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Intermediate Accounting

Charts Summary & Questions

Chart AS 1 “Disclosure of Accounting Policies”

1. Accounting Policies Means

Specific accounting principles & Methods of applying such principles adopted in preparation and presentation of financial statements.

Selection of accounting policies is the responsibility of the management.

In selection of accounting policies, management should consider the following:

Primary consideration

Financial statements should give True & Fair view after applying selected policies

Other Major consideration

Prudence

- It means management should be careful while selecting accounting policies.
- Management should apply knowledge i.e. nature of business, legal requirements, accounting standards, etc. in the selection of policies.

Substance over

- It is Reality over Legality.
- Management should select the accounting policies which help to present a accurate picture of financial statements rather than legality

Materiality

- Financial Statement should disclose all material Items i.e. those items which affect decision making of users

2. Fundamental Accounting Assumption in preparation of financial statements

Going concern

It is assumed that business would continue for foreseeable period.

Consistency

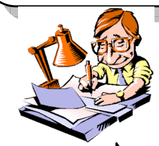
it is always assumed that same accounting policies would be followed every year.

Accrual Assumption

It is assumed that entity record all income & exp. on period basis. They are not recorded on payment basis

Chart AS – 2 Valuation of Inventories (Chart)

Inventory is an asset held for sale in the ordinary course of business (Finished goods), which is used in the process of production (Raw Material) or consumed in the process of production (Consumables and Loose tools)



Valuation of Inventory

1. ***Inventory is valued at COST (or) NRV whichever is LOWER***

Let us understand ***"What Cost of Inventory Includes"***

Cost of Purchase

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

Cost of Conversion

This includes the costs incurred to convert the raw materials into finished goods. (I.e. Factory Overheads)

Absorption of Factory Overheads

- ***Fixed OHs***
  - *Actual Capacity > Normal Capacity* → *Absorb based on Actual Capacity*
  - *Actual Capacity < Normal* → *Absorb based on Normal Capacity*
- ***Variable OHs***
  - *Absorb based on actual capacity utilisation*

Example

Other Cost

All other costs incurred to bring the inventory to the present location and condition. E.g. R & D cost, Packaging cost, Administration OHs in relation to production activities

Cost of inventory should be ascertained in following manner

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

Following Cost should be Excluded from Cost – 1) Abnormal Loss 2) Storage Cost (Unless those cost are necessary for production process) 3) Administrative selling & distribution cost 4) Borrowing cost (Interest)

2. Let us see "How to Calculate Net Realisable Value

Net Realisable Value of

- ***Finished Goods*** – *Expected SP - Selling cost*
- ***Work in Progress*** – *Expected SP of FG - Expected cost to complete - Selling Cost*
- ***Raw Material*** – *Strictly, No need to determine NRV*

3. Valuation of Raw Material

Its valuation is fully based on the valuation of Finished Goods

- ***If finished goods is sold or expected to be sold at cost or above cost*** – *Raw material should be valued at Cost*
- ***If finished goods is sold or expected to be sold below the cost*** – *Raw material should be valued at Replacement Cost*

Examples

Or

4. Disclosure Requirements – The financial statement should disclosed

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

Chart - AS 10 – PROPERTY, PLANT AND EQUIPMENT (PPE)

1.

Let us see "What is PPE"

It is Tangible Assets

Expected to be used during more than a period of 12 months

Held for use in

Producing Goods

Providing Services

Rental to others

For Administration Purpose

Recognition of Plant, Property and Equipments

2.

How entity should do "Recognition of PPE" i.e. (Recording of PPE in the books of account)

Initial Recognisation & Measurement

Asset is acquired by

Payment of Cash/Credit

Asset is recognised at Purchase Price + Expenses incurred on asset to make asset ready to use

Purchase price	xx
+Freight	xx
+Non refundable taxes	xx
+PV of restoration	xx
+All direct exp Inc till ready to use	xx
+ 16- Borrowing cost	xx
-Discount	xx
-Govt. Grants	xx
	xx

Self construction

Asset is recognised at Cost of Construction + Expenses Borrowing cost incurred before asset is ready to use. (Avoid internal profits on stores used and abnormal loss of material and labour)

Exchange with another assets & by issue of securities

1. Asset received is recognised at Fair value of either
(a) Asset given up
(b) Asset acquired.

2. If it is reliable measurement of fair value of asset given up or Asset received is not possible then new asset received is to be recorded at Carrying amount of Asset given up.

Subsequent Recognisation & Measurement

Does subsequent expenditure (including spare parts) increase the future economic benefits? In other words it is PPE if it satisfies the recognition criteria

Yes

Capitalise along with PPE

&

No

Charge to P&L Statement

It is recognised as PPE if it is expected to generate Future economic benefit to Entity

3. *Important Points*

1. *Major assets replacement & overhauling should be capitalised and depreciated over its useful life, if it satisfies PPE recognition criteria.*
2. *If deferred credit terms are involved, it should be recognised at present value and it would be unwinded over the period. PPE should be recognised at cash price (Present Value) on the date of Recognisation.* ***Interest = Total Payment – Cash Price should be debited to P& L unless asset is qualifying asset as per AS -16***
3. *Useful life, Residual value & depreciation method should be reviewed every year end.*
4. *Any change in price. Life, Realisable Value & method of depreciation - Account prospectively.*
5. *Select Cost or revaluation model for the entire class of items. Select and apply consistently.*
6. *If any major components is replaced then component to be recognised separately by removing old component from book and depreciation on new component to be charged on component basis.*

4. *Retirement of PPE*

1. ***PPE is retired from active use and it is held for disposal - such PPE should be stated in balance sheet Carrying amount (Net book value); or Net realisable value (NRV) Whichever is LOWER***

Replaced By →

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

5. *Accounting disposal*

COST Model

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

Revaluation Model & Revaluation surplus exist

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

After disposal, if any Revaluation surplus exists - transfer to General reserve (Revenue reserves)

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

Chart AS - 11 - The Effects of Changes in Foreign Exchange Rates

This AS discusses how to convert the foreign currency transaction into reporting currency i.e.

- ***Which exchange rate should be used to convert it into Rupees*** *and*
- ***How to account for the changes in foreign currency (Forex) rates in financial statements.***

This Standard guides in

- ***Recording of Foreign currency transactions entered by the entity***
- ***Translation of financial statements of foreign operations***
- ***Accounting for forward exchange contracts***

1. *What is Monetary & Non – Monetary Item*

Monetary items

Monetary items are money held assets and liabilities to be received or paid in determinable amounts of money.

Therefore following items are monetary items:

- 1. Money held (i.e. cash and cash equivalents held by the entity).
- 2. Assets which are receivable in terms of money.
- 3. Liabilities which are payable in terms of money.

Non monetary items

Non monetary items are those items in which benefit is receivable in Kinds, Goods or services.

Example :Prepaid expenses, Advances given to suppliers.

In above examples, we will receive either service or goods in return.

2. *Let us understand An entity can have foreign currency transactions in two ways*

- Transactions in foreign currency directly by the entity i.e. imports, exports, foreign currency loans, etc.
- Foreign currency transactions by its foreign branch or subsidiary, etc. (Indirectly)

3. Currency

Reporting Currency - currency in which financial statements are presented.

Foreign currency - currency is other than the reporting currency.

4. Recording of Foreign currency transactions entered by the entity

- **Initial Recognition**
  - Record using the rate on Date of Transaction /Average rate (if no significant fluctuation)
- **Classification of Assets & Liabilities as on Balance Sheet Date**
  - *Monetary item*
    - Closing Rate
  - *Non-Monetary item*
    - Carried At
      - Historical cost
        - Rate on Date of Transaction
      - Fair value
        - Rate on date of valuation

5. Based on classification of foreign operation

- **Integral Foreign Operation**
  - Monetary
    - Closing Rate
  - Non - Monetary
    - Historical Cost
      - Rate on Date of Transaction
    - Fair Value
      - Rate on date of valuation
  - P & L items & others
    - Rate on Date of Transaction

  Difference - Transfer to P & L

- **Non-Integral Foreign Operation**
  - Monetary & Non - Monetary
    - Closing Rate
  - P & L items
    - Rate on Date of Transaction
  - Contingent liabilities
    - Closing Rate

  Difference - transfer to FCTR a/c every year
  FCTR a/c - will be transferred to P & L only on disposal of Foreign Operation.

FCTR – Foreign Currency Transaction Reserve

6.

Types of Forward Contract

Forward Contract entered for its own purpose

1. Premium or discount arising at the inception of the contract should be amortised as an expense or income over the life of the contract.
2. Exchange difference on such contract should be recognised in P&L.
3. Any profit or loss arising on cancellation or renewal of such forward contract should be recognised as income or expense for the period.

Forward Contract entered for Trading/ Speculation

1. Premium or Discount on such contracts need not be recognised.
2. As the forward contract is held for trading or speculation purpose it should be valued at the balance sheet rate .
3. Gain or loss as on the Balance sheet date should be recognised in P&L for the period.
4. Gain or loss = Forward rate available on the reporting date for the remaining maturity of the contract LESS Forward rate fixed at the inception.

Chart AS 12 - Accounting for Government Grants

Government Grants are Govt. assistance in cash/kind for compliance of future/past conditions

Two conditions must be satisfied for recognition of Government Grant

1. There is reasonable assurance that the entity will comply with the conditions
2. Ultimate collection is reasonably certain.

Now Let us see "What will be the Accounting treatment for Grant Received"

Govt. Assistance /Grant in form of Cash

Grant Received - related to Specific Asset

- **Depreciable Assets**
  - **Alternative ONE**
    1. **Amount received is deducted from the gross value of the asset;**
    2. **The reduced amount of fixed asset is depreciated over its useful life**
  - **Alternative Two**
    1. **Amount received is treated as deferred income**
    2. **Deferred income is recognised in P&L a/c on a systematic and rational basis over the useful life of the asset;**
    3. **Apply depreciation method to recognise deferred income in P&L a/c;**
- **Non - Depreciable Assets**
  - No conditions to be fulfilled → **Credit to capital reserve**
  - Conditions to be fulfilled → **Credit to P & L in a systematic Manner**

Grant Received - related to Revenue Expenses

- **Option 1 – Deduct from related Expenses**
- **Option 2 – Credit to P & L A/c as other income in a systematic basis (Matching Concept)**

Govt. Assistance /Grant in form of kind

- Received at Free of cost
  Record at Nominal Value
- Received at Concessional Price.
  Record it at acquisition Rate

Refund of Government Grant

Government grants are generally refundable when the entity does not fulfil certain conditions. Refund of grant is treated as an extraordinary item as per AS 5

Related to Revenue

- Apply first against unamortized deferred GG.
- Balance (if any) - Debit P & L.

Relating to promoters Related to Fixed Asset

Debit Capital Reserve

Related to fixed Asset

- Debit to FA &
- Depreciate the Revised Book Value prospectively over the remaining useful life.
- Debit from Capital Reserve/ Deferred GG. (if any)

Disclosure under Accounting Standard - 12

- Accounting Policy followed by Entity.
- Nature & Extent of Government Grants recognized in Financial Statement.

Chart AS 13 - Accounting For Investments

1. Investment is a

Asset (Not held as Stock in Trade)

- Held for earning Income
  - By the way of
    - Dividend
    - Rental
    - Interest
- Held for Capital Appreciation
- Held for Other Benefits

2. Recognition and Measurement of Investment

Initial Recognition

Recognise at Cost i.e.

Purchase Price	*XX*
+ Incidental expenses	*XX*
- Pre acquisition income	*XX*
	XX

Subsequent measurement on BS date

Based on classification

Current Investment

Two conditions to be satisfied

1. It is readily realisable
2. Intention to hold for not more than one year from date of investment

Measures at Cost OR Fair value whichever is lower (on Individual Investment Basis)

Any reduction to fair value and any reversals of such reductions are transferred to P&L A/c

Long term Investment

Which is not a current investment

Always valued at COST
Exception: Reduce carrying amount if permanent diminution in value

Any reduction to Cost and any reversals of such reductions are transferred to P&L a/c

3. *Sale of Investments*

Profit or Loss on sale of investments should be recognised in the P&L alc.
Profit / (Loss) = Sale proceeds (Net of selling expenses) - Carrying amount (book value).

4. Classification of Income from Investments

PRE Acquisition Income

1. Income Accrued during the PRE acquisition period.
2. But received by the investor after the acquisition.
3. It shall be treated as recovery of cost of investment as it is assumed that Price paid for investment includes pre acquisition income.

Deduct the pre-acquisition income from the cost of investment.

POST Acquisition Income

Income earned and accrued AFTER the acquisition and received after the acquisition.

Recognise the income and credited to P & L A/c

But in case of equity shares it is difficult to make allocation in Pre and post Acquisition Income.

5 What is Accounting Treatment for Right Issue and Rights share?

If shares purchased under right option

If the existing share holders exercise the option
Investment A/c .... Dr.
To Cash/Bank A/c

If right option sold

If the rights are sold, then amount received is an income and it should be taken to P&L A/c.

Exception to the above rule - when the following two conditions are satisfied, the accounting treatment differs:
1. The investments must be acquired on cum-right basis; and
2. Market value of such investments came down below the cost of investment immediately after the issue of right shares;
(Under above 2 situations, income received by sale of rights is credited to investment account in cost column to bring the carrying amount to the market price.)

4. Disclosure

1. A/c policies of the entity
2. Classsification of investent into current & long term
3. Total amount of Quoted & Unquoted investment
4. Total market value of quoted investment
5. Profit or loss on the sale of current and long term investments and adjustment of carrying amount in investment a/c.
6. Other Disclosures etc.,

Chart AS – 16 Borrowing Cost

This Accounting Standard Prescribes rules for accounting treatment for borrowing costs

Whether the borrowing costs should be capitalised along with the assets OR charged to profit and loss statement.

Borrowing costs are interest and other costs incurred in connection with the borrowing of funds.

1. Commitment charges

2. Amortisation of discounts/premiums on loan

3. Finance lease charges

4. Ancillary costs

5. Exchange differences arising from foreign currency borrowings

Let us see how to "Recognise Borrowing Cost"

Borrowing costs directly related to

Acquisition of | **Construction of** | **Production of**

Qualifying Asset → **Capitalise along with Asset**

If Asset is not Qualifying Asset → **Charge to P & L**

What is Qualifying Asset......?

Asset that takes a substantial period of time to get ready for its intended Use or Sale (Generally 12 months or higher)

Examples of Qualifying

A. Tangible - plant and machinery, Building Intangible Assets: Patent
B. Investment Property.
C. Inventories that require a substantial period of time to make it ready for sale. E.g. Wine

Capitalisation of Borrowing Costs

The standard has given guidance on the following points:

Commencement of Capitalisation (When to start capitalisation)

When ALL of the following conditions are satisfied

(a) Expenditure on qualifying asset being incurred;
(b) Borrowing costs are being incurred; &
(c) Activities are in progress.

Suspension of Capitalisation (When to suspend)

When there is NO active development or active development is interrupted. (Not to be suspended if there is temporary delay)

Stop or cease of Capitalisation (When to stop)

When substantially all necessary activities are complete i.e. the asset is ready for its intended use or sale.

How much amount should be capitalised?

If funds are specifically borrowed for obtaining a qualifying asset

Capitalization rate on basis of actual costs

Actual borrowing costs incurred on borrowing during the period	XXX
<u>Less:</u> Any income on the temporary investments of the borrowed amount	XX
Amount to be capitalised	**XXX**

If funds are borrowed generally and used for obtaining a qualifying asset

Compute capitalisation rate based on weighted average rate of borrowing Cost costs;

1.**Capitalisation Rate** = $\frac{\text{BC incurred during the year}}{\text{Aggregate outstanding borrowings}} \times 100$

1 **Aggregate outstanding borrowings**

= $\frac{\text{Amount of borrowings x No. of months loan outstanding}}{\text{12 Months}}$

2 **Interest to be capitalised**

= Expenditure incurred on the asset x capitalisation rate x Period of utilisation / 12 months

Exchange differences arising on foreign currency borrowings

This provision is applicable only if there is loss due to exchange difference from foreign currency borrowings & such loss is debited to P&L A/c.

Compute Interest that would have been paid if loan was taken in India (at interest rate applicable if loan is taken in India.)

Disclosures

The entity should disclose the following in its financial statements:

(a) The accounting policy adopted for borrowing costs; &
(b) The amount of borrowing costs capitalised during the period.

Redemption of Debentures

Debenture Redemption Reserve:- (D.R.R) (Sinking Fund)

A company issuing debentures shall create D.R.R. from profit available for distribution of dividend & such amount credited to D.R.R shall be utilised only for redemption of debentures.

➢ **At the end of year**

1.	Fixed amount is set aside for redemption from P&L A/c.	P&L A/c ……………Dr. To D.R.R. A/c (This entry shall be passed every year)
2.	Amount equivalent to current year transfer to D.R.R. is Invested.	D.R.R. Investment A/c ……….Dr. To Bank A/c (Every Year)
3.	Additional entries in 2nd year / subsequent Year other than last year.	
	a) Receipt of interest on debenture redemption investment A/c.	Bank A/c ……Dr. To Interest on D.R.R Investment A/c
	b) Transfer of Interest to P&L A/c.	Interest on D.R.R. Investment A/c To P&L A/c

Note :- Interest received on D.R.R Investment is generally not re-invested but it is used in business. Hence interest credited to P&L A/c.

- **At the end of last year:-**

a)	Receipt of Interest	Same entry as above. (3rd entry)
b)	Setting aside from P&L A/c to D.R.R. A/c	Same entry as above.
c)	Sale of D.R.R. Investment A/c	Bank A/c .....Dr.
		To D.R.R. Investment A/c
	- If Profit (Transferred to DRR A/c)	D.R.R. Investment A/c
		To P&L A/c
	- If Loss	(Reverse Entry)
d)	Amount due to debentures holders.	__% of Debenture A/c.........Dr.
		Premium on Redemption A/c........Dr.
		To Debenture holders A/c
e)	Payment to debenture holders.	Debenture holder A/c
		To Bank A/c
f)	Premium on redemption adjusted against P&L A/c.	P&L A/c............Dr.
		To Premium On redemption A/c
g)	Balance available in D.R.R. shall be transfer to General Reserve after redemption.	D.R.R. A/c ....Dr.
		To General Reserve A/c

Methods of Redemption of Debentures

1. Redemption By payment in lump sum– (At maturity or expiry of specific period)
2. Redemption By payment in installment – (At specified Intervals)
3. Redemption by Purchase of debentures in open market (Own debenture)

Let's see "Redemption of debentures by Purchase of debentures in open market".

(Journal Entry)

1. Purchase of own debentures

Own debenture A/c ………Dr. (Price excluding interest if price is cum interest)
Interest A/c…………………Dr. (Last due date of interest to present date)
To Bank A/c

2. At the time of cancellation.

Debenture A/c…..Dr.
To Own debenture A/c
To profit on cancellation of debentures

(Own debenture price shall be exclusive of interest. If price is cum interest shall Be deducted from price).

If debentures are cancelled (own debentures) the profit or loss on redemption of debentures will be ascertained as

Face value of debenture Cancelled 100	(-)	Price Paid Excluding interest (95 – 5) (Cum-Interest)

In case of Ex-Interest - The interest to the date of transaction will be paid addition to price.

Note:-

1. Minimum requirements which are required to be checked before accounting for redemption of debenture.
   a) D.R.R. A/c must have minimum balance of 10% of total debentures.

b) If balance is less than 10% transferred amount from P&L A/c to D.R.R. A/c to make it 10%.

c) D.R.R. investments shall be at least 15% of debentures expected to be reddemed before 31st march of next year. This shall be invested at the beginning of year on or before 30th April.

After redemption, balance available in D.R.R. A/c shall be transferred to General Reserve. But only part of debentures are redeemed - then D.R.R. proportionate amount shall transferred to General reserve.

2 Options for cancellation of own debentures

	Option 1	Option 2
1) -	1st show the entry of Purchase of own Debentures.	Directly cancel the debentures In other word – Debit to debenture A/c
	Own debentures A/c…..Dr. (Ex – Interest)	
	Interest A/c……………..Dr.	Debenture A/c ……..Dr.
	To Bank A/c	Interest A/c ……….Dr.
		To Bank A/c
2) -	2nd Pass Entry for Cancellation of own debentures	To profit on cancellation of deb. A/c
	…..% of own debenture A/c …Dr.	
	To own debentures A/c	
	To profit on cancellation of deb. A/c	

If in the question, it is specified to Prepare own debenture A/c, then option - 1 shall be adopted but if nothing is specified in the problem then option - 2 shall adopted.

If debentures are cancelled then next due date interest shall be paid on remaining debentures. (Period – last due date to – present date).

Adequacy of D.R.R. – for theory question – Important

Minimum Limits of D.R.R. (form notes).

	For debentures issued by	Adequacy of Debenture Redemption Reserve (DRR)
1.	All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures.	No D.R.R. is required.
2.	Other Financial Institutions (FIs) within the meaning given in the Companies Act.	D.R.R. will be as applicable to NBFCs registered with RBI.
3.	All NBFCs listed or unlisted with the RBI for both public as well as privately placed debentures.	No D.R.R. is required.
4.	Other unlisted companies.	D.R.R. shall be 10% of the value of the outstanding debentures issued.

