Spring -2022

CAF-01

Financial Accounting and Reporting -I
(Volume-1)

Practice Manual
Examination Question / Answer

RISE PUBLICATIONS

www.riseschool.edu.pk

Scanned with CamScanner

CA CAF-01

IMRAN ASLAM

FINANCIAL ACCOUNTING AND REPORTING – I (VOL-I)

Study Text

Practice Questions and

Topic Wise

Exam Questions & Answers

Including solution of question bank of ICAP

Updated upto Spring 2021

Scanned with CamScanner

ALL RIGHTS RESERVED BY THE PUBLISHERS

21th Edition: November 2021

PUBLISHER
RISE Publications

Scanned with CamScanner

Imran

TABLE OF CONTENTS

CH.	TOPIC	NOTES	PRACTICE		ICAP PAST PAPER		ICAP QB		MCQs	
			Q	A	Q	A	Q	A	Q	A
1	IAS 16: Property, Plant and Equipment	1	27	39	72	82	104	112	133	141
2	Correction of Errors	145	157	160	164	174	192	194	197	206
3	IAS 20: Govt. Grants	210	219	221	228	230	232	233	234	236
	IAS 23: Borrowing Cost	237	250	259	271	275	281	283	285	288
	IAS 40: Investment Property	290	296	298	301	302	-	-	303	306
4	IAS 36: Impairment of Assets	307	313	316	324	326	329	331	335	343
5	Statement of Changes in Equity	346	253	354	355	357	359	363	366	371

Scanned with CamScanner

IAS 16: Property, Plant & Equipment

1

LO 1	DIFFERENCE BETWEEN CAPITAL AND REVENUE EXPENDITURE
LO 2	DETERMINING COST OF ASSET
LO 3	DEPRECIATION AND ITS METHODS
LO 4	RECORDING DEPRECIATION IN BOOKS OF ACCOUNTS
LO 5	CHANGE IN ACCOUNTING ESTIMATE DURING THE PERIOD OF USE
LO 6	DISPOSAL BY SALE/ DISPOSAL BECAUSE OF DESTROY
LO 7	DISPOSAL THROUGH EXCHANGE
LO 8	PREPARING FIXED ASSET ACCOUNT AT BOOK VALUE
LO 9	FIXED ASSET SCHEDULE/ DISCLOSURE NOTE
LO 10	REVALUATION OF PROPERTY PLANT AND EQUIPMENT
LO 11	DISCLOSURES / NOTE
LO 12	ALTERNATE NAMES FOR DIFFERENT TERMINOLOGIES

Scanned with CamScanner

LO1: DIFFERENCE BETWEEN CAPITAL AND REVENUE EXPENDITURE

Capital expenditure

It is cost of buying fixed assets. It includes all expense incurred in bringing it in workable condition and location.

Revenue expenditure

Expenditure which is incurred in running the business on a day-to-day basis and its benefit is not spread over more than one year.

The difference between revenue expenditure and capital expenditure can be seen clearly with the total cost of using a van for a business. To buy a van is capital expenditure. The van will be in use for several years and is, therefore, a fixed asset. Paying for petrol to use in the van is revenue expenditure. To get the van repaired is revenue expenditure.

Example

Expenditure		Type of Expenditure
1.	Buying van	Capital
2.	Petrol costs for van	Revenue
3.	Repairs of van	Revenue
4.	Buying machinery	Capital
5.	Electricity bill paid of using machinery	Revenue
6.	Painting outside of new building	Capital

You already know that revenue expenditure is chargeable to the Profit and Loss Account by increasing expense, while capital expenditure will result in increased figures for fixed assets in the Balance Sheet. It is, therefore, important that this classification is correctly done.

Question-1

Some of the following items should be treated as capital and some as revenue. For each of them state which classification applies:

(a) The purchase of machinery for use in the business.
(b) Carriage paid to bring the machinery in (i) above to the work.
(c) Complete redecoration of the premises at a cost of Rs. 1,500.
(d) A quarterly payment for heating.
(e) The purchase of a soft drinks vending machine for the canteen.

Question-2

Indicate which of the following would be revenue items and which would be capital items in a wholesale bakery:

(a) Purchase of a new van.
(b) Cost of painting business's name on new van.
(c) Repair and maintenance of existing van.

Question-3

State the type of expenditure, capital or revenue, incurred in the following transactions

(a) Van purchased.
(b) Repairs to a fruiterer's van.
(c) The cost of installing a new machine.
(d) Cost of hiring refrigeration plant in a butcher's shop.
(e) Twelve dozen sets of cutlery, purchased by a catering firm for a new dining-room.
(f) A motor vehicle bought for re-sale by a motor dealer.

Question-4

State which of the following you would classify as capital expenditure.

(a) Cost of building extension to factory.
(b) Purchase of extra filing cabinets for sales office.
(c) Cost of repairs to accounting machine.
(d) Legal fees paid in connection with factory extension.

Scanned with CamScanner

Question-5

For the business of J Charles, wholesale chemist, classify the following between 'capital' and 'revenue' expenditure:

(a) Purchase of an extra van.
(b) Carriage costs on bricks for new warehouse extension.
(c) Carriage costs on purchases.
(d) Carriage costs on sales.
(e) Legal costs of collecting debts.
(f) Legal charges on acquiring new premises for office.
(g) Fire insurance premium.
(h) Costs of erecting new machine.
(i) Clearing agent charges
(j) Insurance in transit

Question-6

Classify the following items as either revenue or capital expenditure:

(a) An extension to an office building costing Rs. 24,000.
(b) Repairs to the warehouse roof.
(c) Annual service costs for a courier firm's fleet of vans.
(d) A new bicycle purchased by a news agent for use by the newspaper delivery boy.
(e) Wages paid to employees who worked on the construction of their company's new office building.

Answer-1	Capital (a), (b), (e)	Revenue (c), (d)
Answer-2	Capital (a), (b)	Revenue (c)
Answer-3	Capital (a), (c), (e)	Revenue (b), (d), (f)
Answer-4	Capital (a), (b), (d)	Revenue (c)
Answer-5	Capital (a), (b), (f), (h), (i), (j)	Revenue (c), (d), (e), (g)
Answer-6	Capital (a), (d), (e)	Revenue (b), (c),

LO2: DETERMINING COST OF ASSET

Fair value is the amount for which an asset could be exchanged between:

- *knowledgeable*
- *willing parties*
- *in an arm's length transaction.*

Property, plant and equipment are tangible items that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one period.

Recognition

The cost of an item of property, plant and equipment shall be recognized as an asset if and only if:

(a) It is probable that future economic benefits associated with the item will flow to the entity; and

(b) The cost of the item can be measured reliably.

INITIAL MEASUREMENT OR MEASUREMENT AT RECOGNITION

An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost.

Cost

Cost is the amount of:

- *cash or cash equivalents paid or*

Scanned with CamScanner

- *the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.*

Elements of Cost:

The cost of an item of property, plant and equipment comprises:

(a) *Its purchase price, including import duties and non-refundable purchase taxes after deducting trade discounts and rebates or subsidy.*

(b) *Any costs necessary to bring the asset into current location and condition which is intended by management.*

(c) *The initial estimate of the costs of dismantling and removing the item and restoring the site.*

Examples of directly attributable costs are:

(a) *Costs of employee benefits arising directly from the construction or acquisition of an item of property, plant and equipment.*

(b) *Costs of site preparation*

(c) *Initial delivery and handling charges.*

(d) *Installation and assembly cost.*

(e) *Cost of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced (such as samples produced when testing equipment); and*

(f) *Professional fees.*

Examples of costs that are not costs of an item of property, plant and equipment are:

(a) *Costs of opening a new facility.*

(b) *Cost of introducing a new product or service (including costs of advertising and promotional activities);*

(c) *Costs of conducting business in a new location or with a new class of customer (including costs of staff training); and*

(d) *Administration and other general overhead costs. e.g., staff training cost*

*Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is **ready for use (i.e. it is capable of operating in manner intended by management)**. Following costs are not included in the carrying amount e.g.,*

(a) *Costs paid while an item is yet to be brought into use or is operated at less than full capacity.*

(b) *Initial operating losses while demand for the product's output builds-up; and*

(c) *Costs of relocating/re-organizing part or all of entity's operations.*

Example

A new machine is purchased by Arman Enterprise. Relevant details are as follows:

List price	800,000
Trade discount	10%
Import duties	2,000
Cost of site preparation	1,000
Architect fee	1,000
Non-refundable taxes	6,300
Income tax adjustable (refundable)	5,000
Insurance in-transit	7,000
Fees paid to clearing agent	9,000
Octroi charges	4,600
Land preparation cost	8,300
Installation cost	7,800
Estimate of initial cost of dismantling which company is liable to pay	5,000

Scanned with CamScanner

Cost of furniture broke down during handling the machine	7,000
Insurance for the year	9,000
License fee for the year	11,000
Initial operating losses	12,000
Trial production cost net of sale proceeds of prototype/sample (4,000 – 2,100)	1,900
Admin costs	10,000

Calculate the cost at which machine should be debited?

Answer

Cost of machine is calculated as below:

	Rs.
List price	800,000
Less: Trade discount	(80,000)
Import duties	2,000
Cost of site preparation	1,000
Architect fee	1,000
Non-refundable taxes	6,300
Insurance in-transit	7,000
Fees paid to clearing agent	9,000
Octroi charges	4,600
Land preparation cost	8,300
Installation cost	7,800
Estimate of initial cost of dismantling	5,000
Trial production cost net of sale proceeds of prototype/sample (4,000 – 2,100)	1,900
Total	**773,900**

Cost of self constructed asset

The cost of a self-constructed asset is determined by adding up raw material, labour and overhead costs incurred on that asset.

Example (Self-constructed Asset)

Roads International Limited constructed its own specially designed 'road bulldozer'. Details of related costs incurred are as follows:

Description of cost:	Rs.
Cost of raw materials purchased	500,000
Cost of raw materials used in construction of road bulldozer	100,000
Over head costs incurred on building road bulldozer	40,000
Tests to ensure road bulldozer safe before brought into use	20,000
Factory labour costs	300,000

Additional Information:

- 80% of the total labour costs for the year were incurred on building roads and 20% thereof were incurred in construction of the road bulldozer.
- The road bulldozer was first brought into use on a contract that started on 1 November 20X2, although it was available for use from 1 October 20X2.
- The company uses the straight-line method to depreciate its road bulldozer. This vehicle is expected to be sold for Rs. 7,000 at the end of its expected useful life of 5 years.

Required:

Journalise transactions related to tarring vehicle for the year ended 31 December 20X2.

Scanned with CamScanner

Answer
(a)

Roads International Limited
Accounting entries
For the year ended 31 December, 20X2

Particulars	Dr.	Cr.
Raw materials Bank (Payment of raw material purchased)	500,000	500,000
Road bulldozer Raw materials (Raw material used in construction of Road bulldozer)	100,000	100,000
Road bulldozer Bank/payable (Overhead costs incurred on building road bulldozer)	40,000	40,000
Road bulldozer Bank (Safety test performed cost)	20,000	20,000
Labour cost Bank/payable (Labour cost paid over the year)	300,000	300,000
Road bulldozer (300,000 x 20%) Labour cost (Labour cost incurred on construction of Road bulldozer)	60,000	60,000
Depreciation expense Accumulated dep. - Road bulldozer (220,000- 7,000)/5 × 3/12) (Recording of depreciation on Road bulldozer)	10,650	10,650

Note: The Road bulldozer was available for use from 1 October 20X2, therefore depreciation shall commence from that period.

Workings

Cost of bulldozer 100,000 + 40,000 + 20,000 + 60,000 **220,000**

SUBSEQUENT EXPENDITURE

Subsequent expenditure on non-current assets, after their initial acquisition, should be capitalized if it meets the criteria for recognition of an asset.

Any subsequent expenditure is capitalized if it

- improves the asset (for example, by enhancing useful life, output or performance)
- is for a replacement part (provided that old part is disposed off)

Repairs and maintenance expenditure is revenue expenditure. It is recognized as an expense as it is incurred.

LO 3: DEPRECIATION AND ITS METHODS

Depreciation of tangible fixed assets

Tangible fixed assets such as machinery, motor vehicles, fixtures and even buildings do not last forever. If the value at which asset is expected to be sold at the end of its useful life is less than the cost of the asset, the asset is said to have 'depreciated in value'. For example, if a van was bought for Rs. 10,000 and sold five years later for Rs. 2,000 then its value has depreciated over the period of its use by Rs. 8,000.

Scanned with CamScanner

Depreciation is an expense
Depreciation is that part of the original cost of a fixed asset that is consumed during its period of use by the business. It needs to be charged to profit and loss every year.
For example, if a PC cost Rs. 1,200 and was expected to be used for 3 years, it might be estimated at the end of the first year that one-third of its overall usefulness had been consumed. Depreciation would then be charged at an amount equal to one-third of the cost of the PC, i.e. Rs. 400. Profit would be reduced by Rs. 400 and the value of the PC in the balance sheet would be reduced from Rs. 1,200 to Rs. 800.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.
Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.
Residual value of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal.
Note: If residual value is equal to or greater than cost than no depreciation is charged.
Carrying amount is the amount at which an asset is recognized after deducting any accumulated depreciation and accumulated impairment losses. (Commonly known as book value).
Useful life is the period over which:

(a) an asset is expected to be available for use by an entity; or
(b) the number of production or similar units expected to be obtained from the asset by an entity.

DEPRECIATION

(a) Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost shall be depreciated separately.
(b) The Depreciation charge for each period shall be recognized in profit or loss unless it is included in the carrying amount of another asset.(e.g. the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories)
(c) The depreciable amount of an asset shall be allocated on a systematic basis over its useful life.
(d) The residual value and the useful life of an asset shall be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) shall be accounted for as a change in an accounting estimate.
(e) Commencement and cessation of deprecation
Depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.
Depreciation of an asset ceases the date when the asset is disposed off. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usages methods of depreciation the depreciation charge can be zero while there is no production.
(f) The following factors are considered in determining the useful life of an asset
(a) Expected usage of the asset. Usage is assessed by reference to asset's expected capacity or physical output
(b) Expected physical wear and tear,
(c) Technical or commercial obsolescence
(d) Legal or similar limits on the use of the asset,
(g) Land and Buildings are separable assets and are accounted for separately, even when they are acquired together.
Land is not normally depreciated because it has indefinite life.
(h) The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

Scanned with CamScanner

The depreciation method applied to an asset shall be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern. Such a change shall be accounted for as a change in an accounting estimate

Depreciation methods

Following are the depreciation methods to be used during the period an asset is used by an entity:

(a) Straight line method

It requires allocation of an equal amount to each period. Since this method assumes that the cost of the asset expires at a steady (straight line) function of time, the cost less residual value is divided by the estimated useful life. The rate of depreciation is the reciprocal of the estimated useful life. If the useful life of an asset is 10 years, the depreciation rate will be 1/10 or 10%.

$$\text{Depreciation} = \frac{\text{Cost} - \text{Residual value}}{\text{useful life}} \text{ or (Cost - Residual value) x Rate of depreciation}$$

(Whenever depreciation is charged "on cost" each year, it means the entity is following straight line method assuming that residual value is nil).

This method is appropriate for those assets which give same benefit in each year e.g. building, furniture etc. ***[Refer Q.1-5 of practice set]***

(b) Diminishing balance method

Under this method, instead of a fixed amount, a fixed rate on the reduced balance of the asset is charged as depreciation every year. Since a constant percentage rate is being applied to the written down value, the amount of depreciation charged every year decreases over the life of the asset.

This method is appropriate for those assets which give benefit on a reducing pattern each year e.g. machines. ***[Refer Q. 19-24 of practice set]***

Points of differences among straight line method and WDV method

Description	Straight line method	WDV method
Calculation of depreciation for 1st Year	$\frac{\text{Cost} - \text{Residual value}}{\text{useful life}}$ OR (Cost – Residual value)× (Dep Rate)	Cost × Rate of depreciation
Calculation of depreciation for Subsequent Years	$\frac{\text{Cost} - \text{Residual value}}{\text{useful life}}$ OR (Cost – Residual value)× (Dep Rate)	WDV × Rate of depreciation
Conversion of life to rate	Rate in % = $\frac{1 \quad 1 \quad 0}{\text{useful life}}$	N/A
Calculation of depreciation for each year	- On Cost of opening assets less cost of disposals and fully depreciated assets - On cost of additions - On cost of disposals - On cost of fully depreciated	- On WDV of opening assets at the start of year less WDV of disposals at the start of year - On cost of additions - On WDV of disposals at the start of year
	(In case assets have residual value it will be deducted from the cost to calculate depreciation)	
If no rate is given in WDV method	Depreciation rate % = $1 - \sqrt[n]{\frac{S}{C}}$ S = scrap value C = Cost	

Scanned with CamScanner

If scrap value is not given rather WDV or accumulated depreciation is given	$r = 1 - \sqrt[\text{cumulative period}]{\frac{WDV}{Cost}}$ $r = 1 - \sqrt[\text{cumulative period}]{\frac{Cost - Acc.\ Dep.}{Cost}}$	
Calculation of accumulated depreciation at the time of disposal	It can be calculated through a shortcut working: Accumulated depreciation at the time of disposal = (Cost – RV) × Rate × No. of years used Number of years used will be counted from date of purchase till date of disposal. [Refer Q. 34-35 of practice]	It will be calculated through manual working from the date of purchase till the date of disposal. [Refer Q. 45-47 of practice]
Concept of fully depreciated assets *	Applicable	Not applicable

***Example of fully depreciated**

Mr. Asif purchased an asset on 01.01.08 for Rs. 900. Its life is 3 years and it sold on 30.06.12 for Rs. 30.

Method is straight line.

Required:

Prepare relevant accounts from the date of purchase till the date of disposal.

Answer

Asset a/c

Dr.					Cr.
01.01.08	Cash	900	31.12.08	c/d	900
01.01.09	b/d	900	31.12.09	c/d	900
01.01.10	b/d	900	31.12.10	c/d	900
01.01.11	b/d	900	31.12.11	c/d	900
01.01.12	b/d	900	30.06.12	Disposal	900

Accumulated Depreciation

Dr.					Cr.
31.12.09	c/d	300	31.12.08	Dep. (900/3)	300
			01.01.09	b/d	300
31.12.09	c/d	600	31.12.09	Dep. (900/3)	300
			01.01.10	b/d	600
31.12.10	c/d	900	31.12.10	Dep. (900/3)	300
			01.01.11	b/d	900
31.12.11	c/d	900	01.01.12	b/d	900
30.06.12	Disposal	900			

Disposal A/c

Dr.				Cr.
Asset		900	Accumulated Depreciation	900
P/L (Bal.)		30	Cash	30

Scanned with CamScanner

(c) Output method

This is a method of providing depreciation on annual machine's output in use compared with total anticipated machine's output over the life of the machine. [Refer Q. 30 of practice set]

$$\text{Depreciation} = \frac{\text{Cost - Residual value}}{\text{Total output expected over useful life}} \times \text{Units produced during the year}$$

Example

Mr. Asif has acquired a machine on 1.Mar.2011. Its total capacity is to produce 50 units over 4 years. Year end is December 31.

Expected units to be produced are:

Year end	Units
December 31, 2011	12
December 31, 2012	24
December 31, 2013	4
December 31, 2014	10

Cost of machine is Rs.70,000 with a residual value of Rs. 5,000.

Required:

Calculate depreciation for first 4 years using output method.

Answer

Depreciation

- 2011 $\left(\frac{70,000-5,000}{50}\right) \times 12$ = 15,600
- 2012 $\left(\frac{70,000-5,000}{50}\right) \times 24$ = 31,200
- 2013 $\left(\frac{70,000-5,000}{50}\right) \times 4$ = 5,200
- 2014 $\left(\frac{70,000-5,000}{50}\right) \times 10$ = 13,000

(d) Sum of year digit method

This method assumes that the depreciation charge should be more in the early years of the life of the asset. Under this method, the depreciation expense is calculated by multiplying the depreciable amount by a fraction based on the sum of the number of periods of the useful economic life. [Refer Q. 31 of practice set]

$$\text{Depreciation} = \frac{\text{Cost} - \text{Residual value}}{\text{sum of all year's digits}} \times \text{respective digit} \quad \textbf{sum of all digits} = \left(\frac{n(n+1)}{2}\right)$$

Example

Mr. Akif purchased a machine for Rs. 100,000 on 1.1.2004. Its residual value is Rs. 5,000. Its useful life is 4 years.

Calculate depreciation expense for first 4 years using sum of year digit method. Year end is December 31.

Answer

Depreciation

- 2004 $\left(\frac{100,000-5,000}{10}\right) \times 4$ = 38,000
- 2005 $\left(\frac{100,000-5,000}{10}\right) \times 3$ = 28,500
- 2006 $\left(\frac{100,000-5,000}{10}\right) \times 2$ = 19,000
- 2007 $\left(\frac{100,000-5,000}{10}\right) \times 1$ = 9,500

Scanned with CamScanner

Note:

(i) Diminishing balance method and year digit method are often termed as "accelerated depreciation methods" because both of the methods give more depreciation in the earlier years than the later one.

(ii) At the end of life of asset the written down value of asset will be equal to its residual value.

(iii) No depreciation will be charged on assets after they have completed their life whether in terms of years, units, hours etc.

(iv) In the year of acquisition and disposal depreciation will be charged only for the months asset is used.

Important issue regarding calculation of depreciation

It is not fair to assume that a fixed asset is always purchased on the very first day of a month. Assets are generally purchased in the course of the accounting period whenever required. When an asset is purchased in mid of a month, it is not necessary to compute the amount of depreciation to be charged to the nearest day or week. As we know, the charge for depreciation is a mere estimate, therefore, depreciation is calculated in whole months.

In this case you can give a note that:

"Full month's depreciation is charged in the month of purchase while no depreciation is charged in the month of disposal."

Example

Assume year end is December 31st and following are the dates of additions and disposals.

Additions	Date of purchase	Number of months for which depreciation should be charged
Car-7	March 13, 2013	10
Car-8	July 3, 2013	6
Car-9	December 27, 2013	1

Disposals	Date of Disposal	Number of months for which depreciation should be charged
Car-2	April 9, 2013	3
Car-4	September 3, 2013	8
Car-1	October 26, 2013	9

COMPONENTS OF COST

Each part of an asset that has a cost that is significant in relation to the total cost must be depreciated separately. This means that the cost of an asset might be split into several different assets and each depreciated separately.

Example-1

A company has purchased a new aero plane for Rs.10 million.

The company has identified the following cost components and useful lives in respect of this jet.

	Rs. million	Useful life
Engines	3,000	5 years
Seats	1,000	3 years
Fittings	2,000	15 years
Other parts	4,000	20 years
	10,000	

Scanned with CamScanner

Example-2 (Components of cost)

Ancient Waters Limited is a company involved in bottling spring water. The company purchased a bottling plant on 2 January 20X2. The plant is made up of three significant components, the cost of which is as follows:

Description of component	Cost price Rs.	Residual value Rs.	Expected useful life
Engine	1,500,000	500,000	5 years
Conveyor belt and fittings	2,000,000	0	8 years
Other structure	800,000	50,000	3 years

"Other costs" incurred in relation to the bottling plant are as follows:

Description of cost	Rs.	Transaction date
Delivery and installation	783,000	5 January 20X2
Staff training	60,000	16 January 20X2

Other information:

- The plant was available for use in production on 1 February 20X2, although production only began on 1 March 20X2.
- The plant was temporarily idle during October 20X2 when the factory closed down for its annual holiday period.
- The company uses the straight-line method when depreciating its bottling plant.
- All 'other costs' are considered to be incurred evenly between the three significant components of the bottling plant (i.e. where appropriate, a third of the cost is allocated to each component).

Required:

Show all related journal entries relating to the bottling plant for the year ended 31 December 20X2 and 31 December 20X3.

Answer-2

Journal entries

Date	Particulars	Dr.	Cr.
		Rs in '000'	
2/1/20X2	Engine	1,500	
	Conveyor belt and fittings	2,000	
	Outer structure	800	
	Bank		4,300
	(Purchase of bottling plant)		
5/1/20X2	Engine (783 × 1/3)	261	
	Conveyor belt and fittings (783 × 1/3)	261	
	Outer structure (783 × 1/3)	261	
	Bank		783
	(Delivery and installation charges)		
16/1/20X2	Staff training expense	60	
	Bank		60
	(Recording of staff training cost in P/L)		
31/12/20X2	Depreciation expense (W-2)	799.2	
	Accumulated depreciation – Engines		231.2
	Accumulated dep.- Conveyor belt and fittings		259.1
	Accumulated depreciation Outer structure		308.9
	(Recording of depreciation)		

Scanned with CamScanner

31/12/20X3	Depreciation expense (W-3)	871.8	
	Accumulated depreciation – Engines		252.2
	Accumulated dep.- Conveyor belt and fittings		282.6
	Accumulated depreciation - Outer structure		337.0
	(Recording of depreciation)		

(W-1) **Calculation of cost and depreciable amount**

	Engines	Conveyor Belt and Fittings	Outer Structure	Total
Cost price	1,500	2,000	800	4,300
Delivery and installation charges	261	261	261	783
	1,761	2,261	1,061	5,083
Less: Residual value	(500)	-	(50)	(550)
Depreciable Amount	1,261	2,261	1,011	4,533

(W-2) **Depreciation for the year ended 31 December, 20X2:**

Engines	((W-1) 1,261/5 × 11/12)	231.2
Conveyor belt and fittings	((W-1) 2,261/8 × 11/12)	259.1
Outer structure	((W-1) 1,011/3 × 11/12)	308.9
		799.2

(W-3) **Depreciation for the year ended 31 December, 20X3:**

Engines	((W-1) 1,261/5)	252.2
Conveyor belt and fittings	((W-1) 2,261/8)	282.6
Outer structure	((W-1) 1,011/3)	337
		871.8

LO4: RECORDING DEPRECIATION IN BOOKS OF ACCOUNTS

The depreciation for the period is debited to Depreciation expense Account and credited to 'Accumulated Depreciation Account'. Instead of crediting asset account another account styled Accumulated Depreciation Account is credited so that at any time during the life of an asset we can easily determine what is the total deprecation of asset on a specific reporting date. In the Balance Sheet, asset appears at its original cost and the accumulated depreciation is shown as a deduction from the Asset Account.

1. Recording depreciation expense	Entry	Dr.	Cr.
	Depreciation expense a/c	xxx	
	Accumulated Depreciation a/c		xxx

[Refer Q. 6-9 and 25-27 of practice set for presentation in ledger account]

LO5: CHANGE IN ACCOUNTING ESTIMATE DURING THE PERIOD OF USE

At the end of an accounting year an entity may estimate a change in following as compared to what was expected at the time of purchase and may need to revise the following:

- Useful life
- Depreciation method
- Residual Value
- Depreciation rate

Scanned with CamScanner

Scenarios		Formula to be used in the year of change
i)	If new method is straight line	$\frac{\text{WDV at time at the time the estimate is revised - New Residual value}}{\text{Remaining Useful Life}}$
ii)	If new method is WDV	WDV at the time the estimate is revised x New rate

Question-1

ABC Ltd. purchased an asset costing Rs.20,000 on 1.1.2007. Its useful life is 10 years and its residual value is Rs.5,000. On 1.1.2009 it is decided that remaining life is 4 years with a new residual value of Rs.6,000.

Calculate depreciation for 2007, 2008, 2009 and 2010.

Year end is December 31.

Answer-1

Depreciation – 2007 $= \frac{\text{Cost} - \text{RV}}{\text{Life}} = \frac{20{,}000 - 5{,}000}{10} = 1{,}500$

Depreciation – 2008 $= \frac{20{,}000 - 5{,}000}{10} = 1{,}500$

WDV at the time of change in estimate = 20,000 – 1,500 – 1,500 = 17,000

Depreciation – 2009 $= \frac{\text{WDV} - \text{new residual value}}{\text{Remaining life}} = \frac{17{,}000 - 6{,}000}{4} = 2{,}750$

Depreciation – 2010 $= \frac{17{,}000 - 6{,}000}{4} = 2{,}750$

Question-2

A company uses straight line method with a rate of 12.5% on an asset costing Rs. 50,000 which is purchased on 1.1.2005. Its residual value is Rs. 10,000. On 1.1.2007, the company decided to change the method to WDV using rate of 15%.

Required:

Calculate depreciation expense for 2005, 2006, 2007and 2008. Year end is December 31.

Answer-2

Depreciation – 2005 = (50,000 – 10,000) × 12.5% = 5,000

Depreciation – 2006 = (50,000 – 10,000) × 12.5% = 5,000

WDV of asset at the time the method is changed.

WDV = 50,000 – 5,000 – 5,000 = 40,000

WDV(1.1.2007)		40,000
Less: Depreciation (2007)	(40,000 × 15%)	(6,000)
WDV (1.1.2008)		34,000
Less: Depreciation (2008)	(34,000 × 15%)	(5,100)
		28,900

Question-3

An entity owns an asset costing Rs. 50,000 which is purchased on 1.1.2010. Rate of depreciation is 28% under written down value method. On 1.1.2012 entity decided new rate of 40% without changing method of depreciation.

Calculate depreciation for 2010, 2011, 2012 and 2013. Year end is December 31.

Scanned with CamScanner

Answer-3

Cost	(1.1.2010)		50,000
Depreciation	(2010)	(50,000 × 28%)	(14,000)
WDV	(1.1.2011)		36,000
Depreciation	(2011)	(36,000 × 28%)	(10,080)
WDV	(1.1.2012)		25,920
Depreciation	(2012)	(25,920 × 40%)	(10,368)
WDV	(1.1.2013)		15,552
Depreciation	(2013)	(15,552 × 40%)	(6,221)
WDV	(31.12.2013)		9,331

LO6: DISPOSAL BY SALE/ DISPOSAL BECAUSE OF DESTROY

DERECOGNITION

The item of property, plant and equipment shall be derecognized

(a) On disposal; or

(b) When no future economic benefits are expected from its use or disposal.

The gain/(loss) arising from the derecognition of an item of property, plant and equipment shall be included in profit or loss when the item is derecognized. Gains shall not be classified as revenue.

The gain or loss arising from the derecognition of an item of property, plant and equipment shall be determined as the difference between the disposal proceeds and the carrying amount of the item.

Disposal by sale/destroy

If a fixed asset is sold or it is destroyed because of accident, fire or flood, we have to remove it from our ledger accounts. This means that the cost of that asset needs to be taken out of the asset account. In addition, the accumulated depreciation on the asset which has been sold will have to be taken out of the accumulated depreciation a/c. Finally, the profit and loss on sale, if any, will have to be calculated and posted to the profit and loss account.

	Entry	Dr.	Cr.
2. Entry for disposal of asset	Accumulated Depreciation a/c	xxx	
	Cash/Insurance claim receivable	xxx	
	P/L a/c (balancing)	xxx	
	Asset a/c – at cost		xxx
	(In case there is loss on disposal)		

Disposal a/c appears as follows:

Disposal account

Dr.			Cr.
Asset a/c (cost)	xxx	Accumulated depreciation	xxx
		Cash/Insurance claim receivable	xxx
		P&L (Bal. fig.)	xxx

Note: Insurance claim receivable will appear when an asset is destroyed and insurance company has acknowledged the claim and money is still receivable.

Note: Insurance claim receivable will not be considered as "other income" rather a reduction in loss on disposal.

Example-1

Mr. Zia has informed you that an asset costing Rs. 600,000 on 1.03.2004 is destroyed by fire on 30.09.2007. The insurance company acknowledged the claim at Rs. 35,000. Rate of depreciation is 20% straight line. Year end is December 31.

Required:

Pass the journal entry for disposal and prepare disposal a/c.

Scanned with CamScanner

Solution
Journal entry

	Dr.	Cr.
Insurance claim receivable	35,000	
Accumulated Depreciation (W-1)	429,996	
P/L (Bal.)	135,004	
Asset a/c		600,000

(W-1) Accumulated Depreciation

Years used		3 years and 7 months
Accumulated Depreciation	(600,000 × 20% × 3.5833)	429,996

Disposal – A/c

Dr.			Cr.
Asset – cost	600,000	Accumulated Depreciation	429,996
		Insurance claim receivable	35,000
		P/L (Bal.)	135,004

Example-2
Mr. Latif has an asset costing Rs. 400,000 which was purchased on 1.04.2005. It was destroyed by fire on 30.06.2008 and he received Rs. 45,000 from insurance company in this respect. Year end is December 31.
Required:
Assuming depreciation rate to be 15% on straight line basis, prepare disposal entry. Also prepare disposal a/c?

Solution
Journal entry

	Dr.	Cr.
Cash A/c	45,000	
Accumulated Depreciation (W-1)	195,000	
P/L (Bal.)	160,000	
Asset a/c (Disposal of asset by fire)		400,000

(W-1) Accumulated Depreciation

Years used		3 years and 3 months
Accumulated Depreciation	(400,000 × 15% × 3.25)	195,000

Disposal – A/c

Dr.			Cr.
Asset	400,000	Accumulated Depreciation	195,000
		Cash	45,000
		P/L (Bal.)	160,000

Calculation of cost of disposals if book value of disposals is given [Reserve Back Working]
Sometimes in exam you might be given with the book value of assets sold and you may be required to calculate the cost of disposals to be credited in asset account.
Example-1
On September 30, 2006 various items of plant and machinery having a book value of Rs. 300,000 were sold for Rs. 70,000. These were purchased on 1.4.2004. Rate of depreciation is 10% on declining balance method. Year end is December 31. Calculate cost of disposals?

Scanned with CamScanner

Answer

Cost of items	Rs.
Let the cost on 1.4.2004 be	100
Depreciation-2004 (100x10% × 9/12)	(7.50)
Book value 1.1.2005	92.50
Depreciation-2005 (92.5 × 10%)	(9.25)
Book value on 1.1.2006	83.25
Depreciation-2006 (83.25 × 10% × 9/12)	(6.2438)
Book value on disposal	77.0062

If book value is 77.0062 then it can be grossed up as follows to arrive at cost.

Cost (300,000 / 77.0062 × 100) 389,579

	%	Amount
Cost	100	389,579
Accumulated depreciation	(22.9938)	(89,579)
Book value	77.0062	300,000

Example-2

On September 30, 2006 various items of plant and machinery having a book value of Rs. 300,000 were sold for Rs. 70,000. These were purchased on 1.4.2004. Rate of depreciation is 10% on straight line method. Year end is December 31. Calculate cost of disposals?

Answer

Cost of items

Number of years the asset is used (1.4.2004-30.9.2006)	2.5Y
Assume Cost (in percentage)	100%
Accumulated depreciation at the time of disposal (in percentage) (100 × 10% per year × 2.5Y)	25%
Cost (300,000/75 × 100)	400,000

	%	Amount
Cost	100	400,000
Accumulated depreciation	(25)	(100,000)
Book value	75	300,000

LO7: DISPOSAL THROUGH EXCHANGE

Sometimes instead of selling we exchange the old asset with the new one. In this case normally we will receive new asset and will hand over the old asset to the person from whom new asset is bought Obviously some cash will also be paid to settle the transaction. In this case following steps will be performed while passing the journal entry.

Step 1 The old asset will be removed from books by crediting old asset and by debiting accumulated depreciation a/c.

Step 2 The cash paid to settle the transaction will be credited.

Step 3 The cost of new asset will be debited in books.

Step 4 The balancing figure will be gain or loss.

	Entry	Dr.	Cr.
3. Entry on exchange of asset	Asset a/c (new)	xxx	
	Accumulated Depreciation a/c	xxx	
	P/L a/c (balancing)	xxx	
	Asset a/c (old)		xxx
	Cash		xxx
	(In case there is loss on disposal)		

Scanned with CamScanner

T-accounts

Dr.	Asset account		Cr.
b/d	xxx	Disposal (cost old asset)	xxx
Disposal (cost new asset)	xxx		
		c/d	xxx

Dr.	Disposal account		Cr.
Asset a/c (cost old asset)	xxx	Accumulated depreciation (old asset)	xxx
Cash	xxx	Asset a/c (cost new asset)	xxx
		P&L (Bal. fig.)	xxx

Example-1

Following details are provided as on December 31, 2009.

Cost of machine	32,000
Accumulated depreciation	(8,000)
Book value	24,000

The above asset is exchanged with a new one on the same date:

Fair value of new asset	40,000
Cash paid to settle the transaction	22,000

Required: Pass the journal entry to record the transaction. (Source: ICAP)

Answer-1

Following entry will be passed:

	Dr.	Cr.
Cost- New asset	40,000	
Acc. dep. - old asset	8,000	
P and L (bal.)	6,000	
Cost - old asset		32,000
Cash		22,000

Dr.	Asset account		Cr.
b/d	32,000		
Disposal a/c	40,000	Disposal	32,000
		c/d (bal.)	40,000

Dr.	Disposal account		Cr.
Asset a/c (old)	32,000	Acc. Dep. – old asset	8,000
Cash	22,000	Asset a/c (new)	40,000
		P&L (Bal. fig.)	6,000

Example-2

Mr. Umer exchanged an old asset with a new one. Cost of old asset is Rs. 10,000 and accumulated depreciation is Rs. 3,000. Cost of new asset is Rs. 50,000. Cash paid to settle the transaction is Rs. 22,000. Pass Journal entry?

Answer-2

Asset – new	50,000	
Accumulated Depreciation	3,000	
P/L (Bal.)		21,000
Asset – old		10,000
Cash		22,000

Scanned with CamScanner

Example-3

Mr. Arif exchanged an old asset with a new one. Cost at old asset is Rs. 10,000 and accumulated depreciation is Rs. 2,500. Cost of new asset is Rs. 30,000. Trade-in-allowance is Rs. 3,000. Pass journal entry?

Answer -3

Asset – new	30,000	
Accumulated Depreciation	2,500	
P/L (Bal.)	4,500	
Asset – old		10,000
Cash		27,000

Cash paid = New asset cost – Trade-in-allowance
= 30,000 – 3,000 = 27,000

Example-4

Mr. Usman Elahi exchanged an old asset with new one. Cost of old asset is Rs. 30,000 and its written down value is Rs. 12,000. List price of new asset is Rs. 40,000. Cash paid to settle the transaction is Rs. 23,000. Pass journal entry?

Answer -4

Asset – new		40,000	
Accumulated Depreciation	(30,000 – 12,000)	18,000	
P/L (Bal.)			5,000
Asset – old			30,000
Cash			23,000

Example-5

Mr. Nauman exchanged an old asset with new one. Cost of new asset is Rs. 100,000. Cost of old asset is Rs. 70,000 and its accumulated depreciation is Rs. 30,000 on date of exchange. Trade-in-allowance (value assigned to our old asset) is Rs. 10,000.

Answer -5

Asset – new	100,000	
Accumulated Depreciation	30,000	
P/L (Bal.)	30,000	
Asset – old		70,000
Cash (100,000 – 10,000)		90,000

Example-6

Mr. Anjum has provided following data:

Vehicle	Cost	Accumulated Depreciation
	1.1.2011	
(1) A vehicle costing Rs. 90,000 on 1.4.2009 is exchanged with a new vehicle costing Rs. 200,000. Cash paid in the transaction amounted to Rs. 70,000. Date of exchange is 1.8.2011.	400,000	150,000
(2) A vehicle costing Rs. 60,000 is purchased on 1.3.2011.		

Required:

Prepare Asset a/c, accumulated depreciation a/c and disposal a/c for the year ended 31.12.2011?

Method of depreciation is 5% S.L.

Scanned with CamScanner

Answer-6

Vehicle a/c

Dr.					Cr.
1.1.11	b/d	400,000	1.8.11	Disposal	90,000
1.8.11	Disposal	200,000			
1.3.11	Cash	60,000			
			31.12.11	c/d	570,000

Accumulated Depreciation a/c

Dr.					Cr.
1.8.11	Disposal (W-2)	10,500	1.1.11	b/d	150,000
31.12.11	c/d	164,292	31.12.11	Depreciation Exp. (W-1)	24,792

Disposal a/c

Dr.			Cr.
Vehicle	90,000	Accumulated Depreciation	10,500
Cash a/c	70,000	Vehicle	200,000
P/L (Bal.)	50,500		

Disposal entry

	Dr.	Cr.
Vehicle – new	200,000	
Accumulated Dep.	10,500	
Vehicle – old		90,000
Cash		70,000
P/L (Bal.)		50,500

(W-1) Depreciation Expense

- On opening assets excluding disposals
  (400,000 – 90,000) × 5% — 15,500
- On additions
  (200,000 × 5% × 5/12) + (60,000 × 5% × 10/12) — 6,667
- On disposals
  (90,000 × 5% × 7/12) — 2,625

24,792

(W-2) Accumulated Depreciation of Disposals

Years used (1.4.09 – 1.8.11)	2 years and 4 months	2.3333 years
Accumulated Depreciation	(90,000 × 5% × 2.3333)	10,500

Example-7

Mr. Ghafoor has provided following data:

	Cost 1.1.2012	Accumulated Depreciation 1.1.2012
Building A/c	800,000	250,000

(1) A building costing Rs. 135,000 on 1.4.2009 is exchanged with a new building costing Rs. 400,000 and Rs. 320,000 is paid to settle the transaction. Transaction took place on 30.4.2012.

(2) A building costing Rs. 35,000 is purchased on 1.Dec.2012.

Required:

Prepare Asset a/c, accumulated depreciation a/c and disposal a/c for the year ended December 31, 2012? Depreciation rate is 10% W.D.V

Scanned with CamScanner

Answer-7

Building a/c

Dr.					Cr.
1.1.12	b/d	800,000	30.4.12	Disposal	135,000
30.4.12	Disposal	400,000			
1.12.12	Cash	35,000			
			31.12.12	c/d	1,100,000

Accumulated Depreciation a/c

Dr.					Cr.
Disposals (W-2)		37,224	b/d		250,000
			Depreciation Exp. (W-1)		75,216
c/d		287,992			

Disposal a/c

Dr.					Cr.
Building		135,000	Building		400,000
Cash		320,000	Accumulated Depreciation (W-2)		37,224
			Profit & Loss (Bal.)		17,776

(W-1) Depreciation Expense

- On opening assets excluding disposals
  WDV of opening assets as on 01.01.12 (800,000 – 250,000) 550,000
  Less: WDV of disposal on 01.01.01 (W-2) (101,148)
  448,852 x10% 44,885
- Additions
  (400,000 × 10% × 8/12) 26,667
  (35,000 × 10% × 1/12) 292 26,959
- Disposals (W-2) 3,372
  Total 75,216

(W-2) Accumulated Depreciation of Disposals

Cost	(1.4.09)		135,000
Dep. Exp.	(31.12.09)	(135,000 × 10% × 9/12)	(10,125)
WDV at	(31.12.09)		124,875
Dep. Exp.	(31.12.10)	124,875 × 10%)	(12,488)
WDV at	(31.12.10)		112,387
Dep. Exp.	(31.12.11)	(112,387 × 10%)	(11,239)
WDV at	(31.12.11)		101,148
Dep. Exp.	(31.12.12)	(101,148 × 10% × 4/12)	(3,372)
WDV	(30.04.12)		97,776
Accumulated Depreciation on Disposals		(135,000 – 97,776)	37,224

Journal entry

	Dr.	Cr.
Building (New)	400,000	
Accumulated Depreciation (W-2)	37,224	
Profit & Loss (Bal.)	17,776	
Building (old)		135,000
Cash		320,000

Scanned with CamScanner

Note:

1. Sometimes cash paid to settle the transaction will not be given in the question rather you will be provided with trade-in-allowance. Trade-in-allowance is the value assigned by the shopkeeper to our old asset. In such case cash paid can be calculated through following equation:

   Cash paid = Cost of new asset - Trade in allowance

2. Gain/ (loss) on exchange of asset can be calculated through shortcut way as follows:

   Gain/ (loss) = Trade in allowance - Book value of asset disposed off

Cost of exchanged asset in certain circumstances

Sometimes the fair market value of new asset is not known in the exchange transaction, in this case cost of new asset will be calculated in the following way.

Scenario	Cost of new asset to be debited in exchange entry
Only fair value of new asset is given	Fair value of new asset
Fair value of new asset is not given but fair value of old asset is given	Fair value of old asset + cash paid Fair value of old asset – cash received
Fair value of old assets and fair value of new assets both known	Fair value of old asset + cash paid Fair value of old asset – cash received
Fair value of both new asset and old asset is not given/ Transaction lack commercial substance	Book value of old asset + cash paid Book value of old asset – cash received

Transaction lack commercial substance means that future cash flows from new asset change minimally.

Example

Mr. Umair has exchanged an asset with a new one. The cost of old asset and its accumulated depreciation on date of disposal is Rs.40,000 and Rs.13,000 respectively. Cash paid to settle the transactions was Rs.18,000.

Required:

Pass journal entries under 3 independent scenarios.

(1) Fair market value of new asset is Rs. 50,000.

(2) Fair market value of new asset is not known and fair market value of old asset is Rs. 25,000.

(3) Fair market value of old and new asset is not known.

Solution

(1)

	Dr.	Cr.
Asset (new)	50,000	
Accumulated Depreciation	13,000	
P/L (Bal.)		5,000
Asset (old)		40,000
Cash		18,000

(2)

	Dr.	Cr.
Asset (new) (25,000 + 18,000)	43,000	
Accumulated Depreciation	13,000	
P/L (Bal.)	2,000	
Asset (old)		40,000
Cash		18,000

Scanned with CamScanner

(3)		Dr.	Cr.
Asset (new)	(27,000 + 18,000)	45,000	
Accumulated Depreciation		13,000	
Asset (old)			40,000
Cash			18,000

LO8: PREPARING FIXED ASSET ACCOUNT AT BOOK VALUE

Under this method, depreciation is directly charged to an Asset Account by debiting Depreciation Account and crediting the Asset Account. At the end of the accounting period, depreciation Account is closed by transferring it to the Profit and Loss Account. In the Balance Sheet, the asset appears at its written down value (cost less depreciation provided to-date). Here, actual cost of an asset and the total amount of depreciation that has been provided (to-date) cannot be ascertained from the Balance Sheet.

		Entry	Dr.	Cr.
4.	Recording depreciation expense when asset a/c is prepared at book value	Depreciation expense a/c	xxx	
		Asset a/c – at book value		xxx
		Entry	**Dr.**	**Cr.**
5.	Entry for disposal of asset when asset a/c is prepared at book value	Cash	xxx	
		P/L a/c (balancing)	xxx	
		Asset a/c – at book value		xxx
		(In case there is loss on disposal)		
		Entry	**Dr.**	**Cr.**
6.	Entry on exchange of asset when asset a/c is prepared at book value	Asset a/c – at book value (cost of new asset)	xxx	
		P/L a/c (balancing)	xxx	
		Asset a/c – at WDV (WDV of old asset)		xxx
		Cash		xxx
		(In case there is loss on disposal)		

[Refer Q. 63-69 of practice set]

Example-1

Mr. Umer has provided the following data.

	1.1.2008
Furniture – book value	700,000

(1) During the year on 1. April, 2008 a additions of Rs. 80,000 took place.
(2) On 30.06.08 an asset costing Rs. 120,000 on 1.7.06 is disposed off for Rs. 25,000 only.
(3) Method of depreciation is diminishing balance method and rate is 10%.

Required:

Calculate depreciation expense and prepare asset a/c and disposal a/c for year ended 31.12.08.

Answer

Furniture a/c – at book value

Dr.					Cr.
1.1.08	b/d	700,000	30.06.08	Disposal	97,470
1.4.08	Cash	80,000	31.12.08	Depreciation	70,870
			31.12.08	c/d	611,600

Disposal A/c

Dr.				Cr.
Furniture – BV	97,470	Cash		25,000
		P/L (Bal.)		72,470

Scanned with CamScanner

(W-1) Depreciation Expense

- On opening assets excluding disposals	(700,000 – 102,600) × 10%	59,740
- On additions	(80,000 × 10% × 9/12)	6,000
- On disposals	(W-2)	5,130
		70,870

(W-2) Book value of Disposals

Cost	(1.7.06)		120,000
Depreciation	(31.12.06)	(120,000 × 10% × 6/12)	(6,000)
WDV	(31.12.06)		114,000
Depreciation	(31.12.07)	(114,000 × 10%)	(11,400)
WDV	(31.12.07)		102,600
Depreciation	(30.06.08)	(102,600 × 10% × 6/12)	(5,130)
WDV	(30.06.08)		97,470

Disposal entry

Cash	25,000	
P/L (Bal.)	72,470	
Furniture – BV		97,470

Example-2

Mr. Atif has provided the following data.

	1.1.2013
Building – book value	500,000

(1) On 1 October, 2013 a new building was purchased costing Rs. 60,000.
(2) On 31.3.13 an old building costing Rs. 90,000 on 1.1.11 is disposed off for Rs. 60,000.
(3) ON 30.06.13 another building having book value of Rs. 50,000 on 1.1.13 is disposed off for Rs. 4,200 only.
(4) Rate of depreciation is 15% WDV method.

Required:

Relevant a/c for year ended 31.12.13.

Answer

Building a/c – at book value

Dr.					Cr.
1.1.13	b/d	500,000	31.3.13	Disposal	62,587
1.1.13	Cash	60,000	30.06.13	Disposal	46,250
			31.12.13	Depreciation	66,184
			31.12.13	c/d (Bal.)	384,979

Disposal A/c

Dr.			Cr.
Building – BV	62,587	Cash	60,000
Building – BV	46,250	Cash	4,200
		P/L (Bal.)	44,637

(W-1) Depreciation Expense

- On opening assets excluding disposals (500,000 – 65,025 – 50,000) × 15%	57,746
- On additions (60,000 × 15% × 3/12)	2,250
- On disposals (2,438 + 3,750)	6,188
	66,184

Scanned with CamScanner

(W-2) Book value of Disposal in point 2

Cost	(1.1.11)		90,000
Depreciation	(31.12.11)	(90,000 × 15%)	(13,500)
WDV	(31.12.12)		76,500
Depreciation	(31.12.12)	(76,500 × 15%)	(11,475)
WDV	(31.12.12)		65,025
Depreciation	(31.03.13)	(65,025 × 15% 3/12)	(2,438)
WDV	(31.03.13)		62,587

(W-3) Book value of Disposals in point 3

Book value	(1.113)		50,000
Depreciation	(30.06.13)	(50,000 × 15% 6/12)	(3,750)
WDV	(30.06.13)		46,250

LO9: FIXED ASSET SCHEDULE/ DISCLOSURE NOTE (SAMPLE)

Particular	Building	Plant & Machinery	Vehicle	Furniture
Cost				
As on Jan.1.01				
Addition during the year				
Revaluation				
Disposal				
As on Dec. 31. 01				
Depreciation				
As on Jan.1.01				
Depreciation for the year				
Disposal				
Revaluation				
As on Dec. 31. 01				
WDV on Dec. 31, 01				
Rate %				
Depreciation method				

LO10: REVALUATION OF PROPERTY PLANT AND EQUIPMENT

Measurement after initial recognition

Two measurement models after acquisition of non-current asset are as follows:

(1) ***Cost model***

After recognition as an asset, an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

(2) ***Revaluation model***

After recognition of an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount which is its fair value at the date of the revaluation less any subsequent accumulated depreciation and accumulated impairment losses.

The fair value of land and buildings is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers.

If an item is revalued, the entire class of assets to which that asset belongs should be revalued.

Revalued assets are depreciated in the same way as under the cost model.

Scanned with CamScanner

Frequency of revaluation

Under the revaluation model, revaluations should be carried out regularly, so that the carrying amount of an asset does not differ materially from its fair value at the balance sheet date.

Accounting treatment of revaluation increase/decrease

Change in Carrying Amount	Initial	Subsequent
Increase	Included in Other comprehensive income (heading "Revalution surplus")	Included in OCI and increases revaluation surplus unless it reverses a revaluation decrease of the same asset previously recognized in profit or loss.
Decrease	Debited to Profit or loss	Debited to profit or loss unless any credit balance exists in the revaluation surplus

Accounting treatment of accumulated depreciation a/c at the time of revaluation

It is eliminated against the gross carrying amount of the asset and the net amount is restated to the asset's revalued amount.

Treatment of Revaluation surplus

Transfer revaluation surplus on yearly basis to retained earnings (it will be the difference between depreciation based on the revalued carrying amount and depreciation based on original cost).

Treatment of Revaluation surplus on disposal of asset

Transfer full amount appearing in balance sheet to retained earnings

LO11: DISCLOSURES / NOTE

The financial statements shall disclose, for each class of property, plant and equipment:

(a) The measurement bases used (i.e. cost model or revaluation model); (Narrate)

(b) The depreciation methods used; (Narrate)

(c) The useful lives or the depreciation rates used; (Narrate)

(d) The gross carrying amount and the accumulated depreciation at the beginning and end of the period; and (Table)

(e) A reconciliation of the carrying amount at the beginning and end of the period showing:

- *(i) Additions;*
- *(ii) Acquisitions through business combinations; (Detail in CA Final)*
- *(iii) Increases or decreases resulting from revaluations*
- *(iv) Impairment losses*
- *(v) Disposals;*
- *(vi) Depreciation;*

The financial statements must also disclose:

- *the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities; (Narrate)*
- *the amount of expenditures recognised in the carrying amount in the course of its construction;*
- *the amount of contractual commitments for the acquisition of property, plant and equipment;*
- *if it is not disclosed separately in the statement of comprehensive income, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in profit or loss. and*

Scanned with CamScanner

Disclosures for assets stated at revalued amounts

When items of property, plant and equipment are stated at revalued amounts following must be disclosed:

- *the effective date of the revaluation;*
- *whether an independent valuer was involved;*
- *the extent to which the items' fair values were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques*
- *for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model; and*
- *the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.*

Additional disclosures encouraged by IAS 16

IAS 16 encourages disclosure of the following information as users of financial statements might find it to be useful.

- *the carrying amount of temporarily idle property, plant and equipment;*
- *the gross carrying amount of any fully depreciated property, plant and equipment that is still in use;*
- *the carrying amount of property, plant and equipment retired from active use and held for disposal; and*
- *when the cost model is used, the fair value of property, plant and equipment when this is materially different from the carrying amount.*

LO12: ALTERNATE NAMES FOR DIFFERENT TERMINOLOGIES

Main Name	Alternate names
Residual value	Scrap value, Salvage value
Diminishing balance method	Written down value method/ Book value method/ Carrying amount method/ Net book value Method/ Declining balance method/ Reducing balance method.
Output method	Number of Units produced method/Units of production method/ Machine Hours method/ Service hours method/ Usage method/ Mileage method
Trade-in-allowance	Exchange allowance

Scanned with CamScanner

PRACTICE QUESTIONS

Question-1

Mr. Babar provided you with following information:

	Cost as on 1.1.2009	Accumulated Depreciation as on 1.1.2009	Rate S.L
Machinery	600,000	250,000	10%
Vehicle	700,000	90,000	20%

Following are the additions made during the year:

	Date of Purchase	Cost
Machinery	1.3.2009	90,000
Vehicle	1.5.2009	80,000
Vehicle	1.6.2009	100,000

Required:

Prepare machinery A/C and vehicle A/C (cost and accumulated depreciation) for December 31, 2009 and December 31, 2010. **(6)**

Question-2

Mr. Ali has informed you that following balances are appearing on 1.1.2013 in his books of accounts:

	Cost	Accumulated Depreciation
Machinery a/c	600,000	300,000

Following is the detail of additions during the year ended December 31, 2013:

	Date of Purchase	Cost
Cutter machine	1.3.2013	500,000
Molding machine	1.8.2013	250,000

Method for depreciation is WDV and rate is 20%.

Required:

Prepare relevant accounts for year ended December 31, 2013. **(6)**

Question-3

Mr. A has purchased a machine costing Rs. 100,000 on 1.1.2004. Residual value is Rs. 2,000.

Total life in units	10,000
Units produced in 2004	2,000
Units produced in 2005	3,000
Units produced in 2006	5,000

Calculate depreciation for each year ending at 31 December under the output method. **(3)**

Question-4

Mr. B provided the following data:

Cost of machine	300,000
Date of purchase	1.1.2003
Useful life	4 years
Residual value	50,000

Calculate depreciation for each year ending at 31 December under year digit method. **(3)**

Scanned with CamScanner

Question-5

The following detail is provided by Mr. Aamir on 1.1.2007

	Cost as on 01.01.07	Accumulated Depreciation as on 01.01.07
Vehicle	1,400,000	650,000

Rate of depreciation is 15% on straight line basis

Following is the further detail for year ended December 31, 2007

Additions

Date of Purchase	Cost
1.Mar.07	200,000
1.May.07	250,000
1.June.07	23,000

Disposals

Description	Date of Purchase	Date of Disposal	Cost	Sale proceeds
Vehicle – 1	1.July.05	31.Mar.07	40,000	2,300
Vehicle – 2	1.March.04	30.June.07	70,000	4,700
Vehicle – 3	1.Aug.06	30.Nov.07	90,000	6,600

Required: (8)

Prepare relevant accounts for year ended December 31, 2007.

Question-6

Mr. Umer has provided the following data for the year ended Dec. 31, 2008.

	Cost 1.1.08	Accumulated Depreciation
Assets	1,400,000	840,000

During the year an asset costing Rs. 370,000 on 1.1.06 is destroyed by fire on 31.5.2008.

Method of depreciation is 10% straight line.

Required: (4)

Prepare relevant accounts and pass the entry for disposal

Question-7 {Fully Depreciated}

Mr. Ali has informed you that following balances are appearing on 1.1.2008 in his books of accounts:

	Cost	Accumulated Depreciation
Vehicles	600,000	200,000

Following is the detail of addition during the year ended December 31, 2008:

	Date of Purchase	Cost
Vehicle 9	1.3.2008	50,000

Cost balance of Rs. 600,000 appearing on 1.1.2008 includes following two assets:

	Date of Purchase	Cost
Vehicle 1	1.4.2003	20,000
Vehicle 2	1.3.2004	30,000

Vehicle 5 which was purchased on 1.1.2006 is sold on 31.5.2008. Its cost was Rs. 40,000.

Scanned with CamScanner

Required:
Using straight line method, calculate depreciation expense for year ended December 31, 2008. Rate of depreciation is 20% per annum. Also prepare asset a/c and accumulated depreciation a/c for year ended December 31, 2008. **(8)**

Question -8 {Fully Depreciated}
Asif has provided you with following data:

	Cost as on 1.1.07	Accumulated Depreciation 1.1.07
Vehicle	600,000	345,000

Following is the breakup of above Assets:

Purchased on	1.7.02	150,000
Purchased on	1.1.04	250,000
Purchased on	1.7.05	200,000
		600,000

- Life of all assets is 5 years.
- Additions made during year ended amounted to Rs. 90,000 as on 1.Mar.07.
- An asset having cost of Rs. 70,000 on 1.7.05 is disposed of on 31.3.07 for Rs. 30,000.

Required:
(i) Prepare relevant accounts for year ended Dec. 31, 2007.
(ii) Calculate depreciation Expense for the year ended Dec. 31, 2007. **(8)**

Question-9
Arslan has provided you the following data:

	Cost as on 1.1.09	Accumulated Depreciation 1.1.09
Vehicle	700,000	350,000

- Rate of Depreciation is 20% p.a. on S.L basis.
- Above assets include assets purchased on 1.4.04 costing Rs. 200,000.
- Remaining were purchased in 2008.

Additions

Date	Cost
1.4.09	200,000
1.7.09	300,000
1.7.10	250,000

Disposals

Cost	Date of purchase	Date of Sale
30,000	01.03.08	30.6.09

Required:
Calculate depreciation for year ended Dec. 31, 2009 and Dec. 31, 2010 **(8)**

Scanned with CamScanner

Question-10

Mr. Sannan has provided you with following information:

	Cost 1.1.07	Accumulated Depreciation 1.1.07
Building	2,300,000	800,000

(i) Detail of addition for year ended Dec. 31, 2007

On February 01, 2007	400,000
On April 01, 2007	650,000

(ii) Details of Disposal for year ended Dec. 31, 2007

Date of sale	Date of Purchase	Cost	Sale proceeds
31.08.07	1.1.04	550,000	450,000
31.05.07	1.9.05	700,000	300,000

(iii) Depreciation rate is 10% on diminishing balance method.

Required:

Prepare relevant accounts for the year ended December 31, 2007? (8)

Question-11 {Reverse Back}

Mr. Saad has provided you with following information:

	Cost as on 1.1.2012	Accumulated Depreciation as on 1.1.2012	Rate S.L
Plant and Machinery	600,000	200,000	20%

Following is the addition made for year ended December 31, 2012.

	Date	Cost
Plant and Machinery	1.2.2012	70,000

During the year a plant purchased on 1.7.2009 having book value of Rs. 15,000 is sold on 31.3.2012 for Rs. 15,800.

Required:

Prepare relevant accounts for year ended December 31, 2012 only. (6)

Question-12 {Reverse Back}

Mr. Umer has provided you with following information:

	Cost as on 1.1.2012	Accumulated Depreciation as on 1.1.2012	Rate W.D.V
Plant and Machinery	500,000	150,000	20%

Following is the addition made for year ended December 31, 2012.

	Date	Cost
Plant and Machinery	1.2.2012	77,000

During the year a plant purchased on 1.8.2009 having book value of Rs. 12,000 is sold on 31.3.2012 for Rs. 16,300.

Required:

Prepare relevant accounts for year ended December 31, 2012 only. (6)

Scanned with CamScanner

Question-13 {Change in Estimate}

Mr. Aamir purchased an asset on 1.1.2012 with a life of 10 years. Its cost is Rs. 50,000 and residual value is Rs. 5,000. On 1.1.2014 he decided to change the life to a total of 4 years and a new residual value of Rs. 2,000. Year end is December 31 and method is straight line.

Required:

Calculate depreciation expense for 2012, 2013, 2014 and 2015. **(4)**

Question-14 {Change in Estimate}

Mr. Inzamam-ul-haq has purchased an asset on 1.1.2008 for Rs. 70,000 whose residual value is Rs.10,000 at the end of useful life of six years. On 1.1.2010 he decided to change the method to WDV using rate of 33.12%.

Required:

Calculate depreciation expense for the first 6 years of asset's life? **(4)**

Question -15 {Change in Estimate}

Mr. Inam has purchased an asset on 1.1.2007 for Rs. 80,000 whose residual value is Rs. 10,000 and rate of depreciation is 10% WDV. On 1.1.2009 it is decided to change the method to straight line with a remaining life of 5 years and new residual value of Rs. 5,000.

Required:

Calculate depreciation expense for first 4 years. **(3)**

Question-16{Change in Estimate}

Mr. Omer purchased a plant costing Rs. 50,000 on 1.Jan.2009. Its expected useful life is 10 years with a residual value of Rs. 6,000. At start of year 2011 company decided to change the life to 7 years in total and having a residual value of Rs. 2,000 at the end of life.

Method used is S.L.

Required:

Calculate depreciation expense for year 2009, 2010, 2011 and 2012. Year end is December 31. **(4)**

Question-17 {Change in Estimate}

Mr. Musa purchased a furniture costing Rs. 200,000 on 1.1.2011. Rate of Depreciation decided by company is 20% using WDV method. The residual value estimated on 1.1.2011 is Rs. 10,000.

The company decided on 1.1.2013 that depreciation method should be S.L with a residual value of Rs.6,000 at the end of its remaining useful life of 4 years.

Required:

Calculate depreciation expense for 2011, 2012, 2013 and 2014. Year end is 31 December. **(4)**

Question-18 {Change in Estimate}

Mr. Urva purchased a vehicle costing Rs. 700,000 on 1.1.2012. Initially its life was expected to be 7 years with a residual value of nil using straight line method. On 1.1.2015 it is decided that total life of asset will end on 31.12.2016 with a residual value of Rs.15,000

Required:

(a) Calculate depreciation expense for 2012, 2013, 2014, 2015, 2016. Year end is December 31.

(b) Also calculate WDV on 31.12.2016. **(4)**

Question-19 {Change in Estimate}

A vehicle bought on 1 January 20X0 at a cost of Rs. 16,000. Its useful economic life is estimated at 4 years and its trade-in value at that point is estimated as being Rs. 4,000.

During 20X2 a review of the vehicle's probable useful economic life suggested that it should be retained until 1 January 20X5 and its residual value should be Rs. 2,500.

Scanned with CamScanner

Required:
What is the amount of straight line depreciation charged in the profit and loss account in the year to 31 December 20X2 and the amount included in the balance sheet for accumulated depreciation at that date? (4)

Question-20

Mr. Asad has provided you following data:

	Cost on 1.1.2012	Accumulated Depreciation on 1.1.2012
Plant and Machinery	600,000	200,000

Following transaction took place during the year ended 31.12.2012

- A plant costing Rs. 80,000 purchased on 1.4.2009 is exchanged with a new plant on 30.6.2012. The cost of new plant is Rs. 130,000 and TIA of Rs. 17,000 is agreed and remaining amount is paid in cash.
- Further additions amounting to Rs. 67,000 are made on 1.Sep.2012

Method used is S.L @ 10%.

Required:

a. Pass the journal entry for exchange.
b. Prepare relevant accounts for year ended December 31, 2012. (8)

Question-21

Mr. Nasir has disclosed the following data:

	1.1.2009
Furniture – book value	25,000

Following transactions took place during the year ended December 31, 2009.

Additions	**Cost**	**Date of purchase**
	60,000	1.3.2009
	90,000	1.6.2009

Disposals			
Sale proceeds	**Cost**	**Date of Purchase**	**Date of Disposal**
12,000	30,000	1.4.2007	30.9.2009

Required:
Prepare asset A/C and disposal A/C. Rate of depreciation is 20% W.D.V (5)

Question-22

Mr. Sannan has provided you with following information:

	Book value 1.1.07
Building	1,500,000

(i) Detail of addition for year ended Dec. 31, 2007

On February 01, 2007	400,000
On April 01, 2007	650,000

(ii) Details of Disposal for year ended Dec. 31, 2007

Date of sale	**Date of Purchase**	**Cost**	**Sale proceeds**
31.08.07	1.1.04	550,000	450,000
31.05.07	1.9.05	700,000	300,000

(iii) Depreciation rate is 10% on diminishing balance method. (8)

Prepare relevant accounts for the year ended December 31, 2007.

Scanned with CamScanner

Question -23

Mr. Waqar Younis has provided following data:

	1.1.2010
Furniture – Book value	35,000

Following transactions took place during the year.

(1) Additions of Rs. 12,000 took place on 1.3.2010.

(2) During the year an old asset having book value of Rs. 7,000 on 1.1.2010 is exchanged with a new asset costing Rs. 20,000. The exchange transaction took place on 31.3.2010. Cash paid was Rs.7,500.

(3) Rate of depreciation is 15% W.D.V.

Required:

Prepare relevant accounts at book value **(6)**

Question -24 {Reverse Back}

Following is the detail of fixed assets as on 1.1.2007 for MJE.

Description	Method	Cost	Accumulated Depreciation
Furniture	S.L 10% with R.V of 5 % of cost.	100,000	?
Computer	WDV 5%	200,000	?
Vehicle	WDV 10%	300,000	80,000

(i) 70% of furniture was bought on 1.3.2003 and 30% on 1.4.93. Furniture having book value of Rs. 5,000 purchased on 1.3.03 was sold on 30.9.2007 at a gain of Rs. 6,000.

(ii) All computers were purchased on 1.4.04. w.e.f 1.1.2007 it is decided to change the method of depreciation for computer to S.L with remaining life of 3 years and residual value of Rs. 3,000.

(iii) A vehicle costing Rs. 20,000 purchased on 1.7.2005 was traded in with a new vehicle on 1.4.2007 by paying Rs. 9,000 and loss on transaction was Rs. 4,000.

(iv) A vehicle having book value of Rs. 5,000 purchased on 1.3.03 was sold on 30.11.2007 for Rs. 2,000.

(v) On October 1, 2007 MJE transferred to its factory a vehicle which had been included in its trading stock and which bore a price label of Rs. 18,000 in the showroom. MJE makes a gross profit of 40% of cost, on sale of such assets.

Required:

1. Prepare asset accounts on December 31, 2007.
2. Prepare accumulated depreciation accounts on December 31, 2007.
3. Calculate gain/(loss) on December 31, 2007. **(25)**

Question-25

Following account balances are appearing in the books of Amjad as on

	Cost 31.12.2010	Accumulated Depreciation 31.12.2010
Furniture	800,000	302,000
Plant and Machinery	300,000	70,000

Following errors were identified by the auditors for the year ended December 31, 2010.

(i) Advance paid for purchase of furniture to be delivered on 31.3.2011 is debited to furniture account on 1.7.2010. Amount is Rs. 30,000.

(ii) Asset (furniture) costing Rs. 70,000 purchased on 1.4.2008 is exchanged with new furniture costing Rs. 100,000 on 31.3.2010. Cash of Rs. 12,000 is paid to settle the transaction. The accountant has ignored the exchange transaction and has debited Rs. 12,000 to asset account against cash paid.

Scanned with CamScanner

(iii) Plant and machinery costing Rs. 80,000 purchased on 1.4.2009 was sold on 30.9.2010 for Rs. 33,000 and sale proceeds were credited to plant and machinery A/C.

Rate of Depreciation for both assets is 10% S.L.

Required:

(a) Prepare the journal entries to correct the above errors.

(b) Prepare adjusted Plant and Machinery A/C

Note: Ignore depreciation adjustments for the year while passing journal entries. **(10)**

Question-26 {Revaluation}

A company acquired a land for Rs. 600,000 on January 1, 2009. For land the revaluation model is used. The value of land on respective dates is as follows:

	Rs.
December 31, 2009	750,000
December 31, 2010	580,000
December 31, 2011	650,000
December 31, 2012	800,000

Required:

Prepare the journal entries and land account from year ended December 31, 2009 to December 31, 2012.**(4)**

(Prepare relevant ledger)

Question-27 {Revaluation}

ABC Company acquired land for Rs. 700,000 on Jan. 1, 2005. The company uses revaluation model for valuation of its assets. The value of land on respective dates is as follows:

Revaluation date	Revalued amount
Dec. 31, 2005	800,000
Dec. 31, 2006	680,000
Dec. 31, 2007	750,000
Dec. 31, 2008	825,000

Required:

Prepare journal entries and also prepare Land account from year ended December 31, 2005 to December 31, 2008.

(Prepare relevant ledger) **(4)**

Question-28 {Depreciation of revalued asset}

Cost of plant at 1/1/20X1:	100,000
Depreciation:	10% per annum to a nil residual value
1/1/20X2	180,000
1/1/20X3	60,000
1/1/20X4	77,000
1/1/20X5	120,000

The company's policy is to transfer the realised portion of the revaluation surplus to retained earnings as the asset is used.

Required:

Show the journal entries and ledger accounts for each of the years ended 31 December 20X1 to 20X5 **(14)**

(Prepare relevant ledger)

Scanned with CamScanner

Question-29 {Depreciation of revalued asset}

A company acquired a building for Rs. 500,000 on January 1, 2010. The building is depreciated over its useful life of 20 years. For building the revaluation model is used. The value of building on respective dates is as follows:

Revaluation date	Fair value in Rs.
January 1, 2011	550,000
January 1, 2012	380,000
January 1, 2013	750,000
January 1, 2014	800,000

Required:

Show the journal entries and ledger accounts for each of the years ended 31 December 2010 to 2014.1**(14)**
(Prepare relevant ledger)

Question-30 {Depreciation of revalued asset}

Cost of plant at 1/1/2001: 200,000

Depreciation: **10 years to a nil residual value**

Details of revaluation performed by an independent valuer are as follows:

Date	Fair Value
31/12/2002	280,000
31/12/2003	80,000
31/12/2004	60,000
31/12/2005	120,000

The company's policy is to transfer the realised portion of the revaluation surplus to retained earnings as the asset is used.

Required:

Prepare journal entries to record the above transactions from the date of acquisition of the plant to the year ended 31 December 2005. **(Prepare relevant ledger)** **(10)**

Question-31 {Depreciation of revalued asset}

Mian Limited acquired a plant for Rs. 100 million on July 1, 2015. The following information relating to the plant is available:

(i) It is being depreciated on the straight line basis, over 10 years.

(ii) ML uses the revaluation model for subsequent measurement of its property, plant and equipment and accounts for revaluations on the net replacement value method. The details of revaluation carried out by the independent values during the past years are as follows:

Revaluation date	Fair value (Rs. In 'million')
June 30, 2016	80
June 30, 2017	95
June 30, 2018	110

(iii) ML transfers the maximum possible amount from the revaluation surplus to retained earnings on an annual basis.

(iv) There is no change in the useful life of the building.

Required:

Prepare the journal entries to record the above transactions form the date of acquisition of the Plant to the year ended June 30, 2018. **(Prepare relevant ledger)** **(10)**

Scanned with CamScanner

Question-32 {Revaluation}

Alvi Limited purchased a plant for Rs. 500,000 on 1 July 2010. The plant has an estimated useful life of 20 years and no residual value.

AL uses revaluation model for subsequent measurement of its property, plant and equipment and accounts for revaluations on net replacement value method. The details of revaluations performed by an independent firm of valuers are as follows:

Revaluation date	Fair value
1 July 2011	Rs. 480,000
1 July 2012	Rs. 390,000
1 July 2013	Rs. 450,000

Required:

Prepare journal entries to record the above transactions from the date of acquisition of the plant to the year ended 30 June 2014. **(Prepare relevant ledger)** **(10)**

Question-33 {Revaluation}

Cost of plant at 1/1/2011: 600,000

Depreciation: **15 years to a nil residual value**

Details of revaluation performed by an independent valuer are as follows:

Date	Fair Value
31/12/2012	550,000
31/12/2015	100,000

The company's policy is to transfer the realised portion of the revaluation surplus to retained earnings as the asset is used.

Required:

Prepare journal entries to record the above transactions from the date of acquisition of the plant to the year ended 31 December 2015. **(Prepare relevant ledger)** **(10)**

Question-34 {Revaluation} {Disposal}

Moin purchased a plant for Rs.300 million on 1 January 2010. The plant has an estimated useful life of 10 years and no residual value.

Revaluation date	Fair value
1 January 2011	Rs.500 million

The plant is sold for Rs.750 million on March 31, 2011.

Required:

Prepare journal entries to record the above transactions.

Question-35 {Revaluation} {Disposal}

Abid Limited (AL) uses the revaluation model for subsequent measurement of its property, plant and equipment and has a policy of revaluing its assets on an annual basis using the net replacement value method.

The following information pertains to AL's buildings:

(i) Four similar buildings were acquired in same vicinity on 1 January 2012 at a cost of Rs.300 million. The useful life of the buildings on the date of acquisition was 20 years.

(ii) AL depreciates buildings on the straight line basis over their useful life.

Scanned with CamScanner

(iii) The result of revaluations earned out during the last three years by Premier Valuation Service, an independent firm of valuers, are as follows:

Revaluation date	Fair value Rs. In million
1 January 2013	323
1 January 2014	252
1 January 2015	272

(iv) On 30 June 2015, one of the buildings was sold for Rs.80 million.

Required:

(a) **Prepare**

Building account and accumulated depreciation account for the year ended December 31, 2012, 2013, 2014 and 2015.

(b) Journal Entries.

Question-36 {Revaluation with Disclosure}

The following information pertains to Akhtar Limited (AL).

(1) AL purchased a plant for Rs. 400 million on January 01, 2016 and installed at the cost of Rs.34 million. The plant was acquired by obtaining a specific loan from Habib Bank Limited (HBL) for the plant of 400 million at a markup of 12%. The remaining amount was paid through running finance facility which carries markup at 12.5%. The specific loan is payable by December 31, 2019. AL had mortgaged the plant to obtain the specific loan.

The plant has an estimated useful life of 7 years with no residual value.

AL uses revaluation model for subsequent measurement of its plant and machinery and accounts for revaluations on net replacement value method. The details of revaluations performed by an independent firm of valuers "Ghaznavi & Co" are as follows:

Revaluation date	Fair value
30 December 2016	Rs. 360 million
30 December 2017	Rs. 320 million
30 December 2018	Rs. 220 million

On account of mishandling the plant during December 2018 the plant needs some repairs. The plant could be sold at its fair value as determined by valuer on 30 December 2018 after incurring some repair and selling cost of Rs. 15 million. If plant is not sold the following net cash inflows are expected from its use:

Year ended	Cash flows
December 31, 2019	90 million
December 31, 2020	70 million
December 31, 2021	65 million
December 31, 2022	30 million

The proper discount rate to be used for these cash flows is 10%. (Assume that the cash flows occur at the end of the year).

(2) To open a new factory premises near Multan, an expenditure of Rs. 30 million was spent of the construction of the factory on 1 June 2018, financed by a loan obtained from the bank at the rate of 12% per annum. The construction had not been completed at the end of the year.

Moreover, the directors also made a contract with M/s Shaheen Limited to purchase plant and machinery worth Rs. 100 million once the construction of factory building is completed.

(3) AL purchased buildings, costing Rs. 160 million on 1 July 2014. It is to be depreciated using the straight-line method, with Rs. 10 million residual value. On 31 December 2016 it has accumulated depreciation of Rs. 25 million . About 80% buildings are occupied by factory and remaining for admin purpose

Scanned with CamScanner

On 1 January 2018, AL decided to change the depreciation method from straight line to reducing balance method. There is no change in life, however the estimate of residual value is Rs. 15

(4) AL purchased Cars for its administrative and selling departments, costing Rs. 30 million on Jan 11, 2015. On January 21, 2018 AL purchased Cars for Rs. 10 million. These are depreciated over 10 years using the straight-line method, with no residual value.

Required:

Prepare the disclosure under IAS 16 in relation to Property, Plant and Equipment in the notes to the published accounts for the year ended 31 December, 2018

(Comparatives are Required)

Note: you may round off your workings to the nearest millions.

Scanned with CamScanner

PRACTICE SOLUTIONS

Answer-1

Machinery a/c

Dr.					Cr.
1.1.09	b/d	600,000			
1.3.09	Cash	90,000	31.12.09	c/d	690,000
1.1.10	b/d	690,000			
			31.12.10	c/d	690,000

Accumulated Dep. a/c (Machinery)

Dr.					Cr.
			1.1.09	b/d	250,000
31.12.09	c/d	317,500	31.12.09	Depreciation Exp	67,500
			1.1.10	b/d	317,500
31.12.10	c/d	386,500	31.12.10	Depreciation Exp	69,000

Depreciation Machinery – 2009

On opening assets	(600,000 × 10%)	60,000
On addition	(90,000 × 10% x 10/12)	7,500
		67,500

Depreciation Machinery – 2010

On opening assets	(690,000 × 10%)	69,000

Vehicle a/c

Dr.					Cr.
1.1.09	b/d	700,000			
1.5.09	Cash	80,000			
1.6.09	Cash	100,000	31.12.09	c/d	880,000
1.1.10	b/d	880,000	31.12.10	c/d	880,000

Accumulated Dep. a/c

Dr.					Cr.
			1.1.09	b/d	90,000
31.12.09	c/d	252,334	31.12.09	Depreciation Exp	162,334
			1.1.10	b/d	252,334
31.12.10	c/d	428,334	31.12.10	Depreciation Exp	176,000

Depreciation - 2009	On opening	(700,000 × 20%)	140,000
	On addition	(80,000 × 20% × 8/12) + (100,000 × 20% × 7/12)	22,334
			162,334
Depreciation - 2010	On opening	(880,000 × 20%)	176,000

Answer-2

Asset a/c

Dr.					Cr.
1.1.13	b/d	600,000			
1.3.13	Cash	500,000			
1.8.13	Cash	250,000	31.12.13	c/d	1,350,000

Accumulated Depreciation

Dr.					Cr.
			1.1.13	b/d	300,000
31.12.13	c/d	464,167		Depreciation expense	164,167

Calculation for Depreciation

- On opening assets	(600,000 – 300,000) × 20%	60,000
- On additions	(500,000 × 20% × 10/12) + (250,000 × 20% × 5/1/2)	104,167
		164,167

Scanned with CamScanner

Answer-3

Calculation for Depreciation

Depreciation = $\frac{\text{(Cost – residual value)}}{\text{Total units}} \times$ No. of units produced in current year

Depreciation for 2004 = $\frac{(100,0000 - 2,000)}{10,000} \times 2,000$ = 19,600

Depreciation for 2005 = $\frac{(100,0000 - 2,000)}{10,000} \times 3,000$ = 29,400

Depreciation for 2006 = $\frac{(100,0000 - 2,000)}{10,000} \times 5,000$ = 49,000

Answer-4

Sum of digits = 4 + 3 + 2 + 1 = 10

Depreciation for 2003 = $\frac{(300,0000 - 50,000)}{10} \times 4$ = 100,000

Depreciation for 2004 = $\frac{(300,0000 - 50,000)}{10} \times 3$ = 75,000

Depreciation for 2003 = $\frac{(300,0000 - 50,000)}{10} \times 2$ = 50,000

Depreciation for 2003 = $\frac{(300,0000 - 50,000)}{10} \times 1$ = 25,000

Answer-5

Vehicle A/C

Dr.					Cr.
1.1.07	b/d	1,400,000	31.3.07	Disposal	40,000
1.3.07	Cash	200,000	30.6.07	Disposal	70,000
1.5.07	Cash	250,000	30.11.07	Disposal	90,000
1.6.07	Cash	23,000	31.12.07	c/d	1,673,000

Accumulated Dep. A/c

Dr.					Cr.
31.3.07	Disposal (W-2)	10,500	1.1.07	b/d	650,000
30.6.07	Disposal(W-2)	35,000			
30.11.07	Disposal(W-2)	18,000		Depreciation Exp (W-1)	251,138
31.12.07	c/d	837,638			

(W-1)Depreciation Expense

On opening excluding disposals

(1,400,000 – 40,000 – 70,000 – 90,000) × 15% 180,000

On additions

(200,000 × 15% × 10/12)+
(250,000 × 15% × 8/12) +
(23,000 × 15% × 7/12) 52,013

On disposals

(40,000 × 15% × 3/12) +
(70,000 × 15% × 6/12) +
(90,000 × 15% × 11/12) 19,125

251,138

(W-2) Accumulated Dep. Of Disposals

Disposal on 31.3.07	(1 year and 9 months)	(40,000 × 15% × 1.75)	10,500
Disposal on 30.6.07	(3 year and 4 months)	(70,000 × 15 % × 3.3333)	35,000
Disposal on 30.11.07	(1 year and 4 months)	(90,000 × 15% × 1.3333)	18,000
			63,500

Scanned with CamScanner

Dr.	Disposal A/C		Cr.
Vehicle	40,000	Accumulated Dep.	10,500
Vehicle	70,000	Accumulated Dep.	35,000
Vehicle	90,000	Accumulated Dep.	18,000
		Cash	2,300
		Cash	4,700
		Cash	6,600
		P/L (Bal.)	122,900

Answer-6

Dr.		Asset a/c			Cr.
1.1.08	b/d	1,400,000	31.5.08	Disposal	370,000
			31.12.08	c/d	1,030,000

Dr.	Accumulated Depreciation A/C				Cr.
Disposal (370,000 × 10% × 2.4167)	89,418	1.1.08	b/d		840,000
c/d	868,999		Depreciation	(W-1)	118,417

Dr.	Disposal A/c		Cr.
Cost	370,000	Acc. Depreciation	89,418
		P/L (bal.)	280,582

Disposal Entry

	Dr.	Cr.
Cash	0	
Accumulated Depreciation	89,418	
P/L (bal.)	280,582	
Asset a/c (cost)		370,000
(Asset destroyed by fire)		

Calculation for Depreciation

- On opening assets excluding disposals	(1,400,000 – 370,000) x 10%	103,000
- On disposals	(370,000 × 10% × 5/12)	15,417
		118,417

Answer-7

Dr.		Vehicle a/c			Cr.
1.1.08	b/d	600,000			
1.3.08	Cash	50,000	31.5.08	Disposal	40,000
			31.12.08	c/d	610,000

Dr.		Accumulated Depreciation			Cr.
			1.1.03	b/d	200,000
31.5.08	Disposal (40,000 × 20% × 2.4167)	19,334		Depreciation expense	120,666
31.12.08	c/d	301,332			

Calculation of Depreciation:

On opening assets excluding disposals and fully depreciated

	(600,000 – 20,000 – 40,000) × 20%	108,000
On additions	(50,000 × 20% × 10/12)	8,333
On fully depreciated assets	(20,000 × 20% × 3/12)	1,000
On disposals	(40,000 × 5/12 × 20%)	3,333
		120,666

Answer-8

Dr.		Vehicle A/C			Cr.
1.1.07	b/d	600,000	31.3.07	Disposal	70,000
1.3.07	Cash	90,000	31.12.07	c/d	620,000

Scanned with CamScanner

Accumulated Depreciation A/c

Dr.					Cr.
31.3.07	Disposals (W-2)	24,500	1.1.07	b/d	345,000
				Depreciation Exp. (W-1)	109,500
31.12.10	c/d	430,000			

(W-1) Depreciation Expense

On opening assets excluding disposals and fully depreciated

	(600,000 – 70,000 – 150,000) × 20%	76,000
On addition	(90,000 × 20% × 10/12)	15,000
On disposals	(70,000 × 20% 3/12)	3,500
On fully Depreciated	(150,000 × 20% × 6/12)	15,000
		109,500

(W-2)

Period in use	(1 year and 9 months)	
Accumulated Depreciation	(70,000 × 20% × 1.75)	24,500

Answer-9

Depreciation – 2009

		Rs.
On opening assets excluding disposals excluding fully depreciated		
	(700,000 – 30,000 – 200,000) × 20%	94,000
On additions	(200,000 × 20% × 9/12 + 300,000 × 20% × 6/12)	60,000
On disposals	(30,000 × 20% × 6/12)	3,000
On fully depreciated	(200,000 × 20% 3/12)	10,000
		167,000

Depreciation – 2010

On opening assets excluding disposals excluding fully depreciated.

