CORPORATE ACCOUNTING

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PREFACE

It is a matter of great pleasure for us to present this book to our esteemed readers and students. This book has been designed as standard text on 'Corporate Accounting' for Second Year B. Com.

This book comprehensively covers the entire syllabus of S. Y. B. Com. Course of University of Pune w. e. f. June-2014. It has been written to meet the requirement of students. The special features of the book are :

- Full coverage of the revised syllabus.
- Chapter outline at the beginning of each chapter to give a bird's eye view of the topics covered in the chapter.
- Point wise explanation of each topic in the chapter.
- Topics are logically arranged in numbered paragraphs exactly according to the modified syllabus.
- Proposed questions at the end of each chapter.
- Extensive use of diagrams, tables and various forms to give visual view of key concepts and techniques.
- Conversional, lucid and simple language.

Every effort has been made to provide the readers with most up-to-date and authentic material on the subject.

We are very grateful to our publisher Mr. Dattatray Pashte of Diamond Publication, Pune who have rendered all possible assistance in bringing out this book. We wish to acknowledge our deep gratitude to staff who have assisted and helped us in preparing this book.

We will consider our efforts amply rewarded in case the book proves useful to the students and Faculty Members of the subject.

Suggestions of readers are welcome and shall be acknowledged with gratitude.

With best wishes.

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Contents

- Perface

Ist Term

Chapter 1 : Accounting Standards 1

Chapter 2 : Company Final Accounts 84

Chapter 3 : Company Liquidation Accounts 158

Chapter 4 : Computerized Accounting Practices 247

IInd Term

Chapter 5 : Accounting for Amalgamation, Absorption and External Reconstruction of Companies 260

Chapter 6 : Accounting for Internal Reconstruction 416

Chapter 7 : Holding Company's Balance Sheet 481

Chapter 8 : Valuation of Shares 558

- Referance 613

CHAPTER 1

Accounting Standards

1.1 Introduction
1.2 Nature
1.3 Scope
1.4 Purposes
1.5 AS - 5 : Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies [Effective Date: 1st April, 1996]
1.6 AS - 6 : Depreciation Accounting (Revised) [Effective Date : 1st April, 1995]
1.7 AS - 10 : Accounting for Fixed Assets [Effective Date: 1st April, 1991]
1.8 AS - 14 : Accounting for Amalgamation [Effective Date: 1st April, 1995]
1.9 AS - 21 : Consolidated Financial Statement

1.1 Introduction

Accounting standards are accounting rules and procedures relating to measurement, valuation and disclosure issued by the Council of The Institute of Chartered Accountants of India. Accounting standards are stated to be the norms of accounting policies and practices by way of guidelines that should be followed while preparing accounts and disclosed in the annual financial statements. The accounting standards are intended to apply only to items which are material.

Since accounting standards are the rules to be followed in the preparation of financial statements, these are regarded as a *mechanism* for resolving the conflicts of interest among various preparers and users of accounting information. Accounting standards are generally appropriate to the normal conduct of business and are in conformity with local conditions. Accounting standards serve public interest and are based on a conceptual framework of accounting. Necessarily, the utility of accounting standards results in a consequential improvement in the quality of preparation of financial statements.

1.2 Nature

Accounting standards are *mandatory* in nature. They are mainly applicable to the published accounts of limited companies. However, in case of sole proprietorships or partnerships, accounting standards mandatorily apply when the financial statements are statutorily required to be audited.

The accounting standards apply to the preparation of general purpose financial

statements, i.e., Balance Sheet, Profit and Loss Account, and other statements and statutory notes which form part of the financial statements. It is necessary to examine whether the mandatory accounting standards are complied with in the preparation of financial statements. If there is any deviation, adequate disclosure should be made so that the users of financial statements become aware of such deviations.

Accounting policies have a *direct effect* on the working results and the financial position of a business concern. Accounting policies are the specific accounting bases adopted and constantly followed by a business unit in the preparation of its financial statements. Owing to varying circumstances, different accounting policies are adopted by different business enterprises. Accounting standards, therefore, require that all significant policies adopted in the preparation and presentation of financial statements should be disclosed and should form part of the financial statements. Any change in the accounting policies which has a material effect, and the amount by which any item in the financial statement is affected by such a change should be disclosed. Lastly, if a fundamental *accounting assumption* is not followed, the fact should be disclosed.

Accounting standards could be national, international or both. Every national institute frames its own accounting standards, which generally are in keeping with the international norms. In effect, the development of accounting standards in India has been contemporaneous with that of the International Accounting Standards, which are formulated by global organisations of accounting bodies. As such, there is not much difference among the parameters of these standards.

1.3 Scope

1. Accounting Standards are to be issued in conformity with the provisions of the applicable laws, customs, usages and business environment of our country. If there is any conflict between the accounting standards and laws (because of subsequent amendments in the law), the provisions of the said law will prevail and financial statements should be prepared in conformity with such law.
2. Accounting Standards can not override the local regulations.
3. Accounting Standards are intended to apply only to items which are material.
4. The Institute will use its best endeavours to persuade the government, appropriate authorities, industrial and business community to adopt these standards in order to achieve uniformity in the preparation of financial statements.
5. In carrying out the task of formulation of Accounting Standards, the intention would be to concentrate on basic matters.

1.4 Purposes

The concepts of accounting have permitted a variety of practices to follow and, in effect, different results can be drawn from the same set of data. Consequently, the lack of uniformity of such practices has made it difficult for users of accounting information to

compare the results of different enterprises. The overall direction of the accountant should be towards *uniformity,* so that accounting information may become comparable, leading to better analysis and comparison of performances.

The need for accounting standards is based on the necessity of harmonising the diverse policies and practices adopted by different business firms. When accounting standards are followed, accounting information become transparent and, in effect, it helps towards meaningful comparison and study. It also ensures consistency in the accounting statements of a business enterprise from year to year. In effect, it facilitates a more meaningful comparison among accounting statements of different enterprises. As a result, the users of accounting information can understand and make proper use of accounting statements for decision-making.

The need for the *uses* of accounting standards are as follows :

(1) Accounting standards promote better understanding of accounting statements, the disclosure of significant accounting policies and the manner in which accounting policies are disclosed in the statements.

(2) Accounting information is more useful if it is published on a comparable basis, and *comparability* is not possible without accounting standards.

(3) Accounting standards provide a generally accepted language for financial statements that renders them more comprehensible to the users of accounting information.

(4) Accounting standards may be regarded as a means to establish that the collective wisdom and experience rather than the viewpoint of individual accountant may prevail in the matter.

Status of the Accounting Standards issued by the Institute of Chartered Accountants of India

Number of the Accounting Standard (AS)	Title of the Accounting Standard	Date from which mandatory (accounting periods commencing on or after)	Entity to which applicable
AS-1	Disclosure of Accounting Policies	1-4-1993	All
AS-2	Valuation of Inventories	1-4-1999	All
AS-3	Cash Flow Statement	1-4-2001	Level - I and Non - SMC
AS-4	Contingencies and Events Occurring after the Balance Sheet Date	1-4-1998	All

Number of the Accounting Standard (AS)	Title of the Accounting Standard	Date from which mandatory (accounting periods commencing on or after)	Entity to which applicable
AS-5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	1-4-1996	All
AS-6	Depreciation Accounting	1-4-1995	All
AS-7(Revised)	Construction Contracts	1-4-2002	All
AS-8	Withdrawn and included in AS-26	-	-
AS-9	Revenue Recognition	1-4-1993	All
AS- 10	Accounting for Fixed Assets	1-4-1993	All
AS- 11 (Revised-2003)	The Effects of Changes in Foreign Exchange Rates	1-4-2004	All
AS- 12	Accounting for Govt. Grants	1-4-1994	All
AS- 13	Accounting for Investments	1-4-1995	All
AS- 14	Accounting for Amalgamations	1-4-1995	All
AS- 1 5 (Revised-2005)	Employees benefit	1-4-2006	All
AS- 16	Borrowing Costs	1-4-2000	All
AS- 17	Segment Reporting	1-4-2001	Level - I and Non - SMC
AS- 18	Related Party Disclosures	1-4-2001	Level - I, II and all companies
AS- 19	Leases	1-4-2001	All
AS-20	Earning Per Shares	1-4-2001	All
AS-21	Consolidated Financial Statements	1-4-2001	See Note- 1
AS-22	Accounting for Taxes on Income	1-4-2001	-For Listed Companies

Number of the Accounting Standard (AS)	**Title of the Accounting Standard**	**Date from which mandatory (accounting periods commencing on or after)**	**Entity to which applicable**
		1-4-2002	- Companies other than listed
		1-4-2006	- All
AS-23	Accounting for Investment in Associates in Consolidated Financial Statements	1-4-2002	See Note - I
AS-24	Discontinuing operations	1-4-2004	Level - I, II and all companies
AS-25	Interim Financial Reporting	1-4-2002	Note-2
AS-26	Intangible Assets	1-4-2003	All
AS-27	Financial Reporting of Interests in Joint Ventures	1-4-2002	See Note-I
AS-28	Impairment of Assets	1-4-2004 1-4-2006 1-4-2008	- Level-I - Level-II - Level-III } and all companies
AS-29	Provisions, Contingent liabilities and Contingent Assets	1-4-2004	All
AS-30	Financial Instruments - Recognition and Measurement	To be announced	Non-SME
AS-31	Financial Instruments -Presentation	To be announced	Non-SME
AS-32	Financial Instruments -Disclosures	To be announced	Non-SME

Note 1 : AS-21, AS-23 and AS-27 (relating to consolidated financial statements) are required to be complied with by an entity if the entity, pursuant to the requirements of a statute/regulator or voluntarily, prepares and presents consolidated financial statements.