Example – If total debentures are of ₹ 16,00,000 then,

minimum D.R.R. = 10 % ₹ 1,60,000

But if debentures only of ₹ 8,00,000 are redeemed then,

Only ₹ 80,000 (10% of 8,00,000) transfer to general reserve.

Insurance Claim

This chapter covers :→

1. loss of Asset (Building, machinery & furniture) (RTP)
2. loss of stock
3. loss of Profit.

1 loss of Asset :→

Claim = Original cost of Asset − Opening Balance of provision for Depreciation (−) Depreciation for current upto date of fire

= W.D.V. on the date of fire	xxx
(less) Salvage Value	xxx
Claim	xxx

2 Claim for loss of stock :→

find out cost of goods available in shop / godown on the date of fire. (Prepare Trading A/c to find out Cost of closing stock & not for Gross profit & not for Accounting purpose)

Step 1 → Prepare Trading A/c for current year upto the date of fire to find out closing stock

* But If G.P. is missing then find out G.P. of last year by preparing trading A/c of last year & make adjustment in last years G.P. (if ~~gi~~ adjustment given in problem.

Step 2 :→ loss

loss of stock	xxx
(−) salvage value	xxx
(+) fire fighting exp	xxx
loss	xxx

Step 3 :→ claim

In case of Under insurance → Total loss × $\frac{\text{Insured value}}{\text{Insurable value}}$

In case of full Insurance → loss or policy Amt whichever is less.

Insurance value is value of stock in godown on the date of fire [illegible]

Adjustment in Items of current year's Trading A/c

(1) Adjustments in Purchase of current year

(A) Goods purchased & received but not Recorded → Added in purchase

(B) Machinery / capital items included in Purchase (wrongly) → Deducted from Purchase.

(C) Drawings & Goods distributed as free sample :→ Deducted from purchase at cost price (Sometime value of Drawing & free sample is given at sale price then convert it to cost price)

(d) Purchases are undervalued (example - valued at 90% of cost) → Convert it to cost price

(2) Adjustments in Wages :→
wages includes wages paid for installation of Asset → Deduct it from wages

(3) Adjustments in current years sale :→

(A) Sale includes goods sold but not sent → Deduct it from sales

(B) Sale includes Goods sold on Approval Basis :- Deduct sale value of goods not approved from sales A/c & show it separately on credit side of Trading A/c at cost price.

* Goods sent to consignee shall be credited to trading A/c at cost price.

(C) If there is misappropriation of unrecorded sales then such unrecorded quote shall be added to sales

(4) Separation between Normal & Abnormal items:-

- If in the problem it is given that last year closing stock is written down (to bring it at market price) then we shall add back the amount which was written down to bring last years closing stock at cost price.
- last year closing stock is opening stock of current year
- Opening stock shall be separated between Normal & Abnormal item (Poor selling or slow moving items or stock which is expected to be sold at loss)
- Sale includes sale of goods for loss therefore sale shall be separated in Normal & Abnormal. loss on sale of Abnormal item shall be credited to Trading A/c (In Abnormal column)

G.P shall be calculated on only Normal sale

[3] Loss of Profit

Step 1 → Calculation of Gross Profit Ratio

$$\frac{\text{Net Profit + Insured standing charges}}{\text{Turnover of last year}} \times 100$$

we can calculate G.P. by other way :→ G.P. - Uninsured Standing charges.

(+)/(-) Adjustment in G.P. (if specified in problem)

Step 2 - Calculation of Short sale

Sale for corresponding period of last year	xxx
(+)/(-) Adjustment in sale (Increase/ Decrease)	xxx
Estimated sales	xxx
(-) Actual sales (in the period of disturbance)	xxx
Short sales	xxx

Step 3 → Calculation of loss of profit

Short sales × G.P. Ratio = claim for loss of profit

Step 4 → Claim for Increase in cost of working (Additional expenses)

LEAST OF THE FOLLOWING.

(i) Actual expenses	xxx
(ii) Actual exp × $\frac{\text{G.P. on Adjusted annual turnover}}{\text{G.P. as above + Uninsured standing charges}}$	xxx
(iii) Sale generated in period of disturbance due to additional exp. × G.P. Ratio	xxx
whichever is less (of Above 3)	xxx

Step 5 :- Calculation of Total loss

loss of profit	xxx
(+) Increase in cost of working	xxx
	xxx
(−) saving in expenses (Insured Standing exp)	xxx
Total loss	xxx

Step 6 :- Claim for consequential loss policy

$$\text{Total loss} \times \frac{\text{Insured value (Policy Amt.)}}{\text{Insurable value (G.P. on Adjusted annual turnover)}}$$

* loss of profit policy shall be taken for G.P. on adjusted annual turnover (for coming year) + Estimated increase in Standing charges in coming year.

Question 1

The premises of XY Limited were partially destroyed by fire on 1st March, 20X2 and as a result, the business was practically disorganised upto 31st August, 20X2. The company is insured under a loss of profits policy for ₹1,65,000 having an indemnity period of 6 months.

From the following information, prepare a claim under the policy:

Particulars	Rs.
Actual turnover during the period of dislocation (1-3-20X2 to 31-8-20X2)	80,000
Turnover for the corresponding period (dislocation) in the 12 months immediately before the fire (1-3-20X1 to 31-8-20X1)	2,40,000
Turnover for the 12 months immediately preceding the fire (1-3-20X1 to 28-2-20X2)	6,00,000
Net profit for the last financial year	90,000
Insured standing charges for the last financial year	60,000
Uninsured standing charges	5,000
Turnover for the last financial year	5,00,000

Due to substantial increase in trade, before and up to the time of the fire, it was agreed that an adjustment of 10% should be made in respect of the upward trend in turnover. The company incurred additional expenses amounting to ₹9,300 immediately after the fire and but for this expenditure, the turnover during the period of dislocation would have been only ₹55,000. There was also a saving during the indemnity period of ₹2,700 in insured standing charges as a result of the fire.

Answer

Computation of loss of profit Insurance claim

		₹
(1)	Rate of gross profit:	
	Net profit for the last financial year	90,000
	Add: Insured standing charges	60,000
		1,50,000
	Turnover for the last financial year	5,00,000
	Rate of gross profit =₹ 1,50,000/₹ 5,00,000 × 100 = 30%	
(2)	Short sales:	
	Standard Turnover	2,40,000
	Add: 10% increasing trend	24,000
		2,64,000
	Less: Turnover during the dislocation period (which is at par with the indemnity period of 6 months)	(80,000)
		1,84,000
(3)	Annual (Adjusted) Turnover:	
	Annual Turnover (1-3-20X1 to 23-2-20X2)	6,00,000
	Add: 10% increasing trend	60,000
		6,60,000

Note: Assumed that trend adjustment is required on total amount of annual turnover. However, part of the annual turnover represents trend adjusted figure. Alternatively, the students may ignore trend and take simply annual turnover. The claim would be ₹ 55,000 which is more than the claim computed in Para (5). So the Insurance Company would insist on trend adjusted on annual turnover.

(4) Additional Expenses:	₹
(i) Actual Expenses	9,300
(ii) Gross profit on sales generated by additional expenses = 30/100× (₹ 80,000 - ₹ 55,000)	7,500

(i) $\dfrac{\text{Gross Profit on Annual (Adjusted) Turnover}}{\text{Gross Profit shown in the numerator + Uninsured standing charges}}$ ×Additional Expenses

$$\frac{30\% \text{ on ₹ } 6{,}60{,}000}{30\% \text{ on ₹ } 6{,}60{,}000 + \text{₹ } 5{,}000} \times \text{₹ } 9{,}300 = \quad 9{,}071$$

Least of the above three figures, *i.e.* ₹ 7,500 allowable.

(5) Claim:

Loss of profit on short sales (30% on ₹ 1,84,000)	55,200
Add: Allowable additional expenses	7,500
	62,700
Less: Savings in insured standing charges	(2,700)
	60,000
Application of average clause 60,000 x 1,65,000 / 1,98,000	50,000

Master Problem

Question 2

On 19th May, 2011, the premises of Mr. Gyan were destroyed by fire, but sufficient records were saved, wherefrom the following particulars were ascertained:

Particulars	Amount is Rs.
Stock at cost on 1.1.2010	36,750
Value of Stock on 31.12.2010	39,800
Purchases less returns during 2010	1,99,000
Sales less return during 2010	2,43,500
Purchases less returns during 1.1.2011 to 19.5.2011 (Valued at 90% of Cost Price)	81,000
Sales less returns during 1.1.2011 to 19.5.2011	1,55,600
Wages from 1.1.2011 to 19.5.2011	30,000

In valuing the stock for the balance Sheet as at 31st December, 2010, Rs. 1,150 had been written off on certain stock which was a poor selling line having the cost Rs. 3,450. A portion of these goods were sold in March, 2011 at a loss of Rs. 125 on original cost of Rs 1,725. The remainder of this stock was now estimated to be worth the original cost. Subject to the above exceptions, gross profit has remained at a uniform rate throughout. The stock salvaged was Rs 2,900. Policy is taken for Rs. 30,000

Additional Information:

1. Sales Upto 19th May, 2011 includes Rs. 4,000 for which goods had not been dispatched.
2. Purchases Upto 19th May, 2011 did not include Rs. 10,000 for which purchase invoices had not been received from suppliers, though goods have been received in Godown.
3. Purchases includes purchase of machinery costing Rs. 3000.
4. Wages includes wages Rs. 2,000 for installation of machinery.
5. Sales of 1.1.2011 to 19.5.2011 include goods sold on approval basis amounting to Rs. 40,000. No approval has been received in respect of 3/4th of the goods sold on approval.
6. Sale value of goods drawn by partners Rs. 10,000
7. Cost of goods sent to consignee on 15th April, 2011 lying unsold withthem Rs. 7,000
8. Cost of goods distributed as free samples Rs. 1,500
9. The insurance company also admitted firefighting expenses of 4000.
10. Selling Expenses – Rs. 5000, Administration Expenses – Rs. 8800, Financial Exp. - Rs. 3200.
11. Gross profit of current year shows 5% increasing trend on sales.

Show the amount of the claim of stock destroyed by fire. Memorandum Trading Account to be prepared for the period from 1-1-2011to 19-5-2011 for normal and abnormal items.

Solution

Trading Account
(For the Period 1-1-2011 to 19-5-2011)

			Dr.				Cr.
Particulars	**Normal**	**Abnormal**	**Total**	**Particulars**	**Normal**	**Abnormal**	**Total**
To Opening Stock	37,500	3,450	40,950	By Sales less returns (W.N. 4)	1,20,000	1600	1,21,600
To Purchase (W.N. 1)	88,000	-	88,000	By Loss on Sale	-	125	125
To wages (W.N. 2)	28,000	-	28,000	By Goods with Consignee	7000	-	7000
To Gross Profit (Normal Sales x 25%) (W.N.3)	30,000	-	30,000	By Goods with Customer (W.N. 5)	22,500	-	22,500
				By Closing Stock (Bal. Figure)	34,000	1725	35,725
	183500	**3450**	**186950**		**183500**	**3450**	**186950**

Trading A/c for the year ended 31st December 2010

Particulars	**Amount (₹)**	**Particulars**		**Amount (₹)**
To opening stock	36.750	By sales return		2,43,500

To purchase	1,99,000			
To G.P.	48,700	By closing stock (+) Amt written off to restore at cost	39800 1150	40,950
	2,84,450			**2,84,450**

Calculation of claim for loss of stock

Particulars	Amount (₹)
Stock lost due to fire	35,725
(-) salvaged value	(2,900)
(+) fire fighting expenses	4000
	36,825

Average clause = loss x Insured Value/Insurable Value

= 36,825 x 30000/35,725

= 30,924

Note: - As policy amount is 30,000 & loss is 30,924. Maximum claim can be 30,000 only

Working Notes

1. **Adjusted Purchases:**

Cost Price of Purchase: 81,000 = 90% (Stock shown at 90% of Cost)
? = 100%

81000/90 x 100 = **90,000**

Particulars	Amount
Cost Price	90,000
(+) Unrecorded Purchase	10,000
(-) Purchase of Machinery (it was included in Purchase by mistake)	3000
(-) Drawings at Cost (10,000 – 25%)	7,500
(-) Free Sample	1,500
Total	**88,000**

2. **Wages:**

Particulars	Amount
Wages (as given) Less: Wages for installation	30,000 2,000
Wages to be debited to trading A/c	**28,000**

3. **Percentage of Gross Profit (on the Basis of last year's trading Account)**

Percentage of Gross Profit	= G.P./ Sales x 100 = 48,700/2,43,500 x 100 = 20 = 20% + 5 % Increase in G.P in current year (Given)
Total % of Gross profit	**= 25 %**

4. Sales

Particulars	Amount (₹)
Sales given	1,55,600
(-) goods not dispatched	4,000
(-) sales on approval (40000 x 3/4) (Approval not received)	30,000
	1,21,600

5. Cost price of goods with customer

Particulars	Amount (₹)
Sales on approval – Gross Profit (30,000 - 25%)	22,500

6. Selling Expenses of ₹ 5000, Administration expenses of ₹ 8800, Financial expenses of ₹ 3200 is excluded as these expenses are part of Profit and Loss Account.

Hire Purchase & Installment Purchase System

Hire Purchase	Installment Purchase
① Transfer of ownership Ownership is transferred after making payment of last Installment (After fully Payment)	Ownership is transferred to buyer immediately at the time of agreement and payment will be received after the agreement
② Parties :- i) Hire Purchaser (Hirer) ii) Hire Vendor	i) Buyer ii) seller
③ Option to cancel Hire purchaser has option to cancel Hire Purchase & can return the goods.	Right to cancel & return goods not available
④ Default in Payment :- Vendor can repossess the Goods	*Repossession of goods is not possible

Main intention of both system is common (To sale Goods)

∴ Substance over form is applicable for Hire Purchase (Consider reality over its legal form)

* Hire Purchase transactions are recorded assuming that it is sale so Entries for Both system shall be similar except entries for repossession in case of Hire purchase is not applicable in Installment system/sale.

1. **Cash Price** :→ Price at which goods may be purchase on immediate cash payment.

2. **Hire Purchase Price** :→ Total amount payable by purchase under agreement

   H.P. Price = Cash Price + Interest

* INTEREST CALCULATION *

1 If Cash Price & Interest rate is given in Problem

↓

Missing

→ Installments

Cash Price	xxx
(−) Down Payment	xxx
opening o/s	xxx
(+) Interest on opening o/s	xx
Total o/s	xx
(−) Installment	xx
closing Bal.	xx

* closing Bal. of this year will be opening of next year. Interest on opening o/s calculated every year & Installments are deducted (follow Horizontal format of above)

* No interest on Down Payment.

2 If Installment & Interest rate is given in problem

↓

Missing

→ Cash Price

(Reverse calculation of Situation 1; start from last year)

Closing Balance	xxx
(+) Installment	xxx
Total o/s	xxx
(−) Interest (Int. portion included in total o/s)	xxx
Opening O/s	xxx

opening o/s of last year will be closing balance of Previous year. follow same process & find out opening o/s of 1st year.

Opening o/s + Down Payment = Cash Price.

[follow Horizontal format]

3 If Hire purchase price & Installment & cash price is given in problem

↓

Missing

→ Interest Rate

→ calculate Total Interest

→ H.P. Price − Cash Price

→ Find out proportion of H.P. price o/s every year.

H.P. Price	xxx
(−) Down	xxx
o/s 1st year	xxx → 1
(−) Installment 1	xx
o/s 2nd year	xxx → 2
(−) Installment 2	xxx
o/s 3rd year	xxx → 3
(−) Installment 3	xxx

find out Proportion of these 3 amou[nts]

→ Distribute total interest in proportion to o/s amounts as calculated above.

If any Installment is not received then interest due till that date shall be recorded before repossession.

Journal Entries

In the Books of Hire Vendor

1) When goods are given on H.P.

Hire Purchaser A/c — Dr xxx
To H.P. sale A/c xxx

2) Down Payment

Cash A/c — Dr xxx
To Hire Purchaser A/c xxx

3) Interest Due [Every year]

Hire Purchaser A/c — Dr xxx
To Interest A/c xxx

4) Installment received [Every Year]

Cash A/c — Dr xxx
To Hire Purchaser A/c xxx

5) Depreciation :→ [Every year]

No depreciation is applicable for seller of goods on Goods sold.

6) Goods Reposession [If installment not received]

Goods Repossessed A/c — Dr. xxx
To Hire Purchaser A/c xxx

[At price specified in problem & if price is not specified the separate depreciation rate for goods reposessed may be available in problem apply such rate on original cost/cost price of asset upto the date of reposession]

7) Expenses Incurred on Goods Reposessed :-

Goods reposessed A/c — Dr xxx
To Cash / Bank A/c xxx

8) Resale of Goods Reposessed

Cash / Bank A/c — Dr.
To Goods reposessed A/c

Any Balance in Goods reposessed A/c is transferred to P&L A/c as well as Balance in Hire purchaser A/c is debited to P&L A/c if not recoverable

In the Books of Hire Purchaser

HP Asset A/c — Dr. xxx
To Hire Vendor A/c xxx

Hire vendor A/c — Dr xxx
To Cash A/c xxx

Interest A/c — Dr xxx
To Hire vendor A/c xxx

Hire vendor A/c — Dr xxx
To Cash A/c xxx

Depreciation A/c — Dr xxx
To Asset A/c xxx

Hire vendor A/c — Dr xxx
To Asset A/c xxx

No Entry.

No Entry

Balance in H.P. Asset A/c & Hire vendor A/c is transferred to P&L A/c.

Interest Suspense Method :-

Under this method, Total interest is recorded in interest suspense A/c in the beginning then current years interest is transferred to interest A/c from interest suspence A/c at the year end when interest becomes due.

In the Books of Hire Vendor

Hire Purchaser A/c - Dr xxx
To HP sale A/c xxx
To Interest suspence A/c xxx
(with total interest)
[Entry at beginning when goods transferred]

In the Books of Hire Purchaser

Asset A/c - Dr xxx
Interest suspense A/c - Dr xxx
To Hire Vendor A/c xxx

At year end [Interest becomes due every year]

Interest Suspence A/c - Dr xx
To Interest A/c xx

Interest A/c - Dr xx
To Interest suspence A/c xx

Other entries of Down payment, Instalment etc are same as cash price method.
(Balance of interest suspense A/c is reversed if Goods are repossessed)

Question No. 1

A Ltd. purchases a plant on hire purchase basis for ₹ 1,00,000 (cash price ₹ 86,000) and makes the payment in the following order:

Down payment	₹ 20,000,
1st instalment after one year	₹ 40,000;
2nd instalment after two years	₹ 20,000;

Last instalment after three years.

You are required to calculate: (i) total interest and (ii) interest included in each instalment.

(b) Shyam purchased from Rang Ltd. a colour T.V set on 1st October, 2011 on the hire purchase system. The cash price of the T.V set was ₹ 15,000. Terms of payment were ₹ 1,150 down payment and half yearly instalments of ₹ 4,000 each, over two years. The first instalment was to be paid on 31st March, 2012. Rate of interest was 12% p.a. Shyam could not pay the second instalment due on 30th September, 2012 and as a consequence, Rang Ltd. repossessed the T.V set after fulfilling legal formalities. Prepare Shyam's Account and Goods Repossessed Account in Rang Ltd.'s books. Assume that the estimated value of the T.V set at the time of repossession was ₹ 12,000 and after an expenditure of ₹ 850 on repairs and repacking, the company resold it on 6th December, 2012 for cash to one of its employees at a special discount of 10 percent on cash price i.e. for ₹ 13,500. Rang Ltd. closes its books of accounts every year on 31st March.

Answer

a) (i) Total interest = Hire Purchase price - Cash price = ₹ 1,00,000 - ₹ 86,000 =₹ 14,000

(ii) Hire purchase price outstanding at the beginning of each year

		₹
(a)	Hire purchase price	1,00,000
	Less: Down payment	(20,000)
(b)	Hire Purchase Price outstanding at the beginning of the 1st year	80,000
(c)	*Less*: 1st instalment	(40,000)
	Hire Purchase price outstanding at the beginning of the 2nd year	40,000
	Less: 2nd instalment	(20,000)
	Hire Purchase Price outstanding at the beginning of the 3rd year	20,000
	Less: 3rd instalment	(20,000)
		Nil

Ratio of (a): (b): (c) = 80:40:20 or 4:2:1

Amount of interest included in instalments:

1st instalment	4/7 x ₹ 14,000	₹ 8,000
2nd instalment	2/7 x ₹ 14,000	₹ 4,000
3rd instalment	1/7 x ₹ 14,000	₹ 2,000

(b) Shyam's Account in the books of Rang Ltd.

