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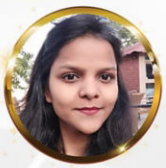
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Chapter 1
Introduction to Accounting Standards

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
StudyMat.	Q.3 to Q.11											
Past Exams	NO	Q.1	NO	NO	NO	NO	NO	NO	NO	Q.2	NO	NO
MTP	NO	NO	NO	NO	NO	NO	NO	Q.1	NO	NO	Q.1	NO
RTP	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO

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Chapter 1
Introduction to Accounting Standards

Question 1

"Accounting Standards standardize diverse accounting policies with a view to eliminate the non- comparability of financial statements and improve the reliability of financial statements." Discuss and explain the benefits of Accounting Standards. (MTP 5 Marks, Nov '21 & April '23) (PYP 5 Marks Nov'18,)

Answer 1

Accounting Standards standardize diverse accounting policies with a view to eliminate the non- comparability of financial statements and improve the reliability of financial statements. Accounting Standards provide a set of standard accounting policies, valuation norms and disclosure requirements. Accounting standards aim at improving the quality of financial reporting by promoting comparability, consistency and transparency, in the interests of users of financial statements. The following are the benefits of Accounting Standards:

(i) **Standardization of alternative accounting treatments:** Accounting Standards reduce to a reasonable extent confusing variations in the accounting treatment followed for the purpose of preparation of financial statements.

(ii) **Requirements for additional disclosures:** There are certain areas where important is not statutorily required to be disclosed. Standards may call for disclosure beyond that required bylaw.

(iii) **Comparability of financial statements:** The application of accounting standards would facilitate comparison of financial statements of different companies situated in India and facilitate comparison, to a limited extent, of financial statements of companies situated in different partsof the world. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in Accounting Standards adopted in different countries.

Question 2

Explain the objective of 'Accounting Standards' in brief. State the advantages of setting Accounting Standards. (PYP 4 Marks Nov '22, Old & New SM)

Answer 2

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 bydifferent companies in India.

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

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

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The main advantages of setting accounting standards are as follows:

a. Accounting Standards make the financial statements of different companies comparable whichhelps investors in decision making.

b. Accounting Standards prevent any misleading accounting treatment.

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

Question 3

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

a. Central Govt	b. State Govt.
c. Institute of Chartered Accountants of India.	d. MCA

Ans: (C)

Question 4

Accounting Standards

a. Harmonies accounting policies and eliminate the non-comparability of financial statements.	b. Improve the reliability of financial statements.
c. Both (a) and (b).	d. Manipulate the data for the management.

Ans: (C)

Question 5

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

a. Transparency	b. Consistency.
c. Comparability	d. All the above

Ans: (d)

Question 6

Which committee is responsible for approval of accounting standards and their modification for thepurpose of applicability to companies?

a. NFRA.	b. MCA.
c. Central Government Advisory Committee.	d. IASB

Ans: (b)

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Question 7

Global Standards facilitate

a. Cross border flow of money.	b. Comparability of financial statements
c. Uniformity and Transparency of financialstatements	d. All the three

Ans: (d)

Theoretical Question and Answer

Question 8

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

Answer 8

Accounting Standards are the written policy documents issued by Government relating to various aspectsof 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 differentcompanies 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 helpsinvestors in decision making.

b. Accounting Standards prevent any misleading accounting treatment.

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

Question 9

Briefly explain the process of issuance of Indian Accounting Standards.

Answer 9

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.

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Ind AS are issued by the Central Government of India under the supervision and control of ASB of ICAI andin consultation with NFRA. NFRA recommends these standards to the MCA and MCA has to spell out the accounting standards applicable for companies in India.

Question 10

Explain the significance of emergence of IFRS as Global Standards.

Answer 10

Global Standards facilitate cross border flow of money, global listing in different bourses and comparability of financial statements. Global Standards improve 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 11

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

Answer 11

Certain changes have been made in Ind AS considering the economic environment of the country, whichis 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 arein deviation to the accounting principles and practices stated in IFRS, are commonly known as 'Carve- outs'. Additional guidance given in Ind AS over and above what is given in IFRS, is termed as 'Carve in'.

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Chapter 2

Framework for Preparation and Presentation of Financial Statements

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.23 TO Q.34											
Past Exams	Q.15	Q.2	Q.16	NO	NO	Q.16,Q.17	Q.10, Q.18 Q.19 Q. 20	NO	NO	Q.21	Q.22	NO
MTP	Q.2,Q.5	Q.5	Q.1 Q.4 Q.5	NO	Q.6	NO	Q.1,Q.9	Q.6	Q.3,Q.4	Q.7,Q.8	Q.9,Q.12	Q.1,Q.7 Q.19
RTP	Q.15	Q.1	Q.12, Q.14	NO	Q.13	Q.12	Q.11	Q.10	Q.16	Q.16	Q.13	Q.13

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Chapter 2

Framework for Preparation and Presentation of Financial Statements

Question 1

Explain in brief, the alternative measurement bases, for determining the value at which an element canbe recognized in the Balance Sheet or Statement of Profit and Loss. [MTP 5 Marks March '19 & April '19 , March '21 ,Oct '23] (RTP Nov 18)

Answer 1

The Framework for Recognition and Presentation of Financial statements recognizes four alternative measurement bases for the purpose of determining the value at which an element can be recognized in the balance sheet or statement of profit and loss. These bases are: (i)Historical Cost; (ii)Current cost (iii) Realizable (Settlement) Value and (iv) Present Value.

A brief explanation of each measurement basis is as follows:

1. **Historical Cost**: Historical cost means acquisition price. According to this, assets are recorded at an amount of cash or cash equivalent paid or the fair value of the asset at the time of acquisition. Liabilities are generally recorded at the amount of proceeds received in exchange for the obligation.
2. **Current Cost**: Current cost gives an alternative measurement basis. 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 acquiredcurrently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
3. **Realizable (Settlement) Value**: As per realizable value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in an orderly disposal. Liabilities are carried at their settlement values; i.e. the undiscounted amount of cash or cash equivalents paid to satisfy the liabilities in the normal course of business.
4. **Present Value**: Under present value convention, assets are carried at present value of future net cash flows generated by the concerned assets in the normal course of business. Liabilities under this convention are carried at present value of future net cash flows that are expected to be required to settle the liability in the normal course of business.

Question 2

"One of the characteristics of financial statements is neutrality"- Do you agree with this statement? Comment. [MTP March '18, 5 Marks, PYP Nov '18 5 Marks, Old & New SM)

Answer 2

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 thereby arriving at a totally different conclusion on the business results.

For example, if the assets of a company primarily consist of trade receivables and insurance claims and

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the financial statements do not specify that the insurance claims have been lying unrealized for a number of years or that a few key trade receivables 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.

Question 3

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

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

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

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

(4) Mr. A withdrew Rs. 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. (MTP 5 Marks April 21, April 22, Old & New SM)

Answer 3

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

Transactions		Assets Rs. lakh	-	Liabilities Rs. lakh	=	Equity Rs. 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 4

State under which head the following accounts should be classified in Balance Sheet, as per Schedule IIIof the Companies Act, 2013:

(i) Share application money received in excess of issued share capital.

(ii) Share option outstanding account.

(iii) Unpaid matured debenture and interest accrued thereon.

(iv) Uncalled liability on shares and other partly paid investments.

(v) Calls unpaid.

(vi) Intangible Assets under development.

(vii) Money received against share warrant.

(viii) Cash equivalents. (MTP 4 Marks, Mar'22, 5 Marks, April'19)

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Answer 4

(i) Current Liabilities/Other Current Liabilities

(ii) Shareholders' Fund / Reserve & Surplus

(iii) Current liabilities/Other Current Liabilities

(iv) Contingent Liabilities and Commitments

(v) Shareholders' Fund / Share Capital

(vi) Property, Plant & Equipment

(vii) Shareholders' Fund/Money received against share warrants

(viii) Current Assets

Question 5

How will a company classify its investment in preference shares, which are convertible into equityshares within one year from the balance sheet date? Will it classify the investment as a current asset or a non-current asset? Explain. (MTP 5 Marks, March'19, Oct'18, Aug'18, Mar'18)

Answer 5

In accordance with the Schedule III, an investment realizable within 12 months from the reporting date is classified as a current asset. Such realisation should be in the form of cash or cash equivalents, rather than through conversion of one asset into another non-current asset. Hence, company must classify such an investment as a non-current asset, unless it expects to sell the preference shares or the equity shares on conversion and realise cash within 12 months.

Question 6

M/s Shyam, a proprietorship firm runs a business of stationary items. It provides you the following information relating to assets and liabilities:

Assets & Liabilities	As on 01.04.2019	As on 31.03.2020
Creditors	20,000	15,000
Outstanding Expenses	600	800
Property, Plant & Equipment	12,000	13,000
Stock	10,000	12,000
Cash in hand	7,500	2,000
Cash at Bank	2,500	10,000
Debtors	?	18,000

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Details of the year's transactions are as follows:

(1)	Discounts allowed to Debtor	4,000
(2)	Returns from debtors	1,450
(3)	Bad debts	500
(4)	Total sales (Cash and Credit)	72,000
(5)	Discount allowed by creditors	700
(6)	Returns to creditors	400
(7)	Receipts from debtors paid into Bank	76,000
(8)	Cash purchases	1,000
(9)	Expenses paid by cash	9,000
(10)	Drawings by cheque	500
(11)	Purchase of Property, Plant & Equipment by cheque	4,000
(12)	Cash deposited into bank	5,000
(13)	Cash withdrawn from bank	9,000
(14)	Payments to creditors by cheque	60,000

No Property, Plant & Equipment were sold during the year. Any difference in cash account to be considered as cash sales. You are required to prepare Trading and Profit & Loss Account for the year ended 31.03.2020 and the Balance Sheet as at 31.03.2020 from the given information. (MTP 16 Marks, Oct '21, May'20)

Answer 6

In the books of M/s Shyam Trading and Profit and Loss Account for the year ended 31st March, 2020

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		10,000	By Sales:		
To Purchases:			Cash	500	
Cash	1,000		Credit	71,500	
Credit (W.N. 3)	56,100		Less: Returns	-1450	70,550
	57,100		By Closing Stock		12,000
Less: Returns	400	56,700			
To Gross Profit c/d		15,850			
		82,550			82,550
To Discount allowed		4,000	By Gross profit b/d		15,850
To Bad Debts		500	By Discount received		700

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To General expenses (W.N. 5)		9,200	By Net Loss (balancing fig.)		150
To Depreciation (W.N. 4)		3,000			
		16,700			**16,700**

Balance Sheet as at 31st March, 2020

Liabilities		₹	Assets		₹
Capital (W.N. 1)	39,850		Property, Plant & Equipment	12,000	
Less: Net loss	150		Add: New asset	4,000	
	39,700			16,000	
Less: Drawings	500	39,200	Less: Depreciation	3,000	13,000
Sundry creditors		15,000	Stock in trade		12,000
Expensesoutstanding		800	Sundry debtors (W.N. 2)		18,000
			Cash in hand		2,000
			Cash in Bank		10,000
		55,000			**55,000**

Working Notes:

(1) Ascertainment of Opening Capital - Statement of Affairs as at 1.4.19

Liabilities	₹	Assets	₹
Sundry creditors	20,000	Property, Plant & Equipment	12,000
Outstanding expenses	600	Stock	10,000
Prasad's Capital		Debtors	28,450
(Balancing figure)	39,850	Cash in hand	7,500
		Cash at Bank	2,500
	60,450		**60,450**

2. Sundry Debtors Account

	₹		₹
To Balance b/d (bal. fig)	28,450	By Cash	76,000
To Sales (72,000 – 500)	71,500	By Discount	4,000
		By Returns (sales)	1,450
		By Bad debts	500

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		By Balance c/d (given)	18,000
	99,950		**99,950**

3. Sundry Creditors Account

	₹		₹
To Bank – Payments	60,000	By Balance b/d	20,000
To Discount	700	By Purchases - credit	56,100
To Returns	400	By (Balancing figure)	
To Balance c/d (closing balance)	15,000		
	76,100		**76,100**

4. Depreciation on Property, Plant & Equipment

	₹
Opening balance of Property, Plant & Equipment	12,000
Add: Additions	4,000
	16,000
Less: Closing balance of Property, Plant & Equipment	(13,000)
Depreciation	3,000

5. Expenses to be shown in profit and loss account

Expenses (in cash)	9,000
Add: Outstanding of 2020	800
	9,800
Less: Outstanding of 2019	600
	9,200

6. Cash and Bank Account

Particulars	Cash	Bank		Cash	Bank
	₹	₹		₹	₹
To balance b/d	7,500	2,500	By Purchases	1,000	-
To debtors	-	76,000	By Expenses	9,000	
To Banks E11 (c)	9,000	-	By Property, Plant & Equipment		4,000
To Cash (c)	-	5,000	By Drawings		500

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To sales (balancing as cash sales)	500	-	By Creditors		60,000
			By Cash (C)		9,000
			By Bank (C)	5,000	
			By Balance c/d	2,000	10,000
	17,000	83,500		17,000	83,500

Question 7

The following extract of Balance Sheet of Ram Ltd. (a non-investment company) was obtained:Balance Sheet (Extract) as on 31st March ,2022

Liabilities	₹
Issued and subscribed capital:	
20,000, 14% Preference shares of ₹ 100 each fully paid	**20,00,000**
1,20,000 Equity shares of ₹ 100 each, ₹ 80 paid-up	**96,00,000**
Capital reserves (₹ 1,50,000 is revaluation reserve)	**1,95,000**
Securities premium	**50,000**
15% Debentures	**65,00,000**
Unsecured loans: Public deposits repayable after one year	**3,70,000**
Investment in shares, debentures, etc.	**75,00,000**
Profit and Loss account (debit balance)	**15,00,000**

You are required to compute Effective Capital as per the provisions of Schedule V to Companies Act, 2013.(MTP 5 Marks, Sep 22 & Oct '23)

Answer 7

Computation of Effective capital

	₹
Paid-up share capital-	
20,000, 14% Preference shares	20,00,000
1,20,000 Equity shares	96,00,000
Capital reserves (excluding revaluation reserve)	45,000
Securities premium	50,000
15% Debentures	65,00,000
Public Deposits	3,70,000
(A)	1,85,65,000
Investments	75,00,000
Profit and Loss account (Dr. balance)	15,00,000

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(B)	90,00,000
Effective capital (A–B)	95,65,000

Question 8

Futura Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 2022:

Amount ₹ in lakhs

Securities Premium Account	**80**
Capital Reserve	**60**
General Reserve	**90**

The company had an accumulated loss of ₹ 250 lakhs on the same date, which it has disclosed under the head "Statement of Profit and Loss" as asset in its Balance Sheet. Comment on accuracy of this treatment in line with Schedule III to the Companies Act, 2013. (MTP 4 Marks Oct '22)

Answer 8

Schedule III to the Companies Act, 2013 provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative. In this case, the debit balance of profit and loss i.e. ₹ 250 lakhs exceeds the total of all the reserves i.e. ₹ 230 lakhs. Therefore, balance of 'Reserves and Surplus' after adjusting debit balance of profit and loss is negative by ₹ 20 lakhs, which should be disclosed on the face of the balance sheet. Thus the treatment done by the company is incorrect.

Question 9

The following is the Balance Sheet of Manish and Suresh as on 1 st April, 2021:

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

They give you the following additional **information:**

(i) **Creditors' Velocity 1.5 month & Debtors' Velocity 2 months. Here velocity indicates the no. of timesthe creditors and debtors are turned over a year.**

(ii) **Stock level is maintained uniformly in value throughout all over the year.**

(iii) **Depreciation on machinery is charged @ 10%, Depreciation on building @ 5% in the current year.**

(iv) **Cost price will go up 15% as compared to last year and also sales in the current year will increase by 25% in volume.**

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(v) **Rate of gross profit remains the same.**

(vi) **Business Expenditures are ₹ 50,000 for the year. All expenditures are paid off in cash.**

(vii) **Closing stock is to be valued on LIFO Basis.**

All sales and purchases are on credit basis and there are no cash purchases and **sales.**

You are required to prepare Trading, Profit and Loss Account, Trade Debtors Account and Trade CreditorsAccount for the year ending 31.03.2022.

(MTP 16 Marks April 23 & Nov '21)

Answer 9

Trading and Profit and Loss account for the year ending 31st March, 2022

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

Trade Debtors Account

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

Trade Creditors Account

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

Working Note:

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

Question 10

What is meant by 'Measurement'? What are the bases of measurement of Elements of Financial Statements? Explain in brief. (RTP Nov 21, PYP 5 Marks Dec '21)

Answer 10

Measurement is the process of determining money value at which an element can be recognized in the balance sheet or statement of profit and loss. The framework recognizes four alternative measurement bases for the purpose. These bases can be explained as:

Historical cost	This is the Acquisition price. According to this, assets are recorded at an amount of cash and cash equivalent paid or the fair value of the assetsat time of acquisition.
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.
Realizable (Settlement) Value	For assets, amount currently realizable on sale of the asset in an orderly disposal. For liabilities, this is the undiscounted amount expected to bepaid on settlement of liability in the normal course of business.

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Present Value	Assets are carried at present value of future net cash flows generated bythe concerned assets in the normal course of business. Liabilities are carried at present value of future net cash flows that are expected to berequired to settle the liability in the normal course of business.

In preparation of financial statements, all or any of the measurement basis can be used in varying combinations to assign money values to financial items.

Question 11

(a) With regard to financial statements, name any five qualitative characteristics and elements. (RTP May'21)

(b) Aman started a business on 1st April 2020 with Rs. 24,00,000 represented by 1,20,000 units of Rs. 20 each.During the financial year ending on 31st March, 2021, he sold the entire stock for Rs. 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Aman in the year 2020-21 if Financial Capital is maintained at historical cost. (RTP May'21, Nov'19) (Same concept different figures Old & New SM, RTP Nov'18)

Answer 11

(a)

(i) Qualitative Characteristics of Financial Statements: Understandability, Relevance, Comparability, Reliability& Faithful Representation

(ii) Elements of Financial Statements:

Asset, Liability, Equity, Income/Gain and Expense/Loss

(b)

Particulars	Financial Capital Maintenance at Historical Cost (Rs.)
Closing equity (Rs. 30 x 1,20,000 units)	36,00,000 represented by cash
Opening equity	1,20,000 units x Rs. 20 = 24,00,000
Permissible drawings to keep Capital intact	12,00,000 (36,00,000 – 24,00,000)

Question 12

With regard to financial statements name any four.

(i) Users

(ii) Qualitative characteristics

(iii) Elements (RTP Nov 20, RTP May 19, MTP 5 Marks Mar'23)

Answer 12

(i) Users of financial statements:

Investors, Employees, Lenders, Supplies/Creditors, Customers, Government & Public

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(ii) **Qualitative Characteristics of Financial Statements:**

Understandability, Relevance, Comparability, Reliability & Faithful Representation

(iii) **Elements of Financial Statements:**

Asset, Liability, Equity, Income/Gain and Expense/Loss

Question 13

A Ltd. has entered into a binding agreement with Gamma Ltd. to buy a custom-made machine Rs.1,00,000. 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.

You are required to advise the accounting treatment and give necessary journal entry in the year 20X1-X2.(RTP May'20, May'23 & Nov '23)

Answer 13

A liability is recognized 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 recognize a liability of Rs.1,00,000 to Gamma 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 recognized as an expense.

Journal entry

Loss on change in production method	Dr.	1,00,000	
To Gamma Ltd.			1,00,000
(Loss due to change in production method)			
Profit and loss A/c	Dr.	1,00,000	
To Loss on change in production method			1,00,000
(Loss transferred to profit and loss account)			

Question 14

What are fundamental accounting assumptions? (RTP May 19)

Answer 14

Fundamental Accounting Assumptions: Accrual, Going Concern and Consistency

Question 15

Explain main elements of Financial Statements. (RTP May 18) (PYP5 Marks May '18)

Answer 15

Elements of Financial Statements

The Framework for preparation and Presentation of financial statements classifies items of financial

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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, thesettlement 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 ofinflows or enhancement of assets or decreases in liabilities that result in increase in equity other than those relating to contributions from equityparticipants
Expense/loss	Decrease in economic benefits during the accounting period in the formof outflows or depletions of assets or incurrence of liabilities that result in decrease in equity other than those relating to distributions to equityparticipants.

Question 16

Summarised Balance Sheet of Cloth Trader as on 31.03.2021 is given below:

Equity & Liabilities	Amount (₹)	Assets	Amount (₹)
Proprietor's Capital	**3,00,000**	**Property, plant and equipment**	**3,60,000**
Profit & Loss Account	**1,25,000**	**Closing Inventory**	**1,50,000**
10% Loan Account	**2,10,000**	**Trade receivables**	**1,00,000**
Trade payables	**50,000**	**Deferred Expenses**	**50,000**
		Cash & Bank	**25,000**
	6,85,000		**6,85,000**

Additional Information is as **follows:**

1. The remaining life of Property, plant and equipment is 8 years. The pattern of use of the asset iseven. The net realisable value of Property, plant and equipment on 31.03.2022 was ₹ 3,25,000.
2. Purchases and Sales in 2021-22 amounted to ₹ 22,50,000 and ₹ 27,50,000 respectively.
3. The cost and net realizable value of inventory on 31.03.2022 were ₹ 2,00,000 and ₹ 2,50,000respectively.
4. Expenses including interest on loan for the year amounted to ₹ 78,000.
5. Deferred Expenses are amortized equally over 5 years.

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6. Sundry Debtors on 31.03.2022 are ₹ 1,50,000 of which ₹ 5,000 is doubtful. Collection of another ₹
7. 25,000 depends on successful re-installation of certain product supplied to the **customer;**
8. Closing Sundry Creditors are ₹ 75,000, likely to be settled at 10% **discount.**
9. Cash balance as on 31.03.2022 is ₹ **4,22,000.**
   (1) There is an early repayment penalty for the loan of ₹ 25,000. You are required to prepare: (Not assuming going concern)
   (2) Profit & Loss Account for the year 2021-22.

Balance Sheet as on 31st March, 2022. (RTP May'22, Nov'22, PYP 5 Marks May'19) (Same concept different figures PYP 4 Marks Nov'20, Old & New **SM)**

Answer 16

Profit and Loss Account for the year ended 2021-22(not assuming going concern)

Particulars	Amount ₹	Particulars	Amount ₹
To Opening Stock	1,50,000	By Sales	27,50,000
To Purchases	22,50,000	By Closing Stock	2,50,000
To Expenses	78,000	By Trade payables	7,500
To Depreciation	35,000		
To Provision for doubtful debts	30,000		
To Deferred expenses	50,000		
To Loan penalty	25,000		
To Net Profit (b.f.)	3,89,500		
	30,07,500		30,07,500

Balance Sheet as at 31st March, 2022 (not assuming going concern)

Liabilities	Amount ₹	Assets	Amount ₹
Capital	3,00,000	Fixed Assets	3,25,000
Profit & Loss A/c	5,14,500	Inventory	2,50,000
10% Loan	2,35,000	Trade receivables (less provision)	1,20,000
Trade payables	67,500	Deferred expenses	Nil
		Bank	4,22,000
	11,17,000		11,17,000

Question 17

What are the qualitative characteristics of the Financial Statements which improve the usefulness of the information furnished therein? (PYP 4 Marks Nov '20, Old & New **SM)**

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Answer 17

The qualitative characteristics are attributes that improve the usefulness of information provided in financialstatements. Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise. The framework for Preparation and Presentation of Financial Statements suggests that the financial statements should maintain the following four qualitative characteristics to improve the usefulness of the information furnished therein.

1. **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.

2. **Relevance:** The financial statements should contain relevant information only. Information, which is likely toinfluence 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.

3. **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 transactions and events reportedare faithfully represented. The reporting of transactions and events should be neutral, i.e. free from biasand be reported on the principle of 'substance over form'. The information in financial statements must be complete. Prudence should be exercised in reporting uncertain outcome of transactions or events.

4. **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 18

Explain how financial capital is maintained at historical cost? Kishore started a business on 1st April, 2019 with ₹ 15,00,000 represented by 75,000 units of ₹20 each. During the financial year ending on 31st March, 2020, he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate the maximumamount, which can be withdrawn by Kishore in the year 2019-20 if Financial Capital is maintained at historical cost. (PYP 4 Marks Jan 21)

Answer 18

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.

Maximum amount withdrawn by Kishore in year 2019-20 if financial capital is maintained at historical cost

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Particulars	Financial Capital Maintenance atHis-torical Cost (₹)
Closing equity (₹ 30 x 75,000 units)	22,50,000 represented by cash
Opening equity	75,000 units x ₹ 20 = 15,00,000
Permissible drawings to keep Capital intact	7,50,000 (22,50,000 – 15,00,000)

Thus ₹ 7,50,000 is the maximum amount that can be withdrawn by Kishore in year 2019-20 if financial capital is maintained at historical cost.

Question 19

A trader commenced business on April 1, 2020 with ₹ 120,000, represented by 6000 units of a certain product at ₹ 20 per unit. During the year 2020-21 he sold these units at ₹ 30/- per unit and had withdrawn ₹ 60,000. The price of the product at the end of financial year was ₹ 25/- per unit. Compute retained profit of the trader under the concept of physical capital maintenance at current cost. Also, state, whether Answer would be different if the trader had not withdrawn any amount. (PYP July'21, 5 Marks) (MTP 5 Marks Sep '23)

Answer 19

Physical Capital Maintenance at Current Cost

In the given case, the specific price index applicable to the product is 125 (25/20X100). Current cost of opening stock = (₹ 1, 20,000 / 100) x 125 Or 6,000 unit's x ₹ 25 = ₹ 1, 50,000

Current cost of closing cash = ₹ 1, 20,000 (₹ 1, 80,000 – ₹ 60,000) Opening equity at closing current costs = ₹ 1,50,000

Closing equity at closing current costs = ₹ 1, 20,000 Retained Profit = ₹ 1, 20,000 – ₹ 1, 50,000 = (-) ₹ 30,000 The negative retained profit indicates that the trader has failed to maintain his capital. The available fund of ₹ 1, 20,000 is not sufficient to buy 6,000 units again at increased price of ₹ 25 per unit. The drawings shouldhave been restricted to ₹ 30,000 (₹ 60,000 – ₹ 30,000).

If the trader had not withdrawn any amount, then the Answer would have been as below:

Current cost of opening stock = ₹ 1, 80,000

Opening equity at closing current costs = ₹ 1, 50,000Retained Profit = ₹ 1, 80,000 – ₹ 1, 50,000 = ₹ 30,000

If the trader had not withdrawn any amount, then the retained profit would have been₹ 30,000.

Question 20

Mrs. A is showing the consolidated aggregate opening balance of equity, liabilities and assets of ₹ 6 lakh, 4lakh and 10 lakhs respectively. During the current year Mrs. A has the following transactions:

1. **Received 20% dividend on 10,000 equity shares of ₹ 10 each held as investment.**
2. **The amount of ₹ 70,000 is paid to creditors for settlement of ₹ 90,000.**
3. **Salary is pending by ₹ 20,000.**
4. **Mrs. A's drawing ₹ 20,000 for her personal use.**

You are required to prepare the statement of the effect of aforesaid each transaction on closing balancesheet in the form of Assets – Liabilities = Equity after each transaction. (PYP 5 Marks, Dec '21)

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Answer 20

Effect of each transaction on Balance sheet of Mrs. A is shown below:

Transactions	Assets ₹ lakh	-	Liabilities ₹ lakh	=	Equity ₹ lakh
Opening	10.00	-	4.00	=	6.00
(1) Dividend earned	10.20 [10.00+0.20]	-	4.00	=	6.20 [6.00+0.20]
(2) Settlement of Creditors	9.50 [10.20-0.70]	-	3.10 [4.00-0.90]	=	6.40 [6.20+0.20]
(3) Salary Outstanding	9.50	-	3.30 [3.10+0.20]	=	6.20 [6.40-0.20]
(4) Drawings	9.30 [9.50-0.20]	-	3.30	=	6.00 [6.20-0.20]

Question 21

As on 1st April, 2021 opening Balance Sheet of Mr. Mohanty is showing the aggregate value of Assets, Liabilities and Equity ₹ 12 Lakhs, 3 Lakhs and 9 lakhs respectively.

During the accounting period 01/04/2021 to 31/03/2022, Mr. Mohanty has the following transactions:

1. A liability of ₹ 50,000 was finally settled at a discount of 2%.
2. Dividend earned @ 15% on 1,000 (F.V 100 each) Equity shares held @ ₹ 12,000.
3. Rent of the premises paid ₹ 20,000.
4. Mr. Mohanty withdrew ₹ 10,000 for personal purposes and also withdrew Goods worth ₹ 5,000 for personal purposes.
5. ₹ 15,000 were received against Bill Receivables.

You are required to show the effect of the above transactions on Balance Sheet in the form of Assets - Liabilities = Equity equation after each transaction. .(PYP 4 Marks Nov '22)

Answer 21

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

Transactions	Assets ₹ lakh	-	Liabilities ₹ lakh	=	Equity ₹ lakh
Opening	12	-	3	=	9
(1) Settlement of Creditors	12 – 0.49 11.51	-	3 – 0.50 2.5	=	9.0 + 0.01 9.01

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(2) Dividend earned	11.51 + 0.15 11.66	-	2.5	=	9.01+ 0.15 9.16
(3) Rent paid	11.66 -0.20 11.46	-	2.5	=	9.16 -0.20 8.96
(4) Drawings	11.46 -0.15 11.31	-	2.5	=	8.96 -0.15 8.81
(5) *Money received against Bills receivables	11.31+0.15 -0.15 11.31	-	2.5	=	8.81

*No change as cash received from bills receivable will have impact on individual asset only (will reduce billreceivables with corresponding increase in cash).

Question 22

Mille started a business on 01.04.2022 with a capital of ₹ 15,00,000. She purchased ₹ 1,500 units of stock at ₹ 1,000 each. She sold the entire stock for ₹ 1,500 each unit till 31.03.2023.

You are required to calculate the maximum amount which can be withdrawn by Mille in order to keep hercapital intact, if Financial Capital is maintained at:

(i) Historical Cost

(ii) Current Purchasing Power (opening index at 100 and closing index at 125)

(iii) Physical Capital Maintenance

(Price per unit at the end of year is ₹ 1,350) **(PYP 5 Marks May '23)**

Answer 22

Financial Capital Maintenance at historical Costs

Sr. No.	Particulars	Computation	₹
(i)	Opening Equity	1,500 x 1,000	15,00,000
(ii)	Closing Equity	1,500 x 1,500	22,50,000
(iii)	Maximum Drawing	(ii)- (i)	7,50,000

Financial Capital Maintenance at current purchasing power

Sr. No.	Particulars	Computation	₹
(i)	Opening Equity	1,500 x 1,000 x 125/100	18,75,000
(ii)	Closing Equity	1,500 x 1,500	22,50,000
(iii)	Maximum Drawing	(ii)- (i)	3,75,000

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Financial Capital Maintenance at Physical Capital Maintenance

Sr. No.	Particulars	Computation	₹
(i)	Opening Equity	1,500 x1,350	20,25,000
(ii)	Closing Equity	1,500 x 1,500	22,50,000
(iii)	Maximum Drawing	(ii)- (i)	2,25,000

Question 23

The 'going concern' concept assumes that

a. The business can continue in operational existence for the foreseeablefuture.
b. The business cannot continue in operational existence for the foreseeable future.
c. The business is continuing to be profitable.
d. The business cannot continue if it is not able to earn profits.

Ans: (a)

Question 24

Two principal qualitative characteristics of financial statements are

a. Understand ability and materiality	b. Relevance and reliability
c. Relevance and materiality	d. Comparability and materiality.

Ans: (b)

Question 25

All of the following are components of financial statements except

a. Balance sheet	b. Statement of Profit and loss
c. Human responsibility report	d. Social responsibility report.

Ans: (c)

Question 26

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)	d. By statute as well as accounting standards.

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Ans: (c)

Question 27

Value of equity may change due to

a. Contribution from or Distribution to equityparticipants	b. Income earned
c. expenses incurred	d. All the three.

Ans: (d)

Theoretical Questions and Answer

Questions 28

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

Answer 28

The qualitative characteristics are attributes that improve the usefulness of information provided in financial statements. Understand ability; Relevance; Reliability; Comparability are the qualitative characteristics of financial statements. For details, refer para 7 of the chapter.

Questions 29

"One of the characteristics of financial statements is neutrality"- Do you agree with this statement?

Answer 29

Yes, one of the characteristics of financial statements is neutrality. To be reliable, the informationcontained 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 areaof business to another thereby arriving at a totally different conclusion on the business results.

Practical Questions Answer

Questions 30

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 theyear 20X1-X2 if Financial Capital is maintained at historical cost.

Answer 30

Particulars	Financial Capital Maintenance at Historical Cost (₹)
Closing equity (₹ 30 x 60,000 units)	18,00,000 represented by cash

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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)

Questions 31

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 31

Effects of each transaction on Balance sheet of the trader is 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

Questions 32

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

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital	**50,000**	**Property, Plant and Equipment**	**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**

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Additional Information:

1. **Remaining life of Property, Plant and Equipment is 5 years with even use. The net realisable value of Property, Plant and Equipment as on 31 st March, 20X2 was ₹ 64,000.**
2. **Firm's sales and purchases for the year 20X1-X2 amounted to ₹ 5 lacs and**
3. **₹ 4.50 lacs respectively.**
4. **The cost and net realisable value of the stock were ₹ 34,000 and ₹ 38,000 respectively.**
5. **General Expenses for the year 20X1-X2 were ₹ 16,500.**
6. **Deferred Expenditure is normally amortised equally over 4 years starting from**
7. **F.Y. 20X0-X1 i.e. ₹ 5,000 per year.**
8. **Out of trade receivables worth ₹10,000, collection of ₹4,000 depends on successful re- design of certain product already supplied to the customer.**
9. **Closing trade payable is ₹10,000, which is likely to be settled at 95%.**
10. **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 32

Profit and Loss Account of Anurag Trading Co. for theyear 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

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Question 33 (Illustration)

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

Liabilities	₹	Assets	₹
Capital	60,000	Property, Plant and Equipment	65,000
Profit and Loss Account	25,000	Stock	30,000
10% Loan	35,000	Trade receivables	20,000
Trade payables	10,000	Deferred expenditure	10,000
		Bank	5,000
	1,30,000		1,30,000

Additional information:

1. **The remaining life of Property, Plant and Equipment is 5 years. The pattern of use of the asset is even. The net realisable value of Property, Plant and Equipment on 31.03.X2 was ₹60,000.**
2. **The trader's purchases and sales in 20X1-X2 amounted to ₹ 4 lakh and ₹ 4.5 lakh respectively.**
3. **The cost and net realisable value of stock on 31.03.X2 were ₹ 32,000 and ₹ 40,000respectively.**
4. **Expenses (including interest on 10% Loan of ₹ 3,500 for the year) amounted to ₹ 14,900.**
5. **Deferred expenditure is amortised equally over 4 years.**
6. **Trade receivables on 31.03.X2 is ₹ 25,000, of which ₹ 2,000 is doubtful. Collection of another**
7. **₹ 4,000 depends on successful re-installation of certain product supplied to the customer.**
8. **Closing trade payable is ₹ 12,000, which is likely to be settled at 5% discount.**
9. **Cash balance on 31.03.X2 is ₹ 37,100.**
10. **There is an early repayment penalty for the loan ₹ 2,500.**

You are required to prepare Profit and Loss Accounts and Balance Sheets of the trader in both cases (i) assuming going concern (ii) not assuming going concern.

Answer 33

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

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To Expenses	14,900	14,900	By Trade		600
To Depreciation	13,000	5,000	payables		
To Provision for doubtful debts	2,000	6,000			
To Deferred expenditure	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

Balance Sheet as at 31st March, 20X2

Liabilities	Case (i) ₹	Case (ii) ₹	Assets	Case (i) ₹	Case (ii) ₹
Capital	60,000	60,000	Property, Plant and Equipment	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 expenditure	7,500	Nil
			Bank	37,100	37,100
	1,51,600	1,56,100		1,51,600	1,56,100

Question 34 (Illustration)

A trader commenced business on 01/01/20X1 with ₹ 12,000 represented by 6,000 units of a certainproduct at₹ 2 per unit. During the year 20X1 he sold these units at

₹ 3 per unit and had withdrawn ₹ 6,000. Let us assume that the price of the product at the end ofyear is ₹ 2.50 per unit. In other words, the specific price index applicable to the product is 125.

Current cost of opening stock = (₹ 12,000 / 100) x 125 = 6,000 x ₹ 2.50 = ₹ 15,000 Current cost ofclosing cash = ₹ 12,000 (₹ 18,000 – ₹ 6,000)

Opening equity at closing current costs = ₹ 15,000 Closing equity at closing currentcosts = ₹ 12,000 Retained Profit = ₹ 12,000 – ₹ 15,000 = (-) ₹ 3,000

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The negative retained profit indicates that the trader has failed to maintain his capital. The available fund of₹ 12,000 is not sufficient to buy 6,000 units again at increased price of ₹ 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.

You are required to compute the Capital maintenance under all three bases ie. (i) Historical costs, (ii) Current purchasing power and (iii) Physical capital maintenance.

Answer 34

Financial Capital Maintenance at historical costs

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

Financial Capital Maintenance at current purchasing power

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

Physical Capital Maintenance

	₹	₹
Closing capital (At current cost) (4,800 units)Less: Capital to be maintained		12,000
Opening capital (At current cost) (6,000 units)		
Introduction (At current cost)	15,000	
	Nil	(15,000)
Loss resulting in non-maintenance of capital		(3,000)

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Chapter 3

Applicability of Accounting Standards

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.5 TO Q.14											
Past Exams	NO	NO	NO	NO	NO	NO	Q.4	NO	NO	NO	NO	NO
MTP	NO	Q.1	NO	NO	NO	NO	NO	NO	NO	Q.1	NO	NO
RTP	NO	NO	NO	NO	NO	Q.2	NO	NO	Q.3	NO	NO	NO

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Chapter 3

Applicability of Accounting Standards

Question 1

M/s X & Co. (a partnership firm) had a turnover of ₹ 5 crores (excluding other income) and borrowings of ₹ 1.5 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 31.3.2022. Advisethe management of M/s X & Co in respect of the exemptions of provisions of ASs, as per the directive issued by the ICAI. (MTP 5 Marks Oct '22) (Same concept different figures MTP Oct'18 5 Marks, Old & New SM)

Answer 1

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 levelof 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:

1. 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.
2. 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.
3. 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 availableto M/s Omega & Co.

Question 2

What are the issues, with which Accounting Standards deal? (RTP Nov 20)(Old & New SM)

Answer 2

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.

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Question 3

(a) **A company with a turnover of Rs. 225 crores and borrowings of Rs. 51 crore during the year ended 31st March, 2021, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3. 2021. Advise the management on the exemptions that are available as per the Companies (Accounting Standards) Rules, 2021.**

(b) **An organization whose objects are charitable or religious, believes that the Accounting Standards are not applicable to it since only a very small proportion of its activities are business in nature. Comment. (RTP May '22)**

Answer 3

(a) The question deals with the issue of Applicability of Accounting Standards for corporate entities. The companies can be classified under two categories viz SMCs and Non-SMCs under the Companies (Accounting Standards) Rules, 2021. As per the Companies (Accounting Standards) Rules, 2021, criteriafor 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 two-fifty crores in the immediately preceding accounting year;
- which does not have borrowings (including public deposits) in excess of rupees fifty crores 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-sizedcompany. Since, XYZ Ltd.'s turnover was Rs. 225 crores which does not exceed Rs. 250 crores but borrowings of Rs. 51 crore are more than Rs. 50 crores, it is not a small and medium sized company (SMC). The exemptions available to SMC are not available to this company.

(b) Accounting Standards apply in respect of any enterprise (whether organized in corporate, co-operative or other forms) engaged in commercial, industrial or business activities, whether or not profit oriented and even if established for charitable or religious purposes. Accounting Standards however, do not applyto enterprises solely carrying on the activities, which are not of commercial, industrial or business nature, (e.g., an activity of collecting donations and giving them to flood affected people). Exclusion of an enterprise from the applicability of the Accounting Standards would be permissible only if no part ofthe activity of such enterprise is commercial, industrial or business in nature. Even if a very small proportion of the activities of an enterprise were considered to be commercial, industrial or business innature, the Accounting Standards would apply to all its activities including those, which are notcommercial, industrial or business in nature.

Question 4

List the Criteria for classification of non-corporate entities as level I Entities for the purpose of application of Accounting Standards as per the Institute of Chartered Accountants of India. (PYP 4 Marks Jan 21)

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Answer 4

Criteria for classification of non-corporate entities as level 1 entities for purpose of application of A counting Standards decided by the Institute of Chartered Accountants of India is given below: Non-corporate entities which fall in any one or more of the following categories, at the end of the relevant accounting period, are classified as Level I entities:

(i) Entities whose equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India.

(ii) Banks (including co-operative banks), financial institutions or entities carrying on insurance business.

(iii) All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees fifty crore ***(as per amendment- Rupees two fifty crore)*** in the immediately preceding accounting year.

(iv) All commercial, industrial and business reporting entities having borrowings (including public deposits) in excess of rupees ten crore ***(as per amendment- Rupees fifty crore)*** at any time during the immediately preceding accounting year.

(v) Holding and subsidiary entities of any one of the above.

Question 5

Non-corporate entities which are not Level I entities whose turnover (excludingother income) exceeds rupees _____but does not exceed rupees two-fifty crores in the immediately preceding accountingyear are classified as Level IIentities.

a. Five crores.	a. Two crores
b. Fifty crores	c. Ten crores

Ans: (C) Ten crores

Question 6

The following Accounting Standard is not applicable to Non-Corporate Entities falling in Level II in its entirety.

a. AS 10	b. AS 17
c. AS 2	d. AS 13

Ans: (b) AS 17

Question 7

All non-corporate entities engaged in commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees 250 crores in the immediately preceding accounting year, are classified as.

a. Level II entities	b. Level I entities
c. Level III entities	d. Level IV entities

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Ans: (b) Level I entities

Question 8

All non-corporate entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees two crores but does not exceed rupees ten crores at any timeduring the immediately preceding accounting year.

a. Level II entities	b. Level IV entities
c. Level III entities	d. Level I entities

Ans: (C) Level III entities

Question 9

"Small and Medium Sized Company" (SMC) means, a company-

a. which may be a bank, financial institution or an insurance company.
b. whose turnover (excluding other income) does not exceed rupees two-fifty crores in the immediately preceding accounting year;
c. whose turnover (excluding other income) does not exceed rupees fifty crores in the immediately preceding accounting year;
d. whose turnover (excluding other income) does not exceed rupees five hundred crores in the immediately preceding accounting year.

Ans: (b)

whose turnover (excluding other income) does not exceed rupees two-fifty crores in the immediately preceding accounting year;

Theory Questions Answer

Question 10

What are the issues, with which Accounting Standards deal?

Answer 10

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 andevents in the financial statements in a manner that is meaningful and understandable to the reader, and (iv) Disclosure requirements.

Question 11

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

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Answer 11

Criteria for classification of Non-company Entities as decided by the Institute of Chartered Accountants ofIndia

Level I Entities

Non-company entities which fall in any one or more of the following categories, at the end of the relevant accounting period, are classified as Level I entities:

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

Level II Entities

Non-company entities which are not Level I entities but fall in any one or more of the following categories are classified as Level II entities:

1. All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds rupees fifty crore but does not exceed rupees two-fifty crore in the immediately preceding accounting year.
2. All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees ten crore but not in excess of rupees fifty crore at any time during the immediately preceding accounting year.
3. Holding and subsidiary entities of any one of the above.

Question 12

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

Answer 12

Level IV Entities

Additional requirements

1. An MSME which avails the exemptions or relaxations given to it shall disclose (by way of a note toits financial statements) the fact that it is an MSME, the Level of MSME and that it has complied with the Accounting Standards insofar as they are applicable to entities falling in Level II or Level III or Level IV, as the case may be.

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2. 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 berevised merely by reason of its having ceased to be covered in Level II or Level III or Level IV, as thecase may be. The fact that the entity was covered in Level II or Level III or Level IV, as the case may

3. 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 periodfigures have not been revised shall also be disclosed in the notes to the financial statements.

4. Where an entity has been covered in Level I and subsequently, ceases to be so 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.

5. 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.

6. 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.

7. 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:

8. Provided that such a partial exemption or relaxation and disclosure shall not be permitted to mislead any person or public.

9. In respect of Accounting Standard (AS) 15, Employee Benefits, exemptions/ relaxations are available to Level II and Level III entities, under two sub- classifications, viz., (i) entities whose average number of persons employed during the year is 50 or more, and (ii) entities whose average number of persons employed during the year is less than 50. The requirements stated in paragraphs (1) to (6) above, mutatis mutandis, apply to these sub- classifications.

Practical Questions Answer

Question 13

XYZ Ltd., with a turnover of Rs. 50 crores during previous year and borrowings of Rs. 1 crore 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 31.3.20X1. Advise the management on the exemptions that are available as per the Companies (Accounting Standards) Rules, 2021.

Answer 13

The question deals with the issue of Applicability of Accounting Standards for corporate entities.

The companies can be classified under two categories viz SMCs and Non SMCs under the Companies (Accounting Standards) Rules, 2021.

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As per the Companies (Accounting Standards) Rules, 2021, 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 two- fifty crores in the immediatelypreceding accounting year;
- which does not have borrowings (including public deposits) in excess of rupees fifty crores at any timeduring 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.
- Since, XYZ Ltd.'s turnover was Rs. 50 crores which does not exceed Rs. 250 crores and borrowings of Rs. 1 crore are

  less than Rs. 50 crores, it is a small and medium sized company (SMC).

Question 14

A company was classified as Non-SMC in 20X1-X2. In 20X2-X3, it has been classified as SMC. The management desires to avail the exemptions or relaxations available for SMCs in 20X2-X3. However, the accountant of the company does not agree with the same. Comment.

Answer 14

As per Companies (Accounting Standards) Rules, 2021, an existing company, which was previously not a SMC and subsequently becomes a SMC, should not be qualified for exemption or relaxation in respect of accounting standards available to a SMC until the company remains a SMC for two consecutive accounting periods. Therefore, the management of the company cannot avail the exemptions/ relaxations available to the SMCs for the FY 20X2-X3.

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Chapter 4.1

AS 1- Disclosure of Accounting Policies

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.10 TO Q.19											
Past Exams	NO	Q.1	Q.8	NO	NO	NO	Q.1, Q.3	NO	Q.2	NO	Q.9	NO
MTP	NO	Q.3, Q.4	Q.4	Q.2	Q.1, Q.2	NO	Q.1	Q.3	Q.1, Q.2	Q.4	Q.1	Q.1, Q.2
RTP	NO	NO	NO	NO	Q.2	Q.6	Q.5	NO	NO	NO	Q.3	NO

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Chapter 4.1

AS 1- Disclosure of Accounting Policies

Question 1

HIL Ltd. was making provision for non-moving stocks based on no issues having occurred for the last 12months up to 31.03.2019. The company now wants to change it and make provision based on technical evaluation during the year ending 31.03.2020. Total value of stock on 31.3.20 is Rs. 120 lakhs. Provision required based on technical evaluation amounts Rs. 3.00 lakhs. However, provision required based on 12 months (no issues) is Rs. 4.00 lakhs. You are required to discuss the following points in the light of Accounting Standard (AS)-1:

1. Does this amount to change in accounting policy?
2. Can the company change the method of accounting?
3. Explain how it will be disclosed in the annual accounts of HIL Ltd. for the year 2019-20. (MTP 5 Mark March '21, MTP 5 Marks April '22 & MTP 5 Marks April '23) (PYP Nov '18, 5 Marks, PYP 5 Marks Dec'21) (Same concept different figures- MTP 5 Marks Mar'23, RTP May'20 & Nov '23)

Answer 1

The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be made but the basis for making provision will not constitute accounting policy. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory from Rs. 4 lakhs to Rs. 3 lakhs are also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of HIL Ltd. for the year 2019-20 in the following manner:

"The company has provided for non-moving inventories on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the value of net assets at the end of the year would have been lower by Rs. 1 lakh."

Question 2

State whether the following statements are 'True' or 'False' in line with the provisions of AS Also give reason for your answer.

1. Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.
2. If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.
3. All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.
4. Any change in an accounting policy, which has a material effect should be disclosed. Where the

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amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need not to be indicated.

5. There is no single list of accounting policies which are applicable to all circumstances. (MTP 5 Marks April 21, Oct 19, Mar 22, May'20 & Oct '23, RTP 5 Marks May 20, PYP 5 Marks May '22, Old & New SM)

Answer 2

1. False; As per AS 1 "Disclosure of Accounting Policies", certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.
2. False; As per AS 1, if the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.
3. True; To ensure proper understanding of financial statements, it is necessary that 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 they should be disclosed at one place.
4. False; Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.
5. True; As per AS 1, there is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable.

Question 3

In the books of Rani Ltd., closing inventory as on 31.03.2020 amounts to ₹1,75,000 (valued based on FIFO method). The Company decides to change from FIFO method to weighted average method for ascertaining the costs of inventory from the year 2019-20. On the basis of weighted average method, closing inventory as on 31.03.2020 amounts to ₹1,59,000. Realizable value of the inventory as on 31;03;2020 amounts to ₹2,07 ,000. Discuss disclosure requirements of change in accounting policy as per AS 1.(MTP Nov '21, 5 Marks, MTP Oct'18 5 Marks, RTP May 23, PYP 5 Marks Dec'21, Old & New SM)

Answer 3

As per AS 1 "Disclosure of Accounting Policies", any change in an accounting policy which has a material effect should be disclosed in the financial statements. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Thus Rani Ltd. should disclose the change in valuation method of inventory and its effect on financial statements. The company may disclose the change in accounting policy in the following manner:

"The company values its inventory at lower of cost and net realizable value. Since net realizable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 2019-20, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by ₹16,000 (1,75,000 – 1,59,000)."

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Question 4

Kumar Ltd. had made a rights issue of shares in 2017. In the offer document to its members, it had projected a surplus of Rs. 40 crores during the accounting year to end on 31 st March, 2017. The draft results for the year, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of Rs. 10 crores. The board in consultation with the managing director, decided not to provide for "after sales expenses" during the warranty period; Till the last year, provision at 2% of sales used to be made under the concept of "matching of costs against revenue" and actual expenses used to be charged against the provision. The board now decided to account for expenses as and when actually incurred. Sales during the year total to Rs. 600 crores.

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2016-2017 (MTP Apr'19, Aug'18, Oct'22 5 Marks)

Answer 4

As per AS 1, any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Accordingly, the notes on accounts should properly disclose the change and its effect.

Notes on Accounts:

So far, the company has been providing 2% of sales for meeting "after sales expenses during the warranty period. With the improved method of production, the probability of defects occurring in the products has reduced considerably. Hence, the company has decided not to make provision for such expenses but to account for the same as and when expenses are incurred. Due to this change, the profit for the year is increased by Rs. 12 crores than would have been the case if the old policy were to continue.

Question 5

The draft results of Surya Ltd. for the year ended 31st March, 2020, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of Rs. 10 crores. The board in consultation with the managing director, decided to value year-end inventory at works cost (Rs. 50 crores) instead of the hitherto method of valuation of inventory at prime cost (Rs. 30 crores). As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2019-2020. (RTP May '21)

Answer 5

As per AS 1, any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Accordingly, the notes on accounts should properly disclose the change and its effect.

Notes on Accounts:

"During the year inventory has been valued at factory cost, against the practice of valuing it at prime cost as was the practice till last year. This has been done to take cognizance of the more capital intensive method of production on account of heavy capital expenditure during the year. As a result of this change,the year-end inventory has been valued at Rs. 50 crores and the profit for the year is increased by Rs. 20 crores."

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Question 6

What are the three fundamental accounting assumptions recognized by Accounting Standard (AS) 1? Briefly describe each one of them. (RTP Nov'20)

Answer 6

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

1. 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 needto materially curtail the scale of operations.

2. 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 (i) by a statute, (ii) by an accounting standard or (iii) for more appropriate presentation of financial statements.

3. Accrual basis of accounting: Under this basis of accounting, transactions are recognized as soon as they occur, whether or not cash or cash equivalent is actually received or paid.

Question 7

(i) ABC Ltd. was previously making provision for non-moving stocks based on stocks not issued for the last 12 months up to 31.03.2020. Now, the company wants to make provisions based on technical evaluation during the year ending 31;03;2021; Total value of stock ₹ 133;75 lakhs Provision required based on technical evaluation ₹ 4;00 lakhs Provision required based on 12 months not issued ₹ 5;00 lakhs; (2.5 Marks, Dec '21)

Answer 7

(i) The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory from ₹ 5 lakhs to ₹ 4 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2020 -21:

"The company has provided for non-moving inventories on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been lower by ₹ 1 lakh."

Question 8

What do you mean by 'Accrual' in reference to AS-1? Also, specify any three reasons for 'Accrual Basis of Accounting'. (PYP May'19, 5 Marks)

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Answer 8

The term "Accrual" has been explained in the AS 1 on Disclosure of Accounting Policies, as "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"

Reasons for Accrual Basis of Accounting

1. Accrual basis of accounting, attempts to record the financial effects of the transactions, events, and circumstances of an enterprises in the period in which they occur rather than recording them in the period(s) in which cash is received or paid by the enterprise.
2. Receipts and payments of the period will not coincide with the buying producing or selling events and other economic events that affect entity performance.
3. The goal of Accrual basis of accounting is to follow the matching concept of income and expenditure so that reported net income measures an enterprise's performance during a period instead of merely listing its cash receipts and payments.
4. Accrual basis of accounting recognizes assets, liabilities or components of revenues and expenses for amounts received or paid in cash in past, and amounts expected to be received or paid in cash in the future.
5. Important point of difference between accrual and accounting based on cash receipts and outlay is in timing of recognition of revenues, expenses, gains and losses.

Question 9

You are required to comment on the following cases as per the provisions of Accounting Standard-1 'Disclosure of Accounting Policies':

(1) Bee Limited has not complied with AS-2 "Valuation of inventories" and the same is disclosed in the Notes on Accounts. Management is of the view that the financial statements give a true and fair view as non-compliance with AS-2 is disclosed.

(2) Cee Limited sold its Office Building for Rs. 10,00,000 on 1st March, 2023. The buyer has paid the full amount and taken possession of the building. The book value of the Office Building is Rs. 4,00,000. On 31st 2023, documentation and legal formalities are pending. The company has not recorded the disposal and the amount received is shown as an advance.

(3) Dee Limited has prepared its accounts on cash basis and the same is not disclosed.

(4) Jee Limited disclosed significant accounting policies adopted in the preparation of financial statements, in the Directors' Report. (PYP 5 Marks May '23)

Answer 9

(1) As per AS-I disclosure of accounting policies is not a remedy for wrong or inappropriate treatment in accounting. In the given case the financial statement does not give a true and fair view as they are not in compliance with AS-2.

(2) Considering the substance over form as per AS-I, documentation and legal formalities represent the form of the transaction, although the legal title has not been transferred, the economic reality and substance are that the rights and beneficial interest in the Office Building have been transferred. Therefore, recording of acquisition/ disposal (by the transferee and transferor respectively) would in substance represent the transaction entered into.

(3) Accrual is a fundamental accounting assumption. If it is not followed by the company, the facts should be disclosed under AS-I. Hence the company should disclose the fact that the cash basis of accounting has been followed in the notes on accounts.

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(4) The practice followed by the company is not correct. It should be disclosed as part of financial statements (The director's report is not part of financial statements).

Question 10

Which of the following is NOT a major consideration in selection and application of accounting policies?

a. Prudence	b. Comparability
c. Materiality	d. Substance over form

Ans: (b)

Question 11

Adoption of different accounting policies by different companies operating in the same industry affects which of the qualitative characteristics the most?

a. Comparability	b. Relevance
c. Faithful representation	d. Reliability

Ans: (a)

Question 12

Which of the following statement would not be correct in relation to disclosures to be made in the financial statements after making any change in an accounting policy?

a. Any change in an accounting policy which has a material effect shouldbe disclosed.

b. The amount by which any item in the financial statements is affected by such change should be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part,the fact should be indicated.

c. If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

d. If a change is made in an accounting policy which has material effect on the financial statements for the current period and is reasonably expected to have a material effect in later periods, the fact of such change shouldbe appropriately disclosed only in the later periods i.e. year(s) next to the year in which the change is adopted.

Ans: (d)

Theoretical Questions Answer

Question 13

What are the three fundamental accounting assumptions recognised by Accounting Standard (AS) 1? Briefly describe each one of them.

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Answer 13

Accounting Standard (AS) 1 recognises three fundamental accounting assumptions. These are: (i) GoingConcern; (ii) Consistency; and (iii) Accrual basis of accounting.

Question 14

Has Accounting Standard 1 prescribed the manner in which the accounting policies followed by the entityshould be disclosed?

Answer 14

Paras 18-20 of Accounting Standard 1, Disclosure of Accounting Policies, lay down the manner in which accounting policies have to be disclosed, which is stated as under:

- To ensure proper understanding of financial statements, it is necessarythat all significant accountingpolicies adopted in the preparation and presentation of financial statements should be disclosed.
- Such disclosure should form part of the financial statements.
- All the disclosures should be made at one place instead of being scattered over several statements, schedules and notes.

Practical Questions Answer

Question 15

State whether the following statements are 'True' or 'False'. Also give reason for your answer.

(i) Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.

(ii) If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.

(iii) All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.

(iv) Any change in an accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need not to be indicated.

Answer 15

(i) False; As per AS 1 "Disclosure of Accounting Policies", certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

(ii) False; As per AS 1, if the fundamental accounting assumptions, viz. Going Concern, Consistency andAccrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

True; To ensure proper understanding of financial statements, it is necessary that all significant

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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 they should be disclosed in one place.

False; Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

Question 16

Give examples of areas where accounting policies adopted could be different for different enterprises. Would there be any adverse impact due to the adoption of different policies, and if yes, how does Accounting Standard 1 seek to address such issue?

Answer 16

There are various areas where different accounting policies could be adopted by different entities within the same industry. An entity may choose to value its inventories using FIFO method, whereas another entity may choose to value the same using Weighted Average method.

While an entity is free to choose its accounting policy as long as in thefinancial statements reflect a trueand fair view of the state of affairs of the enterprise as at the balance sheet date and of the profit or lossfor the period ended, the application of different accounting policies by different entities affects the comparability of the financial statements of such different entities by stakeholders, analysts, investors etc. Tomitigate the loss of comparability, Accounting Standard 1, Disclosure of Accounting Policies requires disclosure of significant accounting policies as a part of the financial statements. This would help users of the financial statements to understand the policies followed by different entities, particularly if they belong to the same industry, and make a correct analysis of each entity resulting in more informed decision-making.

Question 17 (Illustration)

In the books of M/s Prashant Ltd., closing inventory as at 31.03.20X2 amounts to Rs. 1,63,000 (on the basis of FIFO method).

The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 20X1-X2. On the basis of weighted average method, closing inventory as on 31.03.20X2 amounts to Rs. 1,47,000. Realisable value of the inventory as on 31.03.20X2 amounts to Rs. 1,95,000. Discuss disclosure requirement of change in accounting policy as per AS-1.

Answer 17

As per AS 1"Disclosure of Accounting Policies", any change in an accounting policy which has a material effect should be disclosed in the financial statements. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Thus Prashant Ltd. should disclose the change in valuation method of inventory and its effect on financial statements. The company may disclose the change in accounting policy in the following manner:

'The company values its inventory at lower of cost and net realizable value. Since net realizable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 20X1-X2, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by Rs. 16,000.

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Question 18 (Illustration)

Jagannath Ltd. had made a rights issue of shares in 20X2. In the offer document to its members, it hadprojected a surplus of `40 crores during the accounting year to end on 31st March, 20X2. The draft results for the year, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of `10 crores. The board in consultation with the managing director,decided on the following:

(i) Value year-end inventory at works cost (Rs. 50 crores) instead of the hitherto method of valuation ofinventory at prime cost (Rs. 30 crores).

(ii) Provide for permanent diminution in the value of investments, which had taken place over the pastfive years, the amount of provision being `10 crores.

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 20X1-20X2.

Answer 18

As per AS 1, any change in the accounting policies which has a material effect in the current period or whichis reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Accordingly, the notes on accounts should properly disclose the change and its effect.

Notes on Accounts:

(i) During the year inventory has been valued at factory cost, against the practice of valuing it at prime cost as was the practice till last year. This has been done to take cognizance of the more capital intensive method of production on account of heavy capital expenditure during the year. As a resultof this change, the year-end inventory has been valued at Rs. 50 crores and the profit for the year has increased by Rs. 20 crores.

(ii) The company has decided to provide `10 crores for the permanent diminution in the value of investments which has taken place over the period of past five years. The provision so made has reduced the profit disclosed in the accounts by `10 crores.

Question 19 (Illustration)

XYZ Company is engaged in the business of financial services and is undergoing tight liquidity position, since most of the assets of the company are blocked in various claims/petitions in a Special Court. XYZ

has accepted Inter-Corporate Deposits (ICDs) and it is making its best efforts to settle the dues. There

were claims at varied rates of interest, from lenders, from the due date of ICDs to the date of repayment. The company has provided interest, as per the terms of the contract till the due date and a note for non- provision of interest on the due date to date of repayment was affected in the financial statements. On account of uncertainties existing regarding the determination of the amount and in the absence of any specific legal obligation at present as per the terms of contracts, the company considers that these claims are in the nature of "claims against the company not acknowledged as debt", and the same has been disclosed by way of a note in the accounts instead of making a provision in the statement of profit and loss. State whether the treatment done by the Company is correct or not.

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Answer 19

AS 1 'Disclosure of Accounting Policies' recognises 'prudence' as one of the major considerations governing the selection and application of accounting policies. In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

Also as per AS 1, 'accrual' is one of the fundamental accounting assumptions. Irrespective of the terms ofthe contract, so long as the principal amount of a loan is not repaid, the lender cannot be replaced in a disadvantageous position for non- payment of interest in respect of overdue amount. From the aforesaid, it is apparent that the company has an obligation on account of the overdue interest. In this situation, the company should provide for the liability (since it is not waived by the lenders) at an amount estimated oron reasonable basis based on facts and circumstances of each case. However, in respect of the overdue interest amounts, which are settled, the liability should be accrued to the extent of amounts settled. Non- provision of the overdue interest liability amounts to violation of accrual basis of accounting. Therefore, the treatment, done by the company, of not providing the interest amount from due date to the date ofrepayment is not correct.

Reference: The students are advised to refer the full text of AS 1 "Disclosure of Accounting Policies".

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Chapter 4.2

AS 3- Cash Flow Statements

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.16 TO Q.31											
Past Exams	Q.6	NO	NO	Q.9	NO	NO	Q.11	Q.10	Q.12	Q.13	Q.14	NO
MTP	NO	Q.3	NO	NO	Q.1	Q.2	Q.5,Q.9	Q.4	Q.5,Q.9	Q.6	Q.7	Q.9
RTP	NO	NO	NO	NO	Q.1,Q.8	NO	NO	NO	NO	NO	NO	Q.15

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Chapter 4.2

AS 3- Cash Flow Statements

Question 1

Prepare Cash Flow Statement of Tom & Jerry Ltd. for the year ended 31st March, 2020, inaccordance with AS-3 (Revised) from the following Summary Cash Account:

Summary Cash Account

	Rs. in '000	Rs. in'000
Balance as on 01.04.2019		**210**
Receipts from Customers		**16,596**
Sale of Investments (Cost Rs. 90,000)		**102**
Issue of Shares		**1,800**
Sale of Property Plant & Equipment		**768**
		19,476
Payment to Suppliers	**12,204**	
Purchase of Investments	**78**	
Purchase of Property Plant & Equipment	**1,380**	**,**
Wages & Salaries	**414**	
Selling & Administration Expenses	**690**	
Payment of Income Tax	**1,458**	
Payment of Dividends	**480**	
Repayment of Bank Loan	**1,500**	
Interest paid on Bank Loan	**300**	**(18,504)**
Balance as on 31.03.2020		**972**

(MTP 8 Marks May 20) (Same concept different figures RTP May'20)

Answer 1

Cash Flow Statement of Tom & Jerry Ltd. for the year ended 31st March, 2020

(Rs; '000)

Cash flows from operating activities

Cash receipts from customers	16,596	
Cash payments to suppliers	(12,204)	
Cash paid to employees	(414)	
Other cash payments (for Selling & Administrative expenses)	(690)	

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Cash generated from operations	3,288	
Income taxes paid	(1,458)	
Net cash from operating activities		1,830
Cash flows from investing activities		
Payments for purchase of Property Plant & Equipment	(1,380)	
Proceeds from sale of Property Plant & Equipment	768	
Purchase of investments	(78)	
Sale of investments	102	
Net cash used in investing activities		(588)
Cash flows from financing activities		
Proceeds from issue of share capital	1,800	
Bank loan repaid	(1,500)	
Interest paid on bank loan	(300)	
Dividend paid	(480)	
Net cash used in financing activities		(480)
Net increase in cash and cash equivalents		762
Cash and cash equivalents at beginning of period		210
Cash and cash equivalents at end of period		972

Question 2

What do you mean by the term "cash and cash equivalent" as per AS 3? From the following information of XYZ Limited, calculate cash and cash equivalent as on 31-03-2019.

Particulars	Amount (₹)
Cash balance with Bank	10,000
Fixed Deposit created on 01-11-2018 and maturing on15-07-2019	75,000
Short Term Investment in highly liquid Sovereign Debt Mutual fund made on01-03-2019 (having maturity period of less than 3 months)	1,00,000
Bank Balance in a Foreign Currency Account in India	$ 1,000
(Conversion Rate: on the day of deposit ₹ 69/USD; ₹ 70/USD as on 31-03-2019)	
Debentures purchased of ₹ 10 lacs of A Ltd., which are redeemable on 31st October, 2019	90,000
Shares of Alpha Ltd. purchased on 1st January, 2019	60,000

(MTP 5 Marks Oct 20)

Answer 2

As per AS 3, Cash and cash equivalents consists of: (i) Cash in hand and deposits repayable on demand with any bank or other financial institutions and (ii) Cash equivalents, which are short term, highly liquid investments that are readily convertible into known amounts of cash and are subject to insignificant risk or change in value. A short-term investment is one, which is due for maturity within three months from the date of acquisition. Investments in shares are not normally taken as cash equivalent, because of

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uncertainties associated with them as to realizable value.

Computation of Cash and Cash Equivalents as on 31st March, 2019

	₹
Cash balance with bank	10,000
Short term investment in highly liquid sovereign debt mutual fund on 1.3.19	1,00,000
Bank balance in foreign currency account ($1,000 x ₹ 70)	70,000
	1,80,000

Note: Fixed deposit, Shares and Debentures will not be considered as cash and cash equivalents.

Question 3

Classify the following activities as (i) Operating Activities, (ii) Investing Activities, (iii) Financing Activities:

a. **Purchase of Machinery.**

b. **Proceeds from issuance of equity share capital**

c. **Cash Sales.**

d. **Proceeds from long-term borrowings.**

e. Proceeds from Trade receivables.

f. Cash receipts from Trade receivables.

g. Trading Commission received.

h. Purchase of investment.

i. Redemption of Preference Shares.

j. Cash Purchases. (MTP 5 Marks Oct '18)

Answer 3

(i) Operating Activities: c, e, f, g, j.

(ii) Investing Activities: a, h.

(iii) Financing Activities: b, d, i.

Question 4

From the following information, prepare the Cash Flow from Financing activities as per AS 3 'Cash Flow Statements' as the accountant of XYZ Limited is not able to decide and seeks your advice:

(i) Received ₹ 4,00,000 as redemption of short-term deposit

(ii) Proceeds of ₹ 20,00,000 from issuance of equity share capital

(iii) Received interest of ₹ 70,000 on Govt. bonds.

(iv) An amount of ₹ 13,00,000 incurred for purchase of goodwill

(v) Proceeds of ₹ 5,00,000 from sale of patent.
Proceeds of ₹ 12,00,000 from long term borrowing.

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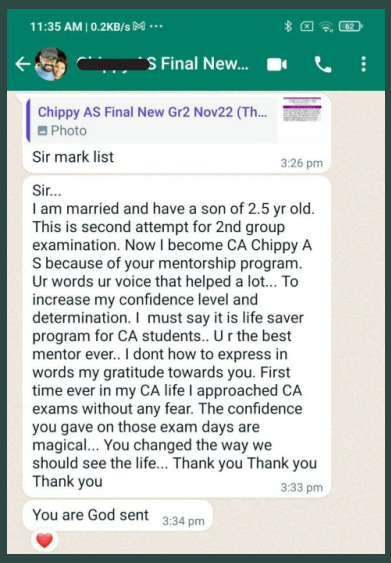

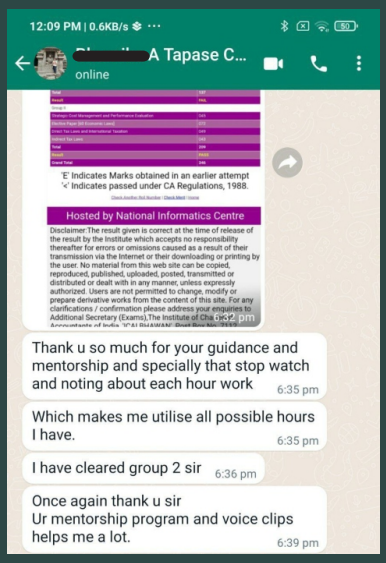

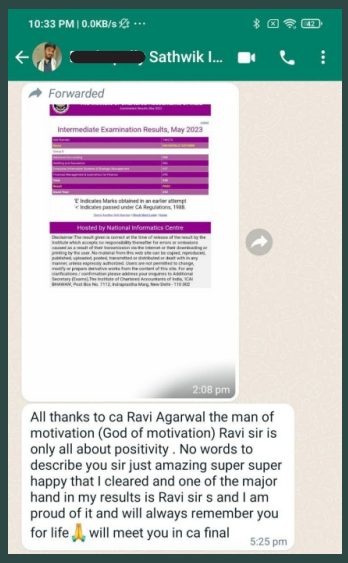

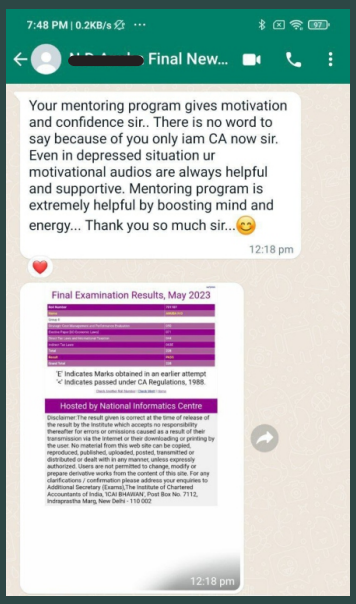

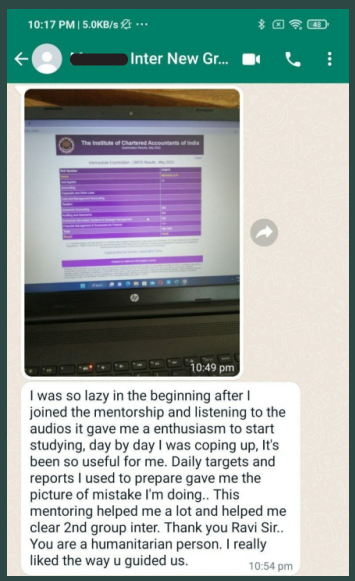

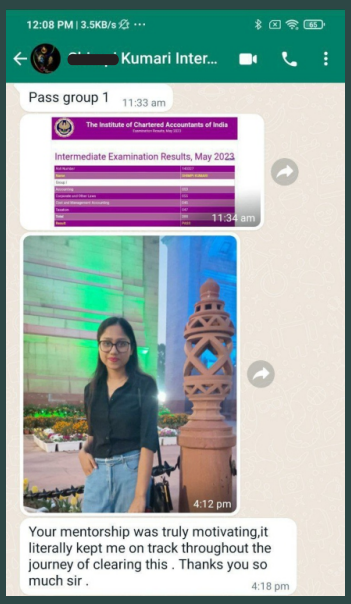

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(vi) Amount paid for redemption of debentures of ₹ 22,00,000

(vii) Underwriting commission of ₹ 40,000 paid on issue of equity share capital

(viii) Interest of ₹ 1,44,0**00 paid on long-term borrowing. (MTP 5 Marks Oct '21)**

Answer 4

Statement showing Cash Flow from Financing Activities

		₹
Cash inflow from financing activity		
Proceeds from issuance of equity share capital	20,00,000	
Proceeds from long term borrowings	12,00,000	
Total cash inflow from financing activity		32,00,000
Less: Cash outflow from financing activity		
Amount paid for redemption of debentures	22,00,000	
Underwriting commission paid	40,000	
Interest paid on long-term borrowings	1,44,000	(23,84,000)
Net cash inflow from financing activity		8,16,000

Question 5

Following is the cash flow abstract of Alpha Ltd. for the year ended 31st March, 2021:
Cash Flow (Abstract)

Inflows	Rs.	Outflows	Rs.
Opening cash and bank balance	80,000	Payment for Account Payables	90,000
Share capital – shares issued	5,00,000	Salaries and wages	25,000
Collection from Trade		Payment of overheads	15,000
Receivables	3,50,000	Machinery acquired	4,00,000
		Debentures redeemed	50,000
Sale of Machinery	70,000	Bank loan repaid	2,50,000
		Tax paid	1,55,000
		Closing cash and bank balance	15,000
	10,00,000		10,00,000

Prepare Cash Flow Statement for the year ended 31st March, 2021 in accordance with AS 3. (MTP5 Marks April 21, Mar 22, Old & New SM)

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Answer 5

Cash Flow Statement for the year ended 31.3.2021

	Rs.	Rs.
Cash flow from operating activities		
Cash received on account of trade receivables	3,50,000	
Cash paid on account of trade payables	(90,000)	
Cash paid to employees (salaries and wages)	(25,000)	
Other cash payments (overheads)	(15,000)	
Cash generated from operations	2,20,000	
Income tax paid	(1,55,000)	
Net cash generated from operating activities		65,000
Cash flow from investing activities		
Payment for purchase of machinery	(4,00,000)	
Proceeds from sale of machinery	70,000	
Net cash used in investment activities		(3,30,000)
Cash flow from financing activities		
Proceeds from issue of share capital	5,00,000	
Bank loan repaid	(2,50,000)	
Debentures redeemed	(50,000)	
Net cash used in financing activities		2,00,000
Net decrease in cash and cash equivalents		(65,000)
Cash and cash equivalents at the beginning of the year		80,000
Cash and cash equivalents at the end of the year		15,000

Question 6

Classify the following activities **as**

(I) Operating Activities,

(ii) Investing activities,

(iii) Financial activities and

(iV) Cash Equivalents.

(1) Cash receipts from Trade Receivables

(2) Highly liquid Marketable Securities without risk of change in value

(3) Purchase of investment

(4) Proceeds from long term borrowings

(5) Wages and Salaries paid

(6) Bank overdraft

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(7) Purchase of Goodwill
(8) Interim dividend paid on equity shares
(9) Short term Deposits
(10) Underwriting commission paid

(MTP 5 Marks, Sep 22) (PYP May '18, 5 **Marks)**

Answer 6

1. Operating Activities: Items 1 and 5.
2. Investing Activities: Items 3,7 and 9
3. Financing Activities: Items 4,6,8 and 10
4. Cash Equivalent: 2

Question 7

How will you disclose following items while preparing Cash Flow Statement of Gagan Ltd. as per AS-3 for the year ended 31st March, 2022?

(i) 10% Debentures issued: As on 01-04-2021 ₹ 1,10,000
As on 31-03-2022 ₹ 77,000

(ii) Debentures were redeemed at 5% premium at the end of the year. Premium was chargedto the Profit & Loss Account for the year.

(iii) Unpaid Interest on Debentures: As on 01-04-2021 ₹ 275
As on 31-03-2022 ₹ 1,175

(iv) Debtors of ₹ 36,000 were written off against the Provision for Doubtful Debts A/c during the year.

(v) 10% Bonds (Investments): As on 01-04-2021 ₹ 3,50,000

(vi) As on 31-03-2022 ₹ 3,50,000

(vii) Accrued Interest on Investments:As on 31-03-2022 ₹ 10,500 (MTP 5 Marks March '23)

Answer 7

Cash Flow Statement of Gagan Ltd. for the year ended March 31, 2022

A	**Cash Flow from Operating Activities**	
	Net Profit as per Profit & Loss A/c	--------
	Add: Premium on Redemption of Debentures	1,650
	Add: Interest on 10% Debentures	11,000
	Less: Interest on 10% Investments	(35,000)
B	**Cash Flow from Investing Activities**	
	Interest on Investments [35,000-10,500]	24,500
C	**Cash Flow from Financing Activities**	
	Interest on Debentures paid [11,000 - (1,175 - 275)]	(10,100)
	Redemption of Debentures [(1,10,000 - 77,000) at 5% premium]	(34,650)

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Note: Debtors written off against provision for doubtful debts does not require any furtheradjustment in Cash Flow Statement.

Question 8

Classify the following activities as (1) Operating Activities, (2) Investing Activities, (3) Financing Activities (4) Cash Equivalents.

a. **Proceeds from long-term borrowings.**

b. **Proceeds from Trade receivables.**

c. **Trading Commission received.**

d. **Redemption of Preference Shares.**

e. **Proceeds from sale of investment**

f. **Interim Dividend paid on equity shares.**

g. **Interest received on debentures held as investment.**

h. **Dividend received on shares held as investments.**

i. **Rent received on property held as investment.**

j. **Dividend paid on Preference shares.**

k. **Marketable Securities (RTP May 20)**

Answer 8

Operating Activities: b, c.

Investing Activities: e, g, h, i.

Financing Activities: a, d, f, j.

Cash Equivalent: k.

Question 9

Prepare cash flow from investing activities as per AS 3 of M/s Subham Creative Limited for year ended 31.3.2019. (PYP Nov;'19,5 Marks, Old & New SM) (Same concept lesser adjustments- MTP 4 Marks March 21, MTP 5 Marks April 22 & Oct '23)

Particulars	Amount (Rs.)
Machinery acquired by issue of shares at face value	2,00,000
Claim received for loss of machinery in earthquake	55,000
Unsecured loans given to associates	5,00,000
Interest on loan received form associate company	70,000
Pre-acquisition dividend received on investment made	52,600
Debenture interest paid	1,45,200
Term loan repaid	4,50,000

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Interest received on investment (TDS of Rs. 8,200 was deducted on the above interest)	73,800
Purchased debentures of X Ltd., on 1st December, 2018 which are redeemable	
within 3 months	3,00,000
Book value of plant & machinery sold (loss incurred Rs. 9,600)	90,000

Answer 9

Cash Flow Statement from Investing Activities of Subham Creative Limitedfor the year ended **31-03-2019**

Cash generated from investing activities	**Rs.**	**Rs.**
Interest on loan received	70,000	
Pre-acquisition dividend received on investment made	52,600	
Unsecured loans given to subsidiaries	(5,00,000)	
Interest received on investments (gross value)	82,000	
TDS deducted on interest	(8,200)	
Sale of Plant & Machinery ₹ (90,000 – 9,600)	80,400	
Cash used in investing activities (before extra-ordinary item)		(2,23,200)
Extraordinary claim received for loss of machinery		55,000
Net cash used in investing activities (after extra-ordinary item)		(1,68,200)

Note:

1. Debenture interest paid and Term Loan repaid are financing activities and therefore not consid-eredfor preparing cash flow from investing activities.
2. Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered inthe above cash flow statement.

The investments made in debentures are for short-term, it will be treated as 'cash equivalent' and willnot be considered as outflow in cash flow statement.

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Question 10

Prepare cash flow statement of Gama Limited for the year ended 31st March, 2021 in accordance with AS-3(Revised) from the following cash account summary: (PYP July'21, 5Marks)

Cash summary Account

Inflows	₹ ('000)	Outflows	₹ ('000)
Opening Balance	945	Payment to suppliers	54,918
Receipts from Customers	74,682	Purchase of Investments	351
Sale of Investments (Cost ₹ 4,05,000)	459	Property, plant and equipment acquired	6,210
Issue of Shares	8,100	Wages and salaries	1,863
Sale of Property, Plant and equipment	3,456	Payment of Overheads	3,105
		Taxation	6,561
		Dividends	2,160
	87,642	Repayment of Bank Overdraft	6,750
		Interest paid on Bank Overdraft	1,350
		Closing Balance	4,374
			87,642

Answer 10

Gama Limited Cash Flow Statement for the Year Ended 31st March 2021

Particulars	Amount (₹'000)	Amount (₹'000)
Cash flow from Operating Activities:		
Cash receipts from customers	74,682	
Cash payments to suppliers	(54,918)	
Cash payments for wages & salaries	(1,863)	
Cash payments of overheads	(3,105)	
Cash Generated from Operations	14,796	
Payment of Taxation	(6,561)	
Net Cash from Operating Activities		8,235
Cash Flow from Investing Activities:		
Proceeds from sale of investments	459	
Proceeds from sale of Property, Plant and Equipment	3,456	
Purchase of Investments	(351)	

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Purchase of Property, Plant and Equipment	(6,210)	
Net Cash Used in Investing Activities		(2,646)
Cash Flow from Financing Activities:		(2,160)
Proceeds from issue of shares	8,100	
Payment of Dividend	(2,160)	
Repayment of Bank Overdraft	(6,750)	
Interest paid on Bank Overdraft	(1,350)	
Net Cash Used in Financing Activities		
Net Increase in Cash & Cash Equivalent		3,429
Cash and Cash Equivalent in the Beginning of the year		945
Cash and Cash Equivalent in the end of the year		4374

Question 11

Following are the extracts from the Balance Sheet of ABC Ltd.

Liabilities	**31.3.2020**	**31.3.2021**
	(₹)	**(₹)**
Equity Share Capital	**25,00,0000**	**35,60,000**
10% Preference Share Capital	**7,00,000**	**6,00,000**
Securities Premium Account	**5,00,000**	**5,50,000**
Profit & Loss A/c	**20,00,000**	**28,00,000**

Equity Share Capital for the year ended 31st March, 2021 includes ₹ 60,000 of equity shares issued to Grey Ltd; at par for supply of Machinery of ₹ 60,000; Profit & Loss account on 31st March, 2021 includes ₹ 50,000 of dividend received on Equity shares invested in X Ltd. Show how the related items will appear in the Cash Flow Statement of ABC Ltd. as per AS-3 (Revised)

(PYP 5 Marks, Dec '21)

Answer 11

The related items given in the question will appear in the Cash Flow Statement of ABC Limitedfor the year ended 31st March, 2021 as follows:

	₹	₹
Cash flows from operating activities		
Closing Balance as per Profit and Loss Account	28,00,000	
Less: Opening Balance as per Profit and Loss Account	(20,00,000)	
	8,00,000	
Less: Dividend received	50,000	
		7,50,000

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Cash flows from investing activities		
Dividend received		50,000
Cash flows from financing activities		
Proceeds from issuance of share capital Equity shares issued for cash ₹ 10,00,000Pro-ceeds from securities premium (₹ 5,50,000 – 5,00,000) ₹ 50,000	10,50,000	
Less: Redemption of Preference shares (₹ 7,00,000 – ₹ 6,00,000)	(1,00,000)	9,50,000

Note:

1. Machinery acquired by issue of shares does not amount to cash outflow, hence also not consideredin the cash flow statement.
2. ABC Ltd. has been considered as a non-financial company in the given answer.

Question 12

The following information is provided by Alpha Limited, for the year ended 31st March, 2022:

(i) **Net profit before taking into account income tax and income from law suits but aftertaking into account the following items was ₹ 40 lakhs;**

(ii) **Depreciation on Fixed Assets ₹ 10 lakhs;**

(iii) **Discount on issue of Debentures written of ₹ 60,000;**

(iv) **Interest on Debentures paid ₹ 7,00,000;**

(v) **Book value of investments ₹ 6 lakhs (Sale of Investments for ₹ 6,40,000);**

(vi) **Interest received on investments ₹ 1,20,000;**

(vii) **Compensation received ₹ 1,80,000 by the company in a suit filed;**

(viii) **Income tax paid ₹ 21,00,000**

(ix) **Current assets and current liabilities in the beginning and at the end of the year were asdetailed below:**

	As on 31.3.2021 ₹	As on 31.3.2022 ₹
Stock	**24,00,000**	**26,36,000**
Sundry Debtors	**4,16,000**	**4,26,200**
Cash in hand	**3,92,600**	**70,600**
Bills Receivable	**1,00,000**	**80,000**
Bills Payable	**90,000**	**80,000**
Sundry Creditors	**3,32,000**	**3,42,600**
Outstanding Expenses	**1,50,000**	**1,63,600**

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You are required to prepare Cash Flow Statement from Operating Activities in accordance withAS-3 (revised) using the indirect method for the year ended 31st March,2022. (PYP 5 Marks May'22)

Answer 12

Alpha Ltd.
Cash Flow Statement (from Operating Activities) for the year ended 31st March, 2022

	₹	₹
Cash flow from Operating Activities		
Net profit before income tax and extraordinary items:		40,00,000
Adjustments for:		
Depreciation on Property, plant and equipment	10,00,000	
Discount on issue of debentures	60,000	
Interest on debentures paid	7,00,000	
Interest on investments received	(1,20,000)	
Profit on sale of investments	(40,000)	16,00,000
Operating profit before working capital changes		56,00,000
Adjustments for:		
Increase in inventory	(2,36,000)	
Increase in Sundry Debtors	(10,200)	
Decrease in Bills receivables	20,000	
Increase in Sundry Creditors	10,600	
Increase in Bills payables	(10,000)	
Increase in outstanding expenses	13,600	(2,12,000)
Cash generated from operations		53,88,000
Income tax paid		(21,00,000)
Cash flow from ordinary items		32,88,000
Cash flow from extraordinary items:		
Compensation received in a suit filed		1,80,000
Net cash flow from operating activities		34,68,000

Question 13

Ridgeway Limited, a Non-Financial company has the following activities:

(i) **Dividend paid for the year.**
(ii) **TDS on interest income earned on investments made.**
(iii) **Loans and advances given to suppliers and interest earned from them.**
(iv) **Deposit with bank for a term of two years.**
(v) **Highly liquid Marketable Securities (without risk of change in value).**
(vi) **Investments made and dividends earned on them.**

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(vii) **Insurance claims received against loss of stock or loss of profits.**

(viii) **Loans and advances given to subsidiaries and interest earned from them.**

(ix) **Issue of Bonus Shares.**

(x) **Term loan repaid.**

You are required to classify the above activities in Cash Flow Statement as per 'AS-3'; (PYP 5Marks Nov '22)

Answer 13

No.		Activities
(i)	Dividend paid for the year	Financing
(ii)	TDS on interest income earned oninvest-ments made	Investing
(iii)	Loans and advances given to suppliers andinter-est earned from them	Operating
(iv)	Deposit with bank for a term of two years	Investing
(v)	Highly liquid Marketable Securities(without risk of change in value)	Cash Equivalent
(vi)	Investments made and dividends earned onthem	Investing
(vii)	Insurance claims received against loss ofstock	Operating
	or loss of profits	
(viii)	Loans and advances given to subsidiariesand interest earned from them	Investing
(ix)	Issue of Bonus Shares	No Cash Inflow/Cash outflow
(x)	Term Loan repaid	Financing

Question 14

The summarized Balance Sheets of Flora Limited for the year ended 31st March, 2022 and 31stMarch, 2023 are as below:

Assts	31/03/2023 (₹)	31/03/2022 (₹)
Goodwill	**15,000**	**28,000**
Land	**5,75,000**	**6,00,000**
Furniture and Fixtures	**48,000**	**44,000**
Vehicles	**22,000**	**28,000**
Office Equipment	**21,000**	**-**
Long-term Investments	**60,000**	**1,10,000**
Stock-in-hand	**96,000**	**88,000**

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Bills Receivables	18,150	14,500
Trade Receivables	46,000	52,000
Cash and Bank Balances	1,29,850	34,500
Total	10,31,000	9,99,000

Liabilities	31/03/2023 (₹)	31/03/2022 (₹)
Equity Shares Capital	6,80,000	5,00,000
General Reserves	90,000	60,000
Profit and Loss Account	93,000	52,000
Capital Reserve	75,000	-
8% Debentures of ₹ 100 each	-	3,00,000
Loan from Mr. Andrew	-	15,000
Bills Payables	11,000	13,000
Trade Payables	49,000	45,000
Creditors for Equipment	10,500	-
Outstanding Expenses	4,500	3,000
Provision for Taxation	18,000	11,000
Total	10,31,000	9,99,000

Additional Information:

1. **On 1st April, 2022, one of the vehicles was sold for ₹ 3,000. No new purchases were made during the year.**
2. **A part of the total land was sold for ₹ 1,25,000 (Cost ₹ 1,00,000) and the balance land was revalued. Capital reserve consists of profit on revaluation of balance land. No new purchases were made during the year. (iii) Depreciation provided during the year-**
   - **Furniture and Fixtures ₹ 5,000**
   - **Vehicles ₹ 2,200**
3. **Interim dividend of 5,000 was paid during the year.**
4. **Provision for taxation for the year 2022-2023 was ₹ 16,000.**
5. **8% Debentures were redeemed at par after half year interest payment on 30th September, 2022.**
6. **Part of t**he long-term investments were sold at a profit of 8,000.
7. **Interest income received during the year on long-term investment was 6,500.**

You are required to prepare Cash Flow Statement from Operating Activities for the year ended31st March, 2023 using indirect method. (All workings should form part of the answer) (PYP 10 Marks May '23)

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Answer 14

Cash Flow Statement of Flora Limited from Operating Activities For the year ended 31st March, 2023

	₹	₹
Net profit before taxation (W.N.1)		92,000
Adjustment: Depreciation on Furniture & Fixtures	5,000	
Depreciation on Vehicles	2,200	
Profit on sale of land (₹ 125000 - ₹ 100000)	(25,000)	
Loss on sale (Vehicle)	800	
Profit on sale of long-term investments	(8,000)	
Interest received	(6,500)	
Interest on debentures	12,000	
Goodwill written off	13,000	(6,500)
Operating profit before working capital changes		85,500
Increase in Stock in Hand	(8,000)	
Increase in Bills Receivables	(3,650)	
Decrease in Trade Receivables	6,000	
Decrease in Bills payable	(2,000)	
Increase in Trade Payables	4,000	
Increase in outstanding expenses	1,500	(2,150)
Cash generated from Operations		83,350
Less: Income taxes paid		9,000
Cash flow from Operating activities		74,350

Alternative presentation:

Cash Flow Statement of Flora Limited from Operating Activities For the year ended 31st March, 2023

		₹
Net profit before taxation (W.N. 1)		92,000
Adjustment: Depreciation on Furniture & fixtures	5,000	
Depreciation on Vehicles	2,200	
Profit on sale of land	(25,000)	
Loss on sale (Vehicle)	800	
Profit on sale of long- term investments	(8,000)	
Interest received	(6,500)	
Interest on debentures	12,000	
Goodwill written off	13,000	(6,500)

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Operating profit before working capital changes		85,500
Increase in inventory	(8,000)	
Decrease in Trade receivables*	2,350	
Increase in Trade payables**	2,000	
Increase in outstanding expenses	1,500	(2,150)
Cash generated from Operations		83,350
Less: Income taxes paid		9,000
Cash flow from Operating activities		74,350

*[(18,150 +46,000) - (14,500 + 52,000)] ** [(11,000 + 49,000) - (13,000+45,000)] Working Notes:

1. (Net Profit before Taxation

Increases in Profit and Loss A/c (93,000-52,000)	41,000
Increases in General Reserve (90,000-60,000)	30,000
Interim dividend Paid	5,000
Transfer – provision for Taxation	16,000
Increase in retained earnings (Net Profit beforeTaxation)	92,000

Provision for Taxation Account

	₹		₹
To Bank (Balancingfigure)	9,000	By Balance b/d	11,000
To Balance c/d	18,000	By Profit and lossaccount	16,000
	27,000		27,000

Vehicles Account

Particulars	(₹)
Opening Balance	28,000
Less: Depreciation	(2,200)
Less: Closing Balance	(22,000)
Book value of vehicle sold	3,800
Less: Sale Value	(3,000)
Loss on sale of Vehicle	800

Question 15

On the basis of the following information prepare a Cash Flow Statement for the year ended 31st March, 2023 (Using direct method):

(i) **Total sales for the year were ₹ 796 crores out of which cash sales amounted to ₹ 524 crores.**

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(ii) Receipts from credit customers during the year, totalled ₹ 268 crores;

(iii) Purchases for the year amounted to ₹ 440 crores out of which credit purchase was 80%;Balance in creditors as on 1.4.2022 ₹ 168 crores 31.3.2023 ₹ 184 crores

(iv) Suppliers of other consumables and services were paid ₹ 38 crores in cash;

(v) Employees of the enterprises were paid 40 crores in cash.

(vi) Fully paid 9% Preference shares of the face value of ₹ 64 crores were redeemed; Equity shares of the face value of ₹ 40 crores were allotted as fully paid up at premium of 20%;

(vii) 10% Debentures of ₹ 40 crores at a premium of 10% were redeemed; Debenture holders were issued equity shares in lieu of their debentures. ₹ 52 crores were paid by way of income tax.

(viii) A new machinery costing ₹ 50 crores was purchased in part exchange of an old machinery; The book value of the old machinery was ₹ 26 crores. Through the negotiations, the vendor agreed to take over the old machinery at a higher value of ₹ 30 crores. The balance was paid in cash to the vendor.

(ix) Investment costing ₹ 36 cores were sold at a loss of ₹ 4 crores;

(x) Dividends totaling ₹ 30 crores was also paid;

(xi) Debenture interest amounting ₹ 4 crore was paid;

(xii) Non-cash expenditure incurred during the current year was 1.2 crores.

(xiii) Dividends declared during the current year was 15% on equity share capital (ESC = '120 crores);

(xiv) On 31st March 2022, Balance with Bank and Cash on hand totalled ₹ 4 crores. (RTP Nov '23)

Answer 15

Cash flow statement (using direct method) for the year ended 31st March, 2023

	(₹ in crores)	(₹ in crores)
Cash flow from operating activities		
Cash sales	524	
Cash collected from credit customers	268	
Less: Cash paid to suppliers for goods & services and to employees (Refer Working Note)	(502)	
Cash from operations	290	
Less: Income tax paid	(52)	
Net cash from operating activities		238
Cash flow from investing activities		
Net Payment for purchase of Machine (50 – 30)	(20)	
Proceeds from sale of investments	32	
Net cash from investing activities		12
Cash flow from financing activities		
Redemption of Preference shares	(64)	
Proceeds from issue of Equity shares	48	
Debenture interest paid	(4)	

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Dividend Paid	(30)	
Net cash used in financing activities		(50)
Net increase in cash and cash equivalents		200
Add: Cash and cash equivalents as on 1.04.2022		4
Cash and cash equivalents as on 31.3.2023		204

Working Note:

Calculation of cash paid to suppliers of goods and services and to employees

	(₹ in crores)
Opening Balance in creditors Account	168
Add: Purchases (440x .8)	352
Total	520
Less: Closing balance in Creditors Account	184
Cash paid to suppliers of goods	336
Add: Cash purchases (440x .2)	88
Total cash paid for purchases to suppliers (a)	424
Add: Cash paid to suppliers of other consumables and services (b)	38
Add: Payment to employees (c)	40
Total cash paid to suppliers of goods & services and to employees[(a)+ (b) + (c)]	502

Question 16

Crown Ltd. wants to prepare its cash flow statement. It sold equipment of book value of ₹ 60,000 at a gain of ₹ 8,000. The amount to be reported in its cash flow statement under operating activities is

a. Nil	b. ₹ 8,000
c. ₹ 68,000	d. ₹ 60,000

Ans: (a)

Question 17

While preparing cash flows statement, an entity (other than a financial institution) should disclose thedividends received from its investment in shares as

a. Operating cash inflow	b. Investing cash inflow
c. Financing cash inflow	d. Cash & cash equivalent

Ans: (b)

Question 18

XYZ Co. is a financial enterprise. In its cash flow statement, interest paid and dividends received

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should be

a. Classified as operating cash flows	b. Classified as financing cash flows
c. Not shown in cash flow statement	d. Classified as investing cash flows

Ans: (a)

Question 19

In the cash flow statement, 'cash and cash equivalents' do not include

a. Bank balances	b. Short-term investments readily convertibleinto Cash are subject to an insignificant risk of changes in value
c. Cash balances	d. Loan from bank

Ans: (d)

Question 20

While preparing a Cash Flow Statement using the Indirect method as required under AS 3, which of the following will not be deducted from/added to the Net Profit to arrive at the "Cash flow from Operating activities"?

a. Interest income	b. Gain on sale of a fixed asset
c. Depreciation	d. Gain on sale of inventory

Ans: (d)

Theoretical Questions Answers

Questions 21

What are the main features of the Cash Flow Statement?

Answers 21

According to AS 3 on "Cash Flow Statement", cash flow statement deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise during the given period from operating, investing and financing activities. Cash flows from operating activities can be reported using either

(a) the direct method, or (b) the indirect method. A cash flow statement when used in conjunction with theother financial statements, provides information that enables users to evaluate the changes in net assets ofan enterprise, its financial structure (including its liquidity and solvency), and its ability to affect the amount and timing of cash flows in order to adapt to changing circumstances and opportunities.

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Questions 22

Mayuri Ltd. acquired Plant and Machinery for ₹ 25 lakhs. During the same year, it also sold Furniture andFixtures for ₹ 4 lakhs. Can the company disclose, Net Cash Outflow towards purchase of Fixed Assets ₹ 21lakhs (i.e., 25 lakhs – 4 lakhs) in the Cash Flow Statement?

Answers 22

As per AS 3, Cash Flow Statements, an enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except in the case of:

- cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the enterprise; and
- cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

In the given case, since the purchase of Plant and Machinery and disposal of Furniture and Fixtures do not fall in the criteria of exception mentioned above, the same should be presented on a gross basis as an outflow of ₹ 25 lakhs and an inflow of ₹ 4 lakhs. Presentation of net cash outflow of ₹ 21 lakhs is not permitted as per AS 3.

Practical Questions Answers

Questions 23

How would the following cash flows be classified in accordance with AS 3?

- **Corporate Income Tax paid amounting to ₹ 70 lakhs during the reporting period.**
- **Payment of advance tax ₹ 8,75,000 out of which ₹ 75,000 was towards capital gains arising on accountof sale of assets during the reporting period.**
- **Fixed Deposits withdrawn by customers of State Bank of I dia ₹ 3 crores.**

Answers 23

As per AS 3, the given cash flows shall be recorded as under:

Corporate Income Tax paid amounting to ₹ 70 lakhs during the reporting period.	₹ 70 lakhs: Operating Cash Flows
Payment of advance tax ₹ 8,75,000 out of which ₹ 75,000 was towards capital gains arising on account of sale of assets during the reporting period.	₹ 8,00,000: Operating Cash Flows ₹ 75,000: Investing Cash Flows
Fixed Deposits withdrawn by customers of State Bank of India ₹ 3 crores.	₹ 3 crores: Operating Cash Flows for State Bank of India.

Questions 24

Money Ltd., a non-financial company has the following entries in its Bank Account. It has sought youradvice on the treatment of the same for preparing Cash Flow Statement.

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(i) Loans and Advances given to the following and interest earned on them:

(1) to suppliers

(2) to employees

(3) to its subsidiaries companies

(i) Investment made in subsidiary Smart Ltd. and dividend received

(i) Dividend paid for the year

Discuss in the context of AS 3 Cash Flow Statement.

Answers 24

Treatment as per AS 3 'Cash Flow Statement'

(i) Loans and advances given and interest earned

(1) to suppliers - Cash flows from operating activities

(2) to employees - Cash flows from operating activities

(3) to its subsidiary companies - Cash flows from investing activities

(i) Investment made in subsidiary company and dividend received Cash flows from investing activities

(i) Dividend paid for the year Cash flows from financing activities

Questions 25

From the following information of XYZ Limited, calculate cash and cash equivalent as on 31-03-20X2 as per AS 3.

Particulars	Amount (₹)
Balance as per the Bank Statement	25,000
Cheque issued but not presented in the Bank	15,000
Short Term Investment in liquid equity shares of ABC Limited	50,000
Fixed Deposit created on 01-11-20X1 and maturing on 15-04-20X2	75,000
Short Term Investment in highly liquid Sovereign Debt Mutual fund on 01-03-20X2 (having maturity period of less than 3 months)	1,00,000
Bank Balance in a Foreign Currency Account in India (Conversion Rate: On the day of deposit ₹ 69/USD as on 31-03-20X2 ₹ 70/USD)	$ 1,000

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Answers 25

Computation of Cash and Cash Equivalents as on 31st March, 20X2

	₹
Cash balance with bank (₹ 25,000 less ₹ 15,000)	10,000
Short term investment in highly liquid sovereign debt mutual fund on 1.3.20X2	1,00,000
Bank balance in foreign currency account ($1,000 x ₹ 70)	70,000
	1,80,000

Note: Short term investment in liquid equity shares and fixed deposit will not be considered as cash and cash equivalents.

Questions 26

Z Ltd. has no Foreign Currency Cash Flow during the reporting period. It held a deposit in a bank in France. The balances as at the beginning of the year and at the end of the year were € 100,000 and € 105,000 respectively. The exchange rate at the beginning of the year was € 1 = ₹ 82, and at the end of the year was€ 1 = ₹ 85. The increase in the deposit balance of € 5,000 was on account of interest credited on the last day of the reporting period. The deposit was reported at ₹ 82,00,000 in the opening balance sheet and at ₹ 89,25,000 in the closing balance sheet. You are required to show how these transactions would be presented in the Cash Flow Statement as per AS 3.

Answers 26

The Statement of Profit and Loss was credited on account of:

Interest Income: € 5,000 x ₹ 85 = ₹ 4,25,000

Exchange difference = € 100,000 x (₹ 85 – ₹ 82) = ₹ 3,00,000

In preparing the Cash Flow Statement, the exchange difference of ₹ 3,00,000 should be deducted from the Net Profit before taxes, since it is a non-cash item. However, in order to reconcile the opening balance ofthe Cash and Cash Equivalents with its closing balance, the Exchange Difference of ₹ 3,00,000 should be added to the opening balance in a Note to the Cash Flow Statement.,

Cash Flows arising from transactions in a Foreign Currency shall be recorded in Z Ltd.'s reporting currencyby applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the cash flow.

Question 27 (Illustration)

Classify the following activities as

(a) Operating Activities,

(b) Investing Activities,

(c) Financing Activities

(d) Cash Equivalents.

(a) **Purchase of Machinery.**

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(b) **Proceeds from issuance of equity share capital**

(c) **Cash Sales.**

(d) **Proceeds from long-term borrowings.**

(e) **Cheques collected from Trade receivables.**

(f) **Cash receipts from Trade receivables.**

(g) **Trading Commission received.**

(h) **Purchase of investment.**

(i) **Redemption of Preference Shares.**

(j) **Cash Purchases.**

(k) **Proceeds from sale of investment**

(l) **Purchase of goodwill.**

(m) **Cash paid to suppliers.**

(n) **Interim Dividend paid on equity shares.**

(o) **Wages and salaries paid.**

(p) **Proceed from sale of patents.**

(q) **Interest received on debentures held as investment.**

(r) **Interest paid on Long-term borrowings.**

(s) **Office and Administration Expenses paid**

(t) **Manufacturing Overheads paid.**

(u) **Dividend received on shares held as investments.**

(v) **Rent Received on property held as investment.**

(w) **Selling and distribution expense paid.**

(x) **Income tax paid**

(y) **Dividend paid on Preference shares.**

(z) **Underwritings Commission paid.**

(aa) **Rent paid.**

(ab) **Brokerage paid on purchase of investments.**

(ac) **Bank Overdraft**

(ad) **Cash Credit**

(ae) **Short-term Deposits**

(af) **Highly liquid Marketable Securities (without risk of change in value)**

(ag) **Refund of Income Tax received.**

Answers 27

(a) Operating Activities: c, e, f, g, j, m, o, s, t, w, x, aa & gg.

(b) Investing Activities: a, h, k, l, p, q, u, v, bb & ee.

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(c) Financing Activities: b, d, i, n, r, y, z, cc & dd.

(d) Cash Equivalent: ff.

Question 28(Illustration)

X Ltd. purchased debentures of ₹10 lacs of Y Ltd., which are redeemable within three months. How will you show this item as per AS 3 while preparing cash flow statement for the year ended on 31st March, 20X1?

Answers 28

As per AS 3 on 'Cash flow Statement', cash and cash equivalents consists of cash in hand, balance with banks and short-term, highly liquid investments. If investment, of ₹10 lacs, made in debentures is for short-term period then it is an item of 'cash equivalents'.

However, if investment of ₹10 lacs made in debentures is for long-term period then as per AS 3, it should be shown as cash flow from investing activities.

Question 29 (Illustration)

Classify the following activities as per AS 3 Cash Flow Statement:

1. Interest paid by financial enterprise
2. Tax deducted at source on interest received from subsidiary company
3. Deposit with Bank for a term of two years
4. Insurance claim received towards loss of machinery by fire
5. Bad debts written off

Answers 29

(i) Interest paid by financial enterprise Cash flows from operating activities As per AS 3, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say three months or less from the date of acquisition and is subject to insignificant risk of change in value.

(ii) TDS on interest received from subsidiary company Cash flows from investing activities

(iii) Deposit with bank for a term of two years Cash flows from investing activities

(iv) Insurance claim received against loss of fixed asset by fire Extraordinary item to be shown as a separate heading under 'Cash flow from investing activities'

(v) Bad debts written off It is a non-cash item which is adjusted from net profit/loss under indirect method, to arrive at net cash flow from operating activity.

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Question 30 (Illustration)

Following is the cash flow abstract of Alpha Ltd. for the year ended 31 st March, 20X1: Cash Flow (Abstract)

Inflows	₹	Outflows	₹
Opening balance:		Payment for Account	
Cash	10,000	Payables	90,000
Bank	70,000	Salaries and wages	25,000
Share capital – shares issued	5,00,000	Payment of overheads	15,000
Collection on account of		Property, plant and	
Trade Receivables	3,50,000	equipment acquired	4,00,000
		Debentures redeemed	50,000
Sale of Property, plant and	70,000	Bank loan repaid	2,50,000
equipment			
		Taxation	55,000
		Dividends	1,00,000
		Closing balance:	
		Cash	5,000
		bank	10,000
	10,00,000		10,00,000

Prepare Cash Flow Statement for the year ended 31st March, 20X1in accordance with Accounting Standard 3.

Answers 30

Cash Flow Statement for the year ended 31.3.20X1

	₹	₹
Cash flow from operating activities		
Cash received on account of trade receivables	3,50,000	
Cash paid on account of trade payables	(90,000)	
Cash paid to employees (salaries and wages)	(25,000)	
Other cash payments (overheads)	(15,000)	
Cash generated from operations	2,20,000	
Income tax paid	(55,000)	
Net cash generated from operating activities		1,65,000
Cash flow from investing activities		

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Payment for purchase of Property, plant and equipment	(4,00,000)	
Proceeds from sale of Property, plant and equipment	70,000	
Net cash used in investment activities		(3,30,000)
Cash flow from financing activities		
Proceeds from issue of share capital	5,00,000	
Bank loan repaid	(2,50,000)	
Debentures redeemed	(50,000)	
Dividends paid	(1,00,000)	
Net cash used in financing activities		1,00,000
Net decrease in cash and cash equivalents		(65,000)
Cash and cash equivalents at the beginning of the year		80,000
Cash and cash equivalents at the end of the year		15,000

Question 31 (Illustration)

Prepare Cash Flow from Investing Activities of M/s. Creative Furnishings Limited for the year ended 31-3-20X1.

Particulars	₹
Plant acquired by the issue of 8% Debentures	1,56,000
Claim received for loss of plant in fire	49,600
Unsecured loans given to subsidiaries	4,85,000
Interest on loan received from subsidiary companies	82,500
Pre-acquisition dividend received on investment made	62,400
Debenture interest paid	1,16,000
Term loan repaid	4,25,000
Interest received on investment	68,000
(TDS of ₹ 8,200 was deducted on the above interest)	
Book value of plant sold (loss incurred ₹ 9,600)	84,000

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Answers 31

Cash Flow Statement from Investing Activities of

M/s Creative Furnishings Limited for the year ended 31-03-20X1

Cash generated from investing activities	₹	₹
Interest on loan received	82,500	
Pre-acquisition dividend received on investment made	62,400	
Unsecured loans given to subsidiaries	(4,85,000)	
Interest received on investments (gross value)	76,200	
TDS deducted on interest	(8,200)	
Sale of plant	74,400	
Cash used in investing activities (before extra-ordinary item)		(1,97,700)
Extraordinary claim received for loss of plant		49,600
Net cash used in investing activities (after extra-ordinary item)		(1,48,100)

Note:

1. Debenture interest paid and Term Loan repaid are financing activities and, therefore, not considered forpreparing cash flow from investing activities.
2. Plant acquired by issue of 8% debentures does not amount to cash outflow, hence also not consideredin the above cash flow statement.

Note:

For details regarding preparation of Cash Flow Statement and Problems based on practical application of AS 3, students are advised to refer unit 2 of Chapter 11.

Reference:

The students are advised to refer the full text of AS 3 "Cash Flow Statement.

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Chapter 4.3

AS 17- Segment Reporting

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.10 TO Q.26											
Past Exams	Q.8	NO	NO	Q.7	NO	Q.7	Q.2,Q.7	NO	Q.9	NO	NO	NO
MTP	NO	NO	NO	NO	NO	NO	NO	Q.1	NO	NO	Q.1,Q.2	Q.7
RTP	NO	Q.1,Q.6	Q.5	Q.1	Q.2	Q.1	Q.1	Q.3	Q.1,Q.4	Q.1	Q.2	Q.7

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Chapter 4.3

AS 17- Segment Reporting

Question 1

A Company has an inter-segment transfer pricing policy of charging at cost less 5%. The market prices are generally 20% above cost. You are required to examine whether the policy adopted by the company is correct or not? (MTP 5 Marks Nov '21 & April '23) (RTP May'21, Nov'20, May'22, Nov '19, May'18, Nov'22, Old & New SM)

Answer 1

AS 17 'Segment Reporting' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter- segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if followed consistently.

Question 2

The Chief Accountant of Cotton Garments Limited gives the following data regarding its five segments:

(₹ in Crore)

Particulars	A	B	C	D	E	Total
Segment Assets	40	15	10	10	5	80
Segment Results	(95)	5	5	(5)	15	(75)
Segment Revenue	310	40	30	40	30	450

The Chief Accountant is of the opinion that segment "A" alone should be reported. Is he justified in his view? Examine his opinion in the light of provisions of AS 17 'Segment Reporting'. (MTP 5 Marks March '23) (RTP May '20 & May '23) (PYP 5 Marks, Jan 21) (Similar to RTP Nov 20 & Nov 19 but different figures) (PYP 5 Marks May '23)

Answer 2

As per para 27 of AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

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

2. 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

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

Further, if the total external revenue attributable to reportable segments constitutes less than 75% of 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 revenue is included in reportable segments.

Accordingly,

1. On the basis of revenue from sales criteria, segment A is a reportable segment.
2. On the basis of the result criteria, segments A & E are reportable segments (sincetheir results in absolute amount is 10% or more of ₹ 100 crore).
3. On the basis of asset criteria, all segments except E are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reportedupon in accordance with AS 17.

Hence, the opinion of chief accountant that only segment 'A' is reportable is wrong.

Question 3

a) **Company A is engaged in the manufacture of chemicals. The company manufactures five types of chemicals that have different applications. Can this company include more than one type of chemical in a single business segment? Comment.**

b) **Is an enterprise required to disclose changes in the basis of allocation of revenue and expenses to segments? Explain. (RTP Nov '21)**

Answer 3

a) As per AS 17, "A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products of 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 of services;

(b) the nature of the productions processes;

(c) the type of class of customers for the products or services;

(d) the methods used to distribute the products or provide the services; and

(e) if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities."

As per provisions of the standard, a single business segment does not include products and services with significantly differing risks and returns. Products and services included in a single business segment may be dissimilar with respect to one or several factors listed above but are expected to be similar with respectto majority of the factors. In the present case, the Company should consider whether the chemicals with different applications, have similar risks end returns. For this purpose, the Company should ascertain whether one or more types of chemicals are related keeping in view the relevant factors including those given in the definition of business segment. Chemicals having different applications can be included in a single business segment if majority of the relevant factors including those listed above

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are similar. This would ensure that the chemicals having significantly different risks and returns are not included in a singlebusiness segment.

b) As per AS 17, "Changesin accounting policies adopted for segment reporting that have a material effect onsegment information should be disclosed. Such disclosure should include a description of the nature of the change, and the financial effect of thechangeifitis reasonably determinable." It also states that "some changes in accounting policies relate specifically to segment reporting. Examples include changes in identification of segments and changes in the basis for allocating revenues and expenses to segments. Such changes can have a significant impact on the segment information reported but will not change aggregate financial information reported for the enterprise. To enable users to understand and impact of such changes, this Statement requires the disclosure of the nature of change and the financial effect of the change, if reasonably determinable".

In view of the above, a change in the basis of allocation of revenue and expenses to segments is a change in the accounting policy adopted for segment reporting. Accordingly, if the change has a material financial effect on the segment information, a description of the nature of the change, and the financial effect of the change, if it is reasonably determinable, should be disclosed.

Question 4

Company A is engaged in the manufacture and sale of products, which constitute two distinct business segments. The products of the Company are sold in the domestic market only. The management information system of the Company is organized to reflect operating information by two broad market segments, rural and urban. Besides the two business segments, how should Company A identify geographical segments? Do geographical segments exist within the same country? Explain in line with the provisions of AS 17. (RTP May 22) (New SM)

Answer 4

AS 17 explains that, "a single geographical segment does not include operations in economic environments with significantly differing risks and returns. A geographical segment may be a single country, a group of two or more countries, or a region within a country". Accordingly, to identity geographical segments, Company A needs to evaluate whether the segments reflected in the management information system function in environments that are subject to significantly differing risks and returns irrespective of the fact whether they are within the same country.

The Standard recognizes that, "Determining the composition of a business or geographical segment involves a certain amount of judgement...". Accordingly, while the management information system of the Company provides segment information for rural and urban geographical segments for the purpose of internal reporting, judgement is required to determine whetherthese segments are subject to significantly differing risks and returns based on the definition of geographical segment. In making such a judgement, aspect like different pricing and other policies, e.g., credit policies, deployment of resources between different regions etc., may be considered for the purpose identifying 'urban and 'rural' as separate geographical segment. Company A, in making judgmentfor identifying geographical segments, should also consider the relevance, reliability and comparability over time of segment information that will be reported. The Standard, explains that, "In making that judgement, enterprise management takes into account the objective of reporting financial information bysegment as set forth in the standard and the qualitative characteristics of financial statements. The qualitative characteristics include the relevance, reliability and comparability over time of financial information that is reported about the different groups of products and services of an enterprise and about its operations in particular geographical areas, and the usefulness of that information for assessingthe risks and returns of the enterprise."

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Question 5

PK Ltd. has identified business segment as its primary reporting format. It has identified India, USA andUK as three geographical segments. It sells its products in the Indian market, which constitutes 70 percent of the Company's sales. 25 per cent is sold in USA and the balance is sold in UK. Is PK Ltd. as part of its geographical secondary segment information, required to disclose segment revenue from export sales, where such sales are not significant? (RTP May 19)

Answer 5

As per AS 17 if primary format of an enterprise for reporting segment information is business segments, it should also report 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 per cent or more of enterprise revenue. Accordingly, for the purposes of disclosing secondary segment information, PK Ltd. is not required to disclose segment revenue from export sales to UK, since that segment does not meet the 10 per cent or more of enterprise revenue threshold. However, other secondary segment information as per AS 17 should be disclosed in respect ofthis segment if the thresholds prescribed in the AS 17 are met.

Question 6

(a) **Calculate the segment results of a manufacturing organization from the following information: (RTP Nov 18 & New SM)**

Segments	A	B	C	Total
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5:4: 2 basis)				1,10,000
Revenue from transactions with othersegments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in5: 4: 2 basis)				77,000
Expenses on transactions with othersegments				
Transaction from B	75,000		30,000	
Transaction from C	6,000	40,000		
Transaction from A		18,000	82,000	

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Answer 6

Calculation of segment result

Segments	A	B	C	Total
	Rs.	Rs.	Rs.	Rs.
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5: 4: 2 basis)	50,000	40,000	20,000	1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Total segment revenue as per AS 17 (A)	6,60,000	4,15,000	2,70,000	13,45,000
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in5 : 4 : 2 basis)	35,000	28,000	14,000	77,000
Expenses on transactions with other segments				
Transaction from B	75,000		30,000	1,05,000
Transaction from C	6,000	40,000		46,000
Transaction from A		18,000	82,000	1,00,000
Total segment expenses as per AS 17 (B)	4,16,000	2,36,000	2,01,000	8,53,000
Segment result (A-B)	2,44,000	1,79,000	69,000	4,92,000

Question 7

The accountant of Parag Limited has furnished you with the following data related to its Business Divisions: (Rs. in Lacs)

Division	A	B	C	D	Total
Segment Revenue	100	300	200	400	1,000
Segment Result	45	-70	80	-10	45
Segment Assets	39	51	48	12	150

You are requested to identify the reportable segments in accordance with the criteria laid down in AS 17. (PYP 5 Marks, Nov 20) (Similar to PYP Jan 21 & Nov 19 but different figures, Old & New SM) (MTP 5 Marks Sep '23) (RTP Nov '23)

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Answer 7

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as areportable segment if:

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

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

On the basis of revenue criteria, segments A, B, C and D - all are reportable segments.

On the basis of the result criteria, segments A, B and C are reportable segments (since their results in absolute amount is 10% or more of 125 Lakhs). On the basis of asset criteria, all segments except Dare reportable segments. Since all the segments are covered in at least one of the above criteria, all segments have to be reported upon in accordance with Accounting Standard (AS) 17.

Question 8

M/s Nathan Limited has three segments namely P, Q and R. The assets of the company are Rs. 15 crores. Segment P has 4 crores, Segment Q has 6 crores and Segment R has 5 crores. Deferred tax assets included in the assets of each segment are P - Rs. 1 crore, Q - Rs. 0.90 crores and R - Rs. 0.80 crores. The accountant contends all these three segments are reportable segments. Comment. (PYP 5 Marks, May 18) (Old & New SM)

Answer 8

According to AS 17 "Segment Reporting", segment Assets do not include income tax assets.

Therefore, the revised total assets are 12.3 crores [`15 – (Rs. 1 + 0.9 + 0.8). Details of Segment wise assets Segment P holds total assets of Rs. 3 crores (Rs. 4 crores – Rs. 1 crores); Segment Q holds Rs. 5.1 crores (Rs. 6 crores – 0.9 crores); Segment R holds Rs. 4.2 crores (Rs. 5 crores – Rs. 0.8 crores).

Thus, all the three segments hold more than 10% of the total assets, all segments are reportable segments. Hence, the contention of the accountant that all three segments are reportable segments is correct.

Question 9

Answer any four of the following:

XYZ Ltd. has 5 business segments. Profit / Loss of each of the segments for the year ended 31st March,2022 has been provided below. You are required to identify from the following whether reportable segments or not reportable segments, on the basis of "profitability test" as per AS-17.

Segment	Profit (Loss) ₹ in lakhs
A	225
B	25
C	(175)
D	(20)
E	(105)

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(PYP 5 Marks May'22)

Answer 9

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

Its segment results whether profit or loss is 10% or more of:

- The combined result of all segments in profit; i.e., ₹ 250 Lakhs or
- The combined result of all segments in loss; i.e., ₹ 300 Lakhs Whichever is greater in absoluteamount i.e., ₹ 300 Lakhs.

Operating Segment	Absolute amount of Profit or Loss (₹ In lakhs)	Reportable Segment Yes or No
A	225	Yes
B	25	No
C	175	Yes
D	20	No
E	105	Yes

On the basis of the profitability test (result criteria), segments A, C and E are reportable segments (since their results in absolute amount is 10% or more of ₹ 300 lakhs i.e., 30 lakhs).

Question 10

As per AS 17, reportable segments are those whose total revenue from external sales and inter- segmentsales is (Old & New SM)

a. 10% or more of the total revenue of all segments	b. 10% or more of the total revenue of all external segments
c. 12% or more of the total revenue of allsegments	d. 12% or more of the total revenue of allexternal segments

Ans: (a)

Question 11

Which of the following statements is correct? (Old & New SM)

a. Management has a discretion to include a segment as a reportable segment even if it passes the 10% materiality test.
b. Management has a discretion to include any segment as a reportable segment if it fails the 12% materiality test.
c. It is mandatory for the management to include the segment as a reportable segment if it passes the 10% materiality test.
d. It is not mandatory for the management to include the segment as a reportable segment if it passes the 10% materiality test.

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Ans: (c)

Question 12

Which of the following statements is correct? (Old & New SM)

a. The overall test of 75% considers only external revenue to compute the threshold limit.
b. The overall test of 75% considers only internal revenue to compute the threshold limit.
c. The overall test of 75% considers both internal and external revenue to compute the threshold limit.
d. It is management choice whether they want to include both external and internal revenue for computing threshold limit.

Ans: (a)

Question 13

Which of the following statements is correct? (Old & New SM)

a. The 10% test computed on the basis of revenue, considers both internal and external revenue to compute the threshold limit.
b. The 10% test computed on the basis of revenue, considers only external revenue to compute the threshold limit.
c. The 10% test computed on the basis of revenue, considers only internal revenue to compute the threshold limit.
d. It is management choice whether they want to include both external and internal revenue for computing threshold limit.

Ans: (a)

Question 14

Which of the following statements is correct? (Old & New SM)

a. In case of 10% test based on profit/loss, we need to consider that any segment whose profit or loss is 10% or more than the net profit or netloss respectively of all segments taken together becomes reportable segment.

b. In case of 10% test based on profit/loss, we need to consider that any segment whose profit or lossis 10% or more than the net profit (after netting the losses) of all segments taken together becomes reportable segment.

c. In case of 10% test based on profit/loss, we need to consider that any segment whose profit or lossis 10% or more than the net profit or loss (whichever is higher in absolute figures) of all segments taken together becomes reportable segment.

d. In case of 10% test based on profit/loss, we need to consider that any segment whose profit or lossis 10% or more than the net profit or loss (whichever is lower in absolute figures) of all

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segments taken together becomes reportable segment.

Ans: (c)

Practical Questions Answers

Questions 15

Nathan Limited has three segments namely P, Q and R. The assets of the company are ₹ 15 crores. Segment P has 4 crores, Segment Q has 6 crores and Segment R has 5 crores. Deferred tax assets included in the assets of each segment are P - ₹ 1 crore, Q - ₹ 0.90 crores and R - ₹ 0.80 crores. The accountant contends all these three segments are reportable segments. Comment.

Answers 15

According to AS 17 "Segment Reporting", segment assets do not include income tax assets.Therefore, the revised total assets are 12.3 crores [₹ 15 - (₹ 1 +0.9 + 0.8).

Details of Segment wise assets:

Segment P holds total assets of ₹ 3 crores (₹ 4 crores - ₹ 1 crores); Segment Q holds ₹ 5.1 crores (₹ 6 crores - ₹ 0.9 crores);

Segment R holds ₹ 4.2 crores (₹ 5 crores - ₹ 0.8 crores).

Thus, all the three segments hold more than 10% of the total assets, all segments are reportable segments. Hence, the contention of the Accountant that all three segments are reportable segments is correct.

Questions 16

Company A is engaged in the manufacture and sale of products, which constitute two distinct business segments. The products of the Company are sold in the domestic market only. The management information system of the Company is organized to reflect operating information by two broad marketsegments, rural and urban.

Besides the two business segments, how should Company A identify geographical segments? Do geographical segments exist within the same country? Explain in line with the provisions of AS 17.

Answers 16

AS 17 explains that, "a single geographical segment does not include operations in economic environments with significantly differing risks and returns. A geographical segment may be a single country, a group of two or more countries, or a region within a country".

Accordingly, to identity geographical segments, Company A needs to evaluate whether the segments reflected in the management information system function in environments that are subject to significantly differing risks and returns irrespective of the fact whether they are within the same country.

The Standard recognizes that, "Determining the composition of a business or geographical segment involves a certain amount of judgement...". Accordingly, while the management information system of the Company provides segment information for rural and urban geographical segments for the purpose of internal reporting, judgement is required to determine whether these segments are subject to significantly differing risks and returns based on the definition of geographical segment. In making such a judgement, aspect like different pricing and other policies, e.g., credit policies, deployment of resourcesbetween different regions etc., may be considered for the purpose identifying 'urban and 'rural' as separate geographical segment.

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Company A, in making judgment for identifying geographical segments, should also consider the relevance, reliability and comparability over time of segment information that will be reported. The Standard, explains that, "In making that judgement, enterprise management takes into account the objective of reporting financial information by segment as set forth in the standard and the qualitative characteristics of financial statements. The qualitative characteristics include the relevance, reliability and comparability over time of financial information that is reported about the different groups of products and services of an enterprise and about its operations in particular geographical areas, and the usefulness ofthat information for assessing the risks and returns of the enterprise."

Questions 17

PK Ltd. has identified business segment as its primary reporting format. It has identified India, USA and UK as three geographical segments. It sells its products in the Indian market, which constitutes 70 percent of the Company's sales. 25 per cent is sold in USA and the balance is sold in UK.

Is PK Ltd. as part of its geographical secondary segment information, required to disclose segment revenue from export sales, where such sales are not significant?

Answers 17

As per AS 17, if primary format of an enterprise for reporting segment information is business segments, it should also report 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 per cent or more of enterprise revenue.

Therefore, for the purposes of disclosing secondary segment information, PK Ltd. is not required to disclose segment revenue from export sales to UK, since that segment does not meet the 10 per cent ormore of enterprise revenue threshold. However, other secondary segment information as per AS 17 should be disclosed in respect of this segment if the thresholds prescribed in the AS 17 are met.

Questions 18

XYZ Ltd. has 5 business segments. Profit / Loss of each of the segments for the year ended 31st March, 20X2 have been provided below. You are required to identify from the following whether reportablesegments or not reportable segments, on the basis of "profitability test" as per AS-17.

Segment	Profit (Loss) ₹ in lakhs
A	225
B	25
C	(175)
D	(20)
E	(105)

Answers 18

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

Its segment results whether profit or loss is 10% or more of:

- The combined result of all segments in profit; i.e. ₹ 250 Lakhs or
- The combined result of all segments in loss; i.e. ₹ 300 Lakhs Whichever is greater in absolute

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amount i.e. ₹ 300 Lakhs.

Operating Segment	Absolute amount of Profit orLoss (₹ In lakhs)	Reportable Segment Yes or No
A	225	Yes
B	25	No
C	175	Yes
D	20	No
E	105	Yes

On the basis of the profitability test (result criteria), segments A, C and E are reportable segments (since their results in absolute amount is 10% or more of₹ 300 lakhs i.e. 30 lakhs).

Questions 19

ABC Limited has 5 segments namely A, B, C, D and E. The profit/loss of each segment for the year ended March 31st, 20X2 is as follows:

Segment	Profit/ (Loss) (₹ in crore)
A	**780**
B	**1,500**
C	**(2,300)**
D	**(4,500)**
E	**6,000**
Total	**1,480**

Identify the Reportable segments.

Answers 19

In compliance with AS 17, the segment profit/loss of respective segment will be compared with thegreater of the following:

All segments in profit, i.e., A, B and E - Total profit ₹ 8,280 crores.All segments in loss, i.e., C and D - Total loss 6,800 crores.

Greater of the above - ₹ 8,280 crores.

Based on the above, reportable segments will be determined as follows:

Segment	Profit/(Loss)	Absolute Profit/Loss as a % of 8,280	Reportable Segment
A	780	9%	No
B	1,500	18%	Yes
C	(2,300)	28%	Yes
D	(4,500)	54%	Yes

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E	6,000	72%	Yes
Total	**1,480**		

Questions 20

Heavy Goods Ltd. has 6 segments namely L-Q (below). The total revenues (internal and external), profitsor losses and assets are set out below:

(In₹)

Segment	Inter Segment Sales	External Sales	Profit / loss	Total assets
L	4,200	12,300	3,000	37,500
M	3,500	7,750	1,500	23,250
N	1,000	3,500	(1,500)	15,750
0	0	5,250	(750)	10,500
P	500	5,500	900	10,500
Q	1,200	1,050	600	5,250
	10,400	35,350	3,750	1,02,750

Heavy Goods Ltd. needs to determine how many reportable segments it has. You are required to advice Heavy Goods Ltd. as per the criteria defined in AS 17.

Answers 20

Quantitative Threshold Test:

Revenue Test:

Combined total sales of all the segment = ₹ 10,400 + ₹ 35,350 = ₹ 45,750.
10% thresholds = 45,750 x 10% = 4,575.

Profitability Test:

In the given situation, combined reported profit = ₹ 6,000 and combined reported loss (₹ 2,250). Hence,for 10% thresholds ₹ 6,000 will be considered.

10% thresholds = ₹ 6,000 x 10% = ₹ 600 Asset
Test:

Combined total assets of all the segment = ₹ 1,02,750 10% thresholds = ₹ 1,02,750 x 10% = 10,275Accordingly, quantitative thresholds are calculated below:

Segments	L	M	N	O	P	Q	Reportable segments
% segment sales to total sales	36.66%	24.59%	9.84%	11.48%	13.11%	4.92%	L, M,O,P
% segment profit to total profits	50%	25%	25%	12.5%	15%	10%	L,M,N,O,P,Q
% segment assets to total assets	36.50%	22.63%	15.33%	10.22%	10.22%	5.11%	L,M,N,O,P

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Conclusion:

Segments L, M, O and P clearly satisfy the revenue and assets tests and they are separate reportable segments.

Segment N does not satisfy the revenue test, but it does satisfy the asset test and it is a reportable segment.

Segment Q does not satisfy the revenue or the assets test but is does satisfy the profits test. Therefore, Segment Q is also a reportable segment.

Hence all segments i.e. L, M, N, O, P and Q are reportable segments.

Questions 21

Calculate the segment results of a manufacturing organization from the following information:

Segments	A	B	C	Total
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5 :4 : 2 basis)				1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in 5 :4 :2 basis)				77,000
Expenses on transactions with other segments				
Transaction from B	75,000		30,000	
Transaction from C	6,000	40,000		
Transaction from A		18,000	82,000	

Answers 21

Computation of segment result:

Segments	A	B	C	Total
	₹	₹	₹	₹
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5 :4 :2 basis)	50,000	40,000	20,000	1,10,000

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Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000			60,000
Transaction from A		50,000	1,00,000	1,25,000
Total segment revenue (1)	6,60,000	25,000	2.70,000	13,45,000
Operating expenses Enterprise expenses (allocated in 5 :4 :2 basis)	3,00,000	4,15,000	75,000	5,25,000
	35,000	1,50,000	14,000	77,000
		28,000		
Expenses on transactions with otherseg-ments				
Transaction from B	75,000		30,000	1,05,000
Transaction from C	6,000			46,000
Transaction from A		40,000	82,000	1,00,000
Total segment expenses (2)	4,16,000	18,000	2,01,000	8,53,000
Segment result (1-2)	2,44,000	2,36,000	69,000	4,92,000
		1,79,000		

Question 22 (Illustration)

The Chief Accountant of Sports Ltd. gives the following data regarding its six segments:

in lakhs

Particulars	M	N	O	P	Q	R	Total
Segment Assets	**40**	**80**	**30**	**20**	**20**	**10**	**200**
Segment Results	**50**	**(190)**	**10**	**10**	**(10)**	**30**	**(100)**
Segment Revenue	**300**	**620**	**80**	**60**	**80**	**60**	**1,200**

The Chief accountant is of the opinion that segments "M" and "N" alone should be reported. Is he justified in his view? Discuss.

Answers 22

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

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

Its segment result whether profit or loss is 10% or more of:

- The combined result of all segments in profit; or

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- The combined result of all segments in loss,whichever is greater in absolute amount; or

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

If the total external revenue attributable to reportable segments constitutes less than 75% of total enterprise revenue, additional segments should be identified as reportable segments even if they do notmeet the 10% thresholds until atleast 75% of total enterprise revenue is included in reportable segments. Onthe basis of turnover criteria segments M and N are reportable segments.

On the basis of the result criteria, segments M, N and R are reportable segments (since their results in absolute amount is 10% or more of₹ 200 lakhs).

On the basis of asset criteria, all segments except R are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reportedin accordance with Accounting Standard (AS) 17. Hence the opinion of chief accountant is wrong.

Question 23 (Illustration)

A Company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 25% above cost. Is the policy adopted by the company correct?

Answers 23

AS 17 'Segment Reporting' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and anychange therein should be disclosed in the financial statements. Hence the enterprise can have its own policy for pricing inter-segment transfers and hence inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the companyis correct if, followed consistently.

Question 24 (Illustration)

M/s XYZ Ltd. has three segments namely X, Y, Z. The total Assets of the Company are ₹ 10.00 crores. Segment X has₹ 2.00 crores, segment Y has ₹ 3.00 crores and segment Z has₹ 5.00 crores. Deferred tax assets included in the assets of each segments are X- ₹ 0.50 crores, Y—₹ 0.40 crores and Z—₹ 0.30 crores. The accountant contends that all the three segments are reportable segments. Comment.

Answers 24

According to AS 17 "Segment Reporting", segment assets do not include income tax assets. Therefore, the revised total assets are ₹ 8.8 crores [₹ 10 crores – (₹ 0.5 + ₹ 0.4 +₹ 0.3)]. Segment X holds total assets of ₹ 1.5 crores (₹ 2 crores –₹ 0.5 crores); Segment Y holds ₹ 2.6 crores (₹ 3 crores –₹ 0.4 crores); and Segment Z holds ₹ 4.7 crores (₹ 5 crores –₹ 0.3 crores). Thus all the three segments hold more than 10% of the total assets, all segments are reportable segments.

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Question 25 (Illustration)

Prepare a segmental report for publication in Diversifiers Ltd. from the following details of the company's three divisions and the head office:

	₹ ('000)
Forging Shop Division	
Sales to Bright Bar Division	4,575
Other Domestic Sales	90
Export Sales	6,135
Bright Bar Division	10,800
Sales to Fitting Division	45
Export Sales to Rwanda	300
Fitting Division	345
Export Sales to Maldives	270

Particulars	Head Office ₹ ('000)	ForgingShop Division ₹ ('000)	Bright BarDivi-sion ₹ ('000)	FittingDivi-sion ₹ ('000)
Pre-tax operating result		240	30	(12)
Head office cost reallocated		72	36	36
Interest costs		6	8	2
Fixed assets	75	300	60	180
Net current assets	72	180	60	135
Long-term liabilities	57	30	15	180

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Answers 25

Diversifiers Ltd. Segmental Report *(₹'000)*

Particulars	Divisions			Inter Segment Eliminations	Consolidated Total
	Forging shop	Bright Bar	Fitting		
Segment Revenue					
Sales:					
Domestic	90	-	-	-	90
Export	6,135	300	270	-	6,705
External Sales	6,225	300	270	-	6,795
Inter-Segment Sales	4,575	45	-	4,620	-
Total Revenue	10,800	345	270	4,620	6,795
Segment Result (Given)	240	30	(12)		258
Head Office Expenses					(144)
Operating Profit					114
Interest Expense					(16)
Profit Before Tax					98
Information in Relation to Assets and Liabilities:					
Fixed Assets	300	60	180	-	540
Net Current Assets	180	60	135	-	375
Segment assets	480	120	315	-	915
Unallocated Corporate Assets (75 + 72)	-	-	-	-	147
Total assets					1,062
Segment liabilities	30	15	180	-	225
Unallocated corporate liabilities					57
Total liabilities					282

Sales Revenue by Geographical Market (₹ '000)

	Home Sales	Export Sales (by forging shop division)	Export to Rwanda	Export to Maldives	Consolidated Total
External sales	90	6,135	300	270	6,795

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Question 26 (Illustration)

Microteach Ltd. produces batteries for scooters, cars, trucks, and specialized batteries for investors andUPS. How many segments should it have and why?

Answers 26

In case of Microtech Ltd., the basic product is the batteries, but the risks and returns of the batteries for automobiles (scooters, cars and trucks) and batteries for invertors and UPS are affected by different set of factors. In case of automobile batteries, the risks and returns are affected by the Government policy, road conditions, quality of automobiles, etc. whereas in case of batteries for invertors and UPS, the risks and returns are affected by power condition, standard of living, etc. Therefore, it can be said that Microtech Ltd. has two business segments viz- 'Automobile batteries' and 'batteries for Invertors and UPS'.

