V'SMART ACADEMY

CA-IPCC AS – 2,7,9,10

Accounts was complicated ,
Unless Taught by Rohan Sir....

By CMA, CS. Rohan Nimbalkar.

INDEX

Accounting Standards

AS – 2 Valuation of Inventories

Objective of this AS

1. To formulate the method of calculation of Inventories/Stock
2. To determine the carrying amount of inventories in Financial Statements (FSs). This includes determination of cost of inventory and any amount to be written off to bring it to Net Realisable Value (NRV).
3. This Standard is very important as it impacts both P&L as well as Balance sheet i.e. if closing stock is overvalued/ undervalued; it impacts CY profits as well as asset value in the Balance sheet.

Applicability of AS - Inventory Valuation

This standard is NOT applicable for the following inventories.

(a) Work-in-progress (WIP) arising under construction contracts;(It is discussed in AS 7)

(b) WIP of service providers;

(c) If the entity holds shares, debentures and other financial instruments as stock-in-trade ;(It is discussed in AS 13.)

(d) Inventories of livestock, agricultural and forest products, mineral oils, ores and gases to the extent that they are measured at NRV in accordance with well established practices in those industries. (NO Accounting standard exists; Industry rules and regulations are followed).

The point (d) is an option to the entity and if it chooses to carry inventory at cost, the standard measurement rules apply i. e. measuring at lower of cost and NRV.

Definitions

Held for sale in the Ordinary course of business i.e. Finished goods (FG).

Used in the process of production for such sale i.e. raw material, WIP etc.

To be consumed in the process of production or in rendering the services e.g. consumables and loose tools, etc.

Chart Presentation Inventories includes

Inventories consist of

- **Held for sale in the Ordinary course of business i.e. Finished goods (FG).**
- **Used in the process of production for such sale i.e. raw material, WIP etc.**
- **To be consumed in the process of production or in rendering the services e.g. consumables and loose tools, etc.**

Measurement of Inventories

Major points for valuation of Inventories

1. Determination cost of Inventories
2. Determination Net Realisable Value of Inventories
3. Comparison between the Cost and Net Realisable Value

Inventory is valued at COST (or) NRV Whichever is LOWER

What is Cost of Inventories

Chart Presentation Cost of Inventories includes

Cost of Inventories Includes

- **Cost of purchase**
- **Cost of Conversion**
- **Other costs incurred to bring the inventory to present location and condition.**

1. Cost Of Inventories

Cost of purchase includes all costs incurred to purchase the material. The following items are directly related to the purchase of material.

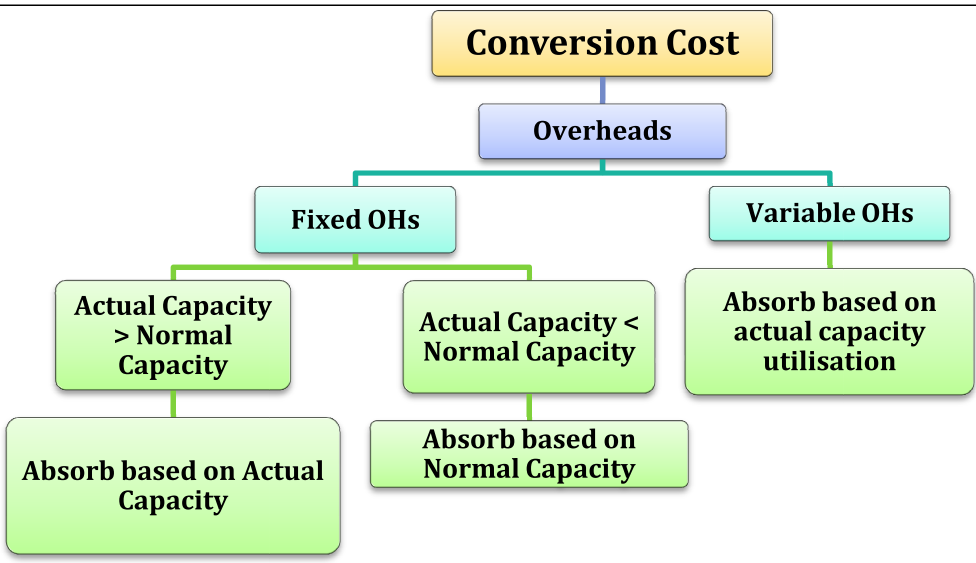
Particulars	Amount
Purchase price i.e. Basic price of material	xxx
Add	
NON refundable taxes & duties	xxx
Carrying Cost i.e. inward freight cost	xxx
Inward Insurance cost	xxx
All other costs incurred directly related to acquisition and bringing it to warehouse.	xxx
Less	
Cost of purchase	xxx
Trade discounts Quantity discounts	xxx
Duty drawbacks & other similar items	xxx
Cost Of Purchase Price	XXX

2 Cost of Conversion

This includes the costs incurred to convert the raw materials into finished goods. For example major costs like Labour, Factory rent, fuel costs, power expenses (factory overheads) and other items.
The overheads (OH) should be absorbed in the following manner:
Factory overheads can be divided into two types based on its nature i.e. variable overheads and fixed OH.

Variable expenses – which vary (change) along with the volume of production;
Fixed expenses – which do not vary with volume of production.

Chart Presentation



Normal Capacity (Meaning)
Normal Capacity is the number of units of production on an average over a period under normal circumstances after considering loss of capacity under normal circumstances. (Normal capacity = Total capacity Less planned maintenance)
Actual capacity (Meaning)
Actual capacity is **actual production** of goods.

1. Fixed Production Overhead will be taken in actual cost on recovery basis

$$\text{Overhead Recovery Rate} = \frac{\text{Production Overhead}}{\text{Normal Production}}$$

Overhead Recovered = Rate X Units Produced

2. If Actual production is very high, then take the actual production as denominator.

$$\text{Overhead Recovery Rate} = \frac{\text{Production Overhead}}{\text{Actual Production}}$$

Overhead Recovered = Rate X Units Produced

Examples of factory cost and these should be absorbed in the calculation of per unit cost. (i)

1. Consumable stores and spares;
2. Depreciation of plant and machinery, factory building etc…
3. Lease rent of production assets;
4. Repair and maintenance of plant and machinery, factory building etc...
5. Indirect employees cost connected with production activities;
6. Drawing and Designing department cost;
7. Insurance of plant and machinery, factory building, stock of RM & WIP etc.
8. Amortized cost of jigs, fixtures, tooling etc.
9. Service department cost such as Tool Room, Engineering & Maintenance etc.