		₹			₹
2011 Oct. 1	To Sales Account - Cash price	15,000	2011 Oct. 1	By Bank - down payment	1,150
2012 Mar. 31	To Interest A/c - on ₹ 13,850 @ 12% p.a. for six months	831	2012 Mar. 31	By Bank – First instalment	4,000
				By Balance c/	10,681
		15,831			**15,831**
2012 Apr. 1	To Balance b/d	10,681	2012 Sept. 30	By Goods Repossessed /c: estimated value of T.V. set on repossession	12,000
Sept. 30	To Interest A/c - on ₹ 10,681 @ 12% p.a. for six months	641			
Sept. 30	To Profit & Loss A/c - Profit on repossession of T.V. set	678			
		12,000			**12,000**

Goods Repossessed Account

		₹			₹
2012 Sept. 30	To Shyam Restaurant - Estimated value of T.V. set on repossession	12,000	2012 Dec. 6	By Cash – Sale proceeds	13,500
Dec. 6	To Bank expenses on repairs, repacking etc.	850			
	To Profit & Loss Account - Profit on resale	650			
		13,500			**13,500**

Question No. 2

(a) On 1.1.2011 Shaan Ltd. purchased a machine on hire purchase basis. The terms of agreement provided for 40% as cash down payment and the balance in three instalments of ₹ 1,63,000 on 31.12.2012, ₹ 1,20,000 on 31.12.2013 and ₹ 1,10,000 on 31.12.2014. The rate of interest charged by the vendor is 10% p.a. compound annually. You are required to calculate the cash Price and periodic interest charged by higher vendor.

(b) On 1.1.2011 Beeta Ltd. purchased a machine from Yama Ltd. on hire purchase basis. The terms of agreement provided for 40% as cash down payment and the balance in three instalment of ₹ 1,30,000 on 31.12.2011, ₹ 1,42,000 on 31.12.2013 and ₹ 1,10,000 on 31.12.2014. The rate of interest charged by the vendor is 10% p.a. compounded annually. You are required to calculate the cash price when 2nd instalment is payable after two years.

Answer

(a) Statement Showing the Computation of Cash Price and Periodic Interest

A ***Instalment***	***B*** ***Balance due at the end after the payment of instalment***	***C*** ***Instalment Amount***	***D=B+C*** ***Total Amount Due at the end before the payment of instalment***	***E =*** ***Interest Dx10/110***	***F=D-E*** ***Balance Due at the Beginning***
III	NIL	1,10,000	1,10,000	10,000	1,00,000
II	1,00,000	1,20,000	2,20,000	20,000	2,00,000
I	2,00,000	1,63,000	3,63,000	33,000	3,30,000
	3,30,000	-	3,30,000	30,000	3,00,000

Let Cash Price be *X*

X = ₹ 3,00,000 + 40% of X

0.6 X = ₹ 3,00,000

X = ₹ 3,00,000/0.6 = ₹ 5,00,000, cash price = ₹ 5,00,000

(b) Statement Showing the Computation of Cash Price and Periodic Interest

A	**B** **Balance Due at the end After the Payment of Instalment**	**C** **Instalment**	**D = B +C** **Total Amount Due at the end Before the payment of instalment**	**E =Dx10/110** **interest**	**F=D-E** **Balance Due at the Beginning**
III	Nil	1,10,000	1,10,000	10,000	1,00,000
II	1,00,000	1,42,000	2,42,000	22,000	2,20,000
	2,20,000	-	2,20,000	20,000	2,00,000
I	2,00,000	1,30,000	3,30,000	30,000	3,00,000

Let Cash Price be *X*

X = ₹ 3,00,000 + 40% of X

0.6 X = ₹ 3,00,000

X = ₹ 3,00,000/0.6 = ₹ 5,00,000, cash price = ₹ 5,00,000

Question No. 3

Lucky bought 2 tractors from Happy on 1-10-2011 on the following terms:

Particulars	Rs.
Down payment	5,00,000
1st installment at the end of first year	2,65,000
2nd installment at the end of 2nd year	2,45,000
3rd installment at the end of 3rd year	2,75,000

Interest is charged at 10% p.a.

Lucky provides depreciation @ 20% on the diminishing balances.

On 30-9-2014 Lucky failed to pay the 3rd installment upon which Happy repossessed 1 tractor. Happy agreed to leave one tractor with Lucky and adjusted the value of the tractor against the amount due. The tractor taken over was valued on the basis of 30% depreciation annually on written down basis. The balance amount remaining in the vendor's account after the above adjustment was paid by Lucky after 3 months with interest @ 18% p.a.

You are required to:

(1) Calculate the cash price of the tractors and the interest paid with each installment.

(2) Prepare Tractor Account and Happy Account in the books of Lucky assuming that books are closed on September 30 every year. Figures may be rounded off to the nearest rupee.

Answer

(i) Calculation of Interest and Cash Price

No. of installments	Outstanding balance at the end after the payment of installment	Amount due at the time of installment	Outstanding balance at the end before the payment of installment	Interest	Outstanding balance at the beginning
[1]	[2]	[3]	[4]= 2 +3	[5]= 4 x 10/110	[6]= 4-5
3rd	-	2,75,000	2,75,000	25,000	2,50,000
2nd	2,50,000	2,45,000	4,95,000	45,000	4,50,000
1st	4,50,000	2,65,000	7,15,000	65,000	6,50,000

Total cash price = ₹ 6,50,000+5,00,000 (down payment) = ₹ 11,50,000.

In the books of Lucky
Tractors Account

Date	Particulars	₹	Date	Particulars	₹
1.10.2011	To Happy a/c	11,50,000	30.9.2012	By Depreciation A/c	2,30,000
				Balance old	9,20,000
		11,50,000			**11,50,000**
1.10.2012	To Balance b/d	9,20,000	30.9.2013	By Depreciation A/c	1,84,000
				Balance c/d	7,36,000
		9,20,000			**9,20,000**
1.10.2013	To Balance bld	7,36,000	30.9.2014	By Depreciation A/c	1,47,200
				By Happy a/c (Value of 1 Tractor taken over after depreciation for 3 years @30% p.a.) {5,75,000-(1,72,500+ 1,20,750+84,525)}	1,97225
				By Loss transferred to Profit and Loss a/c on surrender (Bal. fig.) or (2,94,400-1,97,225)	97,175
				By Balance c/d 1/2 (7,36,000 -1,47,200 = 5,88,800)	2,94,400
		7,36,000			**7,36,000**

Happy Account

Date	Particulars	₹	Date	Particulars	₹
1.10.11	To Bank (down payment)	5,00,000	1.10.11	By Tractors a/c	11,50,000
30.9.12	To Bank (1st Installment)	2,65,000	30.9.12	By Interest a/c	65,000
	To Balance cld	4,50,000			
		12 ,15,000			**12 ,15,000**
30.9.13	To Bank (2nd Installment)	2,45,000	1.10.12	By Balance b/d	4,50,000
	To Balance c/d	2,50,000	30.9.13	By Interest a/c	45,000
		4,95,000			**4,95,000**

30.9.14	To Tractor a/c	1,97,225	1.10.13	By Balance b/d	2,50,000
	To Balance cld	77,775	30.9.14	By Interest a/c	25,000
		2,75,000			**2,75,000**
31.12.14	To Bank (Amount settled after 3 months)	81,275	1.10.14	By Balance bid	77,775
			31.12.14	By Interest a/c (@18% on bal.) (77,775 x 3112 x 18/100)	3,500
		81,275			**81,275**

INVESTMENT ACCOUNTS

Investments
↓
Assets held
↓

- Held for earning Income
  ↓
  By way of
  ↓
  - Dividend
  - Rental
  - Interest
- Held for capital Appreciation
- Held for other Benefit"

Classification of Investments

↓

Current Investment
↓
Two conditions to be satisfied
1. It is readily realisable
2. Intention to hold for not more than one year from date of Investment

↓
Measured at Cost or fair value whichever is lower (on individual investment basis)
↓
Any reduction in fair value & any reversals of such reductions are transferred to P&L A/c

Long term Investment
(Example: Investment Property)
↓
Which is not current Investment
↓
Always valued at cost
Exception:- Reduce carrying Amount if permanent diminution in value
↓
Any reduction to cost & any reversals of such reductions are transferred to P&L A/c

Recognition & Measurement

Initial Measurement

↓

Measured at Cost
(Classification is not relevant)

↓ Investment Aquired

- **By Payment of cash or on Credit**
  ↓
  Cost = Basic Price + Incidental expense like Brokerage

- **By Issue of Shares or other Securities**
  ↓
  Cost = fair value of shares or securities on the date of Aquisition

- **By exchange of Another Asset of entity**
  ↓
  Cost =
  1. fair value of Asset given up
  or
  2. fair value of Investment Aquired

  (Whichever is clearly evident)

Subsequent Measurement & Re-classification

↓

Situation 1:→ Re-Classification from long term to Current:→
→ Valued at lower of cost or carrying Amount on the date of re-classification

Situation 2:→ Re-classification from current to long term
→ Valued at lower of cost or fair value on the date of ~~re-classifi~~ re-classification.

Classification of Income from Investments

PRE Aquisition Income

↓

- Income Accrued during Pre Aquisition period but received by investors after the aquisition

↓

It shall be treated as recovery of cost of investment as it is assumed that price paid for Investment includes Pre-aquisition Income

↓

Deduct/credit income from/to Investment A/c

POST Aquisition Income

↓

Income earned & Accrued after the aquisition & received after the aquisition

↓

Recognise it as income & credited to P&L A/c

[But in case of Equity shares, it is difficult to allocate Income between Pre & Post Aquisition]

Right issue & Right shares

If Right shares are Purchased by Investor

↓

Entry by Investor in his Book

Investment A/c — Dr

To Cash / Bank A/c

If Rights are not purchased but it is directly sold

↓

Amount received is an income & it should be taken to P&L.

~~EXP~~

Exception to Above Rules ↦

1) If investment is aquired cum right basis

2) Market value of such investment came down below cost after right issue.

In the given two situations, income received by sale of rights is credited to investment A/c in cost column to bring carrying amount to market price

Bonus shares

- Cost of Investment of Bonus shares is always Nil but it increases number of shares.
- therefore there is no need to pass any journal entry & only number of bonus shares received will be added to existing number of shares.

Sale of Investments

Profit or loss on sale should be recognised in P&L A/c

Profit / loss = Sale proceeds (net of selling exp) - carrying Amt (Book value)

→ If Part of investment is disposed, the carrying Amt. is determined on the basis of average carrying Amt. of total holding of investment [Not FIFO or LIFO]

↓

unless problem specify to follow FIFO

Accounting Treatment for Investment (4)

In Case of Debentures/Bonds

Interest rate is fixed & receipt of income is certain

→ It is possible to calculate interest receivable / Accrued upto closing of year [on closing Balance & opening Balance of Investment]

→ It is possible to calculate interest receivable by seller of investment which will be received by buyer on due date therefore seller can ask for interest due on the date of transaction therefore transaction price may be:

Ex-interest (Excluding interest)

(* Interest is always calculated from last interest declaration date to present Date)

Cum Interest (Including Interest)

Interest shall be separated from price & shall be shown in interest column & remaining amount in cost column by adding Brokerage & commission.

In Case of Equity Shares

Dividend rate is not fixed & receipt of income is uncertain

Not possible to calculate Dividend accrued unless it is declared.

Calculation of sale Profit Interest ⇒

Sale Price	xxx
(-) Brokerage	xxx
	xxx
(-) Interest (In case of Deb & cum interest)	xxx
Net Sale Price	xxx
(-) cost (FIFO → Specified in Problem; Average cost → otherwise)	xxx
Profit	xxx

* Interim dividend is generally treated as post aquisition income.

* Calculation of cost of Purchase

Purchase Price	xxx
(+) Brokerage	xxx
	xxx
(-) Interest (In case of debentures if Purchase price is cum interest)	xxx
	xxx

* Interest is always calculated on face value.

* Dividend received on opening Bal of investment in equity shares is treated as post aquisition & credited in dividend column & ~~taken~~ Dividend for last year recd on purchase of shares in current year is pre-aquisition

Master Problem

Question No. 1

Following are the details of Investments made by Mr. Gyaan, Prepare Investment Accounts for following investments assuming that Mr. Gyaan closes his books of accounts on 31st March, 2015:

1. 12% Debentures of Face Value ₹ 100 of M/s. A Ltd. as current investments.

Date	Particulars
1-4-2014	Opening balance 4,000 debentures costing ₹ 98 each
1-6-2014	Purchased 2,000 debentures @ ₹ 120 cum interest
1-9-2014	Sold 3,000 debentures @ ₹ 110 cum interest
1-12-2014	Sold 2,000 debentures @ ₹ 105 ex interest
31-1-2015	Purchased 3,000 debentures @ ₹ 100 ex interest
31-3-2015	Market value of the investments ₹ 105 each

Interest due dates are 30th June and 31st December.

He incurred 2% brokerage for all his transactions. Assume that Mr.Gyaan follows FIFO method for Debentures.

2. 12% State Government Bonds having face value ₹ 100

Date	Particulars
01.04.2014	Opening Balance (1200 bonds) book value of ₹ 126,000
02.05.2014	Purchased 2,000 bonds ₹ 100 cum interest
30.09.2014	Sold 1,500 bonds at ₹ 105 ex interest

Interest on the bonds is received on 30th June and 31st Dec. each year.

Assume that Mr.Gyaan follows Average Cost Methodmethodfor Bonds.

3. Equity Shares of X Ltd. With face value of ₹ 10 each.

Date	Particulars
01.04.2014	Opening Balance (1000 Equity Shares) book value of ₹ 2,00,000
15.04.2014	Purchased 5,000 equity shares @ ₹ 200,Brokerage of 1% was paid in addition (Face Value of shares ₹ 10)
03.06.2014	The company announced a bonus issue of 2 shares forevery 5 shares held.
16.08.2014	The company made a rights issue of 1 share for every 7 shares held at ₹250 per share. The entire money was payable by 31.08.2014.
22.8.2014	Rights to the extent of 20% were sold @ ₹ 60. Theremaining rights were subscribed.

02.09.2014	Dividend @ 15% for the year ended 31.03.2014 wasreceived on 16.09.2014
15.12.2014	Sold3,000 shares@ ₹ 300. Brokerage of 1% wasincurred extra.
15.01.2015	Received interim dividend @10% for the year 2014-15
31.03.2015	The shares were quoted in the stock exchange @ ₹ 220

Assume that Mr.Gyaan follows Average Cost Methodmethodfor Equity shares.

Answer

Investment A/c(Scrip: 12% Debentures) for the year ending on 31-3-2015
(Interest Payable on 30th June and 31st December)

Date	Particulars	Nominal Value	Interest	Cost	Date	Particulars	Nominal Value	Interest	Cost
1.4.2014	To Balance b/d	4,00,000	12,000	3,92,000	30.6.2014	By Bank (6,00,000x6%)	-	36,000	-
1.6.2014	To Bank (W.N. 1)	2,00,000	10,000	2,34,800	1.9.2014	By Bank(W.N. 2)	3,00,000	6,000	3,17,400
1.9.2014	To Profit & Loss A/c(W.N. 2)	-	-	23,400	1.12.2014	By Bank(W.N. 3)	2,00,000	10,000	2,05,800
31.1.2015	To Bank	3,00,000	3,000	3,06,000	1.12.2014	By Profit & Loss a/c(W.N. 3)	-	-	9,600
31.3.2015	To Profit & Loss A/c (Bal. Fig,)	-	45,000	-	31.12.14	By Bank (1,00,000 x 6%)	-	6,000	-
					31.3.2015	By Profit & Loss A/c (b.f.)	-	-	3,400
					31.3.2015	By Balance c/d (W.N.4)	4,00,000	12,000	4,20,000
		9,00,000	**70,000**	**9,56,200**			**9,00,000**	**70,000**	**9,56,200**

12% Govt. Bonds (for the year ended 31st March, 2015)
(Interest Payable on 30th June and 31st December)

Date	Particulars	Nominal Value	Interest	Cost	Date	Particulars	Nominal Value	Interest	Cost
1.4.14	To Balance b/d	1,20,000	3,600	1,26,000	30.6.14	By Bank A/c (Interest) (3,20,000 x 12% x 6/12)	-	19,200	-
2.5.14	To Bank A/c	2,00,000	8,000	1,92,000	30.9.14	By Bank A/c	1,50,000	4,500	1,57,500
30.9.14	To P&LA/c (Profit on Sale) (W.N.5)	-	-	8,438	31.12.14	By Bank A/c (Interest) (1,70,000 X 12% X 6/12)	-	10,200	-
31.3.15	P & L A/c (Interest) (b.f.)	-	27,400	-	31.3.15	By Bal. c/d (W.N. 6)	1,70,000	5,100	1,68,938
		3,20,000	**39,000**	**3,26,438**			**3,20,000**	**39,000**	**3,26,438**

Investments in Equity shares of X Ltd. (for year ended 31.3.2015)

Date	Particulars	No.	Dividend	Cost	Date	Particulars	No.	Dividend	Cost
01.04.14	To Balance B/d	1000	-	2,00,000					
15.4.14	ToBank A/c (W.N. 7)	5,000	-	10,10,000	16.9.14	By Bank (Dividend)	-	1500	7,500
3.6.14	ToBonus Issue	2,400	-	-	15.12.14	By Bank (Sale)	3,000	-	8,91,000
31.8.14	ToBank A/c (W.N. 8)	960	-	2,40,000	15.1.15	By Bank (interim dividend)	-	6,360	-
15.12.14	To P & L A/c(profit)(W.N. 9)	-	-	4,28,660					
31.3.15	To P & L A/c (b.f.)	-	7,860	-	31.3.15	By Bal. c/d (W.N. 10)	6,360	-	9,80,160
		9360	**7,860**	**18,78,660**			**9360**	**7,860**	**18,78,660**

Working Notes for 12% Debentures

1. 1.6.2014 Purchase cost of 2,000 debentures

200 Debentures @ ₹ 120 cum interest		2,40,000
Add: Brokerage @ 2%		4,800
	2,44,800	
Less: Interest for 5 months		(10,000)
Purchase cost of 2,000 debentures	**2,34,800**	

---

2. 1.9.2014 Sale value& Profit 0n 3,000 debentures

	₹
Sales price of debentures cum interest (3,000 x ₹ 110)	3,30,000
Less: Brokerage @ 2%	(6,600)
	3,23,400
Less: Interest for 2 months	(6,000)
Sale value for 3,000 debentures	**3,17,400**
Less: Cost Price of Debentures 3,92,000 x 3000 Deb. / 4,000 Deb.	(2,94,000)

Profit on sale 23,400

---

3. 1.12.2014 Loss on sale of debentures as on

	₹
Sales price of debentures (2,000 x ₹ 105)	2,10,000
Less: Brokerage @ 2%	(4,200)
	2,05,800
Less: Cost price of Debentures(98,000 + 1,17,400)	2,15,400
Loss on sale	**9,600**

---

4. Valuation of closing balance as on 31.3.2015:

A. Market value of 4,000 Debentures at ₹ 105 = ₹ 4,20,000

B. Cost price of 1,000 debentures at ₹ 1,17,400&3,000 debentures at ₹ 3,06,000
Therefore total cost is (1,17,400 + 3,06,000) ₹ 4 23 400

Value at the end = 4,20,000 i.e. whichever is less

Working Notes for 12% Bonds

5. Profit on sale of bonds on 30.9.14

= Sales proceeds - Average cost

Sales proceeds = ₹ 1,57,500

Average cost = [(1,26,000+1,92,000) x 1,500/3,200]= 1,49,062.50

Profit = 1,57,500- ₹ 1,49,062.50=₹ 8,438 (approx.)

6. Valuation of bonds on 31st March, 2015

Cost = 3,18,000/3,200 x 1,700 = 1,68,937.50

Working Notes for Equity Shares

7. Cost of equity shares purchased on 15/4/2014

= Cost + Brokerage

= (5,000 x₹ 200) + 1% of (5,000 x ₹ 200) = ₹ 10,10,000

---

8. Right Issue as on 31.08.14

Rights Available : { 1,000 + 5000 + 2400 / 7} = 1200 Shares

Rights Sold 1200 x 20% = 240 at 60 each therefore 14,400 (240 x 60) transferred to P&L A/c

Rights Purchased 1200 x 80% = 960 at ₹ 250 each therefore ₹ 2,40,000 (960 shares x 250 each) debited to investment account.

---

9. Sale proceeds and Profit on Sale of equity shares on 15/12/2014

Sales proceeds (3000 x 300) - 1%₹ 8,91,000

Less: Average cost[(2,00,000 + 10,10,000+2,00,000-7,500) x 3,000/9,360]

₹ [14,42,500 x 3,000/9,360] = 4,62,340

Profit =₹ 8,91,000 - ₹ 4,62,340=₹ 4,28,660.

10. Valuation of equity shares on 31st March, 2015

Cost =₹ {14,42,500 x 6360/9,360} = ₹ 9,80,160

Market Value = 6,360 shares x ₹ 220 **=** **₹**13,99,200

Closing stock of equity shares has been valued at ₹ 9,80,160 i.e. cost being lower than the market value.

Accounts from Incomplete Records ①
[Single Entry]

कितना Incomplete हो सकता है
① One effect is pending.
② Both effects are pending.