Reference: The students are advised to refer the full text of AS 17 "Segment Reporting".

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Chapter 4.4

AS 18- Related Party Disclosures

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.12 TO Q.32											
Past Exams	Q.3	Q.2,Q.10	Q.9	NO	NO	NO	NO	Q.1	NO	NO	Q.11	NO
MTP	NO	NO	NO	NO	Q.3	Q.2	Q.1,Q.2	NO	Q.2	Q.3	Q.4	Q.1,Q.2
RTP	Q.7	Q.4	NO	NO	Q.4	Q.4	Q.6	Q.5	Q.8	Q.1	NO	Q.9

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Chapter 4.4

AS 18- Related Party Disclosures

Question 1

SP hotels Limited enters into an agreement with Mr. A for running its hotel for a fixed return payable to the later every year. The contract involves the day-to-day management of the hotel, while all financial and operating policy decisions are taken by the Board of Directors of the company. Mr. A does not ownany voting power in SP Hotels Limited. Would he be considered as a related party of SP Hotels Limited?Also explain the required related party disclosure requirements under AS 18? (MTP 5 Marks April 21, Sep '23, RTP Nov 22, PYP 5 Marks July'21) (Same concepts but lesser adjustments as RTP Nov'19, May'19)

Answer 1

Mr. A will not be considered as a related party of SP Hotels Limited in view of AS 18 which states, "individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise thatgives them control or significant influence over the enterprise, and relatives of any such individual". In thegiven case, in the absence of share ownership, Mr. A would not be considered to exercise significant influence on SP Hotels Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr. A does not have the ability to direct or instruct the board of directorsdoes not qualify him as a key management personnel.

Related Party Disclosures: 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;

- **(a)** Any other elements of the related party transactions necessary for an
- **(b)** understanding of the financial statements;
- **(c)** 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;
- **(d)** Amounts written off or written back in the period in respect of debts due from or to related parties.

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Question 2

(i) Mr. Raj a relative of key management personnel received remuneration of Rs. 2,50,000 for his services in the company for the period from 1.4.2020 to 30.6.2020. On 1.7.2020, he left the service. Should the relative be identified as at the closing date i.e. on 31.3.2021 for the purposes of AS 18? (MTP 5 Marks March 21, Oct'20, Mar'22, Old & New SM) (Same concept different figures PYP 2.5 Marks July'21, PYP 2.5 Marks, Nov '18)

(ii) X Ltd. sold goods to its associate Company during the 1st quarter ending 30.6.2020. After that, the related party relationship ceased to exist. However, goods were supplied as were supplied to any other ordinary customer. Decide whether transactions of the entire year need disclosure as related party transaction. (MTP 5 Marks March 21, Oct'20, Mar'22 & Oct '23, Old & New SM)

Answer 2

(i) According to AS 18 on 'Related Party Disclosures', 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. Hence, Mr. Raj, a relative of key management personnel should be identified as related party for disclosure in the financial statements for the year ended 31.3.2021.

(ii) As per AS 18, transactions of X Ltd. with its associate company for the first quarter ending 30.06.2020 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did not exist need not be reported.

Question 3

You are required to identify the related parties in the following cases as per AS 18: M Ltd. holds 61 % shares of S Ltd. S Ltd. holds 51 % shares of F Ltd. C Ltd. holds 49% shares of F Ltd. (Give your answer - Reporting Entity wise for M Ltd., S Ltd., C Ltd. and F Ltd.) (MTP 5 Marks May 20 & Sep '22) (PYP 2.5 MarksMay 18)

Answer 3

(a) Reporting entity- M Ltd.

- S Ltd. (subsidiary) is a related party
- F Ltd.(subsidiary) is a related party

(b) Reporting entity- S Ltd.

- M Ltd. (holding company) is a related party
- F Ltd. (subsidiary) is a related party

(c) Reporting entity- F Ltd.

- M Ltd. (holding company) is a related party
- S Ltd. (holding company) is a related party
- C Ltd. (investor/ investing party) is a related party

(d) Reporting entity- C Ltd.

- F Ltd. (associate) is a related party

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Question 4

(i) On the basis of provisions of AS 18 'Related Party Disclosures': Identify the related parties in the following cases:

X Limited holds 60% shares of Y Limited Y Limited holds 55% shares of W Limited Z Limited holds 35% shares of W Limited

(ii) Himalaya Limited sold goods for ₹ 40 Lakhs to Aravalli Limited during financial year ended on March 31, 2022. The Managing Director of Himalaya Limited owns 80% shares of Aravalli Limited. The sales were made to Aravalli Limited at normal selling prices followed by Himalaya Limited. The chief accountant of Himalaya Limited contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per AS 18. You are required to comment on this. (MTP 5 Marks March '23, RTP Nov '20) (Same concept different figures RTP May'20, RTP Nov'18, Old & New SM)

Answer 4

(i) X Ltd., Y Ltd. & W Ltd. are related to each other. Z Ltd. & W Ltd. are related to each other by virtueof associate relationship. However, neither X Ltd. nor Y Ltd. is related to Z Ltd. and vice versa since neither control nor significant influence exists between them.

(ii) Himalaya Ltd. and Aravalli Ltd are related parties since key management personnel of Himalaya Ltd.

i.e. its managing director holds 80% in Aravalli Ltd. and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price. Hence the contention of Chief Accountant of Himalaya Ltd that these sales require no disclosure under related party Transactions, is wrong.

Question 5

(a) Omega Bank Limited holds 25 per cent of the voting power of B Limited. Omega Bank Limited also provides finance by way of a loan to B Limited at market rates of interest, on account of which, Omega Bank Limited would have the power to nominate one person to the board of directors of B Limited. Any major transactions proposed to be entered into by B Limited would need the consent of Omega Bank Limited. Would Omega Bank Limited be considered as related party for B Ltd. (reporting enterprise)?

(b) A Limited has two Associates, B Limited and C Limited, and owns 25 per cent of the voting power of B Limited and 30 per cent of the voting power of C Limited. Would Be Limited be considered a related partyfor the purpose of financial statements of C Limited? (RTP Nov '21)

Answer 5

(a) Omega Bank Limited would be a related party of B Limited. As per AS 18 "associates and joint ventures of thereporting enterprise and the investing party of venture in respect of which the reporting enterprise is an associate or a joint venture" are related party relationship. Further, an associate has been defined as "an enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of the party". Significant influence has been defined to be "participation in the financial and /oroperating policy decisions of an enterprise, but not control of those policies". Further, it is given in the standard that significant influence may be gained by share ownership, agreement or statute. As regards share ownership,there is a presumption that ownership of 20 per cent or more of the voting power enables the enterpriseto exercise significant influence, unless it could be clearly demonstrated otherwise. In the given example, Ome-

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ga Bank Limited exercises significant influence over B Limited by virtue of ownership of 25 per cent of the voting power. Omega Bank Limited is also a provider of finance for B Limited (as it has provided a loan to B Limited), and as per the standard, a provider of finance is deemed not to be a related party during its normal dealings with the enterprise by virtue only of those dealing. However, in this case, the exemption would not be available to Omega Bank Limited as the exercise of significant influence of Omega Bank Limited over B Limited has been demonstrated on account of ownership of more than 20 per cent of votingpower. Accordingly, Omega Bank Limited would be construed to be a related party in the financial statements of B Limited and consequently, the latter would be required to disclose the transactions with Omega Bank Limited in its financial statements.

(b) Both B Limited and C Limited are 'associates' of A Limited. Follow-associates cannot be regarded as a related parties only by virtue of the relationship. AS 18 states that "enterprise that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise" are related parties. Further, it is given that "associates and joint ventures of the reporting enterprise and the investing party or venture in respect of which the reporting enterprise is an associate or a joint venture" are also related parties. As B Limited is not an associate of C Limited, nor is it being controlled, directly or indirectly, by C Limited or is not so controlling C Limited, it is not a related partyof C Limited.

Question 6

R Ltd. has 60% voting right in S Ltd. S Ltd. has 15% voting right in T Ltd. R Ltd. directly enjoys voting right of 10% in T Ltd. T Ltd. is a listed company and regularly supplies goods to R Ltd. The management of T Ltd. has not disclosed its relationship with R Ltd. You are required to assess the situation from the view point of AS 18 on Related Party Disclosures. (RTP May 21)

Answer 6

AS 18 'Related Party Disclosures', defines related party as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other party in makingfinancial and/or operating decisions.

Definition for Control

Here, control is defined as ownership directly or indirectly of more than one-half of the voting power of an enterprise; and Significant Influence is defined as participation in the financial and/or operating policydecisions of an enterprise but not control of those policies.

Nature of Relationship

R Ltd. has direct economic interest in T Ltd. to the extent of 10%, and through S Ltd. in which it is the majority shareholders, it has further control of 9% in T Ltd. (60% of S Ltd.'s 15%). These two taken together (10% + 9%) make the total control of 19%.

Conclusion

In the present case, control of R Ltd. in T Ltd. directly and through S Ltd., is only 19%. Significant influencemay also not be exercised as an investing party (R Ltd.) holds, directly or indirectly through intermediariesonly 19% of the voting power of the T Ltd. Accordingly, R Ltd. and T Ltd. are not related parties. Hence related party disclosure, as per AS 18, is not required.

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Question 7

Is remuneration paid to Board of Directors a related party transaction? Explain. (RTP May 18)

Answer 7

In case of a Company, the Managing Director, whole time director, 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 Managerial Personnel (KMP). Persons who do not have the authority and responsibility for planning, directing and controlling the activities of the enterprise would not be KMP. Conversely, persons without any formal titles may be considered to be KMP, if they plan, direct and control the activities of the enterprise.

Further, as per Sec 2(76) of Companies Act, 2013, a related party includes a director or his relative. Sec 2(34) defines a director as a director appointed to the Board of a Company. Hence, remuneration paid to Board of Directors will be considered as related party transaction.

Question 8

a) **In respect of a key supplier who is dependent on the company for its existence and the company enjoys influence over the prices of this supplier (which may not be formally demonstrable), can the supplier andthe company be considered as related parties?**

b) **Define "Key management personnel" in the context of AS 18. (RTP May 22)**

Answer 8

(a) The supplier and the company cannot be considered to be related parties merely because the latter is able to influence the transaction price between the parties. Paragraph 3 of AS 18 states that "enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise" are considered to be related party relationships. However, the conditions which define the existence of control, as follows, are not satisfied in the given example.

- '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 thecorresponding governing body in case of any other enterprise, or
- a substantial interest in voting power and the power to direct, by statue or agreement, the financial and/oroperating policies of the enterprise". Paragraph 10 of the standard defines significant influence as "participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies". In the given example, although the supplier and the company have entered into a commercial transaction, the terms of which are influenced by the latter because of its better bargaining power in the specific market for such goods, it cannot be concluded that there is participation in the financial and/or operating policy decisions. Therefore, as the conditions specified by the Standard for being classified as a related party are not satisfied in the given example, the company cannot be said to be related to the supplier.This view is supported by paragraph 4 (b) of the Standard which states that "a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of businessmerely by virtue of the resulting economic dependence" would not be deemed to be related parties.

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(b) In context of AS 18, "Key management personnel" are 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 director(s), whole time director(s), 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.

Question 9

Identify the related parties in the following cases as per AS-18

(i) Maya Ltd. holds 61 % shares of Sheetal Ltd. Sheetal Ltd. holds 51 % shares of Fair Ltd.Care Ltd. holds 49% shares of Fair Ltd. (Give your answer - Reporting Entity wise for Maya Ltd., Sheetal Ltd., Care Ltd. and Fair Ltd.) (RTP Nov '23)

(ii) Mr. Subhash Kumar is Managing Director of a Ltd. and also holds 72% capital of B Ltd. (PYP 5 Marks May '19)

Answer 9

(i) a) Reporting entity- Maya Ltd.

- Sheetal Ltd. (subsidiary) is a related party
- Fair Ltd.(subsidiary) is a related party

(b) Reporting entity- Sheetal Ltd.

- Maya Ltd. (holding company) is a related party
- Fair Ltd. (subsidiary) is a related party

(c) Reporting entity- Fair Ltd.

- Maya Ltd. (holding company) is a related party
- Sheetal Ltd. (holding company) is a related party
- Care Ltd. (investor/ investing party) is a related party

(d) Reporting entity- Care Ltd.

- Fair Ltd. (associate) is a related party

(ii) Mr. Subhash Kumar is Key management personnel as he has the authority for planning, directing and controlling the activities of A Ltd. He also holds substantial interest in B Ltd. as he holds 72% capital ofB Ltd. Thus, Mr. Subhash is related party for both A Ltd. and B Ltd. Moreover, as per the definition of related party relationship described in para 3 of AS 18, enterprises over which Subhash is able to exercise significant influence are also related parties. Thus, a Ltd. and B Ltd. willalso be construed as related to each other.

Question 10

Following transactions are disclosed as on 31st March, 2018:

Goods sold amounting to Rs. 50 lakhs to associate company during the 1st quarter ended on 30th June, 2017. After that related party relationship ceased to exist. However, goods were supplied as was supplied to any other ordinary customer. Decide whether transactions of the entire year have to be disclosed as related party transaction. (PYP 2.5 Marks, Nov '18)

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Answer 10

As per provision of AS 18, the transactions only for the period in which related party relationships exist need to be reported.

Hence, transactions of the entity with its associate company for the first quarter ending 30.06.2017 only are required to be disclosed as related party transactions. Transactions of the entire year need not be disclosed as related party transactions and transactions for the period (after 1st July) in which related party relationship did not exist need not be reported.

Hence transaction of sale of goods with the associate company for first quarter ending 30th June, 2017 forRs. 50 Lakhs only are required to be disclosed as related party transaction on 31.3.18.

Question 11

Answer the following with respect to AS-18:

(i) ABC Ltd. sold goods of Rs. 2,00,000 to its associate company for the 1stquarter ending 30.06.2022. After that the related party relationship ceased to exist. However, goods were supplied to any other ordinary customer. Decide whether transactions of the entire year have to be disclosed as related party transaction.

(ii) If the majority of directors of Arjun Ltd. constitute the majority of the Board of another Company Bheem Ltd. in their individual capacity as professionals (and not by virtue of their being Directors in Arjun Ltd.). Are both the companies related?

(iii) Asha Ltd. sells all the manufactured furniture of Rs. 1,00,00,000 to Sasha Ltd, as per agreement. Sasha Ltd. is the only customer to Asha Ltd. In the financial statements, Asha Ltd. wants to presentSasha company as a related party. Comment on the disclosure requirement. (PYP 5 Marks May '23)

Answer 11

i) As per AS 18, parties are considered to be related if any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party. Transactions of ABC Ltd. with its associate company for the first quarter ending 30.06.2022 only are required to be disclosed as related party transactions as the company has the ability to exercise significant influence only till 30.6.2022.

The transactions for the period in which related party relationship did not exist need not be reported.

(ii) In the given case, Arjun Ltd. cannot be said to control the composition of board of directors of Bheem Ltd. as the directors have been appointed in their individual capacity as professionals and not by virtue of their being directors in Arjun Ltd.

Hence, it cannot be concluded that the companies are related merely because the majority of the directorsof one company became the majority of the directors of the second in their individual capacity as professionals.

(iii) In the context of AS 18, a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business cannot be construed as Related Party Relationship merely by virtue of the resulting economic dependence. There is an economic dependence between the companies but no one controls or exercise significant influence on the other.

In the given case, Asha Ltd. need not report Sasha Company as its related party in its financial statements.

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Question 12

According to AS-18 Related Party Disclosures, which ONE of the following is not a related party ofSky-lineLimited?

a. A shareholder of Skyline Limited owning 30% of the ordinary share capital

b. An entity providing banking facilities to Skyline Limited in the normal course ofbusiness

c. An associate of Skyline Limited

d. Key management personnel of Skyline Limited

Ans: (b)

Question 13

Are the following statements in relation to related parties true or false, according to AS-18 Related PartyDisclosures?

A) A **party is related to another entity that it is jointly controlled by.**

B) **A party is related to another entity that it controls.**

Statement (A)	Statement (B)
a. False	False
b. False	True
c. True	False
d. True	True

Ans: (d)

Question 14

Which of the following is not a related party as envisaged by AS-18 Related Party Disclosures?

a. A director of the entity	b. The parent company of the entity
c. A shareholder of the entity that holds 1% stake in the entity	d. The spouse of the managing director of theentity

Ans: (c)

Question 15

According to AS-18 Related Party Disclosures, related party transaction is a transfer of resources orobligations between related parties – provided a price is charged for such transfer.

a. True	b. False

Ans: (b)

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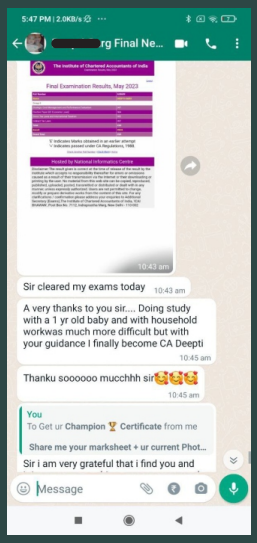

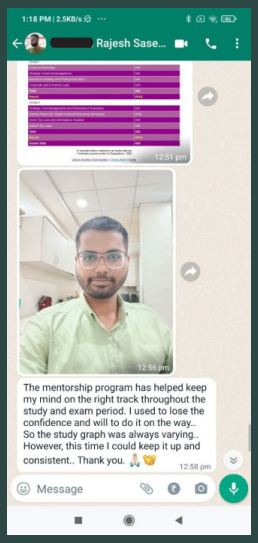

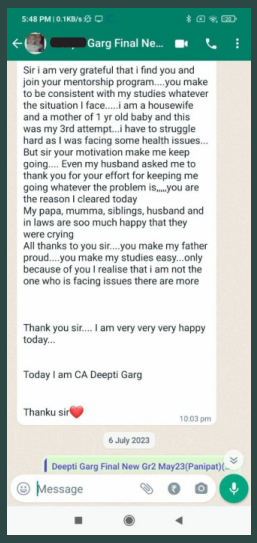

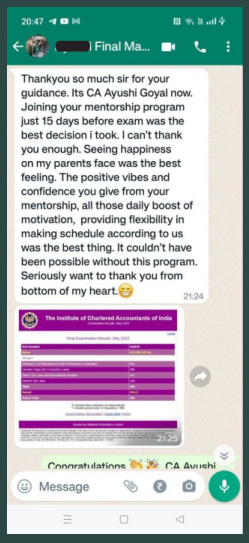

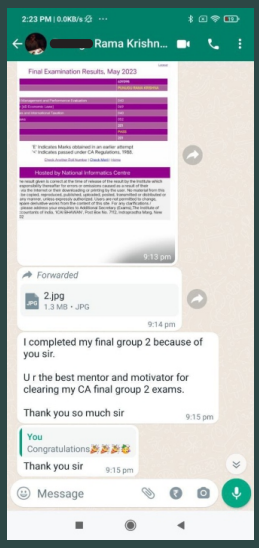

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Question 16

According to AS-18 Related Party Disclosures, parties are considered to be related, if and only if at the end of 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.

a. True	b. False

Ans: (b)

Theoretical Questions Answers

Questions 17

Who are related parties under AS 18? What are the related party disclosure requirements?

Answers 17

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.

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 thebalance 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.

Questions 18

ABC Limited is in the business of manufacturing textiles. It has certain commercial contracts with its customers and those customer contracts carry various clauses, imposing restriction on ABC Limited for disclosure of certain information. Accordingly, the company doesn't intend to provide related party disclosure under AS-18 in its ensuing financial statements. Is this correct?

Answers 18

As per AS-18 stipulate that related party disclosure requirements under AS- 18 do not apply in circumstances, where providing such disclosures would conflict with the reporting enterprise's duties ofconfidentiality, as specifically required in terms of a statute or by any regulator or similar competent authority.

In case, where (1) a statute or (2) a regulator or (3) a similar competent authority governing an en-

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terprise prohibit the enterprise to disclose certain information, which is required to be disclosed as per AS 18, disclosure of such information is not warranted. For example, banks are obliged by law to maintain confidentiality in respect of their customers' transactions and AS-18 would not override the obligation to preserve the confidentiality of customers' dealings.

However, this exemption is not available in respect of confidentiality provisions in a commercial contract between two enterprises - where confidentiality is not specifically required in terms of (1) a statute or (2)by any regulator or (3) similar competent authority.

Therefore, in the given case AS-18 related party disclosures would have to be made by ABC Limited in itsensuing financial statements.

Questions 19

Should the related parties be identified as at the reporting date (i.e. balance sheet date) for the purposes of AS-18? In disclosing transactions with related parties, are the transactions of the entire reporting period to be disclosed or only those for the period during which related party relationship exists?

Answers 19

As per the definition of related parties in AS-18, the existence of a related party relationship should be identified at all points during the year (and not only at the close of the financial year). However, AS 18 requires disclosure of transactions with these parties only during the existence of the related party relationship.

Practical Questions Answers

Questions 20

Mr. Raj, a relative of key management personnel, received remuneration of Rs. 2,50,000 for his servicesin the company for the period from 1.4.20X1 to 30.6.20X1. On 1.7.20X1, he left the service of the company.

Should the relative be identified as at the closing date i.e. on 31.3.20X2 for the purposes of AS 18?

Answers 20

According to AS 18 on 'Related Party Disclosures', 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. Hence Mr. Raj, a relative of key management personnel, should be identified as related party for disclosure in the financial statements for the year ended 31.3.20X2.

Questions 21

X Ltd. sold goods to its associate company during the 1st quarter ended 30.6.20X1. After that, the related party relationship ceased to exist. However, goods were supplied as were supplied to any other ordinary customer. Decide whether transactions of the entire year have to be disclosed as related party transaction.

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Answers 21

As per AS 18, transactions of X Ltd. with its associate company for the first quarter ending 30.06.20X1 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did not exist would not be reported.

Questions 22

You are required to identify the related parties in the following cases as per AS 18:

M Ltd. holds 61 % shares of S Ltd. S Ltd. holds 51 % shares of F Ltd. C Ltd. holds 49% shares of F Ltd. (Give your answer - Reporting Entity wise for M Ltd., S Ltd., C Ltd. and F Ltd.)

Answers 22

Reporting Entity	Related Party
M Ltd.	S Ltd. (subsidiary) FLtd.(subsidiary)
S Ltd.	M Ltd. (holding company) FLtd. (subsidiary)
F Ltd.	M Ltd. (ultimate holding company) SLtd. (holding company) C Ltd. (investor/ investing party)
C Ltd.	F Ltd. (associate)

Question 23 (Illustration)

Identify the related parties in the following case as per AS 18:A Ltd. holds 51% of B Ltd.

B Ltd holds 51% of O Ltd.Z Ltd holds 49% of O Ltd.

Answers 23

In relation to Reporting enterprise - A Ltd.

- B Ltd. (subsidiary) is a related party
- O Ltd.(subsidiary) is a related party

In relation to Reporting enterprise - B Ltd.

- A Ltd. (holding company) is a related party
- O Ltd. (subsidiary) is a related party

In relation to Reporting enterprise - O Ltd.

- A Ltd. (ultimate holding company) is a related party
- B Ltd. (holding company) is a related party
- Z Ltd. (investor/ investing party) is a related party (O Ltd Being Associate of Z Ltd)

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Reporting enterprise - Z Ltd.

- O Ltd. (Associate) is a related party

Question 24 (Illustration)

Consider a scenario wherein:

- **A Ltd. has 60% voting right in B Ltd.**
- **A Ltd. also has 22% voting right in C Ltd.; and**
- **B Ltd. has 30% voting right in C Ltd.**

Whether C Ltd. is to be treated under AS-18 as a party related to A Ltd.?

Answers 24

Yes – in relation to A Ltd. (the reporting enterprise), C Ltd. is a related party under AS-18. This is because A Ltd. indirectly controls C Ltd.

In this case, A Ltd. (together with its subsidiary B Ltd.) controls more than one half of the voting rights ofC Ltd.

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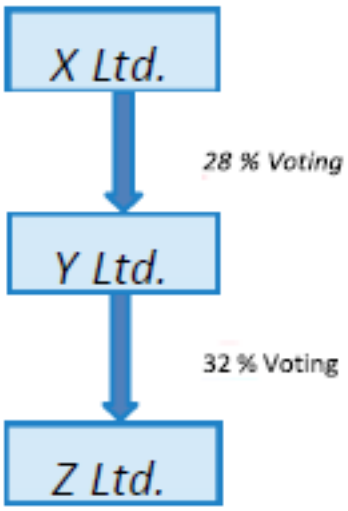
Question 25 (Illustration)

Consider a scenario wherein:

- **X Ltd. holds 28% voting right in Y Ltd. (and hence Y Ltd. is an associate of X Ltd.)**
- **Y Ltd. holds 32% voting right in Z Ltd. (and hence Z Ltd. is an associate of Y Ltd.)**



- **In the above case, since Y Ltd. is an associate of X Ltd. – Y Ltd. is a related party to X Ltd.**
- **Likewise, since Z Ltd. is an associate of Y Ltd. - Z Ltd. is a related party to Y Ltd.**
- **The question is: Whether Z Ltd. is to be treated under AS-18 as a party related to X Ltd.?**

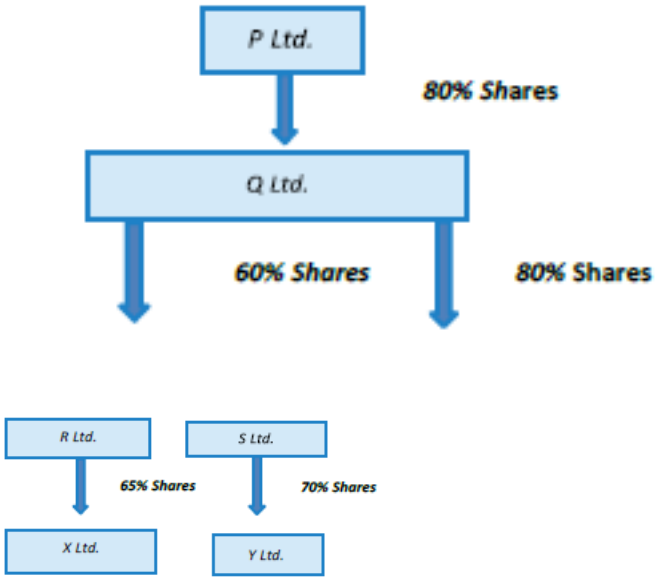
Answer 25

No – In relation to X Ltd. (the reporting enterprise), Z Ltd. is a not a related party.

This is because as per the requirements of AS-18, 'associate of an associate' is not a related party.

Questions 26 Illustrations

Consider the following organization structure related to P Ltd.



Given the above structure: Identify related party relationships, if R Ltd. is the reporting enterprise

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Answers 26

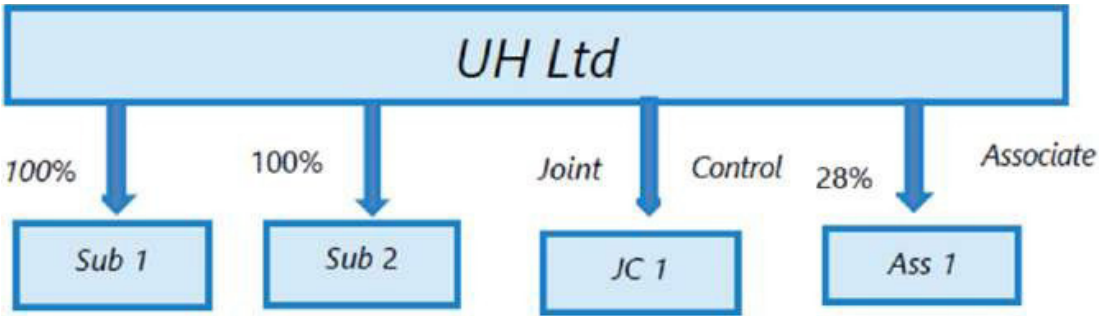
The following table identifies the related party relationships for R Ltd. (being the reporting enterprise):

Party Name	Relationship under AS-18
P Ltd.	P Ltd. has indirect control on R Ltd. (through Q Ltd.) Hence R Ltd. is related to P Ltd.
Q Ltd.	Q Ltd. has direct control of R Ltd. Hence R Ltd. is related to Q Ltd.
S Ltd.	R Ltd. and S Ltd. are under common control of Q Ltd. Hence R Ltd. is related to S Ltd.
X Ltd.	X Ltd. is controlled by R Ltd. Hence R Ltd. is related to X Ltd.
Y Ltd.	Y Ltd. is the sub-subsidiary of Q Ltd. Both R Ltd. and Y Ltd. are under common control of Q Ltd.Hence R Ltd. is related to Y Ltd.

Question 27 (Illustration)

Consider the following organization structure related to UH Ltd. (the ultimate parent company of a Group), wherein UH Ltd. has made the following investments:

- **Investment in two of the wholly owned subsidiaries, viz. Sub 1 and Sub 2**
- **Investment in JC 1, in which UH Ltd. has a joint control**
- **20% investment in Ass 1 (and hence, Ass 1 is an associate of UH Ltd.)**



Given the above structure: Identify related party relationships for each of the above entities under AS-18

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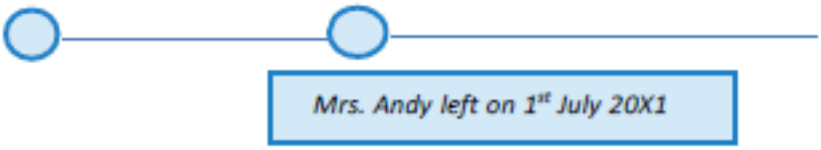
Answers 27

The following table identifies the related party relationships for each of the entities in the Group:



Reportingenterprise	Related Party as per AS-18
UH Ltd.	All the four entities (viz. Sub 1, Sub 2, JC 1 and Ass 1)
Sub 1	Only two of the entities in the Group (viz. UH Ltd. and Sub 2)
Sub 2	Only two of the entities in the Group (viz. UH Ltd. and Sub 1)

JC 1	Only UH Ltd.
Ass 1	Only UH Ltd.

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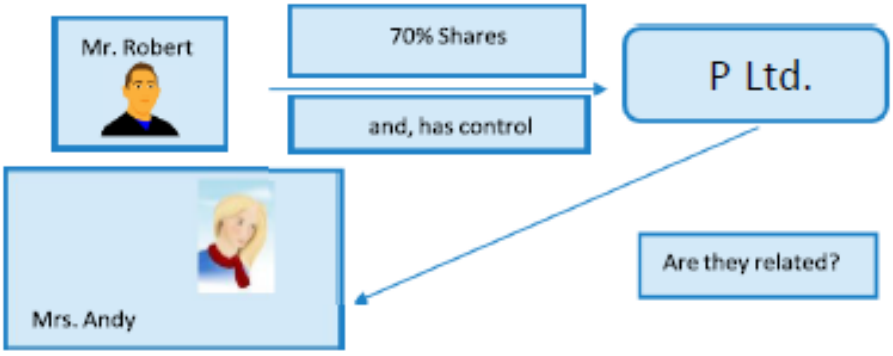
Question 28

Consider a scenario wherein:

- **Mr. Robert holds 70% shares and voting rights in P Ltd**



Determine: Whether Andy (spouse of Mr. Robert) is a related party to P Ltd. under AS-18?

Answer 28

Yes – Andy is a related party to P Ltd., in view of the requirements of AS-18.

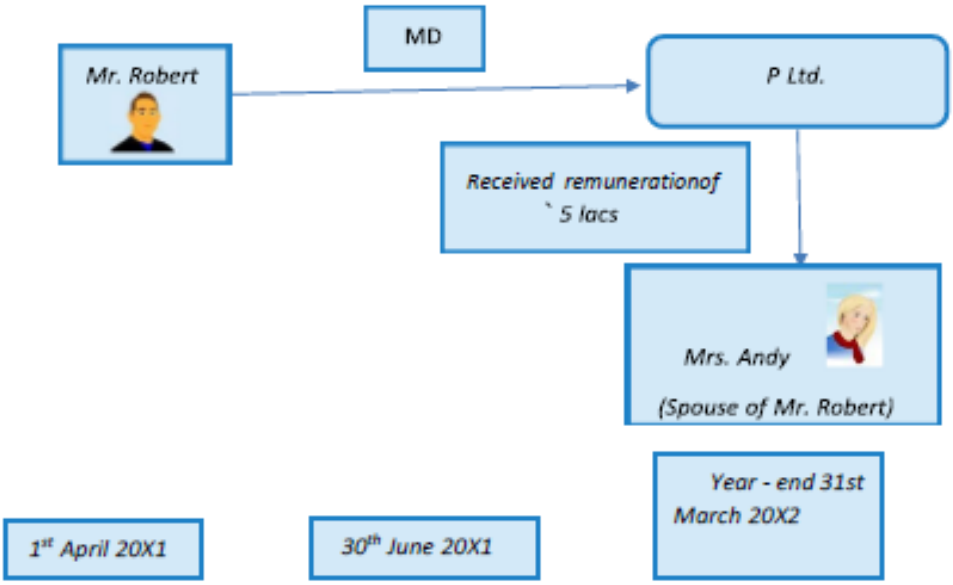
It may be recalled that under AS-18 'relatives of individuals owning an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise' are considered as related parties.

Answer 29

tration)

Consider a scenario wherein:

- **Mr. Robert is a Managing Director of P Ltd.**
- **Andy (spouse of Robert) received a remuneration of Rs 5 lacs from P Ltd. – for the services she rendered to P Ltd. for the period 1st April 20X1 through 30th June 20X1**
- **Andy left the services of P Ltd. on 1st July 20X1**
- **Consider 31st March 20X2 as the year-end date for P Ltd.**



Whether Andy is to be treated as a related party at the year-end date (31st March 20X2) for the purposes of AS-18?

Answers 29

Yes – This is because as per AS-18, 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.

Hence Andy (being the spouse and relative of the KMP of P Ltd.) needs to be reported as related party atthe year-end date (i.e. 31st March 20X2). This is because the remuneration Andy received from P Ltd. (for theperiod April 20X1 to 30 June 20X1) falls within the reporting year April 20X1 to March 20X2.

Question 30(Illustration)

Consider a scenario wherein:

- **UK Bank holds 23% equity shares with voting rights in P Ltd.**
- **The bank has provided a loan of Rs. 20 million to P Ltd. at market interest rate**
- **As per the terms and conditions of the loan agreement, the bank has appointed one person as its nominee to the board of directors of P Ltd. and any major transaction to be entered into by P Ltd. will require the consent of the Bank**

Determine: Whether under AS-18 - UK Bank is a related party to P Ltd. (the reporting enterprise)?

Answers 30

In the instant case, the UK Bank holds 23% shares with voting rights in P Ltd. and hence is deemed to exercise significant influence over P Ltd.

The bank is also a provider of finance to P Ltd. (the reporting enterprise) and as per AS-18, parties like providers of finance are deemed not to be considered as a related party in the course of normal dealings with an enterprise by virtue only of those dealings. However, this exemption will not be available to UK Bank in this case – since it exercises significant influence over P Ltd. (by virtue of holding 23% shares with voting rights in P Ltd.)

Accordingly, for P Ltd. (the reporting enterprise), the UK Bank is a related party and it will be required to disclose the transactions with UK Bank in its financial statements.

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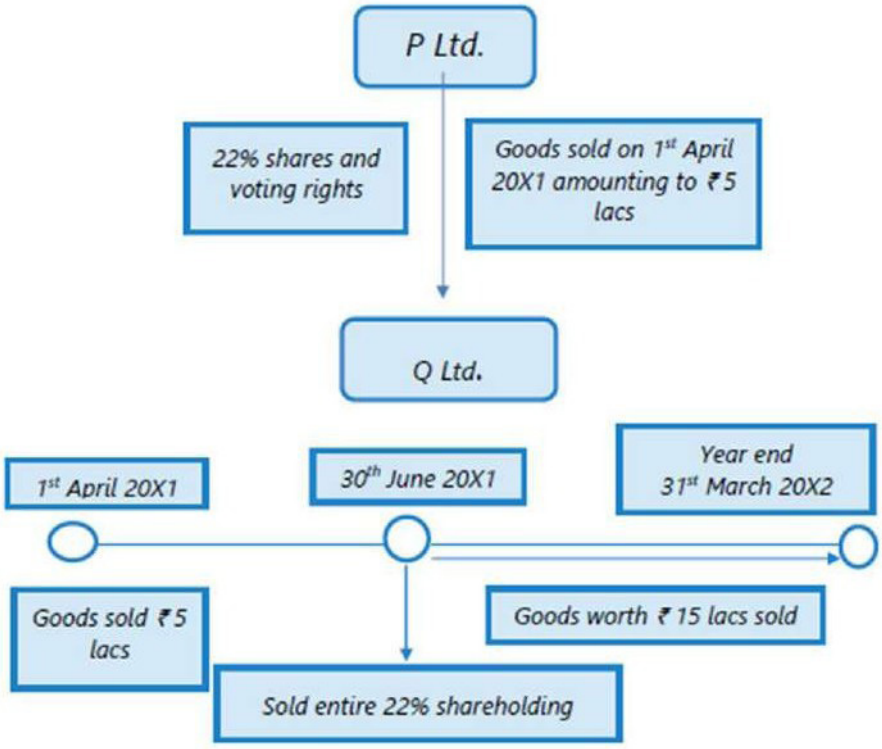
Question 31 (Illustration)

Consider a scenario wherein:

- **P Ltd. hold 22% shares and voting rights in Q Ltd. (and hence Q Ltd. is an associate of P Ltd.)**
- **On 1st April 20X1, P Ltd. sold certain goods to Q Ltd. amounting to Rs. 5 lacs**
- **On 30th June 20X1, P Ltd. sold its entire 22% stake in Q Ltd. (and hence the related party relationshipceased to exist after 30th June 20X1)**
- **However, P Ltd. continued supply goods to Q Ltd. subsequent to 30th June 20X1 (just like any other customer) and sold goods worth Rs. 15 lacs during 9-month period ended 31st March 20X2**
- **Consider 31st March 20X2 as the year-end date for P Ltd.**



Determine whether the transaction for the entire year (ending on 31st March 20X2) is required to bedisclosed under AS-18 as related party transaction

Answers 31

No – This is because as per AS-18, the disclosure requirements under the Standard relate only to the periodduring related party relationship existed.

Accordingly, only transactions between P Ltd and Q Ltd till 30th June 20X1 (being sale of goods worth Rs.5 lacs) are required to be reported / disclosed under AS- 18.

Transactions entered into after 30th June 20X1 are NOT required to be disclosed under AS-18.

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Question 32 (Illustration)

Narmada Ltd. sold goods for Rs. 90 lakhs to Ganga Ltd. during financial year ended 31-3-20X1. The Managing Director of Narmada Ltd. owns 100% shares of Ganga Ltd. The sales were made to Ganga Ltd. at normal selling prices by Narmada Ltd. The Chief accountant of Narmada Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. Is the Chief Accountant correct?

Answers 32

As per AS 18 'Related Party Disclosures', Enterprises over which a key management personnel is able to exercise significant influence are related parties. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprise that have a member of key management in common with the reporting enterprise.

In the given case, Narmada Ltd. and Ganga Ltd are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price.

Hence the contention of Chief Accountant of Narmada Ltd is wrong.

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Chapter 4.5

AS 20- EPS

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.13 TO Q.31											
Past Exams	Q.4	Q.8	NO	Q.2	NO	NO	Q.9	NO	Q.10	Q.11	NO	NO
MTP	Q.2	Q.1	Q.2	NO	Q.2	Q.4	Q.3	Q.1,Q.4	Q.3,Q.4	Q.2	Q.4	Q.4
RTP	Q.1	Q.2	Q.1	Q.1	Q.1	Q.2	Q.6	Q.5	Q.7	Q.1	Q.2	NO

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Chapter 4.5

AS 20- EPS

Question 1

From the following information, you are required to compute Basic and Diluted Earnings Per Share (EPS) of M/s. XYZ Limited for the year ended 31st March, 2019:

Net Profit for the year after tax: Rs. 75,00,000

Number of Equity Shares of Rs.10 each outstanding: Rs. 10,00,000

1,00,000, 8% Convertible Debentures of Rs. 100 each were issued by the Company at the beginning of the year. 1,10,000 Equity Shares were supposed to be issued on conversion. Consider rate of IncomeTax as 30% (MTP 5 Marks Oct'18, RTP May 20) (Same concept different figures- MTP 5 Marks Nov'21, RTP Nov'19, RTP May'19, RTP Nov'22, RTP May'18)

Answer 1

Computation of basic earnings per share

Net profit for the current year / Weighted average number of equity shares outstanding duringthe year Rs. 75,00,000 / 10,00,000 = Rs. 7.50 per share

Computation of diluted earnings per share

Adjusted net profit for the current year

Rs.		
Net profit for the current year		75,00,000
Add: Interest expense for the current year		8,00,000
Less: Tax relating to interest expense (30% of	Rs.8,00,000)	(2,40,000)
Adjusted net profit for the current year		80,60,000

Number of equity shares resulting from conversion of debentures

= 1,10,000 Equity shares (given in the Question)

Weighted average number of equity shares used to compute diluted earnings per share

= 11,10,000 shares (10,00,000 + 1,10,000)

Diluted earnings per share

= Rs. 80,60,000/ 11,10,000

= Rs. 7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

Question 2

From the following information, you are required to compute the basic and adjusted Earnings per share:

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Net profit for 2015-16	11 lakh
Net profit for 2016-17	15 lakh
No. of shares issued before rights issue	5 lakhs
Right issue	One for every 5 held
Right issue price	15 per share
Last date of exercising right option	1-06-2016
Fair value of shares before right issue	21 per share

(MTP 5 Marks- Mar'19, Mar'18) (Same concept different figures MTP 5 Marks May'20, MTP 5 Marks Sep'22, RTP Nov'20, RTP Nov'18, May'23, PYP 5 Marks Nov'19, Old & New SM)

Answer 2

Computation of theoretical ex-rights fair value per Share

$$\frac{\textit{Fair value of all outstanding shares immediately prior to exercise of rights} : \textit{Total amount received from exercise of rights}}{\textit{Number of Shares outstanding prior to exercise} : \textit{number of Shares issued in the exercise}}$$

$$\frac{(Rs.\,21.00 \times 5,00,000\ Shares) + (Rs.\,15.00 \times 1,00,000\ Shares)}{5,00,000\ Shares + 1,00,000\ Shares}$$

Theoretical ex–rights fair value per share = Rs. 20.00

Computation of earnings per share

(a) Computation of adjustment factor

(b) $\frac{\textit{Fair value per share prior to exercise of rights}}{\textit{Theoretical ex ; rights value per share}} = \frac{(21.00)}{(20.00)} = 1.05$

Computation of earnings per share	Year 2015-16	Year 2016-17
EPS for the year 2015–16 as originally reported: (Rs. 11,00,000/5,00,000 shares)	Rs.2.20	
EPS for the year 2015–16 restated for rights issue: [Rs. 11,00,000/ (5,00,000 shares x 1.05)]	Rs.2.10	
EPS for the year 2016–17 including effects of rights issue $\frac{15,00,000}{(5,00,000 \times \frac{2}{12}) + (6,00,000 \times \frac{10}{12})}$		Rs. 2.55

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Question 3

Explain the concept of 'weighted average number of equity shares outstanding during the period'. Also compute, based on AS 20, the weighted average number of equity shares in the following case: (MTP 5 Marks April 21, April 22)

		No. of shares
1st April, 2020	Balance of equity shares	7,20,000
31st August, 2020	Equity shares issued for cash	2,40,000
1st February, 2021	Equity shares bought back	1,20,000
31st March, 2021	Balance of equity shares	8,40,000

Answer 3

As per AS 20, "Earnings Per Share", the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or less number of shares outstanding at any time. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equityshares outstanding during the period.

Weighted average number of equity shares:

7,20,000 X 5/12	= 3,00,000 shares
9,60,000 X 5/12	= 4,00,000 shares
8,40,000 X 2/12	= 1,40,000 shares
	= 8,40,000 shares

Question 4

On 1st April, 2021 a company had 6,00,000 equity shares of Rs. 10 each (Rs. 5 paid up by all shareholders). On 1st September, 2019 the remaining Rs. 5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 2022 was Rs. 21,96,000 after considering dividend on preference shares and dividend distribution tax on such dividend totaling to Rs. 3,40,000. You are required to compute Basic EPS for the year ended 31st March, 2022 as per Accounting Standard 20 "Earnings Per Share". (MTP 5 Marks Mar'22, Oct '20& Oct '21, March '23 & Oct '23, PYP 5 Marks, May '18, Old & New SM)

Answer 4

$$\text{Basic Earnings per share (EPS)} = \frac{\textit{Net Profit attributable to equity shareholders}}{\textit{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{21,96,000}{4,57,500\ \textit{Shares (as per working note)}} = \text{Rs. } 4.80 \text{ per share}$$

Working Note:

Calculation of weighted average number of equity shares

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As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	No. of equityshares	Amount paid per share	Weighted average no. of equityshares
	Rs.	Rs.	Rs.
1.4.2020	6,00,000	5	6,00,000 x 5/10 x 5/12 = 1,25,000
1.9.2020	5,40,000	10	5,40,000 x 7/12 = 3,15,000
1.9.2020	60,000	5	60,000 x 5/10 x 7/12 = 17,500
Total weighted average equity shares			4,57,500

Question 5

AB Limited is a company engaged in manufacturing industrial packaging equipment. As per the terms of an agreement entered with its debenture holders, the company is required to appropriate adequate portion of its profits to a specific reserve over the period of maturity of the debentures such that, at the redemption date, the reserve constitutes at least half the value of such debentures. As such appropriations are not available for distribution to the equity shareholders, AB Limited has excluded this from the numerator in the computation of Basic EPS. Is this treatment correct as per provisions of AS 20? (RTP Nov 21)

Answer 5

The appropriation made to such a mandatory reserve created for the redemption of debentures would be included in the net profit attributable to equity shareholders for the computation of Basic EPS. AS20 states that "For the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period"; With an emphasison the phrase attributable to equity shareholders, it may be construed that such amounts appropriated to mandatory reserves, though not available for distribution as dividend, are still attributable to equity shareholders. Accordingly, these amounts should be included in the computation of Basic EPS. In view of this, the treatment made by the company is not correct.

Question 6

In the following list of shares issued, for the purpose of calculation of weighted average number of shares, from which date, weight is to be considered:

(i) Equity Shares issued in exchange of cash,

(ii) Equity Shares issued as a result of conversion of a debt instrument,

(iii) Equity Shares issued in exchange for the settlement of a liability of the enterprise,

(iv) Equity Shares issued for rendering of services to the enterprise,

(v) Equity Shares issued in lieu of interest and/or principal of another financial instrument,

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(vi) Equity Shares issued as consideration for the acquisition of an asset other than in cash. (RTP May '21) (New SM)

Answer 6

The following dates should be considered for consideration of weights for the purpose of calculationof weighted average number of shares in the given situations:

(i) Date of Cash receivable

(ii) Date of conversion

(iii) Date on which settlement becomes effective

(iv) When the services are rendered

(v) Date when interest ceases to accrue

(vi) Date on which the acquisition is recognized.

Question 7

a) Stock options have been granted by AB Limited to its employees and they vest equally over 5 years, i.e., 20 per cent at the end of each year from the date of grant. The options will vest only if the employee is still employed with the company at the end of the year. If the employee leaves the company during the vesting period, the options that have vested can be exercised, while the others would lapse. Currently, AB Limited includes only the vested options for calculating Diluted EPS. Should only completely vested options be included for computation of Diluted EPS? Is this in accordance with the provisions of AS 20? Explain.

b) X Limited, as at March 31, 2021, has income from continuing ordinary operations of Rs. 2,40,000, a loss from discontinuing operations of Rs. 3,60,000 and accordingly a net loss of Rs. 1,20,000. The Company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 2021. You are required to compute Basic and Diluted EPS? (RTP May 22)

Answer 7

a) The current method of calculating Diluted EPS adopted by AB limited is not in accordance with AS 20. The calculation of Diluted EPS should include all potential equity shares, i.e., all the stock options granted at the balance sheet date, which are dilutive in nature, irrespective of the vesting pattern. The options that have lapsed during the year should be included for the portion of the period the same wereoutstanding, pursuant to the requirement of the standard.

AS 20 states that "A potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares"; Options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and othersimilar plans are examples of potential equity shares. Further, for the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects ofall dilutive potential equity shares.

b) As per AS 20 "Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations";As income from continuing ordinary operations, Rs. 2,40,000 would be considered and not Rs. (1,20,000), for ascertaining whether 200 potential equity shares are dilutive or anti-dilutive. Accordingly,200 potential equity shares would be dilutive potential equity shares since their inclusion would decrease the net profit per share from continuing ordinary operations from Rs. 240 to Rs. 200. Thus thebasic E.P.S would be Rs. (120) and diluted E.P.S. would be Rs. (100).

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Question 8

From the following information given by Sampark Ltd., Calculate Basis EPS and Diluted EPS as per AS20:

Rs.	
Net Profit for the current year	2,50,00,000
No. of Equity Shares Outstanding	50,00,000
No. of 12% convertible debentures of ₹ 100 each Each debenture is convertible into 8 Equity Shares	50,000
Interest expense for the current year	6,00,000
Tax saving relating to interest expense (30%)	1,80,000

(PYP 5 Marks Nov'18)

Answer 8

Calculation of Basic Earnings Per Share

$$\text{Basic EPS} = \frac{\textit{Net Profit for the current year}}{\textit{No.of Equity Shares}} = \frac{\textit{Rs.2,50,00,000}}{\text{50,00,000}}$$

Basic EPS per share = Rs. 5

Calculation of Diluted Earnings Per Share

$$\textbf{Diluted EPS} = \frac{\textit{Adjusted net profit for the current year}}{\textit{Weighted average no.of Equity Shares}}$$

Adjusted net profit for the current year	Rs.
Net profit for the current year	2,50,00,000
Add: Interest expenses for the current year	6,00,000
Less: Tax saving relating to Tax Expenses	(1,80,000)
	2,54,20,000

No. of equity shares resulting from conversion of debentures: 4,00,000 Shares

Weighted average no. of equity shares used to compute diluted EPS: (50,00,000 + 4,00,000) = 54,00,000 Equity Shares

Diluted earnings per share: (2,54,20,000/54,00,000) = Rs. 4.71 (Approx.)

Question 9

"At the time calculating diluted earnings per share, effect is given to all dilutive potential equity shares that are outstanding during the period". Comment and also calculate the basic and diluted earnings per share for the year 2020-21 from the following information:

(i)	Net profit after tax for the year	₹ 64,12,500
(ii)	No. of equity shares outstanding	15,00,000
(iii)	No. of 9% convertible debentures of ₹ 100 issued on 1stJuly,2020	75,000

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(iv)	Each debenture is convertible into 8 Equity Shares	
(v)	Tax relating to interest expenses	35%

(PYP 5 Marks Dec'21)

Answer 9

In calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period;" As per AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding* during the period should be adjusted for the effects of all dilutive potential equity shares for the purpose of calculation of diluted earnings per share. Basic EPS for the year 2020-21= 64,12,500/15,00,000 = ₹ 4;275or ₹ 4;28

Computation of diluted earnings per share for year 2020-21

$$\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity Shares}}$$

Adjusted net profit for the current year will be (64,12,500 + 5,06,250 – 1,77,188) = ₹ 67,41,562No. of equity shares resulting from conversion of debentures: 6,00,000 Shares (75,000 × 8) Weighted average no. of equity shares used to compute diluted EPS:

(15,00,000 X12/12+ 6,00,000X9/12)

= 19,50,000 Shares

Diluted earnings per share: (67,41,562/19,50,000) = ₹ 3;46

Working Note:

Interest expense for 9 months = 75,00,000×9%×9/12 =₹ 5,06,250

Tax expense 35 % on interest is ₹1,77,188 (5,06,250 x 35%)

*Weighted average number of equity shares outstanding during the period is increased by the weighted average number of additional equity shares which would have been outstanding assuming the conversion of all dilutive potential equity shares.

Question 10

NAT, a listed entity, as on 1st April,2021 had the following capital structure:

	₹
10,00,000 Equity Shares having face value of ₹ 1 each	**10,00,000**
10,00,000 8% Preference Shares having face value of ₹ 10 each	**1,00,00,000**

During the year 2021-2022, the company had profit after tax of ₹ 90,00,000

On 1st January,2022, NAT made a bonus issue of one equity share for every 2 equity shares outstanding as at 31st December,2021.

On 1st January,2022, NAT issued 2,00,000 equity shares of ₹ 1 each at their full market price of ₹ 7.60 per share.

NAT's shares were trading at ₹ 8.05 per share on 31st March,2022.

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Further it has been provided that the basic earnings per share for the year ended 31st March,2021 was previously reported at ₹ 62.30.

You are required to:

Calculate the basic earnings per share to be reported in the financial statements of NAT for the year ended 31st March,2022 including the comparative figure, in accordance with AS-20 Earnings Per Share.

Explain why the bonus issue of shares and the shares issue at full market price are treated differently in the calculation of the basic earnings per share? (5 Marks). (PYP 5 Marks May'22)

Answer 10

I. Calculation of Basic Earnings per share for the year ended 31stMarch, 2022 including the comparative figure:

Earnings for the year ended 31st March, 2021 = EPS x Number of shares outstanding during 2020 - 2021

= ₹ 62;30 x 10,00,000 equity shares

= ₹ 6,23,00,000

(a) Adjusted Earnings per share after taking into consideration bonus issue

Adjusted Basic EPS = Earnings for the year 2020-2021 / Total outstanding shares +Bonusissue

= ₹ 6,23,00,000 / (10,00,000+ 5,00,000)

= ₹ 6,23,00,000 / 15,00,000

= ₹ 41;53 per share

(b) Basic EPS for the year 2021-2022

Basic EPS = Total Earnings – Preference Shares Dividend) / (Total shares outstanding at thebeginning + Bonus issue + weighted average of the shares issued in January, 2022)

= (₹ 90,00,000 – ₹ (1,00,00,000 x 8%) / (10,00,000 + 5,00,000 + (2,00,000 x 3/12))

= ₹ 82,00,000 / 15,50,000 shares

= ₹ 5;29 per share

II. In case of a bonus issue, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increasein resources. Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 2021, the earliest period reported.

However, the share issued at full market price does not carry any bonus element and usually results in a proportionate change in the resources available to the enterprise. Therefore, it is taken into consideration from the time it has been issued i.e. the time- weighting factor is considered based on the specific shares outstanding as a proportion of the total number of days in the period.

Question 11

The following information is provided to you:

Net profit for the year 2022: ₹ 72,00,000 Weighted average number of equity shares outstanding during the year 2022: 30,00,000 shares

Average Fair value of one equity share during the year 2022: ₹ 25.00 Weighted average number of shares under option during the year 2022: 6,00,000 shares

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Exercise price for shares under option during the year 2022: ₹ 20.00

You are required to compute Basic and Diluted Earnings Per Share as per AS 20.(PYP 5 Marks Nov'22)

Answer 11

Computation of Basic earnings per share

	Earnings ₹	Shares	Earnings/ Share ₹
Net profit for the year 2022	72,00,000		
Weighted average no. of shares during year		30,00,000	
2022 Basic earnings per share (72,00,000/30,00,000)			2.40

Computation of Diluted earnings per share

	Earnings ₹	Shares	Earnings/Share ₹
Net profit for the year 2022	72,00,000		
Weighted average no. of shares during		30,00,000	
year 2022			
Number of shares under option		6,00,000	
Number of shares that would have been			
issued at fair value			
(6,00,000 x 20.00)/25.00		(4,80,000)	
Diluted earnings per share	72,00,000	31,20,000	2.31
			(rounded-off)

Note: The earnings have not been increased as the total number of shares has been increased only by the number of shares (1,20,000) deemed for the purpose of the computation to have been issued for no consideration.

To the extent that partly paid shares are not entitled to participate in dividends during the reporting period they are considered the equivalent of options.

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Question 12

Net Profit for FY 2021-22 30,00,000

Net Profit for FY 2022-23 50,00,000

No. of shares outstanding prior to rights issue 20,00,000 shares Rights Issue Price ₹ 20

Last day to exercise rights 1st June, 2022

Right issue is one new share for each five equity share outstanding (i.e. 4,00,000 new shares)

Fair value of one equity share immediately prior to exercise of rights on 1st June, 2022 was ₹ 26.00.

Compute Basic Earnings Per Share for FY 2016-17, FY 2022-23 and restated EPS for FY 2021-22. (Nov '23)

Answer 12

Computation of Basic Earnings Per Share (as per AS 20 Earnings Per Share)

₹	Year 2016-17	Year 2017-18
	₹	
EPS for the year 2021-22 as originally reported		
= Net Profit of the year attributable to equity shareholders / Weighted average number of equity shares outstanding during the Year		
= (₹ 30,00,000 / 20,00,000 shares)	1.5	
EPS for the year 2021-22 restated for rights issue		
= [₹ 30,00,000 / (20,00,000 shares 1.04 (W.N. 2)]	1.44 (approx.)	
EPS for the year 2022-23 including effects of rights issue		
₹ 50, 00, 000 (20, 00, 000 shares × 1.04 ×2 / 12) + (24,00, 000 shares × 10 / 12)		2.13 (approx.)
₹ 50,00,000/ 23,46,667 shares		

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Working Notes:

1. Computation of theoretical ex–rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights} + \text{Totalamountreceived from exercise}}{\text{Number of shares outstanding prior to exercise} + \text{Number of shares issued in the exercise}}$$

$$= \frac{(₹\ 26 \times 20,00,000\ Shares) : (₹\ 20 \times 4,00,000\ Shares)}{20,00,000\ shares : 4,00,000\ Shares} = \frac{₹\ 6,00,00,000}{24,00,000\ Shares} = ₹\ 25$$

2. Computation of adjustment factor

$$= \frac{Fair\ value\ per\ share\ prior\ to\ excerise\ of\ rights}{Theoretical\ ex;rights\ value\ per\ share} = \frac{₹\ 26}{₹\ 25\ (Refer\ working\ Note\ 1)} = 1.04$$

(approx..)

Questions 13

AB Company Ltd. had 1,00,000 shares of common stock outstanding on January 1. Additional 50,000 shares were issued on July 1, and 25,000 shares were re- acquired on September 1. The weighted average numberof shares outstanding during the year on Dec. 31 is

a. 1,40,000 shares	b. 1,25,000 shares
c. 1,16,667 shares	d. 1,20,000 shares

Ans: (c)

Questions 14

As per AS 20, potential equity shares should be treated as dilutive when, and only when, their conversionto equity shares would

a. Decrease net profit per share fromcontinuing ordinary operations.	b. Increase net profit per share from continuingordinary operations.
c. Make no change in net profit per share fromcontinuing ordinary operations.	d. Decrease net loss per share from continuingordinary operations.

Ans: (a)

Questions 15

As per AS 20, equity shares which are issuable upon the satisfaction of certain conditions resulting fromcontractual arrangements are

a. Dilutive potential equity shares	b. Contingently issuable shares
c. Contractual issued shares	d. Potential equity shares

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Ans: (b)

Questions 16

In case potential equity shares have been cancelled during the year, they should be:

a. Ignored for computation of Diluted EPS.
b. Considered from the beginning of the year till the date they are cancelled.
c. The company needs to make an accounting policy and can follow thetreatment in (a) or (b) as it decides.
d. Considered for computation of diluted EPS only if the impact of suchpotential equity shares would be material.

Ans: (b)

Questions 17

Partly paid up equity shares are:

a. Always considered as a part of Basic EPS.
b. Always considered as a part of Diluted EPS.
c. Depending upon the entitlement of dividend to the share-holder, it will beconsidered as a part of Basic or Diluted EPS as the case may be.
d. Considered as part of Basic/ Diluted EPS depending on the accountingpolicyof the company.

Ans: (c)

Theoretical Questions Answers

Questions 18

In the following list of shares issued, for the purpose of calculation of weighted average number ofshares, from which date weight is to be considered:

(i) **Equity Shares issued in exchange of cash,**

(ii) **Equity Shares issued as a result of conversion of a debt instrument,**

(iii) **Equity Shares issued in exchange for the settlement of a liability of the enterprise,**

(iv) **Equity Shares issued for rendering of services to the enterprise,**

(v) **Equity Shares issued in lieu of interest and/or principal of another financial instrument,**

(vi) **Equity Shares issued as consideration for the acquisition of an asset other than in cash. Also define Potential Equity Share.**

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Answers 18

The following dates should be considered for consideration of weights for the purpose of calculation ofweighted average number of shares in the given cases:

(i) Date of Cash receivable

(ii) Date of conversion

(iii) Date on which settlement becomes effective

(iv) When the services are rendered

(v) Date when interest ceases to accrue

(vi) Date on which the acquisition is recognised.

A Potential Equity Share is a financial instrument or other contract that entitles or may entitle its holder to equity shares.

Questions 19

Stock options have been granted by AB Limited to its employees and they vest equally over 5 years,i.e., 20 per cent at the end of each year from the date of grant. The options will vest only if the employee is still employed with the company at the end of the year. If the employee leaves the company during the vesting period, the options that have vested can be exercised, while the otherswould lapse. Currently, AB Limited includes only the vested options for calculating Diluted EPS.

Should only completely vested options be included for computation of Diluted EPS? Is this in accordance with the provisions of AS 20? Explain.

Answers 19

As per AS 20 "A potential equity share is a financial instrument or othercontract that entitles, or may entitle, itsholder to equity shares".

Options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans are examples of potential equity shares. Further, forthe purpose of calculating diluted earnings per share, the net profit or lossfor the period attributable to equity shareholders and the weighted average number of shares outstanding duringthe period should be adjusted for the effects of all dilutive potential equity shares.

The current method of calculating Diluted EPS adopted by AB limited is notin accordance with AS 20. The calculation of Diluted EPS should include all potential equity shares, i.e., all the stock options granted at the balance sheet date, which are dilutive in nature, irrespective of the vesting pattern. Theoptions that have lapsed during the year should be included for the portion of the period the same were outstanding, pursuant to the requirement of the standard.

Questions 20

Explain why the bonus issue of shares and the shares issue at full market price are treated differently in the calculation of the basic earnings per share?

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Answers 20

In case of a bonus issue, equity shares are issued to existing shareholders for no additional consideration.Therefore, the number of equity shares outstanding is increased without an increase in resources. Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the earliest period reported.

However, the share issued at full market price does not carry any bonus element and usually results in a proportionate change in the resources available to the enterprise. Therefore, it is taken into consideration from the time it has been issued i.e. the time- weighting factor is considered based on the specific shares outstanding as a proportion of the total number of days in the period.

Practical Questions Answers

Questions 21

NAT, a listed entity, as on 1st April, 20X1 had the following capital structure:

Particulars	₹
10,00,000 Equity Shares having face value of Rs. 1 each	10,00,000
10,00,000 8% Preference Shares having face value of Rs. 10 each	1,00,00,000

During the year 20X1-20X2, the company had profit after tax of Rs. 90,00,000.

On 1st January, 20X2, NAT made a bonus issue of one equity share for every 2 equity shares outstanding as at 31st December, 20X1.

On 1st January, 20X2, NAT issued 2,00,000 equity shares of Rs. 1 each at their full market price of Rs. 7.60 per share.

NAT's shares were trading at Rs. 8.05 per share on 31st March, 20X2.

Further it has been provided that the basic earnings per share for the year ended 31st March, 20X1 was previously reported at Rs. 62.30.

You are required to:

(i) **Calculate the basic earnings per share to be reported in the financial statements of NAT for the yearended 31st March, 20X2 including the comparative figure, in accordance with AS-20 Earnings Per Share.**

(ii) **Explain why the bonus issue of shares and the shares issue at full market price are treated differently in the calculation of the basic earnings per share?**

Answers 21

i) Computation of Basic Earnings per share for the year ended 31st March, 20X2:

(including the comparative figure)Working Note – I:

Earnings for the year ended 31st March, 20X1:

= EPS x Number of shares outstanding during 20X0-20X1

= Rs. 62.30 x 10,00,000 equity shares

= Rs. 6,23,00,000

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Adjusted/Restated Earnings per share for the year ended 31st March20X1:

(after taking into consideration bonus issue)

Adjusted/Restated Basic EPS:

= Earnings for the year 20X0-20X1 / (Total outstanding shares +Bonusissue)

= Rs. 6,23,00,000 / (10,00,000+ 5,00,000)

= Rs. 6,23,00,000 / 15,00,000

= Rs. 41.53 per share

Computation of Basic EPS for the year 20X1-20X2:

Basic EPS = (Total Earnings – Preference Shares Dividend) / (Total shares outstanding atthe beginning + Bonus issue + weighted average of the shares issued in January, 20X2)

= (Rs. 90,00,000 – Rs. (1,00,00,000 x 8%)) / (10,00,000 + 5,00,000 + (2,00,000 x 3/12))

= Rs. 82,00,000 / 15,50,000 shares = Rs. 5.29 per share

ii) In case of a bonus issue, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 20X1, the earliest period reported.

However, the share issued at full market price does not carry any bonus element and usually results in a proportionate change in the resources available to the enterprise. Therefore, it is taken into consideration from the time it has been issued i.e. the time- weighting factor is considered based on the specific shares outstanding as a proportion of the total number of days in the period.

Questions 22

(Accounting year 1.1.20X1– 31.12.20X1)		
Net Profit	:	Year 20X1: ` 20,00,000
	:	**Year 20X2: ` 30,00,000**
No. of shares outstanding prior to Right Issue	:	10,00,000 shares
Right Issue	:	**One new share for each four outstanding i.e., 2,50,000 shares.** **Right Issue price – ` 20** **Last date of exercise rights– 31.3.20X2.**
Fair rate of one Equity share immediately prior to exercise of rights on 31.3.20X2	:	**` 25**

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Answers 22

Computation of Basic Earnings Per Share (as per paragraphs 10 and 26 of AS 20 on Earnings Per Share)

	Year 20X1₹	Year 20X2 ₹

EPS for the year 20X1 as originally reported

$$\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity share outstanding during the year}}$$

= (`20,00,000 / 10,00,000 shares)
2.00
(approx.)

EPS for the year 20X1 restated for rights issue

= [`20,00,000 / (10,00,000 shares × 1.04*)]
1.91

EPS for the year 20X2 including effects of rightsissue

$$\frac{30,00,000}{(10,00,000\ share \times 1.04 \times 3/12) + (12,50,000\ shares \times 9/12)}$$

2.51

$$\frac{30,00,000}{11,97,500\ shares}$$

(approx.)

Working Notes:

1. Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the excercise}}$$

$$= \frac{(₹25 \times 10,00,000\ shares) + (₹20 \times 2,50,000\ shares)}{10,000\ share + 2,50,000\ shares} = \frac{₹3,00,00,000}{12,50,000\ shares} = ₹24$$

2. Computation of adjustment factor

$$= \frac{Fair\ value\ per\ share\ prior\ to\ exercise\ of\ rights}{Theoretical\ exrights\ value\ per\ share}$$

$$= \frac{₹25}{₹24 (Refer\ Working\ Note\ 1)} = 1.04 (approx.)$$

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Questions 23

On 1st April, 20X1 a company had 6,00,000 equity shares of Rs. 10 each (Rs. 5 paid up by all shareholders).On 1st September, 20X1 the remaining Rs. 5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 20X2 was Rs. 21,96,000 after considering dividend on preference shares of Rs. 3,40,000.

You are required to compute Basic EPS for the year ended 31 st March, 20X2 as per Accounting Standard 20 "Earnings Per Share".

Answers 23

Basic Earnings per share (EPS) =

$$= \frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{21,96,000}{4,57,500 \text{ Shares (as per working note)}} = ₹\ 4.80 \text{ per share}$$

Refer working note 2.

Refer working note 2.

Working Note:

Calculation of weighted average number of equity shares

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share duringthe reporting period. Assuming that the partly paid shares are entitled to participate in the dividend tothe extent of amount paid, weighted average number of shares will becalculated as follows:

Date	No. of equity shares	Amount paid per share	Weighted average no. of equityshares
1.4.20X1	6,00,000	5	6,00,000 x 5/10 x 5/12 =
			1,25,000
1.9.20X1	5,40,000	10	5,40,000 x 7/12 = 3,15,000
1.9.20X1	60,000	5	60,000 x 5/10 x 7/12 = 17,500
Total weighted average equity shares			4,57,500

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Questions 24

No. of equity shares outstanding = 30,00,000Basic earnings per share Rs. 5.00

No. of 12% convertible debentures of Rs. 100 each; 50,000 Each debenture is convertible into 10 equityshares Tax Rate 30% Compute Diluted Earnings per Share. Working notes should form part of the answer.

Answers 24

Earnings for the year:

= No. of Shares x Basic EPS

= 30,00,000 shares x Rs. 5 per share = Rs. 1,50,00,000

Computation of Adjusted Net Profit:

= Earnings for the year + Interest on debentures net of tax

= 1,50,00,000 + (6,00,000 - 1,80,000) = Rs. 1,54,20,000

Computation of Adjusted Denominator:

No. of equity shares resulting from conversion of debentures:

= 50,000 x 10 shares = 5,00,000 shares

No. of equity shares for diluted EPS = 30,00,000 + 5,00,000

= 35,00,000 shares

Computation of Diluted EPS:

= Rs. 1,54,20,000/35,00,000 shares = Rs. 4.4 per share.

Question 25 (Illustration)

Date	Particulars			Balance
1st January	Balance at beginning of year	1,800	-	1,800
31st May	**Issue of shares for cash**	**600**	**-**	**2,400**
1st November	**Buy Back of shares**	**-**	**300**	**2,100**

Calculate Weighted Number of Shares.

Answers 25

Computation of Weighted Average:

(1,800 x 5/12) + (2,400 x 5/12) + (2,100 x 2/12) = 2,100 shares.

The weighted average number of shares can alternatively be computed as follows: (1,800 x12/12) + (600 x 7/12) - (300 x 2/12) = 2,100 shares

In most cases, shares are included in the weighted average number of shares from the date the consideration is receivable, for example:

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a. Equity shares issued in exchange for cash are included when cash is receivable;

b. Equity shares issued as a result of the conversion of a debt instrument to equity shares are included as of the date of conversion;

c. Equity shares issued in lieu of interest or principal on other financial instruments are included as of thedate interest ceases to accrue;

d. Equity shares issued in exchange for the settlement of a liability of the enterprise are included as ofthe date the settlement becomes effective;

e. Equity shares issued as consideration for the acquisition of an asset other than cash are included as of the date on which the acquisition is recognised; and

f. Equity shares issued for the rendering of services to the enterprise are included as the services arerendered.

In these and other cases, the timing of the inclusion of equity shares is determined by the specific terms and conditions attaching to their issue. Due consideration should be given to the substance of any contract associated with the issue.

Question 26(Illustration)

Date	Particulars	No. ofShares	FaceValue	Paid upValue
1st January	Balance at beginning of year	1,800	Rs. 10	Rs. 10
31st October	Issue of Shares	600	Rs. 10	Rs. 5

Calculate Weighted Number of Shares.

Answers 26

Assuming that partly paid shares are entitled to participate in the dividend to the extent of amount paid, number of partly paid equity shares would be taken as 300for the purpose of calculation of earnings pershare.

Computation of weighted average would be as follows:

(1,800 x 12/12) + (300 x 2/12) = 1,850 shares.

Where an enterprise has equity shares of different nominal values but with the same dividend rights, the number of equity shares is calculated by converting all such equity shares into equivalent number of shares of the same nominal value.

Contingently Issuable Shares

Equity shares which are issuable upon the satisfaction of certain conditions resulting from contractual arrangements (contingently issuable shares) are considered outstanding, and included in the computation of basic earnings per share from the date when all necessary conditions under the contract have been satisfied.

Bonus Issue, Share split and Right issue

Equity shares may be issued, or the number of shares outstanding may be reduced, without a corresponding change in resources. Examples include:

a. A bonus issue;

b. A bonus element in any other issue, for example a bonus element in a

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rights issue to existingshareholders;

c. A share split; and

d. A reverse share split (consolidation of shares).

In case of a bonus issue or a share split, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. The number of equity shares outstanding before the event is adjusted for the proportionatechange in the number of equity shares outstanding as if the event had occurred at the beginning of theearliest period reported means along with the impact to current year adjustment, it will also impact thecalculation of EPS of last year retrospectively.

For example, upon a two-for-one bonus issue, the number of shares outstanding prior to the issue is multiplied by a factor of three to obtain the new total number of shares, or by a factor of two to obtain the number of additional shares.

Question 27 (Illustration)

Net profit for the year 20X1	18,00,000
Net profit for the year 20X2	60,00,000
No. of equity shares outstanding until 30th September 20X2	20,00,000
Bonus issue 1st October 20X2 was 2 equity shares for each equity share outstanding at 30th September, 20X2	

Calculate Basic Earnings Per Share.

Answers 27

$$\text{Earnings per share for the year 20X2} = \frac{₹\ 60,00,000}{(20,00,000+40,00,000)} = ₹\ 1.00$$

$$\text{Adjusted earnings per share for the year 20X1} \frac{₹\ 18,00,000}{(20,00,000+40,00,000)} = ₹\ 0.30$$

Adjusted earnings per share for the year 20X1 $_{(20,00,000+40,00,000)}$ = ₹ 0.30

Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior tothe beginning of the year 20X1, the earliest period reported.

The issue of equity shares at the time of exercise or conversion of potential equity shares will not usually give rise to a bonus element, since the potential equity shares will usually have been issued for full value,resulting in a proportionate change in the resources available to the enterprise. In a rights issue, on theother hand, the exercise price is often less than the fair value of the shares. Therefore, a rights issue usually includes a bonus element.

[Thus, it may be noted that if a company makes a right issue at fair value itself, then there will be no bonus element in the right issue].

The number of equity shares to be used in calculating basic earnings per share for all periods prior to therights issue is the number of equity shares outstanding prior to the issue, multiplied by the following adjustment factor:

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Fair value per share immediately prior to the exercise of rights / Theoretical ex - rights fair value per share

The theoretical ex-rights fair value per share is calculated by adding the aggregate fair value of the shares immediately prior to the exercise of the rights to the proceeds from the exercise of the rights, and dividing by the number of shares outstanding after the exercise of the rights.

Question 28 (Illustration)

Net profit for the year 20X1	**₹ 11,00,000**
Net profit for the year 20X2	**₹ 15,00,000**
15,00,000 No. of shares outstanding prior to rights issue	**5,00,000 share**
Rights issue price **₹ 15.00**	
Last date to exercise rights	**1st March 20 X 2**

Rights issue is one new share for each five outstanding (i.e. 1,00,000 new shares) Fair value of one equity share immediately prior to exercise of rights on 1st March 20X2 was Rs. 21.00. Compute Basic Earnings Per Share.

Answers 28

$$\frac{\text{Fair value of shares immediately prior to exercise of rights} + \text{Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise} + \text{Number of shares issued in the exercise}}$$

$$\frac{(21.00 \times 5{,}00{,}000\ shares) + (15.00 \times 1{,}00{,}000\ shares)}{5{,}00{,}000\ Shares + 1{,}00{,}000\ Shares}$$

Theoretical ex-rights fair value per share = ` 20.00

Computation of adjustment factor:

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoreticalex-rights value per share}} = \frac{(21.00)}{(20.00)} = 1.05$$

Computation of earnings per share:

EPS for the year 20X1 as originally reported: Rs. 11,00,000/5,00,000 shares = Rs. 2.20 EPS for the year 20X1

restated for rights issue: Rs. 11,00,000/ (5,00,000 shares x 1.05) = Rs. 2.10

EPS for the year 20X2 including effects of rights issue:

(5,00,000 x 1.05 x 2/12) + (6,00,000 x 10/12) = 5,87,500 sharesEPS = 15,00,000/5,87,500 = 2.55

Question 29 (Illustration)

Net profit for the current year	Rs. 1,00,00,000
No. of equity shares outstanding	50,00,000

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Basic earnings per share	Rs. 2.00
No. of 12% convertible debentures of Rs. 100 each	1,00,000
Each debenture is convertible into 10 equity shares	
Interest expense for the current year	Rs. 12,00,000
Tax relating to interest expense (30%)	Rs. 3,60,000

Compute Diluted Earnings Per Share.

Answers 29

Adjusted net profit for the current year (1,00,00,000 + 12,00,000 – 3,60,000) = Rs. 1,08,40,000

No. of equity shares resulting from conversion of debentures: 10,00,000 Shares No. of equity shares used to compute diluted EPS: (50,00,000 + 10,00,000)

= 60,00,000 Shares

Diluted earnings per share: (1,08,40,000/60,00,000) = Rs. 1.81

Question 30 (Illustration)

Net profit for the year 20X1	**Rs. 12,00,000**
Weighted average number of equity shares outstanding during the year 20X1	**5,00,000 shares**
Average fair value of one equity share during the year 20X1	**Rs. 20.00**
Weighted average number of shares under option during the year 20X1	**1,00,000 shares**
Exercise price for shares under option during the year 20X1	**Rs. 15.00**

Compute Basic and Diluted Earnings Per Share.

Answers 30

Computation of earnings per share

	Earnings`	Shares	Earnings/Share`
Net profit for the year 20X1	12,00,000		
Weighted average no. of shares duringyear 20X1		5,00,000	
Basic earnings per share			2.40
Number of shares under option		1,00,000	
Number of shares that would havebeen issued at fair value (100,000 x 15.00)/20.00		(75,000)	
Diluted earnings per share	12,00,000	5,25,000	2.29

Note:

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The earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of the computation to have been issued for no consideration.

Question 31 (Illustration)

X Limited, during the year ended March 31, 20X1, has income from continuing ordinary operations of Rs. 2,40,000, a loss from discontinuing operations of Rs. 3,60,000 and accordingly a net loss of Rs. 1,20,000. The Company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 20X1.

You are required to compute Basic and Diluted EPS?

Answers 31

As per AS 20 "Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations".

As income from continuing ordinary operations, Rs. 2,40,000 would be considered and not Rs. (1,20,000), for ascertaining whether 200 potential equity shares are dilutive or anti-dilutive. Accordingly, 200 potential equity shares would be dilutive potential equity shares since their inclusion would decrease the net profit per share from continuing ordinary operations from Rs. 240 to Rs. 200. Thus, the basic E.P.S would be Rs. (120) and diluted E.P.S. would be Rs. (100).

In case there are more than 1 potential equity shares:

In considering whether potential equity shares are dilutive or antidilutive, each issue or series of potential equity shares is considered separately rather than in aggregate. The sequence in which potential equity shares are considered may affect whether or not they are dilutive. Therefore, in orderto maximise the dilution of basic earnings per share, each issue or series of potential equity shares is considered in sequence from the most dilutive to the least dilutive. For the purpose of determining thesequence from most dilutive to least dilutive potential equity shares, the earnings per incremental potential equity share is calculated. Where the earnings per incremental share is the least, the potential equity share is considered most dilutive and vice-versa.

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Chapter 4.6

AS 24- Discontinuing Operations

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.8 TO Q.14											
Past Exams	NO	Q.4	NO	NO	NO	NO	NO	Q.7	NO	NO	NO	NO
MTP	NO	Q.6	Q.6	NO	NO	NO	NO	NO	NO	NO	NO	NO
RTP	Q.6	Q.1	NO	NO	Q.1	Q.4	Q.7	Q.3	Q.1	Q.5	Q.6	NO

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Chapter 4.6

AS 24- Discontinuing Operations

Question 1

(i) **What are the disclosure and presentation requirements of AS 24 for discontinuing operations? (RTP May 20, May 22, Old & New SM)**

(ii) **Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24,but that might do so in combination with other circumstances. (RTP May 20, Nov 18, May 22, Old &New SM)**

Answer 1

(i) An enterprise should include prescribed information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 15) occurs

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 amounts 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 amounts of net cash flows attributable to the operating, investing, and financing activities ofthe discontinuing operation during the current financial reporting period

DISCLOSURES OTHER THAN INITIAL DISCLOSURES NOTE

All the disclosures above should be presented in the notes to the financial statements except for amounts pertaining to pre-tax profit/loss of the discontinuing operation and the income tax expense thereon (second last bullet above) which should be shown on the face of the statement of profit and loss.

Other disclosures

When an enterprise disposes of assets or settles liabilities attributable to a discontinuing op-

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eration 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 any gain or loss that is recognized 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.

Updating the disclosures

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.

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

Presentation of the required disclosures

The above disclosures should be presented in the notes to the financial statements except the followingwhich 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 recognized on the disposal of assets or settlement of liabilities attributable to the discontinuing operation.

(ii) Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations.

Examples of activities that do not necessarily satisfy criterion (a) of the definition, but that might do soin 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.

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Questions 2

Rohini Limited is in the business of manufacture of passenger cars and commercial vehicles. The Company is working on a strategic plan to close the production of passenger cars and to produce only commercial vehicles over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its prospective plan it will reduce the production of passenger cars by 20% annually. It also plans to establish another new factory for the manufacture of commercial vehicles and transfer surplus employees in a phased manner.
You are required to comment:

(i) If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.

(ii) If the Company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24?

(iii) Would your answer to (ii) above be different if the Company resolves tosell the assets of the passenger car division in a phased but time bound manner? (New SM)

Answers 2

(i) 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 sellingthe 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; and

(c) that can be distinguished operationally and for financial reporting purposes.

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24,

'Discontinuing Operations';

Examples of activities that do not necessarily satisfy criterion of thedefinition, but that might do so incombination with other circumstances, include:

i) Gradual or evolutionary phasing out of a product line or class of service;

ii) Shifting of some production or marketing activities for a particular line of business from one location to another; and

iii) Closing of a facility to achieve productivity improvements or other cost savings. In this case, it cannot be considered as Discontinuing Operation as per AS-24 as the companies' strategic planhas no final approval from the board through a resolution and there isno specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.

(ii) No, the resolution is silent about stoppage of the Car segment in definite time period. Though,

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sale of some assets and some transfer proposals were passed through a resolution to the new factory, butthe closure road map and new segment starting roadmap are missing.

Hence AS 24 will not be applicable and it cannot be considered as Discontinuing operations.

(iii) Yes, phased and time bound program resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap.

Hence this action will attract compliance of AS 24 and it will be considered as Discontinuing Operations as per AS-24.

Question 3

What are discontinuing operations as per AS 24? Should an enterprise include prescribed informationrelating to a discontinuing operation in its financial statements? (RTP Nov '21)

Answer 3

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 transactionor 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 liabilitiesindividually 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.

An enterprise should include prescribed information relating to a discontinuing operation in its financial statements, as per requirements of AS 24, beginning with the financial statements for the period in which the initial disclosure event occurs.

Question 4

What do you understand by Discontinuing Operations? What are the disclosure and presentationrequirements of AS 24 for discontinuing operations? Explain in brief. (RTP Nov 20, PYP 5 Marks Nov'18)

Answer 4

As per AS 24 "Discontinuing Operations", 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 liabilitiesindividually or

(iii) Terminating through abandonment and

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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.

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 description of the discontinuing operation(s);
- The business or geographical segment(s) in which it is reported as per AS 17;
- The date and nature of the initial disclosure event.
- The date or period in which the discontinuance is expected to be completed if known or determinable,
- The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and thetotal liabilities to be settled;
- The amounts of revenue and expenses in respect of the ordinary activities attributable to thediscontinuing operation during the current financial reporting period;
- 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;
- The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

Question 5

What is the disclosure requirement in interim financial reports as per AS 24 for discontinuing operations? (RTP Nov'22)

Answer 5

Disclosure in interim financial reports

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

- Any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation and
- Any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

Question 6

A consumer goods producer has changed the product line as follows:

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	Dish washing Bar	Clothes washing Bar
	(Per month)	(Per month)
January 2021 - September 2021	2,00,000	2,00,000
October 2021 - December 2021	1,00,000	3,00,000
January 2022 - March 2022	Nil	4,00,000

The company has enforced a gradual enforcement of change in product line on the basis of an overall plan. The Board of Directors has passed a resolution in March 2021 to this effect. The company followscalendar year as its accounting year.

You required to advise the company whether it should be treated as discontinuing operation or not as per AS 24? (RTP May '23, MTP 5 Marks Apr'19, Aug'18, RTP May'18)

Answer 6

As per AS 24 'Discontinuing Operations', a discontinuing operation is a component of an enterprise:

(i) that the enterprise, pursuant to a single plan, is:

(1) disposing of substantially in its entirety,

(2) disposing of piecemeal, or

(3) terminating through abandonment; and

(ii) that represents a separate major line of business or geographical area of operations; and

(iii) that can be distinguished operationally and for financial reporting purposes.

As per provisions of the standard, business enterprises frequently close facilities, abandon products oreven product lines, and change the size of their work force in response to market forces. While those kinds of terminations generally are not, in themselves, discontinuing operations, they can occur in connection with a discontinuing operation. Examples of activities that do not necessarily satisfy criterion of discontinuing operation are gradual or evolutionary phasing out of a product line or class of service, discontinuing, even if relatively abruptly, several products within an ongoing line of business;

In the given case, the company has enforced a gradual enforcement of change in product line and does not represent a separate major line of business and hence is not a discontinued operation. If it were a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

- the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or
- the enterprises board of directors or similar governing body has both approved a detailed, formal plan for discontinuance and made an announcement of the plan.

Question 7

Rohini Limited is in the business of manufacture of passenger cars and commercial vehicles. The Company is working on a strategic plan to close the production of passenger cars and to produce only commercial vehicles over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its prospective plan it will reduce the production of passenger cars by 20% annually. It also plans to establish another new factory for the man-

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ufacture of commercial vehicles and transfer surplus employees in a phased manner. You are required to comment:

- If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.
- If the Company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24?
- Would your answer to the above be different if the Company resolves to sell the assets of the passenger car division in a phased but time bound manner? (PYP 5 Marks July 21) (Same concept lesser adjustments RTP May'21)

Answer 7

As per AS 24, 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 liabilitiesindividually; or

(iii) terminating through abandonment; and

(b) that represents a separate major line of business or geographical area of operations; and

(c) that can be distinguished operationally and for financial reporting purposes.

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'; Examples of activities that do not necessarily satisfy criterion 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) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(c) Closing of a facility to achieve productivity improvements or other cost savings. In this case, it cannot be considered as Discontinuing Operation as per AS-24 as the and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e., commercial vehicle production line in a new factory has not started.

(ii) No, the resolution is salient about stoppage of the Car segment in definite time period. Though, saleof some assets and some transfer proposals were passed through a resolution to the new factory, but the closure road map and new segment starting roadmap are missing.

Hence, AS 24 will not be applicable and it cannot be considered as Discontinuing operations.

(iii) Yes, phased and time bound program resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap.

Hence, this action will attract compliance of AS 24 and it will be considered as Discontinuing Operationsas per AS-24.

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Question 8

AB decided to dispose of its Clothing division as part of its long-term strategy.

a. Date of Board approval - 1st March 20X1;	b. Date of formal announcement made toaffected parties - 15th March 20X1
c. Date of Binding Sale agreement – 1st July20X1;	d. Reporting date – 31st March 20X1

The date of initial disclosure event would be:

a. 1st March 20X1	b. 15th March 20X1
c. 31st March 20X1	d. 31st July 20X1

Ans: (b)

Question 9

To qualify as a component that can be distinguished operationally and for financial reporting purposes,the condition(s) to be met is (are):

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 expensescan be directly attributed to it.	d. All of the above

Ans: (d)

Question 10

Identify which of the following statements is incorrect?

a. A discontinuing operation is a component of an enterprise that representsa separate majorline of business or geographical area of operations.

b. A discontinuing operation is a component of an enterprise that can be distinguished operationally and for financial reporting purposes.

c. A discontinuing operation is a component of an enterprise that may ormay not be distinguished operationally and for financial reporting purposes.

d. A discontinuing operation may be disposed of in its entirety or piecemeal, but always pursuant to an overall plan to discontinue the entire component.

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Ans: (c)

Question 11

Identify the incorrect statement.

e. Discontinuing operations are infrequent events, but this does not meanthat all infrequent events are discontinuing operations.

f. The fact that a disposal of a component of an enterprise is classified as a discontinuing operation under AS 24 would always raise a question regarding the enterprise's ability to continue as a going concern.

g. For recognising and measuring the effect of discontinuing operations, AS 24 does not provide anyguidelines, but for the purpose the relevantAccounting Standards should be referred.

h. An enterprise shall include a description of the discontinuing operation,in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs.

Ans: (b)

Theoretical Questions Answers

Questions 12

(ii) What are the disclosure and presentation requirements of AS 24 for discontinuing operations?

(iii) Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS24, but that might do so in combination with other circumstances.

Answers 12

An enterprise should include prescribed information relating to a discontinuing operation in its financialstatements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 15 of AS 24) occurs. For details, please refer Section 6.5 of this Chapter above.

(ii) Examples of activities that do not necessarily satisfy criterion (a) of the definition, but that might do so in combination with other circum- stances, include:

(a) Gradual or evolutionary phasing out of a product line or class ofservice;

(b) Discontinuing, even if relatively abruptly, several products withinan ongoing line of business;

(c) Shifting of some production or marketing activities for a particularline of business from onelocation to another; and

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

Questions 13

What are the initial disclosure requirements of AS 24 for discontinuing operations?

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Answers 13

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 thetotal liabilities to be settled.

(f) The amounts of revenue and expenses in respect of the ordinary activities attributable to thediscontinuing 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 reportingperiod, and the income tax expense related thereto.

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

Practical Questions Answers

Questions 14

Rohini Limited is in the business of manufacture of passenger cars and commercial vehicles. The Company is working on a strategic plan to close the production of passenger cars and to produce onlycommercial vehicles over the coming 5 years. However, no specific plans have been drawn up for saleof neither the division nor its assets. As part of its prospective plan it will reduce the production of passenger cars by 20% annually. It also plans to establish another new factory for the manufacture ofcommercial vehicles and transfer surplus employees in a phased manner.

You are required to comment:

(i) **If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within themeaning of AS-24.**

(ii) If the Company passes a resolution to sell some of the assets in the passenger car division and also

to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24?

(iii) Would your answer to (ii) above be different if the Company resolves tosell the assets of thepassenger car division in a phased but time bound manner?

Answers 14

(i) 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 sellingthe component in a

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single transaction or by demerger or spin-off of ownership of the component to the enterprise'sshareholders; 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; and

(c) that can be distinguished operationally and for financial reporting purposes.

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24,

'Discontinuing Operations'.

Examples of activities that do not necessarily satisfy criterion of thedefinition, but that might do soin combination with other circumstances, include:

i) Gradual or evolutionary phasing out of a product line or class of service;

ii) Shifting of some production or marketing activities for a particular line of business from one location to another; and

iii) Closing of a facility to achieve productivity improvements or other cost savings. In this case, it cannot be considered as Discontinuing Operation as per AS-24 as the companies' strategic plan has no final approval from the board through a resolution and there isno specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.

(ii) No, the resolution is silent about stoppage of the Car segment in definite time period. Though, saleof some assets and some transfer proposal were passed through a resolution to the new factory, but the closure road map and new segment starting roadmap are missing.

Hence AS 24 will not be applicable and it cannot be considered as Discontinuing operations.

(iii) Yes, phased and time bound program resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap.

Hence this action will attract compliance of AS 24 and it will be considered as Discontinuing Operations as per AS-24.

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Chapter 4.7

AS 25 Interim Financial Reporting

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.9 TO Q.23											
Past Exams	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
MTP	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
RTP	Q.7	Q.6	Q.5	NO	NO	Q.3	NO	NO	NO	NO	NO	NO

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Chapter 4.7

AS 25 Interim Financial Reporting

Question 1

Fresh Limited reported a Profit Before Tax (PBT) of Rs. 4 lakhs for the third quarter ending 30-09-2016. On enquiry you observe the following. Give the treatment required under AS 25:

- **Dividend income of Rs. 4 lakhs received during the quarter has been recognized to the extent of Rs. 1 lakh only.**
- **80% of sales promotion expenses Rs. 15 lakhs incurred in the third quarter has been deferred to the fourth quarter as the sales in the last quarter is high.**
- **In the third quarter, the company changed depreciation method from WDV to SLM, which resulted in excess depreciation of Rs.12 lakhs. The entire amount has been debited inthe third quarter, though the share of the third quarter is only Rs. 3 lakhs.**
- **Rs. 2 lakhs extra-ordinary gain received in third quarter was allocated equally to thethird and fourth quarter.**
- **Cumulative loss resulting from change in method of inventory valuation was recognized in the third quarter of Rs. 3 lakhs. Out of this loss Rs. 1 lakh relates to previous quarters.**
- **Sale of investment in the first quarter resulted in a gain of Rs. 20 lakhs. The company had apportioned this equally to the four quarters.**

Prepare the adjusted profit before tax for the third quarter. (MTP 5 Marks Oct 17)

Answer 1

As per para 36 of AS 25 "Interim Financial Reporting", seasonal or occasional revenue and cost within a financial year should not be deferred as of interim date untill it is appropriate to defer at the end of the enterprise's financial year. Therefore, dividend income, extra- ordinary gain, and gain on sale of investment received during 3 rd quarter should be recognised in the 3rd quarter only. Similarly, sales promotion expenses incurred in the 3 rd quarter should also be charged in the 3rd quarter only.

Further, as per the standard, if there is change in the accounting policy within the current financial year, then such a change should be applied retrospectively by restating the financial statements of prior interim periods of the current financial year. The change in the method of depreciation or inventory valuation is a change in the accounting policy. Therefore, the prior interim periods' financial statements should be restated by applying the change in the method of valuation retrospectively.

Accordingly, the adjusted profit before tax for the 3rd quarter will be as follows:

Statement showing Adjusted Profit Before Tax for the third quarter:

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	(Rs. in lakhs)
Profit before tax (as reported)	4
Add: Dividend income Rs. (4-1) lakhs	3
Excess depreciation charged in the 3rd quarter, due tochangein the method, should be applied retrospectively Rs. (12-3)lakhs	9
Extra ordinary gain Rs. (2-1) lakhs	1
Cumulative loss due to change in the method of inventory valuation should be applied retrospectively Rs. (3-2) lakhs	1
Less: Sales promotion expenses (80% of Rs. 15 lakhs)	12
Gain on sale of investment (occasional gain should not be deferred)	5
Adjusted Profit before tax for the third quarter	1

Question 2

On 30-6-2017, L Limited incurred Rs. 6,00,000 net loss from disposal of a business segment. Also on 31-7-2017, the company paid Rs. 1,60,000 for property taxes assessed for the calendar year 2017. How should the above transactions be included in determination of net income of L Limited for the six months interim period ended on 30-9-2017? (MTP 4 Marks Aug 17)

Answer 2

Para 28 of AS 25 "Interim Financial Reporting" states that revenues and gains should be recognized in interim reports on the same basis as used in annual reports. As at September 30, 2017, L Ltd. would report the entire Rs. 6,00,000 loss on the disposal of its business segment since the loss was incurred during the interim period.

A cost charged as an expense in an annual period should be allocated among the interim periods, which are clearly benefited from the expense, through the use of accruals and/or deferrals. Since Rs. 1,60,000 property tax payment relates to the entire 2017 calendar year, only Rs. 80,000 of the payment would be reported as an expense at September 30, 2017, while out of the remaining Rs. 80,000, Rs. 40,000 for Jan.2017 to March, 2017 would be shown as payment of the outstanding amount of previous year and another Rs. 40,000 related to quarter October, 2017 to December, 2017, would be reported as a prepaidexpense.

Question 3

A Ltd. is dealing in seasonal products. The following is the quarterly sales pattern of the product:

Quarter 1	II	III	IV
Ending 31st March	30th June	30th September	31st December
20%	20%	50%	25%

For the first quarter ending 31st March, 2020, A Ltd. gives you the following information:

	Rs. in crore
Sales	**100**

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Salary and other expenses	**60**
Advertisement expenses (routine)	**4**
Administrative and selling expenses	**8**

While preparing interim financial report for the first quarter, A Ltd. wants to defer

Rs. 42 crore expenditure to third quarter on the argument that third quarter is having more sales, therefore third quarter should be debited by higher expenditure, considering the seasonal nature of business. The expenditures are uniform throughout all quarters.

alculate the result of first quarter as per AS 25 and comment on the A Ltd. view. (RTP Nov 20)

Answer 3

(a) Calculation of the result of first quarter as per AS 25

Particulars	(Rs. in crore)
Result of first quarter ending 31st March, 2020	
Turnover	100
Other Income	Nil
Total (a)	100
Less: Changes in inventories	Nil
Salaries and other expenses	60
Administrative and selling expenses (4 + 8)	**12**
Total (b)	72
Profit (a)-(b)	28

As per AS 25 on Interim Financial Reporting, the income and expense should be recognised when they are earned and incurred respectively. As per AS 25, the costs should be anticipated ordeferred only when

- it is appropriate to anticipate that type of cost at the end of the financial year, and
- costs are incurred unevenly during the financial year of an enterprise.
- The expenditure of Rs. 42 crore made in the first quarter shall be charge in that quarter only i.e. when they are earned and incurred. Therefore, the argument given by A Ltd. relating to deferment of Rs. 42 crore is not tenable as expenditures are uniform throughout all quarters.

Question 4

Adam Ltd. provides you the following information and asks you to calculate the tax expense for each quarter with reference to AS 25, assuming that there is no difference between the estimated taxable income and the estimated accounting income:

Estimated Gross Annual Income 33,00,000 (inclusive of Estimated Capital Gains of Rs. 8,00,000) Esti-

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mated Income of Quarter I is Rs. 7,00,000, Quarter II is Rs. 8,00,000, Quarter III (including Estimated Capital Gains of Rs. 8,00,000) is Rs. 12,00,000 and Quarter IV is Rs. 6,00,000.

Tax Rates: On Capital Gains 12%On Other Income: First Rs. 5,00,000 30% Balance Income· 40% (RTP Nov 19)

Answer 4

As per para 29 of AS 25 ₹Interim Financial Reporting₹, income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

If different income tax rates apply to different categories of income (such as capital gains or income earnedin particular industries) to the extent prac ticable, a separate rate is applied to each individual category ofinterim period pre-tax income.

	Rs.
Estimated annual income exclusive of estimated capital gain(33,00,000 – 8,00,000) (A)	25,00,000
Tax expense on other income:	
30% on Rs. 5,00,000	1,50,000
40% on remaining Rs. 20,00,000	8,00,000
(B)	9,50,000
Weighted average annual income tax rate = B/A (9,50,000/25,00,000) x 100 = 38%	

Tax expense to be recognised in each of the quarterly reports

		Rs.
Quarter I - Rs. 7,00,000 x 38%		2,66,000
Quarter II - Rs. 8,00,000 x 38%		3,04,000
Quarter III - Rs. (12,00,000 - 8,00,000) x 38%	1,52,000	
Rs. 8,00,000 x 12%	96,000	2,48,000
Quarter IV - Rs. 6,00,000 x 38%		2,28,000
		10,46,000

Question 5

Faithful Ltd. is dealing in seasonal product sales pattern of the product, quarter wise is as follows: 1st-2nd3rd4th

Information regarding the 1st quarter ending on 30th June, 2018 is as follows:Sales 80 crore

Salary and other expenses 60 crore

Advertisement expenses (routine) 4 crore

Administrative and selling expenses 8 crore

Chapter_4.6 to entire 4th chap-
proof done.indd

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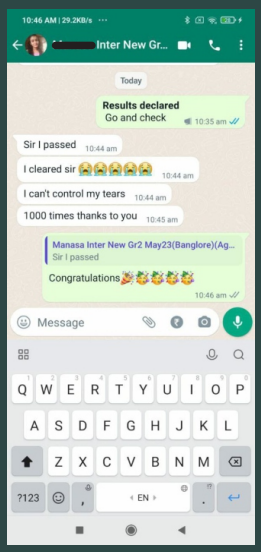

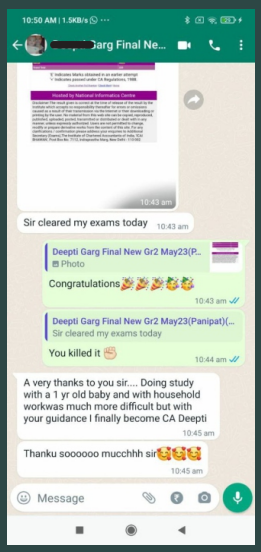

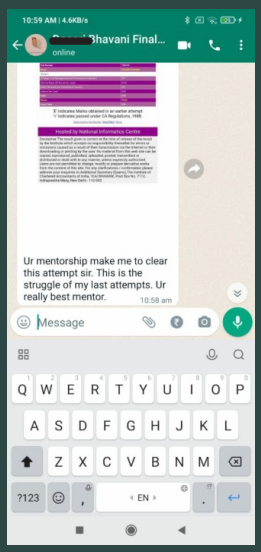

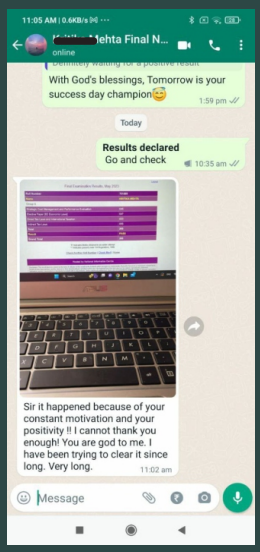

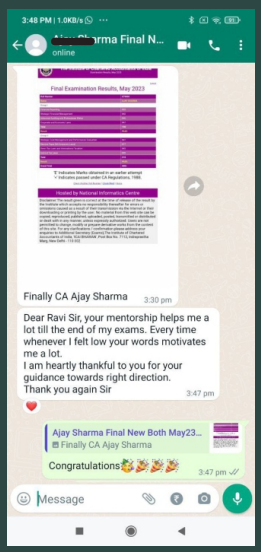

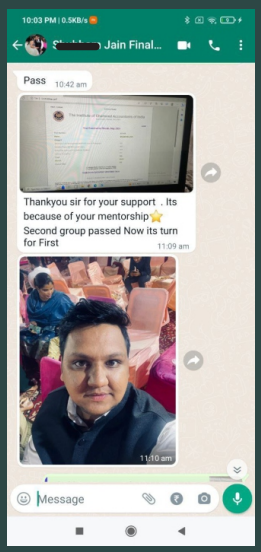

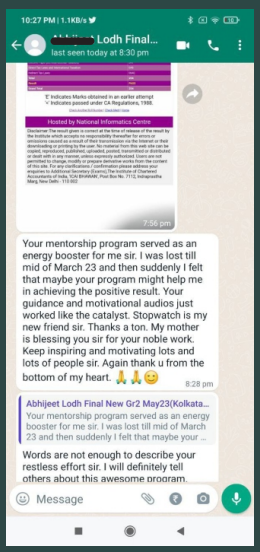

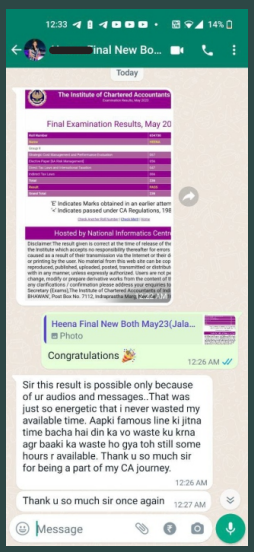

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While preparing interim financial report for first quarter Faithful Ltd. wants to defer

Rs. 10 crore expenditure to third quarter on the argument that third quarter is having more sales therefore third quarter should be debited by more expenditure. Considering the seasonal nature of business and the expenditures are uniform throughout all quarters, calculate the result of the first quarter as per AS 25. Also give a comment on the company's view. (RTP May 19)

Answer 5

According to AS 25 the Income and Expense should be recognized when they are earned and incurred respectively. Therefore, seasonal incomes will be recognized as and when they occur. Thus, the company's view is not as per AS 25. Correct Statement of Profit or Loss for the quarter ending on 30 th June, 2018 would be

Particulars	(Rs. in crore)	
Result of first quarter ending 30th June, 2018		
Turnover	80	
Other Income	Nil	
Total (a)		80
Less: Changes in inventories		Nil
Salaries and other cost		60
Administrative and selling Expenses (4+8)		12
Total (b)		72
Profit (a)-(b)		8

Question 6

To comply with listing requirements and other statutory obligations, Prateek Ltd. prepares interim financial reports at the end of each quarter. The company has brought forward losses of Rs. 350 lakhs under Income-tax Law, of which 90% is eligible for set off as per the recent verdict of the Court, that has attained finality. No deferred tax asset has been recognized on such losses in view of the uncertainty over its eligibility for set off. The company has reported quarterly earnings of Rs. 350 lakhs and Rs. 150 lakhs respectively for the first two quarters of financial year 2017-2018 and anticipates net earnings of Rs. 400 lakhs in the coming half year ended March 2018 of which Rs. 50 lakhs will be the loss in the quarter ended December, 2017. The tax rate for the company is 30% with a 10% surcharge. You are required to calculate the amount of tax expense to be reported for each quarter of financial year 2017-2018. (RTP Nov 18)

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Answer 6

Estimated tax liability on annual income = [Income Rs. 900 lakhs – b/f losses Rs. 315 lakhs (90% of 350)] x33% = 33% of Rs. 585 lakhs = Rs. 193.05 lakhs

As per para 29(c) of AS 25 ₹Interim Financial Reporting₹, income tax expense is recognised in each interimperiod based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

Thus, estimated weighted average annual income tax rate = Rs. 193.05 lakhs divided by Rs. 900 lakhs=21.45%

Tax expense to be recognised in each quarter	Rs. in lakhs
Quarter I – Rs. 350 lakhs x 21.45%	75.075
Quarter II – Rs. 150 lakhs x 21.45%	32.175
Quarter III – (Rs. 50 lakhs) x 21.45%	(10.725)
Quarter IV – Rs. 450 lakhs x 21.45%	96.525
	193.05

Question 7

Estimated annual income ₹ 1 lakh (inclusive of Estimated
Capital Gains (earned in Quarter II) ₹20,000The estimated income of
each quarter is ₹25,000Tax Rates:
On Capital Gains 10%
On other income:
First ₹40,000 30%
Balance income 40%
There is no difference between the estimated taxable income and the estimated accounting income. Calculate tax expense for each quarter and for the year. (RTP May 18)

Answer 7

Tax Expense:

On Capital Gains portion of annual income:

10% of ₹ 20,000	₹ 2,000
On other income: 30% of ₹ 40,000 + 40% of ₹ 40,000	₹ 28,000
Total:	₹ 30,000

Weighted Average Annual Effective Tax Rate:

On Capital Gains portion of annual Income: (2,000 / 20,000) X 100 = 10% On other income: (28,000/ 80,000) X 100 = 35%

When income of ₹ 25,000 for 2nd Quarter includes capital gains of ₹ 20,000, the tax expensefor each quarter will be calculated as below:

		Income	Tax Expense		
Quarter I		₹25,000	35% of ₹ 25,000 =		₹ 8,750

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Quarter II	Capital Gains:	₹20,000	10% of ₹ 20,000 =	₹ 2,000	
	Other:	₹ 5,000	35% of ₹5,000 =	₹ 1,750	₹ 3,750

Quarter III		₹25,000	35% of ₹ 25,000 =		₹ 8,750
Quarter IV		₹25,000	35% of ₹ 25,000 =		₹8,750
Total tax expense for the					
year					₹30,000

Question 8

An enterprise reports quarterly, estimates an annual income of ₹ 10 lakhs. Assume tax rates on 1st ₹ 5,00,000 at 30% and on the balance income at 40%. The estimated quarterly income are ₹ 75,000, ₹ 2,50,000, ₹ 3,75,000 and ₹ 3,00,000.

Calculate the tax expense to be recognized in each quarter. (RTP Nov 17)(New SM)

Answer 8

As per para 29 of AS 25 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

		₹
Estimated Annual Income	(A)	10,00,000
Tax expense:		
30% on ₹ 5,00,000		1,50,000
40% on remaining ₹ 5,00,000		2,00,000
	(B)	3,50,000

Weighted average annual income tax rate = B/A = 3,50,000/ 10,00,000= 35%

Tax expense to be recognized in each of the quarterlyreports		₹
Quarter I -	₹ 75,000 x 35%	26,250
Quarter II -	₹ 2,50,000 x 35%	87,500
Quarter III -	₹ 3,75,000 x 35%	1,31,250
Quarter IV -	₹ 3,00,000 x 35%	1,05,000
	₹ 10,00,000	3,50,000

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Question 9

AS 25 mandates the following in relation to interim financial reports.

a. Which entities should publish interimfinancial reports.	b. How frequently it should publish interimfinancial reports.
c. How soon it should publish after the end ofinterim period.	d. None of the above.

Ans: (d)

Question 10

The standard defines Interim Financial Report as a financial report for an interim period that contains a set of financial statements.

a. Complete	b. Condensed
c. Financial statement similar to annual	d. Either complete or condensed

Ans: (d)

Question 11

ABC Limited has reported Rs. 85,000 as per tax profit in first quarter and expects a loss of Rs. 25,000 each in subsequent quarters. It has corporate tax rate slab of 20% on the first Rs. 20,000 earnings and 40% on all additional earnings. Calculate tax expenses that should report in first quarter interim financial report.

a. Rs. 17,000	b. Rs. 30,000
c. Rs. 2,000	d. AS 25 does not mandate to report tax expenses

Ans: (a)

Question 12

An entity prepares quarterly interim financial reports in accordance with AS 25. The entity is engaged in sale of mobile phones and normally 5% of customers claim on their warranty. The provision in the first quarter was calculated as 5% of sales to date, which was `10 million. However, in the second quarter, a fault was found and warranty claims were expected to be 10% for the whole of the year. Sales in the second quarter were `15 million. What would be the provision charged in the second quarter's interim financial statements?

a. `1 million	**b. Rs. 2 million**
c. Rs. 1.25 million	**d. Rs. 1.5 million**

Ans: (b)

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Theoretical Questions Answers

Questions 13

What are the periods for which Interim Financial Statements are required to be presented? You are required to answer your question in light of preparation of financial statements for the period ended and as at 31st December, 20X1. The Financial Year is FY 20X1-X2.

Answers 13

A.s per Accounting Standard 25, Interim reports should include interimfinancial statements (condensedor complete) for periods as given below.

Statement	Current period	Comparative period
Balance sheet	End of current interimperiod	End of immediately preceding financialyear
Statement of profit andloss	Current interim period andcumulatively for the year-to-date	Comparable interim period and year-todate of immediately preceding financial year
Cash flow statement	Cumulatively for the currentfinancial year- to-date	Comparable year-to-date of immediatelypreceding financial year

In light of the above, following periods needs to be covered in interim financial statements for the period ended and as at 31st December, 20X1:

Balance Sheet	as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year (As at 31 December 20X1 and 31 March 20X1).
Statements of Profitand Loss	for the current interim period and cumulatively for the current financial year to date, with comparative statements of profit and loss for the comparable interim periods (current and year-to-date) of the immediately preceding financial year. (for 3 months and 9 months i.e., year to date ended 31 December 20X1 and samefor 31 December 20X0 being comparative period).
Cash Flow Statement	cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year. (year to date i.e., 1 April 20X1 to 31 December 20X1 and 1 April 20X0 to 31 December 20X0).

Questions 14

Whether quarterly financial results presented under Clause 41 of the Listing Agreement entered into between Stock Exchanges and the listed enterprises meet the definition of 'interim financial report' as per AS 25 and the provisions of AS 25 should be applied on the same?

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Answers 14

The presentation and disclosure requirements contained in AS 25 should be applied only if an enterprise prepares and presents an 'interim financial report' as defined in AS 25. Accordingly, presentation and disclosure requirements contained in AS 25 are not required to be applied in respect of interim financial results (which do not meet the definition of 'interim financial report' as per AS 25) presented by an enterprise.

The quarterly financial results presented under Clause 41 of the Listing Agreement do not meet the definition of 'interim financial report' as per AS 25. However, the recognition and measurement principles laid down in AS 25 should be applied for recognition and measurement of items contained in such interim financial results.

Questions 15

Whether the impairment loss recognized on property, plant and equipment in first quarter of the financial year can be reversed in the second quarter in that financial year?

Answers 15

As per AS 25, the principles for recognising and measuring losses from inventorywrite-downs, restructurings,or impairments in an interim period are the same asthose that an enterprise would follow if it prepared onlyannual financial statements. However, if such items are recognised and measured in one interimperiod andthe estimate changes in a subsequent interim period of that financialyear, the original estimate is changedin the subsequent interim period either byaccrual of an additional amount of loss or by reversal of the previously recognised amount. In light of the same, the impairment loss recognized in onequarter can be reversed in the another quarter of the financial year, if favourableindicator exists as per AS 28 and the recoverable amount increased in comparison to earlier period.

Practical Questions Answers

Questions 16

In view of the provisions of Accounting Standard 25 on Interim Financial Reporting, on what basis will you calculate, for an interim period, the provision in respect of defined benefit schemes like pension, gratuity etc. for the employees?

Answers 16

Accounting Standard 25 suggests that provision in respect of defined benefit schemes like pension and gratuity for an interim period should be calculated based on the year-to-date basis by using the actuarially

determined rates at the end of the prior financial year, adjusted for significant market fluctuations since that time and for significant curtailments, settlements or other significant one-time events.

Questions 17

On 30th June, 20X1, Asmitha Ltd. incurred Rs. 2,00,000, net loss from disposal of a business segment. Also,on 31st July, 20X1, the company paid Rs. 60,000 for property taxes assessed for the calendar year 20X1. How the above transactions should be included in determination of net income of Asmitha Ltd. for the six months interim period ended on 30th September, 20X1.

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Answers 17

According to Para 10 of AS 25 "Interim Financial Reporting", if an enterprise prepares and presents a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial statements. As at 30th September, 20X1, Asmitha Ltd would report the entire amount of Rs. 2,00,000 as lossson the disposal of its business segment since the loss was incurred during interim period. A cost charged asan expense in an annual period should be allocated to interim periods on accrual basis.

Since Rs. 60,000 Property tax payment relates to entire calendar year 20X1, Rs. 30,000 would be reported as anexpense for six months ended on 30th September, 20X1 while out of the remaining Rs. 30,000, Rs. 15,000 for January, 20X1 to March, 20X1 should be shown as payment of the outstanding amount of previous year and another Rs. 15,000 related to quarter October, 20X1 to December, 20X1 would be reported as prepaid expenses.

Questions 18

An enterprise reports quarterly, estimates an annual income of Rs. 10 lakhs. Assume tax rates on 1st Rs. 5,00,000 at 30% and on the balance income at 40%. The estimated quarterly income are Rs. 75,000, Rs. 2,50,000, Rs. 3,75,000 and Rs. 3,00,000.
Calculate the tax expense to be recognized in each quarter.

Answers 18

As per para 29 of AS 25 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

	Rs.
Estimated Annual Income (A)	10,00,000
Tax expense:	
30% on Rs. 5,00,000	1,50,000
40% on remaining Rs. 5,00,000	2,00,000
(B)	3,50,000

$$\text{Weighted average annual income tax rate} = \frac{B}{A} = \frac{3,50,000}{10,00,000} = 35\%$$

Tax expense to be recognized in each of the quarterly reports	`
Quarter I - ` 75,000 x 35%	26,250
Quarter II - Rs. 2,50,000 x 35%	87,500

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Quarter III -	Rs. 3,75,000 x 35%	1,31,250
Quarter IV -	Rs. 3,00,000 x 35%	1,05,000
	Rs. 10,00,000	3,50,000

Questions 19

Antarbarti Limited reported a Profit Before Tax (PBT) of Rs. 4 lakhs for the third quarter ending 30-09-20X1. On enquiry you observe the following. Give the treatment required under AS 25:

(i) Dividend income of Rs. 4 lakhs received during the quarter has been recognized to the extent of Rs. 1 lakh only.

(ii) 80% of sales promotion expenses Rs. 15 lakhs incurred in the third quarter has been deferred to the fourth quarter as the sales in the last quarter is high.

(iii) In the third quarter, the company changed depreciation method from WDV to SLM, which resulted in excess depreciation of Rs. 12 lakhs. The entire amount has been debited in the third quarter, thoughthe share of the third quarter is only Rs. 3 lakhs.

(iv) Rs. 2 lakhs extra-ordinary gain received in third quarter was allocated equally to the third and fourth quarter.

(v) Cumulative loss resulting from change in method of inventory valuation was recognized in the thirdquarter of Rs. 3 lakhs. Out of this loss Rs. 1 lakh relates to previous quarters.

(vi) Sale of investment in the first quarter resulted in a gain of Rs. 20 lakhs. The company had apportioned this equally to the four quarters.

Prepare the adjusted profit before tax for the third quarter.

Answers 19

As per para 36 of AS 25 "Interim Financial Reporting", seasonal or occasional revenue and cost within a financial year should not be deferred as of interim date until it is appropriate to defer at the end of the enterprise's financial year. Therefore, dividend income, extra-ordinary gain, and gain on sale of investmentreceived during 3rd quarter should be recognised in the 3rd quarter only. Similarly, sales promotion expensesincurred in the 3rd quarter should also be charged in the 3rd quarter only.

Further, as per AS 10, Property, Plant and Equipment, if there is change in the depreciation method, such achange should be accounted for as a change in accounting estimate in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, and applied prospectively. Therefore, no adjustment would be required due to change in the method of depreciation.

Accordingly, the adjusted profit before tax for the 3rd quarter will be as follows:

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Statement showing Adjusted Profit Before Tax for the third quarter

	(Rs. in lakhs)
Profit before tax (as reported) Add: Dividend income Rs. (4-1) lakhsExcess depreciation charged in the 3rd quarter, due to change in the method	4 3
Extra ordinary gain Rs. (2-1) lakhsCumulative loss due to change in the method of inventory valuation should be applied retrospectively Rs. (3-2) lakhs	- 1
Less: Sales promotion expenses (80% of Rs. 15 lakhs)	1
Gain on sale of investment (occasional gain should not bedeferred)	9
Adjusted Profit before tax for the third quarter	(12) (5) (8)

Question 20 (Illustration)

Sincere Corporation is dealing in seasonal product. Sales pattern of the product quarter-wise is as follows:

1st quarter 30th June	**10%**
2nd quarter 30th September	**10%**
3rd quarter 31st December	**60%**
4th quarter 31st March	**20%**

Information regarding the 1st quarter ended on 30th June, 20X1 is as follows:

Sales **80 crores**

Salary and other expenses	60 crores
Advertisement expenses (routine)	4 crores
Administrative and selling expenses	8 crores

While preparing interim financial report for first quarter Sincere Corporation wants to defer Rs. 10 crores expenditure to third quarter on the argument that third quarter is having more sales, therefore, the third quarter should be debited by more expenditure. Considering the seasonal nature of business and the expenditures are uniform throughout all quarters, calculate the result of the first quarter as per AS 25. Also give a comment on the company's view.

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Answers 20

Particulars	(₹ In crores)	
Result of first quarter ended 30th June, 20X1		
Turnover	80	
Other Income	Nil	
Total (a)		80
Less: Changes in inventories		Nil
Salaries and other cost		60
Administrative and selling Expenses (4+8)		12
Total (b)		72
Profit (a)-(b)		8

According to AS 25, the Income and Expense should be recognized when they are earned and incurred respectively. Therefore, seasonal incomes will be recognized when they occur. Thus, the company's view isnot as per AS 25.

Question 21 (Illustration)

The accounting year of X Ltd. ends on 30th September, 20X1 and it makes its reports quarterly. However, for the purpose of tax, year ends on 31st March every year. For the Accounting year from 1-10-20X0 to 30-9-20X1, the quarterly income is as under:

1st quarter ending on 31st December, 20X0	**Rs. 200 crores**
2nd quarter ending on 31st March, 20X1	**Rs. 200 crores**
3rd quarter ending on 30th June, 20X1	**Rs. 200 crores**
4th quarter ending on 30th September, 20X1	**Rs. 200 crores**
Total	**Rs. 800 crores**

Average actual tax rate for the financial year ending on 31st March, 20X1 is 20% and for financial year ending 31st March, 20X2 is 30%. Calculate tax expense for each quarter.

Answers 21

Calculation of tax expense

1st quarter ending on 31st December, 20X0	200 × 20%	Rs. 40 lakhs
2nd quarter ending on 31st March, 20X1	200 × 20%	Rs. 40 lakhs
3rd quarter ending on 30th June, 20X1	200 × 30%	Rs. 60 lakhs

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4th quarter ending on 30th September, 20X1	200 × 30%	Rs. 60 lakhs

Question 22 (Illustration)

Accountants of Poornima Ltd. showed a net profit of Rs. 7,20,000 for the third quarter of 20X1 after incorporating the following:

(i) Bad debts of Rs. 40,000 incurred during the quarter. 50% of the bad debts have been deferred tothe next quarter.

(ii) Extra ordinary loss of Rs. 35,000 incurred during the quarter has been fully recognized in this quarter

(iii) Additional depreciation of Rs. 45,000 resulting from the change in the method of chargeof depreciation assuming that Rs. 45,000 is the charge for the 3rd quarter only.

Ascertain the correct quarterly income.

Answers 22

In the above case, the quarterly income has not been correctly stated. As per AS 25 "Interim

Financial

Reporting", the quarterly income should be adjusted and restated as follows:

Bad debts of Rs. 40,000 have been incurred during current quarter. Out of this, the company hasdeferred 50% (i.e.) Rs. 20,000 to the next quarter. Therefore, Rs. 20,000 should be deducted from

Rs. 7,20,000. The treatment of extra-ordinary loss of Rs. 35,000 being recognized in the samequarter is correct.

Recognising additional depreciation of Rs. 45,000 in the same quarter is in tune with AS 25.Hence no adjustments are required for these two items.

Poornima Ltd should report quarterly income as Rs7,00,000 (Rs7,20,000 – Rs20,000).

Question 23 (Illustration)

Intelligent Corporation (I - Corp.) is dealing in seasonal products. The quarterly sales patternof the product is given below:

Quarter I	II	III	IV
Ending 30th June	30th September	31st December	31st March
15%	15%	50%	25%

For the First quarter ending 30th June, 20X1, I -Corp. gives you the following information:

	Rs. crores
Sales	50
Salary and other expenses	30
Advertisement expenses (routine)	02
Administrative and selling expenses	08

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While preparing interim financial report for the first quarter, 'I - Corp.' wants to defer Rs. 21 crores expenditure to third quarter on the argument that third quarter is having more sales,therefore, third quarter should be debited by higher expenditure, considering the seasonal nature of business and that the expenditures are uniform throughout all quarters.

Calculate the result of first quarter as per AS 25 and comment on the company's view.

Answers 23

Result of the first quarter ended 30th June, 20X1

		(Rs. in crores)
Turnover		50
Add: Other Income		Nil
Total		50
Less: Change in inventories	Nil	
Salaries and other cost	30	
Administrative and selling expenses (8 + 2)	10	40
Profit		10

- As per AS 25 on Interim Financial Reporting, the income and expense should be recognized when they areearned and incurred respectively. As per AS 25, the costs should be anticipatedor deferred only whenit is appropriate to anticipate that type of cost at the end of the financial year, and costs are incurred unevenly during the financial year of an enterprise.

Therefore, the argument given by I-Corp relating to deferment of Rs. 21 crores is not tenable asexpendituresare uniform throughout all quarters.

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Chapter 5.1

AS 2- Valuation of Inventory

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.22 TO Q.33											
Past Exams	NO	NO	Q.2,Q.18	Q.17	NO	NO	Q.17	Q.16	Q.19	Q.20	NO	NO
MTP	Q.5	Q.2,Q.6	Q.2,Q.5	Q.17	Q.2	NO	Q.3,Q.4	Q.7	Q.3	Q.8,Q.9	Q.3,Q10	Q.4,Q.17
RTP	Q.13	Q.6	Q.11	Q.8	Q.10	Q.6	Q.12	Q.11	Q.5,Q.14	Q.15	Q1	Q.21

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Chapter 5.1

AS 2- Valuation of Inventory

Question 1

An enterprise ordered 20,000 KG of certain material at ₹ 110 per unit. The purchase price includes GST ₹ 12 per KG, in respect of which full input tax credit (ITC) is admissible. Freight incurred amounted to ₹ 1,17,600. Normal transit loss is 2%. The enterprise actually received 19,500 KG and consumed 18,000 KG of the material.

You are required to calculate cost of material per KG;Allocation of material cost. (RTP May 23) (SM)

Answer 1

Calculation of Normal cost per Kg.

	₹
Purchase price (20,000 Kg. x ₹ 110)	22,00,000
Less: Input Tax Credit (20,000 Kg. x ₹ 12)	(2,40,000)
	19,60,000
Add: Freight	1,17,600
A. Total material cost	20,77,600
B. Number of units normally received = 98% of 20,000 Kg.	Kg. 19,600
C. Normal cost per Kg. (A/B)	106

Allocation of material cost

	Kg.	₹ /Kg.	₹
Materials consumed	18,000	106	19,08,000
Cost of inventory	1,500	106	1,59,000
Abnormal loss	100	106	10,600
Total material cost	19,600	106	20,77,600

Note: Abnormal losses are recognized as separate expense.

Question 2

Omega Ltd. has a normal wastage of 4% in the production process. During the year 2019-20, the Company used 12,000 MT of raw material costing Rs. 150 per MT. At the end of the year 630 MT of wastage was ascertained in stock. The accountant wants to know how this wastage is to be treated inthe books.

You are required to compute the amount of normal and abnormal loss and treatment thereof in line with AS 2 "Valuation of inventories". (MTP 5 Marks, May '20, April '19, Oct '18, Old & New SM)(Same concept different figures PYP May'19 5 Marks)

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Answer 2

As per para AS 2 'Valuation of Inventories', abnormal amounts of wasted materials, Labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

Amount of Normal Loss and Abnormal Loss:

Material used 12,000 MT @ Rs. 150 = Rs. 18,00,000
Normal Loss (4% of 12,000 MT) 480 MT

Net quantity of material	11,520MT
Abnormal Loss in quantity	150 MT (630 MT less 480 MT)
Abnormal Loss	Rs. 23,437.50

[150 units @ Rs. 156.25 (Rs.18,00,000/11,520)] Amount of Rs. 23,437.50 will be charged to the Profit and Loss statement.

Question 3

In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input is Rs. 1,000. The entire quantity of waste and finished output is in stock at the year end. State with reference to Accounting Standard, how will you value the inventories in this case? What will be treatment for normal and abnormal waste? (MTP 5 Marks, March '21, Apr'22 & April '23, Old & New SM)

Answer 3

As per para 13 of AS 2 (Revised), abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred.

In this case, normal waste is 250 MT and abnormal waste is 50 MT. The cost of 250 MT will I be includedin determining the cost of inventories (finished goods) at the year end. The cost of abnormal waste (50 MT x 1,052.6315 = Rs. 52,632) will be charged to the profit and loss statement.

Cost per MT (Normal Quantity of 4,750 MT) = 50,00,000 / 4,750 = Rs. 1,052.6315 Total value of inventory = 4,700 MT x Rs. 1,052.6315 = Rs. 49,47,368.

Question 4

(i) **"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'. (MTP 2.5 Marks April 21 & Oct '23, RTP May'22, Old & New SM)**

(ii) **X Limited purchased goods at the cost of Rs. 40 lakhs in October, 2020. Till March, 2021, 75% of the stocks were sold. The company wants to disclose closing stock at Rs. 10 lakhs. The expected sale value is Rs. 11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct value of closing stock to be disclosed as at 31.3.2021. (MTP 2.5 Marks April 21 & Oct '23)**

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Answer 4

(i) As per AS 2 'Valuation of Inventories', certain costs are excluded from the cost of the inventories and arerecognized 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.

(ii) As per AS 2 "Valuation of Inventories", the inventories are to be valued at lower of cost or net realizablevalue. In this case, the cost of inventory is Rs. 10 lakhs. The net realizable value is 11,00,000 Rs. 90%

= Rs. 9,90,000. So, the stock should be valued at Rs. 9,90,000.

Question 5

On the basis of information given below, find the value of inventory (by periodic inventory method) as per AS 2, to be considered while preparing the Balance Sheet as on 31st March, 2017 on weighted Average Basis.

Details of Purchases:

Date of purchase	Unit(Nos.)	Purchase cost per unit (Rs.)
01-03-2017	20	108
08-03-2017	15	107
17-03-2017	30	109
25-03-2017	15	107

Details of issue of Inventory:

Date of Issue	Unit(Nos.)
03-03-2017	10
12-03-2017	20
18-03-2017	10
24-03-2017	20

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Net realizable value of inventory as on 31st March, 2017 is Rs. 107.75 per unit. You are required to compute the value of Inventory as per AS 2. (MTP March '19, 5 Marks, MTP March '18, 5 Marks, RTP May'22)

Answer 5

Net Realizable Value of Inventory as on 31st March, 2017 = Rs. 107.75 x 20 units = Rs. 2,155 Value of inventory as per Weighted Average basis. Total units purchased and total cost:

01.03.2017	Rs. 108 x 20 units = Rs. 2160
08.3.2017	Rs. 107 x 15 units = Rs. 1605
17.03.2017	Rs. 109 x 30 units = Rs. 3270
25.03.2017	Rs. 107 x 15 units = Rs. 1605

Total 80 units = Rs. 8640

Weighted Average Cost = Rs. 8640/80 units = Rs.108Total cost =Rs. 108 x 20 units = Rs. 2,160

Value of inventory to be considered while preparing Balance Sheet as on 31st March, 2017 is, Cost orNet Realizable value whichever is lower i.e. Rs. 2,155.

Question 6

A Limited is engaged in manufacturing of Chemical Y for which Raw Material X is required. The company provides you following information for the year ended 31st March, 2017.

	Rs. Per unit
Raw Material X	
Cost price	**380**
Unloading Charges	**20**
Freight Inward	**40**
Replacement cost	**300**
Chemical Y	
Material consumed	**440**
Direct Labour	**120**
Variable Overheads	**80**

Additional Information:

(i) Total fixed overhead for the year was Rs. 4,00,000 on normal capacity of 20,000 units.

(ii)Closing balance of Raw Material X was 1,000 units and Chemical Y was Rs. 2,400 units.

You are required to calculate the total value of closing stock of Raw Material X and Chemical Y according to AS 2, when Net realizable value of Chemical Y is Rs. 800 per unit. (MTP Aug. '18, 5 Marks, RTP Nov'18) (Same concept different figures RTP Nov'20)

Answer 6

When Net Realizable Value of the Chemical Y is Rs. 800 per unit NRV is greater than the cost of FinishedGoods Y i.e. Rs. 660 (Refer W.N.)

Hence, Raw Material and Finished Goods are to be valued

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at cost.Value of Closing Stock:

	Qty.	Rate (Rs.)	Amount (Rs.)
Raw Material X	1,000	440	4,40,000
Finished Goods Y	2,400	660	15,84,000
Total Value of Closing Stock			20,24,000

Working Note:

Statement showing cost calculation of Raw Material X and Chemical Y

Raw Material X	Rs.
Cost Price	380
Add: Freight Inward	40
Unloading charges	20
Cost	440
Chemical Y	Rs.
Materials consumed	440
Direct Labour	120
Variable overheads	80
Fixed overheads (Rs.4,00,000/20,000 units)	20
Cost	660

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Question 7

From the following information provided by XYZ Limited you are required to compute the closing inventory:

Raw Material P

Closing balance	600 units ₹ per unit
Cost price including GST	250
Input tax credit available	20
Freight inward	30
Handling charges	15
Replacement cost	180
Finished goods Q	
Closing balance	1500 units ₹ per unit
Material consumed	250
Direct Labour	70
Direct overhead	30

Total fixed overhead for the year was ₹ 3,00,000 on a normal capacity of 30,000 units while actual production has been of 25,000 units.

Calculate the value of closing stock, when

(i) Net realizable value of the finished good Q is ₹ 450 per unit.

(ii) Net Realizable value of the Finished Good Q is ₹ 340 per unit.(MTP Oct '21, 5 marks)

Answer 7

(i) When Net Realizable Value of the Finished Good Q is ₹ 450 per unit Value of Closing Stock:

	Valuation Base	Qty.	Rate (₹)	Amount (₹)
Raw Material P	**Cost**	**600**	**275**	**1,65,000**
Finished Good Q	**Cost**	**1,500**	**360**	**5,40,000**
Total value of closing stock				**7,05,000**

When Net Realizable Value of the Finished Good Q is ₹ 340 per unit Since NRV of finished goods Q is less than its cost i.e. ₹ 360 (Refer W.N.), raw material P is to be valued at replacement cost and finished goods is to be valued at NRV.

Value of Closing Stock:

	Valuation Base	Qty.	Rate (₹)	Amount (₹)
Raw material P	Replacement cost	600	180	1,08,000
Finished good Q	Net Realizable Value	1,500	340	5,10,000

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Total value of closing stock				6,18,000

Working Note:

Statement showing calculation of cost of raw material P and finished good Q

Raw Material P	₹
Cost Price (250-20)	230

Add: Freight Inward	30
Handling charges	15
Cost	275
Finished Goods Q	₹
Materials consumed	250
Direct Labour	70
Variable overheads	30
	10
	360

Question 8

Hello Ltd. purchased goods at the cost of Rs. 20 lakhs in October. Till the end of the financial year, 75% of the stocks were sold. The Company wants to disclose closing stock at Rs. 5 lakhs. The expected sale value is Rs. 5.5 lakhs and a commission at 10% on sale is payable to the agent. You are required to ascertain the value of closing stock? (MTP 5 Marks Sep '22, RTP Nov'19)

Answer 8

As per AS 2 "Valuation of Inventories", the inventories are to be valued at lower of cost or net realizable value.

In this case, the cost of inventory is Rs. 5 lakhs. The net realizable value is Rs. 4.95 lakhs (Rs. 5.5 lakhs less cost to make the sale @ 10% of Rs. 5.5 lakhs). So, the closing stock should be valued at Rs. 4.95 lakhs.

Question 9

U.S.A Ltd. purchased raw material @ ₹ 400 per kg. Company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year, company is having 10,000 kg of raw material in inventory. As the company never sells the raw material, it does not know the selling price of raw material and hence cannot calculate the realizable value of the raw material for valuation of inventories at the end of the year. However replacement cost of raw material is ₹ 300 per kg. How will you value the inventory of raw material? (MTP 5 Marks Oct '22)

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Answer 9

As per AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. Therefore, in this case, USA Ltd. will value the inventory of raw material at ₹ 30,00,000 (10,000 kg. @ ₹ 300 per kg.).

Question 10

The expected production for the year was 15,000 kg of the finished product. Due to fall in market demand the sales price for the finished goods was ₹ 20 per kg and the replacement cost for the raw material was ₹ 9.50 per kg on the closing day. You are required to calculate the closing inventory as on that date. (MTP 5 Marks March '23) (RTP May 20)

Particulars		Kg.	₹
Opening Inventory:	Finished Goods	1,000	25,000
	Raw Materials	1,100	11,000
Purchases		10,000	1,00,000
Labour			76,500
Overheads (Fixed)			75,000
Sales		10,000	2,80,000

Closing Inventory:	Raw Materials	900	
	Finished Goods	1200	

Answer 10

Calculation of cost for closing inventory

Particulars	₹
Cost of Purchase (10,200 x 10)	1,02,000
Direct Labour	76,500
75000 X 10,200 Fixed Overhead 15,000	51,000
Cost of Production	2,29,500
Cost of closing inventory per unit (2,29,500/10,200)	₹ 22.50
Net Realisable Value per unit	₹ 20.00

Since net realisable value is less than cost, closing inventory will be valued at ₹ 20.

As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacementcost i.e. ₹ 9.50.

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Therefore, value of closing inventory: Finished Goods (1,200 x 20) ₹ 24,000Raw Materials (900 x 9.50) ₹ 8,550 **32,550**

Question 11

On 31st March 2020, a business firm finds that cost of a partly finished unit on that date is ₹ 430. Theunit can be finished in 2020-21 by an additional expenditure of ₹ 310. The finished unit can be sold for

₹ 750 subject to payment of 2% brokerage on selling price. The firm seeks your advice regarding the amount at which the unfinished unit should be valued as at 31st March, 2020 for preparation of final accounts. Assume that the partly finished unit cannot be sold in semi-finished form and its NRV is zero without processing it further. (RTP Nov 21)(Same concept different figures RTP May 19)(Old & New SM)

Answer 11

Valuation of unfinished unit

	₹
Net selling price	750
Less: Estimated cost of completion	(310)
	440
Less: Brokerage (2 % of 750)	(15)
Net Realisable Value	425
Cost of inventory	430
Value of inventory (Lower of cost and net realisable value)	425

Question 12

The inventory of Rich Ltd. as on 31st March, 2020 comprises of Product – A: 200 units and Product – B: 800 units.

