Solutions to PYQs

AS 2: Valuation of Inventory

Question 2016: **State four items** which are not to be included in determining the cost of inventories in accordance with Paragraph 6 of Accounting Standard 2 (revised).

Model Answer: AS-2 issued by ICAI, deals with **valuation of inventories**. According to paragraph 6 of AS 2, the cost of inventories **includes all costs of purchase, costs of conversion, and other costs** incurred in bringing the inventories to their present location and condition.

However, **there are certain items that should not be included** in determining the cost of inventories. Such as:

a) abnormal amounts of wasted materials, labour, or other production costs;
b) storage costs, unless those costs are necessary in the production process prior to a further production stage;
c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
d) selling and distribution costs.

The rationale behind exclusion is:

- To ensure that the Costs of inventories are calculated accurately and consistently.
- These costs do not contribute to bringing inventories to their present location and condition.
- These costs are not going to generate extra economic benefits in future.

Question 2014: Write a short note on the provisions of Indian Accounting Standard regarding inventories.

Model answer:

Accounting standard -2, "Valuation of Inventories" deals with the determination of the value at which inventories are carried in the financial statements until the related revenues are recognized.

Inventories are assets held:

a) for sale in the ordinary course of business;
b) in the process of production for such sale; or
c) In the form of materials or supplies to be consumed in the production process or in the rendering of services.

Key Provisions

⇒ **Recognition:** Inventories are recognized on the basis of nature of business such as Raw materials, WIP an Finished goods in case of manufacturing firm.

⇒ **Measurement:** Inventories should be valued at the lower of cost and net realizable value.

⇒ **Presentation:**
- Under Statement of Profit and Loss as a change in inventories.
- Shown as Inventories under Current Asset of Balance Sheet.

⇒ **Disclosure:** The financial statements should disclose:
- the accounting policies adopted in measuring inventories, including the cost formula used; and
- the total carrying amount of inventories and its classification appropriate to the enterprise.

Question 2011: Give your suggestions related to accounting standards on inventories (and Depreciation).

Model Answer:

Accounting standard -2, "Valuation of Inventories" deals with the determination of the value at which inventories are carried in the financial statements until the related revenues are recognized.

Key suggestions

a) **Choose an appropriate cost flow formula:** FIFO or Weighted Average Cost.
b) **Apply right method of cost determination:** Actual Cost or Standard or retail method.
c) **Accurately determine** both cost and net realizable value of each item of inventory separately.
d) **Review inventory levels regularly**: Regular inventory review can help companies identify obsolete or slow-moving inventory and take corrective action.
e) **Keep accurate inventory records:** including the quantity and cost of inventory purchased, sold, and remaining in stock. Inventory in hand should be accurate one.
f) **Disclose** inventory policies: in the notes to the financial statements to help investors and other stakeholders understand the company's inventory management practices.

Companies should maintain consistency in inventory valuation methods from one period to another. Any changes in valuation methods should be disclosed in the financial statements.

Theory PYQs

Internal Reconstruction of Companies:

1986, 2017 : Q. 1 Distinguish between **Internal** and External Reconstruction. 10 Marks

- ⇒ Define reconstruction of companies 20
- ⇒ Define Internal and external reconstructions 40
- ⇒ Comparison table(except meaning written above) 70
- ⇒ Recent cases of internal reconstruction like Suzlon Energy 30

2006: Draft a comprehensive Capital Reduction Scheme taking into account appropriate imaginary figures. **15**

Approach to answer:

- ⇒ Take a balance sheet with heavy amount of debt, fictitious assets and Dr. Balance of P/L
- ⇒ Write Purpose of Internal reconstruction: target to eliminate fictitious assets and losses and resume operations
- ⇒ Script plan of sacrifice by outsiders, Sacrifice + some funds from shareholders
- ⇒ Putting plan into action: Liability side and Asset side
- ⇒ Preparing revised balance sheet
- ⇒ Resuming operations.

Solution to Numerical Questions on Amalgamation Accounting

Solution 1981

Statement of Affairs (in relation to Creditors)

Outside liabilities	Amount	Realizable Assets	Value
Debentures	18,50,000	Building	8,00,000
Trade Creditors	5,00,000	Plant & Machinery	6,00,000
Salary to workers	75,000	Sundry Debtors	2,80,000
		Cash	20,000
		Deficit (BF)	7,25,000
	24,25,000		24,25,000

<u>Scheme of Internal Reconstruction</u>:

(1) Debentures holders: Since they have first charge on fixed Assets, they will compromise least.