→ Rules to be understood

① If information is separately given as adjustment then complete its 2 effects

② If information is given through any A/c then one effect is already completed & only 2nd effect is pending. [cash/Bank A/c may be given]

③ from one A/c, we can find out only one missing figure

example :- If credit sale is missing & debtors closing balance ~~is on~~ both are missing then Debtors A/c can be used to find out closing balance & we need to find out credit sale separately

→ let us know Basics

Dr.	Assets A/c → Real & Personal A/cs	Cr.
↑		↓
Always Dr. Bal. (opening)		

Dr.	Liabilities A/c ← Personal A/cs	Cr.
↓		↑
		Always Cr. Balance

Dr.	Expenses ← Nominal A/c	Cr.
↑		↓
always Dr. Balance		

Dr.	Income ← Nominal A/c	Cr.
↓		↑
		Always credit Balance

→ Understanding About provision :-

Following Items are normally missing & can be calculated in following ways. (2)

① Sales

- Prepare Debtors A/c
  ↓
  find out credit sales + cash sales = Total sales
  (opening, closing Balance & collection shall be given in Problem)

- Find out C.O.G.S.

opening	xxx
+ Purchase	xxx
(-) closing	xxx
COGS	xxx
(+) G.P.	xxx
Sales	xxx

- Refer instructions given in problem
  ① May be last year sale is given & increase in current year is given
  or
  ② Ratio's / turnover pattern is given

- Prepare Cash A/c to find out Cash Sales

② Purchases

- Prepare Creditors A/c
  ↓
  To find out credit Purchase

Credit Purchase	xxx
(+) Cash Purchase	xxx
Total Purchase	xxx

  ↓
  (opening, closing Balance & payment to creditors shall be given in problem)

- Reverse COGS

COGS -	xxx
(+) closing stock	xxx
(-) opening stock	xxx
Purchase	xxx

  or
  Prepare Trading A/c (B.F.)

- Refer instructions given in Problem
  ①. May be last years sale is given & Increase in current year is given
  ② Ratio's / creditors turnover is given

- Prepare Cash A/c to find out Cash Purchase

③ Depreciation / sale or Purchase of fixed Assets

→ Prepare fixed Asset A/c
or
→ Refer instructions.

(4) Opening or closing Balances of Cash A/c, Bank A/c, Debtors A/c or creditors A/c is missing:

→ Prepare respective A/cs

or

→ In case of Debtors & creditors, opening or closing Balance can be calculated using ratio's, if given in problem.

(5) Opening Capital Balance is missing :-

Prepare opening Balance sheet & Balancing figure is treated as opening capital.

(6) Gross Profit is missing :-

→ Refer instructions or,

→ Balancing figure to trading A/c.

(7) Expenses or Income related to current year is missing [Exp./Income not given on Accrual basis)

Total expenses paid (as given in info or given cash book)	xxx
(+) Outstanding of current year	xxx
(+) Prepaid expenses of last year	xxx
(-) Outstanding expenses of last year	xxx
(-) Prepaid exp in current year	xxx
Expenses to be debited to P&L A/c	

(Same format applicable for Income)

→ If Debtors turnover is given then we can find out ~~sales~~ 4
credit sales as = $\text{Debtors} \times \frac{12 \text{ months}}{\text{Debtors turnover}}$

→ In above case we can find out Debtors (If credit sale is available)

$$\text{Debtors} = \text{credit sale} \times \frac{\text{Debtors turnover}}{12 \text{ months}}$$

→ If Creditors turnover is given then we can find out credit purchase as = $\text{creditors} \times \frac{12}{\text{creditors turnover}}$

In above case we can find out creditors (if credit purchase is available)

$$\text{Creditors} = \text{credit purchase} \times \frac{\text{creditors turnover}}{12}$$

→ If Bills Receivable & Debtors A/c given in Balance sheet.

Trade Debtors A/c

To Balance b/d	xxx	By Cash / Bank A/c	xxx
To credit sales A/c (B.F.)	xxx	By Discount allowed	xxx
		By Bills Receivable A/c	xxx
		By Bad debts	xxx
		By Balance c/d	xxx

Bills Receivable A/c

To Balance b/d	xxx	By Cash	xxx
To Trade Debtors (B.F.)	xxx	By Trade creditors (Bills endorsed)	xxx
		By Balance c/d	xxx

Main Components of Debtors A/c

1 Opening Balance 2 closing Balance 3 Collection from debtors 4 Credit sales (one may be missing)

Other :→ Bad debts, discount allowed, sales return, Cheque or B/R dishonoured, Bills receivable.

Dr. Debtors A/c Cr.
↑ ↓

→ If Bills Payable & Creditors A/c given in Balance sheet

Dr Trade Creditors A/c Cr.

To Cash / Bank A/c	xxx	By Balance b/d	xxx
To Discount received	xxx	By Purchase	xxx
To Bills Receivable	xxx		
To Bills Payable	xxx		
To Balance c/d	xxx		
	___		___

Dr Bills Payable A/c Cr

To Cash / Bank		By Balance b/d	
To Balance c/d		By creditors* (Balancing figure)	
	___		___

→ Main Components of creditors A/c :→

① Opening Balance ② Closing Balance

③ Payment to creditors ④ credit purchase

*(one of above may be missing

→ Other Components :→

Discount recd, B.R. endorsed, Bills Payable accepted. Cheque or B.R. endorsed is now dishonoured

Dr Creditors A/c Cr

↓	↑

Question No. 1

The following is the Balance Sheet of Manish and Suresh as on 1st April, 2016:

Liabilities	₹	Assets	₹
Capital:		Building	1,00,000
Manish	1,50,000	Machinery	65,000
Suresh	75,000	Stock	40,000
Creditors for goods	30,000	Debtors	50,000
Creditors for expenses	25,000	Bank	25,000
	2,80,000		2,80,000

They give you the following additional information:

(i) Creditors' Velocity* 1.5 month & Debtors' Velocity* 2 months.
(ii) Stock level is maintained uniformly in value throughout all over the year.
(iii) Depreciation on machinery is charged @ 10%, Depreciation on building @ 5% in the current year.
(iv) Cost price will go up 15% as compared to last year and also sales in the current year will increase by 25% in volume.
(v) Rate of gross profit remains the same.
(vi) Business Expenditures are ₹ 50,000 for the year. All expenditures are paid off in cash.
(vii) Closing stock is to be valued on LIFO Basis.
(viii) All sales and purchases are on credit basis and there are no cash purchases and sales.

Prepare Trading, Profit and Loss Account, Trade Debtors A/c and Trade Creditors A/c for the year ending 31.03.2017.

(* Velocity indicates the no. of times the creditors and debtors are turned over a year.)

Answer

Trading and Profit and Loss account for the year ending 31st March, 2017

Particulars	₹	Particulars	₹
To Opening Stock	40,000	By Sales	4,31,250
To Purchases (Working Note)	3,45,000	By Closing Stock	40,000
To Gross Profit c/d (20% on sales)	86,250		
	4,71,250		4,71,250
To Business Expenses	50,000	By Gross Profit b/d	86,250
To Depreciation on:			
Machinery 6,500			
Building 5,000	11,500		
To Net profit	24,750		
	86,250		86,250

Trade Debtors Account

Particulars	₹	*Particulars*	₹
To Balance b/d	50,000	By Bank (bal.fig.)	4,09,375
To Sales	4,31,250	By Balance c/d (1/6 of 4,31,250)	71,875
	4,81,250		4,81,250

Trade Creditors Account

Particulars	₹	Particulars	₹
To Bank (Balancing figure)	3,31,875	By Balancing b/d	30,000
To Balance c/d/ (1/8 of ₹ 3,45,000)	43,125	By Purchases	3,45,000
	3,75,000		3,75,000

Working Note:

		₹
(i)	Calculation of Rate of Gross Profit earned during previous year	
A	Sales during previous year (₹ 50,000 x 12/2)	3,00,000
B	Purchases (₹ 30,000 x 12/1.5)	2,40,000
C	Cost of Goods Sold (₹ 40,000 + ₹ 2,40,000 - ₹ 40,000)	2,40,000
D	Gross Profit (A-C)	60,000
E	Rate of Gross Profit ₹ 60,000/₹ 3,00,000 x 100	20%
	Calculation of sales and Purchases during current year	₹
(ii) A	Cost of goods sold during previous year	2,40,000
B	Add: Increases in volume @ 25 %	60,000
		3,00,000
C	Add: Increase in cost @ 15%	45,000
D	Cost of Goods Sold during Current Year	3,45,000
E	Add: Gross profit @ 25% on cost (20% on sales)	86,250
F	Sales for current year [D+E]	4,31,250

Question 2

A trader keeps his books of account under single entry system. On 31st March, 2010 his statement of affairs stood as follows:

Liabilities	₹	**Assets**	₹
Trade Creditors	5,80,000	Furniture, Fixtures and Fittings	1,00,000
Bills Payable	1,25,000	Stock	6,10,000
Outstanding Expenses	45,000	Trade Debtors	1,48,000
Capital Account	2,50,000	Bills Receivable	60,000
		Unexpired Insurance	2,000
		Cash in Hand and at Bank	80,000
	10,00,000		**10,00,000**

The following was the summary of Cash-book for the year ended 31st March, 2011:

Receipts	**₹**	**Payments**	**₹**
Cash in Hand and at Bank on 1st April, 2011	80,000	Payments to Trade Creditors	75,07,000
Cash Sales	73,80,000	Payments for Bills payable	8,15,000
Receipts from Trade Debtors	15,10,000	Sundry Expenses paid	6,20,700
Receipts for Bills Receivable	3,40,000	Drawings	2,40,000
		Cash in Hand and at Bank on 31st March, 2011	1,27,300
	93,10,000		93,10,000

Discount allowed to trade debtors and received from trade creditors amounted to ₹ 36,000 and ₹ 28,000 respectively. Bills endorsed amounted to ₹ 15,000. Annual Fire Insurance premium of ₹ 6,000 was paid every year on 1st August for the renewal of the policy. Furniture, fixtures and fittings were subject to depreciation @ 15% per annum on diminishing balances method.

You are also informed about the following balances as on 31st March, 2011:

	₹
Stock	6,50,000
Trade Debtors	1,52,000
Bills Receivable	75,000
Bills Payable	1,40,000
Outstanding Expenses	5,000

The trader maintains a steady gross profit ratio of 10% on sales.

Prepare Trading and Profit and Loss Account for the year ended 31st March, 2011 and Balance Sheet as at that date.

Answer

Trading and Profit and Loss Account for the year ended 31st March, 2011

Particulars	₹	Particulars	₹	₹
To Opening Stock	6,10,000	By Sales		
To Purchases (W.N. 3)	84,10,000	Cash	73,80,000	
To Gross profit c/d	9,30,000	Credit (W.N. 2)	19,20,000	93,00,000
(10% of 93,00,000)		By Closing stock		6,50,000
	99,50,000			99,50,000
To Sundry expenses (W.N. 6)	5,80,700	By Gross profit b/d		9,30,000
To Discount allowed	36,000	By Discount received		28,000
To Depreciation	15,000			
(15% ₹ 1,00,000)				
To Net Profit	3,26,300			
	9,58,000			

Balance Sheet as at 31st March, 2011

Liabilities	Amount	Amount	Assets	Amount
	₹	₹		₹
Capital			Furniture & Fittings 1,00,000	
Opening balance	2,50,000		*Less :* Depreciation (15,000)	85,000
Less : Drawing	(2,40,000)		Stock	6,50,000
	10,000		Trade Debtors	1,52,000
Add : Net profit for the years	3,26,300	3,36,300	Bills receivable	75,000
Bills payable		1,40,000	Unexpired insurance	2,000
Trade creditors		6,10,000	Cash in hand & at bank	1,27,300
Outstanding expenses		5,000		
		10,91,300		**10,91,300**

Working Notes :

1. Bills Receivable Account

Particulars	₹	Particulars	₹
To Balance b/d	60,000	By Cash	3,40,000
To Trade debtors	3,70,000	By Trade creditors (Bills endorsed)	15,000
		By Balance c/d	75,000
	4,30,000		**4,30,000**

2. Trade Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d	1,48,000	By Cash/Bank	15,10,000
To Credit sales (Bal. fig.)	19,20,000	By Discount allowed	36,000
		By Bills receivable	3,70,000
		By Balance c/d	1,52,000
	20,68,000		**20,68,000**

3. Memorandum Trading Account

Particulars	₹	Particulars	₹
To Opening stock	6,10,000	By Sales	93,00,000
To Purchases (Balancing figure)	84,10,000	By Closing stock	6,50,000
To Gross Profit (10% on sales)	9,30,000		
	99,50,000		99,50,000

4. Bills Payable Account

Particulars	₹	Particulars	₹
To Cash/Bank	8,15,000	By Balance b/d	1,25,000
To Balance c/d	1,40,000	By Creditors (balancing figure)	8,30,000
	9,55,000		**9,55,000**

5. Trade Creditors Account

Particulars	₹	Particulars	₹
To Cash/Bank	75,07,000	By Balance b/d	5,80,000
To Discount received	28,000	By Purchases	84,10,000
To Bills receivable	15,000	(as calculated in W.N. 3)	
To Bills payable	8,30,000		
To Balance c/d (bal. figure)	6,10,000		
	89,90,000		**89,90,000**

6. Computation of sundry expenses to be charged to Profit & Loss A/c

Particulars	₹
Sundry expenses paid (as per cash book)	6,20,700
Add : Prepaid expenses as on 31–3–2010	2,000
	6,22,700
Less : Outstanding expenses as on 31–3–2010	(45,000)
	5,77,700
Add : Outstanding expenses as on 31–3–2011	5,000
	5,82,700
Less : Prepaid expenses as on 31–3–2011 (Insurance paid till July, 2011)	(2,000)
	5,80,700

Question No. 3

Lokesh, who keeps books by single entry, had submitted his Income-tax returns to Income-tax authorities showing his incomes to be as follows:

Particulars	₹
Year ending March 31, 2005	33,075
Year ending March 31, 2006	33,300
Year ending March 31, 2007	35,415
Year ending March 31, 2008	61,875
Year ending March 31, 2009	54,630
Year ending March 31, 2010	41,670

The Income-tax officer is not satisfied as to the accuracy of the incomes returned. You are appointed as a consultant to assist in establishing correctness of the incomes returned and for that purpose you are given the following information:

a) Business liabilities and assets at March 31, 2004 were:
b) Creditors: ₹ 32,940, Furniture & Fittings: ₹ 22,500, Stock : ₹ 24,390 (at selling pricewhich is 25% above cost), Debtors: ₹ 11,025, Cash at Bank and in hand ₹ 15,615.
c) Lokesh owned his brother ₹ 18,000 on March 31, 2004. On February 15, 2007 he repaid this amount and on April 1, 2009, he lent his brother ₹ 13,500.
d) Lokesh owns a house which he purchased in 1999 for ₹ 90,000 and a car which he purchased in October, 2005 for ₹ 33,750. In January, 2009, he bought debentures in X Ltd. having face value of ₹ 40,000 for ₹ 33,750.
e) In May, 2009 a sum of ₹ 13,500 was stolen from his house.
f) Lokesh estimates that his living expenses have been 2004-05 - ₹ 13,500; 2005-06 -₹ 18,000; 2006-07 - ₹ 27,000; 2007-08, 2008-09 and 2009-10 - ₹ 31,500 p.a. exclusive of the amount stolen.
g) On March 31, 2010 business liabilities and assets were: Creditors ₹ 37,800, Furniture, Fixtures and Fittings ₹ 40,500, Stock ₹ 54,330 (at selling price with a gross profit of 25%), Debtors ₹ 26,640, Cash-in-Hand and at Bank ₹ 29,025.

From the information submitted, prepare statements showing whether or not the incomes declared by Lokesh are correct.

Answer

Statement of Affairs of 'Lokesh' as on March 31, 2004

Liabilities	₹	Assets	₹
Creditors	32,940	Furniture, Fixtures & Fittings	22,500
Loan from brother	18,000	Stock (24,390 x 100/125)	19,512
Capital (Bal. fig.)	1,07,712	Debtors	11,025
		Cash-in-Hand and at Bank	15,615
		Building (House)	90,000
	1,58,652		**1,58,652**

Statement of Affairs of 'Lokesh' as on March 31, 2010

Liabilities	₹	Assets	₹
Creditors	37,800	Furniture, Fixtures & Fittings	40,500
Capital (Bal. fig.)	2,70,112	Stock (54,330 x 75%)	40,747
		Debtors	26,640
		Cash-in-Hand and at Bank	29,025
		Loan to Brother	13,500
		Building (House)	90,000
		Car	33,750
		Debentures in 'X Ltd.'	33,750
	3,07,912		**3,07,912**

Statement of Profit:

Particulars	₹	₹	₹
Capital as on March 31, 2010			2,70,112
Add: Drawings			
2004-05	13,500		
2005-06	18,000		
2006-07	27,000		
2007-08	31,500		
2008-09	31,500		
2009-10	31,500		1,53,000
			4,23,112
Add: Amount stolen in May, 2009			13,500
			4,36,612
Less: Opening Capital as on March 31, 2004			(1,07,712)
			3,28,900
Less: Profit as shown by I.T.O.			
For the year ending March 31, 2005		33,075	
For the year ending March 31, 2006		33,300	
For the year ending March 31, 2007		35,415	
For the year ending march 31, 2008		61,875	
For the year ending March 31, 2009		54,630	
For the year ending March 31, 2010		41,670	(2,59,965)
Understatement of Income			68,935

Note: In the absence of the information regarding depreciation in the question, no depreciation has been provided on Building (house) and Car. The candidates may assume any appropriate rate of depreciation and can provide depreciation.

CASH FLOW STATEMENT

Categories of Cash Flows

Operating Activities

These are principal/ main revenue generating Activities of Enterprise

Cash Inflow
- Cash sales
- Cash received from Debtors
- Commission & fees received
- Royalty received

Cash Outflow
- Cash Purchase of Goods
- Payment to Creditors
- Payment of wages
- Payment of Income Tax.

Investing Activities

Includes purchase & sale of long term assets & investments other than Cash equivalents.

Cash Inflow
- Sale of Fixed Assets
- Sale of Investments
- Interest received
- Dividend received

Cash Outflow
- Purchase of Fixed Assets
- Purchase of Investments

Financing Activities

Activities which results in change in size & composition of Capital & Borrowings.

Cash Inflow
- Issue of Shares
- Issue of Debentures
- Proceeds from long term/ short term loans/borrowings

Cash Outflow
- Repayment of loans
- Redemption of shares/ debentures
- Dividend Paid on equity & Preference shares
- Interest paid on loans & debentures

Cash funds Includes :-
1. Cash in Hand.
2. Cash at Bank.
3. Cash Equivalents – It is short term Highly liquid investments, readily convertible in cash.

→ **Income Tax Payment** :-

- If nature of Tax is not specified then it is assumed that tax is paid on income generated from operating Activity.
- If it is practicable to separate the tax payment among different activities then it should be separated & presented under respective activity like operating, Investing & financing Activity.

→ **Extra ordinary Items** :-

Should be disclosed separately under appropriate activity based on nature of cash flow.

Example :-

Cash received against insurance claim is treated as Cash flow from operating activity but if cash is received against insurance claim for loss of asset is shown in investing Activity.

Lets Understand Direct & Indirect Method for presenting cash flow from operating Activity

Dr. **Trading & P&L A/c (combined)** Cr.

To Opening stock	Nil	By Sales Cash Sales 50,00,000 Credit Sales 30,00,000	80,00,000
To Purchases Cash 29,00,000 Credit 30,00,000	59,00,000	By closing stock	5,00,000
To Expenses Cash 5,00,000 Credit 6,00,000	11,00,000	By Interest on Investment	2,00,000
To Depreciation	4,00,000		
To Interest on loan	1,00,000		
To Net Profit	21,00,000		
	87,00,000		87,00,000

Direct Method		Indirect Method	
i) Cash Flow from Operating Activities		i) Cash Flow from operating Activities	
A) Operating Cash Receipts	xxx	A] Net profit as per P&L A/c or difference between opening & closing Balance of P&L A/c	xxx
—	xxx	Add :- Transfer to Reserve	xxx
—	xxx	Proposed Dividend for current year	xxx
B) less :- Operating Cash Payments	xxx	Provision for Tax made during year	xxx
—	xxx	Net Profit before taxation & extra ordinary items	
—	xxx	B] Adjustments for Non cash Items & Non operating items	
C) Cash generated from operation (A B)	xxx	Add :→ Depreciation	
D) less :→ Income Tax Paid (Net of Refund)	xxx	Preliminary exp	
E) Cash flow before extra-ordinary items	xxx	Int on Borrowings	
Add / less : cash flow from extra-ordinary items	xxx	loss on sale of fixed assets	
Net Cash Flow from operating Activity	xxx	Discount on issue of shares & debentures written off.	
ii) Cash Flow From Investing Activity [Cash Inflows]	xxx	less :- Interest income received	
less : [cash outflow]			
Net cash flow from Investing Activity			
iii) Cash Flow From financing Activity			
Add :→ [Cash Inflows]			
less :→ [cash outflows]			
Net Cash Flow from financing Activity			

iv) Net Increase/Decrease in Cash & Cash equivalents (i + ii + iii) xxx

v) Add :- Cash & Cash equivalent in the beginning of year xxx

vi) Cash & Cash equivalents at the end of year xxx

↓

Operating Activity under direct method only considers Cash Items

---

Common A/cs Required to be prepared as working Note under Direct Method

① Debtors A/c (To find out receipts from Debtors)

To Bal. b/d	xxx	By Cash* (collection)	xxx
To sale (credit)	xxx	By Balance c/d	xxx

② Creditors A/c (To find out payment to creditors)

Dr | | | Cr
To Cash*	xxx	By Balance	xxx
To Balance c/d	xxx	By Purchase (credit)	xxx

Dividend income received
Rental income received
Profit on sale of fixed Assets

Operating profits before working capital changes
Add:
Decrease in current Assets
Increase in current liabilities
less:
Increase in current Assets
Decrease in current liabilities

Cash Generated from operations
less: Income Tax paid (Net of Refund)

Cash flow from operation before extra ordinary items.
(+/-) Cash flow from extra ordinary items

Cash flow from Operating Activity xx

(Further format is same as Direct Method)

↓

Operating Activity under Indirect method considers items related to P&L A/c which are non cash & non operating which is reversed.