Details of cost for these products are:

Product – A: Material cost, wages cost and overhead cost of each unit are Rs. 40,

Rs. 30 and Rs. 20 respectively, Each unit is sold at Rs. 110, selling expenses amounts to 10% of selling costs.

Product – B: Material cost and wages cost of each unit are Rs. 45 and Rs. 35 respectively and normal selling rate is Rs. 150 each, however due to defect in the manufacturing process 800 units of Product-B were expected to be sold at Rs. 70. You are requested to value closing inventory according to AS 2 after considering the above. (RTP May '21)

Answer 12

According to AS 2 'Valuation of Inventories', inventories should be valued at the lower of cost and net realizable value.

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Product – A

Material cost	Rs. 40 x 200 = 8,000	
Wages cost	Rs. 30 x 200 = 6,000	
Overhead	Rs. 20 x 200 = 4,000	
Total cost		Rs. 18,000
Realizable value [200 x (110-11)]		Rs. 19,800
Hence inventory value of Product -A		Rs. 18,000

Product – B

Material cost	Rs. 45 x 800 = 36,000	
Wages cost	Rs. 35 x 800 = 28,000	
Total cost		Rs. 64,000
Realizable value (800 x 70)		Rs. 56,000
Hence inventory value of Product-B		Rs. 56,000
Total Value of closing inventory i.e. Product A + Product B (18,000+ 56,000)		Rs. 74,000

Question 13

A private limited company manufacturing fancy terry towels had valued its closing inventory of inventories of finished goods at the realizable value, inclusive of profit and the export cash incentives. Firm contracts had been received and goods were packed for export, but the ownership in these goodshad not been transferred to the foreign buyers. You are required to advise the company on the valuation of the inventories in line with the provisions of AS 2. (RTP May '18)

Answer 13

Accounting Standard 2 "Valuation of Inventories" states that inventories should be valued at lower of historical cost and net realizable value. The standard states, "at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases, when sale is assured under forward contract or a government guarantee or when market exists and there is a negligible risk of failure to sell, the goods are often valued at net realizable value at certain stages of production." Terry Towels do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing inventory of finished goods (Fancy terry towel) should have been valued at lower of cost and net realizable value and not at net realizable value. Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing inventory of inventories of finished goods is not correct.

Question 14

Rohan Pvt. Ltd., a wholesaler in agriculture products, has valued the inventory on Net Realizable Value on the ground that AS 2 does not apply to inventory of agriculture products. (RTP May '22)

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Answer 14

AS 2 does not apply to producers of agricultural products but applies to traders in agricultural products. Hence AS 2 will apply to Rohan Pvt. Ltd. and it will have to value inventory at lower of cost or market value.

Question 15

The closing stock of finished goods (at cost) of a company amounted to Rs. 4,50,000. The following items were included at cost in the total:

(a) **100 coats, which had cost Rs. 2,200 each and normally sold for Rs. 4,000 each. Owing to a defect in manufacture their NRV was determined at 50% of their normal selling price.**

(b) **Shirts which had cost Rs. 50,000, their net realizable value at Balance sheet date was Rs. 55,000. Commission @ 10% on sales is payable to agents.**

What should the inventory value be according to AS 2 after considering the above items? (RTP Nov'22)

Answer 15

Valuation of closing stock

	Rs.
Closing stock at cost	4,50,000
Less: Adjustment for 100 coats (Working Note 1)	(20,000)
Value of inventory	4,30,000

Working Notes:

1. **Adjustment for Coats**

	Rs.
Cost included in Closing Stock	2,20,000
NRV of Coats	2,00,000
Adjustment to be made as NRV is less than Cost	20,000

2. No adjustment required for shirts as their NRV is more than their cost which was included in valueof inventory.

Question 16

Joy Ltd. purchased 20,000 kilograms of Raw Material @ ₹ 20 per kilogram during the year 2020-21. They have furnished you with the following further information for the year ended 31st March, 2021:

Particulars	Units	Amount (₹)
Opening Inventory:		
Finished Goods	**2,000**	**1,00,000**
Raw Materials	**2,200**	**44,000**
Direct Labour		**3,06,000**

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Fixed Overheads		**3,00,000**
Sales	**20,000**	**11,20,000**
Closing Inventory:		
Finished Goods	**2,400**	
Raw Materials	**1,800**	

The plant has a capacity to produce 30,000 Units of finished product per annum. However, the actual production of finished products during the year 2020-21 was 20,400 Units. Due to a fall in the market demand, the price of the finished goods in which the raw material has been utilized is expected to be sold @ ₹ 40 per unit. The replacement cost of the raw material was ₹ 19 per kilogram. You are required to ascertain the value of closing inventory as at 31st March, 2021 as per AS 2. (PYP July'21, 5 Marks)

Answer 16

Statement Showing the Computation of Value of Closing Inventory Value of Closing Finished Goods

Particulars	Amount (₹)
Cost of Raw Material consumed (20,400 units X ₹ 20 per kg)	4,08,000
Direct Labour	3,06,000
Fixed Overheads (3,00,000/30,000 x 20,400)	2,04,000
Cost of Production	9,18,000
Cost of Closing Inventory of Finished Goods per unit (₹ 9,18,000/20,400)	45
Net Realizable Value (NRV) per unit	40

Since net realizable value is less than cost, closing inventory of Finished Goods will be valued at ₹ 40 per unit Value of Closing Raw Materials as NRV of finished goods is less than its cost, the relevant raw material will be valued at its replacement cost, which is the best available measure of its NRV i.e. @ ₹ 19 per kg. Therefore, value of closing inventory would be as under:

Finished Goods 2,400 units @ ₹ 40/- per unit	₹ 96,000
Raw Materials 1,800 kg @ ₹ 19/- per kg	₹ 34,200
Total	₹ 1,30,200

Working Note:Calculation of raw material consumed during the year

Particulars	Unit (Kg)
Opening Inventory	2,200
Purchases	20,000
Less: Closing Inventory	(1,800)
Raw Material Consumed	20,400

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Question 17

Mr. Jatin gives the following information relating to the items forming part of the inventory as on 31.03.2019. His enterprise produces product P using Raw Material X.

(i) 900 units of Raw Material X (purchases @ ₹ 100 per unit). Replacement cost of Raw Material X as on3103.2019 is ₹ 80 per unit

(ii) 400 units of partly finished goods in the process of producing P. Cost incurred till date is ₹ 245 per unit. These units can be finished next year by incurring additional cost of ₹ 50 per unit.

(iii) 800 units of Finished Goods P and total cost incurred is ₹ 295 per unit.

Expected selling price of product P is ₹280 per unit, subject to a payment of 5% brokerage on selling price.

Determine how each item of inventory will be valued as on 31.03.2019. Also calculate the value of total Inventory as on 31.03.2019. (PYP 5 Marks Jan '21) (Sam concept different figures PYP 5 Marks Nov'19, MTP Oct'19 5 Marks, Old & New SM)(MTP 5 Marks Sep '23)

Answer 17

As per AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they willbe incorporated are expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. In the given case, selling price of product P is ₹ 266 and total cost per unit for production is ₹ 295.

Hence the valuation will be done as under:

(i) 900 units of raw material X will be written down to replacement cost as market value of finished productis less than its cost, hence valued at ₹ 80 per unit.

(ii) 400 units of partly finished goods will be valued at 216 per unit i.e., lower of cost (₹ 245) or Net realizablevalue ₹ 216 (Estimated selling price ₹ 266 per unit less additional cost of ₹ 50).

(iii) 800 units of finished product P will be valued at NRV of ₹ 266 per unit since it is lower than cost ₹ 295.

2021 Valuation of Total Inventory as on 31.03.2019:

	Units	Cost (₹)	NRV/Replacement cost	Value = unit's x cost or NRVwhichever is less (₹)
Raw material X	900	100	80	72,000
Partly finished goods	400	245	216	86,400
Finished goods P	800	295	266	2,12,800
Value of Inventory				3,71,200

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Question 18

State whether the following statements are 'True' or 'False'. Also give reason for your answer. As per the provisions of AS-2, inventories should be valued at the lower of cost and selling price. (PYP 1 Mark, May'19)

Answer 18

False: Inventories should be valued at the lower of cost and net realizable value (not selling price) as per AS 2.

Question 19

SM Enterprises is a leading distributor of petrol. A detailed inventory of petrol in hand is taken when the books are closed at the end of each month. For the month ending June 2021 following information is available:

- Sales for the month of June 2021 was ₹30,40,000.
- General overheads cost ₹4,00,000.
- Inventory at beginning 10,000 litres @ ₹ 92 per litre.
- Purchases-June 1, 2021, 20,000 litres @ ₹ 90 per litre, June 30, 2021, 10,000 litres @ ₹ 95 per litre.
- Closing inventory 13,000 litres.

You are required to compute the following by FIFO method as per AS 2:

(i) **Value of Inventory on 30th June, 2021.**

(ii) **Amount of cost of goods sold for June,2021.**

(iii) **Profit/Loss for the month of June,2021. (PYP 5 Marks May '22)**

Answer 19

	₹
Cost of closing inventory for 13,000 litres as on 30th June 2021	
10,000 litres @ ₹ 95	9,50,000
3,000 litres @ ₹ 90	2,70,000
Value of inventory (determined at cost in absence of NRV)	-
	12,20,000
Calculation of cost of goods sold	
Opening inventories (10,000 litres @ ₹ 92)	9,20,000
Purchases June – 1 (20,000 litres @ ₹ 90)	18,00,000
June – 30 (10,000 litres @ 95)	9,50,000
	36,70,000

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Less: Closing inventories	(12,20,000)
Cost of Goods Sold	24,50,000
Calculation of Profit	30,40,000
Sales (Given) (A)	24,50,000
Cost of Goods Sold	4,00,000
Add: General Overheads	28,50,000
Total Cost (B)	1,90,000
Profit (A-B)	

Question 20

Following information of Sarah Limited is given:

Sarah Limited uses Raw Material 'A' for production of production of Finished Goods 'B'

Closing balance of Raw Material 'A' in units on 31stMarch,2022	**750**
	Price Per Unit in ₹
Cost Price	**150**
Freight inward	**10**

Replacement Cost	**152**
Closing balance of Finished Good 'B' in units on 31stMarch,2022	1,600
	Price Per Unit in ₹
Material Consumed	225
Direct Labour	75
Direct variable overhead	60

Total Fixed Overheads amounts to ₹ 1,00,000 on normal capacity of 20,000 units.You are required to calculate the value of Closing Stock of Raw materials and Closing Stock of Finished Goods, as on 31st March, 2022, as per AS 2, when selling price of Finished Goods 'B' is ₹ 360 per unit. (PYP 5 Marks Nov '22)

Answer 20

Raw Material A	**₹**
Cost Price	150
Add: Freight Inward	10
Cost per unit	160
Replacement cost per unit of raw material	152

As per AS 2 (Revised) "Valuation of Inventories", the inventories are to be valued at lower of cost or net realizable value. Materials and other supplies held for use in the production of inventories

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are written down below cost if the selling price of finished product containing the material does not exceedthe cost of the finished product. In the given case, net realizable value of the Product 'B' (Finished Goods) is ₹ 360 per unit which is less than its cost ₹ 365 per unit. Raw Material is to be valued at replacement cost.

Value of the closing stock of raw material on 31/03/2022 would be ₹ 1,14,000 (750 units X ₹152 per unit).

Finished Goods B	₹
Materials consumed	225
Direct Labour	75
Direct Variable overheads	60
Fixed overheads (₹ 1,00,000/20,000 units)	5
Cost per unit	365
Net realizable value per unit	360

As per AS 2 (Revised) "Valuation of Inventories", the inventories are to be valued at lower of cost ornet realizable value. Hence, Finished Goods are to be valued at NRV since NRV is less than the cost.

Value of the closing stock of Finished goods as on 31/03/2022 would be ₹ 5,76,000 (1,600 units X ₹ 360 per unit).

Question 21

Alpha Ltd. sells flavored milk to customers; some of the customers consume the milk in the shop run by Alpha Limited. While leaving the shop, the consumers leave the empty bottles in the shop and the company takes possession of these empty bottles. The company has laid down a detailed internal record procedure for accounting for these empty bottles which are sold by the company by calling for tenders.

Keeping this in view:

Decide whether the inventory of empty bottles is an asset of the company;

If so, whether the inventory of empty bottles existing as on the date of Balance Sheet is to be considered as inventories of the company and valued as per AS 2 or to be treated as scrap and shownat realizable value with corresponding credit to 'Other Income'? (RTP Nov '23)

Answer 21

As per the 'Framework on Presentation and Preparation of Financial Statements':

Tangible objects or intangible rights carrying probable future benefits, owned by an enterprise are calledassets.

Alpha Ltd. sells these empty bottles by calling tenders. It means further benefits are accrued on its sale. Therefore, empty bottles are assets for the company.

As per AS 2, inventories are assets held for sale in the ordinary course of business.

Inventory of empty bottles existing on the Balance Sheet date is the inventory and Alpha Ltd. has detailed controlled recording and accounting procedure which duly signify its materiality.

Thus, inventory of empty bottles cannot be considered as scrap and should be valued as inventory in accordance with AS 2.

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Question 22

Which item of inventory is under the scope of AS 2 (Revised)?

a. WIP arising under construction contracts	b. Raw materials
c. Shares	d. Debentures held as stock in trade

Ans: (b)

Question 23

Materials and other supplies held for use in the production of inventories are not written downbelow-cost if the finished products in which they will be incorporated are expected to be

a. Sold at or above cost	b. Sold above cost
c. Sold less than cost	d. Sold at market value(where market value ismore than cost)

Ans: (a)

Question 24

All of the following costs are excluded while computing value of inventories except?

a. Selling and Distribution costs	b. Allocated fixed production overheads basedon normal capacity
c. Abnormal wastage	d. Storage costs (which is necessary part of theproduction process)

Ans: (b)

Questions 25

Identify the statement(s) which is/are incorrect.

a. Storage costs which is a necessary part of the production process isincluded in inventoryvaluation.

b. Administration overheads are never included in inventory valuation.

c. Full amount of variable production overheads incurred are included in inventory valuation.

d. Administration overheads are always included in inventory valuation.

Ans: (b)

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Theoretical Questions Answers

Questions 26

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

Answers 26

As per AS 2 (Revised) 'Valuation of Inventories', certain costs are excluded fromthe cost of the inventories and are recognised as expenses in the period in which incurred. Examples of such costs are:

abnormal amount of wasted materials, labour, or other production costs;

a) storage costs, unless those costs are necessary in the production process prior to a further production stage;

b) administrative overheads that do not contribute to bringing the inventories to their present locationand condition; and

c) selling and distribution costs.

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Practical Questions Answers

Questions 27

Capital Cables Ltd., has a normal wastage of 4% in the production process. During the year 20X1-20X2 the Company used 12,000 MT of raw material costing ₹ 150 per MT. At the end of the year 630 MT of wastage was in stock. The accountant wants to know how this wastage is to be treated in the books.

Explain in the context of AS 2 (Revised) the treatment of normal loss and abnormal loss and also findout the amount of abnormal loss, if any.

Answers 27

As per AS 2 (Revised) 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

Amount of Abnormal Loss:	
Material used	12,000 MT @₹150 = ₹18,00,000
Normal Loss (4% of 12,000 MT)	480 MT
Net quantity of material	11,520 MT
Abnormal Loss in quantity	150 MT
Abnormal Loss	23,437.50
[150 units @ ₹ 156.25 (₹ 18,00,000/11,520)	
Amount ₹ 23,437.50 will be charged to the Statement of Profit and Loss.	

Questions 28

Mr. Mehul gives the following information relating to items forming part of inventory as on 31-3-20X1. His factory produces Product X using Raw material A.

(i) **600 units of Raw material A (purchased @ ₹ 120). Replacement cost of raw material A as on 31-3-20X1 is ₹ 90 per unit.**

(ii) **500 units of partly finished goods in the process of producing X and cost incurred till date ₹ 260 per unit. These units can be finished next year by incurring additional cost of ₹ 60 per unit.**

(iii) **1500 units of finished Product X and total cost incurred ₹ 320 per unit. Expected selling price of Product X is ₹ 300 per unit.**

Determine how each item of inventory will be valued as on 31-3-20X1. Also calculate the value of total inventory as on 31-3-20X1.

Answers 28

As per AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed

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net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost ofthe materials may be the best available measure of their net realisable value. In the given case, selling price of product X is ₹ 300 and total cost per unit for production is ₹ 320.

Hence the valuation will be done as under:

(i) 600 units of raw material will be written down to replacement cost as market value of finishedproduct is less than its cost, hence valued at ₹ 90 per unit.

(ii) 500 units of partly finished goods will be valued at 240 per unit i.e. lower of cost (₹ 260) or Netrealisable value ₹ 240 (Estimated selling price ₹ 300 per unit less additional cost of ₹ 60).

(iii) 1,500 units of finished product X will be valued at NRV of ₹ 300 per unit since it is lower than cost ₹

320 of product X.

Valuation of Total Inventory as on 31.03.20X1:

	Units	Cost (₹)	NRV / Replacement cost	Value = units × cost or NRVwhichever is less (₹)
Raw material A	600	120	90	54,000
Partly finished goods	500	260	240	1,20,000
Finished goods X	1,500	320	300	4,50,000
Value of Inventory				6,24,000

Questions 29

On 31st March 20X1, a business firm finds that cost of a partly finished unit on that date is ₹ 530. The unit can be finished in 20X1-X2 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, 20X1 for preparation of finalaccounts. Assume that the partly finished unit cannot be sold in semi-finished form and its NRV is zerowithout processing it further.

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Answers 29

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 30 (Illustration)

The company deals in three products, A, B and C, which are neither similar nor interchangeable. At the time of closing of its account for the year 20 X1-X2, the Historical Cost and Net Realisable Value of the items of closing stock are determined as follows:

Items	Historical Cost (₹ in lakhs)	Net Realisable Value (₹ in lakhs)
A	40	28
B	32	32
C	16	24

What will be the value of closing stock?

Answers 30

As per AS 2 (Revised) on 'Valuation of Inventories', inventories should be valued at the lower of cost and net realisable value. Inventories should be written down to net realisable value on an item-by-item basis in the given case.

Items	Historical Cost (₹ in lakhs)	Net Realisable Value (₹ in lakhs)	Valuation of closing stock (₹ in lakhs)
A B C	40	28	28
	32	32	32
	16	24	16
	88	84	76

Hence, closing stock will be valued at ₹ 76 lakhs.

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Question 31 (Illustration)

X Co. Limited purchased goods at the cost of ₹ 40 lakhs in October, 20X1. Till March, 20X2, 75% of the stocks were sold. The company wants to disclose closing stock at 10 lakhs. The expected sale value is ₹11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct closing stock to be disclosed as at 31.3.20X2.

Answers 31

As per AS 2 (Revised) "Valuation of Inventories", the inventories are to be valued at lower of cost or net realisable value.

In this case, the cost of inventory is ₹ 10 lakhs. The net realisable value is 11,00,000 90% = ₹ 9,90,000. So,

Question 32 (Illustration)

In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input is ₹ 1,000. The entire quantity of waste is on stock at the yearend. State with reference to Accounting Standard, how will you value the inventories in this case?

Answers 32

As per AS 2 (Revised), abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred.

In this case, normal waste is 250 MT and abnormal waste is 50 MT. The cost of 250 MT will be included in determining the cost of inventories (finished goods) at the year end. The cost of abnormal waste (50 MTx 1,052.6315 = ₹ 52,632) will be charged to the profit and loss statement.

Cost per MT (Normal Quantity of 4,750 MT) = 50,00,000 / 4,750 = ₹ 1,052.6315 Total value of inventory = 4,700 MT x ₹ 1,052.6315 = ₹ 49,47,368.

Question 33 (Illustration)

You are required to value the inventory per kg of finished goods consisting of:

	per kg.
Material cost	**200**
Direct labour	**40**
Direct variable overhead	**20**

Fixed production charges for the year on normal working capacity of 2 lakh kgs is ₹ 20 lakhs. 4,000 kgs of finished goods are in stock at the year end.

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Answers 33

In accordance with AS 2 (Revised), the cost of conversion include a systematic allocation of fixed and variable overheads that are incurred in converting materials into finished goods. The allocation of fixed overheads for the purpose of their inclusion in the cost of conversion is based on normal capacity of the production facilities.

Cost per kg. of finished goods:

		₹
Material Cost		200
Direct Labour	40	
Direct Variable Production Overhead	20	
20,00,000 2,00,000	10	70
Fixed Production Overhead		
		270

Hence the value of 4,000 kgs. of finished goods = 4,000 kgs x 270 = 10,80,000

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Chapter 5.2

AS 10-Property, Plant & Equipment

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.20 TO Q.53											
Past Exams	NO	Q.4	NO	NO	NO	Q.16	NO	Q.17	Q.18	NO	Q.19	NO
MTP	Q.1	Q.1,Q.3 Q.7	Q.6	Q.3,Q.5	Q.1	Q.2,Q.3	Q.1,Q.4	Q.7	Q.1,Q.2 Q.3	Q.1,Q.4	Q.7	Q.4,Q.16
RTP	Q.5	Q.7	Q.7	Q.12	Q.11	Q.10	Q.9	Q.8	Q.13	Q.14	Q.15	Q.7

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Chapter 5.2

AS 10-Property, Plant & Equipment

Question 1

Mohan Ltd. has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period, the company will move its production facilities to another (temporary) site.

The following incremental costs will be incurred:

Setup costs of Rs. 5,00,000 to install machinery in the new location.Rent of Rs. 15,00,000

Removal costs of Rs. 3,00,000 to transport the machinery from the old location to the temporarylocation.

Mohan Ltd. wants to seek your guidance as whether these costs can be capitalized into the cost of the new building. You are required to advise in line with AS 10 "Property, Plant and Equipment". (MTP 5 Marks May 20, April 21, March 18, Oct '18 & Apr'22 & Oct '22) (Old & New SM)

Answer 1

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

The costs to be incurred by the company are in the nature of costs of reducing or reorganizing the operations of the accompany. These costs do not meet that requirement of AS 10 "Property, Plant and Equipment" and cannot, therefore, be capitalized.

Question 2

(i) Entity A carried plant and machinery in its books at ₹ 2,00,000 which were destroyed in a fire. Thesemachines were insured 'New for old' and were replaced by the insurance company with new machines of fair value ₹ 20,00,000. The old destroyed machines were acquired by the insurance company and the company did not receive any cash compensation. State, how Entity A should account for the same? (MTP 2.5 Marks Oct 20, Mar 22)

(ii) Omega Ltd, a supermarket chain, is renovating one of its major stores. The store will have more available space for store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers.

Decide whether Omega Ltd. can capitalize the remodelling cost or not as per provisions of AS 10

"Property plant & Equipment". (MTP 2.5 Marks Oct 20, Oct'19, Mar 22)

Answer 2

(i) Entity A should account for a loss in the Statement of Profit and Loss on de-recognition of the carryingvalue of plant and machinery in accordance with AS 10 on Property, Plant and Equipment. Entity A should separately recognize a receivable and a gain in the income

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statement resulting from the insurance proceeds once receipt is virtually certain. The receivable should be measured at the fair value of assets provided by the insurer.

(ii) The expenditure in remodelling the store will create future economic benefits (in the form of 15%of increase in sales). Moreover, the cost of remodelling can be measured reliably, therefore, it should be capitalized in line with AS 10.

Question 3

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom-made machine amounting to Rs. 4,00,000. As on 31st March, 2020 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'. Show the treatment of machine in the books of ABC Ltd. (MTP 5 Marks Oct 20, Oct 18, Mar 22, Aug 18, Oct'19)

Answer 3

A liability is recognized 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, ABC Ltd. should recognize a liability of ₹ 4,00,000 payable to XYZ 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 benefitfrom the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense. Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2020.

Question 4

Neon Enterprise operates a major chain of restaurants located in different cities. The company has acquired a new restaurant located at Chandigarh. The new-restaurant requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the restaurant will be closed.

Management has prepared the following budget for this period – Salaries of the staff engaged in preparation of restaurant before its opening Rs. 7,50,000 Construction and remodeling cost of restaurant Rs. 30,00,000.

Explain the treatment of these expenditures as per the provisions of AS 10 "Property, Plant and Equipment".(MTP 5 Marks March '21 , Sep '22 & Oct '23) (PYP Nov'18, 5 Marks)

Answer 4

As per provisions of AS 10, any cost directly attributable to bring the assets to the location and conditions necessary for it to be capable of operating in the manner indicated by the management are called directly attributable costs and would be included in the costs of an item of PPE.

Management of Neon Enterprise should capitalize the costs of construction and remodelling the restaurant, because they are necessary to bring the restaurant to the condition necessary for it to be capable of operating in the manner intended by management. The restaurant cannot be opened without incurring the construction and remodelling expenditure amounting Rs. 30,00,000 and thus the expenditure should be considered part of the asset.

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However, the cost of salaries of staff engaged in preparation of restaurant Rs. 7,50,000 before its opening are in the nature of operating expenditure that would be incurred if the restaurant was openand these costs are not necessary to bring the restaurant to the conditions necessary for it to be capable of operating in the manner intended by management. Hence, Rs. 7,50,000 should be expensed.

Question 5

In the year 2018-19, an entity has acquired a new freehold building with a useful life of 50 years for Rs. 75,00,000. The entity desires to calculate the depreciation charge per annum using a straight-line method. It has identified the following components (with no residual value of lifts & fixtures at the end of their useful life) as follows:

Component	Useful life (Years)	Cost
Land	Infinite	Rs. 10,00,000
Roof	25	Rs. 15,00,000
Lifts	20	Rs. 7,50,000
Fixtures	10	Rs. 2,50,000
Remainder of building	50	Rs. 40,00,000
		Rs. 75,00,000

Calculate depreciation for the year 2018-19 as per componentization method. Also state the treatment, in case Roof requires replacement at the end of its useful life. (MTP Oct. '19, 2.5 Marks)(Same concept different figures RTP May'18)

Answer 5

Statement showing amount of depreciation as per Componentization Method

Component	Depreciation (Per annum) (Rs.)
Land	**Nil**
Roof	**60,000**
Lifts	**37,500**
Fixtures	**25,000**
Remainder of Building	80,000
	2,02,500

Note: When the roof requires replacement at the end of its useful life the carrying amount will benil. The cost of replacing the roof should be recognised as a new component.

Question 6

Mohan Ltd. purchased an asset on 1st January 2013 for Rs. 5,00,000 and the asset had an estimated useful life of 5 years and a residual value of nil. On 1st January 2017, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years. You are required to compute the amount of depreciation for each year, if company charges depreciation on Straight Line basis. [MTP April '19, 5 Marks]

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Answer 6

The entity has charged depreciation using the straight-line method at Rs. 1,00,000 per annum i.e (5,00,000/5 years). On 1st January 2017, the asset's net book value is [5,00,000 - (1,00,000 x4)] Rs. 1,00,000. The remaining useful life is 4 years. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of four years. Consequently, it should charge depreciation for the next 4 years at Rs. 25,000 per annum i.e. (1,00,000/4 years).

Question 7

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

Cost of the plant (cost per supplier's invoice plus taxes)	Rs. 25,00,000
Initial delivery and handling costs	Rs. 2,00,000
Cost of site preparation	Rs. 6,00,000
Consultants used for advice on the acquisition of the plant	Rs. 7,00,000
Interest charges paid to supplier of plant for deferred credit	Rs. 2,00,000
Estimated dismantling costs to be incurred after 7 years	Rs. 3,00,000
Operating losses before commercial production	Rs. 4,00,000

Please advise ABC Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised). (MTP Aug. '18, 5 Marks)(Same concept lesser adjustments MTP 5 Marks Nov'21, MTP 5 Marks Mar'23, Old & New SM, RTP May'19, Nov'18 & Nov '23)

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Answer 7

According to AS 10 (Revised), the following costs can be capitalized:

Cost of the plant	Rs. 25,00,000
Initial delivery and handling costs	Rs. 2,00,000
Cost of site preparation	Rs. 6,00,000
Consultants' fees	Rs. 7,00,000
Estimated dismantling costs to be incurred after 7 years	Rs. 3,00,000
	Rs. 43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of Rs.2,00,000 and operating losses before commercial production amounting to Rs.4,00,000 are not regarded as directly attributable costs and thus cannot be capitalized. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 8

A property costing ₹ 10,00,000 is bought on 1.4.2020. Its estimated total physical life is 50 years.

However, the company considers it likely that it will sell the property after 25 years. The estimated residual value in 25 years' time, based on current year prices, is:

Case (a) ₹ 10,00,000

Case (b) ₹ 9,00,000

You are required to compute the amount of depreciation charged for the year ended 31.3.2021. (RTPNov 21, Old & New SM)

Answer 8

Case (a)

The company considers that the residual value, based on prices prevailing at the balance sheet date,will equal the cost. There is, therefore, no depreciable amount and depreciation is zero.

Case (b)

The company considers that the residual value, based on prices prevailing at the balance sheet date,will be ₹ 9,00,000 and the depreciable amount is, therefore, ₹ 1,00,000.

Annual depreciation (on a straight line basis) will be ₹ 4,000 [{10,00,000 – 9,00,000} ÷ 25].

Question 9

You are required to give the correct accounting treatment for the following in line with provisions ofAS 10:

(a) **Trozen Ltd. operates a major chain of supermarkets all over India. It acquires a new store in Pune which requires significant renovation expenditure. It is expected that the renovations will be done in 2 months during which the store will be closed. The budget for this**

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period, including expenditure related to construction and remodelling costs (Rs. 18 lakhs), salaries of staff (Rs. 2 lakhs) who will be preparing the store before its opening and related utilities costs (Rs. 1.5 lakhs), is prepared. The cost of salaries of the staff and utilities are operating expenditures that would be incurred even after the opening of the supermarket. What will the treatment of all these expenditures in the booksof accounts?

(b) ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs the expenditure on the construction/development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Can ABC Ltd. capitalize expenditure incurred on these items as property, plant and equipment (PPE)? (RTP May '21)

Answer 9

(a) Trozen Ltd. should capitalize the costs of construction and remodelling the supermarket, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended. The supermarket cannot be opened without incurring the remodelling expenditure. Therefore, this construction and remodelling expenditure of Rs. 18 lakh should be considered as part of the cost of the asset. However, the cost of salaries of the staff Rs. 2 lakh and utilities cost Rs. 1.5 lakh are operating expenditures that would be incurred even after the opening of the supermarket. Therefore, these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by the management and should be expensed.

(b) AS 10 states that the cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:

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

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

Further, the standard provides that the standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. The cost of an item of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalization of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In view of this, even though ABC Ltd. may not be able to recognize expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalized as a part of overall cost of the project. From this, it can be concluded that, in the given case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalized as part of the items of property, plant and equipment of the refinery.

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Question 10

Omega Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were 1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose at ₹ 45,000 per month.

The machine was purchased at ₹ 1,58,00,000 and ₹ 50,000 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹ 30,000 to supervise machinery installation at the factory site. You are required to ascertain the amount at which the Machinery should be capitalized under AS 10. (RTP Nov 20)

Answer 10

Calculation of Cost of Machinery

Particulars			₹
Purchase Price		Given	1,58,00,000
Add:	Site Preparation Cost	Given	1,40,000
	Technician's Salary	Specific/Attributable overheads for 3 months (45,000 x3)	1,35,000
	Initial Delivery Cost	Transportation	50,000
	Professional Fees for Installation	Architect's Fees	30,000
Total Cost of Asset			**1,61,55,000**

Question 11

(a) Entity A has a policy of not providing for depreciation on PPE capitalized in the year until the following year, but provides for a full year's depreciation in the year of disposal of an asset. Is this acceptable?

(b) Entity A purchased an asset on 1st January 2016 for Rs.1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil. On 1st January 2020, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years. Calculate the amount of depreciation for each year, if company charges depreciation on Straight Line basis.

(c) The following items are given to you:ITEMS

a. Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment);

b. Costs of conducting business in a new location or with a new class of customer (including costs of staff training);

Any costs directly attributable to bringing the asset to the location and condition necessary forit to be capable of operating in the manner intended by management

c. Costs of opening a new facility or business, such as, inauguration costs;

d. Purchase price, including import duties and non–refundable purchase

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taxes, after deductingtrade discounts and rebates.

With reference to AS 10 "Property, Plant and Equipment", classify the above itemsunder the following heads:

HEADS:

(i) Purchase Price of PPE

(ii) Directly attributable cost of PPE or

(iii) Cost not included in determining the carrying amount of an item of PPE. (RTP May 20)

Answer 11

(a) The depreciable amount of a tangible Property Plant & Equipment should be allocated on asystematic basis over its useful life. The depreciation method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. Useful life means the period over which the asset is expected to be available for use by the entity. Depreciation should commence as soon as the asset is acquired and is available for use. Thus, the policy of Entity A is not acceptable.

(b) The entity has charged depreciation using the straight-line method at Rs.10,000 per annum i.e (1,00,000/10 years). On 1st January 2020, the asset's net book value is [1,00,000 – (10,000 x 4)] = Rs.60,000. The remaining useful life is 4 years. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of four years. Consequently, it should charge depreciation for the next 4 years at Rs.15,000 per annum i.e. (60,000 / 4 years). Depreciation is recognized even if the Fair value of the Asset exceeds its Carrying Amount. Repair and maintenance of an asset do not negate the need to depreciate it.

(1) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment) will be classified as "Directly attributable cost of PPE".

(2) Costs of conducting business in a new location or with a new class of customer (including costs of staff training) will be classified under head (iii)as it will not be included in determining the carryingamount of an item of PPE.

(3) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management will be included in determination of Purchase Price of PPE

(4) Costs of opening a new facility or business, such as, inauguration costs will be classified under head (iii) as it will not be included in determining the carrying amount of an item of PPE.

(5) Purchase price, including import duties and non–refundable purchase taxes, after deducting trade discounts and rebates will be included in determination of Purchase Price of PPE.

Question 12

Shrishti Ltd. contracted with a supplier to purchase machinery which is to be installed in its Department A in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were Rs.1,41,870. These activities were supervised by a technician during the entire period, who is employed for this pur-

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pose of Rs.45,000 per month. The technician's services were given by Department B to Department A, which billed the services at Rs.49,500 per month after adding 10% profit margin.

The machine was purchased at Rs.1,58,34,000 inclusive of IGST @ 12% for which input credit is available to Shrishti Ltd. Rs.55,770 transportation charges were incurred to bring the machine to the Page factory site. An Architect was appointed at a fee of Rs. 30,000 to supervise machinery installation at the factory site.

Ascertain the amount at which the Machinery should be capitalized under AS 10 considering that IGST credit is availed by the Shristhi Limited. Internally booked profits should be eliminated in arriving at the cost of machine. (RTP Nov 19)

Answer 12

Calculation of Cost of Property Plant & Equipment (i.e. Machinery)

Particulars			₹
Purchase Price		Given (Rs.158,34,000 x 100/112)	1,41,37,500
Add:	Site Preparation Cost	Given	1,41,870
	Technician's Salary	Specific/Attributable overheads for 3 months (See Note) (45,000 x3)	1,35,000
	Initial Delivery Cost	Transportation	55,770
	Professional Fees for Installation	Architect's Fees	30,000
Total Cost of Asset			1,45,00,140

Question 13

A Ltd. has incurred the following costs. Determine if the following costs can be added to the invoiced purchase price and included in the initial recognition of the cost of the item of property, plant and equipment:

1. **Import duties paid**
2. **Shipping costs and cost of road transport for taking the machinery to factory**
3. **Insurance for the shipping**
4. **Inauguration costs for the factory**
5. **Professional fees charged by consulting engineer for the installation process**
6. **Costs of advertising and promotional activities**
7. **Administration and other general overhead costs**
8. **Cost of site preparation. (RTP May '22)**

Answer 13

Included in Cost: Point no. 1,2,3,5,8 Excluded from Cost: Point no. 4,6,7

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Question 14

RS Ltd. has acquired a heavy plant at a cost of Rs. 2,00,00,000. The estimated useful life is 10 years. At the end of the 2nd year, one of the major components i.e. the Boiler has become obsolete (which wasacquired at price of Rs. 50,00,000) and requires replacement, as further maintenance is un-economical. The remainder of the plant is perfect and is expected to last for next 8 years. The cost of a new boileris Rs. 60,00,000. Can the cost of the new boiler be recognised as an asset, and, if so, what should be thecarrying value of the plant at the end of second year? (RTP Nov'22)

Answer 14

Recognition of Asset: The new boiler will produce economic benefits to RS Ltd., and the cost is measurable. Hence, the item should be recognized as an asset. The cost old boiler should be de- recognized and the new boiler will be added .

Statement showing cost of new boiler and machine after year 2

Original cost of plant	₹ 2,00,00,000
Less: WAccumulated depreciation [(2,00,000/10)*2]	₹ 40,00,000
(Carrying value of the plant after two years	₹ 1,60,00,000

Less: Current Cost of Old Boiler to be derecognized	
Less: WDV of Boiler (replaced) after 2 years	40,00,000
(50,00,000/10 x 8)	
	1,20,00,000
Add: Cost of new Boiler to be recognized	60,00,000
Revised carrying amount of Plant	1,80,00,000

Question 15

Star Limited purchased machinery for ₹ 6,80,000 (inclusive of GST of ₹ 40,000). Input credit is available for entire amount of GST paid. The company incurred the following other expense for installation.

Cost of preparation of site for installation 21,200Total Labour charges 56,000 (200 out of the total of 500 men hours worked, were spent on installation of the machinery)

Spare parts and tools consumed in installation	**5,000**
Total salary of supervisor	**26,000**
(Time spent for installation was 25% of the total time worked)	
Total technical expense	**34,000**
(1/10 relates to the plant installation)	
Test run and experimental production expenses	**18,000**
Consultancy charges to architect for plant set up	**11,000**
Depreciation on assets used for installation	**12,000**

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The machine was ready for use on 15.01.2021 but was used from 01.02.2021. Due to this delay further expenses of ₹ 8,900 were incurred. Calculate the value at which the plant should be capitalized in the books of Star Limited. (RTP May 23)

Answer 15

Calculation of Cost of Plant

Particulars		Rs.
Purchase Price	Given	6,80,000
Add: Site Preparation Cost	Given	21,200
Labour charges	(56,000×200/500) Given	22,400
Spare parts		5,000
Supervisor's Salary	25% of Rs. 26,000	6,500
Technical costs	1/10 of Rs. 34,000	3,400
Test run and experimental production charges	Given	18,000
Architect Fees for set up	Given	11,000
Depreciation on assets used for installation	Given	12,000
Total Cost of Asset		7,79,500
Less: GST credit receivable		(40,000)
Value to be capitalized		7,39,500

Note: Further Expenses of ₹ 8,900 from 15.1.2021 to 1.2.2021 to be charged to profit and loss A/c as plant was ready for production on 15.1.2021.

Question 16

A Ltd. had following assets. Calculate depreciation for the year ended 31st March, 2020 for each Asset as per AS 10 (Revised):

(i) Machinery purchased for ₹ 10 lakhs on 1st April, 2015 and residual value after useful life of 5 years, based on 2015 prices is ₹ 10 lakhs.

(ii) Land for ₹ 50 lakhs.

(iii) A Machinery is constructed for ₹ 5,00,000 for its own use (useful life is 10 years). Construction is completed on 1st April, 2019, but the company does not begin using the machine until 31st March, 2020.

(iv) Machinery purchased on 1st April.2017 for ₹ 50,000 with useful life of 5 years and residual value is NIL. On 1st April, 2019, management decided to use this asset for further 2 years only. (PYP 5 Marks Nov 20)(MTP 5 Marks Sep '23)

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Answer 16

Computation of amount of depreciation as per AS 10

		₹
(i)	Machinery purchased on 1/4/15 for ₹ 10 lakhs (having residual value of ₹ 10 lakhs) Reason: The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost. Therefore, there is no depreciable amount and depreciation is correctly zero.	Nil
(ii)	Land (50 lakhs) (considered freehold) Reason: Land has an unlimited useful life and therefore, it is not depreciated.	Nil
(iii)	Machinery constructed for own use (₹ 5,00,000/10) Reason: The entity should begin charging depreciation from the date the machine is ready for use i.e. 1st April,2019. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.	50,000
(iv)	Machinery having revised useful life Reason: The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e (50,000/5 years). On 1st April,2019 the asset's net book value is [50,000 – (10,000 x 2)] i.e. ₹ 30,000. The remaining useful life is 2 years asper revised estimate. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of 2 years. Consequently, it should charge depreciation for the next 2 years at ₹ 15,000 per annum i.e. (30,000 / 2 years).	15,000

Question 17

I. **A Limited has contracted with a supplier to purchase machinery which is to be installed at its new plant in four months' time. Special foundations were required for the machinery which were to beprepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 2,10,000. These activities were supervised by an Architect during the entire period, who is employed for this purpose at a salary of ₹ 35,000 per month. The machinery was purchased for ₹ 1,27,50,000 and a sum of ₹ 2,12,500 was incurred towards transportation charges to bring the machinery to the plant site. An Engineer was appointed at a fees of ₹ 37,500 to supervise the installation of the machinery at the plant site. You are required to ascertain the amount at which the machinery should be capitalized in the books of A Limited. (PYP 2.5 Marks Jul'21)**

II. **B Limited, which operates a major chain of retail stores, has acquired a new store location. The newlocation requires substantial renovation expenditure. Management expects that the renovation will last for 4 months during which the store will be closed. Management has prepared the budgetfor this period including expenditure related to construction and re-modelling costs, salary of staffwho shall be preparing the store before its opening and related utilities cost. How would such expenditure be treated in the books of B Limited ? (PYP 2.5 Marks, July,21, Old & New SM)**

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Answer 17

I. Statement Showing the Computation of the amount at which the Machinery should be capitalized in the books of A Limited

Particulars		Amount
		(₹)
Purchase cost of machinery	Given	1,27,50,000
Add: Site Preparation Cost	Given	2,10,000
Architect's Salary	Specific / Attributable overheads for 4 months (₹ 35,000 x 4)	1,40,000
Initial Delivery Cost	Transportation	2,12,500
Professional Fees for Installation	Engineer's Fees	37,500
Total Cost of Machinery to be capitalized		1,33,50,000

Management should capitalize the costs of construction and remodelling the store, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the mannerintended by management. The store cannot be opened without incurring the remodelling expenditure, and thus the expenditure should be considered part of the asset. However, if the costof salaries, utilities and storage of goods are in the nature of operating expenditure that would be incurred if the store was open, then these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management and should be expensed.

Question 18

(i) **XYZ Limited provided you the following information for the year ended 31 st March, 2022.**

The carrying amount of a property at the end of the year amounted to ₹ 2,16,000 (cost/value ₹ 2,50,000 and accumulated depreciation ₹ 34,000). On this date the property was revalued and was deemed to have a fair value of ₹ 1,90,000. The balance in the revaluation surplus relating to a previous revaluation gain for this property was ₹ 20,000.

(ii) **You are required to calculate the revaluation loss as per AS 10 (Revised) and give its treatment in the books of accounts.**

An asset that originally cost ₹ 76,000 and had accumulated depreciation of ₹ 62,000 was disposed of during the year for ₹ 4,000 cash.

You are required to explain how the disposal should be accounted for in the financial statementsas per AS 10 (Revised). (PYP 5 Marks May '22)

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Answer 18

As per AS 10, a decrease in the carrying amount of an asset arising on revaluation should be charged to the statement of profit and loss. However, the decrease should be debited directlyto owners' interests under the heading of revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

Calculation of revaluation loss and its accounting treatment

		₹
Carrying value of the asset as on 31st March, 2022	a	2,16,000
Revalued amount of the asset	b	(1,90,000)
Total revaluation loss on asset	c=a-b	26,000
Adjustment of previous revaluation reserve	d	(20,000)
Net revaluation loss to be charged to the Profit and loss account	e=c-d	6,000

AS 10 states that the carrying amount of an item of property, plant and equipment isderecognized on disposal of the asset. It further states that the gain or loss arising from the derecognition of an item of property, plant and equipment should be included in the statement of profit and loss when the item is derecognized. Gains should also not be classified as revenue.

Calculation of loss on disposal of the asset and its accounting treatment

		₹
Original cost of the asset	a	76,000
Accumulated depreciation till date	b	62,000
Carrying value of the asset as on 31st March, 2022	c=a-b	14,000
Cash received on disposal of the asset	d	4,000
Loss on disposal of asset charged to the Profit and loss account	e=c-d	10,000

Question 19

In the books of Top maker Limited, carrying amount of Plant and Machinery as on 1stApril, 2022 is Rs. 56,30,000.

On scrutiny, it was found that a purchase of Machinery worth Rs. 21,12,000 was included in the purchase of goods on 1stJune, 2022. On 30thJune, 2022 the company disposed a Machine having book value of Rs. 9,60,000 (as on 1stApril, 2022) for Rs. 8,25,000 in part exchange of a new machine costing Rs. 15,65,000.

The company charges depreciation @ 10% p.a. on written down value method on Plant and Machinery.

You are required to compute:

(i) **Depreciation to be charged to Profit & Loss Account;**

(ii) **Book value of Plant & Machinery as on 31stMarch, 2023; and**

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(iii) Profit/Loss on exchange of Plant & Machinery. (PYP 5 Marks May '23)

Answer 19

i) Depreciation to be charged in the Profit & Loss Account

Particulars	Amount in Rs.
Depreciation on old Machinery	1,40,750
[10% on Rs . 56,30,000 for 3 months (01.04.2022 to 30.06.2022)]	1,76,000
Add: Depreciation on Machinery acquired on 01.06.2022 (Rs. 21,12,000 X 10% X10/12)	
Add: Depreciation on Machinery after adjustment of Exchange [10% of Rs . 56,30,000 – 9,60,000 + 15,65,000) for 9 months]	4,67,625
Total Depreciation to be charged in Profit & Loss A/c	**7,84,375**

Book value of Plant & Machinery as on 31.3.2023

Particulars		Amount in Rs.
Balance as per books on 01.04.2022		56,30,000
Add: Included in purchases on 01.06.2022	21,12,000	
Add: Purchases on 30.06.2022	15,65,000	36,77,000
		93,07,000
Less: Book value of Machine sold on 30.06.2022		(9,60,000)
		83,47,000
Less: Depreciation on Machinery in use		(7,60,375)
Rs. (7,84,375 -24,000) Book Value as on 31.03.2023		75,86,625

Note: The computation of depreciation and book value of Plant & Machinery can be presented in the following alternative manner:

Particulars	Book Value or Cost or Acquisition	Period	Depreciation	Book Value as on 31.03.2023
Opening Value	46,70,000 (56,30,000 –	01.04.2022 to	4,67,000 (46,70,000 x	42,03,000

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	9,60,000)	31.03.2023	10%)	
Sold	9,60,000	01.04.2022 to 30.06.2022	24,000 (9,60,000 x 10% x 3/12)	-
Purchases	21,12,000	01.06.2022 to 31.03.2023	1,76,000 (21,12,000 x 10% x 10/12)	19,36,000
New Machinery	15,65,000	01.07.2022 to 31.03.2023	1,17,375	14,47,625
			(15,65,000 x 10% x 9/12)	
Total			7,84,375	75,86,625

Profit/Loss on Exchange of Machinery

Particulars	Amount in
Balance as per books on 01.04.2022	9,60,000
Less: Depreciation for 3 months (Rs. 9,60,000 x 10 /100 x 3 / 12)	(24,000)
W.D.V. as on 30.06.2022	9,36,000
Less: Exchange value	(8,25,000)
Loss on Exchange of Machinery	1,11,000

Question 20

As per AS 10 (Revised) 'Property, plant and equipment', which of the following costs is not included in the carrying amount of an item of PPE

a. Costs of site preparation	b. Costs of relocating
c. Installation and assembly costs	d. Initial delivery and handling costs

Ans: (b)

Question 21

As per AS 10 (Revised) 'Property, Plant and Equipment', an enterprise holding investment properties should value Investment property.

a. As per fair value	b. Under discounted cash flow model
c. Under cost model	d. Under cash flow model

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Ans: (c)

Question 22

A plot of land with carrying amount of Rs. 1,00,000 was revalued to Rs. 1,50,000 at the end of Year 2. Subsequently, due to drop in market values, the land was determined to have a fair value of Rs. 1,30,000at the end of Year 4. Assuming that the entity adopts Revaluation Model, what would be the accountingtreatment of Revaluation?

a. Initial upward valuation of Rs. 50,000 credited to Revaluation Reserve. Subsequent downward revaluation of Rs. 20,000 debited to P/L.

b. Initial upward valuation of Rs. 50,000 credited to P/L. Subsequent downward revaluation of Rs. 20,000 debited to P/L.

c. Initial upward valuation of Rs. 50,000 credited to Revaluation Reserve. Subsequentdownward revaluation of Rs. 20,000 debited to Revaluation Reserve.

d. Initial upward valuation of Rs. 50,000 debited to P/L. Subsequent downward revaluation of Rs. 20,000 credited to P/L.

Ans: (c)

Question 23

A plot of land with carrying amount of Rs. 1,00,000 was revalued to Rs. 90,000 at the end of Year 2. Subsequently, due to increase in market values, the land was determined to have a fair value of Rs. 1,05,000 at theend of Year 4. Assuming that the entity adopts Revaluation Model, what would be the accountingtreatmentof Revaluation?

- Initial downward valuation of Rs. 10,000 debited to Revaluation Reserve. Subsequentupward revaluation of Rs. 15,000 credited to P/L.
- Initial downward valuation of Rs. 10,000 debited to P/L. Subsequent upward revaluation of Rs. 15,000 credited to P/L.
- Initial downward valuation of Rs. 10,000 debited to P/L. Subsequent upward revaluation of Rs. 10,000 credited to P/L and Rs. 5,000 credited to Revaluation Reserve.
- (c) Initial downward valuation of Rs. 10,000 credited to P/L. Subsequent upward revaluation of Rs. 10,000 debited to P/L and Rs. 5,000 debited to Revaluation Reserve.

Ans: (c)

Question 24

On sale of an asset which was revalued upwards, what would be the treatment of Revaluation Reserve?

- The Revaluation Reserve is credited to P/L since the profit on sale of such asset is nowrealized.
- The Revaluation Reserve is credited to Retained Earnings as a movement in reserveswithout impacting the P/L.

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- No change in Revaluation Reserve since profit on sale of such asset is already impactingthe P/L.

The Revaluation Reserve is reduced from the asset value to compute profit or loss.

Ans: (b)

Question 25

A machinery was purchased having an invoice price Rs. 1,18,000 (including GST Rs. 18,000) on 1 April 20X1. The GST amount is available as input tax credit. The rate of depreciation is 10% on SLM basis. The depreciation for 20X2 -X3 would be

a. Rs. 10,000	b. Rs. 11,800
c. Rs. 9,000	d. Rs. 10,500

Ans: (a)

Theoretical Questions Answers

Questions 26

A company changed its method of depreciation from SLM to WDV. How should the change be recognised?

Answers 26

As per AS 10, Property, Plant and Equipment, the depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Such a change should be accounted for as a change in an accounting estimate in accordance with AS 5.

Accordingly, the change in method of depreciation should be accounting for as a change in accounting estimate, prospectively.

Questions 27

A company has debited the Building Account with the Cost of the Land on which the building stands and has provided depreciation on such total cost. Comment on the accounting treatment.

Answers 27

As per AS 10, Property, Plant and Equipment, each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately. Further, Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited usefullife and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets.

In the given case, land should not be depreciated unless it has a limited useful life. Accordingly, it is incorrect to debit the cost of land to the Building Account and provide depreciation on the aggregate cost.

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Questions 28

An entity is setting up a manufacturing plant. Construction of the plant is completed in August and theplant is ready for commercial production in November. However, the entity commences production inMarch. When should be company start charging depreciation.

Answers 28

As per AS 10, Property, Plant and Equipment, depreciation of an asset begins when it is available for use,i.e., when it is in the location and condition necessary for it to be capable of ope ating in the manner intended by management.

In the given case, since the plant is ready for commercial production in November, depreciation shall commence from November. The date of commencement of commercial production is irrelevant for charging depreciation.

Questions 29

Which factors should be considered by a company while determining useful life?

Answers 29

All the following factors are considered in determining the useful life of an asset:

(a) Expected usage of the asset. Usage is assessed by reference to the expected capacity or physical output of the asset.

(b) expected physical wear and tear, which depends on operational factors such as the number of shiftsfor which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

(c) technical or commercial obsolescence arising from changes or improvements in production, or from achange in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.

(d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

Questions 30

An entity gave the following Note in its Financial Statements:

'The company chooses not to charge depreciation on Property, Plant and Equipment on account of:

a. **Annual Maintenance Contracts being expensed thereby ensuring timely repairs of Plant and Machinery.**

b. **Depreciation being a non-cash expense has no impact on cash flows. Accordingly, it is not necessaryto depreciate an asset when repairs and maintenance charges are expensed in the Statement of Profit and Loss.**

c. **The values of certain assets like Property increase with passage of time, and hence charging depreciation does not make sense.**

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d. **At the end of the useful life, the asset is ultimately sold, and since the asset is at cost due to no depreciation, exact profit or loss on sale of the asset is stated.'**

You are required to state the appropriateness of the above accounting policy in line with the relevantAccounting Standards.

Answers 30

Depreciation refers to writing off the value of the asset over its useful life. Such write-off is necessitated on account of normal wear-and-tear, usage, or obsolescence. Since items of Property, Plant and Equipment are generally used in generating revenue, the pro-rated write-off in value of such item should be recordedin the books against the income earned by such an asset.

Providing depreciation is mandatory, in spite of the fact that repairs are expensed in the Statement of Profit and Loss, or the value of the Property is appreciating. Depreciation is a systematic allocation of cost of theasset against the income generated from the continued use of the asset. Further, the Companies Act, 2013 mandates depreciation to be charged in order to determine the correct profits. Thus, not charging depreciation would result in non-compliance with the Companies Act provisions as well.

The argument laid down by the company and the reasons for the same being invalid are discussed below.

(a) Annual Maintenance Contracts being expensed thereby ensuring timely repairs of Plant and Machinery:

The fact that the company enters into Annual Maintenance Contracts for timely repairs can be regarded as a running cost. Such expense is incurred in order to ensure that the machine continues torun as intended. Thus, it implies that because the machine is being utilized, it will need regular repairs. In other words, continuous use is resulting in normal wear-and-tear which is the reason why depreciation should be charged by the company. By stating that the company incurs Annual Maintenance Expenses, the company is recording only the 'maintenance expenses', but not the wear- and-tear requiring the maintenance in the first place. Hence, this argument put forth by the companyis not valid.

(b) Depreciation being a non-cash expense has no impact on cash flows. Accordingly, it is not necessary to depreciate an asset when repairs and maintenance charges are expensed in the Statement of Profit and Loss.

When viewed from the prism of depreciation alone, it appears that the fact that depreciation is a non-cash item is correct. However, it must be noted that at the time of procurement of the asset, the company would have paid cash. Depreciation is after all writing off this amount over the life of the asset. Hence the argument that depreciation is a non-cash item is not valid. Depreciation is writing offthe cost of the asset (which was already paid for) over the useful life of the asset, and hence is mandatory.

(c) The values of certain assets like Property increase with passage of time, and hence charging depreciation does not make sense.

Certain assets like immovable property do increase in value with the passage of time. However, such assets are 'used for the purposes of business' and are not 'held for sale' or held as investment property. Accordingly, since the asset is being used for carrying on business, providing depreciation will give a true and fair view of the results of the company, and hence the argument that the value of the property appreciates is not valid.

If the company wants to show the fair market value of the PPE, then it has the option to apply Revaluation model. However, depreciation is mandatory to be charged in Revaluation model also.

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(d) At the end of the useful life, the asset is ultimately sold, and since the asset is at cost due to no depreciation, exact profit or loss on sale of the asset is stated.

The value of any asset, after usage, will reduce. Accordingly, the argument that the 'exact profit or loss on sale of the asset' will be obtained is incorrect. Due to usage of the asset, the value of the asset would be lower than the cost. Charging depreciation would seek to bring the book value approximating to such reduced value. Thereafter, on sale of the asset, the true profit or loss would be available. Accordingly, this argument is also invalid.

It may be pertinent to note that Accounting Standard 1, Disclosure of Accounting Policies states that Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatmentof the item in the accounts. In other words, the company cannot be absolved of the fact that it has not complied with the relevant accounting standards merely by giving a disclosure of incorrect policies or practices being followed.

Thus, the company's stand of disclosing the incorrect policy as a remedy is not correct. The company is suggested to charge depreciation on a systematic basis over the useful life of the asset thereby complyingwith the Accounting Standards.

Practical Questions Answers

Questions 31

With reference to AS-10 Revised, classify the items under the following heads: HEADS

(i) Purchase Price of Property, plant and Equipment (PPE)

(ii) Directly attributable cost of PPE or

(iii) Cost not included in determining the carrying amount of an item of PPE.

ITEMS

(1) Import duties and non-refundable purchase taxes.

(2) Initial delivery and handling costs.

(3) Initial operating losses, such as those incurred while demand for the output of an item builds up.

(4) Costs incurred while an item capable of operating in the manner intended by management has yetto be brought into use or is operated at less than full capacity.

(5) Trade discounts and rebates.

(6) Costs of relocating or reorganizing part or all of the operations of an enterprise.

(7) Installation and assembly costs.

(8) Administration and other general overhead costs.

Answers 31

Heads

(i) Purchase price of PPE

(ii) Directly attributable cost of PPE

(iii) Cost not included in determining the carrying amount of an item of PPE

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Items		Classified under Head
1	Import duties and non-refundable purchase taxes	(i)
2	Initial delivery and handling costs	(ii)
3	Initial operating losses, such as those incurred while demand for the output of an item builds up	(iii)
4	Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.	(iii)
5	Trade discounts and rebates (deducted for computing purchase price)	(i)
6	Costs of relocating or reorganizing part or all of the operations of anenterprise.	(iii)
7	Installation and assembly costs	(ii)
8	Administration and other general overhead costs	(iii)

Questions 32

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

1.	Cost of the plant (cost per supplier's invoice plus taxes)	Rs. 25,00,000
2.	Initial delivery and handling costs	Rs. 2,00,000
3.	Cost of site preparation	Rs. 6,00,000
4.	Consultants used for advice on the acquisition of the plant	Rs. 7,00,000
5.	Interest charges paid to supplier of plant for deferred credit	Rs. 2,00,000
6.	Estimated dismantling costs to be incurred after 7 years	Rs. 3,00,000
7.	Operating losses before commercial production	Rs. 4,00,000

Please advise ABC Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised).

Answers 32

According to AS 10 (Revised), these costs can be capitalised:

1.	Cost of the plant	Rs. 25,00,000
2.	Initial delivery and handling costs	Rs. 2,00,000
3.	Cost of site preparation	Rs. 6,00,000
4.	Consultants' fees	Rs. 7,00,000

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5.	Estimated dismantling costs to be incurred after 7 years	Rs. 3,00,000
		Rs. 43,00,000

Note:

Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of Rs2,00,000 and operating losses before commercial production amounting to Rs. 4,00,000 are not regardedas directly attributable costs and thus cannot be capitalised. They should be written off to the Statementof Profit and Loss in the period they are incurred.

Questions 33

Arka Ltd. purchased machinery for Rs. 3,000 lakhs. Depreciation was charged at 10% on SLM basis for a useful life of 10 years. At the end of Year 4, the machinery was revalued to Rs. 2,700 lakhs and the samewas adopted. What will be the carrying amount of the asset at the end of Year 5 and Year 6? Assume nochange in the useful life.

Answers 33

Particulars	Rs. in lakhs
Original Cost of the Asset	3,000.00
Less: Depreciation for 4 years (Rs. 3,000 lakhs x 10% x 4 years)	(1,200.00)
Book Value at the end of Year 4	1,800.00
Add: Revaluation Surplus (balancing figure)	900.00
Revalued Amount as given (= revised depreciable value)	2,700.00
Less: Depreciation for Year 5 (Rs. 2,700 lakhs ÷ 6 years)	450.00
Carrying Amount at the end of Year 5	2,250.00
Less: Depreciation for Year 6 (Rs. 2,700 lakhs ÷ 6 years)	450.00
Carrying Amount at the end of Year 6	1,800.00

Questions 34

Skanda Ltd. acquired a machinery for Rs. 2,50,00,000 five years ago. Depreciation was charged at 10% p.a.on SLM basis, useful life being 10 years. At the beginning of Year 3, the machinery was revalued to Rs. 3,00,00,000 with the surplus on revaluation being credited to Revaluation Reserve. Depreciation was provided on the revalued amount over the balance useful life of 8 years. The machinery was sold in the current year for Rs. 1,12,50,000. Give the accounting treatment for the above in the Company's accounts.What will be the treatment if the machinery fetched only Rs. 42,50,000 now?

Answers 34

Particulars	Rs.
Original Cost of the Asset	2,50,00,000
Less: Depreciation for 2 years (Rs. 2,50,00,000 x 10% x 2 years)	50,00,000

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Book Value at the beginning of Year 3	2,00,00,000
Add: Revaluation Surplus (balancing figure)	1,00,00,000
Revalued Amount as given (= revised depreciable value)	3,00,00,000
Less: Depreciation for Years 3-5 (Rs. 3,00,00,000 ÷ 8 yrs x 3 yrs)	1,12,50,000
Carrying Amount at the end of Year 5	1,87,50,000

The treatment of Gain / Loss on Disposal / Revaluation is as below:

Particulars	Disposal Proceeds = Rs. 1,12,50,000	Disposal Proceeds = Rs. 42,50,000
Book Value Less Disposal Proceeds = Loss recognized in Profit or Loss	Rs. 1,87,50,000 – Rs 1,12,50,000 = Rs.75,00,000 (Loss)	Rs. 1,87,50,000 – Rs. 42,50,000 = Rs. 1,45,00,000 (Loss)
Revaluation Surplus directly transferred to Retained Earnings	Rs. 1,00,00,000	Rs. 1,00,00,000

Questions 35

Akshar Ltd. installed a new Plant (not a qualifying asset), at its production facility, and incurred the following costs:

- —Cost of the Plant (as per supplier's invoice): Rs. 30,00,000
  - Initial delivery and handling costs: Rs. 1,00,000
  - Cost of site preparation: Rs. 2,00,000
  - Consultant fee for advice on acquisition of Plant: Rs. 50,000
  - Interest charges paid to supplier against deferred credit: Rs. 1,00,000
  - Estimate of Dismantling and Site Restoration costs: Rs. 50,000 after 10 years (Present Value is Rs. 30,000)
  - Operating losses before commercial production: Rs. 40,000

The company identified motors installed in the Plant as a separate component and a cost of Rs. 5,00,000 (Purchase Price) and other costs were allocated to them proportionately. The company estimates the useful life of the Plant and those of the Motors as 10 years and 6 years respectively and SLM method of Depreciation is used.

At the end of Year 4, the company replaces the Motors installed in the Plant at a cost of Rs. 6,00,000 andestimated the useful life of new motors to be 5 years. Also, the company revalued its entire class of Fixed Assets at the end of Year 4. The revalued amount of Plant as a whole is Rs. 25,00,000. At the end of Year 8, the company decides to retire the Plant from active use and also disposed the Plant as a

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whole for Rs. 6,00,000.

There is no change in the Dismantling and Site Restoration liability during the period of use. You are required to explain how the above transaction would be accounted in accordance with AS 10.

Answers 35

1. **Cost at Initial Recognition:**

Particulars	Rs.
Cost of the Plant (as per Invoice)	30,00,000
Initial Delivery and Handling Costs	1,00,000
Cost of Site Preparation	2,00,000
Consultants' Fees	50,000
Estimated Dismantling and Site Restoration Costs	30,000
Total Cost of Plant including Motors	33,80,000
Less: Cost of Motors identified as a separate component (1/6)*	5,63,333
Cost of the Plant (excluding Motors – balance 5/6)	**28,16,667**

* Purchase price of Motors = Rs. 5,00,000 out of Rs. 30,00,000 i.e., 1/6 of value of Plant

Note:

Since the asset is not a qualifying asset, payment of interest to the supplier is not capitalized. Further, operating losses of Rs. 40,000 incurred before commercial production is not a directly attributable cost, andhence excluded from cost of asset. These costs are expensed to the P/L as and when they are incurred.

2. **Recognition of Motors Replacement**

Particulars	Rs.
Cost of Motors determined above	5,63,333
Less: Depreciation for 4 years (as per SLM) 5,63,333 ÷ 6 years x 4 years	3,75,555
Carrying Amount of Motors at the end of Year 4	**1,87,778**

Accounting:

The company should derecognize the existing Carrying Amount of Motors replaced of Rs. 1,87,778. Further,the acquisition cost of new motors of Rs. 6,00,000 would be capitalized as a separate component. This amount will be depreciated over the next 5 years at Rs. 6,00,000 ÷ 5 years = Rs. 1,20,000 p.a.

3. **Revaluation**

Particulars	Rs.
Cost of the Plant at initial recognition [from (1) above]	28,16,667
Less: SLM Depreciation for 4 years: Rs. 28,16,667 ÷ 10 years x 4 years	11,26,667
Carrying Amount of Plant at the end of Year 4	16,90,000

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Revalued Amount of Plant (Excluding Motors, since the same istreated as a separate component: Rs. 25,00,000 – Rs. 6,00,000)	19,00,000
Therefore, Gain on Revaluation credited to Revaluation Reserve	2,10,000
Revised Depreciation Charge p.a.: 19,00,000 ÷ 6 years	3,16,667

Derecognition

Particulars	Motors	Plant (excluding Motors)
Cost / Revalued Amount at end of Year 4	6,00,000	19,00,000
Less: Depreciation for Years 5-8	1,20,000 x 4 = 4,80,000	3,16,667 x 4 =12,66,668
Carrying Amount before Disposal / De- recognition	1,20,000	6,33,332
Less: Disposal Proceeds Rs. 6,00,000 allocated in ratio of carrying amount	95,575	5,04,425
Loss to be written off to P/L	24,425	1,28,907

Notes:

(a) The Revaluation Surplus of Rs. 2,10,000 would be transferred directly to Retained Earnings.

(b) The allocation of disposal proceeds of Rs. 6,00,000 for the plant as whole is apportioned based oncarrying amount of motors and plant (excluding motors)

Alternatively, it may be apportioned as 1/6 towards motors and 5/6 plant (excluding motors) based on thereasoning that the initially, motors amounted to 1/6 of the entire plant. This approach may not be preferable because there has been a revaluation of the plant (excluding motors) and a disposal and subsequent acquisition of the Motor, which is not in the initial proportion of 5/6 and 1/6 respectively.

Questions 36

Bharat Infrastructure Ltd. acquired a heavy machinery at a cost of Rs. 1,000 lakhs, the breakdown of its components is not provided. The estimated useful life of the machinery is 10 years. At the end of Year 6,the turbine, which is a major component of the machinery, needed replacement, as further usage and maintenance was uneconomical. The remainder of the machine is in good condition and is expected tolast for the remaining 4 years. The cost of the new turbine is Rs. 450 lakhs. Give the accounting treatmentfor the new turbine, assuming SLM Depreciation and a discount rate of 8%.

Answers 36

As per AS 10, Property, Plant and Equipment, the derecognition of the carrying amount of components of an item of Property, Plant and Equipment occurs regardless of whether the cost of the previous part / inspection was identified in the transaction in which the item was acquired or constructed. If it is not practicable for an enterprise to determine the carrying amount of the replaced part/ inspection, it may use the cost of the replacement or the estimated cost of a future similar inspection as an indication of what the cost of the replaced part/ existing inspection component was when the item was acquired or constructed.

In the given case, the new turbine will produce economic benefits to Bharat Infrastructure Ltd. and the

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cost is measurable. Since the recognition criteria is fulfilled, the same should be recognised as a separate item of Property, Plant and Equipment. However, since the initial breakup of the components is not available,the cost of the replacement of Rs. 450 lakhs can be used as an indication based on the guidance given above, discounted at 8% for the 6-year period lapsed.

Thus, estimate of cost 6 years back = Rs. 450 lakhs ÷ 1.086 = Rs. 283.58 lakhs

Current carrying amount of turbine (to be de-recognised) = Estimated cost Rs. 283.58 lakhs (–) SLM depreciation at 10% (useful life 10 years) for 6 years Rs. 170.15 lakhs= Rs. 113.43 lakhs.

Hence revised carrying amount of the machinery will be as under:

Particulars	Rs. in lakhs
Historical Cost [Rs. 1,000 lakhs (–) SLM Depreciation at 10% (10 yearlife) for 6 years]	400.00
Add: Cost of new turbine	450.00
Less: Derecognition of current carrying amount of old turbine	(113.43)
New Carrying Amount of Machinery	736.57

Questions 37

Preet Ltd. intends to set up a steel plant, for which it has acquired a dilapidated factor having an area of 5,000 acres at a cost of ₹ 60,000 per acre. Preet Ltd. has incurred Rs. 1.10 crores on demolishing the old Factory Building thereon. A sum of Rs. 63,00,000 (including 5% GST thereon) was realized from the sale ofmaterial salvaged from the site. Preet Ltd. incurred Stamp Duty and Registration Charges of 7% of landvalue, paid legal and consultancy charges Rs. 8,00,000 for land acquisition and incurred Rs. 1,25,000 on titleguarantee insurance. Compute the value of the land acquired.

Answers 37

Particulars	Rs.
Purchase Price: 5,000 acres x Rs. 60,000 per acre	3,000.00
Stamp Duty and Registration Charges at 7%	210.00
Legal and Consultancy Fees	8.00
Title Guarantee Insurance	1.25
Demolition Expenses (Net of Salvage Income) [Rs. 110 lakhs (–)Rs. 60 lakhs (Rs. 63 lakhs x 100/105)]	50.00
Cost of Land	**3,269.25**

Question 38 (Illustration)

(Capitalising the cost of "Remodelling" a Supermarket)

Entity A, a supermarket chain, is renovating one of its major stores. The store will have more availablespace for in store promotion outlets after the renovation and will include a restaurant. Management ispreparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers. State whether the remodelling cost will be capitalised or not.

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Answers 38

The expenditure in remodelling the store will create future economic benefits (in the form of 15% of increase in sales) and the cost of remodelling can be measured reliably, therefore, it should be capitalised.

Question 39 (Illustration)

Entity A has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site.The following incremental costs will be incurred:

1. Setup costs of Rs. 5,00,000 to install machinery in the new location.

2. Rent of Rs. 15,00,000

3. Removal costs of Rs. 3,00,000 to transport the machinery from the old location to the temporary location.

Can these costs be capitalised into the cost of the new building?

Answers 39

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if theasset had not been constructed or acquired. These costs are not to be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to becapable of operating in the manner intended by management. The costs to be incurred by the company arein the nature of costs of relocating or reorganising operations of the company and do not meet the requirement of AS 10 (Revised) and therefore, cannot be capitalised.

Question 40 (Illustration)

Omega Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were Rs1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose of Rs. 45,000 per month. The machine was purchased at Rs. 1,58,00,000 and Rs. 50,000 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of Rs. 30,000 to supervise machinery installation at the factory site. You are required to ascertainthe amount at which the Machinery should be capitalized.

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Answers 40

Particulars		Rs.
Purchase Price	Given	1,58,00,000
Add: Site Preparation Cost	Given	1,40,000
Technician's Salary	Specific/Attributable overheads for 3 months (45,000 x 3)	1,35,000
Initial Delivery Cost	Transportation	50,000
Professional Fees for Installation	Architect's Fees	30,000
Total Cost of Machinery		1,61,55,000

Question 41 (Illustration)

(Capitalisation of directly attributable costs)

Entity A, which operates a major chain of supermarkets, has acquired a new store location. The new location requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the supermarket will be closed.

Management has prepared the budget for this period including expenditure related to construction and remodelling costs, salaries of staff who will be preparing the store before its opening and related utilities costs. What will be the treatment of such expenditures?

Answers 41

Management should capitalise the costs of construction and remodelling the supermarket, because theyare necessary to bring the store to the condition necessary for it to be capable of operating in the mannerintended by management. The supermarket cannot be opened without incurring the remodelling expenditure, and thus the expenditure should be considered part of the asset.

However, if the cost of salaries, utilities and storage of goods are in the nature of operating expenditure that would be incurred if the supermarket was open, then these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management andshould be expensed.

Question 42 (Illustration)

An amusement park has a 'soft' opening to the public, to trial run its attractions. Tickets are sold at a 50% discount during this period and the operating capacity is 80%. The official opening day of the amusement park is three months later. Management claim that the soft opening is a trial run necessary for the amusement park to be in the condition capable of operating in the intended manner. Accordingly, thenet operating costs incurred should be capitalised. Comment.

Answers 42

The net operating costs should not be capitalised but should be recognised in the Statement of

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Profit andLoss.

Even though it is running at less than full operating capacity (in this case 80% of operating capacity), there is sufficient evidence that the amusement park is capable of operating in the manner intended by management. Therefore, these costs are specific to the start-up and, therefore, should be expensed as incurred.

Question 43 (Illustration)

(Consideration received comprising a combination of non-monetary and monetary assets)

Entity A exchanges land with a book value of Rs. 10,00,000 for cash of Rs. 20,00,000 and plant and machinery valued at Rs. 25,00,000. What will be the measurement cost of the assets received. (Consider that the transaction has commercial substance)?

Answers 43

In the given case, Plant & Machinery is valued at Rs. 25,00,000, which is assumed tobe fair value in absenceof information. Further, since fair value of land (asset given up) is not given, the transaction will be recorded at fair value of assets acquired of Rs. 45,00,000 (Rs. Cash 20,00,000 + Rs. Plant & Machinery 25,00,000). Sinceland of book value Rs. 10,00,000 is transferred in exchange of assets worth Rs. 45,00,000, a gain of Rs. 35,00,000 will be recognised in the books of Entity A.

The following journal entry will be passed in the books of Entity A:

Cash/ Bank A/c	Dr.	20,00,000	
Plant & Machinery A/c	Dr.	25,00,000	
To Land			10,00,000
To Profit on Sale of Land (balancing figure)			35,00,000

Question 44 (Illustration)

(Exchange of assets that lack commercial substance)

Entity A exchanges car X with a book value of Rs. 13,00,000 and a fair value of Rs. 13,25,000 for cash of Rs. 15,000 and car Y which has a fair value of Rs. 13,10,000. The transaction lacks commercial substance as thecompany's cash flows are not expected to change as a result of the exchange. It is in the same positionas it was before the transaction. What will be the measurement cost of the assets received?

Answers 44

Since the transaction lacks commercial substance, the entity recognises the assets received at the book value of car X. Therefore, it recognises cash of Rs. 15,000 and car Y as PPE with a carrying value of Rs. 12,85,000.

The following journal entry will be passed in the books of Entity A:

Cash/ Bank A/c	Dr.	15,000
Car Y A/c (balancing figure)	Dr.	12,85,000
To Car X A/c		13,00,000

Determination of Cost in special cases:

Cost of an item of PPE is the cash price equivalent at the recognition date.

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Question 45 (Illustration)

What happens if the cost of the previous part/inspection was/ was not identified in the transaction in which the item was acquired or constructed?

Answers 45

De-recognition of the carrying amount occurs regardless of whether the cost of the previous part/inspection was identified in the transaction in which the item was acquired or constructed.

Question 46 (Illustration)

What will be your answer in the above question, if it is not practicable for an enterprise to determine the carrying amount of the replaced part/inspection?

Answers 46

It may use the cost of the replacement or the estimated cost of a future similar inspection as an indication of what the cost of the replaced part/existing inspection component was when the item was acquired or constructed.

Question 47 (Illustration)

(Revaluation on a class by class basis)

Entity A is a large manufacturing group. It owns a number of industrial buildings, such as factories and warehouses and office buildings in several capital cities. The industrial buildings are located in industrial zones, whereas the office buildings are in central business districts of the cities. Entity A's managementwant to apply the revaluation model as per AS 10 (Revised) to the subsequent measurement of the office buildings but continue to apply the historical cost model to the industrial buildings.

State whether this is acceptable under AS 10 (Revised) or not with reasons?

Answers 47

Entity A's management can apply the revaluation model only to the office buildings. The office buildings can beclearly distinguished from the industrial buildings in terms of their function, their nature and their general location.AS 10 (Revised) permits assets to be revalued on a class by class basis.

The different characteristics of the buildings enable them to be classified as different PPE classes. The different measurement models can, therefore, be applied to these classes for subsequent measurement.

However, all properties within the class of office buildings must be carried at revalued amount.

Question 48 (Illustration)

Entity A has a policy of not providing for depreciation on PPE capitalised in the year until the following year, but provides for a full year's depreciation in the year of disposal of an asset. Is this acceptable?

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Answers 48

The depreciable amount of a tangible fixed asset should be allocated on a systematic basis over its useful life. The depreciation method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

Useful life means the period over which the asset is expected to be available for use by the entity. Depreciation should commence as soon as the asset is acquired and is available for use. Thus, the policy ofEntity A is not acceptable.

Question 49 (Illustration)

(Change in estimate of useful life)

Entity A purchased an asset on 1st January 20X1 for Rs. 1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil.

On 1st January 20X5, the directors review the estimated life and decide that the asset will probably beuseful for a further 4 years.

Calculate the amount of depreciation for each year, if company charges depreciation on Straight Linebasis.

Answers 49

The entity has charged depreciation using the straight-line method at Rs. 10,000 per annum i.e (1,00,000/10 years).

On 1st January 20X5, the asset's net book value is [1,00,000 – (10,000 x 4)] Rs. 60,000.

The remaining useful life is 4 years.

The company should amend the annual provision for depreciation to charge the unamortised cost over the revised remaining life of four years.

Consequently, it should charge depreciation for the next 4 years at Rs. 15,000 per annum i.e. (60,000 / 4years).

Question 50 (Illustration)

Entity B constructs a machine for its own use. Construction is completed on 1st November 20X1 but the company does not begin using the machine until 1 st March 20X2. Comment.

Answers 50

The entity should begin charging depreciation from the date the machine is ready for use – that is, 1st November 20X1. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.

Question 51 (Illustration)

(Depreciation where residual value is the same as or close to Original cost) A property costing Rs. 10,00,000 is bought in 20X1. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 20 years.

The estimated residual value in 20 years' time, based on 20X1 prices, is:

Case (a) Rs. 10,00,000Case (b) Rs. 9,00,000.

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Calculate the amount of depreciation.

Answers 51

Case (a)

The company considers that the residual value, based on prices prevailing at the balance sheet date, willequal the cost.

There is, therefore, no depreciable amount and depreciation is correctly zero.

Case (b)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will be

Rs. 9,00,000 and the depreciable amount is, therefore, Rs. 1,00,000.

Annual depreciation (on a straight-line basis) will be Rs. 5,000 [{10,00,000 – 9,00,000} ÷ 20].

Question 52 (Illustration)

(Determination of appropriate Depreciation Method)

Entity B manufactures industrial chemicals and uses blending machines in the production process. Theoutput of the blending machines is consistent from year to year and they can be used for different products.

However, maintenance costs increase from year to year and a new generation of machines with significant improvements over existing machines is available every 5 years. Suggest the depreciation method to the management.

Answers 52

The straight-line depreciation method should be adopted, because the production output is consistent from year to year.

Factors such as maintenance costs or technical obsolescence should be considered in determiningthe blending machines' useful life.

Question 53 (Illustration)

Gain on replacement of Insured Assets) Entity A carried plant and machinery in its books at Rs. 2,00,000. These were destroyed in a fire. The assets were insured 'New for old' and were replaced by the insurance company with new machines that cost Rs20,00,000. The machines were acquired by the insurance company and the company did not receive Rs. 20,00,000 as cash compensation. State, how Entity A should account for the same?

Answers 53

Entity A should account for a loss in the Statement of Profit and Loss on de- recognition of the carrying value ofplant and machinery in accordance with AS 10 (Revised).

Entity A should separately recognise a receivable and a gain in the income statement resulting from the insurance proceeds under AS 29 (Revised)* once receipt is virtually certain. The receivable should be measured at the fair value of assets that will be provided by the insurer.

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Chapter 5.3

AS 13-Accounting for Investments

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.45 TO Q.67											
Past Exams	Q.9	Q.22	Q.32 Q.34	Q.36	NO	Q.30 Q.39	Q.31 Q.33 Q.38 Q.40	Q.37	NO	Q.35 Q.41	Q.43	NO
MTP	Q.25	Q.3 Q.8 Q.25	Q.7 Q.13	Q.5 Q.6	Q.1 Q.11	Q.2 Q.9	Q.10 Q.12	Q.4 Q.11 Q.16 Q.28	Q.2 Q.9 Q.10	Q.3 Q.12 Q.13	Q.10 Q.15	Q.10 Q.31 Q.37
RTP	Q.16	Q.6 Q.21	Q.3 Q.10	Q.4 Q.26	Q.17 Q.25	Q.17 Q.24	Q.16 Q.23	Q.4 Q.22	Q.19 Q.27	Q.20 Q.28	Q.21 Q.29	Q.44

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Chapter 5.3

AS 13-Accounting for Investments

Question 1

The Investment portfolio of XYZ Ltd. as on 31.03.2020 consisted of the following:

		(Rs. in lacs)	
	Current Investments	**Cost**	**Fair Value as on 31.03.2020**
(1)	1000 Equity Shares of A Ltd.500	5	7
(2)	Equity Shares of B Ltd. 1000 Equity Shares of C Ltd.	10	15
(3)		15	12
	Total	30	34

Give your comments on the following:

(i) The company wants to value the above portfolio at Rs. 30 lakhs being lower of cost or fair market value.

(i) Company wants to transfer 1000 Equity Shares of C Ltd. from current investments to long terminvestments on 31.03.2020 at cost of Rs. 15 lakhs. (MTP 5 Marks May 20)

Answer 1

As per AS 13 "Accounting for Investments", Valuation of current investments on overall (or global) basisis not considered appropriate. Sometimes, the concern of an enterprise may be with the value of a category of related current investments and not with each individual investment, and accordingly the investments may be carried at the lower of cost and fair value computed category-wise (i.e. equity shares, preference shares, convertible debentures, etc.). However, the more prudent and appropriate method is to carry investments individually at the lower of cost and fair value.

(i) Hence the company has to value the current investment at Rs. 27 Lacs (A Ltd. shares at Rs. 5 lacs; B Ltd.shares at Rs. 10 lacs and C Ltd. shares at Rs. 12 lacs). The company's decision to value the portfolio at Rs.30 lacs are not appropriate.

(ii) Moreover, where investments are reclassified from current to long-term, transfers are made at the lowerof cost and fair value at the date of transfer.

Hence, the company has to make transfer of 1,000 equity shares of C Ltd. at Rs. 12 lacs (fair value) and not Rs. 15 lacs (cost) as the fair value is less than cost.

Question 2

Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without providing for any diminution in value is correct and in accordance with the provisions of AS 13. If not,what should have been the accounting treatment in such a situation? What methodology should be adopted for ascertaining the provision for diminution in the value of investment, if any. Explain in brief. (MTP 4 Marks Oct 20, Mar 22)

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Answer 2

The accounting treatment 'at cost' under the head 'Long Term Investment' in the financial statements of the company without providing for any diminution in value is correct and is in accordance with the provisions of AS 13 provided that there is no decline, other than temporary, in the value of investment. If the decline in the value of investment is, other than temporary, compared to the time when the shares were purchased, provision is required to be made. The reduction in market value should not be considered, in isolation to determine the decline, other than temporary. The amount of the provision for diminution in the value of investment may be ascertained considering the factors indicated in AS 13.

Question 3

How you will deal with following in the financial statements of the Parish Electronics Ltd. as on 31.3.18 with reference to AS-13?

Also Parish Electronics Ltd. has current investment (X Ltd.'s shares) purchased for Rs. 5 lakhs, which the company want to reclassify as long term investment. The market value of these investments as on date of Balance Sheet was Rs. 2.5 lakhs. [MTP Aug. '18, 5 Marks, RTP May 19, MTP 5 Marks Oct '22)

Answer 3

As per AS 13 'Accounting for Investments', where investments are reclassified from current tolong - term, transfers are made at the lower of cost or fair value at the date of transfer.

In the given case, the market value of the investment (X Ltd. shares) is Rs.2.50 lakhs, which is lower than its cost i.e. Rs. 5 lakhs. Therefore, the transfer to long term investments should be made at cost of Rs. 2.50 lakhs. The loss of Rs. 2.50 lakhs should be charged to profit and loss account.

Question 4

Z Bank has classified its total investment on 31-3-2021 into three categories (a) held to maturity (b) available for sale (c) held for trading as per the RBI Guidelines. 'Held to maturity' investments are carried at acquisition cost less amortized amount. 'Available for sale' investments are carried at marked to market. 'Held for trading' investments are valued at weekly intervals at market rates. Net depreciation, if any, is charged to revenue and net appreciation, if any, is ignored. You are required to comment whether the policy of the bank is in accordance with AS 13? (MTP 5 Marks Nov '21, RTP Nov 21, Nov 19)

Answer 4

As per AS 13 'Accounting for Investments', the accounting standard is not applicable to Bank, Insurance Company, Mutual Funds. In this case Z Bank is a bank, therefore, AS 13 does not apply to it. For banks, the RBI has issued separate guidelines for classification and valuation of its investment and Z Bank should comply with those RBI Guidelines/Norms. Therefore, though Z Bank has not followed the provisions of AS 13, yet it would not be said as non-compliance since, it is complying with the norms stipulated by the RBI.

Question 5

A fund purchased 10,000 debentures of a company on June 1, 2018 for Rs. 10.7 lakh and further 5,000 debentures on Nov 1, 2018 for Rs. 5.45 lakh. The debentures carry fixed annual coupon of 12%, payable on every 31 March and 30 September. On Feb 28, 2019 the fund sold 6,000 of these debentures for Rs. 6.78 lakh. Nominal value per debenture is Rs. 100. Show Investment in Debentures A/c in books of the fund. (MTP 5 Marks, Oct'19)

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Answer 5

Investment in Debentures A/c

		Rs. Lakh			Rs. Lakh
June 1, 2018	To Bank	10.70	June 1, 2018	By Interest Recoverable (Note 1)	0.20
Nov 1, 2018	To Bank	5.45	Nov 1, 2018	By Interest Recoverable (Note 2)	0.05
Feb 28, 2019	To Interest Recoverable (Note 3)	0.30	Feb 28, 2019	By Bank	6.78
Feb 28, 2019	To Profit ondisposal (Note 4)	0.12	Mar 31, 2019	By Balance c/d	9.54
		16.57			16.57

Working Notes:

1. 10,000 x 100 x 12/100 x 2/12 = Rs. 0.20 Lakhs
2. 5,000 x 100 x 12/100 x 1/12 = Rs. 0.05 Lakhs
3. 6,000 x 100 x 12/100 x 5/12 = Rs. 0.30 Lakhs
4. Cost of investments (per unit) = [(10,70,000 -20,000)+(5,45,000– 5,000)]/15,000 units = [10,50,000+ 5,40,000]/15,000 = Rs. 106

   Cost of investments sold = Rs. 106 x 6,000 = Rs. 6,36,000

   Sale proceeds = Rs. 6,78,000 - Rs. 30,000(interest) = Rs. 6,48,000

   Profit = Rs. 6,48,000 - Rs. 6,36,000 = Rs. 12,000

Question 6

Akash Ltd. had 4,000 equity share of X Limited, at a book value of Rs. 15 per share (face value of Rs. 10 each) on 1st April 2018. On 1st September 2018, Akash Ltd. acquired 1,000 equity shares of X Limited at a premium of Rs. 4 per share. X Limited announced a bonus and right issue for existing share holders.

The terms of bonus and right issue were -

(1) Bonus was declared, at the rate of two equity shares for every five equity shares held on 30th September, 2018.

(2) Right shares are to be issued to the existing shareholders on 1st December, 2018. The company issued two right shares for every seven shares held at 25% premium. No dividend, was payable on these shares. The whole sum being payable by 31st December, 2018.

(3) Existing shareholders were entitled to transfer their rights to outsiders, either wholly or in part.

(4) Akash Ltd. exercised its option under the issue for 50% of its entitlements and sold the remaining rights for Rs. 8 per share.

(5) Dividend for the year ended 31st March 2018, at the rate of 20% was declared by the company andreceived by Akash Ltd., on 20th January 2019.

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(6) **On 1st February 2019, Akash Ltd., sold half of its share holdings at a premium of Rs. 4 per share.**

(7) **The market price of share on 31.03.2019 was Rs. 13 per share.**

You are required to prepare the Investment Account of Akash Ltd. for the year ended 31st March, 2019 and determine the value of shares held on that date assuming the investment as current investment. (MTP Oct. '19, 10 Marks, RTP Nov 18)

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Answer 6

Investment Account-Equity Shares in X Ltd.

Date		No. of shares	Divi-dend	Amount	Date		No. of shares	Divi-dend	Amount
			Rs.	Rs.				Rs.	Rs.
2018					2019				
April 1	To Balance b/d	4,000	-	60,000	Jan. 20	By Bank (dividend)		8,000	2,000
Sept 1	To Bank	1,000	-	14,000	Feb. 1	By Bank	4,000		56,000
Sept.30	To Bonus Issue	2,000		—	Mar. 31	By Balance c/d	4,000		42,250
Dec.1	To Bank (Right)	1,000	-	12,500					
2019									
Feb. 1	To Profit & Loss A/c			13,750					
Feb. 1	To Profit & Loss A/c (Dividend income)		8,000						
		8,000	8,000	1,00,250			8,000	8,000	1,00,250
April. 1	To Balance b/d	4,000		42,250					

Working Notes:

	Rs.
(Rs. 60,000 + Rs. 14,000 + Rs. 12,500)	86,500
Less: Dividend on shares purchased on 1st Sept, 2018	(2,000)
Cost of 8,000 shares	84,500
Cost of 4,000 shares (Average cost basis*)	42,250

Sale proceeds (4,000 shares @ 14/-)	56,000
Profit on sale	13,750

1. Cost of shares sold. Amount paid for 8,000 shares

* For ascertainment of cost for equity shares sold, average cost basis has been applied.

2. Value of investment at the end of the year

Closing balance will be valued based on lower of cost (Rs. 42,250) or net realizable value (Rs.13 x 4,000).Thus investment will be valued at Rs. 42,250.

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3. Calculation of sale of right entitlement

1,000 shares x Rs. 8 per share = Rs. 8,000

Amount received from sale of rights will be credited to P & L A/c as per AS 13

4. Dividend received on investment held as on 1st April, 2018

= 4,000 shares x Rs. 10 x 20%

= Rs. 8,000 will be transferred to Profit and Loss A/c

Dividend received on shares purchased on 1st Sep. 2018

= 1,000 shares x Rs. 10 x 20% = Rs. 2,000 will be adjusted to Investment A/c

Note: It is presumed that no dividend is received on bonus shares as bonus shares are declared on 30th Sept., 2018 and dividend pertains to the year ended 31.3.2018.

Question 7

In 2015, Royal Ltd. issued 12% fully paid debentures of Rs. 100 each, interest being payable half yearly on 30th September and 31st March of every accounting year.

On 1st December, 2016, M/s. Kumar purchased 10,000 of these debentures at Rs.101 cum-interest price, also paying brokerage @ 1% of cum-interest amount of the purchase. On 1st March, 2017 the firm sold all of these debentures at Rs.106 cum-interest price, again paying brokerage @ 1 % of cum- interest amount. Prepare Investment Account in the books of M/s. Kumar for the period 1st December, 2016 to 1st March, 2017[MTP March '19, 6 Marks, Old & New SM)

Answer 7

In the books of M/s Kumar Investment

Account for the period from 1st December 2016 to 1st March, 2017 (Scrip: 12% Debentures of Royal Ltd.)

Date	Particulars	Nominal	Interest	Cost	date	Particulars	Nominal	Interest	Cost
1.12.2016	To Bank A/c (W.N.1)	10,00,000	20,000	10,00,100	1.3.2017	By Bank A/c(W.N.2)	10,00,000	50,000	9,99,400
1.3.2017	To Profit & loss A/c	10,00,000	30,000		1.3.2017	By Profit & loss A/c			700
			50,000	10,00,100			10,00,000	50,000	10,00,100

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Working Notes:

(I) Cost of 12% debentures purchased on 1.12.2016		**Rs.**
Cost Value (10,000 xRs.101)	=	10,10,000
Add: Brokerage (1% of Rs.10,10,000)	=	10,100
Less; Cum Interest (10,000 x 100 x12% x 2/12)	=	(20,000)
Total	=	10,00,100
(ii) Sale proceeds of 12% debentures sold on 1st March, 2017		Rs.
Sales Price (10,000 xRs.106)	=	10,60,000
Less; Brokerage (1% of Rs.10,60,000)	=	(10,600)
Less; Cum Interest (10,000 x 100 x12% x 5/12)	=	(50,000)
Total	=	9,99,400

Question 8

Smart Investments made the following investments in the year 2017-18:
12% State Government Bonds having face value Rs. 100

Date	**Particulars**
01.04.2017	**Opening Balance (1200 bonds) book value of Rs. 1,26,000**
02.05.2017	**Purchased 2,000 bonds @ Rs. 100 cum interest**
30.09.2017	**Sold 1,500 bonds at Rs. 105 ex interest Interest on the bonds is received on 30th June and 31st Dec. each year. Equity Shares of X Ltd.**

15.04.2017	**Purchased 5,000 equity shares @ Rs. 200 on cum right basis Brokerage of 1% was paid in addition (Face Value of shares Rs. 10)**
16.08.2017	**03.06.2017 The company announced a bonus issue of 2 shares for every 5shares held.** **The company made a rights issue of 1 share for every 7 shares held**
22.8.2017	**at Rs. 250 per share.** **The entire money was payable by 31.08.2017.** **Rights to the extent of 20% was sold @ Rs. 60. The remaining rights**
02.09.2017	**were subscribed.** **Dividend @ 15% for the year ended 31.03.2017 was received on 16.09.2017**
15.12.2017	**Sold 3,000 shares @ Rs. 300. Brokerage of 1% was incurred extra.**
15.01.2018	**Received interim dividend @ 10% for the year 2017-18**
31.03.2018	**The shares were quoted in the stock exchange @ Rs. 220**

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Answer 8

Prepare Investment Accounts in the books of Smart Investments. Assume that the averagecost methodis followed. (MTP Aug. '18, 12 Marks, Old & New SM)

In the books of Smart Investments

12% Govt. Bonds for the year ended 31st March, 2018

Date	Particulars		Nos.	Income	Amount	Date	Particulars		Nos.	Income	Amount
1.4.17	To	Open-ing balance b/d	1,200	3,600	1,26,000	30.6.17	By	Bank A/c (Inter-est) (3,200 x 100 x 12% x 6/12)	-	19,200	-
2.5.17	To	Bank A/c	2,000	8,000	1,92,000	30.9.17	By	Bank A/c	1,500	4,500	1,57,500
31.3.18	To	P & L A/c (Inter-est)		27,400		31.12.17	By	Bank A/c (Inter-est) (1,700 x 100 x 12% x 6/12)	-	10,200	-
	To	P & L A/c (Profit on Sale)			8,437.50	31.3.18	By	Bal. c/d	1,700	5,100	1,68,937.50
			3,200	39,000	3,26,437.50				3,200	39,000	3,26,437.50

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Investments in Equity shares of X Ltd. for year ended 31.3.2018

Date	Particu-lars	Nos.	In-come	Amount	Date	Particulars	Nos.	In-come	Amount
15.4.17	To Bank	5,000		10,10,000		By Bank (Divi-dend)			
3.6.17	A/c To Bo-nus	2,000	-	-	16.9.17	By Bank (Sale)	-	-	7,500
31.8.17	Issue	800		2,00,000	15.12.17	By Bank (interim dividend)	3,000	-	8,91,000
31.3.18	To Bank A/c To P & L A/c		4,800	4,28,500	15.1.18			4,800	
					31.3.18	By Bal. c/d	4,800		
		7,800	4,800	16,38,500			7,800	4,800	16,38,500

Working Notes:

1. Profit on sale of bonds on 30.9.17

= Sales proceeds – Average costSales proceeds = Rs. 1,57,500

Average cost = Rs. [(1,26,000+1,92,000) x 1,500/3,200] = 1,49,062.50Profit = 1,57,500– Rs. 1,49,062.50=Rs. 8,437.50

2. Valuation of bonds on 31st March, 2018

Cost = Rs. 3,18,000/3,200 x1,700 = 1,68,937.50

3. Cost of equity shares purchased on 15/4/2017

= Cost + Brokerage

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

4. Sale proceeds of equity shares on 15/12/2017

= Sale price – Brokerage

= (3,000 x Rs. 300) – 1% of (3,000 x Rs. 300) = Rs. 8,91,000.

5. Profit on sale of shares on 15/12/2017

= Sales proceeds – Average costSales proceeds = Rs. 8,91,000

Average cost = Rs. [(10,10,000+2,00,000 -7,500) x 3,000/7,800]

= Rs. [12,02,500 x 3,000/7,800] = 4,62,500 Profit = Rs. 8,91,000 – Rs. 4,62,500=Rs. 4,28,500.

6. Valuation of equity shares on 31st March, 2018

Cost =Rs. [12,02,500 x 4,800/7,800] = Rs. 7,40,000 Market Value = 4,800 shares ×Rs. 220 =Rs. 10,56,000

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Closing stock of equity shares has been valued at Rs.7,40,000 i.e. cost being lower than themarket value.

Note: If rights are not subscribed for but are sold in the market, the sale proceeds are taken to the profitand loss statement as per para 13 of AS 13 "Accounting for Investments".

Question 9

Mr. Vijay entered into the following transactions of purchase and sale of equity shares of JP Power Ltd. The shares have paid up value of ₹ 10 per **share.**

Date	No. of Shares	Terms
01.01.2019	600	Buy @ ₹ 20 per share
15.03.2019	900	Buy @ ₹ 25 per share
20.05.2019	1000	Buy @ ₹ 23 per share
25.07.2019	2500	Bonus Shares received
20.12.2019	1500	Sale @ ₹ 22 per share
01.02.2020	1000	Sale @ ₹ 24 per share

Addition information:

(1) On 15.09.2019 dividend @ ₹ 3 per share was received for the year ended 31.03.2019.

(2) On 12.11.2019 company made a right issue of equity shares in the ratio of one share for five shares held on payment of ₹ 20 per share. He subscribed to 60% of the shares and renounced the remaining shares on receipt of ₹ 3 per share.

(3) Shares are to be valued on weighted average cost basis.

You are required to prepare Investment Account for the year ended 31.03.2019 and 31.03.2020. (MTP 8 Marks Mar'22,Oct 20, PYP May '18 10 Marks)

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Answer 9

(i) Investment in Equity shares of JP Power Ltd.

Date	Particulars	No.	Dividend ₹	Amount ₹	Date	Particulars	No.	Divi-dend ₹	Amount ₹
1.1.19	To Bank A/c	600		12,000	31.3.19	By Balance c/d	1,500		34,500
15.3.19	To Bank A/c	900		22,500				4,500	
		1,500		34,500			1,500		34,500
1.4.19	To Balance b/d	1,500		34,500	15.9.19	By Bank - div-idend			3,000
20.5.19	To Bank A/c	1,000		23,000	20.12.19	By Bank	1,500		33,000
25.7.19	To Bonus shares	2,500		_	1.2.20	By Bank	1,000		24,000
12.11.19	To Bank A/c	600	4,500	12,000	31.3.20	By Balance c/d	3,100		36,812.50
20.12.19	To P& L A/c (profit on sale)			15,187.50					
1.2.20	To P& L A/c (profit on sale)			12,125					
31.3.20	To P & L A/c (dividend)								
		5,600	4,500	96,812.50			5,600	4,500	96,812.50

Working Notes:

1. **Calculation of Weighted average cost of equity shares**

   600 shares purchased at ₹ 12,000

   900 shares purchased at ₹ 22,500

   1,000 shares purchased at ₹ 23,0002,500 shares at nil cost

   600 right shares purchased at ₹ 12,000

   Total cost of 5,600 shares is ₹ 66,500 [₹ 69,500 less ₹ 3,000 (pre-acquisition dividend received on1,000 shares purchased on 20.5.19].

   Hence, weighted average cost per share will be considered as ₹ 11.875 per share (66,500/5,600).

2. It has been considered that no dividend was received on bonus shares as the dividend pertainsto the year ended 31set March, 2019.

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3. **Calculation of right shares subscribed by Vijay Right Shares (considering that right shares have been granted on Bonus shares also) = 5,000/5 x 1= 1,000 shares**

   Shares subscribed = 1,000 x 60%= 600 shares

   Value of right shares subscribed = 600 shares @ ₹ 20 per share = ₹ 12,000 Calculation of sale ofright renouncement

   No. of right shares sold = 1,000 x 40% = 400 shares

   Sale value of right = 400 shares x ₹ 3 per share = ₹ 1,200

   Note: As per para 13 of AS 13, sale proceeds of rights is to be credited to P & L A/c.

4. **Profit on sale of equity shares**

   As on 20.12.19

Sales price	(1,500 shares at ₹ 22)	33,000.00
Less: Cost of shares sold	(1,500 x ₹ 11.875)	(17,812.50)
Profit on sale		15,187.50

   As on 1. 2.20

Sales price	(1,000 shares at ₹ 24)	24,000
Less: Cost of shares sold	(1,000 x ₹ 11.875)	(11,875)
Profit on sale		12,125

   Balance of 3,100 shares as on 31.3.20 will be valued at ₹ 36,812.50 (at rate of ₹ 11.875 per share)

Question 10

A Ltd. purchased on 1st April, 2022 8% convertible debenture in C Ltd. of face value of ₹ 2,00,000 @ ₹ 108. On 1st July, 2022 A Ltd. purchased another ₹ 1,00,000 debentures @ ₹ 112 cum interest. On 1st October, 2022 ₹ 80,000 debentures were sold @ ₹ 105. On 1st December, 2022, C Ltd. give option forconversion of 8% convertible debentures into equity share of ₹ 10 each. A Ltd. received 5,000 equity shares in C Ltd. in conversion of 25% debentures held on that date. The market price of debenture andequity share in C Ltd. on 31st December, 2022 is ₹ 110 and ₹ 15 respectively. Interest on debenture ispayable each year on 31 st March, and 30th September. Prepare investment account in the books of A Ltd. on average cost basis for the accounting year ended 31st December, 2022. (MTP 8 Marks April 23 ,April '22 ,April '21 & Oct '23) (RTP May 19)

Answer 10

Investment Account for the year ending on 31st December, 2022Scrip : 8% Convertible Debentures in C Ltd.

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[Interest Payable on 31st March and 30th September]

Date	Particu-lars	Nominal value Rs.	Inter-est Rs.	Cost Rs.	Date	Particulars	Nominal Value Rs.	interest Rs.	Cost (Rs.)
1.4.22	To Bank A/c	2,00,000	-	2,16,000	30.09.2022	By Bank A/c	-	12,000	
1.7.22	To Bank A/c	1,00,000	2,000	1,10,000		[7 3,00,000			
	(W.N.1)					x 8% x			
						(6/12]			
31.12.22	To P & L A/c		14,033	-	1.10.2022	By Bank A/ c	80,000		84,000
	[Inter-est]				1.10.2022	By P & LA/c (loss) (W.N.3)			2,933
					1.12.2022	By Bank A/c (Ac-crued interest) (T 55,000 x 08 x 2/12)		733	
					1.12.2022	By Equity shares in C Ltd. (W.N. 3 and 4)	55,000		59,767
					31.12.2022	By Bal-ance c/d (W.N.5)	1,65,000	3,300	1,79,300
		3,00,000	16,033	3,26,000			3,00,000	16,033	3,26,000

SCRIP: Equity Shares in C LTD.

Date	Particulars	Cost (Rs.)	Date	Particulars	Cost (Rs.)
1.12.2022	To 8 % debentures	59,767	31.12.2022	By balance c/d	59,767

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Working Notes:

- Cost of Debenture purchased on 1st July = Rs. 1,12,000 — Rs. 2,000 (Interest) = Rs. 1,10,000
- Cost of Debentures sold on 1st Oct. = (Rs.2,16,000 + Rs. 1,10,000) x 80,000/3,00,000
- Loss on sale of Debentures = Rs. 86,933— Rs.84,000 Nominal value of debentures convertedinto equity shares [(Rs. 3,00,000 — 80,000) x.25]
- Interest received before the conversion of debentures
- Interest on 25% of total debentures = 55,000 x 8% x 2/12 = 733
- Cost of Debentures converted = (Rs. 2,16,000 + Rs. 1,10,000) x 55,000/3,00,000 = Rs. 59,767
- Cost of closing balance of Debentures = (Rs. 2,16,000 + Rs.1,10,000) x 1,65,000 / 3,00,000 = Rs. 1,79,300
- Closing balance of Debentures has been valued at cost.
- 5,000 equity Shares in C Ltd. will be valued at cost of Rs. 59,767 being lower than the marketvalue Rs. 75,000 (Rs. 15 x5,000)

Note: It is assumed that interest on debentures, which are converted into cash, has been received atthe time of conversion.

Question 11

On 1st April, 2019, Mr. Vijay had 30,000 Equity shares in X Ltd. (the company) at a book value of ₹ 4,50,000 (Face Value ₹ 10 per share). On 22nd June, 2019, he purchased another 5000 shares of the same company for ₹ 80,000. The Directors of X Ltd. announced a bonus of equity shares in the ratio of one share for seven shares held on 10th August, 2019.

On 31st August, 2019 the Company made a right issue in the ratio of three shares for every eight shares held, on payment of ₹ 15 per share. Due date for the payment was 30th September, 2019, Mr.Vijay subscribed to 2/3rd of the right shares and sold the remaining of his entitlement to Viru for a consideration of ₹ 2 per share.

On 31stOctober,2019, Vijay received dividends from X Ltd. @ 20% for the year ended 31 st March, 2019. Dividend for the shares acquired by him on 22ndJune,2019 to be adjusted against the cost of purchase.

On 15th November, 2019 Vijay sold 20,000 Equity shares at a premium of ₹ 5 per share.

You are required to prepare Investment Account in the books of Mr. Vijay for the year ended 31st March, 2020 assuming the shares are being valued at average cost.(MTP 8 Marks,Oct'21 & MTP 10 Marks May'20, Old & New SM)

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Answer 11

Books of Vijay Investment Account (Scrip: Equity Shares in X Ltd.)

		No.	Amount			No.	Amount
			₹				₹
1.4.2019 22.6.2019	To Bal b/d To Bank	30,000 5,000	4,50,000 80,000	31.10.2019	By Bank (divi-dend	—	10,000
10.8.2019 30.9.2019	To Bonus ToBank (Rights Shares)	5,000 10,000	-1,50,000		on shares acquired on 22/6/2019)		
15.11.2019	To Profit		32,000	15.11.2019	By Bank	20,000	3,00,000
	(on sale ofshares)				(Sale of shares)		
				31.3.2020	By Bal. c/d	30,000	4,02,000
		50,000	7,12,000			50,000	7,12,000

Working Notes:

(1) Bonus Shares30,000+50,000)/7=5,000 shares

(2) Rights shares= $\frac{(30,000+5,000+5,000)}{8} \times 3 = 15,000$ share

(3) Rights shares sold = 15,000×1/3 = 5,000 shares

(4) Dividend received = 30,000×10×20% = ₹60,000 will be taken to P&L statement

(5) Dividend on shares purchased on 22.6.2019= 5,000×10×20% = ₹ 10,000 is adjusted to Investment A/c

(6) Profit on sale of 20,000 shares

= Sales proceeds – Average

Cost Sales proceeds =Rs.3,00,000

Average cost =

$=₹\frac{(4,50,000+80,000+1,50,000-10,000)}{50,000} \times 20,000 = Rs.\ 2,68,000$

Profit = ₹ 3,00,000– ₹2,68,000= ₹32,000.

(7) Cost of shares on 31.3.2020

$=₹\frac{(4,50,000+80,000+1,50,000-10,000)}{50,000} \times 30,000 = Rs.\ 4,02,000$

(8) Sale of rights amounting ₹ 10,000 (₹ 2 x 5,000 shares) will not be shown in investment A/c but will directly be taken to P & L statement.

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Question 12

On 1st April, 2021, Rajat has 50,000 equity shares of P Ltd. at a book value of Rs. 15 per share (face value Rs. 10 each). He provides you the further information:

- **On 20th June, 2021 he purchased another 10,000 shares of P Ltd. at Rs. 16 per share.**
- **On 1st August, 2021, P Ltd. issued one equity bonus share for every six shares held by the share-holders.**
- **On 31st October, 2021, the directors of P Ltd. announced a right issue which entitles the holders to subscribe three shares for every seven shares at Rs. 15 per share. Shareholders can transfer their rights in full or in part.**

Rajat sold 1/3rd of entitlement to Umang for a consideration of Rs. 2 per share and subscribed the rest on 5th November, 2021.

You are required to prepare Investment A/c in the books of Rajat for the year ending 31st March, 2022. (MTP 6 Marks Sep 22, MTP 8 Marks March '21, Old & New SM)

Answer 12

In the books of Rajat

Investment Account (Equity shares in P Ltd.)

Date	Particulars	No. of shares	Amount (Rs.)	Date	Particulars	No. of shares	Amount (Rs.)
1.4.21	To Balance b/d	50,000	7,50,000	31.3.22	By Balancec/d (Bal. fig.)	90,000	12,10,000
20.6.21	To Bank A/c	10,000	1,60,000				
1.8.21	To Bonus issue (W.N.1)	10,000	-				
5.11.21	To Bank A/c (right shares) (W.N.4)	20,000	3,00,000				
		90,000	12,10,000			90,000	12,10,000

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Working Notes:

(1) Bonus shares = $\frac{50,000+10,000}{6}$ = 10,000 Shares

(2) Right Shares = $\frac{50,000+10,000+10,000}{7}$ X 3 = 30,000 Shares

(3) Sale of Rights = 30,000 Shares X $\frac{1}{3}$ X ₹ 2 = ₹ 20,000 to be credited to P & L A/c as per As 13.

(4) Rights Subscribed = 30,000 Shares X $\frac{2}{3}$ X ₹15 = Rs. 3,00,000

Question 13

Gopal holds 2,000, 15% Debentures of ₹ 100 each in Ritu Industries Ltd. as on April 1, 2021 at a cost of ₹ 2,10,000. Interest is payable on June, 30th and December, 31st each year. On May 1, 2021, 1,000 debentures are purchased cum-interest at ₹ 1,07,000. On November 1, 2021, 1,200 debentures are sold ex-interest at ₹ 1,14,600. On November 30, 2021, 800 debentures are purchased ex-interest at ₹ 76,800. On December 31, 2021, 800 debentures are sold cum-interest for ₹ 1,10,000. You are requiredto prepare the Investment Account showing value of holdings on March 31, 2022 at cost, using FIFO Method. (MTP 10 Marks Oct '22 & April '19)

Answer 13

Investment Account of Gopal For the year ended 31.3.2022

(Script: 15% Debentures in Ritu Industries Ltd.) (Interestpayable on 30th June and 31st December)

Date	Particulars	Nominal Value ₹	Interest ₹	Cost ₹	Date	Particulars	Nominal Value ₹	Interest ₹	Cost ₹
1.04.21	To Balance A/c	2,00,000	7,500	2,10,000	30.06.21	By Bank A/c	-	22,500	
1.05.21	To Bank A/c	1,00,000	5,000	1,02,000	1.11.21	By Bank A/c	1,20,000	6,000	1,14,600
30.11.21	To Bank A/c	80,000	5,000	76,800	1.11.21	By Profit & Loss A/c	-	-	11,400
31.12.21	To Profit & Loss A/c			20,000	31.12.21	By Bank A/c	80,000	6,000	1,04,000
31.03.22	To Profit & Loss A/c (Bal. fig.)		37,250		31.12.21	By Bank A/c	-	13,500	-
					31.12.21	By Bank A/c	-	6,750	-

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					31.3.22	By Bal. c/d	1,80,000	-	1,78,800
		3,80,000	54,750	4,08,800			3,80,000	54,750	4,08,800

Working Notes:

(i) Accrued Interest as on 1st April, 2021 = ₹ 2,00,000 X $\frac{15}{100} \times \frac{3}{12}$ = Rs. 7,500

(ii) Accrued Interest as on 1.5.2021 = ₹ 1,00,000 X $\frac{15}{100} \times \frac{4}{12}$ = Rs. 5,000

(iii) Cost of Investment for purchase on 1st May = ₹ 1,07,000 – ₹ 5,000 = ₹ 1,02,000

(iv) Interest received as on 30.6.2021 = ₹ 3,00,000X $\frac{15}{100} \times \frac{6}{12}$ = Rs. 22,500

(v) Accrued Interest on debentures sold on 1.11.2021 = ₹ 1,20,000 X $\frac{15}{100} \times \frac{4}{12}$ = Rs. 6,000

(vi) Accrued Interest = ₹ 80,000 x $\frac{15}{100} \times \frac{5}{12}$ = Rs. 5,000

(vii) Accrued Interest on sold debentures 31.12.2021 = ₹ 80,000 x $\frac{15}{100} \times \frac{6}{12}$ = Rs. 6,000

(viii) Sale Price of Investment on 31st Dec. 2021 = ₹ 1,10,000-₹ 6,000 = ₹ 1,04,000

(ix) Loss on Sale of Debenture on 1.11.2021

Sale Price of debenture	1,14,600
Less: Cost Price of debenture2,10,000 / 2,00,000 x Rs.1,20,000	1,26,000
Loss on sale	11,400

(x) Accrued interest as on 31.12.2021 = ₹ 1,80,000 x $\frac{15}{100} \times \frac{6}{12}$ = Rs. 13,500

(xi) Accrued Interest = ₹ 1,80,000 x $\frac{15}{100} \times \frac{3}{12}$ = ₹6,750

(xii) Cost of investment as on 31st March = ₹ 1,02,000 + ₹ 76,800 = ₹ 1,78,800

(xiii) Profit on debentures sold on 31st December

= ₹ 1,04,000 –(₹ 2,10,000x800/2,000) = ₹ 20,000

Question 14

Sanket had 50,000 Equity shares of XYZ Ltd. on 01.01.2022 at a book value of ₹ 25 per share (face value ₹ 10). On 01.06.2022, he purchased another 10,000 shares of the company at ₹ 20 per share.

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The director of XYZ Ltd. announces a bonus and right issue. No dividend was payable on these issues. The terms of the issue were as follows:

- **Bonus basis 1:6 (Date: 16.08.2022)**
- **Right basis 3: 7 (Date: 31.08.2022) price ₹15 per share**
- **Due date for payment 30.09.2022**
- **Shareholders can transfer their rights in full or in part.**

Accordingly, Sanket sold 33 1/3% of his entitlement in the market for consideration of ₹ 4 per share on 31.08.2022 & he procured other entitlement by payment.

Dividends for the year ended 31.03.2022 at the rate of 20% were declared by XYZ Ltd. and received by Sanket on 31.10.2022. Dividend amount for shares acquired by him on 01.06.2022 are to be adjusted against the cost of purchase.

On 15.11.2022, Sanket sold 25,000 equity shares at premium ₹ 12 per share. You are required to prepare in books of Sanket.

(i) **Investment Account**

(ii) **Profit & Loss Account (Extract for Investment)**

Books of accounts are closed by Sanket on 31.12.2022 and market price of shares on that date is ₹ 20 per share. (10 Marks March '23)(Same concept different figures Old & New SM)

Answer 14

Books of Sanket Investment Account

(Scrip: Equity Shares in XYZ Ltd.)

		No.	Amount ₹			No.	Amount ₹
1.1.2022 1.6.2022	To Bal b/dTo Bank	50,000 10,000	12,50,000 2,00,000	31.10.2022	By Bank (dividend	—	20,000
16.8.2022 30.9.2022	To Bonus (W.N.1) To Bank (RightsShares) (W.N.3)	10,000 20,000	— 3,00,000		on shares acquired on 1.6.2022) (W.N.4)		
15.11.2022	To Profit (on sale of shares)		69,444	15.11.2022	By Bank (Sale of shares)	25,000	5,50,000
				31.12.2022	By Bal. c/d(W.N.6)	65,000	12,49,444
		90,000	18,19,444			90,000	18,19,444

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Profit and Loss Account (An extract for investment)

31.12.2022 To Balance c/d (profit)	2,09,444	31.8.22 By Sale of rights (W.N.3)	40,000
		31.10.22 By Dividend (W.N.4)	1,00,000
		15.11.22 By Profit transferred	69,444
	2,09,444		2,09,444

Working Notes:

(1) Bonus Shares = $\frac{(50,000+10,000)}{6}$ = 10,000 shares

(2) Right Shares = $\frac{(50,000+10,000+10,000)}{7}$ X 3 = 30,000 shares × 2/3 = 20,000 shares

(3) Right shares renounced = 30,000×1/3 = 10,000 shares

Sale of right shares = 10,000 x 4 = ₹ 40,000

Right shares subscribed = 20,000 shares

Amount paid for subscription of right shares = 20,000 x 15 = ₹ 3,00,000

(4) Dividend received = 50,000 (shares as on 1st April 2022) × 10 × 20% = ₹ 1,00,000

Dividend on shares purchased on 1.6.2022 = 10,000×10×20% = ₹ 20,000 is adjusted to Investment A/c

(5) Profit on sale of 25,000 shares

= Sales proceeds – Average

cost Sales proceeds = ₹ 5,50,000

Average cost = $\frac{(12,50,000+2,00,000+3,00,000-20,000)}{90,000}$ = ₹ 4,80,556

Profit = ₹ 5,50,000 – ₹ 4,80,556 = ₹ 69,444.

(6) Cost of shares on 31.12.2022 $\frac{(17,30,000)}{90,000}$ X 65,000 = ₹ 12,49,444

Market value of share = 65,000 shares × ₹ 20 = 13,00,000

Shares will be valued at ₹ 12,49,444 as market value is more than cost.

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Question 15

Omega Limited (listed company) issued ₹ 4,50,000 5% Debentures on 30th September 2020 on which interest is payable half yearly on 31st March and 30th September. The company has power to purchase debentures in the open market for cancellation thereof. On 31 December 2020, investments made for the purpose of redemption were ₹ 67,500. The following purchases were made during the year ended 31st December, 2022 and the cancellation were made on the same date 1st March 2022 -

₹ 75,000 nominal value purchased for ₹ 74,175 ex-interest.

(i) 1st September 2022 - ₹ 60,000 nominal value purchased for ₹ 60,375 cum-interest. You are required to draw up the following accounts up to the date of **cancellation:**

(ii) **Debentures Account; and**

Own Debenture (Investment) Account. Ignore taxation. (MTP 5 Marks March **'23)**

Answer 15

Omega Limited-Debenture Account

2022		₹	2022		₹
Mar 1	To Own Debentures	74,175	Jan 1	By Balance b/d	4,50,000
Mar 1	To Profit on cancellation (25,000-24,725)	825			
Sep 1	To Own Debentures (Note 3)	59,124			
Sep 1	To Profit on cancellation (20,000-19,708)	876			
Dec 31	Balance c/d	3,15,000			
		4,50,000			4,50,000

Dec 31	Balance c/d	3,15,000			
		4,50,000			4,50,000

Own Debenture (Investment) Account

		Nominal Cost ₹	Interest ₹	Cost ₹			Nominal Cost ₹	Interest ₹	Cost ₹
2022					**2022**				
Mar 1	To Bank (W.N. 1)	75000	1563	74,175	Mar 1	By Debentures A/c	75,000	-	74,175

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Sep 1	To Bank (W.N. 2 & 3)	60,000	1,251	59,124	Sep 1	By Debentures A/c	60,000	-	59,124
				-	Dec. 31	By P&L A/c	-	2,814	-
		1,35,000	2,814	1,33,299			1,35,000	2,814	1,33,299

Working notes:

1. 75,000 x 5% x 5/12 = 1,563
2. 60,000 x 5% x 5/12 = 1,251
3. 60,375 – 1,251= 59,124

Question 16

Paridhi Electronics Ltd. invested in the shares of Dhansukh Ltd. on 1st May 2020 at a cost of Rs. 10,00,000. Three fourth of these investments were current investments and the remaining investments were intended to be held for more than a year. The published accounts of Dhansukh Ltd.received in January, 2021 reveals that the company has incurred cash losses with decline in market share and investment of Paridhi Electronics Ltd. may not fetch more than 7,50,000. The reduction in value is apparent to be non-temporary. You are required to explain how you will deal with the abovein the financial statements of the Paridhi Electronics Ltd. as on 31.3.21 with reference to AS 13? (RTP May '21, Old & New SM) (Same concepts different figures RTP May 18, MTP 4 Marks, Oct'21)

Answer 16

As per AS 13, "Accounting for Investments", carrying amount for current investments is the lower of cost and fair value. But long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. The standard also states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. Paridhi Ltd. made three fourth of Rs. 10,00,000 ie. Rs.7,50,000 as current investment and remaining Rs. 2,50,000 as long term. The facts of the case given in the question clearly suggest that the provision for diminution should be made to reduce the carrying amount of shares for both categories of shares to bring them to market value. Hence the carrying value of investments will be shown at amount of Rs. 7,50,000 in the financial statements for the year ended 31st March, 2021 and charge the difference of loss of Rs. 2,50,000 to profit and loss account.

Question 17

A Ltd. on 1-1-2020 had made an investment of ₹ 600 lakhs in the equity shares of B Ltd. of which 50%is made in the long term category and the rest as temporary investment. The realizable value of all such investment on 31-3-2020 became ₹ 200 lakhs as B Ltd. lost a case of copyright. How will you recognize the reduction in the value of the investment in the financial statements for the year end 31-3-2020 as per AS 13 considering this downfall in the value of shares as non-temporary? (RTP Nov 20, Old & New SM)

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Answer 17

A limited invested ₹ 600 lakhs in the equity shares of B Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. ₹ 300 lakhs and remaining as temporary (current) investment i.e. ₹ 300 lakhs. Irrespective of the fact that investment has been held by A Limited only for 3 months (from 1.1.2020 to 31.3.2020), AS 13 lays emphasis on intention of the investor to classify the investment as current or long term even though the long-term investment may be readily marketable.

In the given situation, the realizable value of all such investments on 31.3.2020 became ₹ 200 lakhs i.e. ₹

100 lakhs in respect of current investment and ₹ 100 lakhs in respect of long-term investment.

As per AS 13, 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value. Accordingly, the carrying value of investment held as temporary investment should be shown at realizable value i.e. at ₹ 100 lakhs. The reduction of ₹ 200 lakhs in the carrying value of current investment will be charged in the profit and loss account. Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long-term investment, the carrying amount is reduced to recognize the decline.

Here, B Limited has lost a case of copyright which drastically reduced the realizable value of its shares to one third which is quiet a substantial figure. Losing the case of copyright may affect the business and the performance of the company in long run. Accordingly, it will be appropriate to reduce the carrying amountof long-term investment by ₹ 200 lakhs and show the investments at ₹ 100 lakhs as the downfall in the value of shares is not temporary. The reduction of ₹ 200 lakhs in the carrying value of long-term investment will be charged to the profit and loss account.

Question 18

Omega Equity Investments Ltd., wants to re-classify its investments in accordance with AS 13. State the values, at which the investments have to be reclassified in the following cases:

(i) Long term investments in Company A, costing Rs.8.5 lakhs are to be re-classified as current. The company had reduced the value of these investments to Rs.6.5 lakhs to recognize a permanent decline in value. The fair value on date of transfer is Rs.6.8 lakhs.

(ii) Current investment in Company C, costing Rs.10 lakhs are to be re-classified as long term as the company wants to retain them. The market value on date of transfer is Rs.12 lakhs.

(iii) Certain long term investments no longer considered for holding purposes, to be reclassified as currentinvestments. The original cost of these investments was Rs.18 lakhs but had been written down to Rs.12 lakhs to recognize permanent decline as per AS 13. (RTP May 20)

Answer 18

As per AS 13 'Accounting for 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. And where investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer. Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re- classified current investment should be carried at Rs.6.5 lakhs in the books.

(ii) In this case, reclassification of current investment into long-term investments will be made at Rs.10 lakhs as cost is less than its market value of Rs.12 lakhs.

(iii) In this case, the book value of the investment is Rs.12 lakhs, which is lower than its cost i.e.

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Rs.18 lakhs. Here, the transfer should be at carrying amount and hence this re-classified current investment should be carried at Rs.12 lakhs.

Question 19

JVR Limited has made investment of ₹ 97.84 Crores in Equity Shares of QSR Limited in 2016-17. The investment has been made at par. QSR Limited has been in continuous losses for the last 2 years.

Limited is willing to re-assess the carrying amount of its investment in QSR Limited and wish to provide for diminution in value of investment for the year ended 31st March, 2021. Discuss whether the connection of JVR Limited to bring down the carrying Amount of investment in QSR Limited is in accordance with Accounting Standards. (RTP May '22)

Answer 19

The investments are classified into two categories as per AS 13, viz., Current Investments and Long-term Investments. A current Investment is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost and fair value. Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss. A long - term investment is an investment other than a current investment. The investments referred in the question can be classified as long-term investments and long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long-term investment, the carrying amount is reduced to recognize the decline. The contention of the company to bring down the value of investment may be correct if the decline in value is permanent in nature and the reduction in carrying amount may be charged to the statement of profit and loss. 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.

Question 20

Mother Mart Ltd., wants to re-classify its investment in accordance with AS 13. Decide the treatment to be given in each of the following cases assuming that the market value has been determined in an arm's length transaction between knowledgeable and willing buyer and seller:

(i) **A portion of current investments purchased for Rs. 25 lakhs to be reclassified as long-term investments, as the company has decided to retain them. The market value as on the date of balance sheet was Rs. 30 lakhs. The fair value of the investments on the date of transfer is same as the market value on the balance sheet date**

(ii) **Another portion of current investments purchased for Rs. 20 lakhs has to be re- classified as long-term investments. The Fair value of these investments as on the date of the balance sheet was Rs. 12.5 lakhs.**

(iii) **One portion of long-term investments, no longer considered for holding purposes, to be re-classified as current investments. The original cost of these was Rs. 15 lakhs, but had been written down to Rs. 11lakhs to recognize permanent decline as per AS 13.(RTP Nov'22, Old & New SM)**

Answer 20

As per AS 13 'Accounting for Investments', 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. When long-term investments are re-classified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

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(i) In the first case, the market value of the investments is Rs. 30 lakhs, which is higher than its cost i.e. Rs. 25 lakhs. Therefore, the transfer to long term investments should be made at cost i.e. Rs. 25 lakhs

(ii) In the second case, the market value of the investment is Rs. 12.5 lakhs, which is

lower than its cost i.e. Rs. 20 lakhs. Therefore, the transfer to long term investments should be made inthe books at the market value i.e. Rs. 12.5 lakhs. The loss of Rs. 7.50 lakhs (20-12.5) should be charged to Profit and Loss statement.

(iii) In the third case, the book value of the investments is Rs. 11 lakhs, which is lower than its cost, i.e. Rs. 15 lakhs. As the transfer should be at carrying amount, hence this re-classified current investment should becarried at Rs. 11 lakhs.

Question 21

Gowtham Limited invested in shares of another company (with the intention to hold the shares for short-term period) on 30th November, 2021 at a cost of ₹ 4,25,000. It also earlier purchased Gold of ₹ 8,00,000 and Silver of ₹ 3,50,000 on 31st March, 2019.

Market values as on 31st March, 2022, of the above investments are as follows:Shares ₹ 3,50,000

Gold ₹ 10,25,000

Silver ₹ 5,10,000

You are required to explain how will the above investments be shown (individually and in total) in the books of account of Gowtham Limited for the year ending 31st March, 2022 as per the provisions of AS 13. (RTP May 23, Old & New SM) (Same concept different figures RTP Nov'18)

Answer 21

As per AS 13 (Revised) 'Accounting for Investments', for investment in shares - if the investment is purchased with an intention to hold for short-term period (less than one year), then it will be classified as current investment and to be carried at lower of cost and fair value, i.e., in case of shares, at lower ofcost (₹ 4,25,000) and market value (₹ 3,50,000) as on 31 March 2022, i.e., ₹ 3,50,000.

Gold and silver are generally purchased with an intention to hold it for long term period (more than one year) until and unless given otherwise. Hence, the investment in Gold and Silver (purchased on 31st-March, 2019) should continue to be shown at cost (since there is no 'other than temporary' diminution) as on 31st March, 2022, i.e., ₹ 8,00,000 and ₹3,50,000 respectively, though their market values have been increased.

Thus the shares, gold and silver will be shown at ₹ 3,50,000, ₹ 8,00,000 and

₹ 3,50,000 respectively and hence, total investment will be valued at ₹ 15,00,000 for the year ending on 31st March, 2022 as per AS 13.

Question 22

Following transactions of Meeta took place during the financial year 2020 -21:

1st April, 2020	Purchased ₹ 4,500 8% bonds of ₹ 100 each at ₹ 80.50 cum-interest. Interest is payable on 1st November and 1st May.

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1st May, 2020	Received half year's interest on 8% bonds.
10 July, 2020	Purchased 6,000 equity shares of ₹ 10 each in Kamal Limited for ₹ 44 each through a broker, who charged brokerage @ 2%.
1st October 2020	Sold 1,125 8% bonds at ₹ 81 Ex-interest.
1st November, 2020	Received half year's interest on 8% bonds.
15th January, 2021	Received 18% interim dividend on equity shares of Kamal Limited.
15th March, 2021	Kamal Limited made a rights issue of one equity share for every fourEq-uity shares held at ₹ 5 per share. Meeta exercised the option for 40% of her entitlements and sold the balance rights in the market at ₹ 2.25 per share.

Prepare separate investment account for 8% bonds and equity shares of Kamal Limited in the books of Meeta for the year ended on 31st March, 2021. Assume that the average cost method is followed.(RTP Nov 21, PYP Nov '18 , 10Marks)

Answer 22

In the books of Meeta

8% Bonds for the year ended 31st March, 2021

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
2020 1 April, Oct. 1	To Bank A/c	4,500	15,000	3,47,250	1 May 2020	By Bank-Interest	-	18,000	
2021 March 31	To P & L A/c (W.N.1)	-	-	4,312.50	1 Oct. 2020	By Bank A/c	1,125	3,750	91,125
	To P & L A/c		20,250		1 Nov. 2021	By Bank-Interest		13,500	
					2021 Mar. 31	By Balance c/d (W.N.2)	3,375	-	2,60,437.50
		4,500	35,250	3,51,562.50			4,500	35,250	3,51,562.50

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Investment in Equity shares of Kamal Ltd. for the year ended 31 st March, 2021

Date	Particu-lars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
2020 July 10	To Bank A/c	6,000	--	2,69,280	2021 Jan 15	By Bank – dividend	-	10,800	2,72,280
2021 March 15	To Bank A/c (W.N. 3)	600	-	3,000	March 31	By Balance c/d (bal. fig.)	6,600		
March 31	To P & L A/c	-	10,800						
		6,600	10,800	2,72,280			6,600	10,800	2,72,280

Working Notes:

- **Profit on sale of 8% Bonds**

Sales price ₹ 91,125

Less: Cost of bonds sold = 3,47,250/4,500x 1,125 (₹ 86,812.50)Profit on sale ₹ 4,312.50

- **Closing balance as on 31.3.2021 of 8 % Bonds**

  3,47,250/4,500x 3,375= ₹ 2,60,437.50

- **Calculation of right shares subscribed by Kamal Ltd.**

Right Shares = 6,000/4 x 1= 1,500 shares

Shares subscribed by Meeta = 1,500 x 40%= 600 shares

Value of right shares subscribed = 600 shares @ ₹ 5 per share = ₹ 3,000

- **Calculation of sale of right entitlement by Kamal Ltd.**

No. of right shares sold = 1,500 – 600 = 900 rights for 2,025

Note: As per para 13 of AS 13, sale proceeds of rights are to be credited to P & L A/c.

Question 23

On 1st April, 2019 Mr. Shyam had an opening balance of 1000 equity shares of X Ltd Rs. 1,20,000 (face value Rs.100 each). On 5.04.2019 he further purchased 200 cum-right shares for Rs. 135 each. On 8.04.2019 the director of X Ltd announced right issue in the ratio of 1:6.

Mr. Shyam waived off 100% of his entitlement of right issue in the favour of Mr. Rahul at the rate of Rs. 20 each. All the shares held by Shyam had been acquired on cum right basis and the total market price (ex-right) of all these shares after the declaration of rights got reduced by Rs. 3,400. On 10.10.2019 Shyam sold 350 shares for Rs. 140 each. 31.03.2020 The market price of each share is Rs. 125

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each. You are required to prepare the Investment account in the books of Mr. Shyam for the yearended 31.03.2020 assuming that the shares are being valued at average cost. (RTP May '21)

Answer 23

In the books of Mr. Shyam

for the year ending on 31-3-2020 (Scrip: Equity Shares of X Limited)e 203

1.4.2019	To Balanceb/d	1000	1,20,000	8.04.2019	By Bank A/c (W.N.1)		3,400
5.04.2019	To Bank (200x Rs.135)	200	27,000	10.10.2019	By Bank A/c (350x Rs.140)	350	49,000
10.10.2019	To Profit & Loss A/c (W.N.2)		7,117	31.3.2020	By Balance c/d (W.N.3)	850	1,01,717
		1200	1,54,117			1200	1,54,117

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Working Notes:

1. Sale of Rights Rs. 4,000

The market price of all shares of X Ltd after shares becoming ex-rights has been reduced by Rs. 3,400

In this case out of sale proceeds of Rs.4,000; Rs. 3,400 may be applied to reduce the carryingamount to the market value and Rs. 600 would be credited to the profit and loss account.

2. Profit on sale of 350 shares

		Amount	
Sale price of 350 shares	(350 shares X 140 each)	Rs.	49,000
Less: Cost of 350 shares [(1,20,000+27,000-3,400) X350]/1200		Rs.	41,883
Profit		Rs.	7,117

3. Valuation of 850 shares as on 31.03.2020

Particulars	Amount
Cost price of 850 shares [(1,20,000 +27,000 -3,400) x 850 /1,200]	Rs. 1,01,717
Fair Value as on 31.03.2020 [850 X Rs. 125 each]	Rs. 1,06,250
Cost price or fair value whichever is less	Rs. 1,01,717

Question 24

(a) In 2018, Royal Ltd. issued 12% fully paid debentures of ₹ 100 each, interest being payable half yearly on 30th September and 31st March of every accounting year. On 1st December, 2019, M/s. Kumar purchased 10,000 of these debentures at ₹ 101 (cum-interest) price. On 1st March, 2020 the firm sold all of these debentures at ₹ 106 (cum-interest) price. You are required to prepare Investment (Debentures) Account in the books of M/s. Kumar for the period 1st December, 2019 to 1st March, 2020. (Nov 20)

(b) Mr. X acquires 200 shares of a company on cum-right basis for ₹ 60,000. He subsequently receives anoffer of right to acquire fresh shares in the company in the proportion of 1:1 at ₹ 105 each. He does not subscribe but sells all the rights for ₹ 15,000. The market value of the shares after their becoming ex-rights has also gone down to ₹ 50,000. What should be the accounting treatment in this case? (RTPNov 20)

Answer 24

Investment Account in the books of M/s Kumar for the period from 1st December 2019 to 1st March, 2020(Scrip: 12% Debentures of Royal Ltd.)

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Date	Particu-lars	Nom-inal Value (₹)	Inter-est	Cost (₹)	Date	Particu-lars	No-mina l Value (₹)	Interest	Cost (₹)
1.12.2019	To Bank A/c (W.N.1)	10,00,00	20,000	9,90,000	1.03.2020	By Bank A/c	10,00,00	50,000	10,10,00
1.3.2020	To Profit & loss A/c	0	30,000			(W.N.2)	0		0 Page
				20,000					
		10,00,00 0	50,000	10,10,000			10,00,00 0	50,000	10,10,00 0

Working Notes:		
(i) Cost of 12% debentures purchased on 1.12.2019		₹
Cost Value (10,000 X ₹101)	=	10,10,000
Less: Interest (10,000 x 100 x12% x 2/12)	=	(20,000)
Total	=	9,90,000
(ii) Sale proceeds of 12% debentures sold on 1st March, 2020		₹
Sales Price (10,000 X ₹106)	=	10,60,000
Less: Interest (10,000 x 100 x12% x 5/12)	=	(50,000)
Total	=	10,10,000

As per AS 13, where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value. In this case, the amount of the ex-right market value of 200 shares bought by X immediately after the declaration of rights falls to ₹50,000. In this case, out of sale proceeds of ₹ 15,000, ₹ 10,000 may be applied to reduce the carrying amount to bring it to the market value ₹50,000 and ₹ 5,000 would be credited to the profit and loss account.