	(W-1) (1,170,000 – 200,000) × 20%	194,000
On additions	(250,000 × 20% 6/12)	25,000
Total		219,000

(W-1)

Asset a/c -2009

Dr.				Cr.
	b/d	700,000		
	Cash	200,000	Disposals	30,000
	Cash	300,000		
			c/d	1,170,000

Answer-10

Building A/C

Dr.					Cr.
1.1.07	b/d	2,300,000	31.5.07	Disposal	700,000
1.2.07	Cash	400,000	31.8.07	Disposal	550,000
1.4.07	Cash	650,000	31.12.07	c/d	2,100,000

Accumulated Dep. a/c

Dr.				Cr.
Disposal	(W-2)	175,780	b/d	800,000
Disposal	(W-2)	116,375	Depreciation Exp. (W-1)	186,527
c/d		694,372		

Disposal a/c

Dr.			Cr.
Building A/C	550,000	Accumulated Dep.	175,780
Building A/C	700,000	Accumulated Dep.	116,375
		Cash	450,000
		Cash	300,000
		P/L (Bal.)	207,845

Scanned with CamScanner

(W-1) Depreciation Expense

			Rate	
On opening assets excluding disposal				
Opening WDV	(2,300,000 – 800,000)	1,500,000		
Less: WDV of Disposal as on 1.1.07 (W-2) (400,950 + 609,000)		(1,009,950)		
		490,050	10%	49,005
On addition				
– (400,000 × 10% × 11/12)		36,667		
– (650,000 ×10% × 9/12)		48,750		85,417
On Disposal	(W-2)(26,730 + 25,375)			52,105
Total				186,527

(W-2) Accumulated Depreciation of Disposal

Disposal on 31 Aug 07

Cost		550,000
Dep. (04)	(550,000 × 10%)	(55,000)
WDV (1.1.05)		495,000
Dep. (05)	(495,000 × 10%)	(49,500)
WDV (1.1.06)		445,500
Dep. (06)	(445,500 × 10%)	(44,550)
WDV (1.1.07)		400,950
Dep. (07)	(400,950 × 10% × 8/12)	(26,730)
WDV (as on 31.08.07)		374,220
Accumulated Depreciation	(550,000 – 374,220)	175,780

Disposal on 31 May 07

Cost		700,000
Dep. (05)	(700,000 × 10% × 4/12)	(23,333)
WDV. (1.1.06)		676,667
Dep. (06)	(676,667 × 10%)	(67,667)
WDV (1.1.07)		609,000
Dep. (07)	(609,000 × 10% × 5/12)	(25,375)
WDV (as on 31.May.07)		583,625
Accumulated Depreciation	(700,000 – 583,625)	116,375

Answer-11

Dr.	Plant and machinery – At cost		Cr.
b/d	600,000	Disposal (W-1)	33,333
Cash	70,000	c/d	636,667

Dr.	Accumulated depreciation a/c		Cr.
Disposal (W-1)	18,333	b/d	200,000
c/d	309,500	Depreciation (W-2)	127,833

Dr.	Disposal Account		Cr.
Plant account	33,333	Accumulated depreciation	18,333
P/L	800	Cash	15,800

Workings

(W-1) Accumulated depreciation of disposals of machinery

Number of years the asset is used (1.7.2009 – 31.3.2012)		2 years and 9 months
Cost (in percentage)		100%
Accumulated depreciation (in percentage) (20% per year × 2.75Y)		55%
Book value at time of disposal (in percentage) (100% – 55%)		45%
Cost on 1.7.2009 (in rupees)	(15,000/45 × 100)	33,333
Accumulated depreciation on 30.03.2012 (in rupees)	(33,333 – 15,000)	18,333

Scanned with CamScanner

(W-2) Depreciation

Depreciation - on opening assets excluding disposals		
Opening assets	600,000	
Disposals	(33,333)	
	566,667 × 20%	113,333
Depreciation – on additions	(70,000 × 20% × 11/12)	12,833
Depreciation – on disposals	(33,333 × 20% × 3/12)	1,667
		127,833

Answer –12

Dr.	Plant and machinery - At cost		Cr.
b/d	500,000	Disposal (W-1)	21,531
Cash	77,000	c/d	555,469

Dr.	Accumulated depreciation a/c		Cr.
Disposal (W-1)	9,531	b/d	150,000
c/d	272,692	Depreciation (W-2)	82,223

Dr.	Disposal Account		Cr.
Plant account	21,531	Accumulated depreciation	9,531
P/L	4,300	Cash	16,300

Workings

(W-1) Accumulated depreciation of disposals

Assume cost to be 100		
Cost	(1.08.2009)	100
Depreciation (2009)	(100 × 20% × 5/12)	(8.3333)
WDV		91.6667
Depreciation (2010)	(91.6667 ×20%)	(18.3333)
WDV		73.3334
Depreciation (2011)	(73.3334 × 20%)	(14.6667)
WDV		58.6667
Depreciation (2012)	(58.6667 × 20% × 3/12)	(2.9333)
WDV (31.03.2012)		**55.7334**
Cost of disposals	(12,000 / 55.7334 × 100)	21,531
Accumulated depreciation of disposals	(21,531 – 12,000)	9,531

(W-2) Depreciation

Depreciation - on opening assets excluding disposals		
Opening assets WDV (500,000 – 150,000)	350,000	
Disposals WDV (21,531 / 100 × 58.6667)	(12,632)	
	337,368 × 20%	67,474
Depreciation - on additions	(77,000 × 20% × 11/12)	14,117
Depreciation - on disposals	(12,000 / 55.7334 × 2.9333)	632
		82,223

Scanned with CamScanner

Answer-13

Depreciation 2012 $= \frac{\text{Cost} - \text{Residual value}}{\text{Life}} = \frac{50,000 - 5,000}{10} = 4,500$

2013 $= \frac{\text{Cost} - \text{Residual value}}{\text{Life}} = \frac{50,000 - 5,000}{10} = 4,500$

Depreciation 2014 $= \frac{\text{WDV} - \text{new residual value}}{\text{Remaining life}} = \frac{41,000 - 2,000}{2} = 19,500$

2015 $= \frac{\text{WDV} - \text{new residual value}}{\text{Remaining life}} = \frac{41,000 - 2,000}{2} = 19,500$

WDV at the time of change in estimate = 50,000 – 4,500 – 4,500
= 41,000

Answer-14

Depreciation 2008 $= \frac{\text{Cost} - \text{Residual value}}{\text{Life}} = \frac{70,000 - 10,000}{6} = 10,000$

2009 $= \frac{\text{Cost} - \text{Residual value}}{\text{Life}} = \frac{70,000 - 10,000}{6} = 10,000$

WDV of asset at the time of change in estimate = 70,000 – 10,000 – 10,000
= 50,000

Calculation of WDV

			Rs.
WDV	(1.1.2010)		50,000
Less: Depreciation	(31.12.10)	(50,000 × 33.12 %)	(16,560)
WDV	(1.1.2011)		33,440
Less: Depreciation	(31.12.11)	(33,440 × 33.12%)	(11,075)
WDV	(1.1.2012)		22,365
Less: Depreciation	(31.12.12)	(22,365 × 33.12%)	(7,407)
WDV	(1.1.2013)		14,958
Less: Depreciation	(31.12.13)	(14,958 × 33.12%)	(4,954)
WDV	(31.12.13)		10,004

Answer-15

Cost	(1.1.07)		80,000
Less: Depreciation	(31.12.07)	(80,000 × 10%)	(8,000)
WDV	(31.12.07)		72,000
Less: Depreciation	(31.12.08)	(72,000 × 10%)	(7,200)
WDV	(31.12.08)		64,800

Depreciation 2009 $= \frac{64,800 - 5,000}{5} = 11,960$

Depreciation 2010 $= \frac{64,800 - 5,000}{5} = 11,960$

Answer-16

Depreciation – 2009 $= \frac{\text{Cost} - \text{RV}}{\text{Life}} = \frac{50,000 - 6,000}{10} = 4,400$

Depreciation – 2010 $= \frac{\text{Cost} - \text{RV}}{\text{Life}} = \frac{50,000 - 6,000}{10} = 4,400$

Depreciation – 2011 $= \frac{\text{Book value} - \text{new residual value}}{\text{Remaining life}} = \frac{41,200 \text{ (W-1)} - 2,000}{5} = 7,840$

Depreciation – 2012 $= \frac{\text{Book value} - \text{new residual value}}{\text{Remaining life}} = \frac{41,200 - 2,000}{5} = 7,840$

(W-1) Book value at the time estimate is changed = 50,000 – 4,400 – 4,400
= 41,200

Scanned with CamScanner

Answer-17

Cost			200,000
Depreciation	(31.12.2011)	(200,000 × 20%)	(40,000)
WDV	(31.12.2011)		160,000
Depreciation	(31.12.2012)	(160,000 × 20%)	(32,000)
WDV	(31.12.2012)		128,000

Depreciation – 2013 $= \frac{\text{Book value – new RV}}{\text{Remaining life}} = \frac{128,000 - 6,000}{4} = 30,500$

Depreciation – 2014 $= \frac{\text{Book value – new RV}}{\text{Remaining life}} = \frac{128,000 - 6,000}{4} = 30,500$

Answer-18

(a)

Depreciation expense

Depreciation – 2012 $= \frac{\text{Cost – RV}}{\text{Life}} = \frac{700,000 - 0}{7} = 100,000$

Depreciation – 2013 $= \frac{\text{Cost – RV}}{\text{Life}} = \frac{700,000 - 0}{7} = 100,000$

Depreciation – 2014 $= \frac{\text{Cost – RV}}{\text{Life}} = \frac{700,000 - 0}{7} = 100,000$

Depreciation – 2015 $= \frac{\text{Book value – new residual value}}{\text{Remaining life}} = \frac{400,000\ (W\text{-}1) - 15,000}{2} = 192,500$

Depreciation – 2016 $= \frac{\text{Book value – new residual value}}{\text{Remaining life}} = \frac{400,000 - 15,000}{2} = 192,500$

(W-1) WDV at time of change in estimate = Cost – accumulated depreciation
= 700,000 – 100,000 – 100,000 – 100,000
= 400,000

(b)

WDV as on 31.12.2016

WDV = Cost – Accumulated Depreciation
= 700,000 – 100,000 – 100,000 – 100,000 – 192,500 – 192,500 = 15,000

Remember that WDV at the end of life will always be equal to RV.

Answer-19

Depreciation for the year ended December 31, 20X2 (W-2) 2,500

Accumulated depreciation as on December 31, 20X2

Depreciation charged till December 31, 20X1	(W-1)	6,000
Depreciation, b/d	(W-2)	2,500
		8,500

(W-1) WDV of vehicle at the time of change in estimate i.e. 1.1.20X2

Cost	16,000
Less: Accumulated depreciation	
Number of period in use (1.1.20X0 – 31.12.20X1)	(6,000)
Accumulated depreciation	10,000
WDV as on 1.2.20X2	

(W-2) Calculation of depreciation for the year ended December 31, 20X2

Depreciation = (WDV at time of change - residual value) / remaining life
= ((W-1) 10,000 – 2,500)/ 3years

The remaining life from 1.1.20X2 to 1.1.20X5 is three years 2,500

Scanned with CamScanner

Answer-20

(a) Journal entry

Plant and Machinery	(New)		130,000	
Accumulated depreciation	(Old)	(W-1)	26,000	
P/L (Bal.)			37,000	
Plant and Machinery		(Old)		80,000
Cash A/C		(W-2)		113,000

(W-1) Accumulated Depreciation of Disposals

Period asset is used	(1.4.2009 – 30.6.2012)	3 years and 3 months
Accumulated Depreciation	(80,000 × 10% ×3.25)	26,000

(W-2) Cash paid

New asset cost – TIA	= 130,000 – 17,000	= 113,000

(b)

Plant and Machinery A/c

Dr.			Cr.
b/d	600,000	Disposal (old)	80,000
Disposals (New)	130,000		
Cash	67,000		
		c/d	717,000

Accumulated Depreciation A/C

Dr.			Cr.
Disposal (part-a)	26,000	b/d	200,000
		Depreciation Expense (W-1)	64,733
c/d	238,733		

Disposal A/c

Dr.			Cr.
Plant and Machinery (old)	80,000	Accumulated Depreciation	26,000
		Plant and Mach. (new)	130,000
Cash	113,000		
		P/L (Bal.)	37,000

(W-1) Depreciation Expense

- On opening assets excluding disposals (600,000 – 80,000) × 10%		52,000
- On additions	(130,000 × 10% × 6/12 + 67,000 × 10% × 4/12)	8,733
- On disposals	(80,000 × 10% × 6/12)	4,000
		64,733

Answer-21

Furniture – Book value

Dr.						Cr.
1.1.09	b/d	25,000	30.9.09	Disposals	(W-2)	17,340
1.3.09	Cash	60,000		Depreciation	(W-1)	24,480
1.6.09	Cash	90,000		c/d		133,180

Disposal A/c

Dr.			Cr.
Furniture – BV	17,340	Cash	12,000
		P/L (bal.)	5,340

(W-1) Depreciation expense

- Opening excluding disposal (25,000 – 20,400) × 20%		920
- On addition	(60,000 × 20% × 10/12) + (90,000 × 20% × 7/12)	20,500
- On disposals		3,060
		24,480

Scanned with CamScanner

(W-2) WDV of Disposals

Cost	(1.04.2007)		30,000
Depreciation	(2007)	(30,000 × 20% × 9/12)	(4,500)
WDV			25,500
Depreciation	(2008)	(25,500 × 20%)	(5,100)
WDV			20,400
Depreciation	(2009)	(20,400 × 20% × 9/12)	(3,060)
WDV			17,340

Answer-22

Building – BV

Dr.			Cr.
b/d	1,500,000	Disposals (BV) (W-2)	374,220
Cash	400,000	Disposals (BV) (W-2)	583,625
Cash	650,000	Depreciation Expense(W-1)	186,527
		c/d	1,405,628

Disposal a/c

Dr.			Cr.
Asset	374,220	Cash	450,000
Asset	583,625	Cash	300,000
		P/L (Bal.)	207,845

Workings

(W-1) Depreciation Expense

- On opening assets excluding disposals
  (1,500,000 – 400,950(W-2) – 609,000 (W-2)) × 10% — 49,005
- On addition (400,000 × 10% × 11/12) + (650,000 × 10% × 9/12) — 85,417
- On disposal (W-2) (26,730 + 25,375) — 52,105

186,527

(W-2) WDV of disposals

			Rs.
Disposal on 31.08.09			
Cost			550,000
Depreciation	(2004)	(550,000 × 10%)	(55,000)
WDV			495,000
Depreciation	(2005)	(495,000 × 10%)	(49,500)
WDV			445,500
Depreciation	(2006)	(445,000 × 10%)	(44,550)
WDV			400,950
Depreciation	(2007) (31.08.07)	(400,950 × 10% × 8/12)	(26,730)
WDV			374,220
Disposed on 31.May.07			
Cost			700,000
Depreciation	(2005)	(700,000 × 10% × 4/12)	(23,333)
WDV			676,667
Depreciation	(2006)	(676,667 × 10%)	(67,667)
WDV			609,000
Depreciation	(2007) (31.May.07)	(609,000 × 10% × 5/12)	(25,375)
WDV			583,625

Scanned with CamScanner

Answer-23

Dr.		Building A/c – at BV			Cr.
1.1.2010	b/d	35,000	31.3.2010	Disposals (W-2)	6,737
31.3.2010	Disposals (new)	20,000		Depreciation (W-1)	8,213
1.3.2010	Cash	12,000	31.3.2010	c/d	52,050

Dr.		Disposal A/c		Cr.
Furniture	(old)	6,737	Furniture	20,000
Cash a/c		7,500		
P/L	(bal.)	5,763		

(W-1) Depreciation expense

- On opening excluding disposals	(35,000 – 7,000) × 15%	4,200
- On additions	(20,000 × 15% × 9/12)	2 250
	(12,000 × 15% × 10/12)	1,500
- On disposals **(W-2)**		263
		8,213

(W-2) WDV of disposals

WDV on 01.01.2010		7,000
Depreciation	(7,000 × 15% × 3/12)	(263)
		6,737

Answer-24

Dr.		Furniture			Cr.
b/d		100,000	Disposal	(W-2)	8,856
			c/d		91,144

Dr.		Furniture			Cr.
b/d		100,000	Disposal	(W-2)	8,856
			c/d		91,144

Dr.		Accumulated Depreciation a/c			Cr.
			b/d	(W-1)	53,992
Disposal	(W-2)	3,856			
			Depreciation	(W-3)	6,440
c/d (Bal.)		56,576			

(W-1) Opening accumulated depreciation:

70% furniture	$= \frac{70,000-(70,000 \times 0.05)}{10}$	× 3.8333	25,492
30 % furniture	$= \frac{30,000-(30,000 \times 0.05)}{10}$	× 10 years	28,500
			53,992

(W-2) Cost of Disposal and their Accumulated Depreciation:

Let Cost		100
Accumulated Depreciation	$= \left[\frac{100-5}{10} \times 4.5833\right]$	(43.5417)
WDV		56.4583
Cost in rupees	$= \frac{5,000}{56.4583} \times 100$	8,856
Accumulated Depreciation	(8,856 – 5,000)	3,856

Scanned with CamScanner

Disposal account

Dr.			Cr.
Furniture (W-2)	8,856	Acc. Depreciation (W-2)	3,856
P and L	6,000	Cash (Bal.)	11,000

(W-3) Depreciation Expense:

- On opening cost less cost of Disposal less cost of fully depreciated assets:

Cost	(100,000 – 8,856 – 30,000)	61,144		
Less: Residual value	(61,144 × 5%)	(3,057)		
		58,087	x 10%	5,809

- On disposals $\frac{8{,}856-5\% \text{ of } 8{,}856}{10} \times 9/12$ 631

6,440

Computer account

Dr.			Cr.
b/d	200,000	c/d	200,000

Acc. Depreciation a/c

Dr.				Cr.
		b/d	(W-1)	26,269
		Depreciation	(W-2)	56,910
c/d	83,179			

(W-1) Accumulated Depreciation:

			Rs.
Cost	(1.04.04)		200,000
Depreciation	(31.12.04)	(200,000 × 5% × 9/12)	(7,500)
WDV			192,500
Depreciation	(31.12.05)	(192,500 × 5%)	(9,625)
WDV			182,875
Depreciation	(31.12.06)	(182,875 × 5%)	(9,144)
W.D.V on 01.01.07			173,731
Accumulated Depreciation	(200,000 – 173,731)		26,269

(W-2)	Depreciation expense for the year using straight line	
	$= \frac{\text{WDV}-\text{New Residual Value}}{\text{remaining life}} = \frac{173{,}731-3{,}000}{3 \text{ years}}$	56,910

Vehicle a/c

Dr.			Cr.
b/d	300,000	Disposal (old) (iii)	20,000
Disposal (new) (W-1)	21,672	Disposal (iv) (W-3)	8,237
Purchases (18,000/140 × 100)	12,857	c/d (Bal.)	306,292

Accumulated Depreciation

Dr.			Cr.
Disposal (iii) (W-2)	3,328	b/d	80,000
Disposal (iv) (W-3)	3,237		
c/d	96,054	Dep. Expense (W-4)	22,619

Disposal account

Dr.			Cr.
Vehicle (old)	20,000	Vehicle (new)	21,673
Cash	9,000	Acc. Depreciation (W-2)	3,328
		P and L	4,000

Scanned with CamScanner

Dr.	Disposal account		Cr.
Cost (W-3)	8,237	Acc. Depreciation (W-3)	3,237
		Cash	2,000
		P and L (Bal.)	3,000

Alternatively a combined disposal account can be prepared.

(W-1) Disposal Entry

	Dr.	Cr.
Vehicle (new) (Bal.)	21,673	
Acc. Depreciation (old)	3,327	
Profit and Loss	4,000	
Vehicle (old)		20,000
Cash a/c		9,000

(W-2) Accumulated Depreciation of Disposals (iii)

Cost			20,000
Depreciation	(2005)	(20,000 × 10% × 6/12)	(1,000)
WDV			19,000
Depreciation	(2006)	(19,000 × 10%)	(1,900)
WDV			17,100
Depreciation	(2007)	(17,100 × 10% × 3/12)	(428)
WDV			16,672
Accumulated Depreciation		(20,000 – 16,672)	3,328

(W-3) Cost and Accumulated Depreciation of Disposals (iv)

Let	Cost			100
	Dep.	(2003)	(100 × 10% × 10/12)	(8.3333)
	WDV			91.6667
	Dep.	(2004)	(91.6667 × 10%)	(9.1667)
	WDV			82.5
	Dep.	(2005)	(82.5001 × 10%)	(8.25)
	WDV			74.25
	Dep.	(2006)	(74.2501 × 10%)	(7.425)
	WDV			66.825
	Dep.	(2007)	(66.825 × 10% × 11/12)	(6.1256)
	WDV			60.6994

Cost $= \frac{5,000}{60.6994} \times 100\%$ 8,237

Acc. Dep. = 8,237 – 5,000 3,237

(W-4) Depreciation Expense:

- On opening WDV excluding disposals:

Op. WDV	(300,000 – 80,000)	220,000		
Less: WDV of disposals:				
- Adj. (iii)		(17,100)		
- Adj. (iv)	$\left(\frac{8,237}{100} \times 66.825\right)$	(5,504)		
		197,396	x 10%	19,740

- On disposals

- Adj. (iii)		428
- Adj. (iv)	$\frac{8,237}{100} \times 6.1256$	505

- On additions (21,672 × 10% × 9/12 + 12,857 × 10% × 3/12) 1,946

22,619

Scanned with CamScanner

Answer-25

Rectifying		Original		Wrong	
i) Advance – Furniture	30,000	Advance –Furniture	30,000	Furniture A/C	30,000
Furniture	30,000	Cash	30,000	Cash	30,000
ii) Furniture	18,000	Furniture	100,000	Furniture A/C	12,000
Acc. Dep.	14,000	Acc. Dep.(W-1)	14,000	Cash	12,000
P/L (Bal.)	32,000	P/L (Bal.)	32,000		
		Furniture	70,000		
		Cash	12,000		
iii) Acc. Dep.	12,000	Acc. Dep. (W-2)	12,000	Cash	33,000
P/L	35,000	Cash	33,000	Plant and Mach.	33,000
Plant and Mach.	47,000	P/L (Bal.)	35,000		
		Plant and Mach.	80,000		

(W-1) Accumulated Dep. for adj. (ii)

Period used	2 years
Accumulated Depreciation (70,000 × 10% × 2 years)	14,000

(W-2) Accumulated Dep. of adj. (iii)

Period used	1 year and 6 months
Accumulated Dep. (80,000 × 10% × 1.5 years)	12,000

b)

Dr.	Furniture a/c		Cr.
Un adj. Cl.	800,000	Adj. (i)	30,000
Adj. (ii)	18,000		
		c/d	788,000

Dr.	Plant and Machinery a/c		Cr.
Un adj. cl.	300,000	Adj. (iii)	47,000
		c/d	253,000

Answer-26

Date	Description	Dr.	Cr.
Jan. 1, 2009	Land	600,000	
	Cash		600,000
Dec. 31, 2009	Land	150,000	
	Revaluation surplus		150,000
Dec. 31, 2010	Revaluation surplus	150,000	
	P/L (SOCI)	20,000	
	Land		170,000
Dec. 31, 2011	Land	70,000	
	Revaluation surplus		50,000
	P/L (SOCI)		20,000
Dec. 31, 2012	Land	150,000	
	Revaluation surplus		150,000

Scanned with CamScanner

(W-1) Calculation of revaluation surplus on land

Date	Description	Land	R. Surplus	SOCI(P/L)
1/1/09	Cost	600,000		
31/12/09	Revaluation surplus (bal.)	150,000	150,000	
31/12/09	Revalued amount	750,000		
31/12/10	Revaluation surplus (bal.)	(170,000)	(150,000)	(20,000)
31/12/10	Revalued amount	580,000	-	(20,000)
31/12/11	Revaluation surplus (bal.)	70,000	50,000	20,000
31/12/11	Revalued amount	650,000	50,000	-
31/12/12	Revaluation surplus (bal.)	150,000	150,000	
31/12/12	Revalued amount	800,000	200,000	

(W-2)

Land A/c

Dr.					Cr.
1.1.09	Cash	600,000			
31.12.09	Revaluation surplus	150,000	31.12.09	c/d	750,000
1.1.10	b/d	750,000	31.12.10	Revaluation surplus	150,000
			31.12.10	P/L (SOCI)	20,000
			31.12.10	c/d	580,000
1.1.11	b/d	580,000			
31.12.11	Revaluation Surplus	50,000			
31.12.11	P/L	20,000	31.12.11	c/d	650,000
1.1.12	b/d	650,000			
31.12.12	Revaluation Surplus	150,000	31.12.12	c/d	800,000

Revaluation surplus

Dr		Rs			Cr. Rs
31-12-09	Bal c/d	150,000	31-12-09	Land	150,000
31-12-10	Land	150,000	1-01-10	Bal b/d	150,000
31-12-11	Bal c/d	50,000	31-12-11	Land	50,000
			01-01-12	Bal b/d	50,000
31-12-12	Bal c/d	200,000	31-12-12	Land	150,000
		200,000			200,000

Answer-27

Date	Description	Dr.	Cr.
Jan, 1, 2005	Land	700,000	
	Bank		700,000
Dec, 31, 2005	Land	100,000	
	Revaluation Surplus		100,000
Dec, 31, 2006	Revaluation Surplus	100,000	
	P/L	20,000	
	Land		120,000
Dec, 31, 2007	Land	70,000	
	P/L		20,000
	Revaluation Surplus		50,000
Dec, 31, 2008	Land	75,000	
	Revaluation Surplus		75,000

Scanned with CamScanner

(W-l) Calculation of revaluation surplus on land

Date	Description	Land	R. Surplus	SOCI(P/L)
1/1/05	Cost	700,000		
31/12/05	Revaluation surplus (bal.)	100,000	100,000	
31/12/05	Revalued amount	800,000		
31/12/06	Revaluation surplus (bal.)	(120,000)	(100,000)	(20,000)
31/12/06	Revalued amount	680,000	-	(20,000)
31/12/07	Revaluation surplus (bal.)	70,000	50,000	20,000
31/12/07	Revalued amount	750,000	50,000	-
31/12/08	Revaluation surplus (bal.)	75,000	75,000	
31/12/08	Revalued amount	825,000	125,000	

(W-2)

Land a/c

Dr.					Cr.
1-1-2005	Bank	700,000			
31-12-2005	Revaluation Surplus	100,000	31-12-2005	c/d	800,000
1-1-2006	b/d	800,000	31-12-2006	Revaluation Surplus	100,000
			31-12-2006	P/L	20,000
			31-12-2006	c/d	680,000
1-1-2007	b/d	680,000			
31-12-2007	Revaluation Surplus	50,000			
31-12-2007	P/L	20,000	31-12-2007	c/d	750,000
1-1-2008	b/d	750,000			
31-12-2008	Revaluation Surplus	75,000	31-12-2007	c/d	825,000

Revaluation surplus

Dr.		Rs.			Cr. Rs.
31-12-05	Bal c/d	100,000	31-12-05	Land	100,000
31-12-06	Land	100,000	01-01-06	Bal b/d	100,000
31-12-07	Bal c/d	50,000	31-12-07	Land	50,000
			01-01-08	Bal b/d	50,000
31-12-08	Bal c/d	125,000	31-12-08	Land	75,000
		125,000			125,000

Answer-28

Journal entries

Date	Particular	Dr.	Cr.
1/1/2001	Plant	100,000	
	Cash		100,0
31/12/2001	Depreciation	10,000	
	Accumulated depreciation		10,0
1/1/2002	Accumulated depreciation	10,000	
	Plant		10,0
1/1/2002	Plant	90,000	
	Revaluation surplus		90,0
31/12/2002	Depreciation	20,000	
	Accumulated depreciation		20,0

Scanned with CamScanner

31/12/2002	Revaluation surplus (90,000/9)	10,000	
	Retained earnings		10,000
1/1/2003	Accumulated depreciation	20,000	
	Plant		20,000
1/1/2003	Revaluation surplus	80,000	
	P/L	20,000	
	Plant		100,000
31/12/2003	Depreciation	7,500	
	Accumulated depreciation		7,500
1/1/2004	Accumulated depreciation	7,500	
	Plant		7,500
1/1/2004	Plant	24,500	
	Revaluation surplus		7,000
	P/L		17,500
31/12/2004	Depreciation	11,000	
	Accumulated depreciation		11,000
31/12/2004	Revaluation surplus (7,000/7)	1,000	
	Retained earnings		1,000
1/1/2005	Accumulated depreciation	11,000	
	Plant		11,000
1/1/2005	Plant	54,000	
	Revaluation surplus		54,000
31/12/2005	Depreciation	20,000	
	Accumulated depreciation		20,000
31/12/2005	Revaluation surplus	10,000	
	Retained earnings		10,000

(W-1) Calculation of revaluation surplus and depreciation on plant

Date	Description	Plant	R. Surplus	SOCI(P/L)
01/1/01	Cost	100,000		
31/12/01	Depreciation (100,000/10)	(10,000)		
31/12/01	WDV	90,000		
1/1/02	Revaluation surplus (bal.)	90,000	90,000	
1/1/02	Revalued amount	180,000	90,000	
31/12/02	Depreciation (180,000/9) : (90,000/9)	(20,000)	(10,000)	-
31/12/02	WDV	160,000	80,000	-
1/1/03	Revaluation surplus (bal.)	(100,000)	(80,000)	(20,000)
1/1/03	Revalued amount	60,000	-	(20,000)
31/12/03	Depreciation (60,000/8) : (20,000/8)	(7,500)		2,500
31/12/03	WDV	52,500		(17,500)
1/1/04	Revaluation surplus (bal.)	24,500	7,000	17,500
1/1/04	Revalued amount	77,000	7,000	-
31/12/04	Depreciation (77,000/7):(7,000/7)	(11,000)	(1,000)	
31/12/04	WDV	66,000	6,000	
1/1/05	Revaluation surplus (bal.)	54,000	54,000	
1/1/05	Revalued amount	120,000	60,000	
31/12/05	Depreciation (120,000/6):(60,000/6)	(20,000)	(10,000)	
31/12/05	WDV	100,000	50,000	

Scanned with CamScanner

(W-2)

Plant account

Dr.					Cr
1-1-2001	Cash	100,000	31-12-2001	c/d	100,000
1-1-2002	b/d	100,000	1-1-2002	Acc. Depreciation	10,000
1-1-2002	Rev. Surplus	90,000	31-12-2002	c/d	180,000
1-1-2003	b/d	180,000	1-1-2003	Acc. Depreciation	20,000
			1-1-2003	Rev. Surplus	80,000
			1-1-2003	P/L	20,000
			31-12-2003	c/d	60,000
1-1-2004	b/d	60,000	1-1-2004	Acc. Depreciation	7,500
1-1-2004	Rev. Surplus	7,000			
1-1-2004	P/L	17,500	31-12-2004	c/d	77,000
1-1-2005	b/d	77,000	1-1-2005	Acc. Depreciation	11,000
1-1-2005	Revaluation Surplus	54,000	31-12-2005	c/d	120,000

Accumulated Depreciation a/c

Dr.					Cr.
31-12-2001	c/d	10,000	31-12-2001	Depreciation	10,000
1-1-2002	Plant	10,000	1-1-2002	b/d	10,000
31-12-2002	c/d	20,000	31-12-2002	Dep. Expense	20,000
1-1-2003	Plant	20,000	1-1-2003	b/d	20,000
31-12-2003	c/d	7,500	31-12-2003	Depreciation	7,500
1-1-2004	Plant	7,500	1-1-2004	b/d	7,500
31-12-2004	c/d	11,000	31-12-2004	Depreciation	11,000
1-1-2005	Plant	11,000	1-1-2005	b/d	11,000
31-12-2005	c/d	20,000	31-12-2005	Depreciation	20,000

Revaluation Surplus account

Dr.					Cr.
31-12-2002	Retained Earnings	10,000	1-1-2002	Plant.	90,000
31-12-2002	c/d	80,000			
1-1-2003	Plant	80,000	1-1-2003	b/d	80,000
31-12-2003	c/d	--			
31-12-2004	Retained Earning	1,000	1-1-2004	Plant	7,000
31-12-2004	c/d	6,000			
31-12-2005	Retained Earning	10,000	1-1-2005	b/d	6,000
31-12-2005	c/d	50,000	1-1-2005	Plant	54,000

Retained earnings

Dr		Rs			Rs
31-12-02	Bal c/d	10,000	31-12-02	Rev. surplus	10,000
31-12-03	Bal c/d	10,000	01-01-03	Bal b/d	10,000
			01-01-04	Bal b/d	10,000
31-12-04	Bal c/d	11,000	31-12-04	Rev. surplus	1,000
		11,000			11,000
			01-01-05	Bal b/d	11,000
31-12-05	Bal c/d	21,000	31.12.05	Rev. surplus	10,000
		21,000			21,000

Scanned with CamScanner

Answer-29

Entries:

Date	Particulars	Dr.	Cr.
1-1-2010	Building	500,000	
	Cash		500,000
31-12-2010	Depreciation expenses	25,000	
	Accumulated Depreciation		25,000
1-1-2011	Accumulated Depreciation	25,000	
	Building		25,000
1-1-2011	Building	75,000	
	Revaluation Surplus		75,000
31-12-2011	Depreciation Expense	28,947	
	Accumulated Depreciation		28,947
31-12-2011	Revaluation Surplus (75,000/19)	3,947	
	Retained Earnings		3,947
1-1-2012	Accumulated Depreciation	28,947	
	Building		28,947
1-1-2012	Revaluation Surplus	71,053	
	P/L	70,000	
	Building		141,053
31-12-2012	Depreciation Expense	21,111	
	Accumulated Expenses		21,111
1-1-2013	Accumulated Depreciation	21,111	
	Building		21,111
1-1-2013	Building	391,111	
	Revaluation surplus		325,000
	P/L		66,111
31-12-2013	Depreciation Expense	44,118	
	Accumulated Depreciation		44,118
31-12-2013	Revaluation Surplus (325,000/17)	19,118	
	Retain Earnings		19,118
1-1-2014	Accumulated Depreciation	44,118	
	Building		44,118
1-1-2014	Building	94,118	
	Revaluation Surplus		94,118
31-12-2014	Depreciation Expense	50,000	
	Accumulated Depreciation		50,000
31-12-2014	Revaluation Surplus	25,000	
	Retained Earnings		25,000

(W-I) Calculation of revaluation surplus and depreciation on building

Date	Description	Building	R. Surplus	SOCI(P/L)
1/1/10	Cost	500,000		
31/12/10	Depreciation (500,000/20)	(25,000)		
31/12/10	WDV	475,000		
1/1/11	Revaluation surplus (bal.)	75,000	75,000	
1/1/11	Revalued amount	550,000	75,000	
31/12/11	Depreciation (550,000/19):(75,000/19)	(28,947)	(3,947)	-
31/12/11	WDV	521,053	71,053	-
1/1/12	Revaluation surplus (bal.)	(141,053)	(71,053)	(70,000)
1/1/12	Revalued amount	380,000	-	(70,000)
31/12/12	Depreciation (380,000/18):(70,000/18)	(21,111)		3,889
31/12/12	WDV	358,889		(66,111)

Scanned with CamScanner

1/1/13	Revaluation surplus (bal.)	391,111	325,000	66,111
1/1/13	Revalued amount	750,000	325,000	
31/12/13	Depreciation (750,000/17):(325,000/17)	(44,118)	(19,118)	
31/12/13	WDV	705,882	305,882	
1/1/14	Revaluation surplus (bal.)	94,118	94,118	
1/1/14	Revalued amount	800,000	400,000	
31/12/14	Depreciation (800,000/16):(400,000/16)	(50,000)	(25,000)	
31/12/14	WDV	750,000	375,000	

(W-2)

Building Account

Dr.					Cr.
1-1-2010	Cash	500,000	31-12-2010	c/d	500,000
1-1-2011	b/d	500,000	1-1-2011	Acc. Depreciation	25,000
1-1-2011	Revaluation Surplus	75,000	31-12-2011	c/d	550,000
1-1-2012	b/d	550,000	1-1-2012	Acc. Depreciation	28,947
			1-1-2012	Rev. surplus	71,053
			1-1-2012	P/L	70,000
			31-12-2012	c/d	380,000
1-1-2013	b/d	380,000	1-1-2013	Acc. Depreciation	21,111
1-1-2013	Revaluation surplus	325,000			
1-1-2013	P/L	66,111	31-12-2013	c/d	750,000
1-1-2014	b/d	750,000	1-1-2014	Acc. Depreciation	44,118
1-1-2014	Revaluation surplus	94,118	31-12-2014	c/d	80,000

(W-3)

Accumulated Depreciation Account

Dr.					Cr.
			31-12-2010	Dep. Expense	25,000
31-12-2010	c/d	25,000			
1-1-2011	Building	25,000	1-1-2011	b/d	25,000
31-12-2011	c/d	28,947	31-12-2011	Dep. Expense	28,947
1-1-2012	Building	28,947	1-1-2012	b/d	28,947
31-12-2012	c/d	21,111	31-12-2012	Dep. Expense	21,111
1-1-2013	Building	21,111	1-1-2013	b/d	21,111
31-12-2013	c/d	44,118	31-12-2013	Dep. Expense	44,118
1-1-2014	Building	44,118	1-1-2014	b/d	44,118
31-12-2014	c/d	50,000	31-12-2014	Dep. Expense	50,000

(W-4)

Revaluation Surplus Account

Dr.					Cr.
31-12-2011	Retained Earnings	3,947	1-1-2011	Building	75,000
31-12-2011	c/d	71,053			
1-1-2012	Building	71,053	1-1-2012	b/d	71,053
	C/d				
31-12-2013	Retained Earnings	19,118	1-1-2013	Building	325,000
31-12-2013	c/d	305,882			
31-12-2014	Retained Earnings	25,000	1-1-2014	b/d	305,882
31-12-2014	c/d	375,000	1-1-2014	Building	94,118

Scanned with CamScanner

Dr **Retained earnings**

		Rs			Rs
31-12-11	Bal c/d	3,947	31-12-11	Revaluation surplus	3,947
31-12-12	Bal c/d	3,947	01-01-12	Bal b/d	3,947
			01-01-13	Bal b/d	3,947
31-12-13	Bal c/d	23,065		Revaluation surplus	19,118
		23,065			23,065
			01-01-14	Bal b/d	23,068
31-12-14	Bal c/d	48,065	31-12-14	Revaluation surplus	25,000
		48,065			48,065

Answer-30

Journal entries

Date	Particulars	Dr.	Cr.
1/1/01	Plant Bank (Purchase of plant)	200,000	200,000
31/12/01	Depreciation expense Accumulated depreciation (Recording of depreciation on plant)	20,000	20,000
31/12/02	Depreciation expense Accumulated depreciation (Recording of depreciation on plant)	20,000	20,000
31/12/02	Accumulated depreciation (20,000 + 20,000) Plant (Transfer of accumulated depreciation to plant)	40,000	40,000
31/12/02	Plant Revaluation surplus (Recording of revaluation surplus)	120,000	120,000
31/12/03	Depreciation expense Accumulated depreciation (Recording of depreciation on plant)	35,000	35,000
31/12/03	Revaluation surplus Retained earning (Transfer of revaluation surplus to retained earnings)	15,000	15,000
31/12/03	Accumulated depreciation Plant (Transfer of accumulated depreciation to plant)	35,000	35,000
31/12/03	Revaluation surplus P/L Plant (Recording of revaluation loss)	105,000 60,000	165,000
31/12/04	Depreciation expense Accumulated depreciation (Recording of depreciation on plant)	11,429	11,429
31/12/04	Accumulated depreciation Plant (Transfer of accumulated depreciation to plant)	11,429	11,429
31/12/04	P/L Plant (Recording of revaluation loss)	8,571	8,571
31/12/05	Depreciation expense Accumulated depreciation (Recording of depreciation on plant)	10,000	10,000

Scanned with CamScanner

31/12/05	Accumulated depreciation Plant (Transfer of accumulated depreciation to plant)	10,000	10,000
31/12/05	Plant Revaluation surplus Revaluation loss (Recording of revaluation surplus)	70,000	20,000 50,000

(W-1) Calculation of revaluation surplus and depreciation

Date	Description	Building	R. Surplus	SOCI(P/L)
1/1/01	Cost	200,000		
31/12/01	Depreciation (200,000/10)	(20,000)		
31/12/01	WDV	180,000		
31/12/02	Depreciation (200,000/10)	(20,000)		
31/12/02	WDV	160,000		
31/12/02	Revaluation surplus (bal.)	120,000	120,000	
31/12/02	Revalued amount	280,000	120,000	
31/12/03	Depreciation (280,000/8):(120,000/8)	(35,000)	(15,000)	
31/12/03	WDV	245,000	105,000	
31/12/03	Revaluation surplus (bal.)	(165,000)	(105,000)	(60,000)
31/12/03	Revalued amount	80,000	-	(60,000)
31/12/04	Depreciation (80,000/7):(60,000/7)	(11,429)		8,571
31/12/04	WDV	68,571	-	(51,429)
31/12/04	Revaluation surplus (bal.)	(8,571)		(8,571)
31/12/04	Revalued amount	60,000	-	(60,000)
31/12/05	Depreciation (60,000/6):(60,000/6)	(10,000)		10,000
31/12/05	WDV	50,000		(50,000)
31/12/05	Revaluation surplus (bal.)	70,000	20,000	50,000
31/12/05	Revalued amount	120,000	20,000	-

Plant account

Dr		Rs			Cr Rs
01-01-01	Bank	200,000	31-12-01	Bal c/d	200,000
01-01-02	Bal b/d	200,000	31-12-02	Acc. dep	40,000
31-12-02	Revaluation surplus	120,000	31-12-02	Bal c/d	280,000
		320,000			320,000
01-01-03	Bal b/d	280,000	31-12-03	Acc. dep	35,000
			31-12-03	Rev. surplus	105,000
			31-12-03	P/L	60,000
			31-12-03	Bal c/d	80,000
		280,000			280,000
01-01-04	Bal b/d	80,000	31-12-04	Acc. dep	11,429
			31-12-04	P/L	8,751
			31-12-04	Bal c/d	60,000
		80,000			80,000
01-01-05	Bal b/d	60,000	31-12-05	Acc. dep	10,000
31-12-05	P/L	50,000			
31-12-05	Rev. surplus	20,000	31-12-05	Bal c/d	120,000
		130,000			130,000

Retained earnings

Dr		Rs			Cr Rs
31-12-03	Bal c/d	15,000	31-12-03	Rev. surplus	15,000
31-12-04	Bal c/d	15,000	01-01-04	Bal b/d	15,000
31-12-05	Bal c/d	15,000	01-01-05	Bal b/d	15,000

Scanned with CamScanner

Accumulated depreciation account

Dr		Rs			Cr Rs
31-12-01	Bal c/d	20,000	31-12-01	Depreciation	20,000
31-12-02	Plant	40,000	01-01-02	Bal b/d	20,000
31-12-02	Bal c/d	-	31-12-02	depreciation	20,000
		40,000			40,000
31-12-03	Plant	35,000	01-01-03	Bal b/d	-
31-12-03	Bal c/d	-	31-12-03	depreciation	35,000
		35,000			35,000
31-12-04	Plant	11,429	01-01-04	Bal b/d	-
31-12-04	Bal c/d	-	31-12-04	depreciation	11,429
		11,429			11,429
31-12-05	Plant	10,000	01-01-05	Bal b/d	-
31-12-05	Bal c/d	-	31-12-05	depreciation	10,000
		10,000			10,000

Answer-31

Journal entries

Rs. million

Date	Particulars	Dr.	Cr.
1/7/15	Plant	100	
	Bank		100
	(Purchase of plant)		
30/6/16	Depreciation expense	10	
	Accumulated depreciation		10
	(Recording of depreciation on plant)		
30/6/16	Accumulated depreciation	10	
	Plant		10
	(Transfer of accumulated depreciation to plant)		
30/6/16	P/L (Revaluation loss)	10	
	Plant		10
	(Recording of revaluation deficit)		
30/6/17	Depreciation expense	8.89	
	Accumulated depreciation		8.89
	(Reeording of depreciation on plant)		
30/6/17	Accumulated depreciation	8.89	
	Plant		8.89
	(Transfer of accumulated depreciation to plant)		
30/6/17	Plant	23.89	
	Revaluation surplus		15
	P L		8.89
	(Recording of revaluation surplus)		
30/6/18	Depreciation expense	11.875	
	Accumulated depreciation		11.875
	(Recording of depreciation on plant)		
30/6/18	Revaluation Surplus	1.875	
	Retained earnings		1.875
	(transfer of remaining revaluation surplus to retained earnings)		
30/6/18	Accumulated depreciation	11.875	
	Plant		11.875
	(Transfer of accumulated depreciation to plant)		

Scanned with CamScanner

30/6/18	Plant	26.875	
	Revaluation surplus		26.875
	(Recording of revaluation surplus)		

(W-1) Calculation of revaluation surplus and depreciation

Date	Description	Plant Rs. Million	R. Surplus Rs. Million	SOCI(P/L) Rs. Million
1/7/15	Cost	100		
30/6/16	Depreciation (100/10)	(10)		
30/6/16	WDV	90		
30/6/16	Revaluation surplus/ (loss) (bal.)	(10)		(10)
30/6/16	Revalued amount	80		(10)
30/6/17	Depreciation (80/9):(10/9)	(8.89)		1.11
30/6/17	WDV	71.11		(8.89)
30/6/17	Revaluation surplus (bal.)	23.89	15	8.89
30/6/17	Revalued amount	95	15	0
30/6/18	Depreciation (95/8):(15/8)	(11.875)	(1.875)	
30/6/18	WDV	83.125	13.125	
30/6/18	Revaluation surplus (bal.)	26.875	26.875	
30/6/18	Revalued amount	110	40	

Plant account

Dr		Rs			Cr Rs
01-07-15	Bank	100,000	30-06-16	Acc. dep	10,000
			30-06-16	P/L	10,000
			30-06-16	Bal c/d	80,000
		100,000			100,000
01-07-16	Bal b/d	80,000	30-06-17	Acc. dep	8,889
30-06-17	P/L	8,889			
30-06-17	Rev. surplus	15,000	30-06-17	Bal c/d	95,000
		103,889			103,889
01-07-17	Bal b/d	95,000	30-06-18	Acc. Dep	11,875
30-06-18	Rev. surplus	26,875	30-06-18	Bal c/d	11,000
		121,875			121,875

Revaluation surplus

Dr		Rs			Cr Rs
30-06-16	Bal c/d	-	01-07-15	Bal b/d	-
			01-07-16	Bal b/d	-
30-06-17	Bal c/d	15,000	30-06-17	Plant	15,000
		15,000			15,000
30-06-18	Retained earnings	1,875	01-07-17	Bal b/d	15,000
30-06-18	Bal c/d	40,000	30-06-18	Plant	26,875
		41,875			41,875

Accumulated depreciation account

Dr		Rs			Cr Rs
30-06-16	Plant	10,000	01-07-15	Bal b/d	-
30-06-16	Bal c/d	-	30-06-16	Depreciation	10,000
		10,000			10,000
30-06-17	Plant	8,889	01-07-16	Bal b/d	-
30-06-17	Bal c/d	-	30-06-17	Depreciation	8,889
		8,889			8,889

Scanned with CamScanner

30-06-18	Plant	11,875	01-07-17	Bal b/d	-
30-06-18	Bal c/d	-	30-06-18	Depreciation	11,875
		11,875			11,875

Dr **Retained earnings** **Cr**

		Rs			Rs
30-06-18	Bal c/d	1,875	30-06-18	Revaluation surplus	1,875
		1,875			1,875

Answer-32

Journal entries **Rs.**

Date	Particulars	Dr.	Cr.
1/7/10	Plant	500,000	
	Bank		500,000
	(Purchase of plant)		
30/6/11	Depreciation expense	25,000	
	Accumulated depreciation		25,000
	(Recording of depreciation on plant)		
1/7/11	Accumulated depreciation	25,000	
	Plant		25,000
	(Transfer of accumulated depreciation to plant)		
1/7/11	Plant	5,000	
	Revaluation surplus		5,000
	(Recording of revaluation surplus)		
30/6/12	Depreciation expense	25,263	
	Accumulated depreciation		25,263
	(Recording of depreciation on plant)		
30/6/12	Revaluation surplus	263	
	Retained earning		263
	(Transfer of revaluation surplus to retained earnings)		
1/7/12	Accumulated depreciation	25,263	
	Plant		25,263
	(Transfer of accumulated depreciation to plant)		
1/7/12	Revaluation surplus	4,737	
	P/L (bal.)	60,000	
	Plant		64,737
	(Recording of revaluation loss)		
30/6/13	Depreciation expense	21,667	
	Accumulated depreciation		21,667
	(Recording of depreciation on plant)		
1/7/13	Accumulated depreciation	21,667	
	Plant		21,667
	(Transfer of accumulated depreciation to plant)		
1/7/13	Plant	81,667	
	P/L		56,667
	Revaluation surplus		25,000
	(Recording of revaluation surplus)		
30/6/14	Depreciation expense	26,471	
	Accumulated depreciation		26,471
	(Recording of depreciation on plant)		

Scanned with CamScanner

30/6/14	Revaluation surplus	1,471	
	Retained earnings		1,471
	(Transfer of revaluation surplus to retained earnings)		

(W-1) Calculation of revaluation surplus and depreciation

Date	Description	Plant	R. Surplus	Rs. SOCI(P/L)
1/7/10	Cost	500,000		
30/6/11	Depreciation (500,000/20)	(25,000)		
30/6/11	WDV	475,000		
1/7/11	Revaluation surplus (bal.)	5,000	5,000	
1/7/11	Revalued amount	480,000	5,000	
30/6/12	Depreciation (480,000/19):(5,000/19)	(25,263)	(263)	
30/6/12	WDV	454,737	4,737	
1/7/12	Revaluation surplus (bal.)	(64,737)	(4,737)	(60,000)
1/7/12	Revalued amount	390,000		(60,000)
30/6/13	Depreciation(390,000/18):(60,000/18)	(21,667)		3,333
30/6/13	WDV	368,333		(56,667)
1/7/13	Revaluation surplus (bal.)	81,667	25,000	56,667
1/7/13	Revalued amount	450,000	25,000	-
30/6/14	Depreciation (450,000/17):(25,000/17)	(26,471)	(1,471)	
30/6/14	WDV	423,529	23,529	

Plant account

Dr		Rs			Cr Rs
01-07-10	Bank	500,000	30-06-11	Bal c/d	500,000
01-07-11	Bal b/d	500,000	01-07-11	Acc. dep	25,000
01-07-11	Rev. surplus	5,000	30-06-12	Bal c/d	480,000
		505,000			505,000
01-07-12	Bal b/d	480,000	01-07-12	Acc. dep	25,263
			01-07-12	Rev. surplus	4,737
			01-07-12	P/L	60,000
			30-06-13	Bal c/d	390,000
		480,000			480,000
01-07-13	Bal b/d	390,000	01-07-13	Acc. dep	21,667
01-07-13	Rev. surplus	81,667	30-06-14	Bal c/d	450,000
		471,667			471,667

Accumulated depreciation account

Dr		Rs			Cr Rs
			01-07-10	Bal b/d	-
30-06-11	Bal c/d	25,000	30-06-11	Depreciation	25000
		25,000			25,000
01-07-11	Plant	25,000	01-07-11	Bal b/d	25,000
30-06-12	Bal c/d	25,263	30-06-12	Depreciation	25,263
		50,263			50,263
01-07-12	Plant	25,263	01-07-12	Bal b/d	25,263
30-06-13	Bal c/d	21,667	30-06-13	Depreciation	21,667
		46,930			46,930
01-07-13	Plant	21,667	01-07-13	Bal b/d	21,667
30-06014	Bal c/d	26,471	30-06-14	Depreciation	26,471
		48,138			48,138

Scanned with CamScanner

Revaluation surplus

Dr		Rs			Cr Rs
30-06-12	Retained earnings	263	01-07-11	Plant	5,000
30-06-12	Bal c/d	4,737			
		5,000			5,000
01-07-12	Plant	4,737	01-07-12	Bal b/d	4,737
30-06-14	Retained earning	1,471	01-07-13	Bal b/d	-
30-06-14	Bal c/d	23,529	0107-13	plant	25,000
		25,000			25,000

Retained earnings

Dr		Rs			Cr Rs
30-06-12	Bal c/d	263	30-06-12	Revaluation surplus	263
30-06-13	Bal c/d	263	01-07-12	Bal b/d	263
			01-07-13	Bal b/d	263
30-06-14	Bal c/d	1,734	30-06-14	Revaluation surplus	1,471
		1,734			1,734

Answer-33

Journal entries Rs.

Date	Particulars	Dr.	Cr.
1/1/11	Plant	600,000	
	Bank		600,000
	(Purchase of plant)		
31/12/11	Depreciation expense	40,000	
	Accumulated depreciation		40,000
	(Recording of depreciation on plant)		
31/12/12	Depreciation expense	40,000	
	Accumulated depreciation		40,000
	(Recording of depreciation on plant)		
31/12/12	Accumulated depreciation (40,000 + 40,000)	80,000	
	Plant		80,000
	(Transfer of accumulated depreciation to plant)		
31/12/12	Plant	30,000	
	Revaluation surplus		30,000
	(Recording of revaluation surplus)		
31/12/13	Depreciation expense	42,308	
	Accumulated depreciation		42,308
	(Recording of depreciation on plant)		
31/12/13	Revaluation surplus	2,308	
	Retained earning		2,308
	(Transfer of revaluation surplus to retained earnings)		
31/12/14	Depreciation expense	42,308	
	Accumulated depreciation		42,308
	(Recording of depreciation on plant)		
31/12/14	Revaluation surplus	2,308	
	Retained earning		2,308
	(Transfer of revaluation surplus to retained earnings)		
31/12/15	Depreciation expense	42,308	
	Accumulated depreciation		42,308
	(Recording of depreciation on plant)		

Scanned with CamScanner

31/12/15	Revaluation surplus	2,308	
	Retained earnings		2,308
	(Transfer of revaluation surplus to retained earnings)		
31/12/15	Accumulated depreciation (42,308 × 3)	126,924	
	Plant		126,924
	(Transfer of accumulated depreciation to plant)		
31/12/15	P/L (bal.)	300,000	
	Revaluation surplus	23,076	
	Plant		323,076
	(Recording of revaluation loss)		

W-1) Calculation of revaluation surplus and depreciation

Date	Description	Plant	R. Surplus	Rs. SOCI(P/L)
1/1/11	Cost	600,000		
31/12/11	Depreciation (600,000/15)	(40,000)		
31/12/11	WDV	560,000		
31/12/12	Depreciation (600,000/15)	(40,000)		
31/12/12	WDV	520,000		
31/12/12	Revaluation surplus (bal.)	30,000	30,000	
31/12/12	Revalued amount	550,000	30,000	
31/12/13	Depreciation (550,000/13):(30,000/13)	(42,308)	(2,308)	
31/12/13	WDV	507,692	27,692	
31/12/14	Depreciation (550,000/13):(30,000/13)	(42,308)	(2,308)	
31/12/14	WDV	465,384	25,384	
31/12/15	Depreciation (550,000/13):(30,000/13)	(42,308)	(2,308)	
31/12/15	WDV	423,076	23,076	
31/12/15	Revaluation surplus/loss (bal.)	(323,076)	(23,076)	(300,000)
31/12/15	Revalued amount	100,000	-	(300,000)

Answer-34

Journal Entries

Date	Particulars	Rs. In million Dr.	Cr.
1.1.10	Plant	300	
	Bank		300
31-12-10	Depreciation	30	
	Accumulated depreciation		30
1.1.11	Accumulated depreciation	30	
	Plant		30
1.1.11	Plant	230	
	Revaluation surplus		230
31.3.11	Depreciation	13.89	
	Accumulated depreciation		13.89
31.3.11	Revaluation surplus	6.39	
	Retained earnings		6.39
31.3.11	Bank	750	
	Accumulated depreciation	13.89	
	Plant		500
	Gain on disposal		263.89
31.3.11	Revaluation surplus	323.61	
	Retained earnings		323.61

Scanned with CamScanner

WORKING
(W-1)

Date	Particulars	Plant	Revaluation surplus	Profit / Loss (SOCI)
1.1.10	Cost	300		
31.12.10	Depreciation (300/10)	(30)		
31.12.10	W.D.V	270		
1.1.11	Revaluation surplus	230	230	-
1.1.11	Revalued amount	500	230	-
31.3.11	Depreciation $\left[\frac{500}{9} \times \frac{3}{12}\right] : \left[\frac{230}{9} \times \frac{3}{12}\right]$	(13.89)	(6.39)	-
31.3.11	W.DV	486.11	223.61	
31.3.11	Disposal	(486.11)	(223.61)	

Answer-35

Journal Entries

Date	Particulars	Rs. In million Dr.	Cr.
1.1.12	Building	300	
	Bank		300
31.12.12	Depreciation	15	
	Accumulated depreciation		15
1.1.13	Accumulated depreciation	15	
	Building		15
1.1.13	Building	38	
	Revaluation surplus		38
31.12.13	Depreciation	17	
	Accumulated depreciation		17
31.12.13	Revaluation surplus	2	
	Retained earnings		2
1.1.14	Accumulated depreciation	17	
	Building		17
1.1.14	Revaluation surplus	36	
	Profit & loss	18	
	Building		54
31.12.14	Depreciation	14	
	Accumulated depreciation		14
1.1.13	Accumulated depreciation	14	
	Building		14
1.1.13	Building	34	
	Revaluation surplus		17
	Profit and loss		17
30.6.13	Depreciation	2	
	Accumulated depreciation		2
30.6.13	Revaluation surplus	0.125	
	Retained earnings		0.125
30.6.13	Bank	80	
	Accumulated depreciation	2	
	Building		68
	Gain		14
30.6.13	Revaluation surplus	4.125	
	Retained earning		4.125

Scanned with CamScanner

31.12.15	Depreciation	12	
	Accumulated depreciation		12
31.12.15	Revaluation surplus	0.75	
	Retained earning		0.75

Building Account

		Rs.			Rs.
1.1.10	b/d	-			
1.1.12	bank	300	31.12.12	c/d	300
		300			300
1.1.13	b/d	300	1/1/13	Accumulated depreciation	15
1.1.13	Revaluation surplus	38			
			31.12.13	c/d	323
		338			338
1.1.14	b/d	323	1/1/14	Accumulated depreciation	17
			1.1.14	Revaluation surplus	36
			1.1.14	Profit & loss	18
			31.12.14	c/d	252
		323			323
1.1.13	b/d	252	1.1.13	Accumulated depreciation	14
1.1.15	Revaluation surplus	17	30.6.15	disposal	68
1.1.15	profit & loss	17			
			31.12.15	c/d	204
		286			286

Accumulated Depreciation

		Rs.			Rs.
			1.1.12	b/d	-
31.12.12	c/d	15	31.12.12	Depreciation	15
		15			15
1.1.13	Building	15	1.1.13	b/d	15
	c/d	17	31.12.13	Depreciation	17
		32			32
1.1.14	Building	17	1.1.14	b/d	17
	c/d	14	31.12.14	Depreciation	14
		31			31
1.1.13	Build	14	1.1.13	b/d	14
30.6.18	Disposal	2	30.6.13	Depreciation	2
	c/d	12	31.12.15	Depreciation	12
		28			28

Revaluation Surplus

		Rs.			Rs.
			1.1.13	Building	38
31.12.13	Retained earning	2			
	c/d	36			
		38			38
1.1.14	Building	36	1.1.14	b/d	36
	c/d	-			
		36			36
30.6.15	Retained earning	0.125	1.1.15	b/d	-
30.6.15	Retained earning	4.125	1.1.15	Building	17
31.12.15	Retained earning	0.75			
	c/d	12			
		17			17

Scanned with CamScanner

Retained Earnings

		Rs.			Rs.
31.12.13	c/d	2	31.12.13	Revaluation surplus	2
		2			2
31.12.14	c/d	2	1.1.14	b/d	2
		2			2
			1.1.15	b/d	2
			30.6.15	Revaluation surplus	0.125
			30.6.15	Revaluation depreciation	4.125
31.12.13	c/d	7	31.12.15	Revaluation surplus	0.75
		7			7

Disposal Account

	Rs.		Rs.
Building	68	Bank	80
Gain	14	Accoumulated depreciation	2
	82		82

WORKING

(W-1)

Date	Particulars	Plant	Revaluation surplus	Profit / Loss (SOCI)
1.1.12	cost	300		
31.12.12	Depreciation 300/20	(15)		
31.12.12	W.D.V	285		
1.1.13	Revaluation surplus	38	38	-
1.1.13	Revaluated amount	323	38	-
31.12.13	Depreciation [323/19] : [38/19]	(17)	(2)	
31.12.13	W.D.V	306	36	
1.1.14	Revaluation surplus	(54)	(36)	(18)
1.1.14	Revalued amount	252	-	(18)
31.12.14	Depreciation [252/18] : [18/18]	(14)		
31.12.14	W.D.V	238		(17)
1.1.13	Revaluation surplus	34	17	17
1.1.15	Revaluated amount	272	17	-
30.6.15	Depreciation $\left[\frac{68}{17} \times \frac{6}{12}\right] = \frac{17}{4}\left[\frac{4.25}{17} \times \frac{6}{12}\right]$	(2)	(0.125)	
30.6.15	W.D.V of depreciation	(66)	(4.125)	
31.12.15	W.D.V of retained	204	12.75	
31.12.15	Depreciation 204/17 : 12.75/17	(12)	(0.75)	
31.11.15	W.D.V	192	12	

Scanned with CamScanner

Answer-36

Akhtar Limited
Notes to the Financial Statement
For the year ended June 30, 2018

10. Property Plant & Equipment	2018				2017			
	----Rs. in millions----							
	Plant	**Building**	**Vehicles**	**Total**	**Plant**	**Building**	**Vehicles**	**Total**
Gross Carrying Amount								
Balance 01.Jan	320	160	30	510	360	160	30	550
+Addition			10	10				-
-Transfer	(64)			(64)	(60)			(60)
+Revaluation Surplus/(Rev. Loss)	(36)			(36)	20			20
Balance 31.Dec	220	160	40	420	320	160	30	510
Accumulated Depreciation & Impairment Losses								
Balance 01.Jan	-	35	9	44	-	25	6	31
+Depreciation for the year *	64	21	4	89	60	10	3	73
-Transfer	(64)			(64)	(60)			(60)
+Impairment Loss	11			11	-			-
Balance 31.Dec	(11)	(56)	(13)	(80)	-	(35)	(9)	(44)
WDV 31.Dec	209	104	27	340	320	125	21	466
10.1 Measurement Basis	Revaluation	Cost Reducing	Cost		Revaluation	Cost	Cost	
Depreciation Method	Straight Line	Balance Method	Straight Line		Straight Line	Straight Line	Straight Line	
Useful Life/Depreciation Rate	7 years	16.84%	10 years		7 years	15 years W-3	10 years	

+Depreciation for the year*

*1 Plant Dep 2017 = 360/6 = 60

*2 Plant Dep 2018 = 320/5 = 64

*3 Building Dep 2017 = (160-10)/15 = 10

*4 Building Dep 2018 = 125x16.8373% = 21.05 = 21

*5 Cars Dep 2017 = 30/10 = 3

*6 Cars Dep 2018 = (30/10)+(10/10) = 3+1 = 4

10.2 The last revaluation of plant was perfomed by an independent valuer "Ghaznavi & Co" on 31.12.2018

10.3 Had there been no revaluation the carrying amount of plant would have been

	2018	2017
Cost	434	434
Accumulated Depreciation (434/7 = 62 × 3, 62 × 2)	(186)	(124)
Accumulated Impairment loss (Bal.)	(39)	-
Carrying Amount	209	310

10.4 The entire plant was mortgage with the Habib Bank Limited for obtaining loan of 400 million for the plant acquisition. The loan is repayable by 31-Dec-2019

10.5 During the year plant was impaired by Rs.11 million and charged as expense.

10.6 Revaluation loss of Rs. Nil (2017: Rs.10 million) was reversed during the year.

10.7 An amount of expenditure of Rs.30 million was incurred on the construction of a factory. This amount was captialised as capital workin-progress.

A further borrowing costs of Rs.2.1 million (30 × 12% × 7/12) were capitalised in respect of interest on loan obtained from the bank to finance this project.

Note: Alternatively you may make movement of Capital work in progress (WIP)

Scanned with CamScanner

10.8 A contract was made to purchase plant and machinery worth Rs.100 million with M/s Shaheen Limited once the construction of factory building is completed.

10.9 During the year 2018 company has changed the depreciation method of buildings from straight line to reducing balance method. Had the method not changed, profit for the year would have been higher by Rs. 11 million.

10.10 Depreciation is charged as Follows

			2018	2017
Cost of Sales	(64 + 21 × 80%)	(60 + 10 × 80%)	80.8	68.0
Admin & Selling Expenses	(4 + 21 × 20%)	(3 + 10 × 20%)	8.2	5.0
Total Depreciation			89	73

WORKINGS

(W-1) Calculation of revaluation surplus & depreciation on plant.

Date	Description	Plant	R. Surplus	SOCI (P/L)
1-Jan-16	Cost	434		
	Depreciation (434÷7)	(62)		
31-Dec-16	WDV	372		
	Revaluation loss (bal)	(12)	-	(12)
31-Dec-16	Revalued amount	**360**	-	(12)
	Depreciation (360÷6) (12÷6)	(60)		2
31-Dec-17	WDV	300	-	(10)
	Revaluation surplus (bal.)	20	10	10
31-Dec-17	Revalued amount	**320**	10	
	Depreciation (320/5) (10/5)	(64)	(2)	
31-Dec-18	WDV	256	8	
	Revaluation loss (reversal)	(36)	(8)	(28)
31-Dec-18	Revalued amount	**220**	-	(28)
	Impairment Loss	(11)		11
31-Dec-18	**Impaired Value**	**209**	-	(17)

W-2 Calculation of Impairment Loss

Carrying Value on 31-12-2018			220
Recoverable Amount (Higher of)			
'-Fair Value less cost to sell	(220-15)	**205**	
'-Value in use			
$90(1+0.1)^{-1}+70(1+0.1)^{-2}+65(1+0.1)^{-3}+30(1+0.1)^{-4}$		**209**	**209**
Impairment Loss			**11**

W-3 Life of Building

Acc Dep= Cost - RV/Life x Cumulative Period

25=(160-10)/LIFE x 2.5 years

LIFE = 15 YEARS

W-4 Building Dep Rate-WDV method $1 - \sqrt[11.5]{\frac{15}{125}} = 0.168373$

Scanned with CamScanner

ICAP PAST PAPER QUESTIONS

QUESTION-1 {Calculation Cost of Assets} {Straight Line}

Ammar is a manufacturer of personal products and has factories in two different cities. On 1 November 2011, he bought a new state-of-the-art plant from Krones Inc. USA. The invoice value of the plant was Rs. 250 million. Other relevant details are as follows:

(i) Costs of import:

	Rs. in million
LC opening charges	1.00
Import duty	25.00
Sales tax paid, recoverable against production output	40.00
Clearing & transportation	5.00

(ii) Costs incurred on SITE preparation:

Amount paid to consultants	2.00
Civil and electrical works	3.00
The above includes cost of equipment damaged due to mishandling	0.80

(iii) The plant was received at the SITE on 1 February 2012. The installation and test run were successfully completed in three months time at a cost of Rs. 6 million. The net sale proceeds of test production were Rs. 1.2 million.

(iv) Commercial production commenced on 1 May 2012. During the period in which the plant was installed, administration and general overheads increased by Rs. 1 million as compared to the previous period.

(v) Salary of factory manager is Rs. 250,000 per month. He contributed 30% of his time in supervising the installation.

(vi) Staff training cost amounted to Rs. 0.25 million.

(vii) The plant is expected to last fifteen years with no residual value.

Required:

In accordance with IAS-16 calculate:

- Cost at which the plant would be capitalised.
- Depreciation for the year ended 31 December 2012 under the straight line method. **(08)**

{Spring 2013, Q.1 (b)}

QUESTION-2 {Different methods}

The cost of a machine purchased by S. Yaseer Trading Company (Private) Limited on 1st April, 1992 is Rs. 750,000. It is estimated that the machine will have a Rs. 30,000 trade-in value at the end of its service life. Its life is estimated at 6 years. Its working hours are estimated at 25,000, its production is estimated at 400,000 units. During 1992, the machine was operated for 4200 hours and produced 80,000 units. Compute the depreciation on the machine for 1992 by:

(a) Service hours method;

(b) The productive-output method; and

(c) The sum of the year's digits method

(10)

{October 1993, CA Inter - II}

QUESTION-3 {Different Methods}

A business purchased a machine costing Rs. 1,120,000 on April 01, 2002. The machine can be used for a total of 20,000 hours over an estimated life of 48 months. At the end of that time the machine is expected to have a trade in value of Rs. 112,000.

Scanned with CamScanner

The financial year of the business ends on December 31st each year. It is expected that the machine will be used for:

4,000 hours during the financial year ending December 31, 2002.
5,000 hours during the financial year ending December 31, 2003.
5,000 hours during the financial year ending December 31, 2004.
5,000 hours during the financial year ending December 31, 2005.
1,000 hours during the financial year ending December 31, 2006.

Required:

(a) Calculate the annual depreciation charges on the machine on each of the following bases for each of the financial years ending on December 31, 2002, 2003, 2004, 2005 and 2006:
(i) the straight line method applied on monthly basis and
(ii) the usage method. **(04)**

(b) Suppose that during the financial year ending December 31, 2003 the machine was used for only 1,500 hours before being sold for Rs. 800,000 on June 30, 2003.
Assuring that the business has chosen to apply the straight line method on a month for month basis, show the following accounts for 2003 only;
(i) the machine account
(ii) the provision for depreciation machine account; and
(iii) the assets disposals account **(05)**

{Autumn 2002, Q # 8}

QUESTION-4 {Calculation Cost of Assets & Change in Estimate}

(a) What conditions must be satisfied if an item has to be recognized as property, plant and equipment? Also state at what amount such item shall be carried after the initial recognition if the entity is following the revaluation model.

(b) On 1 January 2013 Delta acquired a specialized machine for its production department. The available information is as follows:

	Rupees
List price of machine	9,200,000
Freight charges	263,000
Electrical installation cost	245,000
Staff training for use of machine	351,000
Pre-production testing	193,000
Purchase of a three year maintenance contract	528,000
Estimated residual value	175,000

Trade discount on list price	5%
Early settlement discount taken	3%
Estimated life (in machine hours)	12,000

Machine hours used during the years ended 31 December 2013, 2014 and 2015 were 2,000, 3,200 and 1,400 respectively.

On 1 January 2015 Delta decided to upgrade the machine by adding new components at a cost of Rs.1,753,000. This upgrade led to a reduction in the production time per unit or goods being manufactured by the machine. The upgrade also increased the estimated remaining life of the machine at 1 January 2015 to 8,000 machine hours and its estimated residual value to Rs.350,000.

Required:

For the years ended 31 December 2013, 2014 and 2015, compute the relevant amounts to be included (under each head) in the income statement and statement of financial position.

Notes to the financial statements are not required. **(10)**

{Spring-16 Q.4 CAF-05}

Scanned with CamScanner

QUESTION-5 {Revaluation}

Shahzad Textile Mills Limited (STML) purchased a plant for Rs. 500 million on 1 July 2010. The plant has an estimated useful life of 10 years and no residual value.
STML uses revaluation model for subsequent measurement of its property, plant and equipment and accounts for revaluations on net replacement value method. The details of revaluations performed by an independent firm of valuers are as follows:

Revaluation date	Fair value
1 July 2011	Rs. 575 million
1 July 2012	Rs. 390 million
1 July 2013	Rs. 380 million

Required:
Prepare journal entries to record the above transactions from the date of acquisition of the plant to the year ended 30 June 2014. (Ignore tax implications) **(15)**

{Autumn 2014, Q# 4, CAF-05}

QUESTION-6 {Revaluation}

Faraday Pharmaceutical Limited (FPL) acquired a building for Rs. 200 million on July 1, 2005. The following information relating to the building is available:

(i) It is being depreciated on the straight line basis, over 20 years.

(ii) FPL uses the revaluation model for subsequent measurement of its property, plant and equipment and accounts for revaluations on the net replacement value method. The details of revaluation carried out by the independent values during the past years are as follows:

Revaluation date	Fair value (Rs. In million)
July 1, 2006	230
July 1, 2007	170
July 1, 2008	180

(iii) FPL transfers the maximum possible amount from the revaluation surplus to retained earnings on an annual basis.

(iv) There is no change in the useful life of the building.

Required:
Prepare the journal entries to record the above transactions from the date of acquisition of the building to the year ended June 30, 2009. (

{Autumn 2009, Q # 3, Module C}

QUESTION-7 {Revaluation}

PQR Enterprises was incorporated on 1 July 2012. The company depreciates its property, plant and equipment on straight line basis over their useful life. It uses revaluation model for subsequent measurement of the property, plant and equipment and has a policy of revaluing these after every two years.

Following information pertains to its property, plant and equipment:

Assets	Cost as on 01-07-2013	WDV as on 01-07-2013	Value as determined by professional valuer on 30-06-2014	Useful life in years	
				Original at acquisition	Remaining as determined by valuer
	-------Rs. in million-------				
Office building	6,000	5,500	5,750	12	8
Factory building	4,400	3,960	3,320	10	9
Warehouse	4,500	4,050	3,350	10	8

Scanned with CamScanner

During the year there were no addition or deletion in the above assets.
As per policy, PQR transfers the maximum possible amount from the revaluation surplus to retained earnings on an annual basis.

Required:
Prepare necessary journal entries for the year ended 30 June 2014 and 2015. **(12)**

{Autumn-15, CAF-05 Q-3}

QUESTION-8 {Revaluation}

The following information pertains to Sherdil Limited (SL):

(i) Buildings and equipment were acquired on 1 January 2014 for Rs. 450 million and Rs. 50 million respectively.

(ii) The relevant information relating to both assets is summarised below:

Assets	Depreciation method	Life /rate	Subsequent measurement
Buildings	Straight line	20 years	Annual revaluation
Equipment	Reducing balance	10%	Cost

SL transfers the maximum possible amount from revaluation surplus to retained earnings on an annual basis.

(iii) The revalued amount of buildings as determined by Accurate Valuers (Private) Limited, an independent valuation company, on 1 January 2015 and 2016 was Rs. 456 million and Rs. 378 million respectively.

(iv) Equipment costing Rs. 35 million was purchased on 1 August 2015. Half of the equipment purchased on 1 January 2014 was disposed off on 30 June 2016.

Required:
In accordance with International Financial Reporting Standards, prepare a note on 'Property plant & equipment' (including comparative figures) for inclusion in SL's financial statements for the year ended 31 December 2016. **(18)**

{Autumn 2017, Q # 2}

QUESTION-9 {Revaluation}

(a) Following information pertains to a building acquired by SK Limited (SKL) on 1 July 2012 for Rs. 360 million:

(i) The building is being depreciated on straight-line basis over 10 years.

(ii) SKL uses revaluation model for subsequent measurement of buildings. It accounts for revaluation on net replacement value method. The details of revaluations as carried out by independent value are as follows:

Revaluation date	Fair value (Rs. in million)
31 December 2013	323
31 December 2015	208
31 December 2017	167

(iii) There is no change in useful life of the building.

(iv) SKL transfers the maximum possible amount from the revaluation surplus to retained earnings on an annual basis.

(v) SKL's financial year ends on 31 December.

Required:
Prepare entries to record revaluation surplus/loss on each of the above revaluation date. *(Entries to record depreciation expense, incremental depreciation and elimination of accumulated depreciation are not required)* **(11)**

Scanned with CamScanner

(b) Following information pertains to three exchange transactions relating to fixed assets:

	(i)	(ii)	(iii)
	--------- Rs. in million ---------		
Cash received/(paid)	1.1	(2.1)	-
Assets given-up:			
Original cost	10.3	12.4	14.5
Book value	6.4	7.3	3.4
Estimated fair value	8.5	6.6	4.6
Assets received:			
Estimated fair value	7.1	9.0	4.1

Additional information:

- In case of transaction (i), fair values of both assets are reliably measurable.
- In case of transaction (ii), fair value of the asset received is clearly more evident.
- In case of transaction (iii), fair value of neither asset is reliably measurable.

Required:

Compute gain or loss on disposal of fixed assets in each of the above transactions. **(06)**

{Spring 2018, Q # 6}

QUESTION-10

The following information is available in respect of machines of Akmal Brothers:

(i) The balances of cost and accumulated depreciation of machines as on 1 January 2017 were Rs.800,000 and Rs.333,000 respectively.

(ii) A machine acquired on 1 January 2014 having net book value of Rs.31,935 on 1 January 2017 was sold for Rs.34,000 on 30 April 2017. Cost of disposal incurred was Rs.5,000.

(iii) On 1 July 2017, a machine having fair value of Rs.40,000 on that date was exchanged for a new machine. The balance of the purchase price was paid through a cheque of Rs.80,000. The list price of the new machine was Rs.130,000. The old machine had been acquired at a cost of Rs. 65,000 on 1 October 2015.

(iv) Machines are depreciated at 15% per annum using the reducing balance method.

Required:

Prepare the following ledger accounts pertaining to the machines for the year ended 31 December 2017:

(a) Cost **(03)**

(b) Accumulated depreciation **(05)**

(c) Gain/loss on disposal **(04)**

{Autumn 2018, Q # 5}

QUESTION-11

The following information pertains to Piano Limited (PL):

	Plant	Equipment
Acquisition		
• Date of acquisition	1 January 2015	1 July 2015
• Cost	Rs. 500 million	Rs. 360 million
• Estimated useful life	10 years	12 years
• Residual value	Rs. 60 million	Nil
• Depreciation method	Straight line method	Straight line method

Scanned with CamScanner

Revaluation on 31 December 2016		
• Fair value	Rs. 526 million	Rs. 280 million
• Residual value	Rs. 78 million	Nil
Revaluation on 31 December 2018		
• Fair value	Rs. 310 million	Rs. 275 million
• Residual value	Rs. 64 million	Nil

Additional information:

(i) PL uses revaluation model for subsequent measurement and accounts for revaluation on net replacement value method.

(ii) There is no change in useful life of plant. The remaining useful life of equipment was estimated as 15 years and 10 years in 2016 and 2018 respectively.

(iii) PL transfers maximum possible amount from the revaluation surplus to retained earnings on an annual basis.

(iv) PL's financial year ends on 31 December.

Required:

(a) Calculate depreciation on each asset for 2015 to 2018. **(08)**

(b) Prepare entries to record revaluation in 2018. (***Entries to record depreciation expense, incremental depreciation and elimination of accumulated depreciation are not required. Further, entries prior to 2018 are also not required.***) **(08)**

{Spring 2019, Q # 5}

QUESTION-12

The following information pertains to Monday Limited (ML):

(i) The balances of property, plant and equipment as on 1 January 2018:

Assets	Cost/Revalued amount	Accumulated depreciation
	Rs. in million	
Office building	240	36
Equipment	190	60

Revaluation surplus related to the office building as at 1 January 2018 amounted to Rs.8.5 million.

(ii) On 1 September 2018, a new equipment was acquired by making payment of Rs.70 million to the supplier. An old equipment was also given in exchange to the supplier. The fair values of the old and new equipment were assessed at Rs.21 million and Rs.93 million respectively. The old equipment had been acquired at a cost of Rs.40 million on 1 July 2016. Cost incurred on installing the new equipment amounted to Rs.5 million.

(iii) On 1 January 2018, ML commenced construction of a manufacturing plant. The whole process of assembling and installation was completed on 31October 2018. However, the work was stopped from 16 to 31 August-2018 due to unexpected rains.

The total cost of Rs.660 million incurred on the plant was paid as under:

Description	Payment date	Rs.in million
1st payment	1 February 2018	140
2nd payment	1 April 2018	214
3rd payment	1 September 2018	146
4th payment	1 December 2018	160

Scanned with CamScanner

The plant was financed through a bank loan of Rs.500 million obtained on 1 March 2018. The loan carries a mark-up of 18% payable annually. The surplus funds available from the loan were invested in a saving account and earned Rs.17 million during capitalization period.

(iv) 31 December 2018, the revalued amount of office building was assessed at Rs.178 million by Precise Valuers, an independent valuation firm. Value in use of the office building as at 31 December 2018 was estimated at Rs.186 million.

(v) Other relevant details are as follows:

Assets	Depreciation method	Life/rate	Subsequent measurement
Office building	Straight line	20 years*	Revaluation
Equipment	Reducing balance	20%	Cost
Manufacturing plant	Straight line	15 years	Cost

** Remaining life at the date of last revaluation*

ML accounts for revaluation on net replacement value method and transfers the maximum possible amount from revaluation surplus to retained earnings on an annual basis.

Required:

In accordance with IFRSs, prepare a note on 'Property plant and equipment' for inclusion in ML's financial statements for the year ended 31 December 2018.

(Comparatives figures and column for total are not required)

(17)

{Autumn 2019, Q # 6}

QUESTION-13

Following information pertains to non-current assets of Distaghil Limited (DL):

(i) DL purchased specialised vehicles for Rs.370 million on 1 July 2017. The vehicles have an estimated useful life of 10 years with residual value of Rs.30 million.

The revalued amounts of the vehicle as at 31 December 2018 and 2019 were determined at Rs.302 million and Rs.290 million respectively. There was no change in useful life or residual value.

(ii) DL setup a manufacturing plant in a remote area at a cost of Rs.280 million. The plant had a useful life of 8 years. The plant was purchased on 1 January 2018 and was available for use on 1 April 2018. The commercial production started on 1 June 2018.

On 1 July 2018, DL received a government grant of Rs.120 million towards the cost of the plant. The sanction letter states that if DL ceases to use the plant in the remote area before 31 December 2021, DL would be required to repay the grant in full.

(iii) A warehouse was given on rent on 1 January 2018. Previously, the warehouse was in use of DL. On 1 January 2018, carrying value and remaining useful life of the warehouse was Rs.80 million and 16 years respectively. Fair value of the warehouse on various dates are as follows:

	Rs. in million
01 January 2018	104
31 December 2018	96
31 December 2019	115

Scanned with CamScanner

Other information:

- DL uses cost model for subsequent measurement of property, plant and equipment except for specialised vehicles for which revaluation model is used.
- DL transfers the maximum possible amount from the revaluation surplus to retained earnings on an annual basis.
- Government grant is recorded as deferred income and a part of it is transferred to income each year.
- Investment property is carried at fair value model.

Required:

Prepare relevant extracts from DL's statement of profit or loss and other comprehensive income for the year ended 31 December 2019 and statement of financial position as on that date. **(Show comparative figures)** **(20)**

(Spring 2020 Q.08)

QUESTION-14

Following information pertain to property, plant and equipment of Harappa Industries Limited (HIL) for the year ended 30 June 2020:

Assets	Balance as on 30 June 2019			Depreciation method	Useful life/rate
	Cost/revalued amount	Accumulated depreciation	Revaluation surplus		
	---------- Rs. in '000 ----------				
Land*	100,000	-	-	-	Infinite
Buildings	70,000	14,000	16,000	Straight line	20 years
Plant	180,000	60,000	-	Straight line	15 years
Vehicles	8,800	4,000	-	Reducing balance	20%

'An amount of Rs. 12 million had been charged to profit or loss upon previous revaluation

(ii) On 30 June 2020, the revalued amounts of the land and buildings were assessed by Smart Consultant at Rs.120 million and Rs.35 million respectively.

(iii) Setting up of a new plant was commenced on 1 July 2019 and substantially completed on 29 February 2020. The plant was available for use on 1 April 2020 and immediately put into use. Useful life of the plant was estimated at 10 years. Details of the cost incurred are as under:

Description	Payment date	Rs. in '000
1st payment	1 August 2019	12,000
2nd payment	1 October 2019	48,000
3rd payment	29 February 2020	48,000
4th payment	31 July 2020	12,000
		120,000

The cost of the plant was financed through an existing running finance facility with a limit of Rs.200 million carrying mark-up of 12% per annum. A government grant of Rs.20 million related to the plant was received on 1 January 2020. The grant amount was used for repayment of the running facility.

Scanned with CamScanner

(iv) One of the vehicles had an engine failure on 1 January 2020 and its engine had to be sold as scrap for Rs.0.1 million. The vehicle had been acquired on 1 January 2018 at a cost of Rs.2.5 million. 40% of the cost is attributable to its engine. Though the engine of similar capacity was available at a cost of Rs.1.2 million, the old engine was replaced on 1 January 2020 with a higher capacity engine at a cost of Rs.1.8 million.

(v) HIL uses cost model for subsequent measurement of property, plant and equipment except for land and buildings.

(vi) HIL accounts for revalidation on net replacement value method and transfers the maximum possible amount from revaluation surplus to retained earnings on an annual basis.

(vii) HIL deducts government grant in arriving at the carrying amount of the asset.

Required:

In accordance with IFRSs, prepare a note on 'Property, plant and equipment' for inclusion in HIL's financial statements for the year ended 30 June 2020. **(20)**

(Comparatives figures and column for total are not required)

(Autumn 2020 Q 8)

QUESTION-15

You have recently joined as the finance manager of Corv Limited (CL). While reviewing the draft financial statements for the year ended 31 December 2020 prepared by the junior accountant, you have noted the following

(i) In January 2020, Government allotted an industrial plot to CL at a prime location subject to the condition that CL will establish a factory. CL constructed the factory building which was available for use on 1 October 2020. Due to delay in recruitment of key factory employees, the production activities will commence on 15 March 2021.

The accountant has not recorded the land as it was given free of cost. While the factory building is still appearing in capital work in progress as production activities will commence on 15 March 2021. **(06)**

(ii) CL acquired a three story building on 1 March 2020. CL uses the ground floor for its marketing department while remaining two floors were in excess of CL's need and therefore were rented out. The first floor was rented out on 1 June 2020 and the second floor was rented out on 1 December 2020.

The accountant has recorded the building as property, plant and equipment. The depreciation on ground first and second floors has been computed from 1 March 2020, 1 June 2020 and 1 December 2020 respectively. **(05)**

(iii) CL is constructing a power generation plant for its factory. The project started on 1 February 2020 and would complete on 30 November 2021. The work remained suspended for 3 months. The project is financed through long term loan, acquired specifically on 1 January 2020. The unutilised amount of loan is kept in a separate saving account.

The accountant has deducted income of separate saving account from full year's interest on loan and presented the net amount as finance cost in the statement of profit or loss. **(05)**

The accounting policy of CL is to carry land and building at fair value (wherever permitted by IFRS).

Required:

Discuss how the above issues should be dealt in the financial statements of CL for the year ended 31 December 2020 in accordance with the requirements of IFRSs.

(Spring 2021 Q 7)

Scanned with CamScanner

QUESTION-16 {Components of Cost}

Sputnik Sea Limited (SSL) runs a cruise business across oceans. Following information in respect of one of SSL's cruise ship is available:

(i) SSL bought a cruise ship on 1 March 2018. After completing all the required formalities, the ship was ready to sail on 1 April 2018.

(ii) Details regarding components of the ship are as under:

Component	Cost (Rs. in million)	Useful life	Estimated residual value (Rs. in million)
Engine	840	50,000 hours	40
Body	535	25 years	35
Dry-docking (overhaul)	60	5 years	-

(iii) On 1 May 2019, the ship suffered an accident which damaged its body. Repair work took 2 months and costed Rs. 26 million. The repair work did not change useful life and residual values of the components.

(iv) The average monthly sailing of the ship during the last three years are as under:

Year	Hours
2018	360
2019	480
2020	600

(v) SSL uses revaluation model for subsequent measurement. SSL accounts for revaluation on net replacement value method and transfers the maximum possible amount from the revaluation surplus to retained earnings on an annual basis.

(vi) The revalued amounts of the ship as at 31 December 2019 and 2020 were determined as Rs. 1,400 million and Rs. 1,000 million respectively. Revalued amounts are apportioned between the components on the basis of their book values before the revaluation.

Required:

Prepare necessary journal entries to record the above transaction from the date of acquisition of the ship to the year ended 31 December 2020.

(17)

(Spring 2021 Q 8)

Scanned with CamScanner

ICAP PAST PAPER SOLUTIONS

Answer-1

Plant will be capitalized at cost of Rs. 290.9 Million.

	Rs in million
Invoice value	250
LC opening charges	1
Import duty	25
Clearing & transportation	5
Site preparation (2 + 3 – 0.8)	4.2
Test run cost (6 – 1.2)	4.8
Factory manger salary (250,000 x 3 x 30%)	0.225
	290.225

(i) Sales tax recoverable is not a part of cost of asset.
(ii) It is not necessary to damage equipment for plant installation so it is excluded from cost.
(iii) Admin and general overheads are not a part of cost of asset.
(iv) Staff training cost is not a part of cost of asset because we do not have control over it.

Depreciation Expense = (290.225 /15 years) × 8/12 = 12.89 Million.

Answer-2

(a) Service hour method

Depreciation expense = Cost – Residual Value × $\frac{\text{Hours in current year}}{\text{Total hours expected}}$

Depreciation-1992 = (750,000 – 30,000) × $\frac{4,200}{25,000}$ $\frac{}{120,960}$

(b) Productive output method

Depreciation expense = Cost – Residual Value × $\frac{\text{Units in current year}}{\text{Total units expected}}$

Depreciation-1992 = (750,000 – 30,000) × $\frac{80,000}{400,000}$ = 144,000

(c) Sum of year's digit method

Depreciation expense = Cost – Residual Value × $\frac{6}{(6+5+4+3+2+1)}$

Depreciation-1992 = (750,000 – 30,000) × $\frac{6}{21}$ = 205,714

Answer-3

(a)(i) Calculation of depreciation expense using straight line method

Depreciation expense = $\frac{\text{Cost – Residual Value}}{\text{Useful life}}$ X $\frac{\text{No. of months in use}}{12}$

Depreciation - 2002 (April - December)	=	$\frac{(1,120,000 - 112,000)}{4}$	X	$\frac{9}{12}$	= 189,000
Depreciation - 2003	=	$\frac{(1,120,000 - 112,000)}{4}$	X	$\frac{12}{12}$	= 252,000
Depreciation - 2004	=	$\frac{(1,120,000 - 112,000)}{4}$	X	$\frac{12}{12}$	= 252,000
Depreciation - 2005	=	$\frac{(1,120,000 - 112,000)}{4}$	X	$\frac{12}{12}$	= 252,000
Depreciation - 2006 (January - March)	=	$\frac{(1,120,000 - 112,000)}{4}$	X	$\frac{3}{12}$	= 63,000

Scanned with CamScanner

(ii) Calculation of depreciation expense using usage method

Depreciation expense = Cost - Residual Value × Hours in current year / Total hours expected

Total expected hours	= 4,000 + 5,000 + 5,000 + 5,000 + 1,000		=	20,000
Depreciation - 2002	= (1,120,000 – 112,000) ×	4,000 / 20,000	=	201,600
Depreciation - 2003	= (1,120,000 – 112,000) ×	5,000 / 20,000	=	252,000
Depreciation - 2004	= (1,120,000 – 112,000) ×	5,000 / 20,000	=	252,000
Depreciation - 2005	= (1,120,000 – 112,000) ×	5,000 / 20,000	=	252,000
Depriciation-2006	= (1,120,000 – 112,000) ×	1,000 / 20,000	=	50,400

(b)

Machine a/c

Dr.			Cr.
b/d	1,120,000	Disposals (bal.)	1,120,000
		Closing balance (c/d)	-
	1,120,000		1,120,000

Provision for depreciation-machine account

Dr.			Cr.
Disposals	315,000	b/d (part – (i) solution)	189,000
(1,120,000 – 112,000) × 1.25 / 4 years			
Closing	-	Depreciation (as below)	126,000
	315,000		315,000

Depreciation – 2003 = $\frac{(1,120,000 - 112,000)}{4} \times \frac{6}{12}$ = 126,000

Machinery Disposal account

Dr.			Cr.
Machine – cost	1,120,000	Accumulated depreciation	315,000
		Cash	800,000
		P and L (bal.)	5,000
	1,120,000		1,120,000

Answer-4

(a)

The cost of an item of property, plant and equipment shall be recognized as an asset if and only if:

(a) It is probable that future economic benefits associated with the item will flow to the entity; and

(b) The cost of the item can be measured reliably.

An item which is revalued shall be carried at a revalued amount which is its fair value at the date of the revaluation less any subsequent accumulated depreciation and accumulated impairment losses.

(b)

Statement of Financial position (Extracts)

Rs.