Note :- If nothing specified whole sale & purchase is treated as on credit

* Item marked with * are balancing figure / required figures

A/cs which may be required to be prepared under Direct Method

Provision for Tax A/c / Income Tax Payable A/c
(To find out Tax Paid)

To Bank * (Tax paid)	xxx	By Balance b/d	xxx
To Bal. c/d	xxx	By P&L A/c (Provision created this year)	xxx

Outstanding Expenses A/c
(To find out specific expenses paid)

To Bank * (Paid in current year)	xx	By Balance b/d	xxx
To Balance c/d	xxx	By expense (for current year)	
	xxx		xxx

Main focus :-> (Direct method)
Only Cash items

(5)

A/cs which may be required to be prepared under Indirect Method

Asset A/c
(To find out Depreciation or profit or loss on sale of asset or loss on or sale & Purchase of Asset)

To Balance b/d	By Bank * (sale)
To Bank * (Purchase)	By Depreciation *
To P&L A/c * (profit on sale)	By Balance c/d
~~To Bank~~	

Provision for Tax A/c / Income Tax Payable A/c
(To find out tax paid or provision for tax created in current year)

Dr. Cr.

To Bank * (Tax Paid)	By Balance b/d
To Balance c/d	By P&L A/c * (Provision created)
	Σ

Main focus:- (Indirect method)
Cash Items + P&L A/c items for reversal

Question 1

From the following Balance Sheet and information, prepare Cash Flow Statement of Ryan Ltd. for the year ended 31st March, 2015:

Balance Sheet

Liabilities	31st March, 2015 (₹)	31st March, 2014 (₹)
Equity Share Capital	6,00,000	5,00,000
10% Redeemable Preference Share Capital	-	2,00,000
Capital Redemption Reserve	1,00,000	-
Capital Reserve	1,00,000	-
General Reserve	1,00,000	2,50,000
Profit and Loss Account	70,000	50,000
9% Debentures	2,00,000	-
Trade payables	1,15,000	1,10,000
Liabilities for Expenses	30,000	20,000
Provision for Taxation	95,000	60,000
Dividend payable	90,000	60,000
	15,00,000	12,50,000
Assets	**31st March, 2015 (₹)**	**31st March, 2014 (₹)**
Land and Building	1,50,000	2,00,000
Plant and Machinery	7,65,000	5,00,000
Investments	50,000	80,000
Inventory	95,000	90,000
Trade receivables	2,50,000	2,25,000
Cash and Bank	65,000	90,000
Voluntary Separation Payments	1,25,000	65,000
	15,00,000	12,50,000

Additional Information:

1. A piece of land has been sold out for ₹ 1, 50,000 (Cost - ₹ 1, 20,000) and the balance land was revalued. Capital Reserve consisted of profit on sale and profit on revaluation.
2. On 1st April, 2014 a plant was sold for ₹ 90,000 (Original Cost - ₹ 70,000 and W.D.V. -₹ 50,000) and Debentures worth ₹ 1 lakh was issued at par as part consideration for plant of ₹ 4.5 lakhs acquired.
3. Part of the investments (Cost - ₹ 50,000) was sold for ₹ 70,000.
4. Pre-acquisition dividend received ₹ 5,000 was adjusted against cost of investment.
5. Directors have declared 15% dividend for the current year.
6. Voluntary separation cost of ₹ 50,000 was adjusted against General Reserve.
7. Income-tax liability for the current year was estimated at ₹ 1,35,000.
8. Depreciation @ 15% has been written off from Plant account but no depreciation has been charged on Land and Building.

Answer

Cash Flow Statement of Ryan Limited For the year ended 31st March, 2015

Cash flow from operating activities	₹	₹
Net Profit before taxation	2,45,000	
Adjustment for		
Depreciation	1,35,000	
Profit on sale of plant	(40,000)	
Profit on sale of investments	(20,000)	
Interest on debentures	18,000	
Operating profit before working capital changes	3,38,000	
Increase in inventory	(5,000)	
Increase in trade receivables	(25,000)	
Increase in Trade payables	5,000	
Increase in accrued liabilities	10,000	
Cash generated from operations	3,23,000	
Income taxes paid	(1,00,000)	
	2,23,000	
Voluntary separation payments	(1,10,000)	
Net cash generated from operating activities		1,13,000
Cash flow from investing activities		
Proceeds from sale of land	1,50,000	
Proceeds from sale of plant	90,000	
Proceeds from sale of investments	70,000	
Purchase of plant	(3,50,000)	
Purchase of investments	(25,000)	
Pre-acquisition dividend received	5,000	
Net cash used in investing activities		(60,000)
Cash flow from financing activities		
Proceeds from issue of equity shares	1,00,000	
Proceeds from issue of debentures	1,00,000	
Redemption of preference shares	(2,00,000)	
Dividends paid	(60,000)	
Interest paid on debentures	(18,000)	
Net cash used in financing activities		(78,000)
Net decrease in cash and cash equivalents		(25,000)
Cash and cash equivalents at the beginning of the year		90,000
Cash and Cash equivalents at the end of the year		65,000

Working Notes:

1.

	₹
Net profit before taxation	
Retained profit	70,000
Less: Balance as on 31.3.2014	(50,000)
	20,000
Provision for taxation	1,35,000
Dividend payable	90,000
	2,45,000

2. Land and Building Account

	₹		₹
To Balance b/d	2,00,000	By Cash (Sale)	1,50,000
To Capital reserve (Profit on sale)	30,000	By Balance c/d	1,50,000
To Capital reserve (Revaluation profit)	70,000		
	3,00,000		**3,00,000**

3. Plant and Machinery Account

	₹		₹
To Balance b/d	5,00,000	By Cash (Sale)	90,000
To Profit and loss account	40,000	By Depreciation	1,35,000
To Debentures	1,00,000	By Balance c/d	7,65,000
To Bank	3,50,000		
	9,90,000		9,90,000

4. Investments Account

	₹		₹
To Balance b/d	80,000	By Cash (Sale)	70,000
To Profit and loss account	20,000	By Dividend	
To Bank (Balancing figure)	25,000	(Pre-acquisition)	5,000
		By Balance c/d	50,000
	1,25,000		1,25,000

5. Capital Reserve Account

	₹		₹
To Balance c/d	1,00,000	By Profit on sale of land	30,000
		By Profit on revaluation of land	70,000
	1,00,000		1,00,000

6. General Reserve Account

	₹		₹
To Voluntary separation cost	50,000	By Balance b/d	2,50,000
To Capital redemption reserve	1,00,000		
To Balance c/d	1,00,000		
	2,50,000		2,50,000

7. Dividend payable Account

	₹		₹
To Bank (Balancing figure)	60,000	By Balance b/d	60,000
To Balance c/d	90,000	By Profit and loss account	90,000
	1,50,000		1,50,000

8. Provision for Taxation Account

	₹		₹
To Bank (Balancing figure)	1,00,000	By Balance b/d	60,000
To Balance c/d	95,000	By Profit and loss account	1,35,000
	1,95,000		1,95,000

2. Voluntary Separation Payments Account

	₹		₹
To Balance b/d	65,000	By General reserve	50,000
To Bank (Balancing figure)	1,10,000	By Balance c/d	1,25,000
	1,75,000		1,75,000

Note: Cash Flow Statement has been prepared using 'indirect method'.

Question 2

From the following information, prepare a Cash Flow Statement as per AS 3 for Banjara Ltd., using direct method:

Balance Sheet as on March 31, 2010

Assets:	2010 (₹ '000)	2009 (₹ '000)
Cash on hand and balances with bank	200	25
Marketable securities (having one month maturity)	670	135
Sundry debtors	1,700	1,200
Interest receivable	100	-
Inventories	900	1,950
Investments	2,500	2,500
Fixed assets at cost	2,180	1,910
Accumulated depreciation	(1,450)	(1,060)
Fixed assets (net)	730	850
Total assets	6,800	6,660

Liabilities:		
Sundry creditors	150	1,890
Interest payable	230	100
Income tax payable	400	1,000
Long term debt	1,110	1,040
Total liabilities	1,890	4,030
Shareholder' s fund:		
Share capital	1,500	1,250
Reserves	3,410	1,380
	4,910	2,630
Total liabilities and shareholder's ₹ fund	**6,800**	**6,660**

Statement of Profit or Loss for the year ended 31-3-10

Particulars	**₹ (000)**
Sales	30,650
Cost of sales	(26,000)
Gross profit	4,650
Depreciation	(450)
Administrative and selling expenses	(910)
Interest expenses	(400)
Interest income	300
Dividend income	200
Net profit before taxation and extraordinary items	3,390
Extraordinary items:	
Insurance proceeds from earthquake disaster settlement	140
Net profit after extraordinary items	3,530
Income tax	(300)
	3,230

Additional information:

1. An amount of ₹ 250 was raised from the issue of share capital and a further ₹ 250 was raised from long-term borrowings.
2. Interest expense was ₹ 400 of which ₹ 170 was paid during the period ₹ 100 relating to interest expense of the prior period was also paid during the period.
3. Dividends paid were ₹ 1,200.
4. Tax deducted at source on dividends received (including in the tax expense of ₹ 300 for the year) amounted to ₹ 40.
5. During the period the enterprise acquired fixed assets for ₹ 350. The payment was made in cash.
6. Plant with original cost of ₹ 80 and accumulated depreciation of ₹ 60 was sold for ₹ 20.
7. Sundry debtors and Sundry creditors include amounts relating to credit sales and credit purchase only.

Answer

Cash Flow Statement (direct method)

Particulars	**₹**	**₹**
Cash flows from Operating Activities		
Cash receipts from customers (W.N.2)	30,150	
Cash paid to suppliers, employees and for expenses (W.N.3)	(27,600)	
Cash generated from operations	2,550	
Income tax paid (W.N.4)	(860)	
	1,690	
Cash flow before extraordinary item:		
proceeds from earthquake disaster settlement	140	
Net cash from operating activities		1,830
Cash flows from Investing Activities		
Purchase of fixed assets	(350)	
Proceeds from sale of equipment	20	
Interest received (300 - 100)	200	
Dividends received (200 - 40)	160	
Net cash from investing activities		30
Cash flows from Financing Activities		
Proceeds from issuance of share capital	250	
Proceeds from long term borrowings	250	
Repayment of long term borrowings (W.N.5)	(180)	
Interest paid (W.N.6)	(270)	
Dividends paid	(1,200)	
Net cash used in financial activities		(1,150)
Net increase in cash and cash equivalents		710
Cash and cash equivalents at beginning of the period (W.N.1)		160
Cash and cash equivalents at end of the period (W.N.1)		870

Working Notes:

(1) Cash and cash equivalents

Cash and cash equivalents consist of cash in hand and balance with banks and investments in money market instruments for short period.

		₹'000
	2010	**2009**
Cash in hand and balance with bank	200	25
Short-term investments	670	135
Cash and cash equivalents	870	160

(2) **Cash receipts from customers**

	₹'000
Total sales	30,650
Add: Sundry debtors at the beginning of the year	1,200
	31,850
Less: Sundry debtors at the end of the year	(1,700)
Cash sales	30,150

(3) Cash paid to suppliers, employees and for expenses

	₹'000	
Cost of sales		26,000
Administrative and selling expenses		910
		26,910
Add: Sundry creditors at the beginning of the year	1,890	
Inventories at the end of year	900	2,790
		29,700
Less: Sundry creditors at the end of year	(150)	
Inventories at the beginning of the year	(1,950)	(2,100)
		27,600

(4) Income tax paid (including TDS from dividends received)

	₹'000
Income tax expense for the year	300
(including tax deducted at source from dividends received)	
Add: Income tax liability at the beginning of the year	1,000
	1,300
Less: Income tax liability at the end of the year	(400)
	900

Out of ₹900 thousands, tax deducted at source on dividends received (amounting to ₹40 thousands) is included in cash flows from investing activities and the balance of ₹860 thousands is included in cash flows from operating activities.

(5) Repayment of long term borrowings during the year

	₹'000
Long term debts at the beginning of the year	1,040
Add: Long term borrowings made during the year	250
	1,290
Less: Long term borrowings at the end of the year	(1,110)
	180

(6) Interest paid during the year

	₹ '000
Interest expense for the year	400
Add: Interest payable at the beginning of the year	100
	500
Less: Interest payable at the end of the year	(230)
	270

Profit or loss Pre & Post Incorporation

Incorporation Date

- Pre-incorporation
  - If Profit → Capital Reserve
  - If loss → Treated as Goodwill
- Post Incorporation
  - Profit → P&L A/c
  - loss → P&L A/c

→ To find out Pre & Post incorporation profit separately, we need to divide Gross profit, common expenses / Income between Pre & Post incorporation.

* Procedure :→

Step I :→ Find out Gross Profit

* Options

1. Prepare Trading A/c [No need to divide items between pre & post while preparing trading A/c]
2. Sales x G.P. Ratio
3. Net Profit + All expenses related to P&L A/c (−) All income related to P&L A/c.

Step II :→ Prepare statement of P&L or P&L A/c depending on information given in problem.

Step III :→ Calculate G.P ratio if instructions for G.P. for pre & post given in problem But if Instructions are not given then sales ratio is treated as G.P. ratio

* Divide G.P. , calculated in Step II & divide it in G.P. ratio / Sales ratio.

Step IV :→ Expenses of P&L A/c

Divide it in Pre & Post incorporation by using Ratio's.

① Sale Ratio :→ for expenses connected with sales like Bad debts, Discount, Advertisement (unless contract is fixed on time basis), Commission, Travelling expenses, Audit fees (if nothing is specified then it is treated as Tax audit fees), Carriage outward.

② Time Ratio :→ for Time based expenses like Salaries, Rent, rate & Taxes, Insurance, depreciation, office & administration expenses, Printing & stationery, Misc. exp.

③ Expenses specifically Related to Pre-Incorporation :→ Partners salary, Interest on capital.

* If interest is payable on consideration due to vendor of business then it shall be allocated on the basis of period upto payment date.

④ Expenses specifically related to Post-Incorporation :→ Interest on Debentures, Directors fees, Preliminary expenses (Incorporation expenses), Audit fees (if specified in problem as company audit)

<u>Note</u> :→ Period of statement of P&L or P&L A/c may be 12 months or 15 months (Refer problem in exam)

Question No. 1

The partners of Shri Enterprises decided to convert the partnership firm into a Private Limited Company Shreya (P) Ltd. with effect from 1st January, 2018. However, company could be incorporated only on 1st June, 2018. The business was continued on behalf of the company and the consideration of ₹ 6,00,000 was settled on that day along with interest @ 12% per annum. The company availed loan of ₹ 9,00,000 @ 10% per annum on 1st June, 2018 to pay purchase consideration and for working capital. The company closed its accounts for the first time on 31st March, 2019 and presents you the following summarized profit and loss account:

	₹	₹
Sales		19,80,000
Cost of goods sold	11,88,000	
Discount to dealers	46,200	
Directors' remuneration	60,000	
Salaries	90,000	
Rent	1,35,000	
Interest	1,05,000	
Depreciation	30,000	
Office expenses	1,05,000	
Sales promotion expenses	33,000	
Preliminary expenses (to be written off in first year itself)	15,000	18,07,200
Profit		1,72,800

Sales from June, 2018 to December, 2018 were 2½ times of the average sales, which further increased to 3½ times in January to March quarter, 2019. The company recruited additional work force to expand the business. The salaries from July, 2018 doubled. The company also acquired additional showroom at monthly rent of ₹ 10,000 from July, 2018.

You are required to prepare a Profit and Loss Account showing apportionment of cost and revenue between pre-incorporation and post-incorporation periods.

Answer

Shreya (P) Limited

Profit and Loss Accountfor 15 months ended 31st March, 2019

	Pre. inc. (5 months) (₹)	Post inc. (10 months) (₹)		Pre. inc. (5 months) (₹)	Post inc. (10 months) (₹)
To Cost of sales	1,80,000	10,08,000	By Sales	3,00,000	16,80,000
To Gross profit	1,20,000	6,72,000	(W.N.1)		
	3,00,000	16,80,000		3,00,000	16,80,000
To Discount to dealers	7,000	39,200	By Gross profit	1,20,000	6,72,000
To Directors' remuneration	-	60,000	By Loss	750	
To Salaries (W.N.2)	18,750	71,250			
To Rent (W.N.3)	15,000	1,20,000			
To Interest (W.N.4)	30,000	75,000			
To Depreciation	10,000	20,000			
To Office expenses	35,000	70,000			
To Preliminary expenses	-	15,000			
To Sales promotion expenses	5,000	28,000			
To Net profit	-	1,73,550			
	1,20,750	6,72,000		1,20,750	6,72,000

Working Notes:

1. **Calculation of sales ratio:**

   Let the average sales per month in pre-incorporation period be x

   Average Sales (Pre-incorporation) = x X 5 = 5x

   Sales (Post incorporation) from June to December, 2018 = 2½ x X 7 = 17.5x

   From January to March, 2019 = 3½ x X 3 = 10.5x

   Total Sales 28.0x

   Sales ratio of pre-incorporation & post incorporation is 5x : 28x

2. **Calculation of ratio for salaries**

   Let the average salary be x

   Pre-incorporation salary = x X 5= 5x Post

   incorporation salary

   June, 2018 = x

   July 18 to March, 2019 = x X 9 X 2 = 18x

   19x

   Ratio is 5 : 19

3. **Calculation of Rent**

			₹
Total rent			1,35,000
Less: Additional rent for 9 months @ ₹ 10,000 p.m.			90,000
Rent of old premises apportioned in time ratio			45,000
Apportionment	Pre Inc.	Post Inc.	
Old premises rent	15,000	30,000	
Additional Rent	—	90,000	
	15,000	1,20,000	

1. **Calculation of interest**

Pre-incorporation period from January, 2018 to May, 2018

$$\left[\frac{6,00,000 \times 12 \times 5}{}\right] = ₹\ 30,000$$

Post incorporation period from June, 2018 to March, 2019

$$\left[\frac{9,00,000 \times 10 \times 10}{100 \times 12}\right] = ₹\ 75,000$$

$$= ₹\ 1,05,000$$

Bonus ISSUE.

Bonus issue means a issue of free additional shares to existing shareholders

* Partly paid up shares can be made fully paid up through Bonus.

Following can be used to issue Bonus shares

① Capital Redemption Reserve (CRR)
② Securities premium Account (Only if realised in cash)
③ Capital Reserves (only if realised in cash)
④ General reserves & other free reserves
⑤ Profit & loss A/c

(Revaluation reserves & statutory reserves shall not be used for Bonus issue)

Journal Entries

When Bonus shares are Issued

→ Capitalisation of profit

C.R.R. A/c —— Dr
Securities Premium A/c — Dr
Capital Reserve A/c — Dr
General Reserve A/c — Dr
P&L A/c — Dr
Other Reserves A/c — Dr
To Bonus to shareholders A/c

→ When Bonus shares are actually issued :-

Bonus to shareholders A/c - Dr
To Equity share capital A/c.

When Partly paid up shares made fully paid up through Bonus.

→ When final call made

Eq. share final call A/c — Dr
To Eq. share capital A/c

→ Same

→ Bonus to shareholders — Dr
To Eq. share final call A/c

Redemption of Preference Shares. (7)

Conditions for redemption

1. Preference shares must be fully paid up before redemption (If partly paid up then it should be made fully paid up or forfeited before redemption).
2. Pref. shares can be redeemed out of
   a. profits available for Dividend
   b.
3. If shares are redeemed out of profit.

   Transfer to C.R.R = Nominal value of shares redeemed
   (−) Nominal value of shares issued

4. Premium payable shall be provided from securities premium A/c or out of profits.
5. C.R.R. available for Bonus shares

No of shares to be issued

When profit is insufficient

Nominal value of Pref. Shares	xxx
(−) maximum possible redemption out of profit	xxx
Deficiency	xxx

$\frac{\text{Deficiency}}{\text{Price per share}}$: No. of shares

F.V.	✓10	10	✓10
I.P.	10	✓9	12

] Price per share to be taken

When funds are insufficient

Amt. Payable to Pref Shareholders	
Face value	xxx
(+) Premium Payable	xxx
Amt. Payable	xxx
(−) Sale of Investment	xxx
(−) Available Bank Balance	xxx
Deficiency	xxx

$\frac{\text{Deficiency}}{\text{Price per share}}$

F.V.	✓10	10	10
I.P.	10	✓9	✓12

] Price per share to be taken

Journal Entries for Redemption

→ Amount payable on Redemption

Redeemable Pref. share capital A/c — Dr
Premium on redemption of pref. share A/c - Dr
To Preference shareholders A/c

→ Payment Made :-

Preference shareholders A/c -- Dr
To Bank A/c

→ Adjustment of Premium

Securities premium A/c - Dr
General Reserve/ P&L A/c - Dr
To Premium payable on redemption A/c

→ Transfer to C.R.R.

General Reserve / P&L A/c - Dr
To C.R.R A/c.