2. Other Costs

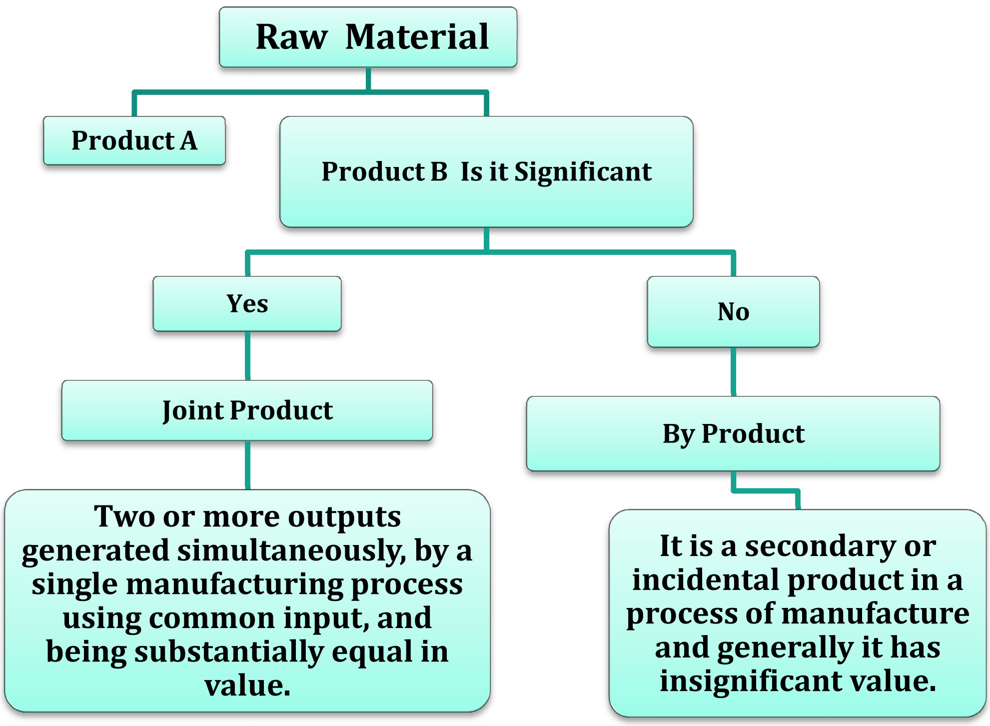
All other costs incurred to bring the inventory to the present location and condition. Examples:

1. Quality control cost - quality control employee cost and other costs of that dept;
2. R&D cost incurred for the development and improvement of the process or product;
3. Administration OHs in relation to production activities; (General admin OHs should NOT be included);
4. Packaging cost - primary and secondary package cost should be included, etc.

Following cost should not included on stock.

1. **Abnormal Loss** (Loss due to Fire, waste of materials, labour or other production costs)
2. **Storage costs**, unless those costs are necessary in the production process prior to a further production stage. (E.g. Electricity used for cold storage)
3. **Administrative, Selling and Distribution** costs. (Expenses such as rent, staff salary, Electricity Bill)
4. **Borrowing costs (Interest)**

Allocation of costs in special situations:



Allocation of costs in special situations:

Points	Joint Products	By Products
Meaning	Two or more outputs generated simultaneously, by a single manufacturing process using common input, and being substantially equal in value.	It is a secondary or incidental product in a process of manufacture and generally it has insignificant value.
Example	(1) Butter, cheese, and cream from milk, (2) Fuel oil, gasoline, and kerosene from	In manufacture of Sugar - Sugar is main product and molasses is by product.

	crude oil.	
Allocation of Cost	In this case, the joint costs (common costs) are allocated between the products on a rational and consistent basis. a) On the Sales value of each product when the products become separately identifiable; (b) On the sale value after completion of production;	1. Find out the joint costs of main product & by products. 2. Compute Net realisable value of by product at the time of separation. 3. Cost of main product = total joint costs of main product & by product Less NRV of by product.

Cost of inventory should be ascertained in following manner

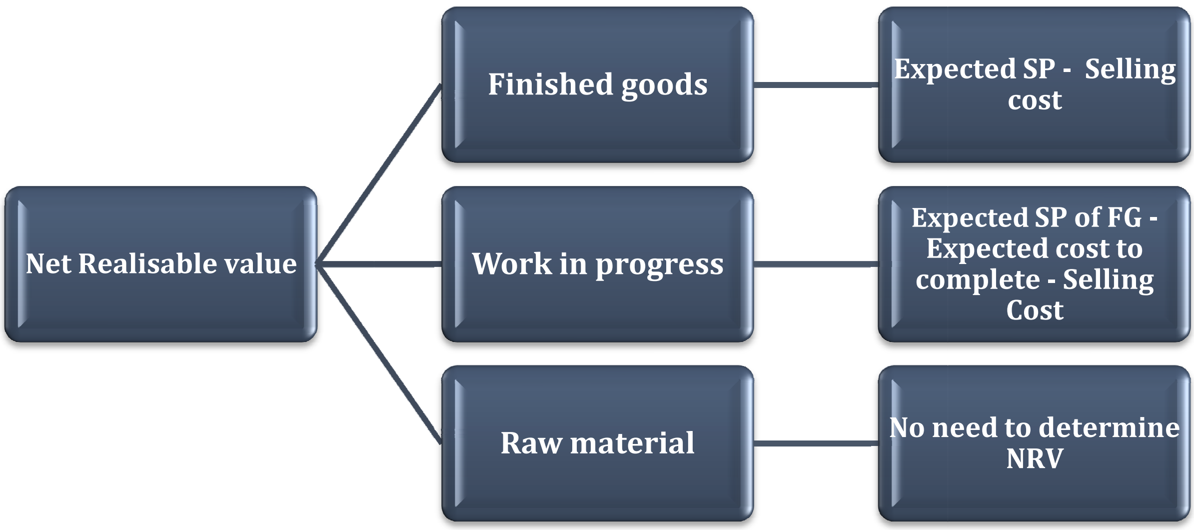
1. If stock in hand is unique not similar to each other, use Specific Identification Method.
2. If stock in hand is similar to each other, then use following two methods of stock valuation
   a) FIFO Method
   b) Weighted Average Method

Net Realisable Value

Calculation of NRV

Expected Selling Price in ordinary course of business		xxx
Less:- Expected Selling Expenses	xxx	
Less:- Expected Cost Of Completion	<u>xxx</u>	xxx
Net Realisable Value		**xxx**

Expected means management estimated, can be made due to contract received. It can be general price also.



Valuation of Raw Material Stock

Valuation is NOT based on Cost (or) NRV whichever is less. Its valuation is fully based on the valuation of finished goods as the entity is purchasing raw material not to sell in the ordinary course of business as raw material BUT to use it for producing the finished goods. Intention is to sell FG and not RM.

Assume stock of Raw paper to make

Value = Cost Price
Value = Lower of Cost Price or Replacement Price

Value in Profit = Cost Price.
Value in Loss = Lower of cost Price or Replacement Price

1. Stock of Raw material is valued at cost price, if Finished goods in which such raw material is to be applied is expected to be sold at cost price or above.
2. Stock of Raw material is valued at cost price or Replacement Value whichever is lower if finished goods in which such material is to be applied expected to be sold below cost price.

Replacement cost/Price is the amount that an entity would have to pay to replace an asset at the present time, according to its current worth. .

Disclosure Requirements

The financial statement should disclosed

1. The accounting policies adopted in measuring inventories, including the cost formula used;
2. The total carrying amount of inventories and its classification appropriate to the enterprise.