Question 25

Meera carried out the following transactions in the shares of Kumar Ltd.:

(1) On 1st April, 2019 she purchased 40,000 equity shares of Rs.1 each fully paid up for Rs.60,000.

(2) On 15th May 2019, Meera sold 8,000 shares for Rs.15,200.

(3) At a meeting on 15th June 2019, the company decided:

(i) To make a bonus issue of one fully paid up share for every four shares held on 1st June 2019 and

(ii) To give its members the right to apply for one share for every five shares held on 1st June

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2019 at a price of Rs.1.50 per share of which 75 paise is payable on or before 15th July 2019 and the balance, 75 paise per share, on or before 15th September, 2019.

The shares issued under (i) and (ii) were not to rank for dividend for the year ending 31st December 2019.

(a) Meera received her bonus shares and took up 4,000 shares under the right issue, paying thesum thereon when due and selling the rights of the remaining shares at 40 paise per share; the proceeds were received on 30th September 2019.

(b) On 15th March 2020, she received interim dividend from Kumar Ltd. of 15 per cent in respectof the current financial year.

(c) On 30th March 2020, she received Rs.28,000 from the sale of 20,000 shares.

You are required to record these transactions in the Investment Account in Meera's books for the year ended 31st March 2020 transferring any profits or losses on these transactions to Profit and Loss account. Apply average cost basis. Expenses and tax to be ignored. (RTP May 20, MTP 8 Marks Oct '18,MTP 10 Marks Mar'18)

Answer 25

Investment Account (Shares in Kumar Limited) in the books of Meera

Date	Particulars		No. of Shares	Income	Amount	Date	Particulars		No. of Shares	Income	Amount
					Page						
2019				**Rs.**	**Rs.**	**2019**				**Rs.**	Rs.
April 1	To	Bank (Purchases)	40,000	-	60,000	May 15	By	Bank (Sale)	8,000	-	15,200
May 15	To	Profit & Loss A/c (W.N.1)	-	-	3,200						
June15	To	Bonus Issue	8,000	-	Nil	2020					
July 15	To	Bank (@ 75 p. paid on 4,000 shares)	4,000	-	3,000	Mar. 15	By	Bank (Dividend @ 15% on Rs.32,000)		4,800	-
Sept.	To	Bank (@ 75 p. paid on 4,000 shares)	-	-	3,000	Mar. 30	By	Bank (Sale)	20,000	-	28,000
2020 Mar. 31	To	Profit & Loss A/c (W.N.2)			3,455	Mar. 31	By	Balance c/d*	24,000	-	29,455
	To	Profit & Loss A/c	-	4,800							
			52,000	4,800	72,655				52,000	4,800	72,655

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*** Working Notes:**

(1)	Profit on Sale on 15-5-2019:		
	Cost of 8,000 shares @ Rs.1.50	Rs.12,000	
	Less: Sales price	Rs.15,200	
	Profit		Rs.3,200
(2)	Cost of 20,000 shares sold:		
	Cost of 44,000 shares (48,000 + 6,000)		Rs.54,000
Cost of 20,000 shares			Rs.24,545
Profit on sale of 20,000 shares (Rs.28,000 – Rs.24,545)			Rs. 3,455

Question 26

A Pvt. Ltd. follows the calendar year for accounting purposes. The company purchased 5,000 (nos.) 13.5% Convertible Debentures of Face Value of Rs.100 each of P Ltd. on 1st May 2018 @ Rs.105 on cum interest basis. The interest on these instruments is payable on 31st March & 30th Septemberrespectively. On August 1st 2018 the company again purchased 2,500 of such debentures @ Rs.102.50each on cum interest basis. On 1st October, 2018 the company sold 2,000 Debentures @ Rs.103 each.On 31st December, 2018 the company received 10,000 equity shares of Rs.10 each in P Ltd. on conversion of 20% of its holdings. Interest for 3 months on converted debentures was also received on 31.12.2018. The market value of the debentures and equity shares as at the close of the year were Rs.106 and Rs.9 respectively. Prepare the Debenture Investment Account & Equity Shares Investment Account in the books of A Pvt. Ltd. for the year 2018 on Average Cost Basis. (RTP Nov 19)(Similar to May 18 but includes additional adjustments)

Answer 26

Books of A Pvt. Ltd.

Investment in 13.5% Convertible Debentures in P Ltd. Account(Interest payable 31st March & 30th September)

Date	Particulars	Nominal	Interest	Amount	Date	Particulars	Nominal	Interest	Amount
		₹	₹	₹			₹	₹	₹
2018					2018				Page
May 1	To Bank	5,00,000	5,625	5,19,375	Sept. 30	By Bank (6 months Int)		50,625	

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Aug.1	To Bank	2,50,000	11,250	2,45,000	Oct.1	By Bank	2,00,000		2,06,000
Oct.1	To P&L A/c			2,167					
Dec. 31	To P&L A/c		52,313		Dec. 31	By Equity share	1,10,000		1,12,108
					Dec. 31	By Bank (See note1)		3,713	
					Dec. 31	By Balance c/d	4,40,000	4,850	4,48,434
		7,50,000	69,188	7,66,542			7,50,000	69,188	7,66,542

Note 1: Rs.3,713 received on 31.12.2018 represents interest on the debentures converted till date ofconver-sion.Note 2: Cost being lower than Market Value the debentures are carried forward at Cost.

Investment in Equity shares in P Ltd. Account

Date	Particulars	Nominal	Amount	Date	Particulars	Nominal	Amount
		₹	₹			₹	₹
2018	To 13.5% Deb.	1,00,000	1,12,108	2018			
Dec 31				Dec.31	By P&L A/c		22,108
				Dec.31	By Bal. c/d	1,00,000	90,000
		1,00,000	1,12,108			1,00,000	1,12,108

Note 1: Cost being higher than Market Value the shares are carried forward at Market Value.

Working Notes:

1. Interest paid on Rs.5,00,000 purchased on May 1st, 2018 for the month of April 2018,as part of purchase price: 5,00,000 x 13.5% x 1/12 = Rs.5,625
2. Interest received on 30th Sept. 2018

   On Rs.5,00,000 = 5,00,000 x 13.5% x ½ = 33,750On Rs.2,50,000 = 2,50,000 x 13.5% x ½ = 16,875

   Total Rs.50,625
3. Interest paid on Rs.2,50,000 purchased on Aug. 1st 2018 for April 2018 to July 2018as part of purchase price:

   2,50,000 x 13.5% x 4/12 = Rs.11,250
4. Loss on Sale of Debentures Cost ofacquisition

   (Rs.5,19,375 + Rs.2,45,000) x Rs.2,00,000/Rs.7,50,000 = 2,03,833

Less: Sale Price (2,000 x 103)	=	2,06,000
Profit on sale	=	Rs. 2,167

5. Interest on 1,100 Debentures (being those converted) for 3 months i.e. Oct-Dec. 2018 1,10,000 x 13.5% x 3/12 = Rs.3,713

6. Cost of Debentures converted to Equity Shares

   (Rs.5,19,375 + Rs.2,45,000) x 1,10,000/7,50,000= Rs.1,12,108

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7. Cost of Balance Debentures

(Rs.5,19,375 + Rs.2,45,000) x Rs.4,40,000/Rs.7,50,000 = Rs.4,48,434

8. Interest on Closing Debentures for period Oct.- Dec. 2018 carried forward (accrued interest) Rs.4,40,000 x 13.5% x 3/12 = Rs.14,850

Question 27

Mr. Wise had 12% Debentures of Face Value ₹ 100 of Alpha Ltd. as current investments. He provides the following details relating to the investments.

1-4-2020 Opening balance 4,000 debentures costing ₹ 98 each

1-6-2020 Purchased 2,000 debentures @ ₹ 120 cum interest

1-9-2020	**Sold 3,000 debentures @ ₹ 110 cum interest**
1-12-2020	**Sold 2,000 debentures @ ₹ 105 ex interest**
31-1-2021	**Purchased 3,000 debentures @ ₹ 100 exinterest**
31-3-2021	**Market value of the investments ₹ 105 each**

Interest due dates are 30th June and 31st December. Mr. Wise closes his books on 31-3-2021. He incurred 2% brokerage for all his transactions. Show investment account in the books of Mr. Wise assuming FIFO method is followed. (RTP May '22)

Answer 27

Investment A/c of Mr. Wise

for the year ending on 31-3-2021 (Scrip: 12% Debentures of Alpha Limited (Interest Payable on 30th June and 31st December) **Amount in ₹**

Date	Particulars	Nominal Value	Interest	Cost	Date	Particulars	Nominal Value	Interest	Cost

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1.4.2020	To Balance b/d	4,00,000	12,000	3,92,000	30.6.2020	By Bank (6,00,000 x	-	36,000	-
						6%)			
1.6.2020	To Bank	2,00,000	10,000	2,34,800	1.9.2020	By Bank	3,00,000	6,000	3,17,400
1.9.2020	To Profit & Loss A/c			23,400	1.12.2020	By Bank	2,00,000	10,000	2,05,800
31.1.2021	To Bank	3,00,000	3,000	3,06,000	1.12.2020	By Profit & Loss a/c	-	-	9,600
31.3.2021	To Profit & Loss A/c (Bal. fig.)		45,000		31.12.20	By Bank (1,00,000 x 6%)	-	6,000	-
					31.3.2021	By Profit & Loss A/c	-	-	3,400
					31.3.2021	By Balance c/d	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 31.3.2021

	₹	
Market value of 4,000 Debentures at ₹ 105		4,20,000
Cost price of 1,000 debentures at	1,17,400	
3,000 debentures at	3,06,000	4,23,400

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

2. **Profit on sale of debentures as on 1.9.2020**

	₹
Sales price of debentures (3,000 x ₹ 110)	3,30,000
Less: Brokerage @ 2%	(6,600)
	3,23,400
Less: Interest for 2 months	(6,000)
Less: Cost price of Debentures	(2,94,000)
Profit on sale	23,400

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3. Loss on sale of debentures as on 1.12.2020

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

4. Purchase Cost of 2,000 debentures on 1.6.2020

	₹
2000 Debentures @₹ 120 cum interest	2,40,000
Add: Brokerage @ 2%	4,800
	2,44,800
Less: Interest for 5 months	(10,000)
Purchase cost of 2,000 debentures	2,34,800

5. Sale value for 3,000 debentures on 1.9.2020

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

Question 28

Alpha Ltd. purchased 5,000, 13.5% Debentures of Face Value of ₹ 100 each of Pergot Ltd. on 1st May 2021 @ ₹ 105 on cum interest basis. The interest on these debentures is payable on 31st & 30th of March & September respectively. On August 1st 2021 the company again purchased 2,500 of such debentures @ ₹ 102.50 each on cum interest basis. On October 1st, 2021 the company sold 2,000 Debentures @ ₹ 103 each on ex- interest basis. The market value of the debentures as at the close ofthe year was ₹ 106. You are required to prepare the Investment in Debentures Account in the books of Alpha Ltd. for the year ended 31st Dec. 2021 on Average Cost Basis. (RTP Nov'22, MTP 8 Marks , Nov '21)

Answer 28

Books of Alpha Ltd.

Investment in 13.5% Debentures in Pergot Ltd. Account (Interestpayable on 31st March & 30th September)

Date	Particulars	Nominal	Interest	Amount	Date	Particulars	Nominal	Interest	Amount
2021		₹	₹	₹	2021		₹	₹	₹

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May 1	To Bank	5,00,000	5,625	5,19,375	Sept.30	By Bank		50,625	
						(6 months Int)			
Aug.1	To Bank	2,50,000	11,250	2,45,000	Oct.1	By Bank	2,00,000		2,06,000
Oct.1	To P&L A/c			2,167					
Dec.31	To P&L A/c		52,313						
					Dec.31	By Balance c/d	5,50,000	18,563	5,60,542
		7,50,000	69,188	7,66,542			7,50,000	69,188	7,66,542

Note: Cost being lower than Market Value the debentures are carried forward at Cost.Working

Notes:

1. nterest paid on ₹ 5,00,000 purchased on May 1st, 2021 for the month of April 2021, as part ofpurchase price: 5,00,000 x 13.5% x 1/12 = ₹ 5,625

2. Interest received on 30th Sept. 2021

On ₹ 5,00,000 = 5,00,000 x 13.5% x ½ = 33,750

On ₹ 2,50,000 = 2,50,000 x 13.5% x ½ = 16,875

Total ₹ 50,625

3. Interest paid on ₹ 2,50,000 purchased on Aug. 1st 2021 for April 2021 to July 2021 as part ofpurchase price:

2,50,000 x 13.5% x 4/12 = ₹ 11,250

4. Loss on Sale of Debentures Cost of acquisition

(₹ 5,19,375 + ₹ 2,45,000) x ₹ 2,00,000/₹ 7,50,000 = 2,03,833

Less: Sale Price (2,000 x 103) = 2,06,000Profit on sale= ₹ 2,167

5. Cost of Balance Debentures

(₹ 5,19,375 + ₹ 2,45,000) x ₹ 5,50,000/₹ 7,50,000 = ₹ 5,60,542

6. Interest on Closing Debentures for period Oct.-Dec. 2021 carried forward (accrued interest)

₹ 5,50,000 x 13.5% x 3/12 = ₹ 18,563

Question 29

Remo Ltd. held on 1st April, 2021, 1000 9% Government Securities at ₹ 90,000 (Face Value of Security ₹ 100 each). Three month's interest had accrued on the above date. On 1 st May, the company purchased the same Government Securities of the face value of ₹ 80,000 at ₹ 95 cum-interest. On 1st June, ₹ 60,000 face value of the security was sold at ₹ 94 cum-interest. Interest on the security was paid each year on 30 th June and 31st December and was credited by the bank on the same date.

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On 30th September, ₹ 40,000 face value of the Govt. securities were sold at ₹ 97 cum-interest. On 1st December, the company purchased the same security ₹ 10,000 at par ex-interest. On 1st March, the company sold ₹ 10,000 face value of the government securities at ₹ 95 ex- interest.

You are required to draw up the 9% Government Security Account in the books of Remo Limited. FIFO method shall be followed.

Calculation shall be made to the nearest rupee or multiple thereof. (RTP May 23)

Answer 29

In the Books of Remo Ltd.

9% Government Securities (Investment) Account

		Face Value	Interest	Cost	Particulars		Face Value	Inter-est	Cost
2021		₹	₹	₹	2021		₹	₹	₹
April 1	To Balance b/d	1,00,000	2,250	90,000	June 1	By Bank A/c	60,000	2,250	54,150
May 1	To Bank A/c	80,000	2,400	73,600	June 30	By Bank A/c	-	5,400	-
June 1	To P&L A/c	-	-	150	Sept. 30	By Bank A/c	40,000	900	37,900
Sept. 30	To P & L A/c	-	-	1,900	Dec. 31	By Bank A/c	-	4,050	-
Dec. 1	To Bank A/c	10,000	375	10,000	Mar.1 2022	By Bank A/c	10,000	150	9,500
Mar. 1 2022	To P&L A/c	-	-	300	Mar. 31 2022	ByBalance c/d	80,000	1,800	74,400
Mar. 31, 2022	To P&L A/c (Transfer)	-	9,525	-					
		1,90,000	14,550	1,75,950			1,90,000	14,550	1,75,950

Working Notes:1.

1. Interest accrued on 1st April 2021 = ₹1,00,000 x 9% x 3/12 = ₹ 2,250
2. Accrued Interest on 800 units as on 01 05.2021 = ₹ 80,000 x 9/100 x 4/12 = ₹ 2,400
3. Cost of Investment for purchase on 01.05.2021 = ₹ 76,000 - ₹ 2,400 = ₹ 73,600
4. Accrued Interest on 600 units as on 01 06.2021 = ₹ 60,000 x 9/100 x 5/12 = ₹ 2,250
5. Profit on Securities sold on 1st June = ₹ 54,150 (56,400 – 2,250)- ₹ 54,000 (60,000 x 90,000/1,00,000) = ₹ 150
6. Interest received on 30 06.2021 = ₹1,20,000 x 9/100 x 6/12 = ₹ 5,400

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7. Accrued Interest on 400 units as on 30 09.2021 = ₹ 40,000 x 9/100 x 3/12 = ₹ 900
8. Cost of 400 Govt. Securities sold on 30.09.2021 = 40,000 x 90,000/1,00,000 = ₹ 36,000
9. Profit on securities sold on 30th September = ₹37,900 (38,800-900) - ₹ 36,000 = ₹ 1,90010. Accrued Interest on 1 12.2021 = ₹ 10,000 x 9/100 x 5/12 = ₹ 375
11. Interest received on 31 12.2021 = ₹ 90,000 x 9/100 x 6/12 = ₹ 4,050
12. Accrued Interest on 100 units as on 01 03.2022 = ₹ 10,000 x 9/100 x 2/12 = ₹ 150 13. Cost of 100 Govt. Securities sold on 01.03.2022 = ₹ 10,000 x 73,600/80,000 = ₹ 9,200
14. Profit on securities sold on 01.03.2022 = ₹ 9,500 - ₹ 9,200 = ₹ 300 15

Calculation of closing balance:	Units	₹
Securities in hand remained in hand at 31/3/2022		
From original holding (1,00,000 – 60,000 – 40,000)		-
Purchased on 1st May (80,000 – 10,000)	70,000	64,400
Purchased on 1st December	10,000	10,000
	80,000	74,400

Question 30

A Limited invested in the shares of XYZ Ltd. on 1st December, 2019 at a cost of ₹ 50,000. Out of these shares, ₹ 25,000 shares were purchased with an intention to hold for 6 months and ₹ 25,000 shares were purchased with an intention to hold as long-term Investment.

A Limited also earlier purchased Gold of ₹ 1,00,000 and Silver of ₹ 30,00,000 on 1st April, 2019.Market value as on 31st March, 2020 of above investments are as follows:

Shares ₹ 47,500 (Decline in the value of shares is temporary.)Gold ₹ 1,80,000

Silver₹ 30,55,000

How above investments will be shown in the books of accounts of M/s A Limited for the year ended 31st March, 2020 as per the provisions of AS 13 (Revised)? (PYP 5 Marks Nov '20)

Answer 30

As per AS 13 (Revised) 'Accounting for Investments, for investment in shares - if the investment is purchased with an intention to hold for short-term period (less than one year), then it will be classified as current investment and to be carried at lower of cost and fair value.

In the given case ₹ 25,000 shares held as current investment will be carried in the books at ₹ 23,750 (₹ 47,500/2).

If equity shares are acquired with an intention to hold for long term period (more than one year), then should be considered as long-term investment to be shown at cost in the Balance Sheet of the company.However, provision for diminution should be made to recognize a decline, if other than temporary, in the value of the investments. Hence, ₹ 25,000 shares held as long-term investment will be carried in the books at ₹ 25,000.

Gold and silver are generally purchased with an intention to hold them for long term period (more than one year) until and unless given otherwise.

Hence, the investment in Gold and Silver (purchased on 1st March, 2019) should continue to be shown at cost (since there is no 'other than temporary' diminution) as on 31st March, 2020. Thus Gold at

₹ 1,00,000 and Silver at ₹ 30,00,000 respectively will be shown in the books.

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Question 31

Kunal Securities Ltd. wants to reclassify its investments in accordance with AS-13 (Revised). State the values, at which the investments have to be reclassified in the following cases:

(i) Long term investment in Company A, costing ₹ 10.5 lakhs is to be re-classified as current investment. The company had reduced the value of these investments to₹ 9 lakhs to recognize a permanent decline in value. The fair value on the date of reclassification is ₹ 9.3 lakhs.

(ii) Long term investment in Company B, costing ₹ 14 lakhs is to be re-classified as current investment The fair value on the date of reclassification is ₹ 16 lakhs and book value is ₹ 14 lakhs.

(iii) Current investment in Company C, costing ₹12 lakhs is to be re-classified as long term investment as the company wants to retain them. The market value on the date of reclassification is ₹ 13.5 lakhs. Current investment in Company D, costing ₹ 18 lakhs is to be re-classified as long term investment. The market value on the date of reclassification is ₹ 16.5 lakhs. (PYP 5 Marks Jan '21, Old & New SM)(MTP 5 Marks Sep '23)

Answer 31

As per AS 13 (Revised) 'Accounting for 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.And where investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹ 9 lakhs in the books.

(ii) The carrying / book value of the long-term investment is same as cost i.e., ₹ 14 lakhs. Hence this-long-term investment will be reclassified as current investment at book value of ₹ 14 lakhs only.

(iii) In this case, reclassification of current investment into long-term investments will be made at ₹ 12lakhs as cost are less than its market value of ₹ 13.5 lakhs.

(iv) Market value of the investment is ₹ 16.5 lakhs, which is lower than its cost i.e., ₹ 18 lakhs. Therefore,

the transfer to long term investments should be done in the books at the market value i.e., ₹ 165 lakhs.

Question 32

On 15th June, 2018, Y limited wants to re-classify its investments in accordance with AS 13 (revised). Decide and state the amount of transfer, based on the following information:

(1) A portion of long term investments purchased on 1st March, 2017 are to be re-classified as current investments. The original cost of these investments was Rs. 14 lakhs but had been written down by Rs. 2 lakhs (to recognise 'other than temporary' decline in value). The market value of these investments on 15th June, 2018 was Rs. 11 lakhs.

(2) Another portion of long term investments purchased on 15th January, 2017 are to be re-classified as current investments. The original cost of these investments was Rs. 7 lakhs but had been written down to Rs. 5 lakhs (to recognize 'other than temporary' decline in value). The fair value of these investments on 15th June, 2018 was Rs. 4.5 lakhs.

(3) A portion of current investments purchased on 15th March, 2018 for Rs. 7 lakhs are to be

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re-classified as long term investments, as the company has decided to retain them. The market value of these investments on 31st March, 2018 was Rs. 6 lakhs and fair value on 15th June 2018 was Rs. 8.5 lakhs.

(4) Another portion of current investments purchased on 7th December, 2017 for Rs. 4 lakhs are to be re- classified as long term investments. The market value of these investments was : on 31st March, 2018 Rs. 3.5 lakhson 15th June, 201 Rs. 3.8 lakhs(PYP May '19, 5 Marks)

Answer 32

As per AS 13 (Revised) 'Accounting for 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; and where investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at Rs. 12 lakhs in the books.

(ii) In this case also, carrying amount of investment on the date of transfer is less than the cost; hence thisre-classified current investment should be carried at Rs. 5 lakhs in the books.

(iii) In this case, reclassification of current investment into long-term investments will be made at Rs. 7 lakhsas cost is less than its fair value of Rs.8.5 lakhs on the date of transfer.

* (Rs. 8,56,667 - Rs. 2,00,000)

** Considering that Rs. 13,00,000 was debited to Building WIP A/c earlier.

(iv) In this case, market value (considered as fair value) is Rs. 3.8 lakhs on the date of transfer which is lower than the cost of Rs. 4 lakhs. The reclassification of current investment into long-term investments will bemade at Rs. 3.8 lakhs.

Question 33

Mr. Mohan has invested some money in various Mutual funds. Following information in this regard is given:

Mutual Funds	Date ofpurchase	Purchase cost (₹)	Brokerage Cost (₹)	Stampduty (₹)	Market value as on31.03.2021 (₹)
A	01.05.2017	50,000	200	20	48,225
B	05.08.2020	25,000	150	25	24,220
C	01.01.2021	75,000	300	75	78,190
D	07.05.2020	70,000	275	50	65,880

You are required to:

1. **Classify his investment in accordance with AS-13 (revised).**
2. **Value of Investment in mutual fund as on 31.03.2021(PYP 5 Marks , Dec '21)**

Answer 33

As per AS "Accounting for Investments", a current investment is an investment that is by its nature
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readily realizable and is intended to be held for not more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost and fair value.

A long-term investment is an investment other than a current investment. Long term investments are usually carried at cost. If there is a decline, other than temporary, in the value of a long-term investment;the carrying amount is reduced to recognize the decline.

Mutual Funds	Classification	Cost (₹)	Market value (₹)	Carrying value (₹)
A	Long-term Investment	50,220	48,225*	50,220
B	Current Investment	25,175	24,220	24,220
C	Current Investment	75,375	78,190	75,375
D	Current Investment	70,325	65,880	65,880
Total				2,15,695

Note: *The reduction in value of Mutual fund A is considered to be temporary. If reduction in Market value is assumed as other than temporary in nature, then the carrying value of ₹48,225 will be considered.

Question 34

State whether the following statements are 'True' or 'False'. Also give reason for your answer.

As per the provisions of AS-13, a current investment is an investment, that by its nature, is readily realizable and is intended to be held for not more than six months from the date on which such investment is made (PYP 1 Mark May'19)

Answer 34

False: A current investment is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made.

Question 35

(i) **An unquoted long term investment made in the shares of Rachel Limited is carried in the books of Ziva Limited at a cost of ₹ 1,00,000. The audited financial statements of Rachel Limited received in May,2021 showed that the company had been incurring cash losses with declining market share and the long term investment may not fetch more than ₹ 55,000.**

(ii) **On 1st December, 2021 Ziva Limited had made an investment of ₹ 5,00,000 in 4,000 Equity Shares of Garry Limited at a price of ₹ 125 per share with an intention to hold it for not more than six months. In the first week of March, 2022, Garry Limited suffered heavy loss due to an earthquake; the loss was not covered by an insurance policy. On 31st March,2022, the shares of Garry Ltd. were traded at a price of ₹ 80 per share on the Stock Exchange.**

How would you deal with the above investments in the books of Ziva Limited for the year ended 31st March,2022 as per the provisions of Accounting Standard 13 'Accounting for Investments'? (PYP 5 Marks Nov '22)

Answer 35

I. Investments classified as long -term investments should be carried in the financial statements

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at cost. However, provision for diminution should be made to recognize a decline, other than temporary, in the value of the investments, such reduction beingdetermined and made for each investment individually.

On this basis, the facts of the given case, it would be appropriate to reduce the carrying value of Long-term investments to ₹ 55,000 in the financial statements for the year ended 31st March, 2022.Thus the unquoted investment in the shares of Rachel Ltd. will be valued at ₹ 55,000

The provision for diminution amounting ₹ 45,000 should be made to reduce the carryingamount of the investments.

Equity Shares in Garry Ltd. will be considered as current investment as intended to hold for not more than six months. As per AS 13, "Accounting for Investments", carrying amount for current. investments is the lower of cost and fair value. In respect of current Investments for which as active market exists, market value generally provides the best evidence of fair value.

Since on 31st March,2022, the shares of Garry Limited were trading at a price of ₹ 80 per share on the stock exchange, the equity shares of Garry Ltd. should be carried in the financial statements at realizable value i.e. at ₹ 3,20,000 (4,000 shares @ ₹ 80 per share).The reduction of ₹ 1,80,000 in carrying value of current investment will be charged to the statement of profit and loss for the year ended 31 st March,2022.

Question 36

Mr. Harsh provides the following details relating to his holding m 10% debentures (face value of Rs. 100 each) of Exe Ltd., held as current assets:

1.4.2018	**opening balance - 12,500 debentures, cost Rs. 12,25,000**
1.6.2018	**purchased 9,000 debentures @ Rs. 98 each ex-interest**
1.11.2018	**purchased 12,000 debentures @ Rs. 115 each cum-interest**
31.1.2019	**sold 13,500 debentures @ Rs. 110 each cum-interest**
31.3.2019	**Market value of debentures @ Rs. 115 each**

Due dates of interest are 30th June and 31st December. Brokerage at 1% is to be paid for each transaction.Mr, Harsh closes his books on 31.3.2019. Show investment account as it would appear in his books assuming FIFO method is followed. (PYP Nov.'19,10 Marks)

Answer 36

Investment Account of Mr. Harsh for the year ending on 31-3-2019(Scrip: 10% Debentures of Exe Limited) (Interest Payable on 30th June and 31st December)

Date	Particulars	Nominal Value Rs.	Interest Rs.	CostRs.	Date	Particulars	Nominal Value Rs.	Interest Rs.	CostRs.
1.4.18	To Balance b/d	12,50,000	31,250	12,25,000	30.6.18	By Bank 21,500 x 100 x 10% x 1/2	-	1,07,500	-
1.6.18	To Bank (ex-Interest) (W.N.1)	9,00,000	37,500	8,90,820	31.12.19	By Bank 33,500 x 100 x10% x 1/2		1,67,500	

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1.11.18	To Bank (cum-Interest) (W.N.2)	12,00,000	40,000	13,53,800	31.1.19	By Bank (W.N.3)	13,50,000	11,250	14,58,900
31.1.19	To Profit & Loss A/c (W.N.3)			1,34,920	31.3.19	By Balance c/d	20,00,000	50,000	21,45,640
						(W.N.4)			-
31.3.19	To Profit & Loss A/c (Bal. fig.)		2,27,500						
		33,50,000	3,36,250	36,04,540			33,50,000	3,36,250	36,04,540

Working Notes:

7. **Purchase of debentures on 1.6.18**

Interest element = 9,000 x 100 x 10% x 5/12 = Rs. 37,500

Investment element = (9,000 x 98) + [1%(9,000 x 98)] = Rs. 8,90,820

8. **Purchase of debentures on 1.11.2018**

Interest element = 12,000 x 100 x 10% x 4/12 = Rs. 40,000

Investment element = 12,000 X 115 X 101% less 40,000 = Rs. 13,53,800

9. **Profit on sale of debentures as on 31.1.19**

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	Rs.
Sales price of debentures (13,500 x Rs. 110)	14,85,000
Less: Brokerage @ 1%	(14,850)
	14,70,150
Less: Interest (1,35,000/ 12)	(11,250)
	14,58,900
Less: Cost of Debentures [(12,25,000 + (890820 X 1,00,000/9,00,000)]	(13,23,980)
Profit on sale	1,34,920

Valuation of closing balance as on **31.3.2019:**Market value of 20,000 Debentures at Rs. 115 = Rs. 23,00,000Cost of

8,000 Debentures	=	8,90,820/ 9,000 X 8,000 =	7,91,840
12,000 Debentures	=		13,53,800
Total			21,45,640

Value at the end is Rs. 21,45,640, i.e., which is less than market value of Rs. 23,00,000.

Question 37

Mr. Z has made following transactions during the financial year 2020-21: Investment 1: 8% Corporate Bonds having face value ₹ 100.

Date	Particulars
01-06-2020	Purchased 36,000 Bonds at ₹ 86 cum-interest. Interest is payable on 30th September and 31st March every year
15-02-2021	Sold 24,000 Bonds at ₹ 92 ex-interest

Interest on the bonds is received on 30th September and 31st March.Investment 2 : Equity Shares of G Ltd having face value ₹ 10

Date	Particulars
01-04-2020	Opening balance 8000 equity shares at a book value of ₹ 190 per share
01-05-2020	Purchased 7,000 equity shares@ ₹ 230 on cum right basis; Brokerageof 1% was paid in addition.
15-06-2020	The company announced a bonus issue of 2 shares for every 5 shares held
01-08-2020	The company made a rights issue of 1 share for every 7 shares held at₹ 230 per share. The entire money was payable by 31.08.2020
25-08-2020	Rights to the extent of 30% of his entitlements was sold @ ₹ 75 pershare. The remaining rights were subscribed.

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15-09-2020	**Dividend @ ₹ 6 per share for the year ended 31.03.2020 was receivedon 16.09.2020. No dividend payable on Right issue and Bonus issue.**
01-12-2020	**Sold 7 ,000 shares @ 260 per share. Brokerage of 1% was incurredextra.**
25-01-2021	**Received interim dividend @ ₹ 3 per share for the year 2020-21.**
31-:03-2021	**The shares were quoted in the stock exchange @ ₹ 260.**

Both investments have been classified as Current investment in the books of Mr. Z. On 15th May 2021,Mr. Z decides to reclassify investment in equity shares of Z Ltd. as Long term Investment. On 15th May 2021, the shares were quoted in the stock exchange @ ₹ 180.

You are required to:

Prepare Investment Accounts in the books of Mr. Z for the year 2020-21, assuming that the average cost method is followed. Profit and loss Account for the year 2020-21, based on the above information. Suggest values at which investment in equity shares should be reclassified in accordance with AS 13. [PYP July'21, 20 Marks](MTP 15 Marks Sep '23)

Answer 37

In the books of Mr. Z

Investment in 8% Corporate Bonds Account For the period 01 April 2020 to 31 March 2021

Date	Particulars	Nos	Interest (₹)	Amount (₹)	Date	Particulars	Nos	Interest (₹)	Amount (₹)
1/6/20	To Bank A/c (WN1)	36,000	48,000	30,48,000	30/9/20	By Bank A/c (Interest 36,000 x 100 x 8% x 6/12)		1,44,000	
15/2/21	To Profit & Loss A/c (WN 3)			1,76,000	15/2/21	By Bank A/c (WN2)	24,000	72,000	22,08,000
31/3/21	To Profit & Loss A/c		2,16,000		31/3/21	By Bank A/c (Interest 12,000 x 100 x 8% x 6/12)		48,000	
						By Balance c/d (WN 4)	12,000		10,16,000
	Total	36,000	2,64,000	32,24,000		Total	36,000	2,64,000	32,24,000

Note: For computing the interest on the bonds sold on 15 Feb 2021, if number of days (138 days) is taken instead of months, the interest received on 15.02.2021 should be ₹72,592 and the total interesttransferred to Profit & Loss Account should be ₹ 2,16,592. Wrongly printed as Z Ltd. in the Question paper. It should have been given as G Ltd.

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Investment in Equity Shares of G Ltd

For the period 1st April 2020 to 31 March 2021

Date	Particulars	Nos	Dividend (₹)	Amount (₹)	Date	Particulars	Nos	Dividend (₹)	Amount (₹)
01/4/20	To Balance b/d	8,000		15,20,000	16/9/20	By Bank A/c (WN 7)		48,000	42,000
01/5/20	To Bank A/c (WN 5)	7,000		16,26,100	1/12/20	By Bank A/c (WN 8)	7000		18,01,800
15/6/20	To Bonus Shares	6,000			25/1/21	By Bank A/c (WN 10)		48,300	
25/8/20	To Bank A/c (Right Shares) (WN 6)	2,100		4,83,000					
01/12/20	To Profit & Loss A/c (Sale of shares) (WN 9)			7,14,800					
31/3/21	To Profit & Loss A/c		96,300		31/3/21	By Balance c/d (WN 11)	16,100		25,00,100
	Total	23,100	96,300	43,43,900		Total	23,100	96,300	43,43,900

Working Notes

1. Computation of the Interest element in the bonds purchased on 01 June 2020

No of Bonds purchased 36,000

Face value per bond	₹ 100
Face value of the bonds purchased	₹ 36,00,000
Interest Rate	8%
Interest Amount	36,00,000 x 8% x 2/12
	₹ 48,000
Cum-interest per bond	₹ 86
Value of bond excluding interest	36,000 x 86 – 48,000

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	₹ 30,48,000

2. Computation of the Interest element in the bonds sold on 15 Feb 2021

No of Bonds sold	24,000
Face value per bond	₹ 100
Face value of the bonds sold	₹ 24,00,000
Interest Rate	8%
Interest Amount	24,00,000 x 8% x 4.5/12 = ₹ 72,000

3. Computation of Profit on Sale of Bonds on 15 Feb 2021

No of Bonds sold	24,000
Face value per bond	₹ 100
Ex- interest Rate per bond	₹ 92
Sales proceeds	₹ 22,08,000
Average Cost of Bonds	(30,48,000/36,000) x 24,000
	₹ 20,32,000
Profit on sale of bonds	Sale Proceeds – Average Cost
	22,08,000 – 20,32,000
	₹ 1,76,000

4. Valuation of Bonds as on 31 March 2021

No of Bonds held as on 31 Mar 2021	12,000
Average Cost of Bonds	(30,48,000/36,000) x 12,000
	₹ 10,16,000

5. Computation of the cost of the equity shares purchased on 01 May 2020

No of shares purchased	7,000
Cum right price per share	₹ 230
Cost of purchase	₹ 16,10,000
Brokerage @1%	₹ 16,100
Cost including brokerage	₹ 16,26,100

6. Right Shares

No of Right Shares Issued	(8,000+7,000+6,000)/7 = 3,000 shares
No of right shares sold	3,000 shares x 30% = 900 shares
Proceeds from sale of right shares to be credited to statement of profit& loss	900 shares x ₹ 75 = ₹ 67,500
No of right shares subscribed	3,000-900 = 2,100 shares
Amount of right shares subscribed	2,100 x 230 = ₹ 4,83,000

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7. Computation of Dividend Received on 16 Sept 2020

No of shares held during the period of dividend	8,000 shares
Dividend per share	₹ 6
Dividend Amount	8,000 x 6 = ₹ 48,000
No of shares received after the period of dividend (Excluding bonus & right shares)	7,000 shares

Dividend per share	₹ 6
Dividend Amount	7,000 x 6 = ₹ 42,000

The amount of dividend for the period for which the shares were not held by the investor has been treated as capital receipt. Thus ₹ 42,000 shall be treated as capital receipt.

8. Sale Proceeds for the shares sold on 1st Dec. 2020

No of shares sold	7,000 Shares
Sale price per share	₹ 260
Proceeds from sale of share	7,000 x 260 = ₹ 18,20,000
Less: Brokerage @ 1%	₹ 18,200
Net Sale Proceeds	₹ 18,01,800

9. Profit on sale of shares on 1st Dec. 2020

Sales Proceeds	₹ 18,01,800
Average Cost	(15,20,000+16,26,100+4,83,000-42,000)/23,100x7000
	= ₹ 10,87,000
Profit on sale of shares	Sales Proceeds – Average Cost
	= ₹ 18,01,800-10,87,000 = ₹ 7,14,800

10. Computation of Amount of Interim Dividend

No of shares held	8,000+7,000+6,000+2,100-7,000
	= 16,100
Dividend per share	₹ 3 per share
Dividend Received	16,100 shares x ₹ 3 per share
	= ₹ 48,300

11. Valuation of Shares as on 31 March 2021

Cost of Shares	(15,20,000 + 16,26,100 + 4,83,000 – 42,000) / 23,100 x 16,100
	= 25,00,100
Market Value of Shares	₹ 260 x 16,100 = ₹ 41,86,000

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Closing stock of equity shares has been value at ₹ 25,00,100 i.e. cost being low-erthan its market value.	

II. Profit & Loss Account (Extract)

For the period 01 April 2020 to 31 March 2021

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance c/d	12,70,600	By Investment in 8% Corporate Bonds Account (Profit on sale of bonds)	1,76,000
		By Investment in 8% Corporate Bonds Account (Interest on bonds)	2,16,000
		By Sale of Right Shares	67,500
		By Investment in Equity Shares of G Ltd (Profit on sale of shares)	7,14,800
		By Investment in Equity Shares of G Ltd (Dividend Income)	96,300

III. As per AS 13, when investments are classified from Current Investments to Long term Investments, transfer is made at Cost and Fair value, whichever is less (as on the date of transfer). So, in the given case valuation shall be done as follows:

Date of reclassification/transfer – 15 May 2021 Per Unit Cost of 16,100 shares held – ₹ 25,00,100/16,100 shares – ₹ 155.29

Market Price/Fair Value per share – ₹ 180

As the cost per unit is lower than its fair value, the shares are to be transferred at its cost i.e., at ₹ 155.29 per share on 15 May 2021

Note:

1. In the eight last line of the Question, investment in equity shares of G Ltd. was wrongly printed asZ Ltd. in the Question paper. In the above solution, it has been considered as investment in G Ltd.If considered as Investment in equity shares in Z Ltd. (some other investment and not investmentin G Ltd.), then the cost of the investment for shares in Z Ltd. will not be available.
2. The entire amount of sale proceeds from rights has been credited to Profit and Loss account in the above solution. However, the sale proceeds of rights in respect of 7,000 shares (purchased cum right on 1.5.20) can be applied to reduce the carrying amount of such investments (without crediting it to profit and loss account) considering that the value of these shares has reduced after becoming their ex -right. In that case, ₹ 22,500 (67,500X 7/21) will be applied to reduce the carrying amount of investment and ₹ 45,000 will be credited to profit and loss account.

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Question 38

During the year ended 31st March, 2021, Purple Ltd. entered into the following transactions:

1st April, 2020	**Purchased ₹ 4,00,000, 10% Govt. loan 1(interest payable on 30th April and 31st October) at ₹ 70 cum interest.**
1st April, 2020	**Purchased 6,000 Equity shares of ₹ 5 each in XY Ltd. for ₹ 1,26,000.**
1st October, 2020	**Sold ₹ 80,000, 10% Govt. loan at ₹75 ex-interest.**
15th January, 2021	**XY Ltd. made a bonus issued of four equity shares for every three shares held. Purple Ltd. sold all of the bonus shares for ₹ 10 each.**
1st March, 2021	**Received dividend @ 22% on shares in XY Ltd. for the year ended31st December, 2020.**

Prepare Investment accounts in the books of Purple Ltd. (PYP 10 Marks , Dec '21)

Answer 38

In the books of Purple Ltd.
10% Govt. Loan
[Interest Payable: 30th April & 31st October]

Date	Particulars	Nominal Value(₹)	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value (₹)	Inter-est (₹)	Cost (₹)
1.4.20	To Bank A/c (W.N.1)	4,00,000	16,667	2,63,333	30.4.20	By Bank A/c (4,00,000 x 10% x 6/12)	-	20,000	-
1.10.20	To Profit & Loss A/c (W.N 5)			7,333	1.10.20	By Bank A/c (W.N.2)	80,000	3,333	60,000
					31.10.20	By Bank A/c	-	16,000	-
31.3.21	To Profit & Loss A/c		35,999		31.3.21	By Balance c/d (W.N.3)	3,20,000	13,333	2,10,666

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		4,00,000	52,666	2,70,666			4,00,000	52,666	2,70,666

Investment in Equity Shares of XY Ltd. Account (of ₹ 5 **each)**

			d			rs			
			(₹)	(₹)				(₹)	(₹)
1.4.20	To Bank A/c	6,000		1,26,000	15.1.21	By Bank A/c	8,000	4,950	80,000
15.1.21 15.1.21	To Bonus Issue To Profit & Loss A/c.	8,000		8,000	1.3.21	By Bank A/c (W.N.6)			1,650
31.3.21	(W.N.4) To Profit & Loss A/c		4,950		31.3.21	By Balance c/d	6,000		52,350
		14,000	4,950	1,34,000			14,000	4,950	1,34,000

Working Notes:

Cost of investment purchased on 1st April, **2020**

4,000, 10% Govt. loan were purchased @ ₹ 70 cum-interest. Total amount paid 4,000 bonds x

1. ₹ 70 = 2,80,000 which includes accrued interest for 5 months, i.e., 1st November, 2020 to 31st March, 2021. Accrued interest will be ₹ 4,00,000 x 10% x 5/12 = ₹ 16,667. Therefore, cost of investment purchased = ₹ 2,80,000 – ₹ 16,667 = ₹ 2,63,333.
Sale of 10% Govt. loan on 1st October, **2020**
800, 10% Govt. loan were sold@ ₹ 75 ex-interest, i.e., Total amount received = 800 x 75

2. + accrued interest for 5 months = ₹ 60,000 + ₹ 3333

Cost of 10% Govt. loan on **31.3.2021**

Cost of 10% Govt. loan on 31.3.2021 will be ₹ 2,63,333 x 3,20,000/4,00,000

= ₹ 2,10,666.

Interest accrued on 10% Government Loan on 31.3.2021 = ₹ 3,20,000 x 10% x 5/12 = ₹

3. 13,333

Profit on sale of bonus **shares**

Cost per share after bonus = ₹ 1,26,000/ 14,000 = ₹ 9 (average cost method beingfollowed)

Profit per share sold (₹ 10 – ₹ 9) = ₹ 1.

4. Therefore, total profit on sale of 8,000 shares = 8,000 x ₹ 1 = ₹ 8,000.

Profit on sale of 10% Govt. **loan ₹**

Sale value = 60,000

Cost of ₹ 80,000 10% Government Loan = 2,63,333 x 80,000/ 4,00,000 =

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52,667 Profit

5. = 7,333

6. Dividend on equity shares = 6,000 x 5 x 22% = ₹ 6,600 out of which ₹ 1,650 will be treated as capital receipt as it has been received for the period of 3 months during which shares were not held.

Note: It has been considered that dividend received relates for the period of 12 months ended 31st Dec., 2020, strictly based on the information, given in the Question. Hence, dividend received for the period of 3 months (1st January, 20 to 31st March, 20) has been treated as pre-acquisition.

Question 39

On 1st April, 2019 Mr. H had 30,000 equity shares of ABC Ltd. at book value of ₹ 18 per share (Nominal value 10 per share). On 10th June, 2019, H purchased another 10,000 equity shares of the ABC ltd. at ₹ 16 per share through a broker who charged 1.5% brokerage.

The Directors of ABC Ltd. announced a bonus and a right issue. The terms of the issues were as follows (i) Bonus shares were declared at the rate of one equity share for every four shares held on 15th July, 2019.

(ii) Right shares were to be issued to the existing equity shareholders on 31st August, 2019. The company decides to issue one right share for every five equity shares held at 20% premium and the due date for payment will be 30th September, 2019. Shareholders were entitled to transfer their rights in full or in part.

(iii) No dividend was payable on these issues.

Mr. H subscribed 60% of the rights entitlements and sold the remaining rights for consideration of ₹ 5 per share.

Dividends for the year ending 31st March, 2019 was declared by ABC Ltd. at the rate of 20% andreceived by Mr. H on 31st October, 2019.

On 15th January, 2020 Mr. H sold half of his shareholdings at ₹ 17.50 per share and brokerage was charged @1 %.

You are required to prepare Investment account in the books of Mr. H for the year ending 31st March, 2020, assuming the shares are valued at average cost. . (PYP 10 Marks Nov '20)

Answer 39

In the books of Mr. H
Investment in equity shares of ABC Ltd. for the year ended 31st March, 2020

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particu-lars	No.	Income ₹	Amount ₹
2019 April 1	To Balance b/d	30,000	-	5,40,000	2019 Oct.	By Bank A/c (W.N. 5)	-	60,000	20,000
June	To Bank A/c	10,000	--	1,62,400	20X2 Jan.	By Bank A/c (W.N.4)	28,000	-	4,85,100

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July	To Bonus Issue (W.N. 1)	10,000	-	-	March 31	By Balance c/d (W.N. 6)	28,000	-	3,77,200
Sept.	To Bank A/c (W.N. 2)	6,000	-	72,000					
2020 Jan.	To P & L A/c(W.N. 4)	-	-	1,07,900					
March 31	To P & L A/c	-	60,000	-					
		56,000	60,000	8,82,300			56,000	60,000	8,82,300

Working Notes:

1. Calculation of no. of bonus shares issued Bonus Shares = (30,000 + 10,000) divided by 4

   = 10,000 shares

2. **Calculation of right shares subscribed**

   Right Shares = $\frac{30{,}000\ Shares + 10{,}000\ Shares + 10{,}000\ Shares}{5}$

   = 10,000 shares

   Shares subscribed 10,000 x 60% = 6,000 shares

   Value of right shares subscribed = 6,000 shares @ ₹ 12 per share = ₹ 72,000

3. **Calculation of sale of right entitlement**

   Amount received from sale of rights will be 4,000 shares x ₹ 5 per share

   = ₹ 20,000 and it will be credited to statement of profit and loss.

4. Calculation of profit/loss on sale of shares-

   Total holding = 30,000 shares original
   10,000 shares purchased
   10,000 shares bonus
   6,000 shares right shares 56,000

   50% of the holdings were sold i.e. 28,000 shares (56,000 x1/2) were sold.
   Cost of total holdings of 56,000 shares

   = ₹ 5,40,000 + ₹ 1,62,400 + ₹ 72,000– ₹ 20,000 = ₹ 7,54,400

   Average cost of shares sold would be:

   = 7,54,400 / 56,000 X 28,000 = Rs. 3,77,200

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	Rs.
Sale proceeds of 28,000 shares (28,000 x ₹17.50)	4,90,000
Less: 1% Brokerage	(4,900)
	4,85,100
Less: Cost of 28,000 shares sold	(3,77,200)
Profit on sale	1,07,900

5. Dividend received on investment held as on 1st April, 2019

   = 30,000 shares x ₹ 10 x 20%

   = ₹ 60,000 will be transferred to Profit and Loss A/c and Dividend received on shares purchased on 10th June, 2019

   = 10,000 shares x ₹ 10 x 20% = ₹20,000 will be adjusted to Investment A/c

6. Calculation of closing value of shares (on average basis) as on 31st March, 20207,54,000 /56,000 X 28,000 = Rs. 3,77,200

Question 40

P Ltd. had 8,000 equity shares of K Ltd., at a book value of ₹ 15 per share (face value of ₹ 10 each) on 1st April,2019. On 1st September, 2019, P Ltd. acquired another 2,000 equity shares of K Ltd. at a premium of ₹ 4 per share. K Ltd. announced a bonus and right issue for existing shareholders.

The term of bonus and right issue were:

(i) Bonus was declared at the rate for two equity shares for every five shares held on 30th September, 2019.

(ii) Right shares are to be issued to the existing shareholders on 1st December, 219. The Company had issued two right shares for every seven shares held at 25% premium on face value. No dividend was payable on these shares. The whole sum being payable by 31st December, 2019.

(iii) Existing shareholders were entitled to transfer their right to outsiders either wholly or in part.

(iv) P Ltd. exercised its option under the issue for 50% of its entitlements and sold the remaining rights for ₹8 per share.

(v) Dividend for the year ended 31st March,2019 at the rate of 20% was declared by K Ltd. and received by P Ltd. on 20th January, 2020.

(vi) On 1st February, 2020, P Ltd. sold half of its shareholdings at a premium of ₹ 4 per share.

(vii) The market price of share on 31st March,2020 was ₹13 per share.

You are required to prepare the Investment account of P Ltd. for the year ended 31st March,2020 and determine the value of shares held on that date, assuming the investment as current investment.Consider average cost basis for ascertainment for cost for equity shares sold. (PYP 10 Marks Jan 21)

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Answer 40

Investment Account-Equity Shares in K Ltd.

Date		No. of shares	Dividend	Amount	Date		No. of shares	Dividend	Amount
			₹	₹				₹	₹
1.4.19	To Bal.b/d	8,000	-	1,20,000	20.1.20	By Bank(dividend)		16,000	4,000
						[8,000 x 10 x 20%] and[2,000 x 10 x 20%]			
1.9.19	To Bank	2,000	-	28,000	1.2.20	By Bank	8,000		1,12,000
30.9.19	To BonusIssue	4,000		—					
31.12.19	To Bank(Right) (W.N.1)	2,000	-	25,000	31.3.20	By Balance c/d (W.N. 3)	8,000		84,500
20.1.20	To Profit & Loss A/c (Dividend income)		16,000						
1.2.20	To P& L A/c (profit on sale)			27,500					
		16,000	16,000	2,00,500			16,000	16,000	2,00,500

Working Notes:Right shares

No. of right shares issued = (8,000 + 2,000 + 4,000)/ 7 X 2= 4,000No. of right shares subscribed = 4,000 x 50% = 2,000 shares Value of right shares issued = 2,000 x ₹12.50 = ₹ 25,000

No. of right shares sold = 2,000 shares

1. Sale of right shares = 2,000 x ₹ 8 = ₹ 16,000 to be credited to statement of profit and loss

2. **Cost of shares sold — Amount paid for 16,000 shares**

	₹
(₹1,20,000 + ₹ 28,000 + ₹ 25,000)	1,73,000
Less: Dividend on shares purchased on Sept.1 (since the dividend	(4,000)
pertains to the year ended 31st March, 2019, i.e., the pre-acquisition period)	
Cost of 16,000 shares	1,69,000
Cost of 8,000 shares (Average cost basis)	84,500

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Sale proceeds (8,000 X ₹14)	1,12,000
Profit on sale	27,500

Value of investment at the end of the year

Assuming investment as current investment, closing balance will be valued based on lower of cost or net realizable value. Here, Net realizable value is ₹13 per share i.e., 8,000 shares x ₹ 13 = ₹ 1,04,000 and cost = 84,500. Therefore, value of investment at the end of the year will be ₹ 84,500.

Question 41

Mr. Saurabh held 10,000 equity shares of BT Limited on 1st April,2021. Nominal value of the shares is

₹ 2 each and their book value is ₹ 7 per share.

- **On 4th July,2021 he purchased another 7,500 shares at ₹ 10 each.**
- **On 31st July 2021 the company announced a Bonus and Right issue.**
- **Bonus was declared of one share for every five shares held and was received on 5th August,2021.**
- **Right issue to be issued on 12th September,2021, which entitled the holders to subscribe to additional 2 shares for every 7 shares held at ₹ 2 per share. Shareholders were entitled to transfer their rights in full or part. Mr. Saurabh sold whole of his entitlements to Mr. Nihal at ₹ 1.50 per share.**
- **Dividend was declared for the year ended 31st March,2021 @ 25% and received by Mr. Saurabhon 19th September 2021.**
- **On 11th December 2021 Mr. Saurabh sold 7,500 shares at ₹ 8 per share.**
- **The market price of the shares on 31st March,2022 was ₹ 7 per share.**

You are required to prepare the Investment Account of Mr. Saurabh on 31st March,2022 considering the above mentioned points, also state the value of shares held on that date. (Assume investment as current investment) (PYP 10 Marks Nov '22)

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Answer 41

Investment Account in Books of Saurabh

(Script: Equity Shares in BT Ltd.)

		No.	Divi-dend	Amount			No.	Divi-dend	Amount
				₹					₹
1.4.21	To Bal b/d	10,000		70,000	19.9.2021	By Bank (dividend on shares acquired on 4.7. 2021)		5,000	3,750
4.7.21	To Bank	7,500		75,000					
5.8.21	To Bonus	3,500		0					
11.12.21	To P&L A/c (Profit on sale of shares)			9,554	11.12.2021	By Bank (Sale of shares)	7,500		60,000
31.3.22	To P&L A/c		5,000		31.3.2022	By Bal. c/d	13,500		90,804
		21,000	5,000	1,54,554			21,000	5,000	1,54,554

Working Notes:

(1) Right Shares = $\frac{(10,000+7,500+3,500)}{7} \times 2 = 6,000$

Sale of rights amounting ₹ 9,000 (₹ 1.5 x 6,000 shares)

It will not be shown in investment A/c but will directly be taken to P & L statement.

(2) Profit on sale of 7,500 shares

= Sales proceeds – Average cost Sales

proceeds = ₹ 60,000

Average cost = (70,000 + 75,000 – 3,750) /21,000 x 7,500 = ₹ 50,446 Profit =

₹ 60,000 – ₹ 50,446 = ₹ 9,554.

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(3) Value of investments

Current investments are valued at lower of cost or net realizable value. Here, cost= (70,000 + 75,000 – 3,750)/ 21,000 X 13,500 = ₹ 90,804

Net realizable value of the shares = ₹ 94,500

Therefore, value of investments will be taken lower of above i.e.₹ 90,804

Note: As question is silent, Average cost basis has been considered for calculation of cost of shares in above solution. Alternatively, FIFO method can also be considered for calculation of cost of shares. An alternative solution is given below based on FIFO method-

Alternative Solution
Investment Account in Books of Saurabh(Script: Equity Shares in BT Ltd.)

		No.	Dividend	Amount			No.	Dividend	Amount
				₹					₹
1.4.21	To Bal b/d	10,000		70,000	19.9.21	By Bank (dividend on shares acquired on 4.7. 2021)		5,000	3,750
4.7.21	To Bank	7,500		75,000					
5.8.21	To Bonus	3,500		0					
11.12.21	To P&L A/c (Profit on sale of shares)			7,500	11.12.21	By Bank (Sale of shares)	7,500		60,000
31.3.22	To P&L A/c		5,000		31.3.22	By Bal. c/d	13,500		88,750
		21,000		1,52,500			21,000		1,52,500

Working Note:

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Working Note:

(1) Right Shares = $\frac{(10,000+7,500+3,500)}{7} \times 2 = 6,000$

Sale of rights amounting ₹ 9,000 (₹ 1.5 x 6,000 shares)

It will not be shown in investment A/c but will directly be taken to P & L statement.

(2) Profit on sale of 7,500 shares

= Sales proceeds – Cost Sales

proceeds = ₹ 60,000 Cost = 7,500 X

₹ 7= ₹ 52,500

Profit = ₹ 60,000 – ₹ 52,500 = ₹ 7,500.

(3) Value of investments

Current investments are valued at lower of cost or net realizable value Here,

cost= (2500 X₹7) + (7500 X₹10) -₹3750 = ₹ 88,750

Net realizable value of the shares = ₹ 94,500

Therefore, value of investments will be taken lower of above i.e.₹ 88,750

Question 42

On 1st April 2021 Ms. Jayshree has 5,000 equity shares of Rama Limited (a listed company) of face value of₹ 10 each. Ms. Jayshree has purchased the above shares at ₹ 15 per share and paid a brokerage of 2% and stamp duty of 1 %.

On 15th May,2021 Ms. Jayshree purchased another 5,000 shares of Rama Limited at ₹ 18 including brokerage and stamp duty.

On 26th August,2021 Rama Limited issued one bonus equity share for every 1 equity share held by the shareholders.

On 23rd October,2021 Rama Limited announced a Right Issue which entitles the holders to subscribe1 equity share for every 2 equity shares held at ₹ 20 per share. Shareholders can exercise their rights in full or in part. Ms. Jayshree sold 1/4th of entitlement to Mr. Mike for a consideration of ₹ 10 per share and subscribed the rest on 1st November 2021.

Ms. Jayshree also sold 10,000 shares at ₹ 25 per share on 1st November,2021. The shares of Rama

Limited were quoted at ₹ 11 per share on 31st March,2022.

You are required to prepare Investment account for Ms. Jayshree for the year ended 31st March 2022. (5 Marks) (May 22)

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Answer 42

In the books of Ms. Jayshree Investment Account (Equity shares in Rama Ltd.)

Date	Particulars	No. of shares	Amount (₹)	Date	Particulars	No. of shares	Amount (₹)
1.4.21	To Balance b/d	5,000	77,250	1.11.21	By Bank A/c	10,000	2,50,000
15.5.21	To Bank A/c	5,000	90,000				
26.8.21	To Bonus issue (W.N.1)	10,000	---	31.3.22	By Balance c/d	17,500	1,92,500
1.11.21	To Bank A/c (right shares) (W.N.4)	7,500	1,50,000	31.3.22	By Profit & Loss A/c (loss on valuation)		9,386
1.11.21	To Profit & Loss A/c		1,34,636				
		27,500	4,51,886			27,500	4,51,886

Working Notes:

1. Profit on sale of shares (average cost basis) on 1.11.21 10,000 shares @ ₹ 25 per share = 2,50,000
Cost of shares sold = [(77,250 + 90,000 + 1,50,000)/27,500 x 10,000]

= ₹ 1,15,364

Profit on sale of shares = ₹ 1,34,636

2. Value of shares on 31.3.22 [(77,250 + 90,000 + 1,50,000)/27,500 x 17,500]

= ₹ 2,01,886 or ₹ 1,92,500 (17,500 shares at ₹ 11)

Shares will be valued at ₹, 1,92,500 as market value is less than cost.

Note: Average cost basis has been considered for valuation of shares at the year end and forcalculation of cost of shares sold in the given answer.

Question 43

The following information is given for Mr. Atwood for the year ended 31.03.2023:

01.04.2022	**Mr. Atwood has 3,000 equity shares in Sun Limited at a book valueof Rs. 3,30,000 (nominal value Rs. 100 each.)**
01.07.2022	**Purchased 1,500 equity shares in Sun Limited for Rs. 1,38,600.**
01.08.2022	**Purchased 5,000.9% Bonds at Rs. 97 cum-interest (face value Rs. 100).The due dates of interest are 1st September and 1st March.**
02.10.2022	**Dividend declared on equity shares and paid by Sun Limited for theyear 2021- 2022 @ 10%.**

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15.10.2022	**Sun Limited made a bonus issue of two equity shares for every fiveshares held.**
01.01.2023	**1,000 equity shares in Sun Limited sold @Rs. 115 per share.**
31.03.2023	**Sold 4,000,9% Bonds @ Rs. 99 ex-interest**

The market price of Equity Shares of Sun Limited is Rs. 125 each and Bonds Rs. 98 each on 31st March2023.

- **Interest on bonds was received on due dates.**

You are required to prepare Investment Account in the books of Mr. Atwood for the year ended 31st-March 2023, assuming that the investments are valued at the average cost or market value whichever is lower. (Round off to nearest Rupee) (PYP 10 Marks May '23)

Answer 43

In the books of Atwood

Investment in Equity Shares of Sun Ltd. Account

Date	Particulars	No.	Dividend (Rs.)	Amount (Rs.)	Date	Particulars	No.	Divi-dend (Rs.)	Amount (Rs.)
1.04.22	To Balance b/d	3,000		3,30,000	2.10.22	By Bank A/c (W.N. 5)		30,000	15,000
1.07.22	To Bank A/c	1,500		1,38,600	1.1.23	By Bank A/c	1,000		1,15,000
15.10.22	To Bonus Issue	1,800			31.3.23	By Balance c/d (W.N.7)	5,300		3,81,600
1.01.23	To Profit & Loss A/c (W.N. 6)			43,000					
31.3.23	To Profit & Loss A/c		30,000						
		6,300	30,000	5,11,600			6,300	30,000	5,11,600

9% Bonds Account

[Interest Payable: 1st September & 1st March]

Date	Particu-lars	Nomi-nal Value (Rs.)	Inter-est (Rs.)	Cost (Rs.)	Date	Particu-lars	Nominal Value (Rs.)	Interest (Rs.)	Cost (Rs.)
1.8.22	To BankA/c (W.N.1)	5,00,000	18,750	4,66,250	1.9.22	By Bank A/c (5,00,000 x 9% x 6/12)	-	22,500	-
31.3.23	To Profit &			23,000	1.3.23	By Bank A/c	-	22,500	-

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	Loss A/c (W.N 3)				31.3.23	By Bank A/c (W.N 2)	4,00,000	3,000	3,96,000
31.3.23	To Profit & Loss A/c		30,000		31.3.23	By Balance c/d (W.N.4)	1,00,000	750	93,250
		5,00,000	48,750	4,89,250			5,00,000	48,750	4,89,250

Working Notes:

1. Cost of Bond purchased on 1st August, 2022

   5,000, 9% bonds were purchased @ Rs. 97 cum-interest. Total amount paid 5,000 bonds x Rs. 97 = 4,85,000 which includes accrued interest for 5 months, i.e., 1st March, 2022 to 31st July, 2022. Accrued interest will be Rs. 5,00,000 x 9/100x 5/12 = Rs. 18,750. Therefore, cost of Bond purchased =

   Rs. 4,85,000 – 18,750 = Rs. 4,66,250.

2. Sale of bonds on 31st March, 2023

   4,000 bonds were sold@ Rs. 99 ex-interest, i.e., Total amount received = 4,000 x 99 + accrued interestfor 1 month = Rs. 3,96,000 + Rs. 3,000 (4,00,000 x 9/100 x 1/12)

3. Profit on sale of bonds Rs.

   Sale value = 3,96,000

   Cost of 4,00,000 9% bonds = 4,66,250/5,000x 4,000 = 3,73,000

   Profit = 23,000

4. Value of bonds on 31.3.2023 Lower of:

   Cost of bonds on 31.3.2023 will be Rs. 4,66,250/ 5,000 x 1,000 = Rs. 93,250.Market Value on 31.3.2023 will be Rs. 1,000 X 98 = 98,000

   Value of bonds on 31.3.2023 = Rs. 93,250

   Interest accrued on bonds on 31.3.2023 = 1,00,000 x 9% x 1/12 = Rs. 750

5. Dividend on equity shares for 2021-22

   Post acquisition dividend = 3,00,000 x 10% = Rs. 30,000 transferred to Profit & Loss account Pre-acquisition dividend = 1,50,000 X 10% = Rs. 15,000 credited to investment A/c

6. Profit on sale of equity shares Rs.

   Sale value = 1,15,000

   Cost of shares = 4,53,600 / 6,300 x 1,000 = 72,000 Profit = 43,000(Average cost method being followed)

7. Value of equity shares at end of year Lower of:

   Cost of shares on 31.3.2023 will be Rs. 4,53,600 / 6,300 x 5,300 = Rs. 3,81,600

   Market Value on 31.3.2023 will be Rs. 5,300 x 125 = 6,62,500Value of shares = Rs. 3,81,600

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Question 44

On 1st April, 2022, Alpha has 1,00,000 equity shares of Beta Ltd. at a book value of ₹ 15 per share (nominal value ₹ 10 each). He provides you the further information:

1. **On 20th June, 2022 he purchased another 20,000 shares of Beta Ltd. at ₹ 16 per share**
2. **On 1st August, 2022, Beta Ltd. issued one equity bonus share for every six shares held by the shareholders.**
3. **On 31st October, 2022, the directors of Beta Ltd. announced a right issue which entitles the holders to subscribe three shares for every seven shares at ₹ 15 per share. Shareholders can transfer their rights in full or in part.**

Alpha sold 1/3rd of entitlement to Umang for a consideration of ₹ 2 per share and subscribed the rest on 5th November, 2022.

You are required to prepare Investment A/c in the books of Alpha for the year ending 31st March, 2023. (RTP Nov '23)

Answer 44

In the books of Alpha Investment Account (Equity shares in Beta Ltd.)

Date	Particulars	No. of shares	Amount (₹)	Date	Particulars	No. of shares	Amount (₹)
1.4.2022	To Balance b/d	1,00,000	15,00,000	31.3.2023	By Balance c/d (Bal. fig.)	1,80,000	24,20,000
20.6.2022	To Bank A/c	20,000	3,20,000				
1.8.2022	To Bonus						
	issue (W.N.1)	20,000	-				
5.11.2022	To Bank A/c						
	(right						
	shares)	40,000	6,00,000				
	(W.N.4)						
		1,80,000	24,20,000			1,80,000	24,20,000

(1) Bonus Shares $= \frac{1,00,000+20,000}{6} = 20,000$ Shares

(2) Right Shares $= \frac{1,00,000+20,000+20,000}{7} \times 3 = 60,000$ Shares

(3) Sale of Rights = 60,000 Shares $\times \frac{1}{3} \times$ Rs. 2 = Rs. 40,000 to be credited to Statement of Profit & Loss

(4) Right subscribed = 60,000 Shares $\times \frac{1}{3} \times$ Rs. 15 = Rs. 6,00,000

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Question 45

The cost of Right shares is

a. Added to the cost of investments	b. Subtracted from the cost of investments
c. No treatment is required	d. Added to cost of investments at marketvalue

Ans: (a)

Question 46

Long term investments are carried at

a. Fair value	b. Cost less 'other than temporary' decline
c. Cost and market value whichever is less	d. Cost and market value whichever is higher

Ans: (b)

Question 47

Current investments are carried at

a. Fair value	b. Cost
c. Cost and fair value, whichever is less	d. Cost and fair value, whichever is higher

Ans: (c)

Question 48

A Ltd. acquired 2,000 equity shares of Omega Ltd. on cum-right basis at Rs. 75 per share. Subsequently, omega Ltd. made a right issue of 1:1 at Rs. 60 per share, which was subscribed for by A. Total cost of investments at the year- end will be Rs.

a. 2,70,000	b. 1,50,000
c. 1,20,000	d. 1,70,000

Ans: (a)

Question 49

Cost of investment includes

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a. Purchase costs	b. Brokerage and Stamp duty paid
c. Both (a) and (b)	d. None of the above

Ans: (c)

Theoretical Questions Answers

Questions 50

Briefly explain disclosure requirements for Investments as per AS-13.

Answers 50

The disclosure requirements as per AS 13 (Revised) are as follows:

(i) Accounting policies followed for the determination of carrying amount of investments.

(ii) Classification of investment into current and long term.

(iii) The amount included in profit and loss statements for

(a) Interest, dividends and rentals for long term and current investments, disclosing therein grossincome and tax deducted at source thereon;

(b) Profits and losses on disposal of current investment and changes in carrying amount of suchinvestments;

(c) Profits and losses and disposal of long term investments and changes in carrying amount ofinvestments.

(iv) Aggregate amount of quoted and unquoted investments, giving the aggregate market value of quotedinvestments;

(v) Any significant restrictions on investments like minimum holding period for sale/disposal, utilisation ofsale proceeds or non-remittance of sale proceeds of investment held outside India.

(vi) Other disclosures required by the relevant statute governing the enterprises

Questions 51

How will you classify the investments as per AS 13? Explain in Brief.

Answers 51

The investments are classified into two categories as per AS 13, viz., Current Investments and Long-term 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 carrying amount for current investments is the lower of cost and fair value. Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss.

A long-term investment is an investment other than a current investment. Long term investments are usu-

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allycarried at cost. However, when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognise the decline. The reduction in carrying amount is charged to the statement of profit and loss.

Questions 52

Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without providing for any diminution in value is correct and in accordance with the provisions of AS 13. If not, what should have been the accounting treatment in such a situation? Explain in brief.

Answers 52

The accounting treatment 'at cost' under the head 'Long Term Investment' in the financial statements of thecompany without providing for any diminution in value is correct and is in accordance with the provisions ofAS 13 provided that there is no decline, other than temporary, in the value of investment. If the decline in the value of investment is, other than temporary, compared to the time when the shares were purchased, provision is required to be made.

Practical Questions Answers

Questions 53

Mr. X acquires 200 shares of a company on cum-right basis for Rs. 70,000. He subsequently receives an offerof right to acquire fresh shares in the company in the proportion of 1:1 at Rs. 107 each. He does not subscribe but sells all the rights for Rs. 12,000. The market value of the shares after their becoming ex- rights has also gone down to Rs. 60,000. What should be the accounting treatment in this case?

Answers 53

As per AS 13, where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value. In this case, the amount of the ex-right market value of 200 shares bought by X immediately after the declaration of rights falls to Rs. 60,000. In this case, out of sale proceeds of Rs. 12,000, Rs. 10,000 may beapplied to reduce the carrying amount to bring it to the market value and Rs. 2,000 would be credited to the profit and loss account.

Questions 54

On 1st April, 20X1, XY Ltd. has 15,000 equity shares of ABC Ltd. at a book value of Rs. 15 per share (nominalvalue Rs. 10 per share). On 1st June, 20X1, XY Ltd. acquired 5,000 equity shares of ABC Ltd. for Rs. 1,00,000. ABC Ltd. announced a bonus and right issue.

(1) Bonus was declared, at the rate of one equity share for every five shares held, on 1st July 20X1.

(2) Right shares are to be issued to the existing shareholders on 1st September 20X1. The company willissue one right share for every 6 shares at 20% premium. No dividend was payable on these shares.

(3) Dividend for the year ended 31.3.20X1 were declared by ABC Ltd. @ 20%, which was

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receivedby XY Ltd. on 31st October 20X1.

XY Ltd.

(i) Took up half the right issue.

(ii) Sold the remaining rights for Rs. 8 per share.

(iii) Sold half of its shareholdings on 1st January 20X2 at Rs. 16.50 per share. Brokerage being 1%.

You are required to prepare Investment account of XY Ltd. for the year ended 31st March 20X2 assuming the shares are being valued at average cost.

Answers 54

In the books of XY Ltd. Investment in equity shares of ABC Ltd. for theyear ended 31st March, 20X2

Date	Particulars	No.	Dividend Rs.	Amount Rs.	Date	Particulars	No.	Dividend Rs.	Amount Rs.
20X1 April 1	To Balance b/d	15,000	-	2,25,000	20X1 Oct. 31	By Bank A/c (W.N. 5)	-	30,000	10,000
June 1	To Bank A/c	5,000	--	1,00,000	20X2 Jan. 1	By Bank A/c (W.N.4)	13,000	-	2,12,355
July 1		4,000	-	-	March 31	By Balance c/d (W.N. 6)	13,000	-	1,69,500
Sept.1	To Bonusissue (W.N.1)	2,000	-	24,000					
20X2 Jan 1	To Bank A/c (W.N. 2)								
"20X2 March 31	To P & L A/c (W.N. 4)	-	-	42,855					
	To P & L A/c	-	30,000	-					
		26,000	30,000	3,91,855			26,000	30,000	3,91,855

Working Notes:

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1. Calculation of no. of bonus shares issued
   Bonus Shares = $\frac{15{,}000\ shares + 5{,}000\ shares}{5} \times 1$ = 4,000 shares

2. Calculation of right shares subscribed
   Right Shares = $\frac{15{,}000\ shares + 5{,}000\ shares + 4{,}000\ shares}{6}$ = 4,000 shares

   Shares subscribed by XY Ltd. = $\frac{4{,}000}{2}$ = 2,000 shares

   Value of Right shares subscribed = 2,000 shares @ ` 12 per share
   = ` 24,000

3. Calculation of sale of right entitlement

   2,000 shares x ` 8 per share = ` 16,000

   Amount received from sale of rights will be credited to statement of profit and loss.

4. Calculation of profit on sale of shares

Total holding =	15,000 shares	Original
	5,000 shares	purchased
	4,000 shares	bonus
	2,000 shares	right shares
	26,000 shares	

   50% of the holdings were sold

   i.e. 13,000 shares (26,000 x1/2) were sold.

   Cost of total holdings of 26,000 shares (on average basis)

   = 2,25,000 + 1,00,000 + 24,000 – 10,000 = 3,39,000

   Average cost of 13,000 shares would be

   = $\frac{3{,}39{,}000}{26{,}000} \times 13{,}000$ = 1,69,500

Sale proceeds of 13,000 shares (13,000 x `16.50)	2,14,500
Less: 1% Brokerage	(2,145)
	2,12,355
Less: Cost of 13,000 shares	(1,69,500)
Profit on sale	42,855

5. Dividend received on investment held as on 1st April, 20X1

   = 15,000 shares x ` 10 x 20%

   = ` 30,000 will be transferred to Profit and Loss A/c

   Dividend received on shares purchased on 1st June, 20X1

   = 5,000 shares x ` 10 x 20% = `10,000 will be adjusted to Investment A/c

   Note: It is presumed that no dividend is received on bonus shares as bonus shares are declared on 1st July, 20X1 and dividend pertains to the year ended 31.3.20X1.

6. Calculation of closing value of shares (on average basis) as on 31st March, 20X2

   $13{,}000 \times \frac{3{,}39{,}000}{26{,}000}$ = 1,69,500

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Questions 55

The following information is presented by Mr. Z (a stock broker), relating to his holding in 9% Central Government Bonds.

Opening balance (nominal value) Rs. 1,20,000, Cost Rs. 1,18,000 (Nominal value of each unit is Rs. 100).

1.3.20X1 Purchased 200 units, ex-interest at Rs. 98.

1.7.20X1 Sold 500 units, ex-interest out of original holding at Rs. 100.1.10.20X1 Purchased 150 units at Rs. 98, cum interest.

1.11.20X1 Sold 300 units, ex-interest at Rs. 99 out of original holdings.

Interest dates are 30th September and 31st March. Mr. Z closes his books every 31st December. Show the investment account as it would appear in his books. Mr. Z follows FIFO method.

Answers 55

In the Books of Mr. Z

9% Central Government Bonds (Investment) Account

Particulars		Nominal Value	Inter-est	Principal	Particulars		Nominal Value	Inter-est	Principal
20X1		Rs.	Rs.	Rs.	20X1		Rs.	Rs.	Rs.
Jan.1	To Balance b/d (W.N.1)	1,20,000	2,700	1,18,000	Mar. 31	By Bank A/c (W.N.3)	-	6,300	-
March 1	To Bank A/c (W.N.2)	20,000	750	19,600	July 1	By Bank A/c (W.N.4)	50,000	1,125	50,000
July 1	To P&L A/c (W.N.5)	-	-	833	Sept. 30	By Bank A/c (W.N.6)	-	4,050	-
Oct. 1	To Bank A/c (150 x 98)	15,000	-	14,700	Nov. 1	By Bank A/c (W.N.7)	30,000	225	29,700
Nov. 1	To P&L A/c (W.N.8)	-	-	200	Dec. 31	By Balance c/d (W.N. 9 & W.N.10)	75,000	1,688	73,633
Dec. 31	To P&L A/c (b.f.) (Transfer)		9,938						
		1,55,000	13,388	1,53,333			1,55,000	13,388	1,53,333

Working Note:

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1. Interest element in opening balance of bonds = 1,20,000 x 9% x 3/12 = Rs. 2,700
2. Purchase of bonds on 1. 3.20X1

   Interest element in purchase of bonds = 200 x 100 x 9% x 5/12 = Rs. 750 Investment element in purchaseof bonds = 200 x 98 = Rs. 19,600
3. Interest for half-year ended 31 March = 1,400 x 100 x 9% x 6/12 = Rs. 6,300
4. Sale of bonds on 1.7.20X1

   Interest element = 500 x 100 x 9% x 3/12 = Rs. 1,125

   Investment element = 500 x 100 = Rs. 50,000

5. Profit on sale of bonds on 1.7.20X1

   Cost of bonds = (1,18,000/ 1,200) x 500 = Rs. 49,167 Sale proceeds = Rs. 50,000Profit element = Rs. 833
6. Interest for half-year ended 30 September

   = 900 x 100 x 9% x 6/12 = Rs. 4,050

7. Sale of bonds on 1.11.20X1

   Interest element = 300 x 100 x 9% x 1/12 = Rs. 225

   Investment element = 300 x 99 = Rs. 29,700

8. Profit on sale of bonds on 1.11.20X1

Cost of bonds = (1,18,000/ 1,200) x 300 = Rs. 29,500 Sale proceeds = Rs. 29,700

Profit element = Rs. 200

9. Closing value of investment

Calculation of closing balance:	**Nominal value**	Rs.
Bonds in hand remained in hand at 31st December 20X1		
From original holding (1,20,000 – 40,000	$\frac{1,18,000}{1,20,000} \times 40,000$	39,333
50,000 – 30,000) =		
Purchased on 1st March	20,000	19,600
Purchased on 1st October	15,000	14,700
	75,000	73,633

10. Interest element in closing balance of bonds = 750 x 100 x 9% x 3/12 = Rs. 1,688

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Questions 56

Mr. Purohit furnishes the following details relating to his holding in 8% Debentures (Rs. 100 each) of P Ltd., held as Current assets:

1.4.20X1 Opening balance – Nominal value Rs. 1,20,000, Cost Rs. 1,18,0001.7.20X1 100 Debentures purchased ex-interest at Rs. 98

1.10.20X1 Sold 200 Debentures ex-interest at Rs. 100 1.1.20X2 Purchased 50 Debentures at Rs. 98 ex-interest1.2.20X2 Sold 200 Debentures ex-interest at Rs. 99

Due dates of interest are 30th September and 31st March.

Mr. Purohit closes his books on 31.3.20X2. Brokerage at 1% is to be paid for each transaction (at ex- interest price). Show Investment account as it would appear in his books. Assume FIFO method. Market value of 8% Debentures of P Limited on 31.3.20X2 is Rs. 99.

Answers56

Investment A/c of Mr. Purohit for the year ending on 31-3-20X2

(Scrip: 8% Debentures of P Limited) (Interest Payable on 30th September and 31st March)

Date	Particulars	Nominal Value	Interest	Cost	Date	Particulars	Nominal Value	Interest	Cost
			Rs.	Rs.				Rs.	Rs.
1.4.20X1	To Balance b/d	1,20,000	-	1,18,000	30.9.20X1	By Bank (1,300 x 100 x 8% x 6/12)	-	5,200	-
1.7.20X1	To Bank (ex-Interest) (W.N.1)	10,000	200	9,898	1.10.20X1	By Bank (W.N.4)	20,000	-	19,800
1.10.20X1	To Profit & Loss A/c (W.N.4)			133	1.2.20X2	By Bank (ex-Interest) (W.N.5)	20,000	533	19,602
1.10.20X2	To Bank (ex-Interest) (W.N.2)	5,000	100	4,949	1.2.20X2	By Profit & Loss A/c (W.N.5)			64Page
31.3.20X2	To Profit & Loss A/c (Bal. fig.)	-	9,233		31.3.20X2	By Bank (950 x 100 x 8% x 6/12)	-	3,800	-

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					31.3.20X2	By Balance c/d (W.N.3)	95,000	-	93,514
		1,35,000	9,533	1,32,980			1,35,000	9,533	1,32,980

Working Notes:

1. **Purchase of debentures on 1.7.20X1**
   Interest element = 100 x 100 x 8% x 3/12 = ` 200
   Investment element = (100 x 98) + [1% (100 x 98)] = ` 9,898
2. **Purchase of debentures on 1.1.20X2**
   Interest element = 50 x 100 x 8% x 3/12 = ` 100
   Investment element = {(50 x 98) + [1%(50 x 98)]} = ` 4,949
3. **Valuation of closing balance as on 31.3.20X2:**
   Market value of 950 Debentures at ` 99 = ` 94,050

   Cost of

   800 Debentures cost = $(\frac{1,18,000}{1,20,000} \times 80,000)$ = 78,667

100 Debentures cost	=	9,898
50 Debentures cost	=	4,949
		93,514
Value at the end	=	` 93,514, i.e., whichever is less

4. **Profit on sale of debentures as on 1.10.20X1**

	`
Sales price of debentures (200 x ` 100)	20,000
Less: Brokerage @ 1%	(200)
	19,800
Less: Cost of Debentures $(\frac{1,18,000}{1,20,000} \times 20,000)$ =	(19,667)
Profit on sale	133

7. **Loss on sale of debentures as on 1 2.20X2**

	`
Sales price of debentures (200 x ` 99)	19,800
Less: Brokerage @ 1%	(198)
	19,602
Cost of Debentures $(\frac{1,18,000}{1,20,000} \times 20,000)$	(19,666)
Loss on sale	64
Interest element in sale of investment = 200 x 100 x 8% x 4/	Rs. 533

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Questions 57

On 1st April, 20X1, Mr. Vijay had 30,000 Equity shares in X Ltd. at a book value of Rs. 4,50,000 (Face Value Rs. 10 per share). On 22nd June, 20X1, he purchased another 5000 shares of the same company for Rs. 80,000.

The Directors of X Ltd. announced a bonus of equity shares in the ratio of one share for seven shares held on 10th August, 20X1.

On 31st August, 20X1 the Company made a right issue in the ratio of three shares for every eight shares held, on payment of Rs. 15 per share. Due date for the payment was 30th September, 20X1, Mr. Vijay subscribed to 2/3rd of the right shares and sold the remaining of his entitlement to Viru for a consideration of Rs. 2 per share.

On 31st October, 20X1, Vijay received dividends from X Ltd. @ 20% for the year ended 31st March, 20X1. Dividend for the shares acquired by him on 22nd June, 20X1 to be adjusted against the cost of purchase.

On 15th November, 20X1 Vijay sold 20,000 Equity shares at a premium of Rs. 5 per share.

You are required to prepare Investment Account in the books of Mr. Vijay for the year ended 31st March, 20X2 assuming the shares are being valued at average cost.

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Answers 57

Investment Account in Books of Vijay (Scrip: Equity Shares in X Ltd.)

		No.	Amount			No.	Amount
			Rs.				Rs.
1.4.20X1 22.6.20X1	To Bal b/d To Bank	30,000 5,000	4,50,000 80,000	31.10.20X1	By Bank (dividend on shares acquiredon 22.6.20X1)	—	10,000
10.8.20X1	To Bonus	5,000	_				
30.9.20X1	To Bank (Rights Shares)	10,000	1,50,000				
15.11.20X1	To P&L A/c(Profit		32,000	15.11.20X1	By Bank	20,000	3,00,000
	on sale ofshares)				(Sale of shares)		
				31.3.20X2	By Bal. c/d	30,000	4,02,000
		50,000	7,12,000			50,000	7,12,000

Working Notes:

1. Bonus Shares = (30,000 + 5,000) / 7 = 5,000 shares
2. Right Shares = $\left(\frac{30,000+5,000+5,000}{8}\right) \times 3$ = 15,000 shares
3. Rights shares sold = 15,000 × 1/3 = 5,000 shares
4. Dividend received = 30,000 × 10 × 20% = ` 60,000 will be taken to P&L statement
5. Dividend on shares purchased on 22.6.20X1

   = 5,000×10×20%

   = ` 10,000 is adjusted to Investment A/c
6. Profit on sale of 20,000 shares

   = Sales proceeds – Average cost

   Sales proceeds = ` 3,00,000

   Average cost = $\left(\frac{4,,50,000+80,000+1,50,000-10,000}{50,000}\right) \times 20,000$

   = ` 2,68,000

   Profit = ` 3,00,000– ` 2,68,000= ` 32,000.

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7. Cost of shares on 31.3.20X2

$$\left(\frac{4,50,000+80,000+1,50,000-10,000}{50,000}\right) \times 30,000$$

= 4,02,000

8. Sale of rights amounting ` 10,000 (` 2 x 5,000 shares) will not be shown in investment A/c but will directlybe taken to P & L statement.

Questions 58

Blue-chip Equity Investments Ltd., wants to re-classify its investments in accordance with AS 13 (Revised). State the values, at which the investments have to be reclassified in the following cases:

(i) Long term investments in Company A, costing Rs. 8.5 lakhs are to be re- classified as current. The company had reduced the value of these investments to Rs. 6.5 lakhs to recognise 'other than temporary' decline in value. The fair value on date of transfer is Rs. 6.8 lakhs.

(ii) Long term investments in Company B, costing Rs. 7 lakhs are to be re- classified as current. The fair value on date of transfer is Rs. 8 lakhs and book value is Rs. 7 lakhs.

(iii) Current investment in Company C, costing Rs. 10 lakhs are to be re- classified as long term as the company wants to retain them. The market value on date of transfer is Rs. 12 lakhs.

Answers 58

As per AS 13 (Revised) 'Accounting for 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.

And where

investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence thisreclassified current investment should be carried at Rs. 6.5 lakhs in the books.

(ii) The carrying / book value of the long term investment is same as cost i.e. Rs. 7 lakhs. Hence this long terminvestment will be reclassified as current investment at book value of Rs. 7 lakhs only.

(iii) In this case, reclassification of current investment into long-term investments will be made at Rs. 10lakhs as cost is less than its market value of Rs. 12 lakhs.

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Question 59 (Illustration)

An unquoted long term investment is carried in the books at a cost of Rs. 2 lakhs. The published accounts of the unlisted company received in May, 20X1 showed that the company was incurring cash losseswith declining market share and the long term investment may not fetch more than Rs. 20,000. How will you deal with this in preparing the financial statements of R Ltd. for the year ended 31st March, 20X1?

Answers 59

As stated in the question that financial statements for the year ended 31st March, 20X1 are still under preparation – The answer has been given on the assumption that the financial statements are yet to be completed and approved by the Board of Directors.

Also, the fall in value of investments has been considered on account of conditions existing on the balance sheet date.

Investments classified as long term investments should be carried in the financial statements at cost. However provision for diminution should be made to recognise a decline, other than temporary, in the valueof the investments, such reduction being determined and made for each investment individually. AS 13 (Revised) 'Accounting forInvestments' states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. On the above basis, the facts of the given case clearly suggest that the provision for diminutionshould be made to reduce the carrying amount of long term investment to Rs. 20,000 in the financial statements for the year ended 31st March, 20X1.

Question 60 (Illustration)

X Ltd. on 1-1-20X1 had made an investment of Rs. 600 lakhs in the equity shares of Y Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realisable value of all such investment on 31 -3-20X1 became Rs. 200 lakhs as Y Ltd. lost a case of copyright. From the given market conditions, it is apparent that the reduction in the value is not temporary in nature. How will you recognise the reduction in financial statements for the year ended on 31 -3-20X1?

Answers 60

X Ltd. invested Rs. 600 lakhs in the equity shares of Y Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. Rs. 300 lakhs and remaining as temporary (current) investment i.e. Rs. 300 lakhs. Irrespective of the fact that investment has been held by X Ltd. only for 3 months (from 1.1.20X1 to 31.3.20X1), AS 13 (Revised) lays emphasis on intention of the investor to classify the investment as current or long term even though the long term investment may be readily marketable.

In the given situation, the realisable value of all such investments on 31.3.20X1 became Rs. 200 lakhs i.e. Rs. 100lakhs in respect of current investment and Rs. 100 lakhs in respect of long term investment.

As per AS 13 (Revised), 'Accounting for Investment', the carrying amount for current investments is the lowerof cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value.

Accordingly, the carrying value of investment held as temporary investment should be shown at realisable value i.e. at Rs. 100 lakhs. The reduction of Rs. 200 lakhs in the carrying value of current investment will be chargedto the profit and loss account.

The Standard further states that long-term investments are usually carried at cost. However, when there is adecline, other than temporary, in the value of long term investment, the carrying amount is reduced to recognise the decline.

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Here, Y Ltd. lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quiet a substantial figure. Losing the case of copyright may affect the business and the performanceof the company in the long run. Accordingly, it will be appropriate to reduce the carrying amount of long terminvestment by Rs. 200 lakhs and show the investments at Rs. 100 lakhs, since the downfall in the value of shares is other than temporary. The reduction of Rs. 200 lakhs in the carrying value of long term investment will also be charged to the Statement of profit and loss.

Question 61 (Illustration)

ABC Ltd. wants to re-classify its investments in accordance with AS 13 (Revised). Decide and state on the amount of transfer, based on the following information:

(1) A portion of current investments purchased for Rs. 20 lakhs, to be reclassified as long term investment, as the company has decided to retain them. The market value as on the date of Balance Sheet was

Rs. 25 lakhs.

(2) Another portion of current investments purchased for Rs. 15 lakhs, to be reclassified as long term investments. The market value of these investments as on the date of balance sheet was Rs. 6.5 lakhs.

(3) Certain long term investments no longer considered for holding purposes, to be reclassified as current investments. The original cost of these was Rs. 18 lakhs but had been written down to Rs. 12 lakhs to recognise other than temporary decline as per AS 13 (Revised).

Answers 61

As per AS 13 (Revised), where investments are reclassified from current to long- term, transfers are made atthe lower of cost and fair value at the date of transfer.

(1) In the first case, the market value of the investment is Rs. 25 lakhs, which is higher than its cost i.e. Rs. 20lakhs. Therefore, the transfer to long term investments should be carried at cost i.e. Rs. 20 lakhs.

(2) In the second case, the market value of the investment is Rs. 6.5 lakhs, which is lower than its cost i.e. Rs. 15 lakhs. Therefore, the transfer to long term investments should be carried in the books at the marketvalue i.e. Rs. 6.5 lakhs. The loss of Rs. 8.5 lakhs should be charged to profit and loss account.

As per AS 13 (Revised), where long-term investments are re-classified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

(3) In the third case, the book value of the investment is Rs. 12 lakhs, which is lower than its cost i.e. Rs. 18 lakhs. Here, the transfer should be at carrying amount and hence this re-classified current investmentshould be carried at Rs. 12 lakhs.

Question 62 (Illustration)

M/s Innovative Garments Manufacturing Company Limited invested in the shares of another company on1st October, 20X3 at a cost of Rs. 2,50,000. It also earlier purchased Gold of Rs. 4,00,000 and Silver of Rs. 2,00,000 on 1st March, 20X1. Market value as on 31st March, 20X4 of above investments are as follows:

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Shares	2,25,000
Gold	6,00,000
Silver	3,50,000

How above investments will be shown in the books of accounts of M/s Innovative Garments Manufacturing Company Limited for the year ending 31st March, 20 X4 as per the provisions of Accounting Standard 13 "Accounting for Investments"

Answers 62

As per AS 13 (Revised) 'Accounting for Investments', for investment in shares if the investment is purchasedwith an intention to hold for short-term period (less than one year), then it will be classified as current investment and to be carried at lower of cost and fair value, i.e., in case of shares, at lower of cost (Rs. 2,50,000) and market value (Rs. 2,25,000) as on 31 March 20X4, i.e., Rs. 2,25,000.

If equity shares are acquired with an intention to hold for long term period (more than one year), then shouldbe considered as long-term investment to be shown at cost in the Balance Sheet of the company. However, provision for diminution should be made to recognise a decline, if other than temporary, in the value of the investments.

Gold and silver are generally purchased with an intention to hold it for long term period (more than one year)until and unless given otherwise. Hence, the investment in Gold and Silver (purchased on 1st March, 20X1) should continue to be shown at cost (since there is no 'other than temporary' diminution) as on 31st March,20X4, i.e., Rs. 4,00,000 and Rs. 2,00,000 respectively, though their market values have been increased.

Question 63 (Illustration)

In 20X1, M/s. Wye Ltd. issued 12% fully paid debentures of Rs. 100 each, interest being payable half yearly on 30th September and 31st March of every accounting year.

On 1st December, 20X2, M/s. Bull & Bear purchased 10,000 of these debentures at Rs. 101 ex-interest price,also paying brokerage @ 1% of ex-interest amount of the purchase. On 1st March, 20X3 the firm sold all these debentures at Rs. 103 ex-interest price, again paying brokerage @ 1 % of ex-interest amount. Prepare Investment Account in the books of M/s. Bull & Bear for the period 1st December, 20X2 to 1st March, 20X3.

Answers 63

In the books of M/s Bull & Bear Investment Account for the period from 1st December 20X2 to 1s March, 20X3 (Scrip: 12% Debentures of M/s. Wye Ltd.)

Date	Particulars	Nominal Value (Rs.)	Interest	Cost (Rs.)	Date	Particulars	Nominal Value (Rs.)	Inter-est	Cost(Rs.)

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1.12.20X2	To Bank A/c (W.N.1)	10,00,000	20,000	10,20,100	1.03.20X3	By Bank A/c (W.N.2)	10,00,000	50,000	10,19,700
1.3.20X3	To Profit & loss A/c* (b.f.)	-	30,000		1.3.20X3	By Profit & loss A/c (b.f.)			400
		10,00,000	50,000	10,20,100			10,00,000	50,000	10,20,100

* This represents income for M/s. Bull & Bear for the period 1st December, 20X2 to 1st March, 20X3, i.e., interest for three months- 1st December, 20X2 to 28 February, 20X3).

Working Notes:

1.	Cost of 12% debentures purchased on 1.12.20X2		Rs.
	Cost Value (10,000 Rs. 101)	=	10,10,000
	Add: Brokerage (1% of Rs. 10,10,000)	=	10,100
	Total	=	10,20,100
2.	Sale proceeds of 12% debentures sold Sales Price (10,000 Rs. 103)	=	Rs. 10,30,000
	Less: Brokerage (1% of Rs. 10,30,000)	=	(10,300)
	Total	=	10,19,700

Question 64 (Illustration)

On 1.4.20X1, Mr. Krishna Murty purchased 1,000 equity shares of Rs. 100 each in TELCO Ltd. @ Rs. 120 each from a Broker, who charged 2% brokerage. He incurred 50 paise per Rs. 100 as cost of shares transfer stamps. On 31.1.20X2, Bonus was declared in the ratio of 1: 2. Before and after the record date of bonus shares, the shares were quoted at 175 per share and Rs. 90 per share respectively. On 31.3.20X2, Mr. Krishna Murty sold bonus shares to a Broker, who charged 2% brokerage.

Show the Investment Account in the books of Mr. Krishna Murty, who held the shares as Current assets and closing value of investments shall be made at Cost or Market value whichever is lower.

Answers 64

In the books of Mr. Krishna Murty Investment Account

for the year ended 31st March, 20X2

(Scrip: Equity Shares of TELCO Ltd.)

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In the books of Mr. Krishna Murty Investment Account
for the year ended 31st March, 20X2
(Scrip: Equity Shares of TELCO Ltd.)

Date	Particulars	Nominal Value (`)	Cost (`)	Date	Particulars	Nominal Value (`)	Cost (`)
1.4.20X1	To Bank A/c (W.N.1)	1,00,000	1,23,000	31.3.20X2	By Bank A/c (W.N.2)	50,000	44,100
31.1.20X2	To Bonus shares (W.N.5)	50,000	-	31.3.20X2	By Balance c/d (W.N.4)	1,00,000	82,000
31.3.20X2	To Profit & loss A/c (W.N.3)	-	3,100				
		1,50,000	1,26,100			1,50,000	1,26,100

Working Notes:

1. Cost of equity shares purchased on 1.4.20X1 = (1,000 × ` 120) + (2% of ` 1,20,000) + (½% of ` 1,20,000) = ` 1,23,000
2. Sale proceeds of equity shares (bonus) sold on 31st March, 20X2= (500 × ` 90) – (2% of ` 45,000) = ` 44,100.
3. Profit on sale of bonus shares on 31st March, 20X2

   = Sale proceeds – Average cost

   Sale proceeds = ` 44,100

   Average cost = ` (1,23,000 /1,50,000) x 50,000 = ` 41,000

   Profit = ` 44,100 – ` 41,000 = ` 3,100.
4. Valuation of equity shares on 31st March, 20X2

   Cost = (` 1,23,000/1,50,000) x 1,00,000 = ` 82,000

   Market Value = 1,000 shares × ` 90 = ` 90,000

   Closing balance has been valued at ` 82,000 being lower than the market value.
5. Bonus shares do not have any cost.

Question 65 (Illustration)

Mr. X purchased 500 equity shares of Rs. 100 each in Omega Co. Ltd. for Rs . 62,500 inclusive of brokerage and stamp duty. Some years later the company resolved to capitalise its profits and to issue to the holders of equity shares, one equity bonus share for every share held by them. Prior to capitalisation, the shares of Omega Co. Ltd. were quoted at Rs. 175 per share. After the capitalisation, the shares were quoted at Rs. 92.50 per share. Mr. X. sold the bonus shares and received at Rs. 90 per

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share.

Prepare the Investment Account in X's books on average cost basis.

Answers 65

In the books of X Investment Account

[Scrip: Equity shares in Omega Co. Ltd.]

Particulars	Nominal Value	Cost	Particulars	Nominal Value	Cost
To Cash	50,000	62,500	By Cash - Sale (500 x 90)	50,000	45,000
To Bonus shares (W.N.1)	50,000	-	By Balance c/d (W.N. 3)	50,000	31,250
To P & L A/c (W.N. 2)	-	13,750			
	1,00,000	76,250		1,00,000	76,250
To Balance b/d	50,000	31,250			

Working Notes:

1. Bonus shares do not have any cost.

2. Profit on sale of bonus shares = Sales proceeds – Average cost

   Sales proceeds = ` 45,000

   Average cost = $\frac{500}{1,000} \times 62,500 = 31,250$

   Profit = ` 45,000 – `31,250 = ` 13,750

3. Valuation of Closing Balance of Shares at the end of year
   The total cost of 1,000 share including bonus is `62,500

   Therefore, cost of 500 shares (carried forward) is = $\frac{500}{1,000} \times 62,500 = 31,250$

   Market price of 500 shares = 92.50 x 500 = ` 46,250

Cost being lower than the market price, therefore shares are carried forward at cost.

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Question66 (Illustration)

On 1st April, 20X1, Rajat has 50,000 equity shares of P Ltd. at a book value of Rs. 15 per share (nominal value Rs. 10 each). He provides you the further information:

(1) On 20th June, 20X1 he purchased another 10,000 shares of P Ltd. at Rs. 16 per share.

(2) On 1st August, 20X1, P Ltd. issued one equity bonus share for every six shares held by the shareholders.

(3) On 31st October, 20X1, the directors of P Ltd. announced a right issue which entitles the holders to subscribe three shares for every seven shares at Rs. 15 per share. Shareholders can transfer their rights in full or in part.

Rajat sold 1/3rd of entitlement to Umang for a consideration of Rs. 2 per share and subscribed the rest on 5th November, 20X1.

You are required to prepare Investment A/c in the books of Rajat for the year ending 31st March,20X2.

Answers 66

In the books of Rajat Investment Account(Equity shares in P Ltd.)

Date	Particulars	No. of shares	Amount (Rs.)	Date	Particulars	No. of shares	Amount (Rs.)
1.4.X1	To Balance b/d	50,000	7,50,000	31.3.X2	By Balance c/d(Bal. fig.)	90,000	12,10,000
20.6.X1	To Bank A/c	10,000	1,60,000				
1.8.X1	To Bonus issue (W.N.1)	10,000	-				
5.11.X1	To Bank A/c (rightshares) (W.N.4)	20,000	3,00,000				
		90,000	12,10,000			90,000	12,10,000

Working Notes:

1. Bonus shares = $\frac{50,000+10,000}{6}$ = 10,000 shares

2. Right shares = $\frac{50,000+10,000+10,000}{7} \times 3$ = 30,000 shares

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3. Sale of rights = 30,000 shares × $\frac{1}{3}$ × 2 = 20,000 to be credited to statement of profit and loss
4. Rights subscribed = 30,000 shares × $\frac{2}{}$ × 15 = 3,00,000

Question 67 (Illustration)

On 1.4.20X1, Sundar had 25,000 equity shares of 'X' Ltd. at a book value of Rs. 15 per share (Nominal value Rs.10). On 20.6.20X1, he purchased another 5,000 shares of the company at Rs. 16 per share. The directors of 'X' Ltd. announced a bonus and rights issue. No dividend was payable on these issues. The terms of theissue are as follows:

Bonus basis 1:6 (Date 16.8.20X1).

Rights basis 3:7 (Date 31.8.20X1) Price Rs. 15 per share. Due date for payment 30.9.20X1.

Shareholders were entitled to transfer their rights in full or in part. Accordingly, Sundar sold 33.33% of his entitlement to Sekhar for a consideration of Rs. 2 per share.

Dividends: Dividends for the year ended 31.3.20X1 at the rate of 20% were declared by X Ltd. and received by Sundar on 31.10.20X1. Dividends for shares acquired by him on 20.6.20X1 are to be adjusted against the cost of purchase.

On 15.11.20X1, Sundar sold 25,000 equity shares at a premium of Rs. 5 per share. You are required to prepare in the books of Sundar.

Investment Account

Profit & Loss Account.

For your exercise, assume that the books are closed on 31.12.20X1and shares are valued at average cost.

Answers 67

Books of Sundar Investment Account(Scrip: Equity Shares in X Ltd.)

		No.	Amount Rs.			No.	Amount Rs.

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1.4.20X1	To Bal b/d To Bank	25,000	3,75,000	31.10.20X1	By Bank (dividend on shares acquired on 20/6/20X1) (W.N.4)	—	10,000
20.6.20X1	To Bonus (W.N.1)	5,000	80,000				
16.8.20X1	To Bank (Rights Shares) (W.N.3)	5,000	—				
30.9.20X1	To Profit (on sale of shares)	10,000	1,50,000				
15.11.20X1			44,444	15.11.20X1	By Bank (Sale of shares)	25,000	3,75,000
				31.12.20X1	By Bal. c/d (W.N.6)	20,000	2,64,444
		45,000	6,49,444			45,000	6,49,444

Profit and Loss Account (An extract)

To Balance c/d	1,04,444	By Profit transferred	44,444
		By Sale of rights (W.N.3)	10,000
		By Dividend (W.N.4)	50,000
	1,04,444		1,04,444

Working Notes:

1. Bonus Shares = $\frac{25,000+5000}{6}$ = 5,000 shares

2. Right Shares = $\frac{(25,000+5,000+5,000)}{7} \times 3$ = 15,000 shares

3. Right shares renounced = 15,000×1/3 = 5,000 shares

   Sale of right shares = 5,000 x 2 = ` 10,000

   Right shares subscribed = 15,000 – 5,000 = 10,000 shares

   Amount paid for subscription of right shares = 10,000 x 15 = ` 1,50,000

4. Dividend received = 25,000 (shares as on 1st April 20X1) × 10 × 20% = ` 50,000

   Dividend on shares purchased on 20.6.20X1 = 5,000×10×20% = ` 10,000 is adjusted to Investment A/c

5. Profit on sale of 25,000 shares

   = Sales proceeds – Average cost

   Sales proceeds = ` 3,75,000

   Average cost = $\frac{(3,75,000+80,000+1,50,000+10,000)}{45,000} \times 25,000$ = 3,30,556

   Profit = 3,75,000 – 3,30,556 = 44,444

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6. Cost of shares on 31.12.20X1

$$\frac{(3,75,000+80,000+1,50,000+10,000)}{45,000} \times 20,000 = 2,64,444$$

Reference: The students are also advised to refer the full bare text of AS 13 (Revised) "Accounting for Investments".

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Chapter 5.4

AS 16-Borrowing Costs

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.18 TO Q.32											
Past Exams	NO	NO	NO	Q.14	NO	Q.13	NO	NO	Q.15	NO	Q.16	NO
MTP	Q.3	Q.4	Q.3	Q.4	NO	NO	Q.1 Q.3	Q.2 Q.6	Q.1	Q.3 Q.4	Q.5 Q.6	Q.3 Q.13
RTP	Q.7	Q.1	Q.9	Q.7	Q.4	Q.5 Q.8	Q.3 Q.8	Q.7	Q.10	Q.11	Q.12	Q.17

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Chapter 5.4

AS 16-Borrowing Costs

Question 1

A company incorporated in June 2020, has setup a factory within a period of 8 months with borrowed funds. The construction period of the assets had reduced drastically due to usage of technical innovations by the company and the company is able to justify the reasons for the same. Whether interest on borrowings for the period prior to the date of setting up the factory should be capitalized although it has taken less than 12 months for the assets to get ready for use. You are required to comment on the necessary treatment with reference to AS 16. (MTP 5 Marks April 21, April 22, RTP Nov'18)

Answer 1

As per AS 16 'Borrowing Costs', a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Further, the standard states that what constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be jus tified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

It may be implied that there is a rebuttable presumption that a 12 months period constitutes substantial period of time.

Under present circumstances where construction period has reduced drastically due to technical innovation, the 12 months period should at best be looked at as a benchmark and not as a conclusiveyardstick. It may so happen that an asset under normal circumstances may take more than 12 monthsto complete. However, an enterprise that completes the asset in 8 months should not be penalized for its efficiency by denying it interest capitalization and vice versa. The substantial period criteria ensures that enterprises do not spend a lot of time and effort capturing immaterial interest cost for purposes of capitalization.

Therefore, if the factory is constructed in 8 months then it shall be considered as a qualifying asset. The interest on borrowings for the same shall be capitalised although it has taken less than 12 months for the asset to get ready to use.

Question 2

U Limited has obtained a term loan of ₹ 620 lacs for a complete renovation and modernization of its Factory on 1st April, 2020. Plant and Machinery was acquired under the modernization scheme and installation was completed on 30th April, 2021. An expenditure of ₹ 564 lacs was incurred on this Plant and Machinery and the balance loan of ₹ 56 lacs has been used for working capital purposes. The company has paid total interest of ₹ 68.20 lacs during financial year 2020-2021 on the above loan. The accountant seeks your advice how to account for the interest paid in the books of accounts. Willyour answer be different, if the whole process of renovation and modernization gets completed by 28th February, 2021?(MTP 5 Marks , Oct '21)

Answer 2

Borrowing Cost: As per AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Borrowing costs should be expensed except where they are directly attributable to acquisition, construction or production of qualifying asset.

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Qualifying Asset: A qualifying asset is an asset that necessarily takes a substantial period of time (ordinarily, a period of twelve months unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case) to get ready for its intended use or sale.

(i) When construction of asset completed on 30th April, 2021

The treatment for total borrowing cost of ₹ 68.20 lakhs will be as follows:

Purpose	Nature	Interest tocapi- be talized ₹ in lakhs	Interest to be charged to profitand loss account ₹ in lakhs
Plant and machinery	Qualifying asset	[68.20 x (564/620)]	
Under Modernization		= 62.04	
and renovation			
scheme			
Working Capital	Not a qualifying		[68.20 x (56/620)]
	asset		= 6.16
		62.04	6.16

When construction of assets is completed by 28th February, 2019

In this scenario, when the process of renovation gets completed in less than 12 months, the plant andmachinery will not be considered as qualifying assets (until and unless the entity specifically considersthat the asset took substantial period of time for completing their construction) and the whole of interest will be required to be charged off / expensed off to Profit and loss account.

Question 3

(Includes concepts of AS 11- Effects of changes in Foreign Exchange Rates)

Omega Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2021-22 for its residential project at 4%. The interest is payable at the end of the Financial Year. At the time of availment of loan exchange rate was Rs. 56 per US $ and the rate as on 31st March, 2022 was Rs. 62 per US $. If Omega Limited had borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%.

You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2022 as per applicable Accounting Standards. (MTP 5 Marks Sep'22,Mar'18, Mar'19, MTP 4 Marks March 21 & Oct '23, RTP May '21)

Answer 3

(i) Interest for the period 2021-22

= US $ 10 lakhs x 4% × Rs. 62 per US$ = Rs. 24.80 lakhs

(ii) Increase in the liability towards the principal amount

= US $ 10 lakhs × Rs. (62 - 56) = Rs. 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency

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= US $ 10 lakhs × Rs. 56 x 10.5% = Rs. 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = Rs.

58.80 lakhs - Rs. 24.80 lakhs = Rs. 34 lakhs.

Therefore, out of Rs. 60 lakhs increase in the liability towards principal amount, only Rs. 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be Rs. 58.80 lakhs being the aggregate of interest of Rs. 24.80 lakhs on foreign currency borrowings plus the exchange difference tothe extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of Rs. 34 lakhs.

Hence, Rs. 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 andthe remaining Rs. 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11.

Question 4

Suhana Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.05.2021, to be utilized as under:

Particulars	Amount (₹ in lakhs)
Construction of factory building	40
Purchase of Machinery	35
Working Capital	25

In March 2022, construction of the factory building was completed and machinery was installed and ready for it intended use. Total interest on debentures for the financial year ended 31.03.2022 was ₹ 11,00,000. During the year 2021-22, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹ 2,00,000. Explain the treatmentof interest under Accounting Standard 16 and also explain nature of assets. (MTP 5 Marks Oct '22, MTP Oct. '18, MTP Aug. '18, MTP Oct. '19, 5 Marks, RTP May 20)

Answer 4

As per AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset.The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which theyare incurred. Also AS 16 "Borrowing Costs" states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible forcapitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= ₹ 11,00,000 – ₹ 2,00,000

= ₹ 9,00,000

Sr. No.	Particulars	Nature of assets	Interestto be Capitalized (₹)	Interest to be charged to Profit & Loss Account (₹)

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i	Construction of factory building	Qualifying Asset*	9,00,000x40/100 = ₹ 3,60,000	NIL
ii	Purchase of Machinery	Not a Qualifying Asset	NIL	9,00,000x35/100 = ₹ 3,15,000
iii	Working Capital	Not a Qualifying Asset	NIL	9,00,000x25/100 = ₹ 2,25,000
	Total		₹ 3,60,000	₹ 5,40,000

* A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Question 5

Vital Limited borrowed an amount of ₹150 crores on 1.4.2021 for construction of boiler plant @ 10% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Vital Ltd. capitalized ₹ 19.50 crores for the accounting period ending on 31.3.2022. Due to surplus fund out of ₹150 crores, an income of ₹ 1.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard. (MTP 5 Marks March '23, RTP Nov 20)

Answer 5

Para 10 of AS 16 'Borrowing Costs' states that to the extent the funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing duringthe period less any income on the temporary investment of those borrowings. The capitalization rateshould be the weighted average of the borrowing costs applicable to the borrowings of the enterprisethat are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Vital Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2021-22 should becalculated as follows:

Actual interest for 2021-22 (10% of ₹ 150 crores)	₹ 15.00 crores
Less: Income on temporary investment from specific borrowings	(₹ 1.50 crores)
Borrowing costs to be capitalized during year 2021-22	₹ 13.50 crores

Question 6

ABC Limited has started construction of an asset on 1st December, 2021, which continues till 31st March, 2022 (and is expected to go beyond a year). The entity has not taken any specific borrowings to finance the construction of the asset but has incurred finance costs on its general borrowings during the construction period. The directly attributable expenditure at the beginning of the month on this asset was ₹ 10 lakh in December 2021 and ₹ 4 lakh in each of the months of January to March 2022. At the beginning of the year, the entity had taken Inter Corporate Deposits of ₹ 20 lakh at 9% rate of interest and had an overdraft of ₹ 4 lakh, which increased to ₹ 8 lakh on 1st March, 2022. Interest was paid on the overdraft at 10% until 1st January, 2022 and then the rate was increased to 12%. You are required to calculate the annual capitalization rate for computation of borrowing cost in accordance with AS 16 'Borrowing Costs'. (5 Marks Nov'21 & April 23)

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Answer 6

Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	Period of Outstanding balance	Amount of loan(Rs.)	Rate of inter-estp.a.	Weighted average amount of Interest (Rs.)
	a	b	c	d=[bXc)X(a/12)]
9% Debentures	12 months	20,00,000	9%	1,80,000
Bank overdraft	9 months	4,00,000	10%	30,000
	2 months	4,00,000	12%	8,000
	1 month	8,00,000	12%	8,000
		36,00,000		2,26,000

Weighted average cost of borrowings

=(20,00,000 x(12/12))+(4,00,000 x(11/12))+(8,00,000 x (1/12)} = 24,33,334

Capitalisation rate = [(Weighted average amount of interest / Weighted average of general borrowings)x 100] = [(2,26,000 / 24,33,334) x 100] = 9.29% p.a.

Question 7

In May, 2020, Omega Ltd. took a bank loan from a Bank. This loan was to be used specifically for the construction of a new factory building. The construction was completed in January, 2021 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was Rs. 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31 st March, 2021 amounted to Rs. 25 lakhs. the company wantsto treat Rs. 25 lakhs as part of the cost of factory building and thus capitalize it on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with theprovisions of AS 16. (RTP Nov 21, Nov 19, May'18)

Answer 7

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2021) i.e. Rs. 18 lakhs alone can be capitalized. It cannot be extended to Rs. 25 lakhs.

Question 8

When capitalization of borrowing cost should cease as per Accounting Standard 16? Explain in brief. (RTP May '21, Nov'20, Old & New SM)

Answer 8

Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used

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while construction continues for the other parts, capitalization of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

Question 9

Zen Bridge Construction Limited obtained a loan of Rs. 64 crores to be utilized as under:

(i)	Construction of Hill link road in Kedarnath	Rs. 50 crores
(ii)	Purchase of Equipment and Machineries	Rs. 6 crores
(iii)	Working Capital	Rs. 4 crores
(iv)	Purchase of Vehicles	Rs. 1crore
(v)	Advances for tools/cranes etc.	Rs. 1crore
(vi)	Purchase of Technical Know how	Rs. 2 crores
(vii)	Total Interest charged by the Bank for the year ending31st March, 2018	Rs. 1.6 crores

Show the treatment of Interest according to Accounting Standard by Zen Bridge Construction Limited. (RTP May 19)

Answer 9

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use. As per the standard, borrowing costs that are directlyattributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

The treatment of interest by Zen Bridge Construction Ltd. can be shown as:

	Qualifying Asset	Interest to be capitalized Rs. in crores	Interest to be charged to Profit & Loss A/c Rs. in crores	
Construction of hill road*	Yes	1.25		1.6/64 x 50
Purchase of equipment and machineries	No		0.15	1.6/64 x 6
Working capital	No		0.10	1.6/64 x 4
Purchase of vehicles	No		0.025	1.6/64 x 1
Advance for tools, cranes etc.	No		0.025	1.6/64 x 1
Purchase of technical know-how	No		0.05	1.6/64 x 2

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Total		1.25	0.35	

***Note: It is assumed that construction of hill road will normally take more than a year (substantialperiod of time), hence considered as qualifying** asset.

Question 10

(a) **An enterprise has constructed a complex piece of equipment (qualifying asset) that is to be installed on the production line of a manufacturing plant. The equipment has been constructed over a period of 15 months. However, on installation, certain calibrations are required to achieve the desired levelof production before it is finally commissioned. This process is expected to take approximately 2 months during which test runs will be made. Should the borrowing costs attributable to borrowings pertaining to the 2 months test run period be capitalized?**

Should capitalization of borrowing costs be continued when the qualifying asset has been constructed but marketing activities to sell the asset are still in progress? (RTP May '22)

Answer 10

(a) As per AS 16 Borrowing Costs "Capitalization of borrowing costs should cease when substantially all theactivities necessary to prepare the qualifying asset for its intended use or sale are complete". On installation of the equipment, an evaluation has to be made to conclude whether substantially all the activities necessary to prepare the asset are complete. After an equipment has been installed it is usually tested and adjusted for commercial production before it is finally commissioned. The calibrations and adjustments required during this period are performed in order to bring the equipment up to the stageat which it is ready to commence commercial production. Until the asset reaches the stage when it is ready to support commercial levels of production, it is not appropriate to conclude that substantially allthe activities necessary to prepare the asset are complete. Thus, the borrowing cost incurred during thenormal period of test runs (after the installation) are required to be capitalized.

As per provisions of AS 16, capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Further, the standard also explains that "An asset is normally ready for its intended use or sale when its physicalconstruction or production is complete even though routine administrative work might sill continue. If minor modifications, such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete". The emphasis in the Standard is on "to prepare the qualifying asset for its intended use or sale" and not the actual activity of sale. Therefore, where the physical construction of the asset is complete, substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Therefore,in the given case, the borrowing costs pertaining to the period during which the marketing activities to sell the asset are still in progress should not be capitalized as part of the cost of the asset.

Question 11

Harish Construction Company is constructing a huge building project consisting of four phases. It is expected that the full building will be constructed over s everal years but Phase I and Phase II of the building will be started as soon as they are completed.

Following is the detail of the work done on different phases of the building during the current **year:**

(Rs. in lakhs)

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	Phase I	Phase II	Phase III	Phase IV
	Rs.	Rs.	Rs.	Rs.
Cash expenditure	**10**	**30**	**25**	**30**
Building purchased	**24**	**34**	**30**	**38**
Total expenditure	**34**	**64**	**55**	**68**
Total expenditure of all phases				**221**
Loan taken @ 15% at the beginning of the year				**200**

During mid of the current year, Phase I and Phase II have become operational. Find out the total amount to be capitalized and to be expensed during the year. (RTP Nov '22)

Answer 11

	Particulars	Rs.
1.	Interest expense on loan Rs. 2,00,00,000 at 15%	30,00,000
2	Total cost of Phases I and II (Rs. 34,00,000 +64,00,000)	98,00,000
3.	Total cost of Phases III and IV (Rs. 55,00,000 + Rs. 68,00,000)	1,23,00,000
4.	Total cost of all 4 phases	2,21,00,000
5.	Total loan	2,00,00,000
6.	Interest on loan used for Phases I & II, based on proportionate Loan amount = $\frac{30,00,000}{2,21,00,000} \times 98,00,000$	1(approx.) 3,30,317
7.	Interest on loan used for Phases III & IV, based on proportionate Loan amount= $\frac{30,00,000}{2,21,00,000}$	16,69,683 (approx.)

Accounting treatment:

1. For Phase I and Phase II

Since Phase I and Phase II have become operational at the mid of the year, half of the interest amount of Rs. 6,65,158.50 (i.e. Rs. 13,30,317/2) relating to Phase I and Phase II should be capitalized (in the ratio of asset costs 34:64) and added to respective assets in Phase I and Phase II and remaining half of theinterest amount of Rs. 6,65,158.50 (i.e. Rs. 13,30,317/2) relating to Phase I and Phase II should be expensed during the year.

2. **For Phase III and Phase IV**

Interest of Rs. 16,69,683 relating to Phase III and Phase IV should be held in Capital Work-in-Progress till assets construction work is completed, and thereafter capitalized in the ratio of cost of assets. Nopart of this interest amount should be charged/expensed off during the year since the work on thesephases has not been completed yet.

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Question 12

Expert Limited issued 12% secured debentures of ₹ 100 lakhs on 01.06.2021. Money raised fromdebentures to be utilized as under:

Intended Purpose	Amount ₹ in lakhs
Construction of factory building	40
Working Capital	30
Purchase of Machinery	**15**
Purchase of Furniture	**2**
Purchase of truck	**13**

Additional Information:

Interest on debentures for the Financial Year 2021-2022 was paid by the Company.

During the year, the company invested idle fund of ₹ 5 lakhs (out of the money raised fromdebentures) in Bank's fixed deposit and earned interest of ₹ 50,000.

In March, 2022 construction of factory building was not completed (it is expected that it will take another 6 months).

In March 2022, Machinery was installed and ready for its intended use.Furniture was put to use at the end of March 2022.

Truck is going to be received in April, 2022.

You are required to show the treatment of interest as per AS 16 in respect of borrowing cost for theyear ended 31st March, 2022 in the Books of Expert Limited. (RTP May 23)

Answer 12

According to AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantialperiod of time to get ready for its intended use. As per the Standard, borrowing costs that are directlyattributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. The amount o f borrowing costs eligible for capitalization should be determined in accordance with this Standard. Other borrowing costs should be recognized as an expense in the period in which they are incurred. It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost = ₹ 10,00,000 (100 lakhs x 12% x 10/12) – ₹ 50,000 = ₹ 9,50,000

Particulars	**Nature of assets**	**Interest to be capitalized (₹)**	**Interest to be charged to Profit & LossAccount (₹)**
Construction of factory	Qualifying Asset	9,50,000x40/100	NIL
building		= ₹ 3,80,000	
Purchase of Machinery	Not a Qualifying Asset	NIL	9,50,000x15/100
			= 1,42,500
Purchase of and furniture	Not a Qualifying Asset	NIL	9,50,000x2/100

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			=19,000
Purchase of truck	Not a Qualifying Asset	NIL	9,50,000x13/100
			= 1,23,500
Working Capital	Not a Qualifying Asset	NIL	9,50,000x30/100
			= ₹ 2,85,000
Total		₹ 3,80,000	₹ 5,70,000

Question 13

On 15th April, 2019 RBM Ltd. obtained a Term Loan from the Bank for ₹ 320 lakhs to be utilized as under:

	₹ (in lakhs)
Construction for factory shed	**240**
Purchase of Machinery	**30**
Working capital	**24**
Purchase of Vehicles	**12**

Advance for tools/cranes etc.	**8**
Purchase of technical know how	**6**

In March, 2020 construction of shed was completed and machinery was installed. Total interest charged by the bank for the year ending 31st March, 2020 was ₹ 40 lakhs.In the context of provisions of AS 16 'Borrowing Costs', show the treatment of interest and also explain the nature of Assets. (PYP 5 Marks Nov '20)(MTP 5 Marks Sep '23)

Answer 13

As per AS 16 A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Other investments and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired alsoare not qualifying assets. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset.Other borrowing costs should be recognized as an expense in the period in which they are incurred. Construction of factory shed amounting ₹ 240 lakhs is qualifying asset in the given case. The interest for this amount during the year will be added to the cost of factory shed. All others (purchase of machinery, vehicles and technical know how, working capital, advance for tools/cranes) are non- qualifying assets and related borrowing cost will be charged to Profit and Loss statement. Qualifying Asset as per AS 16 (construction of a shed) = ₹ 240 lakhs Borrowing cost to be capitalized = ₹ 40 lakhs x 240/320 = ₹ 30 lakhs Interest to be debited to Profit or Loss account: ₹ (40 – 30) = ₹ 10 lakhs. Note: Assumed that construction of factory shed completed on 31st March, 2020.

Question 14

First Ltd. began construction of a new factory building on 1st April, 2017. It obtained Rs. 2,00,000 as a special loan to finance the construction of the factory building on 1st April, 2017 at an interest rateof 8% per annum. Further, expenditure on construction of the factory building was financed through

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other non-specific loans. Details of other outstanding non-specific loans were:

Amount (Rs.)	Rate of Interest per annum
4,00,000	9%
5,00,000	12%
3,00,000	14%

The expenditures that were made on the factory building construction were as follows:

Date	Amount (Rs.)
1st April, 2017	3,00,000
31st May, 2017	2,40,000
1st August, 2017	4,00,000
31st December, 2017	3,60,000

The construction of factory building was completed by 31st March, 2018. As per the provisions of AS16, you are required to:

(1) Calculate the amount of interest to be capitalized.

(2) Pass Journal entry for capitalizing the cost and borrowing cost in respect of the factory building. (PYP May '19, 5 Marks)

Answer 14

(i) Computation of average accumulated expenses

		Rs.
Rs. 3,00,000 x 12 / 12	=	3,00,000
Rs. 2,40,000 x 10 / 12	=	2,00,000
Rs. 4,00,000 x 8 / 12	=	2,66,667
Rs. 3,60,000 x 3 / 12	=	90,000
		8,56,667

Calculation of average interest rate other than for specific borrowings

Amount of loan (Rs.)	Rate of interest	Amount of interest (₹)
4,00,000	9%	= 36,000
5,00,000	12%	= 60,000
3,00,000	14%	= 42,000
Weighted average rate of interest $\left(\frac{1,38,000}{12,00,000} \times 100\right)$		1,38,000

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		= 11.5%

Amount of interest to be capitalized

Interest on average accumulated expenses:	Rs.
Specific borrowings (Rs. 2,00,000 x 8%)	= 16,000
Non-specific borrowings (Rs. 6,56,667* x 11.5%)	= 75,517
Amount of interest to be capitalised	= 91,517

Total expenses to be capitalized for building

	Rs.
Cost of building Rs. (3,00,000 + 2,40,000 + 4,00,000 +3,60,000)	13,00,000
Add: Amount of interest to be capitalized	91,517
	13,91,517

Journal Entry

Date	Particulars	Dr. (Rs.)	Cr. (Rs.)
31.3.2018	Building A/c Dr.	13,91,517	
	To Building WIP* A/c		13,00,000
	To Borrowing costs A/c (Being amount of cost of building and borrowing cost thereon capitalized)		,517

Question 15

Zebra Limited began construction of a new plant on 1st April,2021 and obtained a special loan of ₹ 20,00,000 to finance the construction of the plant. The rate of interest on loan was 10%.The expenditure that was incurred on the construction of plant was as follows:

The company's other outstanding non-specific loan was ₹ 46,00,000 at an interest rate of 12%.The construction of the plant completed on 31st March,2022. You are required to:

- **Calculate the amount of interest to be capitalized as per the provisions of AS 16 "Borrowing Cost".**
- **Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant. (PYP 5 Marks May'22)**

Answer 15

Total expenses to be capitalized for borrowings as per AS 16 "Borrowing Costs":

	₹
Cost of Plant (10,00,000 + 24,00,000 + 4,00,000)	38,00,000

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Add: Amount of interest to be capitalized (W.N.)	3,24,000
	41,24,000

Journal Entry

			₹	₹
31st March, 2022	Plant A/c	Dr.	41,24,000	41,24,000
	To Bank A/c			
	[Being amount of cost of plant and borrowing cost thereon capitalized]			

Working Note:

Computation of interest to be capitalized:

	Expenditure			₹
1st April, 2021	10,00,000	On specific borrowing	₹ 10,00,000 x 10%	1,00,000
1st August, 2021	24,00,000	On specific borrowing	₹ 10,00,000 x 10%	1,00,000
1st August, 2021		On non-specific borrowings	₹ 14,00,000× 8/12 x 12%	1,12,000
1st January, 2022	4,00,000	On non-specific borrowings	₹ 4,00,000 × 8/13 ×12	12,000
				3,24,000

Alternatively, interest cost to be capitalized can be derived by computing average accumulated expenses in the following manner.

Computation of Average Accumulated Expenses:

1st April, 2021	10,00,000 x 12/12	10,00,000
1st August, 2021	10,00,000 x 12/12 14,00,000 x 8/12	10,00,000 9,33,333
1st January, 2022	4,00,000 x 3/12	1,00,000
		30,33,333

Computation of interest to be capitalized:

		₹
On specific borrowing	₹ 20,00,000 x 10%	2,00,000

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On non-specific borrowing	₹ (30,33,333- 20,00,000) x 12%	1,24,000
		3,24,000

NOTE: Since specific borrowings are earmarked for construction of a particular qualifying asset, it cannot be used for construction of any other qualifying asset except for temporary investment. Therefore, once the commencement of capitalization of borrowing cost criteria are met, actual borrowing cost incurred on specific borrowing shall be capitalized irrespective of the fact that amounthad been utilized in parts.

Question 16

On 1stApril, 2022 Workhouse Limited took a loan from a Financial Institution for Rs. 25,00,000 for the construction of Building. The rate of interest is 12%.

In addition to above loan, the company has taken multiple borrowings as follows:

i) 8%	**Debentures**	**Rs. 15,00,000**
ii) 15%	**Term Loan**	**Rs. 30,00,000**
iii) 10%	**Other Loans**	**Rs. 18,00,000**

The company has utilised the above funds in construction / purchase of the following assets:

(i) Building	**Rs. 70,00,000**
(ii) Furniture	**Rs. 22,00,000**
(iii) Plant & Machinery	**Rs. 90,00,000**
Factory Shed	Rs. **43,00,000**

The construction of Building, Plant & Machinery and Factory Shed was completed on 31st March 2023. Readymade Furniture was purchased directly from the market. The factory was ready for production on 1stApril 2023.

You are required to calculate the borrowing cost for both qualifying and non-qualifying assets. (PYP 5 Marks May '23)

Answer 16

Interest to be Capitalized (on qualifying asset)

	Particulars	Computation	Rs.
i.	On specific Borrowings	25,00,000x12%	3,00,000
ii.	On non-specific borrowings	(W.N.1)	6,67,500
iii.	Amount of interest toCapitalised be	(i+ii)	9,67,500

Interest transferred to P&L (on non-qualifying asset)

	Particulars	Computation	Rs.

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i.	On non-specific Borrowings	(W.N.1)	82,500

Working note:

Treatment of interest under AS 16 on non-specific borrowings

	Particulars	Qualify-ingasset	# Computation	Interest-Capital-ized	Interestcharged to P&L A/c
i.	Building	Yes	45,00,000/2,00,00,000 x 63,00,000 x 11.9048%	1,68,750	-
ii.	Furniture	No	22,00,000/2,00,00,000 x 63,00,000 x 11.9048%	-	82,500
iii.	Plant & Machinery	Yes	90,00,000/2,00,00,000 x 63,00,000 x 11.9048%	3,37,500	-
iv.	Factory shed	Yes	43,00,000/2,00,00,000 x 63,00,000 x 11.9048%	1,61,250	-
	Total			6,67,500	82,500

NOTE: Alternative manner of presentation for Treatment of interest under AS 16 on non-specificborrowings:

	Particulars	Qualifying asset	Expenses Share in Incurred borrowings Rs.	Rs.	Interest-Capital-ized Rs.	Interest charged to P&L A/c Rs.
i.	Building	Yes	45,00,000	7,50,000 x 45/200	1,68,750	-
ii.	Furniture	No	22,00,000	7,50,000 x 22/200	-	82,500
iii.	Plant & Machinery	Yes	90,00,000	7,50,000 x 90 /200	3,37,500	-
iv.	Factory shed	Yes	43,00,000	7,50,000 x 43 / 200	1,61,250	-
	Total		**2,00,00,000**		**6,67,500**	**82,500**

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Weighted Average interest rate for non-specific borrowings

Particulars	Amount of loan (a)	Rate of interest (b)	Amount of interest (c) = (a) x (b)
Debentures	15,00,000	8%	1,20,000
Term loan	30,00,000	15%	4,50,000
Other loans	18,00,000	10%	1,80,000
	63,00,000		7,50,000
		# Weighted Average Rate of Interest = 7,50,000 / 63,00,000 x 100 = 11.9048%	

Question 17

Raj & Co. has taken a loan of US$ 20,000 at the beginning of the financial year for a specific projectat an interest rate of 6% per annum, payable annually. On the day of taking loan, the exchange ratebetween currencies was ₹ 48 per 1 US$. The exchange rate at the closing of the financial year was

₹ 50 per 1 US$. The corresponding amount could have been borrowed by the company in Indian Rupee at an interest rate of 11% per annum.

Determine the treatment of borrowing cost in the books of accounts. (RTP Nov '23)

Answer 17

Interest on Foreign Currency Loan:

= US $ 20,000 x₹ 50 per US $ x 6% = ₹ 60,000.

Foreign Exchange Loss on Foreign currency loan:

= US$ 20,000 x₹ (50-48) = ₹ 40,000.

Interest that would have been if the loan was taken in Indian currency i.e. local currency:

= US $ 20,000 x 48 x 11% = ₹1,05,600

Difference between interest on local currency borrowing and foreign currency borrowing:

= ₹ 1,05,600 - ₹ 60,000 = ₹45,600

The entire exchange difference of 40,000 would be considered as borrowing costs.The total borrowing cost would be ₹ 100000 (₹ 60000+ ₹ 40000).

Question 18

As per AS 16, all the following are qualifying assets except

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a. Manufacturing plants and Power generationfacilities	b. Inventories that require substantial period oftime
c. Assets those are ready for sale.	d. None of the above

Ans: (c)

Question 19

Which of the following statement is correct:

a. Entire exchange gain is reduced from the costof the Qualifying asset.	b. Entire exchange loss is added to the cost of aQualifying asset.
c. No adjustment is done for the exchange losswhile computing cost of Qualifying asset.	d. None of the above

Ans: (c)

Question 20

Capitalisation rate considers:

a. Borrowing costs on general borrowings only.	b. Borrowing costs on general and specificborrowings both.
c. Borrowing costs on specific borrowings only	d. None of the above

Ans: (a)

Question 21

If the amount eligible for capitalisation in case of inventory as per AS 16 is ₹ 12,000 and cost of inventory is ₹ 40,000 and its net realizable value is ₹ 45,000; What amount can be capitalised as a part of inventorycost.

a. ₹ 12,000	b. ₹ 5,000
c. ₹ 7,000	d. ₹ 10,000

Ans: (b)

Question 22

X Ltd is commencing a new construction project, which is to be financed by borrowing. The key dates areas follows:

i) **15th May, 20X1: Loan interest relating to the project starts to be incurred**

ii) **2nd June, 20X1: Technical site planning commences**

iii) **19th June, 20X1: Expenditure on the project started to be incurred**

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iv) **18th July, 20X1: Construction work commences**

Identify the commencement date for capitalisation under AS 16.

a. 15th May, 20X1	b. 19th June, 20X1
c. 18th July, 20X1	d. 2nd June, 20X1

Ans: (b)

Theoretical Questions Answers

Questions 23

When capitalization of borrowing cost should cease as per Accounting Standard 16? Explain the provision.

Answers 23

Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrativework might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended useor sale are complete.

Questions 24

H Ltd. incurs borrowing costs for the purpose of construction of a qualifying asset for its own use. Theconstruction gets completed on May 31, 20X1. However, decoration work is under process which is expected to be completed by November 20X1 after which H Ltd. will be able to start using the said asset for its own use. H Ltd. wants to capitalize the eligible borrowing costs incurred up to November 20X1.

Answers 24

The capitalization of borrowing costs shall cease when substantially all the activities necessary to prepare the qualifying assets for its intended use or sale is completed.

In the given case, H Ltd. should capitalize borrowing costs only up to May 31, 20X1. The borrowing costincurred thereafter cannot be capitalized as the asset was ready for its intended use on May 31, 20X1.The fact that decoration work was being carried out should not be considered as the asset was readyfor its intended use on May 31, 20X1.

Questions 25

ABC Ltd. is in the process of getting an entertainment park constructed. For this purpose, it has takenloan from a bank. The said park consists of several rides and facilities, each of which can be used individually. Three fourth part of the park has been constructed and can be opened up for

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public, while construction on the remaining part is continuing. Whether the capitalization of borrowing cost shouldcontinue for the whole park until construction continues?

Answers 25

ABC Ltd. is in process of constructing an entertainment park which consists of several rides and facilities that can operate independently for their intended use. Even though the park as whole is not complete, the individual facilities are ready for their intended use.

The cessation of capitalization depends upon the nature of the qualifying assets, particularly where the qualifying assets consists of various parts. There are qualifying assets where each part is capable of being used while the construction continues on other parts. There are qualifying assets where all parts have to be completed before any earlier completed part can be put to use.

Since in the given scenario, the individual facilities are capable of operating independently and are ready for their intended use, therefore the borrowing costs shall cease to be capitalized for the three-fourth part of the project.

Practical Questions Answers

Questions 26

On 1st April, 20X1, Amazing Construction Ltd. obtained a loan of ₹ 32 crores to be utilised as under:

	Construction of sealink across two cities:	
i)	**(work was held up totally for a month during the yeardue to high water levels)**	**25 crores**
ii)	**Purchase of equipments and machineries**	**3 crores**
iii)	**Working capital**	**2 crores**
iv)	**Purchase of vehicles**	**50,00,000**
v)	**Advance for tools/cranes etc.**	**50,00,000**
vi)	**Purchase of technical know-how**	**1 crores**
vii)	**Total interest charged by the bank for the year ending31st March, 20X2**	**80,00,000**

Show the treatment of interest by Amazing Construction Ltd.

Answers 26

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use.