Question No. 1

The following is the summarized Balance Sheet of Bumbum Limited as at 31st March, 2019:

	₹
Sources of funds	
Authorized capital	
50,000 Equity shares of ₹ 10 each	5,00,000
10,000 Preference shares of ₹ 100 each (8% redeemable)	10,00,000
	15,00,000
Issued, subscribed and paid up	
30,000 Equity shares of ₹ 10 each	3,00,000
5,000, 8% Redeemable Preference shares of ₹ 100 each	5,00,000
Reserves & Surplus	
Securities Premium	6,00,000
General Reserve	6,50,000
Profit & Loss A/c	40,000
Trade payables	4,20,000
	25,10,000
Application of funds	
Property, Plant & Equipment (net)	7,80,000
Investments (market value ₹ 5,80,000)	4,90,000
Deferred Tax Assets	3,40,000
Trade receivables	6,20,000
Cash & Bank balance	2,80,000
	25,10,000

In Annual General Meeting held on 20th June, 2019 the company passed the following resolutions:

(i) To split equity share of ₹ 10 each into 5 equity shares of ₹ 2 each from 1st July, 2019.

(ii) To redeem 8% preference shares at a premium of 5%.

(iii) To issue fully paid bonus shares in the ratio of one equity share for every 3 shares held on record date.

On 10th July, 2019 investments were sold for ₹ 5,55,000 and preference shares were redeemed.

The bonus issue was concluded by 12th September, 2019

You are requested to journalize the above transactions including cash transactions and prepare Balance Sheet as at 30th September, 2019. All working notes should form part of your answer.

Bumbum Limited

Journal Entries

2019		Dr. (₹)	Cr. (₹)
July 1	Equity Share Capital A/c (₹ 10 each) Dr.	3,00,000	
	To Equity share capital A/c (₹ 2 each)		3,00,000
	(Being equity share of ₹ 10 each splitted into 5 equity shares of ₹ 2 each) {1,50,000 X 2}		
July 10	Cash & Bank balance A/c Dr.	5,55,000	
	To Investment A/c To Profit &		4,90,000
	Loss A/c		65,000
	(Being investment sold out and profit on sale credited to Profit & Loss A/c)		
July 10	8% Redeemable preference share capital A/c Dr.	5,00,000	
	Premium on redemption of preference share A/c Dr.	25,000	
	To Preference shareholders A/c		5,25,000
	(Being amount payable to preference share holders on redemption)		
July 10	Preference shareholders A/c To Dr.	5,25,000	
	Cash & bank A/c		5,25,000
	(Being amount paid to preference shareholders)		
July 10	General reserve A/c Dr.	5,00,000	
	To Capital redemption reserve A/c		5,00,000
	(Being amount equal to nominal value of preference shares transferred to Capital Redemption Reserve A/c on its redemption as per the law)		
Sept. 12	Capital Redemption Reserve A/c Dr.	1,00,000	
	To Bonus to shareholders A/c		1,00,000
	(Being balance in capital redemption reserve capitalized to issue bonus shares)		
Sept. 12	Bonus to shareholders A/c Dr.	1,00,000	
	To Equity share capital A/c		1,00,000
	(Being 50,000 fully paid equity shares of ₹ 2 each issued as bonus in ratio of 1 share for every 3 shares held)		
Sept. 30	Securities Premium A/c Dr.	25,000	
	To Premium on redemption of preference shares A/c		25,000
	(Being premium on preference shares adjusted from securities premium account)		

Balance Sheet as at 30th September, 2019

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	4,00,000
	b	Reserves and Surplus	2	12,30,000
2		**Current liabilities**		
	a	Trade Payables		4,20,000
		Total		**20,50,000**
		Assets		
1		**Non-current assets**		
	a	Property, Plant and Equipment		7,80,000
	b	Deferred tax asset		3,40,000
2		**Current assets**		
		Trade receivables		6,20,000
		Cash and cash equivalents		3,10,000
		Total		**20,50,000**

Notes to accounts

1	**Share Capital**	₹	₹
	Authorized share capital		
	2,50,000 Equity shares of ₹ 2 each	5,00,000	
	10,000 8% Preference shares of ₹100 each	10,00,000	15,00,000
	Issued, subscribed and paid up		4,00,000
	2,00,000 Equity shares of ₹ 2 each		
2	Reserves and Surplus		
	Securities Premium A/c		
	Balance as per balance sheet	6,00,000	
	Less: Adjustment for premium on preference Shares	(25,000)	
	Balance		5,75,000
	Capital Redemption Reserve (5,00,000 -1,00,000)		4,00,000
	General Reserve (6,50,000 – 5,00,000) Profit & Loss A/c		1,50,000
	Add: Profit on sale of investment	40,000	
		65,000	1,05,000
	Total		12,30,000

Working Notes:

	₹
1. **Redemption of preference share:**	
5,000 Preference shares of ₹ 100 each	5,00,000
Premium on redemption @ 5%	25,000
Amount Payable	5,25,000
2. **Issue of Bonus Shares**	
Existing equity shares after split (30,000 x 5)	1,50,000 shares
Bonus shares (1 share for every 3 shares held) to be issued	50,000 shares
3. **Cash and Bank Balance**	
Balance as per balance sheet	2,80,000
Add: Realization on sale of investment	5,55,000
	8,35,000
Less: Paid to preference share holders	(5,25,000)
Balance	3,10,000

Question No. 2

Following is the extract of the Balance Sheet of Xeta Ltd. as at 31st March, 2017

	₹
Authorised capital:	
50,000 12% Preference shares of ₹ 10 each	5,00,000
4,00,000 Equity shares of ₹ 10 each	40,00,000
	45,00,000
Issued and Subscribed capital:	
24,000 12% Preference shares of ₹ 10 each fully paid	2,40,000
2,70,000 Equity shares of ₹ 10 each, ₹ 8 paid up	21,60,000
Reserves and surplus:	
General Reserve	3,60,000
Securities premium	1,00,000
Profit and Loss Account	6,00,000

On 1st April, 2017, the Company has made final call @ ₹ 2 each on 2,70,000 equity shares. The call money was received by 20th April, 2017. Thereafter, the company decided to capitalize its reserves by way of bonus at the rate of one share for every four shares held.

Show necessary journal entries in the books of the company and prepare the extract of the balance sheet as on 30th April, 2017 after bonus issue.

Answer

Journal Entries in the books of Xeta Ltd.

			₹	₹
1-4-2017	Equity share final call A/c	Dr.	5,40,000	
	To Equity share capital A/c			5,40,000
	(For final calls of ₹ 2 per share on 2,70,000 equity shares due as per Board's Resolution dated....)			
20-4-2017	Bank A/c	Dr.	5,40,000	
	To Equity share final call A/c			5,40,000
	(For final call money on 2,70,000 equity shares received)			
	Securities Premium A/c	Dr.	1,00,000	
	General Reserve A/c Profit	Dr.	3,60,000	
	and Loss A/c	Dr.	2,15,000	
	To Bonus to shareholders A/c			6,75,000
	(For making provision for bonus issue of one share for every four shares held)			
	Bonus to shareholders A/c	Dr.	6,75,000	
	To Equity share capital A/c			6,75,000
	(For issue of bonus shares)			

Extract of Balance Sheet as at 30th April, 2017 (after bonus issue)

	₹
Authorised Capital	
50,000 12% Preference shares of ₹10 each	5,00,000
4,00,000 Equity shares of ₹10 each	40,00,000
Issued and subscribed capital	
24,000 12% Preference shares of ₹ 10 each, fully paid	2,40,000
3,37,500 Equity shares of ₹10 each, fully paid	33,75,000
(Out of above, 67,500 equity shares @ ₹10 each were issued by way of bonus)	
Reserves and surplus	
Profit and Loss Account	3,85,000

Question No. 3

Following items appear in the Trial Balance of Hello Ltd. as on 31st March, 2017:

Particulars	Amount
9,000 Equity Shares of ₹100 each	9,00,000
Securities Premium	80,000
Capital Redemption Reserve	1,40,000
General Reserve	2,10,000
Profit and Loss Account (Cr. Balance)	90,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 3 shares held. Company decided that there should be the minimum reduction in free reserves. Pass necessary Journal Entries in the books Hello Ltd.

Answer

Capital Redemption Reserve A/c	Dr.	1,40,000	
Securities Premium A/c	Dr.	80,000	
General Reserve A/c	Dr.	80,000	
To Bonus to Shareholders			3,00,000

(Being issue of bonus shares by utilization of various Reserves, as per resolution dated …….)

Bonus to Shareholders A/c	Dr.	3,00,000	
To Equity Share Capital			3,00,000

(Being capitalization of Profit)

Managerial Remuneration

(Section 197 of Companies Act, 2013)
(Also schedule V under the Companies Act, 2013)

Situation 1
Where profit of company is sufficient
↓
Limits of Managerial remuneration for financial year is based on % of profit

Situation 2
Where profit of company is insufficient or in case of loss
↓
Limits of Managerial remuneration for financial year is based on Effective capital.

Situation 1

Total Managerial remuneration is 11% (Including M.D., WTD, Manager)
(It can be increased in General Meeting with approval of central government)

→ Break up of limits :-

(A) Any one M.D., W.T.D. or manager :- 5% of Net Profit
(B) More than One of above Directors (M.D. + W.T.D.) :- 10% of Net Profit
(C) Director who is not M.D. nor W.T.D.
 i) If there is M.D., W.T.D. or manager :- 1% of Net Profit
 ii) in other case : 3% of Net Profit

* Net Profit for this purpose shall be computed as per rules given in section 198 except remuneration of director shall not be deducted

(2)

Situation 2 :→ Where profit is insufficient or in case of losses

Limits for financial year :→

Effective capital	Yearly Limits
i) Negative or less than 5 crores	60 lakhs
ii) 5 crores & Above but less than 100 crores	84 lakhs
iii) 100 crores & Above but less than 250 crores	120 lakhs
iv) 250 crores & Above	120 lakhs + 0.01% of effective capital in excess of 250 crores effective capital.

* Above limits can be doubled by special resolution in general meeting.
* If period is less than 1 year then limits should be pro-rated.

→ Perquisites not included in Managerial Remuneration

1. Contribution to P.F., Superannuation fund or annuity fund to the extent not taxable
2. Gratuity payable not exceeding half months salary for each completed year of service.
3. encashment of leave at the end of tenure
4. Children education allowance - max. 12000 per month per child or actual expenditure whichever is less

Effective Capital Means :→

Paid up share capital (excluding share appl. money & Advance against share)	xxxx
(+) Securities premium A/c, Reserves & surplus (excluding revaluation reserve)	xxx
(+) long term loans and deposits repayable after one year (excluding working capital loans, overdrafts & interest due)	xxx
(–) Investments	
(Not to be deducted if company is investment company)	xxx
(–) Accumulated losses & preliminary expenses not written off	xxx
Effective Capital	xxx

* When to Calculate Effective Capital *

↓

Appointment of managerial remuneration in the year of incorporation

↓

Calculate effective capital on the date of appointment

↓

In Any other Case

↓

Calculate effective Capital on the last date of preceding financial year in which managerial person is appointed

(4)

* Net Profit for the purpose of Managerial Remuneration (in situation 1)

Expenses (Dr)

Allowed for Deduction :->

1. Usual working charges
2. Bonus, commission to staff/employees & Directors fees
3. Interest on debentures
4. Interest on loans
5. Expenses on repairs
6. Depreciation as per Act
7. Compensation or damages for Breach of contract
8. Bad debts
9. Insurance premium
10. Additional Taxes (Not taxes on regular income) :-> Tax on Abnormal income, Tax imposed for special reason

Not allowed for Deduction :->

1. Income Tax
2. Any compensation / Damages paid voluntarily
3. loss of Capital Nature (loss on sale of Asset / Asset destroyed)

Incomes (Cr)

Allowed :->

- Subsidies received from Govt. & Public Authorities
- All revenue Incomes

Not Allowed :->

Capital Profits like :-

1. Securities premium
2. Profit on sale of forfeited share
3. Profit on sale of immovable property
4. Profit on revaluation of asset or liability at fair value

Dividend

- Declaration of dividend out of Reserves

Conditions as per Companies (Declaration of dividend out of Reserves) Rules.

Condition :-

1. Rate of dividend declared should not exceed the average of the rate at which dividend was declared by it in ~~ther~~ Three years immediately preceding that year.
2. Total amount withdrawn from reserves should not exceed 10% of paid up share capital + free reserves. (Equity + Pref.)
3. Balance of reserves after such withdrawal should not fall below 15% of its paid up capital

* The amount so drawn should first be utilised to set off the losses incurred in financial year in which dividend is declared.

Schedule III to the Companies Act

Part I – BALANCE SHEET

Particulars	Note No.	figures as at the end of current reporting period	figures as at the end of previous reporting period
EQUITY & LIABILITIES			
1. Shareholders funds			
a) Share capital			
b) Reserves & surplus			
c) Money received against share warrants			
2. Share application money pending allotment			
3. Non - current liabilities			
a. Long Term borrowings			
b. Deferred tax liabilities (Net)			
c. Other long term liabilities			
d. Long term provisions			
4. Current liabilities			
a. short term borrowings			
b. Trade payables			
(A) Total dues of Micro & small enterprises			
(B) Total dues of other than Micro & small enterprises.			
c. Other current liabilities			
d. short term provisions			
TOTAL			
Assets			
1. Non Current Assets			
a. fixed Assets			
i) Tangible Assets			
ii) Intangible Assets			
iii) Capital Work-in-Progress			
iv) Intangible assets under development			

b) Non current investments
c) Deferred Tax Assets (Net)
d) long term loans & Advances
e) other non current assets.

2. Current Assets
a) Current Investments
b) Inventories
c) Trade receivables
d) Cash & cash equivalents
e) Short term loans & Advances
f) other current Assets.

TOTAL

* Asset shall be treated as current if :-
① it is expected to realized or consumed within normal operating cycle
② it is expected to be realised within 12 months after reporting date.

* liability shall be treated as current if :-
It is due to settled within 12 months after reporting date

Points to Remember for Notes to Accounts

① Share Capital
Specify Authorised & Issued, subscribed & called up with number & value separately for Equity as well as Preference share capital ~~separately~~
(Specify note for shares which have been issued for consideration other than cash)
Deduct calls in arrears if any to find out paid up capital

② Reserves & Surplus

Show each & every reserve (Capital or Revenue) Separately

Reserve specifically represented by earmarked investments shall be termed as "fund"

Debit Balance of P&L A/c (if any) shall be shown as negative figure. If after adjustment balance of reserves & surplus, if there is negative balance still it is to be shown under Reserves & surplus.

* Balance to Preliminary expenses & other fictitious assets shall be adjusted from Reserves & Surplus

③ Long Term Borrowings

Secured :→ (Specify nature of hypothecation / mortgage for each loan)

Unsecured :→

Bank loan	xxx
loan from related Parties	xxx
others	xxx

* Above categories to be specified separately

If above loan includes portion which is repayable within 12 months then such portion to be shown in other current liabilities & not under this heading.

④ Long Term Provisions

ⓐ Provision for employees benefits

ⓑ Others (specify)

Tangible Assets :->

(Specify for every Asset as follows)

eg. Building xxx (original cost)

less:-> Depreciation xxx (Accumulated Dep.)

Trade Receivables

(Specify separately)

- Debts outstanding for a period exceeding six months
- Other Debts

Cash & Cash Equivalents :->

Shall be classified as

(a) Balances with Banks

(b) Cheques, drafts on hands

(c) Cash on hands

(d) Balances with other than scheduled Banks

- Earmaked balances with bank (e.g. unpaid divid

Question No. 1

The following extract of Balance Sheet of X Ltd. (a non-investment company) was obtained:

Balance Sheet (Extract) as on 31st March, 2019

Liabilities	₹
Authorised capital:	
15,000, 14% preference shares of ₹ 100	15,00,000
1,50,000 Equity shares of ₹ 100 each	1,50,00,000
	1,65,00,000
Issued and subscribed capital:	
15,000, 14% preference shares of ₹ 100 each fully paid	15,00,000
1,20,000 Equity shares of ₹ 100 each, ₹ 80 paid-up	96,00,000
Capital reserves (₹ 1,50,000 is revaluation reserve)	1,95,000
Securities premium	50,000
15% Debentures	65,00,000
Investment in shares, debentures, etc.	75,00,000
Profit and Loss account (debit balance)	15,25,000

You are required to compute Effective Capital as per the provisions of Schedule V to the Companies Act, 2013.

Answer

Computation of Effective Capital

		₹
Paid-up share capital-		
15,000, 14% Preference shares		15,00,000
1,20,000 Equity shares		96,00,000
Capital reserves (excluding revaluation reserve)		45,000
Securities premium		50,000
15% Debentures		65,00,000
	(A)	1,76,95,000
Investments		75,00,000
Profit and Loss account (Dr. balance)		15,25,000
	(B)	90,25,000
Effective capital	(A–B)	86,70,000

Question No. 2

The following extract of Balance Sheet of Gaurav Ltd. was obtained:

Balance Sheet (Extract) as on 31st March, 2018

Liabilities	₹
Authorised capital:	
90,000, 14% preference shares of ₹ 100	90,00,000
9,00,000 Equity shares of ₹100 each	9,00,00,000
	9,90,00,000
Issued and subscribed capital:	
67,500, 14% preference shares of ₹ 100 each fully paid	67,50,000
5,40,000 Equity shares of ₹ 100 each, ₹ 80 paid-up	4,32,00,000
Share suspense account	90,00,000
Reserves and surplus	
Capital reserves (₹ 6,75,000 is revaluation reserve)	8,77,500
Securities premium	2,25,000
Secured loans:	
15% Debentures	2,92,50,000
Unsecured loans:	
Public deposits	16,65,000
Cash credit loan from SBI (short term)	5,92,500
Current Liabilities:	
Trade Payables	15,52,500
Assets:	
Investment in shares, debentures, etc.	3,37,50,000
Profit and Loss account (Dr. balance)	68,62,500

Share suspense account represents application money received on shares, the allotment of which is not yet made. You are required to compute effective capital as per the provisions of Schedule V. Would your answer differ if Gaurav Ltd.is an investment company?

Answer

Computation of effective capital:

	Where Gaurav Ltd.is a non-investment company	*Where Gaurav Ltd.is is an investment company*
Paid-up share capital —		
67,500, 14% Preference shares	67,50,000	67,50,000
5,40,000 Equity shares	4,32,00,000	4,32,00,000
Capital reserves	2,02,500	2,02,500
Securities premium	2,25,000	2,25,000
15% Debentures	2,92,50,000	2,92,50,000
Public Deposits	16,65,000	16,65,000
(A)	8,12,92,500	8,12,92,500
Investments	3,37,50,000	-
Profit and Loss account (Dr. balance)	68,62,500	68,62,500
(B)	4,06,12,500	68,62,500
Effective capital (A–B)	4,06,80,000	7,44,30,000

Question No. 3

The following is the Draft Profit & Loss A/c of Harsha Ltd., the year ended 31st March, 20X1:

		₹			₹
To	Administrative, Selling and distribution expenses	41,12,710	By	Balance b/d	28,61,750
To	Directors fees	6,73,900	By	Balance from Trading A/c	201,26,825
To	Interest on debentures	1,56,200	By	Subsidies received from Govt.	13,69,625
To	Managerial remuneration	14,26,750			
To	Depreciation on PPE	26,12,715			
To	Provision for Taxation	62,12,500			
To	General Reserve	20,00,000			
To	Investment Revaluation Reserve	62,500			
To	Balance c/d	71,00,925			
		243,58,200			243,58,200

Depreciation on PPE as per Schedule II of the Companies Act, 2013 was ₹ 28,76,725. You are required to calculate the maximum limits of the managerial remuneration as per Companies Act, 2013.

Answer

Calculation of net profit u/s 198 of the Companies Act, 2013

	₹	₹
Balance from Trading A/c		201,26,825
Add: Subsidies received from Government		13,69,625
		214,96,450
Less: Administrative, selling and distribution expenses	41,12,710	
Director's fees		
Interest on debentures	6,73,900	
Depreciation on PPE as per	1,56,200	
Schedule II	28,76,725	(78,19,535)
Profit u/s 198		136,76,915

Maximum Managerial remuneration under Companies Act, 2013 = 11% of ₹ 136,76,915= ₹ 1504461.