Question 1 **(Nov. 2012, 4 Marks)**

From the following information, ascertain the value of stock as on 31st March, 2012:

Particulars	Rs.
Stock as on 01-04-2011	28,500
Purchases	1,52,500
Manufacturing Expenses	30,000
Selling Expenses	12,100
Administration Expenses	6,000
Financial Expenses	4,300
Sales	2,49,000

At the time of valuing stock as on 31st March, 2011, a sum of Rs. 3,500 was written off on a particular item, which was originally purchased for Rs. 10,000 and was sold during the year for Rs. 9,000. Barring the transaction relating to this item, the gross profit earned during the year was 20% on sales

Question 2 **(PM) (May 2014, 4 Marks)**

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

Raw material X Closing balance	500 units

	Rs. Per unit
Cost price including excise duty	200
Excise duty (Cenvat credit is receivable on the excise duty paid)	10
Freight inward	20
Unloading charges	10
Replacement cost	150

Finished goods Y Closing Balance	1200 units

	Rs. per unit
Material consumed	220
Direct labour	60
Direct overhead	40

Total Fixed overhead for the year was Rs. 2,00,000 on normal capacity of 20,000 units.

Calculate the value of the closing stock, when

(i) Net Realizable Value of the Finished Goods Y is Rs. 400.
(ii) Net Realizable Value of the Finished Goods Y is Rs. 300.

Question 3 **(PM) (Nov. 2014, 5 Marks)**

Capital Cables Ltd., has a normal wastage of 4% in the production process. During the year 2013-14 the Company used 12,000 MT of raw material costing Rs. 150 per MT. At the end of the year 630 MT of wastage was in stock. The accountant wants to know how this wastage is to be treated in the books. Explain in the context of AS 2 the treatment of normal loss and abnormal loss and also find out the amount of abnormal loss if any.

Question 4 **(PM) (May 2015, 5 marks)**

1) Mr. Mehul gives the following information relating to items forming part of inventory as on 31-3-2015. His factory produces Product X using Raw material A.
2) 600 units of Raw material A (purchased @ Rs. 120). Replacement cost of raw material A as on 31-3-2015 is Rs. 90 per unit.
3) 500 units of partly finished goods in the process of producing X and cost incurred till date Rs. 260 per unit. These units can be finished next year by incurring additional cost of Rs. 60 per unit.
4) 1500 units of finished Product X and total cost incurred Rs. 320 per unit.
5) Expected selling price of Product X is Rs. 300 per unit.

Determine how each item of inventory will be valued as on 31-3-2015. Also calculate the value of total inventory as on 31-3-2015.

6) 1500 units of finished Product X and total cost incurred Rs. 320 per unit.
7) Expected selling price of Product X is Rs. 300 per unit.

Determine how each item of inventory will be valued as on 31-3-2015. Also calculate the value of total inventory as on 31-3-2015.

AS 7 = CONSTRUCTION CONTRACTS

Objective of AS – 7

1. This Standard prescribes the accounting treatment of revenue and costs related to construction contracts. Generally the construction activities take a long period and usually fall into different accounting periods.
2. The primary issue in construction contracts is - how to allocate the total contract revenue and costs among the accounting periods.
3. The Standard gives guidance on such allocation/recognition of contract revenue and contract costs in the P&L statement for the accounting periods in which construction work is performed.

Scope of AS – 7

The standard is applicable only for Contractors.

This Standard does not apply to customer

Would not be applicable to construction project undertaken by enterprise on its own account as a commercial venture in the nature of production activities.

[In the books of contractee, the asset constructed will be treated as a fixed asset, inventory or investment and AS 10, AS 2 or AS 13 are applicable respectively]

Definitions & Meaning

Construction Contract

Construction Contract is a contract specifically negotiated for the construction of assets closely interrelated or interdependent
E.g. Contract for contraction o bridges, building, dam, pipeline road, etc...

Construction contracts include

(a) Service contracts which are directly related to the construction of the asset; Example The services of project managers and architects; &

(b) Contracts for destruction or restoration of assets, and the restoration of the environment after the demolition of assets.

Types of Contracts

Types of Contracts

- ***Fixed price contract***
  - **In these contracts contractor agrees for fixed price of the contract or a fixed rate per unit of output.**
  - **E.g. Contractor receives Rs. 5 crore after construction of building or he receives Rs. 5 crore per building constructed.**
- ***Cost plus contract***
  - **In these contracts, contractor is reimbursed all allowable/defined costs as defined plus fixed percentage of fee/profit.**
  - **Contractor receives amount spent for construction + 2 % of amount spent OR receives amount spent for construction + 5 lakh.**

Recognition of Contract Revenue and Expenses

Recognition of revenue and costs in P&L is depending upon the reliabi6+lity of estimation of outcome.

Can outcome be estimated reliably?

Yes
- Recognise revenue and costs based on percentage of completion.

No
- Recognise revenue ONLY to the extent of costs incurred, if the revenue is recoverable;
- Recognise the costs as expense in the period in which it is incurred

Measurement of Contract Revenue

It can be determined in a number of ways. The following are the methods available in the industry:

Based on the costs incurred;

Measurement of Contract Revenue

- **Completion of a physical proportion of the contract work**
- **Percentage of work performed**
  - **Percentage of work performed = Contracts cost incurred till balance sheet date/ Estimated total contract cost**
- **Survey method**

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Calculation of Contract Revenue:

It includes –

Initial Contract Amount	XXX
Add:- Variations in contract work	XXX
Add:- Incentives receipts received by contractor	XXX
Add/Less :- Increase/Decrease in Escalation	XXX
Add:- Claims Amount , raised on customer for delay caused, errors design, etc..	XXX
Add:- Penalties due to delay caused by contractor	XXX
Total Revenue	**XXXX**

Contract Cost

It includes **Direct Cost Incurred on contract + Indirect Cost Incurred.**

Specific Cost (Direct Cost)	Attributable & Allocable Cost (Indirect Cost)
1) Site labour costs, including site supervision; 2) Costs of materials used in construction; 3) Depreciation of plant and equipment used on the	1) Insurance 2) Costs of design and technical assistance that is not directly

contract;	related to a specific contract;
4) Costs of moving plant, equipment and materials to and from site;	3) Construction overheads.
5) Costs of hiring plant and equipment;	
6) Costs of design and technical assistance	
7) The estimated costs of rectification and guarantee.	
8) These costs may be reduced by any incidental income that is not included in contract revenue	

Cost Not Recognised

1) General administration costs for which reimbursement is not specified in the contract;
2) Selling costs;
3) Research and development costs for which reimbursement is not specified in the contract; and
4) Depreciation of idle plant and equipment that is not used on a particular contract

Combining & Segmenting construction contracts

Combining

If the contract satisfies ALL of the following conditions, a group of contracts (irrespective of number of customers) should be treated as a single construction contract:

(a) All contracts are negotiated as **a single package;**

(b) Contracts are so **closely interrelated** with an overall profit margin; and

(c) Contracts are performed at the same time or one contract after another.

Segmenting

If the contract satisfies ALL of the following conditions, construction of each asset should be treated as separate construction contract:

(a) Separate proposals have been submitted for each asset;
(b) Each asset is subject to separate negotiation and parties can accept or reject any contract; &
(c) Costs and revenues of each asset can be identified;

Expected Loss:

Whenever any contract is expected to have loss then provision should be made for expected loss in future.

Provision for Loss: Total Revenue – Total Cost – Loss Recognised

Note:

When an uncertainty arises about the collectability of an amount already included in contract revenue, and already recognised in the statement of profit and loss, the uncollectable amount or the amount in respect of which recovery has ceased to be probable is recognised as an expense rather than as an adjustment of the amount of contract revenue.