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

The treatment of interest by Amazing Construction Ltd. can be shown as:

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	Qualifying Asset	Interest to be capitalised ₹	Interest to be chargedto Profit & Loss A/c ₹	
Construction of sea-link	Yes	62,50,000		[80,00,000x(25/32)]
Purchase of equipment and machineries	No		7,50,000	[80,00,000x(3/32)]
Working capital	No		5,00,000	[80,00,000x(2/32)]
Purchase of vehicles	No		1,25,000	[80,00,000x(0.5/32)]
Advance for tools, cranes etc.	No		1,25,000	[80,00,000x(0.5/32)]
Purchase of technical know-how	No		2,50,000	[80,00,000x(1/32)]
Total		62,50,000	17,50,000	

*It is assumed that work held up for a month due to high water level is normal during the construction of sealink and capitalization of borrowing cost should not be suspended for necessary temporary delay.

Questions 27

Rainbow Limited borrowed an amount of ₹ 150 crores on 1.4.20X1 for construction of boiler plant @11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is13% p.a., the accountant of Rainbow Ltd. capitalized ₹ 19.50 crores for the accounting period ending on 31.3.20X2. Due to surplus fund out of ₹ 150 crores, income of ₹ 3.50 crores were earned and creditedto profit and loss account. Comment on the above treatment of accountant with reference to relevantaccounting standard.

Answers 27

Para 10 of AS 16 'Borrowing Costs' states "To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings."

The capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

Thus, the treatment of accountant of Rainbow Ltd. is incorrect. Amount of borrowing costs capitalized should be calculated as follows:

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Particulars	₹ in crores
Actual interest for 20X1-20X2 (11% of ₹ 150 crores)	16.50
Less: Income on temporary investment from specific borrowings	(3.50)
Borrowing costs to be capitalized during year 20X1-20X2	13.00

Questions 28

Harish Construction Company is constructing a huge building project consisting of four phases. It is expected that the full building will be constructed over several years but Phase I and Phase II of the building will be started as soon as they are completed.

Following is the detail of the work done on different phases of the building during the current year:

(₹ in lakhs)

	Phase I ₹	Phase II ₹	Phase III ₹	Phase IV ₹
Cash expenditure	**10**	**30**	**25**	**30**
Building purchased	**24**	**34**	**30**	**38**
Total expenditure	**3**	**6**	**55**	**68**
Total expenditure of all phases	**4**	**4**		**221**
Loan taken @ 15% at the beginning of the year				**200**

During mid of the current year, Phase I and Phase II have become operational. Find out the total amount to be capitalized and to be expensed during the year.

Answers 28

Computation of amount to be capitalized

No.	Particulars	₹
1.	Interest expense on loan ₹ 2,00,00,000 at 15%	30,00,000
2.	Total cost of Phases I and II (₹ 34,00,000 +64,00,000)	98,00,000
3.	Total cost of Phases III and IV (₹55,00,000 + ₹ 68,00,000)	1,23,00,000
4.	Total cost of all 4 phases	2,21,00,000

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5.	Total loan	2,00,00,000
6.	Interest on loan used for Phases I & II, based on proportionate Loan amount = $\frac{30,00,000}{2,21,00,000} \times 98,00,000$	3,30,317 (approx.)
7.	Interest on loan used for Phases III & IV, based on proportionate Loan amount = $\frac{30,00,000}{2,21,00,000} \times 1,23,00,000$	16,69,683 (approx.)

Accounting treatment For Phase I andPhase II

Since Phase I and Phase II have become operational at the mid of the year, half of the interest amountof ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be capitalized (in the ratioof asset costs 34:64) and added to respective assets in Phase I and Phase II and remaining half of the interest amount of ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be expensed during the year.

For Phase III and Phase IV

Interest of ₹ 16,69,683 relating to Phase III and Phase IV should be held in Capital Work-in-Progress tillassets construction work is completed, and thereafter capitalized in the ratio of cost of assets. No partof this interest amount should be charged/expensed off during the year since the work on these phases has not been completed yet.

Question 29 (Illustration)

PRM Ltd. obtained a loan from a bank for ₹ 120 lakhs on 30-04-20X1. It was utilised as follows:

Particulars	Amount (₹ in lakhs)
Construction of a shed	**50**
Purchase of a machinery	**40**
Working Capital	**20**
Advance for purchase of truck	**10**

Construction of shed was completed in March 20X2. The machinery was installed on the date of acquisition. Delivery of truck was not received. Total interest charged by the bank for the year ending 31- 03-20X2 was ₹ 18 lakhs. Show the treatment of interest.

Answers 29

Qualifying Asset as per AS 16 = ₹ 50 lakhs (construction of a shed)Borrowing cost to be capitalised = 18 x 50/120 = ₹ 7.5 lakhs Interest to be debited to Profit or Loss account = ₹ (18 – 7.5) lakhs = ₹ 10.5 lakhs

Question30 (Illustration)

X Ltd. began construction of a new building on 1st January, 20X1. It obtained ₹ 1 lakh special loan tofinance the construction of the building on 1 st January, 20X1 at an interest rate of 10%. The company's

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other outstanding two non-specific loans were:

Amount	Rate of Interest
₹ 5,00,000	11%
₹ 9,00,000	13%

The expenditures that were made on the building project were as follows:

		₹
January	20X1	2,00,000
April	20X1	2,50,000
July	20X1	4,50,000
December	20X1	1,20,000

Building was completed by 31st December 20X1. Following the principles prescribed in AS 16 'Borrowing Cost,' calculate the amount of interest to be capitalised and pass one Journal Entry for capitalising the cost and borrowing cost in respect of the building.

Answers 30

(i) Computation of weighted average accumulated expenses

		₹
₹ 2,00,000 x 12 / 12	=	2,00,000
₹ 2,50,000 x 9 / 12	=	1,87,500
₹ 4,50,000 x 6 / 12	=	2,25,000
₹ 1,20,000 x 1 / 12	=	10,000
		6,22,500

Amount of loan (₹)	Rate of interest	Amount of interest (₹)
5,00,000	11%	= 55,000
9,00,000	13%	= 1,17,000
14,00,000		1,72,000
Weighted average rate of interest		= 12.285% (approx.)
$\left(\frac{1,72,000}{14,00,000} \times 100\right)$		

Interest on weighted average accumulated **expenses**

		₹
Specific borrowings (₹ 1,00,000 x 10%)	=	10,000
Non-specific borrowings (₹ 5,22,500 x 12.285%)	=	64,189
Amount of interest to be capitalised	=	74,189

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(i) **Total expenses to be capitalized for building**

	₹
Cost of building ₹ (2,00,000 + 2,50,000 + 4,50,000 + 1,20,000)	10,20,000
Add: Amount of interest to be capitalised	74,189
	10,94,189

(ii) **Journal Entry**

Date	Particulars		Dr. (₹)	Cr. (₹)
31.12. 20X1	Building account	Dr.	10,94,189	
	To Bank account (Being amount of cost of building And borrowing cost thereon capitalised)			10,94,189

Question31 (Illustration)

The company has obtained Institutional Term Loan of ₹ 580 lakhs for modernisation and renovationof its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 20X2 amounted to ₹ 406 lakhs, ₹ 58 lakhs has been advancedto suppliers for additional assets and the balance loan of ₹ 116 lakhs has been utilised for working capital purpose. The Accountant is on a dilemma as to how to account for the total interest of ₹ 52.20 lakhs incurred during 20X1-20X2 on the entire Institutional Term Loan of ₹ 580 lakhs.

Answers 31

As per para 6 of AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

A qualifying asset is an asset that necessary takes a substantial period of time* to get ready for its intended use or sale.

The treatment for total interest amount of ₹ 52.20 lakhs can be given as:

Purpose	Nature	Interest to be capitalised	Interest to be charged to profit and loss account
		₹ in lakhs	₹ in lakhs
Modernisation and renovation of plant and machinery	Qualifying asset	$52.20 \times \frac{406}{580} = 36.54$	

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Advance to suppliesfor additional assets	Qualifying asset	$52.20 \times \frac{406}{580} = 5.22$	$52.20 \times \frac{116}{580}$ 10.44
Working Capital	Not a qualifying asset		
		41.76	10.44

* A substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case.** It is assumed in the above solution that the modernisation and renovation of plant and machinery will take substantial period of time (i.e. more than twelve months). Regarding purchase of additional assets, the nature of additional assets has also been considered as qualifying assets. Alternatively, the plant and machinery and additional assets may be assumed to be non-qualifying assets on the basis that the renovation and installation of additional assets will not take substantial period of time. In that case, the entire amount of interest, ₹ 52.20 lakhs will be recognised as expense in the profit and loss accountforyear ended 31 st March, 20X2.

Question 32 (Illustration)

Take Ltd. has borrowed ₹ 30 lakhs from State Bank of India during the financial year 20X1-20X2. Theborrowings are used to invest in shares of Give Ltd., a subsidiary company of Take Ltd., which is implementing a new project, estimated to cost ₹ 50 lakhs. As on 31st March, 20X2, since the said project was not complete, the directors of Take Ltd. resolved to capitalise the interest accruing on borrowings amounting to ₹ 4 lakhs and add it to the cost of investments. Comment.

Answers 32

As per AS 13 (Revised) "Accounting for Investments", the cost of investment includes acquisition charges such as brokerage, fees and duties. In the present case, Take Ltd. has used borrowed funds for purchasing shares of its subsidiary company Give Ltd. ₹ 4 lakhs interest payable by Take Ltd. to State Bank of India cannot be called as acquisition charges, therefore, cannot be constituted as cost of investment.

Further, as per para 3 of AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Since, shares are ready for its intended use at the time of sale, it cannot be considered as qualifying asset that can enable a company to add the borrowing cost to investments. Therefore, the directors of Take Ltd. cannot capitalise the borrowing cost as part of cost of investment. Rather, it has to be charged to the Statement of Profit and Loss for the year ended 31st March, 20X2.

Reference: The students are advised to refer the full text of AS 16 "Borrowing Costs" (issued 2000).

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Chapter 5.5

AS 19- Leases

Attempts Cove age	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.14 TO Q.29											
Past Exams	Q.2	NO	Q.5	Q.10	NO	NO	Q.2 Q.11	NO	Q.12	NO	NO	NO
MTP	Q.2	Q.3	Q.1	Q.1	Q.11	Q.2	Q.4 Q.11	Q.2 Q.5	Q.4	Q.5 Q.6	Q.5	Q.8
RTP	Q.1 Q.9	NO	Q.8	Q.3	Q.1	Q.7	Q.3	NO	Q.7	NO	Q.9	Q.13

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Chapter 5.5

AS 19- Leases

Question 1

ABC Ltd. took a machine on lease from XYZ Ltd., the fair value being Rs. 10,00,000. The economic life of the machine as well as the lease term is 4 years. At the end of each year, ABC Ltd. pays Rs. 3,50,000. The lessee has guaranteed a residual value of Rs. 50,000 on expiry of the lease to the lessor. However, XYZ Ltd. estimates that the residential value of the machinery will be Rs. 35,000 only. The implicit rate of return is 16% and PV factors at 16% for year 1, year 2, year 3 and year 4 are 0.8621, 0.7432, 0.6407 and 0.5523 respectively. You are required to calculate the value of machinery to be considered by ABC Ltd. and the finance charges for each year. (MTP 5 Marks Apr'19, Oct'19, Mar'19, RTP May 20, RTP Nov 18)

Answer 1

As per AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inceptionof a finance lease. Such recognition should be at an amount equal to the fair value of the leased assetat the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the stand point of the lessee.

Value of machinery

In the given case, fair value of the machinery is Rs. 10, 00,000 and the net present value of minimum lease payments is Rs. 10, 07,020 (Refer working Note). As the present value of the machine is more than the fair value of the machine, the machine and the corresponding liability will be recorded at value of Rs. 10,00,000.

Calculation of finance charges for each year

Year	Finance charge	Payment	Reduction in outstanding liability	Outstandingliability
1st year beginning	(Rs.) -	(Rs.) -	(Rs.) -	(Rs.) 10,00,000
End of 1st year	1,60,000	3,50,000	1,90,000	8,10,000
End of 2nd year	1,29,600	3,50,000	2,20,400	5,89,600
End of 3rd year	94,336	3,50,000	2,55,664	3,33,936
End of 4th year	53,430	3,50,000	2,96,570	37,366
Working Note:				

Present value of minimum lease payments

Annual lease rental x PV factor

Rs. 3,50,000 x (0.8621 + 0.7432 + 0.6407+ 0.5523)	Rs. 9,79 ,405
Present value of guaranteed residual value Rs. 50,000 x (0.5523)	Rs. 27,615
	Rs. 10,07,020

Question 2

A Ltd. sold machinery having WDV of Rs. 40 lakhs to B Ltd. for Rs. 50 lakhs and the same machinerywas leased back by B Ltd. to A Ltd. The lease back is operating lease. Explain the accounting treatment as

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per AS 19 in the following cases:

(i) Sale price of Rs. 50 lakhs is equal to fair value.

(ii) Fair value is Rs. 45 lakhs and sale price is Rs. 38 lakhs.

(iii) Fair value is Rs. 40 lakhs and sale price is Rs. 50 lakhs.

(iv) Fair value is Rs. 46 lakhs and sale price is Rs. 50 lakhs

(v) Fair value is Rs. 35 lakhs and sale price is Rs. 39 lakhs. (MTP 5 Marks Mar'18, Oct'18, PYP 5 Marks, May '18) (Same concept different figures PYP 5 Marks Jan 21, MTP 5 Marks Oct'20, MTP 5 Marks Oct'21, Old & New SM)

Answer 2

Following will be the treatment in the given cases:

(i) When sale price of Rs. 24 lakhs is equal to fair value, A Ltd. should immediately recognise the profit of Rs. 4 lakhs (i.e. 24 – 20) in its books.

(ii) When fair value is Rs. 20 lakhs & sale price is Rs. 24 lakhs then profit of Rs. 4 lakhs is to be deferred and amortised over the lease period.

(iii) When fair value is Rs. 22 lakhs & sale price is Rs. 25 lakhs, profit of Rs. 2 lakhs (22 - 20) to be immediately recognised in its books and balance profit of Rs.3 lakhs (25-22) is to be amortised/deferred over lease period.

(iv) When fair value of leased machinery is Rs. 25 lakhs & sale price is Rs. 18 lakhs, then loss of Rs. 2 lakhs(20–18) to be immediately recognised by A Ltd. in its books provided loss is not compensated by future lease payment.

(v) When fair value is Rs. 18 lakhs & sale price is Rs. 19 lakhs, then the loss of Rs. 2 lakhs (20-18) to be immediately recognised by A Ltd. in its books and profit of Rs. 1 lakhs (19-18) should be amortised/deferred over lease period.

Question 3

Sun Limited wishes to obtain a machine costing Rs. 30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 5 years. It enters into an agreement with Star Ltd., for a lease rental for Rs. 3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Sun Limited is not sure about the treatment of theselease rentals and seeks your advise. You are required to explain the necessary accounting treatment in line with AS 19. (use annuity factor at @ 15% for 3 years as 3.36) (MTP 5 Marks, Aug'18, RTP Nov '19, RTP May 21)

Answer 3

As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

Annuity Factor (Year 1 to Year 5) 3.36 (approx.)

Present Value of minimum lease payments (Rs. 3 lakhs each year) Rs. 10.08 lakhs (approx.)

Thus present value of minimum lease payments is Rs. 10.08 lakhs and the fair value of the machine is Rs. 30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machineis 14 years while the lease is only for five years. Therefore, lease agreement is an operating lease. Lease payments

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under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Question 4

You are required to give the necessary journal entry at the inception of lease to record the assettaken on finance lease in books of lessee from the following information:

Lease period = 5 years;

Annual lease rents = Rs. 50,000 at the end of each year.Guaranteed residual value = Rs. 25,000

Fair Value at the inception (beginning) of lease = Rs. 2,00,000

Interest rate implicit on lease is = 12.6% (Discounted rates for year 1 to 5 are .890, .790, .700, .622 and .552 respectively). (MTP 5 Marks April 21, April 22)

Answer 4

Present value of minimum lease payment is computed below:

Year	MLP Rs.	DF (12.6%)	PV Rs.
1	50,000	0.890	44,500
2	50,000	0.790	39,500
3	50,000	0.700	35,000
4	50,000	0.622	31,100
5	50,000	0.552	27,600
5	25,000	0.552	13,800
			1,91,500

Present value of minimum lease payment = Rs. 1,91,500 Fair value of leased asset = Rs. 2,00,000As per AS 19, on the date of inception of Lease, Lessee should show it as an asset and corresponding liability at lower of Fair value of leased asset at the inception of the lease and present value of minimum lease payments from the standpoint of the lessee. The accounting entry at the inception oflease to record the asset taken on finance lease in books of lessee is suggested below:

	Rs.	Rs.
Asset A/c Dr. To Lessor (Lease Liability) A/c (Being recognition of finance lease as asset and liability)	1,91,500	1,91,500

Question 5

S. Square Private Limited has taken machinery on finance lease from S.K. Ltd. The information is asunder: Lease term = 4 years

Fair value at inception of lease = ₹ 20,00,000 Lease rent = ₹ 6,25,000 p.a. at the end of year Guaranteed residual value = ₹ 1,25,000 Expected residual value = ₹ 3,75,000 Implicit interest rate =15% Discounted

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rates for 1st year, 2nd year, 3rd year and 4th year are 0.8696, 0.7561, 0.6575 and 0.5718 respectively.

You are required to calculate the value of the lease liability as per AS-19 and also disclose impact of this on Balance sheet and Profit & loss account at the end of year 1. (MTP 5 Marks Nov '21 & April '23, Old & New SM)(Same concept different figures MTP 5 Marks Oct'22, PYP 5 Marks May '19)

Answer 5

According to AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the lower of the fair value of the leased asset at the inception of the finance lease and the present value of the minimum lease payments from the standpoint of the lessee. In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease. Present value of minimum lease payments will be calculated as follows:

Year	Minimum Lease Payment ₹	Implicit interest rate (Discount rate @15%)	Present value ₹
1	6,25,000	0.8696	5,43,500
2	6,25,000	0.7561	4,72,563
3	6,25,000	0.6575	4,10,937
4	7,50,000	0.5718	4,28,850
Total	26,25,000		18,55,850

Present value of minimum lease payments ₹ 18,55,850 is less than fair value at the inception of lease i.e. ₹ 20,00,000, therefore, the asset and corresponding lease liability should be recognized at ₹18,55,850 as per AS 19.

Minimum LeasePayment of 4th year includes guaranteed residual value amounting ₹ 1,25,000

Question 6

Sun Limited leased a machine to Moon Limited on the following terms:

	(Amount in ₹)
Fair value at inception of lease	**50,00,000**
Lease Term	**4 Years**
Lease Rental per annum	**16,00,000**
Guaranteed residual value	**3,00,000**
Expected residual value	**4,50,000**
Implicit Interest rate	**15%**

Discounted rates for 1st year, 2nd year, 3rd year and 4th year are 0.8696, 0.7561, 0.6575 and 0.5718 respectively.Calculate the value of Lease Liability and ascertain Unearned Finance Income as per AS-19. (MTP 5 Marks Sep'22) (Same concept different figures Old & New SM)

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Answer 6

According to AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of the finance lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from thestandpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee. In calculating the present value ofthe minimum lease payments the discount rate is the interest rate implicit in the lease. Present valueof minimum lease payments will be calculated as follows:

Year	Minimum Lease Payment ₹	Internal rate of return (Discount rate @15%)	Present value ₹
1	16,00,000	0.8696	13,91,360
2	16,00,000	0.7561	12,09,760
3	16,00,000	0.6575	10,52,000
4	19,00,000	0.5718	10,86,420
Total	67,00,000		47,39,540

Present value of minimum lease payments i.e. ₹ 47,39,540 is less than fair value at the inception of lease i.e. ₹ 50,00,000, therefore, the value of lease is ₹ 47,39,540 and lease liability should be recognized in the books at ₹ 47,39,540 as per AS 19.

Calculation of Unearned Finance Income

As per AS 19 on Leases, unearned finance income is the difference between (a) the gross investment in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

Where:

I. **Gross investment** in the lease is the aggregate of (i) minimum lease payments from the stand pointof the lessor and (ii) any unguaranteed residual value accruing to the lessor.

Gross investment = Minimum lease payments + Unguaranteed residual value

= [Total lease rent + Guaranteed residual value(GRV)] + Unguaranteed residual value (URV)

= [(₹ 16,00,000 ×4 years) + ₹ 3,00,000] + ₹ 1,50,000 = ₹ 68,50,000

II. **Present value of minimum lease payment from Lessor's view point**

Lease liability ₹ 47,39,540 + present value of (URV) unguaranteed residual value

(₹ 1,50,000 x 0.5718) = ₹ 48,25,310

Unearned Finance Income = (a) – (b) = ₹ 68,50,000 – ₹ 48,25,310= ₹ 20,24,690

*Minimum Lease Payment of 4th year includes guaranteed residual value amounting i.e 16,00,000 + 3,00,000

=19,00,000.

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Question 7

(a)Classify the following into either operating or finance lease:

(i)If Present value (PV) of Minimum lease payment (MLP) = "X" ; Fair value of the asset is "Y"

and X=Y.

(ii) Economic life of the asset is 7 years, lease term is 6.5 years, but asset is not acquired at the end of the lease term;

(iii) Economic life of the asset is 6 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee . (RTP Nov 20)

(b) Viral Ltd. sold machinery having WDV of Rs. 40 lakhs to Saral Ltd. for Rs. 50 lakhs and the samemachinery was leased back by Saral Ltd. to Viral Ltd. The lease back is in nature of operating lease. You are required to explain the treatment in the given cases –

(i) Fair value is Rs. 45 lakhs and sale price is Rs. 38 lakhs.

(ii) Fair value is Rs. 40 lakhs and sale price is Rs. 50 lakhs.

(iii) Fair value is Rs. 46 lakhs and sale price is Rs. 50 lakhs (RTP Nov 20, May 22)

Answer 7

(a)(i) The lease is a finance lease if X = Y, or if X substantially equals Y.

(ii) The lease will be classified as a finance lease, since a substantial portion of the life of the assetis covered by the lease term.

(iii) Since the asset is procured only for the use of lessee, it is a finance lease.

(b) As per AS 19, where sale and leaseback results in operating lease, then the accounting treatment indifferent situations is as follows:

Situation 1: Sale price = Fair Value

Profit or loss should be recognized immediately.

Situation 2: Sale Price < Fair Value

Profit should be recognized immediately. The loss should also be recognized immediately except that,if the loss is compensated by future lease payments at below market price, it should be deferred andamortized in proportion to the lease payments over the period for which the asset is expected to be used.

Situation 3: Sale Price > Fair Value

The excess over fair value should be deferred and amortized over the period for which the asset is expected to be used.

Following will be the treatment in the situations given in the question:

(i) When fair value of leased machinery is Rs. 45 lakhs & sales price is Rs. 38 lakhs, then loss of Rs. 2 lakhs (40 – 38) to be immediately recognized by Viral Ltd. in its books provided loss is not compensated by future lease payment.

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(ii) When fair value is Rs. 40 lakhs & sales price is Rs. 50 lakhs then, profit of Rs. 10 lakhs is to be deferredand amortized over the lease period When fair value is Rs. 46 lakhs & sales price is Rs. 50 lakhs, profit of Rs. 6 lakhs (46 less 40) to be immediately recognized in its books and balance profit of Rs.4 lakhs (50-46) is to be amortized/deferred over lease period.

Question 8

Aksat International Limited has given a machinery on lease for 36 months, and its useful life is 60 months. Cost & fair market value of the machinery is Rs. 5,00,000. The amount will be paid in 3 equal annual installments and the lessee will return the machinery to lessor at termination of lease. The unguaranteed residual value at the end of 3 years is Rs. 50,000. IRR of investment is 10% and present value of annuity factor of Rs. 1 due at the end of 3 years at 10% IRR is 2.4868 and present value of Rs. 1 due at the end of 3rd year at 10% IRR is 0.7513.

You are required to comment with reason whether the lease constitute finance lease or operating lease. If it is finance lease, calculate unearned finance income. (RTP May 19)(MTP 5 Marks Sep '23)

Answer 8

Determination of Nature of Lease

Present value of unguaranteed residual value at the end of 3rd year = Rs. 50,000 x 0.7513= Rs.37,565

Present value of lease payments = Rs. 5,00,000 – Rs. 37,565= Rs. 4,62,435

The percentage of present value of lease payments to fair value of the equipment is(Rs. 4,62,435/ Rs. 5,00,000) x 100 = 92.487%.

Since, lease payments substantially covers the major portion of the fair value; the lease constitutes finance lease.

Calculation of Unearned Finance Income

Annual lease payment = Rs. 4,62,435/ 2.4868 = Rs. 1,85,956 (approx.)

Gross investment in the lease = Total minimum lease payments + unguaranteed residual value

= (Rs. 1,85,956 × 3) + Rs. 50,000

= Rs. 5,57,868 + Rs. 50,000 = Rs. 6,07,868

Unearned finance income

= Gross investment - Present value of minimum lease payments and unguaranteed residual value

= Rs. 6,07,868 – Rs. 5,00,000 = Rs. 1,07,868

Question 9

WIN Ltd. has entered into a three year lease arrangement with Tanya sports club in respect of Fitness Equipments costing Rs. 16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Values of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be Rs. 1,33,500. The assets would revert to the lessor at the end of the lease. Given that the implicit rate of interest is 10%.

You are required to calculate the amount of the annual lease payment and the unearned finance income. Discounting Factor at 10% for years 1, 2 and 3 are 0.909, 0.826 and 0.751 respectively. (RTP May'18,

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May '23)

Answer 9

Computation of annual lease payment to the lessor

	Rs.
Cost of equipment	16,99,999.50
Unguaranteed residual value	1,33,500.00
Present value of residual value after third year @ 10% (Rs1,33,500 × 0.751)	1,00,258.50
Fair value to be recovered from leasepayments (Rs. 16,99,999.5– Rs. 1,00,258.5)	15,99,741.00
Present value of annuity for three years is 2.486	
Annual lease payment = Rs. 15,99,741/ 2.486	6,43,500.00

Computation of Unearned Finance Income

	Rs.
Total lease payments (Rs. 6,43,500 x 3)	19,30,500
Add: Unguaranteed residual value	1,33,500
Gross investment in the lease	20,64,000.00
Less: Present value of investment (lease payments andresidual value) (Rs. 1,00,258.5+ Rs. 15,99,741)	(16,99,999.50)
Unearned finance income	3,64,000.50

Question 10

Classify the following into either operating lease or finance lease with reason:

(1) Economic life of asset is 10 years, lease term is 9 years, but asset is not acquired at the end of lease term.

(2) Lessee has option to purchase the asset at lower than fair value at the end of lease term.

(3) Lease payments should be recognized as an expense in the statement of Profit & Loss of a lessee.

(4) Present Value (PV) of Minimum Lease Payment (MLP) = "X" Fair value of the asset is "Y" And X = Y.

(5) Economics life of the asset is 5 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee. (PYP 5 Marks, Nov '19, Old & New SM)

Answer 10

(i) The lease will be classified as a finance lease, since a substantial portion of the life of the asset iscovered by the lease term.

(ii) If it becomes certain at the inception of lease itself that the option will be exercised by

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the lessee,it is a Finance Lease.

(iii) It is an operating lease under which lease payments are recognized as expense in the profit andloss account of lessee to have better matching between cost and revenue.

(iv) The lease is a finance lease if X = Y, or where X substantially equals Y.

(v) Since the asset is of special nature and has been procured only for the use of lessee, it is a financelease.

Question 11

A machine was given on 3 years operating lease by a dealer of the machine for equal annual lease rentals to yield 30% profit margin on cost of Rs. 2,25,000. Economic life of the machine is 5 years and output from the machine is estimated as 60,000 units, 75,000 units, 90,000 units, 1,20,000 units and 1,05,000 units consecutively for 5 years. Straight line depreciation in proportion of output is considered appropriate. You are required to compute the following as per AS-19.

(i) **Annual Lease Rent**

(ii) **Lease Rent income to be recognized in each operating year and**

(iii) **Depreciation for 3 years lease (PYP 5 Marks Dec'21, MTP 4 Marks March 21 , MTP 4 Marks May 20, Old & New SM)**

Answer 11

i. **Annual lease rent**

Total lease rent

= 130% of Rs. 2,25,000 X Output during lease period/ Total output

= 130% of Rs. 2,25,000 x (60,000 +75,000+ 90,000)/(60,000 + 75,000 + 90,000 + 1,20,000 + 1,05,000)

= 2,92,500 x 2,25,000 units/4,50,000 units = Rs. 1,46,250

Annual lease rent = Rs. 1,46,250 / 3 = Rs. 48,750

ii. **Lease rent Income to be recognized in each operating year**

Total lease rent should be recognized as income in proportion of output during lease period, i.e. inthe proportion of 60,000 : 75,000 : 90,000 or 4:5:6

Hence income recognized in years 1, 2 and 3 will be as:

Year 1 Rs. 39,000,

Year 2 Rs. 48,750 and

Year 3 Rs. 58,500.

iii. **Depreciation for three years of lease**

Since depreciation in proportion of output is considered appropriate, the depreciable amount Rs2,25,000 should be allocated over useful life 5 years in proportion of output,

i.e. in proportion of 60 :75: 90 : 120 : 105 .

Depreciation for year 1 is Rs. 30,000, year 2 = 37,500 and year 3 = 45,000.

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Question 12

What are the disclosures requirements for operating leases by the lessee as per AS-19? (PYP 5 Marks May'22)(New SM)

Answer 12

As per AS 19, lessees are required to make following disclosures for operating leases:

(a) the total of future minimum lease payments under non-cancelable operating leases for each of thefollowing periods:

(i) not later than one year;

(ii) later than one year and not later than five years;

(iii) later than five years;

(b) the total of future minimum sublease payments expected to be received under non- cancelablesubleases at the balance sheet date;

(c) lease payments recognised in the statement of profit and loss for the period, with separate amountsfor minimum lease payments and contingent rents;

(d) sub-lease payments received (or receivable) recognised in the statement of profit and loss for theperiod;

(e) a general description of the lessee's significant leasing arrangements including, but not limited to,the following:

(i) the basis on which contingent rent payments are determined;

(ii)the existence and terms of renewal or purchase options and escalation clauses; and

(iii) restrictions imposed by lease arrangements, such as those concerning dividends, additionaldebt, and further leasing.

Note: The Level II and Level III non-corporate entities (and SMCs) need not make disclosuresrequired by (a), (b) and (e) above.

Question 13

Jaya Ltd. took a machine on lease from Deluxe Ltd., the fair value being ₹ 11,50,000. Economic life of the machine as well as lease term is 4 years. At the end of each year, lessee pays ₹ 3,50,000 to lessor. Jaya Ltd. has guaranteed a residual value of ₹ 70,000 on expiry of the lease to Deluxe Ltd., however Deluxe Ltd. estimates that residual value will be only ₹ 25,000. The implicit rate ofreturn is 10% p.a. and present value factors at 10% are : 0.909, 0.826, 0.751 and 0.683 at the endof 1st, 2nd, 3rd and 4th year respectively.

Calculate the value of machinery to be considered by Jaya Ltd. and the value of the lease liabilityas per AS-19.(RTP Nov '23)

Answer 13

According to para 11 of AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of the finance lease.However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability shouldbe the present value of

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the minimum lease payments from the standpoint of the lessee.

In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease. Present value of minimum lease payments will be calculated as follows:

Year	Minimum LeasePayment ₹	Internal rate of return(Discount rate @10%)	Present value ₹
1	3,50,000	0.909	3,18,150
2	3,50,000	0.826	2,89,100
3	3,50,000	0.751	2,62,850
4	4,20,000*	0.683	2,86,860
Total	14,70,000		11,56,960

Present value of minimum lease payments ₹ 11,56,960 is more than fair value at the inception of lease i.e. ₹ 11,50,000, therefore, the lease liability and machinery should be recognized in the books at ₹ 11,50,000 as per AS 19.* Minimum Lease Payment of 4th year includes guaranteed residual value amounting i.e.3,50,000 + 70,000 = 4,20,000.

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Chapter 5.6

AS 26- Intangible Assets

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.17 TO Q.31											
Past Exams	Q.4	NO		Q.13	NO	Q.10 Q.15	Q.14 Q.15	NO	NO	NO	NO	NO
MTP	NO	NO	Q.1 Q.2	Q.1	Q.5	Q.4	Q.3 Q.7	Q.5	Q.4 Q.7 Q.11	Q.8 Q.15	Q.5 Q.9	Q.4 Q.15
RTP	Q.2	Q.4	Q.13	Q.2	Q.10	Q.9	Q.8	Q.7	Q.12	Q.2	Q.13	Q.16

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Chapter 5.6

AS 26- Intangible Assets

Question 1

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

Year	Production in bottles (in lakhs)	Net operating cash flow (Rs. 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. (MTP 5 Marks Oct'19, Apr'19)

Answer 1

As per 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. A Ltd. should amortize the license fee of Rs. 200 lakhs as under:

Year	Net operatingCash in flow (Rs.)	Ratio	Amortize amount(Rs. 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

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	27,400	1.00	200

Question 2

K Ltd. launched a project for producing product X in October, 2016. The Company incurred Rs. 40 lakhs towards Research and Development expenses up to 31st March, 2018. 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. (MTP-Mar'19 5 Marks, RTP Nov 19, May 18, RTP Nov'22, Old & New SM)

Answer 2

As per provisions 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 derecognized when no future economic benefits are expected from its use according to para87 of the standard. Thus, the manager cannot defer the expenditure write off to future years in the given case hence, the expenses amounting Rs.40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2018.

Question 3

Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred Rs. 10 lakh on research during first 5 months of the financial year 2020 -21. The development of the process began on 1st September, 2020 and up to 31st March, 2021, a sum of Rs. 8 lakhs were incurred as Development Phase Expenditure, which meets assets recognition criteria. From 1st April, 2021, the Company has implemented the new process design and it is likely that this will result in after tax saving of Rs. 2 lakhs per annum for next five years. The cost of capital is 10%. The present value of annuity factor of Rs. 1 for 5 years @ 10% is 3.7908. Decide the treatment of Research and Development Cost of the project as per AS 26. (MTP 5 Marks April 21)

Answer 3

Research Expenditure – According to AS 26 'Intangible Assets', the expenditure on research of new process design for its product Rs. 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 2020 -

21. 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 Rs. 8 lakhs incurred up to 31st March, 2021 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	Rs. 2 lakhs p.a.
Company's cost of capital	10 %
Annuity factor @ 10% for 5 years	3.7908

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Present value of net cash flows (Rs. 2 lakhs x 3.7908)	Rs. 7.582 lakhs

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

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

The difference of Rs. 0.418 lakhs (i.e. Rs. 8 lakhs – Rs. 7.582 lakhs) will be amortized by Plymouth for the financial year 2020-21. Amortization - The company can amortise Rs. 7.582 lakhs over a period of five years by charging Rs. 1.516 lakhs per annum from the financial year 2021-2022 onwards.

Question 4

Sudesh Ltd. acquired a patent at a cost of Rs. 2,40,00,000 for a period of 5 years and the product life-cycle was also 5 years. The company capitalized the cost and started amortizing the asset at Rs. 48,00,000 per annum. After two years it was found that the product life -cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expectedto be Rs. 36,00,000, Rs. 46,00,000, Rs. 44,00,000, Rs. 40,00,000 and Rs. 34,00,000. Find out the amortization cost of the patent for each of the years if the patent was renewable and Sudesh Ltd. got it renewed after expiry of five years. (MTP 5 Marks Oct '20, Mar'22 & Oct '23)(Same concept different figures RTP Nov'18, Old & New SM, PYP 5 Marks May'18)

Answer 4

The entity amortized Rs. 48,00,000 per annum for the first two years i.e. Rs. 96,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortization may be found as follows:

VI	40,00,000	0.200	28,80,000
VII	34,00,000	0.170	24,48,000
Total	2,00,00,000	1.000	2,40,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., Rs. 1,44,00,000 has been amortized in the ratio of net cash flows arising from the product of Change Ltd.

Question 5

During 2019-20, an enterprise incurred costs to develop and produce a routine low risk computer software product, as follows:

Particular	Rs.
Completion of detailed program and design (Phase 1)	50,000
Coding and Testing (Phase 2)	40,000
Other coding costs (Phase 3 & 4)	63,000
Testing costs (Phase 3 & 4)	18,000
Product masters for training materials (Phase 5)	19,500
Packing the products (1,500 units) (Phase 6)	16,500

After completion of phase 2, it was established that the product is technically feasible for the market. You are required to state how the above referred cost to be recognized in the books of accounts. (

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MTP5 Marks May '20, Oct'21 & April '23, Old & New SM)

Answer 5

As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed program design or working model. In this case, Rs. 90,000 would be recorded as an expense (Rs. 50,000 for completion of detailed program design and Rs. 40,000 for coding and testing to establish technological feasibility/asset recognition criteria).

Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (63,000+ 18,000+ 19,500) = Rs. 1,00,500. Packing cost Rs. 16,500 should be recognized as expenses and charged to Profit & Loss A/c.

Question 7

PIL Ltd. is showing an intangible asset at Rs. 72 lakhs as on 31-3-2022. This asset was acquired for Rs. 120 lakhs as on 01-04-2016 and the same was used 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. You are required to comment on the accounting treatment of asset with reference to AS 26 "Intangible Assets" and also give the necessary rectification journal entry in the books. (MTP 5 Marks April 22, MTP 4 Marks March'21, RTP Nov '21)

Answer 7

As per 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. The Company has been following the policy of amortization of the intangible asset over a periodof 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 31.3.2022 at Rs. 48 lakhs i.e. Rs. 120 lakhs less Rs. 72 lakhs (Rs. 120 Lakhs / 10 years x 6 years = 72 Lakhs). The difference of Rs. 24 Lakhs (Rs. 72 lakhs – Rs. 48 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of Rs. 48 lakhs will be amortized over remaining 4 years by amortizing Rs. 12 lakhs per year.

The necessary journal entry (for rectification) will be RevenueReserves Dr.	Rs. 24 Lakhs	
To Intangible Assets		Rs. 24 Lakhs

Question 8

Surya Ltd. had the following transactions during the year ended 31 st March, 2021.

(i) **It acquired the business of Gomati Limited on a going concern basis for ₹ 25,00,000 on 1st June,2020. The fair value of the Net Assets of Gomati Limited was ₹ 18,75,000. Surya Ltd. believes that due to popularity of the products of Gomati Limited in the market, its goodwill exists.**

(ii) **On 20th August, 2020, Surya Ltd. incurred cost of ₹ 6,00,000 to register the patent for its product.**

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Surya Ltd. expects the Patent's economic life to be 8 years.

(iii) On 1st October, 2020, Surya Ltd. has taken a franchise to operate an ice cream parlour from Volga Ltd. for ₹ 4,50,000 and at an Annual Fee of 10 % of Net Revenues (after deducting expenditure). The franchise expires after six years. Net Revenue for the year ended 31st March, 2021 amounted to ₹ 1,50,000.

Surya Ltd. follows an accounting policy to amortize all Intangibles on Straight Line basis (SLM) over the maximum period permitted by the Accounting Standards taking a full year amortization in the year of acquisition. Goodwill on acquisition of business is to be amortized over 5 years (SLM).

Prepare an extract showing the Intangible Assets section in the Balance Sheet of Surya Ltd. as at 31st March, 2021. (MTP 5 Marks Oct'22, RTP May '21)

Answer 8

Surya Ltd.

Balance Sheet (Extract relating to intangible asset) as on 31st March 2021

	Note No.	₹
Assets		
(1) Non-current assets		
Intangible assets	1	14,00,000

Notes to Accounts (Extract)

		₹	₹
1.	Intangible assets		
	Goodwill (Refer to note 1)	5,00,000	
	Patents (Refer to Note 2)	5,25,000	
	Franchise (Refer to Note 3)	3,75,000	14,00,000

Working Notes:

		₹
(1)	Goodwill on acquisition of business	
	Cash paid for acquiring the business (purchase consideration)	25,00,000
	Less: Fair value of net assets acquired	(18,75,000)
	Goodwill	6,25,000
	Less: Amortization. over 5 years (as per SLM)	(1,25,000)
	Balance to be shown in the balance sheet	5,00,000
(2)	Patent	6,00,000
	Less: Amortization (over 8 years as per SLM)	(75,000)
	Balance to be shown in the balance sheet	5,25,000

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(3)	Franchise	4,50,000
	Less: Amortization (over 6 years)	(75,000)
	Balance to be shown in the balance sheet	3,75,000

Question 9

X Ltd. carried on business of manufacturing of Bakery products. The company has two trademarks "Sun" and "Surya''. One month before the company knows through one of the marketing managers that both trademarks have allegedly been infringed by other competitors engaged in the same field.

"Sun" and strong case in regard to trademark "Surya". X Ltd. incurred additional legal fees to stop infringement on both trademarks. Both trademarks have a remaining legal life of 10 years. How should X Ltd. account for these legal costs incurred relating to the two trademarks? .(MTP 5 Marks March '23, RTP Nov'20)

Answer 9

As per para 59 of AS 26, subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense. However, if the subsequent expenditure enables the asset to generate future economic benefits in excess of its originally assessed standard of performanceor can be measured and attributed to the asset reliably, then such subsequent expenditure should be added to the cost of the intangible asset.

The legal costs incurred for both the trademarks do not enable them to generate future economic benefits in excess of its originally assessed standard of performance. They only ensure to maintain them if the case is decided in favour of the company. Therefore, such legal costs must be recognisedas an expense.

Question 10

A company acquired patent right for Rs.1200 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	1	2	3	4	5
Estimated future cash flows (Rs. in lakhs)	600	600	600	300	300

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 Rs. 150 lakhs. You are required to determine the amortization pattern under Accounting Standard 26. (RTP May 20),(Same concept different figures PYP 5 Marks Nov'20)

Answer 10

Amortization of cost of patent as per AS 26

Year	Estimated future cash flow (Rs. in lakhs)	Amortization Ratio	Amortized Amount (Rs. in lakhs)
1	600	.25	300
2	600	.25	300

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3	600	.25	300
4	300	.40 (Revised)	120
5	300	.40 (Revised)	120
6	150	.20 (Revised)	60
			1,200

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flowsi.e. (600: 600: 600: 300: 300).

The unamortized amount of the patent after third year will be Rs. 300 lakh (1,200-900) which will be amortized in the ratio of revised estimated future cash flows (300:300:150) in the fourth, fifth and sixth year.

Question 11

PQR Ltd. has acquired a Brand from another company for Rs. 100 lakhs. PQR Ltd. contends that since the said brand is a very popular and famous brand, no amortization needs to be provi ed. Comment on this in line with the Accounting Standards. (May 22)

Answer 11

AS 26 'Intangible Assets" provides that an intangible asset should be measured initially at cost. After initial recognition, an intangible asset should be carried at cost less any accumulated amortization and any accumulated impairment losses. The amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life for computing amortization. There is a rebuttable presumption that the useful life of an intangible asset will not exceed 10 years from the date when the asset is available for use. It must be ensured that the value of brand is amortized in accordance with AS 26, as brand is considered to be intangible asset. The contention of PQR Ltd. that Brand is very popular and famous, hence no amortization needs to be provided is not correct as there is no persuasive evidence that the useful life of the intangible asset will exceed 10 years.

Question 12

X Ltd. is engaged in the business of newspaper and radio broadcasting. It operates through different brand names. During the year ended 31st March, 2021, it incurred substantial amount on business communication and branding expenses by participation in various corporate social responsibility initiatives. The company expects to benefit by this expenditure by attracting new customers over a period of time and accordingly it has capitalized the same under brand development expenses and intends to amortize the same over the period in which it expects the benefits to flow. As the accountant of the company do you concur with these views? You are required to explain i n line with provisions of Accounting Standards. (RTP May 22)

Answer 12

As per AS 26 on Intangible Assets, expenditure on an intangible item should be recognized as on expense when it is incurred unless it forms part of the cost of an intangible asset that meets therecognition criteria. An intangible asset should be recognized if, and only if: (i) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and (ii) the cost of the asset can be measured reliably. In the given case, no intangible assets or other asset is acquired or created that can be recognized, the accounting treatment by the company to amortize the entire expenditure over the period in which it expects the benefits to flow is not correct and the same should

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be debited to the profit and loss statement during the year ended 31st March, 2021.

Question 13

As per provisions of AS-26, how would you deal to the following situations:

- Rs. 23,00,000 paid **by a manufacturing company to the legal advisor for defending the patent of a product is treated as a capital expenditure.**
- **During the year 2021-22, a company spent Rs. 7,00,000 for publicity and research expenses on one of its new consumer product which was marketed in the same accounting year but proved to be a failure.**

A company spent Rs. 25,00,000 in the past three years to develop a product, these expenses were charged to profit and loss account since they did not meet AS-26 criteria for capitalization. In the current year approval of the concerned authority has been received. The company wishes to capitalize Rs. 25,00,000 by disclosing it as a prior period item.

A company with a turnover of Rs. 200 crores and an annual advertising budget of Rs. 50,00,000 had taken up for the marketing of a new product by a company. It was estimated that the company would have a turnover of Rs. 20 crore from the new product. The company had debited to its Profit & Loss Account the total expenditure of Rs. 50,00,000 incurred on extensive special initial advertisement campaign for the new product. (RTP May '23, PYP Nov '19 5 Marks) (Same concept different figures RTP May'19, Old & New SM)

Answer 13

As per AS 26 "Intangible Assets", subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense when it is incurred unless (a) it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and (b) expenditure can be measured and attributed to the asset reliably. If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

1. In the given case, the legal expenses to defend the patent of a product amounting Rs. 23,00,000 should not be capitalized and be charged to Profit and Loss Statement.
2. The company is required to expense the entire amount of Rs. 7,00,000 in the Profit and Loss account for the year ended 31st March, 2022 because no benefit will arise in the future.
3. As per AS 26, expenditure on an intangible item that was initially recognized as an expense by a reporting enterprise in previous annual financial statements should not be recognized as part of the cost of an intangible asset at a later date. Thus the company cannot capitalize the amount of Rs. 25,00,000 and it should be recognized as expense
4. Expenditure of Rs. 50,00,000 on advertising and promotional activities should always be charged toProfit and Loss Statement. Hence, the company has done the correct treatment by debiting the sum of 50 lakhs to Profit and Loss Account

Question 14

A Company acquired for its internal use a software on 01.03.2020 from U.K. for £ 1,50,000. The exchange rate on the date was as Rs. 100 per £. The seller allowed trade discount @ 2.5%. The other expenditures were:

(i) Import Duty 10%

(ii) Additional Import Duty 5%

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(iii) Entry Tax 2% (Recoverable later from tax department).

(iv) Installation expenses Rs. 1,50,000.

Professional fees for clearance from customs Rs. 50,000. Compute the cost of software to beCapitalized as per relevant AS. (PYP 5 Marks , Jan 21)

Answer 14

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

Purchase cost of the software	£ 1,50,000
Less: Trade discount @ 2.5%	£ (3,750)
	£1,46,250
Cost in Rs. (UK £1,46,250 x Rs. 100)	146,25,000
Add: Import duty on cost @ 10% (Rs.)	14,62,500
	160,87,500
Add: Additional import duty @ 5% (Rs.)	8,04,375
	168,91,875
Add: Installation expenses (Rs.)	1,50,000
Add: Professional fee for clearance from customs (Rs.)	50,000
Cost of the software to be capitalized (Rs.)	170,91,875

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

Question 15

M/s. Pasa Ltd. is developing a new production process. During the financial year ended 31st March, 2019, the total expenditure incurred on the process was Rs. 80 lakhs. The production process met the criteria for recognition as an intangible asset on 1st November, 2018. Expenditure incurred till this date was Rs. 42 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2020 was Rs. 90 lakhs. As on 31.03.2020, the recoverable amount of know how embodied in the process is estimated to be Rs. 82 lakhs. This includes estimates of future cash outflows and inflows.

You are required to work out :

(1) What is the expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2019 ?

(2) What is the carrying amount of the intangible asset as on 31st March, 2019?

(3) What amount of expenditure to be charged to Profit and Loss Account for the year ended 31st March,2020 ?

(4) What is the carrying amount of the intangible asset as on 31st March, 2020? (PYP 5 Marks Nov 20 & Dec '21) (Same concept lesser adjustments MTP 5 Marks Sep'22 & Sep '23)

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Answer 15

As per AS 26 'Intangible Assets'

(i) Expenditure to be charged to Profit and Loss account for the year ending 31.03.2019

Rs. 42 lakhs is recognized as an expense because the recognition criteria were not met until 1st November, 2018. 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 31.03.2019

At the end of financial year, on 31st March 2019, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of Rs. 38 (80-42) lakhs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st November 2018)

(iii) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2020

	(Rs. in lacs)
Carrying Amount as on 31.03.2019	38
Expenditure during 2019 – 2020	90
Book Value	128
Recoverable Amount	(82)
Impairment loss to be charged to Profit and lossaccount	46

Rs. 46 lakhs to be charged to Profit and loss account for the year ending 31.03.2020.

(iv) Carrying value of intangible asset as on 31.03.2020

	(Rs. in lacs)
Book Value	128
Less: Impairment loss	(46)
Carrying amount as on 31.03.2020	82

Question 16

Swift Limited acquired patent rights to manufacture Solar Roof Top Panels at a cost of ₹ 600 lacs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of future cash flows which are estimated as under:

Year	1	2	3	4	5
Cash Flows (₹ in lacs)	300	300	300	150	150

After 3rd year, it was estimated that the patents would have an estimated balance future life of 3 years and Swift Ltd. expected the estimated cash flow after 5 th year to be ₹ 75 Lacs. Determine the amortization cost of the patent for each of the above years as per Accounting Standard 26.(RTP Nov '23)

Answer 16

Amortization of cost of patent as per AS 26

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Year	Estimated future cashflow (₹ in lakhs)	Amortization Ratio	Amortized Amount (₹ in lakhs)
1	300	.25	150
2	300	.25	150
3	300	.25	150
4	150	.10	60
5	150	.10	60
6	75	.05	30
		1.00	600

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (300: 300: 300: 150: 150).The unamortized amount of the patent after third year will be ₹ 150 lakh (600-450) which will be amortized in the ratio of revised estimated future cash flows (150:150:75 or 2:2:1) inthe fourth, fifth and sixth year.

Question 17

Which of the following is not covered within the scope of AS 26?

a. Intangible assets held-for-sale in the ordinary course of business	b. Assets arising from employee benefits
c. (a) & (b) both	d. Research and development activities

Ans: (c)

Question 18

Intangible asset is recognised if it:

a. Meets the definition of an intangible asset	b. Is probable that future economic benefits will flow
c. The cost can be measured reliably	d. Meets all of the above parameters

Ans: (d)

Question 19

Sun Limited has purchased a computer with various additional software. These are integral part of the computer. Which of the following are true in the context of AS 26:

a. Recognise Computer and software as tangible asset	b.	c. Recognise tangible and intangible separately
d. Recognise computer and software as intangible asset	e.	f. Does not recognize the software as an asset.

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Ans: (a)

Question 20

Hexa Ltd developed a technology to enhance the battery life of mobile devices. Hexa has capitalised development expenditure of Rs. 5,00,000. Hexa estimates the life of the technology developed to be 3 yearsbut the company has forecasted that 50% of sales will be in year 1, 35% in year 2 and 15% in year 3. Whatshouldbe the amortisation charge in the second year of the product's life?

a. 2,50,000	b. 1,75,000
c. 1,66,667	d. 1,85,000

Ans: (b)

Theoretical Questions Answers

Questions 21

What is meant by Intangible Assets and what are the important factors to consider the recognition of item as an Intangible asset? What is the recognition criteria in accordance with the provisions of AS 26?

Answers 21

An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Below are the 3 key ingredients to be satisfied to cover an item as an intangible asset under this standard:

- Identifiability,
- Control over a resource and
- Expectation (i.e. probable – 50% plus) of future economic benefits flowing to the enterprise.

The recognition of an item as an intangible asset requires an enterprise to demonstrate that the item meets the definition of an intangible asset and recognition criteria set out as below:

a. It is probable that the future economic benefits that are attributable to the asset will flow to theenterprise; and

b. The cost of the asset can be measured reliably.

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Questions 22

What is the measurement criteria at the time of initial recognition of Intangible assets acquired throughseparate acquisition?

Answers 22

If an intangible asset is acquired separately, the cost of the intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

The cost of an intangible asset comprises:

- its purchase price,
- 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 asset ready for its intended use. Directly attributable expenditure includes, for example, professional fees for legal services.
- Any trade discounts and rebates are deducted in arriving at the cost.

Questions 23

What is the criteria for recognition and measurement of Internally generated intangible assets. Describewhich kind of cost is considered for capitalisation with respect to provisions of AS 26. Whether the sameapplies for internally generated goodwill also?

Answers 23

To assess whether an internally generated intangible asset meets the criteria for recognition, an enterpriseclassifies the generation of the asset into 2 phases:

- Research Phase &
- Development Phase

Research Phase - The expenses related to Research phase is expensed off in statement of Profit and loss.

Development Phase - Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systemsor services prior to the commencement of commercial production or use.

An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the conditions given in para 6.15.

Cost of an Internally Generated Intangible Asset

The cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria. Reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports is prohibited.

The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, pro-

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ducing and making the asset ready for its intended use from the time when the intangible asset first meets the recognition criteria. For details, refer para 6.16.

Internally generated goodwill is not recognised as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

Questions 24

Advise the complete accounting treatment for Research and development phase as per AS 26.

Answers 24

Research phase means acquisition of knowledge and Development phase means application of knowledge.

The expenditure related to Research phase is expensed off in statement of Profit and loss. However, the expenditure incurred in Development phase is capitalised as a cost of the internally generated intangible asset.

If an enterprise cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the enterprise treats the expenditure on that project as if it were incurred in the research phase only.

Questions 25

What is meant by Amortization of an Intangible asset. What are the different methods for amortization as per AS 26?

Answers 25

Amortization is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

The amortization method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used. A variety of amortization methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include

- the straight-line method,
- the diminishing balance method and
- the unit of production method.

The method used for an asset is selected based on the expected pattern of consumption of economic benefits and is consistently applied from period to period, unless there is a change in the expected pattern of consumption of economic benefits to be derived from that asset.

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Practical Questions Answers

Questions 26

Swift Ltd. acquired a patent at a cost of Rs. 80,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset at Rs. 10,00,000 per annum. Thecompany had amortized the patent at 10,00,000 per annum in first two years on the basis of economic benefits derived from the product manufactured under the patent. After two years it was found that the product life-cycle may continue for another 5 years from then. The patent was renewable and Swift Ltd. got it renewed after expiry of five years. The net cash flows from the product during these 5 years were expected to be Rs. 36,00,000, Rs. 46,00,000, Rs. 44,00,000, Rs. 40,00,000 and Rs. 34,00,000. Find out the amortization costof the patent for each of the years.

Answers 26

Swift Limited amortised Rs. 10,00,000 per annum for the first two years i.e. Rs. 20,00,000. The remaining carrying cost can be amortised during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

S	Net cash flows Rs.	Amortisation Ratio	Amortisation Amount Rs.
I	-	0.125	10,00,000
II	-	0.125	10,00,000
III	36,00,000	0.180	10,80,000
IV	46,00,000	0.230	13,80,000
V	44,00,000	0.220	13,20,000
VI	40,00,000	0.200	12,00,000
VII	34,00,000	0.170	10,20,000
Total	2,00,00,000	1.000	80,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., Rs. 60,00,000 has been amortised in the ratio of net cash flows arising from the product of Swift Ltd.

Questions 27

AB Ltd. launched a project for producing product X in October, 20X1. The Company incurred Rs. 20 lakhs towards Research. 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.

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Answers 27

As per para 41 of AS 26 "Intangible Assets", expenditure on research should be recognised as an expense when it is incurred. Hence, the expenses amounting Rs. 20 lakhs incurred on the research has to be charged to the statement of profit and loss in the current year ending 31st March, 20X2.

Questions 28

During 20X1-X2, an enterprise incurred costs to develop and produce a routine low risk computer software product, as follows:

Particular	
Completion of detailed program and design (Phase 1)	50,000
Coding and Testing (Phase 2)	40,000
Other coding costs (Phase 3 & 4)	63,000
Testing costs (Phase 3 & 4)	18,000
Product masters for training materials (Phase 5)	19,500
Packing the products (1,500 units) (Phase 6)	16,500

After completion of phase 2, it was established that the product is technically feasible for the market. Youare required to state how the above referred cost to be recognized in the books of accounts.

Answers 28

As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established uponcompletion of detailed program design, coding and testing. In this case, Rs. 90,000 would be recorded as an expense (Rs. 50,000 for completion of detailed program design and Rs. 40,000 for coding and testing to establishtechnological feasibility/asset recognition criteria). Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (63,000+ 18,000+ 19,500) = Rs. 1,00,500. Packing cost Rs. 16,500 should be recognized as expenses and charged to P & L A/c.

Question 29 (Illustration)

ABC Ltd. developed know-how by incurring expenditure of Rs. 20 lakhs, The know-how was used by the company from 1.4.20X1. The useful life of the asset is 10 years from the year of commencement of its use. The company has not amortised the asset till 31.3.20X8. Pass Journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.20X8.

Answers 29

Journal Entry

	Rs.	*Rs.*

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Profit and Loss A/c (Prior period item)	Dr.	12,00,000	14,00,000
Amortization A/c	Dr.	2,00,000	
To Know-how A/c			
[Being amortization of 7 years (out of which amortization of 6 years charged as prior period item)]			

Question 30 (Illustration)

The company had spent Rs. 45 lakhs for publicity and research expenses on one of its new consumer product, which was marketed in the accounting year 20X1 -20X2, but proved to be a failure. State, how you will deal with the following matters in the accounts of U Ltd. for the year ended 31st March, 20X2.

Answers 30

In the given case, the company spent Rs. 45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/ benefit because of the failure of the product. Thus, according to AS 26 'Intangible Assets', the company should charge the total amount of Rs. 45 lakhs as an expense in the profit and loss account.

As per para 63 of AS 26 "Intangible Assets", 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. Amortisation should commence when the asset is available for use.

Question 31 (Illustration)

A company with a turnover of Rs. 250 crores and an annual advertising budget of Rs. 2 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of Rs. 25 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of Rs. 2 crore incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the company correct?

Answers 31

According to AS 26 'Intangible Assets', "expenditure on an intangible item should be recognised as an

expense when it is incurred unless it forms part of the cost of an intangible asset".

AS 26 mentions that expenditure on advertising and promotional activities should be recognised as an expense when incurred.

In the given case, advertisement expenditure of Rs. 2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of Rs. 25 crores. Here, no intangible asset or other asset is acquired or created that can be recognised. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of Rs. 2 crores to the Profit and Loss account of the year is correct.

Reference: The students are advised to refer the full text of AS 28 "Intangible Assets" (issued 2002).

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Chapter 5.7

Accounting Standard 28 Impairment of Assets

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.9 TO Q.23											
Past Exams	Q.6	Q.7	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
MTP		Q.1	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
RTP	Q.5	Q.4	NO	NO	Q.3	Q.2	NO	NO	NO	NO	NO	NO

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Chapter 5.7

Accounting Standard 28 Impairment of Assets

Question 1

Wow Ltd. is developing a new production process. During the financial year ending 31st March, 2018, the total expenditure incurred was Rs. 50 lakhs. This process met the criteria for recognition as an intangible asset on 1st December, 2017. Expenditure incurred till this date was Rs.22 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2019 was Rs. 80 lakhs. As at 31st March, 2019, the recoverable amount of know-how embodied in the process is estimated to be Rs. 72 lakhs. This includes estimates of future cash outflows as well as inflows.

You are required to calculate:

i. **Amount to be charged to Profit and Loss A/c for the year ending 31st March, 2018 and carrying value of intangible as on that date.**

ii. **Amount to be charged to Profit and Loss A/c and carrying value of intangible as on 31st March, 2019.Ignore depreciation. (MTP Oct 18 4 Marks)**

Answer 1

As per AS 26 'Intangible Assets'

(i) For the year ending 31.03.2018

(1) Carrying value of intangible as on 31.03.2018:

At the end of financial year 31st March 2018, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of Rs. 28 lakhs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st December 2017).

(2) Expenditure to be charged to Profit and Loss account:

The Rs. 22 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2018. This expenditure will not form part of the cost of the production process recognized in the balance sheet.

(ii) For the year ending 31.03.2019

Expenditure to be charged to Profit and Loss account:

	(Rs. in lakhs)
Carrying Amount as on 31.03.2018	28
Expenditure during 2018 –2019	80
Total book cost	108
Recoverable Amount	(72)
Impairment loss	36

Rs. 36 lakhs to be charged to Profit and loss account for the year ending 31.03.2019.

(1) Carrying value of intangible as on 31.03.2019:

	(Rs.in lakhs)

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Total Book Cost	108
Less: Impairment loss	(36)
Carrying amount as on 31.03.2019	72

Question 2

H Ltd. which is in a business of manufacturing and export of its product. Sometimes, back in 2018, the Government put restriction on export of goods exported by H Ltd. and due to that restriction H Ltd. impaired its assets. H Ltd. acquired identifiable assets worth of Rs. 4,000 lakh for Rs. 6,000 lakh at the End of the year 2014. The difference is treated as goodwill. The useful life of identifiable assets is years and depreciated on straight line basis. When Government put the restriction at the end of 2018, the company recognised the impairment loss by determining the recoverable amount of assets for Rs. 2,720 lakh. In 2020 Government lifted the restriction imposed on the export and due to this favourable change, H Ltd. re-estimate recoverable amount, which was estimated at Rs. 3,420 lakh.

Required:

(i) Calculation and allocation of impairment loss in 2018.

(ii) Reversal of impairment loss and its allocation as per AS 28 in 2020. (RTP Nov 20)

Answer 2

(i) Calculation and allocation of impairment loss in 2018(Amount in Rs. lakh)

	Goodwill	Identifiable assets	Total
Historical cost	2,000	4,000	6,000
Accumulated depreciation/amortisation (4 yrs.)	(1,600)	(1,067)	(2,667)
Carrying amount before impairment	400	2,933	3,333
Impairment loss*	(400)	(213)	(613)
Carrying amount after impairment loss	0	2,720	2,720

Notes:

1. As per para 87 of AS 28, an impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order:

(a) first, to goodwill allocated to the cash-generating unit (if any); and

(b) then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.Hence, first goodwill is impaired at full value and then identifiable assets areimpaired to arrive at recoverable value.

2. Since the goodwill has arisen on acquisition of assets, AS 14 comes into the picture. As per para 19 of AS 14, goodwill shall amortise over a period not exceeding five years unless a somewhat longer period can be justified. Therefore, the amortization period of goodwill is considered as 5 years.

(ii) Carrying amount of the assets at the end of 2020 (Amount in Rs. lakh)

End of 2020	Goodwill	Identifiable assets	Total

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Carrying amount in 2020	0	2,225	2,225
Add: Reversal of impairment loss (W.N.2)	-	175	175
Carrying amount after reversal of impairmentloss	-	2,400	2,400

Working Note:

Calculation of depreciation after impairment till 2020 and reversal of impairment loss in 2020

(Amount in Rs. lakh)			
	Goodwill	Identifiable assets	Total
Carrying amount after impairment loss in 2018	0	2,720	2,720
Additional depreciation (i.e. (2,720/11) x 2)	-	(495)	(495)
Carrying amount	0	2,225	2,225

Recoverable amount			3,420
Excess of recoverable amount over carrying amount			1,195

Note: It is assumed that the restriction by the Government has been lifted at the end of theyear 2020.

Determination of the amount to be impaired by calculating depreciated historical cost ofthe identifiable assets without impairment at the end of 2020 (Amount in Rs. **lakh)**

End of 2020	**Identifiable assets**
Historical cost	4,000
Accumulated depreciation	(266.67 x 6 years) = (1,600)
Depreciated historical cost	2,400
Carrying amount (in W.N.1)	2,225
Amount of reversal of impairment loss	175

Notes:

1. As per para 107 of AS 28, in allocating a reversal of an impairment loss for a cash-generating unit,the carrying amount of an asset should not be increased above the lower of:

(a) its recoverable amount (if determinable); and

(b) the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior accounting periods.

Hence impairment loss reversal is restricted to Rs. 175 lakh only.

2. The reversal of impairment loss took place in the 6th year. However, goodwill is amortised in 5 years. Therefore, there would be no balance in the goodwill account in the 6th year even without impairment loss. Hence in W.N. 2 above there is no column for recalculation of goodwill.

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Question 3

A publisher owns 150 magazine titles of which 70 were purchased and 80 were self - created. The price paid for a purchased magazine title is recognised as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognised as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for each magazine title. Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economiclives and replace them immediately with new titles for the same customer segment.

What is the cash-generating unit as per AS 28? (RTP May 20)(New SM)

Answer 3

It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other titles in the customer segment, cash inflows from direct sales and advertising are identifiable for each title. In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis.

Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent one from another and that each magazine title is a separate cash-generating unit.

Question 4

M Ltd. has three cash-generating units: A, B and C. Due to adverse changes in the technological environment, M Ltd. conducted impairment tests of each of its cash- generating units. On 31st March, 2018, the carrying amounts of A, B and C are Rs. 100 lakhs, Rs. 150 lakhs and Rs. 200 lakhs respectively.

The operations are conducted from a headquarter. The carrying amount of the headquarter assets is Rs. 200 lakhs: a headquarter building of Rs. 150 lakhs and a research centre of Rs. 50 lakhs. The relative carrying amounts of the cash-generating units are a reasonable indication of the proportion of the head-quarter building devoted to each cash-generating unit. The carrying amount of the research centre cannot be allocated on a reasonable basis to the individual cash-generating units.

Following is the remaining estimated useful life of:

	A	B	C	Head quarter assets
Remaining estimated useful life	10	20	20	20

The headquarter assets are depreciated on a straight-line basis.

The recoverable amount of each cash generating unit is based on its value in use sincenet selling price for each CGU cannot be calculated. Therefore, Value in use is equal to

	A	B	C	M Ltd. as a whole
Recoverable amount	199	164	271	720*

***The research centre generates additional future cash flows for the enterprise as a whole. Therefore, the sum of the value in use of each individual CGU is less than the value in use of the business as a whole. The additional cash flows are not attributable to the headquarter building.**

Calculate and show allocation of impairment loss as per AS 28. Ignore tax effects. (RTP Nov 18)

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Answer 4

1. **Identification of Corporate Assets of M Ltd.**

Here, the corporate assets are the headquarter building and the research centre. For corporate building

Since, the carrying amount of the headquarter building can be allocated on a reasonable and consistent basis to the cash-generating units under review. Therefore, only a ₹bottom-up₹ test is necessary.

For research centre

Since the carrying amount of the research centre cannot be allocated on a reasonable and consistent basis to the individual CGU under review. Therefore, a ₹top-down₹ test will be applied in addition to the ₹bottom-up₹ test.

2. **Allocation of Corporate Assets**

Since the estimated remaining useful life of A₹s CGU is 10 years, whereas the estimated remaining useful lives of B and C₹s CGU are 20 years, the carrying amount of the headquarter building is allocated to the carrying amount of each individual cash-generating unit on weight basis.

3. **Calculation of a weighted allocation of the carrying amount of the headquarter building (Amount in Rs. lakhs)**

On 31st March, 2018	A	B	C	Total
Carrying amount **(A)**	100	150	200	450
Useful life	10 years	20 years	20 years	
Weight based on useful life	1	2	2	
Carrying amount after weight	100	300	400	800
Pro-rata allocation of the building	12.5%	37.5%	50%	100%

	(100/800)	(300/800)	(400/800)	
Allocation of the carrying amount of thebuilding (based on pro-rataabove) **(B)**	18.75	56.25	75	150
Carrying amount (after allocation of the building) **(A+B)**	118.75	206.25	275	600

Calculation of Impairment Losses

Application of ₹bottom-up₹ test (Amount in Rs. lakhs)

31st March, 2018	A	B	C
Carrying amount (after allocation of thebuilding)(Refer point 3 above)	118.75	206.25	275
Recoverable amount (given in the question)	199	164	271
Impairment loss	0	(42)	(4)

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Allocation of the impairment losses for cash-generating units B and C (Amount in Rs. lakhs)

Cash-generating unit	B	C
To headquarter building	(12) (42*56/206)	(1) (4*75/275)
To assets in cash-generating unit	(30) (42*150/206)	(3) (4*200/275)
	(42)	(4)

Since the research centre could not be allocated on a reasonable and consistent basis to A, B and C₹s CGU, M Ltd. compares the carrying amount of the smallest CGU to which the carrying amount of the research centre can be allocated (i.e., M as a whole) to its recoverable amount, in accordance with the ₹top-down₹ test.

Application of the ₹top-down₹ test (Amount in Rs. lakhs)

31st March, 2018	A	B	C	Building	Research centre	M Ltd.
Carrying amount	100	150	200	150	50	650
Impairment loss arisingfrom the ₹bottom-up₹ test	–	(30)	(3)	(13)	–	(46)
Carrying amount afterthe ₹bottom-up₹ test	100	120	197	137	50	604
Recoverable amount						720

Since recoverable amount is more than the carrying amount of M Ltd., no additional impairment loss has been resulted from the application of the top- down test. Only an impairment loss of Rs.46 lakhs will be recognized as a result of the application of the ₹bottom-up₹ test.

Question 5

M Ltd. produces a single product and owns plants A, B and C. Each plant is located in a different continent. Plant A produces a component that is assembled in either plant B or plant C. The combined capacity of plants B and C is not fully utilised.M Ltd.₹s products are sold world-wide from either plants B or C i.e. plant B₹s production can be sold in plant C₹s continent if the products can be delivered fasterfrom plant B than from plant C. Utilisation levels of plant B and plant C depend onthe allocation of sales between the two sites.

For each of the following cases, what are the cash-generating units for plants A, Band C?

Case 1: There is an active market for plant A₹s products.

Case 2:There is no active market for plant A₹s products. (RTP May 18)

Answer 5

(a) **Case 1:** It is likely that A is a separate cash-generating unit because there is an active market for its products.

Although there is an active market for the products assembled by B and C, cashinflows for B and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B and C can be determined individually. Therefore, it is likely that B and C together is the smallest identifiable group of assets that generates cash inflows from continuing use

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that are largely independent.

In determining the value in use of A and B plus C, M Ltd. adjusts financial budgets/forecasts to reflect its best estimate of future market prices forA₹s products.

Case 2: It is likely that the recoverable amount of each plant cannot be assessed independently because:

(a) there is no active market for A's products. Therefore, A's cash inflows dependon sales of the final product by B and C; and

(b) although there is an active market for the products assembled by B and C, cash inflows forB and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B and C can be determined individually.

As a consequence, it is likely that A, B and C together (i.e., M Ltd. as a whole) is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent.

Question 6

G Ltd., acquired a machine on 1st April, 20X0 for Rs. 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 20X4, the carrying value of the machine was reassessed at Rs. 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March, 20X6, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only Rs. 79 lakhs. You are required to calculate the loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd. G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.(New SM) (PYP 5 MarksMay '18) (MTP 4 Marks Oct '17)

Answer 6

Statement Showing Impairment Loss

(Rs. in crores)	
Carrying amount of the machine as on 1st April, 20X0	7.00
Depreciation for 4 years i.e. 20X0-20X1 to 20X3-20X $\left[\frac{7\ Crores}{7\ Years} \times 4\ years\right]$	(4.00)
Carrying amount as on 31.03.20X4	3.00
Add: Upward Revaluation (credited to Revaluation Reserveaccount)	2.10
Carrying amount of the machine as on 1st April, 20X4 (revalued)	5.10
Less: Depreciation for 2 years i.e. 20X4-20X5& 20X5-20X6 $\left[\frac{5.10\ Crores}{3\ Years} \times 4\ years\right]$	(3.40)
Carrying amount as on 31.03.20X6	1.70

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Less: Recoverable amount	(0.79)
Impairment loss	0.91
Less: Balance in revaluation reserve as on 31.03.20X6:	
Balance in revaluation reserve as on 31.03.20X4	2.10
Less: Enhanced depreciation met from revaluation reserve	
20X4-20X5 & 20X5-20X6=[(1.70 – 1.00) x 2 years] (1.40)	
Impairment loss set off against revaluation reserve balance asper para 58 of AS 28 "Impairment of Assets"	(0.70)
Impairment Loss to be debited to profit and loss account	0.21

Question 7

C Ltd. acquired S Ltd. business (a cash generating unit) on 31-3-2016 for ₹ 8,000 Lakhs. The details of acquisition are us **under: -**

The anticipated useful life of acquired assets is 5 years Goodwill is to be amortised in 4 years C Ltd. uses straight-line method of depreciation with no residual values anticipated. On 31-3-2018, C Ltd. estimated the significant decline in production due to change in Government policies. The net selling price of identifiable asset is not determinable. The cash flow forecast based on recent financial budget for next 7 years after considering change in Govt. policies are as follows. Incremental financing cost is 8% which represent current market assessment of the time value of money.

			₹ in Crore[1]
Year	**Cash flow**	**Year**	**Cash flow**
2019	**800**	**2022**	**600**
2020	**800**	**2023**	**600**
2021	**800**	**2024**	**500**
		2025	**400**

You are required to calculate:

(i) Value in use

(ii) Impairment loss

(iii) Revised carrying amount on 31-3-2018 (PYP Nov 18 5 Marks)

Answer 7

Value in Use

Year ended on 31st March	Cash flow (₹ in lakh)	Discounting factor @ 8%	Present Value(₹ in lakh)
2019	800	0.926	740.80

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2020	800	0.857	685.60
2021	800	0.794	635.20
2022	600	0.735	441.00
2023	600	0.681	408.60
2024	500	0.630	315.00
2025	400	0.583	233.20
			3459.40

Impairment loss

Impairment loss = Carrying amount of the asset - Recoverable Amount

= ₹ 4,600 lakhs - ₹ 3,459.40 lakhs (Refer W.N.)

(i) = ₹ 1,140.60 lakhs

Revised Carrying Amount on **31.3.2018**

(a) As per para 87 of AS 28 'Impairment of Assets', an impairment loss should be allocated to reducethe carrying amount of the assets of CGU in the following order:

(b) first, to goodwill allocated to the cash-generating unit (if any); and

then, to the other assets of the unit on a pro-rata basis based on the carrying amount ofeach asset in the unit.

Hence, first goodwill is impaired at full value and then identifiable assets are impaired to arriveat recoverable value.

(₹ in lakh)

	Goodwill	Identifiable assets	Total
Useful life	4 years	5 years	
Historical cost	2,000	6,000	8,000
Accumulated depreciation/amortization(for 2 years)	(1,000)	(2,400)	(3,400)
Carrying amount before impairment	1,000	3,600	4,600
Impairment loss	(1,000)	(140.60)	(1,140.60)
Revised carrying amount after impairmentloss	0	3,459.40	3,459.40

Working Note:

Calculation of Recoverable Amount

Recoverable amount = Higher of Asset's Net Selling Price or Value in Use

Where, Asset's net selling price is not determinable

Recoverable Amount of the asset will be equal to the Value in use ie. ₹ 3,459.40 lakh.

Question 8

Himalaya Ltd. which is in a business of manufacturing and export of its product. Sometimes, back in 2014, the Government put restriction on export of goods exported by Himalaya Ltd. and due to that

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restriction Himalaya Ltd. impaired its assets. Himalaya Ltd. acquired identifiable assets worth of ₹ 4,000 lakhs for ₹ 6,000 lakh at the end of the year 2010. The difference is treated as goodwill. The useful life of identifiable assets is 15 years and depreciated on straight line basis. When Government put the restriction at the end of 2014, the company recognised the impairment loss by determining the

Recoverable amount of assets for ₹ 2,720 lakh. In 2016 Government lifted the restriction imposed the export and due to this favourable change, Himalaya Ltd. re-estimate recoverable amount, which was estimated at ₹ 3,420 lakh.

Required:

(i) Calculation and allocation of impairment loss in 2014.

(ii) Reversal of impairment loss and its allocation as per AS 28 in 2016. (PYP Nov 17)

Answer 8

Calculation and allocation of impairment loss in 2014 (Amount in ₹ lakhs)

	Goodwill	Identifiable assets	Total
Historical cost	2,000	4,000	6,000
Accumulated depreciation/amortisation (4 yrs)	(1,600)	(1,067)	(2,667)
Carrying amount before impairment	400	2,933	3,333
Impairment loss*	(400)	(213)	(613)
Carrying amount after impairment loss	0	2,720	2,720

* Notes:

1. As per para 87 of AS 28, an impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order:

   (a) first, to goodwill allocated to the cash-generating unit (if any); and

   (b) then, to the other assets of the unit on a pro-rata basis based on the carrying amount of eachasset in the unit.

Hence, first goodwill is impaired at full value and then identifiable assets are impaired to arrive at recoverable value.

2. Since the goodwill has arisen on acquisition of assets, AS 14 comes into the picture. As per para 19 of AS 14, goodwill shall amortise over a period not exceeding five years unless a somewhat longer period can be justified. Therefore, the amortization period of goodwill is considered as 5 years.

Carrying amount of the assets at the end of 2016 (Amount in ₹ lakhs)

End of 2016	**Goodwill**	**Identifiable assets**	**Total**
Carrying amount in 2016	0	2,225	2,225
Add: Reversal of impairment loss (W.N.2)	-	175	175

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Carrying amount after reversal of impairmentloss	-	2,400	2,400

Working Note:

Calculation of depreciation after impairment till 2016 and reversal of impairment loss in 2016

(Amount in ₹			lakhs)
	Goodwill	Identifiable assets	Total
Carrying amount after impairment loss in2014	0	2,720	2,720
Additional depreciation (i.e. (2,720/11) x 2)	–	(495)	(495)
Carrying amount	0	2,225	2,225
Recoverable amount			3,420
Excess of recoverable amount over carrying amount			1,195

Note: It is assumed that the restriction by the Government has been lifted atthe end of the year2016. Determination of the amount to be impaired by calculating depreciated historical cost of the identifiable assets without impairment at the end of **2016**

(Amount in ₹ lakhs)

End of 2016	Identifiable assets
Historical cost	4,000
Accumulated depreciation	(266.67 x 6 years) = (1,600)
Depreciated historical cost	2,400
Carrying amount (in W.N. 1)	2,225
Amount of reversal of impairment loss	175

Notes:

1. As per para 107 of AS 28, in allocating a reversal of an impairment loss for a cash-generating unit, the carrying amount of an asset should not be increased above the lower of:
   (a) its recoverable amount (if determinable); and
   (b) the carrying amount that would have been determined (net of amortisation or depreciation)had no impairment loss been recognized for the asset in prior accounting periods.

Hence impairment loss reversal is restricted to Rs. 175 lakhs only.

2. The reversal of impairment loss took place in the 6th year. However, goodwill is amortised in 5 years. Therefore, there would be no balance in the goodwill account in the 6th year even without impairment loss. Hence in W.N. 2 above there is no column for recalculation of goodwill.

Question 9

If there is indication that an asset may be impaired but the recoverable amount of the asset ismore

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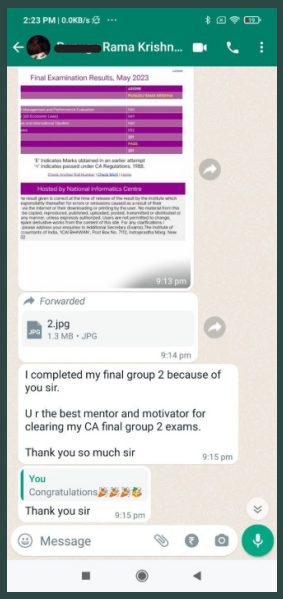

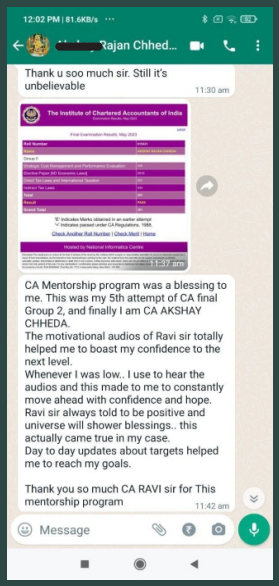

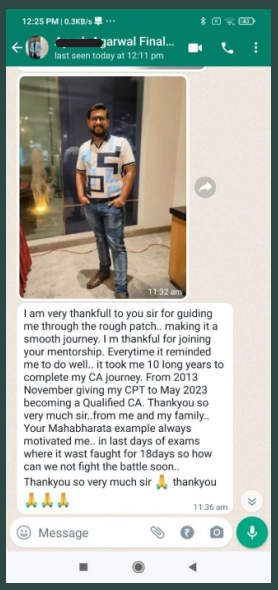

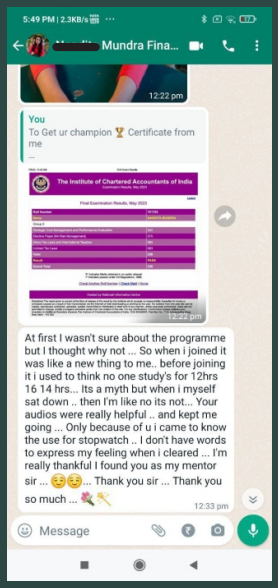

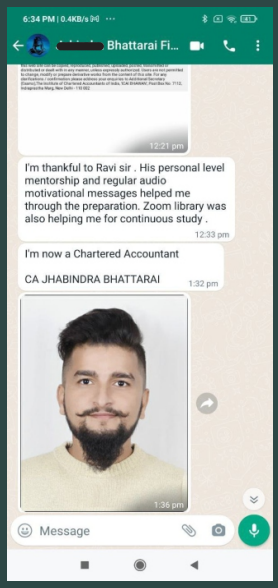

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than the carrying amount of the asset, the following are true:

a. No further action is required and the company can continue the asset in the books at the bookvalue itself.

b. The entity should review the remaining useful life, scrap value and method of depreciation andamortization for the purposes of AS 10.

c. The entity can follow either (a) or (b).

d. The entity should review the scrap value and method of depreciation and amortization for thepurposes of AS 10.

Ans: (b)

Question 10

In case Goodwill appears in the Balance Sheet of an entity, the following is true:

e. Apply Bottom up test if goodwill cannot be allocated to CGU (cash generating unit) under review.

f. Apply Top down test if goodwill cannot be allocated to CGU (cash generating unit) under review.

g. Apply both Bottom up test and Top down test if goodwill cannot be allocated to CGU (cashgenerating unit) under review.

h. Apply either Bottom up test or Top down test if goodwill cannot be allocated to CGU (cashgenerating unit) under review.

Ans: (c)

Question 11

In case of Corporate assets in the Balance Sheet of an entity, the following is true:

i. Apply Bottom up test if corporate assets cannot be allocated to CGU (cash generating unit) underreview.

j. Apply Top down test if corporate assets cannot be allocated to CGU (cash generating unit) underreview.

k. Apply both Bottom up test and Top down test if corporate assets cannot be allocated to CGU (cashgenerating unit) under review.

l. Apply either Bottom up test or Top down test if corporate assets cannot be allocated to CGU (cashgenerating unit) under review.

Ans: (c)

Question 12

In case of reversal of impairment loss, which statement is true:

m. Goodwill written off can never be reversed.

n. Goodwill written off can be reversed without any conditions to be met.

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o. Goodwill written off can be reversed only if certain conditions are met.

p. Goodwill written off can be reversed.

Ans: (c)

Theoretical Questions Answers

Questions 13

Write short note on impairment of asset and its application to inventory.

Answers 13

The objective of AS 28 'Impairment of Assets' is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this Standard requires the enterprise to recognize an impairment loss.

- If carrying amount < = Recoverable amount: Asset is not impaired
- If carrying amount > Recoverable amount : Asset is impaired Impairment Loss = Carrying Amount – Recoverable Amount Recoverable amount is the higher of net selling price and its value in use

This standard should be applied in accounting for the impairment of all assets, other than (i) inventories (AS 2, Valuation of Inventories); (ii) assets arising from construction contracts (AS 7, Accounting for Construction Contracts); (iii) financial assets, including investments that are included in the scope of AS 13, Accounting for Investments; and (iv) deferred tax assets (AS 22, Accounting for Taxes on Income). AS 28 does not apply to inventories, assets arising from construction contracts, deferred tax assets or investments because other accounting standards applicable to these assets already contain specific requirements for recognizing and measuring the impairment related to these assets.

Practical Questions Answers

Question 14

A publisher owns 150 magazine titles of which 70 were purchased and 80 were self-created. The price paid for a purchased magazine title is recognized as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognized as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for each magazine title. Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economic lives and replace them immediately with new titles for the same customer segment. What is the cash-generating unit for an individual magazine title?

Answer 14

It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other titles in the customer segment, cash inflows from direct sales and advertising are identifiable for each title. In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individ-

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ual title basis.

Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent of each other and that each magazine title is a separate cash-generating unit.

Question 15

An asset does not meet the requirements of environment laws which have been recently enacted. The asset has to be destroyed as per the law. The asset is carried in the Balance Sheet at the year end at ₹ 6,00,000. The estimated cost of destroying the asset is ₹ 70,000. How is the asset to be accounted for?

Answer 15

As per AS 28 "Impairment of Assets", impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount, where recoverable amount is the higher of an asset's net selling price* andits value in use*. In the given case, recoverable amount will be nil [higher of value in use(nil) andnet selling price (negative ₹ 70,000)]. Thus impairmentloss will be calculated as ₹ 6,00,000 [carrying amount (₹ 6,00,000) – recoverable amount (nil)]. Therefore, asset is to be fully impaired and impairment loss of ₹ 6,00,000 has to be recognized as an expense immediately in the statement of Profit and Loss as per para 58 of AS 28.

Further, as per para 60 of AS 28, When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an enterprise should recognise a liability if, and only if, that is required by another Accounting Standard. Hence, the entity should recognize liability for cost of disposal of ₹ 70,000 as per AS 10 & 29.

Question 16

Venus Ltd. has a fixed asset, which is carried in the Balance Sheet on 31.3.20X1 at ₹ 500 lakhs. As at that date the value in use is ₹ 400 lakhs and the net selling price is ₹ 375 lakhs.

From the above data:

(i) Calculate impairment loss.

(ii) Prepare journal entries for adjustment of impairment loss.

(iii) Show, how impairment loss will be shown in the Balance Sheet.

Answer 16

(ii) Recoverable amount is higher of value in use ₹ 400 lakhs and net selling price ₹ 375 lakhs.

Recoverable amount = ₹ 400 lakhs

Impairment loss = Carried Amount – Recoverable amount

= ₹ 500 lakhs – ₹ 400 lakhs = ₹ 100 lakhs.

(iii) Journal Entries

	Particulars	Dr. Amount (₹ in lakhs)	Cr. Amount (₹ in lakhs)
(i)	Impairment loss account Dr.	100	

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	To Provision for AccumulatedImpairment Loss Account		100
	(Being theentry for accounting impairment loss)		
(ii)	Profit and loss account Dr.	100	
	To Impairment loss		100
	(Being the entry to transfer impairment loss to profitand loss account)		

Balance Sheet of Venus Ltd. as on 31.3.20X1

	(₹ in lakhs)
Fixed Asset	
Asset less depreciation	500
Less: Impairment loss	(100)
	400

Question 17

Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 20X1 for ₹ 60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 20X1-20X2 the carrying amount was ₹ 41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch ₹ 36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of ₹ 54 crore per annum and has a carrying amount of ₹ 3.46 crore. All such machines put together could fetch a sum of ₹ 4.44 crore if disposed. Discuss the applicability of Impairment loss.

Answer 17

As per provisions of AS 28 "Impairment of Assets", impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit which is group of asset to which the damaged machine belongs is not impaired; and the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.

Question 18

From the following details of an asset

(i) Find out impairment loss

(ii) Treatment of impairment loss

(iii) Current year depreciationParticulars of asset:

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Answer 18

According to AS 28 "Impairment of Assets", an impairment loss on a revalued asset is recognised as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

Impairment Loss and its treatment	₹
Current carrying amount (including revaluation amount of ₹ 14 lakhs)	27,30,000
Less: Current recoverable amount	(12,00,000)
Impairment Loss	15,30,000
Impairment loss charged to revaluation reserve	14,00,000
Impairment loss charged to profit and loss account	1,30,000

After the recognition of an impairment loss, the depreciation (amortization) charge for the asset should beadjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), ona systematic basis over its remaining useful life.

In the given case, the carrying amount of the asset will be reduced to ₹ 12,00,000 after impairment. This amount is required to be depreciated over remaining useful life of 3 years (including current year). Therefore, the depreciation for the current year will be ₹ 4,00,000.

Question 19

A plant was acquired 15 years ago at a cost of ₹ 5 crores. Its accumulated depreciation as at 31st March, 20X1 was ₹ 4.15 crores. Depreciation estimated for the financial year 20X1-20X2 is ₹ 25 lakhs. Estimated Net Selling Price as on 31st March, 20X1 was ₹ 30 lakhs, which is expected to decline by 20 per cent by the end of the next financial year.

Its value in use has been computed at ₹ 35 lakhs as on 1st April, 20X1, which is expected to decrease by 30 per cent by the end of the financial year.

(i) Assuming that other conditions for applicability of the impairment Accounting Standard are satisfied, what should be the carrying amount of this plant as at 31st March, 20X2?

(ii) How much will be the amount of write off for the financial year ended 31st March, 20X2?

(iii) If the plant had been revalued ten years ago and the current revaluation reserves against this plant were to be ₹ 12 lakhs, how would you answer to questions (i) and (ii) above?

If the value in use was zero and the enterprise were required to incur a cost of ₹ 2 lakhs to dispose of the plant, what would be your response to questions (i) and (ii) above?

Answer 19

As per AS 28 "Impairment of Assets", if the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount and that reduction is an impairment loss. An impairment loss on a revalued asset is recognized as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

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In the given case, recoverable amount (higher of asset's net selling price and value in use) will be ₹ 24.5

lakhs on 31.3.20X2 according to the provisions of AS 28 [Refer working note].

		(₹ in lakhs)
(i)	Carrying amount of plant (after impairment) as on 31st March, 20X2	24.50
(ii)	Amount of write off (impairment loss) for the financial year ended 31st March, 20X2 [₹ 60 lakhs – ₹ 24.5 lakhs]	35.50
(iii)	If the plant had been revalued ten years ago	
	Debit to revaluation reserve	12.00
	Amount charged to profit and loss account (₹ 35.50 lakhs – ₹ 12 lakhs)	23.50
(iv)	If Value in use is zero	
	Value in use (a)	Nil
	Net selling price (b)	(-)2.00
	Recoverable amount [higher of (a) and (b)]	Nil
	Carrying amount (closing book value)	Nil
	Amount of write off (impairment loss) (₹ 60 lakhs – Nil)	60.00
	Entire book value of plant will be written off and charged to profit and loss account.	

Working Note:

Calculation of Closing Book Value, Estimated Net Selling Value andEstimated Value in Use of Plant at 31st March, 20X2

	(₹ in lakhs)
Opening book value as on 1.4.20X1 (₹ 500 lakhs – ₹ 415 lakhs)	85
Less: Depreciation for financial year 20X1–20X2	(25)
Closing book value as on 31.3.20X2	60
Estimated net selling price as on 1.4.20X1	30
Less: Estimated decrease during the year (20% of ₹ 30 lakhs)	(6)
Estimated net selling price as on 31.3.20X2	24
Estimated value in use as on 1.4.20X1	35.0
Less: Estimated decrease during the year (30% of ₹ 35 lakhs)	(10.5)
Estimated value in use as on 31.3.20X2	24.5

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Question 20 (Illustration)

Ergo Industries Ltd. gives the following estimates of cash flows relating to Property, Plant and Equipment on 31-12-20X1. The discount rate is 15%.

Year	Cash Flow (₹ in lakhs)
20X2	4000
20X3	6000
20X4	6000
20X5	8000
20X6	4000

Residual value at the end of 20X6	=	₹ 1000 lakhs
Property, Plant and Equipment purchased on 1-1-20XX	=	₹ 40,000 lakhs
Useful life	=	8 years
Net selling price on 31-12-20X1	=	₹ 20,000 lakhs

Calculate on 31-12-20X1:Carrying amount at the end of 20X1

(a) **Value in use on 31-12-20X1**

(b) **Recoverable amount on 31-12-20X1**

(c) **Impairment loss to be recognized for the year ended 31-12-20X1**

(d) **Revised carrying amount**

Depreciation charge for **20X2.**

Note: The year 20XX is the immediate preceding year before the year 20X0.

Answer 20

Calculation of value in use

Year	Cash Flow	Discount as per 15%	Discounted cash flow
20X2	4,000	0.870	3,480
20X3	6,000	0.756	4,536
20X4	6,000	0.658	3,948
20X5	8,000	0.572	4,576
20X6	4,000	0.497	1,988
20X6	(residual) 1,000	0.497	497
			19,025

Calculation of carrying amount:

Original cost = ₹ 40,000 lakhs

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Depreciation for 3 years = [(40,000-1000) 3/8] = ₹ 14,625 lakhs
Carrying amount on 31-12-20X1 = [40,000-14,625] = ₹ 25,375 lakhs

(a) **Value in use = ₹ 19,025 lakhs**

(b) Recoverable amount = higher of value in use and net selling price i.e. ₹ 20,000 lakhs.

Recoverable amount = ₹ 20,000 lakhs

(d) Impairment Loss = ₹ (25,375-20,000) = ₹ 5,375 lakhs

(e) **Revised carrying amount** = ₹ (25,375-5,375) = ₹ 20,000 lakhs

(f) **Depreciation charge for** 20X2 = (20,000-1000)/5 = ₹ 3,800 lakhs

Question 21 (Illustration)

X Ltd. is having a plant (asset) carrying amount of which is ₹ 100 lakhs on 31.3.20X1. Its balance useful life is 5 years and residual value at the end of 5 years is ₹ 5 lakhs. Estimated future cash flow from using the plant in next 5 years are:

For the year ended on	Estimated cash flow (₹ in lakhs)
31.3.20X2	50
31.3.20X3	30
31.3.20X4	30
31.3.20X5	20
31.3.20X6	20

Calculate "value in use" for plant if the discount rate is 10% and also calculate the recoverable amount if net selling price of plant on 31.3.20X1 is ₹ 60 lakhs.

Answer 21

Present value of future cash flow

Year ended	Future Cash Flow	Discount @ 10% Rate	Discounted cash flow
31.3.20X2	50	0.909	45.45
31.3.20X3	30	0.826	24.78
31.3.20X4	30	0.751	22.53
31.3.20X5	20	0.683	13.66
31.3.20X6	20	0.620	12.40
			118.82
Present value of residual price on 31.3.20X6 = 5		0.620	3.10
Present value of estimated cash flow by use of an asset and residual value, which is called "value in use".			121.92

If net selling price of plant on 31.3.20X1 is ₹ 60 lakhs, the recoverable amount will be higher of ₹ 121.92lakhs (value in use) and ₹ 60 lakhs (net selling price), hence recoverable amount is ₹ 121.92 lakhs.

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Question 22 (Illustration)

G Ltd., acquired a machine on 1st April, 20X0 for ₹ 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 20X4, the carrying value of the machine was reassessed at ₹ 5.10 crore and the surplus arising out of the re-valuation being credited to revaluation reserve. For the year ended March, 20X6, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only ₹ 79 lakhs. You are required to calculate the loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd. G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

Answer 22

Statement Showing Impairment Loss

	(₹in crores)
Carrying amount of the machine as on 1st April, 20X0	7.00
Depreciation for 4 years i.e. 20X0-20X1 to 20X3-20X $\left[\frac{7\ Crores}{7\ Years} \times 4\ years\right]$	(4.00)
Carrying amount as on 31.03.20X4	3.00
Add: Upward Revaluation (credited to Revaluation Reserveaccount)	2.10
Carrying amount of the machine as on 1st April, 20X4 (revalued)	5.10

Less: Depreciation for 2 years i.e. 20X4-20X5& 20X5-20X6 $\left[\frac{5.10\ Crores}{3\ Years} \times 4\ years\right]$	(3.40)
Carrying amount as on 31.03.20X6	1.70
Less: Recoverable amount	(0.79)
Impairment loss	0.91
Less: Balance in revaluation reserve as on 31.03.20X6:	
Balance in revaluation reserve as on 31.03.20X4	2.10
Less: Enhanced depreciation met from revaluation reserve	
20X4-20X5 & 20X5-20X6=[(1.70 – 1.00) x 2 years] (1.40)	
Impairment loss set off against revaluation reserve balance asper para 58 of AS 28 "Impairment of Assets"	(0.70)
Impairment Loss to be debited to profit and loss account	0.21

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Question 23 (Illustration)

X Ltd. purchased a Property, Plant and Equipment four years ago for ₹ 150 lakhs anddepreciates itat 10% p.a. on straight line method. At the end of the fourth year, it has revalued the asset at ₹ 75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of re-valuation, the market price is ₹ 67.50 lakhs and expected disposal costs are ₹ 3 lakhs. What will be the treatmentin respect of impairment loss on the basis that fair value for revaluation purpose isdeter-mined by market value and the value in use is estimated at ₹ 60 lakhs?

Answer 23

Treatment of Impairment **Loss**

As per para 57 of AS 28 "Impairment of assets", if the recoverable amount (higher ofnet selling priceand its value in use) of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. In the given case, net selling price is ₹ 64.50 lakhs (₹

67.50 lakhs – ₹ 3 lakhs) and value in use is ₹ 60 lakhs. Therefore, recoverable amountwill be ₹ 64.50 lakhs. Impairment loss will be calculated as ₹ 10.50 lakhs [₹ 75 lakhs (Carrying Amount after revaluation - Re-fer Working Note) less ₹ 64.50 lakhs (Recoverable Amount)].

Thus impairment loss of ₹ 10.50 lakhs should be recognised as an expense in the Statement of Profitand Loss immediately since there was downward revaluation of asset which was already charged to State-ment of Profit and Loss.

Working Note:

Calculation of carrying amount of the Property, Plant and Equipment at the end of the fourth year onrevaluation

	(₹ in lakhs)
Purchase price of a Property, Plant and Equipment	150.00
Less: Depreciation for four years [(150 lakhs / 10 years) x 4 years]	(60.00)
Carrying value at the end of fourth year	90.00
Less: Downward revaluation charged to profit and loss account	(15.00)
Revalued carrying amount	75.00

Reference: The students are advised to refer the full text of AS 28 "Impairmentof Assets" (issued **2002).**

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Chapter 6.1

Employee Benefits

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.9 TO Q.26											
Past Exams	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
MTP	NO	Q.2	NO	NO	Q.1	NO	NO	NO	NO	NO	NO	NO
RTP	Q.7	NO	Q.6	Q.5	NO	Q.4	NO	NO	NO	NO	NO	NO

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Chapter 6.1

Employee Benefits

Question 1

Kumar Ltd., is in engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of Rs. 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to Rs. 2 lakhs instead of Rs. 5 lakhs. The average remaining life of the employee is estimated to be 6 years. You are required to advise the company. (MTP May 20)

Answer 1

According to para 92 of AS 15 (Revised) "Employee Benefits", actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense. Therefore, surplus of Rs. 6 lakhs in the pension scheme on its actuarial valuation is required to be credited to the profit andloss statement of the current year. Hence, Kumar Ltd. cannot spread the actuarial gain of Rs. 6 lakhs over the next 2 years by reducing the annual contributions to Rs. 2 lakhs instead of Rs. 5 lakhs. It has to contribute Rs. 5 lakhs annually for its pension schemes.

Question 2

A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for class theyare entitled to as per company rule and to a lump-sum payment to cover expenses on food and stay during the travel. Alternatively, employees can claim a lump sum amount equal to one month pay last drawn.

The company's contentions in this matter are:

(i) Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.

(ii) Since it is not related to the length of service of the employees, it is accounted for on claim basis.

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer. (MTP 5 Marks Aug 18)

Answer 2

The present case falls under the category of defined benefit scheme under Para 49 of AS 15 "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee ator near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. Thus,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15.

(2) A provision should be made every year in the accounts for the accruing liability on ac-

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count of settlement allowance. The amount of provision should be calculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

Question 3

Samvit Ltd. has three business segments which are FMCG, Batteries and Sports Equipment. The Battery segment has been consistently underperforming and Samvit Ltd. after several discussions with labour unions have finally decided on closure of this segment. Under the agreement with the labour union, the employees of the Battery Segment will earn no further benefit as the arrangement is a curtailment without settlement wherein the employees of the discontinued segment will continue to receive benefits for services rendered when the segment was functioning. As a result of the curtailment, the company's obligations that were arrived on the basis of actuarial valuations before the curtailment have come down. The following information is also furnished:

(i) **The value of gross obligations before the curtailment calculated on actuarial basis was Rs. 6,000 lakhs.**

(ii) **The value of unamortized past service costs is Rs. 150 lakhs.**

(iii) **The curtailment will bring down gross obligations by Rs. 750 lakhs and Samvit Ltd. anticipates a proportional decline in the value of unamortized past service costs also.**

(iv) **The fair value of plan assets on date is estimated at Rs. 4,875 lakhs.**

You are required to calculate the gain from curtailment and also show the li ability to be recognizedin the Balance Sheet of Samvit Ltd. after the curtailment. (Mar 17) (MTP) (5 Marks)

Answer 3

Gain from curtailment

	(Rs. in lakhs
Reduction in gross obligation [(750/6,000) x 100] = 12.5%	750.00
Less: Proportion of unamortised past service cost	
(12.5% of Rs. 150)	(18.75)
Gain from curtailment	731.25

The liability to be recognised after curtailment in the balance sheet of Samvit Ltd. is estimated as under:

	Rs.
Reduced gross obligation (Rs. 6,000 - Rs. 750)	5,250.00
Less: Fair value of plan assets	(4,875.00)
	375.00

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Less: Unamortised past service cost (150.00 – 18.75)	(131.25)
Liability to be recognised in the balance sheet	243.75

Question 4

Luv limited is a private Limited company. As per HR policy of Luv Limited, Grade F employees are eligible for sabbatical leave (Long term compensated absences as per AS 15). Till previous year, there were 15 employees who are eligible for Sabbatical leave and company had duly recorded the liability for long term compensated absences based on the actuarial valuation for eligible employees. During the current period out of total 15 employees, 13 employees have left the organization and only 2 employees are continuing in LUV Limited. Due to budget constraint, CFO has denied to involve actuary and told finance manager to determine the liability based on the recent actuarial report available with them. Finance manager ensured the following:

- **There is no material change in interest rate**
- **There is no change in fair value of plan assets.**

Based on that, Finance manager have manually computed an amount of Rs. 5,00,000 (considering last year actuarial report as base) towards long term compensation liability without involving Actuary during the period ended 31.03.2020. Is this treatment is in line with AS 15? (RTP Nov 20)

Answer 4

As per para 58 of the AS 15, the detailed actuarial valuation of the present value of defined benefit obligations may be made at intervals not exceeding three years. However, with a view that the amounts recognized in the financial statements do not differ materially from the amounts that would be determined at the balance sheet date, the most recent valuation is reviewed at the balance sheet date and updated to reflect any material transactions and other material changes in circumstances (including changes in interest rates) between the date of valuation and the balance sheet date. The fair value ofany plan assets is determined at each balance sheet.

Since AS-15 (Para 58) states that actuarial valuation needs to be done at least once in three years. Since management had done the actuarial valuation in Previous Year, they can go ahead with exemption for this year subject to evaluation and conclusion by management as at balance sheet date that there areno significant changes in the amount of liability compared to previous year. Hence working done by the finance manager is appropriate. It is in line with AS 15, since company had recently done the actuarial valuation in previous year and there is no material changes in the external environment.

Question 5

Synergy Ltd., is in engineering industry. The companyreceived an actuarial valuation for the first time for its pension scheme which revealed a surplus of Rs. 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to Rs. 2 lakhs instead of Rs. 5 lakhs. The average remaining life of the employee is estimated to be 6 years.You are required to advise the company. (RTP Nov 19)

Answer 5

According to para 92 of AS 15 (Revised) "Employee Benefits", actuarial gains and losses should be recognized immediatelyin the statement of profit and loss as income or expense. Therefore, surplus of

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Rs. 6 lakhs in the pension scheme on its actuarial valuation is required to be credited to the profit and loss statement of the current year. Hence, Synergy Ltd. cannot spread the actuarial gain of Rs. 6 lakhs over the next 2 years by reducing the annual contributions to Rs. 2 lakhs instead of Rs. 5 lakhs. It has to contribute Rs. 5 lakhs annually for its pension schemes

Question 6

Peter Ltd. discontinues a business segment. Under the agreement with employee₹s union, the employees of the discontinued segment will earn no further benefit. This is a curtailment without settlement, because employees will continue to receive benefits for services rendered before discontinuance of the business segment. Curtailment reduces the gross obligation for various reasons including change in actuarial assumptions made before curtailment. If the benefits are determined based on the last pay drawn by employees, the gross obligation reduces after the curtailment because the last pay earlier assumed is no longer valid.

Peter Ltd. estimates the share of unamortized service cost that relates to the part of the obligation at Rs. 18 (10% of Rs. 180). Calculate the gain from curtailment and liability after curtailment to be recognised in the balance sheet of Peter Ltd. on the basis of given information:

(a) **Immediately before the curtailment, gross obligation is estimated at Rs. 6,000 based on current actuarial assumption.**

(b) **The fair value of plan assets on the date is estimated at Rs. 5,100.**

(c) **The unamortized past service cost is Rs. 180.**

(d) **Curtailment reduces the obligation by Rs. 600, which is 10% of the gross obligation. (RTP May 19)(New SM)**

Answer 6

Gain from curtailment is estimated as under:

	Rs.
Reduction in gross obligation	600
Less: Proportion of unamortised past service cost	(18)
Gain from curtaliment	582

The liability to be recognised after curtailment in the balance sheet is estimated as under:

	Rs.
Reduced gross obligation (90% of Rs. 6,000)	5,400
Less: Fair value of plan assets	(5,100)
	300
Less: Unamortised past service cost (90% of Rs. 180)	(162)
Liability to be recognised in the balance sheet	138

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Question 7

Neerav Ltd., is in engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of ₹ 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 2 lakhs instead of ₹ 5 lakhs. The average remaining life of the employee is estimated to be 6 years. You are required to advise the company in accordance with AS 15. (RTP May 18)

Answer 7

According to para 92 of AS 15 (Revised) "Employee Benefits", actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense. Therefore, surplus of

₹ 6 lakhs in the pension scheme on its actuarial valuation is required to be credited to the profit and loss statement of the current year. Hence, Neerav Ltd. cannot spread the actuarial gain of ₹ 6 lakhs over the next 2 years by reducing the annual contributions to ₹ 2 lakhs instead of ₹ 5 lakhs. It has to contribute ₹ 5 lakhs annually for its pension schemes.

Question 8

A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for the class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food andstay during the travel. Alternatively, employees can claim a lump-sum amount equal to one month pay last drawn.

The company's contentions in this matter are:

(i) Settlement allowance does not depend upon the length of service of employees. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.

(ii) Since it is not related to the length of service of the employees, it should account for liability on an actual "on claim" basis.

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer. (RTP May 17)

Answer 8

The present case falls under the category of defined benefit scheme under AS 15 "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the Statement of Profit and Loss. The contention of the Company that the settlement allowance will be accounted for 'on claim basis' is not correct even if company's obligation under the scheme is uncertain and requiresestimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control.

Thus,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15.

(2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated ac-

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cording to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

Question 9

Gratuity and Pension would be examples of:(New SM)

(a) Short-term employee benefits

(b) Long-term employee benefits

(c) Post-employment benefits.

(d) None of the above.

Ans: (c)

Question 10

Non-accumulating compensating absence is commonly referred to as: (New SM)

	(a)	Earned Leave
	(b)	Sick Leave
	(c)	Casual leave
	(d)	All of the above

Ans: (c)

Question 11

The plans that are established by legislation to cover all enterprises and are operated by Governments include: (New SM)

	(a)	Multi-Employer plans
	(b)	State plans
	(c)	Insured Benefits
	(d)	Employee benefit plan

Ans: (b)

Question 12

Best estimates of the variable to determine the eventual cost of post- employment benefits isreferred to as: (New SM)

(e) Employer's contribution

(f) Actuarial assumptions

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(g) Cost to Company

(h) Employee's contribution

Ans: (b)

Question 13

Actuarial gains / losses should be: (New SM)

(e) Recognized through reserves

(f) Charged over the expected life of employees

(g) Charged immediately to Profit and Loss Statement

(h) Do not charged to Profit and Loss Statement

Ans: (c)

Theoretical Questions Answers

Question 14

What are the types of Employees benefits and what is the objective of Introduction of this Standard i.e. AS 15? (New SM)

Answer 14

There are four types of employee benefits according to AS 15 (Revised 2005). They are:

(a) short-term employee benefits, such as wages, salaries and social security contributions (e.g., contribution to an insurance company byan employer to pay for medical care of its employees), paidannualleave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medicalcare, housing, cars and free or subsidised goods or services) for current employees;

(b) post-employment benefits such as gratuity, pension, other retirement benefits, post-employment lifeinsurance and post-employmentmedical care;

(c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation; and termination benefits.

Because each category identified in (a) to (d) above has different characteristics, this Statement establishes separate requirements for each category.

The objective of AS 15 is to prescribe the accounting and disclosure for employee benefits. The statement requires an enterprise to recognise:

(a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

(b) an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange foremployee benefits.

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Practical Questions Answers

Question 15

A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food and stayduring the travel. Alternatively, employees can claim a lump sum amount equal to one month pay last drawn.

The company's contentions in this matter are:

(i) **Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn. Since it is not related to the length of service of the employees, it is accounted for on claim basis.**

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer. (New SM)

Answer 15

The present case falls under the category of defined benefit scheme under Para 49 of AS 15 (Revised) "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to

the statement of profit and loss. The contention of the Companythat the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need tobe made regarding futureconditions and events, which are largely outside the company's control. Thus,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS15 (Revised).

(2) A provision should be made every year in the accounts for the accruing liability on accountof settlement allowance. The amount of provision should be calculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accountingfor settlement allowances.

Question 16

The following data apply to 'X' Ltd. defined benefit pension plan for the year ended 31.03.20X2

calculate the actual return on plan assets: (New SM)

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- Benefits paid	**2,00,000**
- Employer contribution	2,80,000
- Fair market value of plan assets on 31.03.20X2	11,40,000
- Fair market value of plan assets as on 31.03.20X1	8,00,000

Answer 16

	₹
Fair value of plan assets on 31.3.20X1	8,00,000
Add: Employer contribution	2,80,000
Less: Benefits paid	(2,00,000)
(A)	8,80,000
Fair market value of plan assets at31.3.20X2 (B)	11,40,000
Actual return on plan assets(B-A)	2,60,000

Question 17

The fair value of plan assets of Anupam Ltd. was ₹ 2,00,000 in respect ofemployee benefit pension plan as on 1st April, 20X1. On 30th September, 20X1 the plan paid out benefits of ₹ 25,000 and received inward contributions of ₹ 55,000. On 31st March, 20X2 the fair value of plan assets was

₹ 3,00,000. On 1st April, 20X1 the company made the following estimates, based on its market studies and prevailing prices.

	%
Interest and dividend income (after tax) payable by fund	**10.25**
Realized gains on plan assets (after tax)	**3.00**
Fund administrative costs	**(3.00)**
Expected rate of return	**10.25**

Calculate the expected and actual returns on plan assets as on 31st March,20X2, as per AS 15. (NewSM)

Answer 17

Computation of Expected Returns on Plan Assets as on 31st March, 20X2, asper AS 15

	₹
Return on opening value of plan assets of ₹ 2,00,000 (heldforthe year) @ 10.25%	20,500

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Add: Return on net gain of ₹ 30,000 (i.e. ₹ 55,000 – ₹ 25,000) during the year i.e. held for six months @ 5% (equivalent to 10.25% annually, compounded every six months)	1,500
Expected return on plan assets as on 31st March, 20X2	22,000

Computation of Actual Returns on Plan Assets as on 31st March, 20X2, as per AS 15

	₹	₹
Fair value of Plan Assets as on 31st March, 20X2		3,00,000
Less: Fair value of Plan as on Assets1st April, 20X1	(2,00,000)	
Add: Contribution received as on 30th September, 20X1	55,000	(2,55,000)
		45,000
Add: Benefits paid as on 30th September, 20X1		25,000
Actual returns on Plan as on Assets as on 31st March, 20X2		70,000

Question 18 (Illustration)

What are the kinds of employees covered in the revised AS 15 and whether a formal employer employee relationship is necessary or not, for benefits to be covered under the Standard? (New SM)

Answer 18

The Standard does not define the term "employee". Paragraph 6 of the Standard states that 'an employee may provide services to an enterprise on a full time, part time, permanent, casual or temporary basis andthe term would also include the whole-time directors and other management personnel. The Standardisapplicable to all forms of employer employee relationships. There is no requirement for a formal employer employee relationship. Several factors need tobe considered to determine the nature of a relationship.

Generally, 'outsourcing contracts' may not meet the definition of employer - employee relationship. However, such contracts need to be carefully examined to distinguish between a "contract of service" and a "contract for services". A 'contract for services' implies a contract for rendering services, e.g., professional, or technical services which is subject to limited direction and control whereas a 'contract of service' implies a relationship of an employer and employee, and the person is obliged to obey orders inthe work to be performed and as to its mode and manner of performance.

Question19 (Illustration)

Whether an enterprise is required to provide for employee benefits arising from informal practices?

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(New SM)

Answer 19

Paragraph 3(c) of the Standard defines employee benefits to include those informal practices that give rise to an obligation where the enterprise has no realistic alternative but to pay employee benefits. The historical pattern of granting such benefits, the expectation created and the impact on the relationship with employees in the event such benefit is withdrawn should be considered in determiningwhether the informal practice gives rise to a benefit covered by the Standard. For example, where an employer has a practice of making a lumpsum payment on occasion of a festival or regularly grants advances against informal benefits to employees it would be necessary to provide for such benefits.

Careful judgement should be applied in assessing whether an obligation has arisen particularly in instances where an enterprise's practice is to provide improvements only during the collective bargainingprocess and not during any informal process. If the employer has not set a pattern of benefits that can beprojected reliably to give rise to an obligation there is no requirement to providefor the benefits.

However, if the practice established by an employer was that of a consistent benefit granted either as part of union negotiations or otherwise that clearly established a pattern (e.g., a cost of living adjustment or fixed rupee increase), it could be concluded that an obligation exists and that those additional benefitsshould be included in the measurement of the benefit obligation.

Employee benefits include:

(a) Short-term employee benefits (e.g., wages, salaries, paid annual leave and sick leave, profit sharing bonuses etc. (payable within 12 months of the year-end) and non-monetary benefits for current employees.

(b) Post-employment benefits (e.g., gratuity, pension, provident fund, post- employment medical careetc.).

(c) long-term employee benefits (e.g., long-service leave, long-term disability benefits, bonuses not wholly payable within 12 months of the year end etc.), and

(d) termination benefits (e.g. VRS payments)

The Standard lays down recognition and measurement criteria and disclosure requirements for the above four types of employee benefits separately.

Question 20 (Illustration)

Entity XY is required to pay salary of ₹ 2 crore for the year 20X1-X2. It actually paid a salary of ₹ 1.90 crore up to 31st March 20X2, and balance in April 20X2. Determine the actual costs to be recognized in the year 20X1-X2 and any amounts to be shown through balance sheet. (New SM)

Answer 20

Total expense for the year (20X1-X2) ₹2 crore

Amount to be shown under liability (unpaid) ₹ 2 crore – 1.90 ₹crore

= ₹10 lakhs

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Question 21 (Illustration)

Whether an entitlement to earned leave which can be carried forward to future periods is a short -term employee benefit or a long-term employee benefit. (New SM)

Answer 21

Paragraph 7.2 of the Standard defines 'Short-term' benefits as employee benefits (other than termination benefits) which fall due wholly within twelve months afterthe end of the period in which the employees render the related service. Paragraph 8(b) of the Standard illustrates the term 'Short

-term benefits' to include "short term compensated absences (such as paid annual leave) where the absences are expected to occur within twelve months after the end of the periodin which the employees render the related employee service".

Paragraph 7.2 of the Standard uses "falls due" as the basis, paragraph 8(b) of the Standard uses "expected to occur" as the basis to illustrate classification of short term compensated absences. A reading of paragraph 8(b) together with paragraph 7.2 would imply that the classification of short -term compensated absences should be only when absences have "fallen due" and are also "expectedto occur". In other words, where employees are entitled to earned leave which can be carried forward to

%encash or utilise the benefit duringthe twelve months after the end of the period when the employee became entitled to the leave and is also expected to utilise the leave.

Where there are restrictions on encashment and/or availment, clearly the compensated absence has not fallen due and the benefit of compensated absences is more likely to be a long-term benefit. For example, where an employee has 100 days of earned leave which he is entitled to an unlimited carry forward, but the rules of the enterprise allow him to encash/utilise only 30 days during the next twelve months, the benefit would be considered as a 'long-term' benefit. In some situations, where there is no restriction but the absence is not expected to wholly occur in the next twelve months, the benefit should be considered as 'long-term'. For example, where an employee has 400 days carry forward earned leave and the past pattern indicates that the employees are unlikely to avail / encash the entire carry forwardduring the next twelve months, the benefit would not be 'short-term'.

Whilst it is necessary to consider the earned leave which "falls due", the pattern of actual utilisation/ encashment by employees, although reflective of the behavioural pattern of employees, does determine the status of the benefit, i.e., whether 'short-term' or 'long-term'. The value of short- term benefits should bedetermined without discounting and if the benefit is determined as long-term, it would be recognised and measured as "Other long-term benefits" in accordancewith paragraph 129 of the Standard.

The categorisation in 'short-term' or 'long-term' employee benefits should be done on the basis of the overall behavioural pattern of all the employees of the enterprise and not on individual basis.

Question 22 (Illustration)

In case an enterprise allows unutilised employee benefits, e.g., medical care, leave travel, etc., to be

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carried forward, whether it is required to recognise a provision in respect of carried forward benefits. (New SM)

Answer 22

A provision should be recognised for all benefits (conditional or unconditional) which an employee becomes entitled to as a result of rendering of the service and should be recorded as part of the cost of service rendered during the period in which the service was rendered which resulted the entitlement. In estimating thecost of such benefit the probability of the employee availing such benefit shouldbe considered.

Question 23 (Illustration)

Omega Limited belongs to the engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of ₹ 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 2 lakhs instead of ₹ 5 lakhs. The average remaining life of the employees is estimated to be 6 years. You are required to advise the company onthe following items from the viewpoint of finalization of accounts, taking note of the mandatory accounting standards. (New SM)

Answer 23

According to AS 15 (Revised 2005) 'Employee Benefits', actuarial gains and losses should be recognized

immediately in the statement of profit and loss as incomeor expense. Therefore, surplus amount of

₹ 6 lakhs is required to be credited tothe profit and loss statement of the current year.

Question 24 (Illustration)

As on 1st April, 20X1 the fair value of plan assets was ₹ 1,00,000 in respect of a pension plan of Zeleous Ltd. On 30th September, 20X1 the plan paid out benefits of ₹ 19,000 and received inward contributions of ₹ 49,000. On 31st March, 20X2 the fair value of plan assets was₹ 1,50,000 and present value of the defined benefit obligation was ₹ 1,47,920. Actuarial losses on the obligations for the year 20X1- 20X2 were ₹ 600.

On 1st April, 20X1, the company made the following estimates, based on its market studies, understanding and prevailing prices.

Interest & dividend income, after tax payable by the fund	**9.25**
Realised and unrealised gains on plan assets (after tax)	**2.00**
Fund administrative costs	**(1.00)**
Expected Rate of Return	**10.25**

You are required to find the expected and actual returns on plan assets.(New SM)

Answer 24

Computation of Expected and Actual Returns on Plan Assets

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		₹
Return on ₹ 1,00,000 held for 12 months at 10.25%		10,250
Return on ₹ 30,000 (49,000-19,000) held for six months at 5% (equivalent to 10.25% annually, compounded every six months)		1,500
Expected return on plan assets for 20X1-20X2		11,750
Fair value of plan assets as on 31 March, 20X2		1,50,000
Less: Fair value of plan assets as on 1 April,20X1	1,00,000	
Contributions received	49,000	(1,49,000)
		1,000
Add: Benefits paid		19,000
Actual return on plan assets		20,000

Alternatively, the above question may be solved without giving compound effectto rate of return.

Question 25 (Illustration)

Rock Star Ltd. discontinues a business segment. Under the agreement with employee's union, the employees of the discontinued segment will earn no further benefit. This is a curtailment without settlement, because employees will continue to receive benefits for services rendered before discontinuance of the business segment. Curtailment reduces the gross obligation for various reasonsincluding change in actuarial assumptions made before curtailment. If the benefits are determined based on the last pay drawn by employees, the gross obligation reduces after the curtailment because the last pay earlier assumed is no longer valid.

Rock Star Ltd. estimates the share of unamortized service cost that relates to the part of the obligation at ₹ 18 (10% of ₹ 180). Calculate the gain from curtailment and liability after curtailment to be recognised inthe balance sheet of Rock Star Ltd. on the basis of given information:

(a) Immediately before the curtailment, gross obligation is estimated at ₹ 6,000 based on currentactuarial assumption.

(b) The fair value of plan assets on the date is estimated at ₹ 5,100.

(c) The unamortized past service cost is ₹ 180.

(d) Curtailment reduces the obligation by ₹ 600, which is 10% of the gross obligation.

(New SM)

Answer 25

Gain from curtailment is estimated as under:

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Reduction in gross obligation	600
Less: Proportion of unamortised past service cost	(18)
Gain from curtailment	582

The liability to be recognised after curtailment in the balance sheet is estimatedas under:

	₹
Reduced gross obligation (90% of ₹6,000)	5,400
Less: Fair value of plan assets	(5,100)
	300
Less: Unamortised past service cost (90% of ₹180)	(162)
Liability to be recognised in the balance sheet	138

Question 26 (Illustration)

An employee Roshan has joined a company XYZ Ltd. in the year 20X1. The annual emoluments of Roshan asdecided is ₹ 14,90,210. The company also has a policy of giving a lump sum payment of 25% of thelastdrawn annual salary of the employee for each completed year of service if the employee retires after completing minimum 5 years of service. The salary of the Roshan is expected to grow @ 10% per annum.

The company has inducted Roshan in the beginning of the year and it is expected that he will completethe minimum five year term before retiring. Thus he will get5 yearly increment.

What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined Benefit obligation? Also calculate the current service cost and the interest cost to be charged per year assuming a discount rate of 8%. (P.V factor for 8% - 0.735, 0.794, 0.857, 0.926, 1) (New SM)

Answer 26

Calculation of Defined Benefit Obligation (DBO)

Expected last drawn salary = ₹14,90,210 x 110% x 110% x 110% x 110% x 110%

= ₹24,00,000

Defined Benefit Obligation (DBO) = ₹24,00,000 x 25% x 5 = ₹30,00,000

Amount of ₹ 6,00,000 will be charged to Profit and Loss Account of the companyevery year as costfor Defined Benefit Obligation.

Calculation of Current Service Cost

Year	Equal apportioned amount of DBO [i.e. ₹ 30,00,000/5 years]	Discounting @8% PV factor	Current service cost (Present Value)
a	b	c	d = b x c
1	6,00,000	0.735 (4 Years)	4,41,000

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2	6,00,000	0.794 (3 Years)	4,76,400
3	6,00,000	0.857 (2 Years)	5,14,200
4	6,00,000	0.926 (1 Year)	5,55,600
5	6,00,000	1 (0 Year)	6,00,000

Calculation of Interest Cost to be charged per year

Year	Openingbal-ance	Interestcost	Currentser-vice cost	Closing balance
a	b	c = b x 8%	d	e = b + c + d
1	0	0	4,41,000	4,41,000
2	4,41,000	35,280	4,76,400	9,52,680
3	9,52,680	76,214	5,14,200	15,43,094
4	15,43,094	1,23,447	5,55,600	22,22,141
5	22,22,141	1,77,859*	6,00,000	30,00,000

*Due to approximations used in calculation, this figure is adjusted accordingly.

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Chapter 6.2

AS 29- Provisions, Contingent Liabilities & Contingent Assets

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.20 TO Q.28											
Past Exams	NO	NO	NO	Q.8	NO	Q.5 Q.15	NO	Q.18	Q.16	Q.17	NO	NO
MTP	Q.2	Q.1 Q.3	Q.2	Q.1	NO	NO	Q.4 Q.5	Q.1 Q.6	Q.4 Q.7	Q.7 Q.8	Q.1 Q.6	Q.6 Q.18 Q.19
RTP	NO	NO	NO	Q.7	Q.5 Q.12	Q.2 Q.11	Q.10	Q.9	Q.13	Q.14	Q.8	Q.19

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Chapter 6.2

AS 29- Provisions, Contingent Liabilities & Contingent Assets

Question 1

An airline is required by law to overhaul its aircraft once in every five years. The pacific Airlines which operate aircrafts does not provide any provision as required by law in its final accounts. You are required to comment on the validity of the treatment done by the company in line with the provisions of AS 29. (MTP 5 Marks- Oct'19, Aug'18, Nov'21 & April '23)

Answer 1

A provision should be recognized only when an enterprise has a present obligation arising from a past event or obligation. In the given case, there is no present obligation but a future one, therefore no provision is recognized as per AS 29. The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts. Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts. Further, the enterprise can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation aftercompletion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime. A provision should berecognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for morethan five years.

Question 2

Sun Ltd. has entered into a sale contract of Rs. 5 crores with X Ltd. during 2015-2016 financial year. The profit on this transaction is Rs. 1 crore. The delivery of goods to take place during the first month of 2016- 2017 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of Rs. 1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last monthof 2015- 2016 financial year. As on balance sheet date (31.3.2016), the goods were not manufactured and it was unlikely that Sun Ltd. will be in a position to meet the contractual obligation.

Should Sun Ltd. provide for contingency as per AS 29? Explain.

(ii) Should provision be measured as the excess of compensation to be paid over the profit? (MTP 5 Marks Mar'19, Mar'18) (Same concept lesser adjustments RTP Nov'20)

Answer 2

(i) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has apresent obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognized. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable thatSun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amountof compensation. Therefore, Sun Ltd. should provide for the contingency amounting Rs. 1.5 crores as per AS 29.

(ii) Provision should not be measured as the excess of compensation to be paid over the profit. The goodswere not manufactured before 31st March, 2016 and no profit had accrued for the financial year 2015- 2016. Therefore, provision should be made for the full amount of compensation amounting Rs. 1.50 crores.

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Question 3

S Ltd. (a Public Sector Company) provides consultancy and engineering services to its clients. In the year 2016-17, the Government has set up a commission to decide about the pay revision. The pay will be revised with respect from 1-1-2012 based on the recommendations of the commission. The company makes the provision of Rs. 680 lakhs for pay revision in the financial year 2016-17 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 this employee s on each job.

The company discloses through notes to accounts:

"Salaries and benefits include the provision of Rs. 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 Rs. 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. (MTP 5 Marks Oct'18)

Answer 3

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 recognized when, and only when, it is virtually certain that reimbursement willbe received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision.

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 employeesof Rs. 680 lakhs will be ultimately collected from the client, as per the terms of the contract. Therefore, the liability of Rs. 680 lakhs is matched by the counter claim from the client. Hence, the provision for salaryof 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 Rs. 680 lakhs is not as per AS-29 and also the concept of prudence will not be followed if Rs. 680 lakhs is simultaneously recognized as income.Rs. 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 Rs. 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 4

(i) XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of Rs. 200 lacs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS

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29? Explainin brief giving reasons for your answer.(RTP Nov 18, May 19)

(ii) What is meant by "Restructuring Provision" as per AS 29? What costs are excluded while computing such provision as per the standard? (MTP 5 Marks April 21, April 22)

Answer 4

(i) As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when

- an enterprise has a present obligation as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle theobligation; and
- a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of Rs. 200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

As per AS 29, a restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both: (a) necessarily entailed by the restructuring; and (b) Not associated with the ongoing activities of the enterprise. A restructuring provision does not include such costs as: (a) Retraining or relocating continuing staff; (b) Marketing; or (c) Investment in new systems and distribution networks.

Question 5

An organization operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it and ten percent arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted. With reference to AS 29, how would you deal with this in the annual accounts of the company at the Balance Sheet date? Explain. (MTP 5 Marks March 21, RTP May'20, PYP 2.5 Marks Nov'20, Old & New SM)

Answer 5

The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is probable. Thus, a provision is recognized for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig. However, thereis no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extractedat the balance sheet date. So, no provision is required for the cost of extraction of oil at balance sheet date. Ten per cent of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.

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Question 6

Saharsh Ltd. is engaged in manufacturing of electric home appliances. The company is in the process of finalizing its accounts for the year ended 31.3.2022 and needs your expert advice on the following issues in line with the provisions of AS 29:

(i) A case has been filed against the company in the consumer court and a notice for levy of a penalty of Rs. 20 lakhs has been received. The company has appointed a lawyer to defend the case for a fee of Rs. 2 lakhs. 50% of the fees has been paid and balance 50% will be paid after finalization of the case. There are 75% chances that the penalty may not be levied.

(ii) The company had committed to supply a consignment worth Rs. 1 crore to one of its dealers by the year-end. As per the contract, if delivery is not made on time, a compensation of 15% is to be paidon the value of delayed/lost consignment. While the consignment was in transit, one of the trucks carrying goods worth Rs. 30 lakhs met with an accident. It was however covered by Insurance. According to the surveyor's report, the policy amount is collectable, subject to 10% deduction. Beforeclosing the books of accounts, the company has received the information that the policy amount has been processed and the dealer has also claimed the compensation for the consignment of goods worth Rs. 30 lakhs which was in transit. (MTP 5 Marks Oct '21 ,March '23 & Oct '23)

Answer 6

(i) As per AS 29, an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not. Liability is a present obligationof the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits. In the given case, there are 75% chances that the penalty may not be levied. Accordingly, Saharsh Ltd. should not make the provision for penalty. However, a provision should be made for remaining 50% fees of the lawyer in the financialstatements of financial year 2021-2022.

(ii) Loss due to accident R s
30,00,000

Insurance claim receivable by company = Rs. 30,00,000 x 90% = Rs.
27,00,000

Loss to be recognised in the books for 2019-2020 Rs. 3,00,000 Insurance claim receivable to be recorded in the books Rs. 27,00,000

Compensation claim by dealer against company to be provided for in the books

= Rs. 30,00,000 x 15% = Rs. 4,50,000

Question 7

XYZ Ltd. has not made provision for warrantee in respect of certain goods due to the fact that th e company can claim the warranty cost from the original supplier. Hence the accountant of the company says that the company is not having any liability for warrantees on a particular date as the amount gets reimbursed. You are required to comment on the accounting treatment done by the XYZ Ltd. in line with the provisions of AS 29. (MTP 5 Marks Mar'22 & Sep '22, RTP Nov'19)

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Answer 7

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 willbe 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 provision. It is apparent from the Question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it is viewed that the accounting treatment adopted by the company with respect to warranty is not correct.

Question 8

A Company dealing in software provides after sales warranty for 2 years to its customer. 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: 3% provision

More than 1 year: 4% provision

The company has raised invoices as under:

Invoice Date	Amount (₹)
19th January, 2019	1,20,000
29th January, 2020	75,000
15th October, 2020	2,70,000

You are required to calculate the provision to be made for warranty under Accounting Standard 29 as at 31st March, 2020 and 31st March, 2021. Also compute the amount to be debited to Profit and Loss Account for the year ended 31st March, 2021. (MTP 5 Marks Oct'22, PYP 5 Marks Nov '19, RTP May '23)

Answer 8

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

As at 31st March, 2020 = ₹ 1,20,000 x .03 + ₹ 75,000 x .04

= ₹ 3,600 + ₹ 3,000 = ₹ 6,600

As at 31st March, 2021 = ₹ 75,000 x .03 + ₹ 2,70,000 x .04

= ₹ 2,250 + ₹ 10,800 = ₹ 13,050

Amount debited to Profit and Loss Account for year ended 31st March, 2021

	₹
Balance of provision required as on 31.03.2021	13,050
Less: Opening Balance as on 1.4.2020	(6,600)

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Amount debited to profit and loss account	6,450

Note: No provision will be made on 31st March, 2021 in respect of sales amounting ₹ 1,20,000 made on 19th January, 2019 as the warranty period of 2 years has already expired.

Question 9

A company, incorporated as NPO under the Companies Act, is having main objective to promote the trade by organizing trade fairs / exhibitions. While organizing the trade fair and exhibitions, it decided to charge 5% contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies, 5% contingency chargesare levied separately in the invoice, the contingency charges in respect of fairs organized by the company itself are inbuilt in the space rent charged from the participants. Both are credited to Income and Expenditure Account of the company.

The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/ exhibitors, etc., due to fire, terrorist attack, stampede, natural calamities and other public and third party liability. The chances of occurrence of these events are high because of large crowds visiting the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated.

The accounting treatment and disclosure was made by the company in its financial statements as: (i) 5% contingency charges are treated as income and matching provision for the same is also being made in accounts and (ii) suitable disclosure to this effect is also made in the notes forming part of accounts.

(a) You are required to comment whether creation of provision for contingencies considering the facts and circumstances of the case is required in line with AS **29.**

An oil company has been contaminating land for several years. It does not clean up because there is nolegislation requiring cleaning up. On 31st March 2021, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary considering the circumstances in line with provisions of AS 29? (RTP Nov '21)

Answer 9

As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", a provision should be recognized when (a) An enterprise has a present obligation as a result of a past event and (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

(a) From the above, it is clear that for the contingencies considered by the company, neither a present obligation exists because of past event, nor a reliable estimate can be made of the amount of the obligation. Accordingly, a provision cannot be recognized for such contingencies under the facts andcircumstances of the case.

As per AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event. However, when environmental damage is caused there may be no obligation to remedy the consequences. The causing of the damage will become an obligating event when a new law requires theexisting damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted. In the given case it is virtuallycertain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean-up cost in the year in which the law is virtually certain to be enacted.

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Question 10

The company has not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier.

(a) You are required to examine in line with the provisions of AS 29. (RTP May 21, May **18)**

Explain whether provision is required in the following situations in line with AS 29:

(i) There is a present obligation that probably requires an outflow of resources and a reliableestimate can be made of the amount of obligation;

(ii) There is a possible obligation or a present 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 ofresources is remote. (RTP May 21)

Answer 10

As per provisions of 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 recognized 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 recognized for the reimbursement should not exceed the amount of the provision.

It is apparent from the Question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it can be said that the accounting treatment adopted by the company with respect to warranty is not correct.

(i) (b)

(ii) There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation – Provision is recognized. Disclosures are required for the provision.

(iii) There is a possible obligation or a present obligation that may, but probably will not, require an outflowof resources – No provision is recognised. Disclosures are required for the contingent liability.

There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote – No provision is recognised. No disclosure is required.

Question 11

(a) How will you distinguish contingent assets with Contingent Liabilities. Explain in brief. (RTP Nov 20)

Answer 11

A Contingent liability is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(i) A present obligation that arises from past events but is not recognized because:

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(ii) It is not probable that an outflow of resources embodying economic benefits will be required tosettle the obligation; or

A reliable estimate of the amount of the obligation cannot be made.

An enterprise should not recognize a contingent liability but should be disclosed. A contingent liabilityis disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain. An enterprise should not recognize a contingent asset, since this may result in the recognition of income that may never be realized. However, when the realization of income is virtually certain, then the related asset is nota contingent asset and its recognition is appropriate. A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and, the corresponding approving authority in the case of any other enterprise), where an inflow of economic benefits is probable. Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliableestimate can be made of the amount of obligation, a provision should be recognized. Alpha Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Alpha Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Alpha Ltd. should provide for the contingency amounting Rs. 2 crores as per AS29.

Question 12

(i) With reference to AS 29, how would you deal with the following in the annual accounts of the company at the Balance Sheet **dates:**

During 2018-19 Ace Ltd. gives a guarantee of certain borrowings of Brew Ltd., whose financial condition at that time is sound. During 2019-20, the financial condition of Brew Ltd. deteriorates and on 31st Dec. 2019, it goes into liquidation. (Balance Sheet date 31-3-19). (RTP May 20)

Answer 12

As per AS 29, for a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation.

The obligating event is the giving of the guarantee by Ace Ltd. for certain borrowings of Brew Ltd., which gives rise to an obligation. No outflow of benefits is probable at 31 March 2019.Thus no provision is recognized. The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

During 2019-20, the financial condition of Brew Ltd. deteriorates and finally goes into liquidation. The obligating event is the giving of the guarantee, which gives rise to a legal obligation. At 31 March 2020, it isprobable that an outflow of resources embodying economic benefits will be required to settle the obligation. Thus, provision is recognized for the best estimate of the obligation.

