marks each) (November, 2008)

Answer

(i) As per para 16 of AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', omission of two pages containing details of inventory worth Rs.20 lakhs in 31.3.2007 is a prior period item. As per para 19 of the standard, prior period items are normally included in the determination of net profit or loss for the current period. Accordingly, Rs.20 lakhs must

be added to opening stock of 1.4.2007. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

(ii) AS 6 on 'Depreciation Accounting', is not applicable in respect of following assets:

- (1) Forest, plantations and similar regenerative natural resources.
- (2) Goodwill.
- (3) Livestock.
- (4) Wasting assets or land (if it has unlimited useful life for the enterprise).

(iii) As per AS 9 on 'Revenue Recognition', interest of Rs.10 lakhs received in the year 2007-2008 should be recognized on the time basis, whereas royalty of Rs.15 lakhs received in the same year should be recognized on accrual basis as per the terms of relevant agreement.

(iv) As per para 7 and 8 of AS 13 on 'Accounting for Investments', there are two categories of investments, viz., Current Investments and Long Term Investments. According to para 14 of the standard, the carrying amount for current investments is the lower of cost and fair value whereas para 17 states that Long Term Investments are valued at cost less permanent diminutions in value of investment. For current investments, para 16 of the standard states that, any reduction to fair value and any reversals of such reductions are included in the profit and loss statement.

(v) As per para 23 of AS 18 on 'Related Party Disclosures', transactions of X Ltd., with its associate company for the first quarter ending 30.6.2007 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did not exist need not to be disclosed as related party transaction.

Question 8

	<i>Exchange Rate per \$</i>
<i>Goods purchased on 1.1.2007 of US \$ 10,000</i>	<i>Rs.45</i>
<i>Exchange rate on 31.3.2007</i>	<i>Rs.44</i>
<i>Date of actual payment 7.7.2007</i>	<i>Rs.43</i>
<i>Ascertain the loss/gain for financial years 2006-07 and 2007-08, also give their treatment as per AS 11.</i>	
<i>(4 Marks) (November, 2008)</i>	

Answer

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 1.1.2007 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 31.3.2007 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 2006-07.

On 7.7.2007, 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 2007-08.

Question9

(i) Enumerate two points which the financial statements should disclose in respect of Borrowing Costs as per AS 16.

(ii) Name two methods of accounting for amalgamations as contemplated by AS 14.

(2 Marks each) (June, 2009)

Answer

(i)

As per AS 16, the Financial Statements should disclose the following:

- (a) The accounting policy adopted for borrowing costs and
- (b) The amount of borrowing costs capitalized during the period.

(ii)

Two methods of accounting for amalgamation as contemplated by AS 14 are:

- (a) The pooling of interests method and
- (b) The purchase method

Question 10

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

(b) Explain the provisions of AS -5 regarding accounting treatment of prior period items.

(c) From the following information relating to X Ltd., calculate Diluted Earnings Per Share as per AS 20:

Net Profit for the current year	Rs.2,00,00,000
Number of equity shares outstanding	40,00,000
Basic earnings per share	Rs.5.00
Number of 11% convertible debentures of Rs.100 each	50,000
Each debenture is convertible into 8 equity shares.	
Interest expense for the current year	Rs.5,50,000
Tax saving relating to interest expense (30%)	Rs.1,65,000

(4 Marks each) (June, 2009)

Answer

(a)

	Rs.
Purchase price (12,000 kg × Rs.80)	9,60,000
Less: CENVAT credit (12,000 kg. × Rs.4)	<u>48,000</u>

	9,12,000
Add: Freight	<u>77,400</u>
Total material cost	<u>9,89,400</u>
Number of units after normal loss = 97% of 12,000 kgs.	11,640 kgs.
Normal cost per kg. $\left(\frac{9,89,400}{11,640} \right)$	Rs.85
Value of closing stock under AS 2 = (11,600 kgs. – 10,100 kgs.) × Rs.85 = Rs.1,27,500	
Abnormal loss = (11,640 kgs. – 11,600 kgs.) × Rs.85 = Rs.3,400	

- (b) As per AS 5, prior period items are income or expenses, which arise, in the current period as a result of errors or omission in the preparation of financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods, are determined in the current period. Example: arrears payable to workers in current period as a result of retrospective revision of wages.