Progress payments and advances received from customers may not necessarily reflect the work performed.

Calculation of Degree of Completion:

On Cost Basis: Cost Incurred / Total Cost x 100

Total Cost = Cost Incurred + Future Cost

On Time Basis: Time Spent / Total Time x 100

Total Time = Time spent + Future Time required for completion.

Disclosure Requirements in Notes to Accounts:

An entity should disclose:

(a) The amount of contract revenue recognised in the period;

(b) The methods used to determine the contract revenue; and

(c) The methods used to determine the percentage of completion;

An entity should disclose the following for contracts in progress at the balance sheet date:

(a) The total amount of costs incurred and recognised profits (less recognised losses) up to the balance sheet date;

(b) The amount of advances received; and

(c) The amount of retention money with the contractee.

Question No. 1

Mr. X obtained contract for Rs. 10,00,000 0n 1st January, 2014. He incurred cost as follows:

During 2014: Cost Incurred- 3,00,000. Future Cost to be incurred- 4,00,000.

During 2015: Cost Incurred- 5,00,000. (cumulative) Future Cost to be incurred- 2,50,000.

During 2016: Cost Incurred- 8,00,000. (cumulative) Future Cost to be incurred- Nil.

Calculate Profit for each year.

Question No. 2 **(May 2012 & PM)**

M/s Excellent Construction Company Limited under took a contract to construct a building for Rs. 3 crore on 1st September, 2011. On 31st March, 2012 the company found that it had already spent Rs. 1 crore 80 lakhs on the construction. Prudent estimate of additional cost for completion was Rs. 1 crore 40 lakhs. What amount should be charged, to revenue in the final accounts for the year ended on 31st March, 2012, as per the provisions of Accounting Standard 7 "Construction Contracts (Revised)"?

Question No. 3 **(Nov 2011) (4 Marks)**

From the following data, show Profit and Loss A/c (Extract) as would appear in the books of a contractor following Accounting Standard-7

Particulars	**Rs. In Lakhs**
Contract price (fixed)	480.00
Cost incurred to date	300.00
Estimated cost to complete	200.00

AS 9 "Revenue Recognition"

Objective of AS "Revenue recognition"

- This standard deals with the recognition (recording) of revenue in the profit and loss statement of an entity.
- Revenue means Gross Inflow of ash, Receivables or other consideration arising in the course of ordinary activities of an enterprise.
- This standard focuses on the **timing of recognition** i.e. when to record in the books.
- Also States the circumstances in which revenue recognition can be postpone
- Generally the amount of revenue is determined by agreement between the parties involved in the transaction.

Scope

This Standard discusses ONLY the following revenues arising in the ordinary course of business:

Revenue means gross inflow of cash and receivable from

1. Sale of goods,
2. Rendering of services,
3. Interest, dividend & royalty.

This AS does not deal with

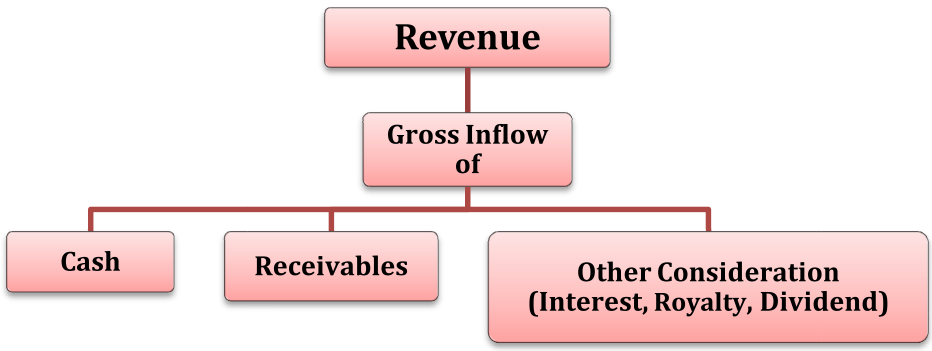
1. Revenue From Construct contract (It is Dealt in AS – 7)
2. Revenue From Government Grants (It is Dealt in AS – 12)
3. Revenue From Lease (H.P.) (It is Dealt in AS – 19)
4. Revenue From insurance contracts of insurance companies; (As per regulatory requirements)

The following revenues are also EXCLUDED from this standard

5. Profit on sale of fixed assets (Realised gains); (It is dealt in AS 10)
6. Unrealised gains of non-current assets (revaluation of fixed assets); (It is dealt in AS 10)
7. The natural increases in herds and agricultural and forest products; (accounted as per industry Standards)
8. Realised/unrealised gains arising from fluctuation of foreign currency and gain on translation of financial statements of foreign operation; (It is dealt in AS 11)
9. Gains on settlement of a liability by paying less than its carrying amount; (general principles of accounting)
10. Unrealised gains on restatement of the carrying amount of a liability. (general principles of accounting)

Meaning & Definition of Revenue

Revenue



Sale OF Goods

Condition must be fulfilled

1. Ownership of goods have been transferred
2. Risk and rewards has been transferred
3. There is no uncertainty regarding consideration (i.e. Cash or Receivables) at the time of recognition

The following table explains the situations and guidance on recognition of revenue under different situations.

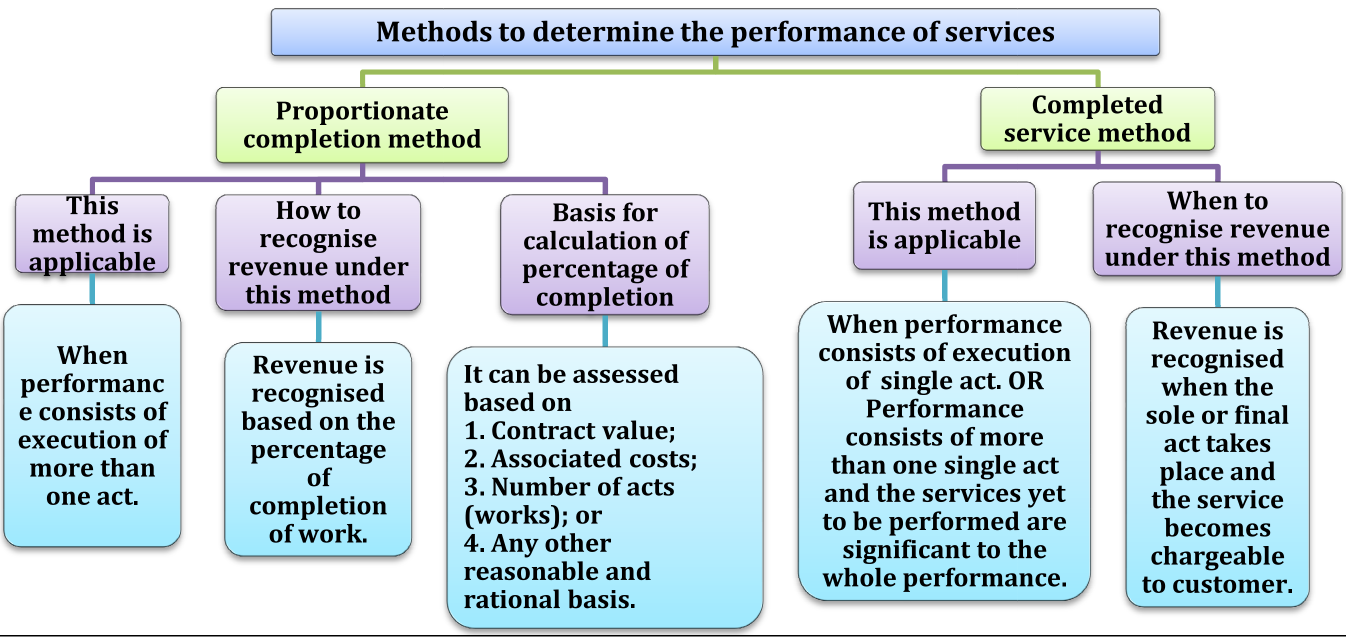
Delivery of goods is delayed at buyer's request and buyer takes title and accepts billing. (i.e. Goods are with seller)	Recognise the revenue when it is expected that delivery will be I made & it should satisfy the following conditions 1. Goods must be in hand; 2. The buyer's goods should be identified; & 3. Goods must be ready for delivery at the time recognition. (i.e. in packed condition)
Delivered subject to conditions: Subject to installation and" inspection	Recognise the revenue only when customer accepts the delivery & installation and inspection is complete. If installation is a simple process, recognise the revenue when goods are delivered.
▪ Subject to approval of customer (Sale on approval)	Recognise only when 1. Goods are formally accepted by the buyer; OR 2. Time period allowed is elapsed; OR 3. Reasonable time period is elapsed - in case NO specific period is mentioned;
▪ Consignment sales	Recognise revenue only when goods are sold to a third party by the consignee.
▪ Cash on delivery sales	Recognise revenue only when cash is received either by the seller or his agent.