(Master Problem)

Question No. 4

Girish Ltd. has the Authorised Capital of ₹ 10,00,000 consisting of 4,000 6% Preference shares of ₹ 100 each and 60,000 equity Shares of ₹10 each. The following was the Trial Balance of the Company as on 31st March , 2016

Particulars	Dr.	Cr.
Investment in Shares at cost	1,00,000	
Purchases	9,81,000	
Selling Expenses	1,58,200	
Inventory as at the beginning of the year	2,90,400	
Salaries and Wages	1,04,000	
Cash on Hand	24,000	
Interim Preference dividend for the half year to 30^{th} September	12,000	
Bills Receivable	83,000	

Interest on Bank overdraft	19,600	
Interest on Debentures upto 30th Sep (1st half year)	7,500	
Trade receivables and trade payables	1,00,200	1,75,700
Freehold property at cost	7,00,000	
Furniture at cost less depreciation of ₹ 30,000	70,000	
6% Preference share capital		4,00,000
Equity share capital fully paid up		4,00,000
5% mortgage debentures secured on freehold properties		3,00,000
Income tax paid in advance for the current year	20,000	
Dividends		8,500
Profit and Loss A/c (opening balance)		57,000
Sales (Net)		13,40,700
Bank overdraft secured by hypothecation of stocks and receivables		3,00,000
Technical knowhow fees at cost paid during the year	3,00,000	
Audit fees	12,000	
Total	29,81,900	29,81,900

You are required to **prepare the Profit and Loss Statement** for the year ended 31st March, 2016 and **the Balance Sheet** as on 31st March, 2016 as per Schedule III of the Companies Act, 2013 after taking into account the following -

1. Closing Stock was valued at ₹ 2,85,000.
2. Purchases include ₹ 10,000 worth of goods and articles distributed among valued customers.
3. Salaries and Wages include ₹ 4,000 being Wages incurred for installation of Electrical Fittings which were to be recorded under "Furniture".
4. Bills Receivable include ₹ 3,000 being dishonoured bills. 50% of which had been considered irrecoverable.
5. Bills Receivable of ₹ 4,000 maturing after 31st March were discounted.
6. Depreciation on Furniture to be charged at 10% on Written Down Value.
7. Investment in shares is to be treated as non-current investments.
8. Interest on Debentures for the half year ending on 31st March was due on that date.
9. Provide Provision for taxation ₹ 8,000.
10. Technical Knowhow Fees is to be written off over a period of 10 years.
11. Salaries and Wages include ₹ 20,000 being Director's Remuneration.
12. Trade receivables include ₹ 12,000 due for more than six months.

Answer

Statement of Profit and Loss of Girish Ltd. for the year ended 31st March, 2016

	Particulars	***Note***	***This Year***
I	Revenue from Operations		13,40,700
II	Other income (Divided income)		8,500
III	Total Revenue (I &+ II)		13,49,200

IV	Expenses: (a) Purchases of Inventory (9,81,000 – Advertisement Expenses 10,000)		9,71,000
	(b) Changes in Inventories of finished Goods / Work in progress & inventory (2,90,400 - 2,85,000)		5,400
	(c) Employee Benefits expense	9	80,000
	(d) Finance costs	10	34,600
	(e) Depreciation & Amortization Expenses [10% of (70,000 + 4,000)]		7,400
	(f) Other Expenses	11	2,31,700
	Total Expenses		13,30,100
V	Profit before exceptional, extraordinary items and tax (III-IV)		19,100
VI	Exceptional items		-
VII	Profit before extra ordinary items and tax (V-IV)		19,100
VIII	Extraordinary items		-
IX	Profit before tax (VII-VIII)		19,100
X	Tax expense: Current Tax		8,000
XI	Profit/Loss for the period (after tax)		11,100

Balance sheet of Garish Ltd. as on 31st March, 2016

	Particulars as on 31st March	***Note***	₹
(1)	Shareholders' funds:		
	(a) Share capital	1	8,00,000
	(b) Reserves and surplus	2	44,100
(2)	Non-current liabilities:		
	Long term borrowings	3	3,00,000
(3)	Current liabilities:		
	(a) Short term borrowings	4	3,00,000
	(b) Trade payables		1,75,700
	(c) Other current liabilities	5	19,500
	Total		**16,39,300**
II	**ASSETS**		
(1)	(a) Non-current Assets		
	Fixed assets (i) Tangible assets	6	7,66,600
	(ii) Intangible assets	7	2,70,000
	(b) Non-current investments (Shares at cost)		1,00,000
	Current Assets:		
	(a) Inventories		2,85,000
	(b) Trade Receivables	8	1,81,700
	(c) Cash and Cash equivalents - Cash on hand		24,000

	(d) Short term loans and advances -Income tax (paid 20,000-Provision 8000)		12,000
	Total		**16,39,300**

Note: There is a Contingent liability for Bills receivable discounted with Bank ₹ 4000.

Notes to accounts

		₹	₹
1.	**Share Capital**		
	Authorized,		
	60,000 Equity Shares of ₹ 10 each.	6,00,000	
	4,000 6% Preference shares of ₹ 100 each	4,00,000	
	Issued, subscribed & called up		
	40,000 Equity Shares of ₹ 10 each	4,00,000	
	4,000 6% Redeemable Preference Shares of 100 each	4,00,000	**8,00,000**
2.	**Reserves and Surplus**		
	Balance as on 1st April, 2015	57,000	
	Add: Surplus for current year	11,100	68,100
	Less: Preference Dividend		24,000
	Balance as on 31st March, 2016		**44,100**
3.	**Long Term Borrowings**		
	5% Mortgage Debentures (Secured against Freehold Properties)		**3,00,000**
4.	**Short Term Borrowings**		
	Secured Borrowings: Loans Repayable on Demand Overdraft from Banks (Secured by Hypothecation of Stocks & Receivables)		**3,00,000**
5.	**Other Current liabilities**		
	Interest Accrued and due on Borrowings (5% Debentures)	7,500	
	Unpaid Preference Dividends	12,000	**19,500**
6.	**Tangible Fixed assets**		
	Furniture		
	Furniture at Cost Less depreciation ₹ 30,000 (as given in Trial Bal^{n})	70,000	
	Add: Depreciation	30,000	
	Cost of Furniture	1,00,000	
	Add: Installation charge of Electrical Fittings wrongly included under the heading Salaries and Wages	4,000	
	Total Gross block of Furniture A/c	1,04,000	
	Accumulated Depreciation Account: Opening Balance-given in Trial Balance 30,000		
	Depreciation for the year:		
	On Opening WDV at 10% i.e. (10% x 70,000) 7,000		
	On additional purchase during the year at 10% i.e. (10% x 4,000) 400		

	Less: Accumulated Depreciation	37,400	66,600
	Freehold property (at cost)		7,00,000
			7,66,600
7.	**Intangible Fixed Assets**		
	Technical knowhow	3,00,000	
	Less: Written off	30,000	**2,70,000**
8.	**Trade Receivables**		
	Sundry Debtors (a) Debt outstanding due more than six months	12,000	
	(b) Other Debts (refer Working Note)	89,700	
	Bills Receivable (83,000 -3,000)	80,000	**1,81,700**
9.	**Employee benefit expenses**		
	Amount as per Trial Balance	1,04,000	
	Less: Wages incurred for installation of electrical fittings to be capitalised	4,000	
	Less: Directors' Remuneration shown separately	20,000	
	Balance amount		**80,000**
10.	**Finance Costs**		
	Interest on bank overdraft	19,600	
	Interest on debentures	15,000	**34,600**
11.	**Other Expenses**		
	Payment to the auditors	12,000	
	Director's remuneration	20,000	
	Selling expenses	1,58,200	
	Technical knowhow written of (3,00,000/10)	30,000	
	Advertisement (Goods and Articles Distributed)	10,000	
	Bad Debts (3,000 x50%)	1,500	**2,31,700**

Working Note

Calculation of Sundry Debtors-Other Debts

Sundry Debtors as given in Trial Balance	1,00,200
Add Back: Bills Receivables Dishonoured	3,000
	1,03,200
Less: Bad Debts written off - 50% ₹ 3,000	(1,500)
Adjusted Sundry Debtors	1,01,700
Less: Debts due for more than 6 months (as per information given)	(12,000)
Total of other Debtors i.e. Debtors outstanding for less than 6 months	89,700

Departmental Accounting

①

Departments are divisions of business. Such division is made to achieve better control & to find out results of each department separately.

General types of departments

Ⓐ

Assembly line / Production Departments

Dept. A ↓ manufacture Goods → Dept. B Processing Goods → Dept. C Processing Goods / Sale

↓

Departments sale price is not possible to trace as one dept. transfers goods to other dept.

↓

∴ It is difficult to find out result of each department

↓

Solution to above problem :→

Transfer goods from one Dept. A to Dept. B or B to C at market price or at a cost + Profit price.

(If Goods sent from one Dept. to another M.P. then only it is possible to know result of each department.)

Ⓑ

Retail Departments

↓

Reliance Mart, Easy day, D-Mart, Big Bazaar

→ Department purchase price & sale price can be identified

↓

As sale price of goods of each Dept. is known it is easy to find out department result compared to assembly departments.

* Departmental Trading & P&L A/c shall be prepared to find out result of each department.

Dr — Departmental Trading & P&L A/c [format] — Cr

Particulars	A	B	C	Particulars	A	B	C
To op. stock	xx	xx	xx	By Sale (every dept. may sell in retail Dept.)	—	—	xx
To Purchases	xx	xx	xx				
To Wages	xx	xx	xx				
To Internal transfers (May or may not be there)	–	xx	xx	By Internal transfer (May or may not be there)	xx	xx	–
To G.P.	xx	xx	xx	By Closing stock	xx	xx	xx
	xx	xx	xx		xx	xx	xx
(Common exp.) to be distributed on suitable basis to each Dept.	xx	xx	xx	By G.P.	xx	xx	xx
To Rent / Repairs / Insurance of Building (Basis - area occupied otherwise time basis)	xx	xx	xx	By Discount Received (on the basis of Purchase of each Dept.)	xx	xx	xx
To Electricity (Basis - consumption by each dept.)	xx	xx	xx				
To selling exp* (Basis sale of each Dept.)	xx	xx	xx				
To Carriage inward (Purchase Basis)	xx	xx	xx				
To Dep. / Repairs of machine (Basis - Value of Asset)	xx	xx	xx				
To Administrative exp (Basis - Time or equally)	xx	xx	xx				
To labour welfare exp (Basis - No. of employees)	xx	xx	xx				
To PF Contribution (Basis - ~~no.~~ wages / salary)	xx	xx	xx				
To Net Profit	xx	xx	xx				

General P&L A/c

Dr. Cr.

Particulars	₹	Particulars	₹
To Expences (Not allocated which are to each Dept.)	xxx	By Profit	
		Dept. A	xxx
		Dept. B	xxx
		Dept. C	xxx
To Stock Reserves (on closing stock)	xxx	By Opening stock Reserve	xxx
To Net Profit	xxx		
	xxx		xxx

* Inter Departmental Transfers.

Basis of Inter Departmental Transfers :-

① At cost → No unrealised profit / stock Reserve

② At current Market Price

③ Cost + Agreed % of Profit

Elimination of unrealised profit required from (Stock Reserve) → ① Inventory ② P&L A/c

* Only on Goods unsold / closing stock

Rule- Record inventory at cost or sale price / Market price whichever is less

→ Journal Entries

A- Elimination of Unrealised profit (Creation of stock Reserve)

Profit & loss A/c — Dr.
 To Stock Reserve A/c
(Provision made for unrealised profit included in closing stock)

B- In the beginning of next accounting year, above entry will be reversed.

Stock Reserve A/c - Dr
 To P&L A/c

In Balance sheet stock reserve of current year shall be deducted from Inventory & Inventory at cost price shown in Bal. sheet

Points to Remember for stock Reserve. (4)

* closing stock with Dept. B includes profit % charged by Department A & closing stock with Dept. C includes profit % charged by Dept. B.

* Stock Reserve / unrealised profit on closing stock shall be reversed to find out Actual profit of organisation. (organisation receives / generates profit only if goods are sold to outsiders ∴ if goods are unsold with any department then profit portion in that goods is not realised by Organisation)

Question No. 1

Mis P and Co., had four departments A,B,C and D. Each department being managed by manager whose commission was 10% of the respective departmental profit, subject to a minimum of ₹ 6,000 in each case. Interdepartmental transfers took place at a 'loaded' price as follows:

From Department	A to Department	B 10% above cost
From Department	A to Department	D 20% above cost
From Department	C to Department	D 20% above cost
From Department	C to Department	B 20% above cost

For the year ending on 31st March, 2014 the firm had already prepared and closed the departmental Trading and Profit and Loss Account. Subsequently, it was discovered that the closing stocks of departments had included interdepartmentally transferred goods at loaded price instead of cost price. From the following information prepare a statement recomputing the departmental profit or loss:

	Dept. A	*Dept. B*	*Dept. C*	*Dept D*
	₹	₹	₹	₹
Final Profit (Loss)	(38,000)	50,400	72,000	1,08,000
Inter departmental transfers included at loaded price in the departmental stock		(₹ 22,000 from and ₹ 48,000 from Dept. C		(₹ 3,600 from Dept. C and ₹ 1,200 from Dept. A)

Answer

Statement showing the re-computation of Departmental Profit or Loss

Particulars	**A**	**B**	**C**	**D**
	₹	**₹**	**₹**	**₹**
A Final Profit/(Loss) (Computed earlier)	(38,000)	50,400	72,000	1,08,000
B *Add:* Departmental Manager's Commission @ 10% of Deptt. Profit subject to a minimum of ₹ 6,000 [Working Note (i)]	6,000	6,000	8,000	12,000
C Profit before Deptt. Manager's commission (A+B)	(32,000)	56,400	80,000	1,20,000
D. *Less:* Profit earned through transfer of goods at loaded price remaining in stock at transfer department (W.N. 2)	(2,200)		(8,600)	
E. Correct Departmental Profit (before manager's Commission) (C-D)	(34,200)	56,400	71,400	1,20,000
F. *Less:* Manager's commission @ 10% of profit subject to a minimum of ₹ 6,000	6,000	(6,000)	(6,000)	(7,140)
G. Departmental Profit after Manager's commission (E-F)	(40,200)	50,400	64,260	1,08,000

Working Note:

1. Manager's Commission:

	Deptt. Profit/Loss	Commission	
A	(-) 38,000	6,000	
B	50,400	6,000	i.e. (50,400 x 1/9 = ₹ 5,600 less than ₹ 6,000)
C	72,000	8,000	i.e. (72,000 x 1/9 = ₹ 8,000)
D	1,08,000	12,000	i.e. (1,08,000 x 119 = ₹ 12,000)

2. Unrealised Profit on stock transfer:

Dept. A:	22,000 to Deptt. B @ 110%, Profit thereon 22,000 x 10/110	2,000
	₹ 1,200 to Deptt. D @ 120% Profit thereon 1,200 x 20/120	200
		2,200
Dept. C	₹ 48,000 to Deptt. B 120% Profit thereon 48,000 x 20/120	8,000
	₹ 3,600 to Deptt. D @ 120 % Profit thereon 3,600 x 20/120	600
		8,600

Question No. 2

If Ltd. has three departments and submits the following information for the year ending on 31st March, 2014:

	L	M	N	Total (₹)
Purchases (units)	12,000	24,000	28,800	
Purchases (Amount)				12,00,000
Sales (Units)	12,240	23,040	29,952	
Selling Price (₹per unit)	40	45	50	
Closing Stock (Units)	1,200	1,920	72	

You are required to prepare departmental trading account of If Ltd., assuming that the rate of profit on sales is uniform in each case.

Answer

Departmental Trading Account for the year ended on 31st March, 2014

Particulars	**L**	**M**	**N**	**Particulars**	**L**	**M**	**N**
	₹	₹	₹		₹	₹	₹
To Opening Stock	23,040	17,280	24,480	By Sales	4,89,600	10,36,800	14,97,600
To Purchases	1,92,000	4,32,000	5,76,000	By Closing Stock	19,200	34,560	1,440
To Gross Profit	2,93,760	6,22,080	8,98,560				
	5,08,800	1,07,1360	14,99,040		5,08,800	10,71,360	14,99,040

Working Notes:

(1) Profit Margin Ratio

	₹
Selling price of unit purchased:	
Department L (12,000 x 40)	4,80,000
Department M (24,000 x 45)	10,80,000
Department N (28,800 x 50)	14,40,000
Total Selling Price	30,00,000
Less: Purchase (Cost) Value	12,00,000
Gross Profit	18,00,000
Profit Margin Ratio = (18,00,000/ 30,00,000) x 100 = 60%	

(2) Statement showing department-wise per unit Cost and Purchase Cost

	L	M	N
Selling Price (Per unit) (₹)	40	45	50
Less: Profit Margin @ 60% (₹)	24	27	30
Purchase price per unit (₹)	16	18	20
Number of units purchased	12,000	24,000	28,800
Purchases (cost per unit x Units	1,92,00		

(3) Statement showing calculation of department-wise Opening Stock (in Units)

	L	M	N
Sales (Units)	12,240	23,040	29,952
Add: Closing Stock (Units)	1,200	1,920	72
	13,440	24,960	30,024
Less: Purchases (units)	12,000	24,000	
Opening Stock (Units)		960	

(4) Statement showing department-wise cost of Opening Stock and Closing Stock

	L	M	N
Cost of Opening Stock (₹)	(1,440 x 16)	(960 x 18)	(1,224 x 20)
₹	23,040	17,280	24,480
Cost of Closing Stock	(1,200 x 16)	(1,920 x 18)	(72 x 20)
₹	19,200	34,560	1,440

Question No. 3

The following balances were extracted from the books of M/s Division. You are required to prepare Departmental Trading Account and Profit and Loss account for the year ended 31st December, 2016 after adjusting the unrealized department profits if any.

	Deptt. A ₹	Deptt. B ₹
Opening Stock	50,000	40,000
Purchases	6,50,000	9,10,000
Sales	10,00,000	15,00,000

General expenses incurred for both the departments were ₹ 1,25,000 and you are also supplied with the following information:

(a) Closing stock of Department A ₹ 1,00,000 including goods from Department B for ₹ 20,000 at cost of Department A.

(b) Closing stock of Department B ₹ 2,00,000 including goods from Department A for ₹ 30,000 at cost to Department B.

(c) Opening stock of Department A and Department B include goods of the value of ₹ 10,000 and ₹ 15,000 taken from Department B and Department A respectively at cost to transferee departments.

(d) The rate of gross profit is uniform from year to year.

Answer

Departmental Trading and Loss Account of M/s Division

For the year ended 31st December, 2016

	Deptt. A	Deptt. B		Deptt. A	Deptt. B
	₹	₹		₹	₹
To Opening stock	50,000	40,000	By Sales	10,00,000	15,00,000
To Purchases	6,50,000	9,10,000	By Closing stock	1,00,000	2,00,000
To Gross profit	4,00,000	7,50,000			
	11,00,000	17,00,000		11,00,000	17,00,000
To General Expenses (in ratio of sales)	50,000	75,000	By Gross profit	4,00,000	7,50,000
To Profit ts/f to general profit and loss account	3,50,000	6,75,000			
	4,00,000	7,50,000		4,00,000	7,50,000

General Profit and Loss Account

	₹		₹
To Stock reserve required (additional:		By Profit from:	
Stock in Deptt. A		Deptt. A	3,50,000
50% of (₹ 20,000 - ₹ 10,000) (W.N.1)	5,000	Deptt. B	6,75,000
Stock in Deptt. B			
40% of (₹ 30,000 - ₹ 15,000) (W.N.2)	6,000		
To Net Profit	10,14,000		
	10,25,000		10,25,000

Working Notes:

1. Stock of department A will be adjusted according to the rate applicable to department B = [(7,50,000 ÷ 15,00,000) x 100] = 50%

2. Stock of department B will be adjusted according to the rate applicable to department A = [(4,00,000 ÷ 10,00,000) x 100] = 40%

BRANCH ACCOUNTS

Distinction between Branch Accounts & Departmental Accounts

Branch Accounts	Departmental Accounts
→ Branch accounts may be maintained either at a branch or Head office	Departmental accounts are maintained at one place only
→ Expences of each branch can be identified separately therefore no allocation problem.	→ Common expences are allotted to each departments on suitable basis.
→ Reconciliation of H.O. & Branch A/cs is necessary in case branches maintaining independent accounting records.	→ No such problem arises in Departmental Accounts

Types of Branch

Dependent Branch

→ H.O. maintains record of transactions by Branch

↓

Methods

- Debtors Method
- Stock-Debtor Method
- Trading & P&L A/c Method

Independent Branch

→ Branch maintains complete record of transactions on its own.

1. Branch maintains A/cs under double entry system.
2. Branch opens H.O. A/c in its Book & H.O. maintains Branch A/c to record transactions betn H.O. & Branch.
3. Branch prepares Trial Balance & Trading & P&L A/c & sends it to H.O.
4. H.O. will pass entries to incorpora branch Trial Balance in its Book.

Independent Branch

Journal Entries [Similar to Regular entries]

Transaction	H.O. Books	Branch Books
(1) Dispatch of Goods by H.O. to branch	Branch A/c — Dr To ~~A/c~~ Goods sent to Branch A/c	Goods recd. from H.O. A/c - Dr To H.O. A/c
(2) Goods returned by Branch	Goods sent to Br. A/c — Dr To Branch A/c	H.O. A/c — Dr To Goods recd. from H.O. A/c
(3) Branch exp paid by Branch	No Entry	Expenses A/c — Dr To Bank A/c
(4) Branch exp paid by H.O.	Branch A/c - Dr To Cash / Bank A/c	Expenses A/c — Dr To H.O. A/c
(5) Purchase by Branch from outside	No entry	Purchase A/c — Dr. To Bank/creditors A/c
(6) Sale effected by Branch	No Entry	Cash / Debtor A/c - Dr To Sales A/c
(7) Collection from Debtors of Branch Recd. by H.O.	Cash A/c — Dr To Branch A/c	H.O. A/c — Dr To Debtors A/c
(8) Payment by H.O. for purchase made by Branch	Branch A/c — Dr To Bank A/c	Purchase / Creditors — Dr To H.O. A/c
(9) Asset purchased by the branch but asset A/c retained at H.O. Books	Branch Asset A/c - Dr To Branch A/c	H.O. A/c — Dr. To Bank / liability
(10) Depreciation on above assets	Branch A/c — Dr To Branch Asset A/c	Depreciation A/c — Dr To H.O. A/c
(11) Remittance of fund to ~~H.O.~~ Branch by H.O.	Branch A/c — Dr To Bank A/c	Bank A/c — Dr To H.O. A/c
(12) Remittance by Branch to H.O.	Reverse of above entry	Reverse of above entry

Transfer of Goods from one Branch to other.	(Recipient) Branch A/c - Dr To (supplying) Branch A/c	Supplying Branch :- H.O. A/c - Dr. To Goods received from H.O. A/c Recipient Branch Goods Recd. from H.O - Dr To H.O. A/c.

