CA INTERMEDIATE

ADVANCED ACCOUNTING

PART - B

CA INTERMEDAITE
ADVANCED ACCOUNTING
INDEX

UPDATE (08.11.2023)

Chapter: 1
Introduction to Accounting Standards

1. GENERALLY ACCEPTED ACCOUTING PRINCIPLES (GAAP)

- Refer to **a common set of accepted**
    - **i. accounting principles,**
    - **ii. standards,**
    - **iii. and procedures**
- That business reporting entity **must follow when it prepares and present its financial statements.**
- **GAAP is a combination of authoritative standards** (set by policy boards) **and the commonly accepted ways of recording and reporting accounting information.**
- **At international level** such authoritative standards are known as International Financial Reporting Standards **(IFRS)** and **in India** we have authoritative standards named as **AS** and **IND-AS.**

2. DEFINITION OF ACCOUNTING STANDARDS

- **written policy documents**
- **Issued by the Government**
- With the **support** of the regulatory bodies (e.g., Ministry of Corporate Affairs **(MCA) issuing Accounting Standards for corporate**
- **In consultation** with National Financial Reporting Authority **(NFRA)**
- Covering the following **aspects** of accounting transaction in financial statements
    - **i. Recognition,**
    - **ii. Measurement,**
    - **iii. Presentation,**

3. ACCOUNTING STANDARDS DEAL WITH THE FOLLOWING (ISSUES COVERED BY AS)

i. **Recognition** of events and transactions in the financial statements,

ii. **Measurement** of these transactions and events,

iii. **Presentation** of these transactions and events in the financial statements in a manner that is meaningful and understandable to the reader, and

iv. **Disclosure** relating to these transactions and events to enable the public at large and the stakeholders and the potential investors in particular, to get an insight into what these financial statements are trying to reflect and there by facilitating them to take prudent and informed business decisions.

4. BENEFITS OF ACCOUNTING STANDARDS

i. Standardization of alternative accounting treatments

ii. Requirements for additional disclosures

iii. Comparability of financial statements

5. STANDARD-SETTING PROCESS

i. Identification of area

⇩

ii. Constitution of study group

⇩

iii. Preparation of draft and its circulation

⇩

iv. Ascertainment of views of different bodies on draft

⇩

v. Finalisation of exposure draft (E.D.)

⇩

vi. Comments received on exposure draft (E.D.)

⇩

vii. Modification of the draft

⇩

viii. Issue of AS

6. STATUS OF ACCOUNTING STANDARDS

- **Developed** by the Accounting Standards Board **(ASB)**
- Issued under the authority of its Council
- The **Institute not being a legislative body** can enforce compliance
- Also, the standards **cannot override laws and local regulations.**
- Made **mandatory from the dates specified** in respective standards and are generally **applicable to all enterprises, subject to certain exception.**
- The implication of mandatory status of an Accounting Standard depends on whether the statute governing the enterprise concerned requires compliance with the Accounting Standards.
- The Companies Act had earlier notified 28 accounting standards and mandated the corporate entities to comply with the provisions stated therein.
- However, in 2016 the MCA has withdrawn AS 6. Hence, effectively there are now **only 27 notified Accounting Standards** as per the Companies (Accounting Standards) Rules, 2006 (as amended in 2016).

7. NEED FOR CONVERGENCE TOWARDS GLOBAL STANDARDS

- Each country has its own set of rules and regulations for accounting and financial reporting. Therefore, when an enterprise decides to raise capital from the markets other than the country in which it is located, the rules and regulations of that other country will apply and this in turn will **require that the enterprise is in a position to understand the differences between the rules governing financial reporting in the foreign country as compared to its own country of origin.** Therefore translation and reinstatements are of utmost importance in a world that is rapidly globalizing in all ways.

- **The harmonization of financial reporting** around the world will help to **raise confidence of investors** generally in the information they are using to make their decisions and assess their risks.
- Also a strong **need was felt by legislation to bring about uniformity, rationalization comparability, transparency and adaptability in financial statements.**
- Having a **multiplicity** of accounting standards around the world is **against the public interest.**
- If accounting for the same events and information produces different reported number, depending on the system of standards that are being used, then it is self-evident that accounting will be increasingly discredited in the eyes of those using the numbers.
- **It created confusion, encourages error and facilitates fraud. The cure for these ills is to have a single set of global standards, of the highest quality, set in the interest of public.**
- Convergence facilitates accounting and reporting for companies with global operations and **eliminates some costly requirements say reinstatement of financial statements**.
- It has the potential to create a new standard of **accountability** and greater **transparency,** which are value of great significance to all market participants including regulators. It reduces operational challenges for accounting firms and focuses their value and expertise around an increasingly unified set of standards.
- It creates an unprecedented opportunity for standard setters and other stakeholders **to improve the reporting model**.
- **For the companies with joint listing in both domestic and foreign country, the convergence is very much significant.**

8. BECOMING IFRS COMPLIANT

- Any country can become IFRS compliant **either by adoption process or by convergence process.**
- Adoption would mean that the country sets a specific timetable when specific entities would be **required to use IFRS as issued by the IASB.**
- Convergence means that the **country will develop high quality, compatible accounting standards over time.**
- Convergence means alignment of the standards of different standard setters with a **certain rate of compromise, by adopting the requirements of the standards either fully or partially.**
- **Indian Accounting Standards are almost similar to IFRS but with few carve outs so as to make them suitable for Indian Environment.**

9. CONVERGENCE WITH IFRS WILL RESULT IN FOLLOWING BENEFITS

- Improves investor confidence across the world with **transparency and comparability**
- **Improves inter-unit/ inter-firm/inter-industry comparison**
- **Group consolidation** will be easy with same standard by all companies in group irrespective of their global location.
- Acceptability of financial statements stock exchanges across the globe, which will **facilitate entry of any Indian company to any stock exchange.**

10. WHAT ARE CARVE OUTS/INS IN IND AS

- The Government of India in consultation with the ICAI decided to converge and not to adopt IFRS issued by the IASB.
- The decision of convergence rather than adoption was taken after the detailed analysis of IFRS requirements and extensive discussion with various stakeholders.
- Accordingly, while formulating IFRS converged Indian Accounting Standards (Ind AS), efforts have been made to keep these Standards, as far as possible, in line with the corresponding IAS/IFRS and departures have been made where considered absolutely essential.
- These changes have been made considering various factors, such as:

  A. **Various terminologies related changes** have been made to make it consistent with the terminology used in law, e.g., 'statement of profit and loss' in place of 'statement of comprehensive income' and 'balance sheet' in place of 'statement of financial position'.

  B. **Removal of options in accounting principles and practices in Ind AS vis-a-vis IFRS,** have been made to maintain consistency and comparability of the financial statements to be prepared by following Ind AS. **However, these changes will not result into carve outs.**

  C. Certain **changes have been made considering the economic environment of the country,** which is different as compared to the economic environment presumed to be in existence by IFRS. These differences are due to differences in economic conditions prevailing in India. **These differences which are in deviation to the accounting principles and practices stated in IFRS, are commonly known as 'Carve-outs'.**

  D. **Additional guidance given in Ind AS over and above what is given in IFRS is termed as 'Carve in'.**

11. WHAT ARE INDIAN ACCOUNTING STANDARDS (IND – AS)

- Indian Accounting control of Accounting Standards Board (ASB) of Standards (Ind AS) are **IFRS converged** standards **issued by the Central Government** of India **under the supervision and ICAI and in consultation with NFRA.**
- ASB is a committee under Institute of Chartered Accountants of India (ICAI) which consists of representatives from government department, academicians, other professional bodies viz. ICSI, ICAI, representatives from ASSOCHAM, CII, FICCI, etc.
- **NFRA recommend these standards to the Ministry of Corporate Affairs (MCA). MCA has to spell out the Accounting Standards applicable for companies in India.**
- **Ind AS are named and numbered in the same way** as the corresponding International Financial Reporting Standards (IFRS).

  A. **Globalization** and **Liberalisation**

  B. **Transparency** of financial statements

  C. **Comparability** of financial statements

  D. **Enhanced Disclosure requirements**

12. ROADMAP FOR IMPLEMENTATION OF INDIAN ACCOUNTING STANDARDS

<table>
<tr><th colspan="2">For Companies Other Than Banks, NBFCs And Insurance Companies</th></tr>
<tr><th>PHASE I</th><th>PHASE II</th></tr>
<tr><td>1st April 2015 (2015-16) or thereafter (with Comparatives): Voluntary Basis for any company and its holding, subsidiary, JV or associate company</td><td rowspan="2">1st April 2017 (2017-18) : Mandatory Basis
• All companies which are listed/or in process of listing inside or outside India on Stock Exchanges not covered in Phase I (other than companies listed on SME Exchanges);
• Unlisted companies having net worth of INR 250 crore or more but less than INR 500crore;
• Parent, Subsidiary, Associate and JV of above.</td></tr>
<tr><td>1st April 2016 (2016-17) : Mandatory Basis
(a) Companies listed/in process of listing on Stock Exchanges in India or Outside India having net worth of INR 500 crore or more;
(b) Unlisted Companies having net worth of INR 500 crore or more;
(c) Parent, Subsidiary, Associate and JV of above.</td></tr>
<tr><td colspan="2">Special Points to Consider:-
(i) Companies listed on SME exchange are not required to apply Ind AS
(ii) Once Ind AS are applicable, an entity shall be required to follow the Ind AS for all the subsequent financial statements.
(iii) Companies not covered by the above roadmap shall continue to apply Accounting Standards notified in Companies (Accounting Standards) Rules, 2006.</td></tr>
</table>

13. ROADMAP FOR IMPLEMENTATION OF INDIAN ACCOUNTING STANDARDS

For Scheduled Commercial Banks (Excluding RRBs), Insurers/Insurance Companies and Non-Banking Financial Companies (NBFC's)

Non-Banking Financial Companies (NBFC's)

PHASE I	PHASE II
From 1st April, 2018 (2018-19) with comparatives • NBFCs (whether listed or unlisted) having **net worth 500 crore or more** • Holding, Subsidiary, JV and Associate companies of above NBFC other than those already covered under corporate roadmap shall also apply from said date	**1st April, 2019 (2019-20) with comparatives** • NBFCs whose equity and/or debt securities are listed or are in the process of listing on any stock exchange in India or outside India and having **net worth less than 500 crore** • NBFCs that are unlisted having **net worth 250 crore or more but less 500 crore** • Holding, Subsidiary, JV and Associate companies of above other than those already covered under corporate roadmap shall also apply from said date

Special Points to Consider:-

- Applicable for both Consolidated and individual Financial Statements
- NBFC having net worth below 250 crore shall not apply Ind AS.
- Adoption of Ind AS is allowed only when required as per the road map.
- Voluntary adoption of Ind AS is not allowed.

Scheduled Commercial banks (excluding RRB's) and Insurers/Insurance companies

- From 1st April, 2019 (with comparatives) for Scheduled Commercial Banks (Excluding RRB's) and
- 1st April, 2021 for Insurers/Insurances Companies
- Holding, subsidiary, JV and Associates companies of scheduled commercial banks (excluding RRB's) shall also apply from the said date irrespective of it being covered under corporate road map.
- Applicable for both Consolidated and individual Financial Statements
- Urban Cooperative banks (UCBs) and Regional Rural banks (RRBs) are not required to apply Ind AS.

MULTIPLE CHOICE QUESTIONS

MCQs

1. Accounting Standards for non-corporate entities in India are issued by

(a) Central Govt.

(b) State Govt.

(c) Institute of Chartered Accountants of India.

2. Accounting Standards

(a) Harmonise accounting policies and eliminate the non-comparability of financial statements.

(b) Improve the reliability of financial statements.

(c) Both (a) and (b).

3. It is essential to standardize the accounting principles and policies in order to ensure

(a) Transparency

(b) Consistency

(c) Both (a) and (b)

4. Which committee is responsible for approval of accounting standards and their modification for the purpose of applicability to companies?

(a) NFRA

(b) Central Government Advisory Committee

(c) Advisory Committee for approval of Accounting Standards.

5. Global Standards facilitate

(a) Cross border flow of money

(b) Comparability of financial statements

(c) Both (a) and (b)

6. Additional guidance given in Ind AS over and above what is given in IFRS are called

(a) Carve-outs

(b) Carve-ins

(c) Carve clarifications

7. IASB stands for

(a) International Accounting Standards Bureau

(b) International Advisory Standards Board

(c) International Accounting Standard Board

8. IFRS stands for

(a) International Financial Reporting System

(b) International Finance Reporting Standard

(c) International Financial Reporting Standard

9. Phase I of Ind AS was applicable to:

(a) All listed companies in India or outside India

(b) Companies with turnover INR 500 crores or more

(c) Companies with net worth INR 500 crores or more.

Answers

1	2	3	4	5	6	7	8	9
C	C	C	A	C	B	C	C	C

Question 1

What are the **issues**, with which Accounting Standards deal?

Answer

Accounting Standards deal with the issues of

(i) **Recognition** of events and transactions in the financial statements,

(ii) **Measurement** of these transactions and events,

(iii) **Presentation** of these transactions and events in the financial statements in as manner that is meaningful and understandable to the reader, and

(iv) **Disclosure** requirements.

Question 2

Short note on Accounting Standards

Answer

- Accounting Standards (ASs) are **written policy documents issued by the Government**
- **with the support of other regulatory bodies** (e.g., Ministry of Corporate Affairs **(MCA)** issuing Accounting Standards for corporate **in consultation** with National Financial Reporting Authority **(NFRA)**
- Accounting Standards deal with the **issues** of
  - **(i)** **Recognition** of events and transactions in the financial statements,
  - **(ii)** **Measurement** of these transactions and events,
  - **(iii)** **Presentation** of these transactions and events in the financial statements in a manner that is meaningful and understandable to the reader, and
  - **(iv)** **Disclosure** requirements which should be there to enable the public at large and the stakeholders and the potential investors in particular, to get an insight into what these financial statements are trying to reflect and thereby facilitating them to take prudent and informed business decisions**.**

- Accounting Standards standardize diverse accounting policies with a view**,** to the maximum possible extent**,**
  - **(i)** **To eliminate the non-comparability** of financial statements and thereby **improving the reliability of financial statements, and**
  - **(ii)** **To provide a set of standard accounting policies, valuation norms and disclosure requirements the existing shareholders**

Question 3

Write short notes on the advantages and disadvantages of setting of Accounting Standards.

Answer

- The Accounting Standards seek to describe the accounting principles, the valuation techniques and the methods of applying the accounting principles in the preparation and presentation of financial statements so that they may give a true and fair view.
- The ostensible purpose of the standard setting bodies is to promote the dissemination of timely and useful financial information to investors and certain other parties having an interest in companies economic performance.
- The setting of accounting standards has the following **advantages**:

  Standardization of selection of accounting treatments: Standards reduce to a reasonable extent or eliminate altogether confusing variations in accounting treatments used to prepare financial statements.

  - **(i)** **Requirement of additional disclosure**: There are certain areas where important information are not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.
  - **(ii)** **Comparability of financial statements:** The application of accounting standards would, to a limited extent, facilitate comparison of financial statement of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in his respect that differences in institutions, traditions and legal systems from one country to another give rise to differences in accounting standards practiced in different countries.
  - **(iii)** **Reduction in scope of creative Accounting**

- However, there are some **disadvantages** of setting of accounting standards:
  - **(i)** **Difficulties in selection of alternatives:** Alternative solutions to certain accounting problems may each have arguments to recommended them. Therefore, the choice between different alternative accounting treatments may become difficult.
  - **(ii)** **Lack of flexibilities:** There may be a trend towards rigidity and away from flexibility in applying the accounting standards.
  - **(iii)** **Restricted Scope**: Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.

Question 4

Explain in brief the reasons for convergence of Indian Accounting Standards towards global standards.

Answer

- Each country has its own set of rules and regulations for accounting and financial reporting. Therefore, when an enterprise decides to raise capital from the markets other than the country in which it is located, the rules and regulations of that other country will apply and this in turn will **require that the enterprise is in a position to understand the differences between the rules governing financial reporting in the foreign country as compared to its own country of origin.** Therefore translation and reinstatements are of utmost importance in a world that is rapidly globalizing in all ways.
- **The harmonization of financial reporting** around the world will help to **raise confidence of investors** generally in the information they are using to make their decisions and assess their risks.
- Also a strong **need was felt by legislation to bring about uniformity, rationalization comparability, transparency and adaptability in financial statements.**
- Having a **multiplicity** of accounting standards around the world is **against the public interest.**
- If accounting for the same events and information produces different reported number, depending on the system of standards that are being used, then it is self-evident that accounting will be increasingly discredited in the eyes of those using the numbers.
- **It created confusion, encourages error and facilitates fraud. The cure for these ills is to have a single set of global standards, of the highest quality, set in the interest of public.**
- Convergence facilitates accounting and reporting for companies with global operations and **eliminates some costly requirements say reinstatement of financial statements**.
- It has the potential to create a new standard of **accountability** and greater **transparency,** which are value of great significance to all market participants including regulators. It reduces operational challenges for accounting firms and focuses their value and expertise around an increasingly unified set of standards.
- It creates an unprecedented opportunity for standard setters and other stakeholders **to improve the reporting model**.
- **For the companies with joint listing in both domestic and foreign country, the convergence is very much significant.**

Question 5

Explain the objective of "Accounting Standards" in brief. State the advantages of setting Accounting Standards.

Answer

Accounting Standards are the written policy documents issued by Government relating to various aspects of measurement, treatment, presentation and disclosure of accounting transactions and events.

Following are the objectives of Accounting Standards:

a) Accounting Standards harmonize the diverse accounting policies and practices followed by different companies in India.

b) Accounting Standards facilitates the preparation of financial statements and make them comparable.

c) Accounting Standards give a sense of faith and reliability to the users.

The main advantage of setting accounting standards are as follows:

a) Accounting Standards makes the financial statements of different companies comparable which helps investors in decision making.

b) Accounting Standards prevent any misleading accounting treatment.

c) Accounting Standards prevent manipulation of data by the management.

Question 6

What is the significance of issue of Indian Accounting Standards?

Answer

- The Government of India in consultation with the ICAI decided to converge and not to adopt IFRSs issued by the IASB.
- The decision of convergence rather than adoption was taken after the detailed analysis of IFRSs requirements and extensive discussion with various stakeholders.
- Accordingly, while formulating IFRS-converged Indian Accounting Standards (Ind AS), efforts have been made to keep these Standards, as far as possible, in line with the corresponding IAS/IFRS and departures have been made where considered absolutely essential.

Question 7

Explain the significance of emergence of IFRS as Global Standards.

Answer

- Global Standards facilitate cross **border flow of money, global listing in different bourses and comparability of financial statements.**
- Global Standards **improves the ability of investors** to compare investments on a global basis and thus **lowers their risk of errors of judgment.**
- It facilitates **accounting and reporting for companies with global operations** and **eliminates some costly requirements** say reinstatement of financial statements.

Question 8

What do you mean by Carve outs/ins in Ind AS? Explain.

Answer

A. Certain **changes have been made considering the economic environment of the country,** which is different as compared to the economic environment presumed to be in existence by IFRS. These differences are due to differences in economic conditions prevailing in India. **These differences which are in deviation to the accounting principles and practices stated in IFRS, are commonly known as 'Carve-outs'.**

B. **Additional guidance given in Ind AS over and above what is given in IFRS is termed as 'Carve in'.**

Question 9

Briefly explain the process of issuance of Indian Accounting Standards.

Answer

- Due to the recent stream of overseas acquisitions by Indian companies, there is **need for adoption of high quality standards to convince foreign enterprises** about the financial standing as also the disclosure and governance standards of Indian acquirers.
- The Government of India in consultation with the ICAI **decided to converge and not to adopt** IFRSs issued by the IASB.
- The decision of convergence rather than adoption was taken after the **detailed analysis of IFRSs requirements and extensive discussion with various stakeholders.**
- The ICAI has worked towards convergence of global accounting standards by considering the application of IFRS in Indian corporate environment.
- Recognising the growing need of full convergence of Ind AS with IFRS, ICAI constituted a Task Force to examine various issues involved.
- Ind AS are issued by the Central Government of India under the supervision and control of ASB of ICAI and in consultation with NFRA.
- NFRA recommends these standards to the MCA and MCA has to spell out the accounting standards applicable for companies in India.

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Chapter: 2

Framework for Preparation and Presentation of Financial Statements

1. PURPOE OF THE FRAMEWORK

- The framework sets out the concepts underlying the preparation and presentation of **general-purpose financial statements** prepared by enterprises for external users.
- The main purpose of the framework is to **assist**:

  (a) Enterprises in preparation of their financial statements in **compliance with Accounting Standards and in dealing with the topics not yet covered by any Accounting Standard,**

  (b) ASB in its task of **development and review of Accounting Standards,**

  (c) ASB in promoting **harmonisation of regulations, Accounting Standards and procedures** relating to the preparation and presentation of financial statements by providing a basis for **reducing the number of alternative accounting treatments permitted by Accounting Standards,**

  (d) **Auditors in forming an opinion as to whether financial statements conform to the Accounting Standards,**

  (e) Users in **interpretation** of financial statements,

  (f) Those who are interested in the work of ASB with information about its information to the formulation of Accounting Standards.

2. STATUS AND SCOPE OF THE FRAMEWORK

- The framework **applies to general-purpose financial statements** (hereafter referred to as 'financial statements' usually prepared **annually for external users,** by all commercial, industrial and business enterprises, whether in public or private sector.
- **The special purpose financial reports,** for example computations prepared for tax purposes are **outside the scope of the framework.**
- Nevertheless, the framework may be applied in preparation of such reports, to the extent not inconsistent with their requirements.
- **Nothing in the framework overrides any specific Accounting Standard.**
- **In case of conflict between an Accounting Standard and the framework, the requirements of the Accounting Standard will prevail over those of the framework.**

3. COMPONENTS OF FINANCIAL STATEMENTS

- All parts of financial statements are **interrelated because they reflect different aspects of same transactions or other events.**
- Although each statement provides information that is different from each other**, none in isolation is likely to serve any single purpose nor can anyone provide all information needed by a user**.

(a) Balance Sheet

- ✓ Portrays value of **economic resources controlled by an enterprise**.

  Also provides information about liquidity and solvency **of an enterprise which is useful in predicting the ability of the enterprise to meet its financial commitments as they fall due.**

(b) Statement of Profit and Loss

- ✓ Presents the result of operations of an enterprise for an accounting period, i.e., it depicts the performance of an enterprise, in particular its **profitability.**

(c) Cash Flow Statement

- ✓ Shows the way an enterprise has generated cash and the way they have been used in an accounting period and helps in **evaluating the investing, financing and operating activities** during the reporting period.

(d) Notes and other statements

- ✓ Present supplementary information explaining different items of financial statements. For example, **they may contain additional information that is relevant to the needs of users** about the items in the balance sheet and statement of profit and loss.
- ✓ **They include various other disclosures** such as disclosure of accounting policies, segment reporting, related party disclosures, earnings per share, etc.

4. OBJECTIVES AND USERS OF FINANCIAL STATEMENTS

- **Objective :**
  - ✓ provide information about the **financial position, performance and cash flows** of an enterprise that is useful to a wide range of users.
- **Users:**
  - ✓ All users of financial statements expect the statements to **provide useful information needed to make economic decisions.**
  - ✓ The financial statements provide information to **suit the common needs of most users.**
  - ✓ However, they cannot and do **not intend to provide all information** that may be needed, e.g. they do **not provide non-financial data** even if they may be relevant for making decisions.

    a. **Investors**

    b. **Employees**

    c. **Lenders**

    d. **Suppliers and creditors**

    e. **Customers**

    f. **Government**

    g. **Public**

5. FUNDAMENTAL ACCOUNTING ASSUMPTIONS

↓

IF FOLLOWED	IF NOT FOLLOWED
No separate disclosure is needed	**Separate disclosure** is needed

↓

GOING CONCERN	ACCRUAL	CONSISTENCY
✓ Enterprise will **continue in operation in the foreseeable future** and neither there is an intention, nor there is a need to materially curtail the scale of operations. ✓ Financial statements prepared on going concern basis recognise among other things the need for **sufficient retention of profit to replace assets** consumed in operation and for **making adequate provision for settlement of its liabilities.** ✓ **If any financial statement is prepared on a different basis, e.g. when assets of an enterprise are stated at net realisable values in its financial statements, the basis used should be disclosed.**	✓ According **to AS-1** Revenues and costs are accrued, that is, **recognised as they are earned or incurred (and not as money is received or paid) and** ✓ Recorded in the financial statements of the **periods to which they relate.** ✓ Further Section 128(1) of the Companies Act, 2013 makes it mandatory for companies to **maintain accounts on accrual basis only.** ✓ In case, any income/ expense is recognised on **cash basis, the fact should be stated.**	✓ It is assumed that accounting policies are **consistent from one period to another.** ✓ The consistency **improves comparability** of financial statements through time. ✓ According to Accounting Standards, an accounting policy can be changed if the **change is required** **(i) By a statute or** **(ii) By an Accounting Standard or** **(iii) For more appropriate presentation of financial statements.**

6. QUALITATIVE CHARACTERISTICS OF FINANCIAL STATEMENTS

a. Understandability

- The financial statements should present information in a manner as to be **readily understandable** by the users with reasonable knowledge of business and economic activities and accounting.

b. Relevancy

- It is **not right to think that more information one discloses the better it is**.
- A mass of **irrelevant information creates confusion** and can be even more harmful than non-disclosure.
- The financial statements should **contain relevant information only**.
- Information, which is likely to **influence the economic decisions by the users, is said to be relevant.**

- **Such information may help the users to evaluate past, present or future events or may help in confirming or correcting past evaluations.**
- The relevance of a piece of information should be judged by its materiality. A piece of information is said to be material if its misstatement (i.e., omission or erroneous statement) can influence economic decisions of a user.

c. Reliability

- **To** be useful, the information must be reliable; that is to say, they must be **free from material error and bias.**
- The information provided are not likely to be reliable unless:
  - **(a)** Transactions and events reported are **faithfully represented.**
  - **(b)** Transactions and events are **reported on the principle of 'substance over form**.
  - **(c)** The reporting of transactions and events are **neutral, i.e. free from bias.**
  - **(d)** **Prudence is exercised** in reporting uncertain outcome of transactions or events.
  - **(e)** The information in financial statements **must be complete.**

d. Comparability

- Comparison of financial statements is one of the **most frequently used and most effective tools of financial analysis.**
- The financial statements **should permit both inter-firm and intra-firm comparison.** One essential requirement of comparability is disclosure of financial effect of change in accounting policies.

7. TRUE AND FAIR VIEW

- Financial statements are required to show a true and fair view **of the performance, financial position and cash flows of an enterprise.**
- The framework does **not deal directly with this concept of true and fair view,** yet application of the principal qualitative characteristics and appropriate accounting standards normally results in financial statements portraying true and fair view of information about an enterprise.

8. ELEMENTS OF FINANCIAL STATEMENTS

A. Asset

- An asset is a resource **controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise.**
- The following points must be considered while recognising an asset:
  - **(a)** **It may be tangible or Intangible assets**
  - (b) An asset is a resource **controlled by the enterprise.** A resource cannot be recognised as an asset if the control is not sufficient. It is possible to recognise a resource not owned but controlled by the enterprise as an asset.

(c) To be considered as an asset, it must be probable that the resource **generates future economic benefit.**

(d) To be considered as an asset, the resource must have a cost or value that can **be measured reliably.**

(e) When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognised as an expense rather than as an asset.

B. Liability

- A liability is a **present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow of a resource embodying economic benefits.**
- The following points may considered:

(a) **A liability is a present obligation** i.e. an obligation the existence of which, based on the evidence available on the balance sheet date is considered probable.

(b) It may be noted that certain provisions, e.g. provisions for doubtful debts, depreciation and impairment losses, represent diminution in value of assets rather than obligations. These provisions are outside the scope of Accounting Standards 29 and hence should not be considered asliability.

(c) **A liability is recognised only when outflow can be reliably measured.** Otherwise, the liability is not recognised. For example, liability cannot arise on account of future commitment. A decision by the management of an enterprise to acquire assets in the future does not, of itself, give rise to a present obligation. An obligation normally arises only when the asset is delivered or the enterprise enters into an irrevocable agreement to acquire the asset.

C. Equity

- Equity is defined as **residual interest** in the assets of an enterprise after deducting all its liabilities.
- Equity is the **excess of aggregate assets of an enterprise over its aggregate liabilities.**
- In other words, *equity* **represents owners' claim** *consisting of items like capital and reserves*, which are clearly distinct from liabilities, i.e. claims of parties other than owners.

D. Income

- Income is **increase in economic benefits** during the accounting period in the form of **inflows** or **enhancement of assets** or **decreases in liabilities** that result in **increase in equity other than those relating to contributions from equity participants.**
- The definition of income encompasses **revenue and gains.**
- **Revenue** is an income that arises in the **ordinary course of activities** of the enterprise, e.g. sales by a trader.

- **Gains** are income, which may or may **not arise in the ordinary course** of activity of the enterprise, e.g. profit on disposal of fixed assets.
- **Gains are showed separately** in the statement of profit and loss because this knowledge is useful in assessing performance of the enterprise.
- Income earned is always associated with either **increase of asset or reduction of liability**. This means, no income can be recognised unless the corresponding increase of asset or decrease of liability can be recognised.
- For example, a bank does not recognise interest earned on non-performing assets because the corresponding asset (increase in advances) cannot be recognised, as flow of economic benefit to the bank beyond current accounting period is not probable.

E. Expense

- An expense is **decrease in economic benefits** during the accounting period in the form of **outflows** or **depletions of assets** or **incurrence of liabilities** that result in **decrease in equity other than those relating to distributions to equity participants.**
- The definition of expenses encompasses **expenses that arise in the ordinary course of activities** of the enterprise, e.g. wages paid. **Losses may or may not arise in the ordinary course** of activity of the enterprise, e.g. loss on disposal of fixed assets.
- **Losses are separately showed** in the statement of profit and loss because this knowledge is useful in assessing performance of the enterprise.
- Expenses are always incurred simultaneously with either **reduction of asset or increase of liability.** Thus, expenses are recognised when the corresponding decrease of asset or increase of liability are recognised by application of the recognition criteria stated above.

9. MEASUREMENT OF ELEMENTS OF FINANCIAL STATEMENTS

- Measurement is the process of **determining money value** at which an element can be **recognised** in the balance sheet or statement of profit and loss.
- The framework recognises **four alternative measurement** bases for the purpose.
- These bases relate **explicitly to the valuation of assets and liabilities.**
- The valuation of income or expenses, i.e. profit is implied, by the value of change in assets and liabilities.

MEASUREMENT BASIS

Basis	**Assets**	**Liabilities**
Historical Cost	Recorded at an amount of cash or cash equivalent paid or the fair value of the asset at the time of acquisition.	Recorded at the amount of proceeds received in exchange for the obligation. In some circumstances a liability is recorded at the amount of cash or cash equivalent expected to be paid to satisfy it in the normal course of business.
Current Cost	Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently.	Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
Realisable (Settlement) Value	For assets, this is the amount of cash or cash equivalents currently realisable on sale of the asset in an orderly disposal.	For liabilities, this is the undiscounted amount of cash or cash equivalents expected to be paid on settlement of liability in the normal course of business.
Present Value	Assets are carried at the present value of the future net cash inflows that the item is expected to generate in the normal course of business.	Liabilities are carried at the present value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

10. CAPITAL MAINTENANCE

- Capital refers to net assets of a business. Since a business uses its assets for its operations, **a fall in net assets will usually mean a fall in its activity level.**
- It is therefore important for any business to maintain its net assets in such a way, **as to ensure continued operations at least at the same level year after year.**
- In other words, **dividends should not exceed profit after appropriate provisions for replacement of assets consumed in operations.**
- For this reason, the Companies Act does **not permit distribution of dividend without providing for depreciation on fixed assets.** Unfortunately, this may not be enough in case of rising prices.

Type	Guidelines
Financial Capital Maintenance At Historical Cost	✓ Under this convention, opening and closing assets are stated at respective historical costs to ascertain opening and closing equity. ✓ If retained profit is greater than or equals to zero, the capital is said to be maintained at historical costs. ✓ This means the business will have enough funds to replace its assets at historical costs. This is quite right as long as prices do not rise.
Financial Capital Maintenance At Current Purchasing Power	✓ Under this convention, opening and closing equity at historical costs are restated at closing prices using average price indices. ✓ A positive retained profit by this method means the business has enough funds to replace its assets at average closing price. This may not serve the purpose because prices of all assets do not change at average rate in real situations.
Physical Capital Maintenance At Current Costs	✓ Under this convention, the historical costs of opening and closing assets are restated at closing prices using specific price indices applicable to each asset. ✓ The liabilities are also restated at a value of economic resources to be sacrificed to settle the obligation at current date, i.e. closing date. ✓ The opening and closing equity at closing current costs are obtained as an excess of aggregate of current cost values of assets over aggregate of current cost values of liabilities. ✓ A positive retained profit by this method ensures retention of funds for replacement of each asset at respective closing prices.

Example 1

Balance sheet of a trader on 31st March, 20X1 is given below:

Liabilities	₹	**Assets**	₹
Capital	60,000	Fixed Assets	65,000
Profit and Loss Account	25,000	Stock	30,000
10% Loan	35,000	Trade receivables	20,000
Trade payables	10,000	Deferred costs	10,000
		Bank	5,000
	1,30,000		**1,30,000**

Additional information:

i. The remaining life of fixed assets is 5 years. The pattern of use of the asset is even. The net realisable value of fixed assets on 31.03.X2 was ₹60,000.

ii. The trader's purchases and sales in 20X1-X2 amounted to ₹4 lakh and ₹4.5 lakh respectively.

iii. The cost and net realisable value of stock on 31.03.X2 were ₹32,000and ₹40,000 respectively.

iv. Expenses for the year amounted to ₹14,900.

v. Deferred cost is amortised equally over 4 years.

vi. Debtors on 31.03.X2 is ₹25,000, of which ₹2,000 is doubtful. Collection of another ₹4,000 depends on successful re-installation of certain product supplied to the customer.

vii. Closing trade payable is ₹12,000, which is likely to be settled at 5% discount.
viii. Cash balance on 31.03.X2 is ₹37,100.
ix. There is an early repayment penalty for the loan ₹2,500.

The Profit and Loss Accounts and Balance Sheets of the trader are shown below in two cases

i. assuming going concern
ii. Not assuming going concern.

Answer

Profit and Loss Account for the year ended 31st March, 20X2

		Case (i) ₹	Case (ii) ₹		Case (i) ₹	Case (ii) ₹
To	Opening Stock	30,000	30,000	By Sales	4,50,000	4,50,000
To	Purchases	4,00,000	4,00,000	By Closing Stock	32,000	40,000
To	Expenses	14,900*	14,900*	By Trade payables		600
To	Depreciation	13,000	5,000			
To	Provision for doubtful debts	2,000	6,000			
To	Deferred cost	2,500	10,000			
To	Loan penalty	–	2,500			
To	Net Profit (b.f.)	19,600	22,200			
		4,82,000	4,90,600		4,82,000	4,90,600

*It is assumed that expense includes interest of 10% on loan as ₹3500.

Balance Sheet as at 31st March, 20X2

Liabilities	Case (i) ₹	Case (ii)₹	Assets	Case (i) ₹	Case (ii) ₹
Capital	60,000	60,000	Fixed Assets	52,000	60,000
Profit & Loss A/c	44,600	47,200	Stock	32,000	40,000
10% Loan	35,000	37,500	Trade receivables (less provision)	23,000	19,000
Trade payables	12,000	11,400	Deferred costs	7,500	Nil
			Bank	37,100	37,100
	1,51,600	1,56,100		1,51,600	1,56,100

Example 2

(a) A trader purchased article A on credit in period 1 for ₹50,000.

(b) He also purchased article B in period 1 for ₹2,000cash.

(c) The trader sold article A in period 1 for ₹60,000 in cash.

(d) He also sold article B in period 1 for ₹2,500 on credit.

Profit and Loss Account of the trader by two basis of accounting are shown below. A look at the cash basis Profit and Loss Account will convince any reader of the irrationality of cash basis of accounting.

Cash basis of accounting

Cash purchase of article B and cash sale of article A is recognised in period 1 while purchase of article A on payment and sale of article B on receipt is recognised in period 2.

Profit and Loss Account

		₹			₹
Period 1	To Purchase	2,000	Period 1	By Sale	60,000
	To Net Profit	58,000			
		60,000			60,000
Period 2	To Purchase	50,000	Period 2	By Sale	2,500
				By Net Loss	47,500
		50,000			50,000

Accrual basis of accounting

Credit purchase of article A and cash purchase of article B and cash sale of article Aand credit sale of article B is recognised in period 1 only.

Profit and Loss Account

		₹			₹
Period 1	To Purchase	52,000	Period 1	By Sale	62,500
	To Net Profit	10,500			
		62,500			62,500

Example 3

- A Ltd. has entered into a binding agreement with P Ltd. to buy a custom-made machine ₹40,000. At the end of 20X1-X2, before delivery of the machine, A Ltd. had to change its method of production.
- The new method will not require the machine ordered and it will be scrapped after delivery. The expected scrap value is nil.
- A liability is recognised when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, A Ltd. should recognise a liability of ₹40,000 to P Ltd.
- When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset.

- In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognised as an expense.
- The accounting entry is suggested below:

		₹	₹
Loss on change in production Method To P Ltd. (Loss due to change in production method)	Dr.	40,000	40,000
Profit and loss A/c To Loss on change in production method (loss transferred to profit and loss account)	Dr.	40,000	40,000

Example 4

- Suppose at the beginning of an accounting period, aggregate values of assets, liabilities and equity of a trader are ₹5 lakh, ₹2 lakh and ₹3 lakh respectively.
- Also suppose that the trader had the following transactions during the accounting period.
  - (a) Introduced capital ₹20,000.
  - (b) Earned income from investment ₹8,000.
  - (c) A liability of ₹31,000 was finally settled on payment of ₹30,000. Balance sheets of the trader after each transaction are shown below:

Transactions	Assets ₹lakh	–	Liabilities ₹lakh	=	Equity ₹lakh
Opening	5.00	–	2.00	=	3.00
(a) Capital introduced	5.20	–	2.00	=	3.20
(b) Income from investments	5.28	–	2.00	=	3.28
(c) Settlement of liability	4.98	–	1.69	=	3.29

- This example given explains the definition of income. The equity increased by₹29,000 during the accounting period, due to (i) Capital introduction ₹20,000 and(ii) Income earned ₹9,000 (Income from investment + Discount earned).
- Incomes are therefore increases in equity without introduction of capital.

Example 5

Continuing with the example 4 given above, suppose the trader had the following further transactions during the period:

(a) Wages paid ₹2,000.
(b) Rent outstanding ₹1,000.
(c) Drawings ₹4,000.

Balance sheets of the trader after each transaction are shown below:

Transactions		**Assets ₹lakh**	**–**	**Liabilities ₹lakh**	**=**	**Equity ₹lakh**
Opening		5.00	–	2.00	=	3.00
(a)	Capital introduced	5.20	–	2.00	=	3.20
(b)	Income from investments	5.28	–	2.00	=	3.28
(c)	Settlement of liability	4.98	–	1.69	=	3.29
(d)	Wages paid	4.96	–	1.69	=	3.27
(e)	Rent Outstanding	4.96	–	1.70	=	3.26
(f)	Drawings	4.92	–	1.70	=	3.22

- The example given above explains the definition of expense.
- The equity decreased by ₹7,000 from ₹3.29 lakh to ₹3.22 lakh due to (i) Drawings ₹4,000 and (ii) Expenses incurred ₹3,000 (Wages paid + Rent).
- The example given above explains the definition of expense. The equity decreased by ₹7,000 from ₹3.29 lakh to ₹3.22 lakh due to (i) Drawings ₹4,000 and (ii) Expenses incurred ₹3,000 (Wages paid + Rent).

Example 6

- Mr. X purchased a machine on 1st January, 20X1 at ₹7,00,000. As per historical cost basis, he has to record it at ₹7,00,000 i.e. the acquisition price.
- As on 1.1.20X6, Mr. X found that it would cost ₹25,00,000 to purchase that machine. Mr. X also took loan from a bank as on 20X1 ₹5,00,000 @ 18% p.a. repayable at the end of 15th year together with interest.
- As per historical cost, the liability is recorded at ₹5,00,000 at the amount or proceeds received in exchange for obligation and asset is recorded at ₹7,00,000.

Example 7

- A machine was acquired for $ 10,000 on deferred payment basis.
- The rate of exchange on the date of acquisition was ₹49/$. The payments are to be made in 5 equal annual instalments together with 10% interest per year.
- The current market value of similar machine in India is ₹5lakhs.
- Current cost of the machine = Current market price = ₹5,00,000.
- By historical cost convention, the machine would have been recorded at ₹4,90,000.
- To settle the deferred payment on current date one must buy dollars at ₹49/$. The liability is therefore recognised at ₹4,90,000 ($ 10,000 × ₹49).
- Note that the amount of liability recognised is not the present value of future payments. This is because, in current cost convention, liabilities are recognised at undiscounted amount.

Example 8

- Carrying amount of a machine is ₹40,000 (Historical cost less depreciation). The machine is expected to generate ₹10,000 net cash inflow.
- The net realisable value (or net selling price) of the machine on current date is ₹35,000.
- The enterprise's required earning rate is 10% per year.
- The enterprise can either use the machine to earn ₹10,000 for 5 years.
- This is equivalent of receiving present value of ₹10,000 for 5 years at discounting rate 10% on current date.
- The value realised by use of the asset is called value in use. The value in use is the value of asset by present value convention.
- Value in use = ₹10,000 (0.909 + 0.826 + 0.751 + 0.683 + 0.621) = ₹37,900
- Net selling price = ₹35,000
- The present value of the asset is ₹37,900, which is called its recoverable value.
- It is obviously not appropriate to carry any asset at a value higher than its recoverable value.
- Thus the asset is currently overstated by ₹2,100 (₹40,000 – ₹37,900).

Example 9

- A trader commenced business on 01/01/20X1 with ₹ 12,000 represented by 6,000 units of a certain product at ₹ 2 per unit.
- During the year 20X1 he sold these units at ₹ 3 per unit and had withdrawn ₹ 6,000.
- Thus: Opening Equity = ₹ 12,000 represented by 6,000 units at ₹ 2 per unit.
- Closing Equity = ₹ 12,000 (₹ 18,000 – ₹ 6,000) represented entirely by cash.
- Retained Profit = ₹ 12,000 – ₹ 12,000 = Nil
- The trader can start year 20X2 by purchasing 6,000 units at ₹ 2 per unit once again for selling them at ₹ 3 per unit.
- The whole process can repeat endlessly if there is no change in purchase price of the product.

Example 10

- In the previous example (Example 9), suppose that the average price indices at the beginning and at the end of year are 100 and 120 respectively.
- Opening Equity = ₹ 12,000 represented by 6,000 units at ₹ 2 per unit.
- Opening equity at closing price = (₹ 12,000 / 100) x 120 = ₹ 14,400 (6,000 x ₹ 2.40)
- Closing Equity at closing price= ₹ 12,000 (₹ 18,000 – ₹ 6,000) represented entirely by cash.
- Retained Profit = ₹ 12,000 – ₹ 14,400 = (–) ₹ 2,400
- The negative retained profit indicates that the trader has failed to maintain his capital.
- The available fund ₹ 12,000 is not sufficient to buy 6,000 units again at increased price ₹ 2.40 per unit.
- In fact, he should have restricted his drawings to₹ 3,600 (₹ 6,000 – ₹ 2,400).
- Had the trader withdrawn ₹ 3,600 instead of ₹ 6,000, he would have left with ₹ 14,400, the fund required to buy 6,000 units at ₹ 2.40 per unit.

Example 11 (Physical capital maintenance)

- In the previous example (Example 9) suppose that the price of the product at the end of year is ₹2.50 per unit.
- In other words, the specific price index applicable to the product is125.
- Current cost of opening stock = (₹12,000 / 100) x 125 = 6,000 x ₹2.50 = ₹15,000 Current cost of closing cash = ₹12,000 (₹18,000 – ₹6,000)
- Opening equity at closing current costs = ₹15,000
- Closing equity at closing current costs = ₹12,000 Retained Profit = ₹12,000 – ₹15,000 = (-) ₹3,000

- The negative retained profit indicates that the trader has failed to maintain his capital.
- The available fund ₹12,000 is not sufficient to buy 6,000 units again at increased price ₹2.50 per unit.
- The drawings should have been restricted to ₹3,000 (₹6,000 – ₹3,000).
- Had the trader withdrawn ₹3,000 instead of ₹6,000, he would have left with ₹15,000, the fund required to buy 6,000 units at ₹2.50 per unit.
- Capital maintenance can be computed under all three bases as shown below:

Financial Capital Maintenance At Historical Costs

	₹	₹
Closing capital (At historical cost)		12,000
Less: Capital to be maintained		
Opening capital (At historical cost)	12,000	
Introduction (At historical cost)	Nil	(12,000)
Retained profit		Nil

Financial Capital Maintenance At Current Purchasing Power

	₹	₹
Closing capital (At closing price)		12,000
Less: Capital to be maintained		
Opening capital (At closing price)	14,400	
Introduction (At closing price)	Nil	(14,400)
Retained profit		(2,400)

Physical Capital Maintenance

	₹	₹
Closing capital (At current cost) (4800units)		12,000
Less: Capital to be maintained		
Opening capital (At current cost)(6000 units)	15,000	
Introduction (At current cost)	Nil	(15,000)
Loss resulting in non-maintenances of capital		(3,000)

Multiple Choice Questions

MCQs

1. **The 'going concern' concept assumes that**
   (a) The business can continue in operational existence for the foreseeable future.
   (b) The business cannot continue in operational existence for the foreseeable future.
   (c) The business is continuing to be profitable.

2. **Two principal qualitative characteristics of financial statements are**
   (a) Under stand ability and materiality
   (b) Relevance and reliability
   (c) Relevance and materiality

3. **All of the following are components of the financial statement except**
   (a) Balance sheet
   (b) Statement of PL
   (c) Human responsibility report

4. **An accounting policy can be changed if the change is required**
   (a) By statute or accounting standard
   (b) For more appropriate presentation of financial statements
   (c) Both (a) and (b)

5. **Value of equity may change due to**
   (a) Contribution from or Distribution to equity participants
   (b) Income earned / expenses incurred
   (c) Both (a) and (b)

6. **An item that meets the definition of an element of financial statements should be recognised in the financial statements if:**
   (a) It is possible that any future economic benefit associated with the item will flow to the enterprise
   (b) Item has a cost or value that can be measured with reliability
   (c) Both (a) and (b)

7. **A machine was acquired in exchange of an old machine and ₹ 20,000 paid in cash. The carrying amount of old machine was ₹ 2,00,000 whereas its fair value was ₹ 1,50,000 on the date of exchange. The historical cost of the new machine will be taken as**
   (a) ₹ 2,00,000
   (b) ₹ 1,70,000
   (c) ₹ 2,20,000

8. **Which of the assumption is not considered as fundamental accounting assumption?**
   (a) Going Concern
   (b) Accrual
   (c) Reliability.

9. Liabilities are recorded at the undiscounted amount of cash expected to be paid on settlement of liability in the normal course of business under:

(a) Present value.

(b) Realizable value.

(c) Current cost.

Answer

1	2	3	4	5	6	7	8	9
A	B	C	C	C	C	B	C	B

Theoretical Question

Question 1

With regard to financial statements name any four.

(1) Users
(2) Qualitative characteristics
(3) Elements

Answer

(1) Users of financial statements	(2) Qualitative Characteristics of Financial Statements	(3) Elements of Financial Statements
i. Investors, ii. Employees, iii. Lenders, iv. Supplies/Creditors, v. Customers, vi. Government & vii. Public	**i.** Understandability, **ii.** Relevance, **iii.** Comparability, **iv.** Reliability	**i.** Asset, **ii.** Liability, **iii.** Equity, **iv.** Income/Gain and **v.** Expense/Loss

Question 2

Explain in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the Balance Sheet or Statement of Profit and Loss.

Answer

- Measurement is the process of **determining money value** at which an element can be **recognised in** the balance sheet or statement of profit and loss.
- The framework recognises **four alternative measurement** bases for the purpose.
- These bases relate **explicitly to the valuation of assets and liabilities**.
- The valuation of income or expenses, i.e. profit is implied, by the value of change in assets and liabilities.

MEASUREMENT BASIS

Basis	Assets	Liabilities
Historical Cost	Recorded at an amount of cash or cash equivalent paid or the fair value of the asset at the time of acquisition.	Recorded at the amount of proceeds received in exchange for the obligation. In some circumstances a liability is recorded at the amount of cash or cash equivalent expected to be paid to satisfy it in the normal course of business.
Current Cost	Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently.	Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
Realisable (Settlement) Value	For assets, this is the amount of cash or cash equivalents currently realisable on sale of the asset in an orderly disposal.	For liabilities, this is the undiscounted amount of cash or cash equivalents expected to be paid on settlement of liability in the normal course of business.
Present Value	Assets are carried at the present value of the future net cash inflows that the item is expected to generate in the normal course of business.	Liabilities are carried at the present value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

Question 3

Write short note on main elements of Financial Statements.