	2015	2014	2013
Machinery	*11,194,000	9,441,000	9,441,000
Less: Accumulated Depreciation	(5,210,294)	(4,015,266)	(1,544,333)
	5,983,706	5,425,734	7,896,667

* 9,441,000 + 1,753,000 = 11,194,000

Scanned with CamScanner

Income Statement (Extracts)	2015	2014	2013
Expenses			
Depreciation	1,195,028	2,470,933	1,544,333
Staff training expense			351,000
Maintenance contract expense (528/3)	176,000	176,000	176,000
Other income			
Discount received ((W-2) 8,740,000 × 3%)			262,200

Workings

(W-1) Depreciation expense

2013	((9,441,000 – 175,000) × 2,000/12,000)	1,544,333
2014	((9,441,000 – 175,000) × 3,200/12,000)	2,470,933
2015	[(5,425,734 + 1,753,000) – 350,000] × 1,400 /8,000	1,195,028
	Written down value at the time estimate is changed (9,441,000 – 1,544,333 – 2,470,933)	5,425,734

(W-2) Cost of asset

List price		9,200,000
Less: Trade discount	(9,200,000 × 5%)	(460,000)
		8,740,000
Freight charges		263,000
Electrical installation		245,000
Pre-production testing		193,000
		9,441,000

Answer-5

Entries

Date	Description	Dr.	Cr.
July 1, 2010	Plant	500	
	Cash		500
Jun. 30, 2011	Depreciation (500/10)	50	
	Accumulated depreciation		50
July 1, 2011	Accumulated depreciation	50	
	Plant		50
July 1, 2011	Plant	125	
	Revaluation surplus		125
Jun. 30, 2012	Depreciation (575/9)	63.89	
	Accumulated depreciation		63.89
Jun. 30, 2012	Revaluation surplus (125/9)	13.89	
	Retained earnings		13.89
July 1, 2012	Accumulated depreciation	63.89	
	Plant		63.89
July 1, 2012	Revaluation surplus (125 – 13.89)	111.11	
	P/L	10	
	Plant		121.11
Jun. 30, 2013	Depreciation (390/8)	48.75	
	Accumulated depreciation		48.75
July 1, 2013	Accumulated depreciation	48.75	
	Plant		48.75
July 1, 2013	Plant	38.75	
	Revaluation surplus		30
	P/L (SOCI)		8.75

Scanned with CamScanner

Jun. 30, 2014	Depreciation (380/7) Accumulated depreciation	54.29	 54.29
Jun. 30, 2014	Revaluation surplus (30/7) Retained earnings	4.29	 4.29

(W-1) Calculation of revaluation surplus and depreciation on plant

Date	Description	Plant	R. Surplus	SOCI(P/L)
		----------Rs. in 'million----------		
1/7/10	Cost	500.00		
30/06/11	Depreciation (500/10)	(50.00)		
30/06/11	WDV	450.00		
1/7/11	Revaluation surplus (bal.)	125.00	125.00	
1/7/11	Revalued amount	575.00	125.00	
30/06/12	Depreciation (575/9):(125/9)	(63.89)	(13.89)	-
30/06/12	WDV	511.11	111.11	-
1/7/12	Revaluation surplus (bal.)	(121.11)	(111.11)	(10.00)
1/7/12	Revalued amount	390.00	-	(10.00)
30/06/13	Depreciation (390/8):(10/8)	(48.75)		1.25
30/06/13	WDV	341.25		(8.75)
1/7/13	Revaluation surplus (bal.)	38.75	30.00	8.75
1/7/13	Revalued amount	380.00	30.00	
30/06/14	Depreciation (380/7):(30/7)	(54.29)	(4.29)	
30/06/14	WDV	325.71	25.71	

Answer-6

Entries

Date	Particulars	Dr.	Cr.
1/7/2005	Plant Cash	200.00	 200.00
30/6/2006	Depreciation Accumulated depreciation	10.00	 10.00
1/7/2006	Accumulated depreciation Plant	10.00	 10.00
1/7/2006	Plant Revaluation surplus (OCI)	40.00	 40.00
30/6/2007	Depreciation Accumulated depreciation	12.11	 12.11
30/6/2007	Revaluation surplus (40.00/19) Retained earnings	2.11	 2.11
1/7/2007	Accumulated depreciation Plant	12.11	 12.11
1/7/2007	Revaluation surplus P/L Plant	37.89 10.00	 47.89

Scanned with CamScanner

30/6/2008	Depreciation	9.44	
	Accumulated depreciation		9.44
1/7/2008	Accumulated depreciation	9.44	
	Plant		9.44
1/7/2008	Plant	19.44	
	Revaluation surplus		10.00
	P/L		9.44
30/6/2009	Depreciation	10.59	
	Accumulated depreciation		10.59
30/6/2009	Revaluation surplus	0.59	
	Retained earnings		0.59

(W-l) Calculation of revaluation surplus and depreciation on building

Date	Description	Plant	Rev. Surplus	SOCI(P/L)
		----------Rs. in 'million----------		
1/7/05	Cost	200.00		
30/06/06	Depreciation (200/20)	(10.00)		
30/06/06	WDV	190.00		
1/7/06	Revaluation surplus (bal.)	40.00	40.00	
1/7/06	Revalued amount	230.00	40.00	
30/06/07	Depreciation (230/19):(40/19)	(12.11)	(2.11)	-
30/06/07	WDV	217.89	37.89	-
1/7/07	Revaluation surplus (bal.)	(47.89)	(37.89)	(10.00)
1/7/07	Revalued amount	170.00	-	(10.00)
30/06/08	Depreciation (170/18):(10/18)	(9.44)		0.56
30/06/08	WDV	160.56		(9.44)
1/7/08	Revaluation surplus (bal.)	19.44	10.00	9.44
1/7/08	Revalued amount	180.00	10.00	
30/06/09	Depreciation (180/17):(10/17)	(10.59)	(0.59)	
30/06/09	WDV	169.41	9.41	

(W-2)

T- account are not a part of requirement, these are only prepared for understanding purpose of students.

Plant Account

Dr.					Cr.
1-7-2005	Cash	200.00	30-6-2006	c/d	200.00
1-7-2006	b/d	200.00	1-7-2006	Acc. depreciation	10.00
1-7-2006	Rev. surplus	40.00	30-6-2007	c/d	230.00
1-7-2007	b/d	230.00	1-7-2007	Acc. depreciation	12.11
			1-7-2007	Rev. surplus	37.89
			1-7-2007	P/L	10.00
1-7-2008	b/d	170.00	30-6-2008	c/d	170.00
1-7-2008	Rev. surplus	10.00	1-7-2008	Acc. depreciation	9.44
1-7-2008	P/L	9.44	30-6-2009	c/d	180.00

Scanned with CamScanner

(W-3)

Accumulated Depreciation account

Dr.					Cr.
			30-6-2006	Dep. Expense	10.00
30-6-2006	c/d	10.00			
1-7-2006	Plant	10.00	1-7-2006	b/d	10
30-6-2007	c/d	12.11	30-6-2007	Dep. Expense	12.11
1-7-2007	Plant	12.11	1-7-2007	b/d	12.11
30-6-2008	c/d	9.44	30-6-2008	Dep. Expense	9.44
1-7-2008	Plant	9.44	1-7-2008	b/d	9.44
30-6-2009	c/d	10.59	30-6-2009	Dep. Expense	10.59

(W-4)

Revaluation Surplus account

Dr.					Cr.
30-6-2007	Retained Earnings	2.11	1-7-2006	Plant	40.00
30-6-2007	c/d	37.89			
1-7-2007	Plant	37.89	1-7-2007	b/d	37.89
30-6-2008	c/d	--			
30-6-2009	Retained Earnings	0.59	1-7-2008	Plant	10.00
30-6-2009	c/d (Bal. Fig.)	9.41			

Answer-7

Office building

Rs. in '000'

Date	Description	Building	Rev. Surplus	SOCI(P/L)
1/7/13	Opening book value	5,500		
30/6/14	Depreciation (6,000/12)	(500)		
30/6/14	WDV	5,000		
30/6/14	Revaluation surplus (bal.)	750	750	
30/6/14	Revalued amount	5,750	750	
30/6/15	Depreciation (5,750/8) : (750/8)	(719)	(94)	
30/6/15	WDV	5,031	656	

Factory building

Date	Description	Building	Rev. Surplus	SOCI(P/L)
1/7/13	Opening book value	3,960		
30/6/14	Depreciation (4,400/10)	(440)		
30/6/14	WDV	3,520		
30/6/14	Revaluation surplus (bal.)	(200)		(200)
30/6/14	Revalued amount	3,320		(200)
30/6/15	Depreciation (3,320/9) : (200/9)	(369)		22
30/6/15	WDV	2,951		(178)

Warehouse

Date	Description	Building	Rev. Surplus	SOCI(P/L)
1/7/13	Opening book value	4,050		
30/6/14	Depreciation (4,500/10)	(450)		
30/6/14	WDV	3,600		
30/6/14	Revaluation surplus (bal.)	(250)		(250)
30/6/14	Revalued amount	3,350		(250)
30/6/15	Depreciation (3,350/8) : (250/8)	(419)		31
30/6/15	WDV	2,931		(219)

Scanned with CamScanner

PQR Enterprise
Journal entries for the year ended June 30, 2014 & 2015

Rs. in '000'

Office Building

Date	Particulars	Dr.	Cr.
30/6/14	Depreciation expense Accumulated depreciation (Recording of depreciation on office building)	500	500
30/6/14	Accumulated depreciation (500 + 500) Office Building (Transfer of accumulated depreciation to office building)	1,000	1,000
30/6/14	Office Building Revaluation surplus (Recording of revaluation surplus)	750	750
30/6/15	Depreciation expense Accumulated depreciation (Recording of depreciation on office building)	719	719
30/6/15	Revaluation Surplus Retained earnings (Transfer of remaining revaluation surplus to retained earnings)	94	94

Factory Building

Date	Particulars	Dr.	Cr.
30/6/14	Depreciation expense Accumulated depreciation (Recording of depreciation on factory building)	440	440
30/6/14	Accumulated depreciation (440 + 440) Factory Building (Transfer of accumulated depreciation to factory building)	880	880
30/6/14	P/L account Factory Building (Recording of revaluation deficit)	200	200
30/6/15	Depreciation expense Accumulated depreciation (Recording of depreciation on factory building)	369	369

Warehouse

Date	Particulars	Dr.	Cr.
30/6/14	Depreciation expense Accumulated depreciation (Recording of depreciation on warehouse)	450	450
30/6/14	Accumulated depreciation (450 + 450) Warehouse (Transfer of accumulated depreciation to warehouse)	900	900
30/6/14	P/L account Warehouse (Recording of revaluation deficit)	250	250
30/6/15	Depreciation expense Accumulated depreciation (Recording of depreciation on warehouse)	419	419

Scanned with CamScanner

Answer-8

Property Plant & Equipment

Note:

	2016		2015	
	Building	**EQ**	**Building**	**EQP**
Cost				
Opening balance	456	85	450	50
Add: Addition/revered	(24)	-	(22.5)	35
Add: Rev/(Rev)	(54)	-	28.5	-
Less: Disposal	-	(25)	-	-
Closing balance	378	60	456	85
Depreciation				
Opening balance	24	10.96	22.5	5
Dep expense for year	21	6.3915	24	5.96
Disposal	-	(5.7625)	-	-
Rev Surplus	(24)	-	(22.5)	-
Closing balance	21	11.589	24	10.96
WDV	357	48.411	432	74.04
Dep rate	**5% (20 year)**	**10% (10 year)**	**5% (20 year)**	**10% (10 year)**
	Rev model S.L Method	Cost model WDV Method	Rev model S.L Method	Cost model WDV Method

(W-1)

Date	Description	Building	Rev Sur	P/L
01/01/14	Cost	450		
31/12/14	Dep 450/20	(22.5)		
31/12/14	WDV	427.5		
01/01/15	Rev Surplus	28.5	28.5	
01/01/15	Rev Amount	456	28.5	
31/12/15	Dep	(24)	(1.5)	
31/12/15	WDV	432	27	
01/01/16	Rev Surplus	(54)	(27)	(27)
01/01/16	Rev Amount	378		(27)
31/12/16	Dep	(21)		1.5
31/12/16	WDV	357		(25.5)

Scanned with CamScanner

Building A/C

	Rs.		Rs.
01/01/14 Cash	450	31/12/14 bal c/d	450
01/01/15 bal b/d	450	01/01/15 ACC dep	22.5
01/01/15 Rev Sur	28.5	31/12/15 c/d	456
	478.5		478.5
01/01/16 bal b/d	456	01/01/16 Revaluation Surplus	27
		01/01/16 P/L	27
		01/01/16 Acc Dep	24
		31/12/16 Bal c/d	378
	456		456

Acc dep A/C

	Rs.		Rs.
31/12/14 c/d	22.5	01/01/14 b/d	-
	22.5	31/12/14 Depreciation	22.5
01/01/15 Building	22.5		22.5
31/12/15 bal c/d	24	01/01/15 bal b/d	22.5
	46.5	31/12/15 Depreciation	24
01/01/16 Building	24		46.5
31/12/16 bal c/d	21	01/01/16 bal b/d	24
	45	31/12/16 Depreciation	21
			45

Revaluation Surplus A/C

	Rs.		Rs.
31.12.15 Retained earning	1.5	01.1.15 Building	28.5
31/12/15 bal c/d	27		
	28.5		28.5
01.01.16 Building	27	01.01.16 bal b/d	27
31/12/16 bal c/d	-		
	27		27

Retained earnings A/C

	Rs.		Rs.
31/12/15 bal c/d	1.5	31/12/15 Rev Sur	1.5
31/12/16 bal c/d	1.5	01/01/16 bal b/d	1.5
	1.5		1.5

Scanned with CamScanner

(W-2)

Equipment A/C

		Rs.			Rs.
01/01/14	cash	50	31/12/14	c/d	50
01/01/15	b/d	50			
01/08/15	cash	35	31/12/15	c/d	85
		85			85
01/01/16	b/d	85	30/06/16	Disposal	25
			31/12/16	c/d	60
		85			85

(W-3)

Accumulated dep A/C

		Rs.			Rs.
			01/01/14	b/d	-
31/12/14	bal c/d	5	31/12/14	c/d	5
		5			5
			01/01/15	b/d	5
31/12/15	bal c/d	10.96	31/12/15	dep	5.96
		10.96			10.96
30/06/16	Disposal (w-4)	5.7625	01/01/16	b/d	10.96
31/12/15	c/d	11.589	31/12/16	dep	6.3915
		17.3515			17.3515

(W-4) Accumulated Depreciation of disposal asset

Date	Dep exp	Dep exp
01/01/14	25	25
31/12/14	(2.5)	(2.5)
	22.5	22.5
31/12/15	(2.25)	(2.25)
	20.25	20.25
30/06/16		(1.10125)
		19.2375
31/12/16	(2.025)	
	18.225	

Acc dep = Cost-WDV = 25 – 19.2375 = 5.7625

(W-5) Addition of Equipment

01/08/15	Cost	35
31/12/15	Dep × 10% × 5/12	(1.46)
31/12/15	WDV	33.54
31/12/16	Dep × 10%	(3.354)
31/12/16	WDV	30.186

Scanned with CamScanner

Answer-9

(a)

Date	Particulars	Dr.	Cr.
31-12-13	Building	17	
	Revaluation surplus		17
	(Recording of revaluation surplus)		
31-12-15	Revaluation surplus	13	
	P/L	26	
	Building		39
	(Recording of revaluation loss)		
31-12-17	Building	23	
	Revaluation surplus		5
	P/L		18
	(Recording of revaluation surplus)		

(W-1)

Date	Description	Building	Rev surplus	P/L
1-7-12	Cost	360		
31-12-12	Dep (360/10 × 6/12)	(18)		
31-12-12	WDV	342		
31-12-13	Dep (342/9.5)	(36)		
31-12-13	WDV	306		
31-12-13	Rev surplus	17	17	
31-12-13	Rev amount	323	17	
31-12-14	Dep(323/8.5)/(17/8.5)	(38)	(2)	
31-12-14	WDV	285	15	
31-12-15	Dep (285/7.5)/(15/7.5)	(38)	(2)	
31-12-15	WDV	247	13	
31-12-15	Rev surplus	(39)	(13)	(26)
31-12-15	Rev amount	208		(26)
31-12-16	Dep (208/6.5)/(26/6.5)	(32)		4
31-12-16	WDV	176		(22)
31-12-17	Dep (176/5.5)/(22/5.5)	(32)		4
31-12-17	WDV	144		(18)
31-12-17	Rev surplus	23	5	18
31-12-17	Rev amount	167	5	-

(b)

	Particulars	Dr.	Cr.
(1)	Asset (new)(8.5 – 1.1)	7.4	
	Cash	1.1	
	Acc. Dep.	3.9	
	Asset(old)		10.3
	Gain(bal)		2.1
(2)	Asset(new)	9	
	Acc.dep(12.4 – 7.3)	5.1	
	P/L bal	0.4	
	Asset(old)		12.4
	Cash		2.1

Scanned with CamScanner

(3)	Asset(new)	3.4	
	Acc dep	11.1	
	Asset (old)		14.5

Answer-10

Machine Account - Cost

		Rs.			Rs.
1-1-17	Balance b/d	800,000	30-4-17	Disposal (W-1.1)	52,000
1-1-17	Bank (W-2)	80,000	30-6-17	Disposal	65,000
1-1-17	Disposal. (TIA) (W-2)	40,000	31-12-17	Balance c/d	803,000
		920,000			920,000

Accumulated Depreciation Account

		Rs.			Rs.
30-4-17	Disposal (W-1.2)	21,662	1-1-17	Balance b/d	333,000
30-6-17	Disposal (W-3)	15,810	31-12-17	Depreciation(W-4)	71,868
31-12-17	Balance c/d	367,396			
		404,868			404,868

Disposal Account

	Rs.		Rs.
Machine	52,000	Acc. depreciation	21,662
Bank	5,000	Bank	34,000
Machine	65,000	Acc. depreciation	15,810
		Machine	40,000
		Loss on disposal	10,528
	122,000		122,000

WORKINGs

(W-1)

1-1-14	Cost	100		
31-12-14	Dep 100 × 15%	(15)		
31-12-14	WDV	85		
31-12-15	Dep 85 × 15%	(12.75)		
31-12-15	WDV	72.25		
31-12-16	Dep 72.25 × 15%	(10.84)		
31-12-16	WDV	61.4125	WDV (Given)	31,935
30-4-17	Dep 61.4125 × 15% × 4/12	(3.07)	Dep 31935 × 15% × 4/12	(1,597)
30-4-17	WDV	58.34	WDV	30,338

(W – 1.1)

		Rs.	%
1-1-17	Cost	52,000	100
	Less Accumulated Depreciation	(20,065)	(38.5875)
	WDV	31,935	61.4125

61.4125 – 31,935

$$1 - \frac{31,935}{61.4125} \times 100 = 52,000$$

Scanned with CamScanner

(W – 1.2)

Accumulative depreciation = Cost WDV

= 52,000 – 30,338 = 21,662

(W-2)

Cost of New Asset = Cash paid + Trade In Allowance (TIA)

= 80,000 + 40,000 = 120,000

(W-3)

1-10-15	Cost	65,000
31-12-15	Depreciation 65,000 × 15% × 3/12	(2,438)
31-12-15	WDV	62,562
31-12-16	Depreciation 62,562 × 15%	(9,384)
31-12-16	WDV	53,178
31-12-17	Depreciation 53,178 × 15% × 6/12	(3,988)
31-6-17	WDV	49,190

(W – 3.1)

Accumulative depreciation = Cost WDV

= 65,000 – 49,190 = 15,810

(W-4)

Depreciation Expenses

Depreciation on opening asset excluding disposal

= (800,00 – 333,000) – 53,178 – 31,935 = 381,887 × 15% 57,283

Depreciation on addition

= 120,000 × 15% × 6/12 9,000

Depreciation on disposal W-1 1,597

W-3 3,988

71,868

Answer-11

(a) Depreciation of plant

Date	Description	Plant	Rev. surplus	P/L
		Rs. in million		
1-1-15	Cost	500		
31-12-15	Dep $\left(\frac{500-60}{10}\right)$	(44)		
31-12-15	WDV	456		
31-12-16	Dep $\left(\frac{456-78}{9}\right)$	(42)		
31-12-16	WDV	414		
31-12-16	Rev surplus	112	112	
31-12-16	Rev amount	526	112	
31-12-17	Dep $\left(\frac{526-780}{8}\right)$ $\left(\frac{112}{8}\right)$	(56)	(14)	
31-12-17	WDV	470	98	

Scanned with CamScanner

31-12-18	Dep $\left(\frac{470-64}{7}\right)$	(58)	(14)	
31-12-18	WDV	412	84	
31-12-18	Rev surplus	(102)	(84)	(18)
31-12-18	Rev amount	310	0	(18)

Depreciation of equipment

Date	Description	Equipment	Rev. surplus	P/L
		----------Rs. in million----------		
1-7-15	Cost	360		
31-12-15	Dep $\left(\frac{360-0}{12} \times \frac{6}{12}\right)$	(15)		
31-12-15	WDV	345		
31-12-16	Dep $\left(\frac{345-0}{15}\right)$	(23)		
31-12-16	WDV	322		
31-12-16	Rev surplus	(42)		(42)
31-12-16	Rev amount	280		(42)
31-12-17	Dep $\left(\frac{280-0}{14}\right)\left(\frac{42}{14}\right)$	(20)		3
31-12-17	WDV	260		(39)
31-12-18	Dep $\left(\frac{260-0}{10}\right)$	(26)		3.9
31-12-18	WDV	234		(35.1)
31-12-18	Rev surplus	41	5.9	35.1
31-12-18	Rev amount	275	5.9	-

(b) **Journal Entry**

Date	Description	Dr.	Cr.
		Rs. million	Rs. million
31-12-18	Revaluation loss (P & L account)	18.00	
	Revaluation surplus	84.00	
	Plant		102.00
31-12-18	Equipment	41.00	
	Revaluation gain (P & L account)		35.10
	Revaluation surplus		5.90

Answer-12

Monday Limited
Notes to the financial statement
For the year ended 31 December 2018

Property, plant and equipment:

	Office building	Equipment	Plant
	---------- Rs. in million ----------		
Gross carrying amount			
Opening	240.00	190.00	-
Addition	-	96.00	699.25
Transfer	(46.20)	-	-
Revaluation	(15.80)	-	-
Disposal	-	(40.00)	-
Closing	178.00	246.00	699.25

Scanned with CamScanner

	-	-	-
Accumulated Depreciation			
Opening	36.00	60.00	-
Depreciation for the year	10.20	30.48	7.77
Transfer	(46.20)	-	-
Disposal	-	(15.04)	-
Closing	-	75.44	7.77
Net carrying amount – closing	178.00	170.56	691.48
Net carrying amount – opening	204.00	130.00	-

	Office building	Equipment	Plant
Measurement base	Revaluation model	Cost model	Cost model
Useful life (years)/depreciation rate %	20 years	20%	15 years
Depreciation method	Straight line	Reducing balance	Straight line

The last revaluation was performed on 31 December 2018 by Precise Valuers, an independent firm of valuers.

Carrying value of building, had the cost model been used instead	xxx

WORKINGS

W-1

		Asset Building	R/S	P/L
1-1-18	Cost/Revalued Amount	240	-	-
1-1-18	Acc Dep	(36)	-	-
1-1-18	WDV	204	8.5	-
31-12-18	Dep 204/20 8.5/20	(10.2)	(0.425)	-
31-12-18	WDV	193.8	8.075	-
31-12-18	Revaluation Loss (P/L)	(15.8)	(8.075)	(7.725)
31-12-18	Revalued Amount	178	-	(7.725)

W-2 Depreciation on equipment

Depreciation on Opening excluding disposal {WDV all – WDV Disposal}×Rate {130-28.8}×20%		20.24
Depreciation on addition	{96×0.2×4/12}	6.4
Depreciation on disposal WDV opening × rate	{40(1-0.2×6/12) = 28.8×20%×8/12}	3.84
Total		30.48

W-3 Exchange of Assets – Journal Entry

	Dr.	Cr.
Asset-New (W.3.1)	96	
Acc Dep-Old (40-24.96) (W-3.2)	15.04	
Loss on Disposal	3.96	
Asset-Old		40
Cash (70 + 5 installation)		75
		96

W.3.1 Asset-New Cost

FV Old + Cash Paid	21 + 70	91
Installation cost		5
Total		96

Scanned with CamScanner

W-3.2 Accumulated depreciation

WDV Opening	40(1-0.2×6/12)(1-0.2)	28.80
Depreciation	28.8×0.2×8/12	(3.84)
WDV Closing		24.96

Accumulated depreciation = Cost - WDV
= 40 - 24.96
= 15.04

ALTERNATIVE WORKING

	Rs. in million
Cost	40.00
Depreciation $40 \times 0.2 \times \frac{6}{12}$	(4.00)
WDV	36.00
Depreciation	(7.20)
WDV	28.80
Depreciation $28.8 \times 0.2 \times \frac{8}{12}$	(3.84)
	24.96

W-4 Cost of plant

		Rs. in million
Payments		660.00
Borrowing cost:		
Interest cost	500×18%×7.5÷12	56.25
Investment income		(17.00)
		699.25

W-4.1 Depreciation or plant

$$\frac{699.25}{15} \times \frac{2}{12} = 7.77$$

Answer-13

Distaghil Limited
Statement of comprehensive income (extracts)
For the year ended 31 December 2019

		2019	2018
		--- Rs. in million ---	
Expenses			
Depreciation expense – Vehicle	(W-1)	(32.00)	(34.00)
Depreciation expense – Plant	(W-2)	(35.00)	(26.25)
Revaluation loss / (Revaluation loss reversal)	(W-1)	15.00	(17.00)
Fair value loss – Warehouse	(W-4)	-	(8.00)
Incomes			
Government grant income	(W-2)	15.00	11.25
Fair value gain – Warehouse	(W-4)	19.00	-
Other comprehensive income			
Revaluation surplus - Specialized vehicle (W-1)		5.00	-
Revaluation surplus – Warehouse (W-3)		-	24.00

Scanned with CamScanner

Distaghil Limited
Statement of financial position (extracts)
As on 31 December 2019

		2019	2018
		--- Rs. in million ---	
Equity and liabilities			
Equity			
Revaluation surplus - Specialized vehicle		5.00	-
Revaluation surplus – Warehouse	(W-3)	21.00	22.50
Liabilities			
Deferred income - Government grant [120 - 11.25(W-2) - 15(W-2)] : [120 - 11.25(W-2)]		93.75	108.75
Assets			
Non current assets			
PPE: Specialized vehicle	(W-1)	290.00	302.00
PPE: Plant [280 - 26.25(W-2) - 35(W-2)] : [280 - 26.25(W-2)]		218.75	253.75
Investment property: Warehouse	(W-4)	115.00	96.00

WORKINGS

(W-1) Specialized Vehicle

Date	Description	Vehicle	R/S	P/L
01.07.17	Cost	370.00		
31.12.17	Depreciation [(370 - 30) / 10] x 6/12	(17.00)		
31.12.17	WDV	353.00		
31.12.18	Depreciation [(370 - 30) / 10]	(34.00)		
31.12.18	WDV	319.00		
31.12.18	Revaluation loss (Bal.)	(17.00)		(17.00)
31.12.18	Revalued amount	302.00		(17.00)
31.12.19	Depreciation [(302 - 30) / 8.5]: [17 / 8.5]	(32.00)		2.00
31.12.19	WDV	270.00		(15.00)
31.12.19	Revaluation surplus (Bal.)	20.00	5.00	15.00
31.12.19	Revalued amount	290.00	5.00	-

(W-2)

Manufacturing plant		
Plant	280.00	
Cash		280.00
Cash	120.00	
Deferred income - Government grant		120.00
Depreciation (280 / 8) x 9/12	26.25	
Plant		26.25
Deferred income - Government grant	11.25	
Government grant income (120 / 8) x 9/12		11.25
Depreciation (280 / 8)	35.00	
Plant		35.00

Scanned with CamScanner

Deferred income - Government grant	15.00	
Government grant income (120 / 8)		15.00

(W-3) Warehouse - PPE

Date	Description	Warehouse	R/S	P/L
1.1.18	WDV	80.00		
1.1.18	Revaluation surplus (Bal.)	24.00	24.00	
1.1.18	Reavalued amount	104.00	24.00	
1.1.18	Transferred to investment property	(104.00)	-	
1.1.18	WDV	-	24.00	
31.12.18	Depreciation [24 / 16]		(1.50)	
31.12.18	WDV		22.50	
31.12.19	Depreciation [24 / 16]		(1.50)	
31.12.19	WDV		21.00	

(W-4) Warehouse - Investment property

1.1.18	PPE	104.00	31.12.18	P&L account (Bal.)	8.00
			31.12.18	c/d - fair value	96.00
1.1.19	b/d	96.00			
31.12.19	P&L account (Bal.)	19.00	31.12.19	c/d - fair value	115.00

Answer-14

Harappa Industries Limited (HIL)
Notes to the Financial statements
For the year ended June 30, 2020

1. Property, plant and equipment:	Land	Buildings	Plant	Vehicles
	---------- Rs. in '000' ----------			
Gross carrying amount				
Opening balance	100,000	70,000	180,000	8,800
Transfer	-	(17,500)	-	-
Revaluation (W-1) : (W-2)	20,000	(17,500)	-	-
Addition (W-3)	-	-	102,840	1,800
Disposal	-	-	-	(1,000)
Closing balance	120,000	35,000	282,840	9,600
Accumulated depreciation				
Opening balance	-	14,000	60,000	4,000
Depreciation (W-2) : (W-4)	-	3,500	14,571	1,068
Transfer	-	(17,500)		-
Disposal (W-4.1)	-	-		(352)
Closing balance	-	-	(74,571)	(4,716)
Written down value	120,000	35,000	208,269	4,884

Scanned with CamScanner

1.1

Measurement basis	Revaluation	Revaluation	Cost model	Cost model
Useful life / depreciation rate	Infinte	15 years	10-15 years	20%
Depreciation method	-	Straight line	Straight line	Reducing balance

1.2 The last revaluation was performed on 30 June 2020 by Smart Consultants, an independent firm of valuers.

1.3 Had there been no revaluation, the carrying value of land and buildings as on 30 June 2020 would have been:

	Land	Buildings
	------- Rs. in '000' -------	
Cost (100,000 + 12,000) : (70,000 - 20,000)	112,000	50,000
Less: Accumulated depreciation	-	(12,500)
Written down value	112,000	37,500

1.4 Movement in revaluation surplus

	Land	Buildings
	------- Rs. in '000' -------	
Opening (1.7.2019)	(12,000)	16,000
Arose during the year	20,000	-
Transferred to retained earnings / adjusted	-	(16,000)
Closing (30.6.2020)	8,000	-

WORKINGS

W-1 Revaluation of land

Date	Description	Land	R / S	P / L
30.6.2019	WDV	100,000	-	(12,000)
30.6.2020	Revaluation surplus (bal.)	20,000	8,000	12,000
30.6.2020	Revalued amount	120,000	8,000	-

W-2 Revaluation of buildings

Date	Description	Buildings	R / S	P / L
30.6.2019	WDV (70,000 - 14,000)	56,000	16,000	-
30.6.2020	Dep. (56,000 / 16) : (16,000 / 16)	(3,500)	(1,000)	-
30.6.2020	WDV	52,500	15,000	-
30.6.2020	Revaluation surplus (bal.)	(17,500)	(15,000)	(2,500)
30.6.2020	Revalued amount	35,000	-	(2,500)

W-3 Cost of plant

Construction payments	120,000
Borrowing cost capitalised (W-3.1)	2,840
Government grant	(20,000)
	102,840

Scanned with CamScanner

W-3.1 Borrowing cost to be capitalised

Interest expense on general loan:		
(12,000 x 12% x 7 / 12)	840	
(48,000 x 12 % x 5 / 12)	2,400	3,240
Interest saving due to grant (20,000 x 12% x 2 / 12)		(400)
		2,840

W-4 Depreciation expense for the year ended 30.06.2020

Plant	
On opening (180,000 / 15)	12,000
On addition (102,840 / 10) x 3 / 12	2,571
	14,571
Vehicle	
On opening [(8,800 - 4,000) - 720 (W-4.1)] x 20%	816
On addition (1,800 x 20%) x 6 / 12	180
On disposal (W-4.1)	72
	1,068

W-4.1 Acc. Dep. and WDV of disposal

1.1.18	Cost	1,000
30.6.18	Depreciation (1,000 x 20%) x 6 / 12	(100)
30.6.18	WDV	900
30.6.19	Depreciation (900 x 20%)	(180)
30.6.19	WDV	720
1.1.20	Depreciation (720 x 20%) x 6 / 12	(72)
1.1.20	WDV	648
	Accumulated depreciation (1,000 - 648)	352

Answer-15

(i) The accounting treatment adopted by accountant for not recording land is incorrect. Allotment of land by Government is a transfer of a non-monetary asset and should be considered as a government grant. Such non-monetary grant may be recorded at fair value or at a nominal value. As per CL's policy, fair value of the land should be assessed and reported in the financial statements under the head property, plant and equipment (PPE). The grant was made subject to construction of factory so the resulting deferred income should be recognized in income on a systematic basis over the useful life of the factory building.

The factory building should also be transferred from capital work in progress to PPE account as the building is available for use on 1 October 2020. Further depreciation should also be charged from same date i.e. 1 October 2020.

(ii) The accounting treatment adopted by accountant to record complete building under PPE head is incorrect. Two floors which have been leased/rented separately so should be accounted for as investment property. While ground floor used by marketing department should be recorded as property, plant and equipment under IAS 16 and depreciated over its useful life.

As per CL policy, investment property should be recorded at fair value and changes in fair value should be taken to statement of profit or loss. Any depreciation already charged on these floors should be reversed.

Scanned with CamScanner

(iii) The accounting treatment adopted by accountant to expense out borrowing cost is incorrect as some borrowing cost is eligible for capitalization. Power generation plant falls under definition of qualifying asset as its construction involves substantial period.

Construction of the power plant is financed through specific borrowing so actual borrowing cost incurred less temporary investment income on the borrowings would be capitalized. However, the borrowing cost will be capitalized from the date when construction actually started i.e. 1 February 2020 rather than 1 January 2020. Further, the capitalization of borrowing costs should be suspended and charged to the statement of profit or loss during the three months when work was suspended.

In the statement of profit or loss, borrowing cost on loan and interest income earned from saving account should be presently separately.

Answer-16

Sputnik Sea Limited
General Journal

Rs. in million

Date	Description	Debit	Credit
01-03-2018	Cruise ship	1,435.00	
	Bank		1,435.00
31-12-2018	Depreciation expense *(W-1)*	75.84	
	Accumulated depreciation - Cruise ship		75.84
01-05-2019	Repair cost	26.00	
	Bank		26.00
31-12-2019	Depreciation expense *(W-1)*	108.80	
	Accumulated depreciation - Cruise ship		108.80
31-12-2019	Accumulated depreciation - Cruise ship	184.64	
	Cruise ship *75.84+108.80*		184.64
31-12-2019	Cruise ship	149.64	
	Revaluation surplus		149.64
31-12-2020	Depreciation expense *(W-1)*	165.82	
	Accumulated depreciation - Cruise ship		165.82
31-12-2020	Revaluation surplus *165.82–147.20 (W-2)*	18.62	
	Retained earnings		18.62
31-12-2020	Accumulated depreciation - Cruise ship	165.82	
	Cruise ship		165.82
31-12-2020	Revaluation surplus *149.64–18.62*	131.02	
	Impairment loss **(Bal. fig)**	103.16	
	Cruise ship 1,234.18–1,000		234.18

Scanned with CamScanner

W-1: Rs. in million

Date	Description	Engine	Ship's Body	Dry Docking	Total
1/3/2018	**Acquisition cost**	**840.0**	**535.0**	**60.0**	**1,435**
31/12/18	Depreciation expense	(51.84) (840–40)÷50,000×(360×9)	(15.0) (535–35)÷25×9÷12	(9.0) 60÷5×9/12	(75.84)
31/12/19	Depreciation expense	(76.80) (840–40)÷50,000×(480×10)	(20.0) (535–35)÷25	(12.0) 60÷5	(108.80)
31/12/19	Carrying value	711.36	500.0	39.0	1,250.36
	Revaluation surplus **(Bal.)**				149.64
31/12/19	Revalued amount	796.49	559.84	43.67	1,400.00
31/12/20	Depreciation expense	(129.81) (796.38–40)÷(50,000–3240–4,800)×(600×12)	(22.57) (559.84–35)÷(25–1.75)	(13.44) 43.67÷(5–1.75)	(165.82)
31/12/20	Carrying value	666.68	537.27	30.23	1,234.18

W-2: Depreciation on cost for 2020

Engine	(840–40)÷50,000×(600×12)	115.20
Body	(535–35)÷25	20.00
Dry docking	60÷5	12.00
		147.20

Scanned with CamScanner

ICAP QUESTION BANK QUESTION

Question-1

1 A business purchased some land and buildings on 1 January 2011 for Rs.800million (land Rs.250 million and buildings Rs.550 million). The buildings are to be depreciated over a period of 50 years.

On 1 January 2015 the land and buildings were revalued to Rs.1,500 million (land Rs.400 million and buildings Rs.1,100 million). At this date the buildings were believed to have a remaining useful life of 40 years.

What is the original depreciation charge for the buildings and the revised charge from 1 January 2015?

2 A business purchased land for Rs.250 million and buildings for Rs.400 million on 1 January 2011. The buildings were to be depreciated over a period of 50 years. On 1 January 2015 the land was revalued to Rs.520 million and the buildings were revalued at Rs.750 million. What amount is to be taken to the revaluation reserve on 1 January 2015?

Question-2 *(ICAP Example 6)*

Rooney has recently finished building a new item of plant for its own use. The item is a press for use in the manufacture of industrial diamonds. Rooney commenced construction of the asset on 1st April 2013 and completed it on 1st April 2015. At a total cost of Rs.30.8 million.

The press comprises two significant parts, the hydraulic system and the 'frame'. The hydraulic system has a three-year life and the 'frame' has an eight-year life. Rooney depreciates plant on a straight line basis. The cost of the hydraulic system is 30% of the total cost of manufacture.

Rooney uses the IAS 16 revaluation model in accounting for diamond presses and revalues these assets on an annual basis.

Revaluation surpluses or deficits are apportioned between the hydraulic system and the 'frame' on the basis of their year-end book values before the revaluation.

Required

(a) Explain the IAS 16 rules on accounting for significant parts of property, plant and equipment and

(b) Show the accounting treatment of the diamond press in the financial statements for the financial years ending:

(i) 31st March 2016 (assume that the press has a fair value of Rs.21 million)

(ii) 31st March 2017 (assume that the press has a fair value of Rs.19.6 million).

Question-3

(ICAP Example 7)

The following information relates to the financial statements of Ehtisham for the year to 31 March 2015. The head office of Ehtisham was acquired on 1 April 2012 for Rs.1 million. Ehtisham intend to occupy the building for 25 years. On 31 March 2014 it was revalued to Rs.1.15 million. On 31 March 2015, a surplus of vacant commercial property in the area had led to a fall in property prices and the fair value was now only Rs.0.8 million.

Required

Explain the correct accounting treatment for the above (with calculations).

(ICAP Example 8)

Scanned with CamScanner

Question-4

The following is an extract from the financial statements of Carly on 31 December 2014.

Property, plant and equipment

	Land and buildings Rs.	Plant and equipment Rs.	Computers Rs.	Total Rs.
Cost				
On 31 December 2014	1,500,000	340,500	617,800	2,458,300
Accumulated depreciation				
On 31 December 2014	600,000	125,900	505,800	1,231,700
Carrying amount				
On 31 December 2014	900,000	214,600	112,000	1,226,600

Accounting policies

Depreciation

Depreciation is provided at the following rates.

On land and buildings	Over 50 years on straight line basis on buildings only
On plant and equipment	25% reducing balance
On computers	33.33% per annum straight line

During 2015 the following transactions took place.

(1) On 31 December the land and buildings were revalued to Rs. 1,750,000. Of this amount, Rs.650,000 related to the land (which had originally cost Rs. 500,000). The remaining useful life of the buildings was assessed as 40 years.

(2) A machine which had cost Rs. 80,000 and had accumulated depreciation of Rs. 57,000 at the start of the year was sold for Rs. 25,000 in the first week of the year.

(3) A new machine was purchased on 30 April 2015. The following costs were incurred:

	Rs.
Purchase price, before discount, inclusive of reclaimable sales tax of Rs.3,000	20,000
Trade Discount	1,000
Delivery costs	500
Installation costs	750
Interest on loan taken out to finance the purchase 300	

(4) On 1 January it was decided to change the method of providing depreciation on computer equipment from the existing method to 40% reducing balance.

Required:

Produce the analysis of property, plant and equipment as it would appear in the financial statements of Cakorly for the year ended 31 December 2015. ***(ICAP Example 9)***

Question-5

Adjustments Limited has carried out a review of its non-current assets.

(a) A grinder was purchased on 1 January 2012 for Rs.100,000. The plant had an estimated useful life of ten years and a residual value of nil. Depreciation is charged on the straight line basis. On 1 January 2015, when the asset's net book value is Rs.70,000, the directors decide that it would be more appropriate to depreciate this asset using the sum of digits approach. The remaining useful life is unchanged.

Scanned with CamScanner

(b) The company purchased a fifty year lease some years ago for Rs.1,000,000. This was being depreciated over its life on a straight line basis. On 1 January 2015, when the net book value is Rs.480,000 and twenty-four years of the lease are remaining, the asset is revalued to Rs.1,500,000. This revised value is being incorporated into the accounts.

Required:

Explain the effects of these changes on the depreciation for the year to 31 December 2015.

(ICAP Example 10)

Question-6

FAM had the following tangible fixed assets at 31 December 2014.

	Cost Rs. 000	Depreciation Rs. 000	NBV Rs. 000
Land	500	-	500
Buildings	400	80	320
Plant and machinery	1,613	458	1,155
Fixtures and fittings	390	140	250
Assets under construction	91	-	91
	2,994	678	2,316

In the year ended 31 December 2015 the following transactions occur.

(1) Further costs of Rs.53,000 are incurred on buildings being constructed by the company. A building costing Rs.100,000 is completed during the year.

(2) A deposit of Rs.20,000 is paid for a new computer system which is undelivered at the year end.

(3) Additions to plant are Rs.154,000.

(4) Additions to fixtures, excluding the deposit on the new computer system, are Rs.40,000.

(5) The following assets are sold.

	Cost	Depreciation brought forward	Proceeds
	Rs. 000	Rs. 000	Rs. 000
Plant	277	195	86
Fixtures	41	31	2

(6) Land and buildings were revalued at 1 January 2015 to Rs. 1,500,000, of which land is worth Rs. 900,000. The revaluation was performed by Messrs Jackson & Co, Chartered Surveyors, on the basis of existing use value on the open market.

(7) The useful economic life of the buildings is unchanged. The buildings were purchased ten years before the revaluation.

(8) Depreciation is provided on all assets in use at the year end at the following rates.

Buildings	2% per annum straight line
Plant	20% per annum straight line
Fixtures	25% per annum reducing balance

Required:

Show the disclosure under IAS 16 in relation to fixed assets in the notes to the published accounts for the year ended 31 December 2015.

(ICAP Example 11)

Scanned with CamScanner

Question-7

The following information pertains to property, plant and equipment of Orchid Limited (OL), a listed company:

Description	Date of purchase	Cost Rs. in million	Original useful life	Depreciation method	Subsequent measurement model
Buildings	1-Jan-15	600	30 years	Straight line	Revaluation
Plant	1-Jan-15	475	25 years	Straight line	Cost

Buildings

The revalued amount of buildings as determined by Shabbir Associates, an independent valuer, on 31 December 2015 and 2017 was Rs.700 million and Rs.463 million respectively.

On 30 June 2017 a building having original cost of Rs.66 million was sold to Baqir Limited for Rs.85 million. It was last revalued at Rs.87 million. OL incurred a cost of Rs.2 million on disposal.

OL transfers the maximum possible amount from revaluation surplus to retained earnings on an annual basis.

Plant

On 31 December 2016 the recoverable amount of the plant was assessed at Rs.360 million with no change in useful life.

During 2017, OL has decided to change the depreciation method for plant from straight line to reducing balance. The new depreciation rate would be 10%.

Required:

Prepare following notes (along with comparative figures) to be presented in the financial statements of OL for the year ended 31 December 2017 in accordance with the requirements of relevant IFRSs and Companies Act, 2017:

(a) Property, plant and equipment

(b) Change in depreciation method *(ICAP Example 12)*

Question-8

Abid Limited (AL) uses the revaluation model for subsequent measurement of its property, plant and equipment and has a policy of revaluing its assets on an annual basis using the net replacement value method.

The following information pertains to AL's buildings:

i. Four buildings were acquired in same vicinity on 1 January 2012 at a cost of Rs.300 million. The useful life of the buildings on the date of acquisition was 20 years.

ii. AL depreciates buildings on the straight line basis over their useful life.

iii. The results of revaluations carried out during the last three years by Premier Valuation Service, an independent firm of valuers, are as follows:

Revaluation date	Fair value Rs. in million
1 January 2013	323
1 January 2014	252
1 January 2015	272

iv. On 30 June 2015, one of the buildings was sold for Rs. 80 million.

Required:

Prepare a note on "Property, plant and equipment" (including comparative figures) for inclusion in AL's financial statements for the year ended 31 December 2015 in accordance with International Financial Reporting Standards. (Ignore taxation) *(ICAP Example 13)*

Scanned with CamScanner

Question-9

Shahwez Limited (SL) revalued its property on 1 April 20X1 to Rs.20 million (Rs.8 million for the land). The property originally cost Rs.10 million (Rs.2 million for the land) 10 years ago. The original useful life of 40 years is unchanged. SL's policy is to make a transfer to realised profits in respect of excess depreciation.

Required:

How will the property be accounted for in the year ended 31 March 20X2? ***(ICAP Example 14)***

Question-10

Hamza Limited (HL) acquired a building on 1 April 20X1 for Rs.100,000 at which point it was considered to have a useful life of 40 years. At the year end 31 March 20X6, HL decided to revalue the building to its current value of Rs.98,000.

Required:

How will the building be accounted for in the year ended 31 March 20X6? ***(ICAP Example 15)***

Question-11

1. When the asset should be derecognised from the balance sheet? What is the accounting treatment for gain or loss on disposal for revaluation model?
2. What is the disclosure requirement of asset carried at revalued amount?

Question 12

Abbas Limited (AL) is engaged in the business of manufacturing near the Karachi-Hyderabad Motorway. Its Property, Plant and Equipment comprises of land and buildings, plant and machinery, and equipment and fittings.

Details for the period up to 30 June 2018 are as follows:

1. The balances of the Property, Plant and Equipment as at 30 June 2018 are given below:

Assets	Gross Carrying Amount (Rs. Million)	Accumulated Depreciation (Rs. Million)
Land	12	N/A
Buildings	125	38
Plant and Machinery	500	300
Equipment	100	36

2. The relevant information pertaining these assets is given below:

Assets	Depreciation Method	Subsequent Measurement Model
Land	N/A	Fair Value
Buildings	Straight-line	Cost
Plant and Machinery	Units of Production	Cost
Equipment	Written down value	Cost

3. Abbas Limited uses proportionate policy to depreciate its Property, Plant and Equipment.
4. All of the plant and machinery pertains to factory use whereas all the equipment pertains to office use. However floor areas occupied by factory and office are in the ratio 60:40 respectively.
5. The equipment was purchased on 1 July 2016. No disposals and acquisitions took place in the period up to 30 June 2018.

Scanned with CamScanner

6. Until 30 June 2018, 12,000 units had been produced by Abbas Limited in its factory. The plant and machinery does not have any residual value. No additions or disposals of plant and machinery took place till this date.
7. The buildings were acquired on 1 July 2014 with a residual value of Rs. 11 million. No additions and disposals took place till 30 June 2018.
8. The land had actually cost Rs. 15 million on the date of its acquisition.
9. It is assumed that value of land and buildings is spread evenly across the area occupied.

The following information pertains to the year ended 30 June 2019:

1. On 1 July 2018, land was revalued to Rs. 20 million on 1 July 2018. The value was determined by an independent firm M/s Ashfaq & Co. Chartered Accountants.
2. This year, 5,000 units were produced in the factory of AL.
3. On January 1, 2019, AL disposed 25% of its area comprising of land and buildings at a price of Rs. 90 million. The portion of land was sold at its fair value as determined on 1 July 2018. The legal costs of drafting transfer agreements were Rs. 0.1 million. It is assumed that this disposal will not affect the proportion of areas occupied by factory and office.
4. Further equipment costing Rs. 60 million was acquired on 1 November 2018.
5. In the meeting of its board of directors, it was decided to open a new factory premises near Lahore-Islamabad motorway. An expenditure of Rs. 20 million was spent on the construction of the factory on 1 December 2018, financed by a loan obtained from the bank at the rate of 12% per annum. The construction had not been completed at the end of the year.
6. Moreover, the directors also made a contract with M/s UniPower& Co. to purchase plant and machinery worth Rs. 35 million once the construction of factory building is completed.

Required:

(a) Prepare journal entries to record the revaluation of land and disposal of land and buildings.

(b) Prepare the disclosure under IAS 16 in relation to Property, Plant and Equipment in the notes to the published accounts for the year ended 30 June 2019. *(ICAP Example 16)*

Question 13

Games Limited (GL) commenced a business of preparing and burning video game CDs on 1 July 2015.

The following information pertains to the year ended 31 March 2016:

(1) GL purchased 30 computers on the date of commencement of business at a cost of Rs.20,000 each, purely for the task of burning CDs. The management of GL estimates that since the computers are subject to obsolescence, more of its benefit can derived in its early life. The total useful life at the date of acquisition was estimated to be 4 years and residual value was estimated to be Rs. 4,802 for each computer.GL decided to adopt historical cost model for subsequently measurement of computers.

(2) GL purchased an office building at the date of start of business worth Rs.3 million. GL decided to adopt fair value model due to fluctuations in property prices. 80% of the building is occupied by computer labs, whereas 20% is used by administrative and selling departments. The useful life is estimated to be 10 years at the date of acquisition with no residual value, and the economic benefits are expected to be derived evenly over its useful life. At the end of the year, the fair value of office buildings was assessed to be Rs.3,237,500.

(3) GL also purchased fittings for its administrative and selling departments, costing Rs.120,000 on 1 July 2015. It is to be depreciated over 10 years using the straight-line method, with no residual value.

Scanned with CamScanner

(4) GL made a contractual commitment with Al-Karim Computers to purchase 6 computers of Rs. 20,000 each to be delivered at GL's premises on 1 May 2016.

The following information pertains to the year ended 31 March 2017:

(1) The computers were delivered at the GL's premises by Al-Karim Computers at the said date. It was decided to use the same method and same rate to depreciate these computers. However, no further space was utilised by the computer labs.

(2) At the end of the year, the fair value of office building was assessed to be Rs. 2 million. At the year-end GL mortgaged entire building with JS Bank to obtain a loan worth Rs.1.75 million for prospective investments in other divisions.

(3) Fittings with a cost of Rs. 30,000 were disposed of for Rs. 22,000 on 1 January 2017. The Suzuki Driver was paid Rs. 1,000 to transfer the fittings to customer's premises.

The fair values of the office building were determined byan independent firm M/s Hafeez Yasir Chartered Accountants& Co. Moreover, GL uses proportionate policy to depreciate its assets.

Required:

(a) Prepare the disposal account to record the sale of fittings on 1 January 2017.

(b) Prepare the disclosure under IAS 16 in relation to Property, Plant and Equipment in the notes to the published accounts for the year ended 31 March 2017 (comparatives are required).

(ICAP Example 17)

Question 14

Indigo Limited (IL) purchased a building on 1 April 2015 for Rs.10 million at which point it was considered to have a useful life of 40 years. At the year ended 31 March 2020, IL decided to revalue the building to its market value of Rs.9.8 million.

Required:

How the above building shall be accounted for in the books of IL for the year ended 31 March 2020?

(ICAP Example 18)

Question 15

At 1 April 2019, Glacier Limited (GL) carried its office at its original cost of Rs.20 million and depreciation of Rs.4 million (based on straight line method to its original life of 50 years). GL decided to revalue the office on 1 October 2019 to its current value of Rs.22 million. The useful life remaining was reassessed at the time of valuation and is considered to be 40 years at this date. It is the company's policy to charge depreciation proportionally.

Required:

How the office will be accounted for in the financial statements of GL for the year ended 31 March 2020?

Question 16

(ICAP Example 19)

Following information pertains to plant and machinery of Alpha Enterprises (AE):

(i) As at 1 January 2018, balances of cost and accumulated depreciation amounted to Rs.12,700,000 and Rs.6,240,000 respectively.

(ii) On 1 April 2018, an old machine having fair value of Rs.340,000 was exchanged for a new machine. The balance of the purchase price was paid through a cheque of Rs.680,000. The list price of the new machine was Rs.1,130,000. The old machine had been acquired for Rs.870,000 on 1 September 2015.

Scanned with CamScanner

(iii) On 1 February 2018, a plant having a list price of Rs.10,000,000 was acquired. A trade discount of 5% was allowed on the list price. The plant was ready for use on 1 August 2018 after incurring the following costs:

	Rs. in '000
Freight charges	660
Consultant fees	540
Installation and testing	600
Administration and other general overheads	160
Staff training	120
Opening ceremony	100
	2,180

(iv) On 31 October 2018, another machine was sold for Rs.334,000. It was acquired on 1 January 2015 and had a net book value of Rs.512,000 on 1 January 2018. A cost of Rs.25,000 was incurred on its disposal.

(v) AE depreciates plant and machinery at 20% per annum using the reducing balance method.

Required:

Prepare following ledger accounts pertaining to the plant and machinery for the year ended 31 December 2018:

(a) Cost **(06)**

(b) Accumulated depreciation **(06)**

(c) Assets disposal **(04)**

(ICAP Example 4)

Question 17

Ali Limited (AL) uses the revaluation model for subsequent measurement of its property, plant and equipment and has a policy of revaluing its assets on an annual basis using the net replacement value method.

The following information pertains to AL's building:

I. The building was purchased on 01 January 2010 for Rs. 2 hundred million with expected useful life of ten years.

II. AL depreciates buildings on the straight line basis over their useful life.

III. The results of revaluations carried out during the last three years by Standard Valuation Service, an independent firm of values, are as follows:

Revaluation date	Fair value Rs. in million
1 January 2011	280
1 January 2012	170
1 January 2013	180

Required:

The journal entries relating to the above transactions including revaluations for the year ended December 31, 2010, 2011, 2012 and 2013.

(ICAP Example 5)

Scanned with CamScanner

ICAP QUESTION BANK SOLUTIONS

Answer-1

(1) Original depreciation $= \frac{\text{Rs.550 million}}{\text{50 years}} =$ Rs. 11 million

Revised depreciation $= \frac{\text{Rs.1,100 million}}{\text{40 years}} =$ Rs. 27 million

(2) The total amount taken to the revaluation reserve is Rs.652 million

(W-1)

Date	Particulars	Land	Building	Revaluation surplus	Profit & Loss / (SOCI)
		----------Rs. Million----------			
1.1.11	Cost	250	400		-
31.12.14	Accumulated depreciation (400/50 × 4)		(32)		-
31.12.14	W.D.V	250	368		-
1.1.15	Revaluation surplus	270	382	652	-
1.1.15	Revaluated amount	520	750	652	-

Answer 2

(a) IAS 16 requires that each part of an item (that has a cost that is significant in relation to the total cost) is depreciated separately. Therefore, the cost recognised at initial recognition must be allocated to each part accordingly

(b)

Date	Particulars	Hydraulic system	Frames	Total	Rev. Surplus	Profit & Loss / (SOCI)
		----------Rs. 000's----------				
1.4.15	Cost (30,800 × 30%) (30,800 × 70%)	9,240	21,560			-
31.3.16	Dep. $\left(\frac{9240}{3}\right), \left(\frac{21560}{8}\right)$	(3080)	(2695)			-
31.3.16	W.D.V	6,160	18,865	25,025		-
31.3.16	Revaluation loss	(991)	(3,034)	(4,025)		(4025)
31.3.16	Revaluated amount $\left(\frac{21,000}{25025} \times 6,160\right), \left(\frac{21,000}{25025} \times 18,865\right)$	5,169	15,831	21,000		(4025)

The carrying value of the assets should be written down by a factor of 21,000/25025. This gives a carrying value for the hydraulic system (in Rs.000) of 5,169 and for the 'frame' 15,831.

The hydraulic plant should be depreciated over remaining life of two more years and the 'frame' over 7 more years.

Scanned with CamScanner

Date	Particulars	HS	Frames	Total	R/S HS	R/S Frame	P & L/ (SOCI) HSc	P & L/ (SOCI) Frames
		----------Rs. 000's----------						
1.4.15	Cost (30,800 × 30%) (30,800 × 70%)	9,240	21,560				-	
31.3.16	Dep. $\left(\frac{9240}{3}\right), \left(\frac{21560}{8}\right)$	(3080)	(2695)				-	
31.3.16	W.D.V	6,160	18,865	25,025			-	
31.3.16	Revaluation loss	(991)	(3,034)	(4,025)			(991)	(3,034)
31.3.16	Revaluated amount $\left(\frac{21,000}{25025} \times 6,160\right), \left(\frac{21,000}{25025} \times 18,865\right)$	5,169	15,831	21,000			(991)	(3,034)
31.3.17	Depreciation $\left(\frac{5169}{2}\right), \left(\frac{991}{2}\right) \left(\frac{15831}{7}\right) \left(\frac{3,034}{7}\right)$	(2,585)	(2,262)				496	433
31.3.17	W.D.V	2,584	13,569	16,153			(495)	(2,601)
31.3.16	Revaluation surplus	551	2,896	3,447	56	295	495	2,601
31.3.16	Revaluated amount $\left(\frac{19,600}{16153} \times 2,584\right), \left(\frac{19,600}{16153} \times 13,569\right)$	3,135	16,465	19,600	56	295		

Hydraulic system = HS

Revalued surplus

The total revaluation gain is 3,447. Of this total amount, 3096 (495 + 2,601) reverses the loss in the previous year net of the benefit obtained through reduced depreciation and is therefore reported in profit and loss for the year. The remaining 351 (56 + 295) is reported as other comprehensive income.

Answer 3

IAS 16 permits assets to be carried at cost or revaluation. Where the latter is chosen, the asset must be stated at its fair value.

The original depreciation was Rs.40,000 (Rs.1,000,000/25 years) per annum.

On 31st March 2014 the asset is two years old. Its carrying value before revaluation was Rs.920,000.

In order to effect the revaluation, the cost is uplifted to fair value of Rs.1.15m, the accumulated depreciation is eliminated, and the uplift to the net book value is credited to a revaluation surplus account.

Following are the journal entries

31.3.14	Accumulated depreciation	80,000	
	Building		80,000
	(The accumulated depreciation is eliminated)		
31.3.14	Building	230,000	
	Revaluation surplus		230,000
	(The uplift to the net book value is credited to a revaluation surplus account.)		

The asset is depreciated over its remaining useful economic life of 23 years giving a charge of Rs.50,000 (Rs.1,150,000/23 years) per annum in the year to 31st March 2015.

31.3.15	Depreciation	50,000	
	Accumulated depreciation		50,000
	(Depreciation charge)		

Transfer from revaluation surplus to retained earnings

As a result of the revaluation, the annual depreciation has increased from Rs.40,000 to Rs.50,000. This extra depreciation of Rs.10,000 is transferred from the revaluation reserve to accumulated profits each year.

31.3.15	Revalue surplus	10,000	
	Retained earning		10,000
	(Transfer of incremental depreciation)		

Scanned with CamScanner

By the 31st March 2015, the balance remaining on the revaluation reserve will be Rs.220,000.

The fall in property values at the year-end. The asset must be revalued downwards to Rs.0.8million, a write-down of Rs.300,000.

Rs.220,000 of this is charged against the revaluation reserve relating to this asset, and the remaining Rs.80,000 must be charged against profits.

The reduction of the carrying amount of the asset is achieved by removing the accumulated depreciation and adjusting the asset account as follows.

31.3.15	Accumulated depreciation	50,000	
	Building		50,000
	(The accumulated depreciation is eliminated)		
31.3.15	Revaluation surplus	220,000	
	Profit and loss	80,000	
	Building		300,000
	(Revaluation adjustment)		

From 31.3.15 the Rs.800,000 will be depreciated over the remaining useful life of the asset (22 years).

(W-1)

Date	Particulars	Head office building	Rev. Surplus	Profit & Loss / (SOCI)
		----------Rs. 000----------		
1.4.12	Cost	1,000		-
31.3.14	Acc. Dep. $\left(\frac{1000}{25} \times 2\right)$	(80)		-
31.3.14	W.D.V	920		-
31.3.14	Revaluation surplus	230	230	-
31.3.14	Revaluated amount	1,150	230	-
31.3.15	Dep. $\left(\frac{1,150}{23}\right), \left(\frac{230}{23}\right)$	(50)	(10)	
31.3.15	W.D.V	1,100	220	-
31.3.15	Revaluation loss	(300)	(220)	(80)
31.3.15	Revaluated amount	800	0	(80)

Answer 4

	Land & building	Plant & machinery	Computer equipment's	Total
Gross Carrying Amount				
Balance 01.January 2015	1,500,000	340,500	617,800	2,458,300
+Addition		17,250	-	(620,000)
-Transfer	(620,000)	-	-	870,000
+Revaluation Surplus/(Rev. Loss)	870,000		-	17,150
- Disposal	-	(80,000)	-	(80,000)
Balance 31.December 2015	1,750,000	277,750	617,800	2,645,550
Accumulated depreciation				
Balance 01.January 2015	600,000	125,900	505,800	1,231,700
+Depreciation for the year	20,000	50,775	44,800	115,575
-Transfer	(620,000)			(620,000)
- Disposal		(57,000)		(57,000)
Balance 31.December 2015	-	119,675	-	670,275
WDV 31.December 2015	1,750,000	158,075	550,600	1,975,275
WDV 31.December 2014	900,000	214,600	67,200	1,226,600
			112,000	

Scanned with CamScanner

WORKINGS

(W-1) Depreciation charges for the year 2015

	Rs.
Buildings = $\frac{(1,500,000 - 500,000)}{50\ years}$ =	20,000
Plant and machinery:	
On opening plant (((340,500 – 80,000) – (125,900 – 57,000)) × 25%)	47,900
Addition (17,250 × 25% × $\frac{8}{12}$)	2875
	50775
Computer equipment = 112,000 × 40% =	Rs.44,800

(2) Cost of new machine

	Rs.
Purchase price (20,000 – 3,000 – 1,000)	16,000
Delivery costs	500
Installation costs	750
	17,250

Answer 5

(a) Grinder

The grinder was purchased in 2012 and was originally being depreciated on a straight line basis. It has now been decided to depreciate this on the sum of digits basis.

IAS 16 requires that depreciation methods be reviewed periodically and if there is a significant change in the expected pattern of economic benefits, the method should be changed. Depreciation adjustments should be made in current and future periods. This change might be appropriate if, for instance, usage of the machine is greater in the early years of an asset's life when it is still new and consequently it is appropriate to have a higher depreciation charge.

If the change is implemented, the unamortised cost (the net book value) of the asset should be depreciation over the remaining useful life commencing with the period in which the change is made. The depreciation charge for the remaining life of the asset will therefore bé as follows.

Sr. #	Year	Digits		Depreciation Rs.
1	2015	7	Rs. 70,000 × $\frac{7}{28}$	17,500
2	2016	6	Rs. 70,000 × $\frac{6}{28}$	15,000
3	2017	5		12,500
4	2018	4		10,000
5	2019	3		7,500
6	2020	2		5,000
7	2021	1		2,500
		$\frac{7(7+1)}{2} = 28$		Rs.70,000

Disclosure will need to be made in the accounts of:

(i) The details of the change, including

(ii) The effect on the charge in the year.

Scanned with CamScanner

The reassessment of the depreciation method is **NOT a change in accounting policy** and neither rectification of a fundamental error so the effects of the change will not affect the previously reported financial statements (opening retained earnings)

(b) **Leasehold land**

IAS 16 requires that the subsequent charge for depreciation should be based on the revalued amount. The annual depreciation will therefore be Rs.62,500, i.e. $\frac{\text{Rs.1,500,000}}{\text{24 years (Remaing life)}}$

There will then be a difference between the revalued depreciation charge and the historical depreciation charge.

The resulting excess depreciation may be dealt with by a movement in reserves, i.e. by transferring from the revaluation reserve to retained earnings a figure equal to the depreciation charged on the revaluation surplus each year. For this amount following journal entry will be made

Revalue surplus
Retained earning

Answer 6

FAM

Notes to financial statement

For the year ended 31 December 2015

Note No. 2: Accounting policies

(a) Property, plant and equipment is stated at historical cost less accumulated depreciation depreciation, except land and building which is stated at revalued amount less accumulated depreciation.

(b) Depreciation is provided on all assets, except land, and is calculated to write down the cost or valuation over the estimated useful life of the asset.

Note No. 12: Property Plant and Equipment

Fixed asset movements	Land	Buildings	Plant and machinery	Fixtures, fittings, etc.,	Total
Cost/valuation	**Rs.000**	**Rs.000**	**Rs.000**	**Rs.000**	**Rs.000**
Cost at 1 January 2015	500	400	1,613	390	2,903
Additions		100	154	40	294
Transfers		(80)			
Revaluation adjustment	400	280	-	-	600
Disposals			(277)	(41)	(318)
Value at 31 December 2015	**900**	**700**	**1,490**	**389**	**1,979**
Accumulated depreciation					
At 1 January 2015	-	80	458	140	678
Transfers	-	(80)	-	-	(80)
Depreciation for year (W2)	-	17	298	70	385
Disposals	-	-	(195)	(31)	(226)
At 31 December 2015		**(17)**	**(561)**	**(179)**	**(757)**
Net book value					
At 31 December 2015	**900**	**683**	**929**	**210**	**2,722**
At 31 December 2014	500	320	1,155	250	2,225

Scanned with CamScanner

12.1

Measurement basis	Revaluation	Revaluation	Cost	Cost
Depreciation method		S.L	S.L	RBM
Depreciation rate		2%	20%	25%

12.2 Land and buildings have been revalued during the year 2015 by Messrs Jackson & Co on the basis of a existing use value on the open market.

12.3 Had there been no revaluation the land and building would be shown at following values (The corresponding historical cost information is as follows).

	Land & buildings Rs.000
Cost	
Opening	900
Reclassification (Transfer from capital WIP)	100
Closing	1,000
Accumulation Depreciation	
Opening	80
Depreciation for the year	10
Closing	90
Net book value	910

12.4 **Movement of capital work in progress**

Cost at 1 January 2015	91
Additions (W1)	73
Reclassifications (Transfer to building account)	(100)
As at 31 December 2015	64
At 31 December 2014	91

WORKINGS

		Rs. 000
(W-1)	Additions to assets under construction	53
	Deposit on computer	20
		73
(W-2)	Depreciation on buildings $\frac{600}{40} + \left(\frac{100}{50}\right)$	17

2% straight line depreciation is equivalent to a 50 year life.
The buildings are ten years old at valuation and therefore have 40 years remaining.

(W-3)	Depreciation on plant (1490 × 20%)	298
(W-4) (W-5)	Depreciation on fixtures {(390 -140) – (41 – 31)} × 25%	70

Capital work in progress (CWIP)

	Rs.		Rs.
B/d	91	Building account	100
Cash (Building)	53		
Cash (For computer)	20	C/d	64

Scanned with CamScanner

Answer 7

Orchid Limited
Notes to Financial statements
For the year ended 31 December 2017

10. Property, plant and equipment

	2017		2016	
	Building	Plant	Building	Plant
	Rs.	Rs.	Rs.	Rs.
Cost				
Opening	700	475	700	475
Additions	-	-	-	-
Revaluation **(W-2)**	(108)	-	-	-
Disposal	(87)	-	-	-
Transfer of Acc. depreciation	(42)	-	-	-
Closing	463	475	700	475
Acc. Depreciation & Impairment				
Opening	24	115	-	19
Dep. For the year **(W-2) : (W-1)**	22.5	36	24	19
Disposal	(4.5)			
Impairment **(W-1)**				77
Transfer to asset account	(42)	-	-	
Closing	-	(151)	(24)	(115)
Carrying amount as on 31/12/2016	463	324	676	360

	Building	Plant
10.1 Measurement Basis	Revaluation model	Cost model
Depreciation Method	Straight line	Reducing balance
Dep. Rate/Useful life	30 years	10%

10.2 The last revaluation on 31 December 2017 by Shabbir Associates, an independent firm of valuers.

10.3 Had there been no revaluation, the buildings would have appeared as follows

		2017	2016
Cost	(600-66)	534	600
Less: Accumulated depreciation	$\left(\frac{600-66}{30} \times 3\right):\left(\frac{600}{30} \times 2\right)$	(53.4)	(40)
WDV as on 31.12.15		480.6	560

10.4 Details of property, plant and equipment disposed of during the year

	Cost/Revalued amount	Accumulated depreciation	Carrying amount	Sale proceeds	*Gain	Mode of disposal	Particulars of buyers
Building	87	4.5 $\left(\frac{87}{29} \times 1.5\right)$	82.5	85	0.5	Tender	Baqir Limited

Scanned with CamScanner

*Gain/(loss)= (Sale price- cost to sell) – W.D.V = (85-2) – 82.5 = 0.5

10.5 Change in Estimate:

During the year 2017, depreciation method of plant was changed from straight line to reducing balance. The new depreciation rate would be 10%. Due to above change, Depreciation for the year has increased whereas, Profit for the year has decreased by Rs. 20 million. $\left\{36(360 \times 10\%) - 16\left(\frac{360}{23}\right)\right\}$

(W-1) Plant W.D.V

1/1/2015	Cost	475
31/12/2015	Dep. (475/25)	(19)
31/12/2016	Dep. (475/25)	(19)
31/12/2016	W.D.V	437
	Impairment Loss	(77)
31/12/2016	Recoverable amount	360
31/12/2017	Dep (360*10%)	(36)
	WDV	324

(W-2) Revaluation schedule

Date	Description	Building	Rev. surplus	SOCI (P/l)
1/1/15	Cost	600		
31/12/2015	Dep. (600/30)	(20)		
31/12/2015	W.D.V	580		
31/12/2015	Rev. surplus	120	120	-
31/12/2015	Revalued amount	700	120	-
31/12/2016	Dep (700/29)	(24)	(4)	-
31/12/2016	WDV	676	116	-
30/06/2017	Dep. Of 1 building for 6 months (W-5)	(1.5)	(0.4)	-
30/06/2017	WDV of 1 building (W-6)	(82.5)	(22)	-
31/12/2017	Depreciation of remaining buildings	(21)	(3.3)	-
31/12/2017	WDV	571	90.3	-
31/12/2017	Revaluation loss	(108)	(90.3)	(17.7)
31/12/2017	Revalued Amount	463	-	(17.7)

(2.1) Total Depreciation on buildings for the year 2017

Dep. Of 1 building for 6 months **(W-3)**	1.5
Depreciation of remaining buildings **(W-5)**	21
	22.5

(W-3) Depreciation of 1 building for 6 months

Cost = $87/29 \times 6/12 = 1.5$: Surplus = $(23.2)/29 \times 6/12 = 0.4$

(W-4) WDV of 1 building

	Rs. 'millions' Building Cost	Rs. ' millions' Surplus
Balance	87	23.2
Acc. Depreciation $(87/29 \times 1.5)$: $(23.2/29 \times 1.5)$	(4.5)	(1.2)
	82.5	22

Scanned with CamScanner

(W-5) Depreciation of remaining buildings for the year

	Rs. 'millions' Building cost	Rs. 'millions' Surplus
Opening	700	120
Disposal	(87)	(23.2)
Balance	613	96.8
÷ Remaining Life	÷29	÷29
	21	3.3

Answer 8

Abid Limited
Notes to the Financial Statements
For year ended December 31, 2015

N-1 Property, plant and equipment

	Rs. in million 2015	2014
Cost		
Opening	252	323
Transfer from accumulated depreciation	(14)	(17)
Revaluation Surplus/(loss)	34	(54)
Disposals	(68)	-
Closing	204	252.00
Accumulated depreciation		
Opening	14	17
Transfer to asset a/c	(14)	(17)
Depreciation expense	14	14
Disposals	(2)	-
Closing	(12)	(14)
Book value	192	238.00

- The last revaluation was performed on 1 January 2015 by M/s Premier Valuation Services, an independent firm of valuers. Revaluation are performed annually.
- Had there been no revaluation, the 3 buildings would have appeared at Rs.180 million (as calculated below) on 31.12.15.

		Rs. in million 2015	2014
Cost of 3 buildings		225	300
Less: Accumulated depreciation on 31.12.15	(300/4 buildings × 3 buildings) (225/20 years × 4 years)	(45)	*(45)
		180	255

* 300/20x3 = 45

Details of property, plant and equipment disposed of during the year

	Cost/Revalued amount	Accumulated depreciation	Carrying amount	Sale proceeds	Mode of disposal	Particulars of buyers
	----------Rs. in million----------					
Building	68	2	66	80		

Scanned with CamScanner

WORKING

Date	Description	Building	R. Surplus	Rs in million SOCI(P/L)
1/1/12	Cost	300		
31/12/12	Depreciation (300/20)	(15)		
1/1/13	WDV	285		
1/1/13	Revaluation surplus (bal.)	38	38	
1/1/13	Revalued amount	323	38	
31/12/13	Depreciation (323/19) : (38/19)	(17)	(2)	
1/1/14	WDV	306	36	
1/1/14	Revaluation loss (bal.)	(54)	(36)	(18)
1/1/14	Revalued amount	252		(18)
31/12/14	Depreciation (252/18) : (18/18)	(14)	-	1
1/1/15	WDV	238	-	(17)
1/1/15	Revaluation surplus (bal.)	34	17	17
1/1/15	Revalued amount	272	17.00	-
30/6/15	Deprecation on Disposal (*68/17 × 6/12) : (*4.25/17 × 6/12)	(2)	(0.125)	
30/6/15	WDV of disposal (68 - 2)	(66.00)	(4.125)	
31/12/15	Depreciation (272 – 68)/17:(17 – 4.25)/17	(12.00)	(0.75)	
31/12/15	WDV	192.00	12.00	-

* 272/4 buildings = 68 and 17/4 buildings = 4.25

Following T-accounts are prepared for better understanding of students. These are not a part of solution.

Building account

Dr.				Cr.
2012	Cash	300	c/d	300
2013	b/d	300	Accumulated Depreciation	15
	Revaluation surplus	38	c/d	323
2014	b/d	323	Accumulated Depreciation	17
			Revaluation loss	54
			c/d	252
2015	b/d	252	Accumulated Depreciation	14
	Revaluation surplus	34	Disposal	68.00
			c/d	204.00

Accumulated depreciation account

Dr.				Cr.
2012	c/d	15	Depreciation	15
2013	Asset	15	b/d	15
	c/d	17	Depreciation	17
2014	Asset	17	b/d	17
	c/d	14	Depreciation	14
2015	Asset	14	b/d	14
	Disposal	2	Depreciation (1 building)	2.0
	c/d	12.00	Depreciation (3 buildings)	12.00

Scanned with CamScanner

Answer 9

Statement of comprehensive income extract for the year ended 31 March 20X2

	Rs. 000
Depreciation expenses	400
Other comprehensive income:	
Revaluation surplus (6,000 + 6,000) (W-1)	12,000

Statement of financial position extract as at 31 March 20X2

	Rs. 000
Non-current assets	
Property {8,000 + (12,000 – 400)}	19,600
Equity	
Revaluation surplus {6,000 + (6,000 - 200)} (W-1)	11,800

Statement of changes in equity extracts

	Retained earning	Revaluation surplus
	Rs. 000	Rs. 000
Total comprehensive income		12,000
Transfer	200	(200)
Closing		**11,800**

(W-1)

Date	Description	Land	Building	R/S land	R/S Building	SOCI (P/L)
	Cost	2,000	8,000			
	Acc. Dep. (8,000/40 × 10)		(2,000)			
1/4/X1	WDV	2,000	6,000			
1/4/X1	Revaluation surplus (bal.)	6,000	6,000	6,000	6,000	
1/4/X1	Revalued amount	8,000	12,000	6,000	6,000	
31/3/X2	Dep. (12,000/30)		(400)		(200)	
31/3/X2	WDV	8,000	11,600	6,000	5,800	

Answer 10

Statement of comprehensive income extract for the year ended 31 March 20X6

	Rs. 000
Depreciation expenses (100,000/40)	2,500
Other comprehensive income:	
Revaluation surplus (W-1)	10,500

Statement of financial position extract as at 31 March 20X6

	Rs. 000
Non-current assets	
Property	98,000
Equity	
Revaluation surplus	10,500

Scanned with CamScanner

Statement of changes in equity extracts

	Retained earning	Revaluation surplus
	Rs. 000	Rs. 000
Total comprehensive income		10,500
Transfer	-	-
Closing		10,500

(W-1)

Date	Description	Building	R/S Building	SOCI (P/L)
1/4/X1	Cost	100,000		-
31/3/X6	Acc. Dep. (100,000/40 × 5)	(12,500)		-
31/3/X6	WDV	87,500		-
31/3/X6	Revaluation surplus (bal.)	10,500	10,500	-
31/3/X6	Revalued amount	98,000	10,500	-

Answer 11

1. Property, Plant and Equipment should be derecognised (removed from PPE) either;
   (i) on disposal (sold or exchanged etc. by cash for asset given up) or
   (ii) when it is withdrawn from use and no future economic benefits are expected from the asset (in other words, it is effectively scrapped).

   A gain or loss on disposal is recognised as the difference between the disposal proceeds (gross proceeds received minus cost of making sale) and the carrying value of the asset (using the cost or revaluation model) at the date of disposal. This net gain is included in the income statement. The sales proceeds should not be recognised as revenue.

   Where assets are measured using the revaluation model, any remaining balance in the revaluation reserve relating to the asset disposed of is transferred directly to retained earnings. No recycling of this balance into the income statement is permitted.

2. **General disclosures**

   The financial statements shall disclose, for each class of property, plant and equipment:
   (a) the measurement bases used for determining the gross carrying amount;
   (b) the depreciation methods used;
   (c) the useful lives or the depreciation rates used;
   (d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and
   (e) a reconciliation of the carrying amount at the beginning and end of the period showing increases or decreases resulting from revaluations from comparing its revalued amount to the book value and recognize in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the revaluation increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

   Specific disclosures

   If items of property, plant and equipment are stated at revalued amounts, the following shall be disclosed:
   (i) The effective date of the revaluation;
   (ii) Whether an independent valuer was involved;
   (iii) For each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model; and

Scanned with CamScanner

(iv) The revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

Answer 12

(a)

Date	Description	Debit (Rs.,000)	Credit (Rs.,000)
1.7.18	Land	8,000	
	Revaluation surplus		5,000
	Profit and loss (Other income)		3,000
	(Revaluation of land)		
1.1.19	Cash (90,000 – 100)	89,900	
	Accumulated depreciation **(W-4)**	10,687.5	
	Building (125,000 × 25%)		31,250
	Land (20,000 × 25%)		5,000
	Gain on disposal (Other income)		64,337.5
	(Disposal of 25% of land & building)		
1.1.19	Revaluation surplus (5,000 × 25%)	1,250	
	Retained earning		1,250
	(Transfer of R/S to R/E on account of Disposal of 25% of land)		

(b) **Abbas Limited**
Notes to the financial statement
For the year ended 30 June 2019
10.1 Property plant & equipment

Fixed asset movements	Land	Buildings	Plant and machinery	Fixtures, fittings, etc.,	Total
Cost/valuation / Gross carrying amount		----------Rs. '000----------			
Cost at 1 July 2018	12,000	125,000	500,000	100,000	737,000
Additions				60,000	60,000
Revaluation adjustment	8,000				8,000
Disposals	(5,000)	(31,250)			(36,250)
Value at 30 June 2019	**15,000**	**93,750**	**500,000**	**160,000**	**768,750**
Accumulated depreciation					
At 1 July 2018		38,000	300,000	36,000	374,000
Depreciation for year		8,312.5 **(W-3)**	125,000 **(W-6)**	20,800 **(W-8)**	154,112.5
Disposals		(10,687.5) **(W-4)**			(10,687.5)
At 30 June 2019		**35,625**	**425,000**	**56,800**	**517,425**
Net book value					
At 30 June 2019	**15,000**	**58,125**	**75,000**	**103,200**	**251,325**
At 30 June 2018	12,000	87,000	200,000	64,000	

10.1

Measurement basis	**Revaluation**	**Cost less Acc. Dep.**	**Cost less Acc. Dep.**	**Cost less Acc. Dep.**
Depreciation method		Starlight line	Units of production	Written down value
Depreciation rate / useful life		12 years with redual value of 8.8% of cost **(W-2)**	20 million units **(W-5)**	20% **(W-7)**

Scanned with CamScanner

10.2 The land was previously revalued on 1 July 2018 by M/s Ashfaq & Co. Chartered Accountants, and independent valuer.

10.3 Had the land been not revalued the carrying amount of land would have been as follows:

	Rs. 000
Cost {Cost 15,000 – Disposal 15,000 × 25%}	11,250

10.4

Details of property, plant and equipment disposed of during the year

	Cost/Revalued amount	Accumulated depreciation	Carrying amount	Sale proceeds	Gain / (Loss)	Mode of disposal	Particulars of buyers
Land & Building	36,200	10,687.5	25,562.5	89,900	64,337.5	N/A	ABC

10.5 Depreciation is charged as follows:

	Rs. 000
Cost of sales (Part of inventory) (125,000 + 8,312.5 × 60%)	129,987.5
Admin and selling expenses (20,800 + 10687.5 × 40%)	24125
Total	154,112.5

10.6 Movement of revaluation surplus

	Rs. 000
Opening Balance	0
Revaluation surplus	5,000
Transfer to retained earning (Disposal)	(1,250)
Closing balance	3,750

Reversal of revaluation loss of Rs. 3 million was reversed during the year.

10.7 An amount of expenditure of Rs.20 million was incurred on the construction of a factory near Lahore-Islamabad Motorway on 1 December 2018. This amount was capitalised as capital work-in-progress.

A further borrowing costs of Rs.1.4 million (20 million×12% × $\frac{7}{12}$) were capitalised in respect of interest on loan obtained from the bank to finance this project.

10.8 A contract was made with M/s UniPower & Co. to purchase plant and machinery worth Rs.35 million once the construction of factory building is completed.

(W-1)

Date	Description	Land	R/S land	SOCI (P/L)
	Cost	15,000		
	Revaluation loss	(3,000)		(3,000)
1/7/18	WDV	12,000		(3,000)
1/7/18	Revaluation surplus (bal.)	8,000	5,000	3,000
1/7/18	Revalued amount	20,000	5,000	-

(W-2) Useful life of building

$$\text{Accumulated Depreciation} = \frac{\text{Cost} - \text{R.V}}{\text{Useful life}} \times (\text{Cumulative Period})$$

$$38{,}000 = \frac{125{,}000 - 11{,}000}{\text{Useful life}} \times 4$$

$$\text{Useful life} = \frac{125{,}000 - 11{,}000}{38{,}000} \times 4 = 12 \text{ years}$$

Scanned with CamScanner

(W-3) Depreciation on Building

	Rs. 000
On opening assets excluding disposal $\left(\frac{125,000 - 11,000}{12}\right) \times 75\%$	7,125
On disposal $\left(\frac{125,000 - 11,000}{12}\right) \times \frac{6}{12} \times 25\% =$	1187.5
Total	8,312.5

(W-4) Accumulated depreciation on disposal of building

	Rs. 000
$\left(\frac{125,000 - 11,000}{12}\right) \times 4.5 \times 25\% =$	10,687.5

(W-5) production units of plant

$$\text{Accumulated Depreciation} = \frac{\text{Cost} - \text{R.V}}{\text{total units}} \times (\text{Cumulative units produced})$$

$$300,000 = \frac{500,000 - 0}{\text{Total units}} \times 12,000$$

$$\text{Useful life} = \frac{500,000-0}{300,000} \times 12,000 = 20,000 \text{ units (in thousands)(i.e.,20 million units)}$$

(W-6) Depreciation on Plant

	Rs. 000
On opening assets excluding disposal $\left(\frac{500,000 - 0}{20,000 \text{ units}}\right) \times 5,000$ units	125,000

(W-7)

Depreciation rate

$$\text{rate} = 1 - \sqrt[\text{cumulative period}]{\frac{\text{WDV}}{\text{Cost}}}$$

$$\text{rate} = 1 - \sqrt[2]{\frac{100,000 - 36,000}{100,000}} = 20\%$$

(W-8)

Depreciation on equipment

	Rs. 000
On opening assets excluding disposal $(100,000 - 36,000) \times 20\%$	12,800
On addition $60,000 \times 20\% \times \frac{8}{12}$	8,000
Total	20,800

Scanned with CamScanner

Answer 13

Games Limited
Notes to the Financial Statement
For the year ended March 31, 2017

10. Property Plant & Equipment	2017			2016		
	Rs.					
	Building	Computers	Fittings	Building	Computers	Fittings
Gross Carrying Amount						
Balance 01 April	3,237,500	600,000	120,000	-	-	-
+Addition	-	120,000	-	3,000,000	600,000	120,000
-Transfer	(350,000)	-	-	(225,000)	-	-
+Revaluation Surplus/(Rev. Loss)	(887,500)	-	-	462,500	-	-
- Disposal		-	(30,000)		-	-
Balance 31. March	2,000,000	720,000	90,000	3,237,500	600,000	120,000
Accumulated Depreciation & Impairment Losses						
Balance 01 April	-	135,000	9,000	-	-	-
+Depreciation for the year (W-3)	350,000	172,500	11,250	225,000	135,000	9,000
-Transfer	(350,000)	-	-	(225,000)	-	-
- Disposal	-	-	(4,500)	-	-	-
+Impairment Loss	-	-	-	-	-	-
Balance 31. March	-	(307,500)	(15,750)	-	(135,000)	(9,000)
WDV 31.March	2,000,000	412,500	74,250	3,237,500	465,000	111,000

10.1 Measurement Basis

	Revaluation	Cost less Acc. Dep.	Cost less Acc. Dep.
Depreciation Method	Straight Line	Reducing Balance Method	Straight Line
Useful Life/Depreciation Rate	10%	30% (W-2)	10%

10.2 Depreciation is charged as Follows

	2017		2016	
	Cost of sales	Admin	Cost of sales	Admin
Computer	172,500			
Building	280,000	70,000	180,000	45,000
	350,000 × 80%	350,000 × 20%	225,000 × 80%	225,000 × 20%
Fittings	-	11,250	-	9,000
Total Depreciation	**452,500**	**81,250**	**315,000**	**54,000**

10.3 Revaluation disclosure

10.3.1 The last revaluation of building was performed by an independent valuer "M/S Hafeez Yasir Chartered Accountants & Co." on 31.March.2017. It was previously revalued on 31 March 2016.

10.3.2 Had there been no revaluation the carrying amount of building would have been

	2017	2016
Cost	3,000,000	3,000,000
Accumulated Depreciation	525,000	225,000
$\left(3{,}000{,}000 \times 10\% \times \frac{9+12}{12}\right)$ $\left(3{,}000{,}000 \times 10\% \times \frac{9}{12}\right)$		
Carrying Amount	2,475,000	2,775,000

10.3.3 Movement of revaluation surplus

	2017	2016
Opening Balance	462,500	-
Revaluation surplus / (loss)	(412,500)	462,500
Transfer to retained earnings (incremental depreciation)	(50,000)	
Closing balance	-	462,500

Scanned with CamScanner

Further more a revaluation loss of Rs. 475,000 was charged in profit and loss at 31 March 2017

10.4 The entire office building was mortgage with the JS Bank on 31 March 2017, for obtaining loan of 1.75 million for the prospective investment in other division

10.5 No contractual commitments were made during the year ended 31 March 2017 to purchase Property, Plant and Equipment.

A contract was made with Al-Karim Computers during the year ended 31 March 2016 to purchase 6 computers of Rs. 20,000 each to be delivered on 1 May 2017.

10.6

Details of property, plant and equipment disposed of during the year

	Cost/Revalued amount	Accumulated depreciation	Carrying amount	Net Sale proceeds	Mode of disposal	Gain / (Loss)	Particulars of buyers
Fittings	30,000	4,500	26,500	*21,000	N/A	(5,500)	ABC

* (22,000 – 1,000)

WORKINGS

(W-1) Calculation of revaluation surplus & depreciation on building.