* Adjustment & Reconciliation of Branch & H.O. A/c.

Reasons of Dis-agreement	H.O. Accounts	Branch A/cs
① Goods dispatched by H.O. but not recd. by Branch (Goods in Transit)	No Entry (Entry already done)	Goods in Transit A/c - Dr To H.O. A/c
② Cash in Transit (Not recd. by H.O.)	Cash in Transit A/c - Dr To Branch A/c	No Entry
③ Direct collection by H.O. on behalf of Branch	(Entry already Done)	H.O. A/c - Dr To Debtors A/c
④ Direct Payment by Branch on behalf of H.O	Sundry Creditors A/c - Dr To Branch A/c	(Entry already done)
⑤ Expenses allocated to Branch	(Entry already done)	Branch Exp. A/c - Dr To H.O A/c.

TECHNIQUES FOR FOREIGN CURRENCY TRANSLATION. (5)

In Case of Integral Foreign Operation

1. Monetary items – closing Rate
2. Non Monetary items –
   (a) If tangible Asset carried at cost – Rate on the date of Purchase
   (b) Carried at fair Value – Rate on the date of Valuation
3. All other transactions – Rate prevailing on the date of transaction (Monthly & weekly average Permitted if there are no significant variations)

Non Integral Foreign Operation

1. Balance sheet items :– closing exchange rate.
2. Items of income & expenses – Actual exchange rate or Average rate subject to materiality. (If separate rate for fixed Asset is given in problem then same shall be applied)

* If Balance of H.O. A/c is given in Branch A/c in $ or any other foreign currency & Balance of Branch appears in H.O. A/c in Indian currency / reporting currency then no need to translate Amt. as actual amt. is available in Indian / Reporting currency.

Above Rule is also applicable for Goods sent & Goods received amount available in H.O. Book & Branch Book separately.

Incorporation of Branch Balance in H.O. Books

In the Books of H.O.	In the Books of Branch
Br. Assets (individual) A/c - Dr. To Branch A/c	H.O. A/c - Dr To Asset A/c. (individual)
Branch A/c - Dr To Br. liab. A/c	Individual liab A/c - Dr To H.O. A/c.

→ Beginning of next year

Above entries will be reversed	Above entries will be reversed.

FOREIGN BRANCHES

Integral foreign Operations

Business of foreign branch is carried on as if it were extension of H.O.

eg. Sale of Goods imported from H.O. & remittance to H.O.

↓

Exchange difference arising from translation of financial statement charged to P&L A/c

---

Non-Integral foreign operation

Business of branch is carried on in substantially ~~diff independent~~ independant way by accumulating cash, incurring exp., generating income.

eg. production by using resource available, in that country.

Indicators of Non-Integral

1. Operation carried independantly
2. Transaction with H.O is not in High proportion of foreign ~~activ~~ activities
3. Activities of Branch not financed by H.O.

Exchange difference accumulated to foreign currency translation reserve.

DEPENDENT BRANCHES

↓

Methods

Debtors Method

↓

Only transactions betn H.O. & Branch is recorded assuming that Branch is debtor of H.O.

↓

H.O. wont record transactions by branch with customer or any other person & only transactions with H.O will be recorded

(Method is similar to Consignment Accounting - Branch Account prepared in by H.O. is similar to Consignment A/c)

↓

(But if any figure is missing then we need to prepare Branch stock, Branch debtors A/c)

Stock Debtor Method

(To exercise reasonable control)

↓

In this method, H.O will record all transactions with and by branch with outsiders.

↓

A/cs required :-

1. Branch stock A/c
2. Branch Cash A/c
3. Branch Asset A/c
4. Branch Debtors A/c
5. Branch expenses A/c.
6. Goods sent to Branch A/c
7. Branch Adjustment A/c (only if Goods are sent by H.O. to branch at Invoice price)

Balance of Branch Adj. A/c will be transferred to Branch P&L A/c.

↓

Branch P&L A/c (Dr. all exp.)

Result is Profit or loss.

Trading & P&L A/c

(Similar to Departmental Trading & P&L A/c)

④

Debtor Method

In the Books of H.O.

Branch Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Balance c/d		By Balance b/d	
Cash in Hand	xx	Stock Reserve	xx
Trade Debtors	xx	By Goods sent to Branch A/c (Returns to H.O.)	xx
Stock	xx	By Goods sent to Branch A/c (Loading on net goods sent to Branch)	xx
Assets (Furniture)	xx	By Bank A/c (Remittance from Branch to H.O.)	xx
To Goods sent to Branch A/c	xx		
To Bank A/c (Payment by H.O. on behalf of Branch	xx		
To Balance c/d		By Balance c/d	
Stock Reserve	xx	Cash in Hand	
O/s expenses	xx	Trade Debtors	
To P&L A/c (Net Profit)		Stock	
		Assets (Furniture)	
	xx		xx

→ If any amount is missing then A/c shall be prepared to find out Amt. of Bal. figure. (A/cs are similar to A/cs prepared in stock debtor method)

Stock-Debtor Method

Branch Adjustment A/c

Dr. Cr.

Particulars	₹	Particulars	₹
To Branch Stock A/c (loading of loss)	xx	By Stock Reserve A/c (on opening stock)	xx
To Stock Reserve (on closing stock)	xx	By Goods sent to Branch A/c (loading on Goods sent)	xx
To Gross Profit *	xx		

(8)

Dr. BRANCH P&L A/c Cr.

Particulars	₹	Particulars	₹
To Branch stock A/c (Close of stock if any)	xx	By Gross Profit (from adjustment A/c)	xx
To Branch expenses A/c (exp., Bad debts, Disc allowed)	xx		
To Net Profit* (Transferred to General P&L A/c)			
	xx		xx

* Other Accounts in stock debtor system shall be maintained by following double entry system principles
* Branch stock A/c is maintained at Invoice price if Goods are sent at I.P by H.O. to Branch.
* In Branch Adjustment A/c loading on opening stock, Goods sent, Goods lost, Goods in transit & closing stock is adjusted but no adjustment to be made for loading related to goods sold as loading portion in goods sent represents realised profit ∴ it shall not be reversed.
* Balancing figure in Branch stock A/c :-

→ If Bal. figure on Dr. side :- represents excess profit over normal & it is transferred / credited to Br. Adjustment A/c

→ If Bal. figure is on Cr. side :- It may be treated as Stock shortage & cost to be transferred / Dr. to P&L A/c & loading portion to .

Question No. 1 **RTP May 2017**

Foreign Branch

M/s Heera & Co. has head office at U.S.A. and branch in Patna(India). Patna branch is an integral foreign operation of Heera & Co.

Patna branch furnishes you with its trial balance as on 31st March, 2016 and the additional information given thereafter:

	Dr.	**Cr.**
	(Rupees in thousands)	
Stock on 1st April, 2015		
Purchases and Sales	800	1,200
Sundry Debtors & Creditors	400	300
Bills of Exchange	120	240
Wages & Salaries	560	-
Rent, Rates & Taxes	360	-
Sundry Charges	160	-
Plant	240	-
Bank Balance	420	-
New York Office A/c	-	1,620
	3,360	3,360

Information:

(a) Plant was acquired from a remittance of US $ 6,000 received from USA head office and paid to the suppliers. Depreciate Plant at 60% for the year.

(b) Unsold stock of Patna branch was worth ₹ 4,20,000 on 31st March, 2016.

(c) The rates of exchange may be taken as follows:

- On 01.04.2015 @ ₹ 55 per US $
- On 31.03.2016 @ ₹ 60 per US $
- Average exchange rate for the year @ ₹58 per US $
- Conversion in $ shall be made up to two decimal accuracy.

You are asked to prepare in US dollars the revenue statement for the year ended 31st March, 2016 and the balance sheet as on that date of Patna branch as would appear in the books of USA head office of Heera& Co. You are informed that Patna branch account showed a debit balance of US $ 29845.35 on 31.3.2016 in USA books and there were no items pending reconciliation

Answer

M/s Heera & Co.

Patna Branch Trial Balance in (US $)as on 31st March, 2016

	Conversion rate per US $ (₹)	**Dr. US $**	**Cr. US $**
Stock on 1.4.15	55	5,454.55	-
Purchases and sales	58	13,793.10	20,689.66
Sundry debtors and creditors	60	6,666.67	5,000.00
Bills of exchange	60	2,000.00	4,000.00
Wages and salaries	58	9,655.17	-
Rent, rates and taxes	58	6,206.90	-
Sundry charges	58	2,758.62	-
Plant	-	6,000.00	-
Bank balance	60	7,000.00	-
USA office A/c	-	-	29,845.35
		59,535.01	59,535.01

Trading and Profit & Loss Account for the year ended 31st March, 2016

	US $		**US $**
To Opening Stock	5,454.55	By Sales	20,689.66
To Purchases	13,793.10	By Closing stock (₹ 4,20,000/60)	7,000.00
To Wages and salaries	9,655.17	By Gross Loss c/d	1,213.16
	28,902.82		28,902.82
To Gross Loss b/d	1,213.16	By Net Loss	13,778.68
To Rent, rates and taxes	6,206.90		
To Sundry charges	2,758.62		
To Depreciation on Plant (US $ 6,000 × 0.6)	3,600.00		
	13,778.68		13,778.68

Balance Sheet of Patna Branch as on 31st March, 2016

Liabilities		**US $**	**Assets**	**US $**	**US $**
USA Office A/c	29,845.35		Plant	6,000.00	
Less: Net Loss	(13,778.68)	16,066.67	Less: Depreciation	(3,600.00)	2,400.00
Sundry creditors		5,000.00	Closing stock		7,000.00
Bills payable		4,000.00	Sundry debtors		6,666.67
			Bills receivable		2,000.00
			Bank balance		7,000.00
		25,066.67			25,066.67

Question No. 2 **RTP Nov 14**

Using the Stock and Debtors system, find out the profit or loss made at the Kolkata Branch in 2014.

	₹
Stock (1st January) invoice price	24,000
Branch Debtors (1st January)	12,400
Goods sent to the Branch (invoice price)	70,000
Goods returned by the Branch (invoice price)	2,000
Sales:	
Credit	42,000
Cash	40,000
Goods returned by customers	1,200
Cash received from debtors	39,600
Discount allowed to them	600
Cash sent for expenses at the Branch	12,200
Shortage of goods at the Branch (invoice price)	800

Goods are invoiced to the Branch at the selling price so as to show a profit of 30% on invoice price.

Answer

Branch Stock Account

Particulars	₹	Particulars	₹
To Balance b/d	24,000	By Cash A/c (Cash sales)	40,000
To Goods sent to Branch A/c	70,000	By Branch Debtors (credit sales)	42,000
To Branch Debtors (Sales Returns)	1,200	By Goods sent to Branch A/c (Returns)	2,000
		By Shortage of goods	800
		By Balance c/d (Bal. fig.)	10,400
	95,200		95,200

Branch Debtors Account

Particulars	**₹**	**Particulars**	**₹**
To Balance b/d	12,400	By Branch stock A/c (Sales Returns)	1,200
To Branch Stock (Credit sales)	42,000	By Cash A/c	39,600
		By Discount A/c	600
		By Balance c/d (Bal. fig.)	13,000
	54,400		54,400

Branch Expenses Account

Particulars	**₹**	**Particulars**	**₹**
To Cash A/c	12,200	By Branch P&L A/c (Bal. fig.)	12,800
To Discount A/c	600		
	12,800		12,800

Goods Sent to Branch Account			
Particulars	**₹**	**Particulars**	**₹**
To Branch Stock A/c (Returns)	2,000	By Branch Stock A/c	70,000
To Branch Adjustment A/c (Loading) (70,000× 30%)	21,000	By Branch Adj. A/c (Loading) (2,000 × 30%)	600
To Trading A/c (Bal. fig.)	47,600		
	70,600		70,600

Branch Adjustment Account			
Particulars	**₹**	**Particulars**	**₹**
To Shortage of goods (Loading) (800 × 30%)	240	By Branch Stock Reserve (24,000 × 30%)	7,200
To Branch Stock Reserve A/c (10,400 × 30%)	3,120	By Goods sent to Branch (Net loading) (21,000 - 600)	20,400
To P&L A/c (Bal. fig.)	24,240		
	27,600		27,600

Branch Profit and Loss Account			
Particulars	**₹**	**Particulars**	**₹**
To Branch Expenses A/c	12,800	By Branch Adjustment A/c	24,240
To Shortage of Goods (cost) (800 × 70%)	560		
To Net Profit	10,880		
	24,240		24,240

Question No. 3 — RTP Nov 2013

M/s X has a branch at Delhi and the goods are invoiced to branch at a profit of 20% on invoice price. Head Office paid all the branch expenses from its bank account, except petty cash expenses which were met by the branch. Branch expenses directly paid by M/s X on behalf of Delhi branch amounted to ₹ 20,000. Following information is available of the transactions at Delhi branch for the year ended 31st December, 2012:

	As on 1.1.2012	As on 31.12.2012
	₹	₹
Stock, at invoice price	80,000	1,00,000
Debtors	24,000	22,000
Petty cash	3,000	5,000

Transactions during the year ended 31st December, 2012:	₹
Goods sent to branch, at invoice price	8,40,000
Goods returned by branch to head office, at invoice price	30,000
Cash sales	3,10,000
Credit sales	3,60,000
Cash sent for petty expenses	12,000
Bad debts at Delhi branch	2,000
Goods returned by debtors	2,000

You are required to prepare Delhi Branch account (on cost basis) in the books of M/s X under Debtors System.

Answer

In the Books of M/s X
Delhi Branch Account

2012		₹	₹	2012		₹	₹
Jan. 1	To Balance b/d			Dec. 31	By Bank		
	Stock	64,000			Cash Sales	3,10,000	
	Debtors	24,000			Cash from Sundry Debtors (W.N.1)	3,58,000	6,68,000
	Petty cash	3,000	91,000				
Dec. 31	To Goods sent to Branch A/c		6,72,000		By Goods sent to Branch A/c - Returns to H.O.		24,000
	To Bank: Sundry Expenses		20,000		By Balance c/d		
	To Petty Expenses (W.N. 2)		10,000		Stock	80,000	
	To Balance being Profit carried to (H.O.) P&L A/c		6,000		Debtors	22,000	
					Petty Cash	5,000	1,07,000
			7,99,000				7,99,000
Jan. 1, 2013	To Balance b/d		1,07,000				

Working Notes:

1. **Cash Collected from debtors**

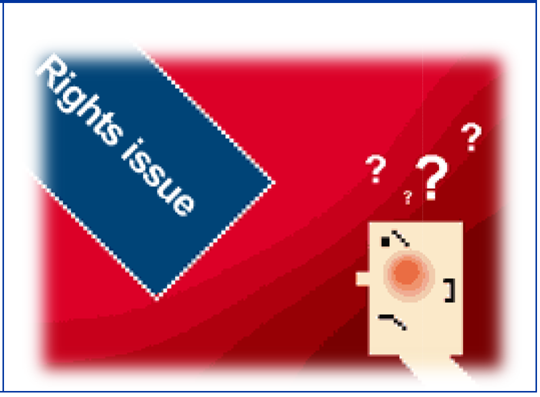
	₹
Debtors as on 1.1.12	24,000
Add: Credit sales	3,60,000
	3,84,000
Less :Bad debts and sales returns (2,000 + 2,000)	(4,000)
Closing balance of debtors	(22,000)
Cash collected during the year	3,58,000

2. **Petty expenses**

	₹
Petty cash as on 1.1.12	3,000
Add: Cash received from H.O	12,000
	15,000
Less: Petty cash as on 31.12.12	(5,000)
Expenses during the year	10,000

Right Issue Meaning

Rights offering (issue) is an issue of rights to a company's existing shareholders that entitles them to buy additional shares directly from the company in proportion to their existing holdings, within a fixed time period. In a rights offering, the subscription price at which each share may be purchased is generally at a discount to the current market price. Rights are often transferable, allowing the holder to sell them on the open market.



My Notes

Conditions required to fulfill for issue of Right Shares

The offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined.

Unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice (referred to in above bullet point) shall contain a statement of this right.

After the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not disadvantageous to the shareholders and the company.

Exceptions to the rights of existing equity shareholders

Section 62 recognises four situations under which the further shares are to be issued by a company, but they need not be offered to the existing shareholders.

1. The company in General Meeting passes a special resolution to this effect; and
2. The price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

The provisions of section 62 are applicable to all types of companies except the Nidhi companies.

My Notes

Financial effects of a further issue

1. The financial position of a business is contained in the balance sheet.
2. Further issue of shares increase the amount of equity (net worth[2]) as well as the liquid resources (Bank).
3. The amount of equity is the product of further number of shares issued multiplied by issue price.
4. The issue price may be higher than the face value (issue at a premium). Companies Act does not allow issue of shares at a discount, except issue of sweat equity shares under Section 53.

Calculation of Book Value of share

Book value of a share = Net worth (as per books)/ Number of shares

Right of Renunciation

Meaning

• Right of renunciation refers to the right of the shareholder to surrender his right to buy the securities and transfer such right to any other person.

Rights Of Shareholder

• Shareholders that have received right shares have three choices of what to do with the rights. They can act on the rights and buy more shares as per the particulars of the rights issue; they can sell them in the market; or they can pass on taking advantage of their rights (i.e., reject the right offer).

Value of Right

• The renunciation of the right is valuable and can be monetised by the existing shareholders in well-functioning capital market. The monetised value available to the existing shareholders due to right issue is known as 'value of right'. If a shareholder decides to renounce all or any of the right shares in favour of his nominee, the value of right is restricted to the sale price of the re-nouncement of a right in favour of the nominee

Value of right is determined by

• **Value of right = Cum-right value of share - Ex-right value of share**

• **Ex-right value of the shares = [Cum-right value of the existing shares + (Rights shares X Issue Price)] / (Existing Number of shares + Number of right shares)**

• The Ex-right value of the share is also known as the average price.

My Notes

ACCOUNTING FOR RIGHT ISSUE

The accounting treatment of rights share is the same as that of issue of ordinary shares and the following journal entry will be made:

S. No.	Particulars	Journal Entries
1.	Issue of Right Shares	Bank A/c…………………………. Dr. To Equity shares capital A/c
2.	Issue of right shares at premium	Bank A/c…………………………. Dr. To Equity Share Capital A/c To Securities Premium A/c

Advantages Of Right Issue

Right issue enables the existing shareholders to maintain their proportional holding in the company and retain their financial and governance rights.

In well functioning capital markets, the right issue necessarily leads to dilution in the value of share.

Right issue is a natural hedge against the issue expenses normally incurred by the company in relation to public issue.

The chance of success of a right issue is better than that of a general public issue and is logistically much easier to handle

Disadvantages Of Right Issue

. The right issue invariably leads to dilution in the market value of the share of the company.

The attractive price of the right issue should be objectively assessed against its true worth to ensure that you get a bargained deal.

Questions

Question No. 1

A company offers new shares of ₹ 100 each at 25% premium to existing shareholders on one for four bases. The cum-right market price of a share is ₹ 150. Calculate the value of a right. What should be the ex-right market price of a share?

Solution:

Ex-right value of the shares = (Cum-right value of the existing shares + Rights shares Issue Price) / (Existing Number of shares + Rights Number of shares)

= (₹ 150 X 4 Shares + ₹ 125 X 1 Share) / (4 + 1) Shares = ₹ 725 / 5 shares = ₹ 145 per share.

Value of right = Cum-right value of the share - Ex-right value of the share

= ₹ 150 - ₹ 145 = ₹ 5 per share.

Hence, any one desirous of having a confirmed allotment of one share from the company at ₹ 125 will have to pay ₹ 20 (4 shares X ₹ 5) to an existing shareholder holding 4 shares and willing to renounce his right of buying one share in favour of that person.

Question 2

A company has decided to increase its existing share capital by making rights issue to its existing shareholders. The company is offering one new share for every two shares held by the shareholder. The market value of the share is ₹ 240 and the company is offering one share of ₹ 120 each. Calculate the value of a right. What should be the ex-right market price of a share?

Solution

Ex-right value of the shares = (Cum-right value of the existing shares + Rights shares x Issue Price)/(Existing Number of shares + Rights Number of shares)

= (₹ 240 x 2 Shares + ₹ 120 x 1 Share) / (2 + 1) Shares = ₹ 600 / 3 shares = ₹ 200 per share.

Value of right = Cum-right value of the share-Ex-right value of the share

= ₹ 240 - ₹ 200 = ₹ 40 per share.

Hence, any one desirous of having a confirmed allotment of one share from the company at ₹ 120 will have to pay ₹ 80 (2 shares x ₹ 40) to an existing shareholder holding 2 shares and willing to renounce his right of buying one share in favour of that person.