Note 2: If an entity is required or elect to prepare and present an interim financial report, it should comply with this standard.

1.5 AS - 5 : Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies [Effective Date: 1st April, 1996]

Introduction

The Profit and Loss Account for any accounting period should be prepared in such a manner that it is comparable with those of the other years and with the financial statements of other enterprises. This standard is intended to enhance the relevance and reliability of the financial statements of the enterprise.

Though the financial information provided by the Profit and Loss Account about the financial performance of an enterprise is historical in nature, yet users use this information to evaluate the enterprise's future performance.

Objective

The objective of this statement is to prescribe the classification and disclosure of certain items in the statement of profit and loss so that all enterprises prepare and present such a statement on a uniform basis.

This statement requires the classification and disclosure of extraordinary and prior period items, and disclosure of certain items within profit or loss from ordinary activities.

It also specifies the accounting treatment for changes in accounting estimates and the disclosures to be made in the financial statements regarding changes in accounting policies.

Scope

1. This Statement should be applied by an enterprise *in presenting profit or loss* from ordinary activities, extraordinary items and prior period items in the statement of profit and loss, in accounting for changes in accounting estimates, and in disclosure of changes in accounting policies.
2. This Statement deals with, among other matters, the disclosure of certain items of net profit or loss for the period. These disclosures are made in addition to any other disclosures required by other Accounting Standards.
3. This Statement *does not deal* with the tax implications of extraordinary items, prior period items, changes in accounting estimates, and changes in accounting policies for which appropriate adjustments will have to be made depending on the circumstances.

Definitions

Ordinary Activities

Ordinary activities are any activities which are undertaken by an enterprise as part of its business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities.

Example : X Ltd, is a software development company operating from Kolkata. Recently they have started a training institute for future software developers. All activities relating to training institute will be treated as ordinary activities.

Extraordinary Items

Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

Example : Sale of old machinery and furniture at a profit / loss is an ordinary activity but sale of excess land adjacent to existing factory should be treated as an extraordinary item. Similarly, loss due to earthquake shall be treated as an extraordinary item.

Prior Period Items

Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods.

Example : Inventory had been overstated in 2006 but it was detected only in 2007. It is a prior period item.

Accounting Policies

Accounting policies are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.

Net Profit or Loss for the Period

All items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise.

The net profit or loss for the period comprises the following components, each of which should be disclosed on the face of the statement of profit and loss:

a. profit or loss from ordinary activities; and
b. extraordinary items.

Profit or Loss from Ordinary Activities

Any item of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and the amount of such items should be disclosed separately. This disclosure will enhance the transparency in

Example : Sale of old furniture is an ordinary transaction, the profit or loss from such sale should be disclosed separately because it is not related to operation of the business.

reporting income and expenses.

A separate disclosure of items of income and expense is necessary in the following cases.

a. the write-down of inventories to net realisable value as well as the reversal of such write-downs;
b. a restructuring of the activities of an enterprise and the reversal of any provisions for the costs of restructuring;
c. disposals of items of fixed assets;
d. disposals of long-term investments;
e. legislative changes having retrospective application;
f. litigation settlements; and
g. other reversals of provisions.

Components of net profit

Net profit or loss for the period consists of two components :

- Profit or loss from ordinary activities
- Extraordinary items.

These components should be disclosed on the face of statement of profit and loss account.

Ordinary activities are defined as any activities, which are undertaken by an enterprise as part of its business and incidental to main business.

Profit/Loss from ordinary activities - Normally all items of income and expenses which are recognized in a period are included in the determination of the net profit or loss for the period. This includes extraordinary items and change in accounting estimates.

When items of income and expenditure from ordinary activities are of such size and nature that their disclosure is relevant to explain the performance of the enterprises for the period. The nature and amount of such items should be separately disclosed. Although these items are not "extraordinary items", examples of such items are :-

- The write down of inventories to net realisable value or reversal of such write down
- Restructuring cost or reversal of provision of restructuring cost
- Profit or loss on disposal of fixed assets
- Profit or loss on disposal of long term investment
- Litigation settlements
- Reversal of provisions
- Legislative charges having long term retrospective application.

Exiraordinary items: Extraordinary items are income of expense that arise from transactions that are clearly distinct from ordinary activities. They are not expected to recur frequently or regularly. The nature and amount of extraordinary items should be separately

disclosed in Profit and Loss Account so that its impact on current profit or loss can be perceived. Example - Attachment of property of the enterprises or loss due to earthquake.

Examples of extraordinary items

- Loss due to earthquakes
- Attachment of property
- Government grants becoming refundable
- Government grants for giving immediate financial support with no further cost
- Governments grant receivable as compensation lor expenses or losses incurred in previous accounting period.

Prior Period item

Period items are income or expenses, which arise, in current period as a result of error or omission in the preparation of financial statement of one or more prior periods.

Example : Mr. Amit an employee of Induga Ltd. went on leave with pay for 9 months on 1-1-2010 upto 30-9-2010. His monthly pay was Rs. 15,000 while 'preparing the financial statement on 30-6-20 1 0 for the year ended 3 1-3-2010, the expense of salary of Mr. Amit for 3 months (1-1-2010 to 31-3-2010) was not provided due to omission. When Mr. Amit joined on 1-10-2010 the whole salary for 9 month (1-1-2010 to 30-9-2010) was paid to him.

In this case three months salary (1-1-2010 to 3 1-3-2010) of Rs. 45,000 is prior period expense and following entry should be passed :

Salary A/ c (15,000 × 6)	Dr.	90,000
Prior period expense (Salary)	Dr.	45,000
To Bank A/c		1,35,000

Suppose in above example Mr. Amit was terminated from service on 1-1-2010 and was re- instated in service by the Court on 30-9-2010 with all back salary. On 1-10-20 10 as per Court order. Company paid the nine months salary to Mr. Amit, as the company accepted the Court verdict. Then there is no prior period expense and the following entry to be passed :

Salary A/c	Dr.	1,35,000
To BankA/c		1,35,000

In this case there is no error or omission while preparing the Financial statement for the earlier year ie. for the year ended 31-3-20 10. As the company intentionally did not make the provision for salary for 3 months of Mr. Amit because company terminated his service.

Disclosure of prior period items : The nature and amount of prior period items

should he separately disclosed in the statement of profit and loss in a manner that their impact on current proftt or loss can be perceived.

- Error in calculation in providing expenditure or income.
- Omission to account for income or expenditure.
- Non-provision of travelling expenses for travel already undertaken.
- Non-provision for salary already due in earlier year.
- Applying incorrect rate of depreciation.
- Treating operating lease as finance lease.
- Capitalisation of borrowing cost on working capital.

Change in Accounting Estimate

It means that estimate is revised due to change in the circumstances/ conditions on which the estimates was based. For example:

- Estimation of provision of Sundry Debtors
- Estimation of provision for any liabilities.
- Computing income-tax provision
- Estimating the useful life of fixed assets.

Effect of Change in Accounting Estimate - The effect of a change in accounting estimate should be classified in following cases:

- If an estimate pertains to ordinary activities, then change in accounting estimate should be classified as ordinary activities.
- If estimates pertain to extraordinary item, then change in accounting estimates should be classified as extraordinary.

Disclosure of Accounting Estimate

- The affect of a change in accounting estimate disclosed in net profit or loss
- The period of change, if the change affects the period only
  Example: Estimation oF provision of sundry debtor
- The period ol change and future periods, if the change affects both
  Example: Estimation of the useful life of the fixed assets.

Examples of change of Accounting Estimates

- Re-estimating the residual value of fixed assets.
- Change in useful life of fixed assets.
- Actual bad debts turning out to be more or less than provisions.

Changes in Accounting Policies

In the following circumstances changes in accounting policies are made :

- For the compliance of accounting standard + For the compliance of the statute or law
- For better and appropriate presentation of the financial statement.

Disclosure of change in Accounting Policies

- Material effect should be shown in financial statement to reflect the effect of such change
- This effect should be disclosed in the year of change
- If the effect of change is not ascertainable, the fact should be disclosed
- If the effect of change is not material for current period, but it is material effect for the later period, then fact should be disclosed in the period of change.

Examples of change in accounting policies :

- Change of depreciation method from WDV to Straight-line method and *vice versa,*
- Change in cost formula in measuring the cost of inventories.

Change in accounting policy v. Change in accounting estimate

Problem : ABC Ltd. was making provision for non-moving stock based on no issue for the last 12 months upto 31 -3-2010, The company wants to provide during the year ending 31-3-2011 based on technical evaluation:

Total value of Stock	Rs. 1 crore
Provision required based on 12 months issue	Rs. 3,50,000
Provision required based on technical evaluation	Rs. 2,50,000

Does this amount to change in accounting policy? Can the company change the method of provision?

Solution : The change does not amount to change in accounting policy. The method is only a guideline and the better way of estimating the provision for non-moving stock. Further the amount of difference is also not material. Hence, it is not a change in accounting policy.