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Question 13

(i) Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2020. It seeks your advice in the following **cases:**

(ii) **Chaos Limited has filed a court case in 2014-2015 against its competitors. It became evident to its lawyers during the year ended 31st March, 2020 that Chaos Limited may lose the case and would have to pay Rs. 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.**

(iii) **A new regulation has been passed in 2019-2020 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2021. The company estimates an expenditure of Rs. 10,00,000for the said upgrade.**

The company gives one year warranty for its healthcare equipment under the contract of sale that it will make good any manufacturing defect by repair or replacement. As per past experience, it is probable that there will be 1% such cases and estimated cost of repair / replacement is estimated at 10% of such sale value. During the year, the company has made a sale of Rs. 5 crores.

Kindly give your Answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29. (RTP May'22)

Answer 13

(i) Principles for recognition of provisions: As per AS 29, "a provision shall be recognised **when:**

(ii) an entity has a present obligation (legal or constructive) as a result of a past event;

it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and provision shall be recognised."

(i) Accounting treatment under the given **scenarios:**

(ii) On 31st March, 2020, since it is evident to the lawyer that Chaos Limited may lose the case and also a reliable estimate of the outflow can be made as Rs. 3,00,000, there is a present obligation. Hence, provision should be recognised for Rs. 3,00,000 for the amount which may be required to settle the obligation.

(iii) Under new regulation, an entity is required to upgrade its facilities by 31 st March, 2021. However, on 31st March, 2020, i.e. at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations. Hence, no provision should be recognized on 31st March, 2020 for upgrading the facilities by 31st March, 2021.

The obligating event is the sale of health care equipment with a warranty, which gives rise to a legal obligation. Here, an outflow of resources embodying economic benefits in settlement is probable for the warranties as a whole. Hence, a provision is recognized for the best estimate of the costs of making goodunder the warranty products sold before the end of the reporting period as follows: Probability of warranty cases for the entity where repair/replacement may be required as per past experience

= 1% of Rs. 5,00,00,000 = Rs. 5,00,000

Estimated cost of repair / replacement = Rs. 5,00,000 x 10% = Rs. 50,000.

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Question 14

(i) Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2022. It seeks your advice in the following **cases:**

(ii) **Chaos Limited entered into an agreement to supply 1 lac face masks to D Limited by 30th April, 2022 failing which it will have to pay a penalty of Rs. 10 per item not supplied. On 31st March, 2022 Chaos Limited assessed that it could only supply 50,000 face masks to D Limited by 30th April, 2022.**

(iii) **Chaos Limited has filed a court case in 2014-2015 against its competitors. It is evident to its lawyers that Chaos Limited may lose the case and would have to pay Rs. 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.**

A new regulation has been passed in 2021-22 by the healthcare ministry to upgrade facilities. Deadlineset by the government is 31.03.2023. The company estimates an expenditure of Rs. 10,00,000 for the said upgrade.

Kindly give your answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29. (RTP Nov'22)

Answer 14

Principles for recognition of provisions:

(a) As per AS 29, "a provision shall be recognised when:

(b) an entity has a present obligation (legal or constructive) as a result of a past event;

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

a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

(i) Accounting treatment under the given **scenarios:**

(ii) In this case, there is no present obligation arising out of a past event as the goods are scheduled for delivery on 30th April, 2022 and there is no delay as at 31st March, 2022. Hence, there is no present obligation to pay the penalty in the current year. Therefore, no provision can be recognized in the instantcase.

On 31st March, 2022, since it is evident to the lawyer that Chaos Limited may lose the case and also a reliable estimate of the outflow can be made as Rs. 3,00,000, there is a present obligation. Hence, provision should be recognised for Rs. 3,00,000 for the amount which may be required to settle the obligation.

Under new regulation, an entity is required to upgrade its facilities by 31st March, 2023. However, on 31st March, 2022, i.e. at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations. Hence, no provision should be recognised on 31st March, 2022 for upgrading the facilities by 31st March, 2023.

Question 15

With reference to AS 29, how would you deal with the following in the Annual Accounts of the company at the Balance Sheet date:

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(i) The Government introduces a number of changes to the taxation laws. As a result of these changes, thecompany will need to train a large proportion of its accounting and legal workforce in order to ensure continued compliances with tax law regulations. At the balance sheet date, no retraining of staff has taken place.(PYP 2.5 Marks , Nov 20)

Answer 15

As per AS 29, a provision for restructuring costs is recognized only when the recognition criteria for provisions are met. A restructuring provision does not include costs as of retraining or relocating continuing staff. The expenditures of training the staff related to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognized on the same basis as if they arose independently of a restructuring. At the balance sheet date, no such expenditure has been incurred hence no provision is required.

Question 16

I. Alloy Fabrication Limited is engaged in manufacturing of iron and steel rods. The company is in the process of finalisation of the accounts for the year ended 31 st March,2022 and needs your advice on the following issues in line with the provisions of **AS-29:**

II. **On 1stApril,2019, the company installed a huge furnace in their plant. The furnace has a lining that needs to be replaced every five years for technical reasons. At the Balance Sheet date 31st March,2022, the company does not provide any provision for replacement of lining of the furnace.**

A case has been filed against the company in the consumer court and a notice for levy of a penalty of

₹ 50 Lakhs has been received. The company has appointed a lawyer to defend the case for a fee of ₹5 Lakhs. 60% of the fees have been paid in advance and rest 40% will be paid after finalization of the case. There are 70% chances that the penalty may not be levied.. (PYP 5 Marks May'22)

Answer 16

I. A provision should be recognized only when an enterprise has a present obligation arising from a past event or obligation. In the given case, there is no present obligation but a future one, therefore no provision is **recognized** as per AS 29. The cost of replacement of lining of furnace is not recognized as a provision because it is a future obligation. Even a legal requirement does not require the company to make a provision for the cost of replacement because there is no present obligation. Even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining.

As per AS 29, an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not. Liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

In the given case, there are 70% chances that the penalty may not be levied. Accordingly, Alloy Fabrication Ltd. should not make the provision for penalty. The matter is disclosed as a contingentliability unless the probability of any outflow is regarded as remote.

However, a provision should be made for remaining 40% fees of the lawyer amounting₹ 2,00,000 in the financial statements of financial year 2021-2022

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Question 17

At the end of the financial year ending on 31stMarch, 2022, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

Particulars	Probability	Loss (₹)
In respect of five cases	100%	-
(Win) Next ten cases (Win)	50%	-
Lose (Low damages)	40%	12,00,000
Lose (High damages)	10%	20,00,000
Remaining five cases	50%	-
Win Lose (Low damages)	30%	10,00,000
Lose (High damages)	20%	21,00,000

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof as per AS - 29. (PYP 5 Marks Nov 22)

Answer 17

According to AS 29 (Revised) '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 requiredto settle the obligation.

(iii) The possibility of an outflow of resources embodying economic benefits is not remote.

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

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 50% and for remaining five cases is 50%. As per AS 29 (Revised), we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is remote, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 40% of ₹ 12,00,000 + 10% of ₹ 20,00,000

= ₹ 4,80,000 + ₹ 2,00,000

= 6,80,000

Expected loss in remaining five cases = 30% of ₹ 10,00,000 + 20% of ₹ 21,00,000

= ₹ 3,00,000 + ₹ 4,20,000

= ₹ 7,20,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of 1,04,00,000 (₹ 6,80,000 X 10 + ₹ 7,20,000 X 5) as contingent liability.

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Question 18

(Includes concepts from AS 9- Revenue Recognition)

A Limited sells goods with unlimited right of return to its customers. The following pattern has been observed in the Return of Sales:

Time frame of Return from date of purchase	% of Cumulative Sales
Between 0-1 month	6%
Between 1-2 months	7%
Between 2-3 months	8%

The Company has made Sales of ₹ 36 Lakhs in the month of January, ₹ 48 Lakhs in the month of February and of ₹ 60 Lakhs in the month of March. The Total Sales for the Financial Year have been ₹ 400 Lakhs and the Cost of Sales was ₹ 320 Lakhs. You are required to determine the amount of Provision to be made and Revenue to be recognized as on 31st March. (PYP 5 Marks, July 21, MTP Sep'23)

Answer 18

Amount of provision

The goods are sold with a right to return. The existence of such right gives rise to a present obligation on the company as per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets'. According to the standard, a provision should be created on the Balance sheet date, for sales returns after the Balance Sheet date, at the best estimate of the loss expected, along with any estimated incremental cost that would be necessary to resell the goods expected to be returned.

Sales during	Sales value (₹in lacs)	Sales value (cumulative) ₹ (in lacs)	Likely returns (%)	Likely returns ₹ (in lacs)	Provision @ 20%(₹ in lacs) (ReferW.N.)
March	60	60	6%	3.60	0.720
February	48	108	7%	7.56	1.512
January	36	144	8%	11.52	2.304
Total				22.68	4.536

Revenue to be recognized

Revenue in respect of sale of goods is recognized fully at the time of sale itself assumed that the company has complied with the conditions stated in AS 9 relating to recognition of revenue in the caseof sale of goods. As per AS 9, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) Seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods. AS 9 also provides that in case of retail sales offering a guarantee of 'money back,if not completely satisfied, it may be appropriate to recognize the sale but to make a suitable provisionfor returns based on previous experiences.

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Therefore, sale of ₹ 36 lakhs, ₹ 48 lakhs and ₹ 60 lakhs made in the months of January, February and March will be recognized at full value. Thus, total revenue to be recognized for RS. 400 lacs for the year.

Working Note:

Calculation of Profit % on sales

	(₹ in lacs)
Sales for the year	400
Less: Cost of sales	(320)
Profit	80
Profit mark up on sales (80/400) x 100 = 20%	

Question 19

With reference to AS 29, how would you deal with the following in the Annual Accounts of the company at the Balance Sheet date:

(i) **The company operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Eighty five percent of the eventual**

costs relate to the removal of the oil rig and restoration of damage caused by building it, and fifteen percent arise through the extraction of oil. At the balance sheet date, rig has been constructed but no oil has been extracted.

(ii) **The Government introduces a number of changes to the taxation laws. As a result of these changes, the company will need to train a large proportion of its accounting and legal workforce in order to ensure continued compliances with tax law regulations. At the balance sheet date, no retraining of staff has taken place.(RTP Nov '23)(MTP 5 Marks Sep '23)**

Answer 19

(i) The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is probable. Thus, a provision is recognized for the best estimate of 85% of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost ofthe oil rig.

However, there is no obligation to rectify the damage that will be caused by extraction of oil, as nooil has been extracted at the balance sheet date. So, no provision is required for the cost of extraction of oil at balance sheet date. 15% of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.

(ii) As per AS 29, a provision for restructuring costs is recognized only when the recognition criteria forprovisions are met. A restructuring provision does not include costs as of retraining or relocating continuing staff.

The expenditures of training the staff related to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognized on the same basis as if they arose independently of a restructuring. At the balance sheet date, no

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such expenditure has been incurred hence no provision is required.

Question 20

Which of the following best describes a provision?

a. A provision is a liability of uncertain timing or amount.

b. A provision is a possible obligation of uncertain timing.

c. A provision is a credit balance set up to offset a contingent asset so that theeffecton the statement of financial position is nil.

d. A provision is a possible obligation of uncertain amount.

Answer

Question 21

X Co is a business that sells second hand cars. If a car develops a fault within 30 days of the sale, X Co willrepair it free of charge. At 1 st March 20X1, X Co had made a provision for repairs of ₹ 25,000. At 31st March20X1, X Co calculated that the provision should be ₹ 20,000. What entry should be made forthe provision in XCo's income statement for the month 31st March 20X1?

e. A charge of ₹ 5,000

f. A credit of ₹ 5,000

g. A charge of ₹ 20,000

h. A credit of ₹ 25,000

Answer

Question 22

Which of the following item does the statement below describe? "A possible obligation that arises from past events and whose existence will be confirmed only by theoccurrence or non-occurrence of one or more uncertain future events not wholly within the entity's control"

i. A provision

j. A current liability

k. A contingent liability

l. Deferred tax liability

Answer

Question 23

Z Ltd has commenced a legal action against Y Ltd claiming substantial damages for supply of a faulty product. The lawyers of Y Ltd have advised that the company is likely to lose the case, although the chancesof paying the claim is not remote. The estimated potential liability estimated by the lawyers are:

Legal cost (to be incurred irrespective of the outcome of the case) ₹ 50,000 Settlement if the claim is

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required to be paid ₹ 5,00,000

What is the appropriate accounting treatment in the books of Z Ltd.?

m. Create a Provision of ₹ 5,50,000

n. Make a Disclosure of a contingent liability of ₹ 5,50,000

o. Create a Provision of ₹ 50,000 and make a disclosure of contingent liability of ₹ 5,00,000

p. Create a Provision of ₹ 5,00,000

Theoretical Questions Answers

Question 24

When should provision be recognized as per provisions of AS 29? Explain in brief.

Answer 24

A provision should be recognized only when: (a) An enterprise has a present obligation as a result of a past event; (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) A reliable estimate can be made of the amount of the obligation.

Practical Questions

Questions 25

Sun Ltd. has entered into a sale contract of ₹ 5 crores with X Ltd. during 20X1-20X2 financial year. Theprofit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 20X2- 20X3 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of ₹ 1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 20X1-20X2 financial year. As on balance sheet date (31.3.20X2), the goods were not manufactured, and it was unlikely that Sun Ltd. will be able to meet the contractual obligation.

(i) Should Sun Ltd. provide for contingency as per AS 29?

(ii) Should provision be measured as the excess of compensation to be paid over the profit? Answer 25

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognized. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that SunLtd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for the contingency amounting ₹ 1.5 crores as per AS29.

Provision should not be measured as the excess of compensation to be paid over the profit. The goods werenot manufactured before 31st March, 20X2 and no profit had accrued for the financial year 20X1- 20X2. Therefore, provision should be made for the full amount of compensation amounting ₹1.50 crores.

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Questions 26

An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. At 31 st March 20X1, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary?

Answer 26

As per para 29 of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event.

However, when environmental damage is caused, there may be no obligation to remedy the consequences.

The causing of the damage will become an obligating event when a new law requires the existing damage

to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only whenthe legislation is virtually certain to be enacted.

In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean-up cost in the year in which the law isvirtually certain to be enacted.

Question 27 (Illustration)

At the end of the financial year ending on 31st December, 20X1, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

	Probability	Loss (₹)
In respect of five cases (Win)	100%	-
Next ten cases (Win)	50%	-
Lose (Low damages)	40%	1,20,000
Lose (High damages)	10%	2,00,000
Remaining five cases		
Win	50%	-
Lose (Low damages)	30%	1,00,000
Lose (High damages)	20%	2,10,000

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss andthe accounting treatment in respect thereof.

Answer 27

According to AS 29 (Revised) 'Provisions, Contingent Liabilities and Contingent Assets', contingent

(i) liability should be disclosed in the financial statements if following conditions are satisfied:

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

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

(iv) The possibility of an outflow of resources embodying economic benefits is not remote.

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

In this case, the probability of winning of first five cases is 100% and hence, Question of providing for contingent loss does not arise. The probability of winning of next ten cases is 50% and for remaining five cases is 50%. As per AS 29 (Revised), we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is remote, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 40% of ₹ 1,20,000 + 10% of ₹ 2,00,000

= ₹ 48,000 + ₹ 20,000 = ₹ 68,000

Expected loss in remaining five cases = 30% of ₹ 1,00,000 + 20% of ₹ 2,10,000

= ₹ 30,000 + ₹ 42,000 = ₹ 72,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore,the better approach will be to disclose the overall expected loss of ₹ 10,40,000 (₹ 68,000 X 10 +

₹ 72,000 X 5) as contingent liability.

Question 28 (Illustration)

(i) EXOX Ltd. is in the process of finalising its accounts for the year ended 31st March, 20X2. The company seeks your advice on the **following:**

The Company's sales tax assessment for assessment year 20X1-X2 has been completed on 14th February, 20X4 with a demand of ₹ 2.76 crore. The company paid the entire due under protest without prejudice to its right of appeal. The Company files its appeal before the appellate authoritywherein the grounds of appeal cover tax on additions made in the assessment order fora sum **of**

(ii) 2.10 **crore.**

The Company has entered into a wage agreement in May, 20X2 whereby the labour union has accepted a revision in wage from June, 20X1. The agreement provided that the hike till May, 20X2 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September, **20X2.**

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Answer 28

(i) Since the company is not appealing against the addition of ₹ 0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 20X4. The amount paid under protest can be kept under the heading 'Loans & Advances' and also disclosed as a contingent liability of ₹ 2.10 crore.

The arrears for the period from June, 20X1 to March, 20X2 are required to be provided for in the accounts of the company for the year ended on 31st March, 20X2.

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Chapter 7.1

AS 4- Contingencies & Events occurring after the Balance Sheet Date

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.14 TO Q.26											
Past Exams	NO	Q.13	Q.1 Q.12	NO	NO	NO	Q.11	Q.1	NO	Q.7	NO	NO
MTP	Q.5	Q.5	Q.4	NO	Q.1	Q.1	NO	Q.2 Q.3	NO	Q.6	Q.3	Q.2
RTP	Q.1	Q.4	Q.5	Q.3	Q.1	Q.9	Q.8	Q.7	Q.1 Q.2	Q.10	NO	NO

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Chapter 7.1

AS 4- Contingencies & Events occurring after the Balance Sheet Date

Question 1

The financial statements of Alpha Ltd. for the year 2019-2020 were approved by the Board ofDirectors on 15th July, 2020. The following information was provided:

(i) A suit against the company's advertisement was filed by a party on 20 th April, 2020 claimingdamages of Rs. 25 lakhs.

(ii) The terms and conditions for acquisition of business of another company had been decided by March,2020. But the financial resources were arranged in April, 2020 and amount invested was Rs. 50 lakhs.

(iii) Theft of cash of Rs. 5 lakhs by the cashier on 31st March, 2020, was detected on 16th July, 2020.

(iv) The company started a negotiation with a party to sell an immovable property for Rs. 40 lakhs in March, 2020. The book value of the property is Rs. 30 lakh on 31st March, 2020. However, the deed was registered on 15th April, 2020.

A major fire had damaged the assets in a factory on 5th April, 2020. However, the assets were fully insured. With reference to AS 4, state whether the above mentioned events will be treated as contingencies, adjusting events or non-adjusting events occurring after the balance sheet date. (MTP 5 Marks Oct '20, May'20, March'22, Old & New SM, RTP-May 20, May 18,PYP 5 Marks July 21, PYP 5 Marks May'19, RTP May'22)

Answer 1

(i) **Non-adjusting event:** Suit filed against the company is a contingent liability but it was not existing as on date of balance sheet date as the suit was filed on 20 th April after the balance sheet date. As per AS 4, 'Contingencies' is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur. Hence, it will have no effect on financial statement and will be a non-adjusting event.

(ii) **Adjusting event:** In the given case, terms and conditions for acquisition of business were finalized before the balance sheet date and carried out before the closure of the books of accounts but transaction for payment of financial resources was effected in April, 2020. Hence, necessary adjustment to assets and liabilities for acquisition of business is necessary in the financial statements for the year ended 31st March 2020.

(iii) **Non-adjusting event:** Only those events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustments to assets and liabilities as at the balance sheet date or may require disclosure. In the given case, as the theft of cash was detected on 16th July, 2020 ie after approval of financial statements, no adjustment is required.

(iv) **Non-adjusting event:** Adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. In the given case, sale of immovable property was under proposal stage (negotiations only started) on the balance sheet date, and was not fi-

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nalized. Therefore, adjustment to assets for sale of immovable property is not necessary in the financial statements for the year ended 31st March, 2020. Disclosure may be given in Report of approving Authority.

(v) **Non-adjusting event:** Adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date.The condition of fire occurrence was not existing on the balance sheet date. Only the disclosure regarding fire and loss, being completely insured may be given in the report of approving authority.

Question 2

Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31 March 2020 are to be approved by the approving authority on 30 June 2020. During the first quarter of 2020-2021, the following events / transactions has taken place. The accountant of the company seeks your guidance for the following:

(i) Tee Ltd. has an inventory of 50 stitching machines costing at Rs. 5,500 per machine as on 31 March 2020. On 31 March 2020 the company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realizable value, whichever is lower. During the month of April 2020, due to fall in demand, the prices have gone down drastically. The company has sold 5 machinesduring this month at a price of Rs. 4,000 per machine.

(ii) A fire has broken out in the company's go down on 15 April 2020. The company has estimated a loss of Rs. 25 lakhs of which 75% is recoverable from the Insurance company.

(iii) The company has entered into a sale agreement on 30 March 2020 to sell a property for a consideration of Rs. 7,50,000 which is being carried in the books at Rs. 5,50,000 at the year end. The transfer of risk and reward and sale is complete in the month of May 2020 when conveyance and possession get completed.

(iv) The company has received, during the year 2018-2019, a government grant of Rs. 15 lakhs for purchase of a machine. The company has received a notice for refund of the said grant on 15 June, 2020 due to violation of some of the conditions of grant during the year 2019-2020. You are required to state with reasons, how the above transactions will be dealt with in the financial statement for the year ended 31st March 2020. (MTP 5 Marks Oct '21 & Oct '23, RTP May'22)

Answer 2

Events occurring after the balance sheet date are those significant events, both favourable 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, and by the corresponding approving authority in the case of any other entity. 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 or that indicate that the fundamental accounting assumption of going concern is not appropriate. In the given case, financial statements are approved by the approving authority on 30 June 2020. On the basis of above principles, following will be the accounting treatment in the financial statementsfor the year ended at 31 March 2020:

(i) Since on 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an adjusting event. Hence, Tee Ltd. needs to adjust the amounts recognized in its financial

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statements w.r.t. net realizable value at the end of the reporting period. Accordingly, inventory should be written down to Rs. 4,000 per machine. Total value of inventory in the books will be 50 machines x Rs. 4,000 = Rs. 2,00,000.

(ii) A fire took place after the balance sheet date i.e. during 2020 -2021 financial year. Hence, corresponding financials of 2019-2020 financial year should not be adjusted for loss occurred due to fire. However, in this circumstance, the going concern assumption will be evaluated. In case the going concern assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements. Otherwise, disclosure be given.

(iii) Since the transfer of risk and reward and sale was complete in the month of May, 2020 when conveyance and possession got complete, no revenue should be recognized with respect to it in the financial statements of 2019-2020. However, a disclosure for the same should be given by the entity.

(iv) Since the notice has been received after 31 March but before 30 June 2020 (approval date), the said grant shall be adjusted in the financial statements for financial year 2019 -2020 because the violationof the conditions took place in the financial year 2019 -2020 and the company must be aware of it.

Question 3

An earthquake destroyed a major warehouse of PQR Ltd. on 30.4.2021. The accounting year of the company ended on 31.3.2021. The accounts were approved on 30.6.2021. The loss from earthquake is estimated at Rs. 25 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company. (MTP 5 Marks Nov '21 & April '23, RTP Nov 19, Old & New SM)

Answer 3

AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The destruction of warehousedue to earthquake did not exist on the balance sheet date i.e. 31.3.2021. Therefore, loss occurred due to earthquake is not to be recognized in the financial year 2020-2021. However, according the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the Question, the earthquake has caused major destruction; therefore, fundamental accounting assumption of going concern is called upon. Hence, the fact of earthquake together with an estimated loss of Rs. 25 lakhs should be disclosed in the Report of the Directors for the financial year 2020-2021.

Question 4

While preparing its final accounts for the year ended 31st March, 2016, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2016 a debtor for Rs. 20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2016 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 31 st March, 2016? Comment with reference to relevant Accounting Standard. (MTP 5 Marks March 19, April'19, RTP Nov 18)

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Answer 4

As per 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 Rs. 20,00,000 suffered heavy loss due to earthquake in the last week of February, 2016 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, 2016 (after the balance sheet date) is only an additional information related to the condition existing onthe balance sheet date. Accordingly, full provision for bad debts amounting Rs. 20,00, 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 2016. Since the company has already made 5% provision of its total debtors, additional provision amounting Rs. 19,00,000 shall be made (20,00,000 x 95%).

Question 5

The Board of Directors of New Graphics Ltd. in its Board Meeting held on 18th April, 2017, considered and approved the Audited Financial results along with Auditors Report for the Financial Year ended 31st March, 2017 and recommended a dividend of Rs. 2 per equity share (on 2 crore fully paid up equity shares of Rs. 10 each) for the year ended 31st March, 2017 and if approved by the members at the forthcoming Annual General Meeting of the company on 18th June, 2017, the same will be paid to all the eligible shareholders. Discuss on the accounting treatment and presentation of thesaid proposed dividend in the annual accounts of the company for the year ended 31st March, 2017 as per the applicable Accounting Standard and other Statutory Requirements. (MTP 5 Marks Aug'18,Mar'18, RTP May'19)

Answer 5

As per the amendment in AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" vide Companies (Accounting Standards) Amendments Rules, 2016 dated 30th March, 2016, the events which take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. However, dividends declared after the balance sheet date but before approval of financial statements are not recognized as a liability at the balance sheet date because no statutory obligation exists at that time. Hence such dividends are disclosed in the notes to financial statements. No, provision for proposed dividends is not required to be made. Such proposed dividends are to be disclosed in the notes to financial statements. Accordingly, the dividend of Rs. 4 crores recommended by New Graphics Ltd.in its Board meeting on 18th April, 2017 shall not be accounted for in the books for the year 2016- 17 irrespective of the fact that it pertains to the year 2016-17 and will be paid after approval in the Annual General Meeting of the members / shareholders.

Question 6

State with reasons, how the following events would be dealt with in the financial statements of HariLtd. for the year ended 31st March, 2022 (accounts were approved on 25th July, 2022):

(1) **Negotiations with another company for acquisition of its business was started on 21st January, 2022. Hari Ltd. invested ₹ 40 lakh on 22nd April, 2022.**

(2) **The company made a provision for bad debts @ 4% of its total debtors (as per trend followed from the previous years). In the second week of March 2022, a debtor for ₹ 2,50,000 had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In May, 2022 the debtorbecame bankrupt.**

(3) **During the year 2021-22, Hari Ltd. was sued by a competitor for ₹ 13 lakhs for infringement**

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of a trademark. Based on the advice of the company's legal counsel, Hari Ltd. provided for a sum of ₹ 8 lakhs in its financial statements for the year ended 31st March, 2022. On 26th May, 2022, the Courtdecided in favour of the party alleging infringement of the trademark and ordered Hari Ltd. to pay the aggrieved party a sum of ₹ 12 lakhs.

(4) **Cashier of Hari Ltd. embezzled cash amounting to ₹ 3,00,000 during March, 2022. However the same comes to the notice of Company management during August, 2022.**

(5) **Cheques dated 31st March, 2022 collected in the month of April, 2022. All cheques are presented tothe bank in the month of April, 2022 and are also realized in the same month in the normal course after deposit in the bank.(MTP 5 Marks Sep'22, Old & New SM)**

Answer 6

I. As per AS 4'Contingencies and Events Occurring After the Balance Sheet Date', 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, 2022 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.

II. As per AS 4, 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 amountsrelating to conditions existing at the Balance Sheet date. A debtor for ₹ 2,50,000 suffered heavy loss due to earthquake in the second week of March, 2022 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in May, 2022 (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 ₹ 2,50,000 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 2022.

III. As per AS 4, 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, since Hari Ltd. was sued bya competitor for infringement of a trademark during the year 2021- 22 for which the provision was also made by it, the decision of the Court on 26 th May, 2022, for payment of the penalty will constituteas an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Hari Ltd. should adjust the provision upward by ₹ 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

IV. As the 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 theprovisions of AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" and the same will not be adjusted in the financial statements for the year ended 31st March,2022. This being an extra-ordinary item should be disclosed in the statement of profit and loss as a part of loss for the year ending March, 2023, in a manner, that its impact on current profit or loss can be perceived.

V. Collection of cheques after balance sheet date is not an adjusting event even if the cheques bear the date of 31st March. Recognition of cheques in hand is therefore not consistent with requirements of AS 4. Moreover, the collection of cheques after balance sheet date does not represent any material change or commitments affecting financial position of the enterprise and no disclosure of such collections in the Directors' Report is necessary.

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Question 7

XYZ Ltd. operates its business into various segments. Its financial year ended on 31st March, 2020 and the financial statements were approved by their approving authority on 15th June, 2020. Thefollowing material events took place:

a. **A major property was sold (it was included in the balance sheet at Rs. 25,00,000) for which contractshad been exchanged on 15th March, 2020. The sale was completed on 15th May, 2020 at a price of Rs. 26,50,000.**

b. **On 2nd April, 2020, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of Rs. 10 million would be fully covered by the insurance company.**

c. **A claim for damage amounting to Rs. 8 million for breach of patent had been received by the entity prior to the year-end. It is the director's opinion, backed by legal advice that the claim will ultimatelyprove to be baseless. But it is still estimated that it would involve a considerable expenditure on legal fees.**

You are required to state with reasons, how each of the above items should be dealt with in the financial statements of XYZ Ltd. for the year ended 31st March, 2020. (RTP Nov 21, PYP 5 Marks Nov'22)

Answer 7

Treatment as per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date'

(a)	The sale of property should be treated as an adjusting event since contracts had been exchanged prior to the year-end. The effect of the sale should be reflected in the financial statements ended on 31.3.2020 and the profit on sale of property Rs. 1,50,000 would be considered.
(b)	The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to considerthe validity of the going concern assumption having regard to the extent of insurancecover. Also, since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.
(c)	On the basis of evidence provided, the claim against the company will not succeed. Thus, Rs. 8 million should not be provided in the account, but should be disclosed by means of a contingent liability with full details of the facts. Provision should be madefor legal fee expected to be incurred to the extent that they are not expected to be recovered.

Question 8

A case is going on between ABC Ltd. and Tax department on claiming the exemption for certain items, for the year 2019-2020. The court has issued the order on 15th April and rejected the claim of the company. Accordingly, company is liable to pay the additional tax. The financial statements wereapproved on 31st May, 2020. Shall company account for such tax in the year 2019-2020 or shall it account for in the year 2020-2021? (RTP May '21)

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Answer 8

To decide whether, the event is adjusting or not adjusting two conditions need to be satisfied,

(a) There has to be evidence

(b) The event must have been related to period ending on reporting date.

Here both the conditions are satisfied. Court order is a conclusive evidence which has been received before approval of the financial statements since the liability is related to earlier year. The event will be considered as an adjusting event and accordingly the amount will be adjusted in accounts of 2019-2020.

Question 9

A fire, on 2nd April, 2020, completely destroyed a manufacturing plant of Omega Ltd. whose financial year ended on 31st March, 2020, the financial statements were approved by their approving authority on 15th June, 2020. It was expected that the loss of Rs. 10 million would be fully covered by the insurance company. How will you disclose it in the financial statements of Omega Ltd. for the year ended 31st March, 2020. (RTP Nov 20)

Answer 9

The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover. Also, since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of anote to the financial statements.

Question 10

AS 4 Contingencies and Events occurring after the Balance Sheet Date

Explain accounting treatment of Contingent Gains as per AS 4 "Contingencies and Events occurring after the Balance Sheet Date". (RTP Nov'22)

Answer 10

Accounting Treatment of Contingent Gains Contingent gains are not recognised in financial statements since their recognition may result in the recognition of revenue which may never be realised. However, when the realisation of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate

Question 11

As per the provision of AS 4, you are required to state with reason whether the following transactions are adjusting event or non-adjusting event for the year ended 31.03.2021 in the books of NEW Ltd. (accounts of the company were approved by board of directors on 10.07.2021):

1. **Equity Dividend for the year 2020-21 was declared at the rate of 7% on 15.05.2021.**
2. **On 05.03.2021, Rs. 53,000 cash was collected from a customer but not deposited by the cashier. This fraud was detected on 22.06.2021.**
3. **One building got damaged due to occurrence of fire on 23.05.221. Loss was estimated to be Rs. 81,00,000. (PYP 5 Marks Dec '21)**

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Answer 11

(i) If dividends are declared after the balance sheet date but before the financial statements are approved, the dividends are not recognized as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise. Such dividends are disclosed in the notes. Thus, no liability for dividends needs to be recognized in financial statements for financial yearended 31 st March, 2021 and declaration of dividend is non-adjusting event.

(ii) As per AS 4 'Contingencies and Events occurring after the Balance Sheet Date' an event occurring afterthe balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes if such events relate to conditions existing at the balance sheet date. In the given case, fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognize the loss. Thus loss amounting Rs. 53,000 should be adjusted in the accounts of the company for the year ended 31st March, 2021 as it is adjusting event.

(iii) AS 4 states that adjustments to assets and liabilities are not appropriate for events occurring after thebalance sheet date, if such events do not relate to conditions existing at the balance sheet date. The damage of one building due to fire did not exist on the balance sheet date i.e. 31.3.2021. Therefore, loss occurred due to fire is not to be recognized in the financial year 2020-2021 as it is non-adjusting event.

However, according to the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the fire has caused major destruction; therefore, fundamental accounting assumption of going concern would have to be evaluated. Considering that the going concern assumption is still valid, the fact of fire together with an estimated loss of Rs. 81 lakhs should bedisclosed in the report of the approving authority for financial year 2020 -21 to enable users of financialstatements to make proper evaluations and decisions.

Question 12

As per the provisions of AS-4, a contingency is a condition or situation, the ultimate outcome of which (gain or loss) will be known or determined only on the occurrence of one or more uncertain future events (PYP 1 Mark, May'19)

Answer 12

False: A contingency is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events.

Question 13

The accounting year of Dee Limited ended on 31st March, 2018 but the accounts were approved on 30th April, 2018. On 15th April, 2018 a fire occurred in the factory and office premises. The loss by fire is of such a magnitude that it was not possible to expect the enterprise Dee Limited to start operation again. State with reasons, whether the loss due to fire is an adjusting or non- adjusting event and how the fact of loss is to be disclosed by the company in the context of the provisions of AS-4 (Revised). (PYP 5 Marks, Nov 18)

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Answer 13

As per AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date", an event occurring after the balance sheet date should be an adjusting event even if it does not reflect any condition existing on the balance sheet date, if the event is such as to indicate that the fundamental accounting assumption of going concern is no longer appropriate.

The fire occurred in the factory and office premises of an enterprise after 31 March, 2018 but before approval of financial statement of 30.4.18. The loss by fire is of such a magnitude that it is not reasonable to expect the Dee Ltd. to start operations again, i.e., the going concern assumption is not valid. Since the fire occurred after 31/03/18, the loss on fire is not a result of any condition existing on 31/03/18. But the loss due to fire is an adjusting event the entire accounts need to be prepared on a liquidation basis with adequate disclosures by the company by way of note in itsfinancial statements in the following manner: "Major fire occurred in the factory and office premiseson 15th April, 2018 which has made impossible for the enterprise to start operations again. Therefore, the financial statements have been prepared on liquidation basis."

Question 14

Cash amounting to Rs. 4 lakhs, stolen by the cashier in the month of March 20X1, was detected in April, 20X1. The financial statements for the year ended 31st March, 20X1 were approved by the Board of Directors on 15th May, 20X1. As per Accounting Standards, this is for the financial statements year ended on 31st March, 20X1.

a. An Adjusting event.
b. Non-adjusting event.
c. Contingency.
d. Provision

Ans: (a)

Question 15

As per Accounting Standards, events occurring after the balance sheet date are

e. Only favourable events that occur between the balance sheet date and the date when the financial statements are approved by the Board of directors.
f. Only unfavourable events that occur between the balance sheet date and the date when the financial statements are approved by the Board of directors.
g. Those significant events, both favourable and unfavourable, that occur between thebalance sheet date and the date on which the financial statements are approved by the Board of directors.
h. Those significant events, both favourable and unfavourable, that occur between thebalance sheet date and the date on which the financial statements are not approvedby the Board of directors.

Ans: (c)

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Question 16

AS 4 does not apply to

i. Obligation under retirement benefit plans.

j. Commitments arising from long term lease contracts

k. liabilities of life assurance and general insurance enterprises arising from policies issued

l. Both (a) & (b).

Ans: (d)

Question 17

A Ltd. sold its building for Rs. 50 lakhs to B Ltd. and has also given the possession to B Ltd. The book value of the building is Rs. 30 lakhs. As on 31st March, 20X1, the documentation and legal formalities are pending.

For the financial year ended 31st March, 20X1

a. The company should record the sale.

b. The company should recognise the profit of Rs. 20 lakhs in its profit and lossaccount.

c. Both (a) and (b).

d. The company should disclose the profit of Rs. 20 lakhs in notes to accounts.

Ans: (c)

Practical Questions

Question 18

A Ltd. has sold its building for Rs. 50 lakhs to B Ltd. and has also given the possession to B Ltd. The book value of the building is Rs. 30 lakhs. As on 31st March, 20X1, the documentation and legal formalities arepending. The company has not recorded the sale and has shown the amount received as advance. Do you agree with this treatment?

Answer 18

The economic reality and substance of the transaction is that the rights and beneficial interest in the property has been transferred although legal title has not been transferred. A Ltd. should record the sale and recognise the gain of Rs. 20 lakhs in its profit and loss account. The building should be derecognized in the financial statements.

Question 19

During the year 20X1-20X2, Raj Ltd. was sued by a competitor for ₹ 15 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Raj Ltd. provided for a sum of ₹ 10 lakhs in its financial statements for the year ended 31st March, 20X2. On 18th May, 20X2, the Court decided in favour of the party alleging infringement of the trademark and ordered Raj Ltd. to pay the aggrieved

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party a sum of ₹ 14 lakhs. The financial statements were prepared by the company's management on 30th April, 20X2, and approved by the board on 30th May, 20X2.

Answer 19

As per AS 4 (Revised), 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, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 20X1-X2 for which the provision was also made by it, the decision of the Court on 18th May, 20X2, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Raj Ltd. should adjust the provision upward by ₹ 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

Had the judgment of the Court been delivered on 1st June, 20X2, it would be considered as an event occurring after the approval of the financial statements which is not covered by AS 4 (Revised). In that case, no adjustment in the financial statements of 20X1-X2 would have been required.

Question 20 (Illustration)

In X Co. Ltd., theft of cash of ₹ 5 lakhs by the cashier in January, 20X1 was detected only in May, 20X1. The accounts of the company were not yet approved by the Board of Directors of the company.Decide whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.20X1.

Answer 20

As per AS 4 (Revised) 'Contingencies and Events occurring after the Balance Sheet Date', an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes.

If a fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognise the loss amounting ₹ 5,00,000 and adjust the accounts of the company for the year ended 31st March, 20X1.

Question 21 (Illustration)

An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.20X2. The accounting year of the company ended on 31.3.20X2. The accounts were approved on 30.6.20X2. The loss from earthquake is estimated at ₹ 30 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company.

Answer 21

AS 4 (Revised) "Contingencies and Events Occurring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.3.20X2. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 20X1-20X2. However, according to the standard, unusual changes affecting the existence or substratum of the enterprise

after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the Question, the earthquake has caused major destruction; therefore, fundamental accounting assumption of going concern would have to be evaluated. Consid-

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ering that the going concern assumption is still valid, the fact of earthquake together with an estimated loss of ₹ 30 lakhs should be disclosed in the report of the approving authority for financial year 20X1-X2 to enable users of financial statements to make proper evaluations and decisions.

Question 22 (Illustration)

A company has filed a legal suit against the debtor from whom ₹ 15 lakh is recoverable as on 31.3.20X1. The chances of recovery by way of legal suit are not good as per legal opinion given by the counsel in April, 20X1. Can the company provide for full amount of ₹ 15 lakhs as provision for doubtful debts? Discuss.

Answer 22

As per 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. In the given case, company should make the provision for doubtful debts, as legal suit has been filed on 31st March, 20X1 and the chances of recovery from the suit are not good. Though, the actual result of legal suit will be known in future yet situation of non-recovery from the debtors exists before finalisation of financial statements. Therefore, provision for doubtful debts should be made for the year ended on 31st March, 20X1.

Question 23(Illustration)

In preparing the financial statements of R Ltd. for the year ended 31st March, 20X1, you come across the following information. State with reasons, how you would deal with this in the financial statements: The company invested 100 lakhs in April, 20X1 before approval of Financial Statements by the Board of directors in the acquisition of another company doing similar business, the negotiations for which had started during the year.

Answer 23

AS 4 (Revised) defines "Events Occurring after the Balance Sheet Date" as those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Approving Authority 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, 20X1. The 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 ₹ 100 lakhs in April, 20X1 for the acquisition of another company should be disclosed in the report of the Approving Authority to enable users of financial statements to make proper evaluations and decisions.

Question 24 (Illustration)

A Limited Company closed its accounting year on 30.6.20X1 and the accounts for that period were considered and approved by the board of directors on 20th August, 20X1. The company was engaged in laying pipeline for an oil company deep beneath the earth. While doing the boring work on 1.9.20X1 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of ₹ 80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.20X1.

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Answer 24

AS 4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date defines 'events occurring after the balance sheet date' as 'significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors in the case of a company'. The given case is discussed in the light of the above-mentioned definition and requirements given in AS 4 (Revised). In this case the incidence, which was expected to push up cost, became evident after the date of approval of the accounts. So it is not an 'event occurring after the balance sheet date'.

Question 25 (Illustration)

While preparing its final accounts for the year ended 31st March, 20X1 a company made a provision for bad debts @ 5% of its total trade receivables. In the last week of February, 20X1 a trade receivable for ₹ 2 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 20X1 the trade receivable became a bankrupt. Can the company provide for the full loss arising out of insolvency of the trade receivable in the final accounts for the year ended 31st March, 20X1?

Answer 25

As per Accounting Standard 4, Assets and Liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist estimation of amounts relating to conditions existing at the balance sheet date. So full provision for bad debt amounting to ₹ 2 lakhs should be made to cover the loss arising due to the insolvency in the Final Accounts for the year ended 31st March, 20X1. It is because earthquake took place before the balance sheet date. Had the earthquake taken place after 31st March, 20X1, then this would have been treated as non-adjusting event and only disclosure required as per AS 4 (Revised), would have been sufficient.

Question 26 (Illustration)

Y Ltd. has book debts and has a doubt over recoverability of some of the book debts. The amount that cannot be recovered is not quantifiable. Thus, Y Ltd. is of the opinion that provision for doubtful debts should not be created. Y Ltd. creates provision for certain other expenses on estimated basis.

Whether contention of Y Ltd. is correct?

Answer: 26

As per AS 4, "Contingencies and Events Occurring After the Balance Sheet Date" if it is likely that a contingency will result in a loss to an entity then it should create provision for that contingency onthe estimated basis.

Based on the above, the contention that provision for doubtful debt is not be created merely because the amount is not quantifiable is not correct. Hence Y Ltd. should make provision in the books on the basis of estimation.

Reference:

The students are advised to refer the full text of AS 4 (Revised) "Contingencies and Events occurringafter the Balance Sheet Date".

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Chapter 7.2

AS 5- Net Profit or Loss for the period, Prior period items & Changes inAccounting policies

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.12 TO Q.23											
Past Exams	Q.10	NO	Q.9	NO	NO	NO	Q.8	NO	Q.11	Q.4	NO	NO
MTP	NO	Q.4	Q.1 Q.4	Q.4	Q.4	NO	Q.2 Q.3	NO	Q.3	Q.5	NO	NO
RTP	Q.7	Q.4	Q.10	Q.4	Q.6	Q.4	Q.1	Q.6	Q.4	Q.7	Q.8	NO

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Chapter 7.2

AS 5- Net Profit or Loss for the period, Prior period items & Changes inAccounting policies

Question 1

(Also includes concepts from AS 29-Provisions, Contingent Liabilities & Contingent Assets) EXOX Ltd. is in the process of finalizing its accounts for the year ended 31 st March, 2017. The company seeks your advice on the following:

(i) The Company's sales tax assessment for assessment year 2014-15 has been completed on 14th February, 2017 with a demand of Rs. 2.76 crore. The company paid the entire due under protest without prejudice to its right of appeal. The Company files its appeal before the appellate authoritywherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore. (RTP May'21)

(ii) The Company has entered into a wage agreement in May, 2017 whereby the labour union has accepted a revision in wage from June, 2016. The agreement provided that the hike till May, 2017 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September, 2017.

You required to examine and give suggestions in line with the relevant Accounting Standards. (MTP 5 Marks April '19)

Answer 1

(i) Since the company is not appealing against the addition of Rs. 0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 2017. The amount paid under protest can be kept under the heading 'Loans & Advances' and disclosed along with the contingent liability of Rs. 2.10 crore.

(ii) The arrears for the period from June, 2016 to March, 2017 are required to be provided for in the accounts of the company for the year ended on 31st March, 2017.

Question 2

S.T.B. Ltd. makes provision for expenses amounting Rs. 7,00,000 as on March 31, 2020, but the actual expenses during the year ending March 31, 2021 comes to Rs. 9,00,000 against provision made during the last year. State with reasons whether difference of Rs. 2,00,000 is to be treated as prior period item as per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' (MTP 5 Marks April 21)

Answer 2

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 resultof new information, more experience or subsequent developments.

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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 Rs. 2 lakhs, is not a prior period item. Therefore, in the given case expenses amounting Rs. 2,00,000 (i.e. Rs. 9,00,000 – Rs. 7,00,000) recorded in the current year, should not be regarded as prior period item.

Question 3

A company created a provision of Rs. 7,50,000 for staff welfare while preparing the financial statements for the year 2020-21. On 31st March 2021, in a meeting with staff welfare association, it was decided to increase the amount of provision for staff welfare to Rs. 10,00,000. The accounts wereapproved by Board of Directors on 15th April, 2021. You are required to explain the treatment of such revision in financial statements for the year ended 31st March 2021 in line with the provisions of AS 5? (MTP 4 Marks March 21, MTP 5 Marks April 22)

Answer 3

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 Rs. 2,50,000 is neither a prior period item nor an extraordinary item. It is a change in estimate, which has been occurred in the year 2020-21. 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 lossfor 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 4

The Accountant of a company has sought your opinion with relevant reasons, whether the following will be treated as change in Accounting Policy or not for the year ended 31st March, 2020. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

(i) **Provision for doubtful debts was created @ 2% till 31st March, 2019. From the Financial year 2019 - 2020, the rate of provision has been changed to 3%.**

(ii) **During the year ended 31st March, 2020, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.**

(iii) **Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.**

(iv) **Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of Rs. 20,000 per month. Earlier there was no such scheme of pension in the organization.**

During the year ended 31st March, 2020, there was change in cost formula in measuring the cost of inventories. (MTP 5 Marks Oct'19, May'20, Mar'19, Oct'18, Old & New SM, RTP May 22, RTP Nov 18, RTP Nov 19, RTP Nov '20, RTP May'20, PYP 5 Marks Nov'22)

Answer 4

(i) In the given case, company has created 2% provision for doubtful debts till 31st March, 2019. Subsequently in 2019-20, the company revised the estimates based on the changed cir-

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cumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in an accounting policy.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

Question 5

The management of Pluto Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as changes in Accounting Policy or not for the year ended 31st March, 2021. Please advise them in the following situations in accordance with the provisions of Accounting Standard 5:

During the year ended 31st March, 2021, the management has introduced a formal retiremen gratuity scheme in place of ad-hoc ex-gratia payments to its employees on retirement.

(i) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees would receive a pension of ₹ 25,000 per month. Earlier there was no such scheme of pension in the organization.

(ii) Provision for doubtful Trade Receivables was created @2.5% till 31 st March, 2020. From 1st April,2020, the rate of provision has been changed to 5%

(iii) For the year ended 31st March,2021 there was change in the cost formula in measuring the cost of Inventories.

(iv) Till the end of the previous year, Computers were depreciated on Straight Line Basis over a period of 5 years. From current year, the useful life of Computers has been changed to 3 years.(MTP 5 MarksOct'22)

Answer 5

(i) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous transaction, will not be treated as change in an accounting policy.

(ii) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of

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new pension scheme is not a change in accounting policy.

(iii) In the given case, company has created 2.5 % provision for doubtful debts till 31st March, 2020. Subsequently from 1st April, 2020, the company revised the estimates based on the changed circumstances and wants to create 5% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(iv) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

(v) Change in useful life of computers from 5 years to 3 years is a change in estimate and is not a changein accounting policy.

Question 6

a) **There was a major theft of stores valued at Rs. 10 lakhs in the preceding year which was detected only during current financial year (2020-2021). How will you deal with this information in preparing the financial statements of R Ltd. for the year ended 31st March, 2021. (RTP Nov 21)**

b) **Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of Rs. 20,000 per month. Earlier there was no such scheme of pension in the organization. Explain whether this will constitute a change in accounting policy or not as per AS 5. (RTP Nov 21, May 20)**

Answer 6

a) Due to major theft of stores in the preceding year (2019-2020) which was detected only during the current financial year (2020–2021), there was overstatement of closing inventory of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year. The adjustments are required to be made in the current year as 'Prior Period Items' as per AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies. Accordingly, the adjustments relating to both opening inventory of the current year and profit brought forward from the previous year should be separately disclosed in the statement of profit and loss together with their nature and amount in a manner that their impact on the current profit or loss can be perceived. Alternatively, it may be assumed that in the preceding year,the value of inventory of stores as found out by physical verification of inventories was considered in the preparation of financial statements of the preceding year. In such a case, only the disclosure as to the theft and the resulting loss is required in the notes to the accounts for the current year i.e, year ended 31st March, 2021.

b) As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the

adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Accordingly, the adoption of a new accounting policy of paying pension to retired employees is a policy for events or transactions which did not occur previously. Hence, it will not be treated as a change in an accounting policy.

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Question 7

Bela Ltd. has a vacant land measuring 20,000 sq. mts, which it had no intention to use in the future. The Company decided to sell the land to tide over its liquidity problems and made a profit of Rs.10 Lakhs by selling the said land. Moreover, there was a fire in the factory and a part of the unused factory shed valued at Rs. 8 Lakhs was destroyed. The loss from fire was set off against the profit from sale ofland and profit of Rs. 2 lakhs was disclosed as net profit from sale of assets. You are required to examine the treatment and disclosure done by the company and advise the company in line with AS 5. (RTP May 18 & Nov 22)

Answer 7

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit orloss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss canbe perceived. In the given case the selling of land to tide over liquidation problems as well as fire in the Factory does not constitute ordinary activities of the Company. These items are distinct from the ordinary activities of the business. Both the events are material in nature and expected not to recur frequently or regularly. Thus, these are Extraordinary Items.

Therefore, in the given case, disclosing net profits by setting off fire losses against profit from sale of land is not correct. The profit on sale of land, and loss due to fire should be disclosed separately in the statement of profit and loss .

Question 8

State whether the following items are examples of change in Accounting Policy / Change in Accounting Estimates / Extraordinary items / Prior period items / Ordinary Activity:

(i) **Actual bad debts turning out to be more than provisions.**

(ii) **Change from Cost model to Revaluation model for measurement of carrying amountof PPE.**

(iii) **Government grant receivable as compensation for expenses incurred in previousaccounting period.**

(iv) **Treating operating lease as finance lease.**

(v) **Capitalization of borrowing cost on working capital.**

(vi) **Legislative changes having long term retrospective application.**

(vii) **Change in the method of depreciation from straight line to WDV.**

(viii) **Government grant becoming refundable.**

(ix) **Applying 10% depreciation instead of 15% on furniture.**

(x) **Change in useful life of fixed assets. (RTP May '23, PYP 5 Marks Jan 21)**

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Answer 8

Classification of given items is as follows:

Sr. No.	Particulars	Remarks
(i)	Actual bad debts turning out to be more thanprovisions	Change in Accounting Estimates
(ii)	Change from Cost model to Revaluation modelfor measurement of carrying amount of PPE	Change in Accounting Policy
(iii)	Government grant receivable as compensationfor expenses incurred in previous accounting period	Extra -ordinary Items
(iv)	Treating operating lease as finance lease.	Prior- period Items
(v)	Capitalization of borrowing cost on workingcapital	Prior-period Items (as interest on workingcapital loans is not eligible for capitalization)
(vi)	Legislative changes having long termretrospective application	Ordinary Activity
(vii)	Change in the method of depreciation fromstraight line to WDV	Change in Accounting Estimates
(viii)	Government grant becoming refundable	Extra -ordinary Items
(ix)	Applying 10% depreciation instead of 15% onfurniture	Prior- period Items
(x)	Change in useful life of fixed assets	Change in Accounting Estimates

Question 9

As per the provisions of AS-5, extraordinary items should not be disclosed in the statement of profit and loss as a part of net profit or loss for the period. (PYP 1 Mark, May 19)

Answer 9

False: The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

Question 10

(i) PQR Ltd. is in the process of finalizing its accounts for the year ended 31 st March, 2018. The company seeks your advice on the **following:**

(ii) **Goods worth Rs. 5,00,000 were destroyed due to flood in September, 2015. A claim was**

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lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2015-16. In March, 2018, the claim was passed and the company received a payment of Rs. 3,50,000 against the claim. Explain the treatment of such receipt in final account for the year ended 31 st March, 2018.

Company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2017-18.

Subsequently, on a review of the credit period allowed and financial capacity of the customers, the company decides to increase the provision to 8% on debtors as on 31.03.2018. 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 extra ordinary item or prior period item? (PYP 5 Marks, May 18, RTP May 19)

Answer 10

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/omission in preparation of financial statements for the year 2015-

(i) 16. Hence, claim received in the financial year 2017- 18 is a prior period item and should be separately disclosed in the statement of Profit and Loss.

In the given case, a limited company created 2.5% provision for doubtful debts for the year 2017-2018.

Subsequently, the company revised the estimates based on the changed circumstances and wants to create 8% provision. As per AS 5, the revision in rate of provision for doubtful debts will be consider as change in estimate and is neither a prior period item nor an extraordinary item.

The effect of such change should be shown in the profit and loss account for the year ending 31st March,2018.

Question 11

TQ Cycles Ltd. is in the manufacturing of bicycles, a labour intensive manufacturing sector. In April 2022, the Government enhanced the minimum wages payable to workers with retrospective effect from the 1st January,2022. Due to this legislative change, the additional wages for the period from January 2022 to March 2022 amounted to ₹ 30 lakhs. The management asked the Finance manager tocharge ₹ 30 lakhs as prior period item while finalizing financial statements for the year 2022-23. Further, the Finance manager is of the view that this amount being abnormal should be disclosed as extra-ordinary item in the Profit and loss account for the financial year 2021-22.

Discuss with reference to applicable Accounting Standards. (PYP 5 Marks May'22)

Answer 11

As per 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 errors or omissions in the preparation of the financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances which though related to prior periods, are deter-

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mined in the current period.

It is given that revision of wages took place in April, 2022 with retrospective effect from 1st January, 2022. Therefore, wages payable for the period from 1 01.2022 to 31.3.2022

cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. The full amount of wages payable to workers will be treated as an expense of current year and it will be charged to profit & loss account for the year 2022-23 as normal expenses.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Such an expense does not qualify as an extraordinary item. Therefore, finance manager is incorrect in treating increase as extraordinary item. However, as per AS 5, 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.

Therefore, additional wages liability of ₹ 30 lakhs should be disclosed separately in the financial statements of TQ Cycles Ltd. for the year ended 31st March, 2023.

Question 12

A change in the estimated life of the asset, which necessitates adjustment in the depreciation is an example of

a. Prior period item.

b. Ordinary item.

c. Extraordinary item.

d. Change in accounting estimate.

Ans: (d)

Question 13

Which of the following is considered as an extraordinary item as per AS 5?

e. Write down or write-off of receivables, inventory and intangible assets.

f. Gains and losses from sale or abandonment of equipment used in a business.

g. Effects of a strike, including those against competitors and major suppliers.

Flood damage from unusually heavy rain or a normally dryenvironment.

Ans: (d)

Question 14

Which one of the following is an example of extraordinary item?

a. The write down of inventories to their net realisable value

b. Reversal of write down of inventories

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c. Government grants become refundable

d. Reversal of provisions.

Ans: (c)

Question 15

Extraordinary items are income or expenses

e. That arise from events clearly distinct from the ordinary activities of the enterprise.

f. That are not expected to recur frequently or regularly.

g. Both (a) and (b).

h. None of the three.

Ans: (c)

Question 16

An audit stock verification during the year ended 31st March, 20X1 revealed that opening stock of the year was understated by Rs. 5 lakhs due to wrong counting. While finalizing accounts, your opinion willbe

i. It is not a prior period item and no separate disclosure is required

It should be treated as a prior period adjustment and should be separately disclosed in the current

j. year's financial statement

k. The adjustment of Rs. 5 lakhs in both opening stock of current year and profit brought forward from previous year should be made

l. Both (b) and (c).

Ans: (d)

Practical Questions

Questions 17

A company (Z Ltd.) is engaged in the business of providing consultancy services. A few days back, it received a notice from GST department raising a demand of GST on consultancy services provided by itfor Rs. 500,000. Recently Z Ltd. paid the demand. In the books, the payment is recorded as an extraordinary expenditure.

Whether payment of tax demand raised by the taxation authority can be recognised as an extraordinary item?

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Answer: 17

No, payment of tax cannot be recognised as an extraordinary item.

As per AS 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" an extraordinary item is income or expenses that arise from events or transactions that are clearly distinct from ordinary activities of the enterprise and, therefore, are not expected to recurfrequently or regularly.

In the given case, providing consultancy service is an ordinary activity of Z Ltd. Thus, GST paid pursuant to the demand raised by GST department is also a part of an ordinary activity of Z Ltd. Recognising such payments as an extra-ordinary item is contrary to AS 5.

Questions 18 (Illustration)

From the past 5 financial years, an old outstanding balance of Rs. 50,000 was still appearing as sundry creditor in the current year balance sheet of People Ltd. The company is certain that this amount is not payable due to one or more reasons. Therefore, it decided to write off the said amount in its current year's books of accounts and recognize it as income. The company treated the amount of Rs. 50,000 written off as a prior period item and made the adjustments accordingly.

The company is of the view that since sundry balances were recognized in the prior period(s), its related written-off amount should be treated as a prior period item.

Answer: 18

No, the company is not correct in treating the amount written off as a prior period item. As per AS 5, prior period items are income or expenses which arise in a current year due to errors or omissions in the preparation of the financial statements of one or more prior period(s).

Writing off an old outstanding balance in the current year which is appearing in its books of accounts from the past 5 financial years does not mean that there has been an error or omission in the preparation offinancial statements of prior period(s). It is just a practice adopted by the company to write off the old outstanding balances of more than 5 years in its current year books of accounts. Therefore, the amountwritten off is not treated as a prior period item.

Hence, adjusting the amount Rs. 50,000 written off as a prior period item on the basis that sundry balanceswere recognized in prior period(s) is not in line with AS 5.

Questions 19 (Illustration)

In the current year, A Ltd. changed the depreciation method from the Straight Line Method (SLM) to Written Down Value (WDV) method. When A Ltd. recomputed depreciation retrospectively as per thenew method, deficiency arose in depreciation in respect of past years. Therefore, it reduced the carrying amount of the asset by the amount of deficiency and such change in carrying amount (deficiency amount) has been debited to the statement of profit and loss as an extraordinary expense.

Whether the change in the carrying amount of assets due to the change in depreciation method should be treated as an extraordinary item?

Answer: 19

No.

As per AS 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Pol-

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icies" extraordinary items are 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 frequently or regularly.

A change in the method of charging depreciation is not an event that is clearly distinct from the ordinary activities of the entity. In the instant case, A Ltd. has changed the depreciation method and treated the reduction in carrying amount (or amount of deficiency in depreciation) of the asset as an extraordinary expense. This is not correct. Such deficiency should be treated as a normal expense.

A change in the estimated useful life of a depreciable asset (i.e. change in depreciation method) affects the depreciation in the current period and in each period during the remaining useful life of the asset. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods, is recognised in future periods.

The change in depreciation method is considered as a change in accounting estimate as per the provisions of AS 5.

Reference:

The students are advised to refer the full text of AS 5" Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies".

Question 20 (Illustration)

Fuel surcharge is billed by the State Electricity Board at provisional rates. Final bill for fuelsurcharge of ₹ 5.30 lakhs for the period October, 20X1 to September, 20X7 has been received and paid in February, 20X8. However, the same was accounted in the year 20X8-X9. Comment on the accounting treatment done in the said case.

Answer 20

The final bill having been paid in February, 20X8 should have been accounted for in the annual accounts of the company for the year ended 31st March, 20X8. However, it seems that as a result of error or omission in the preparation of the financial statements of prior period i.e., for the year ended 31st March 20X8, this material charge has arisen in the current period i.e., year ended 31st March, 20X9. Therefore it should be treated as 'Prior period item' as per AS 5. As per AS 5, prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss. It may be mentioned that it is an expense arising from the ordinary course of business. Although abnormal in amount or infrequent in occurrence, such an expense does not qualify an extraordinary item as per AS 5. For better understanding, the fact that power bill is accounted for at provisional rates billed by the state electricity board and final adjustment thereofis made as and when final bill is received may be mentioned as an accounting policy.

Question 21 (Illustration)

(i) **During the year 20X1-20X2, a medium size manufacturing company wrote down its inventories to net realisable value by ₹ 5,00,000. Is a separate disclosure necessary?**

A company signed an agreement with the Employees Union on 1.9.20X2 for revision of wages with retrospective effect from 30.9.20X1. This would cost the company an additional liability of ₹ 5,00,000 per annum. Is a disclosure necessary for the amount paid in 20X2-X3?

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Answer 21

Although the case under consideration does not relate to extraordinary item, but the nature and amount of such item may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' states that: "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." Circumstances which may require separate disclosure of items of income and expense in accordance with AS 5 include the write-down of inventories to net realisable value as well as the reversal of such write-downs.

It is given that revision of wages took place on 1st September, 20X2 with retrospective effect from 30.9.20X1. Therefore wages payable for the half year from 1.10.20X1 to 31.3.20X2 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. Additional wages liability of ₹ 7,50,000 (for 1½ years @ ₹ 5,00,000 per annum) 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. Such an expense does not qualify as an extraordinary item. However, as per AS 5, 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.

Question 22 (Illustration)

The company finds that the inventory sheets of 31.3.20X1 did not include two pages containing details of inventory worth ₹ 14.5 lakhs. State, how you will deal with the following matters in the accounts of Omega Ltd. for the year ended 31st March, 20X2.

Answer 22

AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', defines Prior Period items as "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". Rectification of error in inventory valuation is a prior period item vide AS 5. Separate disclosure of this item as a prior period item is required as per AS 5.

Question 23 (Illustration)

(i) Explain whether the following will constitute a change in accounting policy or not as per AS **5.**

(ii) **Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex- gratia payments to employees on retirement.**

Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the **organization.**

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Answer 23

(i) As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

(ii) Accordingly, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy.

Similarly, the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial will not be treated as a change in an accounting policy.

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Chapter 7.3

AS 11- The Effects of Changes in Foreign Exchange rates

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.19 TO Q.35											
Past Exams	Q.4	Q.14 Q.15	NO	Q.13	NO	NO	Q.12 Q.14	NO	NO	Q.1 Q.16	Q.17	NO
MTP	NO	NO	NO	NO	Q.1	Q.2	NO	Q.2 Q.3	NO	Q.4 Q.5	Q.3 Q.14	NO
RTP	Q.8	Q.7	Q.1	Q.8	Q.5 Q.15	Q.7	Q.6	Q.1	Q.9	Q.10	Q.11	NO

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Chapter 7.3

AS 11- The Effects of Changes in Foreign Exchange rates

Question 2

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 2020, payable after three months. Company entered into a forward contract for three months @ Rs. 49.15 per dollar. Exchange rate per dollar on 01st Feb. was Rs. 48.85. How will you recognize the profit or loss on forward contract in the books of Rau Ltd.? (MTP 5 Marks, May '20, RTP Nov'21, RTP May'19, Old & New SM)(Same concept different figures PYP 2.5 Marks Nov'22)

Answer 1

Forward Rate	Rs. 49.15
Less: Spot Rate	(Rs. 48.85)
Premium on Contract	Rs. 0.30
Contract Amount	US$ 1,00,000
Total Loss (1,00,000 x 0.30)	Rs. 30,000

Contract period 3 months

Two months falling in the year ended 31st March, 2020; therefore, loss to be recognized (30,000/3) x2 = Rs. 20,000. Balance amount of Rs. 10,000 will be recognized in the following financial year.

Question 2

Om Ltd. purchased an item of property, plant and equipment for US $ 50 lakhs on 01.04.2019 and the same was fully financed by the foreign currency loan [US $] repayable in five equal instalments annually. (Exchange rate at the time of purchase was 1 US $ = ₹ 60]. As on 31.03.2020 the first instalment was paid when 1 US $ fetched ₹ 62.00. The entire loss on exchange was included in cost ofgoods sold. Om Ltd. normally provides depreciation on an item of property, plant and equipment at 20% on WDV basis and exercised the option to adjust the cost of asset for exchange difference arisingout of loan restatement and payment. Calculate the amount of exchange loss, its treatment and depreciation on this item of property, plant and equipment. (MTP 5 Marks Oct 20, Oct 21)

Answer 2

Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring an item of property, plant and equipment should be adjusted in the carrying amount of the respective item of property, plant and equipment as Om Ltd. has exercised the option and it is long term foreign currency monetary item. Thus, the entire exchange loss due to variation of ₹ 20 lakh on 31.03.2020 on payment of US $ 10 lakhs, should be added to the carrying amount of an item of property, plant and equipment and not to the cost of goods sold. Further, depreciation on the unamortized depreciable amount should also be provided.

Calculation of Exchange loss:

Foreign currency loan (in ₹) = (50 lakhs $ x ₹ 60) = ₹ 3,000 lakh

Exchange loss on outstanding loan on 31.03.2020 = ₹ 40 lakh

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US $ x (62.00-60.00) = ₹ 80 lakh. So, ₹ 80 lakh should also be added to cost of an item of property, plant and equipment with corresponding credit to outstanding loan in addition to ₹ 20 lakh on account of exchange loss on payment of instalment. The total cost of an item of property, plant and equipment to be increased by ₹ 100 lakh. Total depreciation to be provided for the year 2019 - 2020 = 20% of (₹ 3,000 Each + 100 lakh) = ₹ 620 lakh.

Question 3

"Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date? Classify the following as monetary or non- monetary item:

(i) Share Capital

(ii) Trade Receivables

(iii) Investments

(iv) Property Pant & Equipment. (MTP 5 Marks Nov '21 & April '23)

Answer 3

As per AS 11'The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realized from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realized from or required to disburse, such item at the balance sheet date.

Share capital	Non-monetary
Trade receivables	Monetary
Investments	Non-monetary
Fixed assets	Non-monetary

Question 4

ABC Ltd. borrowed US $ 5,00,000 on 01/01/2021, which was repaid as on 31/07/2021. ABC Ltd. prepares financial statement ending on 31/03/2021. Rate of Exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/2021	**1 US$ =**	**Rs. 68.50**
31/03/2021	**1 US $ =**	**Rs. 69.50**
31/07/2021	**1 US $ =**	**Rs. 70.00**

You are required to pass necessary journal entries in the books of ABC Ltd. as per AS 11. (MTP 5 Marks , Sep '22, PYP May '18, 5 Marks)(Same concept different figures as Old & New SM)

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Answer 4

Journal Entries in the Books of ABC Ltd.

Date	Particulars		Rs. (Dr.)	Rs. (Cr.)
Jan. 01, 2021	Bank Account (5,00,000 x 68.50)	Dr.	342,50,000	
	To Foreign Loan Account			342,50,000
March 31, 2021	Foreign Exchange Difference Account	Dr.	5,00,000	
	To Foreign Loan Account [5,00,000 x (69.50-68.50)]			5,00,000
Jul. 31, 2021	Foreign Exchange Difference Account [5,00,000 x (70-69.5)]	Dr.	2,50,000	
	Foreign Loan Account	Dr.	347,50,000	
	To Bank Account			350,00,000

Question 5

Assets and liabilities and income and expenditure items in respect of integral foreign operations are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabi lities Account and the Loss, if any, is charged to revenue. You are required to comment in line with AS 11. (MTP 5 Marks Oct '22)(RTP May 20, Old & New SM)

Answer 5

Financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures of AS 11 (Revised 2003). The individual items

in the financial statements of a foreign operation are translated as if all its transactions had been bentered into by the reporting enterprise itself. Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate. Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11 (Revised 2003).

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Question 6

(a) **Classify the following items into Monetary and Non-monetary:**

(i) **Share capital; (ii) Trade Payables; (iii) Cash balance; (iv) Property, plant and equipment**

(b) **Trade payables of CAT Ltd. include amount payable to JBB Ltd., Rs. 10,00,000 recorded at the prevailing exchange rate on the date of transaction, transaction recorded at US $1 = Rs. 80.00. The exchange rate on balance sheet date (31.03.2020) was US $1 = Rs. 85.00. You are required to calculate the amount of exchange difference and also explain the accounting treatment needed for this as per AS 11 in the books of CAT Ltd. (RTP May '21)**

Answer 6

(a) Share capital - Non-monetary; Trade Payables - Monetary

Cash balance – Monetary; Property, plant and equipment - Non-monetary

(b) Amount of Exchange difference and its Accounting Treatment

	Foreign Currency Rate	Rs.
Trade payables		
Initial recognition US $ 12,500 (Rs.10,00,000/80)	1 US $ = Rs. 80	10,00,000
Rate on Balance sheet date	1 US $ = Rs. 85	
Exchange Difference loss US $ 12,500 x Rs. (85-80)		62,500
Treatment: Debit Profit and Loss A/c by Rs. 62,500and Credit Trade Payables		

Thus, Exchange Difference on trade payables amounting Rs. 62,500 is required to be transferred to Profit and Loss.

Question 7

(a) **Classify the following items as monetary or non-monetary item: Share Capital, Trade Receivables,Investment in Equity shares & Fixed Assets. (RTP Nov 20, Nov 18, Old & New SM)**

(b)

	Exchange Rate per $
Goods purchased on 1.1.2019 for US $ 15,000	**₹ 75**
Exchange rate on 31.3.2019	**₹ 74**
Date of actual payment 7.7.2019	**₹ 73**

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You are required to ascertain the loss/gain to be recognized for financial years 2018- 19 and 2019-20 as per AS 11. (RTP Nov 20, Nov 18, Old & New SM)

Answer 7

(a)

Share capital	Non-monetary
Trade receivables	Monetary
Investment in equity shares	Non-monetary
Fixed assets	Non-monetary

(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 1.1.2019 and corresponding creditors would be recorded at ₹ 11,25,000 (i.e.

$15,000 × ₹ 75) According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditors of US $15,000 on 31.3.201 9 will be reported at ₹ 11,10,000 (i.e. $15,000 × ₹ 74) and exchange profit of ₹ 15,000 (i.e. 11,25,000 – 11,10,000) should be credited to Profit and Loss account in the year 2018-19. On 7.7.2019, creditors of $15,000 is paid at the rate of ₹ 73. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 15,000 (i.e. 11,10,000 – 10,95,000) will be credited to Profit and Loss account in the year 2019-20.

Question 8

(i) **Trade receivables as on 31.3.2019 in the books of XYZ Ltd. include an amount receivable from Umesh Rs.5,00,000 recorded at the prevailing exchange rate on the date of sales, i.e. at US $ 1= Rs.58.50. US $ 1 = Rs.61.20 on 31.3.2019. Explain briefly the accounting treatment needed in this case as per AS 11 as on 31.3.2019. (RTP Nov 19)**

(ii) **Power Track Ltd. purchased a plant for US$ 50,000 on 31st October, 2018 payable after 6 months. The company entered into a forward contract for 6 months @Rs.64.25 per Dollar. On 31st October, 2018, the exchange rate was ₹61.50 per Dollar. You are required to recognise the profit or loss on forward contract in the books of the company for the year ended 31st March, 2019. (RTP Nov 19, May 18)**

Answer 8

(I) 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. Accordingly, exchange difference on trade receivables amounting Rs.23,076 {Rs.5,23,076(US $ 8547 x Rs.61.20) less Rs. 5,00,000} should be charged to profit & Loss account.

(II) Calculation of profit or loss to be recognized in the books of Power Track Limited

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	₹
Forward contract rate	64.25
Less: Spot rate	(61.50)
Loss on forward contract	2.75
Forward Contract Amount	$ 50,000
Total loss on entering into forward contract = ($ 50,000 × Rs.2.75)	₹1,37,500
Contract period	6 months
Loss for the period 1st November, 2018 to 31st March, 2019 i.e. 5 monthsfalling in the year 2018-2019	5 months
Hence, Loss for 5 months will be Rs.1,37,500 × $\frac{5}{6}$ =	Rs.1,14,583

Thus, the loss amounting to Rs.1,14,583 for the period is to be recognized in the year ended 31st March, 2019.

Question 9

Kumar Ltd. borrowed US $ 3,00,000 on 31-12-2020 which will repaid as on 30-06-2021. Kumar Ltd. prepares its financial statements ending on 31-03-2021. Rate of exchange between reporting currency(Rupee) and foreign currency (US$) on different dates are as under:

31-12-2020	**1 US $ = ₹ 44.00**
31-03-2021	**1 US $ = ₹ 44.50**
30-06-2021	**1 US $ = ₹ 44.75**

Calculate Borrowings in reporting currency to be recognized in the books on above mentioned dates and also show journal entries for the same.

(i) **if borrowings were repaid on 28-2-2021 on which date exchange rate was 1 US $ = ₹ 44.20 then what entry should be passed? (RTP May '22)**

Answer 9

(i) As per AS 11 'The Effect of Changes in Foreign Exchange Rates", a foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount theexchange rate between the reporting currency and the foreign currency at the date of the transaction. Moreover, at each balance sheet date, foreign currency monetary items should be reported using the closing rate. Accordingly, on 31.12.2020 borrowings will be recorded at ₹ 1,32,00,000 (i.e., ₹ 3,00,000 × ₹44.00). On 31.3.2021 borrowings (monetary items) will be recorded at ₹ 1,33,50,000 (i.e. $ 3,00,000 × ₹ 44.50).

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Journal of Kumar Ltd.

Date	Particular	Dr. (₹)	Cr. (₹)
31-12-2020	Bank A/c Dr.	1,32,00,000	
	To Foreign Loan Account		1,32,00,000
31-03-2021	Foreign Exchange Difference AccountA/c Dr.	1,50,000	
	To Foreign Loan Account		1,50,000
30-06-2021	Foreign Loan Account A/c Dr.	1,33,50,000	
	Foreign Exchange Difference AccountA/c Dr.	75,000	
	To Bank A/c		1,34,25,0000

In case borrowings were repaid before Balance Sheet Date, then the entry would be as follows:

Date	Particular	Dr. (₹)	Cr. (₹)
28-02-2021	Foreign Loan Account A/c Dr.	1,32,00,000	
	Foreign Exchange DifferenceAc-count A/c Dr.	60,000	
	To Bank A/c		1,32,60,000

Working Notes:

(i) The exchange difference of ₹ 1,50,000 is arising because the transaction has been reported at different rate (₹ 44.50 = 1 US $) from the rate initially recorded (i.e., ₹ 44 = 1 US $) from the rate initially recorded (i.e., ₹ 44 = 1 US $)

(ii) The exchange difference of ₹ 75,000 is arising because the transaction has been settled at an exchange rate (₹ 44.75 = 1 US$) different from the rate at which reported in the last financial statements (₹ 44.50 =1 US$).

(iii) The exchange difference of ₹ 60,000 is arising because the transaction has been settled at a different rate(i.e., ₹ 44.20 = 1 US $) than the rate at which initially recorded (1 US $ = ₹ 44.00)

Question 10

A company had imported raw materials worth US Dollars 6,00,000 on 5th January, 2022, when the exchange rate was Rs. 43 per US Dollar. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transaction was made on 5th April, 2022 when the exchange rate was Rs. 47 per US Dollar. However, on 31st March, 2022, the rate of exchange was Rs. 48 per US Dollar. The company passed an entry on 31st March, 2022 adjusting the cost of raw materials consumed for the difference between Rs. 47 and Rs. 43 per US Dollar.

In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss (RTP Nov'22)

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Answer 10

As per AS 11 (revised 2003), 'The Effects of Changes in Foreign Exchange Rates', monetary items denominated in a foreign currency should be reported using the closing rate at each balance sheet date. The effect of exchange difference should be taken into profit and loss account. Trade payables isa monetary item, hence should be valued at the closing rate i.e, Rs. 48 at 31st March, 2022 irrespectiveof the payment for the same subsequently at lower rate in the next financial year. The difference of Rs. 5 (Rs. 48-Rs. 43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2022 and is not to be adjusted against the cost of raw materials. In the subsequent year, the company would record an exchange gain of Rs. 1 per US dollar, i.e., the difference between Rs. 48 and Rs. 47 per US dollar. Hence, the accounting treatment adopted by the company is incorrect.

Question 11

ABC Builders Limited had borrowed a sum of US $ 15,00,000 at the beginning of Financial year 2020- 21 for its residential project at London Interbank Offered Rate (LIBOR) + 4 %. The interest is payable at the end of the Financial Year. At the time of availing the loan, the exchange rate was ₹ 72 per US $ and the rate as on 31st March, 2021 was ₹ 76 per US $. If ABC Builders Limited borrowed the loan in Indian Rupee equivalent, the pricing of loan would have been 9.50%. Compute Borrowing Cost and exchange difference for the year ending 31st March, 2021 as per applicable Accounting Standards. (Applicable LIBOR is 1%).(RTP May 23)

Answer 11

(i) Interest for the period 2020-21

= US $ 15 lakhs x 5% × ₹ 76 per US $ = ₹ 57 lakhs

(ii) Increase in the liability towards the principal amount

= US $ 15 lakhs × ₹ (76 - 72) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency

= US $ 15 lakhs × ₹ 72 x 9.5% = ₹ 102.60 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 102.60 lakhs less ₹ 57 lakhs = ₹ 45.60 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 45.60 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 102.60 lakhs being the aggregate of interest of ₹ 57 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 45.60 lakhs.

Hence, ₹ 102.60 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining ₹ 14.4 lakhs (60 - 45.60) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

Question 12

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.03.2020

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Debtors include amount due from Mr. S ₹ 9,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹ 72.00 US $ 1=₹73.50 on 31st March,2020 US $ 1= ₹ 72.50 on 1st April,2019.

(i) Long term loan taken on 1st April, 2019 from a U.S. company amounting to ₹ 75,00,000. ₹5,00,000 was repaid on 31st December, 2019, recorded at US $ 1 = ₹ 70.50. interest has been paid as and when debitedby the US company. US $1= ₹ 73.50 on 31st March,2020 US $1=1₹ 72.50 on 1st April, 2019. (PYP 5 Marks Jan '21) (Same concepts different figures Old & New SM)

Answer 12

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.

	Foreign Cu rencyRate	₹
Debtors		
Initial recognition US $12,500 (9,00,000/72)	1 US $ = ₹72	9,00,000
Rate on Balance sheet date	1 US $ = ₹ 73.50	
Exchange Difference Gain US $ 12,500 X (73.50- 72)		18,750
Treatment: Credit Profit and Loss A/c by ₹ 18,750		
Long term Loan		
Initial recognition US $ 1,03,448.28 (75,00,000/72.50)	1 US $ = ₹ 73.50	75,00,000
Rate on Balance sheet date	1 US $ = ₹ 73.50	
Exchange Difference Loss after adjustment of ex-changegain on repayment of ₹ 5,00,000		
₹ 67,987.48 [82,171.88 (US $ 96,356.08 X ₹ 73.5 less ₹ 70,00,000) less profit 14,184.40		
[US $ 7,092.2 (5,00,000/70.5) X ₹ 2)] NET LOSS Treatment: Credit Loan A/c and Debit FCMITD A/C or Profit and Loss A/c by ₹ 67,987.48		67,987.48*

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Thus, Exchange Difference on Long term loan amounting ₹ 67,987.48 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 ₹ 18,750 is required to be transferred to Profit and Loss A/c.

NOTE 1: *Exchange Difference Loss (net of adjustment of exchange gain on repayment of ₹ 5,00,000) has been calculated in the above solution. Alternative considering otherwise also possible.

NOTE 2: Date of sales transaction of ₹ 9 lakhs have not been given in the question and hence it has been assumed that the transaction took place during the year ended 31 March 2020.

Question 13

Karan Enterprises having its Head office in Mangalore, Karnataka has a branch in Greenville, USA. Following is the trial balance of Branch as at 31-3-2019:

Particulars	Amount ($) Dr.	Amount ($) Cr.
Fixed assets	8,000	
Opening inventory	800	
Cash	700	
Goods received form Head Office	2,800	
Sales		24,050
Purchases	11,800	
Expenses	1,800	
Remittance to head office	2,450	
Head office account	28,350	4,300 28,350

(i) **Fixed assets were purchased on 1st April, 2019Depreciation at 10% p.a. is to be charged on fixed assets on straight line method,**

(ii) **Closing inventory at branch is $ 700 as on 31-3-2019.**

(iii) **Goods received form Head Office (HO) were recorded at Rs. 1,85,500 in HO books.**

(iv) **Remittances to HO were recorded at Rs. 1,62,000 in HO books.**

(v) **HO account is recorded in HO books at Rs. 2,84,500.**

Exchange rates of US Dollar at different dates can be taken as:1-4-2015 Rs. 63; 1-4-2018 Rs. 65 and 31-3-2019 Rs. 67.

Prepare the trial balance after been converted into Indian rupees in accordance with AS-11. (PYP Nov.'19,5 Marks)

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Answer 13

Trial Balance of Foreign Branch (converted into Indian Rupees) as on March 31, **2019**

Particulars	$ (Dr.)	$ (Cr.)	Conversion Basis	Rate	₹ (Dr.)	₹ (Cr.)
Fixed Assets	8,000		Transaction Date			
			Rate	63	5,04,000	
Open-ing In-ventory	800		Opening Rate	65	52,000	
Goods Received			Actuals		1,85,500	
from HO	2,800					
Sales		24,050	Average Rate	66	15,87,300	
Purchases	11,800		Average Rate	66	7,78,800	
Expenses	1,800		Average Rate	66	1,18,800	
Cash	700		Closing Rate	67	46,900	
Remittance to HO	2,450		Actuals		1,62,000	
HO Account		4,300	Actuals			2,84,500
Exchange Rate						
Difference			Balancing Figure		23,800	
	28,350	**28,350**			**18,71,800**	**18,71,800**
Closing Stock	700		Closing Rate	67	46,900	
Depreciation	800		Fixed Asset Rate	63	50,400	

Question 14

ABC Ltd. an Indian Company obtained long term loan from WWW private Ltd., a U.S. company amounting to Rs.30,00,000. It was recorded at US $1 = Rs.60.00, taking exchange rate prevailing at thedate of transaction. The exchange rate on balance sheet data (31.03.2018) was US $1 = Rs. 62.00.

Trade receivable includes amount receivable from Prakash Ltd., Rs. 10,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = Rs. 59.00. The exchange rate on balance sheet data (31.03.2018) was US $1 = Rs. 62.00.

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of ABC Ltd.

(PYP Nov.'18, 5 Marks)(Same concept different figures -PYP Dec'21 5 Marks, MTP 5 Marks Apr'23)

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Answer 14

Amount of Exchange difference and its Accounting Treatment

Long term Loan	Foreign Currency Rate	Rs.
(i) Initial recognition US $50,000 Rs. (30,00,000/60)	1 US $ = Rs. 60	30,00,000
Rate on Balance sheet date	1 US $ = Rs. 62	
Exchange Difference Loss Us $ 50,000 X Rs. (62 - 60)		1,00,000
Treatment: Credit Loan A/c and Debit FCMITD A/c or Profit and Loss A/c by Rs. 1,00,000		
Trade receivables		
(ii) Initial recognition US $ 16,949.152* (Rs. 10,00,000/59)	1 US $ = Rs. 59	10,00,000
Rate on Balance sheet date	1 Us $ = Rs. 62	
Exchange Difference Gain US $ 16,949.152* x Rs. (62-59)		50,847.456*
Treatment: Credit Profit and Loss A/c by ₹ 50,847.456* And Debit Trade Receivables		

Thus, Exchange Difference on Long term loan amounting Rs. 1,00,000 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on trade receivables amounting Rs. 50,847.456 is required to be transferred to Profit and Loss A/c.

Question 15

AXE Limited purchased fixed assets costing $ 5,00,000 on 1st Jan. 2018 from an American company M/s M&M Limited. The amount was payable after 6 months. The company entered into a forward contract on 1st January 2018 for five months @ f 62.50 per dollar. The exchange rate per dollar was as follows:

On 1st January, 2018 Rs. 60.75 per dollar

On 31st March, 2018 Rs. 63.00 per dollar

You are required to state how the profit or loss on forward contract would be recognized in the booksof AXE Limited for the year ending 2017-18, as per the provisions of AS 11. (PYP Nov.'18, 5 Marks, RTPMay 20)

Answer 15

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", an enterprise may enter into a forward exchange contract to establish the amount of the reporting currency required, the premium or discount arising at the inception of such a forward exchange contract should be amortized as expenses or income over the life of the contract.

Forward Rate	Rs.62.50
Less: Spot Rate	(Rs. 60.75)

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Premium on Contract	Rs. 1.75
Contract Amount	US$5,00,000
Total Loss (5,00,000 x 1.75)	₹ 8,75,000

Contract period 5 months 3 months falling in the year 2017-18; therefore, loss to be recognizeding 2017-18 (8,75,000/5) x 3 = Rs. 5,25,000. Rest Rs. 3,50,000 will be recognized in the following year 2018- 19.

Question 16

Trade Payables of Jared Limited includes amount due to Sterling Limited ₹ 9,75,000 recorded at the prevailing exchange rate on the date of purchase; transaction recorded at US $ 1 = ₹ 75.00. The exchange rate on Balance Sheet date (31st March,2022) was US $ 1 = 79.00 The payment was made on 1st May,2022 when the exchange rate was US $ 1 = ₹ 78.30.

You are required to calculate the amount of exchange difference on 31st March, 2022 and 1st May, 2022 and also explain the accounting treatment needed in the above case as per AS 11 in the books of Jared Limited. (PYP 2.5 Marks Nov '22)

Answer 16

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.

Trade payables	Foreign Currency Rate	Amount ₹
Initial recognition US $13,000 (9,75,000/75)	1 US $ = ₹ 75	
Exchange Rate on Balance sheet date	1 US $ = ₹ 79	
Exchange Difference Loss US $ 13,000 X (79-75)		52,000
Exchange Rate on Settlement date	1 US $ = ₹ 78.30	
Exchange Difference Profit US $ 13,000x(79-78.30)		9,100

For the year ended 31st March, 2022 exchange diffefence loss amounting ₹ 52,000 will be charged to statement of Profit & Loss A/c.

However, there is exchange difference gain of ₹ 13,000 x (79-78.30) = 9,100 on 1st May, 2022. Thus gain of ₹ 9,100 will be credited to statement of Profit & Loss A/c for the year ended 31st March, 2023.

Question 17

Trower Limited is an Indian importer. It imports goods from True View Limited situated at London. Trower Limited has a payable of £50,000 to True View Limited as on 31st March, 2023. True View Limited has given Trower Limited the following two options:

(i) Pay immediately with a cash discount of 1% on the payable.

Pay after 6 months with interest @ 5% p.a. on the payable.The borrowing rate for Trower Limited in rupees is 15% p.a. The following are the exchange rates:

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Date	Rs. /£
31st March,2023	97
30th September, 2023	99

You are required to give your opinion to Trower Limited on which of the above two options to be chosen. (PYP 5 Marks May '23)

Answer 17

Option

(i) Pay immediately with Cash discount of 1% on the payable

	₹
Total amount payable as on 31.3.2023 (50,000 x Rs. 97)	48,50,000
Less: Cash discount	(48,500)
	48,01,500
Add: Borrowing cost @ 15% p.a. for 6 months	3,60,112
If payment made immediate	51,61,612

(ii) Option

Pay after 6 months with interest @ 5% p.a. on the payable

	₹
Total amount payable as on 31.3.2023 (50,000 x Rs. 99)	49,50,000
Interest for 6 months @ 5%	1,23,750
If payment made after 6 months	50,73,750

Thus, Option

(iii) is beneficial to Trower Limited as the Rupee outflow will be lower by Rs. (51,61,612 – 50,73,750) = Rs. 87,862 in option (ii).

Note: The above answer be presented in the alternative manner given as below:Option (i) Pay immediately with Cash discount of 1% on the payable

	₹
Total amount payable on 31.3.2023	50,000
Less: Cash discount (50,000 x 1 / 100)	(500)
	49,500
	48,01,500
49,500 x Rs. 97	3,60,112
Add: Borrowing cost @ 15% p.a. for 6 monthsIf payment made immediate	Rs. 51,61,612

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Option (ii)

Pay after 6 months with interest @ 5% p.a. on the payable

	Rs.
Total amount payable on 31.3.2023	50,000
Interest for 6 months @ 5% (50,000 x 5 / 100 x 6 / 12)	1.250
	51,250
If payment made after 6 months (51,250 x 99)	50,73,750

Thus, Option (ii) is beneficial to Trower Limited as the Rupee outflow will be lower by Rs. (51,61,612 – 50,73,750) = Rs. 87,862 in option (ii).

Question 18

Explain "monetary item" as per Accounting Standard 11.

How are foreign currency monetary items to be recognized at each Balance Sheet date? Classify the following monetary or non-monetary item:

Share Capital. Trade Receivables.Investments.

Fixed Assets. (Nov '23)

Answer 18

As per AS 11, Monetary items are money held and assets and liabilities to be received or paid in fixedor determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realized from, or required to disburse, a foreign currency monetary item at the balance sheet date.

In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realized from or required to disburse, such item at the balance sheet date.

Classification of items as monetary or non-monetary item:

Share capital	Non-monetary
Trade receivables	Monetary
Investments	Non-monetary Fixed
Assets (PPE)	Non-monetary

Questions 19

As per AS 11 assets and liabilities of non-integral foreign operations shouldbe converted at rate

a. Opening	b. Average
c. Closing	d. Transaction

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Ans: (c)

Questions 20

The debit or credit balance of "Foreign Currency Monetary Item Translation Difference Account"

a. Is shown as "Miscellaneous Expenditure" in the Balance Sheet
b. Is shown under "Reserves and Surplus" as a separate line item
c. Is shown as "Other Non-current" in the Balance Sheet
d. Is shown as "Current Assets" in the Balance Sheet

Ans: (b)

Questions 21

If asset of an integral foreign operation is carried at cost, cost and depreciation of tangible fixed asset istranslated at

a. Average exchange rate	b. Closing exchange rate
c. Exchange rate at the date of purchase of asset	d. Opening exchange rate

Ans: (c)

Questions 22

Which of the following can be classified as an integral foreign operation?

a. Branch office serving as an extension of the head office in terms of operations
b. Independent subsidiary of the parent company
c. Branch office independent of the head office in terms of operational decisions
d. None of the above

Ans: (a)

Questions 23

Which of the following items should be converted to closing rate for the purposes of financial reporting?

a. Items of Property, Plant and Equipment	b. Inventory
c. Trade Payables, Trade Receivables and Foreign Currency Borrowings	d. All of the above

Ans: (c)

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Theoretical Questions Answers

Questions 24

Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date?

Answers 24

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets

and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amountin reporting currency that is likely to be realized from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported inthe reporting currency at the amount which is likely to be realized from or required to disburse, such item at the balance sheet date.

Questions 25

Distinguish Non-Integral Foreign Operation (NFO) with Integral Foreign Operation (IFO) as per AS 11.

Answers 25

As per AS 11, Integral foreign operation (IFO) is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations. In contrast, a non-integral foreign operation (NFO) is a foreign operation that is not an integral operation. For details, refer para 2.5 of chapter.

Practical Questions Answers

Questions 26

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3. 20X1.

Trade receivables include amount receivable from Umesh Rs. 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $ 1= Rs. 58.50.

Long term loan taken from a U.S. Company, amounting to Rs. 60,00,000. It was recorded at US $ 1 = Rs. 55.60, taking exchange rate prevailing at the date of transaction. US $ 1 = Rs. 61.20 was on 31.3. 20X1.

Answers 26

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 recognised 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 theperiod, or reported in previous financial statements, in so far as they relate to the acquisition of

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a depreciable capital asset can be added to or deducted from the cost of the asset and should be depreciated over the balance life of the asset, and in other cases, can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortised over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

Trade receivables	Foreign Currency Rate	₹
Initial recognition US $8,547	1 US $ = Rs. 58.50	5,00,000
(5,00,000/58.50)		
Rate on Balance sheet date	1 US $ = Rs. 61.20	
Exchange Difference Gain US $ 8,547 X		23,077
(61.20-58.50)		
Treatment: Credit Profit and Loss A/c by		
Rs. 23,077		
Long term Loan		
Initial recognition US $ 1,07,913.67	1 US $ = Rs. 55.60	60,00,000
(60,00,000/55.60)		
Rate on Balance sheet date	1 US $ = Rs. 61.20	
Exchange Difference Loss US $		6,04,317
1,07,913.67 X (61.20 – 55.60)		
Treatment: Credit Loan A/c		
And Debit FCMITD A/C or Profit and Loss		
A/c by Rs. 6,04,317		

Thus Exchange Difference on Long term loan amounting Rs. 6,04,317 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange differenceon debtors amounting Rs. 23,077 is required to be transferred to Profit and Loss A/c.

Question 27 (Illustration)

Classify the following items as monetary or non-monetary item:

Inventories Trade Receivables Investment inEquity shares Property, Plant and Equipment.

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Answers 27

Inventories	Non-monetary
Trade receivables	Monetary
Investment in equity shares	Non-monetary
Property, Plant and Equipment	Non-monetary

Question 28 (Illustration)

	Exchange Rate per $
Goods purchased on 1.1.20X1 for US $ 15,000	**RS 75**
Exchange rate on 31.3.20X1	**RS 74**
	RS 73
Date of actual payment 7.7.20X1	

You are required to ascertain the loss/gain to be recognized for financial years ended 31st March, 20X1 and 31st March, 20X2 as per AS 11.

Answers 28

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 1.1.20X1 and corresponding creditors would be recorded at Rs. 11,25,000 (i.e. $15,000 × Rs. 75)

According to the standard, at the balance sheet date all monetary transactions should be report-edusing the closing rate. Thus, creditors of US $15,000 on 31.3.20X1 will be reported at Rs. 11,10,000 (i.e.

$15,000 × Rs. 74) and exchange profit of Rs. 15,000 (i.e. 11,25,000 – 11,10,000) should be credited to Profit and Loss account in the year ended 31st March, 20X1.

On 7.7.20X1, creditors of $15,000 is paid at the rate of Rs. 73. As per AS 11, exchange difference on set-tlement of the account should also be transferred to Profit and Loss account. Therefore, Rs. 15,000 (i.e. 11,10,000 – 10,95,000) will be credited to Profit and Loss account in the year ended 31st March,20X2.

Question 29 (Illustration)

Kalim Ltd. borrowed US$ 4,50,000 on 01/01/20X1, which will be repaid as on 31/07/20X1. Kalim Ltd. pre-pares financial statement ending on 31/03/20X1. Rate of exchange between reportingcurrency (INR) and foreign currency (USD) on different dates are as under:

01/01/20X1 1 US$ = Rs. 48.00

31/03/20X1 1 US$ = Rs. 49.00

31/07/20X1 1 US$ = Rs. 49.50

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Answers 29

Journal Entries in the Books of Kalim Ltd.

Date	Particulars	Rs. (Dr.)	Rs. (Cr.)
20X1		216,00,000	
Jan. 01	Bank Account (4,50,000 x 48) Dr.		
	To Foreign Loan Account		216,00,000
March 31	Foreign Exchange Difference Account Dr.	4,50,000	
	To Foreign Loan Account[4,50,000 x (49-48)]		4,50,000
July 01	Foreign Exchange Difference Account Dr. [4,50,000 x (49.5-49)]	2,25,000	
	Foreign Loan Account Dr.	220,50,000	
	To Bank Account		2,22,75,000

Question 30 (Illustration)

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 20X1, payable after three months. Company entered into a forward contract for three months @ Rs. 49.15 per dollar. Exchange rate per dollar on 01st Feb. was Rs. 48.85. How will you recognise the profit or loss on forward contract in the books of Rau Ltd.?

Answers 30

Forward Rate	Rs. 49.15
Less: Spot Rate	(Rs. 48.85)
Premium on Contract	Rs. 0.30
Contract Amount	US$ 1,00,000
Total Loss (1,00,000 x 0.30)	Rs. 30,000

Contract period 3 months (2 months falling in the year ended 31st March, 20X1)

Loss to be recognised (30,000/3) x 2 = Rs. 20,000 in the year ended 31st March, 20X1. Rest Rs. 10,000 will be recognised in the following year.

In recording a forward exchange contract intended for trading or speculation purposes, the premium or discount on the contract is ignored and at each balance sheet date, the value of the contract is marked to its current market value and the gain or loss on the contract is recognised.

Question 31 (Illustration)

Mr. A bought a forward contract for three months of US$ 1,00,000 on 1 st December at 1 US$ = Rs. 47.10 when exchange rate was US$ 1 = Rs. 47.02. On 31st December when he closed his books exchange

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rate was US$ 1 = Rs. 47.15. On 31st January, he decided to sell the contract at Rs. 47.18 perdollar. Show how the profits from contract will be recognised in the books.

Answers 31

Since the forward contract was for speculation purpose the premium on contract i.e. the difference between the spot rate and contract rate will not be recorded in the books. Only when the contract is sold the difference between the contract rate and sale rate will be recorded in the Profit & Loss Account.

Sale Rate	Rs. 47.18
Less: Contract Rate	(Rs. 47.10)
Premium on Contract	Rs. 0.08
Contract Amount	US$ 1,00,000
Total Profit (1,00,000 x 0.08)	Rs. 8,000

Question 32 (Illustration)

Assets and liabilities and income and expenditure items in respect of foreign branches (integral foreign operations) are translated into Indian rupees at the prevailing rate of exchange at the endof the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to the statement of profit and loss. Comment.

Answers 32

The financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures described in AS 11. The individual items inthe financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself.

Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. For practical reasons, a rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheetdate. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed onthe date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate.

Exchange difference arising on the translation of the financial statements of integral foreignoperation should be charged to profit and loss account. Exchange difference arising on the translation of the financial statement of foreign operation may have tax effect which should be dealt as per AS22 'Accounting for Taxes on Income'.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also thetreatment of resultant exchange difference is not in consonance with AS 11.

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Question 33 (Illustration)

A business having the Head Office in Kolkata has a branch in UK. The following is the trial balanceof Branch as at 31.03.20X4:

Account Name	Amount in £	
	Dr.	Cr.
Machinery (purchased on 01.04.20X1)	5,000	
Debtors	1,600	
Opening Stock	400	
Goods received from Head Office Account	6,100	
(Recorded in HO books as Rs. 4,02,000)		
Sales		20,000
Purchases	10,000	
Wages	1,000	
Salaries	1,200	
Cash	3,200	
Remittances to Head Office (Recorded in HO books as	2,900	
Rs. 1,91,000)		
Head Office Account (Recorded in HO books as		7,400
Rs. 4,90,000)		
Creditors		4,000

- **Closing stock at branch is £ 700 on 31.03.20X4.Depreciation @ 10% p.a. is to be charged on Machinery.**
- **Prepare the trial balance after been converted in Indian Rupees.**

Exchange rates of Pounds on different dates are as follow: 01.04.20X1– Rs. 61; 01.04.20X3– Rs. 63 & 31.03.20X4 – Rs. 67

Answers 33

Trial Balance of the Foreign Branch converted into Indian Rupees as on March 31, 20X4

Particulars	£ (Dr.)	£ (Cr.)	Conversion Basis	Rs. (Dr.)	Rs. (Cr.)
			Transaction date		
Machinery	5,000		rate	3,05,000	
Debtors	1,600		Closing Rate	1,07,200	
Opening Stock	400		Opening Rate	25,200	
Goods Received from HO	6,100		Actuals	4,02,000	
Sales		20,000	Average Rate		13,00,000
Purchases	10,000		Average Rate	6,50,000	

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Wages	1,000		Average Rate	65,000	
Salaries	1,200		Average Rate	78,000	
Cash	3,200		Closing Rate	2,14,400	
Remittance to HO	2,900		Actuals	1,91,000	
HO Account		7,400	Actuals		4,90,000
Creditors		4,000	Closing Rate		2,68,000
Exchange Rate Difference			Balancing Figure	20,200	
	31,400	31,400		20,58,000	20,58,000
Closing Stock	700		Closing Rate	46,900	
Depreciation	500		Fixed Asset Rate	30,500	

Question 34 (Illustration)

A Ltd. purchased fixed assets costing Rs. 3,000 lakhs on 1.1.20X1 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were1 Dollar = Rs. 40.00 and Rs. 42.50 as on 1.1.20X1 and 31.12.20X1 respectively. First instalment was paidon 31.12.20X1. The entire difference in foreign exchange has been capitalised.

You are required to state, how these transactions would be accounted for.

Answers 34

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 fromthose at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognised as income or expense.

Calculation of Exchange Difference:

Foreign currency loan = $\frac{3{,}000 \text{ lakhs}}{40}$ = 75 lakhs US Dollars

Exchange difference = 75 lakhs US Dollars = (42.50 – 40.00) = `187.50 lakhs (including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting ` 187.50 lakhs should be charged to profit and loss account for the year.

Note:

The above answer has been given on the basis that the company has not exercised the option of capitalisation available under paragraph 46 of AS 11. However, if the company opts to avail the benefit given in paragraph 46A, then nothing is required to be done since the company has donethe correct treatment.

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Question 35 (Illustration)

A Ltd. has borrowed USD 10,000 in foreign currency on April 1, 20X1 at 5% p.a. annual interest and acquired a depreciable asset. The exchange rates are as under:

01/04/20X1 1 US$ = Rs. 48.00

31/03/20X2 1 US$ = Rs. 51.00

(i) You are required to pass the journal entries in the following cases:

(ii) Option under Para 46A is not availed.

(iii) Option under Para 46A is availed.

The loan was taken to finance the operations of the entity (and not to procure a depreciableasset).

In all cases, assume interest accrued on 31 March 20X2 is paid on the same date.

Answers 35

(i) Journal Entries in the Books of A Ltd.

Option under Para 46A is not availed

Date	Particulars	Rs. (Dr.)	Rs. (Cr.)
20X1			
Apr. 01	Bank Account (10,000 x 48) Dr.	4,80,000	
	To Foreign Loan Account		4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x Rs. 51) ToBank Account	25,500	
	Foreign Exchange Difference Account (P/L) Dr.		25,500
Mar 31	To Foreign Loan Account [10,000 x (51-48)]	30,000	
			30,000

In this case, since the option under Para 46A is NOT availed, the Exchange Loss of Rs. 30,000 is recognised as an expense in the Statement of Profit and Loss for the year ending 31 March 20X2.**Option under Para 46A is availed**

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Date	Particulars	Rs. (Dr.)	Rs. (Cr.)
20X1			
Apr. 01	Bank Account (10,000 x 48) Dr.	4,80,000	
	To Foreign Loan Account		4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x Rs. 51) To Bank Account	25,500	
	Foreign Exchange Difference Account Dr.To Foreign Loan Account [10,000 x (51-48)]		25,500
Mar 31	Property, Plant and Equipment Dr.	30,000	
	To Foreign Exchange Difference Account		30,000
Mar 31		30,000	
			30,000

In this case, since the option under Para 46A is availed, the Exchange Loss of Rs. 30,000 is capitalized in the cost of Property, Plant and Equipment, which will indirectly get recognized in the Profit & Loss A/c by way of increased depreciation over the remaining useful life of the asset.

(ii) Option under Para 46A is availed

Date	Particulars	Rs. (Dr.)	Rs. (Cr.)
20X1			
Apr. 01	Bank Account (10,000 x 48) Dr.	4,80,000	
	To Foreign Loan Account		4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x Rs. 51) ToBank Account	25,500	
	Foreign Exchange Difference Account Dr. ToForeign		25,500
Mar 31	Loan Account [10,000 x (51-48)]	30,000	
	Foreign Currency Monetary Item Translation Differ-		30,000
Mar 31	ence A/c (FCMITDA) Dr.	30,000	
	To Foreign Exchange Difference Account		
			30,000

In this case, since the option under Para 46A is availed, the Exchange Loss of Rs. 30,000 is accumulated in the FCMITD A/c, which will be subsequently spread over and debited to P&L A/c over the tenure of the loan.

Reference:

The students are advised to refer the full text of AS 11 "The Effects of Changes in Foreign Exchange Rates".

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Chapter 7.4

AS 22- Accounting for Taxes on Income

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.12 TO Q.24											
Past Exams	Q.4	NO	Q.4 Q.11	Q.10	NO	Q.10	Q.9	Q.8	NO	Q.3	NO	NO
MTP	NO	NO	NO	Q.1	NO	NO	NO	NO	NO	NO	NO	NO
RTP	NO	Q.1	Q.6	Q.10	Q.9	Q.4	Q.3	Q.2	Q.5	Q.7	NO	Q.10

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Chapter 7.4

AS 22- Accounting for Taxes on Income

Question 1

Beta Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference resulting in a tax liability in year 1 and 2 is Rs. 1,000 lakhs and Rs. 2,000 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by Rs. 50 lakhs. Assuming tax rate of 40%, find out the deferred tax liability at the end of the second year and any charge to the Profit and Loss account. (MTP Oct 19 5 Marks, RTP Nov'18)(Same concept different figures Old & New SM)

Answer 1

As per para 13 of Accounting Standard (AS) 22, Accounting for Taxes on Income", deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognized to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income-tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognized in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of Rs. 1,000 lakhs depreciation, timing difference amounting Rs. 400 lakhs (Rs. 50 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognized. However, for Rs. 600 lakhs (Rs. 1,000 lakhs . Rs. 400 lakhs), deferred tax liability will be recognized for Rs. 240 lakhs (40% of Rs. 600 lakhs) in first year. In the second year, the entire amount of timing difference of Rs. 2,000 lakhs will reverse only after tax holiday period and hence, will be recognized in full. Deferred tax liability amounting Rs. 800 lakhs (40% of Rs. 2,000 lakhs) will be created by charging it to profit and loss accountand the total balance of deferred tax liability account at the end of second year will be Rs. 1,040 lakhs (240 lakhs + 800 lakhs).

Question 2

Can an enterprise offset deferred tax assets and deferred tax liabilities? If yes, prescribe the conditions required for such offset as per provisions of AS 22. ? (RTP Nov '21)

Answer 2

Yes. It can offset deferred tax assets and deferred tax liabilities.

As per AS 22, an enterprise should offset deferred tax assets and deferred tax liabilities if:

(i) the enterprise has a legally enforceable right to set off assets against liabilities representing current tax;and

(ii) the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the samegoverning taxation laws.

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Question 3

(a) **The following information is furnished in respect of Slate Ltd. for the year ending 31-3-2019:**

(i) **Depreciation as per books** **Rs. 2,80,000**
Depreciation for tax purpose **Rs. 1,90,000**

The above depreciation does not include depreciation on new additions.

(ii) **A new machinery purchased on 1.4.18 costing Rs. 1,20,000 on which 100% depreciation is allowed in the 1st year for tax purpose whereas Straight-line method is considered appropriate for accounting purpose with a life estimation of 4 years.**

(iii) **The company has made a profit of Rs. 6,40,000 before depreciation and taxes.**

(iv) **Corporate tax rate of 40%.**

Prepare relevant extract of statement of Profit and Loss for the year ending 31-3-2019 and also show the effect of above items on deferred tax liability/asset as per AS 22.

(b) **What are the disclosure requirements for deferred tax assets and deferred tax liabilities in the balancesheet as per AS 22? (RTP May 21, PYP 5 Marks Nov '22)**

Answer 3

(a) **Statement of Profit and Loss for the year ended 31st March, 2019 (Extract)**

		Rs
Profit before depreciation and taxes		6,40,000
Less: Depreciation for accounting purposes (2,80,000+30,000)		(3,10,000
Profit before taxes (A)		3,30,000
Less: Tax expense (B)		
Current tax (W.N.1) (3,30,000 x 40%) Deferred tax (W.N.2)	1,32,000	,32,000
Profit after tax (A-B)	NIL	1,98,000

Working Notes:

1. **Computation of taxable income**

	Amount (Rs.)
Profit before depreciation and tax	6,40,000
Less: Depreciation for tax purpose (1,90,000 + 1,20,000)	(3,10,000)
Taxable income	3,30,000
Tax on taxable income @ 40%	1,32,000

2. **Impact of various items in terms of deferred tax liability / deferred tax asset**

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S. No.	Transactions	Analysis	Nature ofdiffer-ence	Effect	Amount (Rs.)
(i)	Difference in depreciation	Generally, written down value method of de-preciation is adopted under IT Act which leads to higher depre-ciation in earlier years of useful life of the asset in compari son to later years.	Responding timing differ-ence	Reversal of DTL	(2,80,000 - 1,90,000) x 40% = (36,000)
(ii)	Depreciation on new machinery	Due to allowance of full amount as expenditure under IT Act, tax payable in the earlier years is less.	Timing difference	Creation of DTL	(1,20,000 – 30,000) x 40% = 36,000
	Net impact				NIL

b. The break-up of deferred tax assets and deferred tax liabilities into major components of the respec-tive balance should be disclosed in the notes to accounts. Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separatelyfrom current assets and current liabilities. The nature of the evidence supporting the rec-ognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forwardof losses under tax laws.

Question 4

(a) Write short note on Timing differences and Permanent differences as per AS 22

(b) Rama Ltd., has provided the following information:

	Rs.
Depreciation as per accounting records	**6,00,000**
Depreciation as per income tax records	**10,00,000**
Unamortized preliminary expenses as per tax record	**60,000**

There is adequate evidence of future profit sufficiency. You are required to calculate the amount of deferred tax asset/liability to be recognized as transition adjustment assuming Tax rate as 30%. (RTP Nov 20, PYP 5 Marks May'18, Old & New SM, PYP 5 Marks May'19)(Same concept different figures May'18, Old & New SM)

Answer 4

(a) **Accounting income and taxable income for a period are seldom the same. Permanent** differences arethose which arise in one period and do not reverse subsequently. For e.g., an income exempt fromtax or an expense that is not allowable as a deduction for tax purposes. Timing differences are those which arise in one perio d and are capable of

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reversal in one or more subsequent periods. For e.g., Depreciation, Bonus, etc.

(b) Table showing calculation of deferred tax asset / liability

Particulars	Amount	Timing differences	Deferred tax	Amount @ 30%
	Rs.			Rs.
Excess depreciation as per tax records (Rs. 10,00,000 – Rs. 6,00,000)	4,00,000	Timing	Deferred tax liability	1,20,000
Unamortized preliminary expenses as per tax records	60,000	Timing	Deferred tax asset	(18,000)
Net deferred tax liability				1,02,000

Question 5

The following transactions were reported by PQR Ltd. during the year 2020-2021:

i.	**Tax Rate**	**30%**
ii.	**Items disallowed in 2019-2020 and allowed for tax purposes in 2020-2021.**	**(Rs. in lakh)** **20.00**
iii.	**Interest to Financial Institutions accounted in the books on accrualbasis, but actual payment was made before the due date of filing return and allowed for tax purpose also.**	**20.00**
iv.	**Donations to Private Trust made in 2020-2021 (not allowed under Income Tax Laws).**	**10.00**

You are required to show impact of the above items in terms of Deferred Tax Assets/Deferred Tax Liability for the year ended 31.03.2021. (RTP May 22)

Answer 5

Impact of various items in terms of deferred tax liability/deferred tax asset as per AS 22

Transactions	Analysis	Nature of difference	Effect	Amount
Disallowances,as per IT Act, of earlier years	Tax payable for the earlier year washigher on this account.	Timing difference	Reversal ofDTA	Rs. 20 lakhX 30% = Rs. 6 lakh

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Interest to financial institutions	It is allowed as deduction under IT Act, if the payment is made before the due date of filing the return of income	No timingdifference	Not applicable	Not applicable
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable

Question 6

Is it permissible not to recognize deferred tax liability on the ground that the Company expects that there will be losses both for accounting and tax purposes in near future? You are required to give advice to the company. (RTP May 19)

Answer 6

The Company should provide for deferred tax liability on the timing differences irrespective for the fact that these timing differences will reverse in the period in which the Company expects to be in loss both from the accounting as well as tax point of view. It may, however, be added that the deferred tax liability recognized at the balance sheet date will give rise to future taxable income at the time of reversal thereof.

Question 7

(i) **Define followings as per AS 22:**

(ii) **Accounting income (loss)**

(iii) **Taxable income (tax loss)**

Tax expense (tax saving) (RTP Nov'22)

Answer 7

Accounting income (loss) is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income-tax expense or adding income tax saving.

Taxable income (tax loss) is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income-tax payable (recoverable) is determined.

Taxable expenses is the aggregate of current tax and deferred tax charged or credited to the statementof profit and loss for the period.

Question 8

The following particulars are stated in the Balance Sheet of Deep Limited as on 31st March, 2020:

	(₹ In Lakhs)
Deferred Tax Liability (Cr.)	**28.00**
Deferred Tax Assets (Dr.)	**14.00**

The following transactions were reported during the year 2020 -2021:

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(i) **Depreciation as per books was ₹ 70 Lakhs whereas Depreciation for Tax purposes was ₹ 42 Lakhs. There were no additions to Fixed Assets during the year.**

(ii) **Expenses disallowed in 2019-20 and allowed for tax purposes in 2020-21 were ₹ 14 Lakhs.**

(iii) **Share issue expenses allowed under section 35(D) of the Income Tax Act, 1961 for the year 2020-21 (1/10th of ₹ 70.00 lakhs incurred in 2019-20).**

(iv) **Repairs to Plant and Machinery were made during the year for ₹ 140.00 Lakhs and was spread over the period 2020-21 and 2021-22 equally in the books. However, the entire expenditure was allowed for income-tax purposes in the year 2020-21.**

Tax Rate to be taken at 40%. You are required to show the impact of above items on Deferred Tax Assets and Deferred Tax Liability as on 31st March, 2021. (PYP 5 Marks July 21)

Answer 8

Impact of various items in terms of deferred tax liability/deferred tax asset on 31.3.21

Transactions	Analysis	Nature of difference	Effect	Amount (₹)
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	28 lakhs X 40% = ₹ 11.20 lakhs
Disallowances, asper IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Respondingtiming difference	Reversal ofDTA	14 lakhs X 40% = 5.6 lakhs
Share issue expenses	Due to disallowance of full expenditure under IT Act, tax payable in the earlier years was higher.	Responding timing difference	Reversal of DTA	7 lakhs X 40% = ₹ 2.8 lakhs
Repairs to plantand machinery	Due to allowance of full expenditure under IT Act, tax payable of the current year will be less.	Originatingtiming difference	Increase inDTL	70 lakhs X 40% =28 lakhs

Question 9

The following particulars are stated in the Balance Sheet of HS Ltd. as on 31 -3-2019 :

Particulars	(₹ in lakhs)
Deferred Tax Liability (Cr.)	**60.00**

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Deferred Tax Assets (Dr.)	**30.00**
The following transactions were reported during the year 2019-20 :	
Depreciation as per accounting records	**160.00**
Depreciation as per income tax records	**140.00**
Items disallowed for tax purposes in 2018-19 but allowed in 2019-20	**20.00**
Donation to Private Trust	**20.00**
Tax rate	**30%**

There were no additions to fixed assets during the year. You are required to show the impact of various items on Deferred Tax Assets and Deferred Tax Liability as on 31-3-2020 as per AS-22. (PYP 5 Marks Jan 21, RTP May 20)

Answer 9

Impact of various items in terms of AS 22 deferred tax liability/deferred tax asset

(1) Difference in Depreciation- Generally, written down value method of depreciation is adopted under income Tax Act which leads to higher depreciation in earlier years of useful life of the asset in comparisonto later years. It is timing difference for which reversal of Deferred tax liability is required. Reversal of DTL= ₹ (160 – 140) Lakhs X 30% = ₹6 Lakhs

(2) Disallowances, as per IT Act of earlier years- Due to disallowance tax payable for the earlier years was higher on this account. It is responding timing difference which required Reversal of Deferred tax assets.

Reversal of Deferred tax assets = ₹20 Lakhs X 30% = ₹ 6 Lakhs

(3) Donations to private trusts is not an allowable expenditure under IT Act. It is permanent difference.Hence, no reversal of tax is required.

Question 10

From the following details of Aditya Limited for accounting year ended on 31st March, 2020:

Particulars	₹
Accounting profit	**15,00,000**
Book profit as per MAT	**7,50,000**
Profit as per Income tax Act	**2,50,000**
Tax Rate	**20%**
MAT Rate	**7.5%**

Calculate the deferred tax asset/liability as per AS 22 and amount of tax to be debited to the profit and loss account for the year. (PYP 5 Marks, Nov 20) (Same concept different figures RTP Nov'19 & Nov '23, PYP 5 Marks Nov'19, Old & New SM)

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Answer 10

Tax as per accounting profit 15,00,000X20%= ₹ 3,00,000

Tax as per Income-tax Profit 2,50,000X20% =₹ 50,000Tax as per MAT 7,50,000X7.50%= ₹ 56,250

Tax expense= Current Tax +Deferred Tax

₹ 3,00,000 = ₹ 50,000+ Deferred tax Therefore, Deferred Tax liability as on 31-03-2020

= ₹ 3,00,000 – ₹ 50,000 = ₹ 2,50,000

Amount of tax to be debited in Profit and Loss account for the year 31-03-2020 Current Tax +Deferred Tax liability + Excess of MAT over current tax

= ₹ 50,000 + ₹ 2,50,000 + ₹ 6,250 (56,250 – 50,000) = ₹ 3,06,250

Question 11

Write short note on Timing difference and Permanent Difference as per AS 22. (PYP 5 Marks, May 19)
Answer 11

Matching of taxes against revenue for a period poses special problems arising from the fact that in

number of cases, taxable income may be different from the accounting income. The divergence between taxable income may be different from the accounting income arises due to two main reasons: Firstly, there are differences between items of revenue and expenses as appearing in the statementof profit and loss and the items which are considered as revenue, expenses or deductions for tax purposes, known as Permanent Difference. Secondly, there are differences between the amount in respect of a particular item of revenue or expense as recognised in the statement of profit and loss and the corresponding amount which is recognised for the computation of taxable incom e, known as Timing Difference.

Permanent differences are the differences between taxable income and accounting income which arise in one accounting period and do not reverse subsequently. For example, an income exempt from tax or an expense that is not allowable as a deduction for tax purposes.

Timing differences are those differences between taxable income and accounting income which arise in one accounting period and are capable of reversal in one or more subsequent periods. For e.g., Depreciation, Bonus, etc.

Question 12

As per AS 22 on 'Accounting for Taxes on Income', tax expense is

a. Current tax + deferred tax charged to profit and loss account
b. Current tax-deferred tax credited to profit and loss account
c. Either (a) or (b)

Ans: (c)

Question 13

G Ltd. has provided the following information:

Depreciation as per accounting records =Rs. 2,00,000

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Depreciation as per tax records = Rs. 5,00,000

There is adequate evidence of future profit sufficiency.

How much deferred tax asset/liability should be recognized as transitionadjustment when the tax rate is 50%?

d. Deferred Tax asset = Rs. 2,70,000.

e. Deferred Tax asset = Rs. 1,35,000.

f. Deferred Tax Liability = Rs. 2,70,000

g. Deferred Tax Liability = Rs. 1,35,000.

Ans: (d)

Question 14

State which of the followings statements are correct:

(1) There are no pre-conditions required to recognize deferred tax liability,

(2) Deferred tax asset under all circumstances can only be created if andonly if there is reasonable certainty that future taxable income will arise.

a. Both are correct.

b. Only (1) is correct.

c. Only (2) is correct.

d. None of the statements are correct.

Ans: (a)

Question 15

Which of the following statement are incorrect:

h. Only timing differences result in creation of deferred tax.

i. Permanent differences do not result in recognition of deferred tax.

j. The tax rate used for measurement of deferred tax is substantively enacted tax rate.

k. The entity has to recognize deferred tax liability/asset arising out of timing difference. There are no conditions which are required to evaluated for their recognition.

Ans: (d)

Theoretical Questions Answers

Question 16

Write short note on Timing differences and Permanent differences as per AS 22.

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Answer 16

In current practices, companies, in general, prepare books of accounts as per Companies Act, 2013 generating Accounting Profit/Loss and Income-tax Act, 1961 generating Taxable Profit/Loss. Accounting income and taxable income for a period are seldom the same. Permanent differences are those which arise in one period and do not reverse subsequently. For e.g., an income exempt from tax or an expense that is not allowable as a deduction for tax purposes. Timing differences are those which arise in one period and are capable of reversal in one or more subsequent periods. For e.g., Depreciation etc.

Practical Questions Answers

Question 17

Y Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference resulting in a tax liability in year 1 and 2 is ₹ 200 lakhs and ₹ 400 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by ₹ 10 lakhs. Assuming tax rate of 40%, find out the deferred tax liability at the end of the second year and any charge to the Profit and Loss account.

Answer 17

As per AS 22, 'Accounting for Taxes on Income', deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognised to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income-tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognised in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of ₹ 200 lakhs timing difference due to depreciation, difference amounting ₹ 80 lakhs (₹ 10 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognised. However, for ₹ 120 lakhs (₹ 200 lakhs – ₹ 80 lakhs), deferred tax liability will be recognised for ₹ 48 lakhs (40% of ₹ 120 lakhs) in first year. In the second year, the entire amount of timing difference of ₹ 400 lakhs will reverse only after tax holiday period and hence, will be recognised in full. Deferred tax liability amounting ₹ 160 lakhs (40% of ₹ 400 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be ₹ 208 lakhs (48 lakhs + 160 lakhs).

Question 18

Ultra Ltd. has provided the following information:

Depreciation as per accounting records =₹ 4,00,000 Depreciation as per tax records =₹ 10,00,000

Unamortized preliminary expenses as per tax record = ₹ 30,000 There is adequate evidence of future profit sufficiency. How much deferred tax asset/liability should be recognized as transition adjustment when the tax rate is 50%?

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Answer 18

Calculation of difference between taxable income and accounting income

Particulars	Amount (₹)
Excess depreciation as per tax ₹ (10,00,000 – 4,00,000)	6,00,000
Less: Expenses unamortized in tax records	(30,000)
Timing difference	5,70,000

Tax expense is more than the current tax due to timing difference. Therefore deferred tax liability

= 50% x 5,70,000 = ₹ 2,85,000

Questions 19

Saras Ltd. closes its books as on 31st March 20X2. They have accrued Rs. 5,00,000 towards GST Liability for the month of March 20X2 by debiting their Profit and loss statement which is expected to be paid off by 21st April20X2 . As per the provisions of Section 43B of the Income Tax Act, 1961 – Any expenditure of the nature mentioned in section 43B (e.g. taxes, duty, cess, fees, etc.) accrued in the statement of profit and loss on mercantile basis willbe allowed for tax purposes in subsequent years on payment basis only. Assuming a Tax rate of 30% determine the Deferred Tax Asset/Liability as at31st March 20X2.

Answer 19

Calculation of difference between taxable income and accounting income

Particulars	Amount (Rs.)
GST Liability debited in books	5,00,000
Less: GST Liability allowed under Income Tax Act (Section 43B)Timing difference	Nil
	5,00,000

Tax expense is less than the current tax due to timing difference.Therefore, deferred tax Asset = 30% x 5,00,000 = 1,50,000

Questions 20

ABC Company limited had an investment in Venture Capital amounting Rs. 10 Crores. Venture capital in turn had invested in the below portfolio companies (New Start- ups) on behalf of ABC Limited:

Portfolio Companies	Amount of investment (Rs. in Crores)
Oscar Limited	2
Zee Limited	3
Star Limited	4

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Sony Limited	**1**
Total	**10**

During the FY 2019-2020, Venture Capital had sold their investment in Star Limited and realised an amount of Rs. 8 Crores on sale of shares of star Limited and entire proceeds of Rs. 8 Crores have been transferred by Venture Capital to ABC Company Limited.

The accounts manager has received the following additional information from venture capital on 31.03.2020:

(1) **8 Crores has been deducted from the cost of investment and carrying amount of investment asat year end is 2 Crores.**

(2) **Company had to pay a capital gain tax @ 20% on the net sale consideration of Rs. 4 Crores.**

(3) **Due to COVID-19, the remaining start- ups (i.e. Oscar Limited, Zee Limited, and Sony Limited) are not performing well and will soon wind up their operations. Venture capital is monitoring the situation and if required they will provide an impairment loss in June 2020 Quarter.**

You need to suggest the accounts manager what should be the correct accounting treatment as per AS 22 "Accounting for Taxes on Income".

Answer: 20

As company had to pay capital gain tax @ 20% on the net sale consideration as per income tax laws, the company has to recognise a current tax liability of 0.8 Crores computed as under:

Particulars	**Amount** (Rs. **in Crores**)
Sales Consideration	8
Cost of Investment	4
Net gain on Sale	4
Tax @ 20%	0.8

As per AS 22, Timing differences are those differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.

Particulars	**Amount** (Rs. **in Crores**)	**Rationale**
Taxable Income	4	As per income tax laws
AccountingIncome	Nil	As the same is deductedfrom the cost of investment
Timing Difference	4	

As per AS 22, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets canbe realised.Since in current scenario, due to Covid 19 the portfolio companies are not performing well, thus the company may not have sufficient future taxable income which will reverse deferred tax assets. Therefore, the company should not recognise DTA of Rs. 0.8 Crores and company should recognise only current tax liability of Rs. 0.8 Crores.

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Question 21 (Illustration)

Rama Ltd., has provided the following information:

	₹
Depreciation as per accounting records	**= 2,00,000**
Depreciation as per income tax records	**= 5,00,000**
Unamortised preliminary expenses as per tax record	**= 30,000**

There is adequate evidence of future profit sufficiency. How much deferred tax asset/liabilityshould be recognised as transition adjustment? Tax rate 50%.

Answer 21

Table showing calculation of deferred tax asset / liability

Particulars	Amount	Timing differences	Deferred tax	Amount @ 50%
	₹			₹
Excess depreciation as per tax records (₹ 5,00,000 – ₹ 2,00,000)	3,00,000	Timing	Deferred tax liability	1,50,000
Unamortized preliminary expenses as per tax records	30,000	Timing	Deferred tax asset	(15,000)
Net deferred tax liability				1,35,000

Question 22 (Illustration)

From the following details of A Ltd. for the year ended 31-03-20X1, calculate the deferred tax asset/ liability as per AS 22 and amount of tax to be debited to the Profit and Loss Account for the year.

Particulars	₹
Accounting Profit	**6,00,000**
Book Profit as per MAT	**3,50,000**
Profit as per Income Tax Act	**60,000**
Tax rate	**20%**
MAT rate	**7.50%**

Answer 22

Tax as per accounting profit 6,00,000 X 20%= ₹ 1,20,000Tax as per Income-tax Profit 60,000 X 20% =₹ 12,000

Tax expense= Current Tax +Deferred Tax ₹ 1,20,000 = ₹ 12,000+ Deferred tax Therefore, DeferredTax liability as on 31-03-20X1 = ₹ 1,20,000 – ₹ 12,000 = ₹ 1,08,000

Amount of tax to be debited in Profit and Loss account for the year 31-03-20X1 Current TaxDeferred Tax liability + Excess of MAT over current tax

= ₹ 12,000 + ₹ 1,08,000 + ₹ 14,250 (26,250 – 12,000) = ₹ 1,34,250

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Question 23 (Illustration)

PQR Ltd.'s accounting year ends on 31st March. The company made a loss of ₹ 2,00,000 for the year ending 31.3.20X1. For the years ending 31.3.20X2 and 31.3.20X3, it made profits of ₹ 1,00,000 and ₹ 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.20X1, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the years ending 20X2 and 20X3 for tax purposes. Prepare a statement of Profit and Loss for the years ending 20X1, 20X2 and 20X3.

Answer 23

Statement of Profit and Loss

	31.3.20X1	31.3.20X2	31.3.20X3
	₹	₹	₹
Profit (Loss)	(2,00,000)	1,00,000	1,20,000
Less: Current tax (20,000 x 40%)			(8,000)
Deferred tax:			
Tax effect of timing differences originating duringthe year (2,00,000 x 40%)	80,000		
Tax effect of timing differences reversed/ adjusteddurin g the year (1,00,000 x 40%)		(40,000)	(40,000)
Profit (Loss) After Tax Effect	(1,20,000)	60,000	72,000

Question 24 (Illustration)

Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognises revenue from these contracts on percentage of completion method for financial statements during 20X0-20X1, 20X1-20X2 and 20X2-20X3 for ₹ 11,00,000, ₹ 16,00,000 and ₹ 21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognised revenue of ₹ 7,00,000, ₹ 18,00,000 and ₹ 23,00,000 for the years 20X0-20X1, 20X1-20X2 and 20X2-20X3 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/ liability for the years 20X0-20X1, 20X1- 20X2 and 20X2-20X3.

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Answer 24

Calculation of Deferred Tax Asset/Liability in Omega Limited

Year	Accounting Income	Taxable Income	Timing Difference	Timing Difference (balance)	Deferred Tax	Deferred Tax Liability (balance)
20X0-20X1	11,00,000	7,00,000	4,00,000	4,00,000	1,40,000	1,40,000
20X1-20X2	16,00,000	18,00,000	(2,00,000)	2,00,000	(70,000)	70,000
20X2-	21,00,000	23,00,000	(2,00,000)	NIL	(70,000)	NIL
20X3	48,00,000	48,00,000				

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Chapter 8.1

AS 7- Construction Contracts

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.16 TO Q.33											
Past Exams	Q.3	NO	Q.13	NO	NO	Q.14	NO	Q.7	NO	NO	Q.3	NO
MTP	Q.1	Q.1 Q.2	NO	Q.1	NO	Q.5	Q.5	Q.3 Q.4	Q.3 Q.5 Q.15	Q.6 Q.7	Q.3	Q.5 Q.14
RTP	Q.10	Q.10	Q.1	Q.6	Q.11	Q.10	Q.9	Q.8	Q.12	Q.6	Q.9 Q.13	Q.9 Q.13

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Chapter 8.1

AS 7- Construction Contracts

Question 1

X Ltd. negotiates with Bharat Petroleum Corporation Ltd (BPCL), for construction of "Franchise Retail Petrol Outlet Stations". Based on proposals submitted to different Zonal offices of BPCL, the final approval for one outlet each in Zone A, Zone B, Zone C, Zone D, is awarded to X Ltd. Agreement (in single document) is entered into with BPCL for Rs. 490 lakhs. The agreement lays down values for each of thefour outlets (Rs. 88 + 132 + 160 + 110 lakhs) in addition to individual completion time. You are requiredto examine and comment whether X Ltd., will treat it as a single contract or four separate contracts. (MTP Oct '19, MTP Mar'18, MTP Aug'18 5 Marks) (Same concepts different figures RTP May'19)

Answer 1

As per AS 7 on 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able toaccept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

In the given case, each outlet is submitted as a separate proposal to different Zonal Office, which canbe separately negotiated, and costs and revenues thereof can be separately identified. Hence, each asset will be treated as a "single contract" even if there is one document of contract. Therefore, four separate contractaccounts have to be recorded and maintained in the books of X Ltd. For each contract,principles of revenueand cost recognition have to be applied separately and net income will be determined for each asset as perAS 7.

Question 2

M/s Highway Constructions undertook the construction of a highway on 01.04.2016. The contract was to be completed in 2 years. The contract price was estimated at Rs.150 crores. Up to 31.03.2017 the company incurred Rs. 120 crores on the construction. The engineers involved in the project estimated that a further Rs. 45 crores would be incurred for completing the work. What amount should be charged to profit and loss statement for the year 2016 -17 as per the provisions of Accounting Standard 7 "Construction Contracts"? (MTP Oct'18 5 Marks)

Answer 2

Statement showing amount to be charged to Profit and Loss Statement as per AS 7

	Rs. in crores
Cost of construction incurred upto 31.03.2017Add:	120
Estimated future cost	45
Total estimated cost of construction	165
Degree of completion (120/165 x 100)	72.73%

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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 in the P&L statement	4

Question 3

PRZ & Sons Ltd. are Heavy Engineering contractors specializing in construction of dams. From the records of the company, the following data is available pertaining to year ended 31st March, 2021:

	(Rs. crore)
Total Contract Price	**2,400**
Work Certified	**1,250**
Work pending certification	**250**
Estimated further cost to completion	**1,750**
Stage wise payments received	**1,100**
Progress payments in pipe line	**300**

Using the given data and applying the relevant Accounting Standard you are required to:Compute the amount of profit/loss for the year ended 31st March, 2021.

(i) Arrive at the contract work in progress as at the end of financial year 2020-21.

(ii) Determine the amount of revenue to be recognized out of the total contract value.

Work out the amount due from/to customers as at year end. (MTP 5 Marks Oct '21 & April '23)(Same concept different figures MTP 5 Marks Mar'22, PYP 5 Marks May'18 & May '23)

Answer 3

(i)	**Calculation of profit/ loss for the year ended 31st March, 2021**	*(Rs. in crores)*
	Total estimated cost of construction (1,250 + 250 + 1,750)	3,250
	Less: Total contract price	(2,400)
	Total foreseeable loss to be recognized as expense	850

According to AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costswill exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(ii)	**Contract work-in-progress i.e. cost incurred to date**	*(Rs. in crores)*
	Work certified	1,250
	Work not certified	250
		1,500

(iii) Proportion of total contract value recognized as revenue

Percentage of completion of contract to total estimated cost of construction

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= (1,500 / 3,250) X 100 = 46.15%

Revenue to be recognized till date = 46.15% of Rs. 2,400 crores = Rs. 1,107.60 crores.

(iv) Amount due from / to customers = Contract costs + Recognized profits – Recognized losses – (Progresspayments received + Progress payments to be received)

= Rs. [1,500 + Nil – 850 – (1100 + 300)] crores

= Rs. [1,500 – 850 – 1,400] crores

Amount due to customers (shown as liability) = Rs. 750 crores.

Question 4

A contractor firm obtained a contract for construction of bridge. The following details are available in the records kept for the year ended March 31, 2021:

	(Rs. In Crore)
Total Contract Price	**500**
Work Certified	**250**
Work not Certified	**80**
Estimated further Cost to Completion	**220**
Progress Payment Received	**200**
Payment to be Received	**70**
You are required to calculate :	

The amount of revenue to be recognized.

(i) The amount of profit or loss to be recognized.

(ii) The amount due from/ to customers.

Also present relevant disclosures as per AS-7 (Revised). (MTP 5 Marks Nov '21)(Same concept different figures Old & New SM)

Answer 4

(i) Proportion of total contract value recognized as revenue

Percentage of completion of contract to total estimated cost of construction = [(250 + 80) / (250 +80 +220)]X 100 = 60% Revenue to be recognized till date = 60% of Rs. 500 crore = Rs. 300 crore.

(ii)

Calculation of profit/ loss for the year ended 31st March, 2021		*(Rs. in crore)*
Total estimated cost of construction		
Work certified	250	
Work not certified	80	
Estimated further cost to completion	220	550
Less: Total contract price		(500)
Total foreseeable loss to be recognized as expense		50

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According to AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(iii) **Amount due from / to customers** = Contract costs incurred till date + Recognized profits – Recognizedlosses – (Progress payments received + Progress payments to be received)

= Rs. [(250 + 80) + Nil – 50 – (200 + 70)] crore = Rs. [330 – 50 – 270] crore

Amount due from customers (shown as an asset) = Rs. 10 crore.

(iv) **The relevant disclosures under AS 7 (Revised) are given below:**

	Rs. in crores
Contract revenue till 31st March, 2021	300
Contract expenses till 31st March, 2021	330
Recognized losses for the year 31st March, 2021	50
Progress billings Rs. (200+ 70)	270
Progress (billed but not received from contractee)	70
Gross amount due from customers	10

Question 5

Bricks Ltd. signed on 01/04/21, a construction contract for Rs. 1,50,00,000. Following particulars are extracted in respect of contract, for the period ending 31/03/22:

- Materials issued Rs. 75,00,000
- Labour charges paid Rs. 36,00,000
- Hire charges of plant Rs. 10,00,000
- Other contract cost incurred Rs. 15,00,000
- Out of material issued, material lying unused at the end of period is Rs. 4,00,000
- Labour charges of Rs. 2,00,000 are still outstanding on 31.3.22.