Date	Description	Building	R. Surplus	
1-July-15	Cost	3,000,000		
31-Mar-16	Depreciation $\left(\frac{3,000,000}{10} \times \frac{9}{12}\right)$	(225,000)		
31-Mar-16	WDV	2,775,000		
31-Mar-16	Revaluation surplus (bal)	462,500	462,500	
31-Mar-16	Revalued amount	3,237,500	462,500	
31-Mar-17	Depreciation $\left(\frac{3,237,500}{9.25}\right)$ $\left(\frac{462,500}{9.25}\right)$	(350,000)	(50,000)	
31-Mar-17	WDV	2,887,500	412,500	
31-Mar-17	Revaluation surplus (bal.)	(887,500)	(412,500)	(475,000)
31-Mar-17	Revalued amount	2,000,000	-	(475,000)

(W-2) Depreciation Rate of Computers

$$\text{rate} = 1 - \sqrt[\text{life}]{\frac{\text{Resdual value}}{\text{Cost}}}$$

$$\text{rate} = 1 - \sqrt[4]{\frac{4802}{20,000}} = 30\%$$

(W-3) Depreciation for the year for 2016 and 2017

		Rs.	Rs.
1	Building Depreciation 2016 = refer (W-1)		225,000
2	Building Depreciation 2017 = = refer (W-1)		350,000
3	Computers Depreciation 2016 = $630,000 \times 30\% \frac{9}{12}$		135,000
4	Computers Depreciation 2017		
	Depreciation on opening (600,000 – 135,000) × 30%	139,500	
	Depreciation on addition $120,000 \times 30\% \times \frac{11}{12}$	33,000	172,500
5	Fittings Depreciation 2016 = $\left(\frac{120,000}{10} \times \frac{9}{12}\right)$		9,000
6	Fittings Depreciation 2017		
	Depreciation on opening excluding disposal (120,000 – 30,000) × 10%	9,000	

Scanned with CamScanner

Depreciation on disposal $\left(\frac{30,000}{10} \times \frac{9}{12}\right)$	2,250	11,250

Answer 14

Statement of comprehensive income extract for the year ended 31 March 2020

Profit or loss account:

Depreciation charge = Rs.0.25 million (W1)**Other comprehensive income:**

Revaluation gain = Rs.1.05 million (W2)

Statement of financial position extract as at 31 March 2020

Building at valuation = Rs.9.8 million

Statement of changes in equity extract for the year ended 31 March 2020

Revaluation reserve

Revaluation gain = Rs.1.05 million (W2)

Workings:

Revaluation takes place at year end, therefore a full year of depreciation must first be charged.

(W1) Depreciation for the year ended 31 March 2020

Rs.10 million / 40 years = Rs.0.25 million

(W2) Revaluation

Carrying value of building at revaluation date (10 m – (10 m/40 years x 5 years)) = Rs.8.75 mRevaluation of building = Rs.9.8 m

Gain on revaluation = Rs.1.05 m

Answer 15

Statement of comprehensive income extract for the year ended 31 March 2020 Depreciation charge (200,000 (W1) + 275,000 (W3) = Rs. 475,000

Other comprehensive income:

Revaluation gain (W2) = Rs.6.2 million

Statement of financial position extract as at 31 March 2020

Revaluation (office) = Rs. 22 million

Subsequent depreciation (W3) = (Rs. 275,000) Carrying value = Rs. 21,725,000

Statement of changes in equity extract for the year 31 March 2020

Revaluation reserve (gain) = Rs. 6,200,000 (W2)

Workings:

Revaluation takes place part way through the year and therefore depreciation must first be charged for the period 1 April 2019 – 30 September 2019, then the revaluation occurs so the depreciation needs to be charged for the period 1 October 2019 – 31 March 2020 on current market value.

(W1) Depreciation

1 April – 30 September 2019 = Rs.20 million x 6/12 / 50 years = Rs. 200,000 (W2)

Revaluation

The carrying value of the asset at 1 October 2019 can now be found and revalued.

Carrying value of office at revaluation date (20,000,000 – (4,000,000 + 200,000)) = Rs. 15,800,000

Revaluation of office = Rs.22 million

Scanned with CamScanner

Gain on revaluation = Rs. 6,200,000

(W3) Depreciation

1 October 2019 – 31 March 2020 => Rs. 22,000,000 x 6/12 / 40 years = Rs. 275,000

Answer 16

Alpha Enterprises

Plant and machinery - Cost					
Date	**Description**	**Rs. in '000**	**Date**	**Description**	**Rs. in '000**
1-Jan-2018	Balance	12,700	1-Apr-2018	Assets disposal	870
1-Apr-2018	Exchanged (340 + 680)	1,020	31-Oct-2018	Assets disposal **(W-2)**	1,000
1-Aug-2018	Capital work in progress **(W-4)**	11,300	31-Dec-2018	Balance	23,150
		25,020			**25,020**

Accumulated depreciation - Plant and machinery					
1-Apr-2018	Assets disposal **(W-1)**	376	1-Jan-2018	Balance	6,240
31-Oct-2018	Assets disposal **(W-2)**	573	31-Dec-2018	Depreciation exp. **(W-3)**	2,292
31-Dec-2018	Balance	7,583			
		8,532			**8,532**

Assets disposal - Plant and machinery					
1-Apr-2018	Cost	870	1-Apr-2018	Acc. depreciation **(W-1)**	376
31-Oct-2018	Cost	1,000	1-Apr-2018	Cost (Trade in)	340
31-Oct-2018	Bank (disposal cost)	25	31-Oct-2018	Acc. depreciation **(W-2)**	573
			31-Oct-2018	Bank (Sales proceeds)	334
			31-Dec-2018	Loss on disposal **(P&L)**	272
		1,895			**1,895**

WORKINGS

(W-1) Accumulated depreciation – Machine exchange

Cost (01-09-15)		870
Depreciation expense (31-12-15)	(870 × 20% × 4/12)	(58)
WDV (31-12-15)		812
Depreciation expense (31-12-16)	(812 × 20%)	(162)
WDV (31-12-16)		650
Depreciation expense (31-12-17)	(650 × 20%)	(130)
WDV (31-12-17)		520
Depreciation expense (31-03-18)	(520 × 20% ×3/12)	(26)
WDV (31-03-18)		494
31-03-18 Accumulated depreciation (Cost - WDV)	(870 – 494)	376

(W-2) Accumulated depreciation – Machine sold

Accumulated depreciation = Cost – WDV

Accumulated depreciation = 1,000 – 427 = 573

		Rs. in '000
WDV as at 01-01-2018		512
Depreciation for 2018	512 × 0.2 × 10 ÷ 12	(85)
WDV as at 31-10-2018		427

Scanned with CamScanner

(W-2.1) Cost of machine sold

Cost (01-01-15)		100
Depreciation expense (31-12-15)	(100 × 20% ×)	(20)
WDV (31-12-15)		80
Depreciation expense (31-12-16)	(80 × 20%)	(16)
WDV (31-12-16)		64
Depreciation expense (31-12-17)	(64 × 20%)	(12.8)
WDV (31-12-17)		51.2
Cost	(512/51.2 × 100)	**1,000**
Alternatively working of cost may be		
Cost	$[512 \div (0.8)^3]$	**1,000**

(W-3) Depreciation expense for the year:

		Rupees
On opening assets excluding disposals	(12700 – 6240) – 520(W-1) – 512) = 5428 × 20%	1,086
On additions		
Machine	1,020 × 0.2 × 9 ÷ 12	153
Plant	11,300 **(W-4)** × 0.2 × 5 ÷ 12	942
On disposals		
Machine exchange	(W-1)	26
Machine sold	(W-2)	85
		2,292

(W-4) Cost of the plant:

		Rs. in '000
Purchase price of the plant	10,000 × 0.95	9,500
Other relevant cost	660 + 540 + 600	1,800
		11,300

Scanned with CamScanner

Answer 17

Date	- Property, plant and equipment	Debit	Credit
		---- Rs. in million ----	
January 01, 2010	Building Account Payable	200	200
December 31, 2010	Depreciation (200/10 years) Accumulated depreciation	20	20
January 01, 2011	Accumulated depreciation Building	20	20
January 01, 2011	Building (280 – (200 – 20)) Revaluation surplus (OCI)	100	100
December 31, 2011	Depreciation (200/9 years) Accumulated depreciation	31	31
December 31, 2011	Revaluation surplus (OCI) (31 – 20) Retained earnings	11	11
January 01, 2012	Accumulated depreciation Building	31	31
January 01, 2012	Revaluation surplus (OCI) ((280 – 31) – 170)) Building	79	79
December 31, 2012	Depreciation (170/8 years) Accumulated depreciation	21.25	21.25
December 31, 2012	Revaluation surplus (21.25 – 20) Retained earnings	1.25	1.25
January 01, 2013	Accumulated depreciation Building	21.25	21.25
January 01, 2013	Building Revaluation surplus (180 – (170 – 21.25))	31.25	31.25
December 31, 2013	Depreciation (180/7 years) Accumulated depreciation	25.7	25.7
December 31, 2013	Revaluation surplus (OCI) (25.7 – 20) Retained earnings	5.7	5.7

Scanned with CamScanner

ICAP MULTIPLE CHOICE QUESTIONS (MCQs)

Q.1 An entity purchased a property 15 years ago at a cost of Rs.100,000 and have been depreciating it at a rate of 2% per annum, on the straight-line basis. The entity has had the property professionally revalued at Rs.500,000.

What is the revaluation surplus that will be recorded in the financial statements in respect of this property?

(a) Rs.400,000 (b) Rs.500,000
(c) Rs.530,000 (d) Rs.430,000

Q.2 An entity owns two buildings, A and B, which are currently recorded in the books at carrying amounts of Rs.170,000 and Rs.330,000 respectively. Both buildings have recently been valued as follows:

Building A	Rs.400,000
Building B	Rs.250,000

The entity currently has a balance on the revaluation surplus of Rs. 50,000 which arose when building A was revalued several years ago. Building B has not previously been revalued.

What double entry will need to be made to record the revaluations of buildings A and B?

(a) Dr Non-current assets Rs.150,000
Dr Statement of profit or loss Rs.80,000
Cr Other comprehensive income (revaluation surplus) Rs.230,000

(b) Dr Non-current assets Rs.150,000
Dr Statement of profit or loss Rs.30,000
Cr Other comprehensive income (revaluation surplus) Rs.180,000

(c) Dr Non-current assets Rs.150,000
Cr Other comprehensive income (revaluation surplus) Rs.150,000

(d) Dr Non-current assets Rs.150,000
Dr Statement of profit or loss Rs.50,000
Cr Other comprehensive income (revaluation surplus) Rs.200,000

Q.3 An entity purchased property for Rs.6 million on 1 July 2013. The land element of the purchase was Rs.1 million. The expected life of the building was 50 years and its residual value nil. On 30 June 2015 the property was revalued to Rs.7 million, of which the land element was Rs.1.24 million and the buildings Rs.5.76 million. On 30 June 2017, the property was sold for Rs.6.8 million.

What is the gain on disposal of the property that would be reported in the statement of profit or loss for the year to 30 June 2017?

(a) Gain Rs.40,000 (b) Loss Rs.200,000
(c) Gain Rs.1,000,000 (d) Gain Rs.1,240,000

Q.4 Which of the following statements are correct?

1. If the revaluation model is used for property, plant and equipment, revaluations must subsequently be made with sufficient regularity to ensure that the carrying amount does not differ materially from the fair value at each reporting date.
2. When an item of property, plant and equipment is revalued, there is no requirement that the entire class of assets to which the item belongs must be revalued.

Scanned with CamScanner

(a) Only statement 1 is correct (b) Only statement 2 is correct

(c) Both statements are correct (d) None of the statement is correct

Q.5 The following trial balance extract relates to a property which is owned by Maira Limited as at 1 April 2014.

	Dr Rs. 000	Cr Rs. 000
Property at cost (20 year original life)	12,000	
Accumulated depreciation as at 1 April 2014		3,600

On 1 October 2014, following a sustained increase in property prices, Maira Limited revalued its property to Rs.10.8 million.

What will be the depreciation charge in Maira Limited's statement of comprehensive income for the year ended 31 March 2015?

(a) Rs.540,000 (b) Rs.570,000

(c) Rs.700,000 (d) Rs.800,000

Q.6 A company purchased a building on 1 April 2007 for Rs.10,000,000. The asset had a useful economic life at that date of 40 years. On 1 April 2009 the company revalued the building to its current fair value of Rs.12,000,000.

What is the double entry to record the revaluation?

(a) Dr. Building 1,500,000
Dr. Accumulated depreciation 500,000
Cr. Other comprehensive income 2,000,000

(b) Dr. Building 2,000,000
Dr. Accumulated depreciation 500,000 Cr. Profit or loss 2,500,000

(c) Dr. Building 2,000,000
Dr. Accumulated depreciation 500,000 Cr. Other comprehensive income 2,500,000

(d) Dr. Building 1,500,000
Dr. Accumulated depreciation 500,000 Cr. Profit or loss 2,000,000

Q.7 The carrying value of property at the end of the year amounted to Rs.108 million. On this date the property was revalued and was deemed to have a fair value of Rs.95 million. The balance on the revaluation reserve relating to the original gain of the property was Rs.10 million.

What is the double entry to record the revaluation?

(a) Dr. Profit or loss 3 million
Dr. Other comprehensive income 10 million
Cr. Property 13 million

(b) Dr. Profit or loss 10 million
Dr. Other comprehensive income 3 million
Cr. Property 13 million

(c) Dr. Profit or loss 13 million
Dr. Other comprehensive income 3 million
Cr. Property 16 million

(d) Dr. Profit or loss 13 million
Cr. Property 13 million

Scanned with CamScanner

Q.8 A company revalued its property on 1 April 2009 to Rs.20m (Rs.8m for the land). The property originally cost Rs.10m (Rs.2m for the land) 10 years ago. The original useful economic life of 40 years is unchanged. The company's policy is to make a transfer to realized profits in respect of excess depreciation.

At which amount the property be presented at as at 31 March 2010?

(a) Rs.20 million (b) Rs.19.6 million

(c) Rs.12 million (d) Rs.11.6 million

Q.9 A company revalued its property on 1 April 2009 to Rs.20m (Rs.8m for the land). The property originally cost Rs.10m (Rs.2m for the land) 10 years ago. The original useful economic life of 40 years is unchanged. The company's policy is to make a transfer to realized profits in respect of excess depreciation.

What is amount of balance in revaluation surplus account as at 31 March 2010?

(a) Rs.12 million (b) Rs.10 million

(c) Rs.9.8 million (d) Rs.11.8 million

Q.10 Which of the following is an optional disclosure requirement of IAS 16?

(a) Measurement bases for determining gross carrying amount

(b) Depreciation method

(c) Useful lives or depreciation rates

(d) The carrying amount of temporarily idle PPE

Q.11 Following information is available for equipment account of a business on 1st January 2018:

Opening balance of equipment a/c (Revalued amount)	Rs.7,500,000
Surplus on revaluation of equipment a/c	Rs.2,000,000
At start of year company sold equipment for	Rs.90,000,000.

Company has a policy of charging 20% depreciation on straight line basis.

What will be treatment of revaluation surplus at disposal of asset?

(a) Dr Surplus on revaluation Rs.2,000,000
Cr Retained earnings Rs.2,000,000

(b) Dr Retained earnings Rs.2,000,000,
Cr Surplus on revaluation Rs.2,000,000

(c) Dr Surplus on revaluation Rs.3,500,000
Cr Retained earnings Rs.3,500,000

(d) Dr Surplus on revaluation Rs.2,0000,000
Cr Equipment account Rs.2,000,000

Q.12 A non-current asset costing Rs.216,000 and carrying value Rs.145,000 is revalued to Rs.291,000. How should revaluation be recorded?

(a) Dr Asset a/c Rs.75,000,
Cr Surplus on revaluation Rs.75,000

(b) Dr Asset a/c Rs.75,000,
Dr Accumulated Depreciation Rs.71,000,
Cr Surplus on revaluation Rs.146,000

Scanned with CamScanner

(c) Dr Surplus on revaluation Rs.146,000,
Cr Asset a/c Rs.75,000,
Cr Accumulated Depreciation Rs.71,000

(d) Dr Accumulated depreciation Rs.146,000,
Cr Surplus on revaluation Rs.146,000

Q.13 When items of property, plant and equipment are stated at revalued amounts the following must be disclosed:

(i) The effective date of the revaluation

(ii) Whether an independent valuer was involved

(iii) The methods and significant assumptions applied in estimating the items' fair values

(iv) The extent to which the items' fair values were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques

(v) For each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model;

(vi) The revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

(a) (i), (ii) and (vi) only
(b) (i), (ii), (v) and (vi) only
(c) (i), (ii), (iii) and (iv) only
(d) (i) to (vi) all

Q.14 IAS 16 encourages disclosure of the following information as users of financial statements might find it to be useful.

(i) The carrying amount of temporarily idle property, plant and equipment

(ii) The gross carrying amount of any fully depreciated property, plant and equipment that is still in use

(iii) The carrying amount of property, plant and equipment retired from active use and held for disposal

(iv) When the cost model is used, the fair value of property, plant and equipment when this is materially different from the carrying amount

(a) (i), (ii) and (iii) only
(b) (i), (ii) and (iv) only
(c) (i), (iii) and (iv) only
(d) (i) to (iv) all

Q.15 Which of the following statements is correct?

(a) An entity may present PPE at gross carrying amount or net carrying amount under IAS 16

(b) Either useful lives or depreciation rates are to be disclosed, both are not required.

(c) Under revaluation model, PPE are revalued at end of each year

(d) If an entity chooses revaluation model, it must apply revaluation model to all of its PPE.

Q.16 Waqas Limited purchased a machine for Rs.30,000 on 1 January 2015 and assigned it a useful life of 12 years. On 31 March 2017 it was revalued to Rs.32,000 with no change in useful life. What will be depreciation charge in relation to this machine in the financial statements for the year ending 31 December 2017?

Rs. _____

Scanned with CamScanner

Q.17 A business purchased building costing Rs.7,500,000 on 1 January 2018.

The policy of business is to charge straight line depreciation over its useful life of 20 years.

On 31 December 2020, building was revalued to Rs.7,650,000.

What is the amount of incremental depreciation to be transferred to retained earnings at year ending 31 December 2021?

Rs. _____

Q.18 A business purchased an asset on 1 January 2016 costing Rs.5,000,000 having a useful life of 10 years with nil residual value. On 1 January 2018 balance of accumulated depreciation was Rs.1,000,000. Asset is revalued to Rs.4,500,000 on 1 January 2018 (start of the year).

Business has a policy to charge straight line depreciation.

What is the depreciation charge for the year ended 31 December 2018?

Rs. _____

Q.19 A business purchased an asset on 1 January 2016 costing Rs.5,000,000 having a useful life of 10 years with nil residual value. On 1 January 2018 balance of accumulated depreciation was Rs.1,000,000. Asset is revalued to Rs.4,500,000 on 1 January 2018 (start of the year).

Business has a policy to charge straight line depreciation.

What is the amount of revaluation surplus at the date of revaluation?

Rs. _____

Q.20 A business purchased an asset on 1 January 2016 costing Rs.5,000,000 having a useful life of 10 years with nil residual value. On 1 January 2018 balance of accumulated depreciation was Rs.1,000,000. Asset is revalued to Rs.4,500,000 on 1 January 2018 (start of the year).

Business has a policy to charge straight line depreciation.

What is the amount of incremental depreciation for the year ended 31 December 2018?

Rs. _____

Q.21 A revaluation gain is credited into?

(a) Revaluation reserve (b) Capital reserve

(c) Profit and loss (d) Any of the above

Q.22 After initial recognition, an entity has a choice to choose cost and?

(a) Realizable model (b) Replacement model

(c) Revaluation model (d) Carrying value model

Q.23 When an item of property, plant and equipment is revalued, what should be revalued?

(a) A selection of assets decided by management

(b) The whole class of assets to which it belongs

(c) The individual asset

(d) A selection of assets picked at random

Q.24 If an asset increases in value, the increase is noted as?

(a) An increase in net profit in the SOCI

(b) An increase in retained earnings in SOFP

(c) An increase in revaluation surplus in the SOFP and other comprehensive income in the SOCI

(d) An increase in "other profit" in SOCI

Scanned with CamScanner

Q.25 Which of the following is not a valid reason for reporting non-current assets at revaluation amount rather than cost?

(a) To prevent long life assets from being reported at out of date historical costs

(b) To keep owners of the business better informed of their equity in the business.

(c) To report performance correctly by matching earnings with the proper costs of assets used.

(d) To avoid having to pay higher taxes

Q.26 An entity has a policy of revaluing its PPE. An asset cost Rs.5m on 1 January 2020 and has a useful life of five years and is depreciated on a straight-line basis to a zero residual value. The value of the asset at 31 December 2020 was Rs.3.8m. The fall in value will be accounted for as follows?

(a) Depreciation Rs.1m and fall in value of Rs.200,000 both to the reserves

(b) Depreciation Rs.1m to the income statement and fall in value of Rs.200,000 ignored until there is a revaluation surplus

(c) Depreciation Rs.1m to income statement and fall in value of Rs.200,000 to the reserves

(d) Depreciation Rs.1m and fall in value of Rs.200,000 both to the income statement

Q.27 During the financial year, Akmal Ltd had the following increases in reserves:

i. Rs.5 million from a revaluation of freehold premises

ii. Rs.10 million in share premium

iii. Rs.25 million from trading profit retained

Which of these are increases in capital reserves?

(a) I only (b) II only

(c) I. and ii. Only (d) III. only

Q.28 The following gains may legally be withdrawn from the company by shareholders:

i. gains that arise from the upward revaluation of non-current assets

ii. gains that arise from the sale of non-current assets

What is the validity of each statement?

(a) Both i. and ii are true (b) i. is true and ii. is false

(c) Both i. and ii are false (d) ii. is true and i. is false

Q.29 The financial statements of Saadi Limited for the most recent year indicated the following:

i. a bonus issue of shares

ii. a transfer of profit retained to retained earnings

iii. an increase in the revaluation reserve due non-current assets

iv. a rights issue of shares

Which of the above involved a movement of cash?

(a) i. and ii (b) ii. and iii.

(c) iii only (d) iv only

Scanned with CamScanner

Q.30 An apartment is revalued upwards by Rs. 1 million. It was acquired 5 years ago for Rs. 5 million. Its useful life remains same as 10 years.

What is the revised depreciation charge for the year after revaluation?

(a) Rs.500,000 (b) Rs.600,000

(c) Rs.700,000 (d) Rs.800,000

Q.31 A building is revalued upwards by Rs.2 million. It was acquired five years ago for Rs.10 million. Its useful life remains same as 20 years. What is the incremental depreciation charge for the year?

(a) Rs.100,000 (b) Rs.133,333

(c) Rs.166,667 (d) Rs.200,000

Q.32 An IT equipment being carried at revaluation model has revaluation reserve balance of Rs.50,000. During the year, it reduces its value due to technological obsolescence. It has Rs.70,000 decrease in value. What would be the impact of this revaluation decrease?

(a) The decrease of Rs.50,000 is debited to revaluation reserve and Rs.20,000 to profit or loss for the year

(b) The decrease of Rs.50,000 is debited to profit and loss account and Rs.20,000 to revaluation reserve for the year

(c) The whole decrease is debited to revaluation reserve

(d) The whole decrease is debited to profit or loss for the year

Q.33 The correct accounting treatment of initial operating losses incurred during the commercial production due to under-utilization of the plant would be to:

(a) capitalise as a directly attributable cost

(b) defer and charge to profit or loss account when profit is earned from the plant

(c) charge directly to retained earnings since these are not considered to be normal operating losses

(d) charge to profit or loss account

Q.34 Which of the following is NOT considered as an item of property, plant and equipment?

(a) A standby generator expected to be used for seven years

(b) A plot of land held for resale

(c) A bus for pick and drop of staff members

(d) A generator for rental to others

Q.35 An entity acquires a plant in exchange of old machinery which has carrying amount of Rs. 760,000 and fair value of Rs. 750,000 at the date of exchange. The list price of plant acquired is 850,000. The entity is also required to pay cash of Rs. 55,000 in this exchange transaction.

At which amount the acquired plant should be initially recognised?

(a) Rs. 850,000 (b) Rs. 760,000

(c) Rs. 815,000 (d) Rs. 805,000

Q.36 An item of plant was purchased on 1 April 2008 for Rs. 2,000,000 and is being depreciated at 25% on a reducing balance basis. What would be its residual value after its useful life of 5 years?

(a) Rs. 632,809 (b) Rs. NIL

(c) Rs. 474,609 (d) Rs. 400,000

Scanned with CamScanner

Q. 37. A non-current asset cost Rs.96,000 and was purchased on 1 June Year 1. Its expected useful life was five years and its expected residual value was Rs.16,000. The asset is depreciated by the straight-line method.

The asset was sold on 1 September Year 3 for Rs.68,000. There were no disposal costs. It is the company policy to charge depreciation on a monthly basis. The financial year runs from 1 January to 31 December.

What was the gain or loss on disposal?

Rs. _____

Q.38 A non-current asset was purchased on 1 June Year 1 for Rs.216,000. Its expected life was 8 years and its expected residual value was Rs.24,000. The asset is depreciated by the straight- line method. The financial year is from 1 January to 31 December.

The asset was sold on 1 September Year 4 for Rs.163,000. Disposal costs were Rs.1,000.

It is the company policy to charge a proportionate amount of depreciation in the year of acquisition and in the year of disposal, in accordance with the number of months for which the asset was held.

What was the gain or loss on disposal?

Rs. _____

Q. 39. A change in depreciation method is a?

(a) Change in accounting policy
(b) Change in accounting estimate
(c) Change in accounting method
(d) Change in accounting standard

Q. 40 When an asset is sold or disposed of, where is the gain or loss recognised?

(a) Asset disposal account
(b) Profit and loss
(c) Revaluation reserve
(d) Depreciation

Q. 41 How often should the useful life of an asset be reviewed?

(a) Every six months
(b) As and when the market value will significantly change
(c) At least at each financial year end
(d) Never

Q. 42 An entity acquired laptops in exchange of desktops which have carrying amount of Rs. 450,000 and fair value of Rs. 300,000 at the date of exchange. The list price of the laptops acquired is Rs. 600,000. The entity is also required to pay cash of Rs. 275,000 in this exchange transaction. The laptops should be initially recognized at:

(a) Rs. 300,000
(b) Rs. 575,000
(c) Rs. 450,000
(d) Rs. 600,000

Q. 43 During the year 2019, an entity purchased a machine for Rs. 20 million to be used for 6 years. Which of the following would represent residual value of this machine in 2019?

(a) Rs. 15 million can be currently obtained from disposal of the machine in present condition
(b) Rs. 4 million can be currently obtained from disposal of a 6 year old similar machine
(c) Rs. 18 million can be obtained in 2025 from disposal of the machine in present condition
(d) Rs. 7 million can be obtained in 2025 from disposal of a 6 year old similar machine

Scanned with CamScanner

ICAP MULTIPLE CHOICE QUESTIONS (MCQs) SOLUTIONS

A.1 (d)

	Rs.
Current value	500,000
Carrying amount (100,000 – (100,000 × 2% × 15 yrs))	(70,000)
Revaluation gain	430,000

A.2 (a)

	Building A	Building B
Current value	400,000	250,000
Carrying amount	(170,000)	(330,000)
Revaluation gain/(loss)	230,000	(80,000)

The gain on Building A will be credited to other comprehensive income and the revaluation surplus.

The loss on Building B will be debited to the statement of profit or loss expenses because we do not have a balance on the revaluation surplus in respect of building B to offset the loss.

We make an overall debit to non-current assets of Rs.230,000 – Rs.80,000 = Rs.150,000

A.3 (a)

	Land Rs.	Buildings Rs.m	Total Rs.m
Cost 1 July 2013	1.00	5.00	6.00
Building depreciation Rs. 5 million/50 years x 2 years		(0.2)	(0.2)
Carrying amount 30 June 2015	1.00	4.80	5.80
Revaluation gain	0.24	1.96	1.20
Revalued amount	1.24	5.76	7.00
Building depreciation Rs. 5.76m/48 years x 2 years		(0.24)	(0.24)
Carrying amount 30 June 2017	1.24	5.52	6.76
Disposal proceeds			6.80
Gain on disposal			0.04

The gain on disposal is Rs. 40,000. The Rs. 1.2 million balance on the revaluation reserve is transferred from the revaluation reserve to another reserve account (probably retained earnings) but is not reported through the statement of profit or loss for the year.

A.4 (a) IAS 16 (para 31) states that when the revaluation model is used, revaluations should be made with sufficient regularity to ensure that the carrying value of the assets remains close to fair value. IAS 16 also states (para 36) that, if one item in a class of assets is revalued, all the assets in that class must be revalued.

A.5 (c) Six months' depreciation to the date of the revaluation will be Rs.300,000 (12,000/20 years × 6/12). Six months' depreciation from the date of revaluation to 31 March 2015 would be Rs.400,000 (10,800/13.5 years remaining life × 6/12). Total depreciation is Rs.700,000.

Scanned with CamScanner

A.6 (c)

Building a/c

Particulars	Rs.	Particulars	Rs.
b/d	10,000,000	Acc. Dep	500,000
Surplus	2,500,000	c/d	12,000,000
	12,500,000		12,500,000

Building net debited by Rs.2,000,000 (2,500,000 – 500,000)

A.7 (a) Total loss Rs.13 million, Rs.10 will be charged to revaluation surplus and remaining to profit or loss.

A.8 (b) Depreciation (20 – 8) / 30 years = Rs.0.4 million

Carrying amount Rs.20 million less 0.4 million = Rs.19.6 million

A.9 (c) Depreciation Now (20 – 8) / 30 years = Rs.0.4 million

Depreciation Cost (10 – 2) / 40 years = Rs.0.2 million

Revaluation surplus

= Land Rs.6 million + Building Rs.4 million - incremental depreciation 0.2 million = Rs.9.8 million

A.10 (d)

A.11 (a) On disposal of a revalued asset, the full balance of surplus on revaluation is transferred to retained earnings.

A.12 (b)

Asset

Particulars	Rs.	Particulars	Rs.
b/d	216,000	Acc. Dep (216,000-145,000)	71,000
Surplus (bal)	146,000	c/d	291,000
	362,000		362,000

Net amount debited to asset = Rs.146,000 - Rs.71,000 = Rs.75,000

A.13 (d)

A.14 (d)

A.15 (b)

A.16 Rs.3,087 (625+2,462)

Date		Land Rs.	Rev. surplus Rs.	P/l Rs.
1.1.15	Cost	30,000		
31.2.15&16	Depreciation (30,000/12×2)	(5,000)		
31.12.16	Carrying amount	25,000		
31.3.17	Depreciation (25,000/10×3/12)	(625)		
31.3.17	Carrying amount	24,375		
31.3.17	Revaluation surplus	7625	7,625	
31.12.17	Revalued Amount	32,000	7,625	
31.12.17	Depreciation (32,000/9.75)×9/12	(2,462)		
	Carrying amount	29,538		

Scanned with CamScanner

A.17 Rs.75,000

Incremental depreciation = depreciation on revalued amount – depreciation at cost

Dep. before revaluation = Rs.7,500,000 / 20 years = Rs.375,000

Dep. after revaluation = Rs.7,650,000 / 17 years = Rs.450,000

Incremental depreciation = Rs.75,000

A.18 Rs.562,500

Depreciation = Rs.4,500,000/8 = Rs.562,500

A.19 Rs.500,000

Revaluation surplus = Rs.4,000,000 – 4,500,000= Rs.500,000

A.20 Rs.62,500

Incremental depreciation = Dep on revalued amount – Dep on cost

= (4,500,000/8)– (5,000,000/10)

= Rs. 562,500 – 500,000 = 62,500

Alternatively, Rs.500,000 surplus / 8 years = Rs.62,500

A.21. (a)

A.22. (c)

A.23. (b)

A.24. (c)

A.25. (d)

A.26. (d)

A.27. (c)

A.28. (d)

A.29. (d)

A.30. (c)

A.31. (b)

A.32. (a)

A.33. (d) Charge to profit or loss account

A.34. (b) A plot of land held for resale

A.35. (d) Fair value of asset given up + cash paid
= Rs. 750,000 + 55,000 = Rs. 805,000

A.36. (c) Rs. 2,000,000 x $(0.75)^5$ = 474,609

A.37. **Rs. 8,000 gain**

Net sale proceeds = Rs. 68,000

Accumulated depreciation = Rs. 80,000 / 5 years x 2.25 years = Rs. 36,000Carrying amount = Rs. 96,000 – 36,000 = Rs. 60,000

Gain on disposal = Rs. 68,000 – 60,000 = Rs. 8,000

Scanned with CamScanner

A.38. Rs. 24,000 gain

Net sale proceeds = Rs. 163,000 – 1,000 = Rs. 162,000

Accumulated depreciation	**Rs.**
Depreciation year 1	
(Rs. 216,000 – 24,000) / 8 years = 24,000 x 7/12	14,000
Depreciation year 2 Rs. 24,000 x 12/12	24,000
Depreciation year 3 Rs. 24,000 x 12/12	24,000
Depreciation year 4 Rs. 24,000 x 8/12	16,000
	78,000

Carrying amount = Rs. 216,000 – 78,000 = Rs. 138,000 Gain on disposal = Rs. 162,000 - 138,000 = Rs. 24,000

A.39. (b) Change in depreciation method is change in accounting estimate

A.40. (b) Gain or loss is recognised in profit or loss

A.41. (c) Useful life is reviewed annually at each financial year end, at least.

A.42. (b) Rs. 575,000

A.43. (b) Rs. 4 million can be currently obtained from disposal of 6 year old similarmachine

Scanned with CamScanner

Correction of Errors

2

LO 1	ERRORS NOT AFFECTING THE AGREEMENT OF TRIAL BALANCE / ERRORS IN DOUBLE ENTRY ACCOUNTING SYTSTEM
LO 2	ERRORS AFFECTING THE AGREEMENT OF TRIAL BALANCE (SUSPENSE ACCOUNT)
LO 3	EFFECT OF ERRORS ON PROFIT
LO 4	SYSTEM OF ACCOUNTING USED IN RECTIFICATION OF ERRORS TOPIC

Scanned with CamScanner

CORRECTION OF ERRORS

As errors arising in books need to be located and corrected immediately as they are detected. No rigid rules can be laid down as to how the correcting entries should be passed, but the main object must necessarily be to rectify the wrong position.

Experience has shown that the difference in the Trial Balance ordinarily arises from any one or more of the following reasons, and it is this direction, therefore, that efforts for the search for errors should be made:-

1. Error in bringing forward proper balances from the previous year's books.
2. Errors in additions and carrying forwards.
3. Omission of Cash Balance or Bank Balance from the Trial Balance.
4. Bank Overdraft being placed in the wrong column.
5. Items of the nature of Bad Debt, Return of Goods, Allowance or Discount wrongly passed
6. Omission of any balance from the Ledger.
7. Posting of entries to wrong side of accounts.

LO1: ERRORS NOT AFFECTING THE AGREEMENT OF TRIAL BALANCE / ERRORS IN DOUBLE ENTRY ACCOUNTING SYTSTEM

These are the errors that cannot be traced through trial balance because both sides of trial remain balanced after this error.

1. Error of transposition
2. Error of omission
3. Error of commission
4. Error of principle
5. Error of original entry
6. Compensating error

1. Error of transposition (transposition errors)

This involves getting the digits in a number the wrong way round, for example recording Rs.9,700 as Rs.7,900.

Sometimes the error will be made in both the debit and the credit entries in the ledger. For example a purchase invoice might be recorded as Rs.1,650 instead of Rs.1,560 in both the purchases account and the payables ledger control account. The trial balance will not reveal this sort of error.

Sometimes the error of transposition will be made in one account but not the other. For example, a payment of Rs.1,980 from a customer might be recorded correctly in the cash book but posted incorrectly as Rs.1,890 in the receivables ledger control account.

2. Error of Omission

Failing to record a transaction at all.

Example

Sold goods to Mr. Umer for Rs. 3,700 on credit and the accountant omitted to record the transaction.

Rectifying		Original		Wrong
Debtor A/C	3,700	Debtor A/C	3,700	X
Sale A/C	3,700	Sale A/C	3,700	X

3. Error of Commission

In this error effect is given to wrong accounting head relating to correct main head.

Scanned with CamScanner

Example

Rent paid of Rs. 5,700 had wrongly been debited to repairs account.

Rectifying	Original	Wrong
Rent expense A/C 5,700 Repair expense A/C 5,700	Rent exp. A/C 5,700 Cash A/C 5,700	Repair exp. A/C 5,700 Cash A/C 5,700

4. Error of Principle

In this error effect is given to wrong main head.

Example

Rent paid of Rs. 1,700 was wrongly debited to furniture account.

Rectifying	Original	Wrong
Rent expense A/C 1,700 Furniture A/C 1,700	Rent exp. A/C 1,700 Cash A/C 1,700	Furniture A/C 1,700 Cash A/C 1,700

5. Error of original entry

In this error both Dr. and Cr. effect is given with the same wrong amount.

Example

Credit purchase of Rs. 779 was recorded in both accounts as 797.

Rectifying	Original	Wrong
Creditor A/C 18 Purchase A/C 18	Purchase A/C 779 Creditor A/C 779	Purchase A/C 797 Creditor A/C 797

6. Compensating error

The error in which accounting effect of one error cancels the accounting effect of another error.

LO2: ERRORS AFFECTING THE AGREEMENT OF TRIAL BALANCE (SUSPENSE ACCOUNT)

When both sides of the trial balance do not agree with each other there will be a difference in the trial balance either on a debit side or credit side. As by looking into trial balance it is not clear which accounting head is wrongly treated therefore difference in trial balance is termed as suspense account

Situations

	Nature of suspense account
If debit side of the trial exceeds the credit side	credit nature
If credit side of the trial exceeds the debit side	debit nature

Suspense account will never exist in balance sheet issue to the owner.

In rectifying entry, the balance of suspense account will always be equal to difference between the Dr. & Cr of wrong entry.

Examples of error which have an effect on the suspense account

1. An entry already passed in the books whose debit and credit side do not agree.
2. Casting error in an account
3. Casting error in day book
4. Closing balance of an account is not put in the trial balance
5. Total of one page in day book or T-account is wrongly carried forward to next page
6. Total of day book not posted to ledger
7. Opening balance of an account is wrongly written in T account or omitted from T-account

Scanned with CamScanner

Effect of rectifying entry on depreciation

If in rectifying entry fixed asset is increasing we will increase the depreciation and vice-versa. While passing entry for depreciation you must take care for two things:

1. The number of months to be used in the entry should start from date of error till year end.
2. If method used is written down value, fixed asset increase/decrease net of accumulated depreciation will be used for calculating depreciation.

Effect of rectifying entry on provision for doubtful debt a/c

If in rectifying entry debtor is increasing we will increase the provision and vice-versa.

Example-1

Following trial balance is extracted from the books of Mr. Yasir for year ended June 30, 2011:

Trial Balance as on June 30, 2011		
	Rupees	
	Dr.	Cr.
Land and building-cost	100,000	
Plant – cost	120,000	
Stock in trade	25,000	-
Debtors	15,000	-
Bank	82,500	-
Creditors	-	17,000
Mr. Yasir's Capital Account	-	194,000
Total	**342,500**	**211,000**

A credit purchase of Rs. 131,500 has correctly been posted to purchase account but has not been posted to the credit of creditor account

Required:

a) Prepare journal entry to rectify the error.

b) Prepare Suspense account

c) Prepare trial balance.

Answer-1

Rectifying			Original			Wrong	
a) Suspense	131,500		Purchases	131,500		Purchases	131,500
Creditor		131,500	Creditor		131,500		

b)

Dr.	Suspense account		Cr.
Creditor	131,500	Difference in trial	131,500

c)

Trial Balance as on June 30, 2011		Dr.	Cr.
Land and building-cost		100,000	
Plant – cost		120,000	
Stock in trade		25,000	
Debtors		15,000	
Bank		82,500	
Creditors	(17,000 + 131,500)	-	148,500
Mr. Yasir's Capital Account		-	194,000
Total		342,500	342,500

Scanned with CamScanner

Example-2

Following trial balance is extracted from the books of Mr. Asif for year ended June 30, 2011:

Trial Balance as on June 30, 2011

	Rupees	
	Dr.	Cr.
Land and building-cost	100,000	-
Plant – cost	120,000	-
Stock in trade	25,000	-
Debtors	15,000	-
Bank	82,500	-
Creditors	-	17,000
Mr. Asif's Capital Account	-	194,000
Administration Expenses	5000	
Sales		216,000
Purchases Return		10,957
Purchases	70,000	
Sales Return	15,000	
	432,500	**437,957**

(i) A credit purchase of Rs. 10,000 has correctly been posted to purchase account but has not been posted to the credit of creditor account.

(ii) Sale account has been under casted by Rs. 3,000.

(iii) Purchase day book has been under casted by Rs. 4,500.

(iv) Building account c/d of Rs. 14,000 has not been put in trial.

(v) Sale return day book total of page 6 of Rs. 12 has been c/f to next page as Rs. 15.

(vi) Total of 1 page of purchase return day book is not posted to ledger amounting to Rs.40.

Required:

Prepare journal entries to rectify the error. Also prepare suspense account.

Answer-2

	Rectifying		Original		Wrong	
i)	Suspense	10,000	Purchases	10,000	Purchases	10,000
	Creditor	10,000	Creditors	10,000	-	-
ii)	Suspense	3,000				
	Sales	3,000				
iii)	Purchases	4,500				
	Suspense	4,500				
iv)	Building a/c	14,000				
	Suspense	14,000				
v)	Suspense	3				
	Sale return	3				
vi)	Suspense	40				
	Purchase return a/c	40				

Suspense account

Dr.		Cr.	
Difference in trial	5,457	Purchases	4,500
Creditor	10,000	Building	14,000
Sales	3,000		
Sale return	3		
Purchase return	40		

Scanned with CamScanner

Example-3

Following trial balance is extracted from the books of Mr. Asif for year ended June 30, 2011. What will be corrected profit, if profit before the correction of the following errors was Rs.600,000:

Pass the rectifying entries.

(i) Credit sales of Rs. 1,000 have not been recorded in debtor account.
(ii) Goods sold on credit amounting to Rs. 12,300 have been recorded in debtor account as Rs. 13,200.
(iii) Purchases of Rs. 300 were recorded in creditor account as Rs. 250.
(iv) Plant and machinery purchased for Rs. 3,000 is not debited to plant and machinery account.
(v) Purchase of plant and machinery Rs. 3,200 is wrongly debited to repair account.
(vi) Credit purchase of Rs. 2,000 is posted to debit of creditor account as Rs. 1,800.
(vii) Credit sales amounting to Rs. 10,000 were being credited in debtor account.
(viii) The total of purchase return day book amounting to Rs. 16,160 had not been posted to the ledger.
(ix) A credit sale of Rs. 12,000 is correctly entered in day book but from there it has wrongly been credited in debtor account.
(x) A purchase of goods from M on credit amounting to Rs 15,000 was wrongly passed through the sales book.
(xi) One of the stock sheet had been overcast by Rs.1,000
(xii) Rate of depreciation for plant and machinery is 10% under straight line method.
(xiii) Rate of provision for doubtful debt is 5%.

Answer-3

	Rectifying		Original		Wrong	
(i)	Debtor Suspense	1,000 1,000	Debtor Sales	1,000 1,000	Sales	1,000
(ii)	Suspense Debtor	900 900	Debtor Sales	12,300 12,300	Debtor Sales	13,200 12,300
(iii)	Suspense Creditor	50 50	Purchases Creditor	300 300	Purchases Creditor	300 250
(iv)	Plant & Machinery Suspense	3,000 3,000	Plant & Machinery Cash	3,000 3,000	Cash	3,000
(v)	Plant & Machinery Repair a/c	3,200 3,200	Plant & Machinery Cash	3,200 3,200	Repair a/c Cash	3,200 3,200
(vi)	Suspense Creditors	3,800 3,800	Purchases Creditors	2,000 2,000	Purchases Creditors	2,000 1,800
(vii)	Debtor Suspense	20,000 20,000	Debtor Sales	10,000 10,000	Debtor a/c Sales	10,000 10,000
(viii)	Suspense Purchase return	16,160 16,160				
(ix)	Debtor Suspense	24,000 24,000	Debtor Sales	12,000 12,000	Debtor a/c Sales	12,000 12,000
(x)	Sales Purchases Debtor Creditor	15,000 15,000 15,000 15,000	Purchases Creditor	15,000 15,000	Debtor Sale	15,000 15,000
(xi)	Trading a/c Stock	1,000 1,000				
(xii)	Deprecation Exp. Accumulated dep (3,000 + 3,200) x 10%	620 620				
(xiii)	P/L Provision for D.D (1,000 – 900 + 20,000 + 24,000 – 15,000) x 5%	1,455 1,455				

Scanned with CamScanner

Statement showing adjustments in profits

Un adjusted Profit		600,000
Less:		
(x)	Sales account	15,000
(x)	Purchase account	15,000
(xi)	Trading a/c	1,000
(xii)	Depreciation expense	620
(xiii)	P/L	1,455
		(33,075)
Add:		
(v)	Repair account	3,200
(viii)	Purchase return	16,160
		19,360
Adjusted profit figure		586,285

Rectification Adjustments in depreciation

Following is a list of some common errors made in accounting of fixed assets:

i) Advance paid for purchase of asset is debited to asset account.

Revenue expenditure is treated as capital expenditure and vice-versa.

Example-4

Following errors were identified by the auditors for the year ended December 31, 2010.

(i) Advance paid Rs. 50,000 on 1.08.2010 for purchase of machinery to be delivered in 2011 is debited to machinery a/c.

(ii) Repair costing Rs. 10,000 on 1.4.2010 have been debited to machinery a/c.

Rate of Depreciation is 10% straight line.

Required:

Prepare the journal entries to correct the above errors.

Answer-4

Rectifying		Original		Wrong	
Advance -Machinery	50,000	Advance –Machinery	50,000	Machinery	50,000
Machinery	50,000	Cash	50,000	Cash	50,000
Repair expense	10,000	Repair expense	10,000	Machinery	10,000
Machinery	10,000	Cash	10,000	Cash	10,000
Acc. Dep (W-1)	2,833				
Dep exp.	2,833				

(W-1) Adjustment for depreciation

		(Excess)/ Less
Adj. (i)	(50,000 × 10% × 5/12)	(2,083)
Adj.(ii)	(10,000 × 10% × 9/12)	(750)
Total excess depreciation to be reversed		(2,833)

Example-5

Following errors were identified by the auditors for the year ended December 31, 2010.

(i) Advance paid for purchase of machinery to be delivered on 31.3.2011 is debited to machinery account on 1.11.2010. Amount is Rs. 30,000.

(ii) Installation cost paid for machine on November 1, 2010 amounting to Rs. 50,000 is debited to repair account.

Rate of Depreciation is 10% WDV.

Required:

Prepare the journal entries to correct the above errors.

Scanned with CamScanner

Answer-5

Rectifying		Original		Wrong	
Advance-Machinery	30,000	Advance -Machinery	30,000	Machinery	30,000
Machinery	30,000	Cash	30,000	Cash	30,000
Machinery	50,000	Machinery	50,000	Repair	50,000
Repair	50,000	Cash	50,000	Cash	50,000
Dep. exp. (W-1)	333				
Acc. Dep.	333				

(W-1) Adjustment for depreciation

		(Excess)/ Less
Adj. (i)	(30,000 × 10% × 2/12)	(500)
Adj.(ii)	(50,000 × 10%) × 2/12	833
Total excess depreciation to be reversed		333

Example-6

Following account balances are appearing in the books of Amjad as on:

	Cost 31.12.2010	Accumulated Depreciation 31.12.2010
Machinery	600,000	400,000

Following errors were identified by the auditors for the year ended December 31, 2010.

(i) Machinery costing Rs. 50,000 purchased on 1.4.2006 was sold on 30.9.2010 for Rs.8,000 and sale proceeds were credited to machinery A/C.

(ii) Machine purchased on 1.1.2008 having cost of Rs. 10,000 is sold on 30.6.2010 at a gain of Rs. 3,000. The sale proceeds are credited to sales a/c.

Rate of depreciation for 10% straight line.

Required:

a. Prepare the journal entries to correct the above errors.

b. Prepare adjusted Machinery A/C and accumulated depreciation a/c.

Solution

a)

Rectifying		Original		Wrong	
Acc. Dep.	22,500	Acc. Dep.	22,500	Cash	8,000
P/L	19,500	Cash	8,000	Machinery	8,000
Machinery	42,000	P/L (Bal.)	19,500		
		Machinery	50,000		
		(50,000 × 10% × 4.5)			
Acc. Dep.	2,500	Acc. Dep. (W-3.1)	2,500	Cash	10,500
Sale	10,500	Cash (bal.)	10,500	Sale	10,500
P/L	3,000	P/L	3,000		
Machinery	10,000	Machinery	10,000		
		(10,000 × 10% × 2.5)			
Acc. Depreciation(W-1)	1,550				
Depreciation exp	1,550				

Scanned with CamScanner

(W-1) Adjustment for depreciation

		(Excess)/ Less
Adj.(i)	(42,000 × 10% × 3/12)	(1,050)
Adj.(ii)	(10,000 × 10% × 6/12)	(500)
		(1,550)

b)

Dr.	Machinery a/c		Cr.
Unadjusted closing balance	600,000	Adj. (i)	42,000
		Adj. (ii)	10,000
		c/d (bal.)	548,000

Dr.	Accumulated depreciation a/c		Cr.
Depreciation	1,550	Unadjusted closing balance	400,000
Adj. (i)	22,500		
Adj. (ii)	2,500		
c/d (bal.)	373,450		

Example--7

Following account balances are appearing in the books of Amjad as on:

	Cost 31.12.2010	Accumulated Depreciation 31.12.2010
Machinery	700,000	360,000

Following errors were identified by the auditors for the year ended December 31, 2010.

(i) Advance paid Rs. 50,000 on 1.08.2010 for purchase of machinery to be delivered in 2011 is debited to machinery a/c.

(ii) Machinery costing Rs. 80,000 purchased on 1.1.2009 was sold on 30.9.2010 for Rs. 50,000 and sale proceeds were credited to machinery A/C.

Rate of Depreciation for 10% WDV.

Required:

(i) Prepare the journal entries to correct the above errors.

(ii) Prepare adjusted Machinery A/C and accumulated depreciation a/c

Solution

(a)

	Rectifying		Original		Wrong	
a	Advance–Machinery	50,000	Advance –Machinery	50,000	Machinery A/C	50,000
	Machinery	50,000	Cash	50,000	Cash	50,000
b	Acc. Dep.	13,400	Acc. Dep. (W-1)	13,400	Cash	50,000
	P/L	16,600	Cash	50,000	Machinery	50,000
	Machinery	30,000	P/L (Bal.)	16,600		
			Machinery	80,000		
c	Acc. Dep (W-2)	2,758				
	Dep exp.	2,758				

Scanned with CamScanner

WORKINGS

(W-1) Accumulated Depreciation of Disposal

Cost (1.01.2009)		80,000
Depreciation (2009)	(80,000 × 10 %)	(8,000)
WDV (31.12.2009)		72,000
Depreciation (30.9.2010)	(72,000 × 10% × 9/12)	(5,400)
WDV on (30.9.2010)		66,600
Accumulated depreciation on disposal (80,000 – 66,600)		13,400

(W-2) Adjustment for depreciation

		(Excess)/ Less
Adj. (i)	(50,000 × 10% × 5/12)	(2,083)
Adj.(ii)	(W-3)	(675)
Total excess depreciation to be reversed		(2,758)

(W-3) Accumulated depreciation

		Correct	Wrong	Excess
01-01-2009	Cost	30,000		
31-12-2009	Depreciation (30,000 × 10%)	(3,000)		
31-12-2009	WDV	27,000	27,000	
30-09-2010	Depreciation (27,000 × 10% × 9/12) : (27,000 × 10%)	(2,025)	(2,700)	(675)
30-09-2010	WDV	24,975	24,300	

b)

Dr.	Machinery a/c		Cr.
Unadjusted closing balance	700,000	Adj. (i)	50,000
		Adj. (ii)	30,000
		c/d (bal.)	620,000

Dr.	Accumulated depreciation a/c		Cr.
Adj. (i)	13,400	Unadjusted closing balance	360,000
Depreciation (W-2)	2,758		
c/d (bal.)	343,842		

Example-8

Following account balances are appearing in the books of Amjad as on:

	Cost 31.12.2010	Accumulated Depreciation 31.12.2010
Machinery	1,100,000	700,000

Following errors were identified by the auditors for the year ended December 31, 2010.

(i) Advance paid for purchase of machinery to be delivered on 31.3.2011 is debited to machinery account on 1.11.2010. Amount is Rs. 30,000.

(ii) Machinery costing Rs. 80,000 purchased on 1.4.2009 was sold on 30.9.2010 for Rs.33,000 and sale proceeds were credited to machinery A/C.

(iii) Machine purchased on 1.7.2008 having book value of Rs. 25,000 on 31.5.2010 is sold at a gain of Rs. 3,000. The sale proceeds are credited to sales a/c.

(iv) Installation cost paid for machine on November 1, 2010 amounting to Rs. 50,000 is debited to repair account.

Rate of Depreciation for 10% WDV.

Required:

(i) Prepare the journal entries to correct the above errors.

(ii) Prepare adjusted Machinery A/C and accumulated depreciation a/c.

Scanned with CamScanner

Solution

a)

	Rectifying		Original		Wrong	
i	Adv.–Machinery	30,000	Advance –Machinery	30,000	Machinery	30,000
	Machinery	30,000	Cash	30,000	Cash	30,000
ii	Acc. Dep.	11,550	Acc. Dep. (W-1)	11,550	Cash	33,000
	P/L	35,450	Cash	33,000	Machinery	33,000
	Machinery	47,000	P/L (Bal.)	35,450		
			Machinery	80,000		
iii	Acc. Dep.	5,511	Acc. Dep. (W-2.1)	5,511	Cash	28,000
	Sale	28,000	Cash (bal.)	28,000	Sale	28,000
	P/L	3,000	P/L	3,000		
	Machinery	30,511	Machinery (W-2)	30,511		
iv	Machinery	50,000	Machinery	50,000	Repair	50,000
	Repair	50,000	Cash	50,000	Cash	50,000
	Acc. Dep.	2,246				
	Dep. (W-3)	2,246				

WORKINGS

(W-1) Accumulated Depreciation of Disposal

Cost (1.04.2009)		80,000
Depreciation (2009)	(80,000 × 10 % × 9/12)	(6,000)
WDV (31.12.2009)		74,000
Depreciation (30.9.2010)	(74,000 × 10% × 9/12)	(5,550)
WDV on (30.9.2010)		68,450
Accumulated depreciation on disposal (80,000 – 68,450)		11,550

(W-2) Cost of items having book value Rs. 25,000

Let the cost be

		%
Depreciation-2008	(1.7.2008)	100
Book value on 31.12.2008	(100 × 10% × 6/12)	(5)
Depreciation-2009		95
Book value on 31.12.2009	(95 × 10%)	(9.50)
Depreciation-2010		85.5
Book value on 31.5.2010	(85.5 × 10% × 5/12)	(3.5625)
If book value is 81.9375 then it can be grossed up to arrive at cost.		81.9375
Cost	(25,000/81.9375 × 100)	

(W-2.1) Accumulated Depreciation of Disposal

Accumulated depreciation on disposal (30,511 – 25,000)	30,511
	5,511

(W-3) Adjustment for depreciation

		(Excess) Less
Adj. (i)		(500)
Adj.(ii)	(30,000 × 10% × 2/12)	(1,087)
Adj.(iii)	(W-4)	(1,492)
Adj.(iv)	(W-5)	833
Total excess depreciation to be reversed	(50,000 × 10% × 2/12)	(2,246)

Scanned with CamScanner

(W-4) Accumulated depreciation

		Correct	Wrong	Excess
01-04-2009	Cost	47,000		
31-12-2009	Depreciation (47,000 × 10% × 9/12)	(3,525)		
31-12-2009	WDV	43,475	43,475	
30-09-2010	Depreciation (43,475 × 10% × 9/12): (43,475 × 10%)	(3,261)	(4,348)	(1,087)
30-09-2010	WDV	40,214	39,127	

(W-5) Accumulated depreciation

		Correct	Wrong	Excess
01-07-2008	Cost	30,511		
31-12-2008	Depreciation (30,511 × 10% ×6/12)	(1526)		
31-12-2008	WDV	28,986		
31-12-2009	Depreciation (28,985.45 × 10%)	(2,899)		
31-12-2009	WDV	26,087	26,087	
31-05-2010	Depreciation (26,087 × 10% × 5/12): (26,087 × 10%)	(1,117)	(2,609)	(1,492)
31-05-2010	WDV	24,970	23,478	

b)

Dr.	Machinery a/c		Cr.
Unadjusted closing balance	1,100,000	Adj. (i)	30,000
		Adj. (ii)	47,000
Adj. (iv)	50,000	Adj. (iii)	30,511
		c/d (bal.)	1,042,489

Dr.	Accumulated depreciation a/c		Cr.
Adj. (ii)	11,550	Unadjusted closing balance	700,000
Adj. (iii)	5,511		
Depreciation (W-4)	2,246		
c/d (bal.)	680,693		

LO3: EFFECT OF ERRORS ON PROFIT

Description	Effect on profit
If revenue and expense items are credited in rectifying entry	Increase
If revenue and expense items are debited in rectifying entry	Decrease

LO4: SYSTEM OF ACCOUNTING USED IN RECTIFICATION OF ERRORS TOPIC

In the topic of rectification of errors you should assume that no control accounts are maintained unless it is expressly mentioned in the question.

Following steps are performed if control accounts are not maintained:

1. Credit sale is firstly recorded in sales day book.
2. Secondly, individual debtor account is updated with this figure.
3. Thirdly at the end of month the total of sales day book is posted to the credit of sales account.

It means:

Transaction	Will effect
Casting error in day book	Sale account
Invoice omitted from sales day book	Sale account and debtor account
Invoice recorded in sales day book with wrong amount	Sale account and debtor account

Scanned with CamScanner

Note: Same rules apply for:

- Purchase day book
- Purchase return day book
- Sale return day book

Exam Tip

Whenever in question the word day book is used you must use this system (LO4).

Some important things

- Goods purchased should be recorded when received.
- Goods sold should be recorded when dispatched.

Scanned with CamScanner

PRACTICE QUESTIONS

Question-1

Amir could not agree the Trial Balance. He transferred to the Suspense Account amount of Rs.296 being excess of the debit side total. The following errors were subsequently discovered:

(i) Sales Book was overcast by Rs.300;
(ii) Purchase of furniture for Rs.615 passed through Purchase Book;
(iii) An amount of Rs.55 received from Sheldon was posted to his account as Rs.550;
(iv) Purchase Return Book total was carried forward as Rs.221 instead of Rs.112;
(v) A cash sale of Rs.1,235 duly entered in the Cash Book but posted to Sales Account as Rs.235; and
(vi) Rest of the difference was due to incorrect total in the Salaries Account in the Ledger.

Required:
Give journal entries to rectify the above and prepare Suspense Account.

Question-2

You have extracted a trial balance and drawn up accounts for the year ended 31 December 20X7. There was a shortage of Rs. 78 on the credit side of the trial balance, a suspense account being opened for that amount.

During 20X8 the following errors made in 20X7 were found:

(i) The credit sale has been recorded excess by Rs. 125 in both accounts.
(ii) Purchases day book had been overcast by Rs. 10.
(iii) A private purchase of Rs. 140 had been included in the business purchases.
(iv) Bank charges Rs. 22 entered in the cash book have not been posted to the bank charges account.
(v) A sale of goods to K Lamb Rs. 230 was correctly entered in the sales book but entered in the personal account as Rs. 320.

Required:

(a) Show the requisite journal entries to correct the errors.
(b) Write up the suspense account showing the correction of the errors.
(c) The net profit originally calculated for 20X7 was Rs. 28,400. Show your calculation of the correct figure.

Question-3

Syed Aamir Ali's trial balance failed to agree on 31.12.19 and he entered the difference in a Suspense Account. On examination of the books the following errors were revealed:

(a) Goods sold on credit to A. Mann, valued at Rs. 400, had been credited to his account.
(b) A photocopier, purchased for Rs. 1,800, had been debited to the Purchases Account.
(c) Syed Aamir Ali had received a credit note for Rs. 550 from a creditor, T. Willis, for goods returned. No entry had been made in the books.
(d) A payment for rates, Rs. 950, was entered on the credit side of the Rates Account as Rs. 590.
(e) Bank charges of Rs. 600 were entered in the cash book but not posted to the ledger.
(f) R. Owens, a debtor, was declared bankrupt and was only able to pay 25% in the rupee on a debt of Rs. 1,000. No entry had been made in the books in respect of the bad debt.

The correcting of the above errors enabled the books to be balanced.

Required:

a Journalise the necessary corrections.
b Show the Suspense Account.

Scanned with CamScanner

Question-4

The trial balance of Tom Moran, a car dealer, failed to agree on 31.12.19 and he entered the difference in a Suspense Account. On examination of the books the following errors were revealed:

(a) A car purchased for Rs. 6,000 was debited to the Equipment Account.

(b) A credit note for Rs. 178 received from a creditor, M. Walsh, had been debited in Walsh's account as Rs. 196.

(c) A payment of Rs. 190 for repairs to machinery had been entered in the Plant and Machinery Account.

(d) Discount received, Rs. 700, had been posted to the incorrect side of the Discount Account.

(e) Capital introduced in cash during the year by the owner, Rs. 2,000, had been entered correctly in the Capital Account but the double entry had not been completed.

(f) Cash received, Rs. 400, from a debtor, R. Spade, had been entered correctly in Spade's account but no entry had been made in the cash book.

Required:

a. Journalise the necessary corrections.

b. Show the Suspense Account.

Question-5

Ali Abbas's trial balance failed to agree on 31.3.19 and he entered the difference, a credit balance of Rs.4,030, in a Suspense Account. On examination of the books the following errors were revealed:

(a) Interest received, Rs. 840, had been entered on the incorrect side of the Interest Account.

(b) James Taylor, a debtor, was declared bankrupt and had made a full and final payment of 20% in the rupee in respect of the original debt of Rs. 1,500. No entry had been made in the books in respect of the bad debt.

(c) Shop equipment purchased costing Rs. 2,500 has been debited with Rs. 7,500 in correct account.

(d) A payment of Rs. 790 to a creditor, R. Poole, had been credited to his account as Rs. 970.

(e) The total of the sales book, Rs. 18,990, had been posted to the Sales Account as Rs. 19 880.

(f) A car, costing Rs. 30,000, purchased by Ali Abbas for his wife, had been posted to the Motors Expenses Account.

Required:

a. Journalise the necessary corrections.

b. Show the Suspense Account.

Question-6

The trial balance of a firm is out. The following errors were found subsequently, to have been committed. Pass journal entries to correct them, and ascertain the difference in the Trial Balance.

(a) An amount of Rs. 100 was received from D. Das on 31st December, 1998, but had been entered in the Cash Book on 3rd January, 1999.

(b) The Returns Inwards Books for December has been cast Rs. 100 short.

(c) The purchase of an office table costing Rs. 300 had been passed through the Purchase Day Book.

(d) Rs. 375 paid for wages to workmen for making show cases had been charged to wages account.

(e) A purchase of 671 had been posted to the debit of the creditor's account as Rs. 617. The creditor is P. Panna & Co.

(f) A cheque for Rs. 200 received from P.C Joshi has been dishonoured on maturity and was passed to the debit of Allowance Account.

(g) Goods amounting to Rs. 100 had been returned by a customer and were taken into stock but no entry in respect thereof was made in the books.

Scanned with CamScanner

(h) Rs. 2,000 paid for the purchase of a motor cycle for Mr. Dutt (a partner) had been charged to Miscellaneous Expenses Account.

(i) A sale of Rs. 200 to Singhani & Co. was credited to their account.

(j) A sale of Rs. 1,000 had been passed through the Purchase Day Book. The customer's account has, however, been correctly debited.

(k) While carrying forward the total of the sales book from one page to the next, the amount was written as Rs. 176,658 instead of Rs. 167,568.

Question-7

Mr. Fawwad owns a factory and closes his books on June 30. The trial balance prepared by him, contained a difference which he kept in a suspense account

1. A cheque of Rs. 10,800 was paid to a creditor who allowed 10% cash discount. The payment was correctly entered in the bank account but was posted to purchase account as Rs. 1,080 only. No other entry was made.
2. Purchases of Rs. 4,500 were entered as sales in the Sales Day Book as Rs. 4,400.
3. A sales return from 'R' Rs. 2,808 was wrongly passed through the sales book and from these wrongly posted to the credit of 'R' as Rs. 8,200.
4. In the salaries account, a sub-total of Rs. 12,600 was carried over to the next page as Rs. 1,260 on the wrong side.
5. The total of purchase return day book amounting to Rs. 16,160 had not been posted to the ledger.
6. Purchase returns book was under-casted by Rs. 650.
7. The sales account had been added short by Rs. 10,000.
8. The opening balance of furniture account was brought forward as Rs. 18,300 instead of Rs.13,800. Depreciation on furniture is provided at the rate of 10%.
9. Equipment costing Rs. 200,000 with a carrying value of Rs. 60,000 was traded-in for a new equipment valuing Rs. 250,000 on July 02, 2006. A trade-in allowance of Rs. 45,000 was received on the equipment. However, while recording this transaction only the net payment to supplier was recorded as an addition to fixed assets. Depreciation was provided on the old as well as the new equipments at 10% on straight line basis.
10. The following errors were observed in the valuation of year-end stocks and stores and spares:
    - An-amount of Rs. 152,700 was carried forward as Rs. 125,700 in the stock sheets.
    - Stores and spares item code 35D was over casted by Rs. 37,000.
11. The following cheques were issued on June 30, 2007;

Description	Cheque No.	Amount (Rs.)
Advance to an employee	128364	12,000
For goods supplied in May	128365	17,000

- Cheque No. 128364 was handed over to the employee on June 30 and is appearing as a reconciling item in the bank reconciliation statement related to June 2007.
- Cheque No. 128365 was handed over to the supplier on July 1, 2007 and is not appearing on the bank reconciliation statement.

12. Debit balance on Suspense Account Rs. 9, was found to be due to a sale of Rs. 110 having debited to a customer's account as Rs. 101.

Required:

Pass rectifying Entries and prepare suspense account.

Scanned with CamScanner

PRACTICE SOLUTIONS

Answer-1

	Rectifying		Original		Wrong	
(i)	Sales Ac	300			Sales A/c	300
	Suspense A/c	300				
(ii)	Furniture A/c	615	Furniture A/c	615	Purchases a/c	615
	Creditor	615	Payable for fur.	615	Creditor a/c	615
	Payable for fur.	615				
	Purchases A/c	615				
(iii)	Sheldon A/c	495	Cash a/c	55	Cash a/c	55
	Suspense a/c	495	Sheldon A/c	55	Sheldon A/c	550
(iv)	Purchases Return	109				
	Suspense A/c	109				
(v)	Suspense A/c	1,000	Cash a/c	1,235	Cash a/c	1,235
	Sales A/c	1,000	Sales a/c	1,235	Sales a/c	235
(vi)	Suspense A/c	200				
	Salaries A/c	200				

Dr. Suspense Account Cr.

Date	Particulars	Rs	Date	Particulars	Rs
	Sales A/c	1,000		Balance b/d	296
	Salaries A/c (bal.)	200		Sales A/c	300
				Sheldon	495
				Purchases Return A/c	109

Answer-2

(a)

	Rectifying		Original		Wrong	
i)	Sale	125				
	Debtor	125				
ii)	Suspense	10				
	Purchase	10				
iii)	Drawings	140	Drawings	140	Purchase	140
	Purchase	140	Cash	140	Cash	140
iv)	Bank charges	22	Bank charges	22		
	Suspense	22	Bank	22	bank	22
v)	Suspense	90	Debtor-K Lamb	230	Debtor-K Lamb	320
	Debtor-K Lamb	90	Sale	230	Sale	230

(b)

Dr. Suspense account Cr.

	Purchase	10	Difference in trial	78
	Debtor-K Lamb	90	Bank charges	22
(a)	Unadjusted profit			28,400
	Add:			
	Purchase (10+140)			150
				150
	Less:			
	Sale			125
	Bank charges			22
				(147)
	Adjusted profit			28,403

Scanned with CamScanner

Answer-3

	Rectifying			Original			Wrong		
(a)	Debtor A Mann	800		Debtor A Mann	400		Debtor A Mann	400	
	Suspense		800	Sale		400	Sale		400
(b)	Photocopier	1,800		Photocopier	1,800		Purchases	1,800	
	Purchases		1,800	Cash		1,800	Cash		1,800
(c)	Creditor- T W	550		Creditor- T W	550				
	Purchase return		550	Purchase return		550	X		
(d)	Rates expense	1,540		Rates exp.	950		Rates exp.	590	
	Suspense		1,540	Cash		950	Cash		950
(e)	Bank charges	600		Bank charges	600				
	Suspense		600	Bank		600	Bank		600
(f)	Bad debt	750		Bad debt	750				
	Debtor		750	Debtor		750	X		

Dr. Suspense account Cr.

Difference in trial (bal.)	2,940		
		Debtor A Mann	800
		Rates expense	1,540
		Bank charges	600

Answer -4

	Rectifying			Original			Wrong		
(a)	Car	6,000		Car	6,000		Equipment	6,000	
	Equipment		6,000	Cash		6,000	Cash		6,000
(b)	Suspense	18		Creditor - M W	178		Creditor - M W	196	
	Creditor- M W		18	Purchase return		178	Purchase return		178
(c)	Repair expense	190		Repair exp.	190		Machinery a/c	190	
	Machinery a/c		190	Cash		190	Cash		190
(d)	Suspense	1,400		Creditor	700		Creditor	700	
	Discount rec.		1,400	Discount rec.		700	Discount rec.	700	
(e)	Cash	2,000		Cash	2,000		-	-	
	Suspense		2,000	Capital		2,000	Capital		2,000
(f)	Cash	400		Cash	400		-	-	
	Suspense		400	Debtor R S		400	Debtor R S		400

Dr. Suspense account Cr.

Difference in trial (bal.)	982		
Creditor- M W	18	Cash	2,000
Discount received	1,400	Cash	400

Scanned with CamScanner

Answer-5

	Rectifying		Original		Wrong	
(a)	Suspense	1,680	Bank	840	Bank	840
	Interest income	1,680	Interest inc.	840	Interest income	840
(b)	Bad debt	1,200	Bad debt	1,200	X	
	Debtor	1,200	Debtor	1,200		
			(1,500 x 80%)			
(c)	Suspense	5,000	Shop equipment	2,500	Shop equipment	7,500
	Shop equipment	5,000	Cash	2,500	Cash	2,500
(d)	Creditor - R	1,760	Creditor - R	790	Creditor - R	970
	Suspense	1,760	Cash	790	Cash	790
(e)	Sales	890				
	Suspense	890				
(f)	Drawings	30,000	Drawings	30,000	Motor expense	30,000
	Motor expense	30,000	Cash	30,000	Cash	30,000

Dr. Suspense account Cr.

Interest income	1,680	Difference in trial	4,030
Shop equipment	5,000	Creditor - R	1,760
		Sales	890

Answer-6

	Rectifying		Original		Wrong	
(a)	Cash	100	Cash	100	-	-
	Suspense	100	Debtor DD	100	Debtor DD	100
(b)	Sale return	100				
	Suspense	100				
(c)	Furniture	300	Furniture	300	Purchases	300
	Creditor	300	Payable	300	Creditor	300
	Payable	300				
	Purchases	300				
(d)	Furniture	375	Furniture	375	Wages	375
	Wages	375	Cash	375	Cash	375
(e)	Suspense	1,288	Purchase	671	Purchases	671
	Creditor PP	1,288	Creditor PP	671	Creditor PP	617
(f)	Debtor – PCJ	200	Debtor - PCJ	200	Allowances a/c	200
	Allowances a/c	200	Bank	200	Bank	200
(g)	Sale return	100	Sale return	100		
	Debtor	100	Debtor	100		
(h)	Drawings	2,000	Drawings	2,000	Miscellaneous exp.	2,000
	Miscellaneous exp.	2,000	Cash	2,000	Cash	2,000
(i)	Debtor - SC	400	Debtor – SC	200	Debtor - SC	200
	Suspense	400	Sale	200	Sale	200
(j)	Suspense	2,000	Debtor	1,000	Debtor	1,000
	Purchase	1,000	Sale	1,000	Purchase	1,000
	Sale	1,000				
(k)	Sales	9,090				
	Suspense	9,090				

Scanned with CamScanner

Dr.	Suspense account		Cr.
Difference in trial	6,402		
Creditor PP	1,288	Cash	100
Purchase	1,000	Sale return	100
Sale	1,000	Debtor	400
		Sales	9,090

ANSWER-7

Do it yourself.

Scanned with CamScanner

ICAP PAST PAPER QUESTIONS

QUESTION-1

The trial balance of Eastern Products showed a short credit of Rs. 6,264 as at June 30, 2008. A suspense account was opened for the difference and the profit for the year was then calculated at Rs. 956,180.
The following errors and adjustments were discovered subsequently:

(i) An invoice of Rs. 3,700 was debited to purchases but the goods were received after year-end and were not included in the closing inventory.
(ii) A cheque of Rs. 1,850 received from a customer was dishonoured on June 25, 2008 but no entry was made in the books. Cash there against was received after year-end.
(iii) Purchase of office equipment costing Rs. 15,200 was entered in the purchases account. Depreciation on office equipment is provided at the rate of 10%.
(iv) A purchase invoice of Rs. 197 was debited to the supplier account as Rs. 917.
(v) Purchase returns book was under-casted by Rs. 650.
(vi) The opening balance of furniture account was brought forward as Rs. 18,300 instead of Rs.13,800. Depreciation on furniture is provided at the rate of 10%.
(vii) A balance of Rs.730 in the sales ledger is to be offset against a balance of Rs.880 in the purchase ledger.

Required:

(a) Prepare journal entries to adjust the above items.
(b) Recalculate the net profit for the year.

(18)

{Autumn 2008, Q # 6}

QUESTION-2

Mr. Fawwad owns a factory and closes his books on June 30. The trial balance prepared by him, contained a difference which he kept in a suspense account. On scrutinizing the records, the following errors were detected:

(i) A cheque of Rs. 10,800 was paid to a creditor who allowed 10% cash discount. The payment was correctly entered in the bank book but was posted to purchase account as Rs. 1,080 only. No other entry was made.
(ii) Sundry debtors include an amount of Rs. 15,000 which had proved irrecoverable but was not written off. According to a consistent policy, a reserve for bad debt was created @ 5% on closing debtors;
(iii) Commission of Rs. 3,500 was paid but was debited twice, once in the party's account and again in the commission account;
(iv) Purchases of Rs. 4,500 were entered as sales in the Sales Day Book.
(v) In the salaries account, a sub-total of Rs. 12,600 was carried over to the next page as Rs. 1,260 on the wrong side.
(vi) Rs. 600 collected from a party in respect of dues which had been written off as bad two years ago, was credited to the debtor account.
(vii) Goods invoiced at Rs. 4,600 were returned by a debtor. These were entered in the purchase book and posted from there to debtor's account as Rs. 6,400.
(viii) The discount column in the sales day book was short casted by Rs. 1,500.
(ix) A cash sale of Rs. 7,300 to Mr. Anwar was correctly entered in the cash book but was posted to the credit of Mr. Anwar's account
(x) An amount of Rs. 17,400 was received in full and final settlement from a customer after he was allowed a discount of Rs. 2,600. However, while writing the books, the amount received was entered in the discount allowed column of the bank book and the discount allowed was entered in the bank column.

Required:

Pass rectification entries (without narration) to correct the above errors.

(15)

{Autumn 2010, Q# 5}

Scanned with CamScanner

QUESTION-3

The trial balance prepared by A.A. Enterprise showed a difference of Rs. 47,090 which was put on the credit side of a suspense account. An investigation disclosed that:

(i) The total of purchase return day book amounting to Rs. 16,160 had not been posted to the ledger.

(ii) Discount received amounting to Rs. 11,320 had been debited to discount allowed account.

(iii) The sales account had been added short by Rs. 10,000.

(iv) An asset bought four years ago for Rs. 7,000 and depreciated to Rs. 1,200 had been sold for Rs.1,500 at the beginning of the year. The receipt of cash has been posted in the bank book but corresponding entries have not been recorded.

(v) A credit sale of Rs. 1,470 had been credited to the customer's account as Rs. 1,740. A bad debt of Rs. 1,560 has to be written off. Provision for doubtful debts is to be maintained at 10% of debtors. Debtors appearing in the trial balance are Rs. 23,390 and the provision for bad debts account shows a credit balance of Rs. 2,320.

(vi) A sub-total of Rs. 29,830 on the list of closing stock had been carried over as Rs. 29,380 and another sheet had been overcast by Rs. 1,000.

Required:

Pass rectification/adjustment entries to correct the above errors. (Narrations are not required) **(11)**

{Autumn 2009, Q # 2}

QUESTION-4

The trial balance of Ayub Brothers did not agree as at 31 December 2011 and the difference was carried to a suspense account. On scrutinising the books of account, the following types of errors were detected:

(i) Debtors include Rs. 15,000 which are irrecoverable and need to be written off.

(ii) Goods invoiced at Rs. 4,600 were returned by a customer. It was entered in the purchase book and posted from there to a creditor's account as Rs. 6,400.

(iii) A cheque of Rs. 8,000 received from a customer was not posted to his ledger account. Moreover, the corresponding sales invoice for Rs. 12,000 was incorrectly passed through the sales day book as Rs. 2,000.

(iv) An amount of Rs. 3,800 owed by Zahid & Company for goods supplied was to be adjusted against an amount of Rs. 8,500 owed to Zahid & Company. No entry has been made in this regard.

(v) A purchase of Rs. 15,100 was entered in the purchase day book as Rs. 1,500 and posted to the supplier's account as Rs. 5,100.

(vi) Goods invoiced at Rs. 23,000 and returned by Hamid Khan, a debtor, were entered in the purchase day book and posted therefrom to Hammad Khan, a creditor, as Rs. 32,000.

(vii) A supplier's invoice for Rs. 12,300 had been entered in the purchase day book on 28 December 2011. However, the goods were received on 2 January 2012.

(viii) Some items of furniture which stood in the books at Rs. 24,000 on 1 January 2011 were disposed of on 30 June 2011 in exchange for new furniture costing Rs. 20,800. A net invoice of Rs. 9,200 was passed through the purchase day book. Depreciation on furniture is charged at 10% on written down value.

(ix) Ayub Brothers maintains a provision of 5% of the gross amount of debtors.

Required:

Prepare journal entries to rectify the errors identified above.

(Narrations are not required.) **(21)**

{Spring 2012, Q# 4}

Scanned with CamScanner

QUESTION-5

The trial balance of A.A. Enterprise for the year ended 30 June 2013 shows a difference of Rs. 12,950 which has been placed to the debit of a suspense account. A careful analysis of the accounting records has revealed the following:

(i) Wages included Rs. 60,000 towards installation of a new plant in August 2012. The company charges depreciation on plant and machinery @ 15%.

(ii) A cheque of Rs. 13,500 was paid to a creditor who allowed 10% cash discount, but the payment was posted to purchase account as Rs. 1,350 only.

(iii) Goods invoiced at Rs. 5,700 returned by a debtor were entered in the purchase day book whereas the amount recorded in the debtors account was Rs. 7,500.

(iv) The sub-total of a stock sheet had been carried forward as Rs. 21,380 instead of Rs. 21,830 and another sheet had been over-casted by Rs. 1,000.

(v) Mr. Arslan, the owner, had withdrawn goods worth Rs. 4,680 for personal use. No entry has been made in the books.

(vi) A cheque of Rs. 10,000 received from a customer has not been posted to his ledger.

(vii) A sales invoice for Rs. 14,000 had been wrongly passed through the sales day book as Rs. 1,400.

(viii) Goods invoiced at Rs. 12,000 returned by Salman Khan were entered in the purchase day book and posted therefrom to Saleem Khan's account, who is a creditor, as Rs. 21,000.

(ix) Goods worth Rs. 14,700 purchased on 27 June 2013, had been entered in the purchase day book and credited to the supplier's account but the goods were not delivered till 3 July 2013. The title of the goods had however passed on 27 June 2013.

(x) The trial balance shows a debtor control account balance of Rs. 82,500 and a credit of Rs. 16,320 in provision for bad debts account. Rs. 11,560 is no more receivable and needs to be written off. A provision for doubtful debts is required to be maintained at 10% of debtors.

Required:

Pass rectification entries to correct the above errors. (Narrations are not required) (20)

{September 2013, Q# 4}

QUESTION-6

While closing his books on 30 June 2012, Mr. Rehan identified a difference in the trial balance which he kept in a Suspense Account. He prepared his P & L account on the basis of this trial balance and arrived at a profit of Rs. 679,000. While trying to reconcile the trial balance he detected the following errors:

(i) Bill received from ABC Furnishings on 1 July 2011 for repairs to furniture Rs. 3,000 and for new furniture supplied Rs. 10,000 was entered in the purchase day book as Rs. 11,000. Depreciation on furniture is provided @ 10 % per annum.

(ii) Furniture which stood in the books at Rs. 5,000 was sold on 1 July 2011 for Rs. 2,750 in part exchange of new furniture costing Rs. 8,750 and the net invoice of Rs. 6,000 was passed through the purchase day book.

(iii) Goods worth Rs. 10,200 purchased from a creditor on 28 June 2012 had been entered in the Purchase Day Book and credited to him but were not delivered till 5 July 2012. However, the title of the goods had passed on 28 June 2012.

(iv) A computer bought originally for Rs. 70,000 four years ago and depreciated to Rs. 12,000 had been sold for Rs. 15,000 on the first day of the year. The amount deposited was entered in the bank book but no other entry was passed.

(v) Goods valuing Rs. 13,000 were returned by Zahid. These were entered in the Purchase Day Book and posted to a supplier's account as Rs. 31,000.

(vi) Discount of Rs. 3,700 was allowed but posted to the credit of discount [illegible] Rs. 7,300.

Scanned with CamScanner

(vii) A cheque of Rs. 10,800 was paid to a creditor who allowed 10% cash discount, but the payment was wrongly posted to purchase account as Rs. 1,080 only without any other entry.

Required:

(a) Pass rectification entries (without narration) to correct the above errors. **(20)**

(b) Recalculate the profits after taking into account the above corrections. **(04)**

{Autumn 2012, Q#3}

QUESTION-7

	Rupees '000'	
	Dr.	**Cr.**
Land and building cost	100,000	
Land and Building accumulated depreciation at June 30, 2001	-	20,000
Plant–cost	120,000	
Plant - accumulated depreciation at June 30, 2001	-	30,000
Stocks in trade	25,000	-
Debtors	15,000	-
Bank	82,500	-
Creditors	-	17,000
Prepaid Rent	4,000	-
Accrued Salaries	-	3,000
Mr. Ehsan's Capital Account	-	194,000
Profit for the year ended June 30, 2001	-	97,500
Total	**346,500**	**361,500**

A suspense account was opened for the difference in the trial balance.

Following errors were discovered:

(i) A creditor's account has been debited with a Rs.3.0 million sales invoice (which had been correctly recorded in the sales account).

(ii) The heat and light account had been credited with cash paid Rs. 1.5 million.

(iii) Mr. A Gondal had been credited with a cheque received from Mr. I. Gondal for Rs.8.0 million. Both are debtors.

(iv) The insurance account contained a credit entry for insurance prepaid of Rs.5.0 million, but the balance had not been carried down and hence had been omitted from the above trial balance.

(v) Purchase return had been over cast by Rs.7.0 million.

Required:

a. Prepare journal entries to correct each of the above errors. **(05)**

b. Open the Suspense Account at June 30, 2001 and enter the relevant corrections. **(05)**

c. Name the type of error which has occurred in each of items (i), (ii) & (iii). **(03)**

d. Recalculate the net profit for the year to June 30, 2001. **(03)**

e. Prepare the Balance Sheet at June 30, 2001. **(08)**

{Spring 2002, Q # 2}

QUESTION-8

Messrs Modern Chemicals were unable to agree the trial balance on June 30, 2001 and have raised a 'Suspense Account' for the difference. Later the following errors were discovered and rectified and the 'Suspense Account' was balanced:

(a) The addition of the sundry purchases in the purchase journal was short by Rs. 1,500.

(b) Goods valuing of Rs. 1,050 returned by Mr. Farooq, a customer, had been posted to the debit of Accounts Receivables' and also to sales returns.

(c) Discount amounting to Rs. 300 allowed to customer had been posted in his account, but not posted in the discount account.

Scanned with CamScanner

(d) Insurance premium of Rs. 4,500 paid on June 30, 2000 for the year ended June 30, 2001 had not been brought forward.

Required:

(i) Pass journal entries to rectify the above mistakes,

(ii) Draw up the 'Suspense Account'.

(iii) Show how the above mistakes affect the profit for the year ended June 30, 2001. **(15)**

{Autumn 2001, Q# 4}

QUESTION-9

During the course of audit of Desktop Products for the year ended June 30, 2007, the following information has been gathered:

(a) Equipment costing Rs. 200,000 with a carrying value of Rs. 60,000 was traded-in for a new equipment valuing Rs. 250,000 on July 02, 2006. A trade-in allowance of Rs. 45,000 was received on the equipment. However, while recording this transaction only the net payment to supplier was recorded as an addition to fixed assets. Depreciation was provided on the old as well as the new equipments at 10% on straight line basis.

(b) The following errors were observed in the valuation of year-end stocks and stores and spares:

- An-amount of Rs. 152,700 was carried forward as Rs. 125,700 in the stock sheets.
- Stores and spares item code 35D was overvalued by Rs. 37,000.

(c) Stock costing Rs. 138,750 was received on June 30, 2007 and included in the physical inventory taken on that date. However, the purchase was recorded when the invoice was received on July 4, 2007.

(d) An old machine was sold to Mr. Shafique for Rs. 50,000. According to the agreement, the purchaser made a down payment of Rs. 35,000. The balance was received on December 30, 2006, but was credited to the sales account.

(e) A loan of Rs. 500,000 had been obtained on January 1, 2007. It carried interest @ 12% per annum compounded quarterly. Rs. 450,000 had been repaid on March 31, 2007 which included the amount of interest up to March 31. Interest for the quarter ended June 30, 2007 had not been accrued.

(f) While making adjustments for the year ended June 30, 2006 an adjusting entry to accrue sales commission amounting to Rs. 24,000 was recorded. During the current year, Rs. 17,000 were paid and debited to sales commission account. Rs. 7,000 are still outstanding.

(g) The following cheques were issued on June 30, 2007;

Description	Cheque No.	Amount (Rs.)
Advance to an employee	128364	12,000
For goods supplied in May	128365	17,000

- Cheque No. 128364 was handed over to the employee on June 30 and is appearing as a reconciling item in the bank reconciliation statement related to June 2007.
- Cheque No. 128365 was handed over to the supplier on July 1, 2007 and is not appearing on the bank reconciliation statement.

Required:

Pass necessary journal entries in respect of the above. **(17)**

{Autumn 2007, Q # 3}

Scanned with CamScanner

QUESTION-10

The draft balance sheet of Time Life Enterprises (TLE) as on December 31, 2008, is being prepared. On reviewing the accounts of the business, its auditor found that the records have been correctly maintained except for the following events:

(i) On January 17, 2008 a contract was signed for the purchase of a machine from Makers Limited for Rs. 1,125,000 which is to be delivered on July 17, 2009. TLE paid an advance of Rs. 450,000 on the signing of the contract and the balance was to be paid on delivery of the machine. The advance was debited to plant and machinery account.

(ii) Installation of a machine was completed on January 21, 2008. The cost of machine of Rs.2,700,000 was debited to plant and machinery account. The cost of installation amounting to Rs. 300,000 had been debited to Repairs Account.

The depreciation is charged on declining balance method at 10 per cent per annum. Depreciation on additions is provided from the month in which the asset is acquired. Depreciation expenses for the year 2008 have been correctly calculated and recorded except for the impact of errors discussed above.

Required: Pass the adjusting entries. **(08)**

{Spring 2009, Q # 6}

QUESTION-11

The accountant of BA Enterprises prepared an income statement for the year ended December 31, 2010 which showed gross profit of Rs. 1,050,000 and net profit of Rs. 650,000. The company sells goods at cost plus mark-up of 20%.

The following errors/omissions were found on a detailed review of the financial statements.

(a) Items not included in the income statement:
   - (i) Free samples costing Rs. 25,000 were sent to potential and regular customers.
   - (ii) Goods costing Rs. 10,000 were taken by the owner for personal use and goods having sales value of Rs. 2,500 were used for office repairs,
   - (iii) Unpaid salaries and transportation (inward) expenses payable, amounting to Rs. 20,000 and Rs. 10,000 respectively.

(b) Old furniture items were sold for Rs. 3,000 and entered in the sales day book. The book value of these items was Rs. 2,000.

(c) Rs. 24,500 were paid to a creditor as full and final settlement of an amount of Rs. 25,000 and debited to purchases.

(d) The sales day book was overcast by Rs. 30,000.

(e) An amount of Rs. 67,000 was carried forward in the purchase day book as Rs. 6,700.

(f) Goods sent on sale or return basis and having a sales value of Rs. 18,000 were still held in inventory by the consignee. At the time of dispatch, these were recorded as sales.

Required:

Ascertain the correct amount of gross and net profit for the year. **(13)**

{Spring 2011, Q# 6}

QUESTION-12

The Accountant of Saleem Limited has made the following adjustments for the year ended 30 June 2015 in arriving at the net profit of Rs. 15,500,000.

(i) While preparing the draft financial statements, opening stock of Rs. 1,500,000 was included as Rs. 5,100,000. The error was timely identified and the accountant reduced the value of closing stock by Rs. 3,600,000.