The accounting policy for valuation of inventories is lower of cost and net realisable value. Within this broad policy, some estimates are inherent, for example, in the making of provision for slow moving stocks. As a result of the uncertainties inherent in business activities, any financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. Estimates may be required, for example, of bad debts, inventory obsolescence or the useful lives of depreciable assets. The use of reasonable estimates is an essential part of the preparation of financial statement's and doet not undermine their reliability . An estimate may have to be revised if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.

In the given case the change is a change in an accounting estimate and not change in an accounting policy. Further the company should be able to demonstrate satisfactorily that having regard to circumstances provision made on the basis of technical evaluation, provides

more satisfactory results than provision based on 12 months issue. If that be the case, the company can change the method of provision.

Limited revisions to AS-5 due lo adoption of new accounting standards -

A change in accounting policy consequent upon the adoption of an Accounting Standard should be accounted for in accordance with the specific transitional provisions, if any, contained in that Accounting Standard. However, disclosures required by paragraph 32 of AS-5 should be made unless the transitional provisions of any other Accounting Standard require alternative disclosures in this regard.

Significant difference among AS-5, IFRS/IAS and US GAAP

Prior Period Items - IFRS/IAS-8 prescribes that subject to the practicability, an entity shall correct material prior period errors retrospectively in the first set of financial statements authorized for issue after they are discovered by :

(a) Restating the comparative amounts for the prior period(s) presented in which the error occurred; or

(b) If the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

A prior period error shall be corrected by retrospective restatement except to the extent that it is impracticable to determine either the period specific effects or the cumulative effect of the error.

IFRS/IAS-1 prohibits any items to be disclosed as extraordinary items whereas AS-5 specifically requires disclosure of certain items as extra-ordinary items,

Change in Accounting Policies - IFRS/IAS-8 requires that an entity shall account for a change in accounting policy resulting from the initial application of a standard or an Interpretation in accordance with specific transitional provisions, it any, in that Standard or interpretation; and when an entity changes an accounting policy upon initial application of a Standard or Interpretation that does not include specific transitional provisions applying to that change or changes on accounting policy voluntarily, it shall apply the change retrospectively.

Subject to the impracticability when a change in accounting policy is applied retrospectively, the entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

Under US GAAP, SFAS-154, the accounting treatment of change in accounting policy and correction of errors is the same as in IAS-8.

Accounting Policy - The principles laid down for change in estimates are almost same in Indian GAAP, IfRS and US GAAP.

PROBLEMS

Problem No. 1 : At December 31, 2010, Matson Inc. was holding long-lived assets, which it intended to sell. The company appropriately recognized a loss in 2010 related to these assets. On Matson Inc.'s income statement for the year ended December 3 1, 2010 this loss should be reported as an

(a) Extraordinary item.

(b) Component of income from continuing operations before income-taxes.

(c) Separate component of selling or general and administrative expenses, disclosed net of tax benefit.

(d) Component of the gain (loss) from sale of discontinued operations, disclosed net of income-taxes.

Solution :

As per AS-5 (refer point 6.2-1) losses associated with long-lived assets, which arc to be disposed of, are to be reported as a component of income from continuing operations before income-taxes (or entities preparing income statements. Therefore, answer *(b)* is correct. Answer *(a)* is incorrect because losses on long-lived assets to be disposed of are neither unusual nor infrequent occurrences. Answer *(c)* is incorrect because these losses are not part of selling or general and administrative expenses and they are not disclosed net of tax, answer *(d)* is incorrect, because discontinued operations result from disposal of a business, not the disposal of long-lived assets held for resale.

Problem No. 2 : The company has to pay delayed cotton clearing charges over and above the negotiated price for taking delayed delivery of cotton from the Supplier's Godown. Upto 2008-09, the company has regularly included such charges in the valuation of closing stock. This being in the nature of interest the company has decided to exclude it from closing stock valuation for the year 2009-10. This would result into decrease in profit by Rs. 7.60 lakhs. Comment.

Solution :

AS-5 (refer point 6.5) states that a change in an accounting policy should be made only if the adoption of a different accounting policy 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 an enterprise. Therefore, the change in the method of stork valuation is justified in view of the fact that the change is in line with the recommendations of AS-2 and would result in more appropriate preparation of the financial statements. As per AS-2, this accounting policy adopted for valuation of inventories including the cost formulae used should be disclosed in the financial statements.

Also, appropriate disclosure of the change and the amount by which any item in the financial statements is affected by such change is necessary as per AS-1, AS-2 and AS-5.

Therefore, the undermentioned note should be given in the Annual Accounts.

"In compliance with the Accounting Standard issued by the ICAI, delayed cotton clearing charges which are in the nature of interest have been excluded from the valuation of closing stock unlike preceding years. Had the company continued the accounting practice followed earlier, the value of closing stock as well as profit before tax tor the year would have been higher by Rs. 7.60 lakhs".

Problem No. 3 : Fuel surcharge is billed by the State Electricity Board at provisional rate. Final bill for fuel surcharges of Rs. 5.30 lakhs for the period October, 2005 to September, 2009 has been received and paid in February, 2010. How this should be dealt in accounts for year 2009-10.

Solution :

It seems as a result of errors or omission in the preparation of financial statements of prior period if. 2005 to 2009. This material charge has arisen in the current period i.e. year ended 31st March, 2010, therefore it should be treated as prior period item as per para 16 of AS-5 and as such should be separately disclosed as per para 15 of AS-5 so that impact of this item on current profit can be known. It should be further noted that the item is not an extraordinary item as per para 10 of AS-5 as fuel surcharge expense arises from ordinary course of business.

Problem No. 4 : U.P. Rajya Setu Nigam Ltd. was awarded a contract of construction of a bridge for Rs. 100 crores on 1 -6-2006. Total contract cost estimated was Rs. 80 crores. The position of the contract on 31-3-2009 and 31-3-2010 was under:

	As ib 31-3-2009	**As on 31-3-2010**
Contract Price	100	100
Contract Cost incurred up to date	25	95 (100% complete)
Estimate contract cost of completion	60	NIL

While closing books of account on 31-3-2010, the chief accountant treated excess cost of Rs. 10 crores incurred as against estimated of R.s. (25 + 60) = 85 crores as on 31 -3-2009 as mistakes in estimation of cost, hence categorized Rs. 10 crores (95-85) as prior period expenses. Comment.

Solution :

Cost originally estimated by U.P. Rujya Setu Nigam Ltd. Rs. 85 crores
Excess Cost incurred Rs. 10 crores
Treatment given by the company Prior period item
Hence, the treatment given by the company is incorrect.

Problem No. 5 : State how you will deal with the following matter in the accounts of U Ltd. for the year ended 31st March, 2010 with reference to Accounting Standard :

"The company finds that the stock sheets of 31-3-2009 did not include two pages containing details of inventory worth Rs. 14.5 Lakhs.

Solution :

As per AS-5 an item of expenses or income arises in current period as a result of omission or commission in the preparation of financial statements of one or more prior period is prior period item.

In this case stock sheet of 31-3-2009 (prior year) did not include two pages containing details of inventory worth Rs. 14.5 lakhs which is the omission, and this omission was detected in current period i.e. 31-3-2010. Therefore, it is a prior period item. Entry to be passed is as under :

Opening inventory A/c Dr.	Rs. 14.5 lakhs	
To Prior Period Income		Rs. 14.5 lakhs

Simple Problems

1) Whether the following items are (a) prior period items (b) change in accounting estimate (c) extraordinary items

- Arrears of salaries and wages of Rs. 10 lakhs for the previous year will be paid during the current year as per court judgment delivered in the current year. At the end of previous year, the company assessed that arrears of salaries and wages would not be required to be paid. So no provision was made at the end of previous year.
  [**Ans. :** None of these]
- Expenses of Rs. 50,000 of the previous year, which were omitted from books of account of the previous year due to an oversight.
  [**Ans. :** Prior period item]
- The amount of provision for doubtful debts as at the end of the previous year was Rs. 5,00,000, of these debts of Rs. 3,00,000 were realized during the year.
  [**Ans. :** Change in Accounting estimate]
- Sale of a significant part of the plot of land on which the footing is situated.
  [**Ans. :** Extraordinary items]
- Write off a huge debt of a major customer due for more than a year.
  [**Ans. :** None of these]

2) Discuss the accounting principle as having relevance to the auditors relating to

- Prior-period items
- Extraordinary items
- Change in accounting estimates

3) Distinguish between "changes in accounting policies" and "changes in accounting estimates". How change in accounting estimates is accounted for in the books of an enterprise?

4) The Company found in 2009-10 that stock sheet as on 31-3-2007 had included twice an item ot Rs. 2,00,000.

[**Ans. :** Prior period item to be shown separately in profit and loss account for 2009-10]

5) A claim was lodged with a transport company for loss of goods of Rs. 3 lakhs during 2008-09, the payment of which was received in 2009-10. No entry had been passed in accounts when claim was lodged.

[**Ans.:** Amount to be credited to profit and loss account in 2009-10, if entry was not passed in 2008-09 due to uncertainty of ultimate receipt of claim (refer AS-9) otherwise prior period item]

6) During the year 2009-10, a medium size manufacturing company wrote down its inventories to net realisable value by Rs. 5,00,000. Is a separate disclosure necessary?

[**Ans. :** Yes, considering the nature and amount of such item]

7) A company signed an agreement with the Employees Union on 1-9-2008 for revision of wages with retrospective effect from 30-9-2007. This would cost the company an additional liability of Rs. 5,00,000 per annum. Is a disclosure necessary for the amount paid in 2008-09?