Answer

- **Elements of Financial Statements**
  - ✓ The framework classifies items of financial statements can be classified in five broad groups depending on their economic characteristics
  - ✓ Asset, Liability, Equity, Income/Gain and Expense/Loss.

Asset	Resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise
Liability	Present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow of a resource embodying economic benefits.
Equity	Residual interest in the assets of an enterprise after deducting all its liabilities.
Income/gain	Increase in economic benefits during the accounting period in the form of inflows or enhancement of assets or decreases in liabilities that result in increase in equity other than those relating to contributions from equity participants
Expense/loss	Decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decrease in equity other than those relating to distributions to equity participants.

Question 4

Explain the **purpose and status of the conceptual framework** for preparation and presentation of financial statements in brief.

Answer:

PURPOSE OF THE FRAMEWORK

- The framework sets out the concepts underlying the preparation and presentation of **general-purpose financial statements** prepared by enterprises for external users.
- The main purpose of the framework is to **assist**:

  (a) Enterprises in preparation of their financial statements in **compliance with Accounting Standards and in dealing with the topics not yet covered by any Accounting Standard,**

  (b) ASB in its task of **development and review of Accounting Standards,**

  (c) ASB in promoting **harmonization of regulations, Accounting Standards and procedures** relating to the preparation and presentation of financial statements by providing a basis for **reducing the number of alternative accounting treatments permitted by Accounting Standards,**

  (d) **Auditors in forming an opinion as to whether financial statements conform to the Accounting Standards,**

  (e) Users in **interpretation** of financial statements,

  (f) Those who are interested in the work of ASB with information about its information to the formulation of Accounting Standards.

STATUS AND SCOPE OF THEFRAMEWORK

- The framework **applies to general-purpose financial statements** (hereafter referred to as 'financial statements' usually prepared **annually for external users,** by all commercial, industrial and business enterprises, whether in public or private sector.
- **The special purpose financial reports,** for example computations prepared for tax purposes are **outside the scope of the framework.**
- Nevertheless, the framework may be applied in preparation of such reports, to the extent not inconsistent with their requirements.
- **Nothing in the framework overrides any specific Accounting Standard.**
- **In case of conflict between an Accounting Standard and the framework, the requirements of the Accounting Standard will prevail over those of the framework.**

Question 5

What are the qualitative characteristics of the financial statements which improve the usefulness of the information furnished therein?

Answer

a. Understandability

- The financial statements should present information in a manner as to be **readily understandable** by the users with reasonable knowledge of business and economic activities and accounting.

b. Relevancy

- It is **not right to think that more information one discloses the better it is**.
- A mass of **irrelevant information creates confusion** and can be even more harmful than non-disclosure.

- The financial statements should **contain relevant information only**.
- Information, which is likely to **influence the economic decisions by the users, is said to be relevant.**
- **Such information may help the users to evaluate past, present or future events or may help in confirming or correcting past evaluations.**
- The relevance of a piece of information should be judged by its materiality. A piece of information is said to be material if its misstatement (i.e., omission or erroneous statement) can influence economic decisions of a user.

c. **Reliability**

- **To** be useful, the information must be reliable; that is to say, they must be **free from material error and bias.**
- The information provided are not likely to be reliable unless:
  (a) Transactions and events reported are **faithfully represented.**
  (b) Transactions and events are **reported on the principle of 'substance over form**.
  (c) The reporting of transactions and events are **neutral, i.e. free from bias.**
  (d) **Prudence is exercised** in reporting uncertain outcome of transactions or events.
  (e) The information in financial statements **must be complete.**

d. **Comparability**

- Comparison of financial statements is one of the **most frequently used and most effective tools of financial analysis.**
- The financial statements **should permit both inter-firm and intra-firm comparison.** One essential requirement of comparability is disclosure of financial effect of change in accounting policies.

Question 6

'One of the characteristics of financial statements is neutrality'. Do you agree with this statement?

Answer

- **Yes,** one of the characteristics of financial statements is neutrality.
- **To be reliable,** the information contained in financial statement **must be neutral, that is free from bias.**
- Financial Statements are not neutral if by the selection or presentation of information, the focus of analysis could shift from one area of business to another there by arriving at a totally different conclusion on the business results.
- For example If the assets of a company primarily consist of debtors and insurance claims and the financial statements do not specify that the insurance claims have been lying unrealized for a number of years or that a few key debtors have not given balance confirmation certificates, an erroneous conclusion may be drawn on the liquidity of the company.
- Financial statements are said to **depict the true and fair view of the business** of the organization by virtue of neutrality.

Practical Question

Question 1

Mohan started a business on 1st April 20X1 with ₹12,00,000 represented by 60,000 units of ₹ 20 each. During the financial year ending on 31st March, 20X2, he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Mohan in the year 20X1-X2 if Financial Capital is maintained at historical cost.

Answer:

Particulars	Financial Capital Maintenance at Historical Cost(₹)
Closing equity (₹ 30 x 60,000 units)	18,00,000 represented by cash
Opening equity	60,000 units x ₹ 20 = 12,00,000
Permissible drawings to keep Capital intact	6,00,000 (18,00,000 – 12,00,000)

Question 2

Opening Balance Sheet of Mr. A is showing the aggregate value of assets, liabilities and equity ₹ 8 lakh, ₹ 3 lakh and ₹ 5 lakh respectively. During accounting period, Mr. A has the following transactions:

(1) Earned 10% dividend on 2,000 equity shares held of ₹ 100 each

(2) Paid ₹ 50,000 to creditors for settlement of ₹ 70,000

(3) Rent of the premises is outstanding ₹ 10,000

(4) Mr. A withdrew ₹ 9,000 for his personal use.

You are required to show the effect of above transactions on Balance Sheet in the form of Assets - Liabilities = Equity after each transaction.

Answer

Effects of each transaction on Balance sheet of the trader are shown below:

Transactions	Assets ₹ lakh	-	Liabilities ₹ lakh	=	Equity ₹ lakh
Opening	8.00	–	3.00	=	5.00
(1) Dividend earned	8.20	–	3.00	=	5.20
(2) Settlement of Creditors	7.70	-	2.30	=	5.40
(3) Rent Outstanding	7.70	–	2.40	=	5.30
(4) Drawings	7.61	–	2.40	=	5.21

Question 2

Balance Sheet of Anurag Trading Co. on 31st March, 20X1 is given below:

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital	50,000	Fixed Assets	69,000
Profit and Loss A/c	22,000	Stock in Trade	36,000
10% Loan	43,000	Trade Receivables	10,000
Trade Payables	18,000	Deferred Expenditure	15,000
	-	Bank	3,000
	1,33,000		1,33,000

Additional Information:

(i) Remaining life of fixed assets is 5 years with even use. The net realisable value of fixed assets as on 31st March, 20X2 was ₹64,000.

(ii) Firm's sales and purchases for the year 20X1-X2 amounted to ₹5 lacs and ₹ 4.50 lacs respectively.

(iii) The cost and net realisable value of the stock were ₹34,000 and ₹38,000 respectively.

(iv) General Expenses for the year 20X1-X2 were₹16,500.

(v) Deferred Expenditure is normally amortised equally over 4 years starting from F.Y. 20X0-X1 i.e. ₹5,000 per year.

(vi) Out of debtors worth ₹10,000, collection of ₹4,000 depends on successful redesign of certain product already supplied to the customer.

(vii) Closing trade payable is ₹10,000 which is likely to be settled at 95%.

(viii) There is pre-payment penalty of ₹2,000 for Bank loan outstanding.

Prepare profit & loss account for the year ended 31st March, 20X2 by **assuming it is not a Going Concern**.

Answer

Profit and Loss Account of Anurag Trading Co. for the year ended 31st March, 20X2
(Assuming business is not a going concern)

	(₹)		(₹)
To Opening Stock	36,000	By Sales	5,00,000
To Purchases	4,50,000	By Trade Payables	500
To General Expenses	16,500	By Closing Stock	38,000
To Depreciation (69,000–64,000)	5,000		
To Provision for doubtful debts	4,000		
To Deferred expenditure	15,000		
To Loan penalty	2,000		
To Net Profit (b.f.)	10,000		
	5,38,500		**5,38,500**

****

Chapter: 3
Applicability of Accounting Standards

1. APPLICATION OF AS

All the non-corporate entities divided into 2 categories

NON MSME'S

- ✓ **No relaxation** in relation to application if AS
- ✓ **Exemptions are not available**

LEVEL I under non MSME's (Big entities)

- ✓ **It includes 8 kind Of business**

1. Entities whose securities are **listed** or
2. Are **in the process of listing** on any stock exchange, whether in India or outside India.
3. **Banks**(including co-operative banks), financial institutions or
4. Entities carrying on **insurance business.**
5. All commercial, industrial and business reporting entities, **whose turnover (excluding other income) exceeds rupees 250 crore in the immediately preceding accounting year.**
6. All commercial, industrial and business reporting entities having **borrowings (including public deposits) in excess of rupees 50 crore at any time during the immediately preceding accounting year.**
7. **Holding** and
8. **Subsidiary** entities of any one of the above.

MSME'S

- ✓ **Some relaxation** in relation to application if AS
- ✓ **Exemptions are available** as compare to Non MSME's

LEVEL II under non MSME's (Medium entities)

- ✓ **It must be out of remaining entities other than Level 1**
- ✓ **It includes 4 Business**

(i) All commercial, industrial and business reporting entities, **whose turnover (excluding other income) exceeds rupees 50 crore but does not exceed rupees 250 crore in the immediately preceding accounting year.**

(ii) All commercial, industrial and business reporting entities having **borrowings (including public deposits) in excess of rupees 10 crorebut not in excess of rupees 50 crore at any time during the immediately preceding accounting year.**

(iii) **Holding** and

(iv) **Subsidiary** entities of any one of the above.

LEVEL III under non MSME's (Small entities)

- ✓ **It must be out of remaining entities other than Level I and II**
- ✓ **It includes 4 Business**

(i) All commercial, industrial and business reporting entities, **whose turnover (excluding other income) exceeds rupees 10 crore butdoes not exceed rupees 50 crore in the immediately preceding accounting year.**

(ii) All commercial, industrial and business reporting entities having **borrowings (including public deposits) in excess of rupees 2 crorebut not in excess of rupees 10 crore at any time during the immediately preceding accounting year.**

(iii) **Holding** and

(iv) **Subsidiary** entities of any one of the above.

LEVEL IV under non MSME's (Micro\ Entities)

- ✓ Entities which are not covered under Level I , II and Level III are consideredas Level IV entities.

2. ADDITIONAL NOTES

(1) Where an entity, being covered in Level II or Level III or Level IV, had qualified for any exemption or relaxation previously but no longer qualifies for the relevant exemption or relaxation in the current accounting period, the relevant standards or requirements become applicable from the current period and the figures for the corresponding period of the previous accounting period need not be revised merely by reason of its having ceased to be covered in Level II or Level III or Level IV, as the case may be. The fact that the entity was covered in Level II or Level III or Level IV, as the case may be, in the previous period and it had availed of the exemptions or relaxations available to that Level of entities shall be disclosed in the notes to the financial statements. The fact that previous period figures have not been revised shall also be disclosed in the notes to the financial statements.

(2) Where an entity has been covered in Level I and subsequently, ceases to be s covered and gets covered in Level II or Level III or Level IV, the entity will not qualify for exemption/relaxation available to that Level, **until the entity ceases to be covered in Level I for two consecutive years**. Similar is the case in respect of an entity, which has been covered in Level II or Level III and subsequently, gets covered under Level III or Level IV.

(3) If an entity covered in Level II or Level III or Level IV opts not to avail of the exemptions or relaxations available to that Level of entities in respect of any but not all of the Accounting Standards, it shall disclose the Standard(s) in respect of which it has availed the exemption or relaxation.

(4) If an entity covered in Level II or Level III or Level IV opts not to avail any one or more of the exemptions or relaxations available to that Level of entities, it shall comply with the relevant requirements of the Accounting Standard.

(5) An entity covered in Level II or Level III or Level IV may opt for availing certain exemptions or relaxations from compliance with the requirements prescribed in an Accounting Standard:

(6) Provided that such a partial exemption or relaxation and disclosure shall not be permitted to mislead any person or public

3. APPLICABILITY OF ACCOUNTING STANDARDS TO COMPANIES

✓ Accounting Standards **applicable to all companies in their entirety** for accounting periods commencing on or after 7th December,2006

AS 1	Disclosures of Accounting Policies
AS 2 (Revised)	Valuation of Inventories
AS 4 (Revised)	Contingencies and Events Occurring After the BalanceSheet Date
AS 5	Net Profit or Loss for the Period, Prior Period Items andChanges in Accounting Policies
AS 7	Construction Contracts
AS 9	Revenue Recognition
AS 10 (Revised)	Property, Plant and Equipment
AS 11	The Effects of Changes in Foreign Exchange Rates
AS 12	Accounting for Government Grants

AS13(Revised)	Accounting for Investments
AS14(Revised)	Accounting for Amalgamations
AS 16	Borrowing Costs
AS 18	Related Party Disclosures
AS 22	Accounting for Taxes on Income
AS 24	Discontinuing Operations
AS 26	Intangible Assets

✓ **Exemptions or Relaxations for SMCs**

(A) Accounting Standards not applicable to SMCsin their entirety:

AS3Cash Flow Statements

AS 17 Segment Reporting

(B) Accounting Standards not applicable to SMCssince the relevant Regulations require compliance with them only by certain Non-SMCs

(i) AS 21 (Revised), Consolidated Financial Statements

(ii) AS 23, Accounting for Investments in Associates in Consolidated Financial Statements

(iii) AS 27, Financial Reporting of Interests in Joint Ventures (to the extent of requirements relating to Consolidated Financial Statements)

4. APPLICABILITY OF ACCOUNTING STANDARDS TO NON-CORPORATE ENTITIES

✓ Level I entities are required to comply in full with all the Accounting Standards.

✓ Accounting Standards applicable (Level II, Level III and Level IV)

AS	Level II Entities	Level III Entities	Level IV Entities
AS 1	Applicable	Applicable	Applicable
AS 2	Applicable	Applicable	Applicable
AS 3	Not Applicable	Not Applicable	Not Applicable
AS 4	Applicable	Applicable	Applicable
AS 5	Applicable	Applicable	Applicable
AS 7	Applicable	Applicable	Applicable
AS 9	Applicable	Applicable	Applicable
AS 10	Applicable	Applicable with disclosures exemption	Applicable with disclosures exemption
AS 11	Applicable	Applicable with disclosures exemption	Applicable with disclosures exemption
AS 12	Applicable	Applicable	Applicable
AS 13	Applicable	Applicable	Applicable with disclosures exemption
AS 14	Applicable	Applicable	Not Applicable (Refer note 2(C))

AS 15	Applicable with exemptions	Applicable with exemptions	Applicable with exemptions
AS 16	Applicable	Applicable	Applicable
AS 17	Not Applicable	Not Applicable	Not Applicable
AS 18	Applicable	Not Applicable	Not Applicable
AS 19	Applicable with disclosures exemption	Applicable with disclosures exemption	Applicable with disclosures exemption
AS 20	Not Applicable	Not Applicable	Not Applicable
AS 21	Not Applicable (Refer note 2(D))	Not Applicable (Refer note 2(D))	Not Applicable (Refer note 2(D))
AS 22	Applicable	Applicable	Applicable only for current tax related provisions (Refer Note 2(B)(vi))
AS 23	Not Applicable (Refer note 2(D))	Not Applicable (Refer note 2(D))	Not Applicable (Refer note 2(D))
AS 24	Applicable	Not Applicable	Not Applicable
AS 25	Not Applicable (Refer note 2(D))	Not Applicable (Refer note 2(D))	Not Applicable (Refer note 2(D))
AS 26	Applicable	Applicable	Applicable with disclosures exemption
AS 27	Not Applicable (Refer notes 2(C) and 2(D))	Not Applicable (Refer notes 2(C) and 2(D))	Not Applicable (Refer notes 2(C) and 2(D))
AS 28	Applicable with disclosures exemption	Applicable with disclosures exemption	Not Applicable
AS 29	Applicable with disclosures exemption	Applicable with disclosures exemption	Applicable with disclosures exemption

Example 1

M/s Omega & Co. (a partnership firm), had a turnover of ₹ 1.25 crores (excluding other income) and borrowings of ₹ 0.95 crores in the previous year. It wants to avail the exemptions available in application of Accounting Standards to non-corporate entities for the year ended 31.3.20X1. Advise the management of M/s Omega & Co in respect of the exemptions of provisions of ASs, as per the directive issued by the ICAI.

Solution

- ✓ The question deals with the issue of Applicability of Accounting Standards to a non-corporate entity. For availment of the exemptions, first of all, it has to be seen that M/s Omega & Co. falls in which level of the non-corporate entities. Its classification will be done on the basis of the classification of non-corporate entities as prescribed by the ICAI. According to the ICAI, non-corporate entities can be classified under 4 levels viz Level I, Level II, Level III and Level IV entities.
- ✓ Non-corporate entities which meet following criteria are classified as Level IV entities:
- ✓ All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) does not exceed rupees ten crores in the immediately preceding accounting year.
- ✓ All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) does not exceed rupees two crores at any time during the immediately preceding accounting year.
- ✓ Holding and subsidiary entities of any one of the above.
- ✓ As the turnover of M/s Omega & Co. is less than ₹ 10 crores and borrowings less than ₹ 2 crores, it falls under Level IV non-corporate entities. In this case, AS 3, AS 14, AS 17, AS 18, AS 20, AS 21, AS 23, AS 24, AS 25, AS 27 and AS 28 will not be
- ✓ applicable to M/s Omega & Co. Relaxations from certain requirements in respect of AS 10, AS 11, AS 13, AS 15, AS 19, AS 22, AS 26 and AS 29 are also available to M/s Omega & Co.

Question 1

XYZ Ltd., with a turnover of ₹ 35 lakhs and borrowings of ₹ 10 lakhs during any time in the previous year, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3.2017. Advise the management on the exemptions that are available as per the Companies (AS) Rules, 2006.

If XYZ is a partnership firm is there any other exemptions additionally available.

Answer

- ✓ The question deals with the issue of Applicability of Accounting Standards for corporate & non-corporate entities .
- ✓ The companies can be classified under two categories viz SMCs and Non SMCs under the Companies (AS) Rules, 2006.
- ✓ As per the Companies (AS) Rules, 2006, criteria for above classification as SMCs, are: "Small and Medium Sized Company" (SMC) means, a company- whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;
- which is not a bank, financial institution or an insurance company;
- whose turnover (excluding other income) does not exceed rupees 250 crore in the immediately preceding accounting year;
- which does not have borrowings (including public deposits) in excess of rupees 50 crore at any time during the immediately preceding accounting year; and
- which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

- ✓ The following relaxations and exemptions are available to XYZ Ltd.
  1. AS 3 “Cash Flow Statements” is not mandatory.
  2. AS 17 “Segment Reporting” is not mandatory.
  3. SMEs are exemption from some paragraphs of AS 19 “Leases”.
  4. SMEs are exempt from disclosures of diluted EPS (both including and excluding extraordinary items).
  5. SMEs are allowed to measure the „value in use‟ on the basis of reasonable estimate thereof instead of computing the value in use by present value technique under AS 28 “Impairment of Assets”.
  6. SMEs are exempt from certain disclosure requirements of AS 29 (Revised) “Provisions, Contingent Liabilities and Contingent Assets”.
  7. SMEs are exempt from certain requirements of As 15 “Employee Benefits”.
  8. Accounting Standards 21, 23, 27 are not applicable to SMEs.
- ✓ However, it XYZ is a partnership firm and not a corporate, then its classification will be done on the basis of the classification of non-corporate entities as classified under 4 levels viz Level I, II, III and Level IV.
- ✓ Since, turnover of XYZ, a partnership firm is less than ₹ 10 crore & borrowings of ₹10 lakhs is less than ₹ 2 crore, therefore, it will be classified as Level IV . In this case AS 3, AS 17, AS 18, AS 21 (Revised), AS 23, AS 24, AS27 will not be applicable to XYZ a partnership firm.
- ✓ Relaxations from certain requirements in respect of AS 15, AS 19, AS 20, AS 25, AS 28 and AS 29 (Revised) are also available to XYZ a partnership firm.

Question 2
A company was classified as Non-SMC in 2015-2016. In 2016-2017 it has been classified as SMC. The management desires to avail the exemption or relaxations available for SMCs in 2016-2017. However, the accountant of the company does not agree with the same. Comment.
Answer

- ✓ Asper Rule 5 of the Companies (Accounting Standards) Rules, 2006, an existing company, which was previously not an SMC and subsequently becomes an SMC, should not be qualified for exemption or relaxation in respect of accounting standards available to an SMC until the company remains an SMC for two consecutive accounting periods.
- ✓ Therefore, the management of the company cannot avail the exemptions available with the SMCs for the year ended 31stMarch, 2017.

Question 3

Comment whether the following Companies can be classified as a Small and Medium Sized Company (SMC) as per the Companies (Accounting Standards), Rules, 2006:

(i) A Pvt. Ltd., a subsidiary of a multinational company listed on London Stock Exchange. It has a turnover of Rs. 12 crores and borrowings of Rs. 5 crores.

(ii) B Pvt. Ltd., has a turnover of Rs. 45 crores, other income of Rs. 7 crores and bank borrowings of Rs. 9 crores

Answer

- As per the companies (Accounting Standards) Rules, 2006, “Small and Medium Sized Company” (SMC) means, a company:
  - (a) Whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India‟
  - (b) Which is not a bank, financial institution or an insurance company;
  - (c) Whose turnover (excluding other income) does not exceed rupee; 250 crore in the immediately preceding accounting year;
  - (d) Which does not have borrowings (including public deposits) in excess of rupees 50 crore at any time during the immediately preceding accounting year; and
  - (e) Which is not a holding or subsidiary company of a company which is not a small and medium-sized company.
- Explanation: accompany shall qualify as a Small and Medium Sized Company, if the condition mentioned, there in are satisfied as at the end of the relevant accounting period.
  - (i) As per the definition of SMC, point (v), a company will be a SMC, if it is not holding or subsidiary company of another company which is not a SMC.

    Since A Pvt. Ltd., is a subsidiary of another Company which is listed, on London Stock Exchange (and is therefore not a SMC), A Pvt. Ltd., cannot be a SMC. The turnover and borrowings are not relevant in this case.
  - (ii) As per the definition of SMC, point (iii), accompany will be a SMC if its turnover does not exceed Rs. 250 crores or borrowings do not exceed Rs. 50 crore. For calculating this turnover, other income is not to be included. Since B Pvt. Ltd., has a turnover of Rs. 45 crores and borrowing of Rs. 9 crores, it will satisfy the definition and can be classified as SMC.

Question 4

List the criteria to be applied for rating a non-corporate entity as Level-I entity and Level II entity for the purpose of compliance of Accounting Standards in India

Answer Refer to Level I and II

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Chapter: 4 (Unit – 1)

Accounting Standard 1 Disclosure of Accounting Policies

1. MEANING OF ACCOUNTING POLICIES

- Accounting policies are:
  - (i) Principles and
  - (ii) Methods of applying those principles
- Which are adopted while preparing financial statement.

2. AREA OF ACCOUNTING

No Option

Different Options are Available

1. Valuation of Stock
2. Valuation of Goodwill
3. Valuation of Investment
4. Treatment of Government grant
5. Treatment of retirement benefits
6. Treatment of Long term service contract
7. Conversion of Foreign Country Transaction
8. Treatment of life time membership fee etc.
9. Method of cash flow statement etc.

3. FACTORS EFFECTING SELECTION OF ACCOUNTING POLICY (MPS)

MATERIALITY	PRUDENCE	SUBSTANCE OVER FORM
(i) Disclose material information separately and no need to disclose immaterial information separately. (ii) That information of which existence or non existence will effect decision of user will be considered as material information. (iii) It vary from business to business (iv) Depends on nature and size of business and information. (v) As per companies act any item having value more than 1% of revenue or 1 lakh whichever is higher always considered material information (vi) It results saving of time of user and direct focus on important item (vii) List of shareholders holding shares more than 5% need to be disclosed separately	• Record estimated losses but not record estimated income until it become virtually certain. • The exercise of prudence in selection of accounting policies ensure that: **(i)** Profits are not overstated **(ii)** Losses are not understand **(iii)** Assets are not overstated and **(iv)** Liabilities are not understand	Preference of reality of transaction over legal from

4. MANNER OF DISCLOSURE

- All **significant accounting policies** adopted in the preparation and presentation of financial statements should be disclosed.
- The disclosure of the significant accounting policies as such **should form part of the financial statements** and the significant accounting policies should **normally be disclosed in one place.**

5. CHANGE IN ACCOUNTING POLICIES

Selected Policy Need to follow consistently

Change in accounting policies

Only When

1. Required by AS
2. Statutory requirement
3. Meaning full and better presentation

Disclosures for changes in accounting policies

1. Reason of change
2. Effect on current period and future period
3. Fact of immeasurability

Note

The following are not changes in accounting policies:

(a) The adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, e.g., introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement;

(b) The adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial.

6. FUNDAMENTAL ACCOUNTING ASSUMPTION (CAG)

CONSISTENCY | **ACCRUAL** | **GOING CONCERN**

If followed than no disclosure is

If not followed than disclosure is

QUESTIONS & ANSWER

Question 1—

What are the three fundamental accounting assumptions recognised by Accounting Standard (AS)? Briefly describe each one of them.

Answer—

Accounting Standard (AS) 1 recognizes three fundamental accounting assumptions. These are as follows:

(I) ***Going Concern:***

The financial statements are normally prepared on the assumption that an enterprise will **continue its operations in the foreseeable future** and neither there is intention, nor there is need to materially curtail the scale of operations.

(II) ***Consistency:***

- The principle of consistency refers to the practice of using **same accounting policies** for similar transactions in all accounting periods unless the change is required
  a. **By a statute,**
  b. **By an accounting standard or**
  c. **For more appropriate presentation of financial statements.**

(III) ***Accrual basis of accounting***:

Under this basis of accounting, transactions are **recognised as soon as they occur, whether or not cash or cash equivalent is actually received or paid.**

Question 2—

Mention few areas in which different accounting policies are followed by companies.

Answer—

Following are the examples of the areas in which different accounting policies may be adopted by different enterprises:

i. Valuation of Stock
ii. Valuation of Goodwill
iii. Valuation of Investment
iv. Treatment of Government grant
v. Treatment of retirement benefits
vi. Treatment of Long term service contract
vii. Conversion of Foreign Country Transaction
viii. Treatment of life time membership fee
ix. Method of cash flow statement etc.

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Chapter: 4 (Unit -3)

Accounting Standard 17 SEGMENT REPORTING

1. APPLICATION OF AS 17

- AS 17 is mandatory in respect of non-SMCs (and level I entities in case of non-corporate).
- Other entities are encouraged to comply with AS 17.

2. OBJECTIVE

III. Better understand the performance of the enterprise;

IV. Better assess the risks and returns of the enterprise; and

V. Make more informed judgements about the enterprise as a whole.

3. SCOPE

- AS 17 should be applied in presenting general purpose financial statements.
- An enterprise should comply with the requirements of this Standard fully and not selectively.
- If a single financial report contains both consolidated financial statements and the separate financial statements of the parent, segment information need be presented only on the basis of the consolidated financial statements.

4. DEFINATION

(A) business segment:

- It is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments.
- Factors that should be considered in determining whether products or services are related include:
  - a . The nature of the products or services
  - b . The nature of the production processes
  - c . The type or class of customers for the products or services
  - d . The methods used to distribute the products or provide the services
  - e . If applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities

(B) Geographical segment:

- It is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments.
- Factors that should be considered in identifying geographical segments include:

   a. Similarity of economic and political conditions.
   b. Relationships between operations in different geographical areas.
   c. Proximity of operations.
   d. Special risks associated with operations in a particular area.
   e. Exchange control regulations and
   f. The underlying currency risks.

- The definition allows geographical segments to be based on either:
   a. The location of production or service facilities and other assets of an enterprise; or
   b. The location of its customers.

(C) Reportable segment

- is a business segment or a geographical segment identified on the basis of foregoing definitions for which segment information is required to be disclosed by AS 17.

(D) Segment revenue:

- It is the aggregate of:
   a. Revenue that is directly attributable to a segment,
   b. Revenue that can be allocated on a reasonable basis to a segment, and
   c. Revenue from transactions with other segments of the enterprise.
- Segment revenue does not include:
   a. Extraordinary items as defined in AS 5.
   b. Interest or dividend income, including interest earned on advances or loans to other segments unless the operations of the segment are primarily of a financial nature; and
   c. Gains on sales of investments or on extinguishment of debt unless the operations of the segment are primarily of a financial nature.

(E) Segment expense:

- It is the aggregate of:
   a. The expense that is directly attributable to the segment, and
   b. The expense that can be allocated on a reasonable basis to the segment,
   c. Including expense relating to transactions with other segments of the enterprise.
- Segment expense does not include:
   a. Extraordinary items as defined in AS 5.
   b. Interest expense, including interest incurred on advances or loans from other segments, unless the operations of the segment are primarily of a financial nature.
   c. Losses on sales of investments or losses on extinguishment of debt unless the operations of the segment are primarily of a financial nature.
   d. Income tax expense; and

e. General administrative expenses, head-office expenses, and other expenses that arise at the enterprise level and relate to the enterprise as a whole. However, costs are sometimes incurred at the enterprise level on behalf of a segment. Such costs are part of segment expense if they relate to the operating activities of the segment and if they can be directly attributed or allocated to the segment on a reasonable basis.

(F) Segment result: It is segment revenue less segment expense.

(G) Segment assets

- those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or
- Can be allocated to the segment on a reasonable basis.
- If the segment result of a segment includes interest or dividend income, its segment assets include the related receivables, loans, investments, or other interest or dividend generating assets.
- Segment assets are determined after deducting related allowances/provisions that are reported as direct offsets in the balance sheet of the enterprise.
- Segment assets do not include:

  a . income tax assets;

  b . Assets used for general enterprise or head-office purposes

(H) Segment liabilities:

- Those operating liabilities that result from the operating activities of a segment and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.
- If the segment result of a segment includes interest expense, its segment liabilities include the related interest-bearing liabilities.
- Examples of segment liabilities include trade and other payables, accrued liabilities, customer advances, product warranty provisions, and other claims relating to the provision of goods and services.
- Assets and liabilities that relate jointly to two or more segment should be allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments.
- **Segment liabilities do not include:**

  a . Income tax liabilities;

  b . Borrowings and other liabilities that are incurred for financing rather than operating purposes.

5. <u>PRIMARY AND SECONDARY SEGMENT</u>

- The dominant source and nature of risks and returns of an enterprise should govern whether its primary segment reporting format will be business segments or geographical segments.
- Dominance source is decided on the basis of direction of organisational structure, internal organisation and management structure of an enterprise and its system of

internal financial reporting to the board of directors and the chief executive officer.

Dominance	Primary segment	Secondary segment
Business segments	Business segments	Geographical segments
Geographical segments	Geographical segments	Business segments
Both	Business segments	Geographical segments

Note: 1.

A 'matrix presentation' both business segments and geographical segments as primary segment reporting formats with full segment disclosures on each basis will often provide useful information if risks and returns of an enterprise are strongly affected both by differences in the products and services it produces and by differences in the geographical areas in which it operates. AS 17 does not require, but does not prohibit, a 'matrix presentation'.

6. PRIMARY REPORTING FORMAT

I. Segment revenue, classified into segment revenue from sales to external customers and segment revenue from transactions with other segments;

II. Segment result;

III. Total carrying amount of segment assets;

IV. Total amount of segment liabilities;

V. Total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets);

VI. Total amount of expense included in the segment result for depreciation and amortization in respect of segment assets for the period; and

VII. Total amount of significant non-cash expenses, other than depreciation and amortization in respect of segment assets that were included in segment expense and, therefore, deducted in measuring segment result.

VIII. An enterprise that reports the amount of cash flows arising from operating, investing and financing activities of a segment need not disclose depreciation and amortization expense and non-cash expenses.

7. SECONDARY SEGMENT INFORMATION

I. Segment revenue from external customers by geographical area based on the geographical location of its customers, for each geographical segment whose revenue from sales to external customers is 10% or more of enterprise revenue;

II. The total carrying amount of segment assets by geographical location of assets, for each geographical segment whose segment assets are 10% or more of the total assets of all geographical segments; and

III. The total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets) by geographical location of assets, for each geographical segment whose segment assets are 10% or more of the total assets of all geographical segments.

8. IDENTIFYING REPORTABLE SEGMENTS

A business segment or geographical segment should be identified as a reportable segment if:

(A) Quantities criteria/RRA test/10% Approach or Threshold:

a. Its revenue from sales to external customers and from transactions with other segments is 10% or more of the total revenue, external and internal, of all segments; or

b. Its segment result, whether profit or loss, is 10% or more of -

- The combined result of all segments in profit, or
- The combined result of all segments in loss,

Whichever is greater in absolute amount; or

c. Its segment assets are 10% or more of the total assets of all segments.

(B) At the discretion of the management of the enterprise.

(C) A segment identified as a reportable segment in the immediately preceding period be- cause it satisfied the relevant 10% thresholds should continue to be a reportable segment for the current period notwithstanding that its revenue, result, and assets all no longer meet the 10% thresholds.

(D) Total Approach: If total external revenue attributable to reportable segments constitutes less than 75% of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10% thresholds, until at least 75% of total enterprise revenueis included in reportable segments.

Note: 2

Total Segment revenue will be differ from total of enterprise revenue because segment revenue includes inter segment transfer revenue and enterprise revenue excludes it.

Note:3

Enterprise may have different pricing policy (At cost/At profit/At loss) on goods or services providedto segments. It should be disclosed in the financial statement.

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Chapter: 4 (Unit -4)

Accounting Standard 18 Related Party Disclosures

1. OBJECTIVE

- AS 18 prescribes the requirements for disclosure of related party relationship and transactions between the reporting enterprise and its related parties.
- The requirements of the standard apply to the financial statements of each reporting enterprise as also to consolidated financial statements presented by a holding company.

2. RELATED PARTY RELATIONSHIP

- **Related party** – parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

AS 18 deals only with related party relationships described in (a) to (e) below:

a. Enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries).

b. Associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture.

c. Individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual.

d. Key management personnel and relatives of such personnel and

e. Enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.

In the context of AS 18, the following are deemed not to be related parties:

a. Two companies simply because they have a director in common (unless the director is able to affect the policies of both companies in their mutual dealings).

b. A single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence and

c. The parties listed below, in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of the enterprise or participate in its decision-making process):

   (i) Providers of finance   (ii) Trade unions

   (iii) Public utilities

   (iv) Government departments and government agencies including government sponsored bodies

Note:1

- Related party disclosure requirements as laid down in AS 18 do not apply in circumstances where providing such disclosures would conflict with the reporting enterprise's duties of confidentiality as specifically required in terms of a statute or by any regulator or similar competent authority.
- No disclosure is required in consolidated financial statements in respect of intra- group transactions.
- No disclosure is required in the financial statements of state-controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.

3. DEFINITIONS OF OTHER TERMS USED IN AS 18

I. Related party transaction: A transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

II. Control:
   - ownership, directly or indirectly, of more than one half of the voting power of an enterprise, or
   - control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or
   - a substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of the enterprise.

Note 2:

- an enterprise is considered to control the composition of the board of directors of a company or governing body of an enterprise, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of directors/members of the governing body of that company/enterprise. An enterprise is deemed to have the power to appoint a director/ member of the governing body, if any of the following conditions is satisfied:
- A person cannot be appointed as director/member of the governing body without the exercise in his favour by that enterprise of such a power as aforesaid or
- A person's appointment as director/member of the governing body follows necessarily from his appointment to a position held by him in that enterprise or
- The director/member of the governing body is nominated by that enterprise; in case that enterprise is a company, the director is nominated by that company/subsidiary thereof.

Note 3:

- An enterprise/individual is considered to have a substantial interest in another enterprise if that enterprise or individual owns, directly or indirectly, 20% or more interest in the voting power of the other enterprise.
- Similarly, an individual is considered to have a substantial interest in an enterprise, if that individual owns, directly or indirectly, 20 per cent or more interest in the voting power of the enterprise.

III. **An Associate:** An enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of that party.

IV. **SIGNIFICANT INFLUENCE:**

- Participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies.
- Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investing party holds, directly or indirectly through intermediaries, 20 per cent or more of the voting power of the enterprise, it is presumed that the investing party does have significant influence, unless it can be clearly demonstrated that this is not the case.
- Conversely, if the investing party holds, directly or indirectly through intermediaries, less than 20% of the voting power of the enterprise, it is presumed that the investing party does not have significant influence, unless such influence can be clearly demonstrated. Asubstantial or majority ownership by another investing party does not necessarily preclude an investing party from having significant influence.

V. **Key Management Personnel:**

- Those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.
- For example, in the case of a company, the managing directors, whole time directors, manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.
- A non-executive director of a company should not be considered as a key management person by virtue of merely his being a director unless he has the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.
- The requirements of AS 18 should not be applied in respect of a non-executive director even if he participates in the financial and/or operating policy decision of the enterprise, unless he falls in any of the categories of 'related party relationships' discussed above.

VI. **Relative:** In relation to an individual, means the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by, that individual in his/her dealings with the reporting enterprise.

VII. **Joint Venture -** a contractual arrangement whereby two or more parties undertake an economic activity which is subject to joint control.

VIII. **Joint Control-** the contractually agreed sharing of power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.

IX. **Holding Company-** a company having one or more subsidiaries.

X. Subsidiary - a company:

(a) in which another company (the holding company) holds, either by itself and/or through one or more subsidiaries, more than one-half, in nominal value of its equity share capital; or

(b) of which another company (the holding company) controls, either by itself and/or through one or more subsidiaries, the composition of its board of directors.

XI. Fellow subsidiary- a company is considered to be a fellow subsidiary of another company if both are subsidiaries of the same holding company.

4. DISCLOSURE

Name of the related party and nature of the related party relationship where control exists should be disclosed irrespective of whether or not there have been transactions between the related parties.

This is to enable users of financial statements to form a view about the effects of related party relationships on the enterprise.

If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

(i) The name of the transacting related party;

(ii) A description of the relationship between the parties;

(iii) A description of the nature of transactions;

(iv) Volume of the transactions either as an amount or as an appropriate proportion;

(v) Any other elements of the related party transactions necessary for an understanding of the financial statements;

(vi) The amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date;

(vii) Amounts written off or written back in the period in respect of debts due from or to related parties.

Items of a similar nature may be disclosed in aggregate by type of related party except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the reporting enterprise.

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Chapter: 4 (Unit -6)

Accounting Standard 24 DISCONTINUING OPERATIONS

1. OBJECTIVE AND APPLICATION

- AS 24 is applicable to all discontinuing operations.
- The objective of AS 24 is to establish principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise's cash flows, earnings-generating capacity, and financial position by segregating information about discontinuing operations from information about continuing operations.

2. MEANING OF DISCONTINUING OPERATION

A discontinuing operation is a component of an enterprise:

a. That the enterprise, pursuant to a single plan, is:
   (i) Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or
   (ii) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or
   (iii) Terminating through abandonment and

b. That represents a separate major line of business or geographical area of operations.

c. That can be distinguished operationally and for financial reporting purposes.

Note 1:

- all the reportable segent as per AS 17 is considered separate major line of business.
- Instead of disposing of a component substantially in its entirety, an enterprise may discontinue and dispose of the component by selling its assets and settling its liabilities piecemeal (individually or in small groups).
- To qualify as a discontinuing operation, the disposal must be pursuant to a single coordinated plan.
- An enterprise may terminate an operation by abandonment without substantial sales of assets. An abandoned operation would be a discontinuing operation if it satisfies the criteria in the definition.
- However, changing the scope of an operation or the manner in which it is conducted is not abandonment because that operation, although changed, is continuing.
- Examples of activities that do not necessarily satisfy criterion (a) of the definition, but that might do so in combination with other circumstances, include:
   a. Gradual or evolutionary phasing out of a product line or class of service.
   b. Discontinuing, even if relatively abruptly, several products within an ongoing line of business.
   c. Shifting of some production or marketing activities for a particular line of business from one location to another and

d. Closing of a facility to achieve productivity improvements or other cost savings.

- A component can be distinguished operationally and for financial reporting purposes - criterion (c) of the definition of a discontinuing operation - if all the following conditions are met:
  a. The operating assets and liabilities of the component can be directly attributed to it.
  b. Its revenue can be directly attributed to it.
  c. At least a majority of its operating expenses can be directly attributed to it. Assets, liabilities, revenue, and expenses are directly attributable to a component
- Discontinuing operations are infrequent events, but this does not mean that all infrequent events are discontinuing operations.

3. INITIAL DISCLOSURE EVENT

With respect to a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

a. The enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation or

b. The enterprise's board of directors or similar governing body has both
   (i) approved a detailed, formal plan for the discontinuance and
   (ii) made an announcement of the plan.

   A detailed, formal plan for the discontinuance normally includes:
   - identification of the major assets to be disposed of;
   - the expected method of disposal;
   - the period expected to be required for completion of the disposal;
   - the principal locations affected;
   - the location, function, and approximate number or employees who will be compensated for terminating their services; and
   - the estimated proceeds or salvage to be realised by disposal.

   An enterprise's board of directors or similar governing body is considered to have made the announcement of a detailed, formal plan for discontinuance, if it has announced the main features of the plan to those affected by it, such as, lenders, stock exchanges, trade payables, trade unions, etc. in a sufficiently specific manner so as to make the enterprise demonstrably committed to the discontinuance.

4. PRESENTATION AND DISCLOSURE

(a) Initial disclosure

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

(a) A description of the discontinuing operation(s)

(b) The business or geographical segment(s) in which it is reported as per AS 17

(c) The date and nature of the initial disclosure event.

(d) The date or period in which the discontinuance is expected to be completed if known or determinable

(e) The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled.

(f) The amount of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period.

(g) The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto

(h) The amount of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

(b) Other disclosures

When an enterprise disposes of assets or settles liabilities attributable to a discontinuing operation or enters into binding agreements for the sale of such assets or the settlement of such liabilities, it should include, in its financial statements, the following information when the events occur:

a. For anygain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation, (i) the amount of the pre-tax gain or loss and (ii) income tax expense relating to the gain or loss and

b. The net selling price or range of prices (which is after deducting expected disposal costs) of those net assets for which the enterprise has entered into one or more binding sale agreements, the expected timing of receipt of those cash flows and the carrying amount of those net assets on the balance sheet date.

(c) Updating the disclosure

In addition to these disclosures, an enterprise should include, in its financial statements, for periods subsequent to the one in which the initial disclosure event occurs, a description of any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled and the events causing those changes.

The disclosures should continue in financial statements for periods up to and including the period in which the discontinuance is completed. Discontinuance is completed when the plan is substantially completed or abandoned, though full payments from the buyer(s) may not yet have been received.

If an enterprise abandons or withdraws from a plan that was previously reported as a discontinuing operation, that fact, reasons therefore and its effect should be disclosed.

(d) Separate disclosure for each discontinuing operation

Any disclosures required by AS 24 should be presented separately for each discontinuing operation.

(e) Presentation of the required disclosures

The above disclosures should be presented in the notes to the financial statements except the following which should be shown on the face of the statement of profit and loss:

a. The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto and

b. The amount of the pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation.

(f) Restatement of prior periods

Comparative information for prior periods that is presented in financial statements prepared after the initial disclosure event should be restated to segregate assets, liabilities, revenue, expenses, and cash flows of continuing and discontinuing operations in a manner similar to that mentioned above.

(g) Disclosure in interim financial reports

Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, 'Interim Financial Reporting', including:

a. Any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation and

b. Any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

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Chapter: 5 (Unit-1)

Accounting Standard 2 Valuation of Inventory

1. MEANING OF STOCK

It is part of asset is to be held for:

a. Sale in ordinary course of business (finished goods)

b. To be further produced (WIP)

c. To be consumed in production (RM)

d. Including maintenance supplies and consumables other than machinery spares, servicing equipment and standby equipment meeting the definition of Property, plant and equipment.

Note: 1 Following are excluded from the scope of AS 2 (Revised)

a. Work in progress arising under construction contracts, i.e. cost of part construction, including directly related service contracts, being covered under AS 7, Accounting for Construction Contracts; Inventory held for use in construction, e.g. cement lying at the site should however be covered by AS 2 (Revised).

b. Work in progress arising in the ordinary course of business of service providers i.e. cost of providing a part of service.

c. Shares, debentures and other financial instruments held as stock-in-trade. It should be noted that these are excluded from the scope of AS 13 (Revised) as well. The current Indian practice is however to value them at lower of cost and fair value.

d. Producers' inventories of livestock, agricultural and forest products, and mineral oils, ores and gases to the extent that they are measured at net realisable value in accordance with well-established practices in those industries

2. VALUATION OF FINISHED GOODS AND WORK IN PROGRESS

Cost of NRV Whichever in Lower

3. NRV=

Estimated selling price	xxx
Less: Expenses to be incurred on sale	(xxx)
Estimated cost of completion	(xxx)
NRV	**xxx**

4. COST OF FINISHED GOODS

- Purchase Cost

Purchase Price	XXX
(+)Tax & Duties (non-refundable)	XXX
(+) Other Exp. on purchase	XXX
(–) Discount/rebate/ subsidy	XXX
Purchase Cost	**XXX**

- Conversion Cost
  - Labour
  - Overhead
    - Fixed Overhead
      - Actual production × Fixed overhead recovery rate
        - Taken on the basis of overhead recovery rate which is to be calculated in following manner
          - **If actual production is up to normal capacity than on the basis of normal capacity**

            Fixed overhead recovery rate

            $$= \frac{Total\ fixed\ overhead}{Normal\ Capacity}$$

          - **If actual production is more than normal capacity than on the basis of actual capacity**

            Fixed overhead recovery rate

            $$= \frac{Total\ fixed\ overhead}{Actual\ Capacity}$$

    - Variable Overhead
- Any other cost to bring inventory in present location and condition

Note 2 Other Costs

(a) These may be included in cost of inventory provided they are incurred to bring the inventory to their present location and condition. Cost of design, for example, for a custom made unit may be taken as part of inventory cost.

(b) Interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition. These costs are therefore not usually included in cost of inventory. Interests and other borrowing costs however are taken as part of inventory costs, where the inventory necessarily takes substantial period of time for getting ready for intended sale. Example of such inventory is wine.

(c) The standard is silent on treatment of amortisation of intangibles for ascertaining inventory costs. It nevertheless appears that amortisation of intangibles related to production, e.g. patents right of production or copyright for a publisher should be taken as part of inventory costs.

(d) Exchange differences are not taken in inventory costs.

Note 3

- If there is loss in transit then purchase cost per unit is calculated on the basis of normal receipt and accordingly abnormal loss or gain in transit is to be transferred to P&L A/c
- If there is loss in production then final cost of finish goods per unit is calculated on the basis of normal output.

5. METHOD OF COST OR NRV WHICHEVER IS LOWER IN CASE OF MULTIPLE STOCK

Groping Method

Individual Item wise basis Method

6. EXCLUSION FROM COST-

(a) Administration Overhead
(b) Selling and Distribution Overhead
(c) Storage Cost (if not required)
(d) Abnormal wastage or loss
(e) Borrowing cost unless permitted by AS-16

7. COST OF FORMULA –

(a) FIFO Method
(b) Specific identification method
(c) Standard retail price method
(d) Weighted average cost method

8. VALUATION OF RAW MATERIAL (RM)

Case 1

In NRV of finished goods is more than or equal to total cost of finished goods

Raw material is to be valued as per cost of Raw Material and in this case, Replacement of Raw Material is to be ignored.

Case 2

In NRV of finished goods is less than total cost of finished goods.

Raw material is to be valued at replacement cost and cost of raw material is to be ignored.

Note 4: Replacement Cost of Raw Material Means Current Cost of Raw Material.

9. COST OF JOINT AND BY PRODUCT

- Allocate cost of joint product on separation stage by rational and consistent basis.
- By product is to be valued at his NRV
- NRV of by product is to be deducted from cost of main product in order to calculate cost of main product.

10. DISCLOSURES

The financial statements should disclose:

(a) The accounting policies adopted in measuring inventories, including the cost formula used; and

(b) The total carrying amount of inventories together with a classification appropriate to the enterprise.

(c) Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are:

i. raw materials and components,
ii. work in progress,
iii. finished goods,
iv. Stock-in-trade (in respect of goods acquired for trading),
v. stores and spares,
vi. loose tools, and
vii. Others (specify nature).

Question & Answer

Question: 1

"In determining the cost of inventories, it is appropriate to exclude certain costs and recognize them as expenses in the period in which they are incurred". Provide examples of such costs as per AS 2 "Valuation of Inventories?

Answer—

As per AS 2 "Valuation of Inventories?, certain costs are excluded from the cost of the inventories and are recognised as expenses in the period in which incurred. Examples of such costs are:

a) Abnormal amount of wasted materials, labour, or other production costs;
b) Storage costs, unless those costs are necessary in the production process prior to a further production stage;
c) Administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
d) Selling and distribution costs.
e) Borrowing Cost (Unless Permitted by AS 16)

Question: 2

The company X Ltd., has to pay for delay in cotton clearing charges. The company up to 31.3.2014 has included such charges in the valuation of closing stock. This being in the nature of interest, X Ltd. decided to exclude such charges from closing stock for the year 2014-15. This would result in decrease in profit by ₹ 5 lakhs. Comment.