- **It is estimated that by spending further Rs. 33,50,000 (including material unused Rs. 4,00,000), the work can be completed in all respect. You are required to compute profit/ loss to be taken to Profit & Loss Account and additional provision for foreseeable loss as per AS 7. (MTP 5 Marks April 22, Mar 21 ,Oct 20 & Oct '23 Old & New SM)**

Answer 5

Statement showing the amount of profit/loss to be taken to Profit and Loss Account and additional provision for the foreseeable loss as per AS 7

	Cost of Construction	Rs.	Rs.
	Material Issued	75,00,000	
Less:	Unused Material at the end of period	4,00,000	71,00,000
	Labour Charges paid	36,00,000	

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Add:	Outstanding on 31.03.2022	2,00,000	38,00,000

	Hire Charges of Plant		10,00,000
	Other Contract cost incurred		15,00,000
	Cost incurred upto 31.03.2022		1,34,00,000
Add:	Estimated future cost		33,50,000
	Total Estimated cost of construction		1,67,50,000
	Degree of completion (1,34,00,000/1,67,50,000 x 100)		80%
	Revenue recognized (80% of 1,50,00,000)		1,20,00,000
	Total foreseeable loss (1,67,50,000 - 1,50,00,000)		17,50,000
Less:	Loss for the current year (1,34,00,000 - 1,20,00,000)		14,00,000
	Loss to be provided for		3,50,000

Question 6

On 1st December, 2019, Mahindra Construction Co. Ltd. undertook a contract to construct a building for ₹ 170 lakhs. On 31st March, 2020, the company found that it had already spent ₹ 1,29,98,000 on the construction. Prudent estimate of additional cost for completion was ₹ 64,02,000. Calculate total estimated loss on contract and what should be shown in statement of profit and loss account as contract revenue and contract cost in the final accounts for the year ended 31 st March, 2020, as per provision of Accounting Standard 7 (Revised).(MTP 5 Marks Sep'22) (Same concept different figures Old & New SM, RTP Nov'19, Nov'22)

Answer 6

	₹
Cost incurred till 31st March, 2020	129,98,000
Prudent estimate of additional cost for completion	64,02,000
Total cost of construction	194,00,000
Less: Contract price	(170,00,000)
Total foreseeable loss	24,00,000

As per AS 7 Construction Contracts, when it is probable that total contract costs will exceed total contractrevenue, the expected loss should be recognized as an expense immediately. Hence the foreseeable loss of ₹ 24,00,000 should be recognized as an expense immediately in the year ended 31st March 2020.

Contract work in progress = 129,98,000/194,00,000 X 100= 67% Proportion of contract value recognized as turnover as per AS 7 = 67% of ₹ 170,00,000 = ₹ 113,90,000.

Question 7

The following data is provided for M/s. Raj Construction Co.

(i) **Contract Price - ₹ 85 lakhs**

(ii) **Materials issued - ₹ 21 Lakhs out of which Materials costing ₹ 4 Lakhs is still lying unused.**

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at the endof the period.

(iii) **Labour Expenses for workers engaged at site - ₹ 16 Lakhs (out of which ₹ 1 Lakh is still unpaid)**

(iv) **Specific Contract Costs = ₹ 5 Lakhs**

(v) **Sub-Contract Costs for work executed - ₹ 7 Lakhs, Advances paid to Suh-Contractors - ₹ 4 Lakhs**

(vi) **Further Cost estimated to be incurred to complete the contract - ₹ 35 Lakhs**

You are required to compute the Percentage of Completion, the Contract Revenue and Cost to berecognized as per AS-7.(MTP 5 Marks Oct'22, PYP 5 Marks July 21)

Answer 7

Computation of contract cost

	₹ Lakh	₹ Lakh
Material cost incurred on the contract (net of closing stock)	21-4	17
Add labour cost incurred on the contract (including outstanding amount)		16Pa
Specified contract cost	giv-en	5
Sub-contract cost (advances should not be considered)		7
Cost incurred (till date)		45
Add: further cost to be incurred		35
Total contract cost		80

Percentage of completion = Cost incurred till date/Estimated total cost

= ₹ 45,00,000/₹ 80,00,000

= 56.25%

Contract revenue and costs to be recognized

Contract revenue (₹ 85,00,000x56.25%) = ₹ 47,81,250

Contract costs = ₹ 45,00,000

Question 8

(a) **In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably only when certain conditions prescribed under AS 7 are satisfied. You are required to describe these conditions mentioned in the standard.**

(b) **Mr. 'X' as a contractor has just entered into a contract with a local municipal body for building a flyover. As per the contract terms, 'X' will receive an additional Rs. 2 crore if the construction of the flyover were to be finished within a period of two years of the commencement of the contract. Mr. X wants to recognize this revenue since in the past he has been able to meet similar targets very easily. Is X correct in his proposal? Discuss. (RTP Nov '21)**

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Answer 8

(a) In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:

(i) total contract revenue can be measured reliably;

(ii) it is probable that the economic benefits associated with the contract will flow to the enterprise;

(iii) both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and

(iv) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

(b) According to AS 7 (Revised) 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when: (i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and (ii) the amount of the incentive payment can be measured reliably. In the given problem, the contract has not even begun and hence the contractor (Mr. X) should not recognize any revenue of this contract.

Question 9

(a) **Sky Limited belongs to Heavy Engineering Contractors specializing in construction of Flyovers. The company just entered into a contract with a local municipal corporation for building a flyover. No activity has started on this contract.**

As per the terms of the contract, Sky Limited will receive an additional Rs. 50 lakhs if the construction of the flyover were to be finished within a period of two years from the commencement of the contract. The Accountant of the entity wants to recognize this revenue since in the past the company has been able to meet similar targets very easily. Give your opinion on this treatment.

(b) ABC Ltd., a construction contractor, undertakes the construction of commercial complex for XYZ Ltd. ABC Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreementis entered into between the two parties. The agreement lays down the value of each of the 3 units i .e. Rs. 50 lakh, Rs. 60 lakh and Rs. 75 lakh respectively. Agreement also lays down the completion time for each unit. Comment, with reference to AS 7, whether ABC Ltd., should treat it as a single contract or three separate contracts. (RTP May '21 May '23 & Nov '23)

Answer 9

(a) According to AS 7 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive paymentsare included in contract revenue when both the conditions are met:

(i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and

the amount of the incentive payment can be measured reliably.

(a) In the given problem, the contract has not even begun and hence the contractor (Sky Limited) should not recognize any revenue of this contract. Therefore, the accountant's contention for recognizing Rs. 50 lakhs as revenue is not correct.

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(b) As per AS 7 'Construction Contracts', when a contract covers a number of assets, the construction of eachasset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have beenable to accept or reject that part of the contract relating to each asset; and the costs and revenues of each asset can be identified.

(c) ABC Ltd. has submitted separate proposals for each of the 3 units of commercial complex. Also the revenue and completion time has been laid down for each unit separately which implies separate negotiation for them.

Therefore, ABC Ltd. is required to treat construction of each unit as a separate construction contract as the above-mentioned conditions of AS 7 are fulfilled in the given case.

Question 10

Uday Constructions undertake to construct a bridge for the Government of Uttar Pradesh. The construction commenced during the financial year ending 31.03.2019 and is likely to be completed by the next financial year. The contract is for a fixed price of Rs. 12 crore with an escalation clause. You are given the following information for the year ended 31.03.2019:

Cost incurred upto 31.03.2019	**Rs. 4 crore**
Further cost estimated to complete the contract	**Rs. 6 crore**

Escalation in cost was by 5%. Hence, the contract price is also increased by 5%.

You are requir

ed to ascertain the stage of completion and compute the amount of revenue and profit to be recognized for the year as per AS 7. (RTP Nov'20, Nov '18 & May '18)

Answer 10

	Rs. in crore
Cost of construction of bridge incurred upto 31.3.2019	4.00
Add: Estimated future cost	6.00
Total estimated cost of construction	10.00
Contract Price (12 crore x 1.05)	12.60 crore

Stage of completion

Percentage of completion till date to total estimated cost of construction

= (4/10)X100 = 40%

Revenue and Profit to be recognized for the year ended 31st March, 2019 as per AS 7:

Proportion of total contract value recognized as revenue

= Contract price x percentage of completion

= Rs. 12.60 crore x 40% = Rs. 5.04 crore Profit for the year ended 31st March, 2019 = Rs. 5.04 crore – Rs.4 crore = 1.04 crore.

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Question 11

A construction contractor has a fixed price contract for Rs. 9,000 lacs to build a bridge in 3 years time frame. A summary of some of the financial data is as under:

(Amount Rs. in lacs)

	Year 1	Year 2	Year 3
Initial Amount for revenue agreed in contract	9,000	9,000	9,000
Variation in Revenue (+)	-	200	200
Contracts costs incurred up to the reporting date	2,093	6,168*	8,100**
Estimated profit for whole contract	950	1,000	1,000

***Includes Rs. 100 lacs for standard materials stored at the site to be used in year 3 to complete the work.**Excludes Rs. 100 lacs for standard material brought forward from year 2. The variation in cost andrevenue 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). (RTP May'20, Old & New SM)

Answer 11

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are computed below: (Amount in Rs. L**akhs)**

	Up to the reporting date	Recognized inprevious years	Recognized incurrent year
Year 1			
Revenue (9,000 x 26%)	2,340	-	2,340
Expenses (8,050 x 26%)	2,093	-	2,093
Profit	**247**	**-**	**247**
Year 2			
Revenue (9,200 x 74%)	6,808	2,340	4,468
Expenses (8,200 x 74%)	6,068	2,093	3,975
Profit	**740**	**247**	**493**
Year 3			
Revenue (9,200 x 100%)	9,200	6,808	2,392
Expenses (8,200 x 100%)	8,200	6,068	2,132
Profit	**1,000**	**740**	**260**
Working Note:			
	Year 1	**Year 2**	**Year 3**
Revenue after considering variations	9,000	9,200	9,200

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Less: Estimated profit for whole contract	950	1,000	1,000
Estimated total cost of thecon-tract (A)	8,050	8,200	8,200
Actual cost incurred upto the reporting	2,093	6,068	8,200
date (B)		(6,168 -100)	(8,100+100)
Degree of completion (B/A)	26%	74%	100%

Question 12

B Ltd. undertook a construction contract for Rs. 50 crores in April, 2020. The cost of construction was initially estimated at Rs. 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated that the cost of completion of the contract would be Rs. 53 crores.

Can the company provide for the expected loss in the financial Statements for the year ended 31st March, 2021? Explain. (RTP May 22)

Answer 12

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 recognized as an expense immediately. Therefore, the foreseeable loss of Rs. 3 crores (Rs. 53 crores less Rs. 50 crores) should be recognized as an expense immediately in the year ended 31st March, 2021. 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 provisions of AS 7.

Question 13

On 1st December, 2021, GR Construction Co. Ltd. undertook a contract to construct a building for Rs. 45 lakhs. On 31st March, 2022, the company found that it had already spent Rs. 32.50 lakhs on theconstruction. Additional cost of completion is estimated at Rs. 15.10 lakhs. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2022 as per provisions of AS-7? (RTP May '23 & Nov '23 , PYP 5 Marks May '19)

Answer 13

	Rs. in lakhs
Cost of construction incurred till date	32.50
Add: Estimated future cost	15.10
Total estimated cost of construction	47.60

Percentage of completion till date to total estimated cost of construction

$$= (32.50/47.60) \times 100 = 68.28\%$$

Proportion of total contract value recognized as revenue for the year ended 31st March,2022 per AS 7 (Revised)

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= Contract price x percentage of completion

= Rs. 45 lakh x 68.28% = Rs. 30.73 lakhs.

	(Rs. in lakhs)
Total cost of construction	47.60
Less: Total contract price	(45.00)
Total foreseeable loss to be recognized as expense	2.60

According to of AS 7, when it is probable that total contract costs will exceed total contractrevenue, the expected loss should be recognized as an expense immediately.

Question 14

Rajendra undertook a contract ₹ 20,00,000 on an arrangement that 80% of the value of work done, as certified by the architect of the contractee should be paid immediately and that the remaining 20% be retained until the Contract was completed. In Year 1, the amounts expended were ₹ 8,60,000, the workwas certified for ₹ 8,00,000 and 80% of this was paid as agreed. It was estimated that future expenditure to complete the Contract would be ₹ 10,00,000. In Year 2, the amounts expended were ₹ 4,75,000. Three-fourth of the work under contract was certified as done by December 31st and 80% of this was received accordingly. It was estimated that future expenditure to complete the Contract would be ₹ 4,00,000. In Year 3, the amounts expended were ₹ 3,10,000 and on June 30th, the whole Contract was completed. Show how Contract revenue would be recognized in the P & L A/c of Mr. Rajendra each year. (PYP 5 Marks , Nov 20)(MTP 5 Marks Sep '23)

Answer 14

(a) Year 1	₹
Actual expenditure	8,60,000
Future estimated expenditure	10,00,000
Total Expenditure	18,60,000

% of work completed = $\frac{8,60,000}{18,60,000} \times 100$ = 46.24%(Rounded off)

Revenue to be recognized (cumulative) = 20,00,000 x 76.95% = 15,39,000

Less: revenue recognized in Year 1 = (9,24,800)

Revenue to be recognized in Year 2 ₹ 6,14,200

Year 2

Actual Expenditure 4,75,000

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Future Expenditure	4,00,000
Expenditure incurred in year 1	8,60,000
	17,35,000

% of work completed = $\frac{4,75,000+8,60,000}{17,35,000}$ = 76.95%(Rounded off)

Revenue to be recognized (cumulative) = 20,00,000 ×76.95%
= 15,39,000

Less: revenue recognized in Year 1 = (9,24,800)

Revenue to be recognized in Year 2 = Rs. 6,14,200

Year 3

Whole contract got completed therefore total contract value less revenue recognized up to year 2will be amount of revenue to be recognized in year 3 i.e. 20,00,000 – 15,39,000 (9,24,800 + 6,14,200) = ₹ 4,61,000. Note: Calendar year has been considered as accounting year.

Question 15

Grace Ltd., a firm of contractors provided the following information in respect of a contract for the year ended on 31st March,2022:

Particulars	(₹ in '000)
Fixed Price Contract with an escalation clause Work Certified	**35,000**
Work not Certified (includes ₹ 26,25,000 for materials issued, out of which material lying unused at the end of the period is ₹ 1,40,000)	**17,500**
Estimated further cost to completion	**3,815**
Progress Payment Received Payment to be Received	**17,325**
Escalation in cost is by 8% and accordingly the contract price is increased by 8%	**14,000**
	4,900

From the above information, you are required to:

I. **Compute the contract revenue to be recognized.**

II. **Calculate Profit /Loss for the year ended 31st March,2022 and additional provision for loss to be made, if any, for the year ended 31st March,2022.(MTP 5 Marks May'22)**

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Answer 15

Calculation of total estimated cost of construction

		₹ in thousand
Cost of Contract incurred till date		
Work certified	17,500	
Work not certified (3,815 thousand – 140 thousand)	3,675	21,175
Add: Estimated future cost		17,325
Total estimated cost of construction		38,500
Contract Price (35,000 thousand x 1.08)		37,800

Stage of completion

Percentage of completion till date to total estimated cost of construction = [Cost of work completed tilldate / total estimated cost of the contract] x 100

= [₹ 21,175 thousand / ₹ 38,500 thousand] x 100= 55%

Revenue to be recognized for the year ended 31stMarch, 2022

Proportion of total contract value recognized as revenue = Contract price x percentage of completion = ₹ 37,800 thousand x 55% = ₹ 20,790 thousand

Loss to be recognized for the year ended 31st March, 2022

Loss for the year ended 31stMarch, 2022 = Cost incurred till date – Revenue to be recognized for theyear ended 31st March, 2022

= ₹ 21,175 thousand – ₹ 20,790 thousand = ₹ 385 thousand

Provision for loss to be made at the end of 31stMarch, 2022

		₹ in thousand
Total estimated loss on the contract		
Total estimated cost of the contract	38,500	
Less: Total revised contract price	(37,800)	700
Less: Loss recognized for the year ended 31st March, 2022		(385)
Provision for loss to be made at the end of 31stMarch, 2022		315

Multiple Choice Questions (MCQ)

The below information relates to Questions 16– 18:

XY Ltd. agrees to construct a building on behalf of its client GH Ltd. on 1st April 20X1. The expected completion time is 3 years. XY Ltd. incurred a cost of ₹ 30 lakh up to 31st March 20X2. It is expected that additional costs of ₹ 90 lakh. Total contract value is ₹ 112 lakh. As at 31st March 20X2, XY Ltd. hasbilled GH Ltd. for ₹ 42 lakh as per the agreement. Assume that the work is completed to the extent of75% by the end of Year 2.

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Question 16

Revenue to be recognized by XY Ltd. for the year ended 31st March 20X2 is

l. ₹ 28 lakh
m. ₹ 42 lakh
n. ₹ 30 lakh
o. ₹ 32 lakh

Ans: (a)

Question 17

Total expense to be recognised in Year 1 is

e. ₹ 30 lakh
f. ₹ 120 lakh
g. ₹ 38 lakh
h. ₹ 36 lakh

Ans: (d)

Question 18

Revenue to be recognised for year 2 is

i. ₹ 84 lakh
j. ₹ 42 lakh
k. ₹ 56 lakh
l. ₹ 28 lakh

Ans: (c)

Below information relates to Questions 19 – 20

M/s AV has presented the information for Contract No.XY123:

Total contract value	**₹ 370 lakh**
Certified work completed	**₹ 320 lakh**
Costs incurred to date	**₹ 360 lakh**
Progress Payments received	**₹ 300 lakh**
Expected future costs to beincurred	**₹ 50 lakh**

Question 19

Revenue to be recognised by M/s AV is

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m. ₹ 320 lakh

n. ₹ 370 lakh

o. ₹ 360 lakh

p. ₹ 400 lakh

Ans: (a)

Question 20

Total expense to be recognised by M/s AV is

q. ₹ 360 lakh

r. ₹ 400 lakh

s. ₹ 320 lakh

t. ₹ 360 lakh

Ans: (d)

Question 21

LP Contractors undertakes a fixed price contract of ₹ 200 lakh. Transactions related to the contract include:

Material purchased: ₹ 80 lakh

Unused material: ₹ 30 lakh

Labour charges: ₹ 60 lakh

Machine used for 3 years for the contract. Original cost of the machine is ₹ 100lakh.

Expected useful life is 15 years.

Estimated future costs to be incurred to complete the contract: ₹ 80 lakh.

Losson contract to be recognised is:

u. ₹ 40 lakh

v. ₹ 10 lakh

w. ₹ 90 lakh

x. ₹ 50 lakh

Ans: (b)

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Theory Questions

Questions 22

It is argued that profit on construction contracts should not be recognised until the contract is completed. Please explain whether you believe that this suggestion would improve the quality of financial reporting for long-term construction contracts.

Answer: 22

Usually, construction contracts are long term nature i.e., the contracts areentered in one accounting period, however, the work performed will flow into more than one accounting year. If the profit on construction contracts is not recognised over the construction period, then the costs incurred during the earlier years of the contract would be recognised without any corresponding revenue. This will result in losses for initial years followed high profits in future years.

The current treatment under AS 7 results in matching of revenue and associated costs as they are recognised during the same period. Also, the current accounting incorporates the prudence concept as any foreseeable losses are accounted for immediately.

Therefore, AS 7 results in a fair representation of the underlying financialsubstance of the transaction.

Questions 23

A contractor has entered into a contract with a municipal body for construction of a flyover. As per the contract terms, the contractor will receive an additional ₹ 2 Crore as incentive if the construction of the flyover were to be finished within a period of two years from the start of the contract. The contractor wants to recognize this revenue since in the past he has been able to meet similar targets very easily.Explain whether the contractor's view-point is correct?

Answer: 23

The contractor's view is not entirely correct in considering the variation as apart of contract revenue. There is an argument that he has been able tocomplete similar contracts within stipulated time. However, each contract needs to be assessed in isolation with respect to the specific challenges associated with the timing and uncertainty in completion.

Accordingly, the contractor needs to validate the assumptions with respect to the specific contract. Only after that assessment is done, the incentive of ₹ 2 crore may be included within the contract revenue.

Question 24

A construction contractor has a fixed price contract for ₹ 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
Initial Amount for revenue agreed in contract	9,000	9,000	9,000
Variation in Revenue (+)	-	200	200
Contracts costs incurred up to the reporting date	2,093	6,168*	8,100**
Estimated profit for whole contract	950	1,000	1,000

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*Includes ₹ 100 lacs for standard materials stored at the site to be used in year 3 to complete thework.

****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 tobe recognized in the Statement of Profit and Loss as per AS-7 (revised).

Answer 24

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	2,340		2,340
Revenue (9,000 x 26%)	2,093	-	2,093
Expenses (8,050 x 26%)		-	
Profit	247	-	247
Year 2			
Revenue (9,200 x 74%)	6,808	2,340	4,468
Expenses (8,200 x 74%)	6,068	2,093	3,975
Profit	740	247	493
Year 3			
Revenue (9,200 x 100%)	9,200	6,808	2,392
Expenses (8,200 x 100%)	8,200	6,068	2,132
Profit	1,000	740	260

Working Note:

	Year 1	Year 2	Year 3
Revenue after considering variations	9,000	9,200	9,200
	950	1,000	1,000
Less: Estimated profit forwhole contract			
Estimated total cost of the contract(A)	8,050	8,200	8,200
Actual cost incurred upto thereporting 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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Question 25

Akar Ltd. Signed on 01/04/X1, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the year ended 31/03/X2.

- **Materials used ₹ 71,00,000**
- **Labour charges paid ₹ 36,00,000**
- **Hire charges of plant ₹ 10,00,000**
- **Other contract cost incurred ₹ 15,00,000**
- **Labour charges of ₹ 2,00,000 are still outstanding on 31.3.X2.**

It is estimated that by spending further ₹ 33,50,000 the work can be completed in all respect.

You are required to compute profit/loss for the year to be taken to Profit & Loss Account and anyprovision for foreseeable loss to be recognized as per AS 7.

Answer 25

Statement showing the amount of profit/loss to be taken to Profit and Loss Account and additionalprovision for the foreseeable loss as per AS 7

	Cost of Construction	₹	₹
	Material used		71,00,000
	Labour Charges paid	36,00,000	
Add:	Outstanding on 31.03.20X2	2,00,000	38,00,000
	Hire Charges of Plant		10,00,000
	Other Contract cost incurred		15,00,000
	Cost incurred upto 31.03.20X2		1,34,00,000
Add:	Estimated future cost		33,50,000
	TotalEstimatedcostofconstruction		1,67,50,000
	Degree of completion (1,34,00,000 / 1,67,50,000 x 100)		80%
	Revenue recognized (80% of 1,50,00,000)		1,20,00,000
	Total foreseeable loss (1,67,50,000 - 1,50,00,000)		17,50,000
Less:	Loss for the current year (1,34,00,000 - 1,20,00,000)		14,00,000
	Loss to be provided for		3,50,000

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Questions 26

RT Enterprises has entered into a fixed price contract for construction of a tower with its customer. Initial tender price agreed is ₹ 220 crore. At the start of the contract, it is estimated that total costs tobe incurred will be ₹ 200 crore. At the end of year 1, this estimate stands revised to ₹ 202 crore. Assume that the construction is expected to be completed in 3 years.During year 2, the customer has requested for a variation in the contract. As a result of that, the total contract value will increase by ₹ 5 crore and the costs will increase by ₹ 3 crore.

RT has decided to measure the stage of completion on the basis of the proportion of contract costsincurred to the total estimated contract costs. Contract costs incurred at the end of each year is:

Year 1: ₹52.52 crore

Year 2: ₹ 154.20 crore (including unused material of 2.5 crore)Year 3: ₹205 crore.

You are required to calculate:

(a) **Stage of completion for each year.**

(b) **Profit to be recognised for each year.**

Answer: 26

a) Stage of completion = Costs incurred to date / Total estimated costsYear 1:

52.52 crore / 202 crore = 26%

Year 2: (154.20 crore – 2.50 crore) / 205 crore = 74%

Year 3: 205 crore / 205 crore = 100%

b) Profit for the year

	Year 1	Year 2	Year 3
Contract Revenue(1)	57.20 crore	109.30 crore	58.50 crore
	(220 crore x 26%)	(225 crore x 74% - 57.20 crore)	(225 crore x 100% - 109.30 crore – 57.20 crore)
Contract Cost (2)	52.52 crore	99.18 crore	53.30 crore
	(202 crore x 26%)	(205 crore x 74% - 52.52 crore)	(205 crore x 100% - 99.18 crore – 52.52 crore)
Contract Profit (1) – (2)	4.68 crore	10.12 crore	5.20 crore

Question 27 (Illustration)

A firm of contractors obtained a contract for construction of bridges across river Revathi. The following details are available in the records kept for the year ended 31st March, 20X1.

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	(₹ in lakhs)
Total Contract Price	**1,000**
Work Certified for the cost incurred	**500**
Work yet not Certified for the cost incurred	**105**
Estimated further Cost to Completion	**495**
Progress Payment Received	**400**
To be Received	**140**

The firm seeks your advice and assistance in the presentation of accounts keeping in view therequirements of AS 7 issued by your institute.

Answer 27

(a)	Amount of foreseeable loss	(₹ in lakhs)
	Total cost of construction (500 + 105 + 495)	1,100
	Less: Total contract price	(1,000)
	Total foreseeable loss to be recognized as expense	100

According AS 7, when it is probable that total contract costs will exceed total contract revenue,the expected loss should be recognized as an expense immediately.

(b)	Contract work-in-progress i.e. cost incurred to date are ₹ 605 lakhs	(₹ in lakhs)
	Work certified	500
	Work not certified	105
		605
This is 55% (605/1,100 100) of total costs of construction.		

(c) Proportion of total contract value recognised as revenue: 55% of ₹ 1,000 lakhs = ₹ 550 lakhs

(d) Amount due from/to customers = (Contract costs + Recognised profits – Recognised Losses) – (Progress payments received + Progress payments to be received)

= (605 + Nil – 100) – (400 + 140) ₹ in lakhs

= [505 – 540] ₹ in lakhs Amount due to customers = ₹ 35 lakhs

The amount of ₹ 35 lakhs will be shown in the balance sheet as liability.

(e) The relevant disclosures under AS 7 are given below:

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	₹ in lakhs
Contract revenue	550
Contract expenses	605
Recognised profits less recognised losses	(100)
Progress billings ₹ (400 + 140)	540
Retentions (billed but not received from contractee)	140
Gross amount due to customers	35

Question 28(Illustration

On 1st December, 20X1, Vishwakarma Construction Co. Ltd. undertook a contract to construct a building for ₹ 85 lakhs. On 31st March, 20X2, the company found that it had already spent ₹ 64,99,000 on the construction. Prudent estimate of additional cost for completion was ₹ 32,01,000. What amount should be recognized in the statement of profit and loss for the year ended 31st March, 20X2 as per provisions of Accounting Standard 7 (Revised)?

Answer 28

	₹
Cost incurred till 31st March, 20X2	64,99,000
Prudent estimate of additional cost for completion	32,01,000
Total cost of construction	97,00,000
Less: Contract price	(85,00,000)
Total foreseeable loss	12,00,000

According to AS 7, the amount of ₹ 12,00,000 is required to be recognized as an expense.

$$\text{Contract work in progress} = \frac{Rs.64,99,000 \ X \ 100}{97,00,000} = 67\%$$

Proportion of total contract value recognized as turnover: = 67% of Rs. 85,00,000 = Rs. 56,95,000

Questions 29 (Illustration 8)

XYZ construction Ltd, a construction company undertakes the construction of an industrial complex. Ithas separate proposals raised for each unit to be constructed in the industrial complex. Since each unit is subject to separate negotiation, he is able to identify the costs and revenues attributable to each unit. Should XYZ Ltd, treat construction of each unit as a separate construction contract according to AS 7?

Answer: 29

As per AS 7 'Construction Contracts', when a contract covers a number of assets, the

(a) construction of each asset should be treated as a separate construction contract when:

(b) separate proposals have been submitted for each asset;

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(c) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset;and the costs and revenues of each asset can be identified.

Therefore, XYZ Ltd. is required to treat construction of each unit as a separate construction contract.

Questions 30(Illustration 9)

AB contactors enters into a contract on 1st January 20X1 with XY to construct a 5- storied building. Under the contract, AB is required to complete the construction in 3 years (i.e., by 31st December 20X3). The following information is relevant:

Fixed price (agreed) ₹5 crore

Material cost escalation (to the extent of 20% of increase in material cost) Labour cost escalation (up to 30% of increase in minimum wages)

In case AB is able to complete the construction in less than 2 years and 10 months, it will be entitled for an additional incentive of ₹50 lakh. However, in case the construction is delayed beyond 3 years and 2 months, XY will charge a penalty of ₹20 lakh. At the start of the contract, AB has a reason to believe that construction will be completed in2 years and 8 months. Assume that the construction was actually completed in 2 years 9 months.

Labour cost was originally estimated to be ₹1.20 crore (based on initial minimum wages). However, the costs have increased by 25% during the construction period.

Material costs have increased by 40% due to short-supply. The total increase in material cost due to the 40% escalation is ₹80 lakh.

You are required to suggest what should be the contract revenue in above case?

Assume that in year 20X2, XY has requested AB to increase the scope of the contract. An additional floor is required to be constructed and there is an increase in contract fee by ₹1 crore.

AB has incurred a cost of ₹20 lakh for getting the local authority approvals which it will be entitled to claim from XY in addition to the increase in the fixed fee.

Also measure the total contract revenue in this case.

Answer: 30

Total Revenue after considering the escalation costs, claims and incentives:

	₹	
Fixed Price:		5.00 crore
Incentive for early completion		0.50 crore
Material costs recovery (to the extent of 20%)		0.40 croreLabour
costs recovery (Actual increase is less than 30%)		0.30 crore [1.20
crore x 25%]		
Total Contract Revenue		6.20 crore
Add: Variation to the contract		1.00 crore
Add: Claims recoverable from XY		0.20 crore
Total Contract Revenue		7.40 crore

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(a) Contract costs should comprise:

(i) costs that relate directly to the specific contract;

(ii) costs that are attributable to contract activity in general and can beallocated to the contract; and

(iii) such other costs as are specifically chargeable to the customer undertheterms of the contract.

Questions 31 (Percentage completion method)

X Ltd. commenced a construction contract on 01-04-20X1. The fixed contract price agreed was ₹2,00,000. The company incurred ₹81,000 in 20X1-X2 for 45% work and received ₹79,000 as progresspayment from the customer. The cost incurred in 20X2-X3 was ₹89,000 to complete the rest of work. Show the extract of the Profit and Loss Account and Customer's Account for the related years.

Answer: 31

Profit & Loss Account

Year		₹000	Year		₹ 000
20X1-X2	To Construction	81	20X1-X2	By Contract Price	90
	Costs (for 45% work)			(45% of Contract Price)	
	To Net profit	9			
	(for 45% work)				
		90			90
20X2-X3	To Construction	89	20X2-X3	By Contract Price	110
	costs			(55% of Contract	
	(for 55% work)			Price)	
	To Net Profit	21			
	(for 55% work)				
		110			110

Customer's Account

Year		₹ 000	Year		₹ 000
20X1-X2	To Contract	90	20X1-X2	By Bank	79
	Price				
				By Balance	11
				c/d	
		90			90

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20X2-X3	To Balance b/d	11	20X2-X3		
	To Contract	110		By Bank	121
	Price				
		121			121

(a) AS 7 provides that the percentage completion method should not be applied iftheoutcome of a construction contract cannot be estimated reliably. In such cases:

(b) **revenue should be recognised only to the extent of contract costs incurredofwhich recovery is probable; and contract costs should be recognised as an expense in the period in whichtheyare incurred.**

An expected loss on the construction contract should be recognised as anexpense immediately inaccordance with paragraph 35.

Questions Illustration 32

PQ & Associates undertakes a construction contract the details of which are provided below:

Total Contract Value	**₹40 lakh**
Costs incurred to date	**₹3 lakh**
Estimated future costs of completion	**₹30 lakh**
Work completed 10%	

The work has started some time ago and there is an uncertainty with respect to the outcome of the contract due to expected changes in regulations. PQ is certain that it would be able to recover the costs incurred to date.

Answer: 32

In the given case, revenue and costs can only be recognised to the extent of the costs incurred and those which are expected to be recovered. Therefore, the profit & loss statement would appear as under:

Contract Revenue	₹3 lakh
Contract Costs	₹3 lakh
Contract Profit	Nil

When the uncertainties that prevented the outcome of the contract being estimated reliably cease to exist, revenue and expenses associated with the construction contract should be recognised by the percentage completion method.

Questions Illustration 33

(Stage of completion for a loss-making contract)

Show Profit & Loss A/c (Extract) in books of a contractor in respect of the following data for Year 1.

Contract price (Fixed)	**600**
Cost incurred to date	**390**
Estimated cost to complete	**260**

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Assume that the contract period is 2 years. The contract is 100% completed by Year 2. Actual costs incurredis the same as total estimated costs to complete (Cost incurred to date plus estimated cost to complete).

Answer: 33

		Amount INR ₹ 000	
	Year (1)	Total up to Year2 (2)	Year 2 (2) – (1)
A. Cost incurred to date	(390)	(650)	(260)
B. Estimate of cost to completion	(260)	-	-
C. Estimated total cost	(650)	650	650
D. Degree of completion (A/C)	60%	100%	40%
E. Revenue Recognised			
(60% of 600)	360		
(100% of 600)		600	240
Total foreseeable loss (650 – 600)	50		
Less: Loss for current year (E – A)	(30)		
Expected loss to be recognised immediately	(20)		
Reversal of Loss provision in Year 2			20

Profit & Loss A/c (Year 1)

	₹		₹
To Construction costs ToProvision for loss	390 20	By Contract PriceBy Net Loss	360 50
	410		410

Profit & Loss A/c (Year 2)

	₹		₹
To Construction costs	260	By Contract Price By Reversal of Provisionfor loss	240 20
	260		260

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Chapter 8.2

AS 9- Revenue Recognition

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.18 TO Q.31											
Past Exams	NO	NO	Q.8	Q.15	NO	NO	Q.16	NO	NO	Q.17	Q.4	NO
MTP	NO	Q.2 Q.4	Q.2	Q.4	NO	Q.3	NO	Q.4 Q.6	Q.3	Q.8	Q.5 Q.6	Q.3 Q.16
RTP	Q.11	Q.4	Q.10	Q.9	NO	Q.4	Q.5	Q.7	Q.12 Q.15	Q.13	Q.14	Q.1

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Chapter 8.2

AS 9- Revenue Recognition

Question 1

Given below are the following information of B.S. Ltd.

(i) Goods of ₹ 50,000 were sold on 18-03-2023 but at the request of the buyer these were delivered on 15-04-2023.

(ii) On 13-01-2023 goods of ₹ 1,25,000 are sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-03-2023.

(iii) ₹ 1,00,000 worth of goods were sold on approval basis on 01-12-2022. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-01-2023 and no approval or disapproval received for the remaining goods till 31-03-2023.

You are required to advise the accountant of B.S. Ltd., with valid reasons, the amount to be recognized as revenue for the year ended 31st March, 2023 in above cases in the context of AS- 9.(RTP Nov '23) Old & New SM)

Answer 1

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance shouldbe regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usuallyassociated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i)

The sale is complete but delivery has been postponed at buyer's request. B.S. Ltd. should

recognize the entire sale of ₹ 50,000 for the year ended 31st March, 2023.Case (ii)

In case of consignment sale revenue should not be recognized until the goods are sold to athird party.20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 1,00,000 (80% of ₹ 1,25,000).

Case (iii)

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed,a reasonable time has elapsed. Therefore, revenue should be recognized for the total salesamounting ₹ 1,00,000 as the time period for rejecting the goods had expired.

Thus total revenue amounting ₹ 2,50,000 (50,000 + 1,00,000+ 1,00,000) will be recognizedfor the year ended 31st March, 2023 in the books of B.S. Ltd.

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Question 2

Ruby Ltd. sold goods through its agent. As per terms of sales, consideration is payable within one month. In the event of delay in payment, interest is chargeable @ 10% p.a. from the agent. The company has not realized interest from the agent in the past. For the year ended 31st March, 2017 interest due from agent (because of delay in payment) amounts to Rs. 5 lakhs. The accountant of RubyLtd. booked Rs. 5 lakhs as interest income in the year ended 31st March, 2017. Examine and discuss the contention of the accountant with reference to AS 9 "Revenue Recognition". (MTP 5 Marks Apr'19, Oct'18)

Answer 2

As per AS 9 "Revenue Recognition", "where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty involved. In such cases, the revenue is recognized only when it is reasonably certain thatthe ultimate collection will be made". In this case, the company never realized interest for the delayed payments made by the agent. Hence, based on the past experience, the realization of interest for the delayed payments by the agent is very much uncertain. The interest should be recognized only if the ultimate collection is certain. Therefore, the interest income of Rs. 5 lakhs should not be recognized in the books for the year ended 31st March, 2017. Thus the contention of accountant is incorrect. However, if the agents have agreed to pay the amount of interest and there is an element of certainty associated with these receipts, the accountant is correct regarding booking of Rs. 5 lakhs as interest amount.

Question 3

New Era Publications publishes a monthly magazine on 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The sale of space for the March 2020 issue was madein February 2020. The magazine was published on its scheduled date. It received Rs. 2,40,000 on 10.3.2020 and Rs. 60,000 on 10.4.2020 for the March, 2020 issue. Discuss in the context of AS 9 the amount of revenue to be recognized and the treatment of the amount received from advertisers for the year ending 31.3.2020. What will be the treatment if the publication is delayed till 2.4.2020? (MTP 5 Marks Oct 20, Mar 22 & Oct '23)

Answer 3

As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method as the service is performed, whichever relates the revenue to the work accomplished. In the given case, income accrues when the related advertisement appears before public.The advertisement service would be considered as performed on the day the advertisement is published and hence revenue is recognized on that date. In this case, 15.03.20 20 is the date of publication of the magazine. Hence, Rs. 3,00,000 (Rs. 2,40,000 + Rs. 60,000) is recognized as income in March, 2020. The terms of payment are not relevant for considering the date on which revenue is to be recognized. Since, the revenue of Rs. 3,00,000 will be recognized in the March, 2020, Rs. 60,000 will be treated as amount due from advertisers as on 31.03.20 20 and Rs. 2,40,000 will be treated as payment receivedagainst the sale. However, if the publication is delayed till 02.04.2020 revenue recognition will also be delayed till the advertisements get published in the magazine. In that case revenue of Rs. 3,00,000 will be recognized in the year ended 31.03.2020 after the magazine is published on 02.04.2020. The amount received from sale of advertising space on 10.03.2020 of Rs. 2,40,000 will be considered as an advance from advertisers as on 31.03.2020.

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Question 4

Fashion Limited is engaged in manufacturing of readymade garments. They provide you the following information on 31st March, 2021:

(i) On 15th January, 2021 garments worth Rs. 4,00,000 were sent to Anand on consignment basis of which 25% garments unsold were lying with Anand as on 31st March, 2021.

(ii) Garments worth Rs. 1,95,000 were sold to Shine boutique on 25th March, 2021 but at the request of Shine Boutique, these were delivered on 15th April, 2021.

(iii) On 1st November, 2020 garments worth Rs. 2,50,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods up to 31st December, 2020 and no approval or disapproval received for the remaining goods till 31st March, 2021.

You are required to advise the accountant of Fashion Limited, the amount to be recognized as revenue in above cases in the context of AS 9. (MTP 5 Marks Nov '21, Oct'19, Aug'18, RTP Nov'18, RTP Nov'20)(PYP 5 Marks May '23)

Answer 4

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from thesale of the goods.

Case (i): 25% goods lying unsold with consignee should be treated as closing inventory and sales shouldbe recognized for Rs. 3,00,000 (75% of Rs. 4,00,000) for the year ended on 31.3.21. In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Case (ii): The sale is complete but delivery has been postponed at buyer's request. Fashion Ltd. should recognize the entire sale of Rs.1,95,000 for the year ended 31st March, 2021.

Case (iii): In case of goods sold on approval basis, revenue should not be recognized until the goods havebeen formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting Rs. 2,50,000 as the time period for rejecting the goods had expired. Thus total revenue amounting Rs. 7,45,000 (3,00,000+1,95,000+2,50,000) will be recognized for the year ended 31st March, 2021 in the books of Fashion Ltd.

Question 5

Tonk Tanners is engaged in manufacturing of leather shoes. They provide you the following information for the year ended 31st March, 2022:

(i) On 31st December, 2021 shoes worth ₹ 3,20,000 were sent to Mohan Shoes for sale on consignment basis of which 25% shoes were unsold and lying with Mohan Shoes as on 31st March, 2022.

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(ii) On 10th January, 2022, Tonk Tanner supplied shoes worth ₹ 4,50,000 to Shani Shoes and

1. concurrently agrees to re-purchase the same goods on 11th April. 2022.

(iii) On 21st March, 2022 shoes worth ₹ 1,60,000 were sold to Shoe Shine but due to refurbishing

2. of their showroom being underway, on their request, shoes were delivered on 12 th April, 2022. You are required to advise the accountant of Tonk Tanners when amount is to be recognised as revenue in 2021-2022 in above cases in the context of AS 9. (MTP 5 Marks March '23, RTP May '21)

Answer 5

i. **Shoes sent to Mohan Shoes (consignee) for consignment sale**

In case goods are sent for consignment sale, revenue is recognized when significant risks of ownership have passed from seller to the buyer.

In the given case, Mohan Shoes is the consignee i.e. an agent of Tonk Tanners and not the buyer. Therefore, the risk and reward is considered to vest with Tonk Tanners only till the time the sale is madeto the third party by Mohan Shoes; although the goods are held by Mohan Shoes. Hence, in the year 2021-2022, the sale will be recognized for the amount of goods sold by Mohan Shoes tothe third party i.e. for ₹ 3,20,000 x 75% = ₹ 2,40,000.

ii. **Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date**

For such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue and should not be recognized as revenue in the year 2021 -2022. Hence, sale of ₹ 4,50,000to Shani Shoes should not be recognized as revenue.

iii. **Delivery is delayed at buyer's request**

On 21st March, 2022, if Shoe Shine takes title and accepts billing for the goods then it is implied that the sale is complete and all the risk and rewards of ownership has been transferred to the buyer. In case no significant uncertainty exists regarding the amount of consideration for sale, revenue shall be recognized in the year 2021 -2022 irrespective of the fact that the delivery is delayed on the requestof Shoe Shine.

Question 6

Old Era Publication Publishes a popular monthly magazine on 15 th of every month. The publication sells the advertising space on terms of 90% payable in advance and the balance 10% payable within 30 days of release of the publication. The space for March 2023 issue of the magazine was sold in the month of February, 2023. The magazine was published as per schedule on 15th of the month. The amount of ₹ 2,70,000 has been received upto 31st March, 2023 and ₹ 30,000 was received on 10th April, 2023 for advertisement published in the March issue of the publication.

Please advise the accountant the amount of revenue to be recognized in the context of the provisions of AS 9 'Revenue Recognition' during the year ending on 31 st March, 2023. (MTP 5 Marks April '23, Oct'21)

Answer 6

Definition: As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished.

Analysis of given case: In the given case, income accrues when the related advertisement appears be-

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fore public. The advertisement service would be considered as performed on the day the advertisement is appeared for public and hence revenue is recognized on that date. In this case, it is 15.03.2023, the date of publication of the magazine.

Accounting treatment for given situation: Hence, ₹ 3,00,000 (₹ 2,70,000 + ₹ 30,000) is recognized as income in March, 2023. The terms of payment are not relevant for considering the date on which revenue is to be recognized. ₹ 30,000 is treated as amount due from advertisers as on 31.03.2023 and ₹ 2,70,000 will be treated as payment received against the sale.

Question 7

(a) How will you recognize revenue in the following cases:

1. **Installation Fees;**
2. **Advertising and insurance agency commissions;**
3. **Subscriptions for publications.**

(b) Shipra Ltd., has been successful jewellers for the past 100 years and sales are against cash only (returns are negligible). The company also diversified into apparels. A young senior executive was put in charge of Apparels business and sales increased 5 times. One of the conditions for sales is that dealers can return the unsold stocks within one month of the end of season. Sales return for the year was 25% of sales. Suggest a suitable Revenue Recognition Policy, with reference to AS 9. (RTP Nov '21)

Answer 7

(a) **Installation Fees**: In cases where installation fees are other than incidental to the sale of a product, they should be recognized as revenue only when the equipment is installed and accepted by the customer.

Advertising and insurance agency commissions: Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed. Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

Subscription for publications: Revenue received or billed should be deferred and recognized either on a straight-line basis over time or, where the items delivered vary in value from period to period, revenue should be based on the sales value of the item delivered in relation to the total sales value of all items covered by the subscription.

(b) As per AS 9 "Revenue recognition", revenue recognition is mainly concerned with the timing of recognition of revenue in statement of profit and loss of an enterprise. The amount of revenue arisingon a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

Effect of Uncertainty- In the case of the jewellery business the company is selling for cash and returns are negligible. Hence, revenue can be recognized on sales. On the other hand, in Apparels Industry, the dealers have a right to return the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 25% of its sales. The company may disclose suitable revenue recognition policyin its financial statements separately for both Jewellery and Apparels business.

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Question 8 (Last Day Revision)

The following information of Meghna Ltd. is provided:

(i) Goods of Rs. 60,000 were sold on 20-3-2019 but at the request of the buyer these were delivered on10-4-2019.

(ii) On 15-1-2019 goods of Rs. 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31 -3-2019.

(iii) Rs. 1,20,000 worth of goods were sold on approval basis on 1 -12-2018. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-2019 and no approval or disapproval received for the remaining goods till 31-3-2019.

(iv) Apart from the above, the company has made cash sales of Rs. 7,80,000 (gross). Trade discount of 5% was allowed on the cash sales.

You are required to advise the accountant of Meghna Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS -9. (RTP May'20)(Same concept different figures MTP 5 Marks Oct'22, PYP 5 Marks May '19)

Answer 8

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should

be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effectivecontrol of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived fromthe sale of the goods.

Case (i) The sale is complete but delivery has been postponed at buyer 's request. M/s Paper ProductsLtd. should recognize the entire sale of Rs.60,000 for the year ended 31st March, 2019.

Case (ii) 20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for Rs. 1,20,000 (80% of Rs. 1,50,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Case (iii) In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or thetime period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting Rs. 1,20,000 as the time periodfor rejecting the goods had expired.

Case (iv) Trade discounts given should be deducted in determining revenue. Thus Rs. 39,000 should be deducted from the amount of turnover of Rs. 7,80,000 for the purpose of recognition of revenue. Thus,revenue should be Rs. 7,41,000.

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Question 9

The Board of Directors decided on 31.3.2019 to increase the sale price of certain items retrospectively from 1st January, 2019. In view of this price revision with effect from 1st January 2019, the company has to receive Rs. 15 lakhs from its customers in respect of sales made from 1st January, 2019 to 31st March, 2019. Accountant cannot make up his mind whether to include Rs. 15 lakhs in the sales for 2018-2019. Advise. (RTP Nov'19)

Answer 9

Price revision was effected during the current accounting period 2018-2019. As a result, the company stands to receive Rs. 15 lakhs from its customers in respect of sales made from 1st January, 2019 to 31st March, 2019. If the company is able to assess the ultimate collection with reasonable certainty, then additional revenue arising out of the said price revision may be recognized in 2018 - 2019 vide para 10 of AS 9.

Question 10

Raj Ltd. entered into an agreement with Heena Ltd. to dispatch goods valuing Rs. 5,00,000 every month for next 6 months on receipt of entire payment. Heena Ltd. accordingly made the entire payment of Rs. 30,00,000 and Raj Ltd. started dispatching the goods. In fourth month, due to fire in premise of Heena Ltd., Heena Ltd. requested to Raj Ltd. not to dispatch goods worth Rs. 15,00,000 ready for dispatch. Raj Ltd. accounted Rs. 15,00,000 as sales and transferred the balance to Advance received against Sales account. Comment upon the above treatment by Raj Ltd. with reference to theprovision of AS-9. (RTP May'19)

Answer 10

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

In the given case, transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. Also, the sale price has been recovered by the seller. Hence, the sale is complete but delivery has been postponed at buyer's request. Raj Ltd. should recognizethe entire sale of Rs. 30,00,000 (Rs. 5,00,000 x 6) and no part of the same is to be treated as Advance Received against Sales.

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Question 11

A manufacturing company has the following stages of production and sale in manufacturing fine paper rolls:

Date	Activity	Cost to Date(Rs.)	Net Realizable Value(Rs.)
15.1.16	Raw Material	1,00,000	80,000
20.1.16	Pulp (WIP 1)	1,20,000	1,20,000
27.1.16	Rough & thick paper (WIP 2)	1,50,000	1,80,000
15.2.16	Fine Paper Rolls	1,80,000	3,50,000
20.2.16	Ready for sale	1,80,000	3,50,000
15.3.16	Sale agreed and invoice raised	2,00,000	3,50,000
02.4.16	Delivered and paid for	2,00,000	3,50,000

Explain the stage on which you think revenue will be generated and calculate how much would benet profit for year ending 31.3.16 on this product as per AS 9. (RTP May'18)

Answer 11

According to AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performanceshould be regarded as being achieved when the following conditions have been fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significantrisks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived fromthe sale of the goods.

Thus, sales will be recognized only when following two conditions are satisfied:

(i) The sale value is fixed and determinable.

(ii) Property of the goods is transferred to the customer.

Both these conditions are satisfied only on 15.3.2016 when sales are agreed upon at a price and goodsare allocated for delivery purpose through invoice. The amount of net profit Rs. 1,50,000 (3,50,000 –2,00,000) would be recognized in the books for the year ending 31stMarch, 2016.

Question 12

An infrastructure company has constructed a mall and entered into agreement with tenants towards license fee (monthly rental) and variable license fee, a percentage on the turnover of the tenant (on an annual basis). Chief Financial Officer of the company wants to account/recognize license fee as income for 12 months during current year and variable license fee as income during next year, since invoice is raised in the subsequent year. Comment whether the treatment desired by the CFO is correct or not. (RTP May 22)

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Answer 12

AS 9 on Revenue Recognition, is mainly concerned with the timing of recognition of revenue in the Statement of Profit and Loss of an enterprise. The amount of revenue arising on a transaction is usuallydetermined by agreement between the parties involved in the transaction. However, when uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition. Further, as per accrual concept, revenueshould be recognized as and when it is accrued i.e. recorded in the financial statements of the periods to which they relate. In the present case, monthly rental towards license fee and variable license feeas a percentage on the turnover of the tenant (though on annual basis) is the income related to commonfinancial year.

Therefore, recognizing the fee as revenue cannot be deferred simply because the invoice is raised in subsequent period. Hence it should be recognized in the financial year of accrual. Therefore, the contention of the Chief Financial Officer is not in accordance with AS 9.

Question 13

When revenue will be recognized in the following situation:

(i) **Where the purchaser makes a series of installment payments to the seller and the seller deliverthe goods only when the final payment is received.**

(ii) **Where seller concurrently agrees to repurchase the same goods at a later date.**

(iii) **Where goods are sold to distributors, dealers or others for resale.**

(iv) **Commissions on service rendered as agent on insurance business. (RTP Nov'22)**

Answer 13

i. Revenue from sales where the purchaser makes a series of instalment payments to the seller, and theseller delivers the goods only when the final payment is received, should not be recognised until goods are delivered. However, when experience indicates that most such sales have been consummated, revenue may be recognised when a significant deposit is received.

ii. For sale where seller concurrently agrees to repurchase the same goods at a later date, suchtransactions are in substance a financing agreement. In such a situation, the resulting cash inflow should not be recognised as revenue.

iii. Revenue from sales of goods to distributors, dealers or others for resale can generally be recognised if significant risks of ownership have passed. However, in some situations the buyer may in substance

be an agent and in such cases the sale should be treated as a consignment sale.

ommissions on service rendered as agent on insurance business should be recognised as revenue when the service is completed. Insurance agency commissions should be recognised on the effectivecommencement or renewal dates of the related policies.

Question 14

PQR Ltd., sells agriculture products to dealers. One of the conditions of sale is that interest is at the rate of 2% p.m., for delayed payments. Percentage of interest recovery is only 10% on such overdue outstanding due to various reasons. During the year 2021-22 the company wants to recognize the entire interest receivable. Do you agree? (RTP May '23)

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Answer 14

As per AS 9 'Revenue Recognition', where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g. for escalation of price, export incentives, interestetc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.

Thus, PQR Ltd. cannot recognise the interest amount unless the company actually receives it. 10% rate of recovery on overdue outstanding is also an estimate based on previous record and is not certain. Hence, the company is advised to recognise interest receivable only on receipt basis.

Question 15

Indicate in each case whether revenue can be recognized and when it will be recognized as per As -9.

(1) Trade discount and column received.

(2) Whether goods are sold to distributor or others for resale.

(3) Whether seller concurrently agrees to repurchase the same goods at a late date.

(4) Insurance agency commission for rendering services.

(5) On 11-3-2019 cloths worth Rs. 50,000 were sold to X mart, but due to refurbishing of their showroombeing underway, on their request cloths were delivered on 12-04-2019. (PYP 5 Marks Nov'19, RTP May'22)

Answer 15

(1) Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

(2) When goods are sold to distributor or others, revenue from such sales can generally be recognizedif significant risks of ownership have passed; however, in some situations the buyer may in substancebe an agent and in such cases the sale should be treated as a consignment sale.

(3) For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue.

(4) Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

(5) On 11.03.2019, if X mart takes title and accepts billing for the goods then it is implied that the saleis complete and all risk and reward on ownership has been transferred to the buyers.

Revenue should be recognized for year ended 31st March, 2019 notwithstanding that physical delivery hasnot been completed so long as there is every expectation that delivery will be made and itemswere ready for delivery to the buyer at the time.

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Question 16

Given the following information of Rainbow Ltd.

(i) **On 15th November, goods worth ₹ 5,00,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods sold upto 31st January and no approval or disapproval received for the remaining goods till 31st March.**

(ii) **On 31st March, goods worth ₹ 2,40,000 were sold to Bright Ltd. but due to refurnishing of their show-room being underway, on their request, goods were delivered on 10th April.**

(iii) **Rainbow Ltd. supplied goods worth ₹ 6,00,000 to Shyam Ltd. and concurrently agrees to re-purchasethe same goods on 14th April.**

(iv) **Dew Ltd, used certain assets of Rainbow Ltd. Rainbow Ltd. received ₹ 7.5 lakhs and ₹ 12 as interest and royalties respectively from Dew Ltd. during the year 2020 -21.**

(v) **On 25th December, goods of ₹ 4,00,000 were sent on consignment basis of which 40% of the goods unsold are lying with the consignee at the year-end on 31st March.**

In each of the above cases, you are required to advise, with valid reasons, the amount to be recognized as revenue under the provisions of AS-9.(PYP 5 Marks Dec '21)(MTP 5 Marks Sep '23)

Answer 16

(i) As per AS 9 "Revenue Recognition", in case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting

₹ 5,00,000 as the time period for rejecting the goods had expired.

(ii) The sale is complete but delivery has been postponed at buyer's request. The entity should recognize

the entire sale of ₹ 2,40,000 for the year ended 31st March.

(iii) Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date, such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue. Hence no revenue to be recognized in the given case.

(iv) Revenue arising from the use by others of enterprise resources yielding interest and royalty should be recognized when no significant uncertainty as to measurability or collectability exists. The interest should be recognized on time proportion basis taking into account the amount outstanding and rate applicable. The royalty should be recognized on accrual basis in accordance with the terms of relevant agreement.

(v) 40% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 2,40,000 (60% of ₹ 4,00,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

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Question 17

Indicate in each case whether revenue can be recognized and when it will be recognized as per AS-9.

(i) **Delivery is delayed at buyer's request but buyer takes title and accepts billing.**

(ii) **Instalment Sales.**

(iii) **Trade discounts and volume rebates.**

(iv) **Insurance agency commission for rendering services.**

(v) **Advertising commission. (PYP 5 Marks Nov 22)**

Answer 17

(i) **Delivery is delayed at buyer's request and buyer takes title and accepts billing** : Revenue should be recognized notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made. However, the item must be on hand,identified and ready for delivery to the buyer at the time the sale is recognized rather than there being simply an intention to acquire or manufacture the goods in time for delivery.

(ii) **Instalment sales**: When the consideration is receivable in instalments, revenue attributable to the sales price exclusive of interest should be recognized at the date of sale. The interest element should be recognized as revenue, proportionately to the unpaid balance due to the seller.

(iii) **Trade discounts and volume rebates**: Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

(iv) **Insurance agency commissions for rendering services**: Insurance agency commissions shouldbe recognized on the effective commencement or renewal dates of the relatedpolicies.

(v) **Advertising commission**: Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed.

Question 18

Which of the conditions mentioned below must be met to recognize revenuefrom the sale ofgoods?

(i) **the entity selling does not retain any continuing influence or controlover the goods;**

(ii) **when the goods are dispatched to the buyer;**

(iii) **revenue can be measured reliably;**

(iv) **the supplier is paid for the goods;**

(v) **it is reasonably certain that the buyer will pay for the goods;**

(vi) **the buyer has paid for the goods.**

(a) (i), (ii) and (v)

(b) (ii), (iii) and (iv)

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(c) (i), (iii) and (v)

(d) (i), (iv) and (v)

Ans: (a)

Question 19

Consignment inventory is an arrangement whereby inventory is held by one party but owned by another party. Which of the following indicates that the inventory in question is a consignment inventory?

(a) Manufacturer cannot require the dealer to return the inventory

(b) Dealer has the right to return the inventory

(c) Manufacture is responsible for the pricing of goods and any changes inthe pricing can only beapproved by the manufacturer.

(d) Manufacture is responsible for the holding the goods and any changesin the pricing can onlybe approved by the dealer

Ans: (c)

Question 20

Which of the following transactions qualify as revenue for M/s AB Enterprises?

(a) Sales of ₹ 20 lakhs made under consignment sales.

(b) Sale of an old machine amounting ₹ 5 lakhs

(c) Services provided to the customer in the normal course of business. Sales recorded is ₹ 50,000.

(d) Sales of ₹ 25 lakhs made under consignment sales

Ans: (c)

Question 21

The Accounting Club has 100 members who are required to pay an annual membership fee of ₹ 5,000 each. During the current year, all members have paid the fee. However, 5 members have paid an amount of ₹ 10,000 each. Of these, 3 members paid the current year's fee and also the previous year's dues. Remaining 2 members have paid next years' fee of ₹ 5,000 in advance. Revenue from membership fee for the current year to be recognised will be:

(a) ₹ 5,25,000

(b) ₹ 5,10,000

(c) ₹ 5,00,000

(d) ₹ 5,15,000

Ans: (c)

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Question 22

FlixNet International offers a subscription fee model to allow the paid subscribers an annual viewingof movies, sports events and other content. It allows users to register for free and have access to limited content for one month without any charges. The customer has a right to cancel the subscription within a month's time but is required to pay for 1 year subscription fee after the free period.

XY has subscribed for free viewing on 1st March 20X1. After 1 month, he has agreed to pay the annualmembership and has paid ₹ 1,200 on 31st March 20X1 for the subscription that is valid up to 31st of March 20X2.

Revenue that can be recognized by FlixNet for the year ended 31st March 20X2 is

(a) ₹ 100 (b) ₹ 1,200

(c) Nil

(d) ₹ 1,100

Ans: (b)

Practical Questions Answers

Questions 22

GH manufactures and sells televisions. The televisions are shipped to the customer by sea. In order totransfer risk related to the shipment of the televisions, GH also gets an insurance coverage for the goods while they arein transit from the factory to customer's location.

The insurance policy will reimburse GH for the value of the goods in the event of loss or damage arising anytime up to these goods reaching customer's location. The legal title passes when the goodsarrive at the customer's premises one month later.

When should Entity GH recognize revenue in its books?

Answer: 22

GH should recognize revenue for the sale when the goods arrive at the customer's premises. GH has not transferred the televisions' significant risks and rewards of ownership to the customer when the goods depart from the factory. This is evidenced by the fact that any insurance proceeds receivedfrom the goods' damage or destruction will be repaid to GH. Further, thelegal title does not pass until the goods arrive at the customer's premises.

Questions: 23

For the year ended 31st March 20X1, KY Enterprises has entered into the following transactions.

On 31 March 20X1, KY supplied two machines to its customer ST. Both machines were accepted by ST on 31 March 20X1. Machine 1 was a machine

that was routinely supplied by KY to many customers and the installation process was very simple.

Machine 1 was installed on 2 April 20X1 by ST's employees.

Machine 2 being more specialised in nature requires an installation process which is morecomplicated, requiring significant assistance from KY. Machine2 was installed between 2 and 5

April 20X1. Details of costs and sales prices are as follows:

	Machine 1	Machine 2

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Sale Price	**3,20,000**	**3,00,000**
Cost of production	**1,60,000**	**1,50,000**
Installation fee	**nil**	**10,000**

How should above transactions be recognized by KY Enterprises for theyear ended 31st March 20X1?

Answer: 23

Machine 1: As the installation process is simple, revenue from Machine 1 will be recognized on 31 March 20X1.

Revenue (Machine 1)	₹ 3,20,000
Cost of Goods Sold	₹ 1,60,000
Profit during the period	₹ 1,60,000

Since the question specifies that the machine is already accepted by ST on 31 March 20X1, the revenue arising from sale of the machine needs to be recognized for the year ending 31 March 20X1. This is because acceptance

of the machine indicates that the risks and rewards pursuant to the ownership are transferredto ST.

Machine 2: Installation process for Machine 2 is more complicated, requiring significant assistance from KY Ltd. However, question specifies that the machine is already accepted by ST on 31 March 20X1. Assumingthat there is no further approval/acceptance required from the buyer for the Machinesold, revenue from sale of Machine 2 can be recognized for theyear ending 31 March 20X1.

Revenue (Machine 2)	₹ 3,00,000
Cost of Goods Sold	₹ 1,50,000
Profit during the period	₹ 1,50,000

However, installation fee which is for rendering installation services cannotbe recognized until the installation is complete. Since the machine is pending installation, the revenue in respect of installation charges ₹10,000 needs to be recognized on 5 April 20X1 once the installation process gets completed.

Question 24

The following information of Meghna Ltd. is provided:

(vii) **Goods of ₹ 60,000 were sold on 20-3-20X2 but at the request of the buyer these were delivered on 10-4-20X2.**

(viii) **On 15-1-20X2 goods of ₹ 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-20X2.**

(ix) **₹ 1,20,000 worth of goods were sold on approval basis on 1-12-20X1. The period ofapproval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-20X2 and no approval or disapproval received for the remaining goods till 31-3-20X2.**

(x) **Apart from the above, the company has made cash sales of ₹ 7,80,000 (gross). Trade discount of 5% was allowed on the cash sales.**

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You are required to advise the accountant of Meghna Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS 9.

Answer 24

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should

be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i) The sale is complete but delivery has been postponed at buyer's request. The entity should recognize the entire sale of ₹ 60,000 for the year ended 31st March, 20X2.

Case (ii) 20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 1,20,000 (80% of ₹ 1,50,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Case (iii) In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹ 1,20,000 as the time period for rejecting the goods had expired.

Case (iv) Trade discounts given should be deducted in determining revenue. Thus ₹ 39,000 should be deducted from the amount of turnover of ₹ 7,80,000 for the purpose of recognition of revenue. Thus, revenue should be ₹ 7,41,000.

Questions Illustration 25

Zigato runs a food-delivery business. As per the arrangement, Zigato allows customers to order food from local restaurants and is responsible the delivery of the food within stipulated time. During a particular year, it collects the money on orders made online as under:

Total price for the food item	**-**	**₹ 200 lakhs**
Delivery charges	**-**	**₹ 60 lakhs**
GST	**-**	**₹ 40 lakhs**
Total	**-**	**₹ 300 lakhs**

Zigato has received ₹ 300 lakhs for the above orders from customers and the orderswere delivered to the customer in stipulated time.

How much revenue should be recognised by restaurants and how much revenue should berecognised by Zigato for the year?

Answer 25

The risks and rewards associated with the food item are not with Zigato. When a customer has ordered a food item, whether the item will be prepared or not is the responsibility of the restaurant and not Zigato. Similarly, the responsibility to deliver the food item is with Zigato and the restaurant does

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not undertake responsibility for the same.

Therefore, the restaurant undertakes the principal's responsibility to prepare thefood and ensure its quality. Zigato, on the other hand, is only responsible to deliver the food. Thus, Zigato is acting as an agent. Hence, it can only recognize revenue relating to that activity (which it does in the ordinary course of business). The revenue for Zigato, therefore, is ₹ 60 lakhs, whereas, the revenue for restaurants will be ₹200 lakhs.

It may be noted that the GST of ₹ 40 lakhs is a liability payable to the Government (third party), hence it does not form part of revenue.

Questions Illustration 26

AB sells goods to CD on 1st March 20X1. CD is having significant cash flows issues since last few months. However, it is trying to raise funding through bank loan to be able to run its operations in future. On 5th of May 20X1, CD is able to seek the funding and is expected to be able to pay for the goods in future.

At the time of sale, it is difficult for AB to ascertain whether it will be able to collectthe amount from CD due to poor financial conditions.

Explain how the recognition of revenue be done by AB?

Answer 26

In the above case, AB should not recognise any revenue on 1st of March and until that uncertainty of recovery is clear. Hence, the revenue can only be recognisedby AB on 5th of May 20X1. The inventory transferred to CD until that date is required to be shown as its own inventory [inventory lying with customers].

Questions Illustration 27

AB sells goods to CD on 1st January 20X1 for ₹ 2 lakhs. After the sale was made, CDis having significant cash flows issues. It is trying to raise funding through bank loan to be able to run its operations in future. However, it is unable to do so andhas gone under liquidation on 15th of March 20 X1.

At the time of sale, there was no reason for AB to believe that it will not be able to collect the amount from CD in future.

Explain how the recognition of revenue be done by AB for the year ended 31st March 20X1?

Answer 27

In the above case, at the time of sale, it was not unreasonable for AB to expect ultimate collection from CD. Therefore, AB should recognise the revenue of ₹ 2 lakhs on 1st of January 20X1 and recognise a receivable for the same amount.

Later, since CD went into liquidation, AB should write off the receivables and booka loss in his books.
Accounting in the books of AB 1st January 20X1

CD A/c (Receivables) To Revenue A/c (Beinggoods sold to CD Ltd)	Dr.	₹ 2 lakhs	₹ 2 lakhs

15th March 20X1

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Bad Debts A/c To CD A/c (Receivables)A/c (Being receivables from CD written off dueto its liquidation)	Dr.	₹ 2 lakhs	₹ 2 lakhs

Questions Illustration 28

During the year ended 31st March 20X1, ZX Enterprises has recognized ₹ 100 lakhs on accrual basis income from dividend on units of mutual funds held by it. The dividends on mutual funds were declared on 15th June, 20X1. The dividend wasproposed on 10th April, 20X1.

Whether the above treatment is as per the relevant Accounting Standard?

Answer 28

Dividends from investments in shares are not recognized in the statement of profit and loss until a right to receive payment is established. In the given situation, the dividend is proposed on 10th April, 20X1, while it is declared on 15th June, 20X1. Thus, the right to receive the payment of dividendgets established on 15th June, 20X1.

The recognition of ₹ 100 lakhs on accrual basis in the financial year 20X0-20X1 is not correct as per AS 9 'Revenue Recognition'.

Questions Illustration 29

Y Ltd., used certain resources of X Ltd. In return X Ltd. received ₹ 10 lakhs and ₹ 15 lakhs as interestand royalties respective from Y Ltd. during the year 20 X1-X2. Youare required to state whether and on what basis these revenues can be recognizedby X Ltd.

Answer 29

As per AS 9 on Revenue Recognition, revenue arising from the use by others of enterprise resources yielding interest and royalties should only be recognized when no significant uncertainty as to measurability or collectability exists. These revenues are recognized on the following bases:

(i) Interest: on a time proportion basis taking into account the amount outstanding and the rate applicable. Therefore X Ltd. should recognize interest revenue of ₹ 10 Lakhs

(ii) Royalties: on an accrual basis in accordance with the terms of the relevant agreement. X Ltd. therefore should recognize royalty revenue of ₹ 15 Lakhs.

Questions Illustration 30

The Board of Directors decided on 31.3.20X2 to increase the sale price of certain items retrospectively from 1st January, 20X2. In view of this price revision with effect from 1st January 20X2, the company has to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2.

Accountant cannot make up his mind whether to include ₹ 15 lakhs in the sales for20X1- 20X2.Advise.

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Answer 30

Price revision was affected during the current accounting period 20 X1-20X2. As a result, the companystands to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2. If the company is able to assess the ultimate collection with reasonable certainty, only then additional revenue arising out of the said price revision may be recognized in 20X1-20X2.

If the company is not reasonably certain on ultimate collection ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2, it shall postpone recognition of revenue and disclose it in financial statements for year 20X1-20X2 as per AS 1

Questions Illustration 31

A claim lodged with the Railways in March, 20X1 for loss of goods of ₹ 2,00,000 had been passed forpayment in March, 20X3 for ₹ 1,50,000. No entry was passed in the books of the Company, when the claim was lodged. Advise P Co. Ltd. about the treatment of the following in the Final Statement of Accounts for the year ended31st March, 20X3.

Answer 31

AS 9 on 'Revenue Recognition' states that where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is certain to be collected. In thiscase it may be assumed that collectability of claim was not certain in the earlier periods. This is supposed from the fact that only ₹ 1,50,000 were collected againsta claim of ₹2,00,000. So this transaction can not be taken as a Prior Period Item.

Hence receipt of ₹ 1,50,000 shall be recognized as revenue in year ended 31st March, 20X3

In the light of AS 5, it will not be treated as extraordinary item. However, AS 5states that 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 amountof such items should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately.

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Chapter 9.1

AS 12-Accounting for Government Grants

	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.18 TO Q.35											
Past Exams	Q.5 Q.12	NO	Q.13	NO	NO	Q.5 Q.12	Q.4	Q.14	Q.15	NO	Q.16	NO
MTP	NO	NO	Q.2	NO	Q.1	Q.5 Q.12	Q.1 Q.2	Q.3 Q.4	Q.2 Q.5 Q.12	Q.1 Q.8	Q.3 Q.6	Q.2
RTP	Q.6	Q.10	Q.1	Q.9	Q.8	Q.8	Q.7	Q.6	Q.11	Q.9	NO	Q.17

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Chapter 9.1

AS 12-Accounting for Government Grants

Question 1

Viva Ltd. received a specific grant of Rs. 30 lakhs for acquiring the plant of Rs. 150 lakhs during 2018-19 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet and was not deducted from the cost of plant. During 2021-22, 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 Rs. 21 lakhs and written down value of plant was Rs. 105 lakhs. 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 2021-22 in profit and loss account? (MTP 5 Marks , Sep '22 May 20 ,March '21 ,RTP May '19)

Answer 1

As per 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.

In this case the grant refunded is Rs. 30 lakhs and balance in deferred income is Rs. 21 lakhs, Rs. 9 lakhs shall becharged to the profit and loss account for the year 2021-22. 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.

Question 2

Ram Ltd. purchased machinery for Rs. 80 lakhs (useful life 4 years and residual value Rs. 8 lakhs). Government grant received was Rs. 32 lakhs. The grant had to be refunded at the beginning of third year. Show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if the grant had been credited to Deferred Grant A/c. (MTP 5 Marks April 21, April 19, April 22 & Oct '23)

Answer 2

As per AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (Rs. 32 lakhs /4 years) = Rs. 8 lakhs x 2 years= Rs. 16lakhs will be credited to Profit and Loss Account and Rs. 16 lakhs will be the balance of Deferred Grant Account after two years. Therefore, on refund of grant, following entry will be passed:

		Rs.	*Rs.*
Deferred Grant A/c	Dr.	16 lakhs	
Profit & Loss A/c	Dr.	16 lakhs	
To Bank A/c			32 lakhs
(Being Government grantrefunded)			

Value of Fixed Assets after two years but before refund of grant

Fixed assets initially recorded in the books = Rs. 80 lakhs

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Depreciation for each year = (Rs. 80 lakhs – Rs.8 lakhs)/4 years = Rs. 18 lakhs per year

Book value of fixed assets after two years = Rs. 80 lakhs – (Rs. 18 lakhs x 2 years) = Rs. 44 lakhs

1. **Value of Fixed Assets after refund of grant**

   On refund of grant the balance of deferred grant account will become nil. The fixed assets will continueto be shown in the books at Rs. 44 lakhs.

2. **Amount of depreciation for remaining two years**

   Depreciation will continue to be charged at Rs. 18 lakhs per annum for the remaining two years.

Question 3

Caseworker Limited received a specific grant of ₹ 6 crore for acquiring the plant of ₹ 30 crore on 1.4.2016 having useful life of 10 years. At the beginning of the financial year 2021-2022, due to non- compliance of conditions laid down for the grant of ₹ 6 crore, the company had to refund the grant tothe Government. What should be the treatment of the refund if grant was deducted from the cost of the plant during financial year 2016-2017? Assume depreciation is charged on fixed assets as per Straight Line Method. (MTP 5 Marks April 23 & Nov '21)

Answer 3

As per AS 12, the amount refundable in respect of grant related to specific fixed assets should be recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, 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.

Where grant was deducted from the cost of the asset, initial value of the plant after deduction of grant amount of Rs. 6 crore would have been = Rs. 30 crore — Rs. 6 crore = Rs. 24 crore.

Carrying value of the plant after 5 years on 1.4.2021 = [(Rs. 24 crore / 10 years) x 5 years] = Rs. 12 crore.Annual depreciation charge would be Rs. 2.4 crore.

On refund of grant to the Government, the book value of the plant shall be increased by Rs. 6 crore i.e. Rs. 12 crore + Rs. 6 crore = Rs. 18 crore. The increased cost of Rs. 18 crore of the plant should be amortisedprospectively over remaining 5 years of useful residual life. Depreciation charge in the year 2021-2022 would be Rs. 18 crore 15 years = Rs. 3.6 crore instead of earlier Rs. 2.4 crore.

Question 4

Darshan Ltd. purchased a Machinery on 1st April, 2016 for ₹ 130 lakhs (Useful life is 4 years). Government grant received is ₹ 40 lakhs for the purchase of above Machinery.

Salvage value at the end of useful life is estimated at ₹ 60 lakhs. Darshan Ltd. decides to treat the grant as deferred income. Your are required to calculate the amount of depreciation and grant to be recognized in profit & loss account for the year ending 31st March, 2017,31st March, 2018, 31st March, 2019 & 31st March, 2020. Darshan Ltd. follows straight line method for charging depreci tion.(MTP 5 Marks Oct '21, PYP 5 Marks Jan '21)

Answer 4

As per 12 "Accounting for government grants", grants related to depreciable assets, if treated as deferredincome are recognized in the profit and loss statement on a systematic and rational basis over the usefullife of the asset. Amount of depreciation and grant to be recognized in the profit and loss account each year

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Depreciation per year:

	₹in lakhs
Cost of the Asset	130
Less: Salvage value	(60)
	70
Depreciation per year (70lakhs / 4)	17.50

₹ 17.50 Lakhs depreciation will be recognized for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

Amount of grant recognized in Profit and Loss account each year:

40 lakhs /4 years = ₹ 10 Lakhs for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019and 31st March, 2020.

Question 5

On 01.04.2018, XYZ Ltd. received Government grant of ₹ 100 Lakhs for an acquisition of new machinery costing ₹ 500 lakhs. The grant was received and credited to the cost of the assets. The life span of the machinery is 5 years. The machinery is depreciated at 20% on WDV method. The company had to refund the entire grant in 2nd April, 2021 due to non-fulfilment of certain conditions which was imposed by the government at the time of approval of grant. How do you deal with the refund of grant to the Government in the books of XYZ Ltd. as per AS 12? (MTP 5 Marks, Mar'22, MTP 5 Marks Oct 20)(PYP 5 Marks May '18 & Nov '20)

Answer 5

According to AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset (if the grant had been credited to the cost of fixed asset at the time of receipt of grant) should be recorded by increasing the book value of the asset, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

		(₹ in lakhs)
1st April, 2018	Acquisition cost of machinery (₹ 500 – ₹ 100)	400.00
31st March, 2019	Less: Depreciation @ 20%	(80)
1st April, 2019	Book value	320.00
31st March, 2020	Less: Depreciation @ 20%	(64)
1st April, 2020	Book value	256.00
31st March, 2021	Less: Depreciation @ 20%	(51.20)
1st April, 2021	Book value	204.80
2nd April, 2021	Add: Refund of grant	100.00
	Revised book value	304.80

Depreciation @ 20% on the revised book value amounting ₹ 304.80 lakhs is to be provided prospectively over the residual useful life of the asset.

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Question 6

D Ltd. acquired a machine on 01-04-2017 for ₹ 20,00,000. The useful life is 5 years. The company had applied on 01-04-2017, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 2020. The Company's Fixed Assets Account for the financial year 2020-21 shows a credit balance as under:

Particulars	₹
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation (from 2017-18- to 2019-20 on Straight Line Method)	12,00,000
	8,00,000
Less: Grant received	(16,00,000)
Balance	(8,00,000)

You are required to explain how should the company deal with this asset in its accounts for 2020-21? (MTP 5 Marks March '23) (RTP Nov 21 ,May 18)

Answer 6

From the above account, it is inferred that the Company has deducted grant from the book value of asset for accounting of Government Grants. Accordingly, out of the ₹ 16,00,000 that has been received, ₹ 8,00,000 (being the balance in Machinery A/c) should be credited to the machinery A/c. The balance ₹ 8,00,000 may be credited to P&L A/c, since already the cost of the asset to the tune of ₹ 12,00,000 had been debited to P&L A/c in the earlier years by way of depreciation charge, and ₹ 8,00,000 transferred to P&L A/c now would be partial recovery of that cost.

There is no need to provide depreciation for 2020-21 or 2021-22 as the depreciable amount is now Nil.

Question 7

(i) Hygiene Ltd. had received a grant of Rs. 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. The company, however, failed to comply with the said conditions and consequently was required to refund the said amount in 2020. The company debited the said amount to its machinery account in 2020 on payment of the same. It also

Reworked the depreciation for the said machinery from the date of its purchase and passed adjusting entries in the year 2020 to incorporate the retrospective impact of the same. State whether the treatment done by the company is correct or not. (RTP May '21, May'23)

(ii) ABC Ltd. received two acres of land received for set up of plant. It also received Rs.2 lakhs received for purchase of machinery of Rs. 10 lakhs. Useful life of machinery is 5 years. Depreciation on this machinery is to be charged on straight-line basis. How should ABC Ltd. recognize these government grants in its books of accounts? (RTP May '21)

Answer 7

(i) As per the facts of the case, Hygiene Ltd. had received a grant of Rs. 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. However, the amount of grant has to be refunded since it failed to comply with the

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prescribed conditions.In such circumstances, AS 12, "Accounting for Government Grants", requires that the amount refundablein respect of a government grant related to a specific fixed asset is recorded by increasing the book valueof the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. The Standard further makes it clear that in the first alternative, i.e., 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. Accordingly, the accounting treatment given by Hygiene Ltd. of increasing the value of the plant and machinery is quite proper. However, the accounting treatment in respect of depreciation given by the company of adjustment of depreciation with retrospective effect is improper and constitutes violation of AS 12.

(ii) ABC Ltd. should recognize the grants in the following manner:

- As per AS 12, government grants may take the form of non-monetary assets, such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary assets given free of cost are recorded at a nominal value. Accordingly, land should be recognized at nominal value in the balance sheet.
- The standard provides option to treat the grant either as a deduction from the gross value of the asset or to treat it as deferred income as per provisions of the standard. Under first method, the grant is shownas a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduceddepreciation charge. Accordingly, the grant of Rs. 2 lakhs is deducted from the cost of the machinery. Machinery will be recognised in the books at Rs. 10 lakhs – Rs. 2 lakhs = Rs. 8 lakhs and depreciation will be charged on it as follows:

  Rs. 8 lakhs/ 5 years = Rs. 1.60 lakhs per year.

  Under the second method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged. Rs. 2 lakhs should be recognised as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, Rs. 40,000 [Rs. 2 lakhs / 5 years] should be credited to profit and loss each year over the period of 5 years.

Question 8

How would you treat the following in the accounts in accordance with AS 12 'Government Grants'?

(i) Rs.35 Lakhs received from the Local Authority for providing Medical facilities to the employees. (RTP Nov 20, RTP May 20, MTP Oct'22, 5 Marks, Old & New SM)

(ii) Rs.100 Lakhs received as Subsidy from the Central Government for setting up a unit in a notified backward area. (RTP Nov 20, RTP May 20, MTP Oct'22, 5 Marks, Old & New SM)

(iii) Rs.10 Lakhs Grant received from the Central Government on installation of anti- pollution equipment. (RTP May 20, MTP Oct'22, 5 Marks)

Answer 8

(i) Rs.35 lakhs received from the local authority for providing medical facilities to the employees is a grantreceived in the nature of revenue grant. Such grants are generally presented

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as a credit in the profit and

Loss statements, either separately or under a general heading such as 'Other Income'. Alternatively, Rs.351 May be deducted in reporting the related expense i.e. employee benefit expenses.

(ii) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or byway of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the Central Governmentfor setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relationto revenue. Thus, amount of Rs.100 lakhs should be credited to capital reserve.

(iii) Rs.10 lakhs grant received for installation anti-pollution equipment is a grant related to specific fixed asset. Two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives. Under first method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognized in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Under the second method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

Thus, Rs.10 lakhs may either be deducted from the cost of equipment or treated as deferred income to be recognized on a systematic basis in profit & Loss A/c over the useful life of equipment.

Question 9

Samrat Limited has set up its business in a designated backward area which entitles the company for subsidy of 25% of the total investment from Government of India. The company has invested Rs.80 crores in the eligible investments. The company is eligible for the subsidy and has received Rs.20 crores from the government in February 2019. The company wants to recognize the said subsidy as its income to improve the bottom line of the company. Do you approve the action of the company in accordance with the Accounting Standard? (RTP Nov'19, Nov'22)

Answer 9

As per AS 12 "Accounting for Government Grants", where the government grants are in the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking orby 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 which can be neither distributed as dividend nor considered as deferred income. The subsidy received by Samrat Ltd. for setting up its business in a designated backward area will be treated as grant by the government in the nature of promoter's contribution as the grant is given with reference to the total investment in an undertaking i.e. subsidy is 25% of the eligible investment and also no repayment is apparently expected in respect thereof. US $ 8,547 = 5,00,000/58.50 Since the subsidy received is neither in relation to specific fixed assets nor in relation to revenue. Thus, the company cannot recognize the said subsidy as income in its financial statements in the given case. It should be recognized as capital reserve which can be neither distributed as dividend nor considered as deferred income.

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Question 10

A specific government grant of ₹ 15 lakhs was received by USB Ltd. for acquiring the Hi-Tech Diary plant of ₹ 95 lakhs during the year 2014-15. Plant has useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2017-18, 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 ₹ 10.50 lakhs and written down value of plant was ₹ 66.50 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of plant and the amount of depreciation to be charged during the year 2017 -18 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 2014-15 assuming plant account showed the balance of ₹ 56 lakhs as on 1.4.2017? You are required to explain in the line with provisions of AS 12. (RTP Nov 18)

Answer 10

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. 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 ₹ 15 lakhs and balance in deferred income is ₹ 10.50 lakhs, ₹ 4.50 lakhs shall be charged to the profit and loss account for the year 2017-18. 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 2014-15 then, para 21 of AS 12 statesthat 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 ₹ 15 lakhs. The increased cost of ₹ 15 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2017-18 shall be (56+15)/7 years = ₹ 10.14 lakhs presuming the d preciation is charged on SLM.

Question 11

A fixed asset is purchased for ₹ 30 lakhs. Government grant received towards it is ₹ 12 lakhs. Residual Value is ₹ 6 lakhs and useful life is 4 years. The company charges depreciation based on Straight-Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of ₹ 7.5 lakhs due to non-compliance with certain conditions. You are required to give necessary journal entries for second year. (RTP May '22)

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Answer 11

Journal Entries

Year	Particulars		₹ in lakhs (Dr.)	₹ in lakhs (Cr.)
2nd	Fixed Asset Account	Dr.	7.5	
	To Bank Account			7.5
	(Being government grant on asset partly re-fundedwhich increased the cost of fixed asset)			
	Depreciation Account (W.N.)	Dr.	5.5	
	To Fixed Asset Account			5.5
	(Being depreciation charged on SLM on re-visedvalue of fixed asset prospectively)			
	Profit & Loss Account	Dr.	5.5	
	To Depreciation Account			5.5
	(Being depreciation transferred to Profit and LossAccount at the end of year 2)			

Working Note:

Depreciation for Year 2

	₹ in lakhs
Cost of the Asset	30
Less: Government grant received	(12)
	18
Less: Depreciation for the first year [18-6 / 4]	3
	15
Add: Government grant refundable	7.5
Depreciation for the second year [22.5-6 / 3]	22.5

Question 12

On 1st April, 2016, Mac Ltd. received a Government Grant of ₹ 60 lakhs for acquisition of machinery costing ₹ 300 lakhs. The grant was credited to the cost of the asset. The estimated useful life of the machinery is 10 years. The machinery is depreciated @ 10% on WDV basis. The company had to refund the grant in June 2019 due to non- compliance of certain conditions. How the refund of the grant is dealt with in the books of Mac Ltd. assuming that the company did not charge any depreciation for theyear 2019-20. Pass necessary Journal Entries for the year 2019-20. (PYP 5 Marks Nov '20) (Same concept different figures MTP 5 Marks, Mar'22, MTP 5 Marks Oct 20, PYP 5 Marks May'18)

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Answer 12

		(₹ in lakhs)
1st April, 2016	Acquisition cost of machinery Less: Government Grant	300.00 60.00
		240.00
31st March, 2017	Less: Depreciation @ 10%	(24.00)
1st April, 2017	Book value	216.00
31st March, 2018	Less: Depreciation @ 10%	(21.60)
1st April, 2018	Book value	194.40
31st March, 2019	Less: Depreciation @ 10%	(19.44)
1st April, 2019	Book value Less: Depreciation @10% for 2 months	174.96 (2.916)
1st June, 2019	Book value	172.044
June 2019	Add: Refund of grant*	60.00
	Revised book value	232.044

Depreciation @10% on the revised book value amounting to ₹ 232.044 lakhs is to be providedpro-spectively over the residual useful life of the machinery.

*considered refund of grant at beginning of June month and depreciation for two months already charged. Alternative answer considering otherwise also possible.

Journal Entries

Machinery Account	Dr.	60	
To Bank Account			60
(Being government grant on asset partly refunded whichincreased the cost of fixed asset)			
Depreciation Account	Dr.	19.337	
To Machinery Account			19.337
(Being depreciation charged on revised value of fixed asset prospectively for 10 months)			
Profit & Loss Account	Dr.	22.253	
To Depreciation Account			22.253
(Being depreciation transferred to Profit and Loss Account amounting to ₹ (2.916 + 19.337= 22.253)			

Question 13

State whether the following statements are 'True' or 'False'. Also give reason for your answer. As per the provisions of AS-12, government grants in the nature of promoters' contribution which become refundable should be reduced from the capital reserve. (PYP May '19, 1 Mark)

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Answer 13

True: When grants in the nature of promoters' contribution becomes refundable, in part or in full to the government on non-fulfillment of some specified conditions, the relevant amount refundable to the government is reduced from the capital reserve.

Question 14

Alps Limited has received the following Grants from the Government during the year ended 31st March, 2021:

(i) ₹ 120 Lacs received as Subsidy from the Central Government for setting up an Industrial undertakingin Medak, a notified backward area.

(ii) ₹ 15 Lacs Grant received from the Central Government on installation of Effluent Treatment Plant.

(iii) ₹ 25 Lacs received from State Government for providing Medical facilities to its workmen during thepandemic.

Advise Alps Limited on the treatment of the above Grants in its books of Account in accordance with AS-12 "Government Grants". (PYP July'21, 5 Marks)

Answer 14

(i) As per AS 12 'Accounting for Government Grants', where the government grants are in 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 outly and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the Central Government for setting up an industrial undertaking in Medak is neither in relation to specific fixed asset nor in relation in revenue. Thus, the amount of ₹ 120 Lacs should be credited to capital reserve. (Note: Subsidy for setting up an industrial undertaking is considered to be in the nature of promoter's contribution)

(ii) As per AS 12 'Accounting for Government Grants', two methods of presentation in financial statementsof grants related to specific fixed assets are regarded as acceptable alternatives –

a. The grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.

b. Grants related to depreciable asset are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

In the given case, ₹ 15 Lacs was received as grant from the Central Government for installation of Effluent Treatment Plant. Since the grant was received for a fixed asset, either of the above methods can be adopted.

(iii) ₹ 25 lacs received from State Government for providing medical facilities to its workmen during the pandemic is a grant received in nature of revenue grant. Such grants are generally presented as a creditin the profit and loss statement, either separately or under a general heading such as "Other Income".Alternatively, ₹ 25 lacs may be deducted in reporting the related expense i.e., employee benefit expense.

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Question 15

Answer the following Questions:

(a) **Suraj Limited provides you the following information:**

(i) **It received a Government Grant @40% towards the acquisition of Machinery worth ₹ 25 Crores.**

(ii) **It received a Capital Subsidy of ₹ 150 Lakhs from Government for setting up a Plant costing ₹ 300 Lakhs in a notified backward region.**

(iii) **It received ₹ 50 Lakhs from Government for setting up a project for supply of arsenic free waterin a notified area.**

(iv) **It received ₹ 5 Lakhs from the Local Authority for providing Corona Vaccine free of charge to its employees and their families.**

(v) **It also received a performance award of ₹ 500 Lakhs from Government with a condition of major renovation in the Power Plant within 3 years. Suraj Limited incurred 90% of amount towards Capital expenditure and balance for Revenue Expenditure.**

State, how you will treat the above in the books of Suraj Limited.(PYP 5 Marks, May'22)

Answer 15

a)

(i) As per AS 12 "Accounting for Govt. Grants", two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives. Under the first alternative, the grant of ₹ 10 crores (40% of 25 crores) is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognized the profit and loss statement over the useful

life of a depreciable asset by way of a reduced depreciation charge. Under second alternative method, grant amounting ₹ 10 crores is treated as deferred income which is recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

(ii) In the given case, the grant amounting ₹ 150 lakhs received from the Central Government for setting up a plant in notified backward area may be considered as in the nature of promoters' contribution. Thus, amount of ₹ 150 lakhs should be credited to capital reserve and the plant will be shown at ₹ 300 lakhs.

(iii) ₹ 50 lakhs received from Govt. for setting up a project for supply of arsenic free water in notified area should be credited to capital reserve.

Alternatively, if it is assumed that the project consists of capital asset only, then the amountof ₹ 50 lakhs received from Govt. for setting up a project for supply of arsenic free water shouldeither be deducted from cost of asset of the project concerned in the balance sheet or treated as deferred income which is recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

(iv) ₹ 5 lakhs received from the local authority for providing corona vaccine to the employees is a grant received in nature of revenue grant. Such grants are generally presented as a credit in the profit and loss account, either separately or under a general heading 'Other Income'. Alternatively, ₹ 5 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

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(v) ₹ 500 Lakhs will be reduced from the renovation cost of power plant or will be treated as deferred income irrespective of the expenditure done by the entity out of it as it was specifically received for the purpose major renovation of power plant. However, it may be, later on, decided by the Govt. whether the grant will have to be refunded or not due to non- compliance of conditions attached to the grant.

Question 16

On 1stApril 2021, Eleanor Limited purchased a manufacturing Plant for Rs. 60 lakhs, which has an estimated useful life of Rs. 10 years with a salvage value of Rs. 10 lakhs. On purchase of the Plant, a grant of Rs. 20 lakhs was received from the government.

You are required to calculate the amount of depreciation as per AS-12 for the financial year 2022-23 in the following cases:

(i) If the grant amount is deducted from the value of Plant.

(ii) If the grant is treated as deferred income.

(iii) If the grant amount is deducted from the value of Plant, but at the end of the year 2022 -2023grant is refunded to the extent of Rs. 4 lakhs, due to non-compliance of certain conditions.

(iv) If the grant is treated as the promoter's contribution.

(Assume depreciation on the basis of Straight-Line Method.) (PYP 5 Marks May '23)

Answer 16

Calculation of depreciation as per AS 12 for the financial year 2022-23:

(i) If the grant amount is deducted from the value of Plant, then the amount of deprecation will be Rs.3,00,000 p.a. (Rs. 60,00,000 - Rs. 10,00,000 - Rs. 20,00,000) / 10 year.

(ii) If the grant is treated as deferred income, then amount of depreciation will be Rs. 5,00,000 p.a. (Rs. 60,00,000 - Rs. 10,00,000) / 10 year.

(iii) If the grant amount is deducted from the value of plant, but at the end of the year 2022-23 grant is refunded to the extent of Rs. 4 lakh then the amount of depreciation will be Rs. 3,00,000 p.a. (Rs. 60,00,000 - Rs. 10,00,000 - Rs. 20,00,000) /10 year for year 202122 and for the year 2022-23 Depreciation will be Rs. 3,00,000 calculated as follows, (Rs.60,00,000 - Rs. 10,00,000 - Rs. 20,00,000– Rs. 3,00,000) / 10 years.

Note: It is assumed that the depreciation for the year has been charged on the book value on the plant before making adjustment for grant. Alternatively, if it is considered otherwise then thedepreciation will be charged after making adjustment for grant. In that case depreciation for theyear 2022-23 will be as Rs. 3,44,444 calculated as follows, (Rs. 60,00,000 - Rs.10,00,000 - Rs. 20,00,000 + 4,00,000– Rs. 3,00,000 / 9 years

(iv) If the grant is treated as promoter's contribution, then the amount of depreciation will be Rs. 5,00,000 p.a. (Rs. 60,00,000 -10,00,000) /10 year.

NOTE: The answer can be presented in the following alternative manner:

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		(i)	(ii)	(iii)	(iv)
Date	**Particulars**	**Grant Value deducted from Plant**	**Grant treatedas Deferred Income**	**Grant Refunded**	**Grant is treated as Pro-moter's Contribu-tion**
01.04.2021	Cost of Plant Less: Salvage	60,00,000 10,00,000	60,00,000 10,00,000	60,00,000 10,00,000	60,00,000 10,00,000
		50,00,000	**50,00,000**	**50,00,000**	**50,00,000**
01.04.2021	Less: Grant	20,00,000	-	20,00,000	-
		30,00,000	50,00,000	30,00,000	50,00,000
	Useful Life(years)	10	10	10	10
31.03.2022	Depreciation FY 2021-22	3,00,000	5,00,000	3,00,000	5,00,000
1.4.2022	Cost of Plant Less: Salvage			60,00,000 10,00,000	
				50,00,000	
	Less: Grant			20,00,000	
	Less:			30,00,000	
	DepreciationFY 2022-23			3,00,000	
				27,00,000	
	Book value at the time of refund o f grant i.e. at the end of period			4,00,000	
	Add: Grant Refund-able at endof 22-23 Book value			31,00,000	
	available for remining 8 years.				

Note: It is assumed that the depreciation for the year has been charged on the book value on the plant beforemaking adjustment for grant. Alternatively, if it is considered otherwise then the de-preciation will be charged after making adjustment for grant. In that case depreciation for the year

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2022-23 will be as:

Cost of Plant	60,00,000
Less: Salvage	10,00,000
	50,00,000
Less: Grant	20,00,000
	30,00,000
Add: Grant Refundable	4,00,000
	34,00,000
Less: Depreciation For 2021-22	3,00,000
	31,00,000
Useful Life (years)	9
Depreciation For 2022-23	3,44,444

Question 17

S Ltd. has received a grant of 18 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed 12 crores as dividend.

Also, S 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. (RTP Nov '23)

Answer 17

As per AS 12, when government grant is received for a specific purpose, it should be utilized for the same.

Thus, the grant received for setting up a factory is not available for distribution of dividend.As per AS-12, if an asset is acquired free of cost it is to be recorded at a nominal value.

Thus, 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 of the grant is incorrect as per AS 12.

Question 18

To encourage industrial promotion, IDCI offers subsidy worth Rs. 50 lakhs to all new industries set up in the specified industrial areas. This grant is in the nature of promoter's contribution. How such subsidy shouldbe accounted in the books?

a. Credit it to capital reserve

b. Credit it as 'other income' in the profit and loss account in the year of commencement ofcommercial operations

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

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Ans: (a)

Question 19

Government grants that are receivable as compensation for expenses or losses incurred in a previous accounting period or for the purpose of giving immediate financial support to the enterprise with no further related costs, should be

d. recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable as an ordinary item.

e. recognised and disclosed in the Statement of Profit and Loss of the period in which the losses orexpenses were incurred.

f. recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable, as an extraordinary item if appropriate as per AS 5.

Ans: (c)

Question 20

Which of the following is an acceptable method of accounting presentation for a government grant relatingto an asset?

g. Show the grant as part of Capital Reserve

h. Reduce the grant from the cost of the asset or show it separately as a deferred income on the Liabilityside of the Balance Sheet.

i. Show the grant as part of general Reserve

Ans: (c)

Question 21

X Ltd. has received a grant of ₹ 20 crore for purchase of a qualified machine costing ₹ 80 crore. X Ltd has a policy to recognise the grant as a deduction from the cost of the asset. The expected remaining useful lifeof the machine is 10 years. Assume that there is no salvage value and the depreciation method is straight- line. The amount of annual depreciation to be charged as an expense in Profit and Loss Statement will be:

a. ₹ 10 crore	b. ₹ 6 crore
c. ₹ 2 crore	d. ₹ 8 crore

Ans: (b)

Question 22

X Ltd has received a grant of ₹ 20 crore for purchase of a qualified machine costing ₹ 80 crore. X Ltd. has a policy to recognise the grant as deferred income. The expected remaining useful life of the machine is 10years. Assume that there is no salvage value and the depreciation method is straight-line. The amount ofother income to be to be recognised in Profit and Loss Statement will be:

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a. ₹ 10 crore	b. ₹ 6 crore
c. ₹ 2 crore	d. ₹ 8 crore

Ans: (c)

Theoretical Questions Answers

Questions 23

AS 12 deals with recognition and measurement of government grants. Please elaborate the parameterswhich are required to be met before an entity can recognise government grants in its books?

Answer 23

A government grant is recognised when there is reasonable assurance that:

- the enterprise will comply with the conditions attaching to it; and
- the grant will be received.

Receipt of a grant is not of itself conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.

Practical Questions Answers

Question 24

Supriya Ltd. received a grant of Rs. 2,500 lakhs during the accounting year 20X1-20X2 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 20X2-20X3, it was found that the conditions ofgrants were not complied with and the grant had to be refunded to the government in full. Elucidatethe current accounting treatment, with reference to the provisions of AS-12

Answer 24

As per 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 chargedimmediately 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.

Question 25 -Illustration

Co X runs a charitable hospital. It incurs salary of doctors, staff etc to the extent of ₹ 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of ₹90 lakhs to meet the salary expense for a period of next 5 years.

You are required to pass the necessary journal entries in the books of the company for first year

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if thegrant is:

(a) **Shown separately as Other Income; and**

(b) **Deducted against the Salary costs.**

Answer 25 (a)

Particulars		₹ (Dr.)	₹ (Cr.)
Bank Account		90,00,000	
To Deferred Income Account	Dr.		90,00,000
(Being receipt of grant from government)			
Salary Expense Account To	Dr.		
To Deferred Income Account			
Bank Account		30,00,000	
(Being Salary expense paid for the year)	Dr.		30,00,000

Deferred Income Account			
To Other Income Account		18,00,000	
(Being Year 1 Grant income recognised in Profit & Loss)			18,00,000

Note:

The grant has been spread on a straight-line basis over a period of 5 years [₹90,00,000/5 years = ₹ 18,00,000].

Particulars		₹ (Dr.)	₹ (Cr.)
Bank Account	Dr.	90,00,000	
To Deferred Income Account			90,00,000
(Being receipt of grant from government)			
Salary Expense Account	Dr.	12,00,000	
To Bank Account			12,00,000
(Being Salary expense paid (net of grant income) for the year)			
Deferred Income Account	Dr.	18,00,000	
To Salary Expense Account			18,00,000
(Being Year 1 grant adjusted against Salary expense for theyear)			

Question 26(Illustration)

Z Ltd. purchased a fixed asset for Rs. 50 lakhs, which has the estimated useful life of 5 years with the salvage value of Rs. 5,00,000. On purchase of the assets government granted it a grant for Rs. 10

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lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant amount is deducted from the value of fixed asset.

Answer 26

Journal in the books of Z Ltd.

Year	*Particulars*		*Rs. (Dr.)*	*Rs. (Cr.)*
1st	Fixed Assets Account To Bank Account	Dr.	50,00,000	
	(Being Fixed Assets purchased)			50,00,000
	Bank Account	Dr.	10,00,000	
	To Fixed Assets Account (Being grant received from the government)			10,00,000
	Depreciation Account	Dr.	7,00,000	
	To Fixed Assets Account (Being Depreciation charged on SLM)			7,00,000
	Profit & Loss Account	Dr.	7,00,000	
	To Depreciation Account (Being Depreciation transferred to P/L Account)			7,00,000
2nd	Depreciation Account To Fixed Assets Account	Dr.	7,00,000	
	(Being Depreciation charged on SLM)			7,00,000
	Profit & Loss Account	Dr.	7,00,000	
	To Depreciation Account (Being Depreciation transferred to P/L Account)			7,00,000

Question 27 -Illustration

Z Ltd. purchased a fixed asset for Rs. 50 lakhs, which has the estimated useful life of 5 years with the salvage value of Rs. 5,00,000. On purchase of the assets government granted it a grant for Rs. 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant is treated as deferred income.

Answer 27

Journal in the books of Z Ltd.

Year	*Particulars*		*Rs. (Dr.)*	*Rs. (Cr.)*
1st	Fixed Assets Account	Dr.	50,00,000	
	To Bank Account (Being fixed assets purchased)			50,00,000

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	Bank Account	Dr.	10,00,000	
	To Deferred Government Grant Account (Being grant received from the government)			10,00,000
	Depreciation Account	Dr.	9,00,000	
	To Fixed Assets Account (Being depreciation charged on SLM)			9,00,000
	Profit & Loss Account	Dr.	9,00,000	
	To Depreciation Account (Being depreciation transferred to P/L Account)			9,00,000
	Deferred Government Grants Account	Dr.	2,00,000	
	To Profit & Loss Account (Being proportionate government grant taken to P/LAccount)			2,00,000
2nd	Depreciation Account	Dr.	9,00,000	
	To Fixed Assets Account (Being depreciation charged on SLM)			9,00,000
	Profit & Loss Account	Dr.	9,00,000	
	To Depreciation Account (Being depreciation transferred to P/L Account)			9,00,000
	Deferred Government Grant Account	Dr.		
	To Profit & Loss Account (Being proportionate government grant taken to P/LAccount)		2,00,000	2,00,000

Question 28 -Illustration

Santosh Ltd. has received a grant of Rs.8 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed Rs.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 28

As per AS 12 'Accounting for Government Grants', when government grant is received for a specific purpose, it should be utilised for the same. So the grant received for setting up a factory is not availablefor 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 of the grantis incorrect as per AS 12.

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Question29 Illustration

Top & Top Limited has set up its business in a designated backward area which entitles the companyto receive from the Government of India a subsidy of 20% of the cost of investment, for which no repayment was ordinarily expected. Moreover, there was no condition that the company should purchase any specified assets for this subsidy. Having fulfilled all the conditions under the scheme, the company on its investment of Rs. 50 crore in capital assets received Rs. 10 crore from the Government in January, 20X2 (accounting period being 20X1-20X2). The company wants to treat thisreceipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 20X2. Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.

Answer 29

As per para 10 of AS 12 'Accounting for Government 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 which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus, it is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs. The correct treatment is to credit the subsidy to capital reserve. Therefore, the accounting treatment desired by the company is not proper.

Question 30 Illustration

(i) How would you treat the following in the accounts in accordance with AS 12 'Government **Grants'?**

(ii) **Rs. 35 Lakhs received from the Local Authority for providing Medical facilities to the employees.**

Rs. 100 Lakhs received as Subsidy from the Central Government for setting up a unit in notified backward area. This subsidy is in nature of nature of promoters' **contribution.**

Answer 30

Rs. 35 lakhs received from the local authority for providing medical facilities to the employees is agrant received in nature of revenue grant. Such grants are generally presented as a credit in the

profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, Rs. 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

As per AS 12 'Accounting for Government Grants', where the government grants are in 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 and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of Rs.100 lakhs should be credited to capital reserve.

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Question 31-Illustration

Z Ltd. purchased a fixed asset for Rs. 50 lakhs, which has the estimated useful life of 5 years with thesalvage value of Rs. 5,00,000. On purchase of the assets government granted it a grant for Rs. 10 lakhs (This amount was reduced from the cost of fixed asset). Grant was considered as refundable in the end of 2nd year to the extent of Rs. 7,00,000. Pass the journal entry for refund of the grant as per the first method.

Answer 31

Fixed Assets Account	Dr. Rs.	7,00,000	
To Bank Account	Rs.		7,00,000

(Being government grant on asset refunded)

Question 32-Illustration

A fixed asset is purchased for Rs. 20 lakhs. Government grant received towards it is Rs. 8 lakhs. Residual Value is Rs. 4 lakhs and useful life is 4 years. Assume depreciation on the basis of Straight Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundableto the extent of Rs. 5 lakhs due to non- compliance with certain conditions. Pass journal entries for first two years.

Answer 32

Journal Entries

Year	*Particulars*		*Rs. in lakhs (Dr.)*	*Rs. in lakhs (Cr.)*
1	Fixed Asset Account	Dr.	20	
	To Bank Account (Being fixed asset purchased)			20
	Bank Account	Dr.	8	
	To Fixed Asset Account (Being grant received from the government reduced the cost of fixed asset)			8
	Depreciation Account (W.N.1)	Dr.	2	
	To Fixed Asset Account (Being depreciation charged on Straight Linemethod (SLM))			2
2	Profit & Loss Account	Dr.	2	

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	To Depreciation Account (Being depreciation transferred to Profit and LossAccount at the end of year 1)			2
	Fixed Asset Account	Dr.		
	To Bank Account (Being government grant on asset partly refunded which increased the cost of fixed asset)			
	Depreciation Account (W.N.2)	Dr.	5	
	To Fixed Asset Account (Being depreciation charged on SLM on re-visedvalue of fixed asset prospectively)			5
	Profit & Loss Account	Dr.	3.67	
	To Depreciation Account (Being depreciation transferred to Profit and LossAccount at the end of year 2)			3.67

1. Working **Notes:Depreciation for Year 1**

	Rs. ***in lakhs***
Cost of the Asset	20
Less: Government grant received	(8)
	12
Depreciation 12-4/4	2

Depreciation for Year 2

	Rs. ***in lakhs***
Cost of the Asset	20
Less: Government grant received	(8)
	12
Less: Depreciation for the first year $\left(\frac{12-4}{4}\right)$	2
	10
Add: Government grant refundable	5
	10
Depreciation for the second year $\left(\frac{15-4}{3}\right)$	3.67

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Question 33 -Illustration

On 1.4.20X1, ABC Ltd. received Government grant of Rs. 300 lakhs for acquisition of machinery costing Rs. 1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 20X4 due to non-fulfilment of certain conditions.

How you would deal with the refund of grant in the books of ABC Ltd. assuming that the company did not charge any depreciation for year 20X4?

Answer 33

According to para 21 of AS 12 on Accounting for Government Grants, the amount refundable in respectof a grant related to a specific fixed asset should be recorded by increasing the book value of the assetor by reducing deferred income balance, as appropriate, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

		*(Rs. **in lakhs**)*
1st April, 20X1	Acquisition cost of machinery (Rs. 1,500 – Rs. 300)	1,200.00
31st March, 20X2	Less: Depreciation @ 20%	(240.00)
	Book value	960.00
31st March, 20X3	Less: Depreciation @ 20%	(192.00)
	Book value	768.00
31st March, 20X4	Less: Depreciation @ 20%	(153.60)
1st April, 20X4	Book value	614.40
May, 20X4	Add: Refund of grant	300.00
	Revised book value	914.40

Depreciation @ 20% on the revised book value amounting Rs. 914.40 lakhs is to be provided prospectively over the residual useful life of the asset.

Question 34-Illustration

A Ltd. purchased a machinery for Rs. 40 lakhs. (Useful life 4 years and residual value Rs. 8 lakhs) Government grant received is Rs. 16 lakhs. Show the Journal Entry to be passed at thetime of refund of grant in the third year and the value of the fixed assets, if:

(1) **the grant is credited to Fixed Assets A/c.**

(2) **the grant is credited to Deferred Grant A/c.**

Answer 34

In the books of A Ltd. Journal Entries (at the time of refund of grant)

(1) **If the grant is credited to Fixed Assets Account:**

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		Rs.	Rs.
I	Fixed Assets A/c Dr. To Bank A/c (Being grant refunded)	16 lakhs	16 lakhs

II The balance of fixed assets after two years depreciation will be Rs.16 lakhs (W.N.1) and after refund of grant it will become (Rs.16 lakhs + Rs.16 lakhs)

= Rs.32 lakhs on which depreciation will be charged for remaining two years. Depreciation = (32-8)/2 = Rs.12 lakhs p.a. will be charged for next two years.

(2) If the grant is credited to Deferred Grant Account:

As per para 14 of AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (Rs.16 lakhs /4 years) = Rs.4 lakhs p.a. x 2 years = Rs.8 lakhs were credited to Profit and Loss Account and Rs.8 lakhs was the balance of Deferred Grant Account after two years.

Therefore, on refund in the 3rd year, following entry will be passed:

		Rs.	Rs.
1	Deferred Grant A/c Dr.	8 lakhs	
	Profit & Loss A/c Dr	8 lakhs	
	To Bank A/c		
	(Being Government grant refunded)		16 lakhs

II Deferred grant account will become Nil. The fixed assets will continue to be shown in the books at Rs.24 lakhs (W.N.2) and depreciation will continue to be charged atRs.8 lakhs per annum for the remaining two years.

Working Notes:

1. **Balance of Fixed Assets after two years but before refund (under first alternative)** Fixed assets initially recorded in the books = Rs.40 lakhs – Rs.16 lakhs = Rs.24 lakhsDepreciation p.a. = (Rs.24 lakhs – Rs.8 lakhs)/4 years = Rs.4 lakhs per year Value of fixed assets after two years but before refund of grant = Rs.24 lakhs – (Rs.4 lakhs x2 years) = Rs.16 lakhs

2. **Balance of Fixed Assets after two years but before refund (under secondalternative)**

   Fixed assets initially recorded in the books = Rs.40 lakhs

   Depreciation p.a. = (Rs.40 lakhs – Rs.8 lakhs)/4 years = Rs.8 lakhs per year Book value offixed assets after two years = Rs.40 lakhs – (Rs.8 lakhs x 2 years) = Rs.24 lakhs

   Note: Value of fixed assets given above is after refund of government grant.

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Question 35–Illustration

Co X runs a charitable hospital. It incurs salary of doctors, staff etc to the extent of ₹ 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of ₹90 lakhs to meet the salary expense for a period of next 5 years.

At the start of Year 4, Co X is unable to meet the conditions attached to the grant and is required torefund the entire grant of 90 lakhs.

You are required to pass the necessary journal entries in the books of the company for refund of thegrant if the grant was shown separately as Other Income.

Answer 35

		₹	₹
Deferred Grant A/c	Dr.	36 lakhs	
Profit & Loss A/c	Dr.	54 lakhs	
To Bank A/c			90 lakhs
(Being Government grant refunded)			

Workings:

Total grant received: ₹ 90 Lakhs Grant recognised as

income for first 3 years: ₹ 18 lakhs × 3 = ₹ 54 lakhs

Remaining Deferred Income = ₹ 90 Lakhs – 54 lakhs = ₹ 36 lakhs

Reference: The students are advised to refer the full text of AS 12 "Accounting for Government Grants".

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Chapter 9.2

AS 14- Accounting for Amalgamation

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.2 TO Q.14											
Past Exams	NO	NO	Q.2	NO	NO	NO	NO	NO	NO	NO	NO	NO
MTP	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	Q.1
RTP	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO

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Chapter 9.2

AS 14- Accounting for Amalgamation

Question 1

Briefly explain the methods of accounting for amalgamation as per Accounting Standard-14. (New SM)(MTP 4 Marks Oct '23)

Answer 1

As per AS 14 on 'Accounting for Amalgamations', there are two main methods of accounting for amalgamations:

The Pooling of Interest Method

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 the necessary adjustments).

If at the time of 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 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'. The 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 assetsand liabilities not recorded in the financial statements of the transferor company.

Question 2

Distinguish between Amalgamation, Absorption and External Reconstruction of Company. (PYP 5 Marks May '19)

Answer 2

Difference between Amalgamation, Absorption and External Reconstruction

Basis	Amalgamation	Absorption	External Reconstruction
Meaning	Two or more companies are wound up and a new company is formed to take over their business.	In this case, an existing company takes over the business of one or more existing companies.	In this case, a newly formed company takes over the business of an existingcompany.
Minimum number of Companies involved	At least three are companies involved.	At least two companies areinvolved.	Only two companies areinvolved.

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Number of new resultant companies	Only one resultant Company is formed. Twocompanies are wound upto form a single resultantcompany.	No new resultantcompany is formed.	Only one resultant company is formed. Underthis case a newly formed company takes over the business of an existing company.
Objective	Amalgamation is done to cut competition and reap the economies in large scale.	Absorption is done to cut competition and reap the economies in large scale.	External reconstruction is done to reorganise the financial structure of the company.
Example	A Ltd. and B Ltd.amalgamate to form C Ltd.	A Ltd. takes over thebusiness of another existing company B Ltd.	B Ltd. is formed to take overthe business of an existing company A Ltd.

Question 3

Which of the following statement is correct:

(a) In case of merger – ESH can be issued only equity shares as a part of Purchase consideration.

(b) In case of purchase – ESH can be issued Preference shares also as a part of Purchase consideration.

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

(d) Both (a) and (b) are incorrect.

Ans: (b)

Question 4

State which statement is correct:

(e) In case of merger – assets and liabilities can only be taken over at book values.

(f) In case of purchase – assets and liabilities can be taken over at book values or agreed values.

(g) Both (a) and (b) are correct.

(h) Both (a) and (b) are incorrect.

Ans: (c)

Question 5

State which statement is correct:

(i) In case of merger – All Reserves and surplus of vendor company are taken over by Purchasingcompany.

(j) In case of Purchase – None of the Reserves and surplus of vendor company are taken

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over byPurchasing company.

(k) Both (a) and (b) are correct.

(l) Only (a) is correct.

Ans: (d)

Question 6

State which statement is correct:

(m) In case of merger – We use pooling of interest method for accounting.

(n) In case of Purchase We use purchase method or pooling of interest method depending uponwhether it is take over at agreed values or book values.

(o) Both (a) and (b) are correct.

(p) Only (a) is correct.

Ans: (d)

Question 7

State which statement is incorrect:

(q) In case of merger – We can issue either preference shares or equity shares to PSH.

(r) In case of Purchase – We can issue either preference shares or equity shares toPSH.

(s) In case of merger – We can issue only preference shares to PSH.

(t) none of the above.

Ans: (c)

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Theoretical Questions Answers

Question 8

Briefly describe the disclosure requirements for amalgamation including additional disclosure, if any, for different methods of amalgamation as per AS 14 (Revised).

Answer 8

The disclosure requirements for amalgamations have been prescribed in paragraphs 43 to 46 of AS 14 (Revised) on Accounting for Amalgamation. 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 amortisation of any goodwill arising on amalgamation.

Question 9

List the conditions to be fulfilled as per AS 14 (Revised) for an amalgamation to be in the nature of merger, in the case of companies. (Ch 13)

Answer 9

An amalgamation should be considered to be an amalgamation in the nature of merger if the specified conditions are satisfied. 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

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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.

Question 10

Briefly explain the methods of accounting for amalgamation as per Accounting Standard-14.

Answer 10

As per AS 14 on 'Accounting for Amalgamations', there are two main methods of accounting for amalgamations:

The Pooling of Interest Method

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 the necessary adjustments).

If at the time of 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 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

The 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.

Practical Questions Answers

Question 11

X Co. Ltd. having share capital of Rs. 50 lakhs divided into equity shares of Rs. 10 each was taken over by Y Co. Ltd. Y Co. Ltd. issued 11 equity shares of Rs. 10 each for every 10 shares of X Co. Ltd.

Explain how the difference will be adjusted in the books of Y Co. Ltd. for the shares issued underthe 'Pooling of interests method' of amalgamation as per AS 14.

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Answer 11

Particulars	Rs.
Purchase consideration = 5,00,000 x 11/10 = 55,000	55,00,000
shares of Rs. 10 each	50,00,000
Less: Share capital of X Co. Ltd.	
Difference Adjusted through General Reserve	5,00,000

Question 12

On 1st April, 2018, Tina Ltd. take over the business of Rina Ltd. and discharged purchase consideration as follows:

(i) **Issued 50,000 fully paid Equity shares of Rs. 10 each at a premium of Rs. 5 per share to the equityshareholders of Rina Ltd.**

(i) **Cash payment of Rs. 50,000 was made to equity shareholders of Rina Ltd.**

(ii) **Issued 2,000 fully paid 12% Preference shares of Rs. 100 each at par to discharge the preference shareholders of Rina Ltd.**

(iii) **Debentures of Rina Ltd. 20,000) will he converted into equal number and amount of 10%debentures of Tina Ltd.**

Calculate the amount of Purchase consideration as per AS-14 and pass Journal Entry relating to discharge of purchase consideration in the books of Tina Ltd.

Answer 12

As per AS 14, 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.

Computation of PurchaseConsideration

Particulars	Rs.
Equity Shares (50,000x 15)	7,50,000
Cash payment	50,000
12% Preference Share Capital	2,00,000
Purchase Consideration	10,00,000

Note: Payment to debenture holders are not covered by the term 'consideration'.

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Journal entry

Particulars	Rs.	Rs.
Liquidation of Rina Ltd. A/c	10,00,000	
To Equity share capital A/c		5,00,000
To 12% Preference share capital A/cTo Securities premium A/c		2,00,000
To Bank/Cash A/c		2,50,000
(Being payment of cash and issue of shares for dischargeof purchase consideration)		50,000

Questions Illustration 13

A Ltd. take over B Ltd. on April 01, 20X1 and discharges consideration for the business as follows:

(i) **Issued 42,000 fully paid equity shares of Rs. 10 each at par to the equity shareholders of B Ltd.**

(ii) **Issued fully paid up 15% preference shares of Rs. 100 each to discharge the preferenceshareholders (Rs. 1,70,000) of B Ltd. at a premium of 10%.**

(iii) **It is agreed that the debentures of B Ltd. (Rs. 50,000) will be converted into equal number andamount of 13% debentures of A Ltd.**

Determine the amount of purchase consideration as per AS 14.

Answer 13

Particulars	Rs.
Equity Shares (42,000 x 10)	4,20,000
15% Preference Share Capital	1,70,000
Add: Premium on Redemption	17,000
Purchase Consideration	6,07,000

Note: As per AS 14, consideration for the amalgamation means the aggregate ofthe shares and other securities issued and the payment made in the form of cashor other assets by the transferee company to the shareholders of the transferor company. Thus, payment to debenture holders are not covered by the term 'consideration'.

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Questions Illustration 14

A Ltd. and B Ltd. were amalgamated on and from 1st April, 20X1. A new company C Ltd. was formedto take over the business of the existing companies. A Ltd. and B Ltd. have the following ledger balances as on 31st March, 20X1:

	A Ltd. (Rs. in lakhs)	B Ltd. (Rs. in lakhs)
Land and Building	550	400
Plant and Machinery	350	250
Investments (Non-current)	150	50
Inventory	350	250
Trade Receivables	300	350
Cash and Bank	300	200
Share Capital:		
Equity Shares of Rs. 100 each	800	750
12% Preference shares of Rs. 100 each	300	200
Reserves and Surplus:		
Revaluation Reserve	150	100
General Reserve	170	150
Investment Allowance Reserve	50	50
Profit and Loss Account	50	30
Secured Loans:		
10% Debentures (Rs. 100 each)	60	30
Trade Payables	420	190

Additional Information:

(1) **10% Debenture holders of A Ltd. and B Ltd. are discharged by C Ltd. issuingsuch number of its 15% Debentures of Rs. 100 each so as to maintain the same amount of interest.**

(2) **Preference shareholders of the two companies are issued equivalent numberof 15% preference shares of C Ltd. at a price of Rs. 150 per share (face value of Rs. 100).**

(3) **C Ltd. will issue 5 equity shares for each equity share of A Ltd. and 4 equity shares for each equity share of B Ltd. The shares are to be issued @ Rs. 30 each, having a face value of Rs. 10 per share.**

(4) **Investment allowance reserve is to be maintained for 4 more years.**

Prepare the Balance Sheet of C Ltd. as on 1st April, 20X1 after the amalgamationhas been carried out on the basis of Amalgamation in the nature of purchase.

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Answer1 4

Particulars	Note No.	(Rs.in lakhs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,200
(b) Reserves and Surplus	2	1,650
	3	60
(2) Non-Current Liabilities Long-termborrow-ings	8	610
(3) Current Liabilities Tradepayables		3,520
Total		
II. Assets		
(1) Non-current assets		
(a) Property, Plant andEquipment		1,550
(b) Intangible assets		
(c) Non-current investments		
(2) Current assets	4	
(a) Inventory (350 + 250)		20
(b) Trade receivables	5	
(c) Cash and bank balances (300 +200)	6	200
		600
Total	7	650
		500
		3,520

Notes to Accounts

		(Rs.in lakhs)	(Rs.in lakhs)
1.	Share Capital		
	Equity share capital (W.N.1)		
	70,00,000[1] Equity shares of Rs.10 each	**700**	
	5,00,000[2] Preference shares of Rs.100 each	**500**	
	(all the above shares are allotted as fully paid-uppur-suant to contracts without payment being received in cash)		**1,200**

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2.	Reserves and surplus		
	Securities Premium Account (W.N.3) (950 + 700)	**1,650**	
	Investment Allowance Reserve (50 +50)	**100**	
	Amalgamation Adjustment Reserve(50 + 50)	**100**	**1,650**
3.	Long-term borrowings		
	15 % Debentures		**60**
4.	Property, Plant and Equipment		
	Land and Building (550 + 400)	**950**	
	Plant and Machinery (350 + 250)	**600**	**1,550**
5.	Intangible assets		
	Goodwill [W.N. 2] (110 – 90)		**20**
6.	Non-current Investments		
	Investments (150 + 50)		**200**
7.	Trade receivables (300 + 350)		**650**
	Trade payables (420 + 190)		**610**

Working Notes:

		(Rs. in lakhs)		
		A Ltd.		*B Ltd.*
1.	Computation of Purchase consideration			
	a) Preference shareholders:			
	$\left(\frac{3,00,00,000}{100}\right.$ i. e 3,00,000 *shares*) × ₹ 150 each	450		
	$\left(\frac{2,00,00,000}{100}\right.$ i. e 2,00,000 *shares*) × ₹ 150 each			300
	b) Equity shareholders:			
	$\left(\frac{8,00,00,000 \times 5}{100}\right.$ i. e 40,00,000 *shares*) × ₹ 30 each	1,200		
	$\left(\frac{7,50,00,000 \times 4}{100}\right.$ i. e 3,00,000 *shares*) × ₹ 30 each			900
	Amount of Purchase Consideration	1,650		1,200
2.	Net Assets Taken Over			
	Assets taken over:			
	Land and Building	550		400
	Plant and Machinery	350		250

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	Investments	150		50
	Inventory	350		250
	Trade receivables	300		350
	Cash and bank	300		200
		2000		1500
	Less: Liabilities taken over:		20	
	Debentures 40		190	
	Trade payables 420	460		210
	Net assets taken over	1540		1290
	Purchase consideration	1650		1200
	Goodwill	110		
	Capital reserve			90
	Computation of securities premiumOn			
3.	preference share capital			
	A Ltd.- 3,00,000 x 50	150		
	B Ltd.- 2,00,000 x 50			100
	On equity share capitalA			
	Ltd.- 40,00,000 x 20	800		
	B Ltd.- 30,00,000 x 20			600
	Total	950		700

Note: For problems based on practical application of AS 14 (Revised) students are advised to refer Chapter 14 'Accounting for Amalgamation of Companies' of the study material.

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Chapter 10.1

As – 21 Consolidated Financial Statements

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.26 TO Q.51											
Past Exams	Q.4	Q.22	Q.1	Q.10 Q.11	NO	Q.12	Q.9	NO	Q.23	Q.24	Q.19 Q.20	NO
MTP	Q.2 Q.3	Q.3	Q.1 Q.2	Q.1	Q.7	Q.5 Q.6	Q.4	Q.8 Q.9 Q.10	Q.4 Q.5	Q.10Q.11 Q.12	Q.9	Q.5 Q.8 Q.10Q.12
RTP	Q.3	Q.16	Q.11	Q.4	Q.17	Q.11 Q.15	Q.14	Q.13	Q.17	Q.18	Q.1	Q.25

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Chapter 10.1

As – 21 Consolidated Financial Statements

Question 1

A Ltd. acquired 70% of equity shares of B Ltd. on 1.4.2010 at cost of Rs. 10,00,000 when B Ltd. had an equity share capital of Rs. 10,00,000 and reserves and surplus of Rs. 80,000. In the four consecutive years, B Ltd. fared badly and suffered losses of Rs. 2,50,000, Rs. 4,00,000, Rs. 5,00,000 and Rs. 1,20,000respectively. Thereafter in 2014-15, B Ltd. experienced turnaround and registered an annual profit ofRs. 50,000. In the next two years i.e. 2015-16 and 2016-17, B Ltd. recorded annual profits of Rs. 1,00,000and Rs. 1,50,000 respectively. Show the minority interests and cost of control at the end of each year for the purpose of consolidation. (MTP 10 Marks Mar 19, MTP 12 Marks Oct 19, RTP May '23, PYP 10 Marks May '19, Old & New SM)

Answer 1

The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in theequity of the subsidiary. The excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered. Accordingly, the minority interests will be computed as follows:

Year	Profit/(Loss) Interest (30%)	Minority P&L (Dr.) Cr.	Additional Consolidated	Minority's Share oflosses borne byA Ltd. Rs. Balance		Cost of Control
At the		3,24,000				
time of		(W.N.)				
acquisition						
in 2010			-			
2010-11	(2,50,000)	(75,000)	(1,75,000)			2,44,000
						(W.N.)
Balance		2,49,000				
2011-12	(4,00,000)	(1,20,000)	(2,80,000)			2,44,000
Balance		1,29,000				
2012-13	(5,00,000)	(1,50,000)	(3,50,000)			2,44,000
		(21,000)				
	Loss of minority borne by Holding Co.	21,000	(21,000)	21,000	21,000	

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Balance		Nil	(3,71,000)			
2013-14	(1,20,000)	(36,000)	(84,000)			2,44,000
	Loss of minority borne by Holding Co.	36,000	(36,000)	6,000	57,000	
Balance		Nil	(1,20,000)			
2014-15	50,000	15,000	35,000			2,44,000
	Profit share of minority adjusted against losses of minority	(15,000)	15,000	15,000)	42,000	
	absorbed by Holding Co.	Nil	50,000			
2015-16	1,00,000	30,000	70,000			
	Profit share of minority adjusted against losses of minority absorbed by Holding Co.	(30,000)	30,000	(30,000)	12,000	2,44,000
Balance		Nil	100,000			
2016-17	1,50,000	45,000	1,05,000	(12,000)	Nil	2,44,000
		(12,000)	12,000			
Balance		33,000	1,17,000			

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Working Note:

	100% (Rs.)	Share of Holding Co. 70% (Rs.)	Minority Interest 30% (Rs.)
Share Capital	10,00,000	7,00,000	3,00,000
Reserve	80,000	56,000	24,000
		7,56,000	3,24,000
Less: Cost of investment		(10,00,000)	
Goodwill		2,44,000	

Question 2

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 2016 for Rs. 2,80,000. The issued capital of ABCLtd., on 1st January, 2016 was Rs. 2,00,000 and the balance in the Profit & Loss Account was Rs. 1,20,000. During the year ended 31st December, 2016, ABC Ltd. earned a profit of Rs. 40,000 and at year end,declared and paid a dividend of Rs. 60,000. Show by an entry how the dividend should be recorded in the books of XYZ Ltd. What is the amount of minority interest as on 1st January, 2016 and 31st December, 2016? (MTP 5 Marks, Apr 19, Mar 18) (Same concept different figures New SM)

Answer 2

Total dividend paid = Rs. 60,000

Out of post-acquisition profit = Rs. 40,000Out of pre-acquisition profit = Rs. 20,000

Hence, 2/3rd of dividend received by XYZ will be credited to P & L and 1/3rd will be credited to Investment. XYZ Ltd.'s share of dividend = Rs. 60,000 X 80% = Rs. 48,000

In the books of XYZ Ltd.

		Rs.	Rs.
Bank A/c	Dr.	48,000	
To Profit & Loss A/c			32,000
To Investments in ABC Ltd.			16,000
(Dividend received from ABC Ltd. 1/3 credited to investment			
A/c being out of capital profits – as explained above)			
Goodwill on Consolidation:			Rs.
Cost of shares less dividend out of capital profits			2,64,000
Less: Face value of capital i.e. 80% of capital		1,60,000	
Add: Share of capital profits [1,20,000-20,000			
(dividend portion out of pre-acquisition profits)] X 80 %		80,000	2,40,000
Goodwill			24,000
Minority interest on: 1st January, 2016: 20% of			

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Rs. 3,20,000 [2,00,000 + 1,20,000]			64,000
31st December, 2016: 20% of Rs. 3,00,000			
[2,00,000 + 1,20,000 + 40,000 – 60,000]			60,000

Question 3

Given below are the Profit & Loss Accounts of Hello Ltd. and its subsidiary Sun Ltd. for the year ended 31st March, 2017:

	Hello Ltd. (Rs. in lacs)	Sun Ltd. (Rs. in lacs)
Incomes:		
Sales and other income	**10,000**	**2,000**
Increase in Inventory	**2,000**	**400**
	12,000	**2,400**
Expenses :		
Raw material consumed	**1,600**	**400**
Wages and Salaries	**1,600**	**300**
Production expenses	**400**	**200**
Administrative Expenses	**400**	**200**
Selling and Distribution Expenses	**400**	**100**
Interest	**200**	**100**
Depreciation	**200**	**100**
	4,800	**1,400**
Profit before tax	**7,200**	**1,000**
Provision for tax	**2,400**	**400**
Profit after tax	**4,800**	**600**
Dividend paid	**2,400**	**300**
Balance of Profit	**2,400**	**300**

Other Information:

Hello Ltd. sold goods to Sun Ltd. of Rs. 240 lacs at cost plus 20%. Inventory of Sun Ltd. includes such goods valuing Rs. 48 lacs. Administrative expenses of Sun Ltd. include Rs. 10 lacs paid to Hello Ltd. as consultancy fees. Selling and distribution expenses of Hello Ltd. include Rs. 20 lacs paid to Sun Ltd. as commission. Hello Ltd. holds 80% of equity share capital of Rs. 2,000 lacs in Sun Ltd. prior to 2015- 2016. Hello Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by Sun Ltd. for the year 2015-2016.

You are required to prepare a consolidated profit and loss account of Hello Ltd. and its subsidiary SunLtd. for the year ended 31st March, 2017. (MTP 16 Marks Aug 18, RTP- May 18) (Same concept different figures to MTP 12 Marks Mar'18 & Oct '18)

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Answer 3

Consolidated Profit & Loss Account of Hello Ltd. and its subsidiary Sun Ltd. for the year ended on 31stMarch, 2017

	Particulars	Note No.	Rs. in Lacs
I.	Revenue from operations	1	11,730
II.	Total revenue		11,730
III.	Expenses		
	Cost of Material purchased/Consumed	3	2,360
	Changes of Inventories of finished goods	2	(2,392)
	Employee benefit expense	4	1,900
	Finance cost	6	300
	Depreciation and amortization expense	7	300
	Other expenses	5	1,070
	Total expenses		3,538
IV.	Profit before Tax(II-III)		8,192
V.	Tax Expenses	8	2,800
VI.	Profit After Tax		5,392
	Profit transferred to Consolidated Balance Sheet		
	Profit After Tax		5,392
	Dividend paid		
	Hello Ltd.	2,400	
	Sun Ltd.	300	
		2,700	
	Less: Share of Hello Ltd. in dividend of Sun Ltd.		
	80% of Rs. 300 lacs	(240)	(2,460)
	Profit to be transferred to consolidated balance sheet		2,932

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Notes to Accounts

		Rs. in Lacs	Rs. in Lacs
1.	Revenue from Operations		
	Sales and other income		
	Hello Ltd.	10,000	
	Sun Ltd.	2,000	
		12,000	
	Less: Inter-company Sales	(240)	
	Consultancy fees received by Hello Ltd. from Sun Ltd.	(10)	
	Commission received by Sun Ltd. from Hello Ltd.	(20)	11,730
2.	Increase in Inventory		
	Hello Ltd.	2,000	
	Sun Ltd.	400	
		2,400	
	Less: Unrealized profits Rs. 48 lacs ×20/120	(8)	2,392
			14,122
3.	Cost of Material purchased/consumed		
	Hello Ltd.	1,600	
	Sun Ltd.	400	
		2,000	
	Less: Purchases by Sun Ltd. from Hello Ltd.	(240)	1,760

Di-rect	Expenses		
	Hello Ltd.	400	
	Sun Ltd.	200	600
			2,360
4.	Employee benefits and expenses		
	Wages and Salaries:		
	Hello Ltd.	1,600	
	Sun Ltd.	300	1,900
5.	Other Expenses		
	Administrative Expenses		

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	Hello Ltd.	400	
	Sun Ltd.	200	
		600	
	Less: Consultancy fees received by Hello Ltd. from Sun Ltd.	(10)	590
	Selling and Distribution Expenses:		
	Hello Ltd.	400	
	Sun Ltd.	100	
		500	
	Less: Commission received from Sun Ltd. from Hello Ltd.	(20)	480
			1,070
6.	Finance Cost		
	Interest:		
	Hello Ltd.	200	
	Sun Ltd.	100	300
7.	Depreciation and Amortization		
	Depreciation:		
	Hello Ltd.	200	
	Sun Ltd.	100	300
8.	Provision for tax		
	Hello Ltd.	2,400	
	Sun Ltd.	400	2,800

Note: Since the amount of dividend received by Hello Ltd. for the year 2015-2016 is not given, it has not been deducted from 'sales and other income' in consolidated profit and loss account and not addedto consolidated opening retained earnings (which is also not given).