[**Ans. :** Yes, considering nature and amount of the item]

Advanced Problems

8) During the financial year 2009-10 of NDA Ltd. goods costing Rs. 1 crore were sent to consignee at the sale value of Rs. 1.50 crores. Consignee sold all the goods during the financial year 2009-10. But sent the sale invoice and statement of sales of Rs. 75 lakhs only.

During the financial year 2009-10, NDA Ltd- booked the sale of Rs. 75 lakhs only and balance Rs. 75 lakhs was shown as stock with consignee at cost price.

During the financial year 201 0-1 1, NDA Ltd. received the sale invoice and statement of sale of Rs- 75 lakhs which pertains to the financial year 2009-10.

NDA Ltd. booked sale of Rs. 75 lakhs as prior period item during the financial year 2010-1 1. Comment whether the accounting treatment done by NDA Ltd. is correct.

[**Ans. :** Yes, but corresponding opening stock to be adjusted with prior period item]

9) X Ltd. estimated 1% bad debts while preparing financial statement, for 2009-10. Provision for doubtful debts was created accordingly. However, it appears that in 2009-10 some debts are still uncollected. The management feels that an additional provision of 40%

is necessary on such debts. Should such change in estimate be treated extraordinary items or is it prior period items? Discuss briefly.

[**Ans. :** Change in estimate, separate disclosure]

10) A large textile company during financial year 2009-10 has written down its inventories to net realisable value by Rs. 8.00,000. State with reason whether separate disclosure is required in accounts for the year 2009-10.

[**Ans. :** Yes, if amount is material, otherwise not]

11) A limited company has been including interest in the valuation of closing stock. In 2009-10, the management of the company decided to follow AS-2 and accordingly interest has been excluded from the valuation of closing stock. This has resulted in a decrease in profits by Rs. 3,00,000. Is a disclosure necessary? If so, draft the same.

[**Ans. :** Yes, considering the nature and amount of the item, effect on profit to be stated by way of note]

1.6 AS - 6 : Depreciation Accounting (Revised) [Effective Date : 1st April, 1995]

Introduction

Different fixed assets, for example, buildings, machinery and furnitures are used by an enterprise for different purposes like production, administration, sales and service, etc. Expenditure is made early in the life of the assets for acquiring the assets but benefits are derived throughout their useful life.

When a fixed asset is acquired, it is recorded in the books of account at its acquisition cost and it is capitalised. In each accounting period, a portion of acquisition cost is charged to the Profit and Loss Account as expense. This accounting process of gradually converting the acquisition cost of fixed asset into expense over a series of accounting periods is called *depreciation.*

Objectives

Depreciation has a significant effect in the preparation of the financial statements of an enterprise. It will influence the profit / loss and value of assets of the enterprise. Different enterprises adopt different accounting policies for depreciation.

The main objective of this accounting standard is to prescribe the *guidelines for charging depreciation* for different assets.

Scope

This statement deals with depreciation accounting and applies to all depreciable assets, except the following items to which special considerations apply -

(i) forests, plantations and similar regenerative natural resources;
(ii) wasting assets including expenditure on the exploration for and extraction of minerals, oils, natural gas and similar non-regenerative resources;
(iii) expenditure on research and development;
(iv) goodwill;
(v) live stock.

This statement also does not apply to land unless it has a limited useful life for the enterprise.

Definitions : Depreciation

Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes, Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortisation of assets whose useful life is predetermined.

Depreciable Assets

Depreciable assets are assets which
(i) are expected to be used during more than one accounting period; and
(ii) have a limited useful life; and
(iii) are held by an enterprise for use in the production or supply of goods and services, for rental purpose, or for administrative purposes and not for the purpose of sale in the ordinary course of business.

Useful Life

Useful life is either :
(i) the period over which a depreciable asset is expected to be used by the enterprise; or
(ii) the number of production or similar units expected to be obtained from the use of the asset by the enterprise.

Depreciable Amount

Depreciable amount of a depreciable asset is its historical cost, or other amount substituted for historical cost in the financial statements, less the estimated residual value.

Factors in the Measurement of Depreciation

The amount of depreciation to be charged for a particular fixed asset will depend upon the following three factors :
(i) Cost of the asset
(ii) Useful life of the asset
(iii) Residual value of the asset

Cost of the Asset

The cost of an asset is the basis for calculation of depreciation. For the purpose of determination of cost of an asset, the following points are important as stated in AS-10 "Accounting for Fixed Assets":

(a) Where an asset is purchased from a supplier : The cost of a fixed asset should comprise its purchase price and any attributable cost of bringing the asset to its working condition for its intended use.

Examples of directly attributable costs are :

(i) site preparation;
(ii) initial delivery and handling costs;
(iii) installation cost, such as special foundations for plant; and
(iv) professional fees, for example, fees of architects and engineers.

(b) Where an asset is self-constructed : The cost of a self-constructed fixed asset should comprise those costs that relate directly to the specific asset and those that are attributable to the construction activity in general and can be allocated to the specific asset.

(c) Where a fixed asset is acquired either in exchange or in part exchange for another asset : The asset acquired should be recorded either:

(i) at its fair value; or
(ii) the net book value of the asset given up, adjusted for any balancing payment or receipt of cash or other consideration.

Useful Life of the Asset

The useful life of an asset is its service life which can be defined as the number of accounting periods during which it will be useful to the business. The physical life of an asset may be considered longer than its economic life. When the operating cost of an asset is considered to be more than the revenue which it generates, it has exceeded its economic life and should not be kept in use. Since there is no way to measure correctly how long an asset will be useful, the asset's useful economic life is always estimated.

The useful life of a depreciable asset should be estimated after considering the following factors :-

(i) expected physical wear and tear;
(ii) obsolescence;
(iii) legal or other limits on the use of the asset, e.g., safety limitation or the expiry dates of assets taken on lease.

Estimation of useful life of the asset is very difficult. It is a matter of judgment and depending on the experience of the enterprise with similar assets. Depreciation will vary directly with the useful life of the asset. If the estimated life is too long, each year's depreciation charge will be less and profits in the periods before disposal will be inflated.

Depreciation is loss of value of an asset

It is a measure of wearing out, consumption or other loss of value of a depreciable asset arising from use and passage of time. Depreciation is nothing but distribution of total cost of assets over its useful life.

Depreciable assets

Those assets which -

- Are expected to be used for more than one accounting period.
- Have a limited useful life.
- Are held for use in production of goods and services *(i.e.* not for the purpose of sale in ordinary course of business).

Applicability of Accounting Standard

The accounting standard is applicable to all depreciable assets except, the following :

- Forests, Plantations
- Wasting Assets, Minerals and Natural Gas
- Expenditure on research and development Goodwill
- Live stock - Cattle, Animal Husbandry.

Calculation of Depreciation

- The amount of depreciation is calculated as under :
- Historical cost or other amount in place of historical cost like revalued amount
- Estimated useful life of depreciable assets
- Estimated residual / scrap value of depreciable assets

$$\text{Depreciation} = \frac{\text{Cost - (Scrap value at the end of useful life)}}{\text{Estimated useful life in No. of years}}$$

If straight line method of Depreciation is followed.

What is cost of depreciable assets? - It is total cost spent in connection with its acquisition; installation and commissioning as well as for additional item or improvement of the depreciable assets. The historical cost may change due to following factors :-

- Increase / decrease in long term liability on account of exchange fluctuation if option under amended AS- 11 is exercised.
- Price adjustment
- Changes in duties
- Revaluation of depreciable assets
- Other similar reason.

Estimated useful life of depreciable assets - It is period over which it is expected to be used by the enterprise. Generally useful life is shorter than the physical life. The useful life depends upon the following factors :

- Pre-determined by legal or contractual limits

  Example - Asset given on lease, the estimated life is period of lease.
- Depends upon the number of shifts for which the asset is to be used
- Repair and Maintenance policy of enterprise
- Technological obsolescences
- Innovation / improvements in the production method
- Change in demand of output Legal or other restrictions.

Estimated residual/scrap value of depreciable assets - It is estimated value of depreciable assets at the end of its useful life. It is generally difficult to determine the residual value. It is estimated at the time of acquisition, installation and at the time of revaluation of the assets.

Depreciable amount

It means historical cost or other amount substituted for historical cost less estimated residual value. Depreciable amount is allocated over the estimated useful life of depreciable assets.

Method of Depreciation

There are two methods of depreciation. These are : -

- Straight Line Method (SLM)
- Written Down Value Method (WDVM)

Selection of Appropriate Method - It depends upon the following factors :-

- Type of Asset.
- Nature of the use of such asset.
- Circumstances prevailing in the business.

Note : A combination of more than one method may be used.

Accounting Treatment - Selected depreciation method should be applied consistently from period to period.

Changes in Depreciation Method

Change in depreciation method is done in following conditions :

- For compliance of statute.
- For compliance of accounting standards.
- For more appropriate presentation of the financial statement.

Procedure to be followed in case of change in method -

- Depreciation should be recomputed applying the new method from the date of its acquisition / installation, till the date of change of method.
- Difference between the total depreciation under the new method and accumulated depreciation under the old method till the date of change may be surplus/deficiency.
- Such resultant surplus is credited to profit & loss account under the head "Depreciation written back".
- Such resultant deficiency is charged to profit & loss account.
- Such change of depreciation method should be treated as change in accounting policy and its effect should be quantified and disclosed.

Change in estimated useful life

When there is change in estimated useful life of assets, outstanding depreciable amount on the date of change in estimated useful life of asset should be allocated over the revised remaining useful life of assets.