Answer—

- As per para 12 of AS 2 (revised), interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are therefore, usually not included in the cost of inventories.
- However, X Ltd. was in practice to charge the cost for delay in cotton clearing in the closing stock. As X Ltd. decided to change this valuation procedure of closing stock, this treatment will be considered as a change in accounting policy and such fact to be disclosed as per AS 1.
- Therefore, any change in amount mentioned in financial statement, which will affect the financial position of the company should be disclosed properly as per AS 1, AS 2 and AS 5.
- Also a note should be given in the annual accounts that, had the company followed earlier system of valuation of closing stock, the profit before tax would have been higher by ₹ 5 lakhs.

Question: 2

On 31st March 2013 a business firm finds that cost of a partly finished unit on that date is ₹ 530. The unit can be finished in 2013-14 by an additional expenditure of ₹ 310. The finished unit can be sold for ₹ 750 subject to payment of 4% brokerage on selling price. The firm seeks your advice regarding the amount at which the unfinished unit should be valued as at 31st March, 2013 for preparation of final accounts.

Answer—

Valuation of unfinished unit

	₹
Net selling price	750
Less: Estimated cost of completion	(310)
	440
Less: Brokerage (4% of 750)	(30)
Net Realisable Value	410

Cost of inventory	530
Value of inventory (Lower of cost and net realisable value)	410

Question: 3

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

Raw material X	
Closing balance	500 units
	₹ per unit
Cost price including excise duty	200
Excise duty (Cenvat credit is receivable on the excise duty paid)	10
Freight inward	20
Unloading charges	10
Replacement cost	150
Finished goods Y	
Closing Balance	1200 units
	₹ per unit
Material consumed	220
Direct labour	60
Direct overhead	40

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

Calculate the value of the closing stock, when

(i) Net Realizable Value of the Finished Goods Y is ₹ 400.

(ii) Net Realizable Value of the Finished Goods Y is ₹ 300.

Answer—

Situation (i)

When Net Realisable Value of the Finished Goods Y is ₹ 400

NRV is greater than the cost of Finished Goods Y i.e. ₹ 330 Hence, Raw Material and Finished Goods are to be valued at cost

Value of Closing Stock:

	Qty	Rate	Amount (₹)
Raw Material X	500	220	1,10,000
Finished Goods Y	1,200	330	3,96,000
Total Cost of Closing Stock			5,06,000

Situation (ii)

When Net Realisable Value of the Finished Goods Y is ₹ 300

NRV is less than the cost of Finished Goods Y i.e. ₹ 330 Hence, Raw Material is to be valued at replacement cost and Finished Goods are to be valued at NRV since NRV is less than the cost

Value of Closing Stock:

	Qty.	Rate	Amount (₹)
Raw Material X	500	150	75,000
Finished Goods Y	1,200	300	3,60,000
Total Cost of Closing Stock			4,35,000

Working Notes:

Raw Material X	₹
Cost Price	200
Less: Cenvat Credit	(10)
	190
Add: Freight Inward	20
Unloading charges	10
Cost	220
Finished goods Y	₹
Materials consumed	220
Direct Labour	60
Direct overhead	40
Fixed overheads (₹ 2,00,000/20,000 units)	10
Cost	330

Note: It has been considered that Raw Material X is used for the production of Finished Goods Y.

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CHAPTER 5 (UNIT – 3)
ACCOUNTING STANDARD 13 ACCOUNTING FOR INVESTMENTS

1. OBJECTIVE AND SCOPE

- The standard deals with accounting for investments in the financial statements of enterprises and related disclosure requirements.
- This Standard does not deal with :
  - **a)** The basis for recognition of interest, dividends and rentals earned on investments which are covered by AS 9
  - **b)** Operating or finance leases
  - **c)** Investments on retirement benefit plans and life insurance enterprises
  - **d)** Mutual funds, venture capital funds and/ or the related asset management companies, banks and public financial institutions formed under a Central or State Government Act or so declared under the Companies Act, 2013

2. MEANING OF INVESTMENT

- Investments are assets held by an enterprise
- Earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to the investing enterprise.
- Assets held as stock-in-trade (inventory) are not 'investments'

3. FORMS OF INVESTMENTS

- A current investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made.
- The intention to hold for not more than one year is to be judged at the time of purchase of investment.
- A long term investment is an investment other than a current investment.

4. CARRYING AMOUNT OF INVESTMENTS

- The carrying amount for current investments is the lower of cost and fair value.
- Long term investments are usually carried at cost. The carrying amount of long-term investments is therefore determined on an individual investment basis.
- Where there is a decline, other than temporary, in the carrying amounts of long term valued investments, the resultant reduction in the carrying amount is charged to the profit and loss statement. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.

5. INVESTMENT PROPERTIES

- An investment property is an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise.

- An investment property is accounted for in accordance with cost model as prescribed in AS 10 (Revised), 'Property, Plant and Equipment'. The cost of any shares in a co-operative society or a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property.

6. RECLASSIFICATION OF INVESTMENTS

- Where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.
- Where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer.

7. DISCLOSURE

The following disclosures in financial statements in relation to investments are appropriate:

a) The accounting policies followed for valuation of investments.

b) The amounts included in profit and loss statement for:

- Interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long term and current investments.
- Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes Paid.

c) Profits and losses on disposal of current investments and changes in carrying amount of such investments.

d) Profits and losses on disposal of long term investments and changes in the carrying amount of such investments.

e) Significant restrictions on the right of ownership, reliability of investments or the remittance of income and proceeds of disposal.

f) The aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments.

g) Other disclosures as specifically required by the relevant statute governing the enterprise.

Investment Accounts

MEANING OF INVESTMENT:-

- Assets held by enterprise for:
  - **Periodic income:** In the form of interest, dividend and rent etc.
  - **Capital appreciation:** In the form of increase in market price of the investment.
  - **Other benefit**
- Purchase with intention not to be sold in or Ordinary course of business (assets held as stock in trade are not investments).
- Investment accounting is done as per AS 13.

Note: 1 AS 13 deals with accounting for investment in the financial statements and related disclosure requirements except:

i. Bases for recognition of interest, dividend and rent earned on investment. i .Operating and financing lease.

ii. . Investment of retirement benefits plans and life insurance enterprise.

iv. Mutual fund etc.

CLASSIFICATION/TYPES OF INVESTMENT

Current Investment

If following two conditions are satisfied

- Maximum intention to hold for 12 months
- Readily marketable

Non-current-Investment

Which is not current investment

PRACTICALLY COVERED TOPIC BY ACCOUNTING FOR INVESTMENT

Accounting for Investment In Shares

Accounting for investment in interest bearing securities

Reclassification of Investments

TOPIC 1 :- ACCOUNTING FOR INVESTMENT IN SHARES

1. PURCHASE OF SHARE:

Investment A/c Dr.	XX (with cost of acquisition)
To Bank A/c	XX

2. RECEIVING BONUS SHARE:—

- When company issue equity shares to existing equity shareholder in a certain proportion free of cost.
- Calculate the number of bonus shares to be received on present holdings just before bonus issue.
- Since it is received free of cost, no journal entry is to be passed.
- Not to be disclosed in amount/cost column.
- It will increase the holding therefore it is disclosed in number of shares/face value column only.
- It will decrease the average cost per share of holding.

3. SALES OF SHARE:—

Bank A/c Dr.		XX
To Investment A/c		XX
(With net sale value)		

4. CARRYING AMOUNT OR CLOSING BALANCE OF INVESTMENT

- **Current Investment**
  - It will be lower of cost or fair value
- **Non-Current Investment**
  - It will always be valued at cost. However if fair price decrease permanently then adjustment of such decrease is required

Note 2 : – Separate account are required in the books of a particular investor for each type of script as Per different types of investment on the basis of name or company or rate of investment

Note 3 :— Cost of Acquisition(COA)

Purchase price	XXX
Add : Brokerage and commission	XXX
Add : Taxes and duties	XXX
Add : other expenses on purchase	XXX
	COA

Note 4:— Cost of Acquisition (COA) if securities are acquired under exchange

- If acquired by issue of shares/ other securities then cost will be fair value of share/security issued.
- If acquired in exchange for another asset then cost will fair value of asset given up or fair value of investment acquired whichever is more clearly evident.

Note 5:—Net sales value (NSV)

Total sale value	XX
Less: - Expenses on sale	XX
	NSV

Note 6:—Profit or loss on sale :—

- Net sale value is compared with average cost of sales.
- If the net sale value is more than average cost of sales then the difference is profit on sales.

  Investment A/c Dr. XX

  To P& L A/c XX
- If the average cost of sale is more than net sale value then the difference is loss on sales.

  P & L A/c Dr. XX

  To Investment A/c XX

Note 7 :— Average cost per share :—

- Whenever average cost is needed then details of investment A/c just before current transaction are to be used in the formula given below:
- Average cost per share = $\frac{\text{Total debit amount} - \text{Total credit amount}}{\text{Total debit Nos.} - \text{Total Credit Nos.}}$

<u>Note 8:</u> - If closing balance disclosed at average cost then investment account will automatically get closed. However, if it is disclosed at fair value then short fall of credit side will be expected loss.

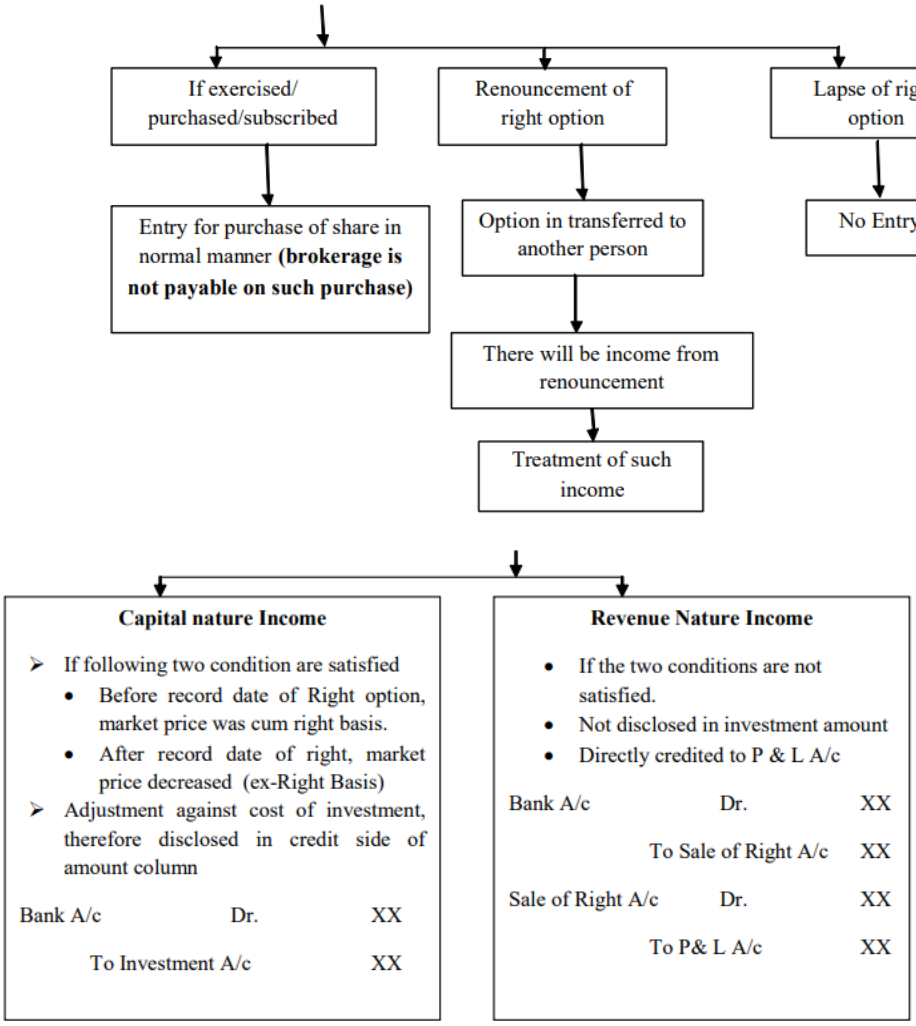
P & LA/c	Dr.	XX
To Investment A/c		XX

Note 9 :— If market price of a particular time needed is not given, then preceding market price is to be considered market price of that point of time.

Note 10:— Sometime question may require FIFO or other method for calculation of cost then accordingly calculate cost of investment instead of average cost method.

1. RECEIVING RIGHT OF OPTION FROM THE COMPANY

- When company further issue shares of already issued class of shares to fulfill requirement of funds, then it is known as right shares.
- Company needs to give option to existing share holder for purchases of such right shares.
- **Treatment of Right Option : -**



Note: From practical point of view if question required to prepare investment account then by default income from renouncement is to be assumed of revenue nature income. However if question is specifically given for renouncement of right shares then income from such renouncement will have to parts

A. Will have capital nature to the extent market value of existing investment decreased

B. Will have revenue nature for remaining part of income.

1. TREATMENT OF DIVIDEND INCOME ON SHARES :—

➢ **Basic Guideline for dividend**

(i) Dividend is calculated always on paid –up value (face value).

(ii) Dividend is always given on yearly basis (no time proportionate of dividend).

(iii) Dividend is given to that person who is share holder on date of dividend irrespective of his period of holding.

(iv) Amount of dividend = rate of dividend × total face of holding

➢ **Types of Dividend :-**

(a) Final Dividend

➢ Dividend which is declared in AGM of the company with consent of shareholder on proposal of board of director.
➢ Generally dividend which is paid in next year for current year is known as final dividend.
➢ Calculate holding on date of dividend and analysis it.
➢ Final dividend not to be received on bonus and right share allotted by company in current year because period of dividend belong to previous year where as it is originally issued in current year.
➢ **Dividend on purchase of share from open market:**

(i) It will be pre- acquisition dividend.

(ii) Capital nature.

(iii) Adjusted against cost of investment.

(iv) Disclosed in amount column of in credit side of investment account

Bank A/c Dr.

To Investment A/c

- **Dividend income on opening Balance:-**
  (i) Post acquisition dividend
  (i) Revenue Nature.
  (ii) Credited to dividend column and thereafter transferred to P & L A/c at the end of Year.
  Bank A/c Dr.
  To Dividend Income A/c
  Dividend Income A/c Dr.
  To P & L A/c

(b) **Interim Dividend**

- Which is declared between two AGM by BOD of company
- Dividend for current year given in current year
- Calculate holding on day of dividend
- Will be received on entire holding on date of dividend
- Credited to dividend column and thereafter transferred to P/L a/c

  Bank A/c Dr.

  To Dividend Income A/c

  Dividend Income A/c Dr.

  To P & LA/c

TOPIC 2: ACCOUNTING FOR INVESTMENT IN DEBT [INTEREST BEARING SECURITIES]

(a) GUIDELINES RELATING TO INTEREST ARE AS UNDER:

1. Interest is calculated on face value of debt.
2. There will be pre-decided due date of interest by issuer (annually, half-yearly, quarterly etc.)
3. Interest is paid on due date of interest to that person who is holder of security on due date irrespective of his period of holding and it will be from last due date to current due date.
4. Therefore, if security is traded in open market then buyer needs to pay interest to seller from last due date to date of purchase.
5. If security is purchased or sold on due date of interest or just next date of due date then interest is not paid/received on such purchase or sale.
6. Amount of interest = Total face value of holding × Rate of interest × $\frac{Time\ Period}{12}$
7. Here time period will be generally from last due date of interest to current action.
8. Here current action means purchased, sale, current due date of interest, opening and closing balance etc.
9. Security traded in open market on the basis of current market price and it will have two types-

- **Ex-Interest Price**
  - Market price does not include interest
  - Interest is to be settled in addition to market price

Buyer		**Seller**	
Purchase price = MP	xx	Sale value = MP	xx
+ Exp. on purchase	xx	Less: Exp. on sale	xx
COA	xx	Net sale value	xx
Interest (last due date to date of purchase)		Interest (last due date to date of sale)	

- **Cum-Interest Price:**
    - Market price already includes interest
    - No adjustment of interest in addition to market price

Buyer		**Seller**	
Total = MP	xx	Total = MP	xx
Less: Interest		Less: Interest	
(last due date to date of purchase price)	xx	(Last due date to date of sale)	xx
Purchase Price	xx	Sale value	xx
Add: Exp. on purchase	xx	(-) Exp. on sale	xx
COA	**xx**	**Net Sale Value**	**xx**

Note 11: If nature of market price not given for all transaction of purchase and sale, then it is to be assumed at ex-interest price. If some market prices are given as ex-interest price and silent for remaining prices, then remaining prices are to be assumed as cum-interest price and vice-versa

Note12: If due date of interest is not given then it is to be assumed annually at the end of every financial year.

Note 13: Accrued Account

- If due date of interest is not coming at the end of year, then adjustment of accrued interest is needed.
- It will be from last due date of end of financial year on opening and closing balance of holding.
- If due date of interest is coming it the end of financial year, then adjustment of accrued interest is not needed

1. PURCHASE OF SECURITY

Investment A/c Dr. [COA]

Interest on Investment A/c Dr. [with interest] To Bank A/c [Total payment]

2. SALE OF SECURITY:

Bank A/c Dr. [Total Amount]

To Investment A/c [Net Sale Value]

To Interest of Investment A/c [with Interest]

3. PROFIT OR LOSS ON SALE:

It is to be calculated similar to investment is shares and then transferred to P&LA/c

Investment A/c Dr. **[Profit on sale]**

To P&L

P&LA/c Dr. [Loss on sale]

To Investment A/c

4. RECEIVING INTEREST ON EVERY DUE DATE:

Bank A/c Dr.

To Interest on Investments A/c

(from last due date to current due date as per holding on current due date)

5. AT THE END OF FINANCIAL YEAR

- Receiving interest if there is due date at the end of year
- Adjustment of accrued interest from last due date to end of year if there is no due date at the end of year.
- Transfer balance of interest A/c to P&L account: Interest on

  Investment A/c Dr.

  To P & LA/c
- Carry down balance of investment account in normal manner similar to closing balance of investment in shares.

Note 14:— Accrued interest is to be disclosed along with opening and closing balance of investment A/c

TOPIC 3 : RE-CLASSIFICATION OF INVESTMENT

- Conversion of nature of investment from current to non-current or non-current to current investment
- At the time of re-classification the investment is to be disclosed as per following guidelines

Conversion from current to non-current investment	Conversion from non-currentto current asset
↓	↓
It is to be disclosed at cost orfair value whichever in lower	It is to be disclosed at cost or carrying amount whichever is lower.

Question & Answer

Question: 1

MY Ltd. had acquired 200 equity shares of YZ Ltd. at 105 per share on 01.01.2009 and paid 200 towards brokerage, stamp duty and STT. On 31st March, 2009, shares of YZ Ltd. were traded at 110 per share. At what value investment is to be shown in the Balance Sheet of MY Ltd. as at 31st March, 2009.

Answer –

	(₹)
Purchase price of Equity shares of YZ Ltd. (200 shares x Rs.1 05 per share)	21,000
Add: Brokerage, stamp duty and STT	200
Cost of investment	21,200

If the investment is a long term investment than it will be shown at cost. Therefore value of investment will be ₹21 ,200. However, if the investment is a current investment, then it will be shown at lower of cost (i.e. ₹21,200) or net realizable value (i.e. ₹200 × 110 = ₹22,000). Therefore value of investment will be ₹21,200.

Question: 2

Mr. Chatur had 12% Debentures of Face Value ₹100 of M/s. Unnati Ltd. as current investments. He provides the following details relating to the investments.

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.

Mr. Chatur closes his books on 31-3-2015. He incurred 2% brokerage for all his transactions. Show investment account in the books of Mr. Chatur assuming FIFO method is followed.

Investment A/c of Chatur
for the year ending on 31-3-2015
(Scrip: 12% Debentures of Unnati Limited)

Amt. in ₹

Date	Particulars	Nominal Value	Interest ₹	Cost ₹	Date	Particulars	Nominal Value	Interest ₹	Cost ₹
1.4.14	To Balance b/d	4,00,000	12,000	3,92,000	30.6.2014	By Bank (6,00,00×6%)	–	36,000	–
1.6.14	To Bank	2,00,000	10,000	2,34,800					
1.9.14	To P & L A/c			23,400	1.9.2014	By Bank	3,00,000	6,000	3,17,400
31.1.15	To Bank	3,00,000	3,000	3,06,000	1.12.2014	By Bank	2,00,000	10,000	2,05,800
					1.12.2014	By P & L A/c	–	–	9,600
31.3.15	To P & L A/c (Bal..fig)		45,000		31.12.14	By Bank (1,00,000×6%)	–	6,000	–
					31.3.2015	By Profit & Loss A/c	–	–	3,400
					31.3.2015		4,00,000	12,000	4,20,000
		9,00,000	70,000	9,56,200			9,00,000	70,000	9,56,200

Working Notes

1. Valuation of closing balance as on 31.3.2015:

Market value of 4,000 Debentures at ₹105 =		₹4,20,000
Cost price of 1,000 debentures at	1,17,400	
	3,06,000	
		4,23,000
Value at the end = ₹4,20,000 i.e. whichever is less		

2. Profit on sale of Debentures as on 1.9.2014

	₹
Sales price of debentures (3,000 ×110)	3,30,000
Less : Brokerage @2%	(6,600)
	3,23,400
Less : Interest for 2 months	(6,000)
	3,17,400

	Less: Cost price of Debentures $\left(3{,}92{,}000 \times \frac{3{,}000}{4{,}000}\right)$	(2,94,000)
	Profit on Sale	2,34,800
		23,400
3.	**Loss on sale c of debentures as on 1.12.2014**	
		₹
	Sales price of debentures (2,000 ×₹105)	2,10,000
	Less : Brokerage @2%	(4,200)
		2,05,400
	Less : Cost price of Debentures (98,000 + 1,17,400	2,15,400
	Loss on sale	9,600
4.	**Purchase Cost of 2,000 debentures on 1.6.2014**	
		₹
	2,000 Debentures @ ₹120 cum interest	2,40,000
	Add : Brokerage @2%	4,800
		2,44,800
	Less : Interest for 5 months	10,000
	Purchases of 2,000 debentures	2,34,800
5.	**Sale value for 3,000 debentures on 1.9.2014**	
		₹
	Sales price of debentures cum interest (3,000 ×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

Question: 3

On 1st December, 2015, M/s Blue & Black purchased, 20,000 12% fully paid debentures of ₹100 each at ₹105 cum interest price, also paying brokerage @ 1% of cum interest amount of the purchase. On 1st March, 2016, the firm sold all these debentures at ₹110 cum-interest price, again paying brokerage @ 1% of cum interest amount. Prepare Investment Account in the books of M/s. Blue & Black for the period 1st December, 2015 to 1st March, 2016. Interest being payable half yearly on 30th September and 31st March of every accounting year.

Answer:

In the books of M/s Blue & Black Investment Account
for the period from 1st December 2015 to 1st March, 2016
(Scrip: 12% fully paid Debentures)

Date	*Particulars*	*Nominal Value (₹)*	*Interest*	*Cost (₹)*	*Date*	*Particulars*	*Nominal Value (₹)*	*Interest*	*Cost (₹)*
1.12.2015	To Bank A/c (W.N.1)	20,00,000	40,000	20,81,000	1.03.2016	By Bank A/c (W.N.2)	20,00,000	1,00,000	20,78,000
1.3.2016	To Profit & loss A/c		60,000		1.3.2016	By Profit & loss A/c			3,000
		20,00,000	1,00,000	20,81,000			20,00,000	1,00,000	20,81,000

Working Notes:

(i)	Cost of 12% debentures purchased on 1.12.2015		₹
	Cost Value (20,000 × 105)	=	21,00,000
	Add: Brokerage (1% of 21,00,000)	=	21,000
	Less: Interest (20,000 × 100 x12% × 2/12)	=	(40,000)
	Total	=	20,81,000
(ii)	Sale proceeds of 12% debentures sold on 1st March, 2016		₹
	Sales Price (20,000 × 110)	=	22,00,000
	Less: Brokerage (1% of 22,00,000)	=	(22,000)
	Less: Interest (20,000 × 100 ×12% × 5/12)	=	(1,00,000)
	Total	=	20,78,000

Question: 4

Kumar invests and disinvests from time to time in 10% Non-convertible Debentures (NCD) of Apple Ltd. on FIFO basis. From the following transactions, prepare investment account as it would appear in her books:

15.6.2011	Purchased	3,000 NCD, ex-interest @ Rs. 96 each
15.9.2011	Sold	3,000 NCD, ex-interest @ Rs. 100 each
15.12.2011	Purchased	2,000 NCD, cum-interest @ Rs. 99 each
15.2.2012	Sold	2,000 NCD, cum-interest @ Rs. 102 each

Opening balance of NCD of ₹100 each was ₹2,00,000 on 1.4.2011 and Cost of acquisition was ₹1,80,000. Interest payment dates on NCD are 30th June and 31st December, Kumar follows financial year as accounting year.

Answer: -

In the books of Kumar

10% Non – Convertible Debentures (NCD) Account

Particular		Face Value	Interest	Cost	Particular		Face Value	Interest	Cost
April 1	To Bal. b/d	2,00,000	5,000	1,80,000	June 30	By Bank		25,000	
June 15	To Bank	3,00,000	13,750	2,88,000	Sept. 15	By Bank	3,00,000	6,250	3,00,000
Sept. 15	To P & L A/c			24,000	Dec. 31	By Bank		20,000	
Dec. 15	To Bank	2,00,000	9,167	1,88,833	Feb. 15	By Bank	2,00,000	2,500	2,01,500
Feb. 15	To P & L A/c			9,500	Mar. 13	By Bal. c/d	2,00,000	5,000	1,88,833
Mar. 31	To P & L A/c (Bal. Fig.)		30,833						
		7,00,000	**58,750**	**6,90,333**			**7,00,000**	**58,750**	**6,90,333**

Working Notes:

(i) Profit/Loss on sale of NCD

		(₹)
Sold on 15.09.2011		
Selling price (3,000 × 100)		3,00,000
Less:	Cost of purchase	
	2000 × 90 (opening)	(1,80,000)

1000 × 96 (purchase)	(96,000)
Profit	24,000
Sold on 15.02.2012	
Selling price (2,000 × 102)	2,04,000
Less: Interest included	(2,500)
	2,01,500
Less: Cost of purchase (2000 × 96)	(1,92,000)
Profit	9,500

(ii) As the disinvestment is done on FIFO basis. NCDs purchased on 15.12.2011 remained in stock on 31.03.2012 at a cost of Rs. 1,88,333.

(iii) Interest calculation on various dates:

(a) on 1.4.11: (`)

$2,00,000 \times 10\% \frac{3}{12} \rightarrow (1.1.09. - 31.3.09)$ - 5,000

(b) On 15.06.11:

$3,00,000 \times 10\% \times \frac{5.5}{12} \rightarrow (1.1.09. - 15.6.09$ = 13,750

(c) On 30.6.11:

$5,00,000 \times 10\% \frac{6}{12} \rightarrow (1.1.09. - 30.6.09$ = 25,000

(d) On 15.9.11

$30,00,000 \times \frac{2.5}{12} \rightarrow (1.7.09. - 15.9.09)$ = 6,250

(e) On 15.12.11:

$3,00,000 \times 10\% \times \frac{5.5}{12} \rightarrow (1.1.09.\ \ 15.6.09)$ = 9,167

(f) On 31.12.11:

$4,00,000 \times 10\% \times \frac{6}{12} \rightarrow (1.7.09. - 31.12.09)$ = 20,000

(g) On 15.2.2012:

$20,00,000 \times 10 \times \frac{1.5}{12} \rightarrow (1.1.10 - 15.2.10)$ = 2,500

(h) On 31.3.2012

$20,00,000 \times 10\% \times \frac{3}{12} \rightarrow (1.1.10 - 31.3.10)$ = 5,000

Question: 5 –

Mr. X purchased 1,000, 6% Government Bonds of Rs. 100 each on 31st January, 2009 at ₹95 each. Interest is payable on 30th June and 31st December, The price quoted is cum interest. Journalize the transaction.

Answer—

Date	Particulars		Amount (Dr.) Rs.	Amount (Cr.) Rs.
31st Jan., 2009	Investment A/c	Dr.		
	Interest A/c (₹1,00,000 × $\frac{6}{12}$)	Dr.	500	
	(Being purchase of 1,000, 6% Government bonds of ₹100 at ₹95 each cum interest.)			

Question: 6 –

Gaama Investment Company holds ₹1,000, 15% debentures of ₹100 each in Beta Industries Ltd. as on April 1, 2009 at a cost of `1,05,000. Interest is payable on June, 30 and December, 31 each year.

On May 1, 2009, 500 debentures are purchased cum-interest at ₹53,500. On November ₹1, 2009, 600 debentures are sold ex-interest at ₹57,300. On November 30, 2009, ₹400 debentures are purchased ex- interest at ₹38,400. On December 31, 2009, 400 debentures are sold cum-interest for ₹55,000.

Prepare the investment account showing value of holdings on March 31, 2010 at cost, using FIFO method.

Answer—

In the books of Gaama Investments Ltd.

Investment Account (15% Debentures in Beta Industries Ltd.)

Date	Particulars	Nominal	Interest	Cost	Date	Particulars	Nominal	Interest	value
1.04.09	To balance b/d (W.N. 1)	1,00,000	3,750	1,05,000	30.06.09	By Bank A/c	– (W.N. 3)	11,250	–
1.05.09	To Bank A/c (W.N. 2)	50,000	2,500	51,000	1.11.09	By Bank A/c (W.N. 4)	60,000	3,000	57,300
30.11.09	To Bank A/c (W.N. 5)	40,000	2,500	38,400	1.11.09	By P & L A/c (W.N. 11)			5,700
31.12.09	To P & L A/c (W.N. 12)			10,000	31.12.09	By Bank A/c (W.N. 6 & 7)	40,000	3,000	52,000
31.03.10	To P & L A/c	–	18,625		31.12.09	By Bank A/c (W.N. 8)	–	6,750	–
					31.03.10	By Bank A/c (W.N. 9 & 10)	90,000	3,375	89,400
		1,90,000	**27,375**	**2,04,400**			**1,90,000**	**27,375**	**2,04,400**

Working Notes : —

1. Accrued interest as on 1.4.09 = Rs. 1,00,000 × $\frac{15}{100} \times \frac{3}{12}$ = Rs. 3,750
2. Accrued interest = Rs. 50,000 × $\frac{15}{100} \times \frac{4}{12}$ = Rs, 2,500
3. Cost of investment for purcahses on 1.5.09 = Rs. 53,500 – Rs. 2,500 = Rs. 51,000
4. Interest received = Rs.. 1,50,000 × $\frac{15}{100} \times \frac{6}{12}$ = Rs. 11,250
5. Accrued interest = Rs. 60,000 × 15/100 × $\frac{4}{12}$ = Rs. 3,000
6. Accrued interest = Rs. 40,000 × $\frac{15}{100} \times \frac{5}{12}$ = Rs. 2,500
7. Accrued interest = Rs. 40,000 × $\frac{15}{100} \times \frac{6}{12}$ = Rs. 3,000

   Sale price of investment on 31.12.09 = Rs. 55,000 – 3,000 = Rs. 52,000

   Accrued interest = Rs. 90,000 × $\frac{15}{100} \times \frac{6}{12}$ = Rs. 6,750

   Accrued interest = Rs. 90,000 × $\frac{15}{100} \times \frac{3}{12}$ = Rs. 3,375

   Cost of investment as on 31.3.10 = Rs. 51,000 + Rs. 38,400 = Rs. 89,400

   Lost on debentures sold on 1.11.2009;

   Sales price of debentures Rs. 57,300

Less: Cost of Investment sold = $\frac{₹1,05,000}{1,000} \times ₹\ 6,000$	₹63,000
Loss on Sales	**5,700**
Profit on debentures sold on 31.12.2009:	
Sales price of debentures	₹52,000
Less: Cost of investment sold = $\frac{₹1,05,000}{1,000} \times 400 =$	₹42,000
Profit on sale	₹10,000

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Chapter: 5 (Unit-6)
Accounting Standard 26 INTENGIBLE ASSETS

1. OBJECTIVE AND APPLICATION

- The objective of AS 26 is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Accounting Standard.
- AS 26 requires an enterprise to recognise an intangible asset if, and only if, certain criteria are met. AS 26 also specifies how to measure the carrying amount of intangible assets and requires certain disclosures about intangible assets.

2. SCOPE

AS 26 should be applied by all enterprises in accounting for intangible assets, except:

a. Intangible assets that are covered by another Accounting Standard For example, AS 26 does not apply to:

(a) intangible assets held by an enterprise for sale in the ordinary course of business (AS 2 and AS 7)

(b) deferred tax assets (AS 22)

(c) leases that fall within the scope of AS 19

(d) good will arising on an amalgamation (AS 14 (Revised)) and goodwill arising on consolidation (AS 21 (Revised))

b. Financial assets.

c. Mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources and

d. Intangible assets arising in insurance enterprises from contracts with policyholders.

However, AS 26 applies to other intangible assets used (such as computer software), and other expenditure (such as start-up costs), in extractive industries or by insurance enterprises.

AS 26 also applies to:

(i) expenditure on advertising, training, start - up cost

(ii) Research and development activities

(iii) Right under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts

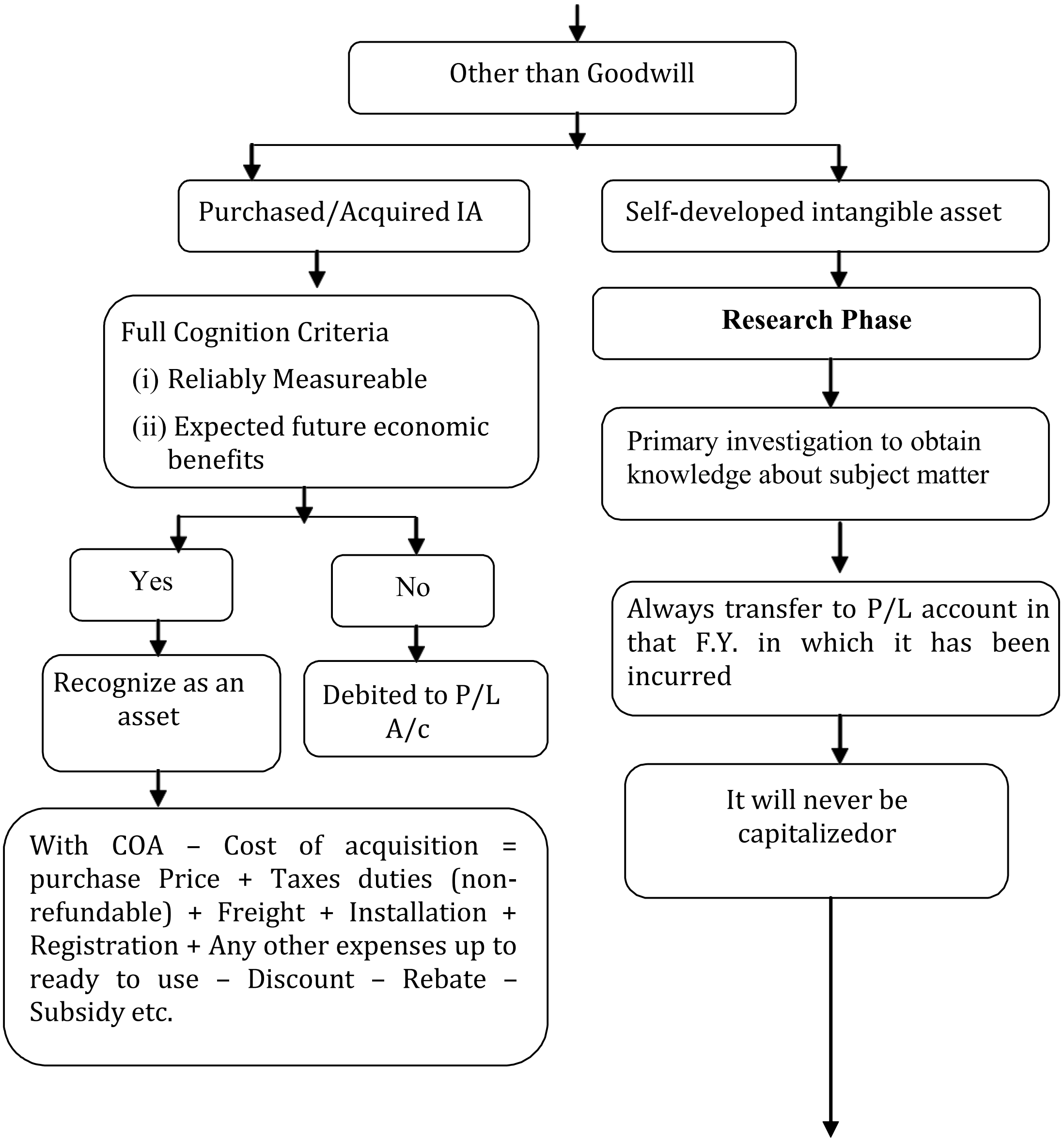
(iv) Patents, copyrights and trademarks

(v) goodwill

3. MEANING OF INTENGIBLE ASSET

Part of fixed assets which doesn't have any physical form but existence of such asset effect business.

4. ACCOUNTING TREATMENT OF INTANGIBLE ASSET

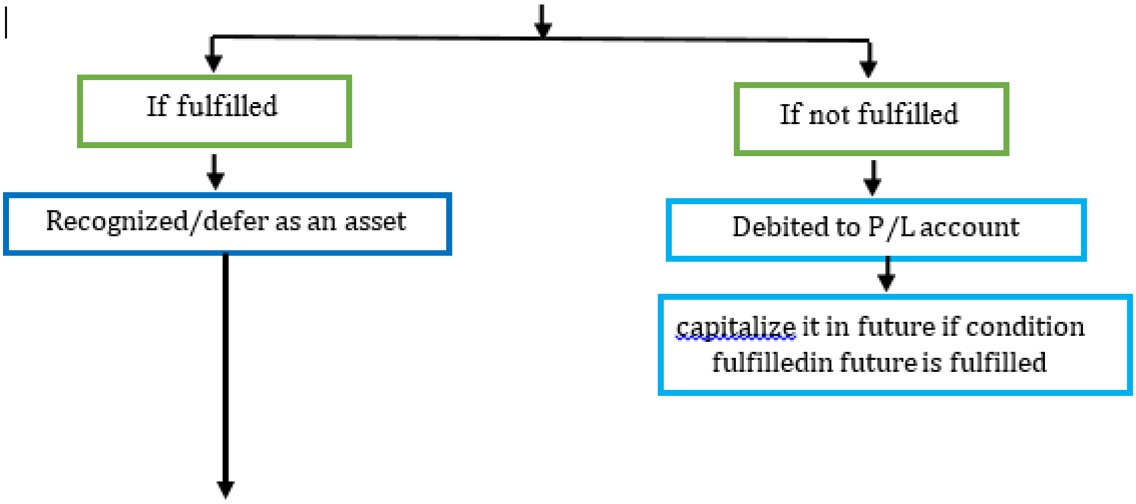


Development phase:

- Systematic execution to complete the development of intangible asset
- Recognition criteria
  a. The technical feasibility of completing the intangible asset so that it will be available for use or sale.
  b. Its intention to complete the intangible asset and use or sell it.
  c. Its ability to use or sell the intangible asset.
  d. How the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.

e. The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset and

f. Its ability to measure the expenditure attributable to the intangible asset during its development reliably.



Lower of two amount: (Capitalization Amount)

(i) Total development phase expenses;

(ii) Total of PV of future expected benefit

↓

Amortize over the period in ratio of benefit maximum 10 years

↓

If ratio of benefit is revised in future, then calculate revised amount of amortization for future (Prospective effect)

5. DISCLOSURE

The financial statements should disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

1. The useful lives or the amortization rates used.
2. The amortization methods used.
3. The gross carrying amount and the accumulated amortization (aggregated with accumulated impairment losses) at the beginning and end of the period.
4. A reconciliation of the carrying amount at the beginning and end of the period showing:
   - I. Additions, indicating separately those from internal development and through amalgamation.
   - II. Retirements and disposals.
   - III. Impairment losses recognised in the statement of profit and loss during the period.
   - IV. Impairment losses reversed in the statement of profit and loss during the period.

V. Amortisation recognized during the period and

VI. Other changes in the carrying amount during the period.

6. OTHER DISCLOSURES

The financial statements should also disclose:

a. If an intangible asset is amortised over more than ten years, the reasons why it is presumed that the useful life of an intangible asset will exceed ten years from the date when the asset is available for use. In giving these reasons, the enterprise should describe the factor(s) that played a significant role in determining the useful life of the asset.

b. A description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the financial statements of the enterprise as a whole.

c. The existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities and

d. The amount of commitments for the acquisition of intangible assets.

The financial statements should disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

Questions & Answer

Question: 1

Decide when research and development cost of a project can be deferred to future periods as per AS 26.

Answer

As per para 41 of AS 26 'Intangible Assets', no intangible asset arising from research should be recognized. The expenditure incurred on development phase can be deferred to the subsequent years if the company can demonstrate all of the following conditions (as specified in para 44 of AS 26 'Intangible Assets'):

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;

(b) its intention to complete the intangible asset and use or sell it;

(c) its ability to use or sell the intangible asset;

(d) how the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

(f) its ability to measure the expenditure attributable to the intangible asset during its development reliably.

Question: 2

How is software acquired for internal use accounted for under AS-26?

Answer:

Paragraphs 10 and 11 of Appendix A to the Accounting Standard 26 on Intangible Assets, lays down the following procedure for accounting of software acquired for internal use:-

- The cost of a software acquired for internal use should be recognised as an asset if it meets the recognition criteria prescribed in paragraphs 20 and 21 of this statement.
- The cost of a software purchased for internal use comprises its purchase price, including any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities) and any directly attributable expenditure on making the software ready for its use.
- Any trade discounts and rebates are deducted in arriving at the cost. In the determination of cost, matters stated in paragraphs 24 to 34 of the Statement which deal with the method of accounting for 'Separate Acquisitions', 'Acquisitions as a part of Amalgamations', Acquisitions by way of Government Grant', and 'Exchanges of Assets', need to be considered, as appropriate.

  Recognition criteria as per paragraphs 20 and 21 of the standard are stated below:-

- An intangible asset should be recognised if, and only if:

  (a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and

  (b) the cost of the asset can be measured reliably.

- An enterprise should assess the probability of future economic benefits using reasonable and supportable assumptions that represent best estimate of the set of economic conditions that will exist over the useful life of the asset.

Question: 3

What are the costs that are to be included in Research and Development costs as per AS 26?

Answer

According to paras 41 and 43 of AS 26, "No intangible asset arising from research (or from the research phase of an internal project) should be recognized in the research phase. Expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred.

Examples of research costs are:

- ♦ Costs of activities aimed at obtaining new knowledge;
- ♦ Costs of the search for, evaluation and final selection of, applications of research findings or other knowledge;
- ♦ Costs of the search for alternatives for materials, devices, products, processes, systems or services; and
- ♦ Costs of the activities involved in formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes systems or services."

According to paras 45 and 46 of AS 26, "In the development phase of a project, an enterprise can, in some instances, identify an intangible asset and demonstrate that future economic benefits from the asset are probable. This is because the development phase of a project is further advanced than the research phase.

Examples of development activities/costs are:

- ♦ Costs of the design, construction and testing of pre-production or pre-use prototypes and models;
- ♦ Costs of the design of tools, jigs, moulds and dies involving new technology;
- ♦ Costs of the design, construction ad operation of a pilot plant that is not of a scale economically feasible for commercial production; and
- ♦ Costs of the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services."

Question: 4

A Company had deferred research and development cost of ₹150 lakhs. Sales expected in the subsequent years are as under:

Years	Sales (₹in lakhs)
I	400
II	300
III	200
IV	100

You are asked to suggest how should Research and Development cost be charged to Profit and Loss account. If at the end of the III year, it is felt that no further benefit will accrue in the IV year, how the unamortised expenditure would be dealt with in the accounts of the Company?

Answer:

(i) Based on sales, research and development cost to be allocated as follows

Year	Research and Development cost allocation (₹ in lakhs)
I	$\frac{400}{1,000} \times 150 = 60$
II	$\frac{300}{1,000} \times 150 = 45$
III	$\frac{200}{1,000} \times 150 = 30$
IV	$\frac{100}{1,000} \times 150 = 15$

(ii) If at the end of the III year, the circumstances do not justify that further benefit will accrue in IV year, then the company has to charge the unamortised amount i.e. remaining ₹45 lakhs [150 - (60 + 45)] as an expense immediately.

Note: As per para 41 of AS 26 on Intangible Assets, expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred. It has been assumed in the above solution that the entire cost of ₹150 lakhs is development cost. Therefore, the expenditure has been deferred to the subsequent years on the basis of presumption that the company can demonstrate all the conditions specified in para 44 of AS 26. An intangible asset should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Hence the remaining unamortised amount of ₹45,00,000 has been written off as an expense at the end of third year.

Question: 5

AB Ltd. launched a project for producing product X in October, 2009. The Company incurred₹ 20 lakhs towards Research and Development expenses upto 31st March, 2011. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.

Advise the Company as per the applicable Accounting Standard.

Answer

As per para 41 of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Therefore, the manager cannot defer the expenditure write off to future years.

Hence, the expenses amounting ₹20 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2011.

Question: 6

An enterprise acquired patent right for ₹400 lakhs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of estimated future cash flows which are as under:

Year	Estimated Future Cash Flows (₹ in lakhs)
1	200
2	200
3	200
4	100
5	100

After 3rd year, it was ascertained that the patent would have an estimated balance future life of 3 years and the estimated cash flow after 5th year is expected to be ₹ 50 lakhs. Determine the amortization under Accounting Standard 26.

Answer

Amortization of cost of patent as per AS 26

Year	Estimated future cash flow (₹in lakhs)	Amortization Ratio	Amortization Amount (₹ in lakhs)
1	200	.25	100
2	200	.25	100
3	200	.25	100
4	100	.40 (Revised)	40
5	100	.40 (Revised)	40
6	50	.20 (Revised)	20
			400

In the first three years, the patent cost will be amortised in the ratio of estimated future cash flows i.e. (200: 200: 200: 100: 100).

The unamortized amount of the patent after third year will be ₹100 (400-300) which will be amortised in the ratio of revised estimated future cash flows (100:100:50) in the fourth, fifth and sixth year.

Question: 7

Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred 10 lakh on research during first 5 months of the financial year 2012-13. The development of the process began on 1st September, 2012 and upto 31st March, 2013, a sum of ₹8 lakh was incurred as Development Phase Expenditure, which meets assets recognition criteria.

From 1st April, 2013, the Company has implemented the new process design and it is likely that this will result in after tax saving of ₹2 lakh per annum for next five years.

The cost of capital is 10%. The present value of annuity factor of ₹1 for 5 years @ 10% is 3.7908. Decide the treatment of Research and Development Cost of the project as per AS 26.

Answer:

Research Expenditure – According to AS 26 'Intangible Assets', the expenditure on research of new process design for its product ₹10 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. It is presumed that the entire expenditure is incurred in the financial year 2012-13. Hence, it should be written off as an expense in that year itself.

Cost of internally generated intangible asset – it is given that development phase expenditure amounting ₹8 lakhs incurred upto 31st March, 2013 meets asset recognition criteria. As per AS 26, for measurement of such internally generated intangible asset, fair value should be estimated by discounting estimated future net cash flows.

Savings (after tax) from implementation of new design for next 5 years	₹2 lakhs p.a.
Company's cost of capital	10 %
Annuity factor @ 10% for 5 years	3.7908
Present value of net cash flows (₹ 2 lakhs x 3.7908)	₹7.582 lakhs

The cost of an internally generated intangible asset would be lower of cost value ₹8 lakhs or present value of future net cash flows ₹7.582 lakhs.

Hence, cost of an internally generated intangible asset will be₹7.582 lakhs.

The difference of 0.418 lakhs (i.e. ₹8 lakhs -₹7.582 lakhs) will be amortized by Plymouth for the financial year 2012-13.

Amortization –

The company can amortise₹7.582 lakhs over a period of five years by charging ₹ ₹1.516 lakhs per annum from the financial year 2013-2014 onwards.

Question: 8

NDA Corporation is engaged in research on a new process design for its product. It had incurred an expenditure of ₹530 lakhs on research upto 31st March, 2011

The development of the process began on 1st April, 2011 and Development phase expenditure was 360 lakhs upto 31st March, 2012 which meets assets recognition criteria.

From 1st April, 2012, the company will implement the new process design which will result in after tax saving of ₹80 lakhs per annum for the next five years.

The cost of capital of company is 10%. Explain:

(1) Accounting treatment for research expenses.

(2) The cost of internally generated intangible asset as per AS 26.

(3) The amount of amortization of the assets. (The present value of annuity factor of ₹1 for 5 years @ 10% = 3.7908)

Answer:

(1) Research Expenditure – According to para 41 of AS 26 'Intangible Assets', the expenditure on research of new process design for its product ₹530 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. As the question states that the expenditure was incurred.

(2) Cost of internally generated intangible asset – The question states that the development phase expenditure amounting ₹360 lakhs incurred upto 31st March, 2012 meets asset recognition criteria. As per AS 26 for measurement of such internally generated intangible asset, fair value can be estimated by discounting estimated future net cash flows.