(ii) Goods purchased worth Rs. 550,000 were recorded in sales journal. The error was rectified by reducing sales by Rs. 550,000.

(iii) On 1 January 2015, miscellaneous items of machinery were purchased for Rs.250,000 but were recorded as Rs. 25,000. The said entry was corrected by debiting the difference to the repairs

Scanned with CamScanner

expense account. It is the company's policy to provide depreciation annually on straight line basis at the rate of 10%.

(iv) Prepaid insurance amounting to Rs. 740,000 pertaining to the period from 1 July 2014 to 31 December 2014 was not brought forward from the previous year. Difference in trial balance was removed by creating a suspense account. At year-end, when actual error was identified, suspense account was credited by debiting prepaid insurance.

(v) Purchase return to a supplier amounting to Rs. 400,000 was not recorded. The error was rectified by debiting the supplier account and crediting the suspense account. The balance in the suspense account was included in current Liabilities.

Required: (08)

Compute the correct net profit.

QUESTION-13

(a) While reviewing the draft financial statements of Sky Electronics (SE) for the year ended 31 December 2017, following errors have been identified:

(i) Computers costing Rs. 240,000 purchased on 1 September 2017 for office use were debited to purchases account. SE depreciates computers at 20% per annum using straight line method.

(ii) Furniture costing Rs. 1,200,000 and having a book value of Rs. 670,000 as on 31 December 2017 had already been sold on 1 November 2017. The proceeds of Rs. 700,000 were credited to sales. SE depreciates furniture at 10% per annum using straight line method.

(iii) On 1 April 2017, SE rented-out one of its premises at an annual rent of Rs. 900,000 payable in advance. The rent received was credited to income.

(iv) Trade receivables include a balance of Rs. 180,000 which is irrecoverable but has not been written-off. Further, a recovery of Rs. 96,000 against receivables written off in prior years was credited to trade receivables. As per SE's policy, provision for doubtful receivables has already been made at 5% on year-end balance.

(v) A cheque of Rs. 192,000 was received after a discount of 4% from a customer. However, in the cash book, the amount received was entered in the discount allowed column and the amount of discount was entered in the bank column.

Required:

(a) Prepare rectification entries to correct the above errors. ***(Narrations are not required)*** (11)

(b) A trial balance is merely a proof of arithmetical accuracy. Name the types of errors which a trial balance fails to disclose. (02)

{Spring 2018,Q#7}

QUESTION-14

Draft income statement of Timothy Enterprises (TE) for the year ended 31 December 2017 shows gross profit of Rs. 850,000 and net profit of Rs. 460,000.

During the review of the financial statements, following errors were noticed:

(i) An invoice of Rs. 3,700 was debited to purchases but the goods were received after year-end and were not included in the closing inventory.

(ii) Transportation inward amounting to Rs. 2,000 was included in transportation outward.

(iii) The sub-total of a closing stock sheet had been carried forward as Rs. 21,830 instead of Rs.21,380.

(iv) A receipt of Rs. 21,850 was credited to sales. The amount was received from a debtor as full and final settlement of an outstanding balance of Rs. 23,000.

(v) Goods having sales value of Rs. 4,500 were used for office repairs. No entry has been made in the books.

Scanned with CamScanner

(vi) Purchase of office computer on 1 April 2017 amounting to Rs. 42,000 was entered in the purchase account.

(vii) An item of furniture was sold on credit for Rs. 3,000 and entered in the sales day book. The book value of this item was Rs. 5,000.

(viii) Purchase return amounting to Rs. 6,700 has been recorded as sales return.

(ix) The owner had withdrawn goods costing Rs. 4,680 for personal use. No entry has been made in the books.

TE uses periodic inventory method. Goods are sold at cost plus mark up of 25%. Depreciation on office computer is provided at the rate of 25%.

Required:

Compute the corrected gross profit and net profit for the year. **(14)**

{Autumn 2018, Q#6}

QUESTION-15

The trial balance of Sibi Brothers (SB), dealer of equipment and machines, did not agree as at 31 December 2018 and the difference was carried to suspense account. The financial statements prepared from the trial balance showed a gross profit of Rs. 854,000.

During review, following errors were detected:

(i) A sales invoice of Rs. 24,000 was debited to the debtor's account as Rs. 42,000.

(ii) A purchase of Rs. 23,000 was entered in purchases day book as Rs. 32,000 and posted to the creditor's account as Rs. 3,200.

(iii) An item was included in closing inventory at its cost of Rs. 94,000. Due to lower demand, it had a net realizable value of Rs. 81,000.

(iv) A sub-total of Rs. 49,000 was carried forward in the sales day book as Rs. 94,000.

(v) Return inward and return outward appearing in the trial balance were Rs. 82,000 and Rs. 99,000 respectively. While preparing the financial statements, the amount of return inward was shown as return outward and vice versa.

(vi) Discount received of Rs. 4,100 was posted to the debit of discount allowed.

(vii) SB started using an inventory item as office machine effective from 1 October 2018. No adjustment has been recorded and this item is included in closing inventory. The cost and selling price of this item are Rs. 145,000 and Rs. 182,000 respectively.

(viii) Another office machine costing Rs. 270,000 with a carrying value of Rs. 127,200 as on 1 January 2018 was disposed off on 1 September 2018 for Rs. 80,000. The sale proceeds were credited to accumulated depreciation account and whole year's depreciation was provided on the machine.

The balance as per bank statement as on 31 December 2018 was reconciled with cash book. During review, following matters were noted in bank reconciliation statement:

(i) List of unpresented cheques included:

- a cheque issued to a creditor on 30 April 2018 amounting to Rs. 28,000.
- a cheque dated 30 December 2018 amounting to Rs. 16,000 which was handed over to the creditor on 6 January 2019.

(ii) List of deposits in transit included a cheque dated 15 January 2019 from a debtor amounting to Rs. 35,000.

(iii) Bank charges of Rs.3,100 correctly debited by bank had been added back.

Scanned with CamScanner

Other information:

SB uses periodic inventory method to record the inventory. Office machines are depreciated at 10% from the month of addition to the month prior to disposal using reducing balance method. Control accounts are not maintained for Debtors and Creditors.

Required:

(a) Prepare journal entries to correct the above errors. ***(Narrations are not required)*** **(15)**

(b) Compute the corrected gross profit. **(03)**

{Spring 2019, Q# 6}

QUESTION-16

Financial statements of Zeta Traders (ZT) for the year ended 30 June 2019 is under preparation. Following information has been gathered in this respect:

(i) Trade receivables as at 30 June 2019:

	Rupees
Trade receivables	2,500,000
Provision for doubtful debts	(400,000)
Net trade receivables	2,100,000

It was noted that:

- an old outstanding balance of Rs.250,000 which was written off previously was settled during the year at 20% discount. The amount received was credited to trade receivables.
- purchase return amounting to Rs.500,000 was mistakenly debited to trade receivables.
- Rana and Sons having a balance of Rs.80,000 due for more than one year was declared bankrupt and its balance needs to be written off.

ZT maintains provision for doubtful debts:

- at 25% for balances outstanding for more than six months. As at 30 June 2019, such balances are aggregated to Rs.600,000 (excluding balance of Rana and Sons); and
- at 5% for the remaining balances

(ii) A cheque dated 25 June 2019 for Rs.150,000 was received from an insurance company and deposited by the owner in his personal bank account. The cheque was received in settlement of an inventory loss claim. Actual inventory loss was determined at Rs.180,000. No entries have been made for loss of inventory and insurance claim.

(iii) The opening balance of accumulated depreciation was brought forward as Rs.280,000 instead of Rs.820,000. The error was tried to be corrected with the difference by crediting accumulated depreciation and debiting depreciation expense.

(iv) Goods amounting to Rs.350,000 received from a supplier on 30 June 2019 were included in the year-end physical inventory count but recorded in purchases day book on 1 July 2019.

(v) Third party stock of Rs.500,000 lying on ZT premises has been included in ZT's year-end inventory.

(vi) ZT uses periodic inventory method.

Required:

(a) Prepare adjusting / correcting entries for the year ended 30 June 2019. (Narrations are not required) **(13)**

(b) Compute the net effect of the above on ZT's profit for the year ended 30 June 2019. **(03)**

(Autumn 2019, Q# 07)

Scanned with CamScanner

QUESTION-17

Following draft statement of financial position as on 31 December 2019 of Naltar Establishment (NE) is under review:

Assets	Rs. in '000	Equity & liabilities	Rs. in '000
Fixed assets – net	22,590	Opening capital	32,240
Current assets:		Net profit for the year	9,360
Stock	15,320		41,600
Trade receivables	19,730	**Current liabilities:**	
Drawings	1,400	Trade payables	17,332
Cash & bank	3,850	Other payables	2,680
	40,300	Suspense account	798
		Discount received	480
			21,290
	62,890		**62,890**

The following matters are identified:

(i) Goods costing Rs. 5,800,000 received on 31 December 2019 were included in the year-end physical count. However, these goods were recorded in purchases day book on 5 January 2020 on receipt of the invoice.

(ii) Year-end physical count sheets include a third party stock of Rs. 1,320,000.

(iii) Goods sold on credit at a trade discount of 10% were recorded at gross amount of Rs.6,400,000.

(iv) An unidentified credit of Rs. 294,000 appearing in the bank statement was accounted for in the suspense account. It was discovered that the credit was a settlement of an old outstanding balance previously written off. The amount was net of 2% bank charges.

(v) A cheque of Rs. 500,000 issued by a customer as an advance was dishonored and returned by the bank on 31 December 2019. No entry was made on return of cheque.

(vi) Operating expenses include insurance premium of Rs. 900,000 paid during the year, out of which Rs. 200,000 pertain to owner's residential premises. The policy is valid up to 30 June 2020.

(vii) An upgradation of a plant to improve quality and efficiency was completed on 1 July 2019 at a cost of Rs. 2,500,000. The cost was charged to repair and maintenance expense.

(viii) Total sales of 26 December 2019 as per sales day book was Rs. 167,000. This was posted in trade receivable control account as Rs. 671,000. Trial balance was balanced by taking the difference to the suspense account.

Other information:

NE uses periodic stock method. The plant is depreciated at 20% using diminishing balance method.

Required:

Prepare corrected statement of financial position as on 31 December 2019. **(17)**

(Spring 2020, Q # 08)

Scanned with CamScanner

ICAP PAST PAPER SOLUTIONS

Note: In all of the solutions original and wrong entries are only prepared for the understanding of students. These are not required in exam solution. However, students may prepare these entries in working.

Answer-1

Rectifying	Original	Wrong
(i) Creditors A/c 3,700 Purchases A/c 3,700		Purchases a/c 3,700 Creditors a/c 3,700
(Entry for purchase of goods passed before the receipt of goods, now being reversed)		
(ii) Debtors a/c 1,850 Bank a/c 1,850	Debtors a/c 1,850 Bank a/c 1,850	
(Entry for dishonoured omitted, now being passed)		
(iii) Equipment a/c 15,200 Purchases a/c 15,200	Equipment a/c 15,200 Payable/cash 15,200	Purchase a/c 15,200 Payable/cash 15,200
(Fixed assets purchased wrongly debited to purchase account, now being rectified)		
Depreciation a/c 1,520 Acc. Dep. a/c 1,520	Depreciation a/c 1,520 Acc. Dep. a/c 1,520	
(Entry for the depreciation of the above mentioned asset)		
(iv) Suspense a/c 1,114 Creditors a/c 1,114	Purchases a/c 197 Creditors a/c 197	Purchases a/c 197 Creditors a/c 917
(Purchased invoice of 197 wrongly debited to supplier account as 917)		
(v) Suspense a/c 650 Purchase Return a/c 650		
(purchase return book under casted, now rectified)		
(v) Suspense a/c 4,500 Furniture a/c 4,500		
(Opening balance wrongly brought forward, now rectified)		
Acc. Dep. a/c 450 Depreciation a/c 450		
(Depreciation on excess balance reversed)		
(vii) Creditor a/c 730 Debtor a/c 730		
(Balance in purchase ledger set off against the balance in sales ledger)		

Statement showing adjustments in profits

Un adjusted Profit	956,180
Less:	
Depreciation	1,520
	(1,520)
Add:	
Purchases	3,700
Purchases	15,200
Purchase return	650
Depreciation	450
	20,000
Adjusted profit figure	974,660

Scanned with CamScanner

Answer-2

	Rectifying		Original		Wrong	
(i)	Creditor	12,000	Creditor	12,000	Purchase	1,080
	Suspense	9,720	Dis. Received	1,200	Bank	10,800
	Discount received	1,200	Bank	10,800		
	Purchase	1,080				
(ii)	Bad debt	15,000	Bad debt	15,000	No entry	
	Debtor	15,000	Debtor	15,000		
(iii)	Suspense	3,500	Commission exp.	3,500	Party a/c	3,500
	Party a/c	3,500	Bank	3,500	Commission exp.	3,500
					Bank	3,500
(iv)	Sale	4,500	Purchases	4,500	Debtor	4,500
	Debtor	4,500	Creditors	4,500	Sale	4,500
	Purchases	4,500				
	Creditors	4,500				
(v)	Salaries a/c	13,860				
	Suspense	13,860				
(vi)	Debtor	600	Cash	600	Cash	600
	Bad debt rec.	600	Bad debt rec.	600	Debtor a/c	600
(vii)	Debtor a/c	1,800	Sale Return	4,600	Purchase a/c	4,600
	Sale return	4,600	Debtor	4,600	Debtor a/c	6,400
	Purchase	4,600				
	Suspense	1,800				
(viii)	Discount allowed	1,500				
	Suspense a/c	1,500				
(ix)	Mr. Anwar a/c	7,300	Cash	7,300	Cash	7,300
	Sale	7,300	Sale	7,300	Mr. Anwar a/c	7,300
(x)	Bank	14,800	Bank	17,400	Discount all.	17,400
	Discount all.	14,800	Discount all.	2,600	Bank	2,600
			Debtor	20,000	Debtor	20,000

Provision for doubtful debt	490	
P/L a/c		490
	9,800 x 5%	

(W-1)

Debtor a/c

	Rs.		Rs.
Bade debt receivable	600	Bad debt	15,000
Suspense	1,800	Sales	4,500
Sales	7,300		
Bal. c/d	9,800		

Scanned with CamScanner

Answer-3

	Rectifying		Original		Wrong	
(i)	Suspense a/c	16,160				
	Purchase Return	16,160				
(Purchase return day book total had not been posted to the ledger)						
(ii)	Suspense a/c	22,640	Creditor	11,320	Creditor	11,320
	Disc. allowed	11,320	Dis. Received	11,320	Dis. Allowed	11,320
	Discount received	11,320				
(Discount received had been wrongly debited to discount allowed account)						
(iii)	Suspense a/c	10,000				
	Sales a/c	10,000				
(Sales account added short now being rectified)						
(iv)	Suspense a/c	1,500	Bank	1,500	Bank	1,500
	Acc. Dep.	5,800	Acc. Dep.	5,800		
	Asset-cost	7,000	Asset-cost	7,000		
	P/L (bal.)	300	Gain on disposal	300		
(Disposal of fixed asset only debited to bank account)						
(v)	Debtors(1,740+1,470)	3,210	Debtors	1,470	Debtors	1,740
	Suspense ac	3,210	Sale	1,470	Sale	1,470
(Credit sale of 1,470 credited to debtors account as 1,740)						
	Bad Debts	1,560	Bad Debts	1,560		
	Debtors	1,560	Debtors	1,560		
(Bad debt expense not recorded)						
	Prov. For doubt ful debt	1,560				
	Bad debt	1,560				
	P & L (W)	1,744				
	Prov. For doubtful debt.	1,744				
(vi)	Closing stock	450				
	Trading a/c	450				
	(29,830-29,380)					
	Trading a/c	1,000				
	Closing stock	1,000				
(Errors in list of stock now being rectified)						

WORKINGS

Dr. Provision for doubtful debt Cr.

Bad debt		b/d	2,320
c/d (25,040 x 10%)	1,560	P & L (bal.)	1,744
	2,504		
	4,064		4,064

Dr. Debtors Cr.

Unadjusted balance	23,390	Bad debt	1,560
Suspense	3,210		
		Adj. cl. Bal.	25,040
	26,600		26,600

Scanned with CamScanner

Answer-4

	Rectifying		Original		Wrong	
(i)	Bad debt	15,000	Bad debt	15,000	x	
	Debtor	15,000	Debtor	15,000		
(ii)	Creditor	6,400	Sale return	4,600	Purchase	4,600
	Sale return	4,600	Debtor	4,600	Creditor	6,400
	Purchase	4,600				
	Debtor	4,600				
	Suspense	1,800				
(iii)	Suspense	8,000	Bank	8,000	Bank	8,000
	Debtor	8,000	Debtor	8,000		
	Debtor	10,000	Debtor	12,000	Debtor	2,000
	Sale	10,000	Sales	12,000	Sales	2,000
(iv)	Creditor-Zahid	3,800	Creditor Zahid	3,800	x	
	Debtor- Zahid	3,800	Debtor Zahid	3,800		
(v)	Purchases	13,600	Purchase	15,100	Purchase	1,500
	Creditor	10,000	Creditor	15,100	Creditor	5,100
	Suspense	3,600				
(vi)	Creditor-Hammad	32,000	Sale return	23,000	Purchase	23,000
	Sale- return	23,000	Debtor	23,000	Creditor	32,000
	Purchase	23,000				
	Debtor-Hamid	23,000				
	Suspense	9,000				
(vii)	Creditor	12,300			Purchase	12,300
	Purchase	12,300			Creditor	12,300
(vii)	Creditor	9,200	Furniture	20,800	Purchase	9,200
	Purchase	9,200	P/L (bal.)	11,200	Creditor	9,200
			Furniture-BV	22,800		
	Furniture	20,800	Payable for Asset	9,200		
	P/L (bal.)	11,200				
	Fur.-BV (W-1)	22,800				
	Payable for asset	9,200				
	Furniture	1,200				
	Depreciation	1,200				
	Depreciation	1,040				
	Furniture	1,040				
(ix)	Prov. For doubtful debts	15,000				
	Bad debts	15,000				
	P/L	17,220				
	Prov. for DD [2,220 (W-2)+15,000]	17,220				

Scanned with CamScanner

WORKINGS

(W-1) Book value of furniture at the time of disposal

Book value (opening as on 1.1.2011)	24,000
Less: Depreciation expense (30.6.2011) (24,000 x 10% x 6/12)	(1,200)
	22,800

(W-2) Increase/ (decrease) in provision required

Decrease in provision required	(44,400 x 5%)	2,220

Net increase / (decrease) in debtors

Adjustment (i)	(15,000)
Adjustment (ii)	(4,600)
Adjustment (iii)	(8,000)
Adjustment (iii)	10,000
Adjustment (v)	(3,800)
Adjustment (vii)	(23,000)
	(44,400)

As debtors are decreasing so provision will decrease.

Answer 5

Rectifying			Original			Wrong		
i) Plant and mach.	60,000		Plant and mach. 60.000			Wages	60,000	
Wages		60,000	Cash	60,000		Cash		60,000
Depreciation	8,250							
Accumulated dep. (60,000 x 15% x 11/12)		8,250						
ii) Creditor	15,000		Creditor		15,000	Purchase	1,350	
Suspense		12,150	Dis. Received		1,500	Bank		13,500
Discount received		1,500	Bank		13,500			
Purchase		1,350						
iii) Sale return	5,700		Sale return		5,700	Purchase	5,700	
Debtor	1,800		Debtor		5,700	Debtor		7,500
Purchase		5,700						
Suspense		1,800						
iv) Stock	450							
Trading a/c		450						
Trading a/c	1,000							
Stock		1,000						
v) Drawings	4,680		Drawings		4,680			
Purchases		4,680	Purchases		4,680			
vi) Suspense	10,000		Bank		10,000	Bank		10,000
Debtor		10,000	Debtor		10,000			
vii) Debtor	12,600		Debtor		14,000	Debtor	1,400	
Sale		12,600	Sale		14,000	Sale.		1,400

Scanned with CamScanner

viii) Sale return	12,000	Sale return	12,000	Purchase	12,000
Creditor	21,000	Debtor	12,000	Creditor	21,000
Suspense	9,000				
Purchases	12,000				
Debtor	12,000				
ix) No entry		Purchases	14,700	Purchases	14,700
		Creditor	14,700	Creditor	14,700
x) Bad debt	11,560	Bad debt	11,560		
Debtor	11,560	Debtor	11,560		
Provision for doubtful debt	11,560				
Bad debt	11,560				
P/L (W-1)	1,574				
Provision	1,574				

WORKINGS

(W-1)

Dr.	Provision for doubtful debt		Cr.
Bad debt	11,560	b/d	16,320
c/d ((W-2) 63,340 x 10%)	6,334	P & L (bal.)	1,574
	17,894		17,894

(W-2)

Dr.	Debtors		Cr.
Unadjusted balance	82,500	Adj vi	10,000
Adj iii	1,800	Adj viii	12,000
Adj vii	12,600	Bad debt	11,560
		Adj. cl. Bal.	63,340
	97,900		97,900

Answer 6

Rectifying		Original		Wrong	
(i) Creditor	11,000	Repair expense	3,000	Purchases	11,000
Purchases	11,000	Furniture	10,000	Creditor	11,000
		Payable to ABC	13,000		
Repair expense	3,000				
Furniture	10,000				
Payable to ABC Fur.	13,000				
Depreciation expense	1,000				
Furniture	1,000				
(10,000 x 10%)					

Scanned with CamScanner

CHAPTER-2

(ii)	Creditor	6,000	Furniture	8,750	Purchase	6,000
	Purchase	6,000	P/L (bal.)	2,250	Creditor	6,000
	Furniture	8,750	Furniture-BV	5,000		
	P/L (bal.)	2,250	Payable	6,000		
	Furniture-BV	5,000				
	Payable	6,000				
	Depreciation expense	375				
	Furniture	375				
	(8,750 - 5,000) x 10%					
(iii)	As title has passed so no entry is required for it.					
(iv)	Accumulated dep.	58,000	Accumulated dep.	58,000	Bank	15,000
	Suspense	15,000	Bank	15,000		
	P/L	3,000	P/L	3,000		
	Computer	70,000	Computer	70,000		
(v)	Sale return	13,000	Sale return	13,000	Purchase	13,000
	Creditor	31,000	Debtor	13,000	Creditor	31,000
	Suspense	18,000				
	Debtor	13,000				
	Purchases	13,000				
(vi)	Discount allowed	3,700	Discount allowed	3,700	Dis. Rec.	7,300
	Discount received	7,300	Debtor	3,700	Debtor	3,700
	Suspense	11,000				
(vii)	Creditor	12,000	Creditor	12,000	Purchases	1,080
	Suspense	1,080	Bank	10,800		
	Bank	10,800	Discount rec.	1,200		
	Discount rec.	1,200				
	Purchases	1,080				

Scanned with CamScanner

(b)

Unadjusted profit		679,000
Add:		
Purchases	(i)	11,000
Purchases	(ii)	6,000
Gain on sale of computer	(iv)	3,000
Sale return	(v)	13,000
Discount received	(vii)	1,200
Purchases	(vii)	1,080
		35,280
Less:		
Repair expense	(i)	3,000
Depreciation expense	(i)	1,000
Loss on exchange of furniture	(ii)	2,250
Depreciation expense	(ii)	375
Sale return	(v)	13,000
Discount allowed	(vi)	3,700
Discount received	(vi)	7,300
		(30,625)
		683,655

Answer-7

(a)

(Rs. In '000')

Rectifying		Original		Wrong	
(i) Debtor	3,000	Debtor	3,000	Creditor	3,000
Creditor	3,000	Sale	3,000	Sale	3,000
(Credit sales wrongly debited to creditor account)					
(ii) Heat & Light	3,000	Heat & Light	1,500	Heat & Light	1,500
Suspense	3,000	Cash	1,500	Cash	1,500
(Heat and light expense wrongly credited to heat and light account)					
(iii) Mr. A Gondal	8,000	Bank	8,000	Bank	8,000
Mr. I Gondal	8,000	Mr. I Gondal	8,000	Mr. A Gondal	8,000
(Cheque received from I Gondal wrongly credited to A Gonda)					
(iv) Prepaid Insurance	5,000				
Suspense	5,000				
(Prepaid insurance balance omitted from trial balance)					
(v) Purchase return	7,000				
Suspense	7,000				
(Purchase return over-casted)					

(b)

Dr. Suspense a/c Cr.

Difference in trial (361,500-346,500)	15,000	Heat & Light	3,000
		Prepaid Insurance	5,000
		Purchase return	7,000
	15,000		15,000

Scanned with CamScanner

(c) (i) Error of commission
(ii) Error of commission
(iii) Error of commission

(d)

Unadjusted profit	97,500
Less:	
Heat & Light	3,000
Purchase return	7,000
	(10,000)
Adjusted profit	87,500

(e)

Mr. XX
Balance Sheet
as on June 30, 2001

Capital and liabilities		
Capital		
Opening capital		194,000
Add: Net Profit (part-d)		87,500
Less: Drawings		-
		281,500
Current Liabilities		
Trade Creditors	(17,000+3,000)	20,000
Wages accrued		3,000
		23,000
Total		304,500
Assets		
Non-Current Assets		
Land and building		100,000
Less: Accumulated depreciation		(20,000)
Plant		120,000
Less: Accumulated depreciation		(30,000)
		170,000
Current Assets:		
Stocks		25,000
Debtors	(15,000+3,000)	18,000
Prepaid rent		4,000
Prepaid insurance		5,000
Bank		82,500
		134,500
Total		304,500

Scanned with CamScanner

Answer-8

(i)

Rectifying		Original		Wrong	
(a) Purchases	1,500				
Suspense	1,500				
(Purchase journal under casted)					
(b) Suspense	2,100	Sale return	1,050	Account Rec.	1,050
Account rec.	2,100	Account Rec.	1,050	Sale return	1,050
(Accounts receivable wrongly debited on sale return, instead of being credited)					
(c) Dis. Allowed	300	Dis. Allowed	300		
Suspense	300	Customer acc.	300	Customer acc.	300
(Discount allowed not debited to discount allowed account)					
(d) Insurance exp.	4,500				
Suspense	4,500				
(Prepaid insurance not brought forward)					

(ii)

Suspense a/c

Dr.			Cr.
Difference in trial (bal.)	4,200	Purchases	1,500
Account receivable	2,100	Discount allowed	300
		Insurance expense	4,500
	6,300		6,300

(iii)

		Effect on Profit
a)	Purchases under casted by Rs. 1,500	Decrease
f)	Discount allowed of Rs. 300 was not recorded	Decrease
g)	Insurance expense was understated by Rs. 1,500	Decrease

Answer-9

Rectifying		Original		Wrong	
(a) Acc. Dep.	140,000	Equipment	250,000	Equipment	205,000
P and L	15,000	Acc. Dep.	140,000	Cash (W-1)	205,000
Equipment	155,000	P and L (bal.)	15,000		
		Equipment	200,000	Dep.	20,000
		Cash (W-1.2)	205,000	Acc. Dep	20,000
Acc. Dep.	15,500	Dep.	25,000	Dep.	20,500
Dep. Exp. (155,000 x 10%)	15,500	Acc. Dep	25,000	Acc. Dep	20,500
(b) Stock	27,000				
Trading acc.	27,000				
Manufacturing acc.	37,000				
Store and spare	37,000				
(c) Purchases	138,750	Purchases	138,750		
Creditor	138,750	Creditor	138,750		

Scanned with CamScanner

(d)	Sale 15,000 Rec. for machine 15,000	Cash 15,000 Rec. for machine 15,000	Cash 15,000 Sale 15,000
(e)	Interest exp. (W-2) 1,950 Interest payable 1,950	Interest exp. 1,950 Interest payable 1,950	
(f)	Sale com. Payable 17,000 Sales com. Exp. 17,000	Sale com. Payable 17,000 Cash 17,000	Sale com. Exp. 17,000 Cash 17,000
(g)	Creditor 17,000 Bank 17,000	Creditor 17,000 Bank 17,000	
(As second cheque is not appearing in the BRS, it means that it has not been recorded, now being recorded)			

WORKINGS

(W-1) Cash paid on exchange

New asset cost	250,000
Less: TIA	(45,000)
	205,000

(W-2) Interest expense

Interest expense from April 1, 2007 to June 30, 2007	((W-2.2)65,000x12%x3/12)	1,950

(W-2.1) Principal repaid

Total amount paid		450,000
Interest expense from January 1, 2007 to March 31, 2007	(500,000x12%x3/12)	(15,000)
Principal repaid		435,000

(W-2.2) Balance amount payable

Total amount of loan		500,000
Repaid on March 31, 2007	(W-2.1)	(435,000)
Balance amount payable		65,000

Answer-10

Rectifying	Original	Wrong
Entry for (i) Advance for Mach. 450,000 Plant & Machinery 450,000	Advance for Mach. 450,000 Cash 450,000	Plant & Mac. 450,000 Cash 450,000
Entry for (ii) Plant & Machinery 300,000 Repair Expense 300,000	Plant & Machinery 3,000,000 Cash 3,000,000 (2,700,000+300,000)	Plant & Mac. 2,700,000 Repair Exp. 300,000 Cash 3,000,000
Entry for depreciation Accumulated Dep. 15,000 Dep. Exp. (W-1) 15,000	(complete data not available to pass these entries)	

Adjustment for depreciation

		(Excess)/ Less
Adj. (i) Excess depreciation charged		(45,000)
Adj.(ii) Less depreciation on machine installed	(450,000 x 10%)	30,000
Total excess depreciation to be reversed	(300,000 x 10%)	(15,000)

Scanned with CamScanner

Answer-11

Profit Reconciliation

Unadjusted Gross Profit		1,050,000
Add:	Purchases	25,000
	Purchases	10,000
	Purchases	2,083
	Purchases	24,500
	Cost of sales	15,000
Less:	Carriage inward	(10,000)
	Sales	(3,000)
	Sales	(30,000)
	Purchases	(60,300)
	Sales	(18,000)
Adjusted gross profit		**1,005,283**
Unadjusted net profit		650,000
Adjustment for gross profit		(44,717)
Add:	Gain on disposal	1,000
	Discount received	500
Less:	Salaries expense	(20,000)
	Office repairs	(2,083)
	Advertisement Expense	(25,000)
Adjusted net profit		**559,700**

Rectifying			Original			Wrong		
Adv. Expense	25,000							
Purchases		25,000						
Drawings	10,000							
Purchases		10,000						
Office repairs	2,083							
Purchases		2,083						
$2,500 \times \frac{100}{120}$								
Salaries expense	20,000							
Salaries payables		20,000						
Carriage inward	10,000							
Carriage inward payable		10,000						
Sales	3,000		Cash	3,000		Cash	3,000	
Furniture		2,000	Furniture		2,000	Sales		3,000
Gain on disposal		1,000	Gain on disposal		1,000			
Creditor	25,000		Creditor	25,000		Purchases	24,500	
Purchases		24,500	Cash		24,500	Cash		24,500
Disc. Received		500	Disc. Received		500			
Sales	30,000							
Suspense		30,000						
Purchases	60,300							
Suspense		60,300						
Sales	18,000							
Debtor		18,000						
Stock	15,000							
Cost of sales		15,000						
$18,000 \times \frac{100}{120}$								

Scanned with CamScanner

Answer-12

			Rupees
Unadjusted profit for the year			15,500,000
Adjustments:			
(i)	Add:	Opening Stock wrongly overvalued	3,600,000
		Undervaluation of Closing Stock	3,600,000
(ii)		Rectified Sales (550,000-550,000)	-
		Recording or purchase	(550,000)
(iii)	Add:	Rectification of Repairs Account	225,000
	Less:	Unrecorded depreciation (250,000-25,000) x 10% x 6 ÷ 12	(11,250)
(iv)	Less:	Debiting of prepaid Insurance	(740,000)
(v)	Add:	Rectification of purchase returns	400,000
			6,523,750
			22,023,750

Answer-13

Rectification Entries

(i)	Computer A/c	240	
	Purchases A/c		240
	Depreciation Exp.	16	
	Acc. Depreciation [240 x 20% x 4/12]		16
(ii)	Acc. Depreciation (w-1)	510	
	Sales A/c	700	
	P/L a/c		10
	Furniture A/c		1200
	Acc. Depreciation (w-1)	20	
	Depreciation Exp.		20
(iii)	Rental Income	225	
	Rent in Advance [900 ÷ 12 x 3]		225
(iv)	Bad Debts	180	
	Debtors		180
	Debtors	96	
	BDR Income		96
	Prov. For bad debts	8.4	
	P/L A/C [-84 x 5% = 8.4]		8.4
(v)	Rectification Entries	184	
	Bank A/c		184
	Discount Allowed Exp.		

Scanned with CamScanner

W-1

Accumulated Depreciation of Furniture

	Rs. (000)
Acc. Dep. till year end	530
Dep. of 2 months(1200 x 10% x $\frac{2}{12}$)	(20)
Acc. Dep. till disposal	**510**

W-2

	Rs. (000)
Gross Debtors	200
Less: Discount (4%)	(8)
Net Debtors	**192**

Original	Bank	192	
	Discount Allowed Exp	8	
	Debtors		200
Wrong	Discount Allowed Exp	192	
	Bank	8	
	Debtors		200

(b) Types of errors which a trial balance fails to disclose:

(i) Errors of commission
(ii) Errors of omission
(iii) Errors of principle
(iv) Compensating error
(v) Posting/Recording wrong amount in the books of primary (original) entry

Answer-14

Timothy Enterprises

Statement for ascertaining correct gross and net profit

	Gross Profit (Rs.)	Net Profit (Rs.)
Profits - as reported	**850,000**	**460,000**
(i) Reversal of purchase / Increase in closing stock	3,700	3,700
(ii) Misclassification of transportation costs	(2,000)	-
(iii) Error in stock sheet	(450)	(450)
(iv) Reversal of sales	(21,850)	(21,850)
Discount allowed	-	(1,150)
	(21,850)	(23,000)
(v) Goods used for repairs (4,500/1.25)	3,600	-
(vi) Office computer wrongly credited to purchases account	42,000	42,000
Depreciation on office computer (42,000×25%×9/12)		(7,875)
	42,000	34,125
(vii) Reversal of sales	(3,000)	(3,000)
Loss on sale of furniture	-	(2,000)
	(3,000)	(5,000)

Scanned with CamScanner

(viii)	Purchase returns recorded	6,700	6,700
	Sales returns reversed	6,700	6,700
(ix)	Goods withdrawn by owner	13,400	13,400
	Adjusted gross/net profit	4,680	4,680
		890,080	487,455

Answer-15

(a) General journal

	Description		Debit	Credit
			Rupees	
(i)	Suspense	42,000-24,000	18,000	
	Debtors			18,000
(ii)	Suspense		28,800	
	Purchases	32,000-23,000		9,000
	Creditors	23,000-3,200		19,800
(iii)	Trading / Cost of goods sold		13,000	
	Closing inventory			13,000
(iv)	Sales	94,000 - 49,000	45,000	
	Suspense			45,000
(v)	No entry			
(vi)	Suspense		8,200	
	Discount allowed			4,100
	Discount received			4,100
(vii)	Machine / Fixed assets		145,000	
	Purchases			145,000
	Trading / Cost of goods sold		145,000	
	Closing inventory			145,000
	Depreciation expense		3,625	
	Accumulated depreciation 145,000x10%x3/12			3,625
(viii)	Depreciation expense (W-1)		3,760	
	Accumulated depreciation			3,760
	Accumulated depreciation 142,800+80,000+3,760+4,720		231,280	
	Loss on disposal		38,720	
	Machine			270,000
(i)	Bank			
	Creditors	28,000+16,000	44,000	
(ii)	Debtors			44,000
	Bank		35,000	
(iii)	Bank charges			35,000
	Bank		3,100	
				3,100

W-1: Depreciation expense

		Rupees
Correct depreciation	127,200x 10%x8/12	8,480
Depreciation charged during the year	(127,200 - 80,000)x10%	(4,720)
		3,760

Scanned with CamScanner

(b) **Correct Gross Profit**

	Rupees
Given	854,000
(ii) Purchases overstated	9,000
(iii) NRV adjustment	(13,000)
(iv) Sales overstated	(15.000)
(v) Return inward overstated (99.000-82.000)	17,000
(v) Return outward understated (99,000-82,000)	17,000
Correct gross profit	869,000

Answer-16

(a) **Zeta Traders**

Adjusting/correcting entries

General journal

	Description	Debit	Credit
		------ Rupees ------	
(i)	Trade receivables	200,000	
	Bad debt expense/Bad debts recovered		200,000
	Trade payables	500,000	
	Trade receivables		500,000
	Provision for doubtful debts	80,000	
	Trade receivables		80,000
	Provision for doubtful debts (W-2)	94,000	
	Bad debt expense		94,000
(ii)	Abnormal loss (P&L)	180,000	
	Purchases		180,000
	Drawings	150,000	
	Abnormal loss (P&L)		150,000
(iii)	Suspense (820,000–280,000)	540,000	
	Depreciation expense		540,000
(iv)	Purchases	350,000	
	Trade payables		350,000
(v)	Trading account/COGS	500,000	
	Closing inventory		500,000

Scanned with CamScanner

WORKINGS

(W-1)

Debtor A/c

	Rs. '000		Rs. '000
Balance	2,500	Trade payable	500
Bad debt recovered	200	Bad debt	80
		Adjusted closing	2,120

(W-2)

Provision for doubtful A/c

	Rs. '000		Rs. '000
Bad debts expense	80	Opening	400
Profit or loss (Bal.)	94		
Closing	226		

Bad debt expense A/c

	Rs. '000		Rs. '000
Debtors	80	Provision for doubtful debt	80

(W-3) Calculation of closing provision

	Amount of Debt	Rate	Amount of provision
Specific provision older then 6 months	600	25%	150
Reaming (balancing)	1,520	5%	76
	2,120		226

(b) **Increase/ (decrease) in net profit**

		Rupees
(i)	Recovery of old outstanding balance previously written-off	200,000
	Adjustment for provision for doubtful debts (174 – 80)	94,000
(ii)	Insurance claim	150,000
(iii)	Correction in depreciation expense	540,000
(iv)	Purchases of 30 June 2019	(350,000)
(v)	Third party inventory	(500,000)
	Net increase in net profit	**134,000**

Scanned with CamScanner

Answer-17

Naltar Establishment

Statement of financial position as at 31 December 2019

		Rs. in '000
Assets		
Fixed assets - net	22,590 + 2,500 – 250	24,840
Current assets:		
Closing stock	15,320 – 1,320	14,000
Trade receivables	19,730 – 640 – 504	18,586
Prepayment		350
Cash & bank	3,850 – 500	3,350
		36,286
		61,126
Equity & liabilities		
Opening capital		32,240
Net profit for the year	(W-1)	5,174
Drawings	1,400 + 200	(1,600)
Net equity		35,814
Current liabilities:		
Trade payables	17,332 + 5,800	23,132
Other payables	2,680 – 500	2,180
Discount received	480 – 480	-
		25,312
		61,126

(W-1)		Rs. in '000
Corrected net profit for the year		9,360
Unadjusted profit		
Corrections:		
Add:	Other income	300
	Drawings	200
	Prepaid insurance	350
	Plant	2,500
	Discount received	480
Less:	Purchases	(5,800)
	Cost of sales	(1,320)
	Sales	(640)
	Bank charges	(6)
	Depreciation	(250)
Adjusted profit		**5,174**

Suspense Account

	Rs. in '000		Rs. in '000
Bad debt expense	300	Given	798
Debtor (671 – 167)	504	Bank charges	6

Scanned with CamScanner

ICAP QUESTION BANK QUESTION

Question 1

The accountant of Grant Company has prepared a trial balance, but has found that the total of debit balances is Rs.864,600 and the total of credit balances is Rs.862,150.

On investigation, he discovers the following errors in the book-keeping:

(1) Total purchases in the period were recorded at Rs.100 below their correct value, although the total value of trade payables was correctly recorded.

(2) Total telephone expenses were recorded at Rs.1,000 above their correct amount, although the total value of the amounts payable was correctly recorded.

(3) Purchase returns of Rs.550 were recorded as a debit entry in the sales returns account, but the correct entry had been made in the trade payables control account.

(4) Equipment costing Rs.2,000 had been recorded as a debit entry in the repairs and maintenance account.

(5) Rental expenses of Rs.5,490 were entered incorrectly as Rs.5,940 in the expense account but were entered correctly in bank account in the ledger.

(6) Bank charges of Rs.200 have been omitted entirely from the ledger.

(Note: Individual debtors and creditors accounts are maintained in the general ledger)

Required

(a) Prepare journal entries for the correction of the errors.

(b) Open a suspense account. Record the appropriate corrections in the suspense account, so that the balance on this account is eliminated.

(ICAP Example 21)

Question 2

A bookkeeper in error recorded the purchase cost of a new item of equipment as Rs.36,000 when it should have been Rs. 360,000.

A draft profit of Rs. 2,560,000 for the period was calculated before the discovery of the error. This included a depreciation charge of 10% (Rs. 3,600) for the equipment.

Required: What is the correct figure for profit?

(ICAP Example 27)

Question 3

A bookkeeper in error recorded the Rs. 60,000 purchase cost of a new machine as repairs and maintenance costs.

A draft profit of Rs. 300,000 for the period was calculated before the discovery of the error. Depreciation on machinery is charged at 20% on cost, with a full year's charge in the year of acquisition.

Required: What is the correct figure for profit?

(ICAP Example 28)

Scanned with CamScanner

Question 4

The bookkeeper has produced the following statement of financial position at 31 December for Smetena's Newsagents.

	Rs.	Rs.
Non-current assets		72,208
Current assets		
Inventory	18,826	
Trade receivables	26,216	
Drawings	8,260	
Suspense account	3,830	
Cash	700	
		57,832
		130,040
Capital account		50,224
Loan – L Franks 12%		20,000
Trade payables		26,782
Bank overdraft		14,634
Profit for year		18,400
		130,040

Jan Smetena, the proprietor, is unhappy with the statement of financial position and asks you to revise it. You discover the following.

(1) The suspense account balance represents the difference on the trial balance.

(2) The purchases day book total for October of Rs.4,130 was posted to the purchases account as Rs.4,310 although the correct entry was made to the payables ledger control account.

(3) Inventory sheets were overcast by Rs.2,000.

(4) Cash should be Rs.110.

(5) Fixtures and fittings account balance of Rs.4,600 has been omitted from the trial balance.

(6) Interest for a half year on the loan account has not been paid and no provision has been made for it.

Required:

(a) Show the journal entries to correct the above errors.

(b) Write up the suspense account.

(c) Draw up a revised statement of financial position at 31 December. Clearly show the adjustments to profit.

(ICAP Example 33)

Scanned with CamScanner

ICAP QUESTION BANK ANSWER

Answer-1

(a) The journal entries for the correction of the errors shall be prepared as follows:

Transaction		Debit	Credit
		Rs.	Rs.
1	Purchases	100	
	Suspense account		100
Correction of error: purchases under-stated by Rs.100.			
2	Suspense account	1,000	
	Telephone expenses		1,000
Correction of error: telephone expenses over-stated by Rs.1,000.			
3	Suspense account	1,100	
	Purchase returns		550
	Sales returns		550
Correction of error. Purchase returns of Rs.550 incorrectly recordedas a debit entry in sales returns.			
4	Equipment	2,000	
	Repairs and maintenance		2,000
Correction of error. Equipment purchase costs incorrectly recorded as repairs andmaintenance expenses			
5	Suspense account	450	
	Rent expenses		450
Correction of error: rent expenses over-stated by Rs.450.			
6	Interest expense	200	
	Bank account		200

(b) The appropriate corrections in the suspense account shall be as follows:

Transaction omitted from the ledger.

Suspense account

	Rs.		Rs.
Telephone expenses	1,000	Opening balance (864,600 – 862,150)	2,450
Purchase returns	550	Purchases	100
Sales returns	550		
Rent expenses	450		
	2,550		2,550

Scanned with CamScanner

Tutorial notes

(1) In the trial balance, total debits exceed total credits by Rs.2,450. A suspense account is therefore opened with a credit balance of Rs.2,450, to make the total debits and credits equal.

(2) It helps to think about the ledger account that needs correcting first, and then make the suspense account entry as the matching debit or credit. For example, since purchases were under-stated in the purchases account, the correction must be to increase the debit side of the purchases account by Rs.100. The matching double entry is a credit in the suspense account.

(3) You also need to recognise that one of the errors and the omission can be corrected without using a suspense account, because the error/omission has not made the total debits and credits unequal.

Answer-2

	Rs.
Draft profit	2,560,000
Add back: Depreciation incorrectly charged	3,600
	2,563,600
Deduct: Correct depreciation charge (10% * Rs. 360,000)	(36,000)
Adjusted figure for profit	2,527,600

Answer-3

	Rs.
Draft profit	300,000
Add back: Repair costs incorrectly charged	60,000
	360,000
Deduct: Depreciation charge (20% * Rs. 60,000)	(12,000)
Adjusted figure for profit	348,000

Answer-4

Part (a) Journal Entries

Date	Particulars	Dr. Rs.	Cr. Rs.
(2)	Suspense		180
	Purchases	180	
(3)	CGS		2,000
	Inventory	2,000	
(4)	Suspense		590
	Cash	590	
(5)	Fixture & fittings		4,600
	Suspense	4,600	
(6)	Interest expense		1,200
	Interest payable	1,200	

Part (b)

Suspense Account

b/d (balancing fig.)	3,830	Fixtures and fittings (5)	4,600
Purchases (2)	180		
Cash (4)	590		
	4,600		4,600

Scanned with CamScanner

Part (c)

SMETENA NEWSAGENTS
Statement of financial position (revised)

As on 31st December Rs.		Rs.	Rs.
Non- current assets (72,208+4,600)	(5)		6,808
Current assets			
Inventory (18,826-2,000)	(3)	16,826	
Trade Receivables		26,216	
Cash (700-590)	(4)	110	43,152
Total assets			119,960
Non – current liabilities			
Loan – L Franks			20,000
Current liabilities			
Bank overdraft		14,634	
Trade payables		26,782	
Accrued expenses		1,200	42,616
Total liabilities			62,616
Opening capital		50,224	
Profit	W	15,380	
Drawings		(8,260)	57,344
Total liabilities and capital			119,960

Working (W)

	Rs.
Profit (unadjusted)	18,400
Inventory overstated	(2,000)
Interest on loan	(1,200)
Purchases overstated	180
Net profit (adjusted)	15,380

Scanned with CamScanner

ICAP MULTIPLE CHOICE QUESTIONS (MCQs)

Q.1 Amna wrongly credited return inwards of Rs. 3,500 to returns outward although Receivable Account was correctly credited.

What will be the difference in trial balance prepared at the year end?

(a) Total of trial balance on the debit side will be Rs. 3,500 more than total of credit side
(b) Total of trial balance on credit side will be Rs. 3,500 more than the total of debit side
(c) Total of trial balance on the debit side will be Rs. 7,000 more than total of credit side
(d) Total of trial balance on credit side will be Rs. 7,000 more than the total of debit side

Q.2 For the year ended 31 December 2018 Ahmad showed a profit of Rs. 15,500.

It was further discovered; during the year he purchased a piece of equipment for Rs. 5,000. Transaction was recorded as Debit Repairs account and Credit Cash account. It is policy to depreciate equipment at 10% and charging full year's deprecation in the year of purchase.

What is the impact of correcting the error on statement of profit or loss for the year?

(a) Profit will be increased by Rs.5,000 (b) Profit will be reduced by Rs.5,000
(c) Profit will be increased by Rs.4,500 (d) Profit will be decreased by Rs.4,500

Q.3 Which of the following errors will require creating a suspense account?

(a) Repairs expense was considered a purchase of asset
(b) Purchase of inventory was considered purchase of non-current asset
(c) An invoice of Rs. 2,500 was totally omitted from the books
(d) Petty cash expenses of Rs. 500 were only credited to bank account

Q.4 Zahid granted only early settlement discount allowed of Rs. 1,500 to one of its customers. The discount amount was correctly entered in the account receivable control account but it was wrongly credited not discount allowed account.

In order to balance the trial balance at year end, what should be the balance of suspense account in trial balance?

(a) Rs. 3,000 Cr (b) Rs. 3,000 Dr
(c) Rs. 1,500 Dr (d) Rs. 1,500 Cr

Q.5 The suspense account shows a debit balance of Rs. 500.

Which of the following errors could be the cause of suspense?

(a) Overstatement of salaries expense by Rs.500
(b) Overcasting sales account by Rs.500
(c) Undercasting of sales by Rs.500
(d) Payment to supplier Rs.500 was wrongly omitted from records

Q.6 Interest expense of Rs. 100 has been wrongly debited to stationery expense.

What entry is required to correct the error?

(a) Dr Interest expense Rs.100; Cr Suspense Account Rs.100
(b) Dr Interest expense Rs.100; Cr Stationery expense Rs.100
(c) Dr Suspense Account Rs.100; Dr Interest expense Rs.100 Cr Stationery expense Rs.200
(d) Dr Suspense Account Rs.100, Cr Stationery expense Rs.100

Scanned with CamScanner

Q.7 Which of the following errors will not affect a trial balance?

(a) Rs.5,000 utility expenses were entirely omitted from recording
(b) Rent paid Rs.2,500 has been recorded as Rs.1,500 in rent account.
(c) Discount allowed Rs.100 has been credited to Discount received and credited to Accounts payable
(d) Cash paid Rs.3,000 for repair of equipment was credited to repairs account

Q.8 Which error will cause an entry in the suspense account?

(a) A transposition error when transferring a ledger account balance to the trial balance
(b) An error of commission where the wrong account is used for a transaction but it is the correct type of account
(c) An error of omission
(d) An error of principle

Q.9 The correction of which error requires an entry in the suspense account?

(a) A cheque, Rs.2,000, paid to Asif had been debited to Arif's account.
(b) A purchase of stationery, Rs.80, had been debited to the purchases account.
(c) Commission income, Rs.120, had been debited to a loan interest account.
(d) Salaries account had been undercast by Rs.300 and the entertainment account had been overcast by Rs. 300.

Q.10 A trial balance was extracted from the books of Nizam. It was found that debit side exceeded credit side. Following errors were identified;

(i) Purchases account was over-cast by Rs. 120,000.
(ii) An amount paid to Sajjad was debited to the control account as Rs. 98,000 instead of Rs.89,000.
(iii) Sales account was under-cast by Rs. 11,000.

What was the balance of suspense account before correction of errors?

(a) Rs.140,000 Cr
(b) Rs.140,000 Dr
(c) 0
(d) Rs.271,000

Q.11 The credit side of a business trial balance is Rs. 2,000 more than the debit side. Which one of the following could be the reason for that?

(a) Credit purchase of Rs. 6,000 was recorded in Purchase day book as Rs. 4,000
(b) Cash paid to supplier Rs. 2,000 was omitted from books
(c) Overpayment of Rs. 2,000 was received from a customer
(d) Credit sales of Rs. 7,000 was posted to account receivable control account as Rs. 5,000 while it was correctly entered in sales account

Q.12 A suspense account was opened when a trial balance failed to agree. The following errors were discovered afterwards:

(i) An electric bill of Rs. 620 had been recorded in the electric charges account as Rs.250
(ii) A discount allowed of Rs. 200 was wrongly credited to discount received account
(iii) Interest given by bank Rs. 450 was debited to bank account only

At what amount the suspense account should be shown in trial balance in order to make trail balance agree?

(a) Rs.320 Dr
(b) Rs.320 Cr
(c) Rs.120 Dr
(d) Rs.120 Cr

Scanned with CamScanner

Q.13 Trial balance of a business did not agree and a suspense account was created.

On investigation it was revealed that while posting insurance expense was posted as Rs.254,000 instead of Rs.245,000.

What entry is required to correct the error?

(a) Dr Suspense a/c Rs.9,000 Cr Insurance a/c Rs.9,000

(b) Cr Suspense a/c Rs.9,000 Dr Insurance a/c Rs.9,000

(c) Dr Insurance a/c Rs.245,000 Cr Cash a/c Rs.245,000

(d) Cr Insurance Rs.245,000 Dr Suspense Rs.245,000

Q.14 A sales return of Rs. 400 has been wrongly posted to the credit of the purchases return account, but has been correctly entered in the customer's account.

Which of the following will be the effects of the error?

(a) Profit for the year will be overstated by Rs.400

(b) Profit for the year will be overstated by Rs.800

(c) Credit side of the trial balance will be Rs.400 more than debit side

(d) Debit side of the trial balance will be Rs.800 more than credit side

Q.15 A company's trial balance failed to agree, the total being:

Debit	Rs.950,300
Credit	Rs.955,300

Which one of the following is the reason of this difference?

(a) Utilities expense of Rs.5,000 entirely omitted from recording

(b) Transportation in of Rs.5,000 is recorded as transportation out

(c) Discount received Rs.2,500 debited in error to the discount allowed account

(d) Discount allowed Rs.2,500 was wrongly recorded as discount received

Q.16 Following errors occurred in books of Majid & Co.

(1) Carriage inwards of Rs. 100 was debited to carriage outwards

(2) Purchase of inventory Rs. 5,000 was debited to repairs account

(3) Rent expense was Rs. 200 was credited to rent account.

What will be the balance of Suspense account?

Rs. _____

Q.17 A return inward of Rs. 180 has been wrongly recorded as carriage inwards and a repair expense of Rs. 250 was wrongly debited to salaries account. What is the impact on net profit of the correction of these errors?

(a) Rs. Nil (b) Rs. 180 Decrease

(c) Rs. 250 Decrease (d) Rs. 70 Decrease

Q.18 A suspense account was opened when a trial balance failed to agree. The following errors were discovered afterwards:

(i) A payment of Rs. 5,000 to a supplier was credited to his account

(ii) A return outwards of Rs. 400 was wrongly debited to return inwards account

(iii) Payment for establishment of petty cash fund by Rs. 1,000 was only credited to bank account

Scanned with CamScanner

At what amount the suspense account would have been created before correction of these errors?

(a) Rs. 5,400 Credit (b) Rs. 10,200 Debit
(c) Rs. 5,400 Debit (d) Rs. 10,200 Credit

Q.19 After extracting trial balance a business has identified following errors:

(i) Owner's home rent paid Rs. 1,500 has been debited to business rent account
(ii) Purchase of stationery Rs. 500 has been debited to machinery account. Depreciation rate is 10%
(iii) Freight paid Rs. 150 for inventory has been debited to stationery account Profit for the year before correction of these errors was Rs. 10,500.

What is the amount of corrected profit?

(a) Rs. 11,500 (b) Rs. 11,550
(c) Rs. 11,600 (d) Rs. 11,750

Q.20 A cash refund of Rs. 20,000 due to customer A was correctly treated in the cash book and then credited to the accounts receivable ledger of customer B.

At what amount the suspense account should be shown in trial balance in order to make trial balance agree?

(a) Rs. 20,000 debit (b) Rs. 20,000 credit
(c) Rs. 40,000 debit (d) Rs. 40,000 credit

Q.21 "Treating a revenue expense as a capital expenditure" is an example of?

(a) Compensating errors (b) Error of omission
(c) Error of commission (d) Error of principle

Q.22 If an effect of an error is cancelled by the effect of some other error, it is commonly known as

(a) Errors of principle (b) Errors of omission
(c) Compensating errors (d) Errors of commission

Q.23 Goods of Rs.100,000 purchased from Abbas Traders were recorded in sales book, the rectification of this error will

(a) Increase the gross profit (b) Reduce the gross profit
(c) Have no effect on gross profit (d) None of the given options

Q.24 What would be the total of the trial balance if a purchase return of Rs.84,000 has been wrongly posted to the debit of the sales return account, but had been correctly entered in the suppliers account?

(a) The credit side to be Rs.84,000 more than debit side
(b) The debit side to be Rs.84,000 more than credit side
(c) The credit side to be Rs.168,000 more than debit side
(d) The debit side to be Rs.168,000 more than credit side

Q.25 When opening stock is overstated, net profit for the accounting period will be

(a) Overstated (b) Understated
(c) No effect (d) None of the above

Q.26 Difference of totals of both debit and credit side of the trial balance is transferred to

(a) Difference account (b) Trading account
(c) Miscellaneous account (d) Suspense account

Scanned with CamScanner

Q.27 Goods purchased from supplier worth Rs.200,000, no entry made in purchases book is an example of;

(a) Error of posting (b) Error of omission
(c) Error of principle (d) Compensating errors

Q.28 Purchase of fuel for the car is capitalised to motor vehicles. It is a type of

(a) Error of posting (b) Error of omission
(c) Error of principle (d) Compensating errors

Q.29 A company incorrectly recorded a credit sales invoice of Rs. 45,000 as Rs. 54,000. What is the appropriate entry, the company should follow regarding the error of Rs. 9,000?

(a) Add Rs. 9,000 to its Cash account
(b) Sales (Dr) and Receivable (Cr) with Rs. 9,000
(c) Receivable (Dr) and Sales (Cr) with Rs. 9,000
(d) None of the above

Q.30 Which of the following account(s) will be affected, while rectifying the error of Carriage paid Rs. 50,000 for the newly purchased machinery mistakenly debited to carriage account?

(a) Only machinery account (b) Only carriage account
(c) Both carriage and machinery account (d) Only cash account

Q.31 If a cash sale is made for Rs. 400,000 and posted as follows:

Account	Debit	Credit
Sales	400,000	
Cash		400,000

What would be the correcting entry?

(a) Sales (debit) = Rs. 800,000 and Cash (credit) = Rs. 800,000
(b) Cash (debit) = Rs. 400,000 and Sales (credit) = Rs. 400,000
(C) Cash (debit) = Rs. 600,000 and Sales (credit) = Rs. 600,000
(d) Cash (debit) = Rs. 800,000 and Sales (credit) = Rs. 800,000

Q.31 Received cheque from debtor – Faraz worth Rs. 100,000 was treated as received from debtor-Sarfaraz. What would be correcting entry?

(a) Sales (debit) = Rs. 100,000 and debtor - Faraz (credit) = Rs. 100,000
(b) Debtor - Faraz (debit) = Rs. 100,000 and debtor – Sarfaraz (credit) = Rs. 100,000
(c) Debtor - Sarfaraz (debit) = Rs. 100,000 and debtor –Faraz (credit) = Rs. 100,000
(d) Sales (debit) = Rs. 100,000 and debtor – Sarfaraz (credit) = Rs. 100,000

Q.33 Which of the following errors will create balance in a suspense account?

(a) Repairs expense was considered as purchase of asset
(b) Purchase of inventory was considered as purchase of non-current asset
(c) An invoice of Rs. 2,500 was totally omitted from the books
(d) Petty cash expenses of Rs. 500 were only credited to bank account

Q.34 Office supplies purchased (and held in stock) were mistakenly debited to Purchases account. This type of error is called:

(a) error of omission (b) compensating error
(c) error of principle (d) error of transposition

Scanned with CamScanner

Q.35 While reviewing the draft financial statements of Sky Electronics (SE) for the year ended 31 December 2017, following error has been identified:
Computers costing Rs. 240,000 purchased on 1 September 2017 for office use were debited to purchases account. SE depreciates computers at 20% per annum using straight line method.
What would be the impact of correcting the above error on property, plant and equipment as at 31 December 2017?

(a) Increase by Rs. 240,000
(b) Increase by Rs. 224,000
(c) Increase by Rs. 200,000
(d) Increase by Rs. 192,000

Q.36 While reviewing the draft financial statements of Sky Electronics (SE) for the year ended 31 December 2017, following error has been identified:
Trade receivables include a balance of Rs. 180,000 which is irrecoverable but has not been written-off. Further, a recovery of Rs. 96,000 against receivables written off in prior years was credited to trade receivables. As per SE's policy, provision for doubtful receivables has already been made at 5% on year-end balance.
If the profit before correcting the above was Rs. 800,000, what would be amount of corrected profit?

(a) Rs. 716,000
(b) Rs. 720,200
(c) Rs. 711,800
(d) None of above

Q.37 While reviewing the draft financial statements of Sky Electronics (SE) for the year ended 31 December 2017, following error has been identified:
A cheque of Rs. 192,000 was received after a discount of 4% from a customer. The related revenue was recorded at gross amount. However, in the cash book, the amount received was entered in the discount allowed column and the amount of discount was entered in the bank column. SE does not maintain separate account for discount allowed and any revenue reversal is directly posted to Sales account.
What would be the correcting entry for above?

(a) Debit Bank Rs. 192,000 and Credit Sales Rs. 192,000
(b) Debit Bank Rs. 184,000 and Credit Sales Rs. 184,000
(c) Debit Sales Rs. 192,000 and Credit Bank Rs. 192,000
(d) Debit Sales Rs. 184,000 and Credit Bank Rs. 184,000

Q.38 Draft income statement of Timothy Enterprises (TE) for the year ended 31 December 2017 shows gross profit of Rs. 850,000 and net profit of Rs. 460,000.
It was subsequently discovered that an invoice of Rs. 3,700 was debited to purchases but the goods were received after year-end and were not included in the closing inventory.
Compute the corrected gross profit and net profit for the year.

(a) Gross Profit Rs. 846,300 & Net Profit Rs. 456,300
(b) Gross Profit Rs. 853,700 & Net Profit Rs. 463,700
(c) Gross Profit Rs. 850,000 & Net Profit Rs. 463,700
(d) Gross Profit Rs. 853,700 & Net Profit Rs. 460,000

Scanned with CamScanner

Q.39 Draft income statement of Timothy Enterprises (TE) for the year ended 31 December 2017 shows gross profit of Rs. 850,000 and net profit of Rs. 460,000.
It was subsequently discovered that transportation inward amounting to Rs. 2,000 was included in transportation outward.
Compute the corrected gross profit and net profit for the year.
(a) Gross Profit Rs. 848,000 & Net Profit Rs. 460,000
(b) Gross Profit Rs. 852,000 & Net Profit Rs. 462,000
(c) Gross Profit Rs. 848,000 & Net Profit Rs. 462,000
(d) Gross Profit Rs. 852,000 & Net Profit Rs. 458,000

Q.40 Draft income statement of Timothy Enterprises (TE) for the year ended 31 December 2017 shows gross profit of Rs. 850,000 and net profit of Rs. 460,000.
It was subsequently discovered that the sub-total of a closing stock sheet had been carried forward as Rs. 21,830 instead of Rs. 21,380.
Compute the corrected gross profit and net profit for the year.
(a) Gross Profit Rs. 850,450 & Net Profit Rs. 460,450
(b) Gross Profit Rs. 849,550 & Net Profit Rs. 459,550
(c) Gross Profit Rs. 850,450 & Net Profit Rs. 459,550
(d) Gross Profit Rs. 849,550 & Net Profit Rs. 460,450

Q.41 Draft income statement of Timothy Enterprises (TE) for the year ended 31 December 2017 shows gross profit of Rs. 850,000 and net profit of Rs. 460,000.
It was subsequently discovered that a receipt of Rs. 24,000 was credited to sales. The amount was received from a credit customer who availed a cash discount of Rs. 1,000 on this payment. It was already expected that this customer will avail the cash discount at the time of sale.
Compute the corrected gross profit and net profit for the year.
(a) Gross Profit Rs. 826,000 & Net Profit Rs. 436,000
(b) Gross Profit Rs. 874,000 & Net Profit Rs. 484,000
(c) Gross Profit Rs. 825,000 & Net Profit Rs. 435,000
(d) Gross Profit Rs. 875,000 & Net Profit Rs. 485,000

Q.42 Draft income statement of Timothy Enterprises (TE) for the year ended 31 December 2017 shows gross profit of Rs. 850,000 and net profit of Rs. 460,000.
It was subsequently discovered that purchase of office computer on 1 April 2017 amounting to Rs. 42,000 was entered in the purchase account. Depreciation on office computer is provided at the rate of 25%.
Compute the corrected gross profit and net profit for the year.
(a) Gross Profit Rs. 892,000 & Net Profit Rs. 491,500
(b) Gross Profit Rs. 892,000 & Net Profit Rs. 494,125
(c) Gross Profit Rs. 808,000 & Net Profit Rs. 491,525
(d) Gross Profit Rs. 808,000 & Net Profit Rs. 428,500

Q.43 Draft income statement of Timothy Enterprises (TE) for the year ended 31 December 2017 shows gross profit of Rs. 850,000 and net profit of Rs. 460,000.
It was subsequently discovered that goods having sales value of Rs. 4,500 were used for office repairs. No entry has been made in the books. TE uses periodic inventory method and goods are sold at cost plus mark up of 25%.
Compute the corrected gross profit and net profit for the year.

Scanned with CamScanner

(a) Gross Profit Rs. 853,600 & Net Profit Rs. 460,000
(b) Gross Profit Rs. 846,400 & Net Profit Rs. 464,500
(c) Gross Profit Rs. 854,500 & Net Profit Rs. 455,500
(d) Gross Profit Rs. 845,500 & Net Profit Rs. 459,100

Q.44 Draft income statement of Timothy Enterprises (TE) for the year ended 31 December 2017 shows gross profit of Rs. 850,000 and net profit of Rs. 460,000.
It was subsequently discovered that purchase return amounting to Rs. 6,700 has been recorded as sales return.
Compute the corrected gross profit and net profit for the year.
(a) Gross Profit Rs. 856,700 & Net Profit Rs. 467,700
(b) Gross Profit Rs. 863,400 & Net Profit Rs. 473,400
(c) Gross Profit Rs. 843,300 & Net Profit Rs. 453,300
(d) Gross Profit Rs. 836,600 & Net Profit Rs. 446,600

Q.45 Draft income statement of Timothy Enterprises (TE) for the year ended 31 December 2017 shows gross profit of Rs. 850,000 and net profit of Rs. 460,000.
It was subsequently discovered that the owner had withdrawn goods costing Rs. 4,680 for personal use. No entry has been made in the books. TE uses periodic inventory method and goods are sold at cost plus mark up of 25%.
Compute the corrected gross profit and net profit for the year.
(a) Gross Profit Rs. 854,680 & Net Profit Rs. 464,680
(b) Gross Profit Rs. 855,850 & Net Profit Rs. 465,850
(c) Gross Profit Rs. 845,320 & Net Profit Rs. 455,320
(d) Gross Profit Rs. 844,150 & Net Profit Rs. 454,150

Q.46 A cheque dated 25 June 2019 for Rs. 150,000 was received from an insurance company and deposited by the owner in his personal bank account. The cheque was received in settlement of an inventory loss claim. Actual inventory loss was determined at Rs. 180,000. No entries have been made for loss of inventory and insurance claim. The business uses periodic inventory method.
Which of the following effect would be part of correcting entry?
(a) Debit Abnormal loss Rs. 30,000
(b) Debit Drawings Rs. 150,000
(c) Credit Purchases Rs. 180,000
(d) All of above

Q.47 Goods amounting to Rs. 350,000 received from a supplier after proper inspection on 30 June 2019 were included in the year-end physical inventory count but recorded in purchases day book on 1 July 2019. The business uses periodic inventory method.
What would be appropriate correcting entry if the year-end is June 30, 2019?
(a) Trade payables Debit Rs. 350,000 and Purchases Rs. 350,000
(b) Drawings Debit Rs. 350,000 and Purchases Rs. 350,000
(c) Purchases Debit Rs. 350,000 and Trade payables Rs. 350,000
(d) None of above

Scanned with CamScanner

Q.48 Zeta Traders (ZT) has prepared its draft financial statements for the year ended on 30 June 2019. On review it was discovered that third party stock of Rs. 500,000 lying on ZT premises has been included in ZT's year-end inventory. ZT uses periodic inventory method.
What correcting entry is required?

(a) No entry is required.
(b) Inventory (debit) Rs. 500,000 and Cost of Sales (credit) Rs. 500,000
(c) Third party (debit) Rs. 500,000 and Purchase return (credit) Rs. 500,000
(d) Cost of Sales (debit) Rs. 500,000 and Inventory (credit) Rs. 500,000

Q.49 On 1 July 2021, a repair expense of Rs. 100,000 was debited to office machinery account. Depreciation of 15% has been recorded at year end of 31 December 2021. What will be impact of correcting above error on gross profit?

(a) Rs. Nil
(b) Rs. 100,000 Decrease
(c) Rs. 85,000 Decrease
(d) Rs. 92,500 Decrease

Q.50 Correct accounts, correct amounts but incorrect sides', which of the following type of error is indicated by preceding phrase?

(a) Error of commission
(b) Error of principle
(c) Error of original entry
(d) Complete reversal of entries

Scanned with CamScanner

ICAP MULTIPLE CHOICE QUESTIONS (MCQs) SOLUTIONS

A.1 (d) Instead of debiting returns inwards; returns outwards have been credited. Hence the effect of error is that credit side exceed by double amount Rs. 3,500x2 = Rs. 7,000

A.2 (c)

O		W		R	
Equipment	5,000	Repair	5,000	Equipment	5,000
Cash	5,000	Cash	5,000	Repair	5,000
				Dep. (5,000×10%)	500
				Acc. Dep.	500

A.3 (d) Suspense account is created when debit and credit side of trial balance are not equal. This does not arise when en entry is posted to incorrect account or totally omitted.

A.4 (b)

O		W	
Dis. Allowed	1,500	Suspense	3,000
Debtor	1,500	Debtor	1,500
		Dis. receive	1,500

A.5 (b) Sales are credit and over casting it is excess credit side (debit side short by Rs.500), so suspense account of Rs. 500 balance would be created.

A.6 (b)

O		W		R	
Interest exp.	100	Stationery	100	Interest	100
Cash	100	Cash	100	Stationary	100

A.7 (a) There is no impact on (a) on trial balance since no double entry has been recorded

A.8 (a) Any error while transferring balance of ledger account to trial balance would affect one balance (and one side) only, and suspense account would be created.

A.9 (c) Commission income is credited but it was incorrectly debited to interest account, creating a difference by double amount.

A.10 (a)
(i) Debit exceeds by Rs. 120,000
(ii) Debit exceeds by Rs. 9,000 (98,000 – 89,000)
(iii) Debit exceeds by Rs. 11,000
= 120,000 + 9,000 + 11,000 = Rs. 140,000 Cr

A.11 (d) Debit and credit sides of the entry are not equal hence suspense arises.

A.12 (a)

Suspense Account

Particular	Rs.	Particular	Rs.
Electricity bill (620 – 250)	370	Interest income	450
Discount allowed (200 × 2)	400		
		c/d	320

Scanned with CamScanner

A.13 (a)

O		W		R	
Insurance Exp.	245,000	Insurance Exp.	254,000	Suspense	9,000
Cash	245,000	Cash	245,000	Insurance	9,000

A.14 (b)

O		W	
Sales return	400	-	-
Debtor	400	Debtor	400
		Purchase return	400

Sales return for Rs.400 has not been recorded rather purchase return for Rs.400 has been wrongly recorded

- Sales return decreased profit
- Purchased return increased profit

A.15 (d)

O		W	
Discount allowed	2,500		
		Discount receive	2,500

A.16 Rs. 400 Suspense account is created when errors affect trial balance

Error (1) and (2) do not affect trial balance

Error (3) is single side error and affects trial balance with double amount as rent expense should have been debited and it was rather credited.

A.17 (a) The recording of return inwards (sales return) would have reduced the profit by Rs. 180, the same was effect of recoding carriage inwards (an expense), there is no effect of correction of this error on profit. Same reason for the other transaction.

A.18 (b)

(i) Double impact Rs. 10,000 debit side short

(ii) Double impact Rs. 800 credit side short

(iii) Rs. 1,000 debit side short

Net impact is = Rs. 10,000+1,000-800 = Rs. 10,200 debit

A.19 (b)

Owner's home rent is drawings not business expense, so expense shall be reversed. Impact of asset related error would be net of depreciation. Debiting one expense instead of other does not affect profit.

Corrected profit = Rs. 10,500 + 1,500 - (500 x 90%) = Rs. 11,550

A.20 (c) Effect on trial balance is double of the amount on debit side since amount has been posted on wrong side (credit side).

A.21 (d) Error of principle: Correct amount but wrong type of account.

A.22 (c) Compensating errors: Two or more errors balance each other out.

A.23 (b) Correction would reduce revenue and increase purchases (and cost of sales), both would reduce gross profit.

A.24 (d) Not recording purchase return (credit side short by Rs. 84,000) Recording incorrect sales return (credit side short by further Rs. 84,000)

Scanned with CamScanner

A.25 (b) Overstatement of opening stock would lead to overstatement of cost of salesresulting in understatement of gross profit and net profit.

A.26 (d) Suspense account is created temporarily for the difference in trial balance.

A.27 (b) Error of omission: Entry missed from the accounting records completely.

A.28 (c) Error of principle: Correct amount but wrong type of account.

A.29 (b) Receivables and sales both were overstated by Rs. 9,000.

A.30 (c) Machinery account shall be debited and carriage account shall be credited to correct the error.

A.31 (d) The error was complete reversal of entry. It has to be rectified by recording the double amount now.

A.32 (c) Receipt of cheque from customer does not affect sales. The relevant customer account should be credited for cheque received.

A.33 (d) Petty cash expenses of Rs. 500 were only credited to bank account, no account was debited that would cause trial balance to disagree resulting in suspense account.

A.34 (c) Error of principle: Correct amount but wrong type of account.

A.35 (b) Recording of computer would increase PPE by Rs. 240,000

Then depreciation of Rs. 16,000 (Rs. 240,000 x 20% x 4/12) would decrease PPE by year-end.

The net increase would be by Rs. 224,000

A.36 (b) Bad debts expense Rs. 180,000 would decrease profit. Recovery of bad debts Rs. 6,000 would increase profit.

Receivables would decrease by Rs. 84,000 due to above two corrections (i.e. credited by 180,000 and debited by Rs. 96,000)

Decrease in allowance for doubtful debts will increase profit by Rs. 4,200 (i.e. Rs. 84,000 x 5%).

Corrected profit = Rs. 800,000 – 180,000 + 96,000 + 4,200 = Rs. 720,200

A.37 (b) The revenue reversal should have been Rs. 8,000 (i.e. Rs. 192,000 x 4/96). Instead it was recorded at Rs. 192,000 (overstating the debit to revenue by Rs. 184,000).

Similarly, the bank should have been debited by Rs. 192,000 but it was debited by only Rs. 8,000, causing understatement of Rs. 184,000.

A.38 (b) Reversal of purchase would increase gross profit by Rs. 3,700 (same effect will carry to net profit).

A.39 (a) Recording of transportation inwards would increase cost of sales, hence, decreasing gross profit by Rs. 2,000. However, there would be nil impact on net profit (increase in transportation in expense and same decrease in transportation out expense).

A.40 (b) Decreasing the closing stock would increase cost of sales, resulting in decrease of gross profit by Rs. 450. The effect of gross profit shall carry to net profit as well.

A.41 (a) The receivable should have been credited by Rs. 24,000 and not sales. Therefore, now sales shall be debited resulting in decrease in gross profit and net profit. No impact of discount allowed is required as sales would have already been recorded at net amount.

A.42 (b) Purchases shall be reduced by Rs. 42,000 (impact on GP and NP both). Depreciation of Rs. 7,875 (i.e. Rs. 42,000 x 25% x 9/12) would affect net profit only.

Scanned with CamScanner

A.43 (a) Correcting entry would be Repairs debit and Purchases credit by Rs. 3,600 (i.e. Rs. 4,500 / 125%). Gross profit would increase but there would be net impact on net profit of Rs. Nil.

A.44 (b) Recording of purchase return would increase GP and NP by Rs. 6,700. Also, reversal of sales return would increase GP and NP by further Rs. 6,700.

A.45 (a) The correcting entry would be Drawings debit and Purchases credit by Rs. 4,680. The reduction in purchase would increase gross profit and net profit. The drawings will decrease owner's capital but would not affect profit.

A.46 (d) The option (a) to (c) reflect complete correcting entry.

A.47 (c) The control of goods was taken on June 30, 2019, therefore, purchase should be recorded in year 2019 and not in next year. Purchases Debit Rs. 350,000 and Trade payables Rs. 350,000

A.48 (d) Third party stock is not stock of the entity. Simply record the reversal of inventory adjustment. Cost of Sales (debit) Rs. 500,000 and Inventory (credit) Rs. 500,000

A.49 (a) Repair expense and depreciation of office machinery will affect net profit but it has no effect on gross profit.

A.50 (d) Complete reversal of entries: Correct accounts and amounts but sides (debit & credit) reversed.

Scanned with CamScanner

IAS 20, IAS 23 and IAS 40 Non-Current Assets: Sundry Standards

3

IAS 20

LO 1	GOVERNMENT GRANT
LO 2	RECOGNITION OF GRANTS RELATED TO INCOME
LO 3	GRANTS RELATED TO ASSETS
LO 4	REPAYMENT OF GOVT GRANT
LO 5	DISCLOSURE RELATED TO GOVERNMENT GRANTS
LO 6	GOVERNMENT ASSISTANCE
LO 7	DISCLOSURE OF GOVT ASSISTANCE

IAS 23

LO 1	BORROWING COST
LO 2	QUALIFYING ASSETS
LO 3	SPECIFIC BORROWINGS
LO 4	GENERAL BORROWINGS
LO 5	COMMENCEMENT, SUSPENSION AND CESSATION OF CAPITALIZATION
LO 6	DISCLOSURES
LO 7	BASIC PRACTICE
LO 8	SOME TERMINOLOGIES
LO 9	SUMMARY

IAS 40

LO 1	INVESTMENT PROPERTY
LO 2	PARTLY OCCUPIED BUILDINGS
LO 3	TRANSFERS AND DISPOSALS OF INVESTMENT PROPERTY
LO 4	GAIN OR LOSS ON DISPOSAL
LO 5	DISCLOSURE REQUIREMENTS

Scanned with CamScanner

GOVERNMENT GRANTS IAS - 20

LO 1: GOVERNMENT GRANT

GOVERNMENT

Government grant are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of govt assistance which cannot reasonably have a value placed upon them and transactions with govt which cannot be distinguished from the normal trading transactions of the entity.
'Government' means Government, government agencies and similar bodies (Whether Local, National or International)

Types of Govt Grants

- Grants related to assets
- Grants related to income

GRANTS RELATED TO ASSETS

Are govt grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

GRANTS RELATED TO INCOME

Are govt grants other than those related to assets

Alternative names of govt grants

- Subsidies
- Subventions
- Premiums

When Govt Grants should be recognised

Govt grants should be recognised when there is a reasonable assurance that:

- The entity will comply with any conditions attaching to the grant and
- The grant will be received

General rules for Govt grant recognition

- Neither type (Income related & assets related) of grant should be credited directly to shareholders interests in the statement of financial position
- Each type of Govt grant must be reported on a systematic basis through the statement of comprehensive income over the period necessary to match them with their related costs

LO 2: RECOGNITION OF GRANTS RELATED TO INCOME

Grants related to income are of two types:

- Reimbursement of expenses already incurred; and
- Grants related to future expenses to be incurred.

Grants related to reimbursement of expenses already incurred are immediately recognized as income in profit or loss account when received.

Grants related to future expenses are recognized as deferred income and transferred to profit or loss account as grant income on the same basis as the related expense is incurred by the entity. This grant income is presented in profit and loss account under two methods:

Method I

Include the grant income for the period as "other income" for inclusion in profit or loss for the period.

Scanned with CamScanner

Example 1

A company receives a cash grant of Rs. 30,000 on 31.12.2018. The grant is towards the cost of training young scientists, and the training program is expected to last for 18 months from 1.1.2019.
Actual costs of the training were Rs. 50,000 in 2019 and Rs. 25,000 in 2020

Required:

(a) Prepare journal entries related to govt grant recognition

(b) Prepare balance sheet and income statement extracts for 2018, 2019 and 2020

Solution

		DR	CR.
31.12.18	Bank A/c	30,000	
	Deferred income A/c		30,000
31.12.19	Training cost A/c	50,000	
	Bank A/c		50,000
31.12.19	Deferred income account	20,000	
	Govt grant income account $\left(\frac{50000}{75000} \times 66.67\%\right)$ $(30000 \times 66.67\%)$		20,000
31.12.20	Training cost account	25,000	
	Bank account		25,000
31.12.20	Deferred income account	10,000	
	Govt grant income account $\left(\frac{25000}{75000} \times 33.33\%\right)$ $(30000 \times 33.33\%)$		10,000

Extract of Income Statement

	2020	2019	2018
G.P	10,000	20,000	-
Add other income	(25,000)	(50,000)	-
Less operating expenses training cost			

Extract of Balance Sheet

	2020	2019	2018
Non current liability deferred income	-	-	10,000
Current liability deferred income	-	10,000	20,000

Method 2

Deduct the grant income for the period from the related expense.

Example 2

A company receives a cash grant of Rs. 30,000 on 31.12.18 the grant is towards the cost of training young scientists and training program is expected to last for 18 months from 1.1.18.
Actual cost of the training were Rs. 50,000 in 2019 and Rs. 25,000 in 2020.

Required:

(a) Prepare journal entries related to govt grants recognition.

(b) Prepare Balance Sheet and Income Statement extracts.

Solution

31-12-18	Bank account		
	Deferred Income Account	30,000	
			30,000

Scanned with CamScanner

31-12-19	Training cost account	50,000	
	Bank account		50,000
31-12-19	Deferred Income account	20,000	
	Training cost account $\left(\frac{50000}{75000} \times 100 = 66.67\%\right)$ (30000 × 66.67%)		20,000
31-12-20	Training Cost Account	25,000	
	Bank Account		25,000
31-12-20	Deferred Income	10,000	
	Training Cost Account (30,000 × 33.33%)		10,000

Income Statement Extracts

	2020	2019	2018
G.P	Xx	xx	xx
Less Operating Expenses			
Training expenses	(15,000)	(30,000)	-

Balance Sheet Extracts

	2020	2019	2018
Non Current Liability	-	-	-
Deferred Income	-	-	10,000
Current Liability	-	-	-
Deferred Income	-	10,000	20,000

LO 3: GRANTS RELATED TO ASSETS

Grants related to assets are accounted for under two methods:

Method 1

Deduct the grant from the cost of the related assets, the assets is included in the statement of financial position at cost minus the grant. Depreciate the net amount over the useful life of the assets.

Example 3

A company receives a govt grant of Rs. 400,000 towards the cost of an asset with a cost of Rs. 1,000,000. The asset has an estimated useful life of 10 years and no residual value.

Required:

(a) Prepare Journal Entries for first 3 years of assets life.

(b) Prepare Income Statement, and Balance Sheet extracts of first 3 years.

Solution

(a) Year 1

	Dr.	Cr.
Fixed Assets Account	1,000,000	
Bank Account		1,000,000
Bank Account	400,000	
Govt Grant Account		400,000
Govt Grant Account	400,000	
Fixed Assets Account		400,000
Depreciation Expenses Account	60,000	

Scanned with CamScanner

Accumulated Depreciation Account $\left(\frac{1,000,000-400,000}{10} = 60,000\right)$		60,000
Year 2		
Depreciation Expenses Account	60,000	
Accumulated Depreciation Account		60,000
Year 3		
Depreciation Expenses Account	60,000	
Accumulated Depreciation		60,000

Income Statement Extract

	Year 3	Year 2	Year 1
Depreciation Expenses	60,000	60,000	60,000
Balance Sheet Extract			
Fixed assets cost	600,000	600,000	600,000
Less Accumulated Depreciation	(180,000)	(120,000)	(60,000)
WDV	-	-	-
	420,000	480,000	540,000

Method 2

Treat the grant as deferred income and recognised it as income on a systematic basis over the useful life of the asset.

Example 4

A company receives a government grant of Rs. 400,000 towards the cost of an asset with a cost of Rs.1,000,000. The assets has an useful life of 10 years and no residual value.

Required:

(a) Prepare Journal Entries for first 3 years of assets useful life.

(b) Prepare Income statement and balance sheet extracts of first 3 years of assets life.

Solution

	Dr.	Cr.
Year 1		
Bank Account		
Deferred Income Account	400,000	
Fixed Assets Account		
Bank Account		400,000
Deferred income	1,000,000	
Govt Grant Income $\left(\frac{400,000}{10}\right)$		1,000,000
Depreciation expense Account	40,000	
Accumulated depreciation Account $\left(\frac{1,000,000-0}{10}\right)$		40,000
Year 2	100,000	
Deferred Income Account		
Govt Grant Income		100,000
	40,000	
		40,000

Scanned with CamScanner

Depreciation Expense Account		
Accumulated Depreciation Account	1,000,000	
Year 3		1,000,000
Deferred Income Account		
Govt Grant Income	40,000	
Depreciation Expense Account		40,000
Accumulated Depreciation Account	100,000	
		100,000

Income Statement Extract

	Year 3	Year 2	Year 1
Gross Profit			
Add Other Income			
Govt. Grant	40,000	40,000	40,000
Depreciation Expense	(100,000)	(100,000)	(100,000)

Balance Sheet Extract

Assets	Year 3	Year 2	Year 2
Non-Current Assets			
Fixed assets cost	1,000,000	1,000,000	1,000,000
Less Accumulated depreciation	(300,000)	(200,000)	(100,000)
	700,000	800,000	900,000
Liabilities:			
Non-current liabilities			
Deferred income	240,000	280,000	320,000
Current liabilities			
Deferred income	40,000	40,000	40,000

LO 4: REPAYMENT OF GOVT GRANT

A govt grant might become repayable by the entity (e.g., when the entity fails to meet the underlying conditions for the grant)

When a govt grant becomes repayable it is accounted for as a change in accounting estimate (IAS - 8)

Repayment of a grant related to Income

- Repayment of grant related to income is applied in the first instance against any unamortised deferred credit recognised in respect of grant.
- If the repayment exceeds any such deferred credit any excess is recognised immediately in profit or loss.

Example 5

On 1.1.2018 X limited received a cash grant of Rs. 500,000 towards the cost of employing an environmental impact analyst on a new project for a 5 year period.

The grant is repayable in full if the project is not completed.

The analyst was employed and the project commenced on 1.1.18.

On 1.1.20 the project was abandoned and the grant became repayable in full.

Required:

Pass journal entries for grant and its repayment.

Scanned with CamScanner

Solution

		DR.	CR
1.1.18	Bank	500,000	
	Deferred Income		500,000
31.12.18	Deferred Income	100,000	
	Govt Grant Income		100,000
31.12.19	Deferred Income	100,000	
	Govt Grant Income		100,000
1.1.20	Deferred Income	300,000	
	Profit and Loss Account	200,000	
	Bank		500,000

Repayment of a Grant Related to an Assets

Case 1. Repayment of a grant related to an asset if grant was accounted for as a reduction in carrying amount of the related asset.

Case 2. Repayment of a grant related to an asset if grant was accounted for as deferred income.

In case 1 repayment is recognised by increasing the carrying amount of the asset.

Example 6

The Punjab Govt granted the company Rs. 10,000 on 1.1.2018 to assist in the purchase of a plant. The grant was conditional upon the company manufacturing for a period of atleast unbroken 2 years. The company purchased the plant on 2-1-2018 for Rs. 100,000 the plant is depreciated on the straight line basis over its useful life of 4 years to a nil residual value.

The company ceased manufacturing on 30-9-2019 due to unforeseen circumstances. The terms of the grant required that the grant be repaid immediately and in full. The asset was not considered to be impaired and the company intended to resume manufacturing in the next year,

Required:

Show the journal entries assuming that the company.

(a) Recognize grant as grant income.

(b) Recognize grant as reduction of asset's cost.

Solution

(a)

			DR.	CR.
1-1-2018	Bank		10,000	
	Deferred Grant Income			10,000
2-1-2018	Plant		100,000	
	Bank			100,000
31-12-18	Depreciation		25,000	
	Accumulated Depreciation	$\left(\frac{100,000-0}{4}\right)$		25,000
31-12-18	Deferred Grant Income		2,500	
	Govt Grant Income	$\left(\frac{10,000}{4}\right)$		2,500
31-9-2019	Depreciation		18,750	
	Accumulated depreciation	$\left(\frac{100,000-0}{4} \times \frac{9}{12}\right)$		18,750

Scanned with CamScanner

30-9-2019 Deferred Grant Income		1,875	
Govt Grant Income	$\left(\frac{10,000}{4} \times \frac{9}{12}\right)$		1,875
30-9-2019 Deferred Grant Income	(10,000 – 2,500 – 1,875)	5,625	
Grant forfeited expenses	(10,000 – 5,625)	4,375	
Bank			10,000

In case 2 repayment is recognised by reducing the deferred income balance by the amount payable and cumulative additional depreciation that would have been recognised in profit or loss to date in the absence of the grant must be recognised immediately in profit or loss

Note: The circumstances giving rise to repayment of the grant might indicate the possible impairment of the new carrying amount of the asset.