Example : Plant has useful life of 10 years. Depreciable amount is Rs. 39 lakhs. The company has charged SLM depreciation. At the end of 6th year, the balance useful life was re-estimated at 8 years. The depreciation will be charged from 7th year.

$$= \frac{39\text{-}39/10\times 6}{8} = 1.95$$

Change in historical cost due to exchange variation on long-term foreign liability, price adjustment and change in duties etc.

- Increase/decrease in amount of historical cost is added/deducted from the outstanding written down value on the date of change.
- Depreciation on the revised WDV will be provided prospectively over the remaining useful life of the asset.

Change in historical cost due to revaluation - Depreciation should be charged on the basis of revalued amount and on the estimate of the remaining useful life of such assets.

'Depreciation charge on addition/extension to an existing asset

- Additional / extension is an integral part of existing asset,
  It is depreciated over the remaining useful life of the existing asset.
- Addition/extension is not an integral part of existing asset.
  It is depreciated over the estimated useful life of additional assets.

When the depreciable asset is disposed of, discarded, demolished or destroyed

Net surplus or deficiency (i.e. sale proceeds less written down value) is credited/ charged to profit and loss accounts.

Disclosure

- Total cost of each class of assets - historical cost or revalued cost.
- Total depreciation for the period of each class of assets.
- Accumulated depreciation of each class of assets.
- Depreciation method.
- Depreciation rates or the useful life of the asset, if they are different than the rates specified in governing statute.
- A change in method of depreciation is treated as a change in accounting policy and is disclosed separately.
- Effect of the revaluation of the fixed asset on the amount of depreciation.

Significant differences among AS-6, IFRS/IAS and US GAAP

- AS-6 allows the depreciation on revalued value of the assets as the AS-10 on fixed assets allows the revaluation of assets. However US GAAP prohibits revaluation. IAS-16 allows fair value accounting (upwards) for fixed assets as an alternative treatment.
- A change in depreciation method under AS-6 is treated as a change in an accounting policy; whereas under TAS-16, and US GAAP, it is treated as a change in estimate, which affects the results of current and future periods. Under IAS-16, a retrospective application of this change with a cumulative adjustment of the surplus/deficiency against the current period income statement is not required.

PROBLEMS

Problem No. : 1 - A Plant was depreciated under two different methods as under -

	Straight Line Method	**Written Down Value**
1st year	3.90	10.69
2nd year	3.90	7.90
3rd year	3.90	5.84
4th year	3.90	4.32
	15.60	28.75
5th year	3.90	3.19

Required :

(a) It the company followed WDV for first four years and decides to switch over to SLM, what would be the amount of resultant surplus/deficiency ?

(b) If the company followed SLM for first four years and decides to switch over to WDV what would be amount of resultant surplus/deficiency?

Solution :

As per para 21 of AS-6 (refer points 7.7 & 7.7-1) 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 recomputation of depreciation in accordance with the new method should he adjusted in the accounts in the year in which the method of depreciation changed. In case I lie change the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged in the statement to profit and loss. In case the change in the method results in surplus, the surplus should be credited to statement of profit and loss.

(a) Surplus of Rs. 13.15 will be written back to profit and loss account.

(b) Deficiency of Rs. 13.15 should be charged 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.

Problem No. : 2 - The Company's plant and machinery was Rs. 3,000 lakhs as on 1 - 4-2009. It provided depreciation at 15% per annum under WDV method. However it noticed that about Rs. 500 lakhs worth of imported asset, which is component of above plant and machinery acquired on 1-4-2009, would be obsolete in 2 years. Company wants to write off this asset over 2 years. Can Company do so? Give comments.

Solution :

As per para 34 of AS-6 (refer point 7.10), where an addition or extension retains a separate identity and is capable of being used after the existing asset is disposed of depreciation should be provided independently on the basis of an estimate of its own useful life.

As it appears that imported asset of Rs. 500 lakhs, which is component of plant and machinery, is having independent useful life. Therefore, the company's policy to write off over two years is correct.

Problem No. : 3 - Gammon (India) Ltd. Uses horses to transport material from one place to another place on hilly area where construction activity is going on. It purchases horses worth Rs. 80,000 for transporting material on 1-4-2009. Useful life of horses was estimated 5 years, therefore company decided to write off depreciation on horses as per SLM over 5 vears. Comment.

Solution :

The treatment followed by the company is not correct as per AS-6 Para l(v) (refer point 7.3) Depreciation Accounting is not applicable to Live Stock.

Problem No. : 4 - NDA Ltd. purchased certain plant and machinery for Rs. 40 lakhs. 20% of the cost net of CENVAT credit is the subsidy component to be realised from a State Government for establishing industry in a backward district. Cost Rs. 40 lakhs include excise Rs. 5 lakhs against which CENVAT credit can bed claimed. Compute Depreciable amount.

Solution:

In this case, it is first necessary to determine the historical cost of the plant and machinery. This is shown as Follows:

(Rs. in lakhs)

Purchase price	40
Less : Specified duty against which CENVAT credit is available	5
Originally cost of plant and machinery for accounting purposes	35
Less : Subsidy	7
Depreciable Amount	28

Alternatively, the original cost of the plant and machinery can be taken at Rs. 35 lakhs and a sum ol Rs. 7 lakhs can be transferred to deferred income account by way of a "subsidy reserve". While CENVAT credit can be presently availed of only in two annual installments of 50% each, that portion of unavailed CENVAT credit is also required to be reduced from cost.

Depreciable amount would be as under :

(a) Where the entire subsidy is adjusted against cost Rs. 28 lakhs

(b) Where the subsidy is held as deferred income Rs. 35 lakhs

PROBLEMS

1) An item of plant was purchased on 1-4-2008 for Rs. 2,00,000. The WDV depreciation rate applicable to the plant was 15%. The written down value of the plant as on 31-3-2010 was Rs. 1,44,500. On 1-4-2010, the enterprise decided to change the method From written down value to straight line. The enterprise decided to write off the book value of Rs. 1,44,500 over the remaining useful life of plant i.e. 15 years (Out of the total useful life of 17 years. 2 years have already elapsed)

Comment whether the accounting treatment is correct. If not, give the correct accounting treatment with reasons.

Ans. : No, recalculate depreciation and surplus credited to Profit and Loss A/c of Rs. 31,970 (cr.)

2) A company has acquired a Plant and Machinery at 6.5 lakhs on installments basis from a dealer (The cash down price is Rs. 6 lakhs). During the year, company paid Rs. 50,000 as down payment and Rs. 1.5 lakhs as the installment for the year. The company provided the depreciation @ 15% on Rs. 2 lakhs. Comment, whether the depreciation on Rs. 2 lakhs is correct with reasons.

Ans. : No.

Advanced Problems

3) How would you deal with the following situation?

(a) The cnterprischas adopted the straight line method for charging depreciation on new machine in factory, while continuing to charge depreciation on the old machinery of the factory on the written down value method.

(b) The enterprise has adopted the written down value method of charging depreciation on its plant and machinery in factory A and the straightline method for charging depreciation on identical plant and machinery in factory B.

Ans. : (a) permissible; (b) permissible

4) The managing director of a company asked you whether in the profit and loss account, depreciation on computer can be charged at the rate specified in the Income-tax Rules. Give your advice.

Ans. : Prima facie - No

5) The management of a company does not want to provide for depreciation on the assets in a particular year because the company has not used the assets at all during the year. Give your comment.

Ans. : Not correct

6) On January 1,2000, Bray Company purchased for Rs. 2,40,000 a machine with a useful life of 10 years and no salvage value. The machine was depreciated by the diminishing balance method and the carrying amount of the. machine was Rs. 1,53,600 on December 31, 2001. Bray changed to the straight-line method on January I. 2002. Bray can justify the change. What should be depreciation expenses on this machine for the year ended December 31, 2002.

(a) Rs. 15,360 (b) Rs. 19,200 (c) Rs. 24,000 (d) Rs. 30,720

Ans. : (c) Besides surplus of Rs. 38,400 to be credited in profit and loss account

1.7 AS - 10 : Accounting for Fixed Assets [Effective Date: 1st April, 1991]

Introduction

Fixed assets represent a significant portion of the total assets of an enterprise. In some industries like iron and steel oil refinery etc., fixed assets consist of 70% to 80% of the total assets. Therefore, fixed assets are very important in the presentation and preparation of financial statements. Furthermore, the operating profits of an enterprise will depend upon whether an expenditure represents an asset or an expense.

This statement deals with accounting for fixed assets. Generally, fixed assets are grouped into various categories e.g., land, building, plant and machinery, furniture and fixtures, vehicles, patents, trade marks, etc,

Objectives

The main objectives of this statement are:

(a) the recognition of the fixed assets; and

(b) determining their carrying amounts.

Scope

1) This statement does not deal with accounting for the following items to which special considerations apply:
   (a) forests, plantations and similar regenerative natural resources;
   (b) wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-generative resources;
   (c) expenditure on real estate development; and
   (d) livestock.

   Expenditure on individual items of fixed assests used to develop or maintain the activities covered in (a) to (d) above, but separable from those activities, are to be accounted for in accordance with this statement.

   Example : Irrigation equipments used for plantation are to be accounted for in accordance with this outside the scope of this statement.
2) This statement does not deal with the accounting for depreciation of the fixed assets.
3) This statement does not deal with the treatment of government grants and subsidies and assets under **leasing rights**.