▪ Guaranteed sales i.e. goods are delivered by giving an unlimited right to return to buyer.	Depends on the substance of the agreement In case of retail sales, if the entity offers a guarantee of "money back if not completely satisfied" - It may be appropriate to recognise revenue for full invoice amount at the time of sale of goods & the entity can create an appropriate provision for expected goods returns based on the previous experience.
▪ Installment sales	1. Recognise revenue on the date of sale to the extent attributable to sale price excluding interest amount. 2. Interest should be recognised on time basis in proportion to receivable balance. (Interest recognition is discussed below)
▪ Sale/ purchase agreements i.e. as per the agreement seller agrees to repurchase the sold goods from buyer at a later date.	Observe the transaction carefully before you come to a decision. Why do someone buy and sell the same goods at different dates. These transactions are in substance financing (a kind of loan) agreements; the resulting cash inflow is NOT revenue as defined and should NOT be recognised as revenue.
▪ Subscriptions for publications	1. Advance Received should be recognised as liability (and revenue should be recognised on a straight line basis over time; 2. If the value of the items differs from period to period, revenue should be recognised in proportion to the value of the items delivered to the total sale value of all items covered by the subscription.

Revenue from Rendering Services

Revenue from services is generally recognised as service is performed. The performance of service measured by two methods as under

1. Service should be PERFORMED.
2. NO significant uncertainty in ultimate collection at the time of recognition.



Situations and guidance on recognition of revenue under each situation.	
Situation	**Guidance on recognition**
Installation fees.	Recognise only when installation is completed and accepted by the customer; (Above guidance is applicable when an entity is providing installation services only and it is NOT a service along with sale of goods)
Advertisement income	Recognise the revenue when the related advertisement appears before the public.
Insurance agency commission	Insurance Commission Recognise on the effective commencement or renewal dates of the related insurance policies.
Admission fees on artistic performances, banquets or any special programs.	▪ Recognise revenue when event takes place. ▪ When a subscription received is for number of events, the fee received should be allocated to each event on a systematic and rational basis.
Tuition fees	Recognise over the period of instruction on SLM basis.
Entrance fees	▪ Revenue recognition depends on the nature of the services being provided. ▪ Entrance fee received is generally capitalised. (It is not related to any particular year hence it is appropriate to capitalise)
Membership fees	▪ If the membership fee permits only membership to the member, recognise when it is received. ▪ If the membership fee entitles the membership and other services or publications during the year, it should be I recognised on a systematic and rational basis by considering the timing and nature of all services provided.
Financial service commissions	▪ Recognition of Revenue depends upon: 1. Whether the service has been provided "once for all" or on a "continuing" basis; 2. The incidence of costs relating to service; 3. When the payment for the service will be received. ▪ If commission is related to 'granting/arranging loan or other facilities' recognise the revenue - when loan is granted or the other facilities are provided. ▪ If such commitment or facilities fees relates to continuing obligations or services- then revenue should be recognised I over the life of such loan or facility in a systematic and rational basis to match with the

	related costs incurred. (Matching concept)

Other Consideration

1. Interest

Meaning

- Interest is income received by the entity as its cash resources are used by other entities.

Recognition

- Interest is recognised on time proportion basis based on the outstanding amount and rate applicable; &
- There should NOT be any significant uncertainty in ultimate collection at the time of recognition. If any uncertainty exists, recognition should be postponed till the time there is NO uncertainty.

2. Royalty Income

Meaning

- Royalty income is received as the intangible assets like know-how, patents, trade-marks and copy rights of the entity are used by the other entity.

Recognition

- Royalty is recognised on accrual basis in accordance with the terms of agreement.
- There should NOT be any significant uncertainty in ultimate collection at the time of recognition.
- If any uncertainty exists, recognition should be postponed.

3. Dividend Income

Meaning

- Dividend is a reward from holding of investments in shares.

Recognition

- Dividend income is recognised only when a right to receive dividend is established irrespective of the year it is relating to.
- The investor gets the right to receive dividend only when the dividend is declared by the members in the General Meeting. Hence it should be recognised only on the date of declaration by General Meeting.
- There should NOT be any significant uncertainty in ultimate collection at the time of recognition. If any uncertainty exists, recognition should be postponed.

Effect of Uncertainties on Revenue Recognition

The uncertainties in revenue recognition will be considered depending on the time it arises.

Effect of Uncertainties on Revenue Recognition

At the time of recognition of revenue

1. Postpone the recognition to the extent of uncertainty involved;
2. Recognise only when there is NO uncertainty in ultimate collection;
3. Postponing due to uncertainties is considered as appropriate accounting;

Subsequent to revenue recognition

1. Make a provision for doubtful debts to the extent of uncertain revenue;
2. Revenue recognised should NOT be REVERSED;

Disclosure Requirements

1. Revenue reorganisation policy should be disclosed.
2. Revenue should be disclosed

Question 1 **(PM)**

The Board of Directors of X Ltd. decided on 31.3.2015 to increase sale price of certain items of goods sold retrospectively from 1st January, 2015. As a result of this decision the company has to receive Rs. 5 lakhs from its customers in respect of sales made from 1.1.2015 to 31.3.2015. But the Company's Accountant was reluctant to make-up his mind. You are asked to offer your suggestion.

Question 2 **(PM) (May 2015, 4 Marks)**

Given the following information of M/s. Paper Products Ltd.

1) Goods of Rs. 60,000 were sold on 20-3-2015 but at the request of the buyer these were delivered on 10-4-2015.
2) On 15-1-2015 goods of Rs. 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-2015.
3) Rs. 1,20,000 worth of goods were sold on approval basis on 1-12-2014. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-2015 and no approval or disapproval received for the remaining goods till 31-3-2015.
4) Apart from the above, the company has made cash sales of Rs. 7,80,000 (gross). Trade discount of 5% was allowed on the cash sales.