Debentures liability			= 18,50,000
Value of Charged Assets:	Building	8,00,000	
	Plant & Mach	6,00,000	14,00,000
Minimum Hair cut required			**4,50,000**

(2) Trade Creditors: 5,00,000 – Debtors Rs. 2,80,000 = 2,20,000

(3) Equity shareholders should sacrifice the Maximum possible. They have to bring Rs. 5,00,000 as Capital. Accordingly:

<u>Total write offs Needed</u>:

Building 12,50,000 – 8,00,000	= 4,50,000
Plant & M = 8,80,000 – 6,00,000	= 2,80,000
Debtors = 4,00,000 – 2,80,000	= 1,20,000
Dr. Balance of P/L	= 4,00,000
	12,50,000

<u>Sacrifice</u>

• Debenture holders	4,50,000	
• Trade Creditors	2,20,000	6,70,000
• **Shareholders to Sacrifice(BF)**		**5,80,000**

"Journal of ABC Ltd"

Bank A/c Dr	5,00,000	
To Share Capital A/c		5,00,000
(Shares issued)		
Share Capital (Old + New) A/c Dr	10,00,000	
To Share Capital (New) A/c		4,20,000
To Reconstruction A/c		5,80,000
Debentures A/c Dr (Old)	18,50,000	
To Debentures (New) A/c		14,00,000
To Reconstruction A/c		4,50,000
Trade Creditors A/c	2,20,000	
To Reconstruction A/c		2,20,000

Reconstruction A/c Dr	12,50,000	
To Building A/c		4,50,000
To Plant & Machinery A/c		2,80,000
To Debtors A/c		1,20,000
To P/L A/c		4,00,000

Balance sheet of ABC

Liabilities	Amt (Rs.)	Assets	Amt (Rs.)
Share Capital	4,20,000	Building	8,00,000
Debentures	14,00,000	Plant & Machinery	6,00,000
Trade Creditors 5,00,000 – 2,20,000	2,80,000	Sundry Debtors	2,80,000
Outstanding: Salary 75,000		Cash	5,20,000
Director Fee 25,000	1,00,000		
	22,00,000		**22,00,000**

Solution 1984

Purchase Consideration Rs.

Equity Share holders = $\frac{6,000}{6}$ x 1 = 1,000 Shares x 10 = 10,000

Preference Share holders = $\frac{5,000}{10}$ x 3 = 1,500 Shares x 10 = 15,000

Preference Dividend: $\frac{5,000}{20}$ x 1 = 250X10 (7% P. Shares) = 2,500

27,500

Realization Account

To Buildings	60,000	By 10% Debentures	12,000
To Stock	18,000	By Trade creditors	8,000
To Debtors	12,000	By X Ltd A/c (PC)	27,500
To Preference Dividend	2,500	By Preference S.H's A/c	35,000
To Cash A/c	500	By ESH's A/c (Loss)	10,500
	93,000		**93,000**

Equity shareholder's Account

To Profit & Loss A/c	15,000	By ESC A/c	60,000
To Patents	24,500		
To realization A/c (Loss)	10,500		
To Equity Shares in X	10,000		
	60,000		60,000

Cash Account

To Balance b/d	500	By Liquidation Exp	5,000
To X ltd A/c	5,000	By Realisation A/c	500
	55,000		55,000

Liquidation Expenses A/c

To Cash A/c	5,000	By X Ltd A/c	5,000

Preference share holder's A/c

To Equity shares in X	15,000	By P.S.C A/c	50,000

To 7% Preference in X To Realisation A/c (B.F)	2,500 35,000	By Preference Dividend	2,500
	52,500		52,500

Books of 'X' Limited

Business Purchase A/c Dr To Liquidator of A Ltd	27,500	 27,500
Building A/c Dr Stock A/c Dr Debtors A/c Dr Cash A/c Dr To 10% Debentures A/c To Trade Creditors To Business Purchase A/c To Capital Reserve A/c (B. F.)	60,000 18,000 12,000 500	 12,000 8,000 27,500 43,000
Liquidator of A ltd Dr To Equity share capital A/c (10,000 + 15,000) To 7% Preference share Capital	27,500	 25,000 2,500
Bank A/c Dr (5000x10) To Equity Share Capital	50,000	 50,000
Liquidation Expenses A/c Dr To Co. A A/c	5,000	 5,000
Co. A A/c Dr To Bank A/c	5,000	 5,000
Trade Creditors A/c Dr To Equity Share Capital A/c To Capital Reserve A/c	8,000	 6,400 1,600
Capital Reserve A/c Dr (43,000 + 1,600) To Liquidation Expenses A/c To Building A/c (B.F)	44,600	 5,000 39,600
10% Debentures A/c Dr. To Bank Account	12,000	 12,000