Definitions

Fixed Assets

Fixed asset is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.

Fair Market Value

Fair market value is the price that would be agreed in an open and unrestricted market between knowledgeable and willing parties dealing at arm's length who are fully informed and are not under any compulsion to transact.

Gross Book Value

Gross book value of a fixed asset is its historical cost or other amount substituted for historical cost in the books of account or financial statements. When this amount is shown net of accumulated depreciation, it is termed as net book value.

Identification of Fixed Assets

An asset wilt be accounted for as a **fixed asset** if the following conditions are satisfied :

(a) It is held with the intention of being used for the purpose of producing or providing goods and services; and

(b) It is not held for sale in the normal course of business.

In some cases, an enterprise may treat an item as expense though it would otherwise be classified as fixed asset, It is done because the amount of the expenditure is not material.

Example : Saraswati Printers (P) Ltd purchased a punching machine for Rs 500. Life of the punching machine is 5 years. As the amount of expenditure is small, it can be treated as an expense instead of recording it as a fixed asset.

It should be noted that the Standard permits the aggregation of individually insignificant items, such as tools, modules and dies, as one fixed asset.

Stand-by Equipment and Servicing Equipment

Stand-by equipment and servicing equipment are accounted for as fixed assets.

Example : Factory washing machine and stanri-hy generator are fixed assets.

Spare Parts

Regularly used spare parts are usually carried as inventory. It is merged to Profit and Loss Account when consumed.

However, if spare parts can only be used in connection with an item of fixed asset and their use is expected to be irregular, they are accounted for as fixed assets. They are depreciated on a systematic basis over the useful life of the principal fixed asset.

Component Accounting

In certain circumstances, the accounting for an item of fixed asset should be done on the basis of its ***separable components*****,** if

(a) they are in practice separable

(b) their useful lives are different.

Example : Instead of treating an aircraft and its engines as one unit, it will be better to treat engines and aircraft as separate units. The useful life of engines are usually shorter than that of the aircraft. It should be noted that separate recognition will lead to better estimation of depreciation.

Components of Cost

The cost of an item of fixed assets comprises its purchase price, including import duties and other non-refundable taxes of levies and any directly attributable cost of bringing the asset to its working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price.

Examples of directly attributable costs are :

(i) site preparation;

(ii) initial delivery and handling costs;

(iii) installation cost, such as special foundations for plant; and

(iv) professional fees, for example fees of architects and engineers.

The cost of a fixed asset may undergo changes subsequent to its acquisition or construction on account of exchange fluctuations, price adjustments, changes in duties or similar factors.

Fixed Assets

It is an asset, which is :

- Held with intention of being used for the purpose of producing or providing goods or services.
- Not held for sale in the normal course of business.
- Expected to be used, tor more than one accounting period.

Examples of fixed assets are :

- Land
- Building - Freehold
- Leasehold - Building
- Plant & Machinery
- Furniture & Fitting etc.

Applicability

- This accounting standard is not applicable to the following items.
- Forests, plantations and similar regenerative natural resource.
- Wasting assets like minerals, oil, and natural gas.
- Expenditure on real estate development.
- Live stock.

Fixed assets in- financial-statement

Fixed assets shall be shown in financial statement either at historical cost or revalued price.

What is Historical cost - The historical cost of acquired fixed assets consists of the following : -

- Purchase price
- Import duties and other non-refundable taxes
- Any directly attributable cost of bringing the asset to the working condition for its intended use like: -
  - Site preparation
  - Delivery and handling cost
  - Installation cost
  - Professional fees (i.e. Fees of engineers and architects).
  - Expenditure incurred on start up and commission of the project including the expenditure on test runs less income by sale of products.

- Administrative and other general overheads are specifically attributable for construction/acquisition/installation of the fixed assets.
- Amount of Govt. grants received/receivable against fixed asset should be deducted from the cost of fixed asset.
- Loss/gain on deferred payment on foreign currency liability if option under AS-11 is exercised.
- Price adjustment, changes in duties or similar factors.

Historical cost of self-constructed fixed assets - Such fixed asset, which was constructed by in-house efforts, is called self-constructed fixed asset. Cost of self-constructed fixed assets; includes the following : -

- All costs which are directly related to the specific asset.
- All costs that are attributable to the construction activity should be allocated to the specific assets.
- Any internal profit included in the cost should be eliminated.

Example : X Ltd. is constructing a fixed asset. The cost ol project is given below :

Materials	Rs. 7,00,000	
Direct Expenses	Rs. 1,00,000	
Total Wages of the company during the year	Rs. 1,20,000	1/12 is chargeable to Project
Total Administrative Exp. of the company during the year	Rs. 8,00,000	5% is chargeable to Project
Depreciation on asset used for the project	Rs. 12,000	
Calculate the cost of fixed assets		

Answer :

Cost of Fixed Assets	**R.f.**
Material	7,00,000
Direct Expenses	1,00,000
Wages	10,000
Administration Overhead	40,000
Depreciation	12,000
Total:	8,62,000

Cost of asset acquired in exchange of existing assets: (i.e. consideration paid is non -monetary) - The cost of acquisition of fixed assets is determined under the different situations differently as under : -

- **Fixed Assets exchanged not similar -** Assets acquired should be recorded either at fair market value of asset given up or fair market value of asset acquired, if this is more clearly evident.
- **Fixed Assets exchanged are similar -** Fixed assets acquired is recorded at fair market value of asset given up or Fair market value of asset acquired, if this is more clearly evident or Net Book value of the asset given up
- **Fixed Assets acquired in exchange of share or other securities -** (when payment of fixed assets is made in shares or securities) Assets should be recorded at - either fair market value of asset purchased or Fair market value of share or securities, whichever is more clearly available.

Revalued price

When the fixed assets are revalued, these assets are shown at revalued price in financial statement. Generally, competent valuer does revaluation, through appraisal. Revaluations may be done using price index appropriate to the concerned fixed assets.

When a fixed asset is revalued, an entire class of assets should be revalued or the selection of assets for revaluation should be made on a systematic basis. That basis must be disclosed.

Method of presentation of revalued asset in financial statement - There are two methods for showing the revalued amount in the financial statement. These are: -

- By re-stating the gross book value and accumulated depreciation.
- By re-stating net book value adding there in the net increase on account of revaluation.

Maximum amount of revaluation - Revaluation of fixed assets should be restricted to the net recoverable amount of fixed asset.

Accounting treatment of revaluation - Treatment in accounting unuer different situations is as under: -

- **First time revaluation (upward)**
  - Increase in net book value is credited to owner's interest under the head 'Revaluation Reserve'.
- **First time revaluation (Downward)**
  - Decrease in net book value is charged to the profit & loss account.
- **First revaluation (downward) subsequent revaluation (upward)**
  - Decrease in net book value is charged to the Profit & Loss Account in the year in which downward revaluation was done.
  - Amount of revaluation that can be credited to Profit & Loss Account is restricted to the amount of devaluation earlier written off. Balance amount of revaluation should be credited to revaluation reserve.

- **First revaluation (upward) subsequent revaluation (downward)**
  - Increase in the net book value is credited to owner's interest under the head 'Revaluation Reserve'.
  - Amount of devaluation can be charged to revaluation reverse to the extent the revaluation reserve earlier credited is unutilized, the balance amount of devaluation is charged to profit and loss account.

Valuation of fixed assets in special cases

- **Assets acquired on hire purchase terms :** Such assets arc recorded at their cash price. However, the recording will be done as per AS-19.
- **Cost of jointly held assets :** Either the original cost, accumulated depreciation, and written down value should be stated in the balance sheet in the proportion in which the entity has right to utilize the asset. **OR**

  Pro rata cost of such jointly owned assets is grouped together with similar fully owned assets.
- **Fixed assets acquired at consolidated price :** Cost of each fixed asset should be determined on a fair basis as per valuation by competent valuers.

Improvements and Repair

There are two accounting treatments of cost of improvement and repairs. These accounting treatments depend upon the following conditions : -

- After the improvements and repairs, expected future benefits from fixed assets do not change. The expenses of improvements and repairs are charged to profit & loss account.
- After the improvement and repairs, expected future benefits from fixed asset will increase beyond the previously assessed standard performance. These expenses on improvements and repairs are included in the gross book value of fixed asset.

Addition or extension of capital nature to an existing asset

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

Retirement and disposals

- Fixed assets are deleted from the financial statement either on disposal or on expected economic benefit is over.
- Gains or losses arising on disposal are generally recognized in profit & loss account.

Fixed assets are retired from active use and held for disposal

- Such asset is stated at the lower of net book value and net realisable value in the financial statement.

- Any expected loss is recognized immediately in the profit & loss statement.
- It should be separately shown in financial statement **i.e.**, balance sheet.

Disposal of previously revalued fixed assets -If there is profit, then it is credited to profit & loss account.

If there is loss, then it can be adjusted against the balance of revaluation reserve (arising out of revaluation of the same asset). If any.

Disclosure

- Gross and net book values of fixed assets at the beginning and at the end of accounting period showing additions, disposal, acquisition and other movements.
- Expenditure incurred on account of fixed assets in the course of construction or acquisition.
- Revalued amount substituted for historical cost of fixed assets, the method adopted to compute the revalued amount, and whether an external valuer has valued the fixed assets, in case where fixed assets arc stated at revalued amount.