Savings (after tax) from implementation of new design for next 5 years	80 lakhs p.a.
Company's cost of capital	10 %
Annuity factor @ 10% for 5 years	3.7908
Present value of net cash flows (₹ 80 lakhs × 3.7908)	303.26 lakhs

The cost of an internally generated intangible asset would be lower of cost value ₹360 lakhs or present value of future net cash flows ₹303.26 lakhs.

Hence, cost of an internally generated intangible asset will be ₹303.26 lakhs.

The difference of 56.74 lakhs (i.e. ₹360 lakhs – ₹303.26 lakhs) will be amortized by the enterprise for the financial year 2011-12.

(3) **Amortization** –

The company can amortise₹303.26 lakhs over a period of five years by charging ₹60.65 lakhs per annum from the financial year 2012-13 onwards.

Question: 9

M Ltd. launched a project for producing product A in Nov. 2008. The company incurred ₹30 lakhs towards Research and Development expenses upto 31st March, 2010. Due to unfavourable market conditions the management feels that it is not possible to manufacture and sell the product in the market for next so many years.

The management hence wants to defer the expenditure write off to future years. Advise the company as per the applicable Accounting Standard.

Answer

As per para 41 of AS 26 "Intangible Assets", expenditure on research should be recognised as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to the provisions of AS 26. Therefore, the management cannot defer the expenditure write off to future years and the company is required to expense the entire amount of ₹30 lakhs in the Profit and Loss account of the year ended 31st March, 2010.

Question: 10

A company acquired for its internal use a software on 28.01.2012 from the USA for US $ 1,00,000. The exchange rate on that date was ₹52 per USD. The seller allowed trade discount @ 5 %. The other expenditure were:

(i) Import Duty : 20%

(ii) Purchase Tax : 10%

(iii) Entry Tax : 5 % (Recoverable later from tax department)

(iv) Installation expenses : ₹25,000

(v) Profession fees for Clearance from Customs : ₹20,000 Compute the cost of Software to be capitalized.

Answer:

Calculation of cost of software (intangible asset) acquired for internal use

Purchase cost of the software	$ 1,00,000
Less: Trade discount @ 5%	($ 5,000)
	$ 95,000
Cost in (US $ 95,000 × 52)	49,40,000
Add: Import duty on cost @ 20% (₹)	9,88,000
	59,28,000
Purchase tax @ 10% (₹)	5,92,800
Installation expenses (₹)	25,000
Profession fee for clearance from customs (₹)	20,000
Cost of the software to be capitalized (₹)	65,65,800

Note: Since entry tax has been mentioned as a recoverable / refundable tax, it is not included as part of the cost of the asset.

Question: 11

Base Limited is showing an intangible asset at ₹85 lakhs as on 1-4-2011. This asset was acquired for ₹112 lakhs on 1-4-2008 and the same was available for use from that date. The company has been following the policy of amortization of the intangible asset over a period of 12 years on straight line basis. Comment on the accounting treatment of the above with reference to the relevant accounting standard.

As per para 63 of AS 26 "Intangible Assets," the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimates of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortization should commence when the asset is available for use.

Base Limited has been following the policy of amortization of the intangible asset over a period of 12 years on straight line basis. The period of 12 years is more than the maximum period of 10 years specified as per AS 26.

Accordingly, Base Limited would be required to restate the carrying amount of intangible asset as on 1.4.2011 at ₹112 lakhs less ₹33.6 lakhs $\left(\frac{112 \text{ lakhs}}{10 \text{ years}} \times 3 \text{ years}\right)$ difference of ₹6.6 lakhs i.e. (₹85 lakhs - ₹78.4 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹78.4 lakhs would be amortized over remaining 7 years by ₹11.2 lakhs per year.

Question: 12

Hera Ltd. has got the license to manufacture particular medicines for 10 years at a license fee of ₹200 lakhs. Given below is the pattern of expected production and expected operating cash inflow:

Year	Production in bottles (in thousands)	Net operating cash flow in(₹ lakhs)
1	300	900
2	600	1,800
3	650	2,300
4	800	3,200
5	800	3,200
6	800	3,200
7	800	3,200
8	800	3,200
9	800	3,200
10	800	3,200

Net operating cash flow has increased for third year because of better inventory management and handling method. Suggest the amortization method.

Answer

As per para 72 of AS 26 'Intangibles Assets', the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used.

In the instant case, the pattern of economic benefit in the form of net operating cash flow vis- à-vis production is determined reliably. Initially net operating cash flow per thousand bottles is ₹3 lakhs for first two years and ₹4 lakhs from fourth year onwards, the pattern is established.

Therefore Hera Ltd. should amortize the license fee of ₹200 lakhs as under:

Year	Net Operating Cash Inflow (NOCI)	Ratio	Amortize amount (₹ in lakhs)
1	900	0.03	6
2	1,800	0.06	12
3	2,300	0.08	16
4	3,200	0.12	24
5	3,200	0.12	24
6	3,200	0.12	24
7	3,200	0.12	24
8	3,200	0.12	24
9	3,200	0.12	24
10	3,200	0.11(bal.)	22
	27,400	1.00	200

Question: 13

A company is showing an intangible asset at ₹88 lakhs as on 01.04.2013. This asset was acquired for ₹120 lakhs on 01.04.2009 and the same was available for use from that date. The company has been following the policy of amortization of the intangible assets over a period of 15 years on straight line basis. Comment on the accounting treatment of the above with reference to the relevant Accounting Standard.

Answer

As per para 63 of AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use.

Company has been following the policy of amortisation of the intangible asset over a period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS 26.

Accordingly, the company would be required to restate the carrying amount of intangible asset as on 01.04.2013 at ₹ 72 lakhs i.e. ₹120 lakhs less ₹48 lakhs .

The difference of 16 Lakhs (₹88 lakhs - ₹ 72 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹72 lakhs will be amortised over remaining 6 years by amortising ₹12 lakhs per year.

Question: 14

M/s. Mahesh Ltd. is developing a new production process. During the Financial Year ended 31st March, 2013, the total expenditure incurred on the process was ₹60 lacs. The production process met the criteria for recognition as an intangible asset on 1st December, 2012. Expenditure incurred till this date was ₹32 lacs.

Further expenditure incurred on the process for the Financial Year ending 31st March, 2014 was ₹90 lacs. As on 31-03-2014, the recoverable account of know-how embodied in the process is estimated to be ₹82 lacs. This includes estimates of future cash outflows and inflows:

You are required to work out:

(i) What is the expenditure to be charged to Profit & Loss Account for the year ended 31st March, 2013 ?

(ii) What is the carrying amount of the intangible asset as on 31st March, 2013 ?

(iii) What is the expenditure to be charged to Profit & Loss Account for the year ended 31st March, 2014 ?

(iv) What is the carrying amount of the intangible asset as on 31st March, 2014 ?

Answer

As per AS 26 'Intangible Assets'

(i) Expenditure to be charged to Profit and Loss account for the year ending 31.03.2013

32 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2012. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the balance sheet.

(ii) Carrying value of intangible asset as on 31.03.2013

At the end of financial year, on 31st March 2013, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹ 28 (60-32) lacs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st December 2012).

(iii) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2014

	(₹ in lacs)
Carrying Amount as on 31.03.2013	28
Expenditure during 2013 – 2014	90
Book Value	118
Recoverable Amount	(82)
Impairment loss	36

₹36 lakhs to be charged to Profit and loss account for the year ending 31.03.2014.

(iv) Carrying value of intangible asset as on 31.03.2014

	(₹ in lacs)
Book Value	118
Less: Impairment loss	(36)
Carrying amount as on 31.03.2014	82

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Chapter: 6 (Unit – 2)

Accounting Standard 29 (Revised)

Provisions, Contingent Liabilities and Contingent Assets

1. OBJECTIVE AND APPLICATION

- The objective of AS 29 (Revised) is to ensure that appropriate recognition criteria and measurement bases are applied to provisions and contingent liabilities and sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount.
- The objective of AS 29 (Revised) is also to lay down appropriate accounting for contingent assets.

2. SCOPE

AS 29 should be applied in accounting for provisions and contingent liabilities and in dealing with contingent assets, other than

a. Those resulting from financial instruments that are carried at fair value;

b. Those resulting from executory contracts except where the contract is onerous;

c. Those arising in insurance enterprises from contracts with policy-holders; and

d. Those covered by another Accounting Standard.

3. PROVISIONS

- Present obligation due to past events which can be estimated on reliable basis.
- In other words, possible obligation due to past event of which possibility of outflow is likely to be more than not likely to be of outflow.
- Create provision out of P/L account and disclose it in liability side of balance sheet.

4. CONTINGENT LIABILITY

- Present obligation due to past event, out-flow of which will depend on happening or non- happening of un-certain future events not within the control of business.
- In other words, possible obligation due to past of which possibility of outflow is not likely to be more than likely to be
- Disclose as part of foot note and don't recognize in Balance Sheet.

5. CONTINGENT ASSET

- Present asset due to past event in flow of which depends on happening or non-happening of future uncertain events not within the control of business.
- Not to be recognized as on asset, until it will virtually become certain.

6. TABLE – PROVISIONS AND CONTINGENT LIABILITIES

Where, as a result of past events, there may be an outflow of resources embodying future economic benefits in settlement of: (a) a present obligation the one whose existence at the balance sheet date is considered probable; or (b) a possible obligation the existence of which at the balance sheet date is considered not probable.		
There is a present obligation that probablyrequires an outflow of resources and a reliable estimate can be made of theamount of obligation.	Thereis a possible obligation that may, but probably will not, require an outflow of resources.	There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.
A provision is recognized. Dis-closures are required for the provision.	No provision is recognized. Disclosures are required forthe contingent liability.	No provision isrecognized. No disclosure is required

7. DISCLOSURE

For each class of provision, an enterprise should disclose:

(a) The carrying amount at the beginning and end of the period;

(b) Additional provisions made in the period, including increases to existing provisions;

(c) Amounts used (i.e. incurred and charged against the provision) during the period; and

(d) Unused amounts reversed during the period.

Note:

SMCs are exempt from the above disclosure requirements of AS 29 (Revised) An enterprise should disclose the following for each class of provision:

(a) A brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;

(b) An indication of the uncertainties about those outflows. Where necessary to provide adequate information, an enterprise should disclose the major assumptions made concerning future events, and

(c) The amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Note:

SMCs are exempt from the above disclosure requirements of AS 29 (Revised)

Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:

(a) An estimate of its financial effect,

(b) An indication of the uncertainties relating to any outflow; and

(c) The possibility of any reimbursement.

Where any of the information required by above paragraph is not disclosed because it is not practicable to do so, that fact should be stated.

In extremely rare cases, disclosure of some or all of the information required by AS 29 can be expected to prejudice seriously the position of the enterprise in a dispute with other parties on the subject matter of the provision or contingent liability. In such cases, an enterprise need not disclose the information, but should disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

Question & Answer

Question: 1—

X Ltd. has its financial year ended 31.3.2011, fifteen law suits outstanding, none of which has been settled by the time the accounts are approved by the directors. The directors have estimated that the probable outcomes as below:

Result	Probability	Amount of Loss
For first ten cases:		
Win	0.6	----
Loss-low damages	0.3	90,000
Loss-high damages	0.1	2,00,000
For remaining five cases:		
Win	0.5	----
Loss-low damages	0.3	60,000
Loss-high damages	0.2	1,00,000

The directors believe that the outcome of each case is independent of the outcome of all the others. Estimate the amount of contingent loss and state the accounting treatment of such contingent loss.

Answer—

According to AS 29 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

(i) There is a present obligation arising out of past events but not recognized as provision.

(ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

(iii) The possibility of an outflow of resources embodying economic benefits is also remote.

(iv) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning first 10 cases is 60% and for remaining five cases is 50%. In other words, probability of losing the cases is 40% and 50% respectively. According to AS 29, we make a provision if the loss is probable. As the loss does not appear to be probable and the probability or possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore, disclosure by way of note of contingent liability amount may be calculated as under:

Expected loss in first ten cases	= [₹90,000 × 0.3 + ₹2,00,000 × 0.1] × 10
	= [₹27,000 + ₹20,000] × 10
	= ₹47,000 × 10 = ₹4,70,000
Expected loss in remaining five cases	= [₹60,000 × 0.3 +₹ 1,00,000 × 0.2] × 5
	= [₹18,000 + ₹20,000] × 5
	= ₹38,000 × 5 = ₹1,90,000
Total contingent liability	= ₹4,70,000 + ₹1,90,000 = ₹ 6,60,000.

Question: 2

Shyam Ltd. (a Public Sector Company) provides consultancy and engineering services to its clients. In the year 2010-11, the Government has set up a commission to decide about the pay revision. The pay will be revised with respect from 1-1-2006 based on the recommendations of the commission. The company makes the provision of ₹680 lakhs for pay revision in the financial year 2010-11 on the estimated basis as the report of the commission is yet to come. As per the contracts with the client on cost plus job, the billing is done on the actual payment made to the employees and allocated to jobs based on hours booked by these employees on each job.

The company discloses through notes to accounts:

"Salaries and benefits include the provision of ₹680 lakhs in respect of pay revision. The amount chargeable from reimbursable jobs will be billed as per the contract when the actual payment is made".

The accountant feels that the company should also book/recognise the income by ₹680 lakhs in Profit and Loss Account as per the terms of the contract. Otherwise, it will be the violation of matching concept & understatement of profit. Comment on the opinion of the Accountant with reference to relevant accounting standards.

Answer

As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provisions.

Accordingly, potential loss to an enterprise may be reduced or avoided because a contingent liability is matched by a related counter-claim or claim against a third party. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim if no significant uncertainty as to its measurability or collectability exists. In this case, the provision of salary to employees of ₹680 lakhs will be ultimately collected from the client, as per the terms of the contract. Therefore, the liability of ₹680 lakhs is matched by the counter claim from the client. Hence, the provision for salary of employees should be matched with the reimbursable asset to be claimed from the client. It appears that the whole amount of Rs. 680 lakhs is recoverable from client and there is no significant uncertainty about the collection. Hence, the net charge to profit and loss account should be nil.

The opinion of the accountant regarding recognition of income of ₹680 lakhs is not as per AS- 29 and also the concept of prudence will not be followed if ₹680 lakhs is simultaneously recognized as income. ₹680 lakhs is not the revenue at present but only reimbursement of claim for which an asset is created. However the accountant is correct to the extent as that non- recognition of 680 lakhs as income will result in the understatement of profit. To avoid this, in the statement of profit and loss, expense relating to provision may be presented net of the amount recognized for reimbursement.

Question: 3

An engineering goods company provides after sales warranty for 2 years to its customers. Based on past experience, the company has been following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period:

Less than 1 year : 2% provision More than 1 year : 3% provision The company has raised invoices as under:

Invoice Date	Amount (₹)
19th January, 2011	40,000
29th January, 2012	25,000
15th October, 2012	90,000

Calculate the provision to be made for warranty under Accounting Standard 29 as at 31st March, 2012 and 31st March, 2013. Also compute amount to be debited to Profit and Loss Account for the year ended 31st March, 2013.

Answer

Provision to be made for warranty under AS 29 'Provisions, Contingent Liabilities and Contingent Assets'

As at 31st March, 2012	=	₹40,000 x .02 +	₹25,000 x .03
	=	₹800 + 750 =	₹1,550
As at 31st March, 2013	=	₹25,000 x .02 +	₹90,000 x .03
	=	₹500 + ₹2,700 =	₹3,200

Amount debited to Profit and Loss Account for year ended 31st March, 2013

	₹
Balance of provision required as on 31.03.2013	3,200
Less: Opening Balance as on	(1,550)
1.4.2012 Amount debited to profit	1,650
and loss account	

Note:

No provision will be made on 31st March, 2013 in respect of sales amounting ₹40,000 made on 19th January, 2011 as the warranty period of 2 years has already expired.

Question 4—

WZW Ltd. is in dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of ₹1000 Lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal the same in the Annual Accounts of the company?

Answer:

As per para 14 of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognised when:

(i) An enterprise has a present obligation as a result of past event;

(ii) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(iii) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised.

A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote. The possibility of an outflow of resources embodying economic benefits seems to be remote in the given situation, since the directors of WZW Ltd. are of the opinion that the claim can be successfully resisted by the company. Therefore, the company shall not disclose the same as contingent liability. However, following note in this regard may be given in annual accounts of the company:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of ₹1,000 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company".

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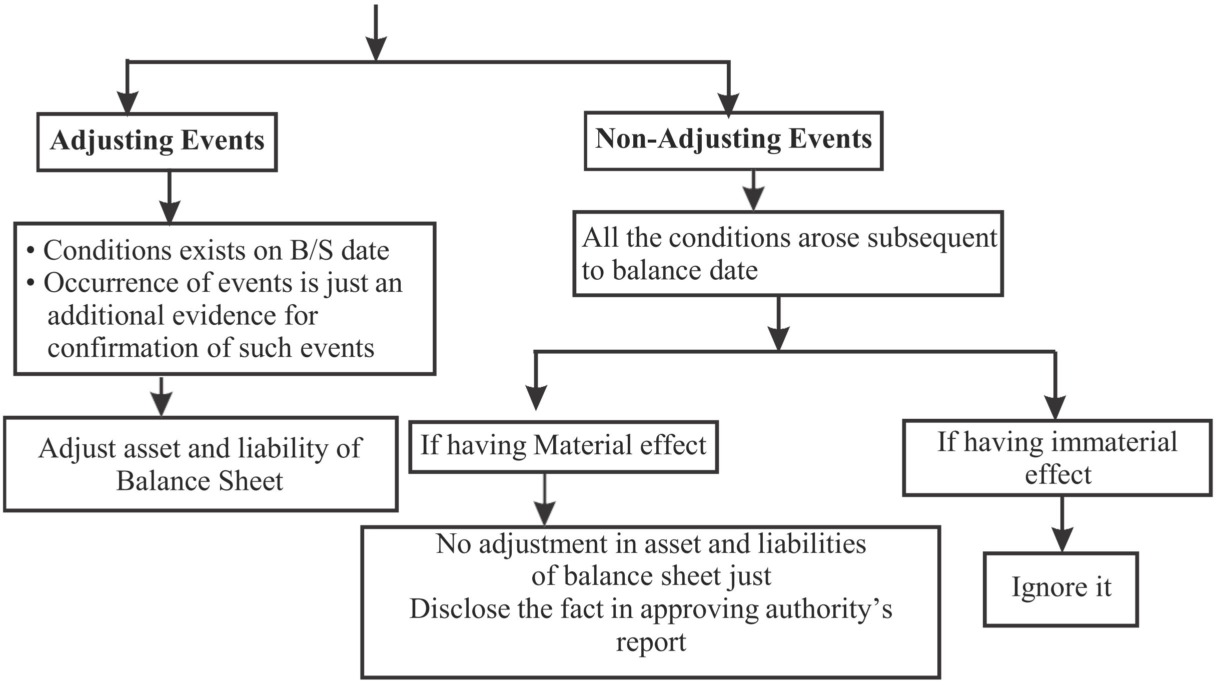
Chapter: 7 (Unit – 1)
Application of Accounting Standard 4
Contingencies and Events Occurring After Balance Sheet Date (Revised)

1. EVENT OCCURRING AFTER BALANCE SHEET

- Those significant events
- Favorable or unfavorable
- Which occur from balance sheet date to approval of financial statements by approving authority

2. **TYPES OF EVENTS**



3. **DISCLOSURE**

Disclosure of events occurring after the balance sheet date requires the following information should be provided:

(a) The nature of the event;

(b) An estimate of the financial effect, or a statement that such an estimate cannot be made.

Notes

- If nature of event is effecting our going concern assumption then it will be adjusting event and adjust asset & liability.
- If suddenly huge loss occurred in question is silent about assumption of going concern then provide alternative solution with going concern and without going concern.
- As per amendment in AS 4 proposed dividend is now non-adjusting event and it is to be

disclosed as part of foot note in the notes to accounts.

- If cheque has been received from debtor then it is to be adjusted on the basis of date on which it was received irrespective of date mention in the cheque.

Question and Answer

Question 1—

You are an accountant preparing accounts of A Ltd. as on 31.3.2011. After year end the following events have taken place in April, 2011:

(i) A fire broke out in the premises damaging, uninsured stock worth ₹10 lakhs (Salvage value₹2 lakhs).

(ii) A suit against the company's advertisement was filed by a party claiming damage of₹20 lakhs.

Describe, how above will be dealt with in the accounts of the company for the year ended on 31.3.2011.

Answer—

Events occurring after the Balance Sheet date that represent material changes and commitments affecting the financial position of the enterprise must be disclosed according to para 15 of AS 4 on 'Contingencies and Events Occurring after the Balance Sheet Date'. The key point here is heather the impact of the loss is material or not. As the loss has arisen from non-insurance the event comes very material not merely on account of the current loss but the future vulnerability. Hence, fire accident and loss thereof must be disclosed as also the fact that the stocks of the company are uninsured with a value of the future risk (if possible). .

Suit filed against the company being a contingent liability must be disclosed with the nature of contingency, an estimate of the financial effect and uncertainties which may affect the future outcome must be disclosed as per para 16 of AS 4.

Question 2—

MEC Limited could not recover an amount of ₹8 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company for the year ended 31-3-2011 were finalized by making a provision @ 25% of the amount due from that debtor. In May 2011, the debtor became bankrupt and nothing is recoverable from him. Do you advise the company to provide for the entire loss of ₹8 lakhs in books of account for the year ended 31-3-2011?

Answer—

As per para 8 of AS 4, 'Contingencies and Events Occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date if such event provides/relates to additional information to the conditions existing at the balance sheet date and is also materially affecting the valuation of assets and liabilities on the balance sheet date.

As per the information given in the question, the company was aware that the debtor was already in a great financial difficulty at the time of closing of accounts. Bankruptcy of the debtor in May 2011 is only an additional information to the condition existing on the balance sheet date. Also the effect of a debtor becoming bankrupt is material as total amount of ₹8 lakhs will be a loss to the company. Therefore, the company is advised to provide for the entire amount of ₹8 lakhs in the books of account for the year ended 31st March, 2011.

Question 3—

A major fire has damaged the assets in a factory of a Limited Company on 5th April - five days after the year end and closure of accounts. The loss is estimated at ₹10 crores out of which ₹7 crores will be recoverable from the insurers. Explain briefly how the loss should be treated in the final accounts for the previous year.

Answer:

The loss due to break out of fire is an example of event occurring after the balance sheet date. The event being in the nature of a fire which is unpredictable does not relate to conditions existing at the balance sheet date. It has not affected the financial position as on the date of balance sheet and therefore requires no specific adjustments in the financial statements. However, paragraph 8.6 of AS 4 states that disclosure is generally made of events occurring after balance sheet date i.e. in subsequent periods that represent unusual changes affecting the existence or substratum of the enterprise after the balance sheet date. In the given case, the amount of loss of assets in a factory is material and may be considered as an event affecting the substratum of the enterprise. Hence, as recommended in paragraph 15 of AS 4, disclosure of the event should be made.

Question 4—

A Company entered into an agreement to sell its immovable property to another company for ₹35 lakhs. The property was shown in the Balance Sheet at ₹7 lakhs. The agreement to sell was concluded on 15th February, 2011 and sale deed was registered on 30th April, 2011.

You are required to state, with reasons, how this event would be dealt with in the financial statements for the year ended 31st March, 2011.

Answer—

According to para 13 of AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. In the given case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 15th February 2011 i.e. before the balance sheet date. Registration of the sale deed on 30th April, 2011, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of immovable property is necessary in the financial statements for the year ended 31st March, 2011.

Question 5—

In Raj Co. Ltd., theft of cash of 2 lakhs by the cashier in January, 2011 was detected in May, 2011. The accounts of the company were not yet approved by the Board of Directors of the company.

Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.2011. Decide.

Answer—

As per para 13 of AS 4 (revised), 'Contingencies and Events Occurring After the Balance Sheet Date', assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

Though the theft, by the cashier ₹2,00,000, was detected after the balance sheet date (before approval of financial statements) but it is an additional information materially affecting the determination of the cash amount relating to conditions existing at the balance sheet date. Therefore, it is necessary to make the necessary adjustments in the financial statements of the company for the year ended 31st March, 2011 for recognition of the loss amounting ₹2,00,000.

Question 6—

A Company follows April to March as its financial year. The Company recognizes cheques dated 31st March or before, received from customers after balance sheet date, but before approval of financial statement by debiting 'Cheques in hand account' and crediting 'Debtors account'. The 'cheques in hand' is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques in hand are presented to bank in the month of April and are also realised in the same month in normal course after deposit in the bank. State with reasons, whether the collection of cheques bearing date 31st March or before, but received after Balance Sheet date is an adjusting event and how this fact is to be disclosed by the company?

Answer—

Even if the cheques bear the date 31st March or before, the cheques received after 31st March do not represent any condition existing on the balance sheet date i.e. 31st March. Thus, the collection of cheques after balance sheet date is not an adjusting event. Cheques that are received after the balance sheet date should be accounted for in the period in which they are received even though the same may be dated 31st March or before as per AS 4 "Contingencies and Events Occurring after the Balance Sheet Date". Moreover, the collection of cheques after balance sheet date does not represent any material change affecting financial position of the enterprise on the balance sheet date, so no disclosure is necessary.

Question 7—

While preparing its final accounts for the year ended 31st March 2010, a company made a provision for bad debts @ 4% of its total debtors (as per trend followed from the previous years). In the first week of March 2010, a debtor for ₹3,00,000 had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2010 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2010.

Answer—

As per para 8 of AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustment to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

A debtor for ₹3,00,000 suffered heavy loss due to earthquake in the first week of March, 2010 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in April, 2010 (after the balance sheet date) is only an additional information related to the existing condition on the balance sheet date. Accordingly, full provision for bad debts amounting ₹3,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2010.

Question 8—

In preparing the financial statements of Lotus Limited for the year ended 31st March, 2010 you come across the following information. State with reason, how you would deal with this in the financial statements?

The company invested ₹50 lakhs in April, 2010 in the acquisition of another company doing similar business, the negotiations for which had just started.

As per AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", events occurring after the balance sheet date which do not affect the figures stated in the financial statements would not normally require disclosure in the financial statements although they may be of such significance that they may require a disclosure in the report of the approving authority to enable users of financial statements to make proper evaluations and decisions.

The investment of ₹50 lakhs in April 2010 for acquisition of another company is under negotiation stage, and has not been finalized yet. On the other hand it is also not affecting the figures stated in the financial statements of 2009-10, hence the details regarding such negotiation and investment planning of ₹50 lakhs in April, 2010 in the acquisition of another company should be disclosed in the Directors' Report* to enable users of financial statements to make proper evaluations and decision.

Question 9—

Cashier of A-One Limited embezzled cash amounting to ₹6,00,000 during March, 2012 . However same comes to the notice of Company management during April, 2012 only. Financial statements of the company is not yet approved by the Board of Directors of the company. With the help of provisions of AS 4 "Contingencies and Events Occurring after the Balance Sheet Date" decide, whether the embezzlement of cash should be adjusted in the books of accounts for the year ending March, 2012?

What will be your reply, if embezzlement of cash comes to the notice of company management only after approval of financial statements by the Board of Directors of the company ?

Answer—

As per para 13 of AS 4, assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

Though the theft, by the cashier ₹6,00,000, was detected after the balance sheet date (before approval of financial statements) but it is an additional information materially affecting the determination of the cash amount relating to conditions existing at the balance sheet date. Therefore, it is necessary to make the necessary adjustments in the financial statements of the company for the year ended 31st March, 2012 for recognition of the loss amounting ₹6,00,000.

If embezzlement of cash comes to the notice of company management only after approval of financial statements by board of directors of the company, then the treatment will be done as per the provisions of AS 5. This being extraordinary item should be disclosed in the statement of profit and loss as a part of loss for the year ending March, 2013. The nature and the amount of prior period items should be separately disclosed on the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

Question 10—

Neel Limited has its corporate office in Mumbai and sells its products to stockists all over India. On 31st March, 2013, the company wants to recognize receipt of cheques bearing date 31st March, 2013 or before, as "Cheques in Hand" by reducing "Trade Receivables". The "Cheques in Hand" is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques are presented to the bank in the month of April 2013 and are also realized in the same month in normal course after deposit in the bank. State with reasons, whether each of the following is an adjusting event and how this fact is to be disclosed by the company, with reference to the relevant accounting standard.

(i) Cheques collected by the marketing personnel of the company from the stockists on or before 31st March, 2013.

(ii) Cheques sent by the stockists through courier on or before 31st March, 2013.

Answer—

(i) Cheques collected by the marketing personnel of the company is an adjusting event as the marketing personnels are employees of the company and therefore, are representatives of the company. Handing over of cheques by the stockist to the marketing employees discharges the liability of the stockist. Therefore, cheques collected by the marketing personnel of the company on or before 31st March, 2013 require adjustment from the stockists' accounts i.e. from 'Trade Receivables A/c' even though these cheques (dated on or before 31st March, 2013) are presented in the bank in the month of April, 2013 in the normal course. Hence, collection of cheques by the marketing personnel is an adjusting event as per AS 4 'Contingencies and Events Occurring after the Balance Sheet Date'. Such 'cheques in hand' will be shown in the Balance Sheet as 'Cash and Cash equivalents' with a disclosure in the Notes to accounts about the accounting policy followed by the company for such cheques.

(ii) Even if the cheques bear the date 31st March or before and are sent by the stockists through courier on or before 31st March, 2013, it is presumed that the cheques will be received after 31st March. Collection of cheques after 31st March, 2013 does not represent any condition existing on the balance sheet date i.e. 31st March. Thus, the collection of cheques after balance sheet date is not an adjusting event. Cheques that are received after the balance sheet date should be accounted for in the period in which they are received even though the same may be dated 31st March or before as per AS 4. Moreover, the collection of cheques after balance sheet date does not represent any material change affecting financial position of the enterprise, so no disclosure in the Director's Re- port is necessary.

Question 11—

State with reasons, how the following events would be dealt with in the financial statements of Pradeep Ltd. for the year ended 31st March, 2013:

(i) An agreement to sell a land for ₹30 lakh to another company was entered into on 1st March, 2013. The value of land is shown at ₹20 lakh in the Balance Sheet as on 31st March, 2012. However, the Sale Deed was registered on15th April, 2013.

(ii) The negotiation with another company for acquisition of its business was started on 2nd February, 2013. Pradeep Ltd. invested ₹40 lakh on 12th April, 2013.

Answer—

(i) According to AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In the given case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 1st March, 2013 i.e. before the balance sheet date. Registration of the sale deed on 15th April, 2013, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of land is necessary in the financial statements of Pradeep Ltd. for the year ended 31st March, 2013.

(ii) AS 4 (Revised) defines "Events occurring after the balance sheet date" as those significant events, both favorable and unfavorable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 2013.

Applying provisions of the standard which clearly state that/disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of 40 lakhs in April, 2013 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

Question 12—

In its Final Accounts for the year ended 31st March, 2014, Z Ltd. made a provision of 3% of its total debtors. On 10th March, 2014, a debtor of ₹5 lakhs suffered a heavy loss and became insolvent in April 2014. The loss was not insured.

State giving reasons, if the company may provide for the full loss in its accounts for the year ended 31st March, 2014.

Answer—

According to para 8.2 of Accounting Standard 4 "Contingencies and Events Occurring after the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

In the given case, though the debtor became insolvent after balance sheet date, yet he had suffered heavy loss (not covered by the insurance), before the balance sheet date and this loss was the cause of the insolvency of the debtor.

Therefore the company must make full provision for bad debts amounting₹5 lakhs in its final accounts for the year ended 31st March, 2014.

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Chapter: 7 (Unit – 2)

Application of Accounting Standard 5

NET PROFIT OR LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS AND CHANGES IN ACCOUNTING POLICIES

1. NET PROFIT OR LOSS FOR THE PERIOD:

- If profit and loss account or trading & P/L account or income statement or statement of Profit or Loss is prepared for current year.
- All items of income and expense which are recognized in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits other- wise.
- Disclose all the items of revenue and expenses affecting profit of current year in that statement.
- Verify in to three categories

Ordinary Item	Extra-Ordinary Item	Exceptional items
Any activities which are undertaken by an enterprise as part of its business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities.	Income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequentlyor regularly	When items of income and expense within profit or loss from ordinary activities are of such size,nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.
For example: i. Revenue by sale ofgoods services ii. Brokerage, Commission, Discount iii. Royalty, Interest Received iv. COGS. v. Operational expenses of P/L vi. Loss of stock i. Claim/Compensation /Da mages paid to employee etc.	**For example:** ii. Loss by natural calamities iii. Claim/Compensation/ Damages received or paid (other than employee) iv. Attachment of propertyby Govt. v. Refund of Govt. Grant etc.	**For example:** i. The write-down of inventories to net realizable value as well as the reversalof such write-downs ii. A restructuring of the activities of an enterprise andthe reversal of any provisions for the costs of restructuring iii. Disposals of items of fixed assets iv. Disposals of long-term investments v. Legislative changes having retrospective application vi. Litigation settlements vii. Other reversals of provisions

• If such item is havingmaterial effect then disclose separately • If such item is not having material effectthen no need to disclose separately	• Always disclose such item separately	• Always disclose such itemseparately

2. PRIOR PERIOD TIMES

- Revenue and expenses which arise in current year,
- As a result error and omissions in preparation of financial statement of one or more prior periods.
- Errors in the preparation of the financial statements of one or more prior periods may be discovered in the current period. Errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, or oversight.
- Adjusted in current year as prior period items always disclose separately
- **For Example:**

(i) Provision needed was not created in previous years

(ii) Revenue and expenses adjusted in previous years with wrong amount

(iii) Revenue and expenses omitted in previous years.

3. CHANGES IN ACCOUNTING ESTIMATES

- Estimations are the approximations which are taken on the basis of conditions or situations or knowledge base of that time
- An estimate may have to be revised if changes occur in the circumstances based on which the estimate was made, or as a result of new information, more experience or subsequent developments. The revision of the estimate, by its nature, does not bring the adjustment within the definitions of an extraordinary item or a prior period item.
- It needs revision with changed condition or situation or obtaining further knowledge
- Such revision in known as change in accounting estimation
- **For Example:**
  - (i) Change in rate of provisions
  - (ii) Application of salary slab from back date.
  - (iii) Change in rate of depreciation/salvage value/life of asset/method of depreciation etc.
- If such item is having material effect then disclose separately
- If such item is not having material effect then no need to disclose separately

4. CHANGES IN ACCOUNTING ESTIMATES

- Principles and methods of applying those principles adopted while preparing financial statements
- Selected accounting policies need to follow consistently

If Accounting Policies is changed

5. CHANGES IN ACCOUNTING POLICIES:

- Principles and methods of applying those principles adopted while preparing financial statement
- Selected accounting policies need to follow consistently
- **If Accounting Policies is changed**

When	Disclosures if having material effect
✓ Required by AS ✓ Statutory requirement ✓ Better and meaningful presentation.	✓ Reason of change ✓ Effect in Current year & Future ✓ If effect is non-measurable disclose the fact

For Example:

(i) Change in cost formula of stock

(ii) Change in method & valuation of goodwill.

Note:- The following are not changes in accounting policies:

(a) The adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, e.g., introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement;

(b) The adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial.

Question and Answer

Question 1—

When can a company change its accounting policy?

Answer—

A change in accounting policy should be made in the following conditions:

(i) If the change is required by some statute or for compliance with an Accounting Standard.

(ii) Change would result in more appropriate presentation of the financial statement.

Change in accounting policy may have a material effect on the items of financial statements. For example, if depreciation method is changed from straight-line method to written-down value method, or if cost formula used for inventory valuation is changed from weighted average to FIFO, or if interest is capitalized which was earlier not in practice, or if proportionate amount of interest is changed to inventory which was earlier not the practice, all these may increase or decrease the net profit. Unless the effect of such change in accounting policy is quantified, the financial statements may not help the users of accounts. Therefore, it is necessary to quantify and disclose the effect of change on financial statement items like assets, liabilities, profit / loss.

Question 2—

A limited company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2010-2011.

Subsequently on a review of the credit period allowed and financial capacity of the customers, the company decided to increase the provision to 8% on debtors as on 31.3.2011. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard can this revision be considered as an extraordinary item or prior period item?

Answer

As per para 21 of AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the preparation of financial statements involves making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revise an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate, by its nature, does not bring the adjustment within the definitions of a prior period item or an extraordinary item [para 21 of AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies].

In the given case, a limited company created 2.5% provision for doubtful debts for the year 2010-2011. Subsequently in 2011 the company revised the estimates based on the changed circumstances and wants to create 8% provision. As per AS-5 (Revised), this change in estimate is neither a prior period item nor an extraordinary item.

However, as per para 27 of AS 5 (Revised), a change in accounting estimate which has material effect in the current period, should be disclosed and quantified. Any change in the accounting estimate which is expected to have a material effect in later periods should also be disclosed and quantified.

Question 3—

X Co. Ltd. signed an agreement with its employees union for revision of wages in June, 2012. The wage revision is with retrospective effect from 1.4.2008. The arrear wages upto 31.3.2012 amounts to ₹80 lakhs. Arrear wages for the period from 1.4.2012 to 30.06.2012 (being the date of agreement) amounts to ₹7 lakhs.

Decide whether a separate disclosure of arrear wages is required.

Answer

It is given that revision of wages took place in June, 2012 with retrospective effect from 1.4.2008. The arrear wages payable for the period from 1.4.2008 to 31.3.2012 cannot be taken as an error or omission in the preparation of financial statements of earlier years and hence this expenditure cannot be taken as a prior period item.

Additional wages liability of ₹87 lakhs (from 1.4.2008 to 30.6.2012) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item.

However, as per para 12 of AS 5 (Revised),' Net Profit or loss for the Period, Prior Period Items and Changes in the Accounting Policies', when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be dis- closed separately.

However, wages payable for the current year (from 1.4.2012 to 30.6.2012) amounting ₹7 lakhs is not a prior period item hence need not be disclosed separately. This may be shown as current year's wages.

Question 4—

Goods of ₹5,00,000 were destroyed due to flood in September, 2009. A claim was lodged with insurance company, but no entry was passed in the books for insurance claim.

In March, 2012, the claim was passed and the company received a payment of ₹3,50,000 against the claim. Explain the treatment of such receipt in final accounts for the year ended 31st March, 2012.

Answer—

As per the provisions of AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", prior period items are income or expenses, which arise, in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. Further, the nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on current profit or loss can be perceived.

In the given instance, it is clearly a case of error in preparation of financial statements for the year 2009-10. Hence, claim received in the financial year 2011-12 is a prior period item and should be separately disclosed in the statement of Profit and Loss.

Question 5—

S.T.B. Ltd. makes provision for expenses worth ₹7,00,000 for the year ending March 31, 2011, but the actual expenses during the year ending March 31, 2012 comes to ₹9,00,000 against provision made during the last year. State with reasons whether difference of ₹2,00,000 is to be treated as prior period item as per AS-5.

Answer:

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', as a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

Estimates may have to be revised, if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.

As per the standard, the effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. Thus, revision of an estimate by its nature i.e. the difference of ₹2 lakhs, is not a prior period item.

Therefore, in the given case expenses amounting ₹2,00,000 (i.e. ₹9,00,000 - ₹7,00,000) relating to the previous year recorded in the current year, should not be regarded as prior period item.

Question 6—

A company created a provision of 75,000 for staff welfare while preparing the financial statements for the year 2010 - 11. On 31st March, in a meeting with staff welfare association, it was decided to increase the amount of provision for staff welfare to 1,00,000. The accounts were approved by Board of Directors on 15th April, 2011

Explain the treatment of such revision in financial statements for the year ended 31st March,2011

Answer—

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the change in amount of staff welfare provision amounting ₹25,000 is neither a prior period item nor an extraordinary item. It is a change in estimate, which has been occurred in the year 2010- 11.

As per the provisions of the standard, normally, all items of income and expense which are recognized in a period are included in the determination of the net profit or loss for the period. This includes extraordinary items and the effects of changes in accounting estimates. However, the effect of such change in accounting estimate should be classified using the same classification in the statement of profit and loss, as was used previously, for the estimate.

Question 7—

Give two examples on each of the following items:

(i) Change in Accounting Policy

(ii) Change in Accounting Estimate

(iii) Extra Ordinary Items

(iv) Prior Period Items.

Answer: -

(i) Examples of Changes in Accounting Policy:
  a. Methods for valuation of Goodwill
  b. Change in cost formula in measuring the cost of inventories.

(ii) Examples of Changes in Accounting Estimates:
  a. Change in estimate of provision for doubtful debts on sundry debtors.
  b. Change in estimate of useful life of fixed assets.
  c. Change of depreciation method from WDV to SLM and vice-versa..

(iii) Examples of Extraordinary items:
  a. Loss due to earthquakes / fire / strike
  b. Attachment of property of the enterprise by government

(iv) Examples of Prior period items:
  a. Applying incorrect rate of depreciation in one or more prior periods.
  b. Omission to account for income or expenditure in one or more prior periods.

Question 8—

Closing Stock for the year ending on 31st March, 2013 is ₹1,50,000 which includes stock damaged in a fire in 2011-12. On 31st March, 2012, the estimated net realizable value of the damaged stock was 12,000. The revised estimate of net realizable value of damaged stock included in closing stock at 2012-13 is 4,000. Find the value of closing stock to be shown in Profit and Loss Account for the year 2012-13, using provisions of Accounting Standard 5.

Answer—

The fall in estimated net realisable value of damaged stock ₹8,000 is the effect of change in accounting estimate. As per para 25 of AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the effect of a change in accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. It is presumed that the loss by fire in the year ended 31.3.2012, i.e. difference of cost and NRV was shown in the profit and loss account as an exceptional item. Therefore, in the year 2012-13, revision in accounting estimate should also be classified as exceptional item in the profit and loss account and closing stock should be shown excluding the value of damaged stock.

Value of closing stock for the year 2012-13 will be as follows:

	₹
Closing Stock (including damaged goods)	1,50,000
Less: Revised value of damaged goods	(4,000)
Closing stock (excluding damaged goods)	1,46,000

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Chapter: 7 (Unit-3)
Accounting Standard 11
The Effects of Changes in Foreign Exchange Rates

1. OBJECTIVE

- The standard deals with the issues involved in accounting for foreign currency transactions and foreign operations i.e., to decide which exchange rate to use and how to recognise the financial effects of changes in exchange rates in the financial statements.

2. SCOPE

This Standard should be applied:

- In accounting for transactions in foreign currencies.
- In translating the financial statements of foreign operations.
- This Statement also deals with accounting for foreign currency transactions in the nature of forward exchange contracts.

This Standard does not:

- Specify the currency in which an enterprise presents its financial statements. However, an enterprise normally uses the currency of the country in which it is domiciled. If it uses a different currency, the Standard requires disclosure of the reasons for using that currency. The Standard also requires disclosure of the reason for any change in the reporting currency.
- Deal with the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation, which are addressed in AS 3 'Cash flow statement'.
- Deal with exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.
- Deal with the restatement of an enterprise's financial statements from its reporting currency into another currency for the convenience of users accustomed to that currency or for similar purposes.

3. INITIAL RECOGNITION

- If Transactions occur in foreign currency
- Record transaction of foreign currency initially by using exchange rate prevailing on the date of transaction.

4. SUBSEQUENT RECOGNITION

- If no further transactions will occur in future in foreign currency related to initially recognised transaction
  - No Adjustments
- If settlement subsequently in same F.Y.
  - Difference of initial recording and settlement is treated as foreign Exchange loss / gain and transferred to PL A/c of same financial year.
- If settlement relating to that transaction in foreign currency in subsequent financial year
  - On balance sheet date monetary item of asset and liability need to be disclosed by using closing rate and difference transferred to P/L A/C of that year
    - Last recording in balance sheet to settlement date, difference will transfer to P/L A/c in the year of settlement

5. FORWARD CONTRACT IN FOREGN CURRENCY

- Contract entered between two parties for purchase/sale of foreign currency on a future date and execution of performance will be also on a future date but terms and conditions are predicated on the date of entering into forward contract.
- Treatment will be as under

Forward contract for non-speculation purpose	Forward contract for speculation purpose
Contract for avoidance of risk or arrangement of foreign currency to fulfils needs	Contract for taking benefits against the changes in exchange rates
Difference of transaction recorded (spot rate) and rate agreed in to forward contract will be treated as loss/gain and, it will be **allocated proportionately according to total period of forward contract**	Difference in rates of sale and purchase of forward contract will be treated as Foreign Exchange loss or gain and, will be transferred to **P/L account in the year of sale of forward contract**
Closing rate and actual rate exist on date of settlement is to be ignored	Spot rate and closing rate is to be ignored

6. AMENDMENTS IN AS-11 (ONLY FOR COMPANY)

Liability arise in foreign currency and is to be settled on a future date due to acquisition of long term asset or fixed asset	Transaction for long term borrowing in foreign currency
Difference of initial recording and closing rate is to be added or deducted from cost of related fixed asset instead of transferring it to PL A/c and thereafter depreciate fixes asset according to revised value.	Loss/gain of initial recording and closing rate is to be transferred to separate reserve account known as foreign currency monetary item translation reserve a/c (FCMITR a/c)
Alternatively adopt older treatment up to 31.3.2020 thereafter amendment compulsory applicable	Amortize over the period according to repayment of loan and un-amortized part will be disclosed as part of reserve & surplus in Balance Sheet . Alternatively adopt older treatment up to 31.3.2020 thereafter amendment compulsory applicable .

7. DISCLOSURES:

- **An enterprise should disclose:**

  (a) The amount of exchange differences included in the net profit or loss for the period.

  (b) Net exchange differences accumulated in foreign currency translation reserve as a separate component of shareholders' funds, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.

- When the reporting currency is different from the currency of the country in which the enterprise is domiciled, the reason for using a different currency should be disclosed. The reason for any change in the reporting currency should also be disclosed.

- When there is a change in the classification of a significant foreign operation, an enterprise should disclose:

  (a) The nature of the change in classification;

  (b) The reason for the change;

  (c) The impact of the change in classification on shareholders' funds; and

  (d) The impact on net profit or loss for each prior period presented had the change in classification occurred at the beginning of the earliest period presented.

Questions & Answer

Question: 1

Beekay Ltd. purchased fixed assets costing ₹ 5,000 lakh on 01.04.2012 payable in foreign currency (US$) on 05.04.2013. Exchange rate of 1 US$ = ₹ 50.00 and ₹ 54.98 as on 01.04.2012 and 31.03.2013respectively.

The company also obtained a soft loan of US$ 1 lakh on 01.04.2012 payable in three annual equal instalments. First instalment was due on 01.05.2013.

You are required to state, how these transactions would be accounted for in the books of accounts ending 31st March, 2013.

Answer—

- As per AS 11 (Revised) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as an expense in the period in which they arise.
- However, Ministry of Corporate Affairs has recently amended AS 11 through a notification.
- As per the notification, exchange difference arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to requisition of depreciable capital asset, can be added to or deducted from cost of asset.
- The MCA has given an option for the enterprises to capitalize the exchange differences arising on reporting of long term foreign currency monetary items till 31st March, 2020.
- Thus the company can capitalize the exchange differences arising due to long term loans linked with the acquisition of fixed assets.

Transaction 1:

Calculation of exchange difference on fixed assets

Foreign Exchange Liability == US $ 100 lakhs.

Exchange Difference = US $ 100 lakhs x (₹ 54.98 - ₹ 50) = ₹ 498 lakhs.

Loss due to exchange difference amounting ₹ 498 lakhs will be capitalised and added in the carrying value of fixed assets. Depreciation on the unamortised amount will be provided in the remaining years

Transaction 2:

Soft loan exchange difference (US $ 1 lakh i.e₹ 50 lakhs) Value of loan 31.3.13 US $ 1 lakh x 54.98 = ₹ 54,98,000

AS 11 also provides that in case of liability designated as long-term foreign currency monetary item (having a term of 12 months or more at the time of origination) the exchange difference is to be accumulated in the Foreign Currency Monetary Item Translation Difference (FCMITD) and should be written off over the useful life of such long-term liability, by recognition as income or expenses in each of such periods.

Exchange difference between reporting currency (INR) and foreign currency (USD) as on 31.03.2013 = US$1.00 lakh X ₹ (54.98 - 50) = ₹ 4.98 lakh.

Loan account is to be increased to 54.98 Iakh and FCMITD account is to be debited by 4.98 lakh. Since loan is repayable in 3 equal annual instalments, ₹ 4.98 lakh/3 = ₹ 1.66 lakh is to be charged in Profit and Loss Account for the year ended 31st March, 2013 and balance in FCMITD A/c ₹ (4.98 lakh - 1.66 lakh) = ₹ 3.32 lakh is to be shown on the 'Equity & Liabilities' side of the Balance Sheet as a negative figure under the head 'Reserve and Surplus' as a separate line item.

Note: The above answer is given on the basis that the company has availed the option under para 46A of AS 11

Question: 2

(a) Sterling Ltd. purchased a plant for US $ 20,000 on 31st December, 2011 payable after 4 months. The company entered into a forward contract for 4 months 48.85 per dollar. On 31st December, 2011, the exchange rate was ₹ 47.50 per dollar.

How will you recognize the profit or loss on forward contract in the books of Sterling Limited for the year ended 31st March, 2012.