(b)

		DR.	CR.
1-1-18 Bank		10,000	
Deferred Grant Income			10,000
2-1-18 Plant		100,000	
Bank			100,000
2-1-18 Deferred Grant Income		10,000	
Plant			10,000
31-1-18 Depreciation		22,500	
Accumulated Depreciation	$\left(\frac{100,000-10,000-0}{4}\right)$		22,500
30-9-19 Depreciation		16,875	
Accumulated Depreciation	$\left(\frac{100,000-10,000-0}{4}\right) \times \frac{9}{12}$		16,875
30-9-19 Plant		10,000	
Bank			10,000
30-9-19 Depreciation		4,375	
Accumulated Depreciation	$\left(\frac{10,000}{4}\right) + \left(\frac{10,000}{4} \times \frac{9}{12}\right)$		4,375

(W – 1)

	Date	Calculation	Was	Is	Difference
Cost	1.1.18	100,000 – 10,000	90,000	100,000	10,000
Depreciation	31.12.18	$\frac{90,000-0}{4}$	(22,500)	(25,000)	(2,500)
		$\frac{100,000-0}{4}$			
WDV			67,500	75,000	7,500
Depreciation	30-9-19	$\left(\frac{90,000}{4}\right) \times \frac{9}{12}$	(16,875)	(18,750)	(1,875)
		$\frac{100,000}{4} \times \frac{9}{12}$	50,625	56,250	5,625

Scanned with CamScanner

LO 5: DISCLOSURE RELATED TO GOVERNMENT GRANTS

IAS 20 requires the following disclosures in the notes to the financial statements:

- The accounting policy adopted for government grants, including the method of presentation in the financial statements
- The nature and extent of government grants recognised in the financial statements and an indication of other forms of government assistance from which the entity has directly benefitted.
- Unfulfilled conditions and other contingencies attaching to government assistance (if this assistance has been recognised in the financial statements).

LO 6: GOVERNMENT ASSISTANCE

Govt assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria. govt assistance does not include benefits provided only indirectly through action affecting general trading conditions such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.

Forgivable Loans

A forgivable loan is treated as a government grant when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan. Until then, such a loan is treated as a liability and recognised at fair value under IFRS 9 (Financial Instruments).

Example 7

ABC Pharmaceutical Company received cash from government for a research and development project of a children vaccine.

Scenario 1

As per the terms of the loan, the cash received from the government shall be waived off if the entity is able to develop the vaccine within 3 years and sell it free of cost for 5 years.

If the entity takes more time than three years in the development or sells the vaccine for a price before 5 years, it will be liable to repay the loan and the loan will not be considered a forgivable loan.

Scenario 2

As per the terms of the loan, the cash received from the government is repayable in cash only if the entity decides to commercialize the results of the research phase of the project. If the entity decides not to commercialize the results of the research phase, the cash received is not repayable in cash, but instead the entity must transfer to the government the rights to the research.

In this scenario, cash received from the government does not meet the definition of a forgivable loan in IAS 20. This is because, in this arrangement, the government does not undertake to waive repayment of the loan, but rather to require settlement in cash or by transfer of the rights to the research. the cash receipt described in the submission gives rise to a financial liability to be dealt with under IFRS 9.

Loans with Below-Market Rate of Interest

- The benefit of a government loan at a below market rate of interest is treated as a government grant. The loan shall be recognized and measured as per IFRS 9.
- The benefit of below market rate of interest shall be measured as the difference between the cash receipt under a government loan and the fair value of the liability the benefit will be accounted for IAS 20.
- The entity shall consider the conditions and obligations to be met when identifying the costs which the benefit of the loan is intended to compensate.

Scanned with CamScanner

Non-monetary government grants

- A government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In such case, the fair value of the non- monetary asset should be assessed and to account for both grant and asset at that fair value.
- Alternatively, both asset and grant may be recorded at a nominal amount.

Exclusion From Definition

The definition of govt grants excludes

- Certain forms of govt assistance which cannot reasonably have a value placed upon them (e.g., free advice and the provision of guarantees) and
- Transaction with govt which cannot be distinguished from the normal trading transaction of the entity (e.g., a govt procurement policy that is responsible for a portion of entity's sales)

Accounting Treatment of Excluded Items

There is no specific accounting treatment for either of these.

LO 7: DISCLOSURE OF GOVT ASSISTANCE

Govt. assistants may be significant so that disclosure of the following are required in order to prevent the financial statements being misleading

- Nature of the assistance.
- Extent of the assistance.
- Duration of the assistance.

Scanned with CamScanner

PRACTICE QUESTIONS

Question-1

FCC Limited is a company that manufactures UPS. FCC Limited operates in the Natal Midlands and employs the local population to manufacture the UPS.

As a result of the positive effect that FCC Limited has had on an otherwise impoverished area, it was awarded a government grant of Rs. 150,000 on 1 January 20X6. This grant was given to FCC Limited to subsidise 20% of future wages.

FCC Limited had complied with all the conditions laid out to obtain the grant during the previous financial year (20X5). The only condition that remained on 1 January 20X6 is to incur future wages.

Wages incurred and paid:	**Rs.**
31 December 20X6	200,000
31 December 20X7	250,000
31 December 20X8	400,000

Required:

(a) Show the journal entries in the company's general journal, for the years ended 31 December 20X6 to 20X8, assuming that the company policy is to present such a grant as grant income.

(b) Show the journal entries in the company's general journal, for the years ended 31 December 20X6 to 20X8, assuming that the company policy is to recognise government grants as an adjustment to expenses.

Question-2

Daffodill Limited manufactures and sells toys for babies. They have been operating a profitable business for many years in the Amakanda area.

Due to a recent baby toy boom, Daffodill Limited found it needed to purchase new equipment. At the time, the directors discovered that the government was allocating grants to manufacturing companies operating in the Amakanda area. Daffodill Limited's directors applied for a grant.

On 1 January 20X5 Daffodill Limited was awarded a grant of Rs. 400,000 to purchase the much needed equipment. Daffodill Limited had met all the conditions of the grant by 31 December 20X4, apart from the actual acquisition of the equipment. Daffodill Limited purchased the equipment immediately on receipt of the grant (1 January 20X5).

The cost of acquiring the equipment was Rs.1,500,000. The useful life is expected to be 4 years. Daffodill Limited does not expect to receive any amount for the equipment at the end of its useful life.

Required:

(a) Show the general journal entries in the years ended 31 December 20X5, 20X6, 20X7 and 20X8. The company has the policy of recognising government grants directly in income.

(b) Show the general journal entries in the years ended 31 December 20X5, 20X6, 20X7 and 20X8. The company has the policy of recognising government grants indirectly in income.

Question-3

Potato Limited is a company that farms corn. Potato Limited is a relatively new company in the corn industry, having previously been in the gun manufacturing industry.

Potato Limited was awarded a government grant of Rs. 500,000 on 1 January 20X5, the details of which are as follows:

- Rs. 300,000 is to assist with the purchase of a new harvester;
- Rs. 200,000 is for immediate financial support and is not associated with any future costs;
- All conditions attaching to the grant have been met.

Scanned with CamScanner

Later that day, the harvester was acquired for Rs. 900,000. The harvester has a useful life of 5 years and. at the end of its useful life, Potato Limited expects to sell it for Rs. 50,000 as scrap metal.

Required:

(a) Show the general journal entries for the years ended 31 December 20X5 to 20X9 using the direct method (recognised as grant income).

(b) Show the general journal entries for the years ended 31 December 20X5 to 20X9 using the indirect method (recognised as a reduction of the related costs).

Question-4

Basit Limited is a newly formed company that is considering entering the ink business. Basit plans to manufacture ink and sell it to printers.

Due to the scarcity of businesses in the sector, Basit Limited was awarded a government grant to purchase the machinery it needed to start operations.

The grant was awarded Basit Limited on 1 January 20X6 for an amount of Rs. 250,000 and is conditional upon Basit manufacturing ink for an unbroken period of 3 years. Should Basit stop manufacturing before the end of the 3 year period, the grant will have to be repaid in full

Basit Limited purchased the requisite machinery on 1 January 20X6 for Rs. 500,000. The machinery is expected to have a useful life of 4 years and a nil residual value.

Due to unforeseen circumstances, Basit Limiated had to stop manufacturing ink on 1 January 20X8, but intends to continue on 1 January 20X9.

Required

(a) Show the general journal entries for the years ended 31 December 20X6 to 20X9 using the direct method (recognised as grant income).

(b) Show the general journal entries for the years ended 31 December 20X6 to 20X9 using the indirect method (recognised as a reduction of the related costs).

Scanned with CamScanner

PRACTICE SOLUTION

Solution-1

(a)

		Debit	Credit
1 January 20X6			
Bank		150,000	
Deferred grant income			150,000
Recognition of government grant			
31 December 20X6			
Staff costs		200,000	
Bank			200,000
Wages paid during the year			
31 December 20X6			
Deferred grant income	200,000 × 20%	40,000	
Grant income			40,000
Recognising grant income to the extent payments made			
31 December 20X7			
Staff costs		250,000	
Bank			250,000
Wages paid during the year			
31 December 20X7			
Deferred grant income	250,000 × 20%	50,000	
Grant income			50,000
Recognising grant income to the extent payments made			
31 December 20X8			
Staff costs		400,000	
Bank			400,000
Wages paid during the year			
31 December 20X8			
Deferred grant income	(400,000 x 20%) but limited to the balance in the deferred income account: 150,000 – 40,000 – 50,000	60,000	
Grant income			60,000
Recognising grant income to the extent payments made			

P.S. Staff costs are an employee benefit. The account could therefore also be called employee benefit expense: wages, if preferred.

(b)

	Debit	Credit
1 January 20X6		
Bank	150,000	
Deferred grant income		150,000
Recognition of government grant		
31 December 20X6		
Staff costs	200,000	
Bank		200,000
Wages paid during the year		

Scanned with CamScanner

31 December 20X6		
Deferred grant income 200,000 × 20%	40,000	
Staff costs		40,000
Recognising grant income to the extent payments made		
31 December 20X7		
Staff costs Given	250,000	
Bank		250,000
Wages paid during the year		
31 December 20X7		
Deferred grant income 250,000 × 20%	50,000	
Staff costs		50,000
Recognising grant income to the extent payments made		
31 December 20X8		
Staff costs Given	400000	
Bank		400,000
Wages paid during the year		
31 December 20X8		
Deferred grant income (400,000 × 20%) but limited to the balance in the	60,000	
Staff costs deferred income account: 150,000 – 40,000 – 50,000		60,000
Recognising grant income to the extent payments made		

P.S. Staff costs are an employee benefit. The account could therefore also be called employee benefit expense: wages, if preferred.

Solution-2

(a)

	Debit	**Credit**
1 January 20X5		
Bank	400,000	
Deferred grant income		400,000
Recognition of government grant		
Equipment: cost	1,500,000	
Bank		1,500,000
Purchase of equipment		
31 December 20X5		
Depreciation (1,500,000 – 0) / 4	375,000	
Equipment: accumulated depreciation		375,000
Depreciation charge for the year		
Deferred grant income (400,000 / 4)	100,000	
Grant income		100,000
Grant income recognised on the same basis as depreciation on the equipment		
31 December 20X6		
Depreciation (1,500,000 – 0)/4	375,000	
Equipment: accumulated depreciation		375,000
Depreciation charge for the year		
Deferred grant income (400,000/4)	100,000	
Grant income		100,000
Grant income recognised on the same basis as depreciation on the equipment		

Scanned with CamScanner

31 December 20X7		
Depreciation (1,500,000 – 0)/4	375,000	
Equipment: accumulated depreciation		375,000
Depreciation charge for the year		
Deferred grant income (400,000/4)	100,000	
Grant income		100,000
Grant income recognised on the same basis as depreciation on the equipment		
31 December 20X8		
Depreciation (1,500,000 – 0)/4	375,000	
Equipment: accumulated depreciation		375,000
Depreciation charge for the year		
Deferred grant income (400,000/4)	100,000	
Grant income		100,000
Grant income recognised on the same basis as depreciation on the equipment		

(b)

	Debit	Credit
1 January 20X5		
Bank	400,000	
Deferred grant income		400,000
Recognition of government grant		
Equipment: cost	1,500,000	
Bank		1,500,000
Purchase of equipment		
Deferred grant income	400,000	
Equipment: cost		400,000
Recognizing grant as reduction of equipment's cost		
31 December 20X5		
Depreciation (1,500,000 – 400,000 – 0)/4	275,000	
Equipment: accumulated depreciation		275,000
Depreciation on equipment		
31 December 20X6		
Depreciation (1,500,000 – 400,000 – 0)/4	275,000	
Equipment: accumulated depreciation		275,000
Depreciation on equipment		
31 December 20X7		
Depreciation (1,500,000 – 400,000 – 0)/4	275,000	
Equipment: accumulated depreciation		275,000
Depreciation on equipment		
31 December 20X8		
Depreciation (1,500,000 – 400,000 – 0)/4	275,000	
Equipment: accumulated depreciation		275,000
Depreciation on equipment		

Scanned with CamScanner

Solution-3

(a)

	Debit	Credit
1 January 20X5		
Bank	500,000	
Deferred grant income		500,000
Recognition of government grant		
Deferred grant income Given	200,000	
Grant income		200,000
Portion of the grant received for immediate financial support is recognised as income immediately		
Harvester: cost	900,000	
Bank		900,000
Purchase of harvester		
31 December 20X5		
Depreciation (900,000 – 50,000) /5	170,000	
Harvester: accumulated depreciation		170,000
Depreciation for the year		
Deferred grant income (500,000 – 200,000) /5	60,000	
Grant income		60,000
Grant income recognised on the same basis as depreciation		
31 December 20X6		
Depreciation (900,000 – 50,000) /5	170,000	
Harvester: accumulated depreciation		170,000
Depreciation for the year		
Deferred grant income (500,000 – 200,000) /5	60,000	
Grant income		60,000
Grant income recognised on the same basis as depreciation		
31 December 20X7		
Depreciation (900,000 – 50,000) /5	170,000	
Harvester: accumulated depreciation		170,000
Depreciation for the year		
Deferred grant income (500,000 – 200,000) /5	60,000	
Grant income		60,000
Grant income recognised on the same basis as depreciation		
31 December 20X8		
Depreciation (900,000 – 50,000) /5	170,000	
Harvester: accumulated depreciation		170,000
Depreciation for the year		
Deferred grant income (500,000 – 200,000) /5	60,000	
Grant income		60,000
Grant income recognised on the same basis as depreciation		
31 December 20X9		
Depreciation (900,000 – 50,000) /5	170,000	
Harvester: accumulated depreciation		170,000
Depreciation for the year		

Scanned with CamScanner

Deferred grant income (500,000 – 200,000) /5	60,000	
Grant income		60,000
Grant income recognised on the same basis as depreciation		

(b)	Debit	Credit
1 January 20X5		
Bank	500,000	
Deferred grant income		500,000
Recognition of government grant		
Deferred grant income	200,000	
Grant income		200,000
Portion of grant for immediate financial support is recognised as income immediately		
Harvester: cost (asset)	900,000	
Bank		900,000
Purchase of harvester		
Deferred grant income (500,000 – 200,000)	300,000	
Harvester: cost (asset)		300,000
Grant set off against cost of harvester		
31 December 20X5		
Depreciation (900,000 – 300,000 – 50,000) /5	110,000	
Harvester: accumulated depreciation		110,000
Depreciation for the year		
31 December 20X6		
Depreciation (900,000 – 300,000 – 50,000) /5	110,000	
Harvester: accumulated depreciation		110,000
Depreciation for the year		
31 December 20X7		
Depreciation (900,000 – 300,000 – 50,000) /5	110,000	
Harvester: accumulated depreciation		110,000
Depreciation for the year		
31 December 20X8		
Depreciation (900,000 – 300,000 – 50,000) /5	110,000	
Harvester: accumulated depreciation		110,000
Depreciation for the year		
31 December 20X9		
Depreciation (900,000 – 300,000 – 50,000) /5	110,000	
Harvester: accumulated depreciation		110,000
Depreciation for the year		

Scanned with CamScanner

Solution-4

(a)

	Debit	Credit
1 January 20X6		
Bank	250,000	
Deferred grant income		250,000
Recognition of government grant		
Machinery: cost	500,000	
Bank		500,000
Purchase of machinery		
31 December 20X6		
Depreciation (500,000 – 0) /4	125,000	
Machinery: accumulated depreciation		125,000
Depreciation for the year		
Deferred grant income (250,000 /4)	62,500	
Grant income		62,500
Recognised on same basis as depreciation		
31 December 20X7		
Depreciation (500,000 – 0) /4	125,000	
Machinery: accumulated depreciation		125,000
Depreciation for the year		
Deferred grant income (250,000 /4)	62,500	
Grant income		62,500
Recognised on same basis as depreciation		
1 December 20X8		
Deferred grant income (250,000 – 62,500 – 62,500)	125,000	
Grant forfeited expense Balancing	125,000	
Bank Given		250,000
Grant forfeited, first reduce deferred grant income then expense rest		
31 December 20X8		
Depreciation (500,000 – 0) /4	125,000	
Machinery: accumulated depreciation		125,000
Depreciation for the year		
31 December 20X9		
Depreciation (500,000 – 0) /4	125,000	
Machinery: accumulated depreciation		125,000
Depreciation for the year		

(b)

1 January 20X6		
Bank	250,000	
Deferred grant income		250,000
Recognition of government grant		
Machinery: cost	500,000	
Bank		500,000
Purchase of machinery		

Scanned with CamScanner

Deferred grant income	250,000	
Machinery: cost (asset)		250,000
Recognising grant as a reduction of asset's cost		
31 December 20X6		
Depreciation (500,000 – 250,000 – 0) /4	62,500	
Machinery: accumulated depreciation		62,500
Depreciation for the year		
31 December 20X7		
Depreciation (500,000 – 250,000 – 0) /4	62,500	
Machinery: accumulated depreciation		62,500
Depreciation for the year		
1 December 20X8		
Machinery: cost	250,000	
Bank		250,000
Depreciation	125,000	
Machinery: accumulated depreciation W1: (250,000 – 125,000)		125,000
Repayment of government grant and change in estimated depreciation		
31 December 20X8		
Depreciation (500,000 – 0) /4	125,000	
Machinery: accumulated depreciation		125,000
Depreciation for the year		
31 December 20X9		
Depreciation (500,000 – 0) /4	125,000	
Machinery: accumulated depreciation		125,000
Depreciation for the year		

WORKING 1:

Change in Estimate

	Date	Calculations	Was	Is	Difference
Cost	1/1/20X6	500,000 – 250,000	250,000	500,000	250,000
Depreciation	20X6 & 20X7	(250,000 – 0) / 4 × 2	(125,000)	(250,000)	(125,000)
Carrying amount	31/12/20X7	(500,000 – 0) / 4 × 2	125,000	250,000	125,000
Depreciation	20X8	(250,000 – 0) /4 × 1	(62,500)	(125,000)	(62,500)
Depreciation	Future	(500,000 – 0) /4 × 1	(62,500)	(125,000)	(62,500)
Residual value	31/12/20X9	(250,000 – 0) /4 × 1	0	0	0
		(500,000 – 0) /4 × 1			
		Given			

It is interesting to note that the change in estimate is calculated on a cumulative catch-up basis, rather than a reallocation basis suggested by IAS 8. This cumulative approach is required in IAS 20.32.

Scanned with CamScanner

ICAP PAST PAPER QUESTIONS

QUESTION-1

Discuss how the following should be dealt with in the financial statements of relevant entities according to IAS 20 Accounting for Government Grants and Disclosure of Government Assistance:

(a) The government makes a grant to an entity which is planning to develop teaching software for children with learning difficulties. The purpose of the grant is to help the entity to meet its general financing requirement in the initial phase. There are no further conditions attached to the grant. **(01)**

(b) A manufacturing entity sets up a plant in an area of high unemployment. A government grant of Rs.4 million is received with a condition that the grant is repayable in full if the number of its employees fell below 100 at any time during the next four years. It is highly probable that the entity will comply with the condition attached to the grant. **(03)**

(c) Free technical advice has been provided by the government's export promotion department to help an exporter to market his new technology in North America. **(01)**

{Autumn 2019, Q #2}

QUESTION-2

On 1 July 2014, Indus Pharma Limited (IPL) received a government grant of Rs.280 million to setup a plant in an under-developed rural area. The grant is repayable in full if the conditions attached to the grant are not met for a period of five years from the date of commencement of the production. At the inception, it was highly probable that IPL would comply with the conditions for the required period.

IPL incurred total cost of Rs.630 million on plant and it started production on 1 January 2015. Useful life of the plant was estimated at 7 years. IPL deducted government grant in arriving at the carrying amount of the asset.

In January 2019, IPL showed its inability to comply with the conditions attached to the grant and regulatory authority issued a notice to IPL for repayment of the grant in full. Accordingly, the grant was repaid by IPL.

In view of repayment of the grant, IPL carried out an impairment review of the plant on 31 December 2019. Net annual cash inflows for the remaining life of the plant have been estimated at Rs.90 million and Rs.80 million for 2020 and 2021 respectively. These cash inflows are net of annual interest and maintenance cost of Rs.10 million and Rs.6 million respectively for both years. Applicable discount rate is 12%.

On the date of impairment review, the existing plant can be sold in the local market for Rs.160 million. Estimated cost of disposal would be Rs.5 million.

Required:

Prepare journal entries for the year ended 31 December 2019 in respect of the above information. ***(Show all necessary workings. Narrations are not required)*** **(08)**

(Autumn 2020 Q 3)

Scanned with CamScanner

QUESTION-3

You have recently joined as the finance manager of Corv Limited (CL). While reviewing the draft financial statements for the year ended 31 December 2020 prepared by the junior accountant, you have noted the following:

(i) In January 2020, Government allotted an industrial plot to CL at a prime location subject to the condition that CL will establish a factory. CL constructed the factory building which was available for use on 1 October 2020. Due to delay in recruitment of key factory employees, the production activities will commence on 15 March 2021.

The accountant has not recorded the land as it was given free of cost. While the factory building is still appearing in capital work in progress as production activities will commence on 15 March 2021.

(06)

(Spring 2021 Q 7 (i))

Scanned with CamScanner

ICAP PAST PAPER SOLUTIONS

Answer-1

(a) The grant has been provided for the purpose of giving immediate financial support to the entity with no further conditions, so this grant should be immediately recognised in profit or loss in full in the period in which the entity qualifies to receive it (when it is receivable) with disclosure to ensure that its effect is clearly understood.

(b) Since there is reasonable assurance that conditions attaching to the grant will be met, the grant is recognised in statement of profit or loss over the four year period in which the entity incurs the costs of employing 100 people. Amount taken to statement of profit or loss may be either be presented as other income or shown as deduction from the related expense. The remaining amount of grant will be presented as deferred income under liabilities in the balance sheet.

(c) Free technical advice is government assistance that cannot reasonably have a value placed upon it and therefore should not be recognised. However, an indication of such assistance should be disclosed in financial statements.

Answer-2

Indus Pharma Limited
General Journal

Date	Description	Debit	Credit
		Rs. in million	
Jan. 2019	Plant	280	
	Cash/Bank		280
Jan. 2019/ 31-12-2019	Depreciation expense/Profit or loss 280÷7×4	160	
	Accumulated depreciation – Plant		160
31-12-2019	Depreciation expense 630÷7	90	
	Accumulated depreciation – Plant		90
31-12-2019	Impairment loss (W-1)	19	
	Accumulated impairment – Plant		19

W-1: Impairment review as on 31 December 2019

Rs. in million

Year	Net inflows		Discounting at 12%	Present value
2020	(90+10)	100	0.8929	89
2021	(80+10)	90	0.7972	72
Value in use				161
Fair value less cost to sell		160–5		155
Recoverable amount (Higher of both)				161
WDV of the plant as on 31 December 2019		630÷7×2		180
Impairment loss		180–161		19

Scanned with CamScanner

Answer-3

(i) The accounting treatment adopted by accountant for not recording land is incorrect. Allotment of land by Government is a transfer of a non-monetary asset and should be considered as a government grant. Such non-monetary grant may be recorded at fair value or at a nominal value. As per CL's policy, fair value of the land should be assessed and reported in the financial statements under the head property, plant and equipment (PPE). The grant was made subject to construction of factory so the resulting deferred income should be recognized in income on a systematic basis over the useful life of the factory building.

The factory building should also be transferred from capital work in progress to PPE account as the building is available for use on 1 October 2020. Further depreciation should also be charged from same date i.e. 1 October 2020.

Scanned with CamScanner

ICAP QUESTION BANK QUESTION

Question-1

During the year ended 30 June Year 2, Katie received three grants, the details of which are set out below.

(1) On 1 September, a grant of Rs.40,000 from local government. This grant was in respect of training costs of Rs.70,000 which Katie had incurred.

(2) On 1 November Katie bought a machine for Rs.350,000. A grant of Rs.100,000 was received from central government in respect of this purchase. The machine, which has a residual value of Rs.50,000, is depreciated on a straight-line basis over its useful life of five years.

(3) On 1 June a grant of Rs.100,000 from local government. This grant was in respect of relocation costs that Katie had incurred moving part of its business from outside the local area The grant is repayable in full unless Katie recruits ten employees locally by the end of Year 2. Katie is finding it difficult to recruit as the local skill base does not match the needs of this part of the business.

Required

Show how the above transactions should be reflected in the financial statements of Katie for the year ended 30 June Year 2. Where any accounting standards allow a choice you should show all possible options.

(ICAP Example 2)

Scanned with CamScanner

ICAP QUESTION BANK ANSWER

Answer-1

Option 1 – Net grants off related expenditure

Statement of financial position as at 30 June Year 2 (extracts)

	Rs.
Non-current assets	
Property, plant and equipment	223,333
Current liabilities	
Other current liabilities	100,000

Notes to the financial statements for the year ended 30 June Year 2 (extracts)

Property, plant and equipment

	Rs.
Cost (350,000 – 100,000)	250,000
Accumulated depreciation ((250,000 – 50,000) ÷ 5 × 8/12)	(26,667)
Carrying amount	223,333

Included in statement of profit or loss for the year ended 30 June Year 2

	Rs.
Depreciation charge	26,667
Training costs (70,000 – 40,000)	30,000

Option 2 – Show grants separately from related expenditure

Statement of financial position as at 30 June Year 2 (extracts)

	Rs.
Non-current assets	
Property, plant and equipment	310,000
Current liabilities	
Other current liabilities	186,667

Notes to the financial statements for the year ended 30 June Year 2 (extracts)

Property, plant and equipment

	Rs.
Cost	350,000
Accumulated depreciation ((350,000 – 50,000) ÷ 5 × 8/12)	(40,000)
Carrying amount	310,000

Other current liabilities

Deferred income relating to government grants (100,000 – (100,000 ÷ 5 × 8/12))	86,667
Government grant repayable	100,000
	186,667

Included in statement of profit or loss for the year ended 30 June Year 2

	Rs.
Depreciation charge	40,000
Training costs	70,000
Government grant received	(40,000)
Release of deferred government grant	(13,333)

Tutorial note

The Rs.100,000 grant in (3) has conditions attached to it. In such a situation, IAS 20 states that grants should not be recognised until there is reasonable assurance that the entity will comply with any conditions attaching to the grant. Since Katie is struggling to recruit, and there is only one month left for recruitment to meet these conditions, then it does not seem that there is 'reasonable assurance'. Hence the grant should not be recognised as such, but should be held in current liabilities, pending repayment.

Scanned with CamScanner

ICAP MULTIPLE CHOICE QUESTIONS (MCQs)

Q.1 On 1 January 2021 Aim Limited (AL) received Rs. 1,000,000 from the local government on the condition that they employ at least 150 persons each year for the next 4 years.
Due to an economic downturn and reduced consumer demand on 1 January 2022, AL no longer needed to employ any more staff and the conditions of the grant required full repayment.
What should be recorded in the financial statements on 1 January 2022?

(a) Reduce deferred income balance by Rs.750,000
(b) Reduce deferred income by Rs.750,000 and recognise a loss of Rs.250,000
(c) Reduce deferred income by Rs.1,000,000
(d) Reduce deferred income by Rs.1,000,000 and recognise a gain of Rs.250,000

Q.2 Which of the following are acceptable methods of accounting for a government grant relating to an asset in accordance with IAS 20 Accounting for Government Grants and Disclosure of Government Assistance?

(i) Set up the grant as deferred income
(ii) Credit the amount received to profit or loss
(iii) Deduct the grant from the carrying amount of the asset
(iv) Add the grant to the carrying amount of the asset

(a) (i) and (ii) (b) (ii) and (iv)
(c) (i) and (iii) (d) (iii) and (iv)

Q.3 On 1 January 2019, Boom Limited (BL) received Rs.2,000,000 from the local government on the condition that they employ at least 200 staff each year for the next 4 years. On this date, it was virtually certain that BL would meet these requirements.
However, on 1 January 2022, due to an economic downturn and reduced consumer demand, BL no longer needed to employ 100 staff. The conditions of the grant required half repayment.
What should be recorded in the financial statements on 1 January 2022 for repayment of grant?

(a) Debit Deferred grant by Rs.500,000 and PL by Rs.500,000
(b) Debit Deferred grant by Rs.250,000 and PL by Rs.250,000
(c) Debit Deferred grant by Rs.1,500,000 and PL by Rs.500,000
(d) Debit Deferred grant by Rs.500,000 and PL by Rs.1,500,000

Q.4 Which TWO of the following statements about IAS 20 Accounting for Government Grants and Disclosure of Government Assistance are true?

(a) A government grant related to the purchase of an asset must be deducted from the carrying amount of the asset in the statement of financial position.
(b) A government grant related to the purchase of an asset should be recognised in profit or loss over the life of the asset.
(c) Free marketing advice provided by a government department is excluded from the definition of government grants.
(d) Any required repayment of a government grant received in an earlier reporting period is treated as prior period adjustment.

Q.5 A manufacturing entity receives a grant of Rs.1,000,000 towards the purchase of a machine on 1 January 2013. The grant will be repayable if the entity sells the asset within 4 years, which it does not intend to do. The asset has a useful life of 5 years.
What is the deferred income liability balance at 30 June 2013?
Rs. _____

Scanned with CamScanner

Q.6 A company receives a government grant of Rs. 500,000 on 1 April 2017 to facilitate purchase on the same day of an asset which costs Rs. 750,000. The asset has a five-year useful life and is depreciated on a 30% reducing balance basis. Company policy is to account for all grants received as deferred income.
What amount of income will be recognised in respect of the grant in the year to 31 March 2019?
Rs. _____

Q.7 A manufacturing entity is entitled to a grant of Rs.3 million for creating 50 jobs and maintaining them for three years. Rs.1.5m is received when the jobs are created and the remaining Rs.1.5m is receivable after three years, provided that the 50 jobs are still in existence. The entity creates 50 jobs at the beginning of year one and there is reasonable assurance that this level of employment will be maintained.
What is the deferred income balance at the end of the first year?
Rs. _____

Q.8 If a government grant must be repaid, then it is;
(a) An error
(b) A change in accounting policy
(c) A change in accounting estimate
(d) A new transaction

Q.9 If an entity receives a non-monetary asset as a grant, this is accounted for at the;
(a) Market value
(b) Fair value
(c) Net realizable value
(d) Present value

Q.10 Which of the following is not covered by IAS 20 - Government Grants?
(a) Tax breaks
(b) Employment grants
(c) Subsidised loans
(d) Forgivable loans

Q.11 Which of the following is not a correct treatment of government grants related to an asset?
(a) Deferred income
(b) Credit to income in period received
(c) Deducting the grant from the carrying amount of the asset
(d) None of the above

Q.12 Which of the following is not a correct treatment of government grants related to income?
(a) Present as. Other income
(b) Deduct from the related expense
(c) Deduct from the cost of the asset
(d) None of the above

Scanned with CamScanner

ICAP MULTIPLE CHOICE QUESTIONS (MCQs) SOLUTIONS

A.1 (b) This is a grant related to income and would therefore be released to the statement of profit or loss over the 4 year life. By the end of year one, Rs.250,000 would have been credited to the statement of profit or loss, leaving Rs.750,000 held in deferred income. At this point the amount is repaid, meaning that the deferred income is removed, as well as the Rs.250,000 income previously recorded.

1.1.2021	Bank	1,000,000	
	Deferred Grant income		1,000,000
31.1.2021	Deferred Grant income	250,000	
	Govt Grant income		250,000
1.1.2022	Deferred Grant income	750,000	
	P/l	250,000	
	Bank		1,000,000

A.2 (c) The grant can be treated as deferred income or deducted from the carrying amount of the asset. It cannot be credited directly to profit or loss.

A.3 (a) Half repayment is Rs.1,000,000 (Rs.2,000,000 x 50%)

At the date of repayment, the balance in deferred grant would be Rs.500,000 and additional Rs.500,000 shall be charged to profit or loss.

A.4 (b, c) Item a is incorrect as the deferred income method can be used.

Item d is incorrect as any repayment is corrected in the current period, not retrospectively.

A.5 Rs.900,000

The grant should be released over the useful life, not based on the possibility of the item being repaid. Therefore, the Rs.1m should be released over 5 years, being a release of Rs.200,000 a year. At 30 June 2013, 6 months should be released, meaning Rs.100,000 has been released (6/12 × Rs.200,000). This leaves Rs.900,000 in deferred income.

A.6 Rs. 105,000.

	Rs.
Grant received 1.4.17	500,000
Recognised year to 31.3.18 (500,000 × 30%)	(150,000)
Balance 31.3.18	350,000
Recognised year to 31.3.19 (350,000 × 30%)	105,000

A.7 Rs.500,000

The total grant income is Rs.3m, to be recognised over a three-year period. Annual income is therefore Rs.1m. At the end of the first year the entity has received Rs.1.5m of which Rs.1m has been recognised in the statement of profit or loss, leaving Rs.500,000 deferred into future periods.

A.8 (c)
A.9 (b)
A.10 (a)
A.11 (b)
A.12 (c)

Scanned with CamScanner

BORROWING COSTS IAS - 23

LO1: BORROWING COST

Borrowing costs are interest and other costs that an entity incurs against borrowing of funds.

Other costs include arrangement fee, bank charges, loan processing charges, commitment fees etc.

Exam note:

Borrowing

In exam following different names for borrowings are normally tested on which we pay interest:

- Loan
- Redeemable preference shares
- Debentures
- Bond
- Loan notes
- Term finance certificate
- Bank Overdraft
- Running finance facility used

Not a Borrowing

1. Issue of share capital (We pay dividend on it which is not a borrowing cost)
2. Issue of right shares (We pay dividend on it which is not a borrowing cost)
3. Down payment received from customer for whom, say a building is constructed

LO2: QUALIFYING ASSETS

A **qualifying asset** is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. They are usually self-constructed non-current assets.

Assets that are ready for their intended use when acquired are not qualifying assets.

Any of the following may be a qualifying asset depending on circumstances.

(a) items of property, plant and equipment
(b) intangible assets
(c) inventory

Qualifying assets are usually self-constructed non-current assets.

The following are not qualifying assets:

- Inventories that are manufactured, or otherwise produced, over a short period of time, are not qualifying assets
- Assets that is ready for their intended use or sale when acquired.

Example 1: expensing borrowing costs

Yay Limited incurred Rs. 100,000 interest (during the year ended 31 December 20X5) on a loan that was used to finance the construction of a factory plant.

The factory plant was *not* considered to be a qualifying asset.

Required:

Provided the necessary journal entries for expensing the interest in Yay Limited's books for the year ended 31 December 20X5.

Scanned with CamScanner

Answer-1

Date	Particulars	Dr.	Cr.
31/12/20X5	Financed charges	100,000	
	Finance charges payable		100,000
	(Interest incurred on loan)		

Interest is not capitalized as the asset is not a qualifying asset.

Example 2: capitalization of borrowing costs - all criteria met at same time

Yippee Limited incurred Rs. 100,000 interest on a loan used to finance the construction of a building during the year ended 31 December 20X5:

- The building was considered to be a qualifying asset.
- Construction of the building began on 1 January 20X5, when the loan was raised.
- It is probable that the building would result in future economic benefits and the borrowing costs are reliably measurable.
- The construction of the building began as soon as the loan was raised.

Required:

Provide the necessary journal entries to capitalise the borrowing costs in Yippee Limited's books for the year ended 31 December 20X5.

Answer-2

Date	Particulars	Dr.	Cr.
31/12/20X5	Capital work in progress	100,000	
	Finance charges payable		100,000
	(Capitalization of interest on loan)		

As it is a qualifying asset so borrowing cost will be capitalized.

The borrowing costs capitalized are those that would have been avoided if the expenditure on the qualifying asset had not been made.

LO3: SPECIFIC BORROWINGS

If an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity shall determine borrowing costs eligible for capitalisation as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

Specific Borrowing cost to be capitalized

Interest incurred on specific borrowing	(Loan outstanding x rate x months outstanding*/12)	Xxx
Less: Investment income	(Investment made x rate x months outstanding*/12)	(xxx)
		Xxx

* Months outstanding shall exclude suspension period and will stop when project will cease.

Journal Entry

Particulars	Dr.	Cr.
Capital work in process	xx	
Cash		Xx

Scanned with CamScanner

Example-3
Baba Limited borrowed Rs. 700,000 from the bank on 1 March 20X9 to begin the construction of a building (a qualifying asset). Construction began on 1 March 20X9. The interest rate payable on the loan was 9%. The company paid construction costs of Rs. 500,000 on 1June 20X9. Surplus funds were invested in a fixed deposit and earned interest at 5% per annum. No capital portion of the loan was repaid during the year ended 31 December 20X9.

Required:
Pass the entry for capitalization.

Answer-3

Cost of capital work in process

Interest incurred on specific borrowing (700,000 x 9% x 7/12)	36,750
Less: Investment income during construction (200,000 x 5% x 7/12)	(5,833)
	30,917

Date	Description	Specific	Balance
1-Jun-09	Loan already raised	700,000	
1-Jun-09	Construction payment	(500,000)	
		200,000	200,000

Particulars	Dr.	Cr.
Capital work in process (500,000 + 30,917)	530,917	
Cash		530,917

LO4: GENERAL BORROWINGS

If an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset.
The capitalisation rate shall be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period.

General Borrowing cost to be capitalized

Interest incurred on general borrowing (Construction payment x capitalisation rate x months outstanding*/12)	xxx

* Months outstanding shall exclude suspension period and will stop when project will cease.

LO4.1 Calculation of Capitalisation rate

Loan

	Loan	Period outstanding	Loan outstanding / Weighted loan	Rate	Interest
Loan 1	XXX	xx/12	XXX	18.0%	XXX
Loan 2	XXX	xx/12	XXX	20.0%	XXX
Loan 3	XXX	xx/12	XXX	22.0%	XXX
			XXX		XXX

Capitalisation rate = Total Interest / Total Loan outstanding x 100

Scanned with CamScanner

Example-4

Calculate capitalization rate in the following cases:

Borrowings made	Date of borrowing	Amount	Rate of interest
From HBL	01.07.00	Rs. 10 million	13%
From NBP	01.10.00	Rs. 15 million	12%
From PICIC	01.11.00	Rs. 20 million	15%

Year-end is 31 December 2000.

Answer-4

Capitalisation Rate of general borrowing

	Loan	Period outstanding	Loan outstanding	Rate	Interest
HBL	10	x 6/12	5.00	13%	0.65
NBP	15	x 3/12	3.75	12%	0.45
PICIC	20	x 2/12	3.33	15%	0.50
			12.08		1.60

Rate for general borrowing (1.60/12.08) 13.25%

Example-5

Wisegroup Ltd borrowed the following amounts from various financial institution/banks for their business:

	Date of borrowing	Rate	Loan (Rs.)	Borrowing cost (Rs.)
PLCIC	01.07.00	10%	15 million	1.5 million
HBL	01.10.00	12%	10 million	0.9 million
MCB	01.11.00	16%	8 million	0.85 million

During the year they spent Rs. 13 million (paid to contractor at the start) on construction of office building. The construction was commenced on 1st August 2000.

Some cash out of amount borrowed was temporarily invested in short term deposits and an income of Rs. 0.2 million was earned from there:

They prepare their financial statements on 30 June.

Required: Calculate the borrowing cost to be capitalized for the year ended 30 June, 2001.

Answer-5

Interest accrued on general borrowings

1-Aug (13 x 11.68% x 11/12) 1.40

Capitalisation Rate of general borrowing

	Loan	Period outstanding	Loan outstanding	Rate	Interest
PICIC	15	x 12/12	15.00	10%	1.50
HBL	10	x 9/12	7.50	12%	0.90
MCB	8	x 8/12	5.33	16%	0.85
			27.83		3.25

Rate for general borrowing (3.25/27.83) 11.68%

Investment income is ignored as the borrowings are general.

Scanned with CamScanner

LO5: COMMENCEMENT, SUSPENSION AND CESSATION OF CAPITALIZATION

Commencement of capitalization	An entity shall begin capitalising borrowing costs on the commencement date. The commencement date is the date when the entity first meets all of the following conditions: (a) it incurs expenditures for the asset; (b) it incurs borrowing costs; and (c) it undertakes activities necessary to prepare the asset for its intended use.
Suspension of capitalization	An entity shall suspend capitalisation during periods in which it suspends active development of a qualifying asset. However if suspension is a necessary part of the process of getting the asset ready then borrowing cost will be capitalized.
Cessation of capitalization	An entity shall cease capitalisation when all the activities necessary to prepare the qualifying asset for its intended use are complete.

Example-6: commencement of capitalisation - criteria met at different times

Dawdle Limited borrowed Rs.100,000 on the 30 June 20X5 to build a factory to store its goods. The necessary building materials were only available on 31 August 20X5 and it was then that Dawdle Limited began construction. The building is considered to be a qualifying asset.

Required:

Discuss when Dawdle Limited may begin capitalising the interest incurred.

Answer-6

Dawdle Limited shall began capitalisation of interest when all the three conditions are met. Dawdle Limited borrowed the loan on 30 June, 20X5 but began construction when raw materials are available i.e.31 August, 20X5

Therefore, Dawdle Limited shall began capitalisation of interest from 31 August, 20X5

Example-7: commencement of capitalisation - criteria met at different times

Hoorah Limited incurred Rs.100,000 interest for the year ended 31 December 20X5 on a loan of Rs.1,000,000, raised on 1 January 20X5. The loan was raised to finance the construction of a building during the year ended 31 December 20X5. The building is a qualifying asset. Construction began on 1 February 20X5.

Required:

Provide the necessary journal entries for finance charges incurred in Hoorah Limited's books for the year ended 31 December 20X5.

Answer-7

Date	Particulars	Dr.	Cr.
31/12/20X5	Capital work in process (100,000 x 11/12)	91,667	
	Finance charges(interest expense)(100,000 x 1/12)	8,333	
	Finance charges payable		100,000
	(Interest cost charged to expenses as well as capitalized)		

Scanned with CamScanner

Example-8: Suspension of capitalization

Haha Limited borrowed Rs. 500,000 from the bank on 1 January 20X5 to begin the construction of a building (a qualifying asset). Construction began on 1 January 20X5. The interest rate payable on the loan was 10%. The company paid construction costs of Rs. 400,000 on 1 March 20X5. Surplus funds were invested in a fixed deposit and earned interest at 6% per annum. No capital portion of the loan was repaid during the year ended 31 December 20X5. There was an un-routine stoppage in the work in the month of June.

Required

Pass the entry for capitalization.

Answer-8

Cost of capital work in process

Interest incurred during construction on specific borrowing	
[500,000 × 10% × (10 – 1)/12]	37,500
Less: Investment income during construction	
[100,000 × 6% × (10 – 1)/12]	(4,500)
	33,000

Date	Description	Specific	Balance
1-Mar-05	Loan already raised	500,000	
1-Mar-05	Construction payment	(400,000)	
		100,000	100,000

Particulars	Dr.	Cr.
Capital work in process (400,000 + 33,000)	433,000	
Cash		433,000

Example 9: delays in construction

A hotel is under construction in 20X5. Borrowing costs of Rs.300,000 are incurred on a loan during 20X5. The loan was specifically raised on 1 January 20X5 for the sole purpose of the construction of the hotel.

Required:

Discuss how much of the interest may be capitalised assuming two independent scenarios:

A. The builders go on strike for a period of two months, during which no progress is made.

B. The builders of the hotel had to wait for five days for the cement in the foundations to dry.

Answer-9

(a) During these two months, the interest incurred will not be capitalised as it is unnecessary interruption to the construction process. The interest to be capitalised is (300,000 × 10/12) = 250,000

(b) The borrowing cost will be capitalised with interest incurred during 5 days, as it is necessary part of completion process. The interest is capitalised with 300,000

LO6: DISCLOSURES

An entity shall disclose:

(a) the amount of borrowing costs capitalised during the period; and

(b) the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.

Scanned with CamScanner

LO7: BASIC PRACTICE Questions

Question-1

Mr. X borrowed a loan of Rs. 600,000 on 1 Jan 2016 at the rate of 12% p.a for construction of a building. Interest is payable at the end of each year.

On 1 Jan 2016 he started the construction work. Following payments were made to the contractor;

Date	Amount
1st January 2016	100,000
30 June 2016	200,000
30 September 2016	300,000

The construction was completed on 30 September 2016. The estimated life of building is 5 years. The entire loan is repayable on 31 December 2020.

The building is a qualifying asset for the purposes of IAS 23.

Required:

Assuming year end is 31 December, you are required to prepare the extracts from the statement of comprehensive income and statement of financial position for the year ended December 31, 2016.

Question-2

Mr. A obtained loan of Rs. 1,000,000 on 1 Jan 2012 at the rate of 15% p.a. for construction of a building. On 1 March 2012 he started construction work on which date he also made first payment for construction. Construction work was completed on 31 Oct 2012.

Required:

For the year ended 31 December 2012, Calculate:

1 Total borrowing cost
2 Borrowing cost to be capitalized
3 Borrowing cost to be expensed out

Question-3

Mr. B started construction of a building on 1 Feb 2012. To finance the outlay he obtained a loan of Rs.300,000 on 1 April 2012 at the rate of 12% p.a. Construction work was completed on 31 July 2012.

Required:

For the year ended 31 December 2012. Calculate;

1 Total borrowing cost
2 Borrowing cost to be capitalized
3 Borrowing cost to be expensed out

Question -4

Mr. J has obtained a loan of Rs. 10 million on 1 Jan 2010 at the rate of 12% p.a. for construction of a qualifying asset. Construction work started on the same date. The payments made to the contractor were as follows:

Date	Rs. m
1st January 2010	4
31st July 2010	2
31st August 2010	4

The project was complete on 30 Sep 2010.

The surplus funds were invested @ 6% p.a.

Required:

Calculate the borrowing cost to be capitalized and cost of building for the year ended December 31, 2010.

Scanned with CamScanner

Question-5

On July 1, 2016 a medium term loan of Rs. 2 million was obtained specifically for the construction of the building. The construction work started on 01-07-2016. The loan carried mark up of 10% per annum. The payments made to the contractor were as follows:

Date	Rs. m
1 Jul 2016	0.8
1 Nov 2016	0.6
1 Jan 2017	0.2
1 Mar 2017	0.4

Project completed on 31 March 2017. Surplus funds are invested @ 4% p.a.

Required:

Calculate the total borrowing cost to be capitalized and cost of the project for year ended June 30, 2017.

Question-6

The following is the information regarding general loans available to Power limited:

Type of Loan	Amount	Interest rate	Loan taken on	Load repaid on
A	200,000	20%	1-March-2013	30-June-2016
B	500,000	25%	1-March-2015	30-June-2018
C	100,000	18%	1-March-2016	30-September-2016
D	70,000	12%	1-Feb-2016	28-February-2019

Required:

Calculate capitalization rate for year ended 31December 2016?

Question-7

Continuing from question 6 following construction data is provided for year ended 31 December 2016:

Commencement of project	1 April 2016
Cessation of project	30 November 2016

The payments made to the contractor were as follows:

1 April 2016	300,000
1 June 2016	100,000
1 November 2016	30,000

Surplus funds are invested @ 5% per annum.

Required:

Calculate borrowing cost to be capitalized for year ended December 31, 2016?

Question-8

Continuing from question 6 we constructed another new building in 2017.

Commencement of project	1 Feb 2017
Cessation of project	30 Sep 2017

The payments made to the contractor were as follows:

1 March 2017	20,000
1 April 2017	30,000
30 September 2017	10,000

Required:

Calculate borrowing cost to be capitalized for year ended December 31, 2017?

Scanned with CamScanner

Question-9

Commencement of project	1 Feb 2012
Cessation of project	30 Sep 2015

General Borrowing's capitalization rate is 13.48%

Construction payments for year ended 30 September 2012:

1 February 2012	200,000
1 April 2012	300,000
1 July 2012	100,000

The project remained stopped for the month of July and August due to delay in receipt of raw material.

Required:
Calculate borrowing cost to be capitalized?

Answer-1

Mr. X
Statement of financial position (Extracts)
As at 31st December, 2016

	Rs.
Non-Current Assets	
Building((W-1) 654,000 – 32,700)	621,300
Non-current liabilities	
Bank loan	600,000

Mr. X
Statement of comprehensive income (Extracts)
For the year ended 31st December, 2016

	Rs.
Interest expense (600,000 x 12% x 3/12)	18,000
Depreciation (654,000/5 x 3 / 12)	32,700

(W-1) Cost of building

		Rs.
Construction cost	(100,000 + 200,000 + 300,000)	600,000
Interest /Borrowing Cost	(W-2)	54,000
		654,000

(W-2)
Borrowing cost to be capitalized

Interest incurred on specific loan	(600,000 × 12% × 9/12)	54,000

Answer-2

1.	**Total borrowing Cost** (1,000,000 × 15%)	150,000

Scanned with CamScanner

2. Borrowing cost to be capitalized

Interest on specific borrowing from 1-Mar to31-Oct	(1,000,000 × 15% × 8/12)	100,000

3. Borrowing cost to be expensed out

Interest (Jan , Feb , Nov , and Dec)	(1,000,000 × 15% × 4 / 12)	50,000

Answer-3

1. Total borrowing Cost

		Rs.
April – December	(300,000 × 12% × 9 / 12)	27,000

2. Borrowing cost to be capitalized

Interest on specific borrowing from April to July	(300,000 × 12% × 4/12)	12,000

3. Borrowing cost to be expensed out

August to December	(300,000 × 12% × 5 / 12)	15,000

Answer-4

Borrowing cost to be capitalized

Interest incurred on specific borrowing from 1-Jan to31-Sep (10x 12% × 9/12)		0.9
Less: Investment income		
- (6 × 6% × 7 / 12)	0.21	
- (4 × 6% × 1 / 12)	0.02	
		(0.23)
		0.67

(W-1)Receipts and payments schedule

Date	Description	Specific	Balance
1-Jan-10	Loan raised	10	
1-Jan-10	Construction payment	(4)	
		6	6
31-Jul-10	Construction payment	(2)	4
31-Aug-10	Construction payment	(4)	-

Answer-5

Borrowing cost to be capitalized

Interest on specific borrowing from 1-jul to30-Sep (2x 10% × 9/12)		0.15
Less: Investment income		
- (1.2 × 4% × 4 /12)	(0.016)	
- (0.6 × 4% × 2 / 12)	(0.004)	
- (0.4 × 4% × 2 / 12)	(0.003)	(0.023)
		0.127

(W-1)Receipt and payment schedule

Date	Description	Specific	Balance
1-Jul-16	Loan raised	2	
1-Jul-16	Construction payment	(0.8)	
		1.2	1.2
1-Nov-16	Construction payment	(0.6)	0.6
1-Jan-17	Construction payment	(0.2)	0.4
1-Mar-17	Construction payment	(0.4)	-

Scanned with CamScanner

Answer-6

Capitalization Rate

(W-1)

Capitalization rate (Average rate) = $\frac{163,200}{722,500}$ x 100

= 22.6 %

Loan	Amount	Months outstanding	Loan outstanding	Rate	Interest
A	200,000	× 6/12	100,000	20 %	20,000
B	500,000	×12/12	500,000	25 %	125,000
C	100,000	× 7/12	58,333	18 %	10,500
D	70,000	× 11/12	64,167	12 %	7,700
			722,500		163,200

Answer-7

Do your self

Answer-8

Do your self

Answer-9

Do your self

LO8: SOME TERMINOLOGIES

1) **Progress billings**

Billings made by the contractor in response to the work performed by him.

2) **Retention money**

The amount deducted by the customer from progress billings, this is deducted for the satisfaction of the customer.

3) **Mobilization Advance**

Advance given by the customer to start the contract. It is normally adjusted with each progress bill.

4) **Right issues**

A rights issue is an invitation to existing shareholders to purchase additional new shares in the company.

Question

Mr. Imam commenced the construction of project on 1 January 2016 and will end on 31December 2016. The cost of the project is estimated amounting to Rs. 200 million. The following terms of the contract are agreed with contractor:

10% of the cost of project will be paid at the time of agreement (i.e. 1 January 2016) as down payment. This amount will be adjusted against the quarterly progress bills.

5% of the cost of project will be retained and shall be paid 6 months after the completion of project

The details of bills submitted by the contractor, during the year are as follows:

Particulars	Date of payment	Rs .m
On completion of 1st phase	31 March 2016	50
On completion of 2nd phase	30 June 2016	50
On completion of 3rd phase	30 September 2016	50
On completion of 4th phase	31 December 2016	50

Scanned with CamScanner

The bill will immediately be paid on receipt.

Required:

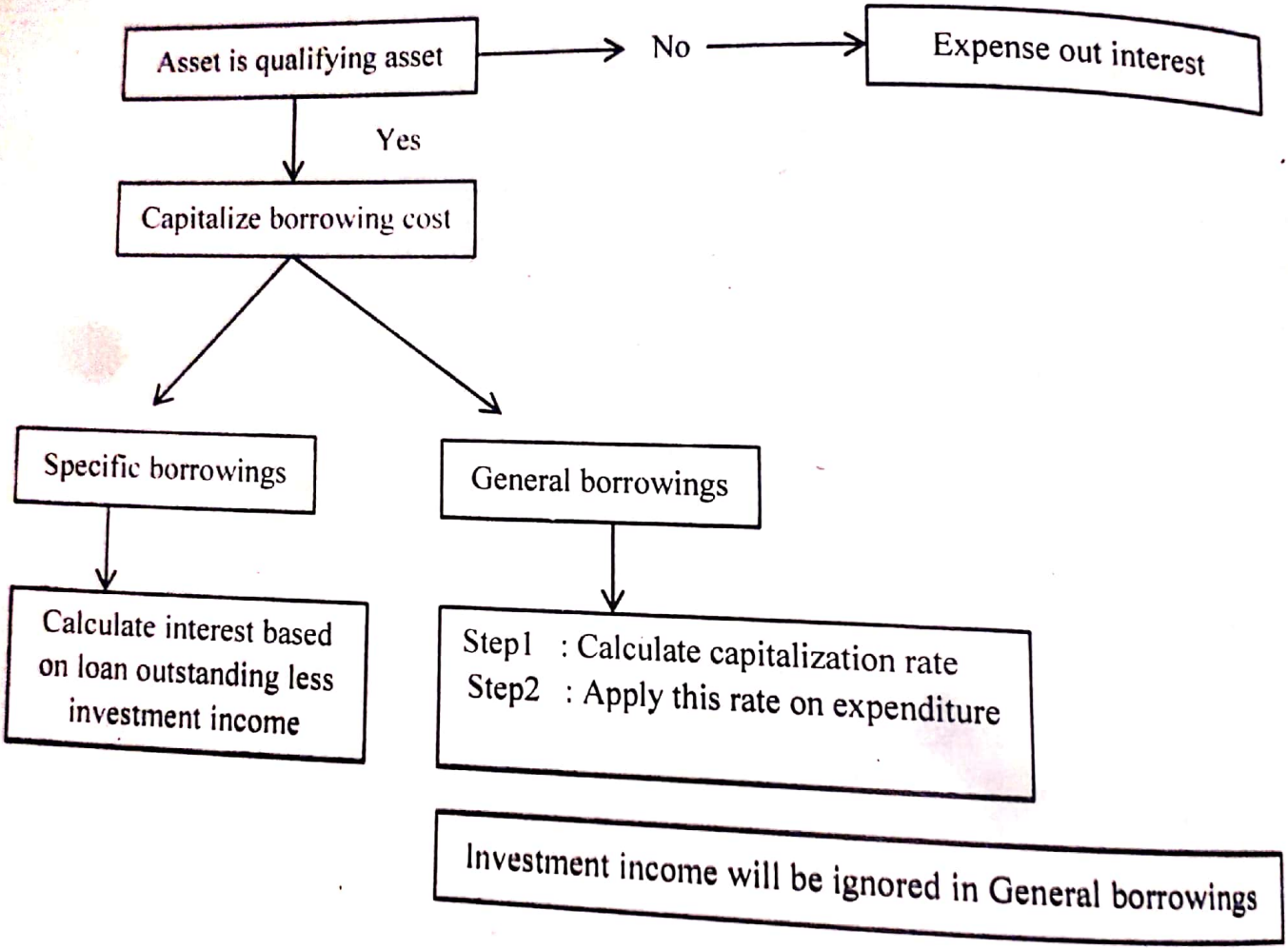
Assuming year end is 31 December you are required to pass journal entries and extracts from statement of financial position for the year 2016.

Answer

1 Jan 2016	Advance Bank (Payment of advance)	20	20
31 Mar 2016	CWIP Advance Retention money payable Bank (Payment of first progress bill)	50	5 2.5 42.5
30 June 2016	CWIP Advance Retention money payable Bank (Payment of second progress bill)	50	5 2.5 42.5
30 Sep 2016	CWIP Advance Retention money payable Bank (Payment of second progress bill)	50	5 2.5 42.5
31Dec 2016	CWIP Advance Retention money payable Bank (Payment of second progress bill)	50	5 2.5 42.5
31Dec 2016	Building CWIP (Payment of advance)	200	200

Scanned with CamScanner

LO9: SUMMARY



Scanned with CamScanner

PRACTICE QUESTIONS

Question-1 [Identification of qualifying asset]

Umer obtained following loans for reasons specified below:

	Rs. in million		
	Amount	**Interest**	**Purposes**
Allied Bank	10	3	Building in process
MPL Bank	6	0.5	Purchase of ready to use air conditioners
Debentures	2.5	0.6	Construction of office building
From Private Placing	7	1.25	Plant installation

Expenses incurred on issue of debentures	0.75 million
Expenses incurred for arranging loan from Private Placing	0.35 million

Required:

Borrowing cost eligible for capitalization

Question-2 [Identification of qualifying asset]

Umair & Co. obtained the following loans for the purposes specified against each along with interest thereon:

	Rs. in million		
	Amount	**Interest**	**Purposes**
From Faysal Bank	12	2	For purchase of stock
From ILI Bank	15	3	For construction of building
Loan from Directors	4.5	0.25	For purchase of land

Required:

Borrowing cost eligible for capitalization

Question-3 [Specific borrowing with investment income]

Haha Limited borrowed Rs. 500,000 from the bank on 1 January 20X5 to begin the construction of a building (a qualifying asset). Construction began on 1 January 20X5 (i.e. all criteria for capitalisation of borrowing costs were met). The interest rate payable on the loan was 10%. The company paid construction costs of Rs. 400,000 on 1 January 20X5. Surplus funds were invested in a fixed deposit and earned interest at 6% per annum. No capital portion of the loan was repaid during the year ended 31 December 20X5.

Required:

Pass the entry for capitalization.

Question-4[Specific borrowing with investment income]

Money Limited began the construction of a new building on the 1 February 20X5. Construction costs incurred in 20X5 were paid for as follows:

	Rs.
On 1 February	500,000
On 1 July	600,000
On 1 November	800,000

Scanned with CamScanner

The construction of the building ended on the 1 December 20X5 when the building was complete and ready for its intended use. This building is to be depreciated over 10 years to a nil residual value using the straight-line method.

The construction was financed by a loan of Rs. 1,900,000 from Cash Limited. The loan was raised on 1 January 20X5 specifically to facilitate the construction of the building. The interest rate is 25% per annum. There were no loan repayments during the year. Surplus funds were invested at 20% per annum. The interest is compounded annually.

The building is a qualifying asset for the purposes of IAS 23.

Required:

a) Calculate the amount of borrowing costs that are eligible for capitalization during the year ended 31 December 20X5.

b) Calculate the depreciation for the year ended 31 December 20X5.

c) Calculate the carrying amount of the buildings as at 31 December 20X5.

Question-5[Specific borrowing with investment income]

Hockey Limited borrowed Rs. 2,000,000 (at an interest rate of 14%) from the Bank of Ball on 1 January 20X5. These funds have been borrowed in order to build a hockey stadium.

Progress payments made in 20X5 are as follows:

	Rs.
On 1 January	600,000
On 1 July	1,200,000
On 1 September	200,000

The surplus funds were invested in a fixed deposit earning interest at 10% per annum.

Construction began on 1 January 20X5 and was still incomplete on 31 December 20X5. Between 1 June and 20 June, construction ceased while concrete cured (a necessary part of the construction process).

The stadium is a qualifying asset as defined by IAS 23.

Required:

a) Calculate the amount of borrowing costs that may be capitalized to the hockey stadium cost account in the year ended 31 December 20X5.

b) Calculate the amount of borrowing costs that may be capitalized to the hockey stadium cost account in the year ended 31 December 20X5 assuming that construction could not begin due to the building plans not meeting municipal standards. The plans have been resubmitted and it is expected that the municipality will give the go-ahead to begin construction in early 20X6.

Question-6[Specific borrowing with investment income]

Loans raised specifically to fund the construction of a building (a qualifying asset):

- Loan A (10%) raised 1 January 20X5: Rs. 500,000
- Loan B (15%) raised 1 June 20X5: Rs. 400,000

Rs. 100,000 of the loan B capital was repaid on 31 July 20X5. No other loan was repaid. Interest was payable (compounded) annually on 31 December.

The only interest income earned during the year was interest income earned on the investment of surplus funds from the specific loans in a 6% interest account.

Construction costs paid for as follows:

Scanned with CamScanner

- 31 March 20X5: Rs. 300,000
- 30 April 20X5: Rs. 100,000
- 31 July 20X5: Rs. 220,000

Commencement date of capitalization of borrowing cost: 1 March 20X5

Cessation date of capitalization: 31 August 20X5

Required:

Calculate the amount of borrowing costs that must be capitalized in terms of IAS 23.

Question-7

For the purpose of construction of qualifying asset during the year ending December 2014, Ahmed limited decided to utilize various funds available to them. The details of funds available to Ahmed ltd. are as follows:

Type of loan	Amount	Interest rate	Loan taken on	Loan repaid on
General purpose loan A	900,000	12%	01-01-2013	31-12-2014
General purpose loan B	560,000	15%	01-01-2014	30-09-2014
General purpose loan C	780,000	10%	01-01-2014	30-11-2014
General purpose loan D	690,000	17%	01-01-2012	30-07-2014
Shareholders' equity	1,000,000	20%	01-07-2005	Not repaid up to 31-12-2014

Required:

You are required to calculate the capitalization rate to be used for calculating the amount of borrowing cost to be capitalized.

Question-8

Calculate capitalization rate in the following case:

Borrowings made	Date of borrowing	Amount	Rate of interest
From HBL	01.05.00	9 million	15%
From NBP	01.09.00	17 million	13%
From ICI	01.07.00	25 million	17%
From Allied Bank	01.11.00	32 million	20%

Year-end is 31 December 2000.

Question-9

Wisegroup Ltd borrowed the following amounts from various financial institution/banks for their business:

	Date of borrowing	Rate	Loan (Rs.)	Borrowing cost (Rs.)
PLCIC	01.07.00	10%	15 million	1.5 million
HBL	01.10.00	12%	10 million	0.9 million
MCB	01.11.00	16%	8 million	0.85 million

During the year they spent Rs. 13 million (paid to contractor at the start) on construction of office building. The construction was commenced on 1st August 2000 and continued upto 31 January 2001. From 1st February 2001 the construction remained suspended due to non-availability of required quality of marble. The marble could be procured only at the end of March 2001.

Some cash out of amount borrowed was temporarily invested in short term deposits and an income of Rs. 0.2 million was earned from there:

They prepare their financial statements on 30 June.

Required: Calculate the borrowing cost to be capitalized for the year ended 30 June, 2001.

Scanned with CamScanner

Question-10

Ammar Corporation has following loans in place at the beginning of 2014.

	1 January 2014
12 % MCB loan repayable	50,000
8.5 % Debentures repayable	70,000
10.5 % Silk Bank loan repayable	60,000

On 1 January 2014, the construction of a qualifying asset started using existing borrowings. Expenditure incurred on the construction was incurred on:-

	Rs.
1 Jan 2014	30,000
1 June 2014	40,000
1 November 2014	20,000
	90,000

The construction will complete on March 31, 2015.

Required:

Calculate the borrowing cost to be capitalized for year ended December 31, 2014.

Question-11

Nasir Corporation has following loans in place at the beginning of 2015.

	1 January 2015
12 % MCB loan	50,000
8.5 % Debentures	80,000

It further borrowed following loans not specifically for the project:

13 % Silk Bank loan obtained on 1-4-2015	6,000
15 % HBL loan obtained on 1-9-2015	90,000

On 1 January 2015, the construction of a qualifying asset started. Expenditure incurred on the construction was incurred on:-

	Rs.
1 Jan 2015	30,000
1 June 2015	50,000
1 December 2015	70,000
	150,000

The construction will complete on March 31, 2016.

Required:

Calculate the borrowing cost to be capitalized for year ended December 31, 2015.

Question-12

Soccer Limited began the construction of a new stadium on 1 January 20X5. Details of the progress payments made during 20X5 are as follows:

	Rs.
On 1 January	300,000
On 1 April	200,000
On 1 July	250,000
On 1 September	150,000
On 1 October	200,000

Scanned with CamScanner

The stadium was still under construction at 31 December 20X5.

The construction was financed by general borrowings within the company. General loans outstanding at any one time during 20X5 averaged Rs. 20,000,000. The interest expense incurred on these loans during 20X5 was Rs. 2,600,000.

The stadium is a qualifying asset as defined by IAS 23. Interest is payable (compounded) annually.

Required:

a) Calculate the amount of borrowing costs that may be capitalized to the stadium during the year ended 31 December 20X5.

b) Calculate the depreciation for the year ended 31 December 20X5.

c) Calculate the carrying amount of the stadium as at 31 December 20X5.

Question-13

A socially responsible multinational corporation (MNC) decided to construct a tunnel that will link two sides of the village that were separated by a natural disaster years ago. Realizing its role as a good corporate citizen, the MNC has been in this village for a couple of years exploring oil and gas in the nearby offshore area. The tunnel would take two years to build and the total capital outlay needed for the construction is Rs. 20 million. General loans were arranged in this way:

- Bank term loans: Rs. 5 million at 7% per annum
- Institutional borrowings: Rs. 7 million at 8% per annum
- Corporate bonds: Rs. 10 million at 9% per annum

Required

When MNC capitalizes borrowing costs under IAS 23, how would it treat the borrowing costs? How would it capitalize the borrowing costs?

Question-14

Rise Co had the following loans

	1 January
10 % Bank loan repayable – Repayable 2016(General)	100,000,000
8 % Bank loan repayable – Repayable 2018(General)	40,000,000
7 % Specific loan obtained on 1.1.2014	20,000,000

Construction of Plant began on 1 Jan 2014.

Expenditure incurred on the construction was given below. Surplus funds were invested at 4 %.

Incurred on	Rs."000"
1 Jan 2014	50,000
1 Oct 2014	30,000
	80,000

Required:

Calculate the borrowing cost to be capitalized for the factory plant for the year ended 31 December, 2014.

Scanned with CamScanner

Question-15

On 1 July 2006, entity A entered into a Rs. 2.2 million contract for the construction of a building. The building was completed at the end of June 2007. During the period, the following payments were made to the contractor:

Payment date	Rs. In '000'
1 July 2006	200
30 September 2006	600
31 March 2007	1,200
30 June 2007	200
Total	**2,200**

Entity A's borrowings as at its year end of 30 June 2007 were as follows:

i) 10% four-year loan obtained on 1 July, 2006 with simple interest payable annually, which relates specifically to the project; debt outstanding at 30 June 2007 amounted to Rs. 700,000. Interest of Rs. 70,000 was incurred on these borrowings during the year, and interest income of Rs. 20,000 was earned on these funds while they were held in anticipation of payments.

ii) 12.5% 10-year general loan with simple interest payable annually; debt outstanding at 1 July 2006 amounted to Rs. 1,000,000 and remained unchanged during the year.

iii) 10% 10-year general loan with simple interest payable annually; debt outstanding at 1 July 2006 amounted to Rs. 1,500,000 and remained unchanged during the year.

Required:

Calculate the borrowing cost to be capitalized for year ended June 30,2007.

Question-16 [Specific + General + mix]

Milo enterprise was working on a project to construct a building. Project started on January 01, 2014. Costs incurred on the project are as follows:

1 January, 2014	7,500,000
1 Sep, 2014	9,500,000

The following amounts were utilized for payment:

1. 10% debentures issued on January 1, 2014 specifically for construction Rs. 5,500,000.
2. 15% bank loan outstanding since 2013 Rs. 6,500,000
3. 12% bank loan was obtained solely for the project July 1, 2014 Rs. 3,250,000
4. 10% bank loan outstanding since December 1, 2014 Rs. 1,000,000

All the above loans and debentures are outstanding till 31st December 2014. Construction of building was still in progress at 31st December 2014.

Required:

Determine the total amount of capital work in process.

Question-17

In the board meeting held on 15th December 2006, management of Power limited decided to construct a qualifying asset amounting to Rs. 1,000,000. The management of Power limited approached to a bank to finance the project but the bank agreed to finance only the 50% of the estimated cost i.e. Rs. 500,000 @ 15% p.a. The loan was sanctioned on 28th December 2006 and was immediately put into the bank account of company. Management of the company decided to utilize other general purpose loans to finance the remaining balance of Rs. 500,000.

Scanned with CamScanner

The construction of qualifying asset started on 1st January 2007. Following is the schedule of payments made by Power limited in connection with the construction of qualifying asset.

Date of installment	Amount of installment (Rs.)
January 1, 2007	200,000
April 1, 2007	200,000
July 1,2007	200,000
October 1,2007	200,000

Management decided to invest the unutilized portion of specific loan in the government securities fetching an income @ 8% p.a. There was an un-routine stoppage in the work from 1st June 2007 to 31st July 2007.

The following is the information regarding all the loans available to Power limited:

Description	Amount	Rate	Loan taken On
Specific loan	500,000	15%	28-12-2006
General purpose loan 1	600,000	12%	01-02-2007
General purpose loan 2	400,000	14%	01-03-2007
General purpose loan 3	300,000	14%	01-01-2007

The general purpose loan 2 was repaid in full on 30-11-2007 and general purpose loan 3 was repaid in full on 31-10-2007. Remaining loans were outstanding till 31st December 2007.

The construction of qualifying asset was not completed up to 31st December 2007. The accounting year ends on 31st December 2007.

Required:

Calculate portion of borrowing cost eligible for capitalization for the year ended December 2007.

Question-18

A company started construction of a qualifying asset. It received loan specifically for qualifying asset on 1 August, 2007 of Rs. 400,000 @ 12%. Project started on 15 August, 2007 following is the detail of construction payments.

Construction payments

Date	Rs.
15.8.07	150,000
1.11.07	200,000
1.03.08	300,000
1.09.08	150,000

The rate of capitalization for general borrowing is 18%. Surplus funds are invested at rate of 3%. Project was stopped for month of December due to flood. The project was completed on May 31, 2008

Required:

Calculate borrowing cost to be capitalized for year ended June 30, 2008.

Question-19

A company started project of construction of a qualifying asset on 1 February 2012. It is financed through following sources:

1. Right issue of shares Rs.3,000,000 on 1 February 2012. Dividend rate is 10%.
2. Specific loan was obtained on 1 April 2012 of Rs.5,000,000 @ 12%.

Scanned with CamScanner

3. The surplus funds are invested @ 3%.
4. General borrowing capitalisation rate is 14%.

Construction payment

Date	Rs.
1.2.12	2,000,000
1.3.12	500,000
1.4.12	3,000,000
1.8.12	6,000,000

Project was still in process on 31.12.12.

Required:

Calculate borrowing cost to be capitalized for year ended December 31, 2012.

Question-20

On 1st Jan 2014, Ghani Co borrowed Rs. 2.5 million to finance the construction of two buildings both of which were expected to take a year to build. Construction started during 2014. The loan facility was drawn down on 1 Jan 2014 and was utilized as follows, with the remaining funds invested temporarily.

	Asset A	Asset B
1 Jan 2014	500,000	750,000
1 Jul 2014	500,000	750,000
	1,000,000	1,500,000

The loan rate was 7 % and Sparkle Co can invest surplus funds at 4 %.

Required:

Calculate the borrowing costs which may be capitalized for each of the asset and consequently the cost of each asset as at 31 Dec 2014.

Question-21

Loan worth of Rs. 400,000 taken on 1st January 2014 for the construction of A and B plants. Interest Rate is 10% per annum and surplus funds are invested @ 7% per annum.

Details of expenditures is:

Year 2014	A	B
1st January	200,000	60,000
30th June	0	70,000
	200,000	130,000

Plant A was completed on June 30, 2014.

Required:

Calculate borrowing cost to be capitalized on A and B Plants as on December 31, 2014, if IAS-23 is adopted.

Scanned with CamScanner

Question-22

Mr. Tipu obtained loan amounting to Rs. 90 million from HBL on January 1, 2015. It carries markup @ 12% per annum. The loan is repayable in semi-annual installments of Rs. 10 million each starting from June 30, 2015 along with interest.

Required:

i) Calculate interest expense for the year ended December 31, 2015 and

ii) Prepare relevant extracts from statement of financial position for year ended December 31,2015.

Question-23

Mr. Atif obtained loan amounting to Rs. 70 million from UBL on July 1, 2014. It carries markup @ 15% per annum. The loan is repayable in semi-annual installments of Rs. 5 million each starting from January 1, 2015 along with interest.

Required:

i) Calculate interest expense for the year ended December 31, 2015 and

ii) Prepare relevant extracts from statement of financial position for year ended December 31,2015.

Question-24

Mr. Taimoor obtained loan amounting to Rs. 150 million from Faysal bank on April 1, 2015. It carries markup @ 13% per annum. The loan is repayable in quarterly installments of Rs. 15 million each starting from June 30, 2015 along with interest.

Required:

i) Calculate interest expense for the year ended December 31, 2015 and

ii) Prepare relevant extracts from statement of financial position for year ended December 31, 2015.

Question-25

Mr. Mouse obtained loan amounting to Rs. 80 million from HBL on October 1, 2015. It carries interest @ 0.25 per thousand per day. The loan is repayable in monthly installments of Rs. 10 million each starting from November 1, 2015 along with interest.

Required:

i) Calculate interest expense for the year ended December 31, 2015 and

ii) Prepare relevant extracts from statement of financial position for year ended December 31, 2015.

Scanned with CamScanner

PRACTICE SOLUTIONS

Answer-1

	Rs in 'million'
Borrowing cost eligible for capitalisation [3 + (0.6 + 0.75) + (1.25 + 0.35)]	5.95

Note: As purchase of ready to use air conditioners is not a qualifying asset transaction therefore borrowing cost associated with it will be expensed out.

Answer-2

	Rs in 'million'
Borrowing cost eligible for capitalisation	3

Note: As purchase of stock and land is not a qualifying asset transaction therefore borrowing cost associated with them will be expensed out.

Answer-3

Particulars	Dr.	Cr.
Capital work in process(400,000 + 44,000)	444,000	
Cash		444,000

(W-1) Borrowing cost to be capitalized

Interest incurred during construction on specific borrowing (500,000 × 10%)	50,000
Less: Investment income during construction (100,000 × 6% × 12/12)	(6,000)
L	44,000

(W-2)

Date	Description	Specific	Balance
1-Jan-05	Loan raised	500,000	
1-Jan-05	Construction payment	(400,000)	
		100,000	100,000

Answer-4

a) **Borrowing cost to be capitalized**

All figure in Rs. in '000'

Interest incurred during construction on specific borrowing from 1-Feb to 1-Dec (1,900 × 25% × 10/12)	396
Less: Investment income during construction (W-2)	(170)
	226

(W-1)

Date	Description	Specific	Balance
1-Feb-05	Balance in loan a/c on commencement of project	1,900	1,900
1-Feb-05	Construction payment	(500)	1,400
1-July-05	Construction payment	(600)	800
1-Nov-05	Construction payment	(800)	-

Scanned with CamScanner

(W-2) Investment Income

1-Feb-05	(1,400 × 20% × 5/12)	117
1-Jul-05	(800 × 20% × 4/12)	53
		170

b) Depreciation (2,126)/10 × 1/12) 18

(W-1) Cost of asset

Construction (500 +.600 + 800)	1,900
Add: Borrowing cost to be capitalized	226
	2,126

c) Net book value

Cost	2,126
Less: Accumulated depreciation	(18)
	2,108

Answer-5

All figure in Rs. in '000'

a) **Borrowing cost to be capitalized**

Interest incurred during construction on specific borrowing (2,000 × 14%)	280
Less: Investment income during construction (W-2)	(73)
	207

(W-1)

Date	Description	Specific	Balance
1-Jan-05	Loan	2,000	2,000
1-Jan-05	Construction payment	(600)	1,400
1-July-05	Construction payment	(1,200)	200
1-Sep-05	Construction payment	(200)	-

(W-2) Investment Income

1-Jan-05	(1,400 × 10% × 6/12)	70
1-Jul-05	(200 × 10% × 2/12)	3
		73

b) No borrowing cost will be capitalised because amongst the 3 criteria of capitalisation, one is that we have started the project which is not the case here.

Answer-6

a) **Borrowing cost to be capitalized**

Interest incurred during construction on specific borrowing	(W-3)	38,750
Less: Investment income during construction	(W-2)	(9,900)
		28,850

(W-1)

Date	Description	Specific	Balance
1-Mar-05	Balance in loan A a/c on commencement of project	500,000	500,000
31-Mar-05	Construction payment	(300,000)	200,000
30-Apr-05	Construction payment	(100,000)	100,000
1-Jun-05	Loan B raised	400,000	500,000
31-Jul-05	Construction payment	(220,000)	
31-Jul-05	Loan repayment	(100,000)	
		(320,000)	180,000

Scanned with CamScanner

(W-2) Investment Income

1-Mar-05	(500,000 × 6% × 1/12)	2,500
31-Mar-05	(200,000 × 6% × 1/12)	1,000
30-Apr-05	(100,000 × 6% × 1/12)	500
1-Jun-05	(500,000 × 6% × 2/12)	5,000
31-Jul-05	(180,000 × 6% × 1/12)	900
		9,900

(W-3) Interest accrued on specific borrowing

Loan A	(500,000 × 10% × 6/12)			25,000
Loan B				
1-Jun-05	Loan received	400,000	× 15% × 2/12	10,000
31-Jul-05	Less: Principal repaid	(100,000)		
		300,000	× 15% × 1/12	3,750
				38,750

Answer-7

Capitalisation Rate of general borrowing

	Loan	Period outstanding	Loan Outstanding	Rate	Interest
Loan A	900,000	× 12/12	900,000	12%	108,000
Loan B	560,000	× 9/12	420,000	15%	63,000
Loan C	780,000	× 11/12	715,000	10%	71,500
Loan D	690,000	× 7/12	402,500	17%	68,425
			2,437,500		310,925
Rate for general borrowing	(310,925/2,437,500)				12.76%

Answer-8

Capitalisation Rate of general borrowing

Rs. in million

	Loan	Period outstanding	Loan outstanding	Rate	Interest
HBL	9	× 8/12	6	15%	0.9
NBP	17	× 4/12	5.67	13%	0.737
ICI	25	× 6/12	12.5	17%	2.125
Allied Bank	32	× 2/12	5.33	20%	1.067
			29.5		4.829
Rate for general borrowing		(4.829/29.5)			16.37%

Scanned with CamScanner

Answer-9

Rs in 'million'

Interest accrued on general borrowings

1-Aug-14 (13 × 11.68% × (11-2)/12) `1.14

Capitlisation will be suspended for the month of February and March.

Capitalisation Rate of general borrowing

	Loan	Period outstanding	Loan outstanding	Rate	Interest
PICIC	15	× 12/12	15.00	10%	1.50
HBL	10	× 9/12	7.50	12%	0.90
MCB	8	× 8/12	5.33	16%	0.85
			27.83		3.25

Rate for general borrowing (3.25/27.83) 11.68%

Investment income is ignored as the borrowings are general.

Answer-10

Interest accrued on general borrowings

1-Jan-14	(30,000 × 10.14% × 12/12)	3,042
1-Jun-14	(40,000 × 10.14% × 7/12)	2,366
1-Nov-14	(20,000 × 10.14% × 2/12)	338
		5,746

(W-1) **Capitalisation Rate of general borrowing**

	Loan	Period outstanding	Loan outstanding	Rate	Interest
MCB	50,000	× 12/12	50,000	12%	6,000
Debenture	70,000	× 12/12	70,000	8.5%	5,950
Silk	60,000	× 12/12	60,000	10.5%	6,300
			180,000		18,250

Rate for general borrowing (18,250/180,000) 10.14%

Answer-11

Interest accrued on general borrowings

1-Jan-15	(30,000 × 10.87% × 12/12)	3,261
1-Jun-15	(50,000 × 10.87% × 7/12)	3,170
1-Dec-15	(70,000 × 10.87% × 1/12)	634
		7,065

(W-1) **Capitalisation Rate of general borrowing**

	Loan	Period outstanding	Loan outstanding	Rate	Interest
MCB	50,000	× 12/12	50,000	12%	6,000
Debenture	80,000	× 12/12	80,000	8.5%	6,800
Silk	6,000	× 9/12	4,500	13.0%	585
HBL	90,000	× 4/12	30,000	15.0%	4,500
			164,500		17,885

Rate for general borrowing (17,885/164,500) 10.87%

Scanned with CamScanner

Answer-12

Capitalisation rate on general borrowing		(2,600,000/20,000,000)	13%
Interest accrued on general borrowings			
General borrowings	1-Jan-20X5	(300,000 × 13% × 12/12)	39,000
	1-Apr-20X5	(200,000 × 13% × 9/12)	19,500
	1-Jul-20X5	(250,000 × 13% × 6/12)	16,250
	1-Sep-20X5	(150,000 × 13% × 4/12)	6,500
	1-Oct-20X5	(200,000 × 13% × 3/12)	6,500
			87,750

b) **Depreciation is not charged as asset is yet not complete.**

Cost of asset	
Construction cost paid (300,000 + 200,000 + 250,000 + 150,000 +200,000)	1,100,000
Add: Borrowing cost to be capitalized	87,750
	1,187,750

c) **Net book value**

Cost	1,187,750
Less: Accumulated depreciation	-
	1,187,750

Answer-13

Borrowing cost to be capitalized

Interest incurred during construction on general borrowing

(20,000,000 × 8.23% × 12/12) 1,646,000

	Loan	Period outstanding	Loan outstanding	Rate	Interest
Bank loan	5,000,000	× 12/12	5,000,000	7%	350,000
Institutional loan	7,000,000	× 12/12	7,000,000	8%	560,000
Corporate bonds	10,000,000	× 12/12	10,000,000	9%	900,000
			22,000,000		1,810,000
Rate for general borrowing		(1,810,000/22,000,000)			8.23%

Answer-14

a) **Borrowing costs to be capitalized**

	Rs. In '000'
Interest incurred during construction on specific borrowing (20,000 × 7%)	1,400
Interest incurred during construction on general borrowing	3,536
	4,936

(W-1) (W-2)

Date	Description	Specific	General	Balance
1/1/2014	Loan raised	20,000		
1/1/2014	Construction cost of Rs. 50,000	(20,000)	(30,000)	
1/10/2014	Construction cost of Rs. 30,000		(30,000)	

As there are no surplus funds, so investment income is not calculated.

Scanned with CamScanner

Loan	Loan amount	Period outstanding	Loan outstanding	Rate	Interest
Loan 1	100,000	× 12/12	100,000	10%	10,000
Loan 2	40,000	× 12/12	40,000	8%	3,200
			140,000		13,200
Rate for general borrowing		(13,200/140,000)			9.43%

(W-2) Interest incurred during construction on general borrowing

(30,000 (W-1) × 9.43% × 12/12)	2,829
(30,000 (W-1) × 9.43% × 3/12)	707
	3,536

Answer-15

Borrowing cost to be capitalized

Interest on specific loan net of investment income	(W-3)	50,000
Interest on general loan		41,250
		91,250

(W-1)

Date	Description	Specific	General	Balance
1/7/06	Loan obtained	700,000		
1/7/06	Construction cost	(200,000)		500,000
30/9/06	Construction cost of 600,000	(500,000)	(100,000)	-
31/3/07	Construction cost		(1,200,000)	
30/6/07	Construction cost		(200,000)	

(W-2)

	Loan	Period outstanding	Loan outstanding	Rate	Interest
12.5% loan	1,000,000	× 12/12	1,000,000	12.5%	125,000
10% loan	1,500,000	× 12/12	1,500,000	10.0%	150,000
			2,500,000		275,000
Rate for general borrowing		(275,000/2,500,000)			11.00%

(W-3)

Specific borrowing interest

Interest incurred during construction on specific borrowing	70,000
Less: Investment income	(20,000)
	50,000

(W-4)

Interest incurred during construction on general borrowing

(100,000 × 11% × 9/12)	8,250
(1,200,000 × 11% × 3/12)	33,000
(200,000 × 11% × 0/12)	-
	41,250

Scanned with CamScanner

Answer-16

Expenditure incurred	(7,500,000 + 9,500,000)		17,000,000
Specific Borrowing		(W-1)	745,000
Interest incurred during construction on general borrowing		(W-3)	610,050
			18,355,050

Date	Description	Specific	General
1/1/2014	Loan raised	5,500,000	
1/1/2014	Construction cost of 7,500,000	(5,500,000)	(2,000,000)
1/7/2014	Loan raised	3,250,000	
1/9/2014	Construction cost of 9,500,000	(3,250,000)	(6,250,000)

(W-1)

Interest incurred during construction on specific loan

(5,500,000 × 10%)	550,000
(3,250,000 × 12% × 6/12)	195,000
	745,000

(W-2)

	Loan	Period outstanding	Loan Outstanding	Rate	Interest
15% Bank loan	6,500,000	x 12/12	6,500,000	15%	975,000
10% Bank loan	1,000,000	x 1/12	83,333	10%	8,333
			6,583,333		983,333
Rate for general borrowing	(983,333/6,583,333)				14.94%

(W-3) **Interest incurred during construction on general borrowing**

(2,000,000 × 14.94% × 12/12)	298,800
(6,250,000 × 14.94% × 4/12)	311,250
	610,050

Answer-17

Borrowing cost to be capitalized **Rs. In '000'**

Interest incurred during construction on specific borr. (500 × 15% × (12-2)/12	62.50	
Less: Investment income during construction (W-2)	(7.33)	55.17
Interest incurred during construction on general borrowing (W-3)		11.92
		67.09

(W-1)

Date	Description	Specific	General	Balance
1-Jan-07	Opening balance of loan	500		300
1-Jan-07	Construction payment of 200	(200)		100
1-Apr-07	Construction payment of 200	(200)		
1-Jul-07	Construction payment of 200	(100)	(100)	
1-Oct-07	Construction payment of 200		(200)	

(W-2) **Investment income**

1-Jan-07	(300 × 8% × 3/12)	6.00
1-Apr-07	(100 × 8% × (3-1)/12)	1.33
		7.33

Scanned with CamScanner

(W-3) **Interest accrued on general borrowings**

1-Jul-07	(100 × 13% × (6-1)/12)	5.42
1-Oct-07	(200 × 13% × 3/12)	6.50
		11.92

(W-4) **Capitalisation Rate of general borrowing**

Loan	Loan amount	Period outstanding	Loan outstanding	Rate	Interest
Loan 1	600	× 11/12	550.00	12%	66.00
Loan 2	400	× 9/12	300.00	14%	42.00
Loan 3	300	× 10/12	250.00	14%	35.00
			1,100.00		143.00
Rate for general borrowing		(143/1,100)			13.00%

Answer-18

Borrowing costs to be capitalized

Interest on specific loan net of investment income	(W-2)	32,062
Interest incurred during construction on general borrowing	(W-4)	11,250
		43,312

(W-1)

Date	Description	Specific	General	Balance
15/8/07	Opening balance	400,000		
15/8/07	Construction cost of Rs. 150,000	(150,000)		250,000
1/11/07	Construction cost of Rs. 200,000	(200,000)		50,000
1/3/08	Construction cost of Rs. 300,000	(50,000)	(250,000)	

(W-2) **Specific borrowing interest**

Interest incurred during construction on specific borrowing	34,000
[(400,000 × 12%) × (9.5-1/12)]	
Less: Investment income (W-3)	(1,938)
	32,062

(W-3) **Investment Income**

15/8/07	(250,000 × 3% × 2.5/12)	1,563
1/11/07	[(50,000 × 3%) × (4-1/12)]	375
		1,938

(W-4) **Interest on general borrowing** 11,250

(250,000 (W-1) × 18% × 3/12)

Scanned with CamScanner

Answer-19

Borrowing costs to be capitalized

Interest on specific loan net of investment income	(W-2)	425,000
Interest incurred during construction on general borrowing	(W-4)	204,167
		629,167

(W-1)

Date	Description	Equity	Specific	General	Balance
1/2/12	Right issues	3,000,000			
1/2/12	Construction cost of Rs. 2,000,000	(2,000,000)			
1/3/12	Construction cost of Rs. 500,000	(500,000)			
1/4/12	Specific loan raised		5,000,000		
1/4/12	Construction cost of Rs. 3,000,000	(500,000)	(2,500,000)		2,500,000
1/8/12	Construction cost of Rs. 6,000,000		(2,500,000)	(3,500,000)	

(W-2) Specific borrowing interest

Interest incurred during construction on specific borrowing	(5,000,000 × 12% × 9/12)	450,000
Less: Investment income	(W-3)	(25,000)
		425,000

(W-3) Investment Income

1/4/12	(2,500,000 × 3% × 4/12)	25,000

(W-4) Interest on general borrowing

(3,500,000 (W-1) × 14% × 5/12)	204,167

Answer-20

Borrowing cost to be capitalized

	Asset A	Asset B
Interest incurred during construction on specific loan		
(1,000,000 × 7%)	70,000	
(1,500,000 × 7%)		105,000
Less: Investment income		
(500,000 × 4% × 6/12)	(10,000)	
(750,000 × 4% × 6/12)		(15,000)
	60,000	90,000

(W-1) Asset A

Date	Description	Specific	General	Balance
1/1/2014	Loan raised	1,000,000		
1/1/2014	Construction cost	(500,000)		500,000
1/7/2014	Construction cost	(500,000)		

(W-2) Asset B

Date	Description	Specific	General	Balance
1/1/2014	Loan raised	1,500,000		
1/1/2014	Construction cost	(750,000)		750,000
1/7/2014	Construction cost	(750,000)		

Scanned with CamScanner

Answer-21

Borrowing cost to be capitalized

		Plant A	Plant B
Interest incurred during construction on specific loan			
(200,000 × 10% × 6/12)		10,000	
(200,000 × 10%)			20,000
Less: Investment income	(W-3)		(7,350)
		10,000	12,650

We will stop capitalization on plant A on 30/06/14 as the construction has ceased.