You are required to advise the accountant of M/s. Paper Products Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS-9 and also determine the total revenue to be recognized for the year ending 31-3-2015.

AS 10 – PROPERTY, PLANT AND EQUIPMENT (PPE)

Objectives of AS – 10 (PPE)

This standard discusses

1. Whether expenditure incurred should be capitalised as PPE or charged to P&L statement,
2. Depreciation
3. Retirement of PPE and
4. Disposal accounting.

PPE Not Applicable to

1. **Biological Assets: -** It means living animal or plant and man income producing asset of agricultural activity. **This standard applies to bearer plants but it does not apply to the produce on bearer plants**

   Bearer Plant is a plant that:

   1. is used in the production / supply of agricultural produce;
   2. is expected to bear produce for more than a period of twelve months (in a way the life of the plant is more than 12 months); and
   3. Has a remote likelihood of selling the bearer plant as an agricultural produce, except for incidental scrap sales. E.g.

Bearer Plant - Mango Tree → Agricultural Produce - Mango

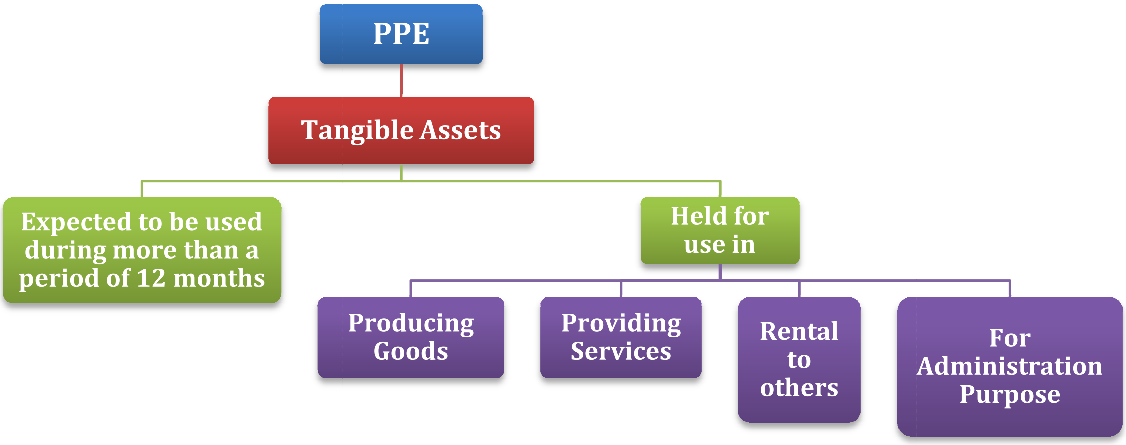
2. Wasting Assets: - It Means Mine, (All Natural Recourses)

Wasting assets including mineral rights, expenditure on exploration for and extraction of minerals, oils, natural gas and similar non-regenerative resources.

Mine

3. **Investment Property:** Investment property is not PPE and it should be accounted for only in accordance with the cost model prescribed in this standard.

PPE Means





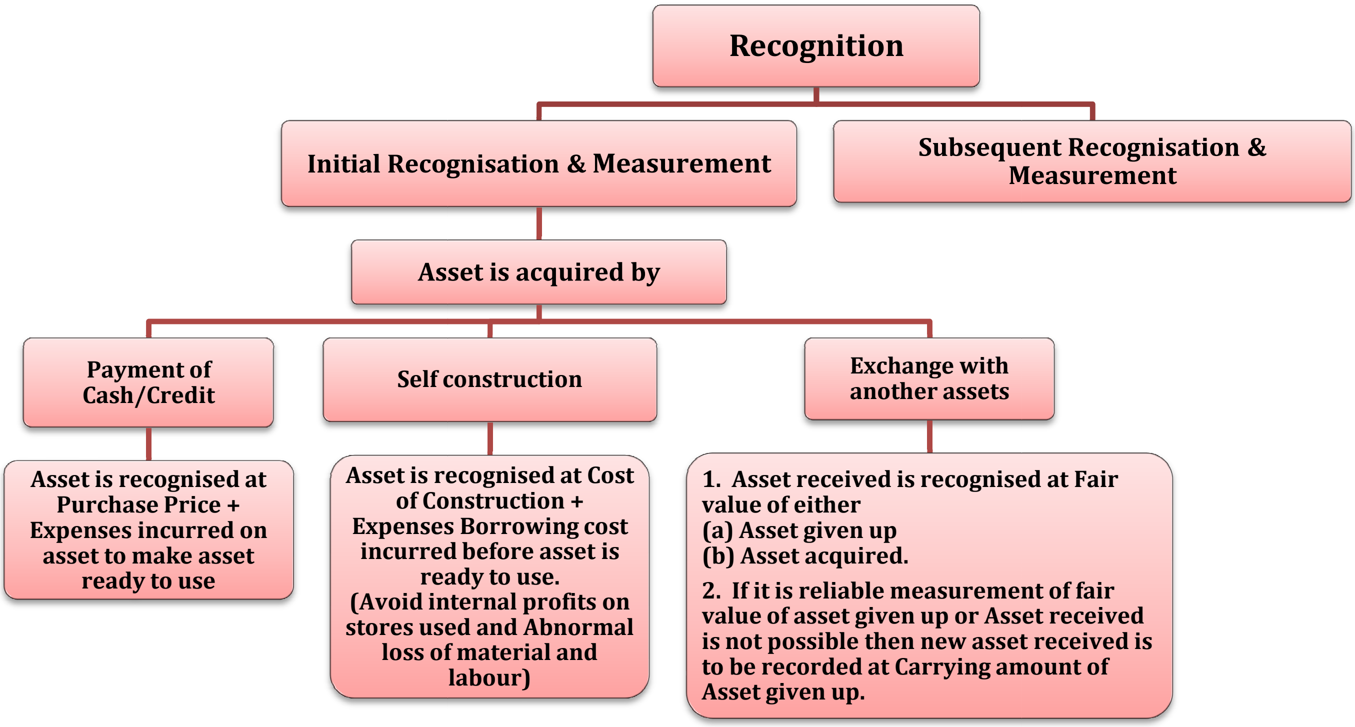

E.g.

Asset	Tangible	Held for use in abovementioned Activity	Life more than 1 year	Conclusion
Machine, computer, camera	Yes	Yes	Yes	PPE
Land, Building, Furniture	Yes	Yes	Yes	PPE
Computer Software	No	Yes	Yes	Not PPE
Stock	Yes	No	Yes /No	Not PPE

Recognition and Measurement of PPE

PPE Should recognised (recorded in the books of account) in financial statements if following conditions are satisfied.