Capitalisation of exchange differences incurred on fixed asset related borrowing

Instructions contain in Part I of Schedule VI of the Companies Act, 1956 regarding adjustment of exchange difference in the carrying amount of the fixed assets due to change in the rate of exchange of fixed assets linked liability denominated in foreign exchange has been super seded by issue of Companies (Accounting Standards) Rules, 2006. Therefore, AS- 11 (Revised 2003) will apply and such exchange difference shall be recognised in profit and loss account and will not be capitalised with the cost of fixed assets. However it is subject to option exercised by the entity as per amendments in AS-11 on 31-3-2009.

Treatment of CENVAT credit on capital goods (fixed assets)

Para 9.1 of AS-10 on "Accounting for Fixed Assets", requires that only non-refundable taxes and duties in respect of the fixed asset should be included in the cost of that fixed asset.

Cenvatable excise duty can be considered as a refundable tax. There-fore, CENVAT credit of such duty should be reduced from the purchase cost of capital goods concerned and recognised as a separate asset if the following conditions are satisfied: (i) The enterprise is entitled to the CENVAT credit as per the Rules, and (ii) there is a reasonable certainty that the CENVAT credit would be utilized and (iii) enterprise intends to avail the CENVAT credit.

The CENVAT credit in respect of capital goods is allowed for an amount not exceeding 50% of the duty paid on such capital goods in the financial year in which the goods are received in factory and the balance will be allowed in the subsequent year(s). If the conditions specified above are met and the enterprise decides to take CENVAT credit, the entire amount

of CENVAT credit should be deducted from the cost of capital goods. The amount of CENVAT credit taken in the financial year, in which goods are received, should be debited to an appropriate account, say, "CENVAT Receivable (Capital goods) Account" and balance may be debited in another appropriate account say "CENVAT credit Deferred Account". In the subsequent financial year(s), when the balance CENVAT credit is availed of, the appropriate adjustment for the same should be made, i.e., amount of "CENVAT credit Deferred Account" with a corresponding debit to "CENVAT Credit Receivable (Capital Goods) Account". On actual utilization, the account will be adjusted against excise duty on the final products. Accordingly, the purchase cost of the capital goods would be net of the specified duty on capital goods. The unadjusted balance standing in the MODVAT Credit Receivable (Capital goods) Account, if any, should be shown on the asset side under the head "Advances".

In following cases excise duty, even though Cenvatable should be included in the cost of fixed assets

(i) the enterprise does not intended to avail it; or

(ii) the recognition criteria is not satisfied.

Review of balance in CENVAT credit receivable accounts - Balance in CENVAT Credit Receivable Accounts, pertaining to capital goods, should be reviewed at the end of the year, if it is found that the balance of the CENVAT credit are not likely to be used in the normal course of business within a reasonable time, then, notwithstanding the right to carry forward such excess credit in the Excise Rules, the non-usable credit should be adjusted in the accounts. As a result, the balance of the CENVAT credit receivable accounts in the financial account may be lower than the credit available as per CENVAT credit registers. In such a case, a reconciliation statement would have to be prepared indicating the amounts adjusted so that a track is kept for the difference between the balance and the difference between financial accounts and the credit available as per the excise registers can be explained in subsequent years also.

The adjustment of excess credit related to capital goods should be made to the concerned Capital Goods Account. The excess CENVAT credit, which is not utilizablc in future within reasonable time, either availed or deferred, which related to fixed assets acquired, should be added to the cost of the relevant fixed asset. For accounting purpose, depreciation on the revised unamortized depreciation amount should be provided prospectively over the residual useful life of the asset. In case the fixed asset no longer exists, the relevant amount should be written off in the profit and loss account. To facilitate aforesaid treatment, CENVAT credit record should be maintained fixed asset-wise in the relevant R.G. Register.

Significant difference among AS-10 and IAS/IFRS-16 and US GAAP

Main difference is regarding revaluation of fixed asset. AS-10 allows revaluation, IAS-16 also allow revaluation. If revaluation model is followed but with detailed guide-lines. US GAAP does not allow revaluation. Difference in exchange arising out of payment or translation of foreign exchange liability on account of fixed asset shall not be added to or subtracted from the cost of fixed assets as per AS-11 (Revised), which is in accordance with IFRS/IAS-21 and US GAAP. However AS-11 has been amended with option to capitalise such difference. However, this option has expired on 31.3.201 l.Now the exchange difference will not be capitalized as per AS-11. But this option has further been extended upto 31-03-2012 by the Ministry of Corporate Affair on Nth May 2011.

PROBLEMS

Problem No. 1 : On 1-4-2010 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 1-4-2010 the revaluation reserve corresponding to these assets stood at Rs. 200 lakhs. 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.

Solution :

As per Para 32 of AS-10 (refer point 10.8-2), 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	Dr.	200	
To Cost of goods sold			150
To General Reserve			50

Problem No. 2 : 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 realisable value is Rs. 3,10,000. Determine the loss /gain on retirement of the fixed assets.

Solution :

Cost of the plant	Rs. 10,00,000
Estimated realisable value	Rs. 30,000
Depreciable amount	Rs. 9,70,000
Depreciation per year	Rs. 97,000
Written down value at me end of 7th Year	
= 10,00,000-(97000X7) =	Rs. 3,21,000

As per Para 14.2 of AS-10 (refer point 10.8), items of fixed assets that have been retired from active use and are held for disposal are stated at the lower of their net hook value and net realisable value and are shown separately in the financial statements. Any expected less is recognized immediately in the profit and loss statement. Accordingly, the loss of Rs. 21,000 (321000-310000) to be shown in the profit and loss account and asset of Rs. 3,10,000 to be shown in the balance sheet separately.

Problem No. 3 : A company has purchased plant and machinery in the year 2006-07 for Rs. 45 lakhs. A balance of Rs. 5 lakhs is still payable to the suppliers for the same. The supplier waived off the balance amount during the financial year 2009-10. The company treated it as income and credited to profit and loss account during 2009-10.

Whether accounting treatment of the company is correct. If not, state with reasons.

Solution :

As per Para 9.1 of AS-10 (refer point 10.3) the cost of fixed assets may undergo changes subsequent to its acquisition or construction on account of exchange fluctuation, price adjustments, changes in duties or similar factors considering Para 9.1 the treatment done by the company is not correct. Rs. 5 lakhs should be deducted from the cost of fixed assets.

Problem No. 4 : 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 machine?

Solution :

As per Para 20 of AS-10, (refer point 10.3), 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 costs 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)

Problem No. 5 : On December 1, 2009, 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 2009 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, 2009 Balance Sheet, Induga Co. should report a balance in the land account.

Solution :

As per Para 20 of AS-10, (refer point 10.3). the cost of land should include all expenditure incurred preparing it for its ultimate use (such as factory size) 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. 400,000
Legal Fees	Rs. 10,000
Title Insurance	Rs. 12,000
Net cost of demolition (Rs. 50,000 - Rs. 8,000)	Rs. 42,000
	Rs. 4,64,000.

Problem No. 6 : On March 31.2010, Winn Company traded in an old machine having a carrying amount of Rs. 16,800, and paid cash difference of Rs. 6,000 for a new machine having a total cash price of Rs. 20,500. On March 31, 2010, what amount of loss should Winn Company recognize on this exchange?

Solution :

As per Para 2.2. ol AS-10 (refer point 10.3-3) - When a fixed asset is acquired in exchange or in part exchange for another asset, the cost of the asset acquired should be recorded either at fair market value or at the net book value of the asset given up, adjusted for any balancing payment or receipt of cash or other consideration. The cash price of the new machine represents its fair market value (FMV). The FMV of the old machine can be determined by subtracting the cash portion of the purchase price (Rs. 6,000) from the total cost of the new machine. Rs. 20,500 - Rs. 6,000 = Rs. 14,500. Since the book value of the machine (Rs. 16,800) exceeds its FMV on the date of the trade in (Rs. 14,500), the difference

of Rs. 2,300 must be recognized as a loss, however, if the FMV of the old machine had exceeded its book value, the gain would not be recognized.

Problem No. 7 : 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

(a) Reduce accumulated depreciation equal to the cost of refurbishing.

(b) 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.

(c) Capitalize the cost refurbishing and record a loss in the current period equal to the carrying amount of the damaged portion of the building.

(d) Capitalize the cost of refurbishing by adding the cost to the carrying amount of the building.

Solution :

(c) 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 (refer point 10.8). 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.

Loss	Dr.	...	
Ace, Depreciation	Dr.	...	
To Building			...
Building	Dr.	...	
Cash			....

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 ot 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 file 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	Dr.	...	
Cash			....

Problem No. 8 - 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

Solution :

(b) As per Para 12.1 of AS-10, (refer point 10.6) - 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.

Problem No. 9 : A conveyor system was capitalized on 01-01-2006 with value of Rs. 41.37 crores. The break-up of the capital cost was as follows :

Civil & Mechanical structure	11.72
Driving units and pluming	05.40
Rope	02.83
Belt	11.17
Safely and electrical equipments	06.15
Other accessories	04.10
	41.37

During the financial year 2009-10 due to wear and tear, the rope used in the conveyor system was replaced by a new one at cost, at Rs. 8 crores. As new rope did not increase the capacity and is a component of the total assets. The company charged the full cost of the new rope to repairs and maintenance. Old rope continues to appear in the book hoi account and is charged with depreciation every year.

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

Solution :

As per Para 23 of AS-10 (refer point 10.6) - Subsequent expenditure relating to an item of fixed asset should be added to its book value only of 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 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.

