Answers to continuous assignment #9

#Part (a)

Question 8.3 Part (a)

i. **Provision for Obsolescence,** in the case of Raw and Material and Production Stores is high; to the tune of ~19%. This showcases that the company expects a lot of its raw materials to go waste in the current Financial Year.

ii. **Stock-In-Trade** for the company is high i.e. Rs 87.23 Cr, compared to the manufactured components the company has which is only Rs 18.49 Cr. This implies that the company is concentrating more on selling finished goods than on manufacturing-and-selling finished goods.

Question 8.3 Part (b)

a) ITI limited operates in the manufacturing of telephone and communications equipment space. Unlike previous years, this industry is highly prone to **development of new technology (e.g., change in product design).** This is because every few years, either the bandwidth spectrum increases (2G, 3G, 4G etc) or the telephone technology takes a quantum leap. Also, for the telecommunication sector, **Inventory becomes obsolete because it is no longer purchased by customers.** This is because the industry is prone to cannibalization, i.e. new products coming up and eating the share of the older products, thereby making the older ones obsolete. It is also observed that the telephones **have a very short-shelf life,** hence the obsolescence.

b) Provisions for inventory schedule:

- **i.** The company may have slow moving inventory and have accounted for any losses caused due to spoilage as the holding period of inventory is high.
- **ii.** The company may have over-estimated the demand for its products, thereby creating excess inventory which has a very short-shelf life, and now has to account for it by making provisions.
- **iii.** New Technology makes the inventories currently used as obsolete, an occurrence very common to the Telecommunication sector.
- **iv.** The company may categorize its inventory as non-moving based on marketing, order in hand and future perception of the good.

#Part (b)

Question 8.10 Part (a)

1. **Long term trade, unquoted at cost**- long-term trade means that the company has invested in such securities for a strategic purpose and has no intention to sell them in the near future usually a year, securities that are not listed on any exchange are called unquoted investments and when they are recorded at the value at which they were acquired they are called long-trade quoted at cost.
2. **Goods in transit**- these are inventories or merchandise that have left the warehouse of the seller, but are yet to reach the buyer. The concept is used to indicate that revenue should be recognised only when the risk and rewards are transferred to the buyer. It is also used to ascertain whether the transportation cost will be allocated to the buyer or seller.
3. **Bonded stock**- if goods enter a country only as a part of transportation to another country it is considered bonded stock. The inventory is called bonded because the importer must post a customs bond to the government as collateral for the duty on goods. When the importer transfers the good to another country, it may redeem the custom bond and get paid back its customer deposit.
4. **Inward LC discount account**- a letter of credit is a legal document that ensures that the exporter of goods is paid only when he has fulfilled conditions related to freight on board, insurance of good etc. and the importer can receive delivery of goods when he/she has made the payment. A letter of credit discount occurs when the bank offers the

exporter to advance you the letter of credit payment before you have fulfilled all the conditions. It is called discount because you will not get the full payment.

Question 8.10 Part (b)

Significant changes in long term investment and journal entries:

Date	Particulars	L.F.	Debit	Credit
1	P&L A/c dr. To MRO-TEK Singapore PTE LTD. (being loss incurred shares of MRO-TEK Singapore PTE LTD)		₹ 1,52,967	₹ 1,52,967
2	SBI MF A/c dr. To Bank A/c (being 9471 units of SBI MF purchases at RS. 10.58)		₹ 1,00,174	₹ 1,00,174

1. The investment in MRO-TEK Singapore PTE. LTD has reduced to nil from RS.152967 as the company has filed an application of voluntary winding up. The purchase value of the investment was RS.1066600 which has diminished to 0 means that the joint venture was a failure and the company incurred loss to the extent of value invested. This reflects poor performance of the company.
2. The company has chosen to invest in SBI mutual fund, 9471 units @ Rs.10.58. This could be due to aggressive growth of wireless technologies and the company not finding its business viable. This could be a good strategy to temporarily park the funds in other avenue till it finds another profitable investment propositions.

Question 8.10 Part (c)

Overall the accounts receivables have fallen from Rs.276323441 to 23619900. This is due to decrease in debt outstanding for a period exceeding 6 months by Rs.498583 and other debts by Rs.30938608. The company has created provisions for bad and doubtful debt of 7.6 percent and discounted letter of credit worth Rs.6824500.