1. Future economic benefits should flow to entity.
2. Cost can be reliably measured.



(A) ASSET IS ACQUIRED BY PAYMENT OF CASH /FOR CREDIT

Cost of Assets Includes following:-

Particulars	Rs.
Net Purchase price (Basic price after deduction of discount)	XXX
(+) Non refundable taxes & duties	XXX
(+) Delivery and handling costs	XXX
(+) Site preparation cost & Installation costs & Trial Run Cost.	XXX
(+) Professional fees (e.g. fees of architects and engineers)	XXX
(+) PRESENT VALUE of Decommissioning, restoration costs.	XXX
(+) Any directly attributable cost to bring the asset to the location & condition necessary to operate for its intended purpose	XXX
(-) Trade discounts and rebates (if included in above items)	XXX

(-) Government grants (As per AS 12)	
Cost of PPE to be capitalised	

Note:

1. General administration and other overhead expenses are usually excluded from the cost as of asset.
2. **Subsequent Addition or increase is to be recognised in same way as above.**

Cost of Decommissioning.

The elements of cost to be incorporated in the inital recognition of an asset are to include the estimated costs of its eventual dismentalment .

This is, the cost of the asset is grossed up for these estimated costs, with the offsetting credit being posted to a laibility account.

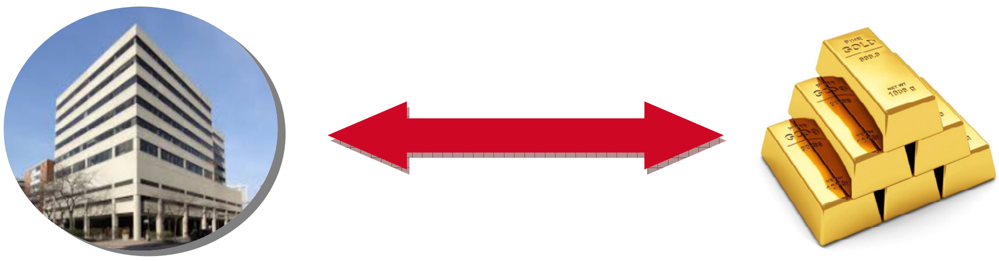
Question

On 1-04-2016, Asha Limited installed a machine in the rented premises at a cost of 15 lakh, whose life is 3 years. As per the rental agreement, the machine should be decommissioned and the building should be brought-into the original position. The company should incur Rs. 5,00,000 at the end of the 3rd year to restore the premise into the original position. Assume borrowing rate applicable to the entity is 10%. Record the Journal entries.

C. PPE IS ACQUIRED BY EXCHANGE OF ASSETS:

Rules are given in above Diagram. Please refer recognition Tree Diagram.

Example of PPE aquired by exchange of assets



Question

Obtained PPE fair value is 5,00,000 through exchange of gold. (Book value of gold is Rs. 4,00,000) journalise.

Question (PM) (Nov 2012, Nov 2013, May 2015)(Modified)

PQR Ltd. constructed a fixed asset and incurred the following expenses on its construction:

Particulars	Rs.
Materials (including excise duty of Rs. 50,000, CENV AT credit is available for 50% of the duty paid)	16,00,000
Direct Expenses	3,00,000
Total Labour charges (200 out of the total of 600 men hours worked, on installation work)	6,00,000
Spare parts and tools consumed in installation	60,000
Total salary of supervisor (time spent for installation was 25 % of the total time worked.)	24,000
Test run and experimental production expenses	23,000
Consultancy changes to architect for plant set up	9,000
Total Office & Administrative Expenses (4 % is chargeable to the construction)	9,00,000
Depreciation on other assets used for the construction of this asset	15,000

The machine was ready for use on 15-1-2015 but was used from 1-2-2015. Due to this delay further expenses of Rs. 19,000 were incurred. Calculate the value at which the plant should be capitalized.

Deferred credit period

- PPE should be recognised at **CASH PRICE equivalent on the date of recognition** (Present value).
- Deferred credit period means excess period than the normal credit period.
- The difference between the cash price and the total payment should be recognised as interest..
- **In general, the interest should be charged to P&L as an expense.**
- **But if the asset is a qualifying asset as per AS 16 where asset takes substantial period of time to get ready for intended use then interest should be capitalised with the PPE.**

Question:-

On 1-04 -2015, X Ltd purchased a Machinery for 10 lakh from Y Ltd. Normal credit period allowed by Y Ltd. is 3 months, Amount of machinery Rs. 10 lakh is payable after 2 years i.e. on 31-03-2017. . If borrowing rate applicable to the entity is 10%. Show accounting treatment according to AS 10.

Machinery spares

1. If such spares do not satisfy the PPE definition, it should be classified as inventory and charged to P&L statement when it is issued for usage;
2. If these are recognised as PPE, the total cost incurred should be depreciated in a systematic basis over the useful life;
3. When the principal PPE is either discarded or sold, the net carrying amount of spares should be written off to P&L.

Subsequent expenditure on PPE.

IMP Point: Subsequent recognised in the same way as initial recognition.

Subsequent expenditure is the expenditure, which is incurred after the initial recognition i.e. after the asset is ready to use or being used.

If the subsequent expenditure increases the future economic benefits i.e. it satisfies the recognition criteria of an asset and PPE - such expenditure should be recognised as a separate component and depreciated over its useful life.

Here Future economic benefits includes :- increase in number of goods produced, reduction in cost, improvement efficiency of PPE

Subsequent Expenditure

Does subsequent expenditure increase the future economic benefits i.e. satisfies the recognition criteria?

- **Yes** → **Capitalise along with PPE**
- **No** → **Charge to P&L Statement**

Replacement of some parts of PPE

Parts of some items of PPE may require replacement at regular intervals.

Under the recognition criteria given in the Standard, an entity should capitalise the cost of replacement as a component of PPE and depreciate such cost over its useful life.

The carrying amount of those parts that are replaced (old component) should be derecognised.

Major inspections parts of the PPE (Not for minor inspections)

A condition of continuing to operate an item of PPE (For example, an aircraft or a ship) may be performing regular major inspections for faults regardless of whether parts of the item are replaced.

When **each major** inspection is performed, its cost is **capitalised** as a part of PPE as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised.




Question

During the current year 2014-15, X Limited made the following expenditure relating to its plant building:

Particulars	Rs. in lakhs
Routine Repairs	.4
Major Overhaul expenses incurred once in 3 years	1
Partial replacement of roof tiles (useful life is 4 years)	2.5
Substantial improvements to the electrical wiring system which will increase efficiency	10

What amount should be capitalized?

Accounting treatment for Major Component of Assets

If assets consists of

a. **Two or more significant components,**
b. **With major difference in useful life of each components.**

Then such components are to be recognised separately and Depreciation is charged on component basis.

IF any component is replaced then old component is removed from books of accounts making its value Nil and cost of new components is to be capitalised.

<u>Question :-</u>

Indigo Airline purchase one aircraft for Rs. 600 Cr.

Components are - Engine Rs. 400 Cr., Aircraft Body Rs. 200Cr.

Life of Engine is 10 yrs. And of body 20 years. Show accounting treatment for recognition and Depreciation.

Subsequent measurement existing PPE

An entity as a matter of choosing as an accounting policy, it should select anyone of the TWO MODELS available after recognising the PPE and follow the same consistently. It is a matter of choice of the Management.

Accounting Models

Cost Model

If this model is chosen - PPE should be measured every year at

Cost	**xxx**
Less: Accumulated depreciation	**xx**
Less: Accumulated Impaired loss	**<u>xx</u>**
Net carrying amount	**xxx**

Revaluation Model

If this model is chosen by this model should be chosen to the PPE, where FAIR VALUE can be measured reliably.