Problem No. 10 : 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 this situations?

Solution :

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 assets given up obviously more clearly evident. Hence, the motor car should he valued at Rs. 5 lakhs. Also the motor car should be recognised as an asset even though it is not yet registered in auditec'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 auditce has control, hence it should be reflected as an asset along with a note to the effect that the registration in auditec name is pending.

Problem No. 11 : 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 would you do in this situation? (C.A. Inter, Nov. 2002)

Solution :

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 he capitalized. If under the circumstances the amount is material the auditor should qualify his report.

Problem No. 12 : A company has scrapped a semi-automatic part of a machine (not writtenoff) 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 fhe whole expenditure to revenue. As an auditor, what would you do in this situation? (C.A. Inter, Nov. 2011)

Solution :

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 he expensed. In this case, the replacement of semi-automatic part with a 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 he charged to revenue.

Problem No. 13 : 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?

Solution :

Year of acquisition **(Rs in lakhs)**

Machine Account	Dr.		16	
CENVAT Credit Receivable Account	Dr.		2	
CENVAT Credit Deferred Account	Dr.		2	
To Supplier's Account	Dr.			
Next Year				20
CENVAT credit receivable Account	Dr.		2	
To CENVAT credit deferred Account				2

Problem No. 14 : Is Project under sale fixed or current asset?

Solution :

According to para 24 of 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.

Problem No. 15 : A Company 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" whether unusual accounting?

Solution :

The treatments in different circumstances as clarified by Accounting Standard Board (ASB) are as follows:

(A) In case the intention of the enterprise is to become a dealer of the asset, which was there to treated as a fixed asset, it is permissible to transfer such assets to current assets. With regard to valuation of such assets, the following alternatives are available :

- Fixed assets reclassificd, as current assets Should be valued at their carrying amount or at the net realisable value, whichever is lower. In this case, no appreciation would be recognised either as capital reserve or the revaluation reserve.
- It would be appropriate to value assets which were there to classified as fixed assets at their market price in order to determine the correct profit, on sale of such assets in the ordinary course of business. The excess of market value over the carrying amount at the date of reclassification can be transferred to revaluation reserve.

The Board also noted another view that the question of revaluation reserve arises in a situation where a fixed asset is revalued and continues to be a fixed asset. However in case an asset, which was originally classified as a fixed asset and is now classified as current asset, the excess can be transferred to a capital reserve instead of revaluation reserve.

In support of this view, it is argued that the nature of revaluation reserve and capital reserve is the same, as both cannot be used for distribution on dividend. The 'revaluation reserve' is covered by the definition of 'capital reserve' as given in Part 111 of Schedule VI to the Companies Act, 1956. The relevant paragraph of Part III is reproduced below:

"The expression 'capital reserve shall be not include any amount regarded as free for distribution through the profit and loss account' and the expression 'revenue reserve' shall mean any reserve other than a 'capital reserve'

For subsequent accounting, the amount arrived at as per above on the date of re-classification would be treated as cost of the current assets for applying AS-2 which requires that inventories should be valued at cost or net realizable value whichever is lower.

(B) In case the intention is not to deal in the assets which were thereto treated as fixed assets, but assets retired from active use and held for disposal, these should continue to be classified as fixed assets and treated as per paragraph 24 oF AS- 10 which requires that such items should be stated at the lower of their net book value and net realisable value and shown separately in the financial statements.

Problem No. 16 : ABC Ltd. imported a machine from Germany at a cost of Euros 150,000. 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 I 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. 2008. The exchange rate was Rs. 55.80 for 1 Euro on this date.

The machine wns installed and put to commercial use on 1st Fcbruarv, 2009.

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

The exchange rate on 31st March. 2009 was Rs. 57 for 1 Euro. The exchange rate on 31st March, 2010 was Rs. 59 for 1 Euro.

10% of the loan was repaid on 1st October, 2009. The exchange rate was Rs. 57.75 on this day.

From the above information work out the following.

(i) Original cost of the machine in the books of account :

(ii) Depreciation for the financial year ended 31st March, 2009 :

(iii) Book value as on 31st March, 2009 :

(iv) Exchange rate differences if any charged to profit and loss for the financial year ended 31st March, 2009;

(v) Depreciation for the financial year ended on 31st March, 2010;

(vi) Book value as on 31st March, 2010;

(vii) Exchange rate difference if any to be charged to profit and loss for the financial year to end 31st March, 2010

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

(i) Original cost of machine in the books of account : (Rs.)

Purchase Price	Euro 150,000	@ 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

(ii) Depreciation for the financial year ended 3 1-03-2009 (Rs.)
@ 13.91% per annum on Rs. 1,14,26,667 for two months 2,64,908

(iii) Book Value as on 31-03-2009: (Rs. 1,14,26,667-2,64,908) 1,11,61,759

(iv) Exchange fluctuation expense for the financial year ended 31-03-2009: is *NIL*, as the loan was denominated in rupees. Hence, no fluctuation is applicable.

(v) Depreciation for the year to end 31-03-2010 @ 13.91% Per annum 15, 89,449

(vi) Book Value as on 31-03-2010: (Rs. 1,11,61,759- 15.89,449) 95,72,310

(vii) Exchange fluctuation expense for financial year ended 31-03-2010: is *NIL*, as the loan was denominated in rupees. Hence, no fluctuation is applicable.

Problem No. 17 : Ltd. purchased machinery from K Ltd. on 30-9-2008. The price was 370.44 lakhs before charging 8% sales tax and giving a trade discount of 2% on the quoted price. Transport charges were 0.25% on the quoted price and installation charges come to 1% on the quoted price.

A loan of Rs. 300 lakhs was taken from the bank on which interest at 15% per annum was to be paid. Expenditure incurred on the trial run was Material Rs. 35.000, wages Rs. 25,000 and Overheads Rs. 15,000.

Machinery was ready for use on 01.12.2008. However it was actually put to use only on 1-5-2009. Find out the cost of the machine and suggest the accounting treatment for the expenses incurred in the interval between the dates 1 -12-2008 to 1-5-2009. The entire loan amount remained unpaid on 1-5-2009.

Solution :

Calculation of cost of Machine as per AS-10

Price of Machine	370.44
Less : Trade discount 2%	7.41
	363.03
Add : Sale Tax 8%	29.04
	392.07
Transport Charges 0.25% on Rs. 370.44	0.93
Installation Charges 19% on Rs. 370.44	3.70
	396.70
Calculation of borrowings cost -	
30-09-2008 to 01-12-2008 (presumed to be qualilying asset)	
300 × 15 / 100 × 2 / 12	7.50
	404.20
Add : Expenses on trial run	0.75
Total Cost	**404.95**

As per AS-10, the capitalization of interest should cease when substantially all the activities necessary for intended use are completed. Therefore interest for the period 1-12-2008 to 1-5-2009 should be expensed.

EXERCISES

1) How would you deal with the following situations?

- The surplus arising in revaluation of land and building has been credited to the profit & loss account to the extent of depreciation charged there on previous year. It is argued that to this extent, depreciation need not have been charged in these years.

  [Ans. : No]

- Interest on substantial loans taken specifically to acquire certain fixed assets is being capitalized even after the commencement of commercial production. The management argues that the interest is attributable exclusively to those fixed assets and should therefore be capitalized.

  [Ans. : No]

- The company has constructed a boiler for use in its nevw factory. A substantial portion of the overheads has been charged to the cost of the boiler. Thus, the cost of the self-constructed boiler is almost double the market price of a similar boiler.

  [Ans. : Not correct see paras 10 & 9 of AS-10]

- A fixed asset costing Rs. 1,00,000 was revalued at Rs. 1,50,000 afrer three years of use, at that time; its book value was Rs. 70,000 (SLM @ 10%). The asset is now sold for Rs. 1,40,000. Its book value at the time of sale is Rs. 94,000. The management wishes to credit a sum of Rs. 1,26,000 as profit from the sale of the asset by transferring the sum of Rs. 80,000 from revaluation reserve.
  [Ans. : No]
- As per report of valuation of existing fixed assets, book value of the net assets of the enterprise is much lower than their market value. The difference between book value and market value is accounted for as goodwill.
  [Ans : No]
- The enterprise had earlier installed its main manufacturing machine on the ground floor of the factory. The company later modified its production process, Which necessitated the installation of the said machine on the first floor. The company, therefore, constructed the entire first door and considering this construction as a foundation tor machine, debited its cost to the plant and machinery account.
  [Ans. : No]

2) A public limited company whose main object as stated in its memorandum of association is to purchase, acquire, contract, develop, cultivate and sell, agricultural and urban land, buys large plots of virgin lands, develops and cultivates them and sells them in small plots. Land purchased by the company and cost of the development has been consistent grouped under fixed assets in its balance sheet. **Comment**

[Ans. : No]

3) Discuss the accounting treatment of the following :

- Fixed assets acquired in exchange for other assets.
- Fixed asset acquired on hire-purchase basis.
- Fixed asset owned jointly with other.

4) What is meant by "revaluation of fixed assets"? What are the various bases on which fixed assets can be revalued? Where a fixed asset is revalued, how would the following items be dealt with in the accounts?

- Surplus arising on revaluation
- Depreciation on the revalued asset
- Gain or loss on disposal of the revalued asset.

5) How would you deal?

"The company has sold some old machinery for Rs. 1 crore. The details of the cost of such machinery are not available since the entire recording relating to fixed asset has been destroyed in on earthquake?