(W-1) Plant A

Date	Description	Specific	General	Balance
1/1/2014	Loan raised (Note)	200,000		
1/1/2014	Construction cost	(200,000)		-

(W-2) Plant B

Date	Description	Specific	General	Balance
1/1/2014	Loan raised (Note)	200,000		
1/1/2014	Construction cost	(60,000)		140,000
30/6/14	Construction cost	(70,000)		70,000

(W-3) Investment income on plant B

(140,000 × 7% × 6/12)	4,900
(70,000 × 7% × 6/12)	2,450
	7,350

Note: Plant A got completed for Rs. 200,000, therefore the remaining loan of Rs. 200,000 (400,000 -200,000) will be used for plant B.

Answer-22

Interest expense for the year

				Rs. in 'm'
1-Jan-15	Loan received	90	× 12% × 6/12	5.40
30-Jun-15	Less: Principal repaid	(10)		
		80	× 12% × 6/12	4.80
31-Dec-15	Less: Principal repaid	(10)		
31-Dec-15	Balance	70		
				10.20

Mr. Tipu

Statement of Financial Position (Extracts)

as on December 31, 2015

		Rs. in 'm.'
Equity and liabilities		
Non-Current Liabilities		
Loan payable	(70 – 10 – 10)	50
Current Liabilities		
Current portion of long term loan	(10 + 10)	20

Note: Current portion is payable on June 30, 2016 and December 31, 2016.

Scanned with CamScanner

Answer-23

Interest expense for the year

				Rs. in 'm.'
1-Jan-15	Opening balance	70		
1-Jan-15	Less: Principal repaid	(5)		
		65	× 15% × 6/12	4.88
1-Jul-15	Less: Principal repaid	(5)		
31-Dec-15	Balance	60	× 15% × 6/12	4.50
				9.38

Mr. Atif
Statement of Financial Position (Extracts)
as on December 31, 2015

		Rs in 'm.'
Equity and liabilities		
Non-Current Liabilities		
Loan payable	(60 – 5 – 5)	50
Current Liabilities		
Current portion of long term loan	(5 + 5)	10
Interest payable		4.5

Note: Current portion is payable on January 1, 2016 and July 1, 2016.

Answer-24

Interest expense for the year

				Rs. in 'm.'
1-Apr-15	Loan received	150	× 13% × 3/12	4.88
30-Jun-15	Less: Principal repaid	(15)		
		135	× 13% × 3/12	4.39
30-Sep-15	Less: Principal repaid	(15)		
		120	× 13% × 3/12	3.90
31-Dec-15	Less: Principal repaid	(15)		
31-Dec-15	Balance	105		
				13.17

Scanned with CamScanner

Mr. Taimoor
Statement of Financial Position (Extracts)
as on December 31, 2015

		Rs in 'm.'
Equity and liabilities		
Non-Current Liabilities		
Loan payable	(105 – 15 – 15 – 15 –15)	45
Current Liabilities		
Current portion of long term loan	(15 + 15 + 15 +15)	60

Note: Current portion is payable on March 31, 2016, June 30, 2016, September 30, 2016 and December 31, 2016.

Answer-25

Interest expense for the year

				Rs. in 'm.'
1-Oct-15	Loan received	80	× 9.125% × 1/12	0.61
1-Nov-15	Less: Principal repaid	(10)		
		70	× 9.125% × 1/12	0.53
1-Dec-15	Less: Principal repaid	(10)		
31-Dec-15	Closing balance of loan	60	× 9.125% × 1/12	0.46
				1.60

Annual rate of interest	(0.25/Rs. 1,000) × 365 days	9.125%

Mr. Mouse
Statement of Financial Position (Extracts)
as on December 31, 2015

		Rs. in 'm.'
Equity and liabilities		
Non-Current Liabilities		
Loan payable		-
Current Liabilities	(80-10-10)	
Current portion of long term loan		60
Interest payable		0.46

Note: Current portion is payable in remaining 6 installments starting from January 1, 2016.

Scanned with CamScanner

The progress bills were paid after deduction of advance and retention money at 10% and 5% of the gross amount of the bills respectively. Retention money is to be refunded on completion of warranty period of one year from the date of completion of the building.

On 1 September 2014, the construction work was stopped for one month to resolve geological complications pertaining to foundation of the building.

The construction cost has been financed from the following sources:

(i) Bank loan of Rs. 100 million was obtained on 1 July 2014. The loan carries a mark-up of 11% payable semi-annually on 31 December and 30 June each year. The principal is repayable in four equal annual instalments, commencing from 1 April 2015.

(ii) Existing finance facility was used for balance payments. Average running finance balance for the year ended 31 December 2014 was Rs. 190 million. Mark-up charges for the year ended 31 December 2014 amounted to Rs. 24.70 million.

(iii) Surplus funds available were invested in a saving account @ 7% per annum.

ATL computes finance cost on a monthly basis.

Required:

From the above information, compute the related amounts and disclose them under appropriate heads in ATL's Statement of Financial Position as at 31 December 2014 in accordance with the International Financial Reporting Standards

(12)

{Spring 2015, Q # 7}

Question-5

On September 1, 2008, Spin Industries Limited (SIL) started construction of its new office building and completed it on May 31, 2009. The payments made to the contractor were as follows:

Date of Payment	Rupees
September 1, 2008	10,000,000
December 1, 2008	15,000,000
February 1, 2009	12,000,000
June 1, 2009	9,000,000

In addition to the above payments, SIL paid a fee of Rs. 8 million on September 1, 2008 for obtaining a permit fee allowing the construction of the building.

The project was financed through the following sources:

(i) On August 1, 2008 a medium term loan of Rs. 25 million was obtained specifically for the construction of the building. The loan carried mark up of 12% per annum payable semi-annually. A commitment fee @ 0.5% of the amount of loan was charged by the bank.

Surplus funds were invested in savings account @ 8% per annum. On February 1, 2009 SIL paid the six monthly interest plus Rs. 5 million towards the principal.

(ii) Existing running finance facilities of SIL

- Running finance facility of Rs. 28 million from Bank A carrying mark up of 13% payable annually. The average outstanding balance during the period of construction was Rs. 25 million.
- Running finance facility of Rs. 25 million from Bank B. The mark up accrued during the period of construction was Rs. 3 million and the average running finance balance during that period was Rs. 20 million.

Required:

Calculate the amount of borrowing costs to be capitalized on June 30, 2009 in accordance with the requirements of International Accounting Standards. ***(Borrowing cost calculations should be based on number of months).***

(18)

{Autumn 2009, Q # 4}

Scanned with CamScanner

Question-6

On 01 January 2012, Marvellous Engineering Limited (MEL) started construction of its new factory. The construction work was completed on 30 November 2012. The payments made to the contractor were as follows:

Date of payment	Rs. in million
01-Jan-12	100
01-Apr-12	310
15-Dec-12	90

The construction work was financed through the following sources:

Date	Description	Rs. in million
01-Jan-12	12% Redeemable preference shares	150
01-Apr-12	14% TFCs for four years	300
01-Jul-12	Issue of right shares (estimated return is 22%)	50

The following additional information is also available:

(i) The preference shares would be redeemed on 31 December 2016.
(ii) Surplus funds were invested in a savings scheme @ 9% per annum.
(iii) Due to delay in supply of construction material, the construction work was suspended from 01 June 2012 to 30 June 2012.

Required:

Calculate the amount of borrowing costs that may be capitalized during the year ended 31 December 2012 in accordance with the requirements of International Financial Reporting Standards. *(Assume that calculations of borrowing costs are based on number of months)* **(10)**

{Spring 2013, Q # 6}

Question-7

On 1 March 2010, Granite Corporation (GC) started the construction of a new plant to meet the growing demand for its products. The new plant was completed at a cost of Rs. 100 million on 31 May 2011.

GC financed the cost of the project from the following sources:

(i) On 1 March 2010, a 7-year loan of Rs. 70 million was obtained specifically for the construction of the plant. The loan earned mark- up @ 13% per annum payable semiannually. An arrangement fee @ 1% of the loan amount was paid to the bank.
Two installments, each comprising of repayment of principal of Rs. 5 million with interest, were paid on 31 August 2010 and 28 February 2011.
(ii) GC also has a running finance facility of Rs. 100 million carrying mark-up @ 14% per annum. Any additional amount required for the project was provided through this facility.
(iii) Surplus funds were invested in savings account @ 8% per annum.

Payments made to the contractor were as follows:

Payment date	Rs. in million
01 March 2010	25
31 January 2011	65
30 September 2011	10

The construction work was suspended from 1 February 2011 to 28 February 2011. The suspension was caused due to delay in shipment of essential components for the installation of the plant.

Required:

Calculate the amount of borrowing costs that may be capitalized during the years ended 30 June 2010 and 2011 in accordance with the requirements of International Financial Reporting Standards. **(20)**

{Autumn 2011, Q # 2}

Scanned with CamScanner

ICAP PAST PAPER SOLUTIONS

Answer-1

All figure in Rs. in '000'

Borrowing cost to be capitalized

Interest incurred during construction on specific borrowing	(W-1)	3,231
Less: Investment income excluding suspension period	(500/10 × 8)	(400)
		2,831

(W-1) Interest accrued on specific loan

1-Mar-07	First loan	32,000 × 13% × (10-2)/12	2,773
1-Aug-07	Second loan	10,000 × 11% × 5/12	458
			3,231

Answer-2

All figure in Rs. in '000'

Borrowing cost to be capitalized

Interest incurred during construction on specific borrowing (W-1) 8,100

(W-1) Interest accrued on specific loan

1-Mar-06	Loan A	30,000 × 12% × 9/12	2,700
1-Mar-06	Loan B	40,000 × 18% × 9/12	5,400
			8,100

We will start capitalisation from March 1 because it is the date on which we started incurring borrowing cost.

Answer-3

a) **Actual interest cost**

All figure in Rs. '000'

Interest incurred on specific borrowing	(1,500 × 15%)	225
Interest incurred on general borrowing	(1,100 × 10%) + (1,200 × 12%)	254
		479

b) **Capitalisation Rate of general borrowing**

	Loan	Period outstanding	Loan outstanding	Rate	Interest
Loan payable	1,100	× 12/12	1,100	10.0%	110
Bonds issued	1,200	× 12/12	1,200	12.0%	144
			2,300		254
Rate for general borrowing			(254/2,300)		11.04%

c) **Borrowing costs to be capitalized**

Interest incurred during construction on specific borrowing	(1,500 × 15%)	225
Interest incurred during construction on general borrowing	(W-1)	44
		269

(W-1) **Interest accrued on general borrowings**

1-May-02 (600 × 11.04% × 8/12) 44

Scanned with CamScanner

(W-2)

Date	Description	Specific	General
1/1/2002	Opening balance of specific	1,500	
1/1/2002	Construction payment of Rs. 420	(420)	
1/3/2002	Construction payment of Rs. 600	(600)	
1/5/2002	Construction payment of Rs. 1,080	(480)	(600)
31/12/2002	Construction payment of Rs. 900		(900)

Answer-4

Alpha Trading Limited
Statement of Financial Position (Extracts)
as on 31 December 2014

Assets		Rs in 'million'
Non-current assets		
Capital work in progress	(W-1)	216.358
Non-current liability		
Bank loan	(100 × 3/4)	75
Retention money payable	(W-6) (4.7 + 5.9)	10.6
Current liability		
Current portion of bank loan	(100 × 1/4)	25
Payable for construction	(W-6)	100.3

Note: "Advance" is not shown in SOFP because no bifurcation can be made between its current and non-current portion as future progress bill details is not available.

(W-1) Cost of capital work in process

Interest on Specific borrowing	(W-3)	3.708
Interest on general borrowing	(W-4)	0.65
Gross payments	(W-5)	212.00
		216.358

(W-2) Receipt and payment schedule

Year ended 31 December 2014

Date	Description	Specific loan	General loan	Balance
1-July-14	Receipt	100		50
1-July-14	Advance payment	(50)		
31-Oct-14	1st progress bill of 79.90	(50)	(29.9)	

*As interest payment is on 31 December so it will not effect any of the calculation.

(W-3) Specific Borrowing

Interest incurred on specific loan		
1-Jul-14 Loan received	(100 × 11% × (6 – 1) /12)	4.583
Less: Investment Income		
1-July-14	(W-2) (50 × 7% × (4 – 1) /12)	(0.875)
		3.708

Scanned with CamScanner

(W-4) General Borrowing

Interest incurred on general loan		
General	(W-2) (29.9 × 13% × 2/12)	0.65
		0.65
Rate on general	(24.7 / 190)	13%

(W-5) Payments detail

		Gross Amount (Net payment/85x100)	Retention money (Gross x 5%)	Advance adj. (Gross x 10%)	Net payment
1-Jul-14	Advance				50.0
31-Oct-14	1st Progress bill	94.0	4.7	9.4	79.9
31-Jan-15	2nd Progress bill	118.0	5.9	11.8	100.3
		212			

(W-6) Entries for construction related payments only (for understanding of students only)

1-Jul-14	Advance	50	
	Bank		50
	(Payment of advance)		
10-Sep-14	CWIP	94	
	Advance		9.4
	Retention money payable		4.7
	Payable for construction		79.9
	(Recording of first progress bill)		
31-Oct-14	Payable for construction	79.9	
	Bank		79.9
	(Payment of first progress bill)		
30-Dec-14	CWIP	118	
	Advance		11.8
	Retention money payable		5.9
	Payable for construction		100.3
	(Recording of second progress bill)		

Answer-5

Borrowing costs to be capitalized

All figure in Rs in '000'

Commitment fee	(25,000 × 0.5%)		125
Interest incurred during construction on specific borrowing (W-2)		2,050	1,912
Less: Investment income during construction (W-4)		(138)	1,421
Interest incurred during construction on general borrowing (W-3)			3,458

Scanned with CamScanner

(W-1) Receipt and payment schedule

Date	Description	Specific	General	Balance
1-Sep-08	Opening balance of specific loan	25,000		
1-Sep-08	Commitment fee (25,000 × 0.5%)	(125)		
1-Sep-08	Construction payment	(10,000)		
1-Sep-08	Permit fee	(8,000)		
		(18,125)		6,875
1-Dec-08	Construction payment of Rs. 15,000	(6,875)	(8,125)	
1-Feb-09	Principal payment of loan		(5,000)	
	Interest on loan (25,000 × 12% × 6/12)		(1,500)	
	Construction payment of Rs. 12,000		(12,000)	
			(18,500)	

Although these 2 amounts relate to 1 -Aug but the project is started on 1-Sep therefore this date is written.

(W-2) Interest accrued on specific borrowing

1-Sep-08	Opening balance of loan	25,000	× 12% × 5/12	1,250
1-Feb-09	Less: Principal repaid	(5,000)		
		20,000	× 12% × 4/12	800
				2,050

(W-3) Interest accrued on general borrowing

General	(8,125 × (W-5) 13.89 × 6/12)	564
General	(18,500 × (W-5) 13.89 × 4/12)	857
		1,421

On 31-5-09 building is complete, so we will stop capitalisation.

(W-4) Investment Income

1-Sep-08 Onwards (6,875 × 8% × 3/12) 138

(W-5) Rate of general borrowing

	Weighted loan	Rate	Interest
Bank A	25,000	13%	3,250
Bank B	20,000		3,000
	45,000		6,250
Rate of general loan (6,250/45,000)		13.89%	

Answer-6

All figures in Rs in '000'

Borrowing cost to be capitalized

Interest incurred during construction on specific borrowing (W-2)	39,500
Less: Investment income during construction (W-3)	(3,225)
	36,275

Scanned with CamScanner

(W-1)

Date	Description	Equity	Specific	General	Balance
1-Jan-12	Preference shares		150,000		
1-Jan-12	Construction payment		(100,000)		50,000
1-Apr-12	TFC loan		300,000		
1-Apr-12	Construction payment		(310,000)		40,000
1-Jul-12	Right shares	50,000			

(W-2) Interest accrued on specific loan

1-Jan-12	Preference shares	150,000	× 12% × (11-1)/12	15,000
1-Apr-12	TFC	300,000	× 14% × (8-1)/12	24,500
				39,500

(W-3) Investment Income

1-Jan-12	(50,000 × 9% × 3/12)	1,125
1-Apr-12	(40,000 × 9% × (8-1)/12)	2,100
		3,225

Answer-7

All figure in Rs in '000'

Year ended 30 June 2010

Borrowing costs to be capitalized

Commitment fee	(7,000 × 1%)		700
Interest incurred during construction on specific loan	(W-2)	3,033	
Less: Investment income during construction	(W-3)	(1,181)	1,852
			2,552

(W-1)

Date	Description	Specific	General	Balance
1-Mar-10	Loan receipt	70,000		
1-Mar-10	Commitment fee (70,000 × 1%)	(700)		
1-Mar-10	Construction payment	(25,000)		
		(25,700)		44,300

(W-2) Interest accrued on specific borrowing

1-Mar-10 (70,000 × 13% × 4/12) 3,033

(W-3) Investment Income

1-Mar-10 Onwards (44,300 × 8% × 4/12) 1,181

Year ended 30 June 2011

Borrowing costs to be capitalised

Interest incurred during construction on specific borrowing	(W-5)	6,988	5,239
Less: Investment income during construction	(W-7)	(1,749)	1,382
Interest incurred during construction on general borrowing	(W-6)		6,621

Scanned with CamScanner

Date	Description	Specific	General	Balance
1-Jul-10	Opening balance available for investment			44,300
31-Aug-10	Principal payment	(5,000)		
31-Aug-10	Interest (70,000 × 13% × 6/12)	(4,550)		
		(9,550)		34,750
31-Jan-11	Construction payment of 65,000	(34,750)	(30,250)	
28-Feb-11	Principal payment		(5,000)	
28-Feb-11	Interest (65,000 × 13% × 6/12)		(4,225)	
			(9,225)	

(W-5) Interest accrued on specific borrowing

1-Jul-10	Opening payable	70,000	× 13% × 2/12	1,517
31-Aug-10	Less: Principal repaid	(5,000)		
		65,000	× 13% × (6-1)/12	3,521
28-Feb-11	Less: Principal repaid	(5,000)		
		60,000	× 13% × 3/12	1,950
				6,988

- Instead of 6 months, 5 months are used in calculation as work was suspended for 1 month.
- On 31-5-11 plant is complete, so will stop capitalisation.

(W-6) Interest accrued on general borrowing

General	(30,250 × 14% × (4-1) /12)	1,059
General	(9,225 × 14% × 3/12)	323
		1,382

- Instead of 4 months, 3 months are used in calculation as work was suspended for 1 month.

(W-7) Investment Income

1-Jul-10	Brought forward	(44,300 × 8% × 2/12)	591
31-Aug-10	Onwards	(34,750 × 8% × 5/12)	1,158
			1,749

Scanned with CamScanner

ICAP QUESTION BANK QUESTION

Question 1

Shayan Limited (SL) started the construction of its new factory on 1 January 2018 with a loan of 5,000,000 borrowed at an interest rate of 8% per annum.

The loan was used on the factory as follows:

Date of Payment	Rs. in million
Jan 1, 2018	15
May 1, 2018	20
Oct 1, 2018	10

The construction of the asset was completed on 31 December 2018. However, during the accounting period SL invested the surplus funds at an interest rate of 3%.

Required

How much the amount of borrowing cost eligible for capitalization at 31.12.2018

(ICAP Example 3)

Question 2

On January 1, 2018 Sara Limited (SL) started the construction of an asset. To meet the financing requirements, borrowing was made from three different banks at the start of the year as follows:

Banks	Amount	Interest Rate p.a
A	70,000	10%
B	60,000	8%
C	50,000	12%

The funds were used on the assets as follows:

Date of Payment	Rs.in million
Jan 1, 2018	30,000
May 1, 2018	20,000
Oct 1, 2018	15,000

The construction of asset was completed on 31 December 2018.

Required

Calculate the general weighted average borrowing rate and eligible borrowing cost

(ICAP Example 4)

Question-3

Looney has recently finished building a new item of plant for its own use. The item is a press for use in the manufacture of industrial diamonds. Rooney commenced construction of the asset on 1st April 2013 and completed it on 1st April 2015.

1st January 2013, Rooney took out a loan to finance the construction of the asset. Interest is charged on the loan at the rate of 5% per annum. The annual interest must be paid in four equal instalments at the end of each quarter. Rooney capitalises interest on manufactured assets in accordance with the rules in IAS 23 Borrowing costs.

The costs (excluding finance costs) of manufacturing the asset were Rs. 28 million.

Required

State the IAS 23 rules on the capitalisation of borrowing costs, calculate the cost of the asset on initial recognition and explain the amount of borrowing cost capitalised. (5)

(ICAP Example 5)

Scanned with CamScanner

Question 4

On 1 January 20X6 Googly Industries Limited (GIL) borrowed Rs.15 million to finance the production of two assets, both of which were expected to take a year to build. Work started during 20X6. The loan facility was drawn down and incurred on 1 January 20X6, and was utilised as follows, with the remaining funds invested temporarily.

	Asset A	Asset B
	---------- Rs. in million	---------
1 January 20X6	2.5	5
1 July 20X6	2.5	5

The loan rate was 9% and GIL can invest surplus funds at 7%.

Required

Ignoring compound interest, calculate the borrowing costs which may be capitalised for each of the assets and consequently the cost of each asset as at 31 December 20X6. ***(ICAP Example 6)***

Question 5

Khan Limited (KL) has the following loan arrangements as at 1 January 2020:

7% Debentures	55
8% Loan notes	110
12% Line of credit	85
10% Running finance arrangement	150

On the 1 January 2020, KL commenced the construction of a new factory. The construction of the factory will cost Rs.100 million and the company funded the construction with the existing borrowings.

The factory was completed on 31 August 2020 but was not available for use until 31 January 2021 as a result of minor modification. During the construction period, active work was interrupted and the building construction was stopped for two months as a result of adverse weather conditions.

Required

Calculate the borrowing cost to be capitalised and the cost of the building to be recognised upon initial recognition. ***(ICAP Example 7)***

Scanned with CamScanner

ICAP QUESTION BANK SOLUTIONS

Answer-1

Eligible Borrowing Cost = Actual Borrowing Cost – Income from temporary investment of funds = (50,000,000 × 8%) less 375,000

Eligible Borrowing Cost = 3,625,000

Income from investment of Surplus funds:

(25,000,000 × 3%) × 4/12 + (1,000,000 × 3%) × 5/12 = 375,000

Answer 2

Calculation of Eligible Borrowing Cost:

Loan	Amount	Period outstanding	Loan outstanding	Rate %	Interest amount
A	70,000	12/12	70,000	10%	7,000
B	60,000	12/12	60,000	8%	4,800
C	50,000	12/12	50,000	12%	6,000
			180,000		17,800

Capitalization rate = $\frac{17,800}{180,000} \times 100 = 9.89\%$

Eligible borrowing cost = Rs.4,657

(W-1) Expenditure × Rate × Period outstanding

	Rs. in million
$30,000 \times 9.89\% \times \frac{12}{12} =$	2,967
$20,000 \times 9.89\% \times \frac{8}{12} =$	1,319
$15,000 \times 9.89\% \times \frac{3}{12} =$	371
	4,657

Answer 3

IAS-23 should be applied in accounting for borrowing costs.

Borrowing costs are recognized as an expense in the period in which they are incurred unless they are capitalized in accordance with IAS-23 which says that borrowing costs are directly attributable to the acquisition, construction or production of a qualifying asset can be capitalized as a part of the cost of that asset.

1) A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.
2) Borrowing costs that are directly attributable to acquisition, construction or production are taken to mean those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made.

Scanned with CamScanner

When an enterprise borrows specifically for the purpose of funding an asset, the identification of the borrowing costs presents no problem as the amount capitalized is the actual borrowing costs net of any income earned on the temporary investment of those borrowings.

If funds are borrowed, generally, the amount of borrowing costs eligible for capitalisation is determined by applying a capitalisation rate to the expenditure on that asset calculated as weighted average of the borrowing costs applicable to general borrowings.

Cost of capital work in process	**Rs in '000'**
Construction cost	28,000
Add: Interest incurred during construction on specific borrowing (28,000 × 5% × 2 years)	2,800
	30,800

Answer-4

The borrowing cost to be capitalized & cost of assets are as under

Cost of asset A	**Rs.**
Expenditure	5,000,000
Borrowing costs incurred 5m x 9% x 12/12	450,000
Less: Temporary investment income 2.5m x 7% x 6/12	(87,500)
	362,500
	5,362,000

Cost of asset B	**Rs.**
Expenditure	10,000,000
Borrowing costs incurred 10m x 9% x 12/12	900,000
Less: Temporary investment income 5m x 7% x 6/12	(175,000)
	725,000
	10,725,000

Answer 5

The borrowing cost to be capitalized & cost of assets are as under:

	Rs.
Expenditure	100,000,000
Borrowing costs to be capitalised 100,000,000 x 9.46% x 6/12	4,730,000
	104,730,000

January to August are 8 months – two months suspension = 6 months

Capitalisation rate = $\frac{(55 \times 7\%) + (110 \times 8\%) + (85 \times 12\%) + (150 \times 10\%)}{55+110+85+150} \times 100 =$ **9.46%**

Scanned with CamScanner

ICAP MULTIPLE CHOICE QUESTIONS (MCQs)

Q.1 Which TWO of the statements below regarding IAS 23 Borrowing Costs are correct?

(a) Borrowing costs must be capitalised if they are directly attributable to qualifying assets

(b) Borrowing costs should cease to be capitalised once the related asset is substantially complete

(c) Borrowing costs must be capitalised if they are directly attributable to non-current assets

(d) Borrowing costs may be capitalised if they are directly attributable to qualifying assets

Q.2 Fine Limited (FL) received a Rs.10 million loan at 7.5% on 1 April 2017. The loan was specifically issued to finance the building of a new store.

Construction of the store commenced on 1 May 2017 and it was completed and ready for use on 28 February 2018 but did not open for trading until 1 April 2018.

How much should be recorded as finance costs in the statement of profit or loss for the year ended 31 March 2018?

(a) Rs.250,000 (b) Rs.750,000

(c) Rs.125,000 (d) Rs.625,000

Q.3 Fine Limited (FL) received a Rs.10 million loan at 7.5% on 1 April 2017. The loan was specifically issued to finance the building of a new store.

Construction of the store commenced on 1 May 2017 and it was completed and ready for use on 28 February 2018 but did not open for trading until 1 April 2018.

How much interest should be capitalised as part of property, plant and equipment as at 31 March

Q.4 An entity decided that not all of the funds raised were needed immediately and temporarily invested some of the funds for one month before the construction started, earning Rs.40,000 interest.

How should the Rs.40,000 be accounted for in the financial statements?

(a) Net off the amount capitalised in property, plant and equipment

(b) Taken to the statement of profit or loss as investment income

(c) Taken as other comprehensive income

(d) Deducted from the outstanding loan amount in the statement of financial position

Q.5 Shine Limited (SL) had the following bank loans outstanding during the whole of 2018:

	Rs. m
9% loan repayable 2019	15
11 % loan repayable 2022	24

SL began construction of a qualifying asset on 1 April 2018 and withdrew funds of Rs. 6 million on that date to fund construction. On 1 August 2018 an additional Rs. 2 million was withdrawn for the same purpose.

Calculate the borrowing costs which can be capitalised in respect of this project for the year ended 31 December 2018.

(a) Rs.545,600

(c) Rs.750,600 (b) Rs.472,350

(d) Rs.350,350

Scanned with CamScanner

Q.6 Jazz Limited (JL) has borrowed Rs.24 million to finance the building of a factory. Construction is expected to take two years.

The loan was drawn down and incurred on 1 January 2019 and work began on 1 March 2019. Rs.10 million of the loan was not utilized until 1 July 2019 so JL was able to invest it until needed. JL is paying 8% on the loan and can invest surplus funds at 6%.

Calculate the borrowing costs to be capitalised for the year ended 31 December 2019 in respect of

(a) Rs.1,400,000 (b) Rs.1,920,000

(c) Rs.1,300,000 (d) Rs.1,620,000

Q.7 A company has the following loans in place throughout the year ended 31 December 2018.

	Rs. m
10% bank loan	140
8% bank loan	200

On 1 July 2018 Rs.50 million was drawn down for construction of a qualifying asset which was completed during 2019.

What amount should be capitalised as borrowing costs at 31 December 2018 in respect of this

(a) Rs. 5.6 million (b) Rs. 2.8 million

(c) Rs. 4.4 million (d) Rs. 2.2 million

Q.8 An entity uses funds from its general borrowings to build a new production facility. Details of the entity's borrowings are shown below:

Rs.10 million 6% loan

Rs.6 million 8% loan

The entity used Rs.12 million of these funds to construct the facility, which was under construction for the entire year.

How much interest should be capitalised as part of the cost of the asset?

Rs. _____

Q.9 Which of the following is not considered a "borrowing cost" under IAS 23?

(a) Interest expense calculated by the effective interest method

(b) Finance charges in respect of loan

(c) Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs

(d) Principal repayments on a loan for property, plant and equipment

Q.10 When activities to prepare an asset for its sale or use are suspended, borrowing costs must be?

(a) Capitalized (b) Expensed

(c) Ignored (d) Charged to equity

Q.11 Which of the following is not a condition to commence capitalisation of borrowing costs?

(a) Expenditures are being incurred

(b) Borrowing costs are being incurred

(c) Repayment of borrowings has commenced

(d) Activities to produce the asset for its intended use or sale have commenced

Scanned with CamScanner

Q.12 Ghazi Limited (GL) is constructing an office building and is capitalising borrowing costs in accordance with IAS 23. The office is almost complete; the only remaining work is to install furniture. Is GL allowed to continue capitalising the borrowing costs?

(a) Yes (b) No

(c) Don't know (d) None of the above

Q.13 Which of the following is not a "qualifying asset" under IAS 23?

(a) Mass produced inventory (b) Manufacturing plants

(c) Made to order inventory (d) Investment property

Q.14 Capitalisation of borrowing costs should be suspended:

(a) when substantially all the activities necessary to prepare a qualifying asset for its intended use or sale are complete

(b) during a temporary delay which is a necessary part of the process of getting an asset ready for its intended use or sale

(c) during extended periods in which active development of a qualifying asset is interrupted

(d) all of the above

Q.15 Which of the following statements is correct in the context of capitalisation of borrowing costs?

(a) If funds have been arranged from various general borrowings, the amount to be capitalised is based on the weighted average cost of borrowings

(b) Capitalisation always commences as soon as expenditure for the asset is incurred

(c) Capitalisation always continues until the asset is brought into use

(d) Capitalisation always commences as soon as borrowing costs are incurred

Scanned with CamScanner

ICAP MULTIPLE CHOICE QUESTIONS (MCQs) SOLUTIONS

A.1 (a, b) Borrowing costs must be capitalised if they are directly attributable to qualifying assets, which are assets that take a substantial time to complete. Capitalisation should cease once substantially all the activities to prepare the asset are complete.

A.2 (c) Rs.10 million x 7.5% x 2/12 = Rs.125,000

A.3 (d) Rs.10 million x 7.5% x 10/12 = Rs.625,000

A.4 (b) Temporary investment income earned during the construction period should be netted off the amount capitalised.

However, the interest was earned prior to the period of construction. Therefore the investment income earned should be taken to the statement of profit or loss as investment income.

A.5 (a) Capitalisation rate $= \frac{3.99m}{39} \times 100 = 10.23\%$

	Loan	Rate	Interest
Loan A	15	9%	1.35
Loan B	24	11%	2.64
	39		3.99

Borrowing cost to be capitalized

Rs.6m × 10.23% × 9/12 = Rs.460,350

Rs.2m × 10.23% × 5/12 = Rs.85,250

Total Rs.545,600

A.6 (a)

	Rs.
March – December (Rs.24m × 8% × 10/ 12)	1,600,000
Less investment income (Rs.10m × 6% × 4/12)	(200,000)
	1,400,000

Temporary investment income before commencement would be recognised as finance income in profit or loss.

A.7 (d) Capitalisation rate $= \frac{30}{340} \times 100 = 8.8\%$

	Loan	Rate	Interest
Loan A	140	10%	14
Loan B	200	8%	16
	340		30

A.8 Rs.50 million × 8.8% × 6/12 = Rs.2.2 million

Rs.810,000

Rs.12m × 6.75% = Rs. 810,000

Capitalisation rate

= ((Rs.10m × 6%) + (Rs.6m × 8%))/Rs.16m = 6.75%.

Scanned with CamScanner

A.9 (d)

A.10 (b)

A.11 (c)

A.12 (b)

A.13 (a)

A.14 (c) during extended periods in which active development of a qualifying asset isinterrupted

A.15 (a) If funds have been arranged from various general borrowings, the amount to be capitalised is based on the weighted average cost of borrowings

Scanned with CamScanner

INVESTMENT PROPERTY IAS 40

LO 1: INVESTMENT PROPERTY

An investment property is property (land or a building, part of a building or both) held to earn rentals or for capital appreciation or both.

Properties which differ from investment property

Investment property differs from other property which is.

- Used in production, or supply of goods or for administrative purposes (IAS – 16)
- Held for sale in the ordinary course of business (IAS – 2)

Examples of Investment Property

- Land held for long term capital appreciation rather than for short term sale in the ordinary course of business
- Land held for a currently undetermined future use (if an entity has not determined that it will use the land as owner occupied property or for short term sale in the ordinary course of business.
- Property that is being constructed or developed for future use as investment property.

Examples of Non-Investment Property

- Property intended for sale in the ordinary course of business.
- Owner occupied property including (among other things)
  - (i) Property held for future use as owner occupied property
  - (ii) Property held for future development and subsequent use as owner occupied property
  - (iii) Property occupied by employees (whether or not the employees pay rent at market rates) and
  - (iv) Owner occupied property awaiting disposal

LO 2: PARTLY OCCUPIED BUILDINGS

An entity may

- Use part of a property for the production or supply of goods or services or for administrative purpose (owner occupied) and
- Hold another part of the same property to earn rentals or for capital appreciation (held as investment)

Rules for Partly Occupied Buildings

- The two parts are accounted for separately if they could be sold separately (or leased out separately under a finance lease)
- If above is not the case, the property is investment property only if an insignificant portion is held for use in the production or supply of goods or services or administrative purposes.

Accounting Treatment of Investment Property

Recognition criteria for investment property are the same as for PPE (IAS – 16)

An owned investment property should be recognised as an asset only when.

- It is probable that future economic benefits associated with the property will flow to the entity and
- The cost of the property can be measured reliably

Scanned with CamScanner

Measurement of Investment Property at Recognition

	Rs.
Purchase price	
Add legal fee	
Non refundable taxes	
Other transaction cost	
Govt. duty	
Professional charges	
Total cost to be recognised	

Costs Specifically Excluded from Cost of Investment Property

- Startup costs (except necessary to bring the property to the condition necessary for it to be capable of operating in the manner intended by management)
- Operating losses incurred before the investment property achieves the planned level of occupancy
- Abnormal waste incurred in constructing or developing the property.

Subsequent Measurement

After Initial Recognition an entity may choose as its accounting policy

- Cost model
- Fair value model (different from revaluation model IAS – 16)

The chosen Model will be applied to all the investment property of the entity the chosen model can only be changed if change results in a more appropriate presentation

Cost Model

This model follows the provision of IAS – 16.

The property is measured at cost less accumulated depreciation less impairment loss

Fair Value Model

Under fair value model the entity should

- Revalue all its investment property to fair value (M . V) at the end of each financial year and
- Recognize any resulting gain or loss in profit or loss for the period
- The property would not be depreciated

This is different to the revaluation model of IAS 16, where gains are reported as other comprehensive income and accumulated as a revaluation surplus.

If an entity's policy is to measure investment properties at fair value but its fair value cannot be measured reliably such investment property shall be measured at cost for example an investment property under construction. However, if the entity expects the fair value of the investment property under construction to be reliably measured when construction is complete it shall measure that investment property under construction at cost until either its fair value becomes reliably measured or construction is completed (whichever is earlier).

If it is not possible to arrive at a reliable fair value figure then the cost model should be adopted for that property using the cost model in accordance with IAS 16 for owned assets or IFRS 16 for investment property held by a lessee as a right-of-use asset. This is an exception to the rule that all investment property must be valued under either one model or the other.

Scanned with CamScanner

Example 1

On 1.1.18 entity P purchased a building for its investment potential,. The building cost Rs. 1,000,000 with transaction cost of Rs. 10,000.

The depreciable amount of the building component of the property at this date was Rs. 300,000 . The property has a useful life of 50 years at the end of the year 1 the property fair value had risen to Rs.1,300,000.

Required:

Prepare income statement and balance sheet extracts for the year ended 31-12-18 under both cost and fair value model.

Solution

Cost Model

Income Statement Extract

	Rs.
Depreciation expenses $\frac{300,000-0}{50}$	6,000

Balance Sheet Extract

Assets

Investment property cost (1,000,000 + 10,000)	1,010,000
Less accumulated depreciation $\frac{300,000-0}{50}$	(6,000)
WDV	1,004,000

Fair Value Model

Income Statement Extract

	Rs.
Fair value gain (W – 1)	290,000

(W – 1) gain / (loss)

Fair value	1300,000
Cost	(1,010,000)
Gain	290,000

Balance Sheet Extract

Assets

	Rs.
Investment property	1,300,000

Reasons of treating investment properties differently from other properties

Most properties are held to be used directly or indirectly in the entity's business. For example a factory, plant and equipment which is used to produce goods for sale. The property is being consumed and it is appropriate to depreciate it over its useful life.

Scanned with CamScanner

An investment property is held primarily because it is expected to increase in value over time (capital appreciation0) or it is held to earn rentals. It generates economic benefits for the entity because it might earn regular stream of income in the form of rentals or might be sold at a profit. An investment property also differs from owner-occupied properties (IAS – 16) because it generates cash flows that are largely independent of other assets held by an entity.

The most relevant information about an investment property is its fair value. Depreciation is largely irrelevant. Therefore it is appropriate to re-measure an investment property to fair value each year and to recognize gain and losses in profit or loss for the period.

LO 3:TRANSFERS AND DISPOSALS OF INVESTMENT PROPERTY

If a property is transferred into or out of this category it must be reclassified as an investment property or as no longer being an investment property. A transfer of investment property can only be made where there is a change in use (when the property meets or ceases to meet, the definition of investment property) as illustrated below.

Circumstance for a change in use	Transfer from/to	Deemed transfer value
Commencement of or development with a view to owner-occupation	Transfer from investment property to owner-occupied property	Fair value at the date of change of use becomes the deemed cost for future accounting purposes
End of owner-occupation	Transfer from owner-occupied property to investment property	Where investment properties are measured at fair value, revalue in accordance with IAS 16 prior to the transfer
Commencement of development with a view to sale	Transfer from investment property to inventories	Fair value at the date of change of use becomes the deemed cost for future accounting purposes
Inception of an operating lease to another party	Transfer from inventories to investment property	Fair value at the date of the transfer, and any difference compared to previous carrying amount is recognised in profit or loss

LO 4: GAIN OR LOSS ON DISPOSAL

Gains or losses on disposals of investment properties are included in profit or loss in the period in which the disposal occurs.

EXAMPLE: DISPOSAL OF INVESTMENT PROPERTY

The investment property in the previous example (example-1) was sold early in Year 2 for Rs. 1,550,000. Selling costs were Rs.50,000.

The amount that would be included in the statement of profit or loss for Year 2 in respect of this disposal under the cost model is as follows:

Cost model	Rs.
Sale value	1,550,000
Selling costs	(50,000)
Net disposal proceeds	1,500,000
Minus: Carrying amount	(1,004,000)
Gain on disposal	496,000

Scanned with CamScanner

The amount that would be included in the statement of profit or loss for Year 2 in respect of this disposal under the fair value model is as follows:

Fair value model	Rs.
Sale value	1,550,000
Selling costs	(50,000)
Net disposal proceeds	1,500,000
Minus: Carrying amount	(1,300,000)
Gain on disposal	200,000

LO 5: DISCLOSURE REQUIREMENTS

The following disclosures are required by IAS 40 in the notes to the accounts.

Disclosure requirements applicable to both the fair value model and the cost model

- whether the fair value model or the cost model is used
- the methods and assumptions applied in arriving at fair values
- the extent to which the fair value of investment property was based on a valuation by a qualified, independent valuer with relevant, recent experience
- amounts recognised as income or expense in the statement of profit or loss for:
  - rental income from investment property
  - operating expenses in relation to investment property
- details of any restrictions on the ability to realise investment property or any restrictions on the remittance of income or disposal proceeds
- the existence of any contractual obligation to purchase, construct or develop investment property or for repairs, maintenance or enhancements.

Disclosure requirements applicable to the fair value model only

There must be a reconciliation, in a note to the financial statements, between opening and closing values for investment property, showing:

- additions during the year
- assets classified as held for sale in accordance with IFRS 5
- net gains or losses from fair value adjustments
- acquisitions through business combinations

This reconciliation should show separately any amounts in respect of investment properties included at cost because their fair values cannot be estimated reliably.

For investment properties included at cost because fair values cannot be estimated reliably, the following should also be disclosed:

- a description of the property
- an explanation as to why fair values cannot be determined reliably
- if possible, the range within which the property's fair value is likely to lie.

Scanned with CamScanner

Disclosure requirements applicable to the cost model only

- the depreciation methods used
- the useful lives or depreciation rates used
- gross carrying amounts and accumulated depreciation at the beginning and at the end of the period
- a reconciliation between opening and closing values showing:
  - Companies Act, 2017additions
  - depreciation
  - assets classified as held for sale in accordance with IFRS 5
  - acquisitions through business combinations
  - impairment losses
  - transfers

When the cost model is used, the fair value of investment property should also be disclosed. If the fair value cannot be estimated reliably, the same additional disclosures should be made as under the fair value model.

Scanned with CamScanner

PRACTICE QUESTIONS

Question-1

(a) Explain the difference between an investment property and an owner-occupied property.

(b) What are the two models allowed for investment properties and briefly explain how these two models compare to the two models allowed for property, plant and equipment.

Question-2

Sapphire Limited is a dairy company and owns a farm (consisting of 200 hectares including a total of five sheds), which it purchased for Rs.2 000 000. Sapphire Limited uses the farm for the following:

- One stand-alone shed is used for the milking of Sapphire Limited cattle.
- 40 hectares surrounding the stand-alone shed is used for grazing for Sapphire Limited's dairy cattle; and
- The remaining 160 hectares of land and four other sheds are let to fellow farmers for grazing of their own cattle and storage of fodder. The leases are non-cancellable operating leases.

The 160 hectares of land together with the four sheds was purchased by Sapphire five years ago and has a separate title deed to the other 40 hectares (including the stand-alone shed).

Required:

Discuss how Sapphire Limited should account for the farm in the financial statement in terms of International Financial Reporting Standards. You may assume that Sapphire Limited intends to keep the farm in its existing use for the foreseeable future.

Question-3

Star Plc is an investment company that purchases buildings and holds them for a number of purposes, such as resale, leasing and its own use.

Hally Towers

- On 1 January 20X4, Star Plc purchased an old building for Rs.300,000. Conveyance's fees amounted to Rs.20,000.
- This building has always been fully let out.
- This building is situated in an isolated part of Balochistan and there is no development anywhere nearby. As a result there is no market for building in this area and therefore a fair value is not reliably ascertainable.
- On 31 July 20X4, the directors decided to repaint the building. The repainting was done at a total cost of Rs. 50,000.
- This building has never had an air-conditioning system. After numerous complaints from tenants about not being able to tolerate the Balochistan heat, Star Plc decided to upgrade the building by installing a ducted air-conditioning system on 1 October 20X4.
- The cost of installation included the following

	Rs.
Adjustments to the structure of the building	30,000
Air-conditioning units	200,000
Installation costs	50,000

Scanned with CamScanner

- On 31 December 20X4, a huge property boom took place in the area with the result that the fair value of Hally Towers could now be determined. Star Plc does not, however, wish to change their policy of measuring investment property using the cost model.
- The building has a 10 year useful life and a nil residual value.
- The ducted air-conditioning system has a 10 years life and a nil residual value.

Star Plc also holds other investment property, all of the which are carried under the fair value model. The fair values are as follows:

	Rs.
1 January 20X4	1,000,000
31 December 20X4	1,250,000

Required:
Journalise the entries that would arise from the above information for the year-ended 31 December 20X4

Question-4
SPL Limited owns two buildings, each with a different purpose:
- The Popular; and
- The Palms

The Popular:
- SPL Limited had purchased this building on 31 July 20X4 for Rs. 500,000 cash.
- The popular is a high rise building in the centre of Karachi's central business district. This building is leased out to corporate clients.
- Its fair values are as follows:

31 December 20X4	Rs.600,000
31 December 20X5	Rs.700,000
31 December 20X6	Rs.750,000

The Palms:
- On 2 January 20X5, SPL Limited bought this property for Rs. 200,000 in cash.
- Although no tenants would rent space in this building, SPL Limited identified that the buildings would be prime investment as the are around. The Palms was being extensively developed. Expectations are that, once this development is completed, this property will attract a very high price, at which time the plan would probably be to sell it. The property is not, however, held as inventory.
- The building's fair values were as follows:

31 December 20X5	Rs.250,000
31 December 20X6	Rs.400,000

Other information:
- Both buildings, when purchased, where determine to have useful lives of ten years and nil residual values.
- SPL Limited holds all investment property under the fair value model.

Required:
(a) Prepare the journal entries to account for the popular for years-ended 31 December 20X4, 20X5 and 20X6.
(b) Prepare the journal entries to account for the Palms for the year-ended 31 December 20X5 and 20X6.

Scanned with CamScanner

PRACTICE SOLUTION

Solution-1

a) An investment property is held for rental income or capital appreciation whereas an owner-occupied property is used by the entity in the production of goods or services or for administration purposes.

b) A comparison of the models allowed in terms of IAS 40 for investment properties with the models allowed in terms of IAS 16 for property, plant and equipment is as follows:

- Property, plant and equipment may be measured under the cost model or revaluation model.
- Investment properties may be measured under the cost model or fair value model.
- The cost model is the same in both cases.
- The revaluation model requires that increases/ decreases recognised as other comprehensive income (revaluation surplus: equity)
- The fair value model requires that all increases/ decreases, irrespective of the be recognised directly in profit or loss.

Solution-2

INTRODUCTION

The farm is used:

By Sapphire Limited for milking and grazing (stand-alone shed and 40 hectares of land); and

To earn rentals (from the 160 hectares and four sheds).

According to IAS 40 if a building is owner occupied building and can be sold separately (which it can because it has separate title deeds) it must be disclosed as property, plant and equipment in accordance with IAS 16.

Owner-occupied

This means that the owner-occupied stand-alone shed together with the related 40 hectares must be measured using either:

The cost model; or

Revaluation model.

Whichever model is used, the property will be initially measured at cost. Assuming that all the sheds are similar, the owner-occupied shed and 40 hectares should be recorded at Rs.400 000 (Rs.2 000 000 x 40 / 200 hectares).

Cost model:

The cost model entails measuring the asset at cost less accumulated depreciation and impairment losses.

Revaluation model:

The revaluation model entails measuring the asset at fair value less subsequent accumulated depreciation and impairment losses. If the revaluation model is adopted and a revaluation to fair value results in an increase in carrying amount above its historical carrying amount, this increase must be recognised in other comprehensive income and accumulated in equity (not profit and loss).

Depreciation under both models:

Depreciation must be provided over the useful life of the property to its estimated residual value. The most appropriate methods of depreciation would be either the straight-line or reducing balance method. If at any stage the residual value is greater than the property's carrying amount, depreciation must cease. Depreciation should begin when the property is available for use and should not cease when temporarily idle. Land would not be depreciated as it has an indefinite useful life.

Scanned with CamScanner

Not owner-occupied

Since the 160 hectares and remaining four sheds are leased out to earn rentals, this property is recognised and measured as investment property in terms of IAS 40. Investment properties may be measured using either the:

- Cost model (IAS 16) or
- Fair value model (IAS 40 prefers this method).

Whichever model is used, the investment property will be initially measured at cost. Assuming that all the sheds are similar, the four remaining sheds and 160 hectares should be recorded at Rs.1 600 000 (Rs.2 000 000 x 160 / 200 hectares).

Cost model:

If Sapphire Limited uses the cost model the farm sheds and 160 hectares are carried at cost less subsequent accumulated depreciation and impairment losses (i.e. in terms of IAS 16). It may not be re-valued.

Fair value model:

If Sapphire Limited uses the fair value model, the entity must report the farm (the four sheds and the 160 hectares) at fair value. Any increase or decrease in fair value from the end of one reporting period to the next must be recognised as an income or expense in the year of the change.

If Sapphire Limited cannot ascertain the fair value (where fair value is the market price between knowledgeable, willing parties in an arms length transaction) of the investment property it must apply the following rules:

- If the fair value could not be ascertained on the date of purchase, the investment property must be carried at depreciated historic cost (cost model).
- If the fair value could not be ascertained at the end of a subsequent reporting period, the investment property must be carried at the last available fair value.

Solution-3

	Debit	Credit
1 January 20X4		
Investment property: cost (300,000 + 20,000)		
Bank	320,000	
Purchase price plus conveyancer's fees (which are necessarily incurred in order to bring the building into use)		320,000
31 July 20X4		
Maintenance expense		
Bank	50,000	
Painting expensed (does not increase the future economic benefits embodied in the asset)		50,000
1 October 20X4		
Investment property: cost (200,000 + 30,000 + 50,000)		
Bank	280,000	
Capitalisation of the air-conditioning system		280,000
31 December 20X4 (320,000 / 10) + (280,000 / 111m x 3m)		
Depreciation		
Investment property: accumulated depreciation	39,568	
Depreciation of investment property – see note 1		39,568
31 December 20X4		
Investment property 1,250,000 – 1,000,000		
Fair value adjustment to investment property	250,000	
Fair value adjustment on other investment property – see note 2		250,000

Scanned with CamScanner

Note 1: Although the air-conditioning system has a useful life of 10 years, it is integral to the building. This means that it must be depreciated over the remaining useful life of the building. At the time of installation, there were 9 years and 3 months left (9 x 12 months + 3m months = 111 months).

Note 2: This fair value adjustment relates to other investment property (not Hally Towers). Please note that the question did not give you the fair value of Star Plc on 31 December 20X4. If the question had given you the fair value of Star Plc, however, you would have had to ignore it because IAS - 40.53 states that if a fair value was not reliably determinable on a continuing basis on initial acquisition and was therefore forced to use the cost model initially, then that property must always be held under the cost model (i.e. even if it subsequently becomes possible to determine the fair values, the fair value model may never be used for this property).

Solution-4

(a)

	Debit	Credit
31 July 20X4		
Investment property: the Popular	500,000	
Bank		500,000
Recording the acquisition of investment: the Popular		
31 December 20X4		
Investment property: the Popular 600,000 – 500,000	100,000	
Fair value adjustment to investment property (Income)		100,000
Fair value adjustment to investment property: the Popular		
31 December 20X5		
Investment property: the Popular 700,000 – 600,000	100,000	
Fair value adjustment to investment property		100,000
Fair value adjustment to investment property: the Popular		
31 December 20X6		
Investment property: the Popular 750,000 – 700,000	50,000	
Fair value adjustment to investment property		50,000
Fair value adjustment to investment property		

(b)

	Debit	Credit
2 January 20X5		
Investment property: Palms	200,000	
Bank		200,000
Purchase of investment property: The Palms		
31 December 20X5		
Investment property: Palms (250,000 – 200,000)	50,000	
Fair value adjustment to investment property		50,000
Fair value adjustment to investment property: The Palms		
31 December 20X6		
Investment property: Palms (400,000 – 250,000)	150,000	
Fair value adjustment to investment property		150,000
Fair value adjustment to investment property		

Scanned with CamScanner

ICAP QUESTION BANK QUESTION

Question-1

Victoria owns several properties and has a year end of 31 December. Wherever possible, Victoria carries investment properties under the fair value model.

Property 1 was acquired on 1 January Year 1. It had a cost of Rs.1 million, comprising Rs.500,000 for land and Rs.500,000 for buildings. The buildings have a useful life of 40 years. Victoria uses this property as its head office.

Property 2 was acquired many years ago for Rs.1.5 million for its investment potential. On 31 December Year 7 it had a fair value of Rs.2.3 million. By 31 December Year 8 its fair value had risen to Rs.2.7 million,.This property has a useful life of 40 years.

Property 3 was acquired on 30 June Year 2 for Rs.2 million for its investment potential. The directors believe that the fair value of this property was Rs.3 million on 31 December Year 7 and Rs.3.5 million on 31 December Year 8. However, due to the specialised nature of this property, these figures cannot be corroborated. This property has a useful life of 50 years.

Required

(a) For each of the above properties briefly state how it would be treated in the financial statements of Victoria for the year ended 31 December Year 8, identifying any impact on profit or loss.

Produce an analysis of property, plant and equipment for Victoria for the year ended 31 December Year 8, showing each of the above properties separately. ***(ICAP Example 10)***

Scanned with CamScanner

ICAP QUESTION BANK SOLUTIONS

Answer-1

(a) Treatment in the financial statements for the year ended 31 December Year 8 (IAS16)

Property 1

This is used by Victoria as its head office and therefore cannot be treated as an investment property. It will be stated at cost minus accumulated depreciation in the statement of financial position. The depreciation for the year will be charged in the statement of profit or loss.

Property 2

This is held for its investment potential and should be treated as an investment property. It will be carried at fair value, Victoria's policy of choice for investment properties. It will be revalued to fair value at each year end and any resultant gain or loss taken to the statement of profit or loss (Rs.400,000 gain in Year 8).

Property 3

This is held for its investment potential and should be treated as an investment property. However, since its fair value cannot be arrived at reliably it will be held at cost minus accumulated depreciation in the statement of financial position. The depreciation for the year will be an expense in the statement of profit or loss.

This situation provides the exception to the rule whereby all investment properties must be held under either the fair value model, or the cost model.

(b) Analysis of property, plant and equipment for the year ended 31 December Year 8

	Other land and buildings (W1)	Investment property held at fair value	Investment property held at cost (W2)	Total
	Rs.	Rs.	Rs.	Rs.
Cost/valuation				
On 1 January Year 8	1,000,000	2,300,000	2,000,000	5,300,000
Revaluation	-	400,000	-	400,000
On 31 December Year 8	1,000,000	2,700,000	2,000,000	5,700,000
Accumulated depreciation				
On 1 January Year 8	87,500	-	220,000	307,500
Charge for the year (W1)	12,500	-	40,000	52,500
On 31 December Year 8	100,000	-	260,000	360,000
Carrying amount				
On 31 December Year 7	912,500	2,300,000	1,780,000	4,992,500
On 31 December Year 8	900,000	2,700,000	1,740,000	5,340,000

Tutorial note

In practice, with a more complex property, plant and equipment table the investment properties would be included within the land and buildings column with the required disclosures being given separately in a note to the table.

WORKINGS

(W-1) **Depreciation on Property 1**

	Rs.
Brought forward (500,000 ÷ 40 × 7)	87,500
Year 8 (500,000 ÷ 40)	12,500

(W-1) **Depreciation on Property 3**

	Rs.
Brought forward (2,000,000 ÷ 50 × 5.5)	220,000
Year 8 (2,000,000 ÷ 50)	40,000

Scanned with CamScanner

ICAP MULTIPLE CHOICE QUESTIONS (MCQs)

Q.1 An entity purchased an investment property on 1 January 2013 for a cost of Rs.35m. The property had an estimated useful life of 50 years, with no residual value, and at 31 December 2015 had a fair value of Rs.42m.

On 1 January 2016 the property was sold for net proceeds of Rs.40m.

Calculate the profit or (loss) on disposal under both the cost and fair value (FV) model.

(a) Cost model: Rs.7.1 m and FV model: (Rs.2.0 m)

(b) Cost model: Rs.2.0 m and FV model: Rs.2.0 m

(c) Cost model: Rs.5.0 m and FV model: (Rs.2.0 m)

(d) Cost model: Rs.7.1 m and FV model: Rs.5.0 m

Q.2 An investment property with a useful life of 10 years was purchased by Akram Limited on 1 January 2019 for Rs.200 million. By 31 December 2019 the fair value of the property had risen to Rs.300 million. Akram Limited measures its investment properties under the fair value model.

What values would go through the statement of profit or loss in the year?

(a) Gain: Rs.100 million and Depreciation Rs.30 million

(b) Gain: Rs.0 and Depreciation of Rs.30 million

(c) Gain: Rs.100 million and Depreciation of 0

(d) Gain: Rs.120 million and Depreciation of Rs.20 million

Q.3 Which of the following properties owned by an entity would be classified as an investment property?

(a) A property that had been leased to a tenant, but which is no longer required and is now being held for resale

(b) Land purchased for its investment potential. Planning permission has not been obtained for building construction of any kind

(c) A new office building used as entity's head office, purchased specifically in order to exploit its capital gains potential

(d) A banglow used for executive training

Q.4 Sarfraz Limited (SL) uses fair value accounting where possible and has an office building used by SL for administrative purposes. At 1 April 2012 it had a carrying amount of Rs.20 million and a remaining life of 20 years. On 1 October 2012, the property was let to a third party and reclassified as an investment property. The property had a fair value of Rs.23 million at 1 October 2012, and Rs.23.4 million at 31 March 2013.

What is the correct treatment when the above property is reclassified as an investment property?

(a) Take Rs.3,500,000 gain to other comprehensive income

(b) Take Rs.3,500,000 gain to the statement of profit or loss

(c) Take Rs.4,000,000 gain to other comprehensive income

(d) Take Rs.4,000,000 gain to the statement of profit or loss

Q.5 Cool Limited acquired a building with a 40-year life for its investment potential for Rs.8 million on 1 January 2013. At 31 December 2013, the fair value of the property was estimated at Rs.9 million with costs to sell estimated at Rs.200,000.

If Cool Limited uses the fair value model for investment properties, what gain should be recorded in the statement of profit or loss for the year ended 31 December 2013?

Rs. _____

Scanned with CamScanner

Q.6 Under IAS 40 - Investment Property, where should a gain or loss on disposal be recognised?

(a) Statement of Financial Position
(b) Profit and loss statement
(c) Statement of changes in equity
(d) None

Q.7 If an entity uses part of a building for their own use, and rents the remainder. How should this be treated?

(a) All as investment property under IAS 40 - Investment Property
(b) All under IAS 16 - Property, Plant and Equipment
(c) Account for separately under 'IAS - 16 Property, Plant and Equipment' and 'IAS - 40 Investment Property'
(d) None of these

Q.8 An investment property should initially be measured at?

(a) Cost
(b) Fair value
(c) Market value
(d) Net realizable value

Q.9 If an entity wishes to change from a cost model to fair value model under IAS 40 - Investment Property, when may it do so?

(a) When the board of directors approves a change
(b) When the value of the assets will improve with a revised model
(c) When a change will result in a more appropriate presentation
(d) When the market for these properties is fluctuation

Q.10 Which two of the following properties fall under the definition of investment property and therefore within the scope of IAS 40?

(a) Property occupied by an employee paying market rent
(b) A building owned by an entity and leased out under an operating lease
(c) Property being constructed on behalf of 3rd parties
(d) Land held for long term appreciation

Q.11 Afternoon Limited (AL) uses cost model for its property, plant and equipment and fair value model for its investment property. AL has an office building which was being used for administrative purposes. At 1 July 2018, the building had a carrying amount of Rs. 20 million. On that date, the building was let out to a third party and therefore reclassified as an investment property. The building had a fair value of Rs. 23 million on 1 July 2018 and Rs. 23.4 million on 30 June 2019.

What would be the increase in the profit or loss and other comprehensive income for the year ended 30 June 2019?

	Profit or loss	Other comprehensive income
(a)	Nil	Rs. 3.4 million
(b)	Rs. 0.4 million	Rs. 3 million
(c)	Rs. 3.4 million	Nil
(d)	Rs. 3 million	Rs. 0.4 million

Scanned with CamScanner

Q.12 Which TWO of the following fall under the definition of investment property?

(a) Property occupied by an employee

(b) A building owned by an entity and leased out under an operating lease

(c) Property being constructed on behalf of third party

(d) Land held for long term appreciation

Q.13 Under IAS 40 'Investment property', which of the following disclosures is NOT required to be made under cost model?

(a) Fair value of the property

(b) Depreciation method

(c) Reconciliation of carrying amounts at the beginning and end of a period

(d) Residual value of the property

Scanned with CamScanner

ICAP MULTIPLE CHOICE QUESTIONS (MCQs) SOLUTIONS

A.1 (a) Under the cost model the property will be depreciated over 50 years for 3 years up to the date of disposal. Therefore, at the disposal date the carrying value would have been Rs.35m – (Rs.35m/50 × 3 years) = Rs.32.9m and the profit on disposal Rs.7.1m (Rs.40m – Rs.32.9).

Under the fair value model the property will not be depreciated hence the loss on disposal would be Rs.2m (Rs.40m – Rs.42m).

A.2 (c) Under the fair value model the property will not be depreciated hence the gain on valuation would be Rs.100 million (Rs.300 million – Rs.200 million).

A.3 (b) Asset A would be classed as a non-current asset held for sale under IFRS 5. Assets C and D would both be classified as property, plant and equipment under IAS 16.

A.4 (a) As SL uses the fair value model for investment properties, the asset should be revalued to fair value before being classed as an investment property. The gain on revaluation should be taken to other comprehensive income, as the asset is being revalued while held as property, plant and equipment.

At 1 October, the carrying amount of the asset is Rs.19.5 million, being Rs.20 million less 6 months' depreciation. As the fair value at 1 October is Rs.23 million, this leads to a Rs.3,500,000 gain which will be recorded in other comprehensive income.

A.5 Rs.1,000,000

The fair value gain of Rs.1 million (Rs.9m – Rs.8m) should be taken to the statement of profit or loss. Costs to sell are ignored and, since entity uses the fair value model, no depreciation will be charged on the building.

A.6 (b)

A.7 (c)

A.8 (a)

A.9 (c)

A.10 (b) & (d)

A.11 (b) Profit or loss Rs. 0.4 million and Other comprehensive income Rs. 3 million

A.12 (b) & (d) A building owned by an entity and leased out under an operating lease & Land held for long term appreciation

A.13 (d) Residual value of the property

Scanned with CamScanner

IAS 36: Impairment of Assets

4

LO 1	INTRODUCTION
LO 2	MEASURING RECOVERABLE AMOUNT
LO 3	ACCOUNTING FOR IMPAIRMENT

Scanned with CamScanner

IMPAIRMENT OF ASSETS IAS - 36

LO 1: INTRODUCTION

An asset is said to be impaired when its recoverable amount is less than its carrying amount in the statement of financial position.

Impairment means that the asset has suffered a permanent loss in value.

Definitions

The recoverable amount of an asset is defined as the higher of:

- its fair value minus costs of disposal, and
- its value in use.

Fair value is the price that would be received to sell an asset at the measurement date.

Value in use is the present value of future cash flows from using an asset, including its eventual disposal.

Scope of IAS 36

IAS 36 applies to accounting for impairment of all assets except the following:

- inventories (IAS 2: Inventories);
- Assets arising from contracts with customers that are recognised in accordance with IFRS 15: Revenue from contracts with customers.
- investment property that is measured at fair value (IAS 40):

Identifying impairment or possible impairment

An entity must carry out an impairment review when there is evidence or an indication that impairment may have occurred. If such an indication exists, the entity must estimate the recoverable amount.

Indicators of impairment

External sources	Internal sources
An unexpected decline in the asset's market value.	Evidence that the asset is damaged or no longer of use to the entity.
Significant changes in technology, markets, economic factors or laws and regulations that have an adverse effect on the company.	There are plans to discontinue or restructure the operation for which the asset is currently used.
An increase in interest rates, affecting the value in use of the asset.	There is a reduction in the asset's expected remaining useful life.
	There is evidence that the entity's actual performance is worse than expected.

LO 2: MEASURING RECOVERABLE AMOUNT

Remember recoverable amount of an asset is defined as the higher of:

- its fair value minus costs of disposal, and
- its value in use.

Fair value less costs of disposal	Fair value is normally market value. If no active market exists, it may be possible to estimate the amount that the entity could obtain from the disposal. Direct selling costs normally include: • legal costs, • Cost of removing asset • taxes paid and

Scanned with CamScanner

	• costs necessary to bring the asset into a condition to be sold. However, redundancy and similar costs (for example, where a business is reorganised following the disposal of an asset) are not direct selling costs.
Value in use	It is the present value of the expected **future cash flows** from use of the asset, discounted at a suitable discount rate.

Example-1 (Measurement of recoverable amount)

A company has a machine in its statement of financial position at a carrying amount of Rs.300,000.

The machine is used to manufacture the company's best-selling product range, but the entry of a new competitor to the market has severely affected sales.

As a result, the company believes that the future sales of the product over the next three years will be only Rs.150,000, Rs.100,000 and Rs.50,000.

The asset will then be sold for Rs.25,000.

An offer has been received to buy the machine immediately for Rs.240,000, but the company would have to pay shipping costs of Rs.5,000.The risk-free market rate of interest is 10%.

Required:

Calculate the impairment loss.

Solution-1

Calculation of impairment loss

Carrying Amount		300,000
Recoverable Amount (higher of:		
- Fair value less cost to sell(W-2)	235,000	
- Value in use (W-1)	275,357	(275,357)
Impairment loss		24,643

(W-1) **Calculation of Value in Use**

$[150,000 \times (1.1)^{-1} + 100,000 \times (1.1)^{-2} + (50,000 + 25,000) \times (1.1)^{-3}]$ 275,357

(W-2) **Fair value less cost to sell**

Fair value less cost to sell (240,000-5,000) 235,000

Example-2: (recoverable amount – fair value less costs to sell)

A company has an asset with the following details at 31 December 20X3:

Expected selling price	200,000
Costs of delivery to potential customer	20,000
Legal costs involved in sale agreement	10,000

Required:

Calculate the fair value less costs to sell of the asset at 31 December 20X3

Solution -2

Fair value less costs to sell

	Rs.
Expected selling price	200,000
Less the costs of disposal (20 000 + 10 000)	(30,000)
	170,000

Scanned with CamScanner

Future cash flow in value in use

Include	Does not include
1. Cash inflows from the continuing use of the asset;	1. Cash inflows or outflows from financing activities; • Lease payment their interest • Loan receipts/repayments and their interest
2. Cash outflows that will be necessarily incurred to generate inflows from use of asset; and	2. Income tax receipts or payments.
3. Net disposal proceeds at the end of the asset's useful life.	3. Cash flow from a future restructuring to which an entity is not yet committed; or
	4. Cash flow improving or enhancing the asset's performance.
	5. Cash outflows that have already been recognized as liabilities (for example, a payment of an accounts payable)
The discount rate must be a pre-tax rate that reflects current market assessments of: • the time value of money; and • the risks specific to the asset for which the future cash flow estimates have not been adjusted.	

Example-3: (recoverable amount - value in use – cash flows)

A machine has the following future cash flows, based on management's most recently approved budgets:

	20X4	20X5	20X6
Outflows:	'000'	'000'	'000'
Maintenance costs	100	120	80
Operational costs (electricity, water, labour etc.)	200	220	240
Interest on lease	60	50	40
Tax payments on profits	16	20	28
Cost of increasing the machine's capacity	0	220	0
Depreciation	80	80	80
Expenses to be paid in respect of 20X3 accruals	30	0	0
Inflows:			
Basic inflows: see note 1	1,000	1,200	1,400
Extra profits resulting from the upgrade	0	20	50

Note 1:	Machine	Plant
Cash inflows stem from	40%	60%

The useful life of the machine is expected to last for 5 years. The growth rate in the business in 20X3 was an unusual 15% whereas the average growth rate over the last 7 years is.

In the industry 10%

In the business 8%

Required:

Calculate the future net cash flows to be used in the calculation of the value in use of the machine at 31 December 20X3 assuming that a 5-year projection is considered to be appropriate.

Scanned with CamScanner

Solution -3

Future cash flows – Machine	20X4	20X5	20X6	20X7	20X8
	Rs. 000	Rs. 000	Rs .000	Rs. 000	Rs. 000
Outflows:					
Maintenance costs (direct cost)	(100)	(120)	(80)		
Operational costs (allocated indirect costs)	(200)	(220)	(240)		
Interest on lease (financing always excluded)	-	-	-		
Tax payments (tax always excluded)	-	-	-		
Cost of upgrading machine (upgrades always excluded)	-	-	-		
Depreciation (not a cash flow – a 'sunk' cost)	-	-	-		
Expenses to be paid in 20X3 accruals (not a future expense - already recognized in 20X3 financial statements)	-	-	-		
Inflows:					
Basic inflows: (only 40% relates to machine)	400	480	560		
Extra profits from the upgrade (always exclude)	-	-	-		
Net cash inflows (20X7:240 x 1.08) (20X8: 259 x 1.08)	100	140	240	259*	280*

*** Rounded**

- The net cash inflows per year would still need to be present valued and the total of the present values per year would then be totaled to give the 'net present value' or 'value in use'.
- It was assumed in this question that the machine would not be able to be sold at the end of its Useful life and the disposal thereof would not result in any disposal costs.
- The current year growth rate of 15% seems unusual given the company's average growth rate was only 8%. The industry average of 10% is also greater than the business average of 8%. Prudence dictates that we should therefore use 8%.

LO 3: ACCOUNTING FOR IMPAIRMENT

Valuation model used	Treatment
Asset carried at cost model	The impairment loss is normally recognised immediately in profit or loss.
Asset carried at revaluation model	Impairment loss is recognised in revaluation surplus to the extent that it is covered by that surplus. Impairment not covered by a previously recognised surplus on the same asset is recognised in profit or loss.

Impairment of an asset should be identified and accounted for as follows:

Step	Description
1	At the end of each reporting period, the entity should assess whether there are any indications that an asset may be impaired.
2	If there are such indications, the entity should estimate the asset's **recoverable amount.**
3	When the recoverable amount is less than the carrying value of the asset, the entity should reduce the asset's carrying value to its recoverable amount. The amount by which the value of the asset is written down is an **impairment loss.**
4	Accounting for impairment is done as discussed above
5	Depreciation charges for the impaired asset in future periods should be adjusted to allocate the asset's revised carrying amount, minus any new residual value, over its remaining useful life.

Scanned with CamScanner

Example-4

On 1 January Year 1 Entity Q purchased for Rs.240,000 a machine with an estimated useful life of 20 years and an estimated zero residual value.

Depreciation is on a straight-line basis.

On 1 January Year 4 an impairment review showed the machine's recoverable amount to be Rs.100,000 and its remaining useful life to be 10 years.

Calculate:

(a) The carrying amount of the machine on 31 December Year 3 (immediately before the impairment).

(b) The impairment loss recognised in the year to 31 December Year 4.

(c) The depreciation charge in the year to 31 December Year 4.

Solution-4

(a) Carrying Amount(Year 3)

Carrying Amount	=	240,000 – 36,000	=	**204,000**
Acc. Dep.	=	$\frac{240,000}{20} \times 3$	=	36,000

(b) Impairment Loss(Year 4)

1/1/Y4	Book value	204,000
1/1/Y4	Recoverable amount	(100,000)
1/1/Y4	Impairment loss	**104,000**

(c) Depreciation Expense(Year 4)

Date	Particulars	Dr.	Cr.
31.12.Y4	Dep. Exp	10,000	
	Acc. Dep.		10,000
	(Recording of depreciation)		
	(100,000/10)		

Example-5

On 1 January Year 1 Entity Q purchased for Rs.240,000 a machine with an estimated useful life of 20 years and an estimated zero residual value.

Depreciation is on a straight-line basis.

The asset had been re-valued on 1 January Year 3 to Rs.250,000, but with no change in useful life at that date.

On 1 January Year 4 an impairment review showed the machine's recoverable amount to be Rs.100,000 and its remaining useful life to be 10 years.

Calculate:

(a) The carrying amount of the machine on 31 December Year 2 and hence the revaluation surplus arising on 1 January Year 3.

(b) The carrying amount of the machine on 31 December Year 3 (immediately before the impairment).

(c) Journal entry for the impairment loss recognised in the year to 31 December Year 4.

(d) Journal entry for the depreciation charge in the year to 31 December Year 4.

Scanned with CamScanner

Solution-5

(a)

Carrying Amount (31/12/02)	(W-1)	216,000
Revaluation Surplus (1/1/03)	(W-1)	34,000

(b)

Carrying Amount (31/12/03)	(W-1)	236,111

(c) Impairment loss (1/1/Y4):

Date	Particulars		Dr.	Cr.
1/1/04	Revaluation Surplus	(W-1)	32,111	
	Impairment Loss(bal.)		104,000	
	Accumulated Impairment	(W-2)		136,111
	(Recording of Impairment loss)			

(d) Depreciation Expense(Year 4)

Date	Particulars	Dr.	Cr.
31.12.04	Depreciation Expense	10,000	
	Accumulated Depreciation		10,000
	(Recording of depreciation)		

(W-1) Calculation of revaluation surplus and depreciation

Date	Description	Machine	R. Surplus	SOCI(P/L)
1/1/01	Cost	240,000		
01-02	Depreciation (240,000/20) x 2	(24,000)		
31/12/02	WDV	216,000		
1/1/03	Revaluation surplus (bal.)	34,000	34,000	
1/1/03	Revalued amount	250,000	34,000	
31/12/03	Depreciation (250,000/18):(34,000/18)	(13,889)	(1,889)	
31/12/03	WDV	236,111	32,111	
1/1/04	Impairment Loss (bal.)	(136,111)	(32,111)	
1/1/04	Recoverable amount	100,000	-	
31/12/04	Depreciation (100,000/10)	(10,000)		
31/12/04	WDV	90,000	-	

Scanned with CamScanner

PRACTICE QUESTIONS

Question-1

Figs Limited (FL) purchased a machine for Rs. 2,500,000 on 01 January, 2014. The machine has an estimated useful life of 10 years. On 31 December, 2014, the machine is now become obsolete and therefore the value in use and fair value less cost to sell are Rs. 1,500,000 and Rs. 1,700,000 respectively.

Required:

Prepare journal entries to record the above transactions from the date of acquisition of the plant to the year ended 31 December 2014.

Question-2

Awesome Limited (AL) purchased a machine for Rs. 300,000 on 01 January, 2015. The machine has an estimated useful life of 8 years. On 31 December, 2017, the machine is now become obsolete and therefore the value in use and fair value less cost to sell are Rs. 50,000 and Rs. 70,000 respectively.

Required:

Prepare journal entries to record the above transactions from the date of acquisition of the plant to the year ended 31 December 2017.

Question-3

Walnut Limited (WL) purchased an vehicle for Rs. 5,000 on July 01, 2015. The asset has an estimated useful life of 4 years with no residual value. On June 30, 2016 the vehicle has a fair value less cost to sell and value in use is Rs. 2,800 and Rs. 2,250 respectively. There was no indication of impairment on 30June, 2017.

Required:

Prepare journal entries to record the above transactions from the date of acquisition of the plant to the year ended 30 June, 2017.

Question-4

Giggly Jelly (GJ) purchased a machine for Rs. 500,000 on July 01, 2005. The vehicle has an estimated useful life of 5 years with no residual value. On June 30, 2007 the vehicle has a fair value less cost to sell and value in use is Rs. 150,000 and Rs. 100,000 respectively.

Required:

Prepare journal entries to record the above transactions from the date of acquisition of the plant to the year ended 30 June, 2008.

Question-5

Friends & Co. purchased a machine for Rs. 800,000 on January 01, 2012. The machine has an estimated useful life of 5 years with no residual value. On December 31, 2012 the machine has a fair value less cost to sell of Rs. 548,000. If machine is not sold the following net cash inflows are expected from its use:

Year ended	Cash flows
December 31, 2013	200,000
December 31, 2014	200,000
December 31, 2015	100,000
December 31, 2016	100,000

The proper discount rate to be used for these flows is 10%. (Assume that the cash flows occur at the end of the year).

Required:

Prepare journal entries to record the above transactions from the date of acquisition of the machine to the year ended 31 December, 2012.

Scanned with CamScanner

Question-6

Fabian Limited (FL) purchased an asset on Rs. 45,000 on January 01, 2003. The asset has an estimated useful life 10 years. On January 01, 2005 the asset has a fair value less cost to sell and value in use are Rs. 50,000 and 40,000 respectively.

Required:

Prepare journal entries to record the above transactions from the date of acquisition of the plant to the year ended 31 December, 2005.

Question-7

Shahzad Textiles Limited (STL) purchased a plant for Rs. 1,000,000 on January 01, 2007. The plant has an estimated useful life of 20 years with no salvage value.

STL uses revaluation model for subsequent measurement of its P,P&E. The detail of revaluation performed by an independent valuer is:

Revaluation Date	Fair Value
31 December, 2007	1,500,000

On 31 December, 2010 the plant is now obsolete and therefore the value in use and fair value less cost to sell are Rs. 700,000 and Rs. 600,000 respectively.

Required:

Prepare journal entries to record the above transactions from the date of acquisition of the plant to the year ended 31 December 2010.

Question-8

Salamat industries purchased a machine for Rs. 1,570,000 on January 01, 2010. The machine has a useful life of 16 years with no salvage value.

Salamat industries performed revaluation. Details are as follows:

Revaluation Date	Fair value
January 1, 2011	1,700,000
January 1, 2012	1,750,000

On 31 December, 2012 fire broke out due to which value of machine fell down. Fair value of machine reduced to Rs. 800,000. The value in use is Rs. 1,000,000.

Required:

Prepare journal entries to record the above transaction from the date of acquisition of plant to the year ended December 31, 2012.

Question-9

As part of annual routine, PQR & Company is testing the value of its assets to ascertain the impairment (if any) Following information is available in respect of the assets:

Asset	----------Rs. in thousand----------		
	WDV	Value in use	Fair value
A	3,200	3,100	2,500
B	1,500	1,200	1,400
C	1,700	1,500	2,000

Every asset is sold through public tender, which costs around Rs. 50,000. Assets A and C are required to be dismantled at the time of sales and the cost of dismantling is Rs. 100 thousand and Rs. 200 thousand respectively and these costs are already included in the cost of asset. Sale agreements of the assets are prepared by the company's legal advisor whose annual fee is Rs. 365 thousand. It takes about 4 days to draft a sale agreement.

Required:

Compute impairment (if any) on each asset.

(02)

Scanned with CamScanner

Question-10

We purchase an asset costing Rs. 100 on 01-01-2010. Life is 10 years. Entity uses revaluation model. Following details are available on 31-12-2012:

.Fair value	90
.Cost to sell	15
.Value in use	82

Required:

Pass journal entries for the year ended 31-12-2010, 2011,2012.

Scanned with CamScanner

PRACTICE SOLUTIONS

Answer-1

Entries in the books of FL

Date	Particulars	Dr.	Cr.
1/1/14	Machine	2,500,000	
	Bank		2,500,000
	(Purchase of machine)		
31/12/14	Depreciation Expense (2,500,000/10years)	250,000	
	Accumulated Depreciation		250,000
	(Recording of depreciation)		
31/12/14	Impairment loss	550,000	
	Accumulated impairment loss		550,000
	(Recording of impairment loss)		

(W-1) Calculation of impairment loss:

Book value on 31/12/14 (2,500,000 – 250,000)		2,250,000
Recoverable Amount (higher of:)		
- Fair value	1,700,000	
- Value in use	1,500,000	(1,700,000)
Impairment loss		550,000

Answer-2

Entries in the books of AL

Date	Particulars	Dr.	Cr.
1/1/15	Machine	300,000	
	Bank		300,000
	(Purchase of machine)		
31/12/15	Depreciation Expense (300,000/8years)	37,500	
	Accumulated Depreciation		37,500
	(Recording of depreciation)		
31/12/16	Depreciation expense (300,000/8years)	37,500	
	Accumulated Depreciation		37,500
	(Recording of depreciation)		
31/12/17	Depreciation expense (300,000/8years)	37,500	
	Accumulated Depreciation		37,500
	(Recording of depreciation)		
31/12/17	Impairment loss	117,500	
	Accumulated impairment loss		117,500
	(Recording of impairment loss)		

Scanned with CamScanner

(W-1) Calculation of impairment loss:

Book value on 31/12/17 (300,000 – (37,500 x 3))		187,500
Recoverable Amount (higher of:)		
- Fair value	70,000	
- Value in use	50,000	(70,000)
Impairment loss		117,500

Answer-3

Entries in the books of Walnut Limited

Date	Particulars	Dr.	Cr.
1/7/15	Vehicle Bank (Purchase of plant)	5,000	5,000
30/6/16	Depreciation Expense (5,000/4years) Accumulated Depreciation (Recording of depreciation)	1,250	1,250
30/6/16	Impairment loss(W-1) Accumulated impairment (Recording of impairment loss)	950	950
30/6/17	Depreciation expense ((5,000 – 1,250 – 950)/3years) Accumulated Depreciation (Recording of depreciation)	933	933

(W-1) Calculation of impairment loss:

Book value on 30/6/16 (5,000 – 1,250)		3,750
Recoverable Amount (higher of:)		
- Fair value	2,800	
- Value in use	2,250	(2,800)
Impairment loss		950

Answer-4

Entries in the books of Giggly Jelly

Date	Particulars	Dr.	Cr.
1/7/05	Vehicle Bank (Purchase of vehicle)	500,000	500,000
30/6/06	Depreciation Expense (500,000/5years) Accumulated Depreciation (Recording of depreciation)	100,000	100,000
30/6/07	Depreciation expense (500,000/5years) Accumulated Depreciation (Recording of depreciation)	100,000	100,000
30/6/07	Impairment loss Accumulated impairment loss (Recording of impairment loss)	150,000	150,000

Scanned with CamScanner

(W-1) Calculation of impairment loss:

30/6/08	Depreciation expense ((500,000 – 200,000 – 150,000)/3years)	50,000	
	Accumulated Depreciation		50,000
	(Recording of depreciation)		

Book value on 30/6/07 (500,000 – 100,000 – 100,000)		300,000
Recoverable Amount (higher of:)		
- Fair value	150,000	
- Value in use	100,000	
Impairment loss		(150,000)
		150,000

Answer-5

Entries in the books of Friends & Co.

Date	Particulars	Dr.	Cr.
1/1/12	Machine	800,000	
	Bank		800,000
	(Purchase of machine)		
31/12/12	Depreciation Expense (800,000/5years)	160,000	
	Accumulated Depreciation		160,000
	(Recording of depreciation of machine)		
31/12/12	Impairment loss	92,000	
	Accumulated impairment loss		92,000
	(Recording of impairment loss)		

(W-1) Calculation of impairment loss

Book value on 31/12/12 (800,000 – 160,000)		640,000
Recoverable Amount (higher of:)		
- Fair value	548,000	
- Value in use (W-2)	490,530	
Impairment loss		(548,000)
		92,000

(W-2) Calculation of Value in Use

Year	Cash flows	Discount factor @ 10%	Present value
1	200,000	0.9091	181,820
2	200,000	0.8264	165,280
3	100,000	0.7513	75,130
4	100,000	0.6830	68,300
			490,530

Scanned with CamScanner

Answer-6

Entries in the books of Fabian Limited

Date	Particulars	Dr.	Cr.
1/1/03	Asset	45,000	
	Bank		45,000
	(Purchase of asset)		
31/12/03	Depreciation Expense (45,000/10years)	4,500	
	Accumulated Depreciation		4,500
	(Recording of depreciation)		
31/12/04	Depreciation expense (45,000/10years)	4,500	
	Accumulated Depreciation		4,500
	(Recording of depreciation)		

Note: No impairment loss is recognized as carrying amount is less than recoverable amount.

31/12/05	Depreciation expense (45,000/10years)	4,500	
	Accumulated Depreciation		4,500
	(Recording of depreciation)		

(W-1) **Calculation of impairment loss:**

Book value on 1/1/05 (45,000 – 4,500 – 4,500)		36,000
Recoverable Amount (higher of:)		
- Fair value	50,000	
- Value in use	40,000	(50,000)
Impairment loss		-

Answer-7

Entries in the books of STL

Date	Particulars	Rs. in '000' Dr.	Cr.
1/1/07	Plant	1,000	
	Bank		1,000
	(Purchase of plant)		
31/12/07	Depreciation Expense	50	
	Accumulated Depreciation		50
	(Recording of depreciation)		
31/12/07	Accumulated Depreciation	50	
	Plant		50
	(Transfer of accumulated depreciation to plant)		
31/12/07	Plant	550	
	Revaluation surplus		550
	(Recording of revaluation surplus)		
31/12/08	Depreciation expense	78.95	
	Accumulated Depreciation		78.95
	(Recording of depreciation)		
31/12/08	Revaluation Surplus	28.95	
	Retained earning		28.95
	(Transfer of revaluation surplus to retained earnings)		

Scanned with CamScanner

31/12/09	Depreciation expense Accumulated Depreciation (Recording of depreciation)	78.95	78.95
31/12/09	Revaluation Surplus Retained earning (Transfer of revaluation surplus to retained earnings)	28.95	28.95
31/12/10	Depreciation expense Accumulated Depreciation (Recording of depreciation)	78.95	78.95
31/12/10	Revaluation surplus Retained earning (Transfer of revaluation surplus to retained earnings)	28.95	28.95
31/12/10	Impairment loss(bal.) Revaluation surplus Accumulated Impairments loss (Recording of impairment loss)	100 463.15	563.15

(W-1)

Rs in '000'

Date	Description	Plant	Rev. Surplus	SOCI (P/L)
1/1/07	Cost	1,000		
31/12/07	Depreciation (1,000/20)	(50)		
31/12/07	WDV	950		
31/12/07	Revaluation surplus (Bal.)	550	550	
31/12/07	Revalued amount	1,500	550	
31/12/08	Depreciation (1,500/19) : (550/19)	(78.95)	(28.95)	
31/12/08	WDV	1,421.05	521.05	
31/12/09	Depreciation (1,500/19):(550/19)	(78.95)	(28.95)	
31/12/09	WDV	1,342.1	492.1	
31/12/10	Depreciation (1,500/19):(550/19)	(78.95)	(28.95)	
31/12/10	WDV	1,263.15	463.15	

(W-2) Calculation of impairment loss:

31/12/10	Book value		1,263.15
31/12/10	Recoverable amount (Higher of:) - Fair value less cost to sell - Value in use	 600 700	
31/12/10	Impairment loss		(700) 563.15

Scanned with CamScanner

Answer-8

Entries in the books of Salamat industries

Date	Particulars	Rs. in '000' Dr.	Cr.
1/1/10	Machine Bank (Purchase of machine)	1,570	1,570
31/12/10	Depreciation Expense Accumulated Depreciation (Recording of depreciation)	98.13	98.13
1/1/11	Accumulated Depreciation Machine (Transfer of accumulated depreciation to machine)	98.13	98.13
1/1/11	Machine Revaluation surplus (Recording of revaluation surplus)	228.13	228.13
31/12/11	Depreciation expense Accumulated Depreciation (Recording of depreciation)	113.3	113.3
31/12/11	Revaluation surplus Retained earning (Transfer of revaluation surplus to retained earnings)	15.21	15.21
1/1/12	Accumulated depreciation Machine (Transfer of accumulated depreciation to machine)	113.3	113.3
1/1/12	Machine Revaluation surplus (Recording of revaluation surplus)	163.3	163.3
31/12/12	Revaluation Surplus Retained earning (Transfer of revaluation surplus to retained earnings)	26.87	26.87
31/12/12	Depreciation expense Accumulated Depreciation (Recording of depreciation)	125	125
31/12/12	Impairment loss(bal.) Revaluation surplus Accumulated Impairments loss (Recording of impairment loss)	275.65 349.35	625

(W-1)

Date	Description	Rs in '000' Machine	Rev. Surplus	SOCI (P/L)
1/1/10	Cost	1,570		
31/12/10	Depreciation (1,570/16)	(98.13)		
31/12/10	WDV	1,471.87		
1/1/11	Revaluation surplus (Bal.)	228.13	228.13	
1/1/11	Revalued amount	1,700	228.13	
31/12/11	Depreciation (1,700/15) : (228.13/15)	(113.3)	(15.21)	
31/12/11	WDV	1,586.7	212.92	

Scanned with CamScanner

1/1/12	Revaluation Surplus (bal.)	163.3	163.3
1/1/12	Revalued Amount	1,750	376.22
31/12/12	Depreciation (1,750/14) : (376.22/14)	(125)	(26.87)
31/12/12	WDV	1,625	349.35

(W-2) Calculation of impairment loss:

31/12/12	Book value		1,625
31/12/12	Recoverable amount (Higher of:)		
	- Fair value less cost to sell	800	
	- Value in use	1,000	(1,000)
31/12/12	Impairment loss		625

Answer-9

Impairment loss

	A	B	C
Carrying amount	3,200	1,500	1,700
Recoverable amount (Higher of)			
- value in use	3,100	1,200	1,500
- fair value less cost to sell (W-1)	2,450	1,350	1,950
Impairment	(3,100)	(1,350)	(1,950)
	100	**150**	**-**

WORKINGS

(W-1) Fair value less cost to sell

A	(2,500 – 50)	2,450
B	(1,400 – 50)	1,350
C	(2,000 – 50)	1,950

Company's legal advisor cost is not an incremental cost, so ignored.