PPE should be measured at

Fair Value of PPE	**xxx**
Less: SUBSEQUENT accumulated depreciation	**xx**
Less: SUBSEQUENT acc. impairment loss	**<u>xx</u>**
Net carrying amount	**xxx**

Revaluation of PPE

Revaluation Model of Accounting policy is an option given to the entity (NOT mandatory).

It is the management who takes decision about model to be adopted for measurement.

1. Frequency of Revaluation

Revaluation should be performed whenever there is a material difference between

(a) The carrying amount and

(b) Its fair value as on the balance sheet date.

It should be checked regularly & shall be performed by a professionally qualified valuer. If there is no material difference in carrying amount and fair value on balance sheet date, then fair value calculation is to be ignored.

2. Method of Revaluation

Usually fair value is determined from market-based evidence by appraisal method.

If market based evidence for fair value is NOT available, an entity may need to estimate fair value using:

1. An income approach e.g. based on discounted cash flow projections Or
2. A depreciated replacement cost approach i.e. If the same potential PPE is acquired/constructed what would be the cost i.e. replacement cost.

3. Revaluation model for ALL or only SELECTED PPE?

It is not compulsory to revaluate all PPE's at on time but if revaluation of any class of PPE is adopted then revaluation shall be done for ENTIRE CLASS of PPE. i.e. if the entity is willing to revalue its Machinery then it should revalue ALL machinery of the entity.

In other words Revaluation of selective assets within same class is NOT permitted.

Conclusion: Entity can follow revaluation model for selective CLASS of PPE and for remaining PPE, it can follow cost model.

4. Limit on revalued amount

The revalued amount should not be more than recoverable amount i.e. recoverable from sale or its usage over the life.

Revaluation Accounting

A. First Time Revaluation:

1. Upward revaluation is transferred to Revaluation Reserve

PPE A/C ....Dr.
To Revaluation Profit/ Reserve
(Being asset Revalued)

2. Downward revaluation is charged to P&L

P&L A/c ....Dr.
To PPE Asset A/c
(Being asset downward Revalued)

B. **Subsequent revaluation of existing PPE**

The following accounting treatment is based on the first time revaluation (upward/downward):

1. If first time is upward revaluation

a) Next time also upward revaluation - Further increase should be transferred to revaluation surplus. JE is same as upward revaluation.
b) Next time downward revaluation - Utilise the revaluation surplus to the extent available in the balance sheet and the remaining balance should be charged to P&L alc.

Revaluation surplus a/c.................... Dr
P&L a/c ....Dr (balancing fig)
To PPE a/c

If first time is downward revaluation

a) Next time also downward revaluation- Further decrease should be transferred to P&L statement. JE is same as downward revaluation.
b) Next time upward revaluation- Credit the P&L statement to the extent it was charged to P&L in earlier revaluation and remaining balance should be credited to revaluation surplus.

PPE a/c ....Dr
To P&L a/c (to the extent charged earlier)
To Revaluation surplus (balancing figure)

Retirement of PPE

PPE is retired from active use and it is held for disposal - such PPE should be stated in balance sheet at

Carrying amount (Net book value); or Net realisable value (NRV)

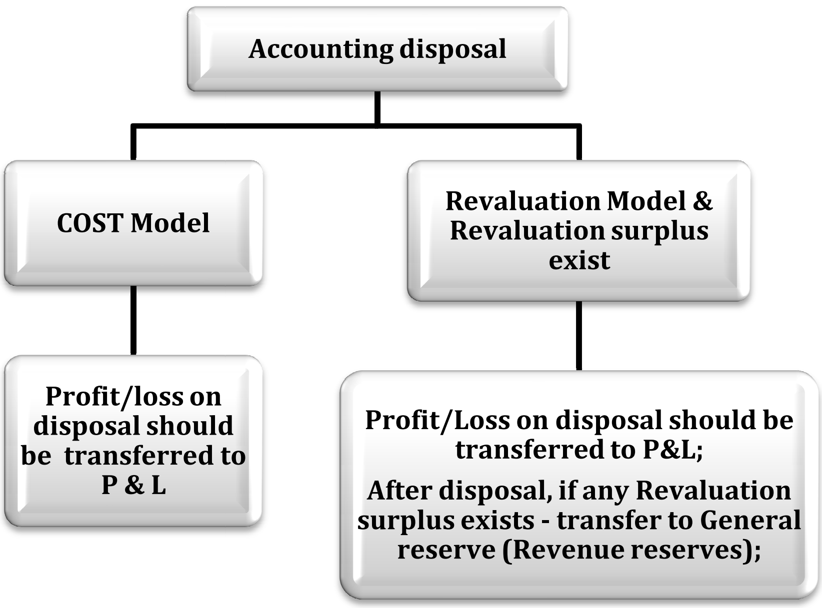
Whichever is LOWER

Disclose such items separately in the financial statements. Any expected loss should be recognised immediately in the profit and loss statement.

Derecognition (Disposal) of PPE

The following diagram helps to understand the accounting treatment of disposal of PPE.

Profit /Loss on disposal should be transferred to P&L



In case of Revaluation Model, Transfers from revaluation surplus to the general reserves should not be made through the statement of P&L. It means, the entity can record the following entry only

Revaluation surplus a/c ..... Dr

To General reserves a/c

After disposal of a PPE, it should be completely eliminated from the financial statements i.e. gross value and accumulated depreciation related to the asset:

Depreciation on PPE

Meaning

- Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Depreciable amount

Historical cost OR revalued amount	XXX
Less: Estimated residual value-	XX
Depreciable amount	XXX

Useful life of the asset

- The period over which a depreciable asset is expected to be used by the entity i.e. time/number of years; or
- The number of unit's production or similar units expected to be obtained from its use.
- Determination of the useful life is a matter of estimation and is normally based on various factors including experience with similar types of assets.
- Estimation is more difficult for an asset using new technology or used in the production of a new product or in the provision of a new service.
- Irrespective of difficulty in assessment, it should be estimated on a reasonable basis.

Depreciation of an addition/ extension to an existing asset

- If the addition/extension is an integral part of the existing asset - Depreciate the cost of integral part over the remaining life of existing asset.

Methods of Depreciation Used

- Should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the entity
- Should be reviewed at least at each financial year-end
- Should be changed to reflect the changed pattern of consumption of the future economic benefits embodied in the asset . It means the remaining carrying amount of asset should be depreciated over the remaining useful life using the NEW depreciation method.

Estimated residual value

- It is an estimated amount, which can be recovered from the asset at the end of its useful life .
- Initially, the estimation is made by the entity's management at the time of acquisition/installation;
- If estimated residual value is insignificant (immaterial) - Normally considered as NIL.

Question

A computer costing Rs. 60,000 is depreciated on straight line basis, assuming 10 years working life and 2000 residual value, for three years. The estimate of remaining useful life after third year was reassessed at 5 years. Calculate depreciation as per the provisions of Accounting Standard 10 "Depreciation Accounting".

Disclosure Requirements

1. PPE Should Disclosed
   - Gross Book Value cost
   - Accumulated Depreciation
   - Addition of PPE
   - Deletion of PPE
2. Depreciation Method
3. Useful life of asset should be disclosed.
4. If company is following revaluation model, fact should be disclosed.