Balance Sheet of X Limited

Liabilities	**Amt (Rs.)**	**Assets**	**Amt (Rs.)**
Equity Share Capital (25,000 + 50,000 + 6,400)	 81,400	Building 60,000 – 39,600 Stock	20,400 18,000
7% Preference Shares	2,500	Debtors	12,000
~~10% Debentures~~	~~Nil~~	Cash (500 + 50,000 – 5,000-12000)	33,000
	83,900		83,900

Solution 1987 Q.1

Journal of Seven Seas Ltd

7% Debentures A/c Dr (2,000 x 10)	20,000	
To 9% Debentures (2,000 x 5)		10,000
To 10% Preference share (2,000 x 2.5)		5,000
To Equity share Capital (2,000 x 2.5)		5,000
(Re organization of 7% Debentures)		
6% Preference shares Capital A/c Dr (4,000 x 10)	40,000	
To 10% Preference share Capital A/c (4,000 x 2)		8,000
To Equity share Capital (4,000 x 1.75)		7,000
To Reconstruction A/c (B. F)		25,000
(Re organisation of Preference Share Capital)		
Equity share Capital A/c Dr (10,000 x 10)	1,00,000	
To Equity Share capital A/c (10,000 x 2.5)		25,000
To Reconstruction A/c (B.F.)		75,000
(Re organisation of Equity Share Capital)		
10% Preference Share capital (Rs. 2.5) A/c Dr	5,000	
10% Preference Share capital (Rs. 2) A/c Dr	8,000	
To Preference Share Capital (Rs. 10) A/c		13,000
(Consolidation of Preference shares)		
Equity share Capital (Rs. 2.5) 5,000 + 25,000	30,000	
Equity share Capital (Rs. 1.75)	7,000	
To Equity share Capital (Rs. 10) A/c		37,000
(Consolidation of Equity share Capital)		
Reconstruction A/c Dr (25,000 + 75,000)	1,00,000	
Reserves A/c Dr	45,350	
To P/L A/c		55,650
To Fixed Assets A/c (Note 1)		32,739
To Stock A/c (Note 1)		56,961
(use of Reconstruction fund to write off P/L and asset values)		

Note 1. Balance in Reconstruction & Reserves: 45,350 + 1,00,000 – 55,650 = 89,700

$$\text{Fixed Assets} = \frac{89{,}700}{1{,}27{,}950} \times 46{,}700 = 32{,}739 \qquad \text{Stock} = \frac{89{,}700}{1{,}27{,}950} \times 81{,}250 = 56{,}961$$

Revised Balance sheet of Seven Seas

Share Capital		Fixed Assets 46,700 - 32,739	13,961
Authorized Capital		Stock: 81,250 – 56,961	24,289
Equity : 10,000 x 10	1,00,000	Debtors	46,750
Preference: 4,000 x 10	40,000	Cash	2,450
Paid up Capital			
Equity 3700 x 10	37,000		
Preference 1300 x 10	13,000		
9% Debentures	10,000		
Creditors	27,450		
	87,450		87,450

Solution 1989 Q1

Journal of Hard Times Ltd

Particulars	Dr. Amt	Cr. Amt
Equity share Capital A/c Dr To Reconstruction A/c (ESC W. off)	20,00,000	 20,00,000
Reconstruction A/c Dr To Goodwill A/c To Trademarks & Patents A/c To Plant & Equipment A/c To Motor Vehicles A/c To Building leases A/c (B.F) (Assets brought down to realistic values) * Imaginary figures.	20,00,000	 6,00,000 3,00,000 4,00,000* 4,00,000* 3,00,000

Year 1998 Q.2

Books of S Ltd
Realization Account

To works & Properties	1,80,000	By Sundry Liabilities	40,000
To Liquid Assets	20,000	By T. Co. Ltd	1,44,000
To Bank A/c	40,000	By Shareholders A/c (Loss)	60,000
To Absorption Expenses	4,000		
	2,44,000		2,44,000

Shareholder's Account

To Profit & Loss A/c	40,000	By Share Capital A/c	2,00,000
To Realisation A/c (Loss)	60,000		
To Shares in T. Ltd	1,00,000		
	2,00,000		2,00,000

Bank Account

To T. Co. Ltd	44,000	By Realisation A/c (Payment of Liabilities)	40,000
		By Liquidation Exp (B.F.)	4,000
	44,000		44,000