Answer-10

Journal entries

For the year ended 31st December, 2010

Date	Particulars	Dr.	Cr.
01-01-10	Asset		
	Cash	100	
31-12-10	Depreciation		
	Accumulated depreciation	10	

For the year ended 31st December, 2011

Date	Particulars	Dr.	Cr.
31-12-11	Depreciation		
	Accumulated depreciation	10	

Scanned with CamScanner

For the year ended 31st December, 2012

Date	Particulars	Dr.	Cr.
31-12-12	Depreciation	10	
	Accumulated depreciation		10
31-12-12	Accumulated depreciation (10 + 10 + 10)	30	
	Asset		30
31-12-12	Asset	20	
	Revaluation surplus		20
31-12-12	Impairment loss expense	0	
	Revaluation surplus	8	
	Accumulated impairment loss		8

(W-I) Calculation of revaluation surplus and depreciation on building

Date	Description	Asset	R. Surplus	SOCI(P/L)
1/1/10	Cost	100		
31/12/10	Depreciation (100/10)	(10)		
31/12/10	WDV	90		
31/12/11	Depreciation	(10)		
31/12/11	WDV	80		
31/12/12	Depreciation	(10)		
31/12/12	WDV	70		
31/12/12	Revaluation surplus (bal.)	20	20	
31/12/12	Revalued amount	90	20	
31/12/12	Impairment loss (bal.)	(8)	(8)	
31/12/12	Recoverable amount	82	12	

Scanned with CamScanner

ICAP PAST PAPERS QUESTION

Question-1

Dominant Fertilizers has two plants. Following Information is available for the purpose of impairment testing:

(i) The remaining useful life of both plants is expected to be 3 years.

(ii) The fair values and written down values of the plants as on 31 December 2012 were as follows:

Plants	Cost	Accumulated Depreciation	WDV	Fair value	Incremental selling cost
			----------Rs. in million----------		
P-1	300	80	220	210	7
P-2	200	40	160	150	4

(iii) Expected cash flows from each plant in next 3 years are as follows:

	P-1	P-2
	------Rs. in million------	
Annual inflows	105	55
Annual outflows	11	5
Sale proceeds at end of year 3	8	3
Disposal costs at end of year 3	2	1

(iv) Present value factor, based on a pre tax discount factor of 10%, for year 1, year 2 and year 3 are 0.909, 0.826 and 0.751 respectively.

Required:

Compute impairment (if any) on each plant as on 31 December 2012. (11)

{Spring 2013, Q#5}

Question-2

On October 01, 2004 ARC Limited, in the course of improvement and enhancement of its production facility bought a plant having invoice value of Rs. 25 million for the production of its popular brand of electrical goods. Mr. Aslam, one of the directors, was assigned the duty of supervising the installation of the plant. Other information is given below:

(a) A special trade discount of 25% was allowed by the supplier due to efforts of the agent involved in the deal, who had close association with Mr. Aslam. Normally the supplier allows only 10% trade discount to his customers.

(b) The following costs were incurred on site preparation:

		Rs. in '000'
i.	Salary of civil engineers and labour	1,200
ii.	Civil and electrical work (refer (c) below)	2,800
iii.	Electrical item received from the company's own production department at cost plus 10% profit (similar items are sold to customers at cost plus 30% profit)	330
iv.	Remuneration of employees during site preparation	600

(c) Civil and electrical work includes cost of certain instruments amounting to Rs. 150,000, which were poorly handled by the workers and were totally damaged. Now they carry no value.

(d) On January 01, 2005 test run was started and successfully completed on January 31, 2005 at a cost of Rs. 550,000. The sale proceeds of test production were Rs. 320,000.

Scanned with CamScanner

(e) The company is presently obliged to dismantle plant at end of life and present value of dismantling cost is Rs. 250.

(f) The plant went into normal production from February 01, 2005 and attained 45% capacity during the period ended on June 30, 2005. The company, at this stage, discovered that the actual capacity of the plant is about 85% of the capacity declared by the supplier. The matter was discussed with the supplier and his agent. The agent finally agreed to pay a compensation of 3% on invoice value and issued his credit note to this effect on June 30, 2005.

(g) The company accounts for its assets under cost model and on June 30, 2005 it estimated Rs. 21 million as the fair value of the plant. It is further estimated that in case of disposal the following expenditure will have to be incurred:

	Rs. '000'
- Cost of transportation	100
- Terminal benefits of labour to be laid off	300
- Legal costs	100
- Stamp duty	50

(g) Depreciation is to be charged at 10% on straight-line basis from the commencement of normal production.

Required:

Calculate the following, also submit your explanation if necessary:

(a) Initial recognition of the cost of plant. **(05)**

(b) Impairment loss, if any, as at June 30, 2005 and accounting treatment thereof. **(06)**

{Autumn 2005, Q# 2}

QUESTION-3

Scientific Pharma Limited (SPL) is a manufacturer of pharmaceutical products. In January 2015, one of its plants suffered a major break down. It was repaired at a cost of Rs. 1.5 million but the production capacity was reduced significantly. The plant was ready for production on June 30, 2015. At that time the company's engineers advised that the plant could be used at a reduced level for 3 years only. The plant was estimated to have a recoverable amount of Rs. 19,277,000 at June 30, 2015.

Other related information is as under:

(i) The plant was imported at FOB price of US$ 800,000. The payment was made at the time of shipment on July 1, 2005 at Rs. 52 per US$. Other charges including installation cost amounted to Rs. 7 million. Installation of the plant was completed on December 31, 2005 and commercial production commenced from April 1, 2006.

(ii) The company uses straight line method of deprecation. Depreciation is charged from the month the asset is available for use upto the month prior to disposal. At the time of purchase, the estimated useful life of the plant was estimated at 15 years whereas the salvage value was estimated at Rs. 2.0 million.

(iii) Based on the report of a professional independent valuer, the plant was revalued on July 1, 2010 at Rs. 45 million. There was however, no change in estimated useful life of the plant.

(iv) The factory remained closed from April 1, to June 30, 2012 due to law and order situation.

(v) The salvage value has not changed since it was first estimated at the time of purchase.

Required:

Prepare accounting entries for the year ended June 30, 2015. Give all the necessary calculations. **(20)**

{Autumn-10, Q.2}

Scanned with CamScanner

ICAP PAST PAPERS SOLUTIONS

Answer-1

		P-1	P-2	P-1	P-2
Impairment loss					
Carrying amount				220	160
Recoverable amount (Higher of)					
- value in use (W-1)		238.19	126.71		
- fair value less cost to sell	(W-2)	203	146	(238.19)	(146)
Impairment				-	14

WORKINGS

(W-1) Value in Use

P-1 = $(105 - 11) \times 0.909 + (105 - 11) \times 0.826 + (105 - 11 + 8 - 2) \times 0.751$ = 238.19

OR

P-1 = $(105 - 11) \times \frac{[1-(1.1)^{-3}]}{0.1} + (8-2) \times (1.1)^{-3}$ = 238.19

P-2 = $(55 - 5) \times 0.909 + (55 - 5) \times 0.826 + (55 - 5 + 3 - 1) \times 0.751$ = 126.71

OR

P-2 = $(55 - 5) \times \frac{[1-(1.1)^{-3}]}{0.1} + (3-1) \times (1.1)^{-3}$ = 126.71

(W-2)

	P-1	P-2
	Rs in million	
Fair value less cost to sell (210 – 7) : (150 – 4)	203.00	146.00

Answer-2

(a) Cost of plant is calculated as below:

		Rs. '000'
Invoice value		25,000
Less: Trade discount @ 25%		(6,250)
Salary of civil engineer		1,200
Civil & electrical work		2,650
Cost of electrical items	(2,800 -150)	300
Remuneration	(330/110 x 100)	600
Trial production cost net of sale proceeds of prototype/sample	(550 – 320)	230
Cost of dismantling		350
Less: Compensation	(2,500 x 3%)	(750)
Total		23,330

(b) Calculation of impairment loss

Total carrying amount			23,330
Recoverable amount (Higher of)			
- Value in use	[23,330 - (23,330 x 10%) x 5/12]		22,358
- Fair value less cost to sell		Not available	
Impairment loss		20,750	20,750
			1,608

Scanned with CamScanner

WORKINGS

(W-1) Calculation of fair value less cost to sell

	Rs. '000'	Rs. '000'
Fair market value		21,000
Less: legal costs	100	
Stamp duty	50	
Transportation cost	100	(250)
Net selling price		**20,750**

Note: Termination benefits are ignored as it is not a part of cost to sell. As dismantling cost is already included as a part of cost of asset so it is ignored in "fair value less cost to sell" calculation.

Answer-3

Scientific Pharma

Entries

Rs in '000'

Particulars	Dr.	Cr.
Repair expense	1,500	
Bank		1,500
(Repair incurred)		
Depreciation expense (45,000 – 2,000)/10.5 (W-3)	4,095	
Accumulated depreciation		4,095
(Calculation of depreciation for the year)		
Revaluation surplus ((W-3) 10,380/10.5)	989	
Retained earnings		989
(Transfer of revaluation surplus for the year)		
Revaluation surplus (W-4)	5,297	
Accumulated impairment loss		5,297
(Recording of impairment loss)		

(W-1) Cost of asset

FOB price	(800 × 52)	41,600
Installation cost		7,000
		48,600

(W-2) WDV of asset on date of revaluation on 30.06.10

		4.5 Years
Number of years used till revaluation date	(1-1-2006 to 30-6-10)	48,600
Cost		(13,980)
Accumulated depreciation on 30.6.10	((W-1) 48,600 – 2,000)/15 × 4.5)	34,620

(W-3) Calculation of WDV on 30.6.2015

		Plant	Rev. Sur.
1/7/10	WDV on the date of revaluation (W-2)	34,620	
1/7/10	Revaluation surplus (bal.)	10,380	10,380
1/7/10	Revalued amount	45,000	10,380
1/7/10-30/6/15	Less: Accumulated Dep (45,000–2,000)/10.5×5):(10,380/10.5×5)	(20,476)	(4,943)
30/6/15	WDV	24,524	5,437
	Remaining life on date of revaluation (15 – 4.5)		10.5

Scanned with CamScanner

(W-4) Calculation of impairment loss

Recoverable amount	19,227
WDV on 30.6.2015	(24,524)
	(5,297)

The impairment loss is less than revaluation surplus, therefore whole of loss will be debited to revaluation surplus account instead of SOCI.

The following table is not a part of solution. It is only prepared for understanding that how revaluation surplus will be shifted on yearly basis to retained earnings. The difference between this table and (W-3) is that this table shows each year depreciation charge separately. The results of this table and (W-3) are same with a difference of 2 due to decimals.

		Plant	Rev. Sur.
1/7/10	WDV	34,620	
1/7/10	Revaluation surplus (bal.)	10,380	10,380
1/7/10	Revalued amount	45,000	10,380
30/6/11	Depreciation (45,000 – 2,000/10.5) : (10,380/10.5)	(4,095)	(989)
30/6/11	WDV	40,905	9,391
30/6/12	Depreciation (45,000 – 2,000/10.5) : (10,380/10.5)	(4,095)	(989)
30/6/12	WDV	36,810	8,402
30/6/13	Depreciation (45,000 – 2,000/10.5) : (10,380/10.5)	(4,095)	(989)
30/6/13	WDV	32,715	7,413
30/6/14	Depreciation (45,000 – 2,000/10.5) : (10,380/10.5)	(4,095)	(989)
30/6/14	WDV	28,620	6,424
30/6/15	Depreciation (45,000 – 2,000/10.5) : (10,380/10.5)	(4,095)	(989)
30/6/15	WDV	24,525	5,435

Scanned with CamScanner

ICAP QUESTION BANK QUESTION

Question-1

Aba Limited conducts its activities from two properties, a head office in the city centre and a property in the countryside where staff training is conducted. Both properties were acquired on 1 April 2013 and had estimated lives of 25 years with no residual value. The company has a policy of carrying its land and buildings at current values. However, until recently property prices had not changed for some years. On 1 October 2015 the properties were revalued by a firm of surveyors. Details of this and the original costs are:

		Land	Buildings
		Rs.	Rs.
Head office	– cost 1 April 2013	500,000	1,200,000
	– revalued 1 October 2015	700,000	1,350,000
Training premises	– cost 1 April 2013	300,000	900,000
	– revalued 1 October 2015	350,000	600,000

The fall in the value of the training premises is due mainly to damage done by the use of heavy equipment during training. The surveyors have also reported that the expected life of the training property in its current use will only be a further 10 years from the date of valuation. The estimated life of the head office remained unaltered.

Note: Aba Limited treats its land and its buildings as separate assets. Depreciation is based on the straight-line method from the date of purchase or subsequent revaluation.

Required

Prepare extracts of the financial statements of Aba Limited in respect of the above properties for the year to 31 March 2016. ***(ICAP Example 1)***

Question-2

The assistant financial controller of the Hussain Associates Ltd group has identified the matters below which she believes may indicate impairment of one or more assets:

Hussain Associates Ltd owns and operates an item of plant that cost Rs.640,000 and had accumulated depreciation of Rs.400,000 at 1 October 2015. It is being depreciated at 12½% on cost.

On 1 April 2016 (exactly half way through the year) the plant was damaged when a factory vehicle collided into it. Due to the unavailability of replacement parts, it is not possible to repair the plant, but it still operates, albeit at a reduced capacity. It is also expected that as a result of the damage the remaining life of the plant from the date of the damage will be only two years.

Based on its reduced capacity, the estimated present value of the plant in use is Rs.150,000. The plant has a current disposal value of Rs.20,000 (which will be nil in two years' time), but Hussain Associates Ltd has been offered a trade-in value of Rs.180,000 against a replacement machine which has a cost of Rs.1 million (there would be no disposal costs for the replaced plant). Hussain Associates Ltd is reluctant to replace the plant as it is worried about the long-term demand for the product produced by the plant. The trade-in value is only available if the plant is replaced.

Required

Prepare extracts from the statement of financial position and statement of profit or loss of Hussain Associates Ltd in respect of the plant for the year ended 30 September 2016. Your answer should explain how you arrived at your figures. ***(ICAP Example 2)***

Scanned with CamScanner

Question-3

Sky-Line Limited (SL) operates a 4 Star Hotel facility in Murree. The hotel was constructed at a cost of Rs.300 million, 5 years back and it is depreciated on a straight-line basis (total useful life of 15 years and residual value of 20%). There are indications that the property is not performing as expected due to;

(a) opening of a competing hotel nearby,

(b) a significant drop in number of tourists to the area because of terrorism.

There is a 40% probability that the hotel will generate net cash flows of Rs.40 million per annum and 60% probability that the cash flows would only be Rs.20 million per annum.

The property's net operating income is Rs.30 million which is at the rate of 15%. 5% of the proceeds from sale would be expended in closing the deal.

Required:

Calculate the impairment loss if the appropriate discount rate is 10%.

(ICAP Example 3)

Question-4

Premier Limited (PL) owns a plant which has a carrying amount of Rs.248 million asat 1 April 2019. It is being depreciated at 12½% per annum on a reducing balance basis.

The plant is used to manufacture a specific product which has been suffering a decline in salesdue to obsolescence.

PL has estimated that the plant will be retired from use on 31 March 2023.

The estimated net cash flows from the use of the plant and their present values are:

	Net cashflows	Presentvalues
		Rs. In million
Year to 31 March 2021	120	109.2
Year to 31 March 2022	80	66.4
Year to 31 March 2023	52	39
	252	214.6

On 1 April 2020, PL had an alternative offer from the competitor to purchase the plant for Rs.200million.

Required:

Calculate the impairment loss

(ICAP Example 4)

Question-5

Naveed Limited has an item of plant which has a carrying value of Rs.1,800,000 as atthe end of the year December 2020. It has undergone an impairment review and the following estimates were produced:

Fair value of plant = Rs.1,400,000Costs to sell 2% of selling price

Revenue and associated costs per annum for remaining useful life:(assume all cash flows occur at the end of the year).

	Revenue	Costs
2021	Rs.960,000	Rs.240,000
2022	Rs.880,000	Rs.220,000
2023	Rs.700,000	Rs.290,000

The plant has an estimated residual value of Rs.50,000.

A discount rate of 10% is applicable to investments equivalent in risk to this plant.

Required:

Calculate the impairment loss if the appropriate discount rate is 10%.

(ICAP Example 5)

Scanned with CamScanner

ICAP QUESTION BANK SOLUTIONS

Answer-1

ABA Limited
Statement of Financial Position (Extracts)
as on March 31, 2016

		Rs.
Capital and liabilities		
Equity		
Revaluation Surplus		
• Head office	(200,000 (W-1) + 264,000 (W-2))	464,000
• Training premises	(W-3)	50,000
		514,000
Assets		
Non-Current Assets		
Property, Plant and Equipment		
• Head office	(700,000 (W-1) + 1,320,000 (W-2))	2,020,000
• Training premises	(350,000 (W-3) + 570,000 (W-4))	920,000
		2,940,000

ABA Limited
Statement of Comprehensive Income (Extracts)
for the year ended March 31, 2016

Expenses:		
Depreciation		
• Head office	(W-2) (24,000 + 30,000)	54,000
• Training premises	(W-4) (18,000 + 30,000)	48,000
		102,000
Revaluation Loss		
• Training premises	(W-4)	210,000

(W-1) Head Office - Land

Date	Description	Land Asset	Land R. Surplus
		500,000	
30/9/15	WDV	200,000	200,000
1/10/15	Revaluation surplus (bal.)	700,000	200,000
1/10/15	Revalued Amount		

(W-2): Head Office Building

Date	Description	Building	R. Surplus	SOCI(P/L)
1/4/13	Cost	1,200,000		
31/3/15	Depreciation (1,200,000/25) × 2	(96,000)		
31/3/15	WDV	1,104,000		
30/9/15	Depreciation (1,200,000/25) × 6/12	(24,000)		
30/9/15	WDV	1,080,000		
1/10/15	Revaluation surplus (bal.)	270,000	270,000	
1/10/15	Revalued amount	1,350,000	270,000	
31/3/16	Depreciation ((1,350,000/22.5) × 6/12) ((270,000/22.5) × 6/12)	(30,000)	(6,000)	
31/3/16	WDV	1,320,000	264,000	-

Scanned with CamScanner

(W-3) Training premises: Land

Date	Description	Land Asset	Land R. Surplus
30/9/15	WDV	300,000	
1/10/15	Revaluation surplus (bal.)	50,000	50,000
1/10/15	Revalued Amount	350,000	50,000

(W-4) Training premises - Building

Date	Description	Building	R. Surplus	SOCI(P/L)
1/4/13	Cost	900,000		
31/3/15	Depreciation (900,000/25) × 2	(72,000)		
31/3/15	WDV	828,000		
30/9/15	Depreciation (900,000/25) × 6/12	(18,000)		
30/9/15	WDV	810,000		
30/9/15	Revaluation Loss (bal.)	(210,000)		(210,000)
30/9/15	Revalued Amount	600,000		(210,000)
31/3/16	Depreciation (600,000/10) × 6/12 ; (210,000/10) × 6/12	(30,000)		10,500
31/3/16	WDV	570,000	-	199,500

Answer-2

The accident that may have caused impairment occurred on 1 April 2016 and an impairment test would be done at this date. An impairment test requires the plant's carrying amount to be compared with its recoverable amount.

The recoverable amount of the plant is the higher of its value in use of Rs.150,000 or its fair value less costs to sell. If Hussain Associates Ltd trades in the plant it would receive Rs.180,000 by way of a part exchange, **but this is conditional on buying new plant** which **Hussain Associates Ltd is reluctant to do**. A more realistic amount of the fair value of the plant is its current disposal value of only Rs.20,000. Thus the recoverable amount would be its value in use of Rs.150,000.

Extracts are as follows:

Hussain Associate
Statement of Comprehensive Income
For the year ended 30.09.2016

Expenses :		
Depreciation	(W-1)	80,000
Impairment loss	(W-1)	10,000

Hussain Associate
Statement of Financial Position
As on 30.09.2016

Assets		
Non-Current Assets		
Property, Plant and Equipment	(W-1)	150,000

Scanned with CamScanner

(W-1)

Date	Description	Plant	R. Surplus	SOCI(P/L)
1/10/15	WDV (640,000 – 400,000)	240,000		
30/9/16	Depreciation (640,000 × 12.5%)	(80,000)		
30/9/16	WDV	160,000		
30/9/16	Impairment loss (bal.)	(10,000)		
30/9/16	Recoverable amount (W-2)	150,000		

(W-2) Recoverable amount

Recoverable amount is Higher of:

- Fair value less cost to sell	20,000
- Value in use	150,000
	150,000

Answer-3

Carrying value of asset = Rs.300 million – [5 x (300 – 60) / 15 years]
= Rs.220 million

Recoverable amount is the higher of fair value less cost to sell and value is use

Fair value less cost to sell = Net operating income / capitalization rate (since no active market) x (1 - disposal process)

= Rs.30 m / 15% =200 million

= Rs.200 million – 200 million (5%)=190 million

Value in use = Present value of net cash flows discounted at 10% for 10 years

= (Rs.40 m x 0.4 + Rs.20 m x 0.6) x [1- (1.10)-10]/ 10%]

= Rs.28 m x 6.145

= Rs.172 m

Recoverable amount = Rs.190 million

Impairment loss = Rs.30 million

Answer-4

At 31 March 2021

Recoverable amount is the higher of value in use [PV of future net cash flows (Rs.214.6 million) and fair value less costs of disposal (Rs.200 million)].

Carrying amount = Rs.217 million [248 m – (248 m x 12·5%)] Impairment loss = Carrying amount – Recoverable amount

= Rs.217 million – Rs.214.6 million

= Rs.2.4 million

Scanned with CamScanner

Answer-5

Cash flows	2021	2022	2023
	---------- Amount in Rs. ----------		
Revenue	960,000	880,000	700,000
Costs	(240,000)	(220,000)	(290,000)
Net Cash Inflow	720,000	660,000	410,000
Discount factor	0.909	0.826	0.751
Present Value	654,545	545,457	308,037

Residual Value (50,000 x 0.751) = 37,566

Value in use = 654,545 + 545,457 + 308,037 + 37,566 = Rs.1,545,605

Fair value less cost to sell = Rs.1,400,000 – 2% of Rs.1.4 million = Rs.1,372,000 Recoverable amount = Rs. 1,545,605

Carrying value = Rs.1,800,000

Impairment loss = Rs.254,395

Scanned with CamScanner

ICAP MULTIPLE CHOICE QUESTIONS (MCQs)

Q.1 If the fair value less costs to sell cannot be determined

(a) The asset is not impaired.

(b) The recoverable amount is the value-in-use.

(c) The net realizable value is used.

(d) The carrying value of the asset remains the same.

Q.2 Which TWO of the following could be an indication that an asset may be impaired according to IAS 36 Impairment of Assets?

(a) Decrease in market interest rates

(b) Increase in market values for the asset

(c) Damage caused to the asset

(d) Management intention to reorganise the business

Q.3 IAS 36 Impairment of Assets contains a number of examples of internal and external events which may indicate the impairment of an asset.

In accordance with IAS 36, which of the following would definitely NOT be an indicator of the potential impairment of an asset (or group of assets)?

(a) An unexpected fall in the market value of one or more assets

(b) Adverse changes in the economic performance of one or more assets

(c) A significant change in the technological environment in which an asset is employed making its software effectively obsolete

(d) The carrying amount of an entity's net assets being below the entity's market capitalisation

Q.4 A fire at the factory on 1 October 2016 damaged the machine, leaving it with a lower operating capacity. The accountant considers that entity will need to recognise an impairment loss in relation to this damage. The accountant has ascertained the following information at 1 October 2016:

- The carrying amount of the machine is Rs.60,750.
- An equivalent new machine would cost Rs.90,000.
- The machine could be sold in its current condition for a gross amount of Rs.45,000. Dismantling costs would amount to Rs.2,000.
- In its current condition, the machine could operate for three more years which gives it a value in use figure of Rs.38,685.

What is the total impairment loss associated with the above machine at 1 October 2016?

(a) Rs.nil

(b) Rs.17,750

(c) Rs.22,065

(d) Rs.15,750

Scanned with CamScanner

Q.5 Which of the following is NOT an indicator of impairment?

(a) Advances in the technological environment in which an asset is employed have an adverse impact on its future use.

(b) An increase in interest rates which increases the discount rate an entity uses.

(c) The carrying amount of an entity's net assets is higher than the entity's number of shares in issue multiplied by its share price.

(d) The estimated net realisable value of inventory has been reduced due to fire damage although this value is greater than its carrying amount.

Q.6 Cost of disposal are

(a) Incremental costs, directly attributable to the disposal of an asset, excluding finance costs and income tax expense

(b) Incremental costs, directly attributable to the disposal of an asset, plus finance costs, but excluding income tax expense

(c) Incremental costs, directly attributable to the disposal of an asset, plus finance costs and income tax expense

(d) Incremental costs, directly attributable to the disposal of an asset, plus tax expense, but excluding finance costs

Q.7 An asset is impaired if:

(a) Its carrying amount equals the amount to be recovered through use (or sale) of the asset

(b) Its carrying amount exceeds the amount to be recovered through use (or sale) of the asset

(c) The amount to be recovered through use (or sale) of the asset exceeds its carrying amount

(d) If it has been damaged

Q.8 Value in use is:

(a) The market value

(b) The discounted present value of future cash flows arising from use of the asset and from its disposal.

(c) The higher of an asset's fair value less cost to sell and its market value.

(d) The amount at which an asset is recognized in the statement of financial position.

Q.9 IAS 36 applied to which of the following assets:

(a) Inventories.

(b) Financial assets including property plant and equipment and intangible assets

(c) Assets held for sale.

(d) Property, plant, and equipment and intangible assets

Q.10 In accordance with IAS 36 Impairment of Assets which of the following statements are true?

1. An impairment review must be carried out annually on all intangible assets.
2. If the fair value less costs to sell of an asset exceed the carrying amount there is no need to calculate a value in use.
3. Impairment is charged to the statement of profit or loss unless it reverses a gain that has been recognised in equity in which case it is offset against the revaluation surplus.

(a) All three

(b) 1 and 2 only

(c) 1 and 3 only

(d) 2 & 3 only

Scanned with CamScanner

Q.11 What is the recoverable amount of an asset?

(a) Its current market value less costs of disposal
(b) The lower of carrying amount and value in use
(c) The higher of fair value less costs of disposal and value in use
(d) The higher of carrying amount and market value

Q.12 A machine has a carrying amount of Rs. 850,000 at the year end of 31 March 2019. Its market value is Rs. 780,000 and costs of disposal are estimated at Rs. 25,000. A new machine would cost Rs. 1,500,000. The company which owns the machine expects it to produce net cash flows of Rs.300,000 per annum for the next three years. The company has a cost of capital of 8%.

What is the impairment loss on the machine to be recognised in the financial statements at 31 March

(a) Rs.76,870
(b) Rs.95,000
(c) Rs.1,66,700
(d) Rs.220,000

Q.13 IAS 36 Impairment of Assets suggests how indications of impairment might be recognised.

Which TWO of the following would be external indicators that one or more of an entity's assets may be impaired?

(a) An unusually significant fall in the market value of one or more assets
(b) Evidence of obsolescence of one or more assets
(c) A decline in the economic performance of one or more assets
(d) An increase in market interest rates used to calculate value in use of the assets

Q.14 The following information relates to an item of plant.

- Its carrying amount in the statement of the financial position is Rs. 3 million.
- The company has received an offer of Rs. 2.7 million from a company in Karachi interested in buying the plant.
- The present value of the estimated cash flows from continued use of the plant is Rs. 2.6 million.
- The estimated cost of transport the plant to Karachi is Rs. 50,000.

What is the amount of the impairment loss that should be recognised on the plant?

(a) Rs.300,000
(b) Rs.400,000
(c) Rs.350,000
(d) Rs.250,000

Q.15 When calculating the estimates of the future cash flows, which of the following cash flows should not be included?

(a) Cash flows from disposal.
(b) Income tax payments.
(c) Cash flows from the sale of assets produced by the asset.
(d) Cash outflows on the maintenance of the asset.

Scanned with CamScanner

Q.16 The following information relates to three assets held by a company:

	Asset A	Asset B	Asset C
	Rs.m	Rs.m	Rs.m
Carrying amount	200	100	80
Value in use	160	120	70
Fair value less cost to sell	180	130	60

What is the total impairment loss?

Rs. _____

Q.17 The following information relates to four assets held by the company:

	A	B	C	D
	Rs.m	Rs.m	Rs.m	
Carrying amount	240	60	80	140
Value in use	160	140	160	40
Fair value less costs to sell	180	80	140	60

What is the total impairment loss?

Rs. _____

Q.18 A vehicle was involved in an accident exactly halfway through the year. The vehicle cost Rs.10 million and had a remaining life of 10 years at the start of the year. Following the accident, the expected present value of cash flows associated with the vehicle was Rs.3.4 million and the fair value less costs to sell was Rs.6.5 million.

What is the recoverable amount of the vehicle following the accident?

Rs. _____

Q.19 Radium Limited (RL) acquired a non-current asset on 1 October 2019 at a cost of Rs.100 million which had a useful life of ten years and a nil residual value. The asset had been correctly depreciated up to 30 September 2024.

At that date the asset was damaged and an impairment review was performed. On 30 September 2024, the fair value of the asset less costs to sell was Rs.30 million and the expected future cash flows were Rs.8.5 million per annum for the next five years.

The current cost of capital is 10% and a five year annuity of Rs.1 per annum at 10% would have a present value of Rs.3.79.

What amount would be charged to profit or loss for the impairment of this asset for the year ended 30 September 2024?

Rs. _____

Q.20 Metal Limited (ML) owns an item of plant which has a carrying amount of Rs. 248 million as at 1 April 2013. It is being depreciated at 12.5% per annum on a reducing balance basis.

The plant is used to manufacture a specific product which has been suffering a slow decline in sales. ML has estimated that the plant will be retired from use on 31 March 2017.

The estimated net cash flows from the use of the plant and their present values are:

	Net cash flows	Present values
	Rs.000	Rs.000
Year to 31 March 2015	120,000	109,200
Year to 31 March 2016	80,000	66,400
Year to 31 March 2017	52,000	39,000
	252,000	214,600

Scanned with CamScanner

On 1 April 2014, Metric had an offer from a rival to purchase the plant for Rs. 200 million

At what value should the plant appear in Metric's statement of financial position as at 31 March 2014?

Rs. _____

Q.21 Which of the following is covered by IAS 36 - Impairment?

(a) Non-current assets held for sale (b) Investment property carried at cost
(c) Investment property carried at fair value
(d) Inventories

Q.22 Which of the following is not covered by IAS 36 - Impairment?

(a) Goodwill (b) Investment property carried at cost
(c) Investment property carried at fair value
(d) Intangible assets

Q.23 When should an impairment loss be recognised?

(a) Immediately (b) Over a number of accounting periods
(c) At management's discretion
(d) When requested by the entity's auditors

Q.24 Value in use is?

(a) The undiscounted present value of future cash flows expected to arise from continuing use of asset, and from its disposal at the end of its useful life.
(b) The undiscounted future value of present cash flows expected to arise from continuing use of asset, and from its disposal at the end of its useful life.
(c) The discounted present value of future cash flows expected to arise from continuing use of asset, and from its disposal at the end of its useful life.
(d) The discounted present value of historical cash flows expected to arise from continuing use of asset, and from its disposal at the end of its useful life.

Q.25 Which of the following element is not considered while computing value in use?

(a) expectations about possible variations in the amount or timing of those future cash flows
(b) the time value of money, represented by the current market risk-free rate of interest
(c) the price for bearing the uncertainty inherent in the asset
(d) estimated future restructuring cost

Q.26 In measuring value in use, the discount rate used for discounting the cash flows should be the?

(a) Pre-tax rate that reflects the market assessment of time value of money and risks specific to the asset
(b) Pre-tax rate that reflects the market assessment of time value of money and risks specific to the entity's competitors
(c) Post-tax rate that reflects the entity's assessment of time value of money and risks specific to the asset
(d) Pre-tax rate that reflects the entity's assessment of time value of money and risks specific to the asset

Q.27 When the recoverable amount of an asset is less than its carrying value in the Statement of Financial Position, the asset is?

(a) in a revaluation deficit (b) Flawed
(c) In negative equity (d) Impaired

Scanned with CamScanner

Q.28 Which of the following is an internal indication of impairment?

(a) Decline in market value
(b) Worse economic performance than expected
(c) Increase in market interest rates
(d) Technological obsolescence

Q.29 Which of the following is an external indication of impairment?

(a) Physical damage
(b) Worse economic performance than expected
(c) Increase in market interest rates
(d) Asset is part of a restructuring program

Q.30 Under IAS 36, what is the recoverable amount of an asset?

(a) The lower of its cost and net realisable value
(b) The higher of fair value less costs of disposal and value in use
(c) The lower of net present value and cost
(d) The higher of net present value and cost

Q.31 Which of the following is not permitted as a cost to sell under IAS 36?

(a) Cost to dismantle machine
(b) Auctioneers fees
(c) Standard wages for employees
(d) Transport costs for machine

Q.32 If the fair value less costs to sell for an asset cannot be determined, then recoverable amount is its?

(a) Market value
(b) Fair value
(c) Value in use
(d) Replacement value

Q.33 Which of the following is the best evidence of an asset's fair value less costs to sell?

(a) The carrying value of the asset
(b) The price in a binding sale agreement
(c) The disposal value of the asset in an arm's length transaction
(d) An asset that is traded in an active market

Q.34 When calculating the estimates of future cash flows which of the following cash flows should not be included?

(a) Cash out flows on the maintenance of the asset
(b) Cash flows from disposal
(c) Cash flows from the sale of inventory produced by the asset
(d) Benefits from future restructuring

Q.35 Which of the following future cash flows should NOT be included in the calculation of value in use of an asset?

(a) Cash flows on maintaining the asset's performance
(b) Cash flows on enhancing the asset's performance
(c) Cash flows from continuing use of the asset
(d) Cash flows from disposal of the asset

Scanned with CamScanner

Q.36 When an impairment review is carried out, an impaired asset is measured at:

(a) fair value less cost to sell
(b) value in use
(c) cost
(d) recoverable amount

Q.37 Which of the following would be an external indicator that an asset of an entity may be impaired?

(a) Increase in central bank discount rates
(b) Decline in economic performance of an asset
(c) Physical obsolescence of an asset
(d) Future restructuring plan of an asset
(e)

Q.38 Which of the following is NOT a measurement base for assets as referred in the Conceptual Framework?

(a) Value in use
(b) Fulfilment value
(c) Current cost
(d) Fair value

Q.39 Under IAS 36 Impairment of Assets, if the fair value less costs to sell of an asset cannot be determined then:

(a) the asset is not impaired
(b) the recoverable amount is the value in use
(c) the net realizable value is used
(d) the carrying value of the asset remains the same

Q.40 Which TWO of the following would be external indicators that one or more of an entity's assets may be impaired?

(a) A n unusually significant fall in the market value of one or more assets
(b) Evidence of obsolescence of one or more assets
(c) A decline in the economic performance of one or more assets
(d) An increase in market interest rates used to calculate value in use of the assets

Q.41 Which of the following future cash flows should NOT be included in the calculation of value in use of an asset?

(a) Cash flows from disposal
(b) Income tax payments
(c) Cash flows from the sale of inventory produced by the asset
(d) Cash outflows on the maintenance of the asset

Q.42 A plant has a carrying amount of Rs. 1,500,000 as at 31 December 2019. Its fair value is Rs. 900,000 and costs of disposal are estimated at Rs. 50,000. A new plant would cost Rs. 2,500,000. Cash flows from the plant for the next four years are estimated at Rs. 350,000 per annum. Applicable discount rate is 10%.

What is the approximate impairment loss on the plant to be recognised in the financial statements as at 31 December 2019?

(a) Rs. 650,000
(b) Rs. 390,000
(c) Rs. 1,000,000
(d) Nil

Scanned with CamScanner

Q.43 In measuring value in use, the discount rate used for discounting the cash flows should be the:

(a) pre-tax rate that reflects the market assessment of time value of money and risks specific to the asset

(b) pre-tax rate that reflects the market assessment of time value of money and risks specific to the entity

(c) post-tax rate that reflects the entity's assessment of time value of money and risks specific to the asset

(d) pre-tax rate that reflects the entity's assessment of time value of money and risks specific to the asset

Scanned with CamScanner

ICAP MULTIPLE CHOICE QUESTIONS (MCQs) SOLUTIONS

A.1 (b) The recoverable amount is higher of value in use and fair value less cost to sell and in case fair value cannot be measured reliably, the recoverable amount is value in use.

A.2 (c)&(d) A decrease in interest rates would reduce the discount applied to future cash flows in calculating the value in use, therefore increasing the value in use. An increase in market values will lead to the asset value increasing rather than being impaired.

A.3 (d) The entity's market capitalisation would not be reflected within the values on the statement of financial position.

A.4 (b)

Calculation of Impairment Loss		Rs.	Rs.
Carrying Value (1.10.16			60750
Recoverable Amount (Higher of)			
Fair Value less cost to sell	(45,000 – 2,000)	43,000	
Value in use		38,685	43,000
Impairment Loss			**17,750**

A.5 (d) Although the estimated net realisable value is lower than it was (due to fire damage), the entity will still make a profit on the inventory and thus it is not an indicator of impairment.

A.6 (a) Tax and finance costs are not cost of disposal.

A.7 (b) Asset may not be impaired even after damage. Impairment loss is excess of carrying amount over recoverable amount.

A.8 (b) This is definition of value in use

A.9 (d) (a), (b) and (c) are excluded from scope of IAS 36 as the prudence mechanism is already incorporated in the relevant standards of these items.

A.10 (d) Item 1 is untrue. An annual impairment review is only required for intangible assets with an indefinite life.

A.11 (c) The higher of fair value less costs of disposal and value in use.

A.12 (a)

Calculation of Impairment Loss		Rs.	Rs.
Carrying Value (31.3.19)			850,000
Recoverable Amount (Higher of)			
Fair Value less cost to sell	(780,000 – 25,000)	755,000	
Value in use		773,130	773,130
$300,000\ (1.08)^{-1}+300,000\ (1.08)^{-2}+300,000\ (1.08)^{-3}$			
Impairment Loss			**76,870**

A.13 (a&d) The other options are internal indicators of impairment.

A.14 (c)

Calculation of Impairment Loss		Rs.	Rs.
Carrying Value			3,000,000
Recoverable Amount (Higher of)			
Fair Value less cost to sell	(2,700,000 – 50,000)	2,650,000	
Value in use		2,600,000	2,650,000
Impairment Loss			**350,000**

Scanned with CamScanner

A.15 (b) Cash flows related to taxations are ignored while calculating value in use.

A.16 Rs.30 million

Calculation of Impairment Loss	**A**	**B**	**C**	**Total**
Carrying Value	200	100	80	
Recoverable Amount (Higher of)	(180)	(130)	(70)	
Impairment Loss	20	-	10	30

Recoverable Amount (Higher of)				
Fair Value less cost to sell	180	130	60	
Value in use	160	120	70	

A.17 Rs.140 million

60 + Nil + Nil +80 = Rs.140 million

A.18 Rs. 6.5 million

The recoverable amount of an asset is the higher of its value in use (being the present value of future cash flows) and fair value less costs to sell. Therefore the recoverable amount is Rs.6.5 million.

A.19 Rs.17.785 million

	Rs.m
Cost 1 October 2019	100
Depreciation (100 /10 x 5 years)	(50)
Carrying amount	50

The recoverable amount is the higher of fair value less costs to sell (Rs.30 million) and the value in use (Rs.8.,5 x 3.79 = Rs.32.215). Recoverable amount is therefore Rs.32.215.

	Rs. m
Carrying amount	50
Recoverable amount	(32.215)
Impairment to statement of profit or loss	17.785

A.20 Rs.214,600,000

Is the lower of its carrying amount (Rs.217 million) and recoverable amount (Rs.214.6 million) at 31 March 2015.

Recoverable amount is the higher of value in use (Rs.214.6 million) and fair value less costs to (Rs.200 million).

Carrying amount = Rs.217 million (248 million – (248 million × 12.5%)) Value in use is based on present values = Rs.214.6 million

Scanned with CamScanner

A.21 (b)
A.22 (c)
A.23 (a)
A.24 (c)
A.25 (d)
A.26 (a)
A.27 (d)
A.28 (b)
A.29 (c)
A.30 (b)
A.31 (c)
A.32 (c)
A.33 (b)
A.34 (d)
A.35 (b) Cash flows on enhancing the asset's performance
A.36 (d) Recoverable amount
A.37 (a) Increase in central bank discount rates
A.38 (b) Fulfilment value
A.39 (b) the recoverable amount is the value in use
A.40 (a) & (d) An unusually significant fall in the market value of one or more assets & An increase in market interest rates used to calculate value in use of the assets
A.41 (b) Income tax payments
A.42 (b) Rs. 390,000
A.43 (a) pre-tax rate that reflects the market assessment of time value of money and risks specific to the asset

Scanned with CamScanner

IAS 1 Statement of Changes in Equity

5

LO 1	OVERVIEW
LO 2	PREPARATION OF FINANCIAL STATEMENTS
LO 3	PURPOSE AND IMPORTANCE
LO 4	ELEMENTS OF STATEMENT OF CHANGES IN EQUITY
LO 5	JOURNAL ENTRIES
LO 6	PRESENTATION OF STATEMENT OF CHANGES IN EQUITY
LO 7	FORMAT OF STATEMENT OF CHANGES IN EQUITY

Scanned with CamScanner

STATEMENT OF CHANGES IN EQUITY (SOCIE)

LO 1 OVERVIEW

A change in equity is simply the increase or decrease in the net assets of the equity.

The statement of changes in equity separates owner and non-owner changes in equity in the following manner:

- Transactions with owners; and
- Non-owner changes in equity, referred to as total comprehensive income.

LO 2 IAS 1 PREPARATION OF FINANCIAL STATEMENTS

IAS 1 prescribes the basis for presentation of financial statements for the comparability of company's financial position to last year's performance or with other entities. It sets the requirement, guidelines for structure and presentation for the preparation of following statements

Complete set of financial statements consists of:

(i) a statement of financial position (balance sheet) as at the end of the period;

(ii) a statement of comprehensive income for the period;

(iii) a statement of changes in equity for the period;

(iv) a statement of cash flows for the period

(v) notes to the financial statements

Notes to these statements, consisting of a summary of significant accounting policies used by the entity and other explanatory information;

Note: Comparative information also form part of the financial statements.

IAS 1 Presentation of Financial Statements

(i) specifies what published 'general-purpose' financial statements should include, and

(ii) provides a format for a statement of financial position, statement of comprehensive income, and statement of changes in equity.

LO 3 PURPOSE AND IMPORTANCE

Statement of changes in equity

(i) helps users of financial statement to identify the factors that cause a change in the owners' equity over the accounting periods.

(ii) tells the users about the status of owner's equity at the beginning of the financial period, how it has changed during the year and the status of equity at the end of the period.

(iii) provide insights about the effects of business operations and related factors on the wealth of the owners invested in the business.

Examples of the information provided in the statement of changes in equity include:

(i) share capital issue and

(ii) redemption during the period,

(iii) the effects of changes in accounting policies and correction of prior period errors,

(iv) gains and losses recognised outside profit or loss,

(v) dividends and

(vi) bonus shares issued during the period.

Scanned with CamScanner

LO 4: ELEMENTS OF STATEMENT OF CHANGES IN EQUITY

A statement of changes in equity shows for each component of equity the amount at the beginningof the period, changes during the period, and its amount at the end of the period that includes:

A). Transactions with owners

The detail of transactions with owners is as under:

- Share capital
- Share premium
- Redemption
- Dividend
- Bonus shares
- Right issue

(i) Share capital

Share capital is the sum of all funds raised by the company in the form of ordinary shares and preference shares. Preference shares confer preferential rights for their holders such entitlement to a dividend out of profits before ordinary shareholders. Once the preference dividend has been paid, the remaining profit 'belongs' to the ordinary shareholders at the discretion of the board of directors of the company. The directors may decide to retain some profits (retained earnings) within the company or declare the dividend.

Types of Share Capital

Following are the different types of share capital:

(a) Authorized Share Capital

It is the maximum amount of share capital that a company is authorized to raise. A company does not usually issue the full amount of its authorized share capital. Instead, some of it is held in reserve by the company for possible future use.

(b) Issued Share Capital

A company may elect to only issue a portion of the total share capital with the plan of issuing more shares at a later date. Issued share capital is the total value of the shares a company sells. The issued share capital of a company is the par value of the shares that have actually been issued to shareholders.

(c) Subscribed Share Capital

When a company issues its authorised share capital, some part of it may not be subscribed by the investors. Subscribed share capital is the monetary value of all the shares that the investors have committed to buy.

(d) Paid up Share Capital

Paid-up share capital is the amount of money a company has received from shareholders in exchange for its shares.

(ii) Preference Shares

Preference shares are of two types: redeemable and irredeemable. Only irredeemable preference shares are treated as share capital.

Redeemable Preference shares which the company is entitled to redeem in future are treated as non-current liabilities

(iii) Share premium

The difference between the par value of a company's shares and the total amount a company received for shares is called Share premium.

Scanned with CamScanner

Example: if a Rs.10 share is sold for Rs.12 then Rs.2 is the share premium.

(iv) **Redemption**

It is the reacquisitions of the entity's own equity instruments. A company may redeem its shares for a number of reasons such as to buy out certain shareholders or to provide an exit strategy to a third party investor.

(v) **Dividend**

It is the distribution of profits to shareholders.

Many companies pay dividends in two stages during the course of their accounting year.

(a) In mid-year, after the half-year financial results are published, the company might pay an interim dividend.

(b) At the end of the year, the company might propose a further final dividend.

The **proposed dividend** is not accounted for, instead it is disclosed in the notes to the accounts.

According to financial reporting framework the dividends are incorporated as under

(a) In case of interim dividend, it must be incorporated in the statement of changes in equity of same year.

(b) In case of final dividend, the final dividend of current year shall be incorporated in the statement of changes of the next year provided that it has been declared by Directors and approved by shareholders in annual general meeting. In the current year only disclosure note is given for final dividend.

The dividend on preference shares may be cumulative or non-cumulative. Any unpaid cumulative dividends pass to future years and have to be paid out before dividends for ordinary shareholders.The accounting treatment is as follows:

(a) If preference dividend is cumulative, such dividend for the period need to be taken into accountirrespective of whether declared or not.

(b) If preference dividend is non-cumulative, such dividend for the period need to be taken into account only for the amount of dividend declared for the period.

(vi) **Bonus shares**

These shares are distributed by a company to its current shareholders free of charge. A bonus issue does not involve any cash inflow. The company converts some of its reserves (share premium or retained earnings or both) into new fully-paid share capital issued at its par value.

(vii) **Right issue**

It is an invitation to existing shareholders to purchase additional new shares in proportion to their shareholding in the company at a discount to the market price on a stated future date.

Say a company with a paid up capital of 10 million shares raises funds by issuing 2 million new shares. It can offer the new shares to existing shareholder in a '1 for 5' rights issue: each existing shareholder is offered one new share for every five shares currently held (10 million/2 million=5).

B). Total comprehensive income

The detail of total comprehensive income is as under:

- Profit for the year & Retained Earnings
- Revaluation Surplus

Scanned with CamScanner

(i) Profit for the year & Retained Earnings

Retained earnings comprise the income (profits and gains less losses) that the company retains within the business, i.e., income that has not been paid out as dividends or transferred to any other reserve. A company might hold retained earnings that it has no intention of distributing to owners as a dividend at any time in the future in a general reserve rather than in retained earnings.

A debit balance on the retained earnings account indicates that the company has accumulated losses.

(ii) Revaluation surplus

The result of an upward revaluation of a non-current asset is a 'revaluation surplus'. The amount accumulated in revaluation surplus is non-distributable, as it represents un-realised profits on the revalued assets. It is another capital reserve. The revaluation surplus can only become realised if the asset is sold. The revaluation surplus may diminish if an asset which had previously been revalued upwards is devalued later.

(iii) Reserves

Reserves are of two types

- Capital reserves
- Revenue reserves / General reserves

Capital reserves are statutory reserves which a company is required to set up by law, and which are not available for the distribution of dlvidends. Examples include: share premium, revaluation, contingencies.

Revenue reserves / General resveres are non-statutory reserves consisting of profits which are distributable as dividends at the discretion of the company.

Profits are transferred to these reserves by making an appropriation out of profits, usually profits for the year. This is further explained below:

Profit after taxation	300,000
Appropriations of profit:	
Dividend	(100,000)
Transfer to general reserve	(50,000)
Retained earnings for the year	(150,000)
Retained earnings b/f	150,000
Retained earnings c/f	500,000
	650,000

LO 5: JOURNAL ENTRIES

Following journal entries are made in order to record the effects of changes in elements of equity during the period.

Ref	Account / Description	Debit	Credit
1	Bank	X	
	Share Capital		X
	Issue of new shares/ right shares at par value		
2	Bank	X	

Scanned with CamScanner

Ref	Account / Description	Debit	Credit
	Share capital		X
	Share premium		X
	Issue of new shares/ right shares at premium		
3	Retained earnings	X	
	Share capital		X
	Issue of bonus shares		
4	Share premium	X	
	Share capital		X
	Issue of bonus share (If share premium balance is available)		
5	Retained earnings	X	
	Dividend payable		X
	On approval of interim / final dividend		
6	Dividend payable	X	
	Bank		X
	Payment of interim/final dividend		
7	Retained earnings	X	
	General reserves		X
	Transfer of balance to general reserves		
8	Revaluation surplus	X	
	Retained earnings		X
	Transfer of balance in case of incremental depreciation of revalued assets		
9	Revaluation surplus	X	
	Retained earnings		X
	Transfer of balance in case of disposal of revalued asset		
10	Share capital (par value)	X	
	Bank		X
	Payment of cash for redemption (and cancellation) of shares at par		
11	Share capital (par value)	X	
	Share premium / Retained earnings (excess of par value)	X	
	Bank		X
	Payment of cash for redemption (and cancellation) of shares at premium		
12	Share capital (par value)	X	
	Capital repurchase reserve account (discount)		X
	Bank		X
	Payment of cash for redemption (and cancellation) of shares at discount		
13	Retained earnings	X	
	Capital repurchase reserve account		X

Scanned with CamScanner

Ref	Account / Description	Debit	Credit
	Share Premium	X	
	Cash		X
	Share issue cost if share premium exists		
	Retained Earnings	X	
	Cash		X
	Share issue cost if share premium does not exist		
	Transfer from distributable reserves to capital repurchase reserve account on redemption Transfer equal to par value (if redemption is at par value or at premium) Transfer equal to par value less discount (if redemption is at discount)		

Accounting for treasury shares is not examinable at this level.

LO 6 PRESENTATION OF STATEMENT OF CHANGES IN EQUITY

In accordance with the requirements of IAS 1, an entity is required to present a statement of changes in equity which includes the following information:

(a) total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interests;

(b) for each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with IAS 8

(c) for each component of equity a reconciliation between the carrying amount at the beginning and the end of period separately disclosing changes resulting from:

- profit or loss;
- other comprehensive income; and
- transactions with owners in their capacity as owners showing separately
  - (i) contributions by owner and
  - (ii) distributions to owners and
  - (iii) changes in ownership interests in subsidiaries that do not result in a loss of control

Effect of Changes in Accounting Policies

Since changes in accounting policies are applied retrospectively, an adjustment is required in stockholders' reserves at the start of the comparative reporting period to restate the opening equity to the amount that would be arrived if the new accounting policy had always been applied.

Say a company decided to change its inventory costing system from last-in-first-out (LIFO) to first-in-first-out (FIFO). Since the change affects past income, the company must address the change retrospectively and disclose its impact on the statement of changes in equity).

Effect of Correction of Prior Period Error

The effect of correction of prior period errors must be presented separately in the statement of changes in equity as an adjustment to opening reserves. The effect of the corrections may not be netted off against the opening balance of the equity reserves so that the amounts presented in current period statement might be easily reconciled and traced from prior period financial statements.

Scanned with CamScanner

An example could be where depreciation of an assembly plant is charged from the date of production, instead of from the date the plant is ready to be used.

Example 1:

Statement of changes in equity for the year ended 31 December 2019 considering there is redemption, bonus and right issues along with dividends paid during the year

	Share Capital	Share Premium	Retained earnings	Total
	---------- Rs. -------			
Balance as at 1 January 2019	100,000	10,000	60,000	170,000
Profit after tax for the year	-	-	20,000	20,000
Bonus issue	10,000	-	(10,000)	-
Right issue	5,000	2,000	-	7,000
Redemption	(10,000)	-	10,000	-
Dividends paid during the year	-	-	(20,000)	(20,000)
Balance as at 31 December 2019	105,000	12,000	60,000	177,000

LO 7 FORMAT OF STATEMENT OF CHANGES IN EQUITY

Statement of changes in equity for the year ended 31 December 2019

	Share Capital	Share Premium	Retained earnings	Revaluation Surplus	Total
	---------- Rs. in million ----------				
Balance as at 1 January 2019	100	10	60	5	175
Profit after tax for the year	-	-	20	-	20
Revaluation loss	-	-	-	(3)	(3)
Balance as at 31 December 2019	**100**	**10**	**80**	**2**	**192**

Statement of changes in equity for the year ended 31 December 2019 considering there is redemption, bonus and right issues along with dividends paid during the year

	Share Capital	Share Premium	Capital repurchase reserve	Retained earnings	Total
	---------- Rs. in million -------				
Balance as at 1 January 2019	100	10	-	60	170
Profit after tax for the year	-	-	-	20	20
Bonus issue	10	-	-	(10)	-
Right issue	5	-	-	-	5
Redemption	(10)	-	10	(10)	(10)
Dividends paid during the year	-	-	-	(20)	(20)
Balance as at 31 December 2019	**105**	**10**	**10**	**40**	**165**

Scanned with CamScanner

PRACTICE QUESTIONS

QUESTION # 1

XYZ Ltd started its business in January 2017:

(1) Its started with capital of Rs.50 million.

(2) Profit after tax 2017 30 million 2018 45 million

(3) In March 2018 final dividend of 2017 is announced at 15% (Cash dividend)

(4) In September 2018 interim dividend is announced as follows:

  (i) 4% cash dividend and

  (ii) 6% bonus dividend.

(5) In November 2018 20% right shares were issued at Rs.13 each. (1 new share for every 5 shares held)

Required:

Prepare statement of changes in equity for year ended 31 December 2018?

QUESTION # 2

Following is the summarized trial balance of Moonlight Pakistan Limited (MPL), a listed company as on 30.06.2018.

	Rs. in million	
	Debit	**Credit**
Land and buildings - at cost	2,600	-
Accumulated depreciation as on July 1, 2017 – Buildings	-	400
Ordinary shares of Rs.10 each fully paid on July 01, 2017	-	1,200
Retained earnings as at July 1, 2017	-	510
Right subscription received during the year ended 30.06.18	-	420
	8,982	**8,982**

Additional Information

(i) The land and buildings were acquired on July 1, 2013. The cost of land was Rs.600 million. On July 1, 2017 a professional valuation firm valued the buildings at Rs.1,840 million with no change in the value of land. The estimated life at acquisition was 20 years and the remaining life has not changed as a result of the valuation.

(ii) Right shares were issued on May 1, 2018 at Rs.12 per share.

(iii) The profit after tax for year ended June 30, 2018 & 2019 is Rs.566 million & 800 million respectively.

(iv) Cash dividend and bonuses declared/paid during the three years:

For the year ended	Final		*Interim	
	Cash	Bonus	Cash	Bonus
30 June 2017	11%	–	5%	5%
30 June 2018	10%	–	–	1 share for every 6 held
30 June 2019	–	15%		8%

* Declared with half yearly accounts

Required:

Statement of Changes in Equity for the year ended June 30, 2019. (8)

Note: round off the working to the nearest millions

Scanned with CamScanner

PRACTICE SOLUTIONS

Answer # 1
XYZ Ltd
Statement of changes in equity
For year ended 31-12-18

	Share Capital	Share Premium	Retained Earning	Revaluation Surplus	General Reserves	Total
Balance (1.1.17)	-	-	-	-	-	-
Capital introduced	50					50
Profit after tax 2017			30			30
Balance (1.1.18)	50	-	3-	-	-	80
Final dividend–17 (50×15%)	-	-	(7.5)	-	-	(7.5)
Interim Dividend – 18						
Cash (50 × 4%)	-	-	(2)	-	-	(2)
Bonus (50 × 6%)	3	-	(3)	-	-	0
Right issue (W-3)	10.6	3.18	-	-	-	13.78
Profit after tax - 18			45			45
	63.6	3.18	62.5	-	-	129.28

WORKINGS

(W-1) No. of shares before right issue

$$50 + 3 = \frac{\text{Rs. 53 million}}{\text{Rs. 10 per share}} = 5.3 \text{ million shares}$$

(W-2) No. of right shares

$$5.3 \times 20\% = \frac{5.3}{5} \times 1 = 1.06 \text{ million new shares}$$

(W-3) Journal entry

Cash (1.06 × 13)	13.78	
Share capital (1.06 × 10)		10.6
Share premium (1.06 × 3)		3.18

Answer # 2

Description	Share Capital	Share Premium	Retained Earnings	Rev. Surplus	Total
			Rs, million		
Balance 01.07.2017	1,200	-	510	-	1,710
Final Dividend 2017 (1200 x 11%)			(132)		(132)
Interim Dividend 2018 (Bonus) 1,200 × $\frac{1}{6}$	200		(200)		-
Right Issue 420/12=35 million Share, 35 × 10;35 × 2	350	70			420
Total Comprehensive Income			566	240	806
Transfer			15	(15)	-
Balance 30.06.2018	1,750	70	759	225	2,804
Final Dividend 2018 (Cash) (1,750 × 10%)			(175)		(175)
Interim Dividend 2019 (Bonus) (1,750 × 8%)	140	(70)	(70)		-
Total Comprehensive Income			800		800
Transfer			15	(15)	-
Balance 30.06.2019	1,890	-	1,329	210	3,429

W-1

		Land	Building	P.S
01.07.17	Cost	600	2,000	
01.07.17	Acc Dep		(400)	
01.07.17	WDV	600	1,600	
01.07.17	Revaluation Surplus		240	240
01.07.17	Revalued Amount (Remaining Life = 16 years)		1,840	240
30.06.18	Dep 2018, Transfer		N/A	(15)

Scanned with CamScanner

ICAP PAST PAPER QUESTIONS

QUESTION-1

The following information pertains to Wednesday Limited (WL) for the year ended 30 June 2019:

(i) Shareholders' equity as at 1 July 2018:

	Rs. in million
Share capital (Rs.100 each)	200
Share premium	85
Retained earnings	124
Revaluation surplus	65

(ii) On 30 November 2018, WL issued 30% right shares at a premium of Rs.120 per share.

(iii) Cash dividend and bonus shares for the last two years:

For the year ended	Final dividend		* Interim dividend	
	Cash	Bonus	Cash	Bonus
30 June 2018	18%	-	20%	-
30 June 2019	-	25%	-	10%

Declared with half yearly accounts

(iv) Profit for the year amounted to Rs.95 millions

(v) Revaluation surplus arising during the year amounted to Rs.35 million whereas transfer of incremental depreciation for the year was Rs.9 million.

Required:

Prepare WL's Statement of Changes in Equity for the year ended 30 June 2019. **(07)**

(Column for total and comparative figures are not required)

{Autumn 2019, Q #1}

QUESTION-2

Following information pertains to Astrazenca Limited (AL):

(i) Shareholders' equity as on 1 January 2020:

	Rs. in million
Share capital (Rs. 100 each)	250
Share premium	138
Retained earnings	142
Revaluation surplus: Land	25
Buildings	20

(ii) Profit and transfer of incremental depreciation as per the draft financial statements for the year ended 31 December 2020 amounted to Rs. 45 million and Rs. 5 million respectively.

(iii) Dividends for the last two years:

For the year ended	*Interim cash dividend	Final bonus dividend
31 December 2019	10%	20%
31 December 2020	12%	15%

*Declared with half yearly accounts

Scanned with CamScanner

(iv) AL uses revaluation model for subsequent measurement of its land and buildings only. The revalued amounts of land and buildings have been assessed at 31 December 2020 but not incorporated in draft financial statements. The relevant details are as under:

	Land	Buildings
	--- Rs. in million ---	
Balances as on 31 December 2020 before revaluation:		
Cost	75	240
Accumulated depreciation	-	60
Revalued amounts assessed at 31 December 2020	65	158

Required:

Prepare AL's statement of changes in equity for the year ended 31 December 2020. **(08)**

(Column for total and comparative figures are not required)

{Spring 2021, Q #1}

Scanned with CamScanner

ICAP PAST PAPER SOLUTIONS

Answer-1

Wednesday Limited
Statement of changes in equity
For the year ended 30 June 2019

	Share capital	Share premium	Retained earnings	Revaluation surplus
	---------- Rs. in million ----------			
Balance as at 1 July 2018 (As given)	200	85	124	65
Final cash dividend @ 18% for 2018 (200×18%)			(36)	
Right issue @ 30% (0.6 m × Rs.100 ; 0.6 m × Rs.120) ;	60	72		
Interim bonus dividend @ 10% for 2019 (260×10%)	26		(26)	
Total comprehensive income for the year:				
Profit for the year			95	
Other comprehensive income – revaluation surplus				35
Transfer of incremental depreciation			9	(9)
Balance as at 30 June 2019	286	157	166	91

(W-1) Number of share to be issued

$$\frac{\text{Rs. 200 million}}{\text{Rs. 100}} \times 30\% = 0.6 \text{ million shares}$$

Note: Alternate journal entry for bonus issue is

	Debit	Credit
Shares premium	26	
Share capital		26

Answer-2

Astrazenca Limited
Statement of changes in equity
For the year ended 31 December 2020

		Share capital	Share premium	Retained earnings	Revaluat-ion surplus
		---------- Rs. in million ----------			
Balance as at 1 January 2020	*(As given)*	250	138	142	45
Final bonus dividend @ 20% for 2019	*(250×20%)*	50		(50)	
Interim cash dividend @ 12% for 2020	*(250+50)×12 %)*			(36)	
Total comprehensive income for the year:					
Profit for the year	45–7 (W-1)			38	
Other comprehensive income	(10+15)(W-1)				(25)
Transfer of incremental depreciation				5	(5)
Balance as at 31 December 2020		300	138	99	15

Scanned with CamScanner

W-1: Revaluation of building

	Building	Land
	Rs. in million	
Revalued amount	158	65
Carrying value (240–60)	180	75
Revaluation loss	(22)	(10)
Available surplus (20–5)	15	25
Revaluation loss taken to profit or loss	7	-

Scanned with CamScanner

ICAP QUESTION BANK QUESTION

Question-1

The equity of SMS Ltd as on December 31, 2019 is as follows:	
	Rs. in million
Total equity at the beginning of the year:	
- Share Capital (@ Rs. 10 fully paid ordinary shares)	3,000
- Share premium	1,900
- Retained earnings	4,500
Profit for the year	400
Dividends declared and paid	(300)
Total equity at the end of the year	**9,500**
The company made a bonus issue of 2 to 1.	

Required:
The Statement of Changes in Equity of SMS Ltd for the year ended on December 31, 2019.

(ICAP Example 1)

Question-2

The following information pertains to draft financial statements of Pak Ocean Limited (POL) for the year ended 31 December 2018.

	2018
Shareholders' equity as at 1 January 2018 was as follows:	**Rs in million**
Share capital (Rs. 100 each)	200
Retained earnings	45
Profit after tax	78
Other comprehensive income (gain on revaluation)	12
Incremental depreciation on revaluation of property, plant and equipment	1.5

On 30 November 2018, POL issued 25% right shares to its ordinary shareholders at Rs. 120 per share.
Cash dividend @ 18% for the year ending 2017 was declared in January 2018
Bonus issue declared during the year ended 31 December 2018:

- Interim(declared with half yearly accounts) 10%
- Final 25%

Required:
Prepare the statement of changes in equity for the year ended December 31, 2018 for Pak Ocean Limited.

(ICAP Example 2)

Scanned with CamScanner

Question-3

For the purpose of preparation of statement of changes in equity for the year ended 31 December 2017, Daffodil Limited (DL) has extracted the following information:

	2017	2016	2015
	Draft	Audited	Audited
	---------- Rs. in million ----------		
Net profit	650	318	214
Transfer to general reserves	112	-	141
Final cash dividend	-	-	7.5%

Additional information:

(i) Details of share issues:

- 25% right shares were issued on 1 May 2016 at Rs.18 per share. The market price per share immediately before the entitlement date was also Rs.18 per share.
- A bonus issue of 10% was made on 1 April 2017 as final dividend for 2016.
- 50 million right shares were issued on 1 July 2017 at Rs.15 per share. The market price per share immediately before the entitlement date was Rs.25 per share.
- A bonus issue of 15% was made on 1 September 2017 as interim dividend.

(ii) Share capital and reserves as at 31 December:

	2015	2014
	----- Rs. in million -----	
Ordinary share capital (Rs. 10 each)	1,600	1,600
General reserves	1,850	1,709
Retained earnings	1,430	1,302

Required

Prepare DL's statement of changes in equity for the year ended 31 December 2017. (Ignore taxation) ***(ICAP Example 3)***

Question-4

MK corporation Limited, an entity listed in Pakistan Stock Exchange is in the business of manufacturing and sale of yarn products. Company year-end is December. Below is the relevant information given:

Opening balances as at January 01, 2018

Description	Rs.
Opening Share Capital (at par value of Rs. 10 per share)	25,000,000
Share Premium	7,500,000
Opening General Reserves	750,000
Opening RE	18,250,000
Revaluation Surplus	1,500,000

Following events have taken place in year 2018 and 2019:

1. On March 31, 2018, Company issued Right shares for Rs.20 per share. Right shares were issued in the proportion of 1 right share against 5 ordinary shares held.
2. Board of Directors of the Company approved Interim dividend of Rs.2.25 per share for the half year ended June 30, 2018.
3. Annual profit for the year ended December 31, 2018 is Rs.10,250,000.
4. The Board of Directors of the Company recommended annual dividend of Rs.4.25 per share on February 15, 2019, which was duly approved by the Shareholders on March 21, 2019.

Scanned with CamScanner

5. The Board of Directors approved Bonus Shares of 20% of the Outstanding shares on June 30, 2019 which were duly credited in Shareholders account on August 31, 2019.
6. Board of Directors of the Company approved Interim dividend of Rs.1.25 per share for the third quarter ended September 30, 2019.
7. Annual profit for the year ended December 31, 2019 is Rs.12,500,000.
8. The Board of Directors of the Company recommended annual dividend of Rs. 5 per share on February 15, 2020, which was duly approved by the Shareholders on March 21, 2020.
9. The Company has a policy to transfer 5% of the Annual Profit to General Reserves.
10. Company revalued Fixed assets on December 31, 2017 resulting in Revaluation Surplus of Rs.1,500,000. Remaining useful life of the Asset is 10 years and Company has a straight line method for Depreciation.

Required

Make Statement of Changes in Equity for the year ended December 31, 2018 and 2019. Ignore taxation impact if any. ***(ICAP Example 4)***

Question-5

ABC corporation Limited, an entity listed in Pakistan Stock Exchange is in the business of manufacturing and sale of Cars. Company's year-end is December. Below is the relevant information given:

Opening balances as at January 01, 2018

Description	Rs.
Opening Share Capital (at par value of Rs. 10 per share)	100,000,000
Share Premium	50,000,000
Opening General Reserves	5,000,000
Opening RE	55,000,000

Following events have taken place in year 2018 and 2019:

(1) On February 28, 2018, the Company issued Initial Public Offering, thereby offering 5 million shares for Rs.25 each. All shares were subscribed and company received the subscription money by March 31, 2018.
(2) The Board of Directors of the Company recommended annual dividend for the year ended December 31, 2017 of Rs.5 per share on February 15, 2018, whereas Shareholders only approved Rs.4 per share on March 31, 2018.
(3) Board of Directors of the Company approved Interim dividend of Rs.1 per share for the third quarter ended September 30, 2018.
(4) Annual profit for the year ended December 31, 2018 is Rs.130,250,000.
(5) The Board of Directors of the Company recommended annual dividend of Rs.4.25 per share on February 15, 2019, whereas Shareholders approved Rs.6 per share on March 31, 2019.
(6) The Board of Directors approved Bonus Shares of 10% of the Outstanding shares on June 30, 2019 which were duly credited in Shareholders account on August 31, 2019.
(7) Board of Directors of the Company approved Interim dividend of Rs.1.5 per share for the third quarter ended September 30, 2019.
(8) Annual profit for the year ended December 31, 2019 is Rs.175,000,000.
(9) The Board of Directors of the Company recommended annual dividend of Rs.5.5 per share on February 15, 2020, which was duly approved by the Shareholders on March 31, 2020.
(10) The Company has a policy to transfer 5% of the Annual Profit to General Reserves.

Required

Make Statement of Changes in Equity for the year ended December 31, 2018 and 2019. Ignore taxation impact if any. ***(ICAP Example 5)***

Scanned with CamScanner

Question-6

ABC corporation Limited, an entity listed in Pakistan Stock Exchange is in the business of manufacturing and sale of Cars. Company year-end is December. Below is the relevant information given:

Opening balances as at January 01, 2018

Description	Rs.
Opening Share Capital (at par value of Rs.10 per share)	100,000,000
Share Premium	50,000,000
Opening General Reserves	5,000,000
Opening RE	55,000,000

Following events taken place in year 2018 and 2019:

(1) On February 28, 2018, the Company issued Initial Public Offering, thereby offering 5 million shares for Rs.25 each. Only 75% shares were subscribed and company received the subscription money by March 31, 2018.

(2) The Board of Directors of the Company recommended annual dividend for the year ended December 31, 2017 of Rs.5 per share on February 15, 2018, whereas Shareholders only approved Rs.4 per share on March 31, 2018.

(3) Board of Directors of the Company approved Interim dividend of Rs.1 per share for the third quarter ended September 30, 2018.

(4) Annual profit for the year ended December 31, 2018 is Rs.175,000,000.

(5) The Government of Pakistan, vide Finance Bill introduced a section whereby each Company declaring Profit after Tax of Rs.150,000,000 or more has to distribute Dividend @ 20% of the Profit after Tax. The Board intends to comply with the minimum threshold and declared dividend accordingly on February 15, 2019, which was duly approved by Shareholders on March 21, 2019.
Note: The Board wants to meet the requirement of the law (Interim + final dividend)

(6) The Board of Directors approved Bonus Shares of 10% of the Outstanding shares on June 30, 2019 which were duly credited in Shareholders account on August 31, 2019.

(7) Board of Directors of the Company approved Interim dividend of Rs.1.5 per share for the third quarter ended September 30, 2019.

(8) Annual profit for the year ended December 31, 2019 is Rs.185,250,000.

(9) The Company has a policy to transfer 5% of the Annual Profit to General Reserves.

Required

Make Statement of Changes in Equity for the year ended December 31, 2018 and 2019. Ignore taxation impact if any. ***(ICAP Example 6)***

Scanned with CamScanner

ICAP QUESTION BANK SOLUTIONS

Answer-1

Statement of Changes in equity for the year ended on December 31, 2019

	Share Capital	Share Premium	Retained earnings	Total
	---------- Rs. in million ----------			
Balance as at 1 January 2019	3,000	1,900	4,500	9,400
Profit after tax for the year	-	-	400	400
Bonus shares	6,000	(1,900)	(4,100)	-
Dividends	-	-	(300)	(300)
Balance as at 31 December 2019	**9,000**	**-**	**500**	**9,500**

Answer-2

Statement of Changes in Equity for the year ended 31 December 2018					
	Share capital	Share premium	Retained earnings	Revaluation Surplus	Total
	---------- Rupees in million ----------				
Balance as at 1 January 2018	**200**	**-**	**45**	**-**	**245**
Total comprehensive income			78	12	90
Transfer from surplus on revaluation of incremental depreciation for the period			1.5	(1.5)	-
Final cash dividend at 18% forthe year ended 31 December 2017 (200 × 18%)			(36)		(36)
Interim bonus issue at 10% forthe year ended 31 December 2018 (200 × 10%)	20	-	(20)		-
25% Right issue at a premiumof Rs. 20 per share (200 + 20) × 25%	55	11	-		66
Balance as at 31 December2018	**275**	**11**	**68.5**	**10.5**	**365**

Scanned with CamScanner

Answer-3

Statement of changes in equity

For the year ended 31 December 2017

	Ordinary share capital	Share premium	General reserves	Retained earnings	Total
	------ Rs. in million ------				
Balance as at 31 December 2015	1,600		1,850	1,430	4,880
Final cash dividend @ 7.5% - 2015 (1,600×7.5%)				(120)	(120)
Right issue @ 25%	400	320			720
	(1,600×25%)	(160×25%×8)			
Net profit – 2016				318	331
Balance as at 31 December 2016 -	**2,000**	**320**	**1,850**	**1,628**	**5,798**
Final bonus dividend @ 10% - 2016 (2,000×10%)	200			(200)	-
Right issue	500	250			750
	(50×10)	(50×10)			
Interim bonus dividend @ 15% - 2017 (2,700×15%)	405			(405)	-
Net profit – 2017				650	650
Transfer to general reserves			112	(112)	-
Balance as at 31 December 2017	**3,105**	**570**	**1,962**	**1,561**	**7,198**

Answer-4

Description	Share Capital	Share Premium	General Reserves	Retained Earnings	Revaluation Surplus	Total
	---------- Rs, 000's ----------					
Opening Balance	25,000	7,500	750	18,250	1,500	53,000
Issuance of Right Shares (W-1)	5,000	5,000	-	-	-	10,000
Interim Dividend $\left(\frac{30,000}{10} \times \text{Rs. } 2.25\right)$				(6,750)		(6,750)
Profit for the year				10,250		10,250
Transfer (10,250 × 5%)			512.50	(512.50)		-
Transfer of Rev Surplus to RE $\left(\frac{1,500}{10}\right)$				150	(150)	-
Balance at the end of the year	**30,000**	**12,500**	**1,262.5**	**21,387.5**	**1,350**	**66,500**
Annual Dividend $\left(\frac{30,000}{10} \times \text{Rs. } 4.25\right)$				(12,750)		(12,750)
Bonus Shares (30,000 × 20%)	6,000	(6,000)		-		-
Interim Dividend $\left(\frac{36,000}{10} \times \text{Rs. } 1.25\right)$				(4,500)		(4,500)
Profit for the year				12,500		12,500
Transfer (12,500 × 5%)			625	(625)		-
Transfer of Rev Surplus to RE $\left(\frac{1,500}{10}\right)$				150	(150)	-
Balance at the end of the year	**36,000**	**6,500**	**1,887.5**	**16,162.5**	**1,200**	**61,750**

(W-1)

$$\text{Right issue} = \frac{25,000}{\text{Rs. } 10} \times \frac{1 \text{ share}}{5 \text{ share}} \times \text{Rs. } 20 = \text{Rs. } 5,000$$

Scanned with CamScanner

STATEMENT OF CHANGES IN EQUITY

Answer-5

Description		Share Capital	Share Premium	General Reserves	Retained Earnings	Total
		---Rs, 000's---				
Opening Balance		100,000	50,000	5,000	55,000	210,000
Issuance of Shares under IPO	(5,000 ×10) : (5,000 ×15)	50,000	75,000	-	-	125,000
Annual Dividend 17	$\left(\frac{100,000}{10} \times \text{Rs. } 4\right)$				(40,000)	(40,000)
Interim Dividend	$\left(\frac{150,000}{10} \times \text{Rs. } 1\right)$				(15,000)	(15,000)
Profit for the year					130,250	130,250
Transfer	(130,250 × 5%)			6,512.5	(6,512.5)	-
Balance at the end of the year		**150,000**	**125,000**	**11,512.5**	**123,737.5**	**410,250**
Annual Dividend	$\left(\frac{150,000}{10} \times \text{Rs. } 4.25\right)$				(63,750)	(63,750)
Bonus Shares	(150,000 × 10%)	15,000	(15,000)			-
Interim Dividend	$\left(\frac{165,000}{10} \times \text{Rs. } 1.5\right)$				(24,750)	(24,750)
Profit for the year					175,000	175,000
Transfer	(175,000 × 5%)			8,750	(8,750)	-
Balance at the end of the year		**165,000**	**110,000**	**20,262.5**	**201,487.5**	**496,750**

Answer-6

Description		Share Capital	Share Premium	General Reserves	Retained Earnings	Total
		---Rs, 000's---				
Opening Balance		100,000	50,000	5,000	55,000	210,000
Issuance of Shares under IPO	(5,000 ×75% × Rs.10) : (5,000 ×75% × Rs.15)	37,500	56,250	-	-	93,750
Annual Dividend 17	$\left(\frac{100,000}{10} \times \text{Rs. } 4\right)$				(40,000)	(40,000)
Interim Dividend	$\left(\frac{137,500}{10} \times \text{Rs. } 1\right)$				(13,750)	(13,750)
Profit for the year					175,000	175,000
Transfer	(175,000 × 5%)			8,750	(8,750)	-
Balance at the end of the year		**137,500**	**106,250**	**13,750**	**167,500**	**425,000**
Annual Dividend	(175,000 × 20% = 35,000 – 13,750)				(21,250)	(21,250)
Bonus Shares	(137,500 × 10%)	13,750	(13,750)			-
Interim Dividend	$\left(\frac{137,500+137,50}{10} \times \text{Rs. } 1.5\right)$				(22,687.5)	(22,687.5)
Profit for the year					185,250	185,250
Transfer	(185,250 × 5%)			9,262.5	(9,262.5)	-
Balance at the end of the year		**151,250**	**92,500**	**23,012.5**	**299,550.5**	**566,312.5**

Scanned with CamScanner

ICAP MULTIPLE CHOICE QUESTIONS (MCQs)

Q.1 Which TWO of the following are separately identified in statement of changes in equity?
(a) Profit for the year (b) Transactions with owners
(c) Other comprehensive income (d) Non-owner changes in equity

Q.2 Which of the following is not considered transaction with owners with reference to statement of changes in equity?
(a) Share capital
(b) Redemption of equity shares
(c) Profit for the year
(d) Bonus issue of shares (no cash received from owners)

Q.3 The maximum amount of share capital that a company is authorised to raise is called:
(a) Authorised share capital (b) Issued share capital
(c) Subscribed share capital (d) Paid up share capital

Q.4 The total value of shares a company offers to subscribe is called:
(a) Authorised share capital (b) Issued share capital
(c) Subscribed share capital (d) Paid up share capital

Q.5 The monetary value of all the shares that the investors have committed to buy is called:
(a) Authorised share capital (b) Issued share capital
(c) Subscribed share capital (d) Paid up share capital

Q.6 The amount of money a company has received from shareholders in exchange for its shares is called:
(a) Authorised share capital (b) Issued share capital
(c) Subscribed share capital (d) Paid up share capital

Q.7 Which of the following issued by an entity is treated as liability?
(a) Ordinary share capital (b) Redeemable preference share capital
(c) Irredeemable preference share capital (d) None of above

Q.8 A debit balance on the retained earnings account indicates that:
(a) The company has made more dividend payments than the profit earned.
(b) The company has accumulated losses
(c) The company has redeemed some of its share capital
(d) The company has issued bonus shares

Q.9 A company has profit after tax of Rs.80 million for the financial year ended on 30 June 2019. It has share capital of Rs.500 million. During the year company has declared interim dividend of 10%. How this dividend shall be presented in financial statements for the year ended 30 June 2019?
(a) Rs.8 million deducted from retained earnings in statement of changes in equity
(b) Rs.50 million deducted from retained earnings in statement of changes in equity
(c) Rs.50 million deducted from profit or loss as finance cost
(d) It shall not be recorded, only disclosure shall be made.

Q.10 A company has profit after tax of Rs.80 million for the financial year ended on 30 June 2019. It has share capital of Rs.500 million. The board of directors proposed a final dividend of 10% just after the year end, for the year ended 30 June 2019
How this dividend shall be presented in financial statements for the year ended 30 June 2019?
(a) Rs.8 million deducted from retained earnings in statement of changes in equity
(b) Rs.50 million deducted from retained earnings in statement of changes in equity
(c) Rs.50 million deducted from profit or loss as finance cost
(d) It shall not be recorded, only disclosure shall be made.

Scanned with CamScanner

Q.11 Which TWO of the following are usually shown in statement of changes in equity when right issue of shares is made?

(a) Increase in share capital (b) Decrease in share premium
(c) Increase in share premium (d) Increase in retained earnings

Q.12 Which TWO of the following are usually shown in statement of changes in equity when bonus issue of shares is made?

(a) Increase in share capital (b) Decrease in share premium
(c) Increase in share premium (d) Increase in retained earnings

Q.13 Transaction costs relating to issue of shares are usually debited to:

(a) Profit or loss (b) Share capital
(c) Share premium (d) Revaluation surplus

Q.14 If there is no balance in share premium account, transaction costs relating to issue of shares are usually debited to:

(a) Profit or loss (b) Share capital
(c) Retained earnings (d) Revaluation surplus

Q.15 Incremental depreciation has following effects on statement of changes in equity:

(a) Increase in revaluation surplus and decrease in retained earnings
(b) Decrease in revaluation surplus and increase in retained earnings
(c) Decrease in revaluation surplus and decrease in retained earnings
(d) No effect

Q.16 A company has following balances on 1 January 2019:

	Rs. m
Share capital (Rs. 100 each)	100
Share premium	30
Revaluation surplus	20
Retained earnings	35

The company made a right issue of 1 for 5 shares already held at Rs. 145 per share.
What amount of share capital shall be presented in statement of changes in equity as at 31 December 2019?

Rs. _____

Q.17 A company has following balances on 1 January 2019:

	Rs. m
Share capital (Rs. 100 each)	100
Share premium	30
Revaluation surplus	20
Retained earnings	35

The company made a right issue of 1 for 5 shares already held at Rs. 145 per share.
What amount of share premium shall be presented in statement of changes in equity as at 31 December 2019?

Rs. _____

Q.18 A company has following balances on 1 January 2019:

	Rs. m
Share capital (Rs. 100 each)	100
Share premium	30
Revaluation surplus	20
Retained earnings	35

The company made a bonus issue of 2 for 5 shares already held.
What amount of share capital shall be presented in statement of changes in equity as at 31 December 2019?

Rs. _____

Scanned with CamScanner

Q.19 A company has following balances on 1 January 2019:

	Rs. m
Share capital (Rs. 100 each)	100
Share premium	30
Revaluation surplus	20
Retained earnings	35

The company made a bonus issue of 2 for 5 shares already held.

What amount of share premium shall be presented in statement of changes in equity as at 31 December 2019?

Rs. _____

Q.20 A company has following balances on 1 January 2019:

	Rs. m
Share capital (Rs. 100 each)	100
Share premium	30
Revaluation surplus	20
Retained earnings	35

On 2 January 2019, all the revalued assets were disposed of for Rs. 90 million.

Profit for the year ended was Rs. 32 million.

Interim dividend of 5% was paid in July 2019 and final dividend of 8% has been proposed by directors.

What amount of retained earnings shall be presented in statement of changes in equity as at 31 December 2019?

Rs. _____

Q.21 Which of the following does not appear in statement of changes in equity?

(a) Share premium (b) Retained earning
(c) Goodwill (d) Revaluation surplus

Q.22 Which of the following statements is likely to be true, for a company making profits?

(a) The operating profit will be less than the profit for the year.
(b) The profit for the year will be greater than the gross profit.
(c) Retained profits at the year end will be greater than shareholders' equity.
(d) Retained profits at the year end will be greater than retained profits at the beginning of the year.

Q.23 Which of the following is NOT a component of the statement of changes in equity?

(a) Total comprehensive income for the period
(b) The revaluation gain
(c) The amount of cash that the company has on hand
(d) Dividends paid to shareholders during the period

Q.24 Which of the following statements is not true about preferred stock?

(a) The rate of dividend is usually fixed
(b) Shareholders always have a voting right
(c) Shareholders' usually have a preference as to assets upon liquidation of the corporation
(d) Shareholders' usually have a preference as to dividends

Q.25 Redeemable preferred shares is required to be reported as:

(a) Liability (b) Equity
(c) Asset (d) None of the above

Scanned with CamScanner

Q.26 Any unpaid dividend is carried forward to the future periods for which type of stock?
(a) Ordinary shares
(b) Cumulative preferred shares
(c) Non-cumulative preferred shares
(d) All of the above

Q.27 What is the impact of dividend payments to shareholders on the statement of changes in equity?
(a) It increases the retained earnings balance
(b) It decreases the retained earnings balance
(c) It increases the share capital balance
(d) It decreases the share capital balance

Q.28 What is the impact of an additional share issue on the statement of changes in equity?
(a) It increases the share capital balance
(b) It increases the retained earnings balance
(c) It decreases the share capital balance
(d) It decreases the retained earnings balance

Q.29 Xavier Limited issued 5,000 shares of its Rs.10 par value to its shareholder. These shares were issued at a premium at a price of Rs.25 per share.
The correct journal entry to record this transaction is:
(a) Cash Rs.125,000 (Debit); Share capital Rs.125,000 (Credit)
(b) Cash Rs.50,000 (Debit); Share capital Rs.50,000 (Credit)
(c) Share capital Rs.50,000 (Debit); Share premium Rs.75,000 (Debit); Cash Rs.125,000 (Credit)
(d) Cash Rs.125,000 (Debit); Share capital Rs.50,000 (Credit); Share premium Rs.75,000 (Credit)

Q.30 Dynasty Limited issues 1 million, Rs.10 shares at Rs.50 for each share. Which of the following statements is true?
(a) Ordinary share capital will increase by Rs.10 million and share premium will increase by Rs.50 million.
(b) Ordinary share capital will increase by Rs.10 million and share premium will increase by Rs.40 million.
(c) Ordinary share capital will increase by Rs.20 million and share premium will increase by Rs.50 million.
(d) Ordinary share capital will increase by Rs.10 million and share premium will increase by Rs.30 million.

Q.31 Handsome Limited statement of financial position shows ordinary share capital of Rs.150 million and share premium of Rs.50 million at the beginning of a financial year. If the ordinary share capital is Rs.250 million and share premium is Rs.120 million at the end of the financial year, how much did the ordinary share with share premium issue raise?
(a) Rs.100 million
(b) Rs.150 million
(c) Rs.160 million
(d) Rs.170 million

Q.32 Gigantic Limited opening retained earning balance was Rs.150 million. It made a net profit for the year ended 31 March 2020 of Rs.30 million. During that year, an ordinary dividend of Rs.50 paisa per share was paid on 40 million ordinary shares. What was the retained profit for the year ended 31 March 2020?
(a) Rs.150 million
(b) Rs.160 million
(c) Rs.165 million
(d) Rs.170 million

Q.33 SK Limited paid Rs.10 million in debenture interest and an ordinary dividend of 10 paisa per share on Rs.50 million ordinary shares. The retained profit was Rs.120 million. What was SK Limited profit for the year?
(a) Rs.125 million
(b) Rs.135 million
(c) Rs.130 million
(d) Rs.140 million

Scanned with CamScanner

Q.34 Which of the following would be an entry in the statement of changes in equity?

(a) Taxation (b) Long term loans

(c) Revaluation gain (d) Revaluation reserve

Q.35 During the year ended 30 June 2021, a company's revaluation reserve increased from Rs.300,000 to Rs.380,000 as a result of a property (land) revaluation. At the start of that financial year, the company's property had been valued at Rs.810,000. Assuming that no property was disposed of during the year, which of the following statements is true?

(a) The property's revalued amount was Rs.890,000.

(b) The property's revalued amount was Rs.1,190,000.

(c) The property's revalued amount was Rs.380,000.

(d) The property's revalued amount was Rs.1,310,000

Q.36 A debit balance on the retained earnings account indicates that the company has:

(a) Made more dividend payments than the profit earned

(b) Redeemed some of its share capital

(c) Accumulated losses

(d) Issued bonus shares

Scanned with CamScanner