(b)

	Exchange Rate per $
Goods purchased on 1.1.2011 of US $ 10,000	₹ 45
Exchange rate on 31.3.2011	₹ 44
Date of actual payment 7.7.2011	₹ 43

Ascertain the loss/gain for financial years 2010-11 and 2011-12, also give their treatment as per AS 11.

Answer:

(a) Calculation of profit or loss to be recognized in the books of Sterling Limited

	₹
Forward Contract rate	48.85
Less: Spot rate	(47.50)
Loss	1.35
Forward Contract Amount	$ 20,000
Total loss on entering into forward contract =($20,000 × ₹ 1,35)	₹ 27,000
Contract period	4 months
Loss for the period 1st January, 2012 to 31st March, 2012 i.e. 3 months falling in the year 2011-2012 will be ₹ 27,000 ×=	₹ 20,250

Balance loss of ₹ 6,750 (i.e. ₹ 27,000 - ₹ 20,250) for the month of April, 2012 will be recognized in the financial year 2012-2013.

(b) As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions Thus, goods purchased on 1.1.2011 and corresponding creditor would be recorded at ₹ 4,50,000 (i.e. $10,000 × ₹ 45)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditor of US $10,000 on 31.3.2011 will be reported at ₹ 4,40,000 (i.e. $10,000 × ₹ 44) and exchange profit of ₹ 10,000 (i.e. 4,50,000 - 4,40,000) should be credited to Profit and Loss account in the year 2010-11.

On 7.7.2011, creditor of $10,000 is paid at the rate of ₹ 43. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account.

Therefore, ₹ 10,000 (i.e. 4,40,000 - 4,30,000) will be credited to Profit and Loss account in the year 2011-12.

Question: 3

Sunshine Company Limited imported raw materials worth US Dollars 9,000 on 25th February, 2011, when the exchange rate was ₹ 44 per US Dollar. The transaction was recorded in the books at the above mentioned rate. The payment for the transaction was made on 10th April, 2011, when the exchange rate was ₹ 48 per US Dollar. At the year end 31st March, 2011, the rate of exchange was ₹ 49 per US Dollar.

The Chief Accountant of the company passed an entry on 31st March, 2011 adjusting the cost of raw material consumed for the difference between ₹ 48 and ₹ 44 per US Dollar. Discuss whether this treatment is justified as per the provisions of AS-11 (Revised).

Answer:

- As per para 9 of AS 11, 'The Effects of Changes in Foreign Exchange Rates', initial recognition of a foreign currency transaction is done in the reporting currency by applying the exchange rate at the date of the transaction. Accordingly, on 25th February 2011, the raw material purchased and its creditors will be recorded at US dollar 9,000 × ₹ 44 = ₹ 3,96,000.
- Also, as per para 11 of the standard, on balance sheet date such transaction is reported at closing rate of exchange, hence it will be valued at the closing rate i.e. ₹49 per US dollar (USD 9,000 x ₹ 49 = ₹ 4,41,000) at 31st March, 2011, irrespective of the payment made for the same subsequently at lower rate in the next financial year.
- The difference of ₹ 5 (49 - 44) per US dollar i.e. ₹ 45,000 (USD 9,000 x ₹ 5) will be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2011 and will not be adjusted against the cost of raw materials.
- In the subsequent year on settlement date, the company would recognize or provide in the Profit and Loss account an exchange gain of ₹ 1 per US dollar, i.e. the difference from balance sheet date to the date of settlement between ₹ 49 and ₹ 48 per US dollar i.e. ₹ 9,000. Hence, the accounting treatment adopted by the Chief Accountant of the company is incorrect i.e. it is not in accordance with the provisions of AS 11.

Question: 4

Mr. Y bought a forward contract for three months of US $ 2,00,000 on 1st December 2010 at 1 US $ = ₹ 44.10 when the exchange rate was 1 US $ = ₹ 43.90. On 31-12-2010, when he closed his books, exchange rate was 1 US $ = ₹ 44.20. On31st January, 2011 he decided to sell the contract at ₹ 44.30 per Dollar. Show how the profits from the contract will be recognized in the books of Mr. Y.

Answer:

- As per para 39 of AS 11 'Changes in Foreign Exchange Rates", in recording a forward exchange contract intended for trading or speculation purpose, the premium or discount on the contract is ignored and at each balance sheet date, the value of contract is marked to its current market value and the gain or loss on the contract is recognised.
- Since the forward contract was for speculation purposes the premium on forward contract i.e. the difference between the spot rate and the forward contract rate will not be recorded in the books. Only when the forward contract is sold the difference between the forward contract rate and sale rate will be recorded in the Profit & Loss Account.

	₹
Sale rate	44.30
Less: Contract rate	(44.10)
Profit on sale of contract per US$	00.20

Contract Amount US $ 2,00,000

Total profit (2,00,000 x 0.20) ₹ 40,000

Question: 5

Stem Ltd. purchased a Plant for US$ 30,000 on 30th November, 2013 payable after 6 months. The company entered into a forward contract for 6 months @ ₹ 62.15 per dollar. On 30th November, 2013, the exchange rate was ₹ 60.75 per dollar.

How will you recognise the profit or loss on forward contract in the books of Stem Ltd. for the year ended 31st March, 2014 ?

Answer:

Calculation of Profit or Loss on forward contract to be recognised in the book of Stem Ltd.

Forward contract rate	₹ 62.15 per dollar	
Less: Spot Rate	₹ 60.75 per dollar	
Loss	₹ 1.40 per dollar	
Forward Contract Amount	US$ 30000	
Total Loss on entering into forward contract	= US$ 30,000 x ₹ 1.40	= ₹ 42,000
Contract Period	6 Months	

Out of total contract period of 6 months, 4 months are falling in the financial year 2013-14.

Loss for the period from 1st Dec.2013 to 31st March, 2014= (₹ 42,000/6) x 4 = ₹ 28,000.

Thus the loss amounting to ₹ 28,000 for the period is to be recognised in the year ended 31st March, 2014.

Question: 6

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3.2015.

Sundry Debtors include amount receivable from Umesh₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $ 1= ₹ 58.50.

Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at US $ 1 = ₹ 55.60, taking exchange rate prevailing at the date of transaction.

US $ 1 = ₹ 61.20 on 31.3.2015.

Answer:

- As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

- However, at the option of an entity, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

Debtors	**Foreign Currency Rate**	**₹**
Initial recognition US $8,547 (5,00,000/58.50)	1 US $ = ₹ 58.50	5,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Gain US $ 8,547 × (61.20-58.50)		23,077
Treatment: Credit Profit and Loss A/c by ₹ 23,077		
Long term Loan		
Initial recognition US $ 1,07,913.67 (60,00,000/55.60)	1 US $ = ₹ 55.60	60,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Loss US $ 1,07,913.67 X (61.20 – 55.60)		6,04,317
Treatment: Credit Loan A/c And Debit FCMITD A/C or Profit and Loss A/c by ₹ 6,04,317		

Thus Exchange Difference on Long term loan amounting ₹ 6,04,317 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting ₹ 23,077 is required to be transferred to Profit and Loss A/c.

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CHAPTER 8 (UNIT – 1)
ACCOUNTING STANDARDS 7
CONSTRUCTION CONTRACTS

1. OBJECTIVE

- prescribes the principles of accounting for construction contracts in the financial statements of contractors.
- The focus of the standard is on principles of revenue recognition by the contractors.

2. MEANING OF CONSTRUCTION CONTRACT

- A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are
- closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.
- It also includes service contracts related to it.

4. TYPES OF CONSTRUCTION CONTRACT

- **Fixed Price Contract**
  - With Escalation Clause
  - Without Escalation Clause
- **Cost Plus Contract**
  - With Budget Restrictions
  - Without Budget Restrictions

5. CONTRACT FOR MULTIPLE OF GROUP ASSET

- **Will Be Treated as Single Contract if**
  1. Assets are closely Relate to Each Other
  2. No price negotiation for individual Asset
  3. Cost & Revenue individually is not measurable
  4. Partial Selection is not allowed
- **Each Assets is Treated as Separate Contract if**
  1. Asset not closely related to each other
  2. Separate price negotiation is possible
  3. Separate cost & Revenue is measurable
  4. Partial selection is allowed

6. ADDITIONAL CONTRACT

- **Part of existing contract**
  1. Relate to existing asset
  2. Revision of existing contract price
- **New contract**
  1. Not relate to existing asset
  2. Price Negotiation separately

7 CONTRACT REVENUE AND CONTRACT COST

- **Contract Revenue**
  - It includes initial contract price &
    1. Variation in Contract,
    2. Claim in contract and,
    3. Incentive in contract
- **Contract cost**
  - It includes Material, labour and overhead
    1. Deduct incidental recovery
    2. Overhead only directly attributable
    3. Plant:-
       - **Specific**
         - All Cost will added to contract cost
       - **General**
         - Idle time
           - Not added to Contract cost
         - Active Time
           - Added to contract cost

8 DETERMINATION OF PROFIT OR LOSS CONSTRUCTION CONTRACT

If completed same year

Profit or Loss = Contract Revenue – Contract Cost

Completed in more than one year

Stage of completion or % of completion method will be used

Calculate % of completion on the basis of cost

$$\%\text{ of Completion} = \frac{\textit{Cost incurred so far}}{\textit{Total estimated Cost}} \times 100$$

Recognize revenue according to % of completion

Note 1: In case of expected, loss, entire amount of loss will recognized immediately (part is by actual loss and balance create provision)

Note 2: Uncollectable Contract Revenue:

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

9. DISCLOSURE

(a) An enterprise should disclose:

(i) the amount of contract revenue recognised as revenue in the period;

(ii) the methods used to determine the contract revenue recognised in the period; and

(iii) the methods used to determine the stage of completion of contracts in progress.

(b) An enterprise should disclose following in respect of contracts in progress at the reporting date:

(i) the aggregate amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;

(ii) the amount of advances received; and

(iii) the amount of retentions.

- **Retentions** are amounts of progress billings which are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified.
- **Progress billings** are amounts billed for work performed on a contract whether or not they have been paid by the customer.
- **Advances** are amounts received by the contractor before the related work is performed.

(c) An enterprise should present:

(i) the gross amount due from customers for contract work as an asset; and

(ii) the gross amount due to customers for contract work as a liability.

Particulars	₹
Costs incurred	xxx
Plus: Recognized profits	xxx
Less: Recognized losses	xxx
Less: Progress billings	xxx
Amount	xxx

If above amount is **positive**- Gross amount due **from** customers

If above amount is **negative**- Gross amount due **to** customers

Question & Answer

Question 1—

What are the disclosure requirements of AS-7 (Revised)?

Answer

According to paragraphs 38, 39 and 41 of AS 7, an enterprise should disclose:

(a) the amount of contract revenue recognized as revenue in the period;

(b) the methods used to determine the contract revenue recognized in the period; and

(c) the methods used to determine the stage of completion of contracts in progress.

In case of contract still in progress the following disclosures are required at the reporting date:

(a) the aggregate amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;

(b) the amount of advances received; and

(c) the amount of retentions.

An enterprise should also present:

(a) the gross amount due from customers for contract work as an asset; and

(b) the gross amount due to customers for contract work as a liability.

Question 2—

B Ltd. undertook a construction contract for ₹ 50 crores in April, 2014. The cost of construction was initially estimated at ₹ 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated the cost of completion of the contract at ₹53 crores.

Can the company provide for the expected loss in the book of account for the year ended 31st March, 2015?

Answer

As per para 35 of AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Therefore, The foreseeable loss of ₹ 3 crores (₹ 53 crores less ₹ 50 crores) should be recognised as an expense immediately in the year ended 31st March, 2015. The amount of loss is determined irrespective of

(i) Whether or not work has commenced on the contract;

(ii) Stage of completion of contract activity; or

(iii) The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance with para 8 of AS 7.

Question 3—

M/s Excellent Construction Company Limited undertook a contract to construct a building for ₹ 3 crore on 1st September, 2014. On 31st March, 2015 the company found that it had already spent ₹ 1 crore 80 lakhs on the construction. Prudent estimate of additional cost for completion was ₹ 1 crore 40 lakhs. What amount should be charged, to revenue in the final accounts for the year ended on 31st March, 2015, as per the provisions of Accounting Standard 7 "Construction Contracts (Revised)"?

Answer:

	₹ in crores
Cost of construction incurred till date	1.80
Add: Estimated future cost	1.40
Total estimated cost of construction	3.20

Percentage of completion till date to total estimated cost of construction

= (1.80/3.20) 100 = 56.25%

Proportion of total contract value recognised as revenue as per AS 7 (Revised)

= Contract price x percentage of completion

= ₹ 3 crores x 56.25% = ₹ 1.6875 crores

Amount of foreseeable loss	(₹ in crores)
Total cost of construction	3.20
Less: Total contract price	(3.00)
Total foreseeable loss to be recognized as expense	0.20

According to of AS 7 (Revised 2002), when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

Question 4—

M/s Highway .Constructions undertook the construction of a highway on 01.04.2013. The contract was to be completed in 2 years. The contract price was estimated at ₹150 crores. Up to 31.03.2014 the company incurred ₹120 crores on the construction. The engineers involved in the project estimated that a further ₹45 crores would be incurred for completing the work.

What amount should be charged to revenue for the year 2013 -14 as per the provisions of Accounting Standard 7 "Construction Contracts"? Show the extract of the Profit & Loss A/c in the books of M/s. Highway Constructions.

Answer:

Statement showing the amount to be charged to Revenue as per AS 7

		₹ in crores
	Cost of construction incurred upto 31.03.2014	120
Add:	Estimated future cost	45
	Total estimated cost of construction	165
	Degree of completion (120/165 x 100)	72.73%
	Revenue recognized (72.73% of 150)	109 (approx)
	Total foreseeable loss (165 – 150)	15
Less:	Loss for the current year (120 – 109)	11
	Loss to be provided for	4

Profit and Loss Account (Extract)

	in crores		₹ in crores
To Construction Costs	120	By Contract Price	109
To Provision for loss	4	By Net loss	15
	124		124

Question 5—

A construction contractor has a fixed price contract for 1 9,000 lacs to build a bridge in 3 years time frame. A summary of some of the financial data is as under:

	(Amount ₹ in lacs)		
	Year 1	Year 2	Year 3
Intial Amount for revenue agreed in contract	9,000	9,000	9,000
Variation in Revenue (+)	–	200	200
Contracts costs incurred up to the reporting data	2,093	6,168*	8,100**
Estimated profit for whole contract	950	1,000	1,000

*Includes ₹ 100 lacs for standard materials stored at the site to be used in year 3 to complete the work.

**Excludes ₹ 100 lacs for standard material brought forward from year 2. The variation in cost and revenue in year 2 has been approved by customer.

Compute year wise amount of revenue, expenses, contract cost to complete and profit or loss to be recognized in the Statement of Profit and Loss as per AS-7 (revised).

Answer:

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are computed below:

(Amount in₹ lakhs)

	Up to the reporting date	Recognized in previous years	Recognized in current year
Year 1			
Revenue (9,000×26%)	2,340	–	2,340
Expenses (8,050×26%)	2,093	–	2,093
Profit	247	–	247
Year 2			
Revenue (9,200×74%)	6,808	2,340	4,468
Expenses (8,200×74%)	6,068	2,093	3,975
Profit	740	247	493
Year 3			
Revenue (9,200×100%)	9,200	6,808	2,392
Expenses (8,200×100%)	8,200	6,808	2,132
Profit	1,000	740	260

Working Note:

	Year 1	Year 2	Year 3
Revenue after consider variations	9,000	9,200	9,200
Less: Estimated profit for whole contract	950	1,000	1,000
Estimated total cost of the contract (A)	8,050	8,200	8,200
Actual cost incurred upto the reporting date (B)	2,093	6,068	8,200
		(6,168-100)	(8,100+100)
Degree of completion (B/A)	26%	74%	100%

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Chapter: 9 (Unit-1)

Accounting Standard 12 ACCOUNTING FOR GOVERNMENT GRANTS

1. OBJECTIVE AND SCOPE

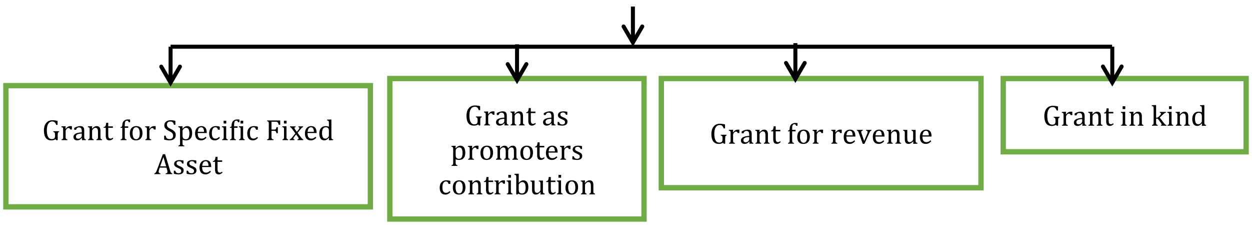
- AS 12 deals with accounting for government grants such as subsidies, cash incentives, duty drawbacks, etc. and specifies that the government grants should not be recognised until there is reasonable assurance that the enterprise will comply with the conditions attached to them, and the grant will be received.
- The standard also describes
  - (i) The treatment of non-monetary government grants;
  - (ii) Presentation of grants related to specific fixed assets and revenue
  - (iii) Those in the nature of promoters' contribution;
  - (iv) Treatment for refund of government grants etc.

- This Standard does not deal with:
  - (i) The special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature.
  - (ii) Government assistance other than in the form of government grants.
  - (iii) Government participation in the ownership of the enterprise.

2. GOVERNMENT GRANT

- Grant means assistance by government in the form of cash or kind in order to promote the business.
- May be with or without condition
- Government means CG, SG and Local bodies etc.

TYPES OF GOVERNMENT GRANT



3. GRANT FOR FIXED ASSETS

Capital Approach (Deductive Method)	Revenue Approach (Deferment Method)
• Deduction from cost of Fixed Asset Bank A/c Dr. To Fixed Asset A/c • Depreciation on balance amount of FA • In case of refund of grant increase the carrying amount of fixed asset and charge depreciation on revised carrying value Fixed Asset A/c Dr. To Bank A/c **Note** • If grant is equal to cost of Fixed asset, Then disclose FA at nominal value and depreciation will not be charged on such value of FA • In this method there will be direct effect on value of fixed asset for receiving & refund of grant	• Credited to deferred grant account Bank A/c Dr. To Deferred grant A/c • Written off over the period In ratio of Depreciation to be charged: Deferred Grant A/c Dr. To P/L • Unamortised balance of deferred grant is to be disclosed as a part of reserve & surplus in the balance sheet • In case of refund first debited to deferred grant a/c up to the credit balance of deferred grant and for balance refund P/L account is debited. Deferred grant A/c Dr. ↓ P&L a/c Dr. To Bank A/c **Note** • In this method there will be no effect on value of fixed asset for receiving & refund of grant

4. GRANT AS PROMOTER CONTRIBUTION

When received credited to CR A/c
Bank A/c Dr.
To CR A/c

When refund of grant
CR a/c Dr.
To Bank A/c

5. GRANT FOR REVENUE EXPENSES

Received only against expenses of same F.Y.

- Credited to P/L A/c
- Disclose in credit side of P/L account or as deduction from related expenses
- If refunded then debited to PL account

Received against expenses to be incurred for more than one F.Y.

↓

Similar to be deferment approach

6. **GRANT IN KIND**

If received at Free of cost

- Disclose asset at nominal value
- In case of refund of the amount of fixed asset

  Fixed asset A/c Dr.
  To Bank A/c

If received at Concessional Price

- Cost of fixed asset will be equal to price paid
- Increase cost of fixed asset for refund of concessional amount

7. DISCLOSURE

(i) The accounting policy adopted for government grants, including the methods of presentation in the financial statements;

(ii) The nature and extent of government grants recognised in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.

Questions & Answer

Question: 1

Explain the treatment of refund of Government Grants as per Accounting Standard 12.

Answer—

Para 11 of AS 12, "Accounting for Government Grants", explains treatment of government grants in following situations:

(i) When government grant is related to revenue

- **(a) When deferred credit account has a balance:** The amount of government grant refundable will be adjusted against unamortized deferred credit balance remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit the amount is immediately charged to profit and loss account.
- **(b) Where no deferred credit account balance exists:** The amount of government grant refundable will be charged to profit and Loss account.

(ii) **When government grant is related to specific fixed assets**

- (a) Where at the time of receipt, the amount of government grant reduced the cost of asset: The amount of government grant refundable will increase the book value of the asset at the time of refund.
- (b) Where at the time of receipt, the amount of government grant was credited to "Deferred Grant Account": The amount of government grant refundable will reduce unamortized balance of deferred grant account and remaining refund debited to P & L A/c

(iii) When government grant is in the nature of Promoter's contribution

The amount of government grant refundable in part or in full on non-fulfillment of specific conditions, the relevant amount recoverable by the government will be reduced from capital reserve.

Note:

A government grant that becomes refundable is treated as an extra-ordinary item as per AS 5.

Question: 2

Supriya Ltd. received a grant of ₹ 2,500 lakhs during the accounting year 2010-11 from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilization. However, during the year 2011-12, it was found that the conditions of grants were not complied with and the grant had to be refunded to the government in full. Elucidate the current accounting treatment, with reference to the provisions of AS-12.

Answer—

- As per para 11 of AS 12 'Accounting for Government Grants', Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5.
- The amount refundable in respect of a government grant related to revenue is applied first against any unamortized deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

- In the present case, the amount of refund of government grant should be shown in the profit & loss account of the company as an extraordinary item during the year 2011-12.

Question: 3

Santosh Ltd. has received a grant of ₹ 8 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed ₹ 2 crores as dividend. Also, Santosh Ltd. received land free of cost from the State Government but it has not recorded it at all in the books as no money has been spent. In the light of AS 12 examine, whether the treatment of both the grants is correct.

Answer—

- As per AS 12 'Accounting for Government Grants', when government grant is received for a specific purpose, it should be utilized for the same. So the grant received for setting up a factory is not available for distribution of dividend.
- In the second case, even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value. The treatment of both the elements in the treatment of the grant is incorrect as per AS 12.

Question: 4

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2007-08 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2010-11, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2010-11 in profit and loss account?

(ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2007-08 assuming plant account showed the balance of ₹ 84 lakhs as on 1.4.2010?

Answer—

- As per para 21 of AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

  (i)

  - In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2010-11.
  - There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

  (ii)

  - If the grant was deducted from the cost of the plant in the year 2007-08 then, para 21 of AS-12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable.

- Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.
- Therefore, in this case, the book value of the plant shall be increased by ₹ 30 lakhs. The increased cost of ₹ 30 lakhs of the plant should be amortized over 7 years (residual life).
- Depreciation charged during the year 2010-11 shall be (84 + 30)/7 years = ₹ 16.286 lakhs presuming the depreciation is charged on SLM.

Question: 5

M/s A Ltd. has set up its business in a designated backward area with an investment of₹ 200 Lakhs. The Company is eligible for 25% subsidy and has received ₹50 Lakhs from the Government.

Explain the treatment of the Capital Subsidy received from the Government in the Books of the Company.

Answer—

- As per para 10 of AS 12 "Accounting for Govt. Grants", Where the government grants are of the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve.
- Subsidy received by A Ltd. is in the nature of promoter's contribution, since this grant is given with reference to the total investment in an undertaking and by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof.
- Therefore, this grant should be treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

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Chapter: 10 (Unit-1)
Accounting Standard 21 Consolidated Financial Statements (WITH REFERENCE TO AS 21)

1. MEANING OF CONSOLIDATED FINANCIAL STATEMENT

- Consolidated financial statements are presented by a parent (holding company) to provide financial information about the economic activities of the group as a single economic entity.
- Section 129(3) of companies act require to prepare consolidated financial statement
- Also need to prepare his own financial statement separately by holding company
- It includes following:
  - (i) Consolidated Balance Sheet
  - (ii) Consolidated Profit & Loss Statement
  - (iii) Notes to Accounts, other statements and explanatory material
  - (iv) Consolidated Cash Flow Statement, if parent company presents its own cash flow statement.

2. IMPORTANT DEFINITIONS

Subsidiary company	A **subsidiary** is an enterprise that is controlled by another enterprise (known as the parent).
Parent or holding company	A **parent** is an enterprise that has one or more subsidiaries.

3. MEANING OF CONTROL

Having voting power more than 50%	Having control over composition of board of director	Subsidiary of subsidiary

4. CALCULATION OF NET ASSET OR EQUITY OF SUBSIDIARY COMPANY ON DATE OF ACQUISITION

Liability side approach		Asset side approach	
Paid up equity share capital	xxx	Assets	xxx
Add: Pre acquisition reserve	xxx	Less: External liabilities	(xxx)
Profit on revaluation on date of acquisition	xxx	Preference share capital	(xxx)
Less: Pre acquisition Losses	(xxx)		
Loss on revaluation on date of acquisition	(xxx)		
	Xxx		xxx

5. PARTS OF NET ASSET OR EQUITY ON DATE OF ACQUISITION OF SUBSIDIARY COMPANY

(A) Belongs to holding company	(B) Belongs to Minorities
Net asset on Date of acquisition × % of holding company = Net asset available for holding company on date of acquisition	*Net asset on Date of acquisition* *×* *% of Minorities* *=* Minority interest on date of acquisition

6. ANALYSIS OF PROFIT OR LOSS OF SUBSIDIARY COMPANY

(A) Pre-acquisition Profit or loss	(B) Post-acquisition Profit or loss
➢ Capital nature ➢ Adjusted in calculation of net asset or equity on date of acquisition of subsidiary company	➢ Revenue nature ➢ Part of profit or loss belongs to holding company is to be adjusted to profit of holding company in preparation of consolidated balance sheet ➢ Part of profit or loss belongs to minorities is to be adjusted in calculation of minority interest

7. CALCULATION OF GOODWILL OR CAPITAL RESERVE (COST OF CONTROL)

- Compare Cost of investment to holding company with net asset available for holding company on date of acquisition

Cost of investment to holding company > Net asset available for holding company	Cost of investment to holding company < Net asset available for holding company
Difference will be goodwill	Difference will be capital reserve
Note: If pre acquisition dividend is received by holding company from subsidiary company then it is to be deducted from the cost of the investment.	

8. CALCULATION OF MINORITY OF INTEREST (MI)

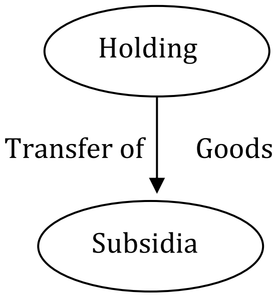
- Minority interest is the interest of the share holders other than shares owned by parent company in subsidiary company
- For example 70% shares is held by holding company then holders of 30% will be minorities.
- Net asset attributable to minorities is known as minority interest.
- Disclose separately from shareholders' funds and liabilities
- It is disclosed under a separate heading below the heading of shareholder fund in the equity & liabilities part under the consolidated balance sheet of the company
- If minority interest become negative then it is to be adjusted with majority interest (from the balance of Profit and Loss of holding company).
- In future when it become positive then again it will become part of minority interest after recovering already total amount adjusted with majority interest.

Minority interest on date of acquisition	xxx
Add: share of MI in post-acquisition profits	xxx
Less: share of MI in post-acquisition losses	(xxx)
Minority interest at the end of the financial year	xxx

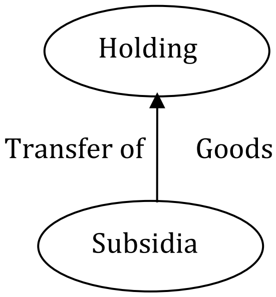
9. <u>ACCOUNTING IN THE BOOKS OF HOLDING COMPANY FOR TREATMENT OF DIVIDEND DECLARED BY SUBSIDIARY COMPANY AND RECEIVED BY HOLDING COMPANY</u>

If declared out of pre-acquisition profit	If declared out of post-acquisition profit
➢ Capital nature in income ➢ Deducted from cost investment ➢ Credited to investment account Bank a/c DR To Investment a/c	➢ Revenue nature in income ➢ Credited to Profit and Loss account Bank a/c DR To Profit and Loss a/c

10. <u>STOCK RESERVE</u>

IF DOWNSTREAM TRANSFER OF GOODS	ADJUSTMENTS
	• Find out profit element included in closing stock of subsidiary company • Deduct it from the closing stock of subsidiary company • Deduct it from the profit and loss account of holding company

11. <u>STOCK RESERVE</u>

IF UPSTREAM TRANSFER OF GOODS	ADJUSTMENTS
	• Find out profit element included in closing stock of holding company • Deduct it from the closing stock of holding company • Deduct it from the profit and loss account of subsidiary company keeping in mind pre or post nature

12. PREPARATION OF CONSOLIDATED BALANCE SHEET

- Disclose goodwill or capital reserve is the appropriate side as calculated in cost of control.
- Disclose claim of minority interest at the balance sheet date in the equity & liabilities.
- Elimination of:-
    - a. Investment of holding company.
    - b. Equity share capital of subsidiary company
    - c. Reserve & profit up to date of acquisition of subsidiary company.
    - d. Mutual assets & liabilities of subsidiary company with holding company.
    - e. Unrealized gain or stock reserve.
- Post acquisition Profit-
    - a. Share of holding company will be added to balance of P&L A/c of holding company.
    - b. Share of minority interest will be adjusted to claim of minority interest.
- If asset & liabilities has been revalued then disclose at revalued price & depreciate accordingly.
- All others asset & liabilities is to be added on line by line basis for preparation of consolidated Balance Sheet.
- Preparation of Notes to accounts accordingly.

13. PRAPARATION OF CONSOLIDATED STATEMENT OF PROFIT & LOSS

- It is to be prepared as per revised format of part 2 of schedule (III).
- Disclose each item by adding line by line basis with value of subsidiary company.
- Elimination of -
    - a. Unrealized gain is stock
    - b. Mutual transaction of revenue & expenses between subsidiary & holding like sale and purchase, expenses incurred and income generated etc. from holding to subsidiary or subsidiary to holding.

14. ADJUSTMENT OF PREFERENCE SHARE CAPITAL

- It will be almost similar to adjustment of equity share capital.
- Eliminate investment of preference share and preference share capital of subsidiary company in preparation of consolidated Balance Sheet.
- Other adjustment will be

Part hold by holding Company	Part not hold by holding company
Calculate goodwill or CR by comparing face of preference share capital with cost of investment	Calculate minority interest & disclose it in liability side.

15. UNIFORMITY IN ACCOUNTING POLICY

- It may be possible that holding company and subsidiary company is having different policies in preparation of books of accounts.
- At the time of consolidation it should be uniform taking base of holding company's A/c policies.
- Therefore appropriate adjustment is needed before consolidation into detail given of subsidiary company.
- If it is not possible to adopt uniform policy at the time of consolidation, then appropriate disclosure is needed in the consolidated Final Accounts.

16. ADJUSTMENT OF INVESTMENT IN DEBENTURE OF SUBSIDIARY COMPANY

- If holding company has investment in debentures of subsidiary company then eliminate investment & calculate loss or gain on such investment by comparing cost of investment and face value.
- Profit or Loss Calculated will be not treated as goodwill or CR., It is to be adjusted against P/L

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CHAPTER 13
AMALGAMATION OF COMPANIES

1. OBJECTIVE AND SCOPE

- AS 14 (Revised) deals with the accounting to be made in the books of Transferee company in the case of amalgamation and the treatment of any resultant goodwill or reserve.
- An amalgamation may be either in the nature of merger or purchase. The standard specifies the conditions to be satisfied by an amalgamation to be considered as amalgamation in nature of merger or purchase.

2. GOVERNMENT GRANT

- Amalgamation means an amalgamation pursuant to the provisions of the Companies Act, 2013 or any other statute which may be applicable to companies and includes 'merger'.
- Transferor company means the company which is amalgamated into another company.
- Transferee company means the company into which a transferor company is amalgamated.

3. TYPEST OF AMALGAMATIONS

(A)Amalgamation in the Nature of Merger Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions.

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

(B) Amalgamation in the Nature of Purchase

Amalgamation in the nature of purchase is an amalgamation which does not satisfy any one or more of the conditions specified above.

4. METHODS OF ACCOUNTING FOR AMALGAMATIONS

There are two main methods of accounting for amalgamations.

- The pooling of interests method and
- The purchase method.

(A) **Pooling of Interests Method**

Pooling of interests is a method of accounting for amalgamations the object of which is to account for the amalgamation as if the separate businesses of the amalgamating companies were intended to be continued by the transferee company. Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating companies.

Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (after making adjustment required in next paragraph).

If, at the time of the amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with AS 5.

(B) Purchase Method

Under the purchase method, the transferee company accounts for the amalgamation either

- By incorporating the assets and liabilities at their existing carrying amounts or
- By allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

5. CONSIDERATION

- Consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.
- In determining the value of the consideration, an assessment is made of the fair value of its elements.

6. TREATMENT OF RESERVES OF THE TRANSFEROR COMPANY ON AMALGAMATION

- If the amalgamation is an 'amalgamation in the nature of merger', the identity of the reserves is preserved and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company. Thus, for example, the General Reserve of the transferor company becomes the General Reserve of the transferee company, the Capital Reserve of the transferor company becomes the Capital Reserve of the transferee company and the Revaluation Reserve of the transferor company becomes the Revaluation Reserve of the transferee company.
- As a result of preserving the identity, reserves which are available for distribution as dividend before the amalgamation would also be available for distribution as dividend after the amalgamation.

7. DISCLOSURES

For all amalgamations, the following disclosures are considered appropriate in the first financial statements following the amalgamation:

a. Names and general nature of business of the amalgamating companies;
b. Effective date of amalgamation for accounting purposes;
c. The method of accounting used to reflect the amalgamation; and
d. Particulars of the scheme sanctioned under a statute.

For amalgamations accounted for under the pooling of interests method, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation:

a. Description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation;
b. The amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

For amalgamations accounted for under the purchase method, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation:

a. Consideration for the amalgamation and a description of the consideration paid or contingently payable; and
b. The amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortization of any goodwill arising on amalgamation.

MEANING OF AMALGAMATION –

- When two or more existing companies owned separately comes under the jointownership then it is known as amalgamation.
- It includes external reconstruction and absorption of companies
- Amalgamation is one of the major strategic decision of the company

PARTIES INVOLVED IN AMALGAMATION

Transferee Company	Transferor Company
It is also known as amalgamated company or resulting company or purchasing company	It is also known as amalgamating company or merged company or selling company orvendor company

CLASSIFICATION OF AMALGAMATION AS PER AS14

Amalgamation in nature of merger	Amalgamation in nature of purchase
If all the five condition are satisfied	Which is not amalgamation in nature ofmerger

CONDITIONS OF AMALGAMATION IN THE NATURE OF MERGER

(i) All the assets and liabilities of the transferor company transferred tothe transferee company.

Exception: Share capital is not transferred

(ii) All the asset and liabilities taken at book value

Exception: changes are possible due to maintain uniformity of accountingpolicies

(iii) At least 90% equity share holder of selling company agreed to becomeshareholder in purchasing company

Exception: excluding those no of equity share of selling company which isalready taken by purchasing company

(iv) Consideration to above agreed equity share holder is only by issue of equityshare

Exception: cash is to be given for fractional part

(v) Intention of continuation of business of selling company

METHODS OF ACCOUNTING OF AMALGAMATION AS PER AS14

Pooling of Interest Methods

Will be used in case of amalgamation in nature of merger

Purchase Method

Will be used in case of amalgamation in nature of purchases

PURCHASE CONSIDERATION UNDER AMALGAMATION

- ❖ P.C. refers to aggregate amount of payment by 'P' Company in different forms to shareholders of the 'S' Company
- ❖ Payment by 'P' company only to shareholders (equity shareholder and preference shareholders) will be considered as a part of P.C.
- ❖ Payment to liability other than share holder will not be considered as a part of P.C.

METHODS OF CALCULATION OF PC

In order to determine amount of P.C. following steps will be followed:

I. <u>If lump sum amount is given</u>

- ❖ In such case aggregate amount for which P Company acquires S. Company or 'S' Company itself sold 'P' Company is given
- ❖ Then such aggregate amount will be considered as PC

II. <u>If intrinsic value per equity share of 'S' Company is given</u>

- ❖ in such case fair value/market value/real worth/intrinsic value per equity share of 'S' Company is given
- ❖ In such a case PC will be determined as under:

(i)	Total payment to equity share holders (Total no. of equity shares of 'S' Company x I.V per equity share of ' S' company)	xx
(ii)	Total payment to preference shareholders (given)	xx
	PC {(1) +(2)}	xx

III. <u>Net payment Method</u>

- ❖ It is applied when complete mode of payment of PC is given or calculate table can PC
- ❖ If exchange ratio is given then quantity is calculated by using exchange ratios

IV. <u>Net Asset Method/Intrinsic Value Method</u>

- ❖ It is applied when it is not possible to calculate by above mentioned three steps
- ❖ PC will be as under –

Value of Asset taken	Agreed Value (AV)	xxx
	↓	
Less: Value of Liability taken	Market Value (MV)	(xxx)
	↓	
	Book Value (BV)	
	PC/ Net Asset	**xxx**

Note

(1) Mode of payment of PC means details of payment by P. Company in different forms like by issue of equity shares in P. Company, Preference share, Debenture in P. Company or cash etc.

(2) The above mentioned detail of calculation of P.C. will apply in the nature of merger or purchase both cases.

(3) In case of merger, Net Asset will be always equal to total share capital of 'S' company and if in such case PC is calculated by Net Asset Method then PC will also be equal to total value of share capital of 'S' Company

(4) If PC is calculated by Net Payments Method then no need to calculate separately mode of payment of PC because PC itself is calculated by mode of payment of PC However in case of calculation of PC by other than net payment we need to calculate mode of payment of P.C. separately after calculation of PC

(5) Step II applied only on when intrinsic value of 'S' Company is already given. If PC is required to calculate on the basis of intrinsic value but it is not given in question then net asset will apply

$$\text{I.V. per equity Share} = \frac{\text{Net Asset}}{\text{No. of equity share}}$$

(6) If 'P' company issues share and securities at premium or discount then need to calculate separate detail for amount of capital, premium and discount for 'P' company however it is not required separately for the 'S' company point of view.

(7) When share are to be issued by 'P' company in partly paid up form then ignore face value of such shares for the purpose of calculation
In such case difference of paid up price and issue price is securities premium or discount on issued shares and paid up price will be equal to capital.

(8) If term of premium/discount given for share or debentures need to be read out carefully. If premium/discount is on redemption then calculate required amount of that liability according to premium/discount and if premium/discount is given for issue of shares or debenture then divide it in to capital, premium and discount from 'P' company point of view.

(9) If intrinsic value/market value/fair value for share of P. Company is given it means 'P' company will issue its shares according to its intrinsic value for discharging of PC

ACCOUNTING FOR AMALGAMATION IN THE NATURE OF PURCHASE IN THE BOOKS OF SELLING COMPANY (BY PURCHASE METHOD)

(1) **Forwarding of Balance Sheet into ledger**

- ❖ It will be always on book value
- ❖ Transfer equity share capital a/c, Reserve and Fictitious Asset to equity shareholder A/ c

Reserve A/c	Dr.
Equity Share Capital A/c	Dr.
To Equity Shareholder A/c	
Equity Shareholder A/c	Dr.

To fictitious Asset

- ❖ Transfer preference shares capital to preference share holder a/c

  Preference share capital Dr.

  To Preference Share holder

- ❖ Transfer assets and liability taken by 'P' Company to realization A/c

  Realization A/c Dr.

  To Asset A/c

  Liabilities A/c Dr.

  To Realization A/c

- ❖ Carry forward other assets and liabilities not taken by 'P' Company to their separate A/c's

Note:

(i) Alternatively it may be transferred to realization

(2) Adjustment of PC

(a) Due entry of PC

'P' Company A/c Dr.

To Realization A/c

(b) Receiving PC

Equity share in 'P' company Dr.

Preference share in 'P' Company Dr. according to

Debenture in 'P' A/c Dr. mode of PC

Bank A/c Dr.

To 'P' Company A/c

Note:

(10) If 'P' Company issue shares and debentures at discount or premium then disclose it by adjusted amount without showing capital/discount/premium separately

(3) <u>Payment to Preference Share Holders:</u>

(a) Entry for payment

Preference share holder a/c Dr.

To Equity share in P Company

To Preference share in P Company To debenture in P. Company

To Cash A/c

- ❖ Balance of Preference share holder a/c after payment transferred to realization a/

(4) <u>Adjustment of Asset not taken</u>

a. Realization from Asset

Cash A/c Dr.

To Asset A/c

b. Transfer balance of asset a/c to realization A/c

(5) <u>Settlement of liability not taken</u>

a. Payment to liabilities
Liability A/c Dr.
To Bank A/c
b. After payment, balance of liability A/c will be transferred to realization A/c

Note:

(11) If asset and liability not taken has been transferred to realization a/c as per Note no.
(i) then realization of asset and payment to liabilities will be recorded by realization a/c.

(6) <u>Balance of Realization A/c transferred to equity shareholder a/c</u>

(a) Profit on realization if Cr. Balance
Realization A/c Dr.
To Equity Share Holder a/c

(b) Loss on realization if Dr. Balance
Equity Share holder A/c Dr.
To Realization A/c

(7) <u>Final Payment to equity share holders according to remaining balance ofother a/c</u>

Equity shares holder a/c Dr.
To Equity share 'P' Company a/c
To Preference share 'P' Company A/c
To Debentures in 'P' Company A/c
To Cash / Bank A/c

Note:

(12) After final payment to E.S.H., it will get automatically closed and all other a/cs of 'S' company is also already closed.

ACCOUNTING OF AMALGAMATION IN BOOKS OF 'P' COMPANY IN CASE OF AMALGAMATION IN NATURE OF PURCHASE BY PURCHASE METHOD

1. Due Entry of PC
Business purchase a/c Dr.
To Liquidation of 'S' Company A/c
2. Incorporation asset and liability taken from 'S' Company (Big Entry)

Asset A/c	Dr.	[AV → MV → BV]
Goodwill A/c	Dr.	[PC > Net Assets]
To Liabilities A/c		[AV → MV → BV]
To Capital Reserve A/c		[PC < Net Assets]
To Business Purchase a/c		[PC]

3. Payment of PC

Liquidation of 'S' Company a/c	Dr.	[PC]
Discount on issue a/c	Dr.	
To Equity Share Capital	[Paid up price]	
To Preference Share capital	[Paid up price]	
To Debentures	[Paid up price]	
To Securities Premium		
To Bank A/c		

Note:

(12) If 'P' Company issue share or debenture at premium/discount then disclose separatelyCapital, premium and discount

ACCOUNTING IN BOOKS OF 'S' COMPANY FOR AMALGAMATION IN NATURE OF MERGER

1. Forwarding of Balance Sheet
2. Adjustment of P.C.
3. Payment to PSH than balance transferred to realization a/c
4. Transfer balance of realization A/c to equity share holder a/c
5. Final payment to equity share holder.

ACCOUNTING IN BOOKS OF 'P' COMPANY FOR AMALGAMATION IN NATUREOF MERGER BY POOLING OF INTEREST METHOD

1. Due Entry of PC
2. Big entry

    Asset A/c Dr.
    Fictitious Asset A/c Dr.
    To Liability A/c
    To Reserve A/c
    To Business Purchase A/c

3. Payment to PC

TREATMENT OF SPECEIFIC ITEM

(1) Treatment of Realization / Liquidation / Amalgamation cost of Expenses

<table>
<tr><th></th><th>Case</th><th colspan="2">S. Company</th><th colspan="2">'P' Company</th></tr>
<tr><td>1</td><td>Paid and Borne by S. Company</td><td colspan="2">Realization Dr.
To Bank</td><td colspan="2">No Entry</td></tr>
<tr><td rowspan="2">2</td><td rowspan="2">Paid and borne by 'P' Company</td><td colspan="2" rowspan="2">No Entry</td><td>Merger</td><td>Purchase</td></tr>
<tr><td>G/R Dr.
To Bank</td><td>Goodwill C/R Dr.
To Bank</td></tr>
<tr><td rowspan="2">3</td><td rowspan="2">Paid by 'S' Co. but borne by 'P' Company</td><td rowspan="2">P. Co. Dr.
To Bank</td><td rowspan="2">Bank Dr.
To P. Comp.</td><td>G/R Dr.
To S Comp.</td><td>Goodwill/CR Dr.
To 'S' Com.</td></tr>
<tr><td>S. Co. Dr.
To Bank</td><td>S. Com.
To Bank</td></tr>
<tr><td>4</td><td>Paid by 'P' Com. But borne by 'S' Company</td><td>Realization Dr.
To 'P' Co.</td><td>P. Co. a/c Dr.
To Bank A/c</td><td>S. Co. A/c Dr.
To Bank a/c</td><td>Bank A/c Dr.
To S. Co. A/c</td></tr>
</table>

(2) TREATMENT OF DIFFERENCE IN P.C. AND NET ASSETS [IN CASE OFPURCHASE]

❖ If P.C. company is calculated by Net Asset Method then there will be no difference b/w P.C. and Net Asset

❖ If PC is by other than Net Asset Method

If PC is more than Net Asset → Difference will be treated as goodwill

If Net Asset is more than PC → Difference will be treated as capital reserve

(3) <u>Treatment of difference b/w PC and Net Asset in case of Merger</u>

❖ In this case Net Asset = Total share capital of 'S' Company

❖ There will be no difference in P.C. and Net assets if PC is calculated by Net assets method

❖ If P.C. is calculated by other than Net Assets Method

PC is more than Net Asset → Difference will be deducted from G/R a/c in Big Entry

Net Asset more than P.C. → Difference is added to G/R Big Entry

Note:

(14) In case of merger difference in P.C. and Net Asset is not treated as goodwill or C/R. itis adjusted with G/R or P&L A/c. (Free Reserve)

(4) <u>Treatment of Mutual debt or Intercompany debt</u>

❖ No special adjustment in books of 'S' company

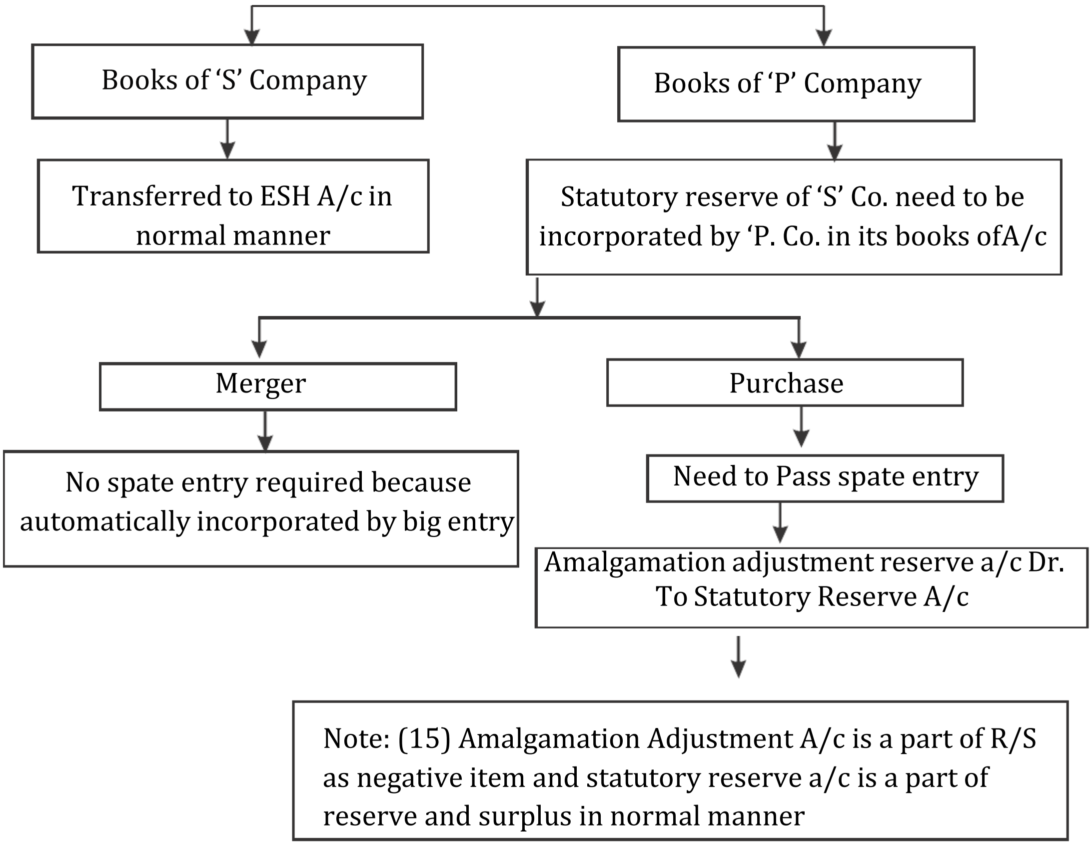
❖ Need to cancel in books of 'P' company

Liability A/c Dr.

  Asset A/c

(5) <u>Treatment of statutory Reserve of 'S' Company</u>

- ❖ Part of Reserve required to keep intact for a certain period according to a particular act then it is known as statutory reserve
- ❖ It will be free for use after expiry of required period
- ❖ For example, export profit reserve, investment allowance reserve, development rebate reserve etc.