Inward LC discount- Ques a, Part 4. Impact of discounting letter of credit is that the cash balance increases and the debtor decreases. There is no impact on liability side. However, a contingent liability is created in case the debtor fails to make the payment on time.

Provision for Bad and doubtful debts- A business creates this provision based on historical experience that a given portion of customer will not pay their dues. This provision is based on conservatism principle so that when the bad debt occurs the company is prepared for it. Thus the impact is to accelerate recognition of bad debts into earlier years. Provisions is created out of profits. Hence, Reserve and surplus decrease on the liability side and debtors on the asset side.

The company must maintain adequate amount of such items based on historical experience to give a true picture of the business. The company may indulge in excess provisioning to evade tax. The company with an intent to fraud will discount letter of credit excessively and not fulfil the terms of the trade.

Question 8.10 Part (d)

The company has three different types of inventory- Raw material, work in progress/ semi-finished goods and finished goods. There are different categories because each applies to a different stage of production process. The first stage is gathering material. When labour and capital are used with raw material, they are transformed into work-in-progress and finally with finishing process are transformed into finished goods.

The significance of raw material and WIP is to keep the factory running so that all the assets are utilised to the maximum extent possible which results in minimization of cost. Finished goods inventory is maintained to meet unprecedented demand of goods.

To finalise inventory at the end of the period a physical stock check is conducted and is compared with the stock worksheet. If the actual inventory is less than recorded, then excess is written off. The stock is valued at cost or net realisable value whichever is lower based on prudence principle.

COGS= opening stock+ purchases + direct expenses – closing stock.

The cost of goods sold accounts for all the direct expenses associated with procurement and conversion of raw material to transformation in finished goods. It is finalised by calculating the value of raw material, labour and capital used in manufacturing the goods sold.

#Part (c)

The inventories are valued at the lower of cost and net realizable value. Cost of inventories is determined on Weighted Average Cost Method (net of CENVAT credit availed) of stock accounting apart from manufactured finished goods and goods in process. Their cost includes cost of raw materials consumed on weighted average basis, allocable overheads, excise duty and taxes. Scrap does not form part of closing inventory.

In this method the purchase prices over a period are averaged for that product. Organizations follow this method only if they do not make frequent purchases that cause fluctuations in the calculated price.

#Part (d)

The company's management approves the useful life of the assets based on tehnical estimates and as prescribed by under schedule II of the Companies Act, 2013. The company uses Straight Line Method (SLM) and depreciates every year on the estimated useful life of the company as given below:

S.No.	Asset	Useful Life
1	Factory Building	30 Years
2	Plant & Equipment	15 Years
3	Dies & Moulds	15 Years
4	Electric Installation & Equipments	10 Years
5	Furniture & Fixtures	10 Years
6	Office Equipment	5 Years
7	Computers	3 Years
8	Servers & Networks	6 Years
9	Motor Cars & Buses	8 Years
10	Motor Cycles	10 Years

Note: Assets individually costing less than Rs. 5,000/- are fully depreciated in the year of acquisition

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Part (e).

Particulars	Total	Depreciation
Tangible Assets		
Plant & Equipments	76,89,37,156	5,03,54,052
Furniture & Fixture	27,56,77,760	2,88,48,177
Vehicles	15,01,70,957	1,76,01,145
Office Equipments	11,32,60,184	1,27,50,645
Building	22,85,72,279	77,79,091
Moulds	25,15,04,895	41,41,722
Total	1,78,81,23,231	12,14,74,832
Intangible Assets		
Software	1,43,56,786	27,63,037
Total	1,43,56,786	27,63,037

It is clearly visible that the plant & equipment have the highest depreciation of around 6.54% (SLM) as the wear and tear of the machinery is high in producing shoes. (Life – 15 years)
Furniture and fixture having a useful life of only 10 years accounts for a depreciation of 10.44% (SLM) because the same needs to be changed from time to time in a long run.
Vehicles depreciate at 11.72% (SLM) which is highest among fixed assets in terms of percentage.
Software would expire in around 5 years and maybe the company would have got 3 months extra for trial.

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