The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in manner that their impact on current profit or loss can be perceived.

As per para 19 of AS 5, prior period items are normally included in determination of net profit or loss for the current profit, they can be added (or deducted as the case may be) from the current profit. An alternative approach is to show such items in the statement of profit or loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

(c)

Adjusted Net profit for the current year

$$= 2,00,00,000 + 5,50,000 - 1,65,000 = \text{Rs. } 2,03,85,000$$

Number of equity shares resulting from conversion of debentures

$$= 50,000 \times 8 = 4,00,000 \text{ equity shares}$$

Total number of equity shares resulting from conversion of debentures

$$= 40,00,000 + 4,00,000 = 44,00,000 \text{ shares}$$

$$\text{Diluted Earnings per share} = \frac{\text{Rs. } 2,03,85,000}{44,00,000}$$

$$= \text{Rs. } 4.63 \text{ (Approximately)}$$

Question 11

(i) An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.2009. The accounting year of the company ended on 31.3.2009. The accounts were approved on 30.6.2009. The loss from earthquake is estimated at Rs.30 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company?

(ii) X Co. Ltd. having share capital of Rs.50 lakhs divided into equity shares of Rs.10 each was taken over by Y Co. Ltd. X Co. Ltd. has General Reserve of Rs.10,00,000 and Profit and Loss account Cr. Rs.5,00,000. Y Co. Ltd. issued 11 equity shares of Rs.10 each for every 10 shares of X Co. Ltd.

How the Journal entry would be passed in the books of Y Co. Ltd. for the shares issued under the 'Pooling of interest method' of amalgamation.

(iii) ABC Ltd. developed know-how by incurring expenditure of Rs.20 lakhs. The know-how was used by the company from 1.4.2002. The useful life of the asset is 10 years from the year of commencement of its use. The company has not amortised the asset till 31.3.2009. Pass Journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.2009.

(2 Marks each)(November, 2009)

Answer

(i) Para 8.3 of AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.3.2009. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 2008-2009.

However, according to para 8.6 of the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the earthquake has caused major destruction; therefore fundamental accounting assumption of going concern is called upon. Hence, the fact of earthquake together with an estimated loss of Rs. 30 lakhs should be disclosed in the Report of the Directors for the financial year 2008-2009.

(ii)

In the books of Y Co. Ltd.

Journal Entries

		Rs.	Rs.
Business Purchase A/c	Dr.	55,00,000	
To Liquidator of X Co. Ltd.			55,00,000
(Being business of X Co. Ltd. purchased)			
Assets A/c (Bal. Fig.)	Dr.	65,00,000	
To Business Purchase A/c			55,00,000
To General Reserve A/c*(10,00,000 – 5,00,000)			5,00,000
To Profit and Loss A/c			5,00,000
(Being assets and reserves and surplus taken over)			
Liquidator of X Co. Ltd.	Dr.	55,00,000	
To Equity share capital A/c			55,00,000

* Purchase consideration
Less : Share capital of X Co. Ltd.
To be adjusted from general reserve

Rs. 55,00,000
Rs. 50,00,000
Rs. 5,00,000

(Being purchase consideration discharged through equity shares of Y Co. Ltd.)		
---	--	--

(iii) **Journal Entry**

		Rs.	Rs.
Profit and Loss A/c (Prior period item)	Dr.	12,00,000	
Depreciation A/c	Dr.	2,00,000	
To Know-how A/c*			14,00,000
[Being depreciation of 7 years (out of which depreciation of 6 years charged as prior period item)]			

* As per para 63 of AS 26 “Intangible Assets”, there is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.