(6) Treatment of Stock Reserve or unrealized gain in stock

- ❖ It may be possible that before amalgamation 'P' co. sold goods to 'S' Company and vice-versa and such stock unsold in sold as pa part of stock at the time of amalgamation.
- ❖ Profit included in such stock in known as stock reserve or unrealized gain in stock which is to be reduced by that amount for which 'P' company takes that stock already at reduced price.

❖ Accounting treatment will be as under

- Books of 'S' Company
  - No special adjustment
- Books of 'P' Company
  - Need to eliminate profit included in such stock
    - Merger
      - G/R a/c Dr.
        To Stock A/c
    - Purchase
      - Goodwill or CR Dr.
        To Stock A/c

(7) Treatment of Debentures of 'S' Company

- If not taken by 'P' Co.
  - Settled by 'S' Company itself and no adjustment in 'P' Company
- If taken by 'P' Co.
  - Books of 'S' Company
    - Transfer to Realization A/c
  - Books of 'P' Company
    - Record in Big Entry by liabilityof debenture a/c and pass separate entry for conversion/payment

QUESTIONS & ANSWERS

Question 1—

What are the conditions, which, according to AS 14 on Accounting for Amalgamations, must be satisfied for an amalgamation in the nature of merger?

Answer

According to AS 14 on Accounting for Amalgamations; the following conditions must be satisfied for an amalgamation in the nature of merger:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when the year incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

If any one of the condition is not satisfied in a process of amalgamation, it cannot be treated as amalgamation in the nature of merger.

Question 2—

Distinguish between

(i) the pooling of interests method and

(ii) the purchase method of recording transactions relating to amalgamation.

Answer

The following are the points of distinction between (i) the pooling of interests method and (ii) the purchase method of recording transactions relating to amalgamation:

(i) The pooling of interests method is applied in case of an amalgamation in the nature of merger whereas purchase method is applied in the case of an amalgamation in the nature of purchase.

(ii) In the pooling of interests method all the reserves of the transferor company are also recorded by the transferee company in its books of account while in the purchase method the transferee company records in its books of account only the assets and liabilities taken over, the reserves, except the statutory reserves, of the transferor company are not aggregated with those of the transferee company.

(iii) Under the pooling of interests method, the difference between the consideration paid and the share capital of the transferor company is adjusted in the general reserve or other reserves of the transferee company. Under the purchase method, the difference between the consideration and net assets taken over is treated by the transferee company as goodwill or capital reserve.

(iv) Under the pooling of interests method, the statutory reserves are recorded by the transferee company like all other reserves without opening amalgamation adjustment account. In the purchase method, while incorporating statutory reserves the transferee company has to open amalgamation adjustment account debiting it with the amount of the statutory reserves being incorporated.

Question 3—

The following is the summarized Balance Sheet of 'A' Ltd. as on 31-3-2015

Liabilities	(₹)	Assets	(₹)
14,000 Equity Shares ₹of 100 each fully paid	14,00,000	Sundry Assets	18,00,000
General Reserve	10,000	Discount on issue of Deb.	10,000
10% Debentures	2,00,000	P & L A/c	90,000
Trade Payables	2,40,000		
Bank Overdraft	50,000		
	19,00,000		**19,00,000**

'R' Ltd. agreed to take over the business of 'A' Ltd. Calculate purchase consideration under Net Assets method on the basis of the following:

The market value of 75% of the sundry assets is estimated to be 12% more than the book value and that ofthe remaining 25% at 8% less than the book value. The liabilities are taken over at book values. There is anunrecorded liability of ₹ 25,000.

Answer

Calculation of Purchase Consideration under Net Assets Method

Sundry Assets		**(₹)**
$18,00,000 \times \frac{75}{100} \times \frac{112}{100} =$	15,12,000	
$18,00,000 \times \frac{25}{100} \times \frac{92}{100} =$	4,14,000	19,26,0000
Less: Liabilities;		
10% Debentures	2,00,000	
Trade Payable	2,40,000	
Bank Overdraft	50,000	
Unrecorded Liability	25000	(5,15,000)
Purchase Consideration		14,11,000

Question 4—

The following is the summarized Balance Sheet of A Ltd. as at 31st March, 2015:

Liabilities	₹	Assets	₹
8,000 equity shares of ₹100 each	8,00,000	Building	3,40,000
10% debentures	4,00,000	Machinery	6,40,000
Loan from A	1,60,000	Inventory	2,20,000
Trade payables	3,20,000	Trade receivables	2,60,000
General Reserve	80,000	Bank	1,36,000
		Goodwill	1,30,000
		Share issue Expenses	34,000
	17,60,000		17,60,000

B Ltd. agreed to absorb A Ltd. on the following terms and conditions:

(1) B Ltd. would take over all assets, except bank balance at their book values less 10%. Goodwill is to be valued at 4 year's purchase of super profits, assuming that the normal rate of return be 8% on the combined amount of share capital and general reserve.

(2) B Ltd. is to take over trade payables at book value.

(3) The purchase consideration is to be paid in cash to the extent of ₹6,00,000 and the balance in fully paid equity shares of ₹100 each at ₹125 per share.

The average profit is ₹1,24,400. The liquidation expenses amounted to ₹16,000. B Ltd. sold prior to 31st March, 2015 goods costing ₹1,20,000 to A Ltd. for ₹1,60,000. ₹1,00,000 worth of goods are still in Inventory of A Ltd. on 31st March, 2015. Trade payables of A Ltd. include ₹40,000 still due to B Ltd.

Show the necessary Ledger Accounts to close the books of A Ltd. and prepare the Balance Sheet of B Ltd. as at 1st April, 2015 after the takeover.

Answer

Books of A Limited
Realisation Account

	₹		₹
To Building	3,40,000	By Trade payables	3,20,000
To Machinery	6,40,000	By B Ltd.	12,10,000
To Inventory	2,20,000	By Equity Shareholders (Loss)	76,000
To Trade receivables	2,60,000		
To Goodwill	1,30,000		
To Bank (Exp.)	16,000		
	16,06,000		16,06,000

Bank Account

To	Balance b/d	1,36,000	By	Realisation (Exp.)	16,000
To	B Ltd.	6,00,000	By	10% debentures	4,00,000
			By	Loan from A	1,60,000
			By	Equity shareholders	1,60,000
		7,36,000			7,36,000

10% Debentures Account

To	Bank	4,00,000	By	Balance b/d	4,00,000
		4,00,000			4,00,000

Loan From A Account

To	Bank	1,60,000	By	Balance b/d	1,60,000
		1,60,000			1,60,000

Share Issue Expenses Account

To	Balance b/d	34,000	By	Equity shareholders	34,000
		34,000			34,000

General Reserve Account

To	Equity shareholders	80,000	By	Balance b/d	80,000
		80,000			80,000

B Ltd. Account

To	Realisation A/c	12,10,000	By	Bank	6,00,000
			By	Equity share in B Ltd.(4,880 shares at ₹ 125 each)	6,10,000
		12,10,000			12,10,000

Equity Shares in B Ltd. Account

To	B Ltd.	6,10,000	By	Equity shareholders	6,10,000
		6,10,000			6,10,000

Equity Share Holders Account

To	Realisation	76,000	By	Equity share capital	8,00,000
To	Share issue Expenses	34,000	By	General reserve	80,000
To	Equity shares in B Ltd.	6,10,000			
To	Bank	1,60,000			
		8,80,000			8,80,000

B Ltd.

Balance Sheet as on 1st April, 2015 (An extract)*

Particulars	Notes	(₹)
Equity and Liabilities		
1. Shareholders' Funds		
a Share Capital	1	4,88,000
b Reserves and Surplus	2	1,07,000
2. Current Liabilities		
a Trade Payables	3	2,80,000
b Bank overdraft		6,00,000
	Total	**14,75,000**
Assets		
1. Non-current Assets		
(a) PPE	4	8,82,000
(b) Intangible Assets	5	2,16,000
2. Current Assets		
a Inventories	6	1,83,000
b Trade receivables	7	1,94,000
		14,75,000

Note to accounts

				(₹)
1.	**Share Capital**			
	Equity Share Capital			
	4,880 Equity Share of ₹100 each			
	(Shares have been issued for consideration other than cash)			4,88,000
		Total		**4,88,000**
2.	**Reserves and Surplus (an extract)**			
	Securities Premium			1,22,000
	Profit and loss account		....	
	Less: unrealised profit		(15,000)	(15,000)
		Total		**1,07,000**
3.	**Trade Payables**			
	Opening Balance		3,20,000	
	Less: Inter-company transaction cancelled upon amalgamation		(40,000)	**2,80,000**

4.	**PPE**		
	Buildings		3,06,000
	Machinery		5,76,000
	Total		**8,82,000**
5.	**Intangible Assets**		
	Goodwill		2,16,000
6.	**Inventories**		
	Opening Balance	1,98,000	
	Less: Cancellation of profit upon amalgamation	(15,000)	
		1,83,000	
7.	**Trade receivables**		
	Opening Balance	2,60,000	
	Less: Inter company transaction cancelled upon amalgamation	(40,000)	
	Less: Provision for doubtful debts	(26,000)	**1,94,000**

Working Notes:

1.	**Valuation of Goodwill**	**(₹)**
	Average profit	1,24,400
	Less: 8% of ₹ 8,80,000	(70,400)
	Super Profit	54,000
	Value of Goodwill = 54,000 × 4	2,16,000

2.	**Net Assets for purchase consideration**	
	Goodwill as valued in W.N. 1	2,16,000
	Building	3,06,000
	Machinery	5,76,000
	Inventory	1,98,000
	Trade Receivables (2,60,000 – 26,000)	2,34,000
	Total Assets	15,30,000
	Less: Trade Payables	(3,20,000)
	Net Assets	12,10,000

Out of this ₹6,00,000 is to be paid in cash and remaining i.e., (12,10, 000 - 6,00,000) ₹6,10,000 in shares of ₹125. Thus, the number of shares to be allotted 6,10,000/125 = 4,880 shares.

3. **Unreaslised Profit on Inventory** **(₹)**

The inventory of A Ltd. includes goods worth ₹ 1,00,000 which was soldby B Ltd. on profit. Unrealized profit on this Inventory will be

$$\frac{40,000}{1,60,000} \times 1,00,000$$ 25,000

As B Ltd. purchased assets of A Ltd. at a price 10% less than the book value, 10% need to be adjusted from the inventory i.e., 10% of 1,00,000.	10,000
Amount of unrealized profit	15,000

Question 5—

Following is the summarized Balance Sheet of X Co. Ltd. as at 31st March, 2015:

Balance Sheet as at 31st March, 2015

Liabilities	(₹)	Assets	(₹)
Equity share capital (₹100 each)	15,00,000	Land and building	10,00,000
11% Pref. share capital	5,00,000	Plant and Machinery	7,00,000
General Reseve	3,00,000	Furniture and Fittings	2,00,000
Trade Payables	2,00,000	Inventory in trade	3,00,000
		Trade Receivables	2,00,000
		Cash in hand & at Bank	1,00,000
	25,00,000		**25,00,000**

Y Co. Ltd. agreed to take over X Co. Ltd. on the following terms:

(i) Each equity share in X Co. Ltd. for the purpose of absorption is to be valued at ₹80.

(ii) Equity shares will be issued by Y Co. Ltd. by valuing its each equity share s of₹100 each at ₹120 per share.

(iii) 11% Preference shareholders of X Co. Ltd. will be given 11% redeemable debentures of Y Co. Ltd. at equivalent value.

(iv) All the Assets and Liabilities of X Co. Ltd. will be recorded at the same value in the books of Y Co. Ltd.

(a) Calculate Purchase consideration.

(b) Pass Journal entries in the books of Y Co. Ltd. for absorbing X Co. Ltd.

Answer

Computation of Purchase Consideration

	₹
Value of ₹15,000 equity shares @ ₹80 per share = ₹12,00,000	
Shares to be issued by Y Co. Ltd. (₹ 12,00,000/120 per share) = 10,000 shares @ ₹120 each)	12,00,000
11% Preference shareholders to be issued equivalent 11% Redeemable Debentures by Y Co. Ltd.	5,00,000
Total Purchase consideration	17,00,000

Journal Entries in the Books of Y Co. Ltd.

		(₹)	(₹)
Business Purchases A/c	Dr.	17,00,000	
To Liquidator of X Co. Ltd.			17,00,000
(Being the amount payable to X Co. Ltd.'s liquidator)			
Land & Building A/c	Dr.	10,00,000	
Plant & Machinery A/c	Dr.	7,00,000	
Furniture & Fittings A/c	Dr.	2,00,000	
Inventory in Trade A/c	Dr.	3,00,000	
Trade Receivables A/c	Dr.	2,00,000	
Cash & Bank A/c	Dr.	1,00,000	
To Trade Payables			2,00,000
To Capital Reserve (Balancing Figure)			6,00,000
To Business Purchases			17,00,000
(Being the value of assets and liabilities taken over from X Co. Ltd.)			
Liquidators of X Co. Ltd. Account	Dr.	17,00,000	
To Equity Share Capital			10,00,000
To Securities Premium Account			2,00,000
To 11% Debentures			5,00,000
(Being purchases consideration discharged)			

Question 6—

Ram Limited and Shyam Limited carry on business of a similar nature and it is agreed that they should amalgamate. A new company, Ram and Shyam Limited, is to be formed to which the assets and liabilities ofthe existing companies, with certain exception, are to be transferred. On 31st March 2015, the SummarizedBalance Sheets of the two companies were as under:

Ram Limited

Balance Sheet as at 31st March, 2015

Liabilities		(₹)	Assets	(₹)
Issued and Subscribed			Freehold Property, at cost	2,10,000
Share Capital:			Plant and Machinery, at cost less	
30,000 Equity Shares of	₹10 each		Depreciation	50,000
fullypaid		3,00,000	Motor Vehicles, at cost Less Dep.	20,000
General Reserve		1,60,000	Inventory	1,20,000
Profit and Loss Account		40,000	Trade Receivables	1,64,000
Trade Payables		1,50,000	Cash at Bank	86,000
		6,50,000		**6,50,000**

Shyam Limited
Balance Sheet As at 31st March, 2015

Liabilities	(₹)	Assets	(₹)
Issued and Subscribed Share Capital:		Freehold Property, at cost	1,20,000
16,000 Equity Shares of 10 each, fully Paid	1,60,000	Plant & Machinery, at cost less Dep.	30,000
Profit and Loss A/c	40,000	Trade Receivables	42,000
6% Debentures	1,20,000	Cash at Bank	36,000
Trade Payables	64,000	Stock	1,56,000
	3,84,000		3,84,000

Assets and Liabilities are to be taken at book-value, with the following exceptions:

(a) Goodwill of Ram Limited and of Shyam Limited is to be valued at ₹1,60,000 and ₹60,000 respectively.

(b) Motor Vehicles of Ram Limited are to be valued at ₹60,000.

(c) The debentures of Shyam Limited are to be discharged at 5% premium by the issue of 6% Debentures of Ram and Shyam Limited at a premium of 5%.

(d) The Trade receivables of Shyam Ltd. realized fully and Bank Balance of Shyam Limited are to be retained by the liquidator and the Trade payables of Shyam Ltd. are to be paid out of the proceeds thereof.

You are required to:

(i) Compute the basis on which shares in Ram and Shyam Limited will be issued to the Shareholders of the existing companies assuming that the nominal value of each share in Ram and Shyam Limited is 10.

(ii) Draw up a Balance Sheet of Ram and Shyam Limited as of 1st April, 2015, the date of completion of amalgamation.

(iii) Write up Journal entries, including Bank entries, for closing the books of Shyam Limited.

Answer

Calculation of Purchase consideration

Purchases Consideration	Ram Ltd. (₹)	Shyam Ltd. (₹)
Goodwill	1,60,000	60,000
Freehold Property	2,10,000	1,20,000
Plant and Machinery	50,000	30,000
Motor Vehicles	60,000	–
Inventory	1,20,000	1,56,000
Trade Receivables	1,64,000	–
Cash at Bank	86,000	–
	8,50,000	3,66,000

Less: Liabilities		
6% Debentures (1,20,000 × 105%)	–	(1,26,000)]
Trade Payables		–
	(1,50,000)	
Net Assets taken over	7,00,000	2,40,000
To be satisfied by issue of shares of Ram and Shyam Ltd. @ 10 each	70,000	24,000

Balance Sheet of Ram and Shyam Ltd. as at 1st April, 2015

				(₹)
		Equity and Liabilities		
1		**Shareholders' Funds**		
	a	Share capital	1	9,40,000
	b	Reserve and Surplus	2	6,000
2		**Non-current Liabilities**		
	a	Long-term borrowings	3	1,20,000
3		**Current Liabilities**		
	a	Trade Payables		1,50,000
		Total		**12,16,000**
		Assets		
1		**Non-current Assets**		
		(a) PPE	4	4,70,000
		(b) Intangible Assets	5	2,20,000
2		**Current Assets**		
	a	Inventors (1,20,000 +1,56,000)		2,76,000
	b	Trade Receivables		1,64,000
	c	Cash and cash equivalents		86,000
		Total		**12,16,000**

Notes to Accounts

1.	**Share Capital**	
	Equity Share Capital	
	94,000 shares of ₹ 10 each	9,40,000
2.	**Reserves and Surplus**	
	Securities Premium (W.N.1)	6,000
3.	**Long-term borrowings**	
	Secured	
	6% Debentures (assumed to be secured)	1,20,000
4.	**PPF**	
	Free hold Property (2,10,000 + 1,20,000)	3,30,000
	Plant & Machinery (50,000 + 30,000)	80,000
	Motor vehicles	60,000
	Total	**4,70,000**
5.	**Intangible Assets**	
	Goodwill (1,60,000 + 60,000)	2,20,000

In the books of Shyam Ltd.
Journal Entries

			(₹)	(₹)
1.	Realisation A/c	Dr.	3,48,000	
	To Freehold Property			1,20,000
	To Plant and Machinery			30,000
	To Inventory			1,56,000
	To Trade Receivables			42,000
	(Being all assets except cash transferred to Realization A/c)			
2.	6% Debentures A/c	Dr.	1,20,000	
	Trade Payables A/c	Dr.	64,000	
	To Realisation A/c			1,84,000
	(Being all liabilities transferred to Realisation Account)			
3.	Equity Share Capital A/c	Dr.	1,60,000	
	Profit and Loss A/c	Dr.	40,000	
	To Equity Shares holder A/c			2,00,000
	(Being equity transferred to equity shareholders account)			
4.	Ram and Shyam Ltd.	Dr.	2,40,000	
	To Realisation A/c			2,40,000
	(Being purchase consideration due)			

5.	Bank A/c	Dr.	42,000	
	To Realisation			42,000
	(Being Cash realized from trade receivables in full.)			
6.	Realisation A/c	Dr.	64,000	
	To Bank A/c			64,000
	(Being payment made to trade payables)			
7.	Shares in Ram and Shyam Ltd.	Dr.	2,40,000	
	To Ram and Shyam Ltd.			2,40,000
	(Being purchase consideration received in the form ofShares of Ram and Shyam Ltd.)			
8.	Realisation A/c	Dr.	54,000	
	To Equity Shareholders A/c			54,000
	(Being profit on Realisation account transferred to shareholders account)			
9.	Equity Shareholders A/c	Dr.	2,54,000	
	To Share in Ram and Shyam Ltd.			2,40,000
	To Bank A/c			14,000
	(Being Final payment made to Shareholders)			

Working Note:

Calculation of Securities Premium Balance

Debentures issued by Ram and Shyam Ltd. to Shyam Ltd. at 5% premium Therefore, securities premium account will be credited with (₹1,20,000 × 5%) ₹6,000.

Question 7—

The summarized Balance Sheet of Mars Limited as on 31st March, 2015 was as follow:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets:	
1,00,000 Equity Shares of 10 each		Land and Building	7,64,000
fullypaid	10,00,000	Current Assets:	
Reserve and Surplus:		Inventory	7,75,000
Capital Reserve	42,000	Trade Receivables	1,82,000
Contingency Reserve	2,70,000	Cash at Bank	3,29,000
Profit and Loss A/c	2,52,000		

Current Liabilities & Provisions:		
Trade Payables	2,66,000	
Provision for income Tax	2,20,000	
	20,50,000	20,50,000

On 1st April, 2015, Jupiter Limited agreed to absorb Mars Limited on the following terms and conditions:

(1) Jupiter Limited will take over the assets at the following values:

	(₹)
Land and Building	10,80,000
Inventory	7,70,000
Bills Receivable	30,000

(1) Purchase consideration will be settled by Jupiter Ltd. as under:
₹4,100 fully paid 10% preference shares of ₹100 will be issued and the balance will be settled by issuing equity shares of ₹10 each at ₹8 paid up.

(2) Liquidation expenses are to be reimbursed by Jupiter Ltd. to the extent of ₹5,000.

(3) trade receivables realized ₹1,50,000. Bills payable were settled for ₹38,000. Income tax authorities fixed the taxation liability at₹2,22,000 and the same was paid.

(4) Trade payables were finally settled with cash remaining after meeting liquidation expenses amounting to₹ 8,000.

(5) Details of trade receivables and trade payables as under:

Trade Receivables		(₹)
Trade receivables	1,60,000	
Less: Provision for doubtful Debts	(8,000)	1,52,000
Bill Receivable		30,000
		1,82,000
Bills Payables		40,000
Creditors		2,26,000
Trade Payable		2,66,000

Your are required to:

(i) Calculate the number of equity shares and preference shares to be allotted by Jupiter limited indischarge of purchase consideration.

(ii) Prepare the Realization account, Bank account, Equity shareholders account and Jupiter Limited'saccount in the books of Mars Ltd.

Answer

(i) Calculation of number of shares to be allotted

Particulars	Amount (₹)
Land and Building	10,80,000
Inventory	7,70,000
Bills Receivable	30,000
Total	18,80,000
Amount discharged by issue of preference shares	4,10,000
Number of preference shares to be issued (4,10,000/100)	4,100 shares
Amount discharged by issue of equity shares (₹18,80,000 – ₹4,10,000)	14,70,000
Number of equity shares to be issued (₹ 14,70,000 /8)	1,83,750 Shares

(ii) Ledger Accounts in the books of Mars Limited Realizatioin Account

Particulars	₹	Particulars	₹
To Land and building	7,64,000	By Provision for doubtful debts	8,000
To Inventory	7,75,000	By Bills payable	40,000
To debtors	1,60,000	By creditors	2,26,000
To Bills receivable	30,000	By Provision for taxation	2,20,000
To Bank A/c –liquidationexpenses	3,000	By JupiterLtd. (purchase consideration)	18,80,000
To Bank A/c- bills payable	38,000	By Bank A/c- debtors	1,50,000
To Bank A/c –income tax	2,22,000		
To Bank A/c – creditors	2,16,000		
To Profit transferred to equity shareholders A/c	3,16,000		
	25,24,000		25,24,000

Bank A/c

Particulars	(₹)	Particulars	(₹)
To Balance b/d	3,29,000	By Realisation A/c (Liquidation expenses)	3,000
To Realisation A/c (payment received from debtors)	1,50,000	By Jupiter Ltd.	5,000
To Jupiter Ltd. (Liquidation Exp.)	5,000	By Bills Payable	38,000
		By Income Tax	2,22,000
		By Creditors (Bal. Fig.)	2,16,000
	4,84,000		4,84,000

Equity Shareholders Account

	₹		₹

Particulars	(₹)	Particulars	(₹)
To 10% Preference Shares in Jupiter Ltd.	4,10,000	By Equity Share capital A/c	10,00,000
To Equity Shares in Jupiter Ltd.	14,70,000	By Capital Reserve	42,000
		By Contingency Reserve	2,70,000
		By Profit and Loss A/c	2,52,000
		By Realisation A/c (profit)	3,16,000
	18,80,000		18,80,000

Jupiter Limited Account

Particulars	(₹)	Particulars	(₹)
To Realisation A/c	18,80,000	By 10% Preference Shares in Jupiter Ltd.	4,10,000
To Bank A/c (Reimbursement exp.)	5,000	By Bank A/c (Liquidation exp.)	5,000
		By Equity shares in Juptier Ltd.	14,70,000
	18,85,000		**18,85,000**

Question 8—

The summarized Balance Sheet of Srishti Ltd. as on 31st March, 2014 was as follows:

Liabilities	Amount (₹)	Assets	Amount (₹)
Equity Shares of ₹ 10 fully paid	30,00,000	Goodwill	5,00,000
Export Profit Reserves	8,50,000	Tangible Fixed Assets	30,00,000
General Reserves	50,000	Stock	10,40,000
Profit and loss Account	5,50,000	Debtors	1,80,000
9% Debentures	5,00,000	Cash & Bank	2,80,000
Trade Creditors	1,00,000	Preliminary Expenses	50,000
	50,50,000		50,50,000

Anu Ltd. agreed to absorb the business of Srishti Ltd. with effect from 1st April, 2014.

(a) The purchase consideration settled by Anu Ltd. as agreed:
- (i) 4,50,000 equity Shares of ₹10 each issued by Anu Ltd. by valuing its share @₹15 per share.
- (ii) Cash payment equivalent to ₹2.50 for every share in Srishti Ltd.

(b) The issue of such an amount of fully paid 8% Debentures in Anu Ltd. at 96% as is sufficient to discharge 9% Debentures in Srishti Ltd. at a premium of 20%.

(c) Anu Ltd. will take over the Tangible Fixed Assets at 100% more than the book value, Stock at ₹7,10,000 and Debtors at their face value subject to a provision of 5% for doubtful Debts.

(d) The actual cost of liquidation of Srishti Ltd. was ₹75,000. Liquidation cost of Srishti Ltd. is to be reimbursed by Anu Ltd. to the extent of ₹50,000.

(e) Statutory Reserves are to be maintained for 1 more year.

You are required to:

(i) Close the books of Srishti Ltd. by preparing Realisation Account, Anu Ltd. Account, Shareholders Account and Debenture Account, and

(ii) Pass Journal Entries in the books of Anu Ltd. regarding acquisition of business.

Answer

(i) Purchase consideration computation

	(₹)
Cash payment for (3,00,000× 2.5)	7,50,000
Equity Shares (4,50,000 × 15)	67,50,000
	75,00,000

In the books of Srishti Ltd.

Realisation Account

	₹		₹
To Goodwill	5,00,000	By 9%	5,00,000
To Tangible Fixed Assets	30,00,000	By Debentures	1,00,000
To Stock	10,40,000	By Creditors	75,00,000
To Debtors	1,80,000	By Anu Ltd.	
To Cash & Bank A/c (2,80,000– 25,000)	2,55,000	(Purchase consideration)	
To Cash & Bank A/c (Realization expenses)	25,000		
To Profit on realization transfer to shareholders	31,00,000		
	81,00,000		81,00,000

Equity Shareholders A/c

		₹		₹
To	Preliminary expenses	50,000	By Equity Share Capital	30,00,000
To	Equity Shares in Anu Ltd.	67,50,000	By Export Profit Reserves	8,50,000
To	Cash & Bank A/c	7,50,000	By General Reserves	50,000
			By P & L A/c	5,50,000
			By Realization A/c	31,00,000
		75,50,000		75,50,000

9 % Debentures Account

	₹		₹
To Realization A/c	5,00,000	By Balance b/d	5,00,000

Anu Ltd.

	₹		₹
To Realization A/c	75,00,000	By Share CapitalBy Bank A/c	67,50,000 7,50,000
	75,00,000		75,00,000

(i) Journal Entries in the books of Anu Ltd.

			(₹)	(₹)
1.	Business Purchase A/c	Dr.	75,00,000	
	To Liquidator of Srishti Ltd.			75,00,000
	(Being Business of Srishti Ltd. taken over)			
2	Tangible Fixed Assets	Dr.	60,00,000	
	Stock	Dr.	7,10,000	
	Debtors	Dr.	1,80,000	
	Cash & Bank	Dr.	2,55,000	
	Goodwill A/c (Bal. Fig.)	Dr.	10,64,000	
	To Provision for doubtful debts			9,000
	To Liability for 9% Debentures			6,00,000
	To Creditors			1,00,000
	To Business Purchase account			75,00,000
	(Being assets and liabilities taken over)			
3.	Amalgamation Adjustment reserve A/c	Dr.	8,50,000	
	To Export Profit Reserves			8,50,000
	(Being statutory Reserves taken over)			
4.	Goodwill	Dr.	50,000	
	To Bank A/c			50,000
	(Liquidation expenses Reimbursed)			
5.	Liquidator of Shristi Ltd.	Dr.	75,00,000	
	To Equity Share Capital			45,00,000
	To Securities Premium			22,50,000
	To Bank A/c			7,50,000
	(Being Purchases consideration discharged)			
6.	Liability for 9% Debentures (5,00,000 ×120/100)	Dr.	6,00,000	
	Discount on issue of debentures	Dr.	25,000	
	To 8% Debentures (6,00,000 × 100/96)			6,25,000
	(Being liability of Debentures holder's discharged)			

Question 9—

The financial position of two companies M/s. Abhay Ltd. and M/s. Asha Ltd. as on 31-3-2015 is as follows:

Balance Sheet as on 31-3-2015

	Abhay Ltd. ₹	Asha Ltd. ₹
Sources of Funds		
Share Capital – Issued and Subscribed		
15,000 equity shares @ ₹100, fully paid	15,00,000	
10,000 equity shares @ ₹ 100 fully paid		10,00,000
General Reserve	2,75,000	1,25,000
Profit & Loss	75,000	25,000
Securities Premium	1,50,000	50,000
Contingency Reserve	45,000	30,000
12% Debentrues, @ ₹ 100 fully paid		2,50,000
Sundry Creditors	55,000	35,000
	21,00,000	15,15,000
Application of Funds		
Land and Buildings	8,50,000	5,75,000
Plant and Machinery	3,45,000	2,25,000
Goodwill		1,45,000
Inventory	4,20,000	2,40,000
Sundry Debtors	3,05,000	2,85,000
Bank	1,80,000	45,000
	21,00,000	15,15,000

They decided to merge and form a new company M/s. Abhilasba Ltd. as on 1-4-2015 on the following terms:

(1) Goodwill to be valued at 2 years purchase of the super profits. The normal rate of return is 10% of the combined share capital and general reserve. All other reserves are to be ignored for the purpose of goodwill.
Average profits of M/s. Abhay Ltd. is ₹ 2,75,000 and M/s. Asha Ltd. is ₹1,75,000.

(2) Land and Buildings, Plant and machinery and Inventory of both companies to be valued at 10% above book value and a provision of 10% to be provided on Sundry Debtors.

(3) 12% debentures to be redeemed, by the issue of 12% preference shares of M/s. Abhilasha Ltd. (face value of 100), at a premium of 10%.

(4) Sundry creditors to be taken over at book value. There is an unrecorded liability of ₹15,500 of M/s. Asha Ltd. as on 1-4-2015.

(5) The bank balance of both companies to be taken over by M/s. Abhilasha Ltd. after deducting liquidation expenses of ₹60,000 to be borne by M/s. Abhay Ltd. and M/s. Asha Ltd. in the ratio of 2:1.

You are required to:

(i) Compute the basis on which shares of M/s. Abhilasha Ltd. are to be issued to the shareholders ofthe existing company assuming that the nominal value of per share of M/s. Abhilasha Ltd. is ₹ 100.

(ii) Draw Balance Sheet of M/s. Abhilasha Ltd. as on 1-4-2015 after the amalgamation.

Answer

(i) Computation of Purchase consideration and Basis for issue of Shares

	Abhay Ltd.	**Asha Ltd.**
Average profits	2,75,000	1,75,000
Less: Normal profits	1,77,500	1,12,500
Super Profit	97,500	62,500
Goodwill (at 2 years purchase)	1,95,000	1,25,000
Land and Building	9,35,000	6,32,500
Plant and Machinery	3,79,500	2,47,500
Inventory	4,62,000	2,64,000
Debtors less provision	2,74,500	2,56,500
Bank (less liquidation expenses 40,000: 20,000)	1,40,000	25,000
	23,86,000	15,50,500
Less: Creditors	(55,000)	(50,500)
Debentures	-	(2,75,000)
Purchase consideration (Basis for issue of shares)	23,31,000	12,25,000
To be satisfied by issue of equity share of Abhilasha Ltd. @ 100 face value	23,310	12,250

(ii) Balance Sheet of Abhilasha Ltd. (After Amalgamation) as on 01.04.2015

	Particulars		Notes	(₹)
	Equity and Liabilities			
1	**Shareholder's Funds**			
	a	Share Capital	1	38,31,000
	b	Reserve and surplus		–
2	**Current Liabilities**			
	a	Trade Payables		1,05,500
		Total		39,36,500
1	**Non-Current Assets**			
	(a)	PPE	2	21,94,500
	(b)	Intangible assets	3	3,20,000
2	**Current Assets**			
	Inventories			7,26,000
	Trade Receivables		4	5,31,000
	Cash and Cash equivalents		5	1,65,000
	Total			**39,36,500**

Notes to accounts

			(₹)
1.	**Share Capital**		
	Equity share capital		
	35,560 equity shares of ₹ 100 each	35,56,000	
	2,750 12% Preference Shares @ ₹ 100 each	2,75,000	38,31,000
	(The above shares have been issued for consideration other than cash)		
2.	**PPE**		
	Fixed Assets		
	Land and Building (₹ 9,35,000 + ₹ 6,32,500)	15,67,500	
	Plant and Machinery (₹3,79,500 + ₹ 2,47,500)	6,27,000	21,94,500
3.	**Intangible Assets**		
	Goodwill (₹ 1,95,000 + ₹ 1,25,000)		3,20,000
	Current Assets		
4.	Trade Receivables ₹ (3,05,000 + 2,85,000)	5,90,000	
	Less: Provision for doubtful debts	(59,000)	5,31,000
5.	Cash and cash equivalents (Bank)		1,65,000

Question 10—

Exe Limited was wound up on 31.3.2013 and it's summarized Balance Sheet as on that date was givenbelow:

Balance Sheet of Exe Limited as on 31.3. 2013

Liabilities	**(₹)**	**Assets**	**(₹)**	**(₹)**
Share Capital:		Fixed Assets		9,64,000
1,20,000 Equity shares of ₹ 10 each	12,00,000	Current Assets:		
Reserves and surplus:		Inventory	7,75,000	
Profit prior to incorporation	42,000	Trade receivables		1,82,000
Contingency Reserve	2,70,000	Cash at Bank	3,29,000	12,86,000
Profit and Loss A/c	2,52,000			
Current Liabilities:				
Trade Payables	2,66,000			
Provisions:				
Provision for income tax	2,20,000			
	22,50,000			22,50,000

The details of Trade receivables and trade payables are as under:

Trade receivables		
Sundry Debtors	1,60,000	
Less: Provision for bad and doubtful debts	(8,000)	1,52,000
Bills Receivables		30,000
		1,82,000
Trade Payables		
Bills payables		40,000
Sundry Creditors		2,26,000
		2,66,000

Wye Limited took over the following assets at values shown as under:

Fixed assets ₹12,80,000, Inventory ₹7,70,000 and Bills Receivable ₹30,000. Purchase consideration was settled by Wye Limited as under:

₹5,10,000 of the consideration was satisfied by the allotment of fully paid 10% Preference shares of ₹100 each. The balance was settled by issuing equity shares of ₹10 each at ₹8 per share paid up.

Trade receivables realised ₹1,50,000. Bills payable was settled for ₹38,000. Income tax authorities fixed the taxation liability at ₹2,22,000.

Creditors were finally settled with the cash remaining after meeting liquidation expenses amounting to₹ 8,000.

You are required to:

(i) Calculate the number of equity shares and preference shares to be allotted by Wye Limited indischarge of purchase consideration.

(ii) Prepare the Realisation account, Cash/Bank account, Equity shareholders account and Wye Limitedaccount in the books of Exe Limited.

(iii) Pass journal entries in the books of Wye Limited.

Answer

(i) Purchase consideration

	₹
Fixed assets	12,80,000
Inventory	7,70,000
Bills receivable	30,000
Purchase consideration	20,80,000

Amount discharged by issue of preference shares = ₹5,10,000

No. of Preference shares to be allotted = $\frac{5,10,000}{100}$ = 5,100 shares

Amount discharged by allotment of equity shares =₹20,80,000 – ₹5,10,000 = ₹15,70,000

Paid up value of equity share = ₹8

Hence, number of equity shares to be issued = $\frac{15,70,000}{8}$ = ₹1,96,250 shares of ₹10 each with ₹8 paid

(ii)

Realisation Account
In the Books of Exe Ltd.

	(₹)		(₹)
To Fixed assets	9,64,000	By Provision for bad and doubtful debts	8,000
To inventory	7,75,000	By Bills Payable	40,000
To Sundry Debtors	1,60,000	By Sundry Creditors	2,26,000
To Bills Receivable	30,000	By Provision for taxation	2,20,000
To Bank Account:		By Wye Ltd. account	
Liquidation Exp.	8,000	(Purchase consideration)	20,80,000
Bills Payable	38,000	By Bank Account: Sundry debtors	1,50,000
Tax Liability	2,22,000		
Sundry Creditors	2,11,000		
To Equity Shareholders			
(Profit transferred)	3,16,000		
	27,24,000		27,24,000

Cash/Bank Account

To Balance b/d	3,29,000	By Realisation Account:	
To Realisation account:		Liquidation Expenses	8,000
Sundry Debtors	1,50,000	Bills Payable	38,000
		Tax Liability	2,22,000
		Sundry Creditors (Bal. fig.)	2,11,000
	4,79,000		4,79,000

Equity Shareholders Account

		₹			₹
To	10% Preference shares in Wye Ltd.	5,10,000	By	Equity share capital account	12,00,000
			By	Profit prior to incorporation	42,000
To	Equity shares in Wye Ltd.	15,70,000	By	Contingency reserve	2,70,000
			By	Profit and loss account	2,52,000
			By	Realisation account (Profit)	3,16,000
		20,80,000			20,80,000

WYe Limited Account

	₹		₹
To Realisation account	20,80,000	By 10% Preference shares in Wye Ltd.	5,10,000
		By Equity shares in Wye Ltd.	15,70,000
	20,80,000		20,80,000

(iii) **Journal Entries**

In the Books of Wye Ltd.

Particulars		Dr.	Cr.
		Amount	**Amount**
		₹	₹
Business purchase account	Dr.	20,80,000	
To Liquidator of Exe Ltd. account			20,80,000
(Being the amount of purchase consideration payable to liquidator of Exe Ltd. for assets taken over)			
Fixed assets account	Dr.	12,80,000	
Inventory account	Dr.	7,70,000	
Bills receivable account	Dr.	30,000	
To Business purchase account			20,80,000
(Being assets taken over)			
Liquidator of the Exe Ltd. account	Dr.	20,80,000	
To 10% Preference share capital account			5,10,000
To Equity share capital account			15,70,000
(Being the allotment of 10% fully paid uppreference shares and equity shares of ₹10 each, ₹8 each paid up as per agreement for discharge ofpurchase consideration)			

Question 11—

Given below are the summarized balance sheets of Vasudha Ltd. and Vaishali Ltd as at 31st March, 2013.

Liabilities	Vasudha Ltd	Vaishali Ltd.	Assets	Vasudha Ltd.	Vaishali Ltd.
Issued Share Capital:			Factory Building	2,10,000	1,60,000
Equity Shares of 10 each	5,40,000	4,03,300	Trade receivables	2,86,900	1,72,900
General Reserves	86,000	54,990	Inventory	91,500	82,500
Profit & Loss A/c	66,000	43,500	Goodwill	50,000	35,000
Trade payables	44,400	58,200	Cash at Bank	98,000	1,09,590
	7,36,400	**5,59,990**		**7,36,400**	**5,59,990**

Goodwill of the Companies Vasudha Ltd. and Vaishali Ltd. is to be valued at ₹75,000 and ₹50,000 respectively. Factory Building of Vasudha Ltd is worth ₹1,95,000 and of Vaishali Ltd ₹1,75,000. Inventory of Vaishali has been shown at 10% above of its cost.
It is decided that Vasudha Ltd will absorb Vaishali Ltd, by taking over its entire business by issue of shares at the Intrinsic Value.
You are required to draft the balance sheet of the Vasudha Ltd after putting through the scheme assuming that the assets & liabilities of Vaishali Ltd. were incorporated in Vasudha Ltd at fair value and assets and liabilities of Vasudha Ltd. have been carried at carrying values only.

Answer

Balance Sheet of Vasudha Ltd. as on 31st March, 2013
(After absorption)

		Particulars	Note No	Amount
				₹
		EQUITY AND LIABILITIES		
1		**Shareholders' funds**		
	(a)	Share capital	1	9,43,300
	(b)	Reserves and Surplus	2	2,72,990
2	(a)	**Current liabilities**		
		Trade payables (44,400+58,200)		1,02,600
		Total		13,18,890
		ASSETS		
1	(a)	**Non-current assets**		
		Fixed assets		
	i	Tangible assets	3	3,85,000
	ii	Intangible assets	4	1,00,000
2		**Current assets**		
	(a)	Inventories(91,500 + 75,000)		1,66,500
	(b)	Trade receivables(2,86,900 + 1,72,900)		4,59,800
	(c)	Cash and cash equivalents(98,000 + 1,09,590)		2,07,590
		Total		13,18,890

Notes to Accounts

		(₹)	(₹)
1.	**Share Capital**		
	Equity Share Capital		
	(54,000 + 40,330) Equity shares of ₹10 each		9,43,300
2.	**Reserves and Surplus**		
	Porfit and Loss A/c	66,000	
	General Reserves	86,000	
	Securities Premium A/c (Refer W.N.)	1,20,990	2,72,990
3.	**Tangible Assets**		
	Factory Building (2,10,000 + 1,75,000)		3,85,000
4.	**Intangible Assets**		
	Goodwill (50,000 + 50,000)		1,00,000

NOTE: As the assets of Vasudha Ltd are shown in the Books after absorption at carrying value only, no adjustment for revaluation of the same has been done in the Balance Sheet. However, assets of Vaishali Ltdhave been taken at the fair value as indicated.

Working Note:

Computation of shares issued on the basis of intrinsic Values.

	Vasudha Ltd.	Vaishali Ltd.
	₹	₹
Goodwill	75,000	50,000
Factory building	1,95,000	1,75,000
Trade receivables	2,86,900	1,72,900
Inventory	91,500	(82,500/110%)= 75,000
Cash at Bank	98,000	1,09,590
	7,46,400	5,82,490
Less: Trade payables	(44,400)	(58,200)
Net assets	**7,02,000**	**5,24,290**
Number of shares	54,000	40,330
Intrinsic value	13	13

Hence, Vasudha Ltd. will give its 40,330 shares of 10 each @ 13 each to Vaishali Ltd. Discharge of Purchase consideration

	Share Capital ₹	Securities Premium ₹
40,330 Shares @ ₹10 each	4,03,300	
40,330 shares @ ₹3 each		1,20,990

Question 12—

The summarized Balance Sheet of M/s. A Ltd. and M/s. B Ltd. as on 31.03.2014 were as under:

Liabilities	A Ltd. (₹)	B Ltd. (₹)	Assets	A Ltd. (₹)	B Ltd. (₹)
Share Capital:			Freehold Property	3,00,000	2,40,000
40,000 Equity Share of ₹10 each,			Plant & Machinery	60,000	40,000
Fully paid	4,00,000	–	Motor Vehicle	30,000	20,000
30,000 Equity shares of ₹			Trade Receivables	2,00,000	80,000
10 each, fully paid	–	3,00,000	Invenrtory	2,30,000	1,80,000
Generarl Reserve	2,40,000	–	Cash at Bank	80,000	40,000
Profit & Loss Account	50,000	50,000			
Trade Payables	2,10,000	1,30,000			
6% Debentrues	–	1,20,000			
	9,00,000	6,00,000		9,00,000	6,00,000

M/s. A Ltd. and M/s. B Ltd. carry on business of similar nature and they agreed to amalgamate. A new Company, M/s. AB Ltd. is formed to take over the Assets and Liabilities of M/s. A Ltd. and M/s. B Ltd. on the following basis:

Assets and Liabilities are to be taken at Book Value, with the following exceptions:

(a) Goodwill of M/s. A Ltd. and M/s. B Ltd. is to be valued at ₹ 1,40,000 and ₹40,000 respectively.

(b) Plant & Machinery of M/s. A Ltd. are to be valued at ₹1,00,000.

(c) The Debentures of M/s. B Ltd. are to be discharged, by the issue of 6% Debentures of M/s. AB Ltd., at a premium of 5%.

You are required to:

(i) Compute the basis on which shares in M/s. AB Ltd. will be issued to Shareholders of the existing Companies assuming nominal value of each share of M/s. AB Ltd. is ₹10.

(ii) Draw up a Balance Sheet of M/s. AB Ltd. as on 1st April, 2014, when Amalgamation is completed.

(iii) Pass Journal entries in the Books of M/s. AB Ltd. for acquisition of M/s. A Ltd. and M/s. B Ltd.

Answer

(i) Calculation of Purchase consideration (or basis for issue of shares of AB Ltd.)

Purchase Consideration	A Ltd. (₹)	B. Ltd. (₹)
Goodwill	1,40,000	40,000
Freehold property	3,00,000	2,40,000
Plant and Machinery	1,00,000	40,000
Motor vehicles	30,000	20,000
Inventory	2,30,000	1,80,000
Trade Receivables	2,00,000	80,000
Cash at Bank	80,000	40,000
	10,80,000	6,40,000
Less: Liabilities:		
6% Debentures (1,20,000 × 105%)	–	(1,26,000)
Trade Payable	(2,10,000)	(1,30,000)
Net Assets taken over	8,70,000	3,84,000
To be satisfied by issue of shares of AB Ltd. @ 10 each	87,000	38,400

(ii) **Balance Sheet AB Ltd. as on 1st April, 2014**

	Particulars	Note No.	Amount(₹)
	Equity and Liabilities		
1	**Shareholder's funds**		
	(a) Share Capital	1	12,54,000
2	**Non-current Liabilities**		
	Long-term borrowings	2	1,26,000
3	**Current Liabilities**		
	(a) Trade Payables (2,10,000 + 1,30,000)		3,40,000
		Total	17,20,000
	Assets		
1	**Non-Current Assets**		
	(a) PPE	3	7,30,000
	(b) Intangible Assets	4	1,80,000
2	**Current Assets**		
	(a) Inventories (2,30,000 + 180,000)		4,10,000
	(b) Trade Receivables (2,00,000 + 80,000)		2,80,000
	(c) Cash and cash equivalents (80,000 + 40,000)		1,20,000
		Total	17,20,000

Notes to Accounts		(₹)	(₹)
1.	**Equity Share Capital**		
	Equity share Capital		
	1,25,400 shares of ₹10 each		12,54,000
	(All the above shares are issued for consideration other than cash)		
2.	**Long-term borrowings**		
	Secured		
	6% 1,260 Debentures of ₹100 each		1,26,000
3.	**PPE**		
	Freehold Property		
	A Ltd.	3,00,000	
	B Ltd.	2,40,000	5,40,000
	Plant and Machinery		
	A Ltd.	1,00,000	
	B Ltd.	40,000	1,40,000
	Motot Vehicle A Ltd.		
	A Ltd.	30,000	
	B Ltd.	20,000	50,000
			7,30,000
4.	Intangible		
	AssetsGoodwill		
	A Ltd.	1,40,000	
	B Ltd.	40,000	180,000

(iii) **Journal Entries**

In the Books of M/s AB Ltd.

Particulars		Amount (₹)	Amount (₹)
Business Purchases A/c	Dr.	12,54,000	
To Liquidator of A Ltd. Account			8,70,000
To Liquidator of B Ltd. Account			3,84,000
(Being the amount of purchase consideration payable to liquidator of A Ltd. and B Ltd. for assets taken over			

Goodwill	Dr.	1,40,000	
Freehold Property	Dr.	3,00,000	
Plant and Machinery	Dr.	1,00,000	
Motor Vehicles	Dr.	2,00,000	
Trade Receivables	Dr.	2,00,000	
Inventory	Dr.	2,30,000	
Cash at Bank	Dr.	80,000	
To Trade Payables			2,10,000
To Business Purchase A/c			8,70,000
(Being assets and liabilities of A Ltd. taken over)			
Goodwill	Dr.	40,000	
Freehold Property	Dr.	2,40,000	
Plant and Machinery	Dr.	40,000	
Motor Vehicles	Dr.	20,000	
Trade receivables	Dr.	80,000	
Inventory	Dr.	1,80,000	
Cash at Bank	Dr.	40,000	
To Trade payables			1,30,000
To 6% Debentures of B Ltd.			1,26,000
To Business Purchases Account			3,84,000
(Being assets and Liabilities of B Ltd. taken over)			
6% Debentures of B Ltd.	Dr.	1,26,000	
To 6% Debentures			1,26,000
(Being issue of 6% debentures to debenture holders of B Ltd.			
Liquidator of the A Ltd. Account	Dr.	8,70,000	
Liquidator of The B Ltd. Account	Dr.	3,84,000	
To Equity Share Capital			12,54,000
(Being the allotment of equity shares of 10 each, as per the agreement for discharge of purchase consideration)			

Note:

It is assumed that the nominal value of debentures of B Ltd. is 100 each.

Question 13—

Liabilities	Gee Ltd. (₹)	Pee Ltd. (₹)	Assets	Gee Ltd. (₹)	Pee Ltd. (₹)
Equity Share Capital	25,00,000	15,00,000	Buildings	12,50,000	7,75,000
(10 per share)			Plant and Machinery	16,25,000	8,50,000
14% Preference share	11,00,000	8,50,000	Furniture & Fixtures	2,87,500	1,75,000
Capital (100 each)	–	–	Investments	3,50,000	2,50,000
General Reserve	2,50,000	2,50,000	Inventory	6,25,000	4,75,000
Export Profit reserve	1,50,000	1,00,000	Trade Receivables	4,50,000	5,15,000
Investment allowance reserve	–	50,000	Cash at bank	3,62,500	2,60,000
Profit and Loss A/c	3,75,000	1,25,000			
15% Debentures (100 each)	2,50,000	1,75,000			
Trade payables	2,25,000	1,75,000			
Other current liabilities	1,00,000	75,000			
	49,50,000	33,00,000		49,50,000	33,00,000

All the bills receivables of Pee Ltd. were having Gee Ltd.'s acceptances.
Gee Ltd. takes over Pee Ltd. on 1st April, 2015. The purchase consideration is discharged as follows:

(i) Issued ₹1,65,000 equity shares of ₹10 each at par to the equity shareholders of Pee Ltd.
(ii) Issued 15% preference shares of ₹100 each to discharge the preference shareholders of Pee Ltd. at 10% premium.
(iii) The debentures of Pee Ltd. will be converted into equivalent number of debentures of Gee Ltd.
(iv) The statutory reserves of Pee Ltd. are to be maintained for two more years.
(v) Expenses of amalgamation amounting to ₹10,000 will be borne by Gee Ltd.
(vi) Details of trade receivables and trade payables as under:

	Gee L td.	Pee Ltd.
Trade payables		
Trade payables	1,50,000	75,000
Bills payables	75,000	1,00,000
	2,25,000	1,75,000
Trade receivables		
Debtors	4,00,000	4,60,000
Bills receivables	50,000	55,000
	4,50,000	5,15,000

Show the opening Journal entries and the opening balance sheet of Gee Ltd. as at 1st April, 2015 after amalgamation, on the assumption that the amalgamation is in the nature of the merger.

Answer

In the books of Gee Ltd.

Journal Entries

Particulars		Debit (₹)	Credit (₹)
Business purchases A/c (W.N. 1)	Dr.	25,85,000	
To Liquidator of Pee Ltd.			25,85,000
(Being business of Pee Ltd. taken over)			
BuildingA/c	Dr.	7,75,000	
Plant and Machinery A/c	Dr.	8,50,000	
Furniture And Fixtures A/c	Dr.	1,75,000	
Investment A/c	Dr.	2,50,000	
Inventory A/c	Dr.	4,75,000	
Debtors A/c	Dr.	4,60,000	
Bills Receivables A/c	Dr.	55,000	
Bank A/c	Dr.	2,60,000	
To General Reserve A/c (W.N. 2) (2,50,000–2,35,000)			15,000
To Export profit reserve A/c			1,00,000
To Investment allowance Reserve A/c			50,000
To Profit and Loss A/c			1,25,000
To Liability for 15% Debentures A/c (100 each)			1,75,000
To Trade creditors A/c			75,000
To Bills Payables A/c			1,00,000
To Other current liabilities A/c			75,000
To Business Purchases A/c			25,85,000
(Being assets and liabilities taken over)			
Liquidator of Pee Ltd.	Dr.	25,85,000	
To Equity Share Capital A/c			16,50,000
To 15% Preference Share Capital A/c			9,35,000
(Being purchase consideration discharges)			
General Reserve* A/c	Dr.	10,000	
To Cash at Bank			10,000
(Being Expenses of amalgamation paid)			
Liability for 15% Debentures in Pee Ltd. A/c	Dr.	1,75,000	
To 15% Debentures A/c			1,75,000
(Being debentures in Pee Ltd. Discharged by issuing own 15% debentures)			

Bills Payables A/c	Dr.	55,000	
To Bill receivables A/c			55,000
(Cancellation of mutual owing on account of bills of exchange)			

Opening Balance Sheet of Gee Ltd. (after absorption)as on 1st April, 2015

		Particulars	Notes	(₹)
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share Capital	1	61,85,000
	b	Reserve and Surplus	2	10,55,000
2		**Non-current Liabilities**		
	a	Long-term borrowings	3	4,25,000
3		**Current Liabilities**		
	a	Trade Payable	4	3,45,000
	b	Other current liabilities	5	1,75,000
		Total		**81,85,000**
		Assets		
1		**Non-currents**		
	a	PPE	6	49,62,500
	b	Investment	7	6,00,000
2		**Current Assets**		
	a	Inventories	8	11,00,000
	b	Trade receivables	9	9,10,000
	c	Cash and cash equivalents	10	6,12,500
			Total	**81,85,000**

Notes to accounts

		(₹)
1	**Share Capital**	
	Equity share capital	
	4,15,000 Equity shares of ₹ 10 each (Out of above, 1,65,000 shares were issued for consideration other than cash)	41,50,000
	Preference share capital	
	9,350 15% Preference shares of ₹ 100 each (Out of above, 9,350 shares were issued for consideration other than cash)	9,35,000
	11,000 14% Preference Shares of ₹ 100 each	11,00,000
	Total	**61,85,000**

2.	**Reserve and Surplus**		
	General Reserve		
	Opening balance	2,50,000	
	Add: Adjustment under scheme of amalgamation	15,000	
	Less: Amalgamation Expenses Paid	(10,000)	2,55,000
	Export profit reserve		
	Opening Balance	1,50,000	
	Add: Adjustment under scheme of amalgamation	(1,00,000)	2,50,000
	Investment allowance reserve		50,000
	Profit and Loss Account		
	Opening Balance	3,75,000	
	Add: Adjustment under scheme of amalgamation	1,25,000	5,00,000
	Total		**10,55,000**
3.	**Long-term Borrowings**		
	Secured		
	15% Debentures	2,50,000	
	Add: Adjustment under scheme of amalgamation	1,75,000	4,25,000
	Total		**4,25,000**
4.	**Trade Payable**		
	Creditors: Opening Balance	1,50,000	
	Add: Adjustment under scheme of amalgamation	75,000	2,25,000
	Bills Payables : Opening Balance	75,000	
	Add: Adjustment under scheme of amalgamation	1,00,000	
	amalgamation	(55,000)	1,20,000
			3,45,000
5.	**Other current Liabilities**		
	Opening Balance	1,00,000	
	Add: Adjustment under scheme of amalgamation	75,000	**1,75,000**
6.	**PPE**		
	Building– Opening Balance	12,50,000	
	Add: Adjustment under scheme of amalgamation	7,75,000	20,25,000
	Plant and Machinery– Opening Balance	16,25,000	
	Add: Adjustment under scheme of amalgamation	8,50,000	24,75,000
	Furniture and fixtures – Opening Balance	2,87,500	
	Add: Adjustment under scheme of amalgamation	1,75,000	4,62,500
	Total		**49,62,500**

7.	**Investments**		
	Opening Balance	3,50,000	
	Add: Adjustment under scheme of amalgamation	2,50,000	**6,00,000**
8.	**Inventories**		
	Opening Balance	6,25,000	
	Add: Adjustment under scheme of amalgamation	4,75,000	11,00,000
9.	**Trade Receivables**		
	Debtors: Opening Balance	4,00,000	
	Add: Adjustment under scheme of amalgamation	4,60,000	8,60,000
	Bills Payables: Opening balance	50,000	
	Add: Adjustment under scheme of amalgamation	55,000	
	Less: Cancellation of mutual owning upon amalgamation	(55,000)	50,000
	Total		**9,10,000**
10.	**Cash and cash equivalents**		
	Opening Balance	3,62,500	
	Add: Adjustment under scheme of amalgamation	2,60,000	
	Less: Amalgamation	(10,000)	**6,12,500**

Working Notes:

1. Calculation of purchases consideration

	(₹)
Equity shareholders of Pee Ltd. (1,65,000 × 10)	16,50,000
Preference shareholders of Pee Ltd. (8,50,000 ×110%)	9,35,000
Purchase consideration would be	25,85,000

2. Amount to be adjustment from general reserve

The difference between the amount recorded as share capital issued and the amount of sharecapital of transferor company should be adjusted in General Reserve.

Thus, General reserve will be adjusted as follows:

	(₹)
Purchases consideration	25,85,000
Less: Share capital issued (₹ 15,00,000 + ₹ 8,50,000)	23,50,000
Amount to be adjusted from general reserve	2,35,000

Question 14—
The following was the Balance Sheet of V Ltd. as on 31st March, 2015

	Particulars	Note No.	Amount (in ₹ lakhs)
	Equity and Liabilities		
(1)	Shareholder's Funds		
	(a) Share Capital	1	1,150
	(b) Reserve and Surplus	2	(87)
(2)	Non-current Liabilities		
	(a) Long-term Borrowings	3	630
(3)	Current Liabilities		
	Trade Payables		170
	Total		1,863
	Assets		
(1)	Non-current Assets		
	PPE	4	1,152
(2)	Current Assets		
	Inventories		380
	Trade Receivables		256
	Cash and Cash equivalents	5	75
	Total		1,863

Notes:

(1)	Share Capital			?
	Authorized:			
	Issued, Subscribed and Paid up:			
	80 Lakh Equity Shares of ₹ 10 each, fully paid up			800
	35 Lakh 12% Cumulative Performance	Shares of ₹10 each,	Fully paid up	350
			Total	1,150
(2)	Reserve and Surplus			
	Profit & Loss Account			87
			Total	87
(3)	Long-term Borrowing			
	10% Secured Cumulative Debentures	Of ₹100 each, fully paid	up	600
	Outstanding Debentures Interest			30
			Total	630
(4)	Tangible Asset			
	Land and Buildings			445
	Plant and Machinery			593
	Furniture, Fixtures and Fittings			114
			Total	1152

(5)	Cash and Cash Equipment's	
	Balance at Bank	69
	Cash in hand	6
	Total	75

On 1st April, 2015, P Ltd. took over the entire business of V Ltd. on the following terms:

V Ltd.'s equity shareholders would receive 4 fully paid equity shares of P Ltd. of ₹10 each issued at a premium of ₹2.50 each for every five shares held by them in V Ltd.

Preference shareholders of V Ltd. would get ₹35 lakhs 13% Cumulative Preference Shares of ₹10 each fully paid up in P Ltd., in lieu of their present holding.

All the debentures of V Ltd. would be converted into equal number of 10.5% Secured Cumulative Debentures of ₹100 each, fully paid up after the take -over by P Ltd., which would also pay outstanding debenture interest in cash.

Expenses of amalgamation would be borne by P Ltd. Expenses came to be ₹2 lakhs. P Ltd. discovered that its trade payables included 7 lakhs due to V Ltd. for goods purchased.

Also P Ltd.'s Inventory included goods of the invoice price of ₹5 lakhs earlier purchased from V Ltd., which had charged profit @ 20% of the invoice price.

You are required to :

(i) Prepare Realisation A/c in the books of V Ltd.

(ii) Pass journal entries in the books of P Ltd. assuming it to be an amalgamation in the nature of merger.

Answer

(i) In the Books of V Ltd. Realisation Account

	(₹) in Lakhs		(₹) in Lakhs
To Land and Buildings A/c	445	By 10% Secured Cumulative Deb. A/c	600
To Plant & Machinery A/c	593	By Outstanding Debenture Interest A/c	30
To Furniture, Fixture & Fittings A/c	114	By Trade Payable A/c	170
To Inventories A/c	380	By P Ltd. A/c	1,150
To Trade Receivable A/c	256	(purchase consideration- Refer working note	
To Bank A/c	69		
To Cash in Hand A/c	6		
To Equity Shareholder's A/c (Profit on Realisation)	87		
	1,950		1,950

(ii) **In the Books of P Ltd.**
Journal Entries

			Dr. (₹) in lakhs	Cr. (₹) in lakhs
1.	Business Purchase A/c	Dr.	1,150	
	To Liquidator of V Ltd. A/c			1,150
	(Being Purchase consideration due)			
2.	Land and Building A/c	Dr.	445	
	Plant and Machinery A/c	Dr.	593	
	Furniture, Fixtures & Fittings	Dr.	114	
	Inventories A/c	Dr.	380	
	Trade Receivables A/c	Dr.	256	
	Bank A/c	Dr.	69	
	Cash in Hand A/c	Dr.	6	
	Profit and Loss A/c	Dr.	87	
	To 10% Debentures A/c			600
	To Outstanding Debenture in interest A/c			30
	To Trade Payables A/c			170
	To Business Purchases A/c			1,150
	(Being assets and liabilities taken over from V Ltd. underthe scheme of amalgamation in the nature of merger)			
3.	Liquidators of V Ltd. A/c	Dr.	1,150	
	To Equity Share Capital A/c			640
	To 13% cumulative Preference Shares A/c			350
	To Securities Premium A/c			160
	(Being discharge of consideration, by allotment of 64 lakhs equity shares of ₹10 each at a premium of ₹2 .50 per share and ₹35 lakhs 13% cumulative preference shares of ₹ 10 each at par			
4.	10% Secured Cumulative Debentures A/c	Dr.	600	
	To 10.5% Secured Cumulative Debentures A/c			600
	(Being 10% secured cumulative debentures of V Ltd. converted into 10.50% Secured Cumulative Deb. of P Ltd.)			
5.	Outstanding Debentures Interest A/c	Dr.	30	
	To Bank A/c			30
	(Being outstanding debentures interest paid in cash by P Ltd.)			
6.	Profit and Loss A/c	Dr.	2	
	To Bank A/c			2
	(Being amalgamation expenses met by P Ltd.)			

7.	Trade Payable A/c	Dr.	7	
	To Trade Receivables A/c			7
	(Being settelment of mutual liability)			
8.	Profit and Loss A/c	Dr.	1	
	To Inventories A/c (5 × 20%)			1
	(Being uinrealized profit on Inventory eliminated from the inventories of P Ltd.			

Working Note:

Calculation of Purchases Consideration payable by P Ltd.

	₹in Lakhs
Payment to Preference shareholders:	
13% Cumulative Preference Shares of ₹ 10 each (35 lakhs shares × ₹10)	350
Payment to Equity shareholders:	
(80 lakhs shares × 4/5 = 64 lakhs equity shares₹ 10)	640
Securities Premium (64 lakhs equity shares₹2.5)	160
Total Purchases consideration	1,150

Question 15—

Following is the summarized Balance Sheets as at March 31, 2013:

Liabilities	Max Ltd.	Mini Ltd.	Assets	Max Ltd.	(₹0000) Mini Ltd.
Share Capital			Goodwill	20	–
Equity shares of100 each	1,500	1,000	Other fixed assets	1,500	760
9% Preference shares of 100 each	500	400	Trade receivables	651	440
			Inventory	393	680
General Reserve	180	170	Cash at bank	26	130
Profit and Loss Account	–	15	Own debenture (Nominal value 2,00,000	192	
12% Debenture of 100 each	600	200			
Trade payables	415	225	Discount on issue of Deb.	2	
			Profit and Loss Account	411	
	3,195	2,020		3,195	2,020

On 1.4.2013, Max Ltd. adopted the following scheme of reconstruction:

(i) Each equity share shall be sub-divided into 10 equity shares of ₹10 each fully paid up. 50% of the equity share capital would be surrendered to the Company.

(ii) Preference dividends are in arrear for 3 years. Preference shareholders agreed to waive 90% of the dividend claim and accept payment for the balance.

(iii) Own debentures of ₹80,000 were sold at ₹98 cum-interest and remaining own debentures were cancelled.

(iv) Debenture holders of ₹2,80,000 agreed to accept one machinery of book value of 3,00,000 in full settlement.

(v) Trade payables, trade receivables and inventory were valued at ₹3,50,000,₹ 5,90,000 and ₹3,60,000 respectively. The goodwill, discount on issue of debentures and Profit and Loss (Dr.) are to be written off.

(vi) The Company paid ₹15,000 as penalty to avoid capital commitments of ₹3,00,000.

On 2.4.2013 a scheme of absorption was adopted. Max Ltd. would take over Mini Ltd. The purchase consideration was fixed as below:

(a) Equity shareholders of Mini Ltd. will be given 50 equity shares of ₹10 each fully paid up, in exchange for every 5 shares held in Mini Ltd.

(b) Issue of 9% preference shares of ₹100 each in the ratio of 4 preference shares of Max Ltd. for every 5 preference shares held in Mini Ltd.

(c) Issue of one 12% debenture of ₹100 each of Max Ltd. for every 12% debentures in Mini Ltd.

You are required to give Journal entries in the books of Max Ltd. and draw the resultant Balance Sheet as at 2nd April, 2013

In the Books of Max Ltd.

Particulars 01.04.2023		Dr. Amount (₹)	Cr. Amount (₹)
Equity Share Capital	Dr.	15,00,000	
To Equity Share Capital			15,00,000
(Being Sub-division of one share of ₹ 100 each into 10 shares of ₹10 each)			
Equity Share Capital	Dr.	7,50,000	
To Capital Reduction A/c			7,50,000
(Being reduction of Equity capital by 50%)			
Capital Reduction A/c	Dr.	13,500	
To Bank A/c			13,500
(Being payment in cash of 10% of arrear or preference dividend)		78,400	
Bank A/c	Dr.		
To own Debentures A/c			76,800
To Capital Reduction A/c			1,600
(Being Profit on cancellation of own debentures transferred to Capital reduced A/c)			
12% Debentures A/c	Dr.	2,80,000	
Capital Reduction A/c	Dr.	20,000	

To Machinery A/c			3,00,000
(Being machinery taken up by debenture holders for ₹2,80,000)			
Trade Payable A/c	Dr.	6,500	
Capital Reduction A/c (balancing Figure)	Dr.	29,000	
To Trade Receivables A/c			61,000
To inventory A/c			33,000
(Being Assets and Liabilities Revalued)			
Capital reduction A/c	Dr.	4,33,000	
To Goodwill A/c			20,000
To Discount on Debentures A/c			2,000
To Profit and Loss A/c			4,11,000
(Being the above assets written off)			
Capital Reduction A/c	Dr.	15,000	
To Bank			15,000
(Being Penalty paid for avoidance of capital commitments.)			
Capital Reduction A/c	Dr.	2,45.900	
To Capital Reserve A/c			
(Being the credit balance in Capital Reduction A/c transferred to Capital Reserve.)			
02.04.2013			
Business Purchase A/c	Dr.	13,20,000	
To Liquidators of Mini Ltd.			13,20,000
(Being the purchase consideration payable Mini Ltd.)			
Fixed Assets A/c	Dr.	7,60,000	
Inventory A/c	Dr.	6,80,000	
Trade Receivables A/c	Dr.	4,40,000	
Cash at Bank A/c	Dr.	1,30,000	
To Trade Payable A/c			2,25,000]
To 12% Debentures A/c of Mini Ltd.			2,00,000
To Profit and Loss A/c			15,000
To General Reserve A/c (1,70,000 + 80,000*)			2,50,000
To Business Purchase A/c			13,20,000
(Being the take over of all assets and liabilities of Mini Ltd. by Max Ltd.)			
Liquidators of Mini Ltd. A/c	Dr.	13,20,000	
To Equity Share Capital			10,00,000
To 9% Preference share capital			3,20,000
(Being the purchases consideration discharged)			
12% Debentures of Mini Ltd.	Dr.	2,00,000	
To 12% Debentures A/c			2,00,000
(Being Max Ltd. issued their 12% Debentures in against of every debentures of Mini Ltd..)			

Balance Sheet of Max Ltd. as at 2.4.2013

	Particulars	Note No.	Amount(₹)
I.	**Equity and Liabilities**		
	(1) Shareholder's Funds		
	(a) Share Capital	1	25,70,000
	(b) Reserve and surplus	2	6,90,900
	(2) Non-Current Liabilities		
	(a) Long-term borrowings – 12% Debentures		4,00,000
	(3) Current Liabilities		
	(a) Trade Payables		5,75,000
		Total	**42,35,900**
II.	**Assets**		
	(1) Non-Current assets		
	(a) PPE		19,60,000
	(2) Current Assets		
	(a) Inventories		10,40,000
	(b) Trade Receivables		10,30,000
	(c) Cash and cash equivalents		2,05,900
		Total	**42,35,900**

Notes to Account

			₹
1	**Share Capital**		
	Equity Share Capital		17,50,000
	9% Preference share capital		8,20,000
			25,70,000
2	**Reserves and Surplus**Profit		
	and Loss A/c General Reserve		15,000
	Share Capital of Mini Ltd. (Equity + Preference)Less:		
	Share Capital issued by Max Ltd.	14,00,000	
	General reserve (resulted due to absorption)	13,20,000	
	Add: General reserve of Mini Ltd.General	80,000	
	reserve of Max Ltd.	1,70,000	
	Capital Reserve	1,80,000	4,30,000
			2,45,900
			6,90,900

Working Note:

1. **Arrear dividend to Preference Shareholders**

   Preference Share Capital 500,000 @ 9% will yield dividend of ₹45,000/- per year and for 3 years =₹1,35,000/–. Out of this only 10% is paid and the balance is waived off. Hence, amount paid = ₹13,500/-

2. **Profit on redemption of own debentures**

   Own Debentures with Nominal Value of ₹80,000 sold for ₹98 per deb = 80,000 * 98/100 = ₹78,400/–.

   Book Value = ₹1,92,000/ 2,00,000 × 80,000 = ₹ 76,800/-.

   Profit on own debentures sold = ₹78,400 –₹76,800 =₹1,600

   Balance Own Debentures = ₹1,92,000 – 76,800 =₹1,15,200 which are cancelled

3. **Purchase Consideration**

Equity share capital 10,000 × $\frac{50}{5}$ × 10	= 10,00,000
9% Preference share capital 4,000 × $\frac{4}{5}$ × 100	=3,20,000
	₹13,20,000

Question 16—

Following are the summarized Balance Sheet of Companies K Ltd. and W Ltd., as at 31-12-2012 **:**

Liabilities	(₹in '000) **K. Ltd.**	**W Ltd.**	**Assets**	(₹in'000) **K. Ltd.**	**W Ltd.**
Share Capital:			Goodwill	20	–
Equity shares of₹100 each	2,000	1,500	Other Fixed Assets	2,400	1,150
10% Preference Share of ₹ 100 each		400	Trade Receivables	625	615
General Reserve	240	170	Cash At Bank	38	155
Profit & Loss Account		15	Stock	412	680
12% Debentures of ₹ 100 each	600	200	Own Debenture	192	–
Trade payables	560	315	(Nominal Value of ₹ 2,00,000)		
			Discount on issue of Deb.	2	
			Profit and Loss Account	411	
	4,100	**2,600**		**4,100**	**2,600**

On 01-04-2013, K Ltd. adopted the following scheme of reconstruction:

(i) Each equity share shall be sub-divided into 10 equity shares of ₹10 each fully paid up. 50% of the equity share capital would be surrendered to the company.

(ii) Preference dividends are in arrear for 3 years. Preference shareholders agreed to waive 80% of the dividend claim and accept payment for the balance.

(iii) Own debentures of ₹80,000 (nominal value) were sold at ₹98 cum interest and remaining own debentures were cancelled.

(iv) Debenture holders of ₹3,00,000 agreed to accept one machinery of book value of ₹3,20,000 in full settlement.

(v) Trade payables, Trade receivables and inventory were valued at ₹5,00,000, ₹6,00,000 and ₹4,00,000 respectively. Goodwill, discount on issue of debentures and Profit and Loss account (Dr.) are to be written off.

(vi) The company paid ₹20,000 as penalty to avoid capital commitments of ₹4,00,000.

On 02.04.2013, a scheme of absorption was adopted. K Ltd. would take over W Ltd. The purchase consideration was fixed as below:

(a) Equity shareholders of W Ltd. will be given 50 equity shares of ₹10 each fully paid up, in exchange for every 5 shares held in W Ltd.

(b) Issue of 10% preference shares of ₹100 each in the ratio of 4 preference shares of K Ltd. for every 5 preference shares held in W Ltd.

(c) Issue of 12% debentures of ₹100 each of K Ltd. for every 12% debenture in W Ltd.

Pass necessary Journal entries in the books of K Ltd. and draw the resultant Balance Sheet as at 2nd April, 2013.

Answer

In the Books of K Ltd. Journal Entries

	Particulars		Dr. Amount (₹)	Cr. Amount (₹)
01.04.2013				
1.	Equity share Capital A/c	Dr.	20,00,000	
	To Equity Share Capital			20,00,000
	(Being sub-division of one share ₹100 each into of 10 shares of ₹10 each)			
2.	Equity Share Capital A/c	Dr.	10,00,000	
	To Capital Reduction A/c			10,00,000
	(Being reduction of capital by 50%)			
3.	Capital Reduction A/c	Dr.	42,000	
	To Bank A/c			42,000
	(Being payment in cash of 20% of arrears of 3 years' preference dividend)			
4.	Bank A/c	Dr.	78,400	
	To Own Debentures A/c [(1,92,000/2,00,000) × 80,000]			76,800
	To Capital Reduction A/c			1,600
	(Being Profit on sale of own debentures transferred to capital reduction A/c)			
5.	12% Debentures A/c	Dr.	1,20,000	
	To Own Debentures A/c [1,92,000/2,00,000]×1,20,000			1,15,200
	To Capital Reduction A/c			4,800
	(Being profit on cancellation of own debentures transferred to capital reduction A/c)			

6.	12% Debentures A/c	Dr.	3,00,000	
	Capital Reduction A/c	Dr.	20,000	
	To Machinery A/c			3,20,000
	(Being Machinery of ₹3,20,000 taken up by the debenture holders for ₹3,00,000.			
7.	Trade payables A/c	Dr.	60,000	
	To Capital Reduction A/c			60,000
	(Being Liabilities revalued.)			
8.	Capital Reduction A/c	Dr.	10,04,400	
	To Trade receivables A/c			25,000
	To Inventory A/c			12,000
	To Goodwill A/c			20,000
	To Discount on debentures A/c			2,000
	To Profit and Loss A/c			4,11,000
	To Bank A/c			20,000
	To Capital Reserve A/c			5,14,400
	(Being assets revalued and losses written off and penalty paid off through capital reduction account and the balance of capital reduction account transferred to capital reserve account)			
02-04-2013				
9.	Business Purchases A/c	Dr.	18,20,000	
	To Liquidators of W Ltd.			18,20,000
	(Being the purchase consideration payable to W Ltd.)			
10.	Fixed Assets A/c	Dr.	11,50,000	
	Inventory A/c	Dr.	6,80,000	
	Trade Receivables A/c	Dr.	6,15,000	
	Cash at bank A/c	Dr.	1,55,000	
	To Trade Payables A/c			3,15,000
	To 12% Debentures A/c of W Ltd.			2,00,000
	To Profit and Loss A/c			15,000
	To General Reserve A/c			2,50,000
	To Business Purchase A/c			18,20,000
	(Being the takeover of all assets and liabilities of W Ltd. by K Ltd.)			
11.	Liquidators of W Ltd. A/c	Dr.	18,20,000	
	To Equity Share Capital A/c			15,00,000
	To 10% Preference Share capital A/c			3,20,000
	(Being the purchase consideration discharged)			
12.	12% Debentures of W Ltd. A/c	Dr.	2,00,000	

To 12% Debentures A/c 2,00,000

(Being K Ltd. Issued their 12% Debentures against 12% Debentures of W Ltd.

Balance Sheet of K Ltd. as on 2nd April, 2013

Particulars	Notes No.	Amount (₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	35,20,000
(b) Reserves and Surplus	2	10,19,400
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	3,80,000
(3) Current Liabilities		
(a) Trade payables	4	8,15,000
Total		**57,34,400**
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(i) Tangible assets	5	32,30,000
(2) Current assets		
(a) Inventories	6	10,80,000
(b) Trade receivables	7	12,15,000
(c) Cash and cash equivalents	8	2,09,400
Total		**57,34,400**

Notes of Accounts

			(₹)
1	**Share Capital**		
	Equity Share Capital	20,00,000	
	Less: Surrender 50% equity Capital	(10,00,000)	
	Add: Equity Share capital issued to W Ltd.	15,00,000	25,00,000
	10% Preference Share capital	7,00,000	
	Add: Preference share capital issued to W Ltd.	3,20,000	10,20,000
			35,20,000
2.	**Reserve and Surplus**		
	Profit and Loss A/c	15,000	
	General Reserve (2,40,000 + 1,70,000)	4,10,000	
	Capital Reserve (5,14,400 + 80,000)	5,94,400	10,19,400
3.	**Long-term Borrowings**		
	12% Debentures	6,00,000	
	Less; Settled in consideration of machinery	(3,00,000)	
	Less: Cancelled debentures	(1,20,000)	
	Add: 12% Debentures Issued to W Ltd.	2,00,000	3,80,000
4.	**Trade payables**		
	Of K Ltd.	5,60,000	
	Less: Reduction due to Revaluation	(60,000)	
	Add: Trade Payables of W Ltd.	3,15,000	8,15,000
5.	**PPE**		
	Balance of Other fixed Assets	24,00,000	
	Less: Machinery taken up by debenture holders	(3,20,000)	
	Add: Other fixed assets of W Ltd.	11,50,000	32,30,000
6.	**Inventories**	4,12,000	
	Less: Reduction due to revaluation	(12,000)	
	Add: Inventories of W Ltd.	6,80,000	10,80,000
7.	**Trade Receivables**	6,25,000	
	Less: Reduction due to revaluation	(25,000)	
	Add: Trade receivables of W Ltd.	6,15,000	12,15,000
8.	**Cash and Cash equivalents**	38,000	
	Less: Payment of arrear of preference dividend	(42,000)	
	Add: Profit on sale of own debentures	78,400	
	Less: Penalty paid	(20,000)	
	Add: Cash and cash equivalents of W Ltd.	1,55,000	2,09,400

Working Notes:

1. Purchases Consideration

	(₹)
Equity share capital [(15,000 × 50/5) × ₹ 100]	15,00,000
10% Preference share capital	3,20,000
	18,20,000

2.

	(₹)
Share Capital of W Ltd. (Equity + Preference)	19,00,000
Less: Share capital issued by K Ltd.	(18,20,000)
Added to General Reserve	80,000

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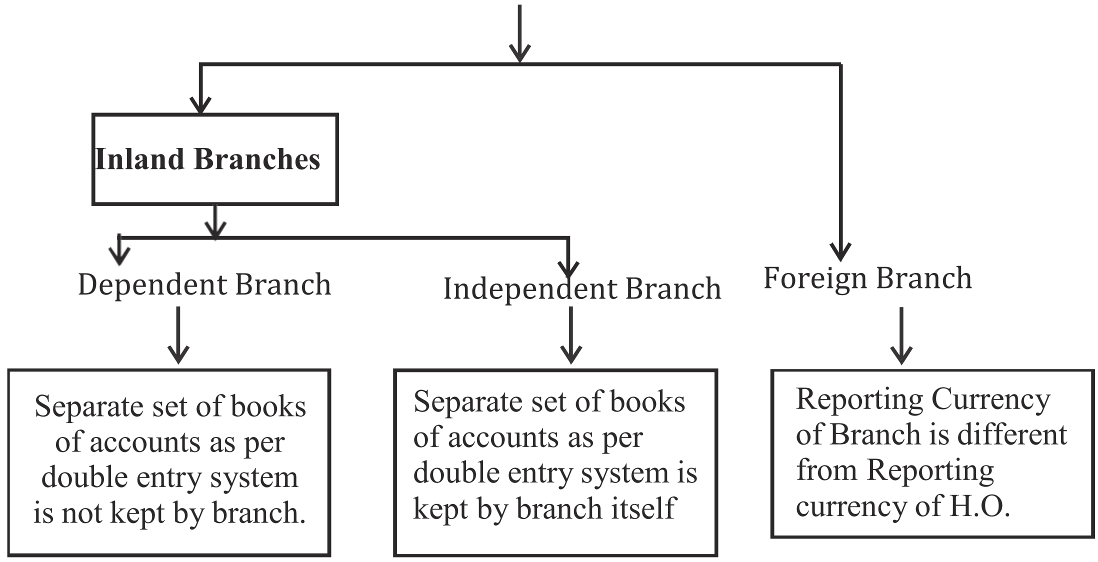
Chapter: 15

Accounting for Branches Including Foreign Branches

CONCEPT OF BRANCH ACCOUNTING

- Expansion of business by opening branches of the business geographically in different areas.
- Determination of Branch profits separately for each branch.
- Final result of the branch as a profit or loss and asset and liability of branch will be disclosed as a part of overall financial statement of the enterprise in the books of head-office.

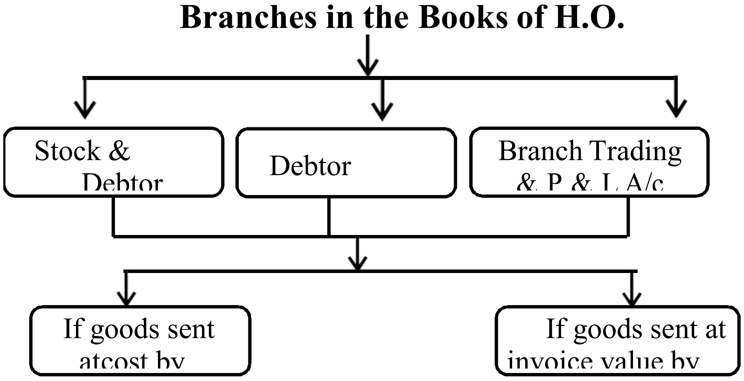
Classification of Branches



DEPENDENT BRANCH

- In case of dependent branch, branch itself does not maintain separate set of books of accounts ondouble entry system.
- Branch maintains the list of transactions in normal manner without using double entry system.
- Detail of transactions is sent to H.O. periodically.
- Transactions of Branch is recorded by H.O. in its books of accounts, therefore accounting of dependent branch will always in the books of head office by using following method:

Methods of Accounting of Dependent Branches in the Books of H.O.



TOPIC – 1 :

ACCOUNTING OF DEPENDENT BRANCH IN THE BOOKS OF H.O. BY 'STOCK AND DEBTOR' METHOD (IF GOODS ARE SENT AT COST)

- Each transaction will be posted into appropriate account according to Journal Entry of that transaction.
- Open different account as required by journal entries of the transactions e.g.
  (1) Branch Stock A/C
    - Disclose details of stock at cost except sale.
    - Disclose opening (Dr. Side) and closing balance (Cr. side) of stock.
    - Dr. Branch stock A/C whenever branch stock increases and Cr branch stock A/C whenever branch stock A/C is decreases.
- Final result will be G.P. and it is transferred to Branch P&L A/C
  (2) Branch Debtors A/C
  (3) Branch Cash A/C
  (4) Branch Petty Cash A/C
  (5) Branch Asset A/C
  (6) Branch Expense A/C
  - Dr. each time whenever branch incurred expenses.
  - Balance will transferred to Branch P&L A/C

(7) Branch P&L A/C
  - Final Balance will be Net Profit of Branch and it is transferred to General P&L A/C
  - The manner in which entries are recorded in the above method is shown below:

	Transaction	Account debited	Account credited
(a)	Cost of goods sent to the Branch	Branch Stock A/C	Goods sent to Branch A/C
(b)	Remittances for expenses	Branch Cash A/C	H.O. Cash A/c
(c)	Any assets (e.g. furniture) provided by H.O.	Branch Asset (Furniture) A/C	(i) (H.O.) Cash A/C or (ii) Creditors A/C (iii) (H.O.) Furniture A/C
(d)	Cost of goods returned by thebranch	Goods sent to Branch A/C	Branch Stock A/C
(e)	Cash Sales at the Branch	Branch Cash A/C	Branch Stock A/C
(f)	Credit Sales at the Branch	Branch Debtors A/C	Branch Stock A/C
(g)	Return of goods by debtors to the Branch	Branch Stock A/C	Branch Debtors A/C
(h)	Cash paid by debtors	Branch Cash A/C	Branch Debtors A/C
(i)	Discount & allowance to debtors, bad debts	Branch Expenses A/C	Branch Debtors A/C
(j)	Remittances to H.O.	(H.O.) Cash A/C	Branch Cash A/C
(k)	Expenses met by H.O.	Branch Expenses A/C	(H.O.) Cash A/C

NOTE: 1

- Goods sent to branch A/C is always prepared and its balance is transferred to Trading / Purchase A/C (It belongs to part of HO ledger)
- Alternative accounting treatments for recording expenses:
  - (a) Initially recording to Branch expense A/C and then transfer it to Branch P&L A/C.
  - (b) Initially recording to related expense A/C and then transfer to branch P&L A/C.
  - (c) Initially recording to related expense A/C then transfer to branch expense A/C and thereafter transfer of branch expenses to branch P & L A/C.

TOPIC: 2

ACCOUNTING OF DEPENDENT BRANCH IN THE BOOKS OF H.O. BY STOCK AND DEBTOR METHOD

(IF GOODS SENT BY H.O. TO BRANCH AT INVOICE VALUE)

- In this case, Branch stock A/C is prepared on invoice value basis.
- Profit element of Branch Stock A/C is reversed in Branch adjustment A/C except profit included in Sales.
- Branch adjustment A/C will reflect G.P. and it will be transferred to Branch P&L A/C.
- Concept of Branch stock A/C at Invoice value and Branch Adjustment A/C is almost similar to departments stock A/C with Markup A/C.
- Specific general entries will be as under:

NOTE 2:

Journal entries for Goods sent to Branch A/C

Option I

Branch Stock A/c Dr. (I.V.)
To Good Sent to Branch A/c (I.V.)
Goods sent to Branch A/c Dr. (Loading)
To Branch Adjustment A/c (Loading)

Option II

Branch Stock A/c Dr. (I.V.)
To Good Sent to Branch A/c (Cost) To
Branch Adjustment A/c (Loading)

NOTE: 3

Treatment of Stock Reserve

- Opening and Closing Stock includes profit element and it is known as opening and closing stock reserve.
- It will be treated as opening and closing balance of Branch Adjustment A/C.

OR

- If stock reserve is required in question then firstly it is disclosed as opening and closing balance of Stock Reserve A/C and thereafter it is transferred to Branch Adjustment A/C(separately or net basis).

NOTE: 4

Treatment of difference of Branch Stock A/C (after whole adjustment)

If deficiency in debit side exists

Possible reason is part of the stock has been sold out for valuemore than normal selling price (N.S.P.)

Entire balance is transferred
To Branch Adjustment A/c

Branch Stock A/c Dr.
To Branch Adjustment A/c

If deficiency in credit side exists

Possible reason

Option-I
Part of the stock is sold at a valueless than N.S.P. and entire difference is transferred to Branch adjustment A/C

Branch Adjustment A/c Dr.
To Branch Stock A/c

Option-II
Due to Shortage of Stock

Profit Element

Transferred to Branch Adjustment A/c

Cost

Transferred to Branch P & L A/c

TOPIC – 3:

ACCOUNTING OF DEPENDENT BRANCH IN THE BOOKS OF H.O. BY DEBTOR METHOD (IF GOODS ARE SENT TO BRANCH AT COST)

- In this method, H.O. will prepare only Branch A/C in order to calculate final profit of Branch.
- For the purpose of Branch A/C, Transactions of Branch is classified into three categories.

(A) Transactions effecting only H.O.:
- Journal Entry of transaction affect only ledger of H.O.
- e.g. Sale by HO, purchase by H.O. etc.
- Ignore it for the purpose of preparation of Branch A/C.

(B) Transactions effecting only Branch:
- Journal Entry of transaction includes ledgers of only branch.
- for e.g. –
  - (i) cash sales by branch
  - (ii) cash purchase by branch
  - (iii) Branch expenses paid by branch
  - (iv) Branch Debtors collected by branch
- Ignore it for the purpose of preparation of Branch A/C.

(C) Transactions affecting ledgers of H.O. and Branch both in a single entry:

- Those transactions which includes one A/C in relation to branch and other one in relation to H.O.
- Classified into two categories

↓

If H.O. giver and Branch is receiver	If H.O. receiver and branch is giver
↓	↓
(i) Goods sent to Branch	(i) Goods returned to H.O.
(ii) Cash remitted to Branch	(ii) Cash remitted to H.O.
(iii) Branch expense paid by H.O.	(iii) Branch debtor collected by H.O.
(iv) H.O. asset given to Branch	
↓	↓
Debited to Branch A/c	Credited to Branch A/c

- In addition to above, opening and closing balances of assets and liabilities of branch will be disclosed in Branch A/C.
- Final result of Branch A/C will be Net Profit and it will be transferred to General P&L A/C.
- Format of Branch A/c will be as under:

Branch A/C (By debtor method) in the book of H.O.

Particulars	(Rs.)	Particulars	(Rs.)
To Balance b/d(opening balances of branch assets)	xxx	By Balance b/d(opening balances of branch liabilities)	xxx
To Goods sent to Branch A/C	xxx	By Goods sent to Branch (Return)	xxx
To Cash A/C:		By Cash A/C	
- Remittance by H.O. to branch	xxx	(Remittance by Branch to HO)	xxx
- Branch expenses paid by HO	xxx	By Balance c/d	
- Branch creditor paid by HO	xxx	(Closing balances of branch assets)	xxx
- Branch purchase paid by H.O. etc.	xxx		
To N.P. of Branch transferred to General P&L A/C as **(B/F)**	xxx		
To Balance C/d (Closing balancesof branch liabilities)	xxx		
	xxx		xxx

NOTE 5:—

- Only those transactions will be disclosed in branch A/C which effect both parties i.e. H.O. and branch.
- In addition to branch A/C suitable working note will be prepared to determine different missing values required to disclose in branch A/C e.g. branch cash A/C and branch debtor A/C etc.

NOTE 6:

If H.O. sends goods at invoice price to branch then adjustment will be as under:

- o Disclose opening stock, closing stock, goods sent and goods returned at invoice price in Branch A/C.
- o Reverse the profit element of opening and closing stock as opening and closing stock reserve in Branch A/C.
- o Reverse the profit element in goods sent and return in branch A/C as loading (may be separately or net basis).
- o All other adjustment will be similar to if goods sent by H.O. to branch at cost.

TOPIC – 4:

ACCOUNTING OF DEPENDENT BRANCH IN THE BOOKS OF H.O. BY BRANCH TRADING AND P&L A/C METHOD (IF GOODS ARE SENT AT COST)

- Normal Trading and P&L A/C in relation to branch will be prepared in the books of H.O.
- Disclose all expenses and revenues relating to branch.
- Final balance as Branch Net profit from Branch P&L A/C will be transferred to General P&L A/C

NOTE 7:

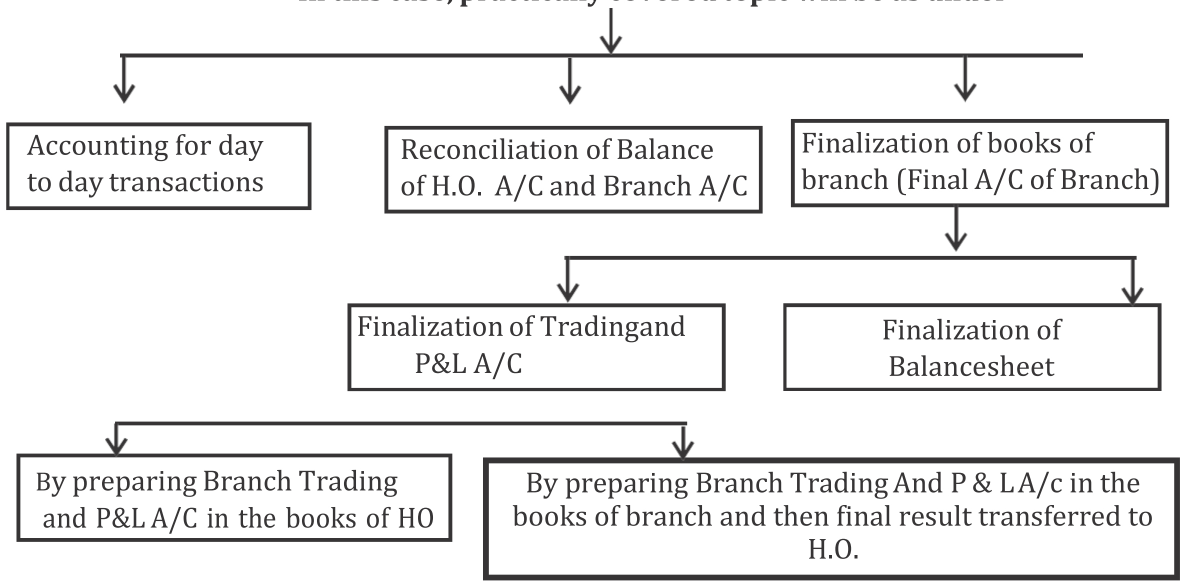
If H.O. sends goods at Invoice Value then convert at cost opening stock, closing stock, good sent and returned then disclose accordingly in the Branch Trading A/C.

TOPIC-5 :

INDEPENDENT BRANCH

- Branch will maintain separate set of books of accounts on the basis of double entry system.
- Therefore accounting will be in the books of H.O. and branch separately.
- In this case, practically covered topic will be as under

In this case, practically covered topic will be as under



TOPIC – 6:

ACCOUNTING FOR DAY TO DAY TRANSACTIONS IN CASE OF INDEPENDENT BRANCH

- Branch and H.O. will record transactions separately by treating them independent from each other.
- Transactions which affect only H.O. are recorded only by H.O. in normal manner.
- Transactions which affect only Branch will be recorded only by branch in normal manner.
- Transactions which affect both branch and H.O. (Mutual) will be recorded by H.O. and Branch separately.
- In order to record mutual transactions books of H.O. will open branch A/C and in books of branch H.O. A/C will be opened.

If Branch is received from H.O.
H.O. A/c is credited in branch books
And Branch A/c is debited In H.O's Books

If Branch is giver is from H.O.
H.O. A/c is debited in the books of branch and Branch of Branch and Branch A/c will be Credited in Books of H.O.

	Transaction	Head Office Books	Branch Books
1	Dispatch of goods tobranch by H.O.	Branch A/c Dr. To Good sent to Branch A/c	Goods Received from H.O. A/c Dr.To Head Office A/c
2	When goods are returnedby the branch to H.O.	Good sent to Branch A/c Dr.To Branch A/c	Head Office A/c Dr. To Goods received from H.O. A/c
3	Branch Expenses are paidby the Branch	No Entry	Expenses A/c Dr. To Bank or Cash A/c
4	Branch Expenses are paidby H.O.	Branch A/c Dr. To Bank or Cash	Expenses A/c Dr. To Head Office A/c
5.	Outside purchases madeby the Branch	No Entry	Purchases A/c Dr. To Bank (or) Creditors A/c
6.	Collection from Debtorsof the Branch reced. by H.O.	Bank A/c Dr. To Branch A/c	Head Office A/c Dr. To Sundry Debtors A/c
7.	Payment by H.O. forPurchases made by Branch	Branch A/c Dr. To Bank A/c	Purchases/Sundry Creditors A/c Dr.To Head Office
8.	Purchases of Assets byBranch	No Entry	Sundry Assets Dr.To Bank (or) Liability
9.	Assets purchased by theBranch but Assets A/c retained at H.O. books	Branch Assets A/c Dr. To Branch A/c	Head Office Dr. To Bank (or) Liability
10.	Depreciation on (9) above	Branch A/c Dr. To Branch	Depreciation A/c Dr.

		Asset	To Head Office A/c
11.	Remittence of funds by H.O. to Branch	Branch A/c Dr. To Bank A/c	Bank A/c Dr. To H.O. A/c
12.	Remittence of funds byBranch to H.O.	Bank A/c Dr. To Branch A/c	HO A/c Dr. To Bank A/c
13.	Sales by Branch	No Entry	Cash/Debtors A/c Dr. To Sales A/c

Special Adjustment of Inter Branch Transactions

- One Branch will not open A/C of other Branch in its books.
- For Inter Branch transactions from accounting point of view, there will be always intermediation of
  H.O. between two branches.
- Therefore, Inter Branch transactions will be divided into two parts and it is recorded in books of both branches as well as books of H.O.
- **For example -** cash remitted by Branch A to Branch B.

– Cash remitted by Branch A to H.O. (in books of branch A)
  H.O. A/C Dr.
  To Cash A/C

– Cash remitted by H.O. to Branch B (in books of branch B) Cash A/C Dr.
  To H.O. A/C

– Books of H.O.
  Branch B A/C Dr.
  To Branch A A/C

(3) Special Adjustment for fixed assets of Branch used by branch but record for that assets is maintained by H.O.

- In this case, instead of Related Asset A/C, recording is done in H.O. A/C in the books of branch.
- H.O. will record it in similar manner to dependent branch.

– Asset purchased by the Branch but Asset A/C is retained by H.O. books

- In the books of H.O.
  Branch Assets A/c Dr.
  To Branch A/c
- In the books of Branch:
  H.O. A/c Dr.
  To Cash or Creditors A/c
- Depreciation on such asset in books of H.O.
  Branch A/C Dr.
  To Branch Asset A/C
- In books of branch:
  Depreciation A/C Dr.
  To H.O. A/C.

TOPIC– 7:

RECONCILIATION OF BALANCE OF HO A/C IN BRANCH BOOK WITH BALANCE OF BRANCH A/C IN HO BOOKS

- Generally Balance of H.O. A/C will agree with Balance of Branch A/C at any point of time having opposite nature of balances.
- Sometimes it may be possible that balance of both accounts does not agree to each other.
- In such case, Reconciliation of balance of both A/C is needed.
- Reason of Reconciliation is as under:

(A) Difference due to transit item

- Sender has already passed the entry but receiver has not passed any entry up to the end of the year.
- **It will be adjusted in the books of recipient.**

Name of Transit Item	Books of H.O.	Books of Branch
I. Goods sent by H.O. not received by Branch	No Entry	Goods in Transit A/C Dr. To H.O.
II. Goods returned by Branch but notreceived by H.O.	GIT A/C Dr. To Branch	No Entry
III. Cash remitted by Branch to H.O.but not received by H.O.	Cash in Transit A/C Dr. To Branch	No Entry
IV. Cash remitted by H.O. to branchbut not received by Branch	No Entry	C.I.T. A/C Dr. To H.O. A/C

NOTE: 9

G.I.T. will be treated as a part of closing stock of the receiver and C.I.T. is treated as part of cash and cash equivalent of receiver.

(B) Difference due to error incurred in Accounting

– It is rectified by those books of accounts in which error has been incurred.

TOPIC - 8:

FINAL A/C OF BRANCH (FOR ITEMS RELATING TO TRADING AND P&L A/C)

- If Branch itself prepare Trading and P&L A/C and then final balance as Net Profit or Net Loss out of PL account is transferred to H.O. in order to merge it into general PL of HO.

Name of Transaction	In books of Branch	In Books of H.O.
(1) If Net Profit of Branch	P&L A/ Dr. To HO A/C	Branch A/C Dr. To P&L A/C
(2) If Net loss of Branch	H.O. A/C Dr. To P&L A/C	P&L A/C Dr. To Branch A/C

- Entire list of Revenue and expenditure A/C is transferred by Branch to H.O. and thereafter

H.O. will prepare Branch trading and P&LA/C in its books of accounts and then final result is transferred to General P&L A/C

TOPIC-9:

FINAL A/C OF INDEPENDENT BRANCH (FOR ITEMS OF B/S OF BRANCH)

- Assets and liabilities of Branch will be transferred to H.O. at the end of the year.
- H.O. will disclose Branch's assets and liabilities in its balance sheet.
- Transfer of asset and liability will be as under:

Name of Item	Branch books	H.O. Books
(1) For Assets	HO A/C Dr. To Asset A/C	Branch Assets A/C Dr. To Branch A/C
(2) For liabilities	Liabilities A/C Dr. To H.O. A/C	Branch A/C Dr. To Branch liabilities

NOTES:

10. After adjustment of Final A/C, Branch A/C in book of HO and HO A/C in books of branch will get automatically closed. Therefore in consolidated B/s, HO A/C and Branch A/C is not disclosed any- where.
    However if separate balance sheet is prepared for HO and Branch then balance of HO account is disclosed in liability side of balance sheet of branch and balance of branch account is disclosed in asset side of balance sheet of HO.
11. Reverse entry at the beginning of year will be passed for above table in order to incorporate Branch asset and liability in branch books.
12. Goods sent to Branch will not be disclosed in Total column of Trading and P&L A/C.
13. If HO sent goods to branch at invoice in case of independent branch then adjustment will be as under:
    - Calculate opening and closing stock reserve out of stock of branch that was earlier received from HO.
    - Disclose stock reserve to PL account of HO.
    - Credit opening stock reserve and debit closing stock reserve alternatively treatment may be on net basis.
    - Another treatment of stock reserve will be deduct closing stock reserve from the value of closing stock in the balance sheet.

TOPIC - 10: FOREIGN BRANCH

- If recording currency of Branch is different from 'recording currency' of H.O. then Branch shall be treated as 'foreign Branch' for H.O.
- Foreign Branch is classified into following to categories from accounting point of view.

Integral Foreign Operation (IFO)

– Objective Branches to extension business of H.O.
– Freedom of business is not given to branch
– Direct purchase by Branch is not allowed (Deals exclusively in Goods received from H.O.)

Non- Integral Foreign Operation (NIFO)

– Local purchases are allowed
– Local borrowings are allowed

– Local Borrowings by Branch is not allowed.

Practically topics covered by Foreign Branch

(1) Conversion of Branch's trail balance in H.O.'s currency (in the books of H.O.)

(2) Preparation of Branch Trading and P&L A/C and Balance Sheet in the books of H.O. after conversion.

Basis for conversion of Branch's Trial Balance into HO's currency. (Use of Foreign Exchange Rates)

Name of Ledger	If IFO	If NIFO
(1) Opening Stock	Opening Rate	Opening Rate
(2) Closing Stock	Closing Rate	Closing Rate
(3) Item of Revenue and Expenditure	Average Rate or actual rate on date of transaction	Average Rate or actual rate on date of transaction
(4) Monetary Item	Closing Rate	Closing Rate
(5) Fixed Assets and Depreciation on Fixed Assets	Rate existing on Date of purchase if not revalued or Rate on Date of Revaluation if revalued	Closing Rate
(6) Goods received from H.O.	As per value recorded by H.O.	As per value recorded by H.O.
(7) Balance of H.O. A/Cs	As per balance of Branch A/C in H.O. Book	As per balance of Branch A/C in HO's Books
(8) Other Transactions with H.O.	As per value recorded by H.O.	As per value recorded by H.O.
(9) Treatment of difference of converted Trial Balance	Treated as foreign exchange loss/gain and disclosed in Branch P&L A/C	Treated as foreign exchange translation reserve and it will disclosed in B/S.

Question & Answer

Question 1 —

Concept, with its Head Office at Mumbai has a branch at Nagpur. Goods are invoiced to the Branch at cost plus 33-1/3%. The following information is given in respect of the branch for the year ended 31st March, 2013:

	₹
Goods sent to Branch (invoice price)	4,80,000
Stock at Branch on 1.4.2012 (invoice price)	24,000
Cash sales	1,80,000
Return of goods by customers to the Branch	6,000
Branch expenses (paid in cash)	53,500
Branch debtors balance on 1.4.2012	30,000
Discount allowed	1,000
Bad debts	1,500
Collection from Debtors	2,70,000
Branch debtors cheques returned dishonoured	5,000
Stock at Branch on 31.3.2013 (Invoice price)	48,000
Branch debtors balance on 31.3.2013	36,500

Prepare, under the Stock and Debtors system, the following Ledger Accounts in the books of the Head Office:

(i) Nagpur Branch Stock Account

(ii) Nagpur Branch Debtors Account

(iii) Nagpur Branch Adjustment Account.

Also compute **shortage** of Stock at Branch, if any.

Answer—

In the books of head office

Nagpur Branch Stock Account

						₹
1.4.2012	To Balance b/d	24,000	31.3.13	By Bank A/c (Cash Sales)		1,80,000
31.3.2013	To Goods sent toBranch A/c	4,80,000		By Branch Debtors (CreditSales)		2,80,000
	To Branch Debtors	6,000		By Stock shortage :		
				Branch P & L A/c	1,500*	
				Branch Adjustment A/c(Loading)	500	2,000
				By Balance c/d		48,000
		5,10,000				5,10,000

Nagupur Branch Debtors Account

		₹			₹
1.4.2012	To Balance b/d	30,000	31.3.20-13	By Bank A/c (Collection)	2,70,000
31.3.2013	To Bank Ac/			By Branch Stock A/c	6,000
	(dishonour of cheques)	5,000		By Bad Debts	1,500

	To Branch Stock A/c	2,80,000*		By Discount Allowed	1,000
				By Balance c/d	36,500
		3,15,000			3,15,000

Nagupur Branch Adjustment Account

To Branch Stock A/c (loading of loss)	500*	By Stock Reserve A/c	6,000
To Stock Reserve	12,000	By Goods sent to Branch A/c	1,20,000
To Gross Profit c/d	1,13,500		
	1,26,000		**1,26,000**
To Branch Stock A/c (Cost of loss)	1,500	By Gross Profit b/d	1,13,500
To Branch Expenses	56,000		
To Net Profit (Transferred to General P& L A/c)	56,000		
	1,13,500		**1,13,500**

*Balancing figure.

Working Notes:

1. Loading is 33.33 % or Cost; i.e. 25% of invoice value]
   Loading on opening stock =₹24,000 25% = 6,000
2. Total Branch Expenses = Cash expenses + Bad debt + Discount allowed
   =₹ 53,500 +₹1,500 +₹1,000 =₹ 56,000
3. Gross Profit
   Total sales (at invoice price) - Goods returned by customers (at invoice price) × $\frac{33.33}{100+33.33}$
   {(1,80,000 + 2,80,000)– 6,000} × $\frac{33.33}{133.33}$ =₹1,13,500
4. Loading on goods sent = 4,80,000 25% = 1,20,000
   Loading on Closing Stock = 48,000 25% = 12,000

Question: 2 –

Red and White of Mumbai started a branch at Bangalore on 1.4.2012 to which goods were sent at 20% above cost. The branch makes both cash sales and credit sales. Branch expenses are met from branch cash and balance money remitted to H.O. The branch does not maintain double entry books of account and necessary accounts relating to branch are maintained in H.O. Following further details are given for the year ending on 31.3.2013:

	₹
Cost of goods sent to branch	1,00,000
Goods received by branch till 31.3.2013 at Invoice price	1,08,000
Credit sales for the year	1,16,000
Closing debtors on 31.3.2013	41,600
Bad debts written off during the year	400
Cash remitted to H.O.	86,000
Closing cash on hand at branch on 31.3.2013	4,000
Cash remitted by H.O. to branch during the year	6,000

Closing stock in hand at branch at invoice price	12,000
Expenses incurred at branch	24,000

Draw up the necessary Ledger Accounts like Branch Debtors Account, Branch Stock Account, Goods sent to Branch Account, Branch Cash Account, Branch Expenses Account and Branch Adjustment A/c for ascertaining gross profit and Branch Profit and Loss A/c for ascertaining Branch profit.

Answer—

Branch Debenture A/c

To Branch Stock A/c	1,16,000	By Branch Cash A/c (Balancing figure)	74,000
		By Bad Debts (Written off)	400
		By Balance c/d	41,600
	1,16,000		**1,16,000**

Goods Sent To Branch A/c

	₹		₹
To Branch Adjustment A/c $1,00,000 \times \frac{20}{100}$	20,000 1,20,000	By Branch Stock	1,20,000
To Purchases Trading A/c	1,00,000		
	1,20,000		**1,20,000**

Branch Cash A/c

	₹		₹
To Good set to Branch A/c	74,000	By Branch Expenses A/c	24,000
To H.O. A/c (cash remittance)	6,000	By H.O. (cash remittance)	86,000
To Branch Stock A/c		By Balance c/d	4,000
- Cash Sales (balancing figure)	34,000		
	1,14,000		**1,14,000**

Branch Expenses A/c

	₹		₹
To Branch A/c	24,000	By Branch P & L A/c	24,000

Branch Adjustment A/c

To Stock Reserve A/c	2,000	By Goods sent to Branch A/c	20,000
To Goods in transit Reserve A/c	2,000	By Branch Stock A/c	54,000
To Branch P & L A/c (Balancing figure)	70,000		
	74,000		**74,000**

Branch P & L A/c

	₹		₹
To Branch Expenses A/c	24,000	By Branch Adjustment A/c	70,000
To Bad Debts	400		
To Net Profit (transferred to General P & L A/c)	46,600		

	70,000	70,000

Working Notes:

1. Loading is 20% of cost i.e. 16.67% (1/6th) of invoice value.
   Loading on closing stock = 1/6th of ₹12,000 = ₹2,000.
2. Loading on goods sent to branch = 1/6th of ₹1,20,000 = ₹20,000.
3. Loading on goods in transit = 1/6th of ₹12,000 =₹2,000.

Question: 3

Neo with headquarters at Mumbai, maintains a branch at Goa. Goods are invoiced at cost plus 25%. In respect of Goa branch, the following information pertaining to the year ended 31st March, 2013 are made available to you:

		₹
Goods sent to Branch (at Invoice price)		6,75,000
Goods returned by branch during the year (at Invoice price)		24,000
Cash sales effected by branch		1,85,000
Discount allowed to customers		2,500
Amount received from branch debtors		3,25,000
Cheques of customers which got dishonoured		8,000
Branch expenses met in cash		72,500
Sales return at Goa branch		10,000
Bad debts		5,500
	On 31st March, 2013	**On 31st March, 2012**
Branch debtors	1,05,000	50,000
Stock at branch (at Invoice price)	2,36,000	1,50,000

Adopting the Stock and debtors system, you are required to prepare the following Ledger accounts, as appearing in the books of the Head Office:

(i) Goa branch debtors account;
(ii) Goa branch adjustment account;
(iii) Goa branch profit and loss account.

Answer—

In the books of Neo (Head Office)
Goa Branch Debtors Account

Date	Particulars	₹	Date	Particulars	₹
14.2012.	To Balance b/d	50,000	31.3.13	By Bank (Collection from debtors)	3.25.000
31.3.2013	To Bank A/c (Dishonor of Cheque)	8,000		By Branch Stock (Goods returned by Customers)	10,000
	To Branch Stock A/c (Credit Sales)	3,90,000		By Bad debts	5,500

				By Discount Allowed	2,500
				By Balance c/d	1,05,000
		4,48,000			4,48,000

Goa Branch Adjustment Account

Date	Particulars	₹	Date	Particulars	₹
31.3.2013	To Goods sent to Goa Branch A/c (goods returns toH.O.)	4,800	1.4.2012	By Balance b/d	30,000
	To Branch P & L A/c (Profiton sale at invoice price)	1,13,000	31.3.2013	By Goods sent to GoaBranch A/c (Loading)	1,35,000
	To Balance c/d (ClosingStock reserve)	47,200			
		1,65,000			1,65,000

Goa Branch Profit and Loss Account
for the year ending 31st March, 2013

Particulars	Amount ₹	Particulars	Amount ₹
To Branch Expenses A/c	72,500	By Branch Adjustment A/c	1,13,000
To Branch Debtors - Discount	2,500		
Bad Debts	5,500		
To Net Profit (Transferred to General Profit & Loss A/c)	32,500		
	1,13,000		**1,13,000**

Working Notes:

Goa Branch Stock Account

Particulars	₹	Date	Particulars	₹
To Branch Expenses A/c	1,50,000	31.3,13	By Bank (Cash Sales)	1,85,000
To Branch Debtors – Discount	6,75,000		By Branch Debtors (Credit sales)	3,90,000
Bad debts	10,000		By Goods sent to Goa Br. (Goods Returned to H.O)	24,000
	8,35,000		By Balance c/d	2,36,000
	8,35,000			**8,35,000**

Question: 4

Pawan, of Delhi has a branch at Jaipur. Goods are invoiced to the branch at cost plus 25%. The branch is instructed to deposit the receipts every day in the head office account with the bank. All the expenses are paid through cheque by the head office except petty cash expenses which are paid

by the Branch.
From the following information, you are required to prepare Branch Account in the books of Head office:

	₹
Stock at invoice price on 1.4.2012	1,64,000
Stock at invoice price on 31.3.2013	1,92,000
Debtors as on 1.4.2012	63,400
Debtors as on 31.3.2013	84,300
Furniture & fixtures as on 1.4.2012	46,800
Cash sales	8,02,600
Credit sales	7,44,200
Goods invoiced to branch by head office	12,56,000
Expenses paid by head office	2,64,000
Petty expenses paid by the branch	20,900
Furniture acquired by the branch on 1.10.2012 (payment was made by the branch from cash sales and collection from debtors)	5,000
Depreciation to be provided on branch furniture & fixtures @ 10% p.a. on WDV basis.	

Answer:

In the Books of Pawan Delhi (Head Office)
Jaipur Branch Account

			₹
To Opening balances:		By Branch stock reserve	32,800
Branch stock A/c	1,64,000	By Bank A/c (W.N. 4)	15,00,000
Branch debtors A/c	63,400	By Goods sent to branch A/c (Loading)	2,51,200
Branch Furniture A/c	46,800		
To Goods sent to branch	12,56,000	By Closing Balances:	
To Bank (Branch expenses)	2,64,000	Branch stock A/c	1,92,000
To Branch stock reserve A/c	38,400	Branch debtors A/c	84,300
To Profit and Loss A/c (Bal. Fig.)	2,74,570	Branch furniture A/c (W.N. 2)	46,870
	21,07,170		**21,07,170**

Working Notes:

1. Depreciation on Furniture

	₹
10% p.a. on 46,800	4,680
10% p.a. for 6 months on 5,000	250
	4,930

2. Closing Balance of Branch furniture as on 31.3.2013

	₹
Branch furniture as on 1.4.2012	46,800
Add: Acquired during the year	5,000
	51,800
Less: Depreciation (W.N. 10	4,930
Branch furniture as on 31.3.2013	46,870

3. Collection from branch debtors

Branch Debtors Account

To Balance b/d	63,400	By Bank A/c (Bal. Fig.)	7,23,300
To Sales	7,44,200	By Balacne c/d	84,300
	8,07,600		**8,07,600**

4. Cash remitted by the branch to head office

Cash sales + Collection from debtors - Petty expenses - Furniture acquired by branch
₹8,02,600 +₹7,23,300 (W.N. 3) –₹20,900 -₹5,000 =₹15,00,000

Question:5

Ram of Chennai has a branch at Nagpur to which office, goods are invoiced at cost plus 25%. The branch makes sales both for cash and on credit. Branch expenses are paid direct from Head Office and the branch has to remit all cash received into the Head Office Bank Account at Nagpur.
From the following details, relating to the year 2013, prepare the accounts in Head Office Ledger and ascertain Branch Profit as per stock and debtors method. Branch does not maintain any books of accounts, but sends weekly returns to head office:

Goods received from head office at invoice price		1,20,000
Returns to head office at invoice price		2,400
Stock at Nagpur branch on 1.1.2013 at invoice price		12,000
Sales during the year -	Cash	40,000
	Credit	72,000
Debtors at Nagpur branch as on 1.1.2013		14,400
Cash received from debtors		64,000
Discounts allowed to debtors		1,200
Bad debts during the year		800
Sales returns at Nagpur branch		1,600
Salaries and wages at branch		12,000
Rent, rates and taxes at branch		3,600
Office expenses at Nagpur branch		1,200
Stock at branch on 31.12.2013 at invoice price		24,000

Answer—

Nagpur Branch Stock Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	12,000	By Goods sent to branch A/c (Returns)	2,400
To Goods sent to Branch A/c	1,20,000	By Bank A/c (Cash sales)	40,000
To Branch debtors A/c	1,600	By Branch debotors (Credit sales)	72,000
To Branch adjustment A/c		By Balance c/d	24,000
(Surplus over invoice price)	4,800		
	1,38,400		1,38,400

Nagpur Branch Adjustment Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Branch Expenses A/c	16,800	By Branch Adjustment A/c (Gross Profit)	25,920
To Branch Debtors A/c (Discount)	1,200		
To Branch debtors A/c (Bad Debts)	800		
To Net profit (transferred to Profit & Loss A/c)	7,120		
	25920		**29,920**

Branch Expenses Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Bank A/c (Rent, rates & taxes)	3,600	By Branch profit and loss A/c (Transfer)	16,800
To Bank A/c (Salaries & Wages)	12,000		
To Bank A/c (Office Expenses)	1,200		
	16,800		16,800

Branch Debtors Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	14,400	By Bank A/c	64,000
To Branch Stock A/c	72,000	By Branch profit and loss A/c	2,000
		By Branch stock a/c (Sales returns)	1,600
		By Balance c/d (Bal. Fig.)	18,800
	86400		**86,400**

Goods Sent to Branch Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Branch stock A/c	2,400	By Branch Stock A/c	1,20,000
To Branch adjustment A/c	23.520		

To Purchases A/c	94,080		
	1,20,000		**1,20,000**

Question: 6 –

XYZ is having its Branch at Kolkata. Goods are invoiced to the branch at 20% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the Branch Manager. From the following particulars prepare branch account in the books of Head Office.

	₹		₹
Stock on 1st April 2011	30,000	Discount allowed to debtors	160
(Invoice price)		Expenses paid by head office:	
Sundry Debtors on 1st April, 2011	18,000	Rent	1,800
Cash in hand as on 1st April, 2011	800	Salary	3,200
Office furniture on 1st April, 2011	3,000	Stationery & Printing	800
Goods invoiced from the head		Petty expenses paid by the branch	600
office (invoice price)	1,60,000	Depreciation to be provided on branch	
Goods return to Head Office	2,000	furniture at 10% p.a.	
Goods return by debtors	960	(invoice price)	
Cash received from debtors	60,000		
Cash Sales	1,00,000	Stock on 31st March, 2012	
Credit sales	60,000	(at invoice price)	28,000

Answer—

In the books of Head Office - XYZ
Kolkata Branch Account (at invoice)

	₹		₹
To Balance b/d			
Stock	30,000	By Stock reserve (opening)	6,000
Debtors	18,000	By Remittances:	
Cash in hand	800	Cash Sales	1,00,000
Furniture	3,000	Cash from Debtors	60,000
To Goods sent to branch	1,60,000	By Goods sent to branch (loading)	32,000
To Goods returned by branch (loading)	400	By Goods returned by	
To Bank (expenses paid by H.O.)		Branch (Return to H.O.)	2,000
Rent	1,800	By Balance c/d	
Salary	3,200	Stock	28,000
Stationary & printing	800	Debtors	16,880
To Stock reserve (closing)	5,600	Cash (800–600)	200
To Profit transferred to		Furniture (3,000–300)	2,700
General Profit & Loss A/c	24,180		
	2,47,780		**2,47,780**

Working Note:

Debtors Account

	₹		₹
To Balance b/d	18,000	By Cash account	60,000
To Sales account (credit)	60,000	By Sales return account	260
		By Discount allowed account	160
		By Balance c/d	16,880
	78,000		**78,000**

Note: It is assumed that goods returned by branch are at invoice price.

Question: 7 -

Give Journal Entries in the books of Head Office to rectify or adjust the following:

(i) Goods sent to Branch ₹12,000 stolen during transit. Branch manager refused to accept any liability.

(ii) Branch paid₹15,000 as salary to the officer of Head Office on his visit to the branch.

(iii) On 28th March, 2012, the H.O. dispatched goods to the Branch invoiced at ₹25,000 which was not received by Branch till 31st March, 2012.

(iv) A remittance of ₹10,000 sent by the branch on 30th March, 2012, received by the Head Office on 1st April, 2012.

(v) Head Office made payment of₹25,000 for purchase of goods by Branch and wrongly debited its own purchase account.

Answer—

In the books of Head Office Journal Entries

	Particulars		Dr. (Amount) ₹	Cr. Amount ₹
(i)	Loss of goods due to theft during transit	Dr.	12,000	
	To Branch Account			
	(Being goods lost on account of theft during transit)			
(ii)	Salaries Account	Dr.	15,000	
	To Branch account			15,000
	(Being salary paid by the branch for H.O. Employee)			
(iii)	No entry in the books of head office for goods sent to branch not received by branch till 31st March 2012			
(iv)	Cash in transit account	Dr.	10,000	
	To Branch account			10,000
	(Being remittance by branch not received by 31st March, 2012)			
(v)	Branch Account	Dr.	25,000	

To Purchases account 25,000

(Being rectification of entry for payment for goods purchased)
by Branch wrongly debited to purchased account)

Note: -

In entry (i), it is assumed that refusal of branch manager (to accept liability of stolen goods) is accepted by the Head Office. Alternatively, Branch account will be credited on the basis of assumption that refusal of branch manager is not accepted by the Head Office.

Note: In entry (iii) the goods in transit entry will be passed in the Books of the Branch.

Question: 8 –

M/s. Sandeep, having Head Office at Delhi has a Branch at Kolkata. The Head Office does wholesale trade only at cost plus 80%. The Goods are sent to Branch at the wholesale price viz. cost plus 80%. The Branch at Kolkata wholly engaged in retail trade and the goods are sold at cost to Head Office plus 100%.

Following details are furnished for the year ended 31st March, 2014:

	Head Office (₹)	Kolkata Branch (₹)
Opening Stock (As on 01.04.2013	1,25,000	–
Purchases	21,50,000	–
Goods sent to Branch (Cost to H.O. plus 80%)	7,38,000	–
Sales	23,79,600	7,30,000
Office Expenses	50,000	4,500
Selling Expenses	32,000	3,300
Staff Salary	45,000	8,000

You are required to prepare Trading and Profit & Loss Account of the Head Office and Branch for the Year ended 31st March, 2014.

Answer:

Trading and Profit and Loss A/c
For the year ended 31St March, 2014

Particulars	H.O.	Branch	Particulars	H.O.	Branch
To Opening Stock	1,25,000	–	By Sales	23,79,600	7,30,000
To Purchases	21,50,000	–	By Goods sent to branch	7,38,000	-
To Goods received from H.O.	–	7,38,000	By Closing Stock (W.N. 1 & 2)	5,43,000	81,000
To Gross Profit c/d	13,85,600	73,000			
	36,60,600	8,11,000		36,60,600	8,11,000
To Office Expenses	50,000	4,500	By Gross Profit b/d	13,85,600	73,000

To Seling Expenses	32,000	3,300			
To Staff salaries	45,000	8,000			
To Branch Stock Reserve (W.N. 3)	36,000	–			
To Net Profit	12,22,600	57,200			
	13,85,600	73,000		13,85,600	73,000

Working Notes:

(1) Calculation of Closing Stock of head office ₹

	₹
Opening stock of head office	1,25,000
Goods purchased by head office	21,50,000
Less: Cost of goods sold [(31,17,600 (23,79,600 + 7,38,000) × 100/180]	(17,32,000)
	5,43,000

(2) Calculation of closing stock of branch:

	₹
Goods received from head office [At invoice value]	7,38,000
Less: Invoice value of goods sold [7,30,000 × 180/200]	6,57,000
	81,000

(3) Calculation of unrealized profit in branch stock:

Branch stock ₹81,000

Profit included 80% of cost

Hence, unrealized profit would be = ₹81,000 × 80/180 = ₹ 36,000

Question: 9 –

M/s Shah commenced business on 1.4.2012 with Head Office at Mumbai and a Branch at Chennai. Purchases were made exclusively by the Head Office, where the goods were processed before sale. There was no loss or wastage in processing.

Only the processed goods received from Head Office were handled by the Branch. The goods were sent to branch at processed cost plus 10%.

All sales, whether by Head Office or by the Branch, were at uniform gross profit of 25% on their respective cost.

Following is the Trial Balance as on 31.3.2013.

	Head Office		Branch	
	Dr.(₹)	Cr.(₹)	Dr.(₹)	Cr.(₹)
Capital		3,10,000		
Drawings	55,000			
Purchases	19,69,500			
Cost of Processing	50,500			
Sales		12,80,000		8,20,000

Goods sent to Branch		9,24,000		
Administrative expenses	1,39,000		15,000	
Selling expenses	50,000		6,200	
Debtors	3,09,600		1,13,600	
Branch Current account	3,89,800			
Creditors		6,01,400		10,800
Bank Balance	1,52,000		77,500	
Head Office Current account				2,61,500
Goods received from H.O.			8,80,000	
	31,15,400	31,15,400	10,92,300	10,92,300

Following further information is provided:

(i) Goods sent by Head Office to the Branch in March, 2013 of₹44,000 were not received by the Branch till 2.4.2013.

(ii) A remittance of₹84,300 sent by the Branch to Head Office was also similarly not received upto 31.3.2013.

(iii) Stock taking at the Branch disclosed a shortage of₹20,000 (at selling price to the branch).

(iv) Cost of unprocessed goods at Head Office on 31.3.2013 was₹1,00,000.

Prepare Trading and Profit and Loss account in columnar form and Balance Sheet of the business as a whole as at 31.3.2013

Answer—

In the Books of Shah

Trading and Profit and Loss Account for the year ended 31st March, 2013

Particulars	**H. O.**	**Branch**	**Total**	**Particulars**	**H.O.**	**Branch**	**Total**
	(₹)	(₹)	(₹)		(₹)	(₹)	(₹)
To Purchases	19,69,500	–	19,69,500	By Sales	12,80,000	8,20,000	21,00,000
To Cost of Processing	50,500	–	50,500	By Goods sent to Branch	9,24,000	–	–
To Goods received from H.O.	–	8,80,000	–	By Stock shortage	–	16,000	14545
To Gross Profit c/d	3,40,000	1,64,000	5,02,545	By Goods in transit			44,000
				By Closing Stock:			
				Processed goods	56,000	2,08,000	2,64,000
				Unprocessed goods	1,00,000	–	1,00,000

	23,60,000	10,44,000	25,22,545		23,60,000	10,44,000	25,22,545
To Admn. Exp.	1,39,000	15,000	1,54,000	By Gross Profit b/d	3,40,000	1,64,000	5,02,545
To Selling Exp.	50,000	6,200	56,200				
To Stock Shortage	–	16,000	14,545				
To Stock reserve	22,909	–	22,909				
To Net Profit	1,28,091	1,26,800	2,54,891				
	3,40,000	1,64,000	5,02,545		3,40,000	1,64,000	5,02,545

Balance Sheet as at 31st March 2013

Liabilities		₹	**Assets**		₹
Captial	3,10,000		Debtors		
Add; Net Profit	2,54,891		HO.		3,09,600
	5,64,891		Branch		1,13,600
Less: Drawings	(55,000)	5,09,891	Closing Stock:		
Creditors:			Processed goods		
H.O.	6,01,400		H.O.	56,000	
Branch	10,800	6,12,200	Branch	2,08,000	
				2,64,000	
			Less: Stock reserve	18,909	2,45,091
			Unprocessed goods		1,00,000
			Bank Balance		
			H.O.		1,52,000
			Branch		77,500
			Goods in transit	44,000	
			Less: Stock reserve	4,000	40,000
			Cash in transit		84,300
		11,22,091			11,22,091

Working Notes:

1. Calculation of closing stock:
Stock at Head office:

		₹
Cost of goods processed ₹(19,69,500 + 50,500 – 1,00,000)		
Less: Cost of goods sent to Branch		
$9{,}24{,}000 \times \frac{100}{125}$	8,40,000	
Cost of goods sold $12{,}80{,}000 \times \frac{100}{125}$	10,24,000	18,64,000

2. Stock Branch:

		₹
Goods received from H.O. (at invoice price)		8,80,000
Less: Invoice value of goods sold		
$8{,}20{,}000 \times \frac{100}{125}$	6,56,000	
Invoice value of stock shortage $20{,}000 \times \frac{100}{125}$	16,000	(6,72,000)
Stock at Branch at invoice price		2,08,000
Less: Stock Reserve $20{,}8000 \times \frac{10}{100}$		(18,909)
Stock of processed goods with Branch (at cost)		1,89,091

3. Stock Reserve :

	₹
Unrealised profit on Branch stock $\left(20{,}8000 \times \frac{10}{110}\right)$	18,909
Unrealised profit on goods in transit $\left(44{,}000 \times \frac{10}{110}\right)$	4,000
	22,909

Question: 10 –
On 31st March, 2012, the following ledger balances have been extracted from the books of Washington branch office of A Ltd whose Head Office is in Mumbai:

Ledger Accounts	$
Building	180
Stock as on 1.4.2011	26
Cash and Bank Balances	57
Purchases	96
Sales	110
Commission receipts	28
Debtors	46

Creditors	65

You are required to convert above Ledger balances into Indian Rupees. Use the following rates of exchange:

	₹ per $
Opening rate	46
Closing rate	50
Average rate	48
For fixed assets	42

Answer—

Conversion of ledger balances (in Dollars) into Rupees

	$	Rete Per $	Amount in ₹
Building 180	42	7,560	
Stock as on 01.04.2011	26	46	1,196
Cash and bank balances	57	50	2,850
Purchases	96	48	4,608
Sales	110	48	5,280
Commission receipts	28	48	1,344
Debtors	46	50	2,300
Creditors	65	50	3,250

Notes:

Unless otherwise stated, all Balance Sheet items will be valued at the specific opening or closing rates as applicable. All P&L Account balances will be valued at the average exchange rate as these trans- actions were settled at various applicable exchange rates during the year.

Question: 11 –

Omega has a branch at Washington. Its Trial Balance as at 30th September, 2012 is as follows:

	Dr.	Cr.
	US $	US $
Plant and machinery	1,20,000	-
Furniture and fixtures	8,000	-
Stock, Oct. 1, 2011	56,000	-
Purchases	2,40,000	-
Sales -		4,16,000
Goods from Omega (H.O.)	80,000	-
Wages	2,000	-
Carriage inward	1,000	-
Salaries	6,000	-
Rent, rates and taxes	2,000	-
Insurance	1,000	-
Trade expenses	1,000	-
Head Office A/c	-	1,14,000
Trade debtors	24,000	-

Trade creditors	-	17,000
Cash at bank	5,000	-
Cash in hand	1,000	-
	5,47,000	5,47,000

The following further information is given:

(1) Wages outstanding - $ 1,000.

(2) Depreciate Plant and Machinery and Furniture and Fixtures @ 10 % p.a.

(3) The Head Office sent goods to Branch for₹39,40,000.

(4) The Head Office shows an amount of₹43,00,000 due from Branch.

(5) Stock on 30th September, 2012 - $ 52,000.

(6) There were no in transit items either at the start or at the end of the year.

(7) On September 1, 2010, when the fixed assets were purchased, the rate of exchange was 38 to one $. On October 1, 2011, the rate was₹39 to one $.

On September 30, 2012, the rate was₹41 to one $. Average rate during the year was ₹40 to one $.

You are asked to prepare:

(a) Trial balance incorporating adjustments given under 1 to 4 above, converting dollars into rupees.

(b) Trading and Profit and Loss Account for the year ended 30th September, 2012 and Balance Sheet as on that date depicting the profitability and net position of the Branch as would appear in India for the purpose of incorporating in the main Balance Sheet.

Answer: -

(a) **In the books of Omega**

Washington Branch Trail Balance (In Rupees)

as on 30th September, 2022

	Dr. US $	Cr. US $	Conversion rate	Dr. ('000)	Cr. ('000)
Plant and Machinery	1,08,000		41	44,28,000	
Depreciation on plant and machinery	12,000		41	4,92,000	
Furniture and fixtures	7,200		41	2,95,200	
Depreciation on furniture and fixtures	800		41	32,800	
Stock, Oct. 1, 2011	56,000		39	21,84,000	
Purchases	2,40,000		40	96,00,000	
Sales		4,16,000	40		1,66,40,000
Goods from Omega (H.O.)	80,000			39,40,000	
Wages	3,000		40	1,20,000	
Outstanding wages		1,000	41		41,000
Carriage inward	1,000		40	40,000	
Salaries	6,000		40	2,40,000	
Rent, rates and taxes	2,000		40	80,000	
Insurance	1,000		40	40,000	
Trade expenses	1,000		40	40,000	

Head Office A/c		1,14,000			43,00,000
Trade debtors	24,000		41	9,84,000	
Trade creditors		17,000	41		6,97,000
Cash at bank	5,000		41	2,05,000	
Cash in hand	1,000		41	41,000	
Exchange gain (bal. fig.)					10,84,000
	5,48,000	5,48,000		2,27,62,000	2,27,62,000

(b) Washington Branch Trading and Profit and Loss Account for the year ended 30th September, 2012

	₹		₹
To Opening stock	21,84,000	By Sales	1,66,40,000
To Purchases	96,00,000	By Closing stock (52,000 US $ × 41)	21,32,000
To Goods from Head Office	39,40,000		
To Wages	1,20,000		
To Carriage inward	40,000		
To Gross profit c/d	28,88,000		
	1,87,72,000		**1,87,72,000**
To Salaries	2,40,000		28,88,000
To Rent, rates and taxes	80,000		
To Insurance	40,000		
To Trade expenses	40,000		
To Depreciation on plant and machinery	4,92,000		
To Depreciation on furniture and fixtures	32,800		
To Net Profit c/d	19,63,200		
	28,88,000		**28,88,000**

Balance Sheet of Washington Branch as on 30th September, 2012

Liabilities			Assets		
Head Office A/c	43,00,000		Plant and Machinery	49,20,000	
Add: Net Profit	19,63,200	62,63,200	Less: Depreciation	4,92,000	44,28,000
Foreign currency			Furniture & Fixture	3,28,000	
Trnalation reserve		10,84,000	Less: Depreciation	32,800	2,95,200
Trade creditors		6,97,000	Closing Stock		21.32.000
Outstanding wages		41,000	Trade debtors		9,84,000
			Cash in hand		41,000

			Cash at bank		2,05,000
		80,85,200			80,85,200

Note:

(1) Depreciation has been calculated at the given depreciation rate of 10% on WDV basis.

(2) The above solution has been given assuming that the Washington branch is a non-integral foreignoperation of the Omega.

Question: 12 –

Moon Star has a branch at Virginia (USA). The Branch is a non-integral foreign operation of the Moon Star. The trial balance of the Branch as at 31st March, 2012 is as follows:

Particulars	**Dr.**	**US $ Cr.**
Office equipment's	48,000	
Furniture and Fixtures	3,200	
Stock (April 1, 2011)	22,400	
Purchases	96,000	
Sales	---	1,66,400
Goods sent from H.O	32,000	
Salaries	3,200	
Carriage inward	400	
Rent, Rates & Taxes	800	
Insurance	400	
Trade Expenses	400	
Head Office Account	---	45,600
Sundry Debtors	9,600	
Sundry Creditors	---	6,800
Cash at Bank	2,000	
Cash in Hand	400	.
	2,18,800	2,18,800

The following further information's are given:

(1) Salaries outstanding $ 400.

(2) Depreciate office equipment and furniture & fixtures @10% p.a. at written down value.

(3) The Head Office sent goods to Branch for ₹15,80,000

(4) The Head Office shows an amount of ₹20,50,000 due from Branch.

(5) Stock on 31st March, 2012 -$21,500.

(6) There were no transit items either at the start or at the end of the year.

(7) On April 1, 2010 when the fixed assets were purchased the rate of exchange was ₹43 to one $. On April 1, 2011, the rate was 47 per $. On March 31, 2012 the rate was ₹50 per $. Average

rate during the year was 45 to one $.

Prepare:

(a) Trial balance incorporating adjustments given converting dollars into rupees.

(b) Trading, Profit and Loss Account for the year ended 31st March, 2012 and Balance Sheet as on date depicting the profitability and net position of the Branch as would appear in the books of Moon Star for the purpose of incorporating in the main Balance Sheet.

Answer: -

In the books of Moon Star
Trial Balance (in Rupees) of Virginia (USA)
Branch as on 31st March, 2012

	Dr.	Cr.	Conversion	Dr.	Cr.
	US$	US $	rate	₹	₹
Office Equipment	43,200		50	21,60,000	
Dep. on Office equip.	4,800		50	2,40,000	
Furniture & Fixtures	2,880		50	1,44,000	
Dep. on Furniture & Fixtures	320		50	16,000	
Stock (1st April, 2011)	22,400		47	10,52,800	
Purchases	96,000		45	43,20,000	
Sales		1,66,400	45		74,88,000
Goods sent from H.O.	32,000			15,80,000	
Carriage inward	400		45	18,000	
Salaries (3,200 + 400)	3,600		45	1,62,000	
Outstanding Salaries		400	50		20,000
Rent, rates and taxes	800		45	36,000	
Insurance	400		45	18,000	
Trade Expenses	400		45	18,000	
Head Office A/c		45,600			20,50,000
Trade debtors	9,600		50	4,80,000	
Trade Creditors		6,800	50		3,40,000
Cash at Bank	2,000		50	1,00,000	
Cash in hand	400		50	20,000	

Exchange gain (bal. fig.)					4,66,800
	2,19,200	2,19,200		1,03,64,800	1,03,64,800

(c) Trading and Profit and Loss Account of Virginia Branch for the year ended 31st Marc, 2012

	₹		₹
To Opening stock	10,52,800	By Sales	74,88,000
To Purchases	43,20,000	By Closing stock	10,75,000
To Goods from Head Office	15,80,000	(21,500 US $ × 50)	
To Carriage inward	18,000		
To Gross profit c/d	15,92,200		
	85,63,000		85,63,000
To Salaries	1,62,000	By Gross profit b/d	15,92,200
To Rent, rates and taxes	36,000		
To Insurance	18,000		
To Trade expenses	18,000		
To Depreciation on office equipment	2,40,000		
To Depreciation on furniture and fixtures	16,000		
To Net Profit c/d	11,02,200		
	15,92,200		15,92,200

Balance Sheet of Virginia Branch
As on 31st March 2012

Liabilities	₹	₹	Assets	₹	₹
Head Office A/c	20,50,000		Office Equipment	24,00,000	
Add : Net profit	11,02,200	31,52,200	Less : Depreciation	(2,40,000)	21,60,000
Foreign Currency Translation Reserve		4,66,800	Furniture and fixtures	1,60,000	
Trade creditors		3,40,000	Less : Depreciation	(16,000)	1,44,000
Outstanding salaries		20,000	Closing stock		10,75,000
			Trade debtors		4,80,000
			Cash in hand		20,000
			Cash at bank		1,00,000
		39,79,000			39,79,000

Question 13 -
DM Delhi has a branch in London which is an integral foreign operation of DM. At the end of the year 31st March, 2011, the branch furnishes the following trial balance in U.K. Pound:

Particulars	£ Dr.	£ Cr.
Fixed assets (Acquired on 1st April, 2007)	24,000	
Stock as on 1st April, 2010	11,200	
Goods from head Office	64,000	
Expenses	4,800	
Debtors	4,800	
Creditors		3,200
Cash at bank	1,200	
Head Office Account		22,800
Purchases	12,000	
Sales		96,000
	1,22,000	**1,22,000**

In head office books, the branch account stood as shown below:

London Branch A/c

Particulars	Amount ₹	Particulars	Amount ₹
To Balance B/d	20,10,000	By Bank A/c	52,16,000
To Goods sent to branch	49,26,000	By Balance C/d	17,20,000
	69,36,000		**69,36,000**

The following further information is given:

(a) Fixed assets are to be depreciated @ 10% p.a. on WDV.

(b) On 31st March, 2010:

Expenses outstanding	-	£ 400
Prepaid expenses	-	£ 200
Closing stock	-	£ 8,000

(c) Rate of Exchange:

1st April, 2007	-	70 to £ 1
st April, 2010	-	76 to £ 1
31st March, 2011	-	77 to £ 1
Average	-	75 to £ 1

You are required to prepare:

(1) Trial balance, incorporating adjustments of outstanding and prepaid expenses, converting

U.K. pound into Indian rupees.

(2) Trading and profit and loss account for the year ended 31st March, 2011 and the Balance Sheet as on that date of London branch as would appear in the books of Delhi head office of DM..

Answer: -

Trial Balance of London Branch as on 31st March, 2011

Particulars	U.K. Pound	Rate Per U.K. Pound	Dr. (₹)	Cr. (₹)
Fixed Assets	24,000	70	16,80,000	
Stock (as on 1st April, 2010)	11,200	76	8,51,200	
Goods from Head Office	64,000	-	49,26,000	
Sales	96,000	75		72,00,000
Purchases	12,000	75	9,00,000	
Expenses (4,800 + 400 - 200)	5,000	75	3,75,000	
Debtors	4,800	77	3,69,600	
Creditors	3,200	77		2,46,400
Outstanding Expenses	400	77		30,800
Prepaid expenses	200	77	15,400	
Cash at Bank	1,200	77	92,400	
Head office Account		–		17,20,000
Difference in Exchange				12,400
			92,09,600	92,09,600
Closing stock will be (8,000 × 77) =	₹6,16,00 0			

Trading and Profit & Loss A/c
for the year ended 31st March, 2011

Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Stock	8,51,200	By Sales	72,00,000
To Purchases	9,00,000	By Closing Stock	6,16,000
To Goods from H.O.	49,26,000		
To Gross Profit	11,38,800		
	78,16,000		78,16,000
To Expenses	3,75,000	By Gross Profit	11,38,800

To Depreciation	1,68,000	By Profit due to Exchange difference	12,400
To Net Profit	6,08,200		
	11,51,200		**11,51,200**

Balance Sheet as on 31st March, 2011

Liabilities			Assets		
Head office			Fixed Assets	16,80,000	
Balance	17,20,000		Less: Depreciation	(1,68,000)	15,12,000
Add: Net Profit	6,08,200	23,28,200	Debtors		3,69,600
Outstanding expenses		30,800	Cash at bank		92,400
Creditors		2,46,400	Prepaid expenses		15,400
			Closing stock		6,16,000
		26,05,400			**26,05,400**

Working Note:

Since London Branch is an integral foreign operation. Hence,

(1) Fixed assets (cost and depreciation) are translated using the exchange rate at the date of purchase of the assets.

(2) Exchange difference arising on translation of the financial statement is charged to Profit and Loss Account.

Question: 14

ABCD Ltd., Delhi has a branch in New York, USA, which is an integral foreign operation of the company. At the end of 31st March, 2013, the following ledger balances have been extracted from the books of the Delhi office and the New York Branch :

	Delhi (₹ thousand)		New York ($ thousands)	
	Debit	Credit	Debit	Credit
Share Capital		1,250		
Reserves and Surplus		940		
Land	475			
Building (cost)	1,000			
Buildings Depreciation Reserve		200		
Plant & Machinery (Cost)	2,000		100	
Plant & Machinery Dep. Reserve		500		20

Trade Receivables/Payables	500	270	60	20
Stock (01.04.2012)	250		25	
Branch Stock Reserve		65		
Cash & Bank Balances	125		4	
Purchases/Sales	275	600	25	125
Goods sent to Branch		1,500	30	
Managing Director's Salary	50			
Wages & Salary	100		18	
Rent			6	
Office Expenses	25		12	
Commission receipts		275		100
Branch/H.O. Current A/c	800			15
	5,600	5,600	280	280

The following information is also available:

(1) Stock as at 31-03-2013
Delhi - 2,00,000
New York - $ 10 (all stock received from Delhi)

(2) Head Office always sent goods to the Branch at cost plus 25%.

(3) Provision is to be made for doubtful debts at 5%.

(4) Depreciation is to be provided on Buildings at 10% and on Plant and Machinery at 20% on written down values.

You are required:

(a) To convert the branch Trial Balance into rupees, using the following rates of exchange: Exchange:

Opening rate	1 $ =	₹50
Closing rate	1 $ =	₹55
Average rate	1 $ =	₹52
For fixed assets	1 $ =	₹45

(b) To prepare the Trading and Profit & Loss Account for the year ended 31st March, 2013, showing to the extent possible, Head Office results and Branch results separately.

Answer:

ABCD Ltd.
New York Branch Trial Balance As on 31st March 2013

	$ thousand)			(₹ ' 000)	
	Debit	Credit	Conversion per $	Dr.	Cr.
Plant & Machinery (cost)	100		45	4,500	
Plant & Machinery Dep. Reserve		20	45		900
Trade receivable/payable	60	20	55	3,300	1,100
Stock (1.4.2012)	25		50	1,250	
Cash & Bank	4		55	220	
Purchases/Sales	25	125	52	1,300	6,500
Goods received from H.O.	30		Actual	1,500	
Wages & Salaries	18		52	936	
Rent	6		52	312	
Office Expenses	12		52	624	
Commission Receipts		100	52		5,200
H.O. Current A/c		15	Actual		800
				13,942	14,500
Exchange loss (bal. fig.)				558	
	280	280		14,500	14,500
Closing stock	0.010		55	0.55	

Trading and Profit & Loss Account
for the year ended 31st March, 2013

			(₹000)				(₹000)
Particulars	H.O.	Branch	Total ()	Particulars	H.O.	Branch	Total (₹)
To Opening Stock	250	1,250.00	1,500.00	By Sales	600	6,500.00	7100.00
To Purchases	275	1,300.00	1,575.00	By Goods sent to branch	1,500	–	1,500.00
To Goods received from H.O.	–	1,500.00	1,500.00	By Closing Stock	200	0.55	200.55
To Wages & Salaries	100	936.00	1,036.00				
To Gross Profit c/d	1,675	1514.55	3,189.55				
	2,300	**6,500.55**	**8,800.55**		**2,300**	**6,500.55**	**8,800.55**
To Rent	–	312.00	312.00	By Gross Profit b/d	1,675	1514.55	3189.555
To Office expenses	25	624.00	649.00	By Commission Receipts	275	5,200.00	5475.00
To Provision for doubtul debts @ 5%	25	165.00	190.00				
To Depreciation (W.N. 1)	380	720.00	1,100.00				
To Balance c/d	1,520	4,893.55	6,413.55				
	1,950	**6,714.55**	**8,664.55**		**1,950**	**6,714.55**	**8664.55**
To Exchange loss			558.00	By Balance b/d			6,413.55
To Managing Director's Salary			50.00	By Branch Stock Reserve (W.N. 2)			64.89
To Balance c/d			5870.44				
			6,478.44				**6,478.44**

Working Notes:

(1) Calculation of Depreciation -

	H.O.	₹' 000	Branch	₹200
Building – Cost		1,000		
Less: Dep. Reserve		(200)		
		800		
Depreciation @ 10% (A)		80		
Plant & Machinery		2,000		4,500
Less: Dep. Reserve		(500)		(900)
		1,500		3,600
Depreciation @ 20% (B)		300		720
Total Depreciation (A + B)		380		720

(2) Calculation of Additional Branch Stock Reserve

	(₹000)
Closing stock of Branch	0.55
Reserve on closing stock (0.55 × 1/5)	0.11
Less: Branch Stock Reserve (as on 1.4.2012)	(65)
Reversal of Stock Reserve	(64.89)

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