Question 4

H Ltd. and its subsidiary S Ltd. Give the following information as on 31st March, 2021:

	H Ltd. (Rs.)	S Ltd. (Rs.)
Share Capital		
Equity Share Capital (fully paid up shares of Rs. 10 each)	**12,00,000**	**2,00,000**
Reserves and Surplus	**4,35,000**	**1,55,000**
General Reserve	**2,80,000**	**65,000**

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Cr. Balance in Profit and Loss Account		
Current Liabilities		
Trade Payables	**3,22,000**	**1,23,000**
Non-Current Assets		

Property, Plant and Equipment		
Machinery	**6,40,000**	**1,80,000**
Furniture	**3,75,000**	**34,000**
Non-Current Investments		
Shares in S Ltd. - 16,000 shares @ Rs. 20 each	**3,20,000**	**-**
Current Assets		
Inventories	**2,68,000**	**62,000**
Trade Receivables	**4,70,000**	**2,35,000**
Cash and Bank	**1,64,000**	**32,000**

H Ltd. acquired the 80% shares of S Ltd. on 1st April, 2020. On the date of acquisition, General Reserve and Profit Loss Account of S Ltd. stood at Rs. 50,000 and Rs. 30,000 respectively.Machinery (book value Rs. 2,00,000) and Furniture (book value Rs. 40,000) of S Ltd. were revalued at Rs. 3,00,000 and Rs. 30,000 respectively on 1st April,2020 for the purpose of fixing the price of its shares (rates of depreciation on W.D.V basis: Machinery 10% and Furniture 15%). Trade Payables of H Ltd. include Rs. 35,000 due to S Ltd. for goods supplied since the acquisition of the shares. These goods are charged at 10% above cost. The inventories of H Ltd. includes goods costing Rs. 55,000 (cost to H Ltd.) purchased from S **Ltd. st**

You are required to prepare the Consolidated Balance Sheet of H Ltd. With its subsidiary as at 31 March, 2021. (MTP 16 Marks April 21, MTP 15 Marks Mar 22, RTP Nov 19, PYP 20 Marks May 18)

Answer 4

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, **2021**

Particulars	Note No.	(Rs.)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital (1,20,000 equity shares of Rs. 10 each)		12,00,000
(b) Reserves and Surplus	1	8,16,200
(2) Minority Interest (W.N.4)		99,300
(3) Current Liabilities		
(a) Trade Payables	2	4,10,000
Total		25,25,500
II. Assets		
(1) Non-current assets		

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	(i) Property, plant and equipment	3	13,10,500
	(ii) Intangible assets	4	24,000
(2)	Current assets		
	(i) Inventories	5	3,25,000
	(ii) Trade Receivables	6	6,70,000
	(iii) Cash at Bank	7	1,96,000
	Total		25,25,500

Notes to Accounts

				Rs.
1.	Reserves and Surplus			
	General Reserves		4,35,000	
	Add: 80% share of S Ltd.'s postacquistion reserves (W.N.3)		84,000	5,19,000
	Profit and Loss Account		2,80,000	
	Add: 80% share of S Ltd's postacquistion profits (W.N.3)	21,200		
	Less: Unrealised gain	(4,000)	17,200	2,97,200
2.	Trade Payables			8,16,200
	H Ltd.		3,22,000	
	S Ltd.		1,23,000	
	Less: Mutual transaction		(35,000)	4,10,000
3.	Property, plant and equipment			
	Machinery			
	H Ltd.		6,40,000	
	S Ltd.	2,00,000		
	Add: Appreciation	1,00,000		
		3,00,000		
	Less: Depreciation	(30,000)	2,70,000	9,10,000
	Furniture			
	H. Ltd.		3,75,000	
	S Ltd.	40,000		
	Less: Decrease in value	(10,000)		
		30,000		
	Less: Depreciation	(4,500)	25,500	4,00,500
4.	Intangible assets			13,10,500

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	Goodwill [WN 5]			24,000
5.	Inventories			
	H Ltd.		2,68,000	
	S Ltd.		62,000	3,30,000
	Less: Inventory reserve			(5,000)
6.	Trade Receivables			3,25,000
	H Ltd.		4,70,000	
	S Ltd.		2,35,000	7,05,000
	Less: Mutual transaction			(35,000)
7.	Cash and Bank			6,70,000
	H Ltd.		1,64,000	
	S Ltd.		32,000	1,96,000

1. Working **Notes:Profit or loss on revaluation of assets in the books of S Ltd. and their book values as on1.4.2020**

	Rs.
Machinery	
Revaluation as on 1.4.2020	3,00,000
Less: Book value as on 1.4.2020	(2,00,000)
Profit on revaluation	1,00,000
Furniture	
Revaluation as on 1.4.2020	30,000
Less: Book value as on 1.4.2020	(40,000)
Loss on revaluation	(10,000)

2. **Calculation of short/excess depreciation**

	Machinery	***Furniture***
Upward/ (Downward) Revaluation	1,00,000	(10,000)
Rate of depreciation	10% p.a.	15% p.a.
Difference [(short)/excess]	(10,000)	1,500

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3. Analysis of reserves and profits of S Ltd. as on 31.03.2021

				Pre- acquisition profit upto 1.4.2020	Post-acquisition profits (1.4.2020 – 31.3.2021)		
	(Capital profits)	General Reserve	Profit and loss account				
General reserve as on 31.3.2021				50,000	1,05,000		
Profit and loss account as on 31.3.2021				30,000		35,000	
Upward Revaluation of machinery as on 1.4.2020				1,00,000			
Downward Revaluation of Furniture as on 1.4.2020				(10,000)			
Short depreciation on machinery						(10,000)	
Excess depreciation on furniture						1,500	
Total							26,500
				1,70,000	1,05,000		

4. Minority Interest

	Rs.
Paid-up value of (2,00,000 x 20%)	40,000
Add: 20% share of pre-acquisition profits and reserves	
[(20% of (50,000 + 30,000)]	16,000
20% share of profit on revaluation	18,000
20% share of post-acquisition reserves	21,000
20% share of post-acquisition profit	5,300
	1,00,300
Less: Unrealised Profit on Inventory	
(55,000 x 10/110) x 20%	(1,000)
	99,300

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5. Cost of Control or Goodwill

Cost of Investment		3,20,000
Less: Paid-up value of 80% shares	1,60,000	
80% share of pre-acquisition profits andre-serves (Rs. 64,000 + Rs.72,000)	1,36,000	(2,96,000)
Cost of control or Goodwill		24,000

Question 5

A Ltd. holds 80% of the equity capital and voting power in B Ltd. A Ltd sells inventories costingRs. 180 lacs to B Ltd at a price of Rs. 200 lacs. The entire inventories remain unsold with B Ltd at the financial year end i.e. 31 March 2020. What will be the accounting treatment for this transaction in the consolidated financial statements of A Ltd? (MTP 5 Marks Oct 20, MTP 4 Marks Mar 22 & Oct '23)

Answer 5

This would be the case of downstream transaction. In the consolidated profit and loss account for the year ended 31 March 2020, entire transaction of sale and purchase of Rs. 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales). Further, the unrealized profits of Rs. 20 lacs (i.e. Rs. 200 lacs – Rs. 180 lacs), would be eliminated from the consolidated financial statements for financial year ended 31 March 2020, by reducing the consolidated profits/ increasing the consolidated losses, and reducing the value of closing inventories as of 31 March 2020.

Question 6

Hemant Ltd. purchased 80% shares of Power Ltd. on 1st January, 2019 for Rs. 2,10,000. The issued capital of Power Ltd., on 1st January, 2019 was Rs. 1,50,000 and the balance in the Profit & Loss Account was Rs. 90,000. During the year ended 31st December, 2019, Power Ltd. earned a profit of Rs. 30,000 and at year end, declared and paid a dividend of Rs. 22,500. What is the amount of minority interest as on 1st January, 2019 and 31st December, 2019? Also compute goodwill/ capital reserve at the date of acquisition. (MTP 6 Marks Oct 20, Old & New SM)

Answer 6

Total dividend paid is Rs. 22,500 (out of post-acquisition profits), hence dividend received by Hemant will be credited to P & L account.

Hemant Ltd.'s share of dividend = Rs. 22,500 X 80% = Rs. 18,000

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Goodwill on consolidation (at the date of acquisition):	Rs.	Rs.
Cost of shares		2,10,000
Less: Face value of capital i.e. 80% of capital	1,20,000	
Add: Share of capital profits [90,000 X 80 %]	72,000	(1,92,000)
Goodwill		18,000
Minority interest on: - **1st January, 2019:** 20% of Rs. 2,40,000 [1,50,000 + 90,000]		48,000
- **31st December, 2019:** 20% of Rs.2,47,500 [1,50,000 + 90,000 + 30,000 – 22,500]		49,500

Question 7

The summarized Profit and Loss Accounts of A Ltd. and its subsidiary B Ltd. for the year ended 31st March, 2020 are given below:

Rs. in Lakhs

Incomes	A Ltd.	B Ltd.
Sales and other income	**7,500**	**1,500**
Increase in Inventory	**1,500**	**300**
Total	**9,000**	**1,800**
Expenses		
Raw material consumed	**1,200**	**300**
Wages and Salaries	**1,200**	**225**
Production expenses	**300**	**150**
Administrative expenses	**300**	**150**
Selling and distribution expenses	**300**	**75**
Interest	**150**	**75**
Depreciation	**150**	**75**
Total	**3,600**	**1,050**
Profit before tax	**5,400**	**750**
Provision for tax	**1,800**	**300**
Profit after tax	**3,600**	**450**

The following information is also given:

(i) **A Ltd sold goods of Rs. 180 Lakhs to B Ltd at cost plus 25% (1/6 of such goods were still in inventory of B Ltd at the end of the year).**

(ii) **Administrative expenses of B Ltd include Rs. 8 Lakhs paid to A Ltd as consultancy fees.**

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(iii) Selling and distribution expenses of A Ltd include Rs.15 Lakhs paid to B Ltd as commission.

(iv) A Ltd. holds 72% of the Equity Capital of B Ltd. The Equity Capital of B Ltd prior to 2018-19 is Rs.1,500 Lakhs. Prepare a consolidated Profit and Loss Account of A Ltd. with its subsidiary B Ltd. for the year ended 31st March, 2020. (MTP 15 Marks May 20)

Answer 7

Consolidated Profit & Loss Account of A Ltd. and its subsidiary B Ltd. for the year ended on 31st March, 2020

Particulars		Note No.	Rs. in Lacs
I.	Revenue from operations	1	8,797
II.	Total revenue		8,797
III.	Expenses		
	Cost of Material purchased/consumed	3	1,770
	Changes of Inventories of finished goods	2	(1,794)
	Employee benefit expense	4	1,425
	Finance cost	6	225
	Depreciation and amortization expense	7	225
	Other expenses	5	802
	Total expenses		2,653
IV.	Profit before Tax(II-III)		6,144
V.	Tax Expenses	8	2,100
VI.	Profit After Tax		4,044

Notes to Accounts

		Rs. in Lacs	*Rs. in Lacs*
1.	Revenue from Operations		
	Sales and other income		
	A Ltd.	7,500	
	B Ltd.	1,500	
		9,000	
	Less: Inter-company Sales	(180)	
	Consultancy fees received by A Ltd. from B Ltd.	(8)	
	Commission received by B Ltd. from A Ltd.	(15)	8,797
2.	Increase in Inventory		
	A Ltd.	1,500	
	B Ltd.	300	
		1,800	

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	Less: Unrealized profits Rs. 180×1/6 x 25/125	(6)	1,79
3.	Cost of Material purchased/consumed		4
	A Ltd.	1,200	
	B Ltd.	300	
		1,500	
	Less: Purchases by B Ltd. from A Ltd.	(180)	1,320
	Direct Expenses		
	A Ltd.	300	
	B Ltd.	150	450
			1,770

4.	Employee benefits and expenses		
	Wages and Salaries:		
	A Ltd.	1,200	
	B Ltd.	225	1,425
5.	Other Expenses		
	Administrative Expenses		
	A Ltd.	300	
	B Ltd.	150	
		450	
	Less: Consultancy fees received by A Ltd. from B Ltd.	(8)	442
	Selling and Distribution Expenses:		
	A Ltd.	300	
	B Ltd.	75	
		375	
	Less: Commission received from B Ltd. from A Ltd.	(15)	360
			802
6.	Finance Cost		
	Interest:		
	A Ltd.	150	
	B Ltd.	75	225
7.	Depreciation and Amortization		
	Depreciation:		
	A Ltd.	150	
	B Ltd.	75	225

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8.	Provision for tax		
	A Ltd.	1800	
	B Ltd.	300	2100

Question 8

A Ltd. had acquired 80% shares of B Ltd. for Rs. 15 lakhs at the beginning of year. During the year, A Ltd. sold the investment for Rs. 30 lakhs and net assets of B Ltd. on the date of disposal was Rs. 35 lakhs. Calculate the profit or loss on disposal of this investment to be recognized in the Financial Statements of A Ltd. (MTP 4 Marks Oct '21 & Oct '23)

Answer 8

Calculation of Profit/Loss on disposal of investment in subsidiary

Particulars	Rs.
Proceeds from the sale of Investment	30,00,000
Less: A Ltd.'s share in net assets of B Ltd.	(28,00,000)
	2,00,000

Working Note:

A Ltd.'s share in net assets of B Ltd.

	Rs.
Net Assets of B Ltd. on the date of disposal	35,00,000
Less: Minority Interest (20% of Rs. 35 lakhs)	(7,00,000)
A Ltd.'s share in the net assets of B Ltd.	28,00,000

Question 9

On 31st March, 2023 H Ltd. and its subsidiary S Ltd. give the following information:

	H Ltd.	**S Ltd.**
	Rs.	**Rs.**
Shareholders' Fund:		
Equity shares of Rs. 10 each	**13,40,000**	**2,40,000**
Reserves and Surplus	**4,80,000**	**1,80,000**
Profit & Loss Account	**2,40,000**	**60,000**
Secured Loans:		
12% Debentures	**1,00,000**	**-**
Current Liabilities:		
Creditors	**2,00,000**	**1,22,000**

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Bank Overdraft	1,00,000	-
Bills Payable	60,000	14,800
Property, Plant & Equipment:		
Machinery	7,20,000	2,16,000
Furniture	3,60,000	40,800
Investments:		
Investments in S Ltd.	3,84,000	-
(19,200 shares at Rs. 20 each)		
Current Assets:		
Inventories	6,00,000	2,00,000
Trade Receivables	3,00,000	90,000
Bill Receivables	1,00,000	30,000
Cash at Bank	56,000	40,000

The following information is also provided to you:

(a) **H Ltd. purchased 19,200 shares of S Ltd. on 1st April, 2019, when the balances of Reserves & Surplus and Profit & Loss Account of S Ltd. stood at Rs. 60,000 and Rs. 36,000 respectively.**

(b) **Machinery (Book value Rs. 2,40,000) and Furniture (Book value Rs. 48,000) of S Ltd were revalued at Rs. 3,60,000 and Rs. 36,000 respectively on 1st April, 2019, for the purpose of fixing the price of its shares. (Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%).**

(c) **On 31st March, 2022, Bills payable of Rs. 12,000 shown in S Ltd.'s Balance Sheet had been accepted in favour of H Ltd.**

(d) **You are required to prepare Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2023.(MTP 20 Marks Nov '21 & March '23 & April '23, PYP 20 Marks Jan 21)**

Answer 9

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2023

Particulars			Note No.	(Rs.)
I.		Equity and Liabilities		
	1	Shareholder's Funds		
		(a) Share Capital	1	13,40,000
		(b) Reserves and Surplus	2	8,27,040
	2	(Minority Interest		1,15,560
	3	Non- Current Liabilities		
		(a) 12% Debentures		1,00,000
	4	Current Liabilities		

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		(a) Trade Payables	3	3,84,800
		(b) Short term Borrowings (Bank)		1,00,000
		Total		28,67,400
II.		Assets		
	1	Non-current assets		

		(a)		
		(i) Property, Plant and Equipment	4	14,34,600
		(ii) Intangible assets	5	28,800
	2	Current assets		
		(a) Inventory (6,00,000+2,00,000)		8,00,000
		(b) Trade Receivables	6	5,08,000
		(c) Cash and Cash equivalents		96,000
		Total		28,67,400

Notes to Accounts

				Rs.
1.	Share Capital Equity share capital 1,34,000 shares of Rs. 10 each fully paidup			13,40,000
2.	Reserves and Surplus			
	Reserves		4,80,000	
	Add: 4/5th share of S Ltd.'s post-acquisition reserves (W.N.3)		96,000	5,76,000
	Profit and Loss Account		2,40,000	
	Add: 4/5th share of S Ltd.'s post-acquisition profits (W.N.4)		11,040	2,51,040
3.	Trade Payables			8,27,040
	Creditors			
	H Ltd.	2,00,000		
	S Ltd.	1,22,000	3,22,000	
	Bills Payables			
	H Ltd.	60,000		
	S Ltd.	14,800	74,800	

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			3,96,800	
	Less: Mutual Owings		(12,000)	3,84,800
4.	Property Plant and Equipment			
	Machinery			
	H. Ltd.		7,20,000	
	S Ltd.	2,40,000		
	Add: Appreciation	1,20,000		
		3,60,000		
	Less: Depreciation (3,60,000 X 10%)	(36,000)	3,24,000	
	Furniture			
	H. Ltd.		3,60,000	
	S Ltd.	48,000		
	Less: Decrease in value	(12,000)		
		36,000		
	Less: Depreciation (36,000 X 15%)	5,400	30,600	14,34,600
5.	Intangible assets			
	Goodwill [WN 6]			28,800
6.	Trade receivables			

	H Ltd.	3,00,000		
	S Ltd.	90,000	3,90,000	
	Bills Receivables			
	H Ltd.	1,00,000		
	S Ltd.	30,000	1,30,000	
			5,20,000	
	Less: Mutual Owings		(12,000)	5,08,000

Working Notes:

1.	Pre-acquisition profits and reserves of S Ltd.	*Rs.*
	Reserves	60,000
	Profit and Loss Account	36,000
		96,000
	H Ltd.'s = 4/5 (or 80%) × 96,000	76,800
	Minority Interest= 1/5 (or 20%) × 96,000	19,200
2.	Profit on revaluation of assets of S Ltd.	
	Profit on Machinery Rs. (3,60,000 – 2,40,000)	1,20,000
	Less: Loss on Furniture Rs.(48,000 –36,000)	(12,000)

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Net Profit on revaluation	1,08,000
H Ltd.'s share 4/5 × 1,08,000	86,400
Minority Interest 1/5 × 1,08,000	21,600
3. Post-acquisition reserves of S Ltd. Totalre-serves Less: Pre- acquisition reserves	1,80,000 (60,000)
Post-acquisition reserves	1,20,000
H Ltd.'s share 4/5 × 1,20,000	96,000
Minority interest 1/5 × 1,20,000	24,000
4. Post -acquisition profits of S Ltd.	
Post-acquisition profits (Profit & loss account balance less pre-acqui-sition profits = Rs. 60,000 – 36,000)	24,000
Add: Excess depreciation charged on furniture @ 15%	
on Rs. 12,000 i.e. (48,000 – 36,000)	1,800
Less: Under depreciation on machinery @ 10%	25,800
on Rs. 1,20,000 i.e. (3,60,000 – 2,40,000)	(12,000)
Adjusted post-acquisition profits	13,800
H Ltd.'s share 4/5 × 13,800	11,040
Minority Interest 1/5 × 13,800	2,760
5. Minority Interest	
Paid-up value of (24,000 – 19,200) = 4,800 shares	
held by outsiders i.e. 2,40,000 X 20%	48,000
Add: 1/5th share of pre-acquisition profits and reserves	19,200
1/5th share of profit on revaluation	21,600
1/5th share of post-acquisition reserves	24,000
1/5th share of post-acquisition profit	2,760

6. Cost of Control or Goodwill		1,15,560
Price paid by H Ltd. for 19,200 shares *Less*: Intrinsic value of the shares	(A)	3,84,000
Paid-up value of shares held by H Ltd. i.e. 2,40,000 X 80%		1,92,000
Add: 4/5th share of pre-acquisition profits and reserves		76,800
4/5th share of profit on the revaluation		86,400
Intrinsic value of shares on the date of acquisition	(B)	3,55,200
Cost of control or Goodwill B)	(A-B)	28,800

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Question 10

Consider the following information of subsidiary MNT Ltd.

	2020-21	2021-22
	Amount in ₹	Amount in ₹
Share Capital		
Issued and subscribed 7500 Equity Shares of ₹ 100 each	7,50,000	7,50,000
Reserve and Surplus		
Revenue Reserve	2,14,000	5,05,000
Securities Premium	72,000	2,07,000
Current Liabilities and Provisions		
Trade Payables	2,90,000	2,46,000
Bank Overdraft	-	1,70,000
Provision for Taxation	2,62,000	4,30,000
Non-current assets		
Property, Plant and equipment (Cost)	9,20,000	9,20,000
Less: Accumulated Depreciation	(1,70,000)	(2,82,500)
	7,50,000	6,37,500
Investment at Cost	-	5,30,000
Current Assets		
Inventory	4,12,300	6,90,000
Trade Receivable	2,95,000	3,43,000
Prepaid expenses	78,000	65,000
Cash at Bank	52,700	42,500

Other Information:

(1) **MNT Ltd. is a subsidiary of LTC Ltd.**

(2) **LTC Ltd. values inventory on FIFO basis, while MNT Ltd. used LIFO basis. To bring MNT Ltd.'s inventories values in line with those of LTC Ltd., its value of inventory is required to be reduced by ₹ 5,000 at the end of 2020-21 and increased by ₹ 12,000 at the end of 2021-22. (Inventory of2020-21 has been sold out during the year 2021-22)**

(3) **MNT Ltd. deducts 2% from Trade Receivables as a general provision against doubtful debts.**

(4) **Prepaid expenses in MNT Ltd. include Sales Promotion expenditure carried forward of ₹**

25,000 in 2020-21 and ₹ 12,500 in 2021-22 being part of initial Sales Promotion expenditure of

₹ 37,500 in 2020-21, which is being written off over three years. Similar nature of Sales Promotion expenditure of LTC Ltd. has been fully written off in 2020-21.

Restate the balance sheet of MNT Ltd. as on 31st March, 2022 after considering the above informa-

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tionfor the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by LTC Ltd. and MNT Ltd. uniform.(MTP 10 Marks Sep'22, MTP 16 Marks Oct '21 & Oct '23, PYP 10 Marks Nov '19) (Same concept different figures MTP 12 Marks Apr 19)

Answer 10

Restated Balance Sheet of MNT Ltd. as at 31st March, 2022

Particulars	Note No.	(₹)
I. **Equity and Liabilities**		
(1) **Shareholder's Funds**		
(a) Share Capital		7,50,000
(b) Reserves and Surplus	1	7,18,500
(2) **Current Liabilities**		
(a) Short term borrowings	2	1,70,000
(b) Trade Payables		2,46,000
(c) Short-term provision	3	4,30,000
Total		**23,14,500**
II. **Assets**		
(1) **Non-current assets**		
(a) Property, Plant & Equipment	4	6,37,500
(b) Non-current Investment		5,30,000
(2) **Current assets**		
(a) Inventories (6,90,000 +12,000)	5	7,02,000
(b) Trade Receivables $\frac{3,43,000}{98} \times 100$		3,50,000
(c) Cash & Cash Equivalents		42,500
(d) Other current assets	6	52,500
Total		**23,14,500**

Notes to Accounts

			₹
1.	Reserves and Surplus		
	Revenue Reserve (refer W.N.)	5,11,500	
	Securities Premium	2,07,000	7,18,500
2.	Short term borrowings		
	Bank overdraft		1,70,000
3.	Short-term provision		
	Provision for taxation		4,30,000
	Provision for taxation		4,30,000

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4.	Property, Plant and Equipment		
	Cost	9,20,000	
	Less: Depreciation to date	(2,82,500)	6,37,500
5.	Inventories	6,90,000	
	Increase in value as per FIFO	12,000	7,02,000
6.	Other current assets		
	Prepaid expenses (After adjusting salespromotion expenses to be written off each year) (65,000 -12,500)		52,500

Working Note:

Adjusted revenue reserves of MNT Ltd.:

	₹	₹
Revenue reserves as given		5,05,000
Add: Provision for doubtful debts [3,43,000 X 2/98)	7,000	
Add: Increase in value of inventory	12,000	19,000
		5,24,000
Less: Sales Promotion expenditure to be written off		(12,500)
Adjusted revenue reserve		5,11,500

Question 11

From the following data, determine Minority Interest on the date of acquisition and on the date of consolidation in each case:

Case	Subsidiary Company	% of Share Owned	Cost	Date of Acquisition		Consolidation date	
				01-01-2021		31-12-2021	
				Share Capital	Profit andLoss A/c	Share Capital	Profit andLoss A/c
				₹	₹	₹	₹
Case-i	X	85%	1,85,000	1,35,000	60,000	1,35,000	70,000
Case-ii	Y	70%	1,60,000	1,25,000	45,000	1,25,000	5,000
Case-iii	Z	65%	83,000	25,000	5,000	25,000	5,000
Case-iv	M	90%	60,000	45,000	20,000	45,000	40,000
Case-v	N	100%	85,000	25,000	25,000	25,000	50,000

(MTP 5 Marks Sep'22, PYP 5 Marks Nov '19, RTP Nov 20, Old SM) (Same concept different figures RTP May'19)

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Answer 11

Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case,it should be equal to Share Capital + Profit & Loss A/c

A = Share capital on 1.1.2021

B = Profit & loss account balance on 1.1.2021 C = Share capital on 31.12.2021D = Profit & loss account balance on 31.12.2021

	Minority % Shares Owned [E]	Minority interest as atthe date of acquisition [E] x [A + B] ₹	Minority interest as at thedate of consolidation [E] X [C + D] ₹
Case i [100-85]	15%	29,250	30,750
Case ii [100-70]	30%	51,000	39,000
Case iii [100-65]	35%	10,500	10,500
Case iv [100-90]	10%	6,500	8,500
Case v [100-100]	NIL	NIL	NIL

Question 12

Sun Ltd. acquired 3,200 ordinary shares of ₹ 100 each of Star Ltd. on 1st October, 2021. On 31stMarch, 2022, the balance sheets of the two companies were as given below:

Balance Sheet of Sun Ltd. and its subsidiary, Star Ltd. as at 31st March, 2022

Particulars	Note No.	Sun Ltd. (₹)	Star Ltd. (₹)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	**1**	**10,00,000**	**4,00,000**
(b) Reserves and Surplus	**2**	**5,94,400**	**3,64,000**
(2) Current Liabilities			
(a) Trade Payables		**94,200**	**34,800**
(b) Short term borrowings	**3**	**1,60,000**	**-**
Total		**18,48,600**	**7,98,800**

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II.	**Assets**			
	(1) Non-current assets			
	(a) Property, Plant andEquipment	**4**	**7,80,000**	**6,30,000**
	(b) Non-current Investments	**5**	**6,80,000**	
	(2) Current assets			
	(a) Inventories		**2,40,000**	**72,800**
	(b) Trade receivables		**1,19,600**	**80,000**
(c)	**Cash & Cash equivalents**	**6**	**29,000**	**16,000**
	Total		**18,48,600**	**7,98,800**

Notes to Accounts

		Sun Ltd.	Star Ltd..
		Rs.	Rs.
1	**Share Capital** 10,000 shares of Rs. 100 each, fully paid up	10,00,000	
	4,000 shares of Rs. 100 each, fully paid up		4,00,000
	Total	10,00,000	4,00,000
2	**Reserves and Surplus** General Reserves	4,80,000	2,00,000
	Profit & loss	1,14,400	1,64,000
	Total	5,94,400	3,64,000
3	**Short term borrowings** Bank overdraft	1,60,000	
4	**Property plant and equipment** Land and building	3,00,000	3,60,000
	Plant & Machinery	4,80,000	2,70,000
	Total	7,80,000	6,30,000
5	**Non-current Investments** Investment in Star Ltd. (at cost)	6,80,000	
6	**Cash & Cash equivalents** Cash	29,000	16,000

The Profit & Loss Account of Star Ltd. showed a credit balance of ₹ 60,000 on 1st April, 2021 out of which a dividend of 10% was paid on 1st November, 2021; Sun Ltd. credited the dividend received to its Profit & Loss Account. The Plant & Machinery which stood at ₹ 3,00,000 on 1st April, 2021 was considered as worth ₹ 3,60,000 on 1st October, 2021; this figure is to be considered while consolidating the Balance Sheets. The rate of depreciation on plant & machinery is 10% (computed on the basis of useful lives).Prepare consolidated Balance Sheet as at 31st March, 2022. (MTP 20 Marks Oct'22)(Same concept different figures PYP 15 Marks Nov'20, MTP 15 Marks Sep'23, Old & New SM)

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Answer 12

Consolidated Balance Sheet of Sun Ltd.and its subsidiary, Star Ltd. as at 31st March, 2022

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	10,00,000
(b) Reserves and Surplus	2	6,17,600
(2) Minority Interest		1,67,200
(3) Current Liabilities		
(a) Trade Payables	3	1,29,000
(b) Short term borrowings	4	1,60,000
Total		20,73,800
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	14,82,000
(b) Intangible assets	6	34,400
(2) Current assets		
(a) Inventories	7	3,12,800
(b) Trade receivables	8	1,99,600
(c) Cash & Cash equivalents	9	45,000
Total		20,73,800

Notes to Accounts

1	Share Capital			
	10,000 shares of ₹ 100 each			
2	Reserves and Surplus			
	Reserves		4,80,000	
	Profit & loss (Refer to W.N 8)		1,37,600	
	Total			6,17,600
3	Trade Payables			
	Sun Ltd.	94,200		
	Add: Star Ltd.	34,800		1,29,000
	Total			
4	Short term borrowings			
	Bank overdraft			1,60,000
5	Property, plant and equipment			

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	Land and building- Sun Ltd.	3,00,000	
	Add: Land and building- Star Ltd.	3,60,000	6,60,000
	Plant & Machinery (Refer to W.N 7)		8,22,000
	Total		14,82,000
6	Intangible assets		-
	Goodwill (refer to W.N 6)		34,400
7	Inventories		
	Sun Ltd.	2,40,000	
	Star Ltd..	72,800	
	Total		3,12,800
8	Trade Receivables		
	Sun Ltd.	1,19,600	
	Star Ltd.	80,000	
	Total		1,99,600
9	Cash & Cash equivalents		
	Cash of Sun Ltd	29,000	
	Add: cash of Star Ltd..	16,000	
	Total	-	45,000

Share holding Pattern

Total Shares of Star Ltd. 4,000 shares

Shares held by Sun Ltd 3,200 shares i.e. 80 %

Minority Shareholding 800 shares i.e. 20 %

Working Notes:

1. The dividend @ 10% on 3,200 shares - ₹32,000 received by Sun Ltd. should have been credited to the investment A/c, being out of pre-acquisition profits. Sun Ltd., must pass a rectification entry, viz.

Profit & Loss Account Dr.	₹ 32,000	
To Investment		₹ 32,000

2.. The Plant & Machinery of Star Ltd. would stand in the books at ₹ 2,85,000 on 1st Oct, 2021, considering only six months' depreciation on ₹ 3,00,000 total depreciation being ₹ 30,000. The value put on the assets being ₹ 3,60,000, there is an appreciation to the extent of ₹ 75,000 (3,60,000 – 2,85,000).

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3. Capital profits of Star Ltd.

	₹	₹
Reserve on 1st April, 2021 (Assumed there is no movement in reserves during the year and hence balance as on 1st April 2021 is same as of 31st March, 2022)		2,00,000
Profit & Loss Account Balance on 1st April, 2021	60,000	
Less: Dividend paid	(40,000)	20,000
Profit for 2021-22:		
Total ₹ 1,64,000		
Less: (₹ 20,000)		
₹ 1,44,000		
Proportionate upto 1st Oct, 2021 on time basis (₹ 1,44,000/2)		72,000
Appreciation in value of Plant & Machinery		75,000
		3,67,000
Less: 20% due to outsiders		(73,400)
Holding company's share		2,93,600

4. Revenue profits of Star Ltd.:

Profit after 1st Oct, 2021 [(1,64,000 – 20,000) x ½]		72,000
Less: Depreciation		
10% depreciation on ₹ 3,60,000 for 6 months	18,000	
Less: Depreciation already charged for 2nd half year on 3,00,000	(15,000)	(3,000)
		69,000
Less: 1/5 due to outsiders		(13,800)
Share of Sun Ltd.		55,200

5. **Minority interest:**

Par value of 800 shares (4,00,000 X 20%)	80,000	
Add: 1/5Capital Profits [WN 3]	73,400	
1/5 Revenue Profits [WN 4]	13,800	
	1,67,200	

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6. **Cost of Control:**

Amount paid for 3,200 shares	6,80,000	
Less: Dividend out of pre-acquisition profits	(32,000)	6,48,000
Par value of shares	3,20,000	-
Capital Profits –share of Sun Ltd. [WN 3]	2,93,600	(6,13,600)
Cost of Control or Goodwill		34,400

7. Value of Plant & Machinery:

Sun Ltd.		4,80,000
Star Ltd.	2,70,000	
Add: Appreciation on 1st Oct, 2021 [3,60,000 – (3,00,000 – 15,000)]	75,000	
	3,45,000	
Add: Deprecation for 2nd half charged on pre-revalued value	15,000	
Less: Depreciation on ₹3,60,000 for 6 months	(18,000)	3,42,000
		8,22,000

8. Profit & Loss Account (Consolidated):

Sun Ltd.as given	1,14,400	
Less: Dividend transferred to Investment A/c	(32,000)	82,400
Share of Sun Ltd.in revenue profits of Star Ltd.(WN 4)		55,200
		1,37,600

Question 13

On 31st March, 2015, P Ltd. acquired 1,05,000 shares of Q Ltd. for Rs. 12,00,000. The position of Q Ltd. on that date was as under:

	Rs.
Property, plant and equipment	**10,50,000**
Current Assets	**6,45,000**
1,50,000 equity shares of Rs. 10 each fully paid	**15,00,000**
Pre-incorporation profits	**30,000**
Profit and Loss Account	**60,000**
Trade payables	**1,05,000**

P Ltd. and Q Ltd. give the following information on 31st March, 2021:

	P Ltd. Rs.	Q Ltd. Rs.
Equity shares of Rs. 10 each fully paid (before bonus issue)	**45,00,000**	**15,00,000**
Securities Premium	**9,00,000**	**–**

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Pre-incorporation profits	**-**	**30,000**
General Reserve	**60,00,000**	**19,05,000**
Profit and Loss Account	**15,75,000**	**4,20,000**
Trade payables	**5,55,000**	**2,10,000**
Property, plant and equipment	**79,20,000**	**23,10,000**
Investment: 1,05,000 Equity shares in Q Ltd. at cost	**12,00,000**	**-**
Current Assets	**44,10,000**	**17,55,000**

Directors of Q Ltd. made bonus issue on 31.3.2021 in the ratio of one equity share of Rs. 10 each fully paid for every two equity shares held on that date. Bonus shares were issued out of post- acquisition profits by using General Reserve.

Calculate as on 31st March, 2021 (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii)Consolidated Profit and Loss Account in each of the following cases:

(a) Before issue of bonus shares.

(b) Immediately after issue of bonus shares. (RTP Nov 21, Old & New SM)

Answer 13

Shareholding pattern

Particulars	Number of Shares	% of holding
a. P Ltd.		
(i) Purchased on 31.03.2015	1,05,000	
(ii) Bonus Issue (1,05,000/2)	52,500	
Total	1,57,500	70%
b. Minority Interest	67,500	30%

Calculations of (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account as on 31st March, 2021:

(a) Before issue of bonus shares

(i)	Cost of control/capital reserve	Rs.	Rs.
	Investment in Q Ltd.		12,00,000
	Less: Face value of investments	10,50,000	
	Capital profits (W.N.)	63,000	(11,13,000)
	Cost of control		87,000
(ii)	Minority Interest		Rs.
	Share Capital		4,50,000
	Capital profits (W.N.)		27,000
	Revenue profits (W.N.)		6,79,500
			11,56,500
(iii)	Consolidated profit and loss account – P Ltd.		Rs.

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	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		15,85,500
			31,60,500

Immediately after issue of bonus shares

(i)	Cost of control/capital reserve	Rs.	Rs.
	Face value of investments (Rs. 10,50,000 +Rs. 5,25,000)	15,75,000	
	Capital Profits (W.N.)	63,000	16,38,000
	Less: Investment in Q Ltd.		(12,00,000)
	Capital reserve		4,38,000
(ii)	Minority Interest		Rs.
	Share Capital (Rs. 4,50,000 + Rs. 2,25,000)		6,75,000
	Capital Profits (W.N.)		27,000
	Revenue Profits (W.N.)		4,54,500
			11,56,500
(iii)	Consolidated Profit and Loss Account – P Ltd.		Rs.
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		10,60,500
			26,35,500

Working Note:Analysis of Profits of Q Ltd.

	Capital Profits	Revenue Profits	
	(Before and afterissue of bonus shares) Rs.	Before Bonus Issue Rs.	After BonusIssue Rs.
Pre-incorporation profits	30,000		
Profit and loss account on 31.3.2015	60,000		
	90,000		
General reserve*		19,05,000	19,05,000
Less: Bonus shares			(7,50,000)
			11,55,000
Profit for period of 1st April, 2015 to 31st March, 2021 (Rs. 4,20,000 – Rs. 60,000)		3,60,000	3,60,000

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		22,65,000	15,15,000
P Ltd.'s share (70%)	63,000	15,85,500	10,60,500
Minority's share (30%)	27,000	6,79,500	4,54,500

*Share of P Ltd. in General reserve has been adjusted in Consolidated Profit and Loss Account.

Question 14

A Ltd. acquired 70% equity shares of B Ltd. @ Rs.20 per share (Face value - Rs.10) on 31st March, 2021at a cost of Rs. 140 lakhs. Calculate the amount of share of A Ltd. and minority interest in the net assets of B Ltd. on this date. Also compute goodwill/capital reserve for A Ltd. on acquisition of shares of B Ltd. from the following information available from the balance sheet of B Ltd. as on 31st March, 2021: (RTP May 21)

	Rs. in lakhs
Property, plant and equipment	**360**
Investments	**90**
Current Assets	**140**
Loans & Advances	**30**
15% Debentures	**180**
Current Liabilities	**100**

Answer 14

Net assets of B Ltd. as on 31st March, 2021

	Rs. in lakhs	*Rs. in lakhs*
Property, plant and equipment		360
Investments		90
Current Assets		140
Loans and Advances		30
Total Assets		620
Less: 15% Debentures	180.0	
Current Liabilities	100.0	(280)
Equity / Net Worth		340

Share of Minority Interest in net assets (30% of 340)		102
A Ltd.'s share in net assets (70% of 340)		238
A Ltd.'s cost of acquisition of shares of B Ltd.		
(Rs.140 lakhs)		(140)
Capital reserve		98

Question 15

A Ltd holds 75% of the equity capital and voting power in B Ltd. A Ltd purchases inventories costing

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Rs. 150 lacs from B Ltd at a price of Rs. 200 lacs. The entire inventories remain unsold with A Ltd at the financial year end i.e. 31 March 2019. Suggest the accounting treatment for this transaction in the consolidated financial statements of A Ltd giving reference of the relevant accounting standard. (RTP Nov 20)

Answer 15

As per para provisions of AS 21, Intragroup balances and intragroup transactions and resulting unrealized profits should be eliminated in full. Unrealized losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered. Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealised profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and Property, Plant & Equipment, are eliminated in full. Unrealised losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered. One also needs to see whether the intragroup transaction is "upstream" or "down- stream". Upstream transaction is a transaction in which the subsidiary company sells goods to holding company. While in the downstream transaction, holding company is the seller and subsidiary company is the buyer.

In the case of upstream transaction, since the goods are sold by the subsidiary to holding company; profit is made by the subsidiary company, which is ultimately shared by the holding company and the minority shareholders. In such a transaction, if some goods remain unsold at the balance sheet date, the unrealized profit on such goods should be eliminated from minority interest as well as from consolidated profit on the basis of their share-holding besides deducting the same from unsold inventory.

But in the case of downstream transaction, the whole profit is earned by the holding company, therefore, whole unrealized profit should be adjusted from unsold inventory and consolidated profit and loss account only irrespective of the percentage of the shares held by the parent.

The case given in the Question is the case of upstream transaction. In the consolidated profit and loss account for the year ended 31 March 2019, entire transaction of sale and purchase of Rs. 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales). Further, the unrealized profits of Rs. 50 lacs (i.e. Rs. 200 lacs – Rs. 150 lacs), would be eliminated in the consolidated financial statements for financial year ended 31 March 2019, by reducing the value of closing inventories by Rs.50 lacs as of 31 March 2019. In the consolidated balance sheet as of 31 March 2019, A Ltd's share of profit from B Ltd will be reduced by Rs. 37.50 lacs (being 75% of Rs. 50 lacs) and the minority's share of theprofits of B Ltd would be reduced by Rs. 12.50 lacs (being 25% of Rs. 50 lacs).

Question 16

The Summarised Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017 are as follows:

Particulars	Amounts as at 31st March, 2017	
	X Ltd. (Rs. in lakhs)	Y Ltd.(Rs. in lakhs)
LIABILITIES		
Share Capital:		
Authorised	20,000	8,000
Issues and subscribed:		

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Equity share of Rs. 10 each, fully paid up	15,000	6,000
15% preference shares of Rs. 10 each, fully paid up	4,000	1,000
General Reserves	2,500	1,450
Profit & Loss Account	2,750	1,250
Trade payables	1,646	1,027
	25,896	10,727
ASSESTS		
Land & Building	3,550	1,510
Plant & Machinery	5,275	3,600
Furniture & Fittings	1,945	655
Investment in Y Ltd.: 450 Lakh Equity share in		
Y Ltd. purchased on 1st April, 2016	6,800	
Inventory	4,142	2,520
Trade Receivables	3,010	1,882
Cash and Bank Balance	1,174	560
	25,896	10,727

(a) The following information is also given to **you**

(b) **10% dividend on Equity shares was declared by Y Ltd. on 31st March, 2016 for the year ended 31stMarch, 2016. X Ltd. credited the dividend received to its Profit & Loss Account.**

(c) **Credit Balance of Profit & Loss account of Y Ltd. as on 1st April, 2016 was Rs. 650 Lakhs.**

(d) **General Reserve of Y Ltd. stood at same Rs. 1,450 Lakhs as on 1st April, 2016.**

(e) **Y Ltd.'s Plant & machinery showed a balance of Rs. 4,000 Lakh on 1st April 2016. At the time ofpurchase of shares in Y Ltd., X Ltd. revalued Y's Ltd. Plant & Machinery upward by Rs. 1,000 Lakh.**

(f) **Included in Trade Payables of Y Ltd. are Rs. 50 Lakh for goods supplied by X Ltd.**

On 31st March, 2017, Y's ltd. inventory included goods for Rs. 150 lakhs which it had purchased from X Ltd. X Ltd. sold goods to Y Ltd. at cost plus 25%.

You are required to prepare a Consolidated Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on31stMarch, 2017 giving working notes. (Ignoring dividend on preference shares). (RTP Nov 18)

Answer 16

Consolidated Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017

	Particulars	Note No.	Rs. in lakhs
I	Equity and Liabilities		
1	Shareholders' Funds		
	(a) Share Capital	1	19,000

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	(b) Reserves and Surplus	2	5,620
2.	**Minority interest**	3	3,400
3.	**Current Liabilities**		
	(a) Trade payables	4	2,623
	Total		30,643
II	**Assets**		
1	**Non Current Assets**		
	Property, Plant & Equipment		
	(i) Tangible Assets	5	17,435
2	**Current Assets**		
	(a) Inventories	6	6,632
	(b) Trade Receivables	7	4,842
	(c) Cash and Cash equivalents	8	1,734
			30,643

Notes to Accounts

			Rs. in lakhs
1.	**Share Capital**		
	Issued, Subscribed and Paid up (1,500 lakh Equity Shares of Rs. 10 each fully paid up)		15,000
	400 lakh Preference Shares of Rs. 10 each fully paid up		4,000
2.	**Reserves and Surplus**		
	Credit Balance of Profit & Loss Account	2,750	19,000
	Less: Capital Receipt wrongly credited (Dividend @ 10% on Rs. 4500 Lakh Equity Shares)	450	
		2,300	
	Add: Share in Y Ltd. Revenue Profit (Working Note i)	825	
		3,125	
	Less: Unrealised Profit (Working Note iv)	30	3,095
	Capital Reserve (Working Note iii)	25	
	General Reserve	2,500	2,525
3.	Minority interest		5,620
	100 Lakh Preference Shares of Rs. 10 fully paid up	1,000	
	150 Lakh Equity Shares of Rs.10 each fully paid up	1,500	2,500
	Share in Revenue Profits (Working Note i)	275	
	Share in Capital Profit (working Note ii)	625	900
4.	Trade payables		

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	X Ltd.	1,646	3,400
	Y Ltd.	1,027	
		2,673	
	Less: Mutual owing	50	2,623
5.	Tangible Assets		
	Land & Building		
	X Ltd.	3,550	
	Y Ltd	1,510	5,060
	Plant & Machinery		
	X Ltd.	5,275	
	Y Ltd (Working note v)	4,500	9,775
	Furniture & Fixtures		
	X Ltd.	1,945	
	Y Ltd	655	2,600
6.	Inventories		17,435
	X Ltd.	4,142	
	Y Ltd	2,520	
		6,662	
	Less: Unrealized Profit	(30)	6,632

Working Notes:

i. Calculation of Revenue Profits Y's Ltd Profit & Loss Account

	Rs. in lakh		Rs. in lakh
To Equity Dividend		By Balance b/d	650
10 % of 6,000 lakh	600	By Net profit for the year (Bal Fig.)	1,200
To balance c/d	1,250		
	1,850		**1,850**

Depreciation provided on Plant & Machinery	
Balance as on 1st April, 2016	4,000
Less Balance as 31st March 2017	3,600
	400
Hence rate of Depreciation = 400/4000 x 100	10%

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Net Profit for the year ended 31st March 2017	1,200
Less: Additional Depreciation	100
Revenue Profit	1,100
X Ltd's share- 1100 x 450/600	825
Y Ltd's share = 1100 x150/600	275

ii. Calculation of Capital Profits	
Profit & Loss Balance as on 1st April, 2016	650
Less: Dividend Paid	600
	50
Add: General Reserve as on 1st April, 2016	1,450
Add: Profit on Revaluation of Plant & machinery	1,000
Capital Profit	2,500
X Ltd's Share in Capital Profit = 2,500 x 450/600	1,875
Y Ltd's Share in Capital Profit = 2,500 x 150/600	625
iii. Calculation of Capital Reserve	
Paid up value of 450 Lakh equity shares	4,500
Add: Share in Capital Profits	1,875
	6,375
Amount Paid to acquire the 450 Lakh Equity Shares	6,800
Less: Dividend received out of Pre acquisition profits	450
	6,350
Capital Reserve = 6,375-6,350	25
iv. Unrealized Profit	
Rs. 150 Lakh x 25/125* = 30 lakh	

Plant & Machinery of Y Ltd.

Balance as on 31st March, 2017		3,600
Add: Addition due to revaluation	1,000	
Less: Depreciation on additional Value of Plant & Machinery @ 10 %	100	900
		4,500

* Rs. 150 lakh considered as cost to Y Ltd.

Question 17

From the following information of Beta Ltd. and its subsidiary Gamma Ltd. drawn up at 31st March, 2021, prepare a consolidated balance sheet as at that date:

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	Beta Ltd.	Gamma Ltd.
	Rs.	Rs.
Share Capital:		
Shares of Rs. 100 each	**15,00,000**	**2,50,000**
Reserves	**5,00,000**	**1,87,500**
Profit and Loss Account	**2,50,000**	**62,500**
Trade Payables	**3,75,000**	**1,42,500**
Property, plant and Equipment:		
Machinery	**7,50,000**	**2,25,000**
Furniture	**3,75,000**	**42,500**
Other non-current assets	**11,00,000**	**3,75,000**
Non-current Investments:		
Shares in Gamma Ltd.: 2,000 shares at Rs. 200 each	**4,00,000**	

Other information:Reserves and Profit and Loss Account of Gamma Ltd. stood at Rs. 62,500 and Rs. 37,500 respectivelyon the date of acquisition of its 80% shares by Beta Ltd. on 1st April, 2020.

Machinery (Book-value Rs. 2,50,000) and Furniture (Book value Rs. 50,000) of Gamma Ltd. were revalued at Rs. 3,75,000 and Rs. 37,500 respectively on 1st April, 2020 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.] (RTP May 22, RTP May'20, Old & New SM)

Answer 17

Consolidated Balance Sheet of Beta Ltd. and its Subsidiary Gamma Ltd. as at 31st March, 2021

Particulars	Note No.	(Rs.)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		15,00,000
(b) Reserves and Surplus	1	8,61,500
(2) Minority Interest (W.N.5)		1,20,375
(3) Current Liabilities		
(a) Trade Payables	2	5,17,500
Total		29,99,375
II. Assets		
(1) Non-current assets		
(a) (i) Property, Plant & Equipment	3	14,94,375
(ii) Intangible assets	4	30,000

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(b) Other non- current assets		5	14,75,000
	Total		29,99,375

Notes to Accounts

				Rs.
1.	Reserves and Surplus			
	Reserves		5,00,000	
	Add: 4/5th share of Gamma Ltd.'s post-acquisition reserves (W.N.3)		1,00,000	6,00,000
	Profit and Loss Account		2,50,000	
	Add: 4/5th share of Gamma Ltd.'s post-acquisition profits (W.N.4)		11,500	2,61,500
2.	Trade Payables			8,61,500
	Beta Ltd.		3,75,000	
	Gamma Ltd.		1,42,500	5,17,500
3.	Property, Plant & Equipment			
	Machinery			
	Beta Ltd.		7,50,000	
	Gamma Ltd.	2,50,000		
	Add: Appreciation	1,25,000		
		3,75,000		
	Less: Depreciation	(37,500)	3,37,500	
	Furniture			
	Beta Ltd.		3,75,000	
	Gamma Ltd.	50,000		
	Less: Decrease in value	(12,500)		
		37,500		
	Less: Depreciation	(5,625)	31,875	14,94,37
4.	Intangible assets			
	Goodwill [WN 6]			30,000
5.	Other non-current assets			
	Beta Ltd.		11,00,000	
	Gamma Ltd.		3,75,000	14,75,00

Working Notes:

1. Pre-acquisition profits and reserves of Gamma Ltd.	Rs.
Reserves	62,500
Profit and Loss Account	37,500

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	1,00,000
Beta Ltd.'s = 4/5 × 1,00,000	80,000
Minority Interest = 1/5 × 1,00,000	20,000
2. Profit on revaluation of assets of Gamma Ltd.	
Profit on Machinery Rs. (3,75,000 – 2,50,000)	1,25,000
Less: Loss on Furniture Rs. (50,000 – 37,500)	12,500
Net Profit on revaluation	1,12,500
Beta Ltd.'s share 4/5 × 1,12,500	90,000
Minority Interest 1/5 × 1,12,500	22,500
3. Post-acquisition reserves of Gamma Ltd.	
Post-acquisition reserves (Total reserves less pre-acquisition reserves = Rs. 1,87,500 – 62,500)	1,25,000
Beta Ltd.'s share 4/5 × 1,25,000	1,00,000
Minority interest 1/5 × 25,000	25,000
4. Post -acquisition profits of Gamma Ltd.	
Post-acquisition profits (Profit & loss account balance less pre- acquisition profits = Rs. 62,500 – 37,500)	25,000
Add: Excess depreciation charged on furniture @ 15%	
on Rs. 12,500 i.e. (50,000 – 37,500)	1,875
Less: Under depreciation on machinery @ 10%	26,875
on Rs. 1,25,000 i.e. (3,75,000 – 2,50,000)	(12,500)
Adjusted post-acquisition profits	14,375
Beta Ltd.'s share 4/5 × 14,375	11,500
Minority Interest 1/5 × 14,375	2,875
5. Minority Interest	
Paid-up value of (2,500 – 2,000) = 500 shares	
held by outsiders i.e. 500 × Rs. 100	50,000
Add: 1/5th share of pre-acquisition profits and reserves	20,000

1/5th share of profit on revaluation	22,500
1/5th share of post-acquisition reserves	25,000
1/5th share of post-acquisition profit	2,875
6. Cost of Control or Goodwill	1,20,375
Paid-up value of 2,000 shares held by Beta Ltd. i.e. 2,000 × Rs. 100	2,00,000
Add: 4/5th share of pre-acquisition profits and reserves	80,000
4/5th share of profit on the revaluation	90,000
Intrinsic value of shares on the date of acquisition	3,70,000

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Price paid by Beta Ltd. for 2,000 shares	4,00,000
Less: Intrinsic value of the shares	(3,70,000)
Cost of control or Goodwill	30,000

Question 18

On 31st March, 2022, H Ltd. and S Ltd. give the following information:

	H Ltd. (Rs. in 000's)	S Ltd. (Rs. in 000's)
Equity Share Capital – Authorised	**5,000**	**3,000**
Issued and subscribed in Equity Shares of Rs. 10 each fully paid	**4,000**	**2,400**
General Reserve	**928**	**690**
Profit and Loss Account (Cr. Balance)	**1,305**	**810**
Trade payables	**611**	**507**
Provision for Taxation	**220**	**180**
Other Provisions	**65**	**17**
Plant and Machinery	**2,541**	**2,450**
Furniture and Fittings	**615**	**298**
Investment in the Equity Shares of S Ltd.	**1,500**	**-**
Inventory	**983**	**786**
Trade receivables	**820**	**778**
Cash and Bank Balances	**410**	**102**
Sundry Advances (Dr. balances)	**260**	**190**

Following Additional Information is available:

(a) **H Ltd. purchased 90 thousand Equity Shares in S Ltd. on 1st April, 2021 at which date the followingbalances stood in the books of S Ltd.:**

General Reserve Rs. 1,500 thousand; Profit and Loss Account Rs. 633 thousand.

(b) **On 14th July, 2021 S Ltd. declared a dividend of 20% out of pre-acquisition profits. H Ltd. credited the dividend received to its Profit and Loss Account.**

(c) **On 1st November, 2021, S Ltd. issued 3 fully paid Equity Shares of Rs. 10 each, for every 5 shares held as bonus shares out of pre-acquisition General Reserve.**

(d) **On 31st March, 2021, the Inventory of S Ltd. included goods purchased for Rs. 50 thousand from HLtd., which had made a profit of 25% on cost.**

(e) **Details of Trade payables and Trade receivables:**

	H Ltd. (Rs. in 000's)	S Ltd. (Rs. in 000's)
Trade payables		
Bills Payable	**124**	**80**

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Sundry creditors	**487**	**427**

Trade receivables	**611**	**507**
Debtors	**700**	**683**
Bills Receivables	**120**	**95**
	820	**778**

Prepare a consolidated Balance Sheet as on 31st March, 2022. (RTP Nov'22)

Answer 18

Consolidated Balance Sheet of H Ltd. with its subsidiary S Ltd. as at 31st March, 2022

Particulars	Note No.	(Rs. in 000's)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	4,000
(a) Reserves and Surplus	2	3,063
(2) Minority Interest (W.N.6)		1,560
(3) Current Liabilities		
Trade payables	3	1,118
Short term provisions	4	482
Total		10,223
II. Assets		
(1) Non-current assets		
PPE	5	5,904
(2) Current assets		
(a) Inventories	6	1,759
(b) Trade receivables	7	1,598
(c) Cash and cash equivalents	8	512
(d Short term loans and advances	9	450
Total		10,223

Notes to Accounts

		(Rs. in 000's)	(Rs. in 000's)
1.	Share Capital		
	Authorised share capital		
	5 lakhs equity shares of Rs. 10 each		5,000
	Issued, Subscribed and Paid up		
	4 lakhs equity shares of Rs. 10 each fully paid		4,000

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2.	Reserves and surplus		
	Capital Reserve (Note 5)	679.8	
	General Reserve	928	
	Profit and Loss Account:		
	H Ltd. Rs. 1,305 Add: Share in S Ltd Rs. 340.20		
	Rs. 1,645.20		
	Less: Dividend wrongly credited Rs. (180)		
	Rs. 1,465.20		
	Less: Unrealised profit (50 X 1/5) Rs. (10)	1,455.20	3,063
3.	Trade payables		
	H Ltd.	611	
	S Ltd.	507	1,118
4.	Short –term provisions		
	Provision for Taxation H Ltd. Rs. 220		
	S Ltd. Rs. 180	400	
	Other Provisions H Ltd Rs. 65		
	S Ltd. Rs. 17	82	482
5.	PPE		
	Plant and Machinery		
	H Ltd. Rs. 2,541		
	S Ltd. Rs. 2,450	4,991	
	Furniture and fittings		
	H Ltd. Rs. 615		
	S Ltd. Rs. 298	913	5,904
6.	Inventories		
	Inventory H Ltd. Rs. 983S Ltd. Rs.786	1,769	
	Less: Unrealised profit (Rs. 50 x 1/5)	(10)	1,759
7.	Trade receivables		
	H Ltd.	820	
	S Ltd.	778	1,598
8.	Cash and cash equivalents		
	Cash and Bank Balances H Ltd	410	

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	S Ltd.	102	512
9.	Short term loans and advances		
	Sundry Advances H Ltd.	260	
	S Ltd.	190	450

Working Notes:Share holding pattern
***2,40,000 is after issue of bonus shares as per balance sheet as at 31.3.2022**

1.**S Ltd. General Reserve**

		(Rs. in 000)			(Rs. in 000)
To	Bonus to equity shareholders 2,400 × 3 8	900	By By	Balance b/d Profit and Loss A/c	1,500
To	Balance c/dType equation here.	690		(Balancing figure)	90
		1,590			1,590

2.S Ltd.'s Profit and Loss Account

		(Rs. in 000)			(Rs. in 000)
To	General Reserve	90	By	Balance b/d	633
To	Dividend paid on 14.7.2021 1,500 X 20 100	300	By	Net Profit for the year (Balancing figure)	567*
To	Balance c/d	810			
		1,200			1,200

3. * Out of Rs. 5,67,000 profit for the year, Rs. 90,000 has been transferred to reserves by S Ltd.Distribution of Revenue Profits

	Rs. in '000
Revenue Profit as above	567.00
Share of H Ltd. (60%)	340.20
Share of Minority shareholders (567– 340.20)	226.80

4. Computation of Capital Profits

	Rs. in 000	Rs. in 000
General Reserve on the date of acquisition		1,500
Less: Bonus issue of shares		(900)
Profit and Loss Account balance on the date of acquisition	633	600
Less: Dividends paid	(300)	333
		933

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Share of H Ltd. (60%)		559.80
Share of Minority shareholders		373.20

5. Computation of Capital Reserve

		Rs. in '000
60% of share capital of S Ltd.		1,440
Add: Share of H Ltd. in the capital profits as in working note (4)		559.80
Less: Investments in S Ltd.	1,500	1,999.80
Less: Dividends received out of pre- acquisition profits	(180)	(1,320)
$\frac{Rs.30 \times 60}{100}$		679.80

6. Calculation of Minority Interest

	Rs. in '000
40% of share capital of S Ltd.	960.00
Add: Share of Revenue Profits (Note 3)	226.80
Share of Capital Profits (Note 4)	373.20
	1,560.00

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Question 19

G Ltd.. and its subsidiary K Ltd. give the following information for the year ended 31stMarch, 2023:

Particulars	G Ltd.	K Ltd
Sales and other Income	3000	750
Increase in Inventory	750	100
Raw material consumed	600	100
Wages and Salaries	600	75
Production expenses	100	50
Administrative expenses	75	50
Selling and Distribution expenses	100	25
Interest	75	30
Depreciation	75	30

(i) The following information is **also given:G sold goods of Rs. 200 crores to K Ltd. at cost plus 25%. (1/5th of such goods were still in inventoryof K Ltd. at the end of the year)**

(ii) **G Ltd. holds 75% of the Equity share capital of K Ltd. and the Equity share capital of K Ltd. is Rs.800 crores on 01.04.2022 (date of acquisition of shares)**

Administrative expenses of K Ltd. include Rs. 5 crore paid to G Ltd. as consultancy fees. Also, sellingand distribution expenses of G Ltd. include Rs. 20 crores paid to K Ltd. as commission.

Prepare a consolidated statement of Profit and Loss of G Ltd. with its subsidiary K. Ltd. for the year ended 31st March, 2023. (PYP 15 Marks May '23) (Same concept different figures MTP 15 Marks March 21, Apr 22, Old & New SM)

Answer 19

Consolidated statement of profit and loss of G Ltd. and its subsidiary K Ltd. for the year endedon 31st March, 2023

Particulars	Note No.	Rs. in Crores
I. Revenue from operations	1	3,525
II. Total Income		3,525
III. Expenses		
Cost of material purchased/consumed	2	650
Changes of inventories of finished goods	3	(842)
Employee benefit expense	4	675
Finance cost	5	105
Depreciation and amortization expense	6	105
Other expenses	7	225
Total expenses		918
IV. Profit before tax (II-III)		2,607

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Notes to Accounts

		Rs. in Crores	Rs. in Crores
1.	Revenue from operationsSales and other income		
	G Ltd.	3,000	
	K Ltd.	750	
		3,750	
	Less: Inter-company sales	(200)	
	Consultancy fees received by G Ltd. from K Ltd.	(5)	
	Commission received by K Ltd. from G Ltd.	(20)	3,525
2.	Cost of material purchased/consumed		
	G Ltd.	600	
	K Ltd.	100	
		700	
	Less: Purchases by K Ltd. from G Ltd.	(200)	500
	Direct expenses (Production)		
	G Ltd.	100	
	K Ltd.	50	150
			650
3.	Changes of inventories of finished goods		
	G Ltd.	750	
	K Ltd.	100	
		850	
	Less: Unrealized profits Rs. 40 crores × 25/125	(8)	842
4.	Employee benefits and expenses Wagesand salaries:		
	G Ltd.	600	
	K Ltd.	75	675
5.	Finance cost Interest:		
	G Ltd.	75	
	K Ltd.	30	105
6.	Depreciation		
	G Ltd.	75	
	K Ltd.	30	105

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7.	Other expenses Administrative expenses G Ltd.	75	
	K Ltd.	50 125	
	Less: Consultancy fees received by G Ltd. from K Ltd.	(5)	120
	Selling and distribution Expenses: G Ltd.	100	
	K Ltd.	25 125	
	Less: Commission received by K Ltd. from G Ltd.	(20)	105 225

Note: The information (i) given in the question states that G Ltd. sold goods of Rs. 200 crores to K Ltd. at cost plus 25%. In the above solution it has been considered that the amount of Rs. 200 crores is sale value.Alternatively, Rs. 200 crores may be assumed as the cost of the goods sold. In that case, the solution will differ and will be as follows:Alternative solution:

Consolidated statement of profit and loss of G Ltd. and its subsidiary K Ltd. for the year ended on 31st March, 2023

Particulars	Note	Rs. in Crores
	No.	
I. Revenue from operations	1	3,475
II. Total Income		3,475
III. Expenses Cost of material purchased/consumed	2	600
Changes of inventories of finished goods	3	(840)
Employee benefit expense	4	675
Finance cost	5	105
Depreciation and amortization expense	6	105
Other expenses	7	225
Total expenses		870
IV. Profit before tax (II-III)		2,605

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Notes to Accounts

		Rs. in Crores	Rs. in Crores
1.	Revenue from operationsSales and other income		
	G Ltd.	3,000	
	K Ltd.	750	
		3,750	
	Less: Inter-company sales	(250)	
	Consultancy fees received by G Ltd. from K Ltd.	(5)	
	Commission received by K Ltd. from G Ltd.	(20)	3,475
2.	Cost of material purchased/consumed		
	G Ltd.	600	
	K Ltd.	100	
		700	
	Less: Purchases by K Ltd. from G Ltd.	(250)	450
	Direct expenses (Production)G Ltd.	100	
	K Ltd.	50	150
			600
3.	Changes of inventories of finished goodsG Ltd.	750	
	K Ltd.	100	
		850	
	Less: Unrealized profits Rs. 40 crores × 25/100	(10)	840
4.	Employee benefits and expenses Wagesand salaries:		
	G Ltd.	600	
	K Ltd.	75	675
5.	Finance cost Interest:G Ltd.	75	
	K Ltd.	30	105
6.	Depreciation		
	G Ltd.	75	
	K Ltd.	30	105

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7.	Other expenses Administrative expenses G Ltd.	75	
	K Ltd.	50 125	
	Less: Consultancy fees received by G Ltd. from KLtd.	(5)	120
	Selling and distribution Expenses: G Ltd.	100	
	K Ltd.	25 125	
	Less: Commission received by K Ltd. from G Ltd.	(20)	105 225

Question 20

H Ltd acquired 15000 shares in S Ltd. for 1,55,000 on July 1, 2022. The Balance sheet of the twocompanies as on 31st March, 2023 were as follows:

	H Ltd.Rs.	S Ltd.Rs.
Equity and Liabilities:		
Equity Share Capital	**9,00,000**	**2,50,000**
(Fully paid shares of Rs. 10 each)		
General Reserve	**1,60,000**	**40,000**
Surplus i.e., Balance in Statement of Profit and	**80,000**	**25,000**
Loss	**40,000**	**20,000**
Bills payable	**50,000**	**30,000**
Trade Creditors		
Total	**12,30,000**	**3,65,000**
Assets		
Machinery	**7,00,000**	**1,50,000**
Furniture	**1,00,000**	**70,000**
Investment in Equity Shares of S Ltd.	**1,55,000**	**-**
Stock-in Trade	**1,00,000**	**50,000**
Trade Debtors	**60,000**	**35,000**
Bills Receivable	**25,000**	**20,000**
Cash at Bank	**90,000**	**40,000**
Total	**12,30,000**	**3,65,000**

The following additional information is provided to you:

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(i) **General reserve appearing in the Balance Sheet of S Ltd. remained unchanged since 31st March,2022.**

(ii) **Profit earned by S Ltd. for the year ended 31st March, 2023 amounted to Rs. 20,000.**

(iii) **H Ltd. sold goods to S Ltd. costing Rs. 8,000 for Rs. 10,000, 25% of these goods remained unsold with S Ltd. on 31st March, 2023.**

(iv) **Creditors of S Ltd. include Rs. 4000 due to H Ltd. on account of these goods.**

(v) **Out of Bills payable issued by S Ltd. Rs. 15,000 are those which have been accepted in favour of H Ltd. Out of these, H Ltd. had endorsed by 31st March, 2023, Rs. 8000 worth of bills receivable in favour of its creditors.**

You are required to draw a consolidated Balance Sheet as on 31st March, 2023. (PYP 15 Marks May '23)

Answer 20

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2023

Particulars	Note No.	(Rs.)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	9,00,000
(b) Reserves and Surplus	2	2,73,500
(2) Minority Interest	3	1,26,000
(3) Current Liabilities		
(a) Trade Payables	4	1,29,000
Total		14,28,500
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	10,20,000
(2) Current assets		
(i) Inventory	6	1,49,500
(ii) Trade Receivables	7	1,29,000
(iii) Cash & cash equivalent	8	1,30,000
Total		14,28,500

Notes to Accounts

			Rs.
1.	Share capital		
	Authorised, issued, subscribed and paid up capital		
	90,000 equity shares of Rs. 10 each, fully paid up		9,00,000

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2.	Reserves and Surplus General Reserves	1,60,000	
	Profit and Loss Account (W.N.5) Capital Reserve (W.N. 4)	88,500 25,000	2,73,500
3.	Minority interest in S Ltd. (WN 3)		1,26,000
4.	Trade pay-ablesBills Payable 40,000 H Ltd. S Ltd. 20,000 60,000 Less: Mutual pay-ables (7,000)	53,000	

	Trade CreditorsH Ltd. S Ltd. 50,000 Less: Mutual owing 30,000 80,000 (4,000)	76,000	1,29,000	
5.	Property, plant and equipment Machinery H Ltd. 7,00,000 S Ltd. 1,50,000		8,50,000	
	Furniture H Ltd.S Ltd. 1,00,000 70,000		1,70,000	10,20,000
6.	InventoryH Ltd.		1,00,000	
	S Ltd.		50,000	
	Less: Unrealized profit (2,000x 25%)		500	1,49,500

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7.	Trade receivablesBills receivable H Ltd.S Ltd. Less: Mutual payables 25,000 20,000 45,000 (7,000)	38,000		
	DebtorsH Ltd.S Ltd. 60,000 Less: Mutual owing 35,000 95,000 (4,000)	91,000	1,29,000	
8.	Cash & cash equivalent Cash at Bank HLtd.		90,000	
	S Ltd.		40,000	1,30,000

Working Notes:

1. **Percentage of holding**	No. of Shares	Percentage
Holding Co. :	15,000	(60%)
Minority shareholders :	10,000	(40%)
Total Shares :	25,000	
2. **Analysis of Profits**		

	Pre-acquisition profits and reserves of S Ltd. (Rs.)	**Post- acquisi-tionprofits of S Ltd. (Rs.)**
General Reserve	40,000	---
Opening balance of Profit and	5,000	---
Loss	5,000	15,000
Current Year's profit (in 1:3)	50,000	15,000

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H Ltd.'s share (60%) Minority Interest (40%)	30,000 20,000	9,000 6,000

Minority Interest

Paid up value of 10,000 shares @ Rs. 10 each	Rs. 1,00,000
Add: Share in pre-acquisition profits and reserve (40%)	Rs. 20,000
Add: Share in post-acquisition profits (40%)	Rs. 6,000
	Rs. 1,26,000

Capital Reserve for H Ltd.

(A)	Cost of acquiring 15,000 shares of S Ltd.	Rs. 1,55,000
(B)	Paid up value of 15,000 shares of S Ltd. @ Rs. 10 each	Rs. 1,50,000
	Add: Share in pre-acquisition profit and reserves of S Ltd.	Rs. 30,000
		Rs. 1,80,000
	Capital Reserve (B-A)	Rs. 25,000

Consolidated Balance of Profits of H Ltd.

Balance as per Statement of Profit and Loss	Rs. 80,000
Add: Share in post-acquisition profits of S Ltd.	Rs. 9,000
	Rs.
Less: Unrealised Profit in unsold stock of S Ltd.	(500)
	Rs. 88,500

Question 21

The Trial Balances of X Limited and Y Limited as on 31st March, 2021 were as under:

	X Limited (Rs. In000)		Y Limited (Rs. In 000)	
	Dr.	Cr.	Dr.	Cr.
Equity Share capital (Share of Rs. 100 each)		**2,000**		**400**
7% Preference share capital		**-**		**400**
Reserves		**600**		**200**
6% Debentures		**400**		**400**
Trade Receivables/Trade Payables	**160**	**180**	**100**	**120**
Profit & Loss A/c balance		**40**		**30**

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Purchases /Sales	**1,000**	**1,800**	**1,200**	**1,900**
Wages and Salaries	**200**		**300**	
Debenture Interest	**24**		**24**	
General Expenses	**160**		**120**	
Preference share dividend up to 30.09.2020		**7**	**14**	

Inventory (as on 31.03.2021)	**200**		**100**	
Cash at Bank	**27**		**12**	
Investment in Y Limited	**1,056**		**-**	
Property, Plant & Equipment	**2,200**		**1,580**	
Total	**5,027**	**5,027**	**3,450**	**3,450**

– Investment in Y Limited was acquired on 1st July, 2020 and consisted of 80% of Equity Share Capital and 50% of Preference Share **Capital.After acquiring control over Y Limited, X Limited supplied to Y Limited goods at cost plus 25%, the total invoice value of such goods being Rs. 1,20,000, one fourth of such goods were still lying in inventory at the end of the year.**

Depreciation to be charged @ 10% in X Limited and @ 15% in Y Limited on Property, Plant & Equipment.

You are required to prepare the Consolidated Statement of Profit and Loss for the year ended on 31st March, 2021. (15 Marks , July 21)

Answer 21

Consolidated Profit and Loss Account of X Ltd. and Y Ltd. for the year ended 31st March, **2021**

Particulars	Note No.	Rs.
I. Revenue from operations	1	35,80,000
II. Total revenue		35,80,000
III. Expenses		
Cost of Material purchased/Consumed	2	20,80,000
Changes of Inventories of finished goods		-
Employee benefit expense	3	5,00,000
Finance cost	4	48,000
Depreciation and amortization expense	5	4,57,000

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Other expenses	6	2,80,000
Total expenses		33,65,000
IV. Profit before Tax (II-III)		2,15,000
Profit transferred to Consolidated Balance Sheet		
Profit After Tax		2,15,000
Preference dividend	7,000	
Preference dividend payable	7,000	(14,000)
		2,01,000
Share in pre-acquisition loss (WN 3)		1,800
Share of Minority interest in losses (WN 1)		1,800
Less: Investment Account- dividend for 3 months (prior toacquisition)		(3,500)
Inventory reserve (WN 2)		(6,000)
Profit to be transferred to consolidated balance sheet		1,95,100

Notes to Accounts

		Rs.	Rs.
1	Revenue from Operations		
	X Ltd.	18,00,000	
	Y Ltd.	19,00,000	
	Total	37,00,000	
	Less: Intra-group sales (X sold to Y)	(1,20,000)	35,80,000
2	Cost of Materials Purchased/Consumed		
	X Ltd.	10,00,000	
	Y Ltd.	12,00,000	
	Total	22,00,000	
	Less: Intra-group sales (X sold to Y)	(1,20,000)	20,80,000
3	Employee benefit and expenses		
	Wages and salaries		
	H Ltd.	2,00,000	
	S Ltd.	3,00,000	5,00,000
4	Finance cost		
	Interest		
	H Ltd.	24,000	
	S Ltd.	24,000	48,000
5	Depreciation		
	H Ltd.	2,20,000	

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	S Ltd.	2,37,000	4,57,000
6	Other expenses		
	H Ltd.	1,60,000	
	S Ltd.	1,20,000	2,80,000

Working Note1.

Profit of Subsidiary **Rs.**

Revenue from Operations		19,00,000
Less: Expenses		
Cost of Material purchased/Consumed	12,00,000	
Changes of Inventories of finished goods	-	
Employee benefit expense	3,00,000	
Finance cost	24,000	
Depreciation and amortization expense	2,37,000	
Other expenses	1,20,000	
Total expenses		(18,81,000)
Profit Before Tax		19,000
Less: Preference Dividend	14,000	
Less: Preference Dividend Payable	14,000	(28,000)
Profit available for shareholders		(9,000)
Minority Share (20% of loss Rs. 9,000)		(1,800)

2. **Inventory reserve** =: $[\frac{120,000}{4} \times \frac{25}{125}]$ =Rs. 6,000

3. **Pre-acquisition loss** = 80% of 3 month's profit up to 30th June,2020 i.e. 80 % of ¼ of loss Rs. 9,000.Hence, pre-acquisition loss = Rs. 1,800

4. Investment account includes Preference dividend for 3 months prior to acquisition i.e. Rs. 4,00,000X 50% X 7% X1/4 = Rs. 3,500

Question 22

The Profit and Loss Accounts of A Ltd. and its subsidiary B Ltd. for the year ended 31st March, 2018 aregiven below :

Incomes	**A Ltd.**	**Rs. in Lakhs B Ltd.**
Sales and other income	**7,500**	**1,500**
Increase in Inventory	**1,500**	**300**

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Total	9,000	1,800
Expenses		
Raw material consumed	1,200	300
Wages and Salaries	1,200	225
Production expenses	300	150
Administrative expenses	300	150
Selling and distribution expenses	300	75
Interest	150	75
Depreciation	150	75
Total	3,600	1,050
Profit before tax	5,400	750
Provision for tax	1,800	300
Profit after tax	3,600	450
Dividend paid	1,800	225
Balance of Profit	1,800	225

The following information is also given:

A Ltd sold goods of Rs. 180 Lakhs to B Ltd at cost plus 25%. (1/6 of such goods were still in inventory of B Ltd at the end of the year)

Administrative expenses of B Ltd include Rs. 8 Lakhs paid to A Ltd as consultancy fees.

Selling and distribution expenses of A Ltd include Rs. 15 Lakhs paid to B Ltd as commission.

(i) A Ltd holds 72% of the Equity Capital of B Ltd. The Equity Capital of B Ltd prior to 2016-17 is Rs. 1,500 Lakhs

Prepare a consolidated Profit and Loss Account for the year ended 31st March, 2018. [PYP 10 Marks , Nov '18]

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Answer 22

Consolidated Profit & Loss Account of A Ltd. and its subsidiary B Ltd.for the year ended on 31st March, 2018

Particulars		Note No.	Rs.in Lacs
I. Revenue from operations		1	8,797
II. Total revenue			8,797
III. Expenses			
Cost of Material purchased/Consumed		3	1,770
Changes of Inventories of finished goods expense		2	(1,794)
Employee benefit expense		4	1,425
Finance cost		6	225
Depreciation and amortization e		7	225
Other expenses		5	802
Total expenses			2,653
IV. Profit before Tax(II-III)			6,144
V. Tax Expenses		8	2,100

Notes to Accounts

		Rs. in Lacs	Rs. in Lacs
1.	Revenue from Operations		
	Sales and other income		
	A Ltd.	7,500	
	B Ltd.	1,500	
		9,000	
	Less: Inter-company Sales	(180)	
	Consultancy fees received by A Ltd. from B Ltd.	(8)	
	Commission received by B Ltd. from A Ltd.	(15)	8,797
2.	Increase in Inventory		
	A Ltd.	1,500	
	B Ltd.	300	
		1,800	
	Less: Unrealised profits Rs. 180×1/6 x 25/125	(6)	1,794
3.	Cost of Material purchased/consumed		
	A Ltd.	1,200	
	B Ltd.	300	

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		1,500	
	Less: Purchases by B Ltd. from A Ltd.	(180)	1,320
	Direct Expenses		
	A Ltd.	300	
	BLtd.	150	450
			1,770
4.	Employee benefits and expenses		
	Wages and Salaries:		
	A Ltd.	1,200	
	B Ltd.	225	1,425

5.	Other Expenses		
	Administrative Expenses		
	A Ltd.	300	
	B Ltd.	150	
		450	
	Less: Consultancy fees received by A Ltd. from BLtd.	(8)	442
	Selling and Distribution Expenses:		
	A Ltd.	300	
	B Ltd.	75	
		375	
	Less: Commission received from B Ltd. from A Ltd.	(15)	360
			802
6.	Finance Cost		
	Interest:		
	A Ltd.	150	
	B Ltd.	75	225
7.	Depreciation and Amortisation		
	Depreciation:		
	A Ltd.	150	
	B Ltd.	75	225
8.	Provision for tax		

	A Ltd.	1800	
	B Ltd.	300	2100

Note: it is assumed that dividend adjustment has not be done in sales & other income of A Ltd i.e. dividend received from B Ltd is not included in other income of A Ltd. Alternative Answer is possible considering is **otherwise.**

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Question 23

White Ltd. acquired 2,250 shares of Black Ltd. on 1st October,.2020. The summarized balance sheets of both the companies as on 31st March, 2021 are given below:

	White Ltd. (₹)	Black Ltd. (₹)
(I) Equity and Liabilities		
(1) Shareholder's fund		
Share capital (Equity shares of ₹ 100 each fully paidup)	6,50,000	3,00,000
Reserves and Surplus General Re-serveProfit and loss account	60,000	30,000
(2) Current Liabilities		
Trade payables Due to White Ltd.	1,50,000	90,000
	1,15,000	75,000
	-	30,000
Total	9,75,000	5,25,000
(II) Assets:		
Non-current assets		
Property, Plant and Equipment	5,80,000	3,51,000
Investments		
Shares in Black Ltd. (2,250 shares)	2,70,000	
Current assets		
Inventories	50,000	1,20,000
Due from Black Ltd.	36,000	
Cash and Cash equivalents	39,000	54,000
Total	9,75,000	5,25,000

Other information:

(i) **During the year, Black Limited fabricated a machine, which is sold to White Ltd. for ₹ 39,000, the transaction being completed on 30th March,2021.**

(ii) **Cash in transit from Black Ltd. to White Ltd. was ₹ 6,000 on 31st March,2021. Profits during theyear 2020-2021 were earned evenly**

(iii) **The balances of Reserve and Profit and Loss account as on 1st April,2020 were as follows:**

	Reserves ₹	Profit and Loss A/c ₹
White Ltd.	30,000	15,000 Profit
Black Ltd.	30,000	10,000 Loss

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You are required to prepare consolidated Balance Sheet of the group as on 31st March,2021 as per the requirement of Schedule III of the Companies Act, 2013.(PYP 15 Marks May '22)

Answer 23

Consolidated Balance Sheet of White Ltd. and its Subsidiary Black Ltd.as at 31st March, 2021

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,50,000
(b) Reserves and Surplus	2	2,55,000
(2) Minority Interest	3	1,05,000
(3) Current Liabilities		
(a) Trade Payables	4	1,90,000
Total		12,00,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	9,31,000
(2) Current assets		
(i) Inventory	6	1,70,000
(ii) Cash & cash equivalent	7	99,000
Total		12,00,000

Notes to Accounts

			₹
1.	Share capital		
	6,500 equity shares of ₹ 100 each, fully paid up		6,50,000
	Total		6,50,000
2.	Reserves and Surplus		
	General Reserves		60,000
	Profit and Loss Account	1,50,000	
	Add: 75% share of Black Ltd.'s post-acquisition profits(W.N.1)	37,500	1,87,500
	Capital reserve (W.N. 5)		7,500
	Total		2,55,000
3.	Minority interest in Black Ltd. (WN 4)		1,05,000
4.	Trade payables		
	White Ltd.	1,15,000	
	Black Ltd.	75,000	1,90,000

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5.	Property, plant and equipment		
	White Ltd.	5,80,000	
	Black Ltd.	3,51,000	9,31,000
6	Inventory		
	White Ltd.	50,000	
	Black Ltd.	1,20,000	1,70,000
7	Cash & cash equivalent		
	White Ltd.	39,000	
	Black Ltd.	54,000	
	Cash in transit	6,000	99,000

Working Notes:

1. Post-acquisition profits of Black Ltd.	₹
profits earned during the year = ₹ 90,000 + ₹10,000	1,00,000
Pre-acquisition profits (1.4.20 to 30.9.20)	50,000
Post-acquisition profits (1.10.20 to 31.3.21)	50,000
White Ltd.'s share 75% of 50,000	37,500

Minority Interest 25% of 50,000	12,500
2. Pre-acquisition profits and reserves of Black Ltd.	
Reserves as on 1.4.2020	30,000
Profit and Loss Account [10,000 (loss as on 1.4.20) +50,000 (6 month Adjusted pre-acquisition profits)]	40,000
	70,000
White Ltd.'s = (75%) × 70,000	52,500
Minority Interest= (25%) × 70,000	17,500
3. Post-acquisition reserves of Black Ltd.	
Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 30,000 – 30,000)	nil
4. Minority Interest	
Paid-up value of (3,000 – 2,250) = 750 shares	
held by outsiders i.e. 750 × ₹ 100	75,000
Add: 25% share of pre-acquisition reserves & Profit	17,500
25% share of post-acquisition profit	12,500
5. Capital Reserve	1,05,000
Price paid by White Ltd. for 2,250 shares (A)	2,70,000

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Intrinsic value of the shares-		
Paid-up value of 2,250 shares held by White Ltd. i.e. 2,250 × ₹ 100	2,25,000	
Add 75% share of pre-acquisition reserves & profit (70,000 x 75%)	52,500 (B)	2,77,500
Capital reserve (A – B)		7,500

Question 24

H Ltd. and S Ltd. provide the following information as at 31st March,2022:

	H Ltd.₹	S Ltd.₹
Property, Plant and Equipment	**2,00,000**	**2,60,000**
Investments (14,000 Equity Shares of S Ltd.)	**2,52,000**	**-**
Current Assets	**1,48,000**	**1,40,000**
Share capital (Fully paid equity shares of ₹ 10 each)	**3,00,000**	**2,00,000**
Profit and loss account	**1,00,000**	**80,000**
Trade Payables	**2,00,000**	**1,20,000**

Additional information:

H Ltd. acquired the shares of S Ltd. on 1stJuly, 2021 and Balance of profit and loss account of SLtd. on 1stApril, 2021 was ₹ 60,000. Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31st March, 2022. (PYP 15 Marks Nov '22)

Answer 24

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 2022

		Note No	Amount (₹)
	I Equity and Liabilities		
1	Shareholders' Fund:		
	(a) Share Capital	1	3,00,000
	(b) Reserve and Surplus	2	1,10,500
2	Minority interest	3	84,000
3	Current Liabilities		
	Trade payables	4	3,20,000
	Total		8,14,500
	II Assets		
1	Non-Current Assets:		
	Property, plant and equipment	5	4,60,000

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	Intangible Asset	6	66,500
2	Current Assets	7	2,88,000
	Total		8,14,500

Notes to Accounts

		Amount (₹)
1	Share capital 30,000 Equity Shares @ ₹10 each	3,00,000
2	Reserve and Surplus Profit and loss account (₹ 1,00,000 + 70% of 9/12 x 20,000 i.e. ₹ 10,500)	1,10,500
3	Minority Interest (W/N 2)	84,000
4	Trade payables HLtd. S Ltd.	2,00,000 1,20,000
		3,20,000
5	Property, plant and equipment HLtd. S Ltd.	2,00,000 2,60,000
		4,60,000
6	Intangible Asset:	
	Goodwill (W/N 3)	66,500
7	Current Assets H Ltd. S Ltd.	1,48,000 1,40,000 2,88,000

Working Notes:

1. **Percentage of holding**

		No. of Shares	Percentage
Holding Co.	:	14,000	(70%)
Minority shareholders:		6,000	(30%)
Total Shares	:	20,000	

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2. **Calculation of Minority Interest**

Share capital (30% of ₹ 2,00,000)	60,000	84,000
Share in Profit and loss account (₹ 80,000 X 30%)	24,000	

Calculation of Cost of Control (Goodwill)

Cost of Investment	2,52,000
Less: Paid up value of shares (70% of ₹ 2,00,000)	(1,40,000)
Share in pre-acquisition profits	
70% of [60,000+3/12(80,000-60,000)]	(45,500)
	66,500

Question 25

Chand Ltd. and its subsidiary Sitara Ltd. provided the following information for the year ended 31st March, 2023:

Particulars	Chand Ltd (₹)	Sitara Ltd. (₹)
Equity Share Capital	20,00,000	6,00,000
Finished Goods Inventory as on 01.04.2022	4,20,000	3,01,000
Finished Goods Inventory as on 31.03.2023	8,57,500	3,76,250
Dividend Income	1,68,000	43,750
Other non-operating Income	35,000	10,500
Raw material consumed	13,93,000	4,72,500
Selling and Distribution Expenses	3,32,500	1,57,500
Production Expenses	3,15,000	1,40,000
Loss on sale of investments	26,250	Nil
Sales and other operating income	33,25,000	19,07,500
Wages and Salaries	13,30,000	2,45,000
General and Administrative Expenses	2,80,000	1,22,500
Royalty paid	Nil	5,000
Depreciation	31,500	14,000
Interest expense	17,500	5,250

Other information

- **On 1st September 2020 Chand Ltd., acquired 5,000 equity shares of ₹ 100 each fullypaid up in Sitara Ltd.**
- **Sitara Ltd. paid a dividend of 10% for the year ended 31st March 2022. The dividendwas co rectly accounted for by Chand Ltd.**

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- **Chand Ltd. sold goods of ₹ 1,75,000 to Sitara Ltd. at a profit of 20% on selling price.**

  Inventory of Sitara Ltd. includes goods of ₹ 70,000 received from Chand Ltd.

- **Selling and Distribution expenses of Sitara Ltd. include ₹ 21,250 paid to Chand Ltd. asbrokerage fees.**
- **General and Administrative expenses of Chand Ltd. include ₹ 28,000 paid to SitaraLtd. as consultancy fees.**
- **Sitara Ltd. used some resources of Chand Ltd., and Sitara Ltd. paid ₹ 5,000 to ChandLtd. as royalty.**

Consultancy fees, Royalty and brokerage received is to be considered as operating revenues.

Prepare Consolidated Statement of Profit and Loss of Chand Ltd. and its subsidiary Sitara Ltd. for the year ended 31st March, 2023 as per Schedule III to the Companies Act, 2013.(RTP Nov '23)(Same concepts different figures PYP 15 Marks Dec'21)

Answer 25

Consolidated statement of profit and loss of Chand Ltd. and its subsidiary Sitara Ltd. for the yearended on 31st March, 2023

Particulars	Note No.	₹
Revenue from operations	1	50,03,250
Other Income	2	1,81,000
Total revenue (I)		51,84,250
Expenses:		
Cost of material purchased/consumed	3	21,45,500
Changes (Increase) in inventories of finished goods	4	(4,98,750)
Employee benefit expense	5	15,75,000
Finance cost	6	22,750
Depreciation and amortization expense	7	45,500
Other expenses	8	8,43,250
Total expenses (II)		41,33,250
Profit before tax (II-III)		10,51,000

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Notes to Accounts:

			₹	₹
1.	Revenue from operations			
	Sales and other operating revenues			
	Chand Ltd.		33,25,000	
	Sitara Ltd.		19,07,500	
			52,32,500	
	Less: Inter-company sales		(1,75,000)	
	Consultancy feesreceived by Sitara Ltd. from Chand Ltd.		(28,000)	
	Royalty received by Chand Ltd.from Sitara Ltd.		(5,000)	
	Brokage received by Chand Ltd.from Sitara Ltd.		(21,250)	50,03,250
2.	Other Income			
	Dividend income:	1,68,000		
	Sitara Ltd.	43,750	2,11,750	
	Loss on sale of investments Sitara Ltd.		(26,250)	
	Other Non-operating Income			
	Chand Ltd.	35,000		
	Sitara Ltd.	10,500		
	Less: Dividend realized from SitaraLtd. (5,00,000 x 10%)	(50,000)	4,500	1,81,000
3.	Cost of material purchased/ consumed			
	Chand Ltd.	13,93,000		
	Sitara Ltd.	4,72,500		
		18,65,500		
	Less: Purchases by Sitara Ltd. FromChand Ltd.	(1,75,000)	16,90,500	
	Direct expenses (Production)			
	Chand Ltd.	3,15,000		
	Sitara Ltd.	1,40,000	4,55,000	21,45,500

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4.	Changes (Increase) in inventories offin-ished goods			
	Chand Ltd.		4,37,500	
	Sitara Ltd.		75,250	
			5,12,750	
	Less: Unrealized profits ₹ 7,00,00 × 20/100		(14,000)	4,98,750
5.	Employee benefits and expenses			
	Wages and salaries:			
	Chand Ltd.		13,30,000	
	Sitara Ltd.		2,45,000	15,75,000
6	Finance cost			
	Interest:			
	Chand Ltd.		17,500	
	Sitara Ltd.		5,250	22,750
7.	Depreciation			
	Chand Ltd.		31,500	
	Sitara Ltd.		14,000	45,500
8.	Other expenses			
	General & Administrative expenses:			
	Chand Ltd.	2,80,000		
	Sitara Ltd.	1,22,500		
		4,02,500		
	Less: Consultancy fees received bySitara Ltd. from Chand Ltd.	(28,000)	3,74,500	
	Royalty: Sitara Ltd. Less: Received by Chand Ltd. Selling and distribution Expenses:	5,000 (5,000)	Nil	
	Chand Ltd.	3,32,500		
	Sitara Ltd.	1,57,500		
		4,90,000		
	Less: Brokerage received by ChandLtd. from Sitara Ltd.	(21,250)	4,68,750	
				8,43,250

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Question 26

Minority interest should be presented in the consolidated balance sheet As a part of liabilities.

(a) As a part of equity of the parent's shareholders.

(b) Separately from liabilities and the equity of the parent's shareholders.

(c) As a part of assets.

Ans: (c)

Question 27

Minority of the subsidiary is entitled to

(a) Capital profits of the subsidiary company.

(b) Revenue profits of the subsidiary company.

(c) Both capital and revenue profits of the subsidiary company.

(d) Neither capital nor revenue profits of the subsidiary.

Ans: (c)

Question 28

In consolidation of accounts of holding and subsidiary company is eliminated in full.

(a) Current liabilities of subsidiary company.

(b) Reserves and surplus of both holding and subsidiary company.

(c) Mutual indebtedness.

(d) Nothing.

Ans: (c)

Question 29

In consolidated balance sheet, the share of the outsiders in the net assets of the subsidiary must be shown as

(e) Minority interest.

(f) Capital reserve.

(g) Current liability.

(h) Current assets.

Ans: (a)

Question 30

Provision for Tax made by the subsidiary company will appear in the consolidated balance sheet as an item of

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(i) Current liability.

(j) Revenue profit.

(k) Capital profit.

(l) Current assets.

Ans: (a)

Question 31

Hemant Ltd. purchased 80% shares of Power Ltd. on 1st January, 20X1 for ₹ 2,10,000. TheIssued capital of Power Ltd., on 1st January, 20X1 was ₹ 1,50,000 and the balance in the Profit & Loss Account was ₹ 90,000. During the year ended 31st December, 20X1, Power Ltd. earned a profit of ₹ 30,000 and at year end,declared and paid a dividend of ₹ 22,500. What is the amount of minority interest as on 1st January, 20X1 and 31st December, 20X1? Also compute goodwill/ capital reserve atthe date of acquisition.

Answer 31

Total dividend paid is ₹ 22,500 (out of post-acquisition profits), hence dividend received by Hemant will becredited to P & L account. Hemant Ltd.'s share of dividend = ₹ 22,500 X 80% = ₹ 18,000

Goodwill on consolidation (at the dateofacquisition):	₹	₹
Cost of shares		2,10,000
Less: Face value of capital i.e. 80% of capital	1,20,000	
Add: Share of capital profits [90,000 X 80 %]	72,000	(1,92,000)
Goodwill		18,000
Minority interest on: - **1st January, 20X1:** 20% of ₹ 2,40,000 [1,50,000 + 90,000]		48,000
- **31st December, 20X1:** 20% of ₹2,47,500 [1,50,000 + 90,000 + 30,000 – 22,500]		49,500

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Question 32

King Ltd. acquires 70% of equity shares of Queen Ltd. as on 31st March, 20X1 at a cost of ₹ 140 lakhs. The following information is available from the balance sheet of Queen Ltd. as on 31st March, 20X1:

	₹ in lakhs
Property, plant and equipment	**240**
Investments	**110**
Current Assets	**140**
Loans & Advances	**30**
15% Debentures	**180**
Current Liabilities	**100**

The following revaluations have been agreed upon (not included in the above figures):

Property, plant and equipment- up by 20% and Investments- down by 10%. King Ltd. purchased the shares of Queen Ltd. @ ₹20 per share (Face value - ₹10). Calculate the amount of goodwill/ capital reserve on acquisition of shares of Queen Ltd.

Answer 32

Revalued net assets of Queen Ltd. as on 31st March, 20X1

	₹ in lakhs	₹ in lakhs
PPE [240 X 120%]		288
Investments [110 X 90%]		99
Current Assets		140
Loans and Advances		30
Total Assets after revaluation		557
Less: 15% Debentures	180.0	
Current Liabilities	100.0	(280)
Equity / Net Worth		277
King Ltd.'s share of net assets (70% of 277)		193.9
King Ltd.'s cost of acquisition of shares of Queen Ltd.		
(₹140 lakhs)		(140)
Capital reserve		53.9

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Question 33

From the following information, determine Minority Interest on the date of acquisition and on the dateof consolidation in each case:

Case	Subsidi-aryCom-pany	% of Share owned	Cost	Date of Acquisition 01-01-20X1		Consolidation date 31-12-20X1	
				Share Capi-tal	Profit andLoss A/c	Share Capi-tal	Profit andLoss A/c
				Rs.	Rs.	Rs.	Rs.
Case-A	X	90%	2,00,000	1,50,000	75,000	1,50,000	85,000
Case-B	Y	75%	1,75,000	1,40,000	60,000	1,40,000	20,000
Case-C	Z	70%	98,000	40,000	20,000	40,000	20,000
Case-D	M	95%	75,000	60,000	35,000	60,000	55,000

Answer 33

Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in thiscase, it should be equal to Share Capital + Profit & Loss A/c

A = Share capital on 1.1.20X1

B = Profit & loss account balance on 1.1.20X1 C = Share capital on 31.12.20X1 D = Profit & loss account balance on 31.12.20X1

	Minority % Shares Owned [E]	Minority interest as at the date of acquisition [E] x [A + B] Rs.	Minority interest as at the date of consolidation [E] X [C + D] Rs.
Case A [100-90]	**10 %**	**22,500**	**23,500**
Case B [100-75]	**25 %**	**50,000**	**40,000**
Case C [100-70]	**30 %**	**18,000**	**18,000**
Case D [100-95]	**5%**	**4,750**	**5,750**

Question 34

A Ltd acquired 1,600 ordinary shares of Rs.100 each of B Ltd on 1st July, 20X1. On 31st December, 20X1, the balance sheets of the two companies were as given below:

Balance Sheet of A Ltd. and its subsidiary, B Ltd. as at 31st December, 20X1

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Particulars	Note No.	A Ltd. (Rs.)	B Ltd. (Rs.)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	1	5,00,000	2,00,000
(b) Reserves and Surplus	2	2,97,200	1,82,000
(2) Current Liabilities			
(a) Trade Payables	3	47,100	17,400
(b) Short term borrowings		80,000	
Total		9,24,300	3,99,400
II. Assets			
(1) Non-current assets			
(a) Property, Plant andEquipment	4		
(b) Non-current Investments		3,90,000	3,15,000
(2) Current assets	5		
(a) Inventories		3,40,000	
(b) Trade receivables			--
(c) Cash & Cash equivalents			
Total		1,20,000	
	6	59,800	36,400
		14,500	40,000
			8,000
		9,24,300	3,99,400

Notes to Accounts

		A Ltd. Rs.	B Ltd. Rs.
1.	Share Capital		
	5,000 shares of Rs. 100 each, fully paid up	5,00,000	-
	2,000 shares of Rs. 100 each, fully paid up	-	2,00,000
	Total	5,00,000	2,00,000
2.	Reserves and Surplus		
	General Reserves	2,40,000	1,00,000

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	Profit & loss	57,200	82,000
	Total	2,97,200	1,82,000
3.	Short term borrowings		
	Bank overdraft	80,000	--
4.	Property plant and equipment		
	Land and building	1,50,000	1,80,000
	Plant & Machinery	2,40,000	1,35,000
	Total	3,90,000	3,15,000
5.	Non-current Investments		
	Investment in B Ltd (at cost)	3,40,000	--
6.	Cash & Cash equivalents		
	Cash	14,500	8,000

The Profit & Loss Account of B Ltd. showed a credit balance of Rs.30,000 on 1st January, 20X1 out of which a dividend of 10% was paid on 1st August, 20X1; A Ltd. credited the dividend received to its Profit & Loss Account. The Plant & Machinery which stood at Rs. 1,50,000 on 1st January, 20X1 was considered asworth Rs. 1,80,000 on 1st July, 20X1; this figure is to be considered while consolidating the Balance Sheets. The rate of depreciation on plant & machinery is 10% (computed on the basis of useful lives).

Prepare consolidated Balance Sheet as at 31st December, 20X1.

Answer 34

Consolidated Balance Sheet of A Ltd. and its subsidiary, B Ltd. as at 31st December, 20X1

Particulars		Note No.	(Rs.)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital		1	5,00,000
(b) Reserves and Surplus		2	3,08,800
(2) Minority Interest			83,600
(3) Current Liabilities			
(a) Trade Payables		3	64,500
(b) Short term borrowings		4	80,000
	Total		10,36,900

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II. Assets			
(1) Non-current assets			
(a) Property, PlantEquipment	and	5	7,41,000
(b) Intangible assets		6	17,200
(2) Current assets			
(a) Inventories		7	1,56,400
(b) Trade receivables		8	99,800
(c) Cash & Cash equivalents		9	22,500
	Total		10,36,900

Notes to Accounts

				Rs.
1.	Share Capital			
				5,00,000
2.	5,000 shares of Rs. 100 each			
	Reserves and Surplus		2,40,000	
	Reserves		68,800	
	Profit & loss (Refer to W.N 8)			3,08,800
	Total			
3.	Trade Payables			
	A Ltd.	47,100		
	Add: B Ltd	17,400		
	Total			64,500
4.	Short term borrowings			
	Bank overdraft			80,000
5	Property, plant and equipment			

	Land and building- A Ltd	1,50,000		
	Add: Land and building- B Ltd	1,80,000	3,30,000	
	Plant & Machinery (Refer to W.N 7)		4,11,000	
	Total			7,41,000
6.	Intangible assets			
	Goodwill (refer to W.N 6)			17,200
7.	Inventories			
	A Ltd.		1,20,000	

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	B Ltd.		**36,400**	
	Total			**1,56,400**
8	**Trade Receivables**			
	A Ltd.	**59,800**		
	B Ltd.	**40,000**		
	Total			**99,800**
9	**Cash & Cash equivalents**			
	Cash of A Ltd		**14,500**	
	Add: cash of B Ltd.		**8,000**	
	Total			**22,500**

Share holding Pattern

Total Shares of B Ltd	2,000 shares
Shares held by A Ltd	1,600 shares i.e. 80 %
Minority Shareholding	400 shares i.e. 20 %

Working Notes:

1. The dividend @ 10% on 1,600 shares - Rs. 16,000 received by A Ltd. should have been credited to the investment A/c, being out of pre-acquisition profits. A Ltd., must pass a rectification entry, viz.

   Profit & Loss Account Dr. Rs. 16,000 ToInvestment Rs.16,000

2. The Plant & Machinery of B Ltd. would stand in the books at Rs. 1,42,500 on 1st July, 20X1, considering only six months' depreciation on Rs. 1,50,000 total depreciation being

   Rs. 15,000. The value put on the assets being Rs. 1,80,000, there is an appreciation tothe extent of Rs.37,500 (1,80,000 – 1,42,500).

3. Capital profits of B Ltd.

	Rs.	Rs.
Reserve on 1st January, 20X1 (Assumed there		1,00,000
is no movement in reserves during the year		
and hence balance as on 1st January 20X1 is		
same as of 31st December 20X1)		
Profit & Loss Account Balance on 1st January,	30,000	
20X1		
Less: Dividend paid	(20,000)	10,000

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Profit for 20X1:		
Total Rs.82,000		
Less: Rs.10,000		
Rs.72,000		
Proportionate upto 1st July, 20X1 on time		
basis (Rs. 72,000/2)		36,000
Appreciation in value of Plant & Machinery		37,500
		1,83,500
Less: 20% due to outsiders		(36,700)
Holding company's share		1,46,800

1. **Revenue profits of B Ltd.:**

Profit after 1st July, 20X1 [(82,000 – 10,000) x ½]		36,000
Less: Depreciation		
10% depreciation on Rs.1,80,000 for 6 months	9,000	
Less: Depreciation already charged for 2nd half		
year on 1,50,000	(7,500)	(1,500)
		34,500
Less: 1/5 due to outsiders		(6,900)
Share of A Ltd.		**27,600**

2. **Minority interest:**

Par value of 400 shares (2,00,000 X 20%)	40,000
Add: 1/5Capital Profits [WN 3]	36,700
1/5 Revenue Profits [WN 4]	6,900
	83,600

3. **Cost of Control:**

Amount paid for 1,600 shares	3,40,000	
Less: Dividend out of pre-acquisition profits	(16,000)	3,24,000
Par value of shares	1,60,000	

Capital Profits –share of A Ltd. [WN 3]	1,46,800	(3,06,800)
Cost of Control or Goodwill		17,200

4. **Value of plant & Machinery:**

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B Ltd. Add: Appreciation on 1st July, 20X1 [1,80,000 – (1,50,000 – 7,500)]	1,35,000 37,500 1,72,500	2,40,000
Add: Deprecation for 2nd half charged on pre-		
revalued value	7,500	
Less: Depreciation on Rs.1,80,000 for 6 months	(9,000)	1,71,000
		4,11,000

5. **Profit & Loss Account (Consolidated):**

A Ltd. as given	57,200	
Less: Dividend transferred to Investment A/c	(16,000)	41,200
Share of A Ltd. in revenue profits of B Ltd.		27,600
(WN 4)		
		68,800

Question 35

On 31st March, 20X1, the Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:
Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X1

Non-current Investments (Shares in S Ltd.)		**3,000**	
(2) Current assets			
(a) Inventories		**3,949**	**1,956**
(b) Trade receivables	**6**	**2,960**	**1,562**
(c) Cash and cash equivalents		**1,490**	**204**
(d) Short term loans andadvances	**7**	**520**	
Total		**21,387**	**9,208**

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Notes to Accounts

		H Ltd. (Rs. inlacs)	S Ltd. (Rs. inlacs)
1.	Share Capital Authorized share capital		
	Equity shares of Rs. 10 each, fully paid up Issued and Subscribed:	15,000	6,000
	Equity shares of Rs. 10 each, fully paid up	12,000	4,800
2.	Reserves and surplus General Reserve		
	Profit and Loss Account:Total	2,784	1,380
	Trade Payables	2,715	1,620
	Creditors	5,499	3,000
3.			
	Bills Payable	1,461	854
		372	160
		1,833	1,014
4.	Short term provisions Provision for Taxation		
		855	394
5.	Property, plant and equipmentLand and Buildings		
		2,718	-
	Plant and Machinery Furniture and Fittings	4,905	4,900
	Total	1,845	586
	Trade receivablesDebtors	9,468	5,486
6.	Bills ReceivableTotal		
	Short term loans and advances	2,600	1,363
		360	199
		2,960	1,562
7.			
	Sundry Advances	520	--

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The following information is also provided to you:

(a) H Ltd. purchased 180 lakh shares in S Ltd. on 31st March, 20X0 when the balances of General Reserve and Profit and Loss Account of S Ltd. stood at Rs. 3,000 lakh and Rs. 1,200 lakh respectively.

(b) On 1st April, 20X0, S Ltd. declared a dividend @ 20% for the year ended 31st March, 20X0. H Ltd. credited the dividend received by it to its Profit and Loss Account.

(c) On 1st January, 20X1, S Ltd. issued 3 fully paid-up bonus shares for every 5 shares held out of balances of its general reserve as on 31st March, 20X0.

(d) On 31st March, 20X1, all the bills payable in S Ltd.'s balance sheet were acceptances in favour of H Ltd. But on that date, H Ltd. held only Rs. 45 lakh of these acceptances in hand, the rest having been endorsed in favour of its trade payables.

(e) On 31st March, 20X1, S Ltd.'s inventory included goods which it had purchased for Rs. 100 lakh from H Ltd. which made a profit @ 25% on cost.

Prepare a Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X1.

Answer35

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X1

Particulars	Note No.	(Rs. in Lacs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	12,000
(b) Reserves and Surplus	7,159	
(2) Minority Interest [W.N.6]	3,120	
(3) Current Liabilities		
(a) Trade payables	2,802	
(b) Short term provisions	1,249	
2		
3		
4		
(c) Other current liabilities	5	1,200
Total		27,530
II. Assets		
(1) Non-current assets	6	14,954
Property, Plant and Equipment		
(2) Current assets		
(a) Inventories	7	5,885

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(b)	Trade receivables	8	4,477
(c)	Short term loans and advances	9	520
(d)	Cash and cash equivalents	10	1,694
	Total		27,530

Notes to Accounts

			(Rs. in lacs)	(Rs. in lacs)
1.	Share Capital			
	Authorized share capital			15,000
	Equity shares of Rs.10 each, fully paid upIssued and Subscribed:			
	Equity shares of Rs. 10 each, fully paid up Total		12,000	
	Reserves and surplus		12,000	
2.	Capital Reserve (Note 5) General Reserve (2,784 + 108) Profit and Loss Account:			
	H Ltd.	2,715		
	Less: Dividend wrongly credited 360 Unrealized Profit	20 (380)		
		2,335		
	Add: Share in S Ltd.'s Revenue profits 612 Total	1,320		
		2,892	7,159	
		2,947		
3.	Trade payables			
	Creditors			
	H Ltd.	1,461		
	S Ltd.	854	2,315	
	Bills Payable			
	H Ltd.	Rs. 372		
	S Ltd.	Rs. 160		
		Rs. 532		
	Less: Mutual owing	Rs. (45)	487	2,802

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4.	Short term provisions			
	Provision for Taxation			
	H Ltd.		855	
	S Ltd.		394	
	Total			1,249
5.	Other current liabilities			
	Dividend payable			
	H Ltd.			1,200
6.	Property, plant and equipment			
	Land and Buildings			
	H Ltd.		2,718	
	Plant and Machinery			
	H Ltd.	Rs. 4,905		
	S Ltd.	Rs. 4,900	9,805	
	Furniture and Fittings			
	H Ltd.	Rs. 1,845		
	S Ltd.	Rs. 586	2,431	
	Total			14,954
7.	Inventories			
	Stock			
	H Ltd.		3,949	
	S Ltd.		1,956	
			5,905	
	Less: Unrealized profit		(20)	5,885
8.	Trade receivables			
	Debtors			
	H Ltd.	Rs. 2,600		
	S Ltd.	Rs. 1,363	3,963	
	Bills Receivable			
	H Ltd.	Rs. 360		
	S Ltd.	Rs. 199		
		Rs. 559		
	Less: Mutual Owing	Rs. (45)	514	4,477
9.	Short term loans and advances			
	Sundry Advances			520

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10.	Cash and cash equivalents			
	Cash and Bank Balances			1,694

Share holding pattern of S Ltd.

Shares as on 31st March, 20X1 (Includes bonusshares issued on 1st January, 20X1)	480 lakh shares (4,800 lakhs/ Rs. 10)
H Ltd.'s holding as on 1st April, 20X0	180 lakhs
Add: Bonus received on 1st January, 20X1	108 lakhs (180 / 5 × 3)
Total H Ltd.'s holding as on 31st March, 20X1	288 lakhs i.e. 60 % [288/480×100]
Minority Shareholding	40%

Working Notes:

S Ltd.'s General Reserve Account

	Rs. in lakhs		Rs. in lakhs
To Bonus to equity shareholders (WN-8)	1,800	By Balance b/d	3,000
To Balance c/d	1,380	By Profit and Loss A/c (Balancing figure)	180
	3,180		3,180

S Ltd.'s Profit and Loss Account

	Rs. in lakhs		Rs. in lakhs
To General Reserve		By Balance b/d	1,200
[WN 1]	180	By Net Profit for the year* (Balancing figure)	
To Dividend paid			1,200
(20% on Rs.3,000 lakhs)	600		
To Balance c/d	1,620		
	2,400		2,400

*Out of Rs. 1,200 lakhs profit for the year, Rs. 180 lakhs has been transferred to reserves. Distribution of Revenue profits

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Note: The question can also be solved by taking Rs. 1,020 lakhs as post acquisition Profit and Loss balance and Rs. 180 lakhs as post acquisition General Reserve balance. The final answer will be same.

Calculation of Capital Profits

	Rs. in lakhs
General Reserve on the date of acquisition less bonus	1,200
shares (Rs. 3,000 – Rs. 1,800)	
Profit and loss account on the date of acquisition less	600
dividend paid (Rs. 1,200 – Rs. 600)	
	1,800

H Ltd.'s share = 60% of Rs. 1,800 lakhs = Rs. 1,080 lakhs Minority interest = Rs.1,800 – Rs. 1,080 = Rs. 720 lakhs

Calculation of capital reserve

	Rs. in lakhs
Paid up value of shares held (60% of Rs.4,800)	2,880

Add: Share in capital profits [WN 4]	1,080
	3,960
Less: Cost of shares less dividend received (Rs. 3,000 – Rs. 360)	(2,640)
Capital reserve	1,320

Calculation of Minority Interest

	II Rs. in lakhs
40% of share capital (40% of Rs. 4,800)	1,920
Add: Share in revenue profits [WN 3]	480
Share in capital profits [WN 4]	720
	3,120

Unrealized profit in respect of inventory

$$`100 \text{ lakhs} \times \frac{25}{125} = `20 \text{ lakhs}$$

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Question 36 Illustration

From the following data, determine in each case:

(1) **Minority interest at the date of acquisition and at the date of consolidation.**

(2) **Goodwill or Capital Reserve.**

(3) **Amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own Profit & Loss Account to be Rs. 2,00,000 ineach case:**

Case	Sub-sidiary Com-pany	% shares owned	Cost Rs.	Date of acquisition 1.1.20X1 Share Capital Rs.	Date of acquisition 1.1.20X1 Profit & Loss Ac-count Rs.	Consolidation Date 31.12.20X1 Share Capital Rs.	Consolidation Date 31.12.20X1 Profit & Loss Ac-count Rs.
Case 1	A	90%	1,40,000	1,00,000	50,000	1,00,000	70,000
Case 2	B	85%	1,04,000	1,00,000	30,000	1,00,000	20,000
Case 3	C	80%	56,000	50,000	20,000	50,000	20,000
Case 4	D	100%	1,00,000	50,000	40,000	50,000	55,000

Answer 36

(1)

Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. inthis case it should be equal to Share Capital + Profit & Loss A/c

	Minority % Shares Owned [E]	Minority interest as at the date of acquisition [E] x [A + B] Rs.	Minority interest as at the date of consolidation [E] X [C + D] Rs.
Case 1 [100-90]	10 %	15,000	17,000
Case 2 [100-85]	15 %	19,500	18,000
Case 3 [100-80]	20 %	14,000	14,000
Case 4 [100-100]	NIL	Nil	Nil

A = Share capital on 1.1.20X1

B = Profit & loss account balance on 1.1.20X1C = Share capital on 31.12.20X1

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D = Profit & loss account balance on 31.12.20X1

(2) Calculation of Goodwill or Capital Reserve

	Shareholding % [F]	Cost [G]	Total Equity [A] + [B] = [C]	Parent's Portion of equity [F] x [C] =H	Goodwill Rs. [G] – [H]	CapitalReserve Rs. [H] – [G]
Case 1	90 %	1,40,000	1,50,000	1,35,000	5,000	–
Case 2	85 %	1,04,000	1,30,000	1,10,500	–	6,500
Case 3	80 %	56,000	70,000	56,000	Nil	Nil
Case 4	100 %	1,00,000	90,000	90,000	10,000	–

(3) The balance in the Profit & Loss Account on the date of acquisition (1.1.20X1) is Capital profit, as such the balance of Consolidated Profit & Loss Account shall be equal to Holding Co.'s profit.

On 31.12.20X1 in each case the following amount shall be added or deducted from the balance of holding Co.'s Profit & Loss account.

Question 37 Illustration

Exe Ltd. acquires 70% of equity shares of Zed Ltd. as on 31st March, 20X1 at a cost of Rs. 70 lakhs. Thefollowing information is available from the balance sheet of Zed Ltd. as on 31st March, 20X1:

	Rs. in lakhs
Property, plant and equipment	120
Investments	55
Current Assets	70
Loans & Advances	15
15% Debentures	90
Current Liabilities	50

The following revaluations have been agreed upon (not included in the above figures):

Property, plant and equipment	Up by 20%
Investments	Down by 10%

Zed Ltd. declared and paid dividend @ 20% on its equity shares as on 31st March, 20X1 (Face value

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- Rs. 10 per share). Exe Ltd. purchased the shares of Zed Ltd. @ Rs. 20 per share. Calculate the amount of goodwill/capital reserve on acquisition of shares of Zed Ltd.

Answer 37

Revalued net assets of Zed Ltd. as on 31st March, 20X1

	Rs. in lakhs	Rs. in lakhs
Property, plant and equipment [120 X 120%]		144.0
Investments [55 X 90%]		49.5
Current Assets		70.0
Loans and Advances		15.0
Total Assets after revaluation		278.5
Less: 15% Debentures	90.0	
Current Liabilities	50.0	(140.0)
Equity / Net Worth		138.5
Exe Ltd.'s share of net assets (70% of 138.5)		96.95
Exe Ltd.'s cost of acquisition of shares of Zed Ltd.		
(Rs. 70 lakhs – Rs. 7 lakhs*)		63.00
Capital reserve		33.95

*** Total Cost of 70 % Equity of Zed Ltd Rs. 70 lakhs**

Purchase Price of each share Rs. 20 Number of

shares purchased [70 lakhs /Rs. 20] 3.5 lakhs

Dividend @ 20 % i.e. Rs. 2 per share Rs. 7 lakhs

Since dividend received is for pre-acquisition period, it has been reduced from the cost of investment

in the subsidiary company.

Question 38 Illustration

A Ltd. acquired 70% of equity shares of B Ltd. on 1.4.20X1 at cost of Rs. 10,00,000 when B Ltd. had an equity share capital of Rs. 10,00,000 and reserves and surplus of Rs. 80,000. In the four consecutive years,B Ltd. fared badly and suffered losses of Rs. 2,50,000, Rs. 4,00,000, Rs. 5,00,000 and Rs. 1,20,000 respectively. Thereafter in 20X5- X6, B Ltd. experienced turnaround and registered an annual profit of Rs. 50,000. In the next two years i.e. 20X6-X7 and 20X7-X8, B Ltd. recorded annual profits of Rs. 1,00,000 and Rs. 1,50,000respectively. Show the minority interests and cost of control at the end of each year for the purpose of consolidation.

Answer 38

The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. In such cases, AS 21 prescribes that the excess, and any further losses ap-

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plicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

aWhere the minority interest has a binding obligation (say by way of a shareholders' agreement), then the share of losses will be attributed to the minority interest even if it exceeds the minority interest in the equity (i.e., debit balance in minority interest). Since information on the existence of a binding obligation is not given in the question, we solve as if such obligation does not exist, and hence the minority interests will be computed as follows:

Year	Profit/ (Loss)	Minority Interest (30%)	Additional ConsolidatedP & L (Dr.) Cr. (for the year ended balance)	Minority's Shareof losses borneby A Ltd.		Cost of Con-trol
				Rs.	Balance	
At the time			-			
of		3,24,000				
acquisition in20X1		- (W.N.)				
20X1-X2	(2,50,000)	(75,000)	(1,75,000)			2,44,000
						(W.N.)
Balance		2,49,000				
20X2-X3	(4,00,000)	(1,20,000)	(2,80,000)			2,44,000
Balance		1,29,000				
20X3-X4	(5,00,000)	(1,50,000)	(3,50,000)			2,44,000
		(21,000)				
	Loss of minority borne by Holding Co.	21,000	(21,000)	21,000	21,000	
Balance		Nil	(3,71,000)			
20X4-X5	(1,20,000)	(36,000)	(84,000)			2,44,000

	Loss of					
	minority borne by	36,000	(36,000)	36,000	57,000	
	Holding Co.					

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Balance		Nil	(1,20,000)			
20X5-X6	50,000	15,000	35,000			2,44,000
	Profit share of minority adjusted against losses of minority absorbed by Holding Co.	(15,000)	15,000	(15,000)	42,000	
Balance		Nil	50,000			
20X6-X7	1,00,000	30,000	70,000			
	Profit share of minority adjusted against losses of minority absorbed by Holding Co.	(30,000)	30,000	(30,000)	12,000	2,44,000
Balance		Nil	100,000			
20X7-X8	1,50,000	45,000	1,05,000	(12,000)	Nil	2,44,000
		(12,000)	12,000			
Balance		33,000	1,17,000			

Working Note:

Calculation of Minority interest and Cost of control on 1.4.20X1

		Share of Holding Co.	Minority Interest
	100%	70%	30%
	(Rs.)	(Rs.)	(Rs.)
Share Capital	10,00,000	7,00,000	3,00,000
Reserve	80,000	56,000	24,000
		7,56,000	3,24,000

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Less: Cost of investment		(10,00,000)	
Goodwill		2,44,000	

Question 39 Illustration

Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31 March, 20X1 from the following information:

	H Ltd.	S Ltd.
	Rs.	Rs.
PPE	5,00,000	3,00,000
Investments		
(20,000 equity shares of S Ltd.)	2,20,000	
Current Assets	1,55,000	1,00,000
Share capital (Fully paid equity shares of Rs. 10	5,00,000	2,50,000
each)		
Profit and loss account	2,00,000	1,00,000
Trade Payables	1,75,000	50,000

H Ltd. acquired the shares of S Ltd. on 31st March, 20X1.

Answer 39

Percentage of holding:

		No. of Shares	Percentage
Holding Co	:	20,000	(80%)
Minority shareholders	:	5,000	(20%)
TOTAL SHARES	:	25,000	

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd.as at 31st March,20X1

		Note No	Amount (Rs.)
1	I EQUITY AND LIABILITIES Shareholder's Fund		
	(a) Share Capital	1	5,00,000
	(b) Reserve and Surplus	2	2,60,000
2	Minority interest	3	
3	Current Liabilities		70,000
	(a) Trade payables	4	

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			2,25,000
	Total		10,55,000
	II ASSETS		
1.	Non-Current Assets		
	PPE	5	8,00,000
2.	Current Assets	6	2,55,000
	Total		10,55,000

Notes to Accounts

		Amounts (Rs.)
1	Share capital	
	50,000 Equity Shares @ Rs.10 each	5,00,000
2	Reserve and Surplus	
	Capital Reserve (W.N.)	60,000
	Profit and loss account	2,00,000
		2,60,000
3	Minority Interest	
	Paid up value of shares 50,000	
	Add: Share in Profit and loss account 20,000	70,000
4	Trade payables	
	H Ltd.	1,75,000
	S Ltd.	50,000
		2,25,000
5	PPE	
	H Ltd.	5,00,000
	S Ltd.	3,00,000
		8,00,000
6	Current Assets	
	H Ltd.	1,55,000
	S Ltd.	1,00,000
		2,55,000

Working Note:

Determination of Goodwill/(Capital Reserve)	(Rs.)

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Cost of investment		2,20,000
Less: Paid up value of shares (80% of 2,50,000)	2,00,000	
Share in pre-acquisition profits (80% of 1,00,000)	80,000	
		(2,80,000)
Capital Reserve		(60,000)

Question 40 Illustration

H Ltd. and S Ltd. provide the following information as at 31st March,20X2:

	H Ltd.	S Ltd.
	Rs.	Rs.
PPE	1,00,000	1,30,000
Investments (8,000 equity shares of S Ltd.)	1,26,000	
Current Assets	74,000	70,000
Share capital (Fully paid equity shares of Rs.10 each)	1,50,000	1,00,000

Profit and loss account	50,000	40,000
Trade Payables	1,00,000	60,000

Additional information:H Ltd. acquired the shares of S Ltd. on 1-7-20X1 and Balance of profit and loss account of S Ltd. on 1-4- 20X1 was 30,000.

Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31st March, 20X2.

Answer 40

Percentage of holding:

	No. of Shares	Percentage
Holding Co. :	8,000	(80%)
Minority shareholders :	2,000	(20%)
TOTAL SHARES :	10,000	

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X2

		Note No	Amount (Rs.)
	I EQUITY AND LIABILITYES		
1	Shareholder's Fund		
	(a) Share Capital	1	1,50,000
	(b) Reserve and Surplus	2	56,000
2	Minority interest	3	28,000

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3	Current Liabilities		
	(a) Trade payables	4	1,60,000
	Total		3,94,000
	II ASSETS		
1	Non-Current Assets:		
	PPE	5	2,30,000
	Intangible Asset	6	20,000
2	Current Assets	7	1,44,000
	Total		3,94,000

Notes to Accounts

		Amount (Rs.)
1	Share capital 15,000 Equity Shares @ Rs.10 each	1,50,000
2	Reserve and Surplus	
	Profit and loss account (Rs. 50,000+ 80% of 9/12 x 10,000)	56,000
3	Minority Interest	

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	Share capital (20% of Rs. 1,00,000)	20,000Share in	
	Profit and loss account (Rs. 40,000 X 20%)	8,000	28,000
4	Trade payablesH Ltd.		
	S Ltd.		1,00,000
			60,000
	PPE		1,60,000
5	H Ltd.		
	S Ltd.		1,00,000
			1,30,000
			2,30,000
6			
	Intangible Asset		1,26,000
	Cost of Investment		
	Less: Paid up value of shares (80% of Rs. 1,00,000) Share in pre-acquisition profits		(80,000)
	80% of [30,000+3/12(40,000-30,000)]		(26,000)
			20,000
7	Goodwill Current Assets H Ltd.		
	S Ltd.		74,000
			70,000
			1,44,000

Question 41 Illustration

From the Balance Sheets and information given below, prepare Consolidated Balance Sheet of Virat Ltd. and Anushka Ltd. as at 31st March. Virat Ltd. holds 80% of Equity Shares in Anushka Ltd. since its (Anushka Ltd.'s) incorporation.

Balance Sheet of Virat Ltd. and Anushka Ltd. as at 31st March, 20X1

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Particulars	Note No.	Virat Ltd. (Rs.)	Anushka Ltd. (Rs.)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	1	6,00,000	4,00,000
(b) Reserves and Surplus	2	1,00,000	1,00,000
(2) Non-current LiabilitiesLong Term Borrowings		2,00,000	1,00,000
(3) Current Liabilities			
(a) Trade Payables		1,00,000	1,00,000
Total		10,00,000	7,00,000
II. Assets			
(1) Non-current assets			
(a) Property, Plant andEquipment		4,00,000	3,00,000
(b) Non-current investments	3	3,20,000	-
(2) Current Assets			
(a) Inventories		1,60,000	2,00,000
(b) Trade Receivables		80,000	1,40,000
(c) Cash & Cash Equivalents		40,000	60,000
Total		10,00,000	7,00,000

Notes to Accounts

	Particulars	**(Rs.)**	**Virat Ltd. (Rs.)**	**Anushka Ltd. (Rs.)**
1.	**Share capital**			
	60,000 equity shares of Rs. 10 each fully paid up		**6,00,000**	**--**
	40,000 equity shares of Rs. 10 each fully paid up		**--**	**4,00,000**

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	Total		6,00,000	4,00,000
2.	Reserves and Surplus			
	General Reserve		1,00,000	1,00,000
	Total		1,00,000	1,00,000
3.	Non-current investments			
	Shares in Anushka Ltd		3,20,000	--

Answer 41

Consolidated balance Sheet of Virat Ltd. and its Subsidiary Anushka Ltd. as at 31st March, 20X1

Particulars		Note	Amount (Rs.)
I	EQUITY AND LIABILITIES:		
(1)	Shareholders' Funds:		
	(a) Share Capital	1	6,00,000
	(b) Reserve and Surplus	2	1,80,000
(2)	Minority Interest	3	1,00,000
(3)	Non-Current Liabilities:		
	Long Term Borrowings	4	3,00,000
(4)	Current Liabilities:		
	Trade Payables	5	2,00,000
	Total		13,80,000

II	ASSETS:		
(1)	Non-Current Assets		
	Property, Plant & Equipment	6	7,00,000
(2)	Current Assets:		
	(a) Inventories		
	(b) Trade receivables	7	3,60,000
	(c) Cash and Cash Equivalents	8	2,20,000
		9	1,00,000
	Total		13,80,000

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Notes to Accounts

	Particulars	Rs.	Rs.
1.	Share capital		
	60,000 equity shares of Rs.10 each fully paid up		6,00,000
2.	Reserves and Surplus		
		1,00,000	
	General Reserve	80,000	
	Add: General reserve of Anushka Ltd (80%) Total		1,80,000
3.	Minority interest		
			1,00,000
4	20% share in Anushka Ltd (WN 3)		
	Long term borrowings	2,00,000	
	Long term borrowings of Virat	1,00,000	
	Add: Long term borrowings of Anushka		3,00,000
	Total		
5.	Trade payables		
	Trade payables of Virat	1,00,000	
	Add: Trade payables of Anushka	1,00,000	
	Total		2,00,000
6.	Property, Plant and Equipment (PPE)		
	PPE of Virat Ltd	4,00,000	
	Add: PPE of Anushka Ltd	3,00,000	
	Total		7,00,000
7.	Inventories		
	Inventories of Virat Ltd	1,60,000	
	Add: Inventories of Anushka Ltd	2,00,000	
	Total		3,60,000
8.	Trade receivables		

	Trade receivables of Virat Ltd	80,000	
	Add: Trade receivables of Anushka Ltd	1,40,000	
	Total		2,20,000

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9	Cash and cash equivalents		
	Cash and cash equivalents of Virat Ltd	40,000	
	Add: Cash and cash equivalents of Anushka Ltd	60,000	
	Total		1,00,000

Working Notes:Basic Information

Company Status	Dates	Holding Status
Holding Co. = Virat Ltd. Subsidiary = AnushkaLtd.	Acquisition: Anushka's Incorporation	Holding Company = 80% Minority Interest = 20%
	Consolidation: 31st March, 20X1	

Analysis of General Reserves of Anushka Ltd

Since Virat holds shares in Anushka since its incorporation, the entire Reserve balance of Rs.1,00,000 will be Revenue.

Consolidation of Balances

Holding- 80%, Minority - 20%	Total	Minority Interest	Holding Company	
Equity Capital	4,00,000	80,000	3,20,000	-
General				
Reserves	1,00,000	20,000	Nil (pre-acq)	80,000 (post-acq)
Total		1,00,000	3,20,000	80,000
Cost of				
Investment			(3,20,000)	-
Goodwill/capital reserve			NIL	
Parent's				1,00,000
Balance				
Amount for				1,80,000
Consolidated				
Balance Sheet				

Question 42Illustration

A Ltd. holds 80% of the equity capital and voting power in B Ltd. A Ltd. sells inventories costing Rs. 180 lacs to B Ltd at a price of Rs. 200 lacs. The entire inventories remain unsold with B Ltd. at the A Ltd.

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holds 75% of the equity capital and voting power in B Ltd. A Ltd. purchases inventories costing Rs. 150 lacs from B Ltd at a price of Rs. 200 lacs. The entire inventories remain unsold with ALtd. at the financial year end i.e. 31 March 20X1.

Suggest the accounting treatment for the above mentioned transactions in the consolidated financialstatements of A Ltd. giving reference of the relevant guidance/standard.

Answer 42

As per para 16 and 17 of AS 21, intragroup balances and intragroup transactionsand resulting unrealized profits should be eliminated in full. Unrealized losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.

Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealized profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full. Unrealized losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminatedunless cost cannot be recovered.

One also needs to see whether the intragroup transaction is "upstream" or "down-stream". Upstream transaction is a transaction in which the subsidiary company sells goods to holding company. While in the downstream transaction, holding company is the seller and subsidiary company is the buyer.

In the case of upstream transaction, since the goods are sold by the subsidiary to holding company; profit is made by the subsidiary company, which is ultimately shared by the holding company and the minority shareholders. In such a transaction, if some goods remain unsold at the balance sheet date, the unrealizedprofit on such goods should be eliminated from minority interest as well as from consolidated profit on the basis of their share-holding besides deducting the same from unsold inventory.

But in the case of downstream transaction, the whole profit is earned by the holding company, therefore, whole unrealized profit should be adjusted from unsold inventory and consolidated profit and loss account only irrespective of the percentage of the shares held by the parent.

Using above mentioned guidance, following adjustments would be required:

a. This would be the case of downstream transaction. In the consolidated profit and loss account for the year ended 31 March 20X1, entire transactionof sale and purchase of Rs. 200 lacs each, would be eliminated by reducingboth sales and purchases (cost of sales).

   Further, the unrealized profits of Rs. 20 lacs (i.e. Rs. 200 lacs – Rs. 180 lacs), would be eliminated from the consolidated financial statements for financial year ended 31 March 20X1, by reducing the consolidated profits/ increasing the consolidated losses, and reducing the value of closing inventoriesas of 31 March 20X1.

b. This would be the case of upstream transaction. In the consolidated profitand loss account for the year ended 31 March 20X1, entire transaction ofsale and purchase of Rs. 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales).

   Further, the unrealized profits of Rs. 50 lacs (i.e. Rs. 200 lacs – Rs. 150 lacs), would be eliminated in the consolidated financial statements for financial year ended 31 March 20X1, by reducing the value of closing inventories by Rs.50 lacs as of 31 March 20X1. In the consolidated balance sheet as of 31 March 20X1, A Ltd.'s share of profit from B Ltd will be reduced by Rs. 37.50lacs (being 75% of Rs. 50 lacs) and the minority's share of the profits of B Ltd would be reduced by Rs.12.50 lacs (being 25%of Rs.50 lacs).

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Question 43 Illustration

H Ltd and its subsidiary S Ltd provide the following information for the year ended 31st March, 20X3:

	H Ltd. (Rs. in lacs)	S Ltd. (Rs. in lacs)
Sales and other income	**5,000**	**1,000**

Increase in Inventory (closing less opening)	**1,000**	**200**
Raw material consumed	**800**	**200**
Wages and Salaries	**800**	**150**
Production expenses	**200**	**100**
Administrative Expenses	**200**	**100**
Selling and Distribution Expenses	**200**	**50**
Interest	**100**	**50**
Depreciation	**100**	**50**

Other Information:

H Ltd. sold goods to S Ltd. of Rs. 120 lacs at cost plus 20%. Inventory of S Ltd. includes such goods valuing Rs. 24 lacs. Administrative expenses of S Ltd. include Rs. 5 lacs paid to H Ltd. as consultancy fees. Selling and distribution expenses ofH Ltd. include Rs.10 lacs paid to S Ltd. as commission.

H Ltd. holds 80% of equity share capital of Rs.1,000 lacs in S Ltd. prior to 20X1-20X2.H Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by S Ltd. for the year 20X1-20X2.

Prepare a consolidated statement of profit and loss..

Answer 43

Consolidated statement of profit and loss of H Ltd. and its subsidiary S Ltd. for the year ended on 31st March, 20X3

Particulars	Note No.	Rs. in Lacs
I. Revenue from operations	**1**	**5,865**
II. Total Income		**5,865**
III. Expenses		
Cost of material purchased/consumed	**2**	**1,180**
Changes of inventories of finished goods	**3**	**(1,196)**
Employee benefit expense	**4**	**950**

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	Finance cost	5	150
	Depreciation and amortization expense	6	150
	Other expenses	7	535
	Total expenses		1,769
	IV. Profit before tax (II-III)		4,096

Notes to Accounts

		Rs. in Lacs	Rs. in Lacs
1.	Revenue from operations Sales		
	and other incomeH Ltd.		
	S Ltd.	5,000	
		1,000	
	Less: Inter-company sales	6,000	
	Consultancy fees received by H Ltd. from S Ltd.Com-	(120)	
	mission received by S Ltd. from H Ltd.	(5)	
	Cost of material purchased/consumed HLtd.	(10)	5,865
2.	S Ltd.		
		800	
		200	
	Less: Purchases by S Ltd. from H Ltd.Direct	1,000	
	expenses (Production)	(120)	880
	H Ltd.S Ltd.		
	Changes of inventories of finished goods HLtd.	200	
	S Ltd.	100	300
	20		1,180
3.	Less: Unrealized profits Rs. 24 lacs × 120		
		1,000	
		200	
		(4)	1,196

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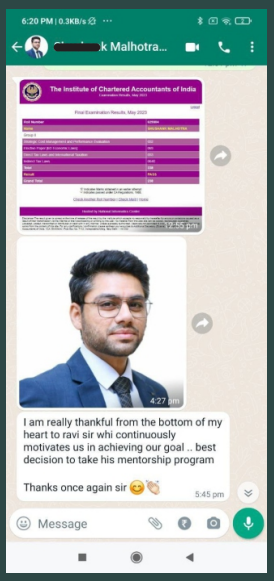

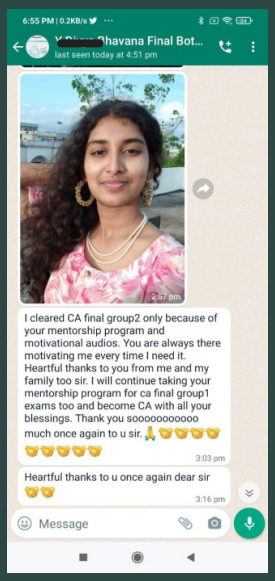

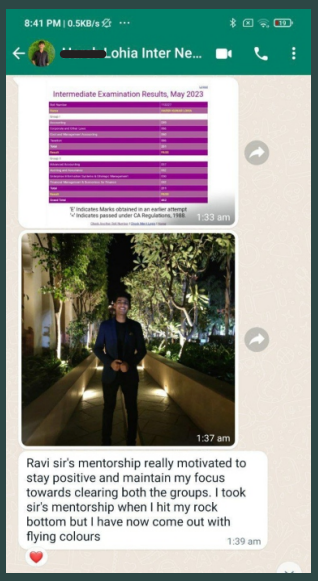

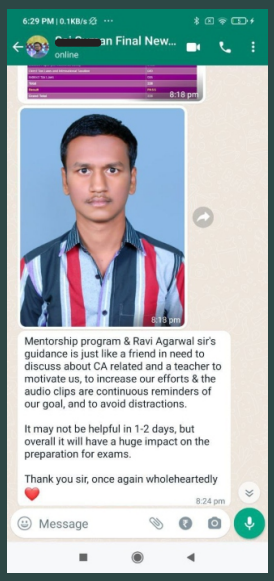

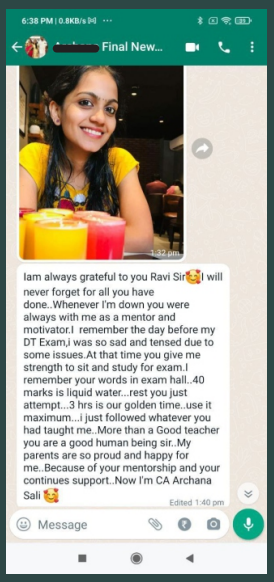

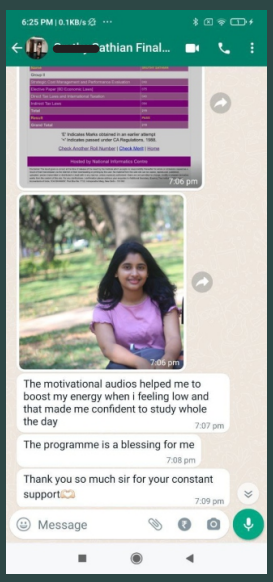

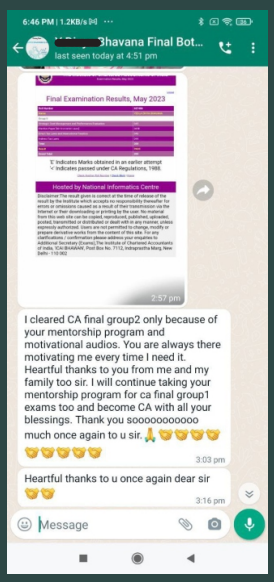

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4.	Employee benefits and expensesWages and salaries:		
	H Ltd.S Ltd.	800	
	Finance cost Interest:H Ltd.	150	950
5.	S Ltd.		
	DepreciationH Ltd.		
	S Ltd.	100	
	Other expenses Administrativeexpenses	50	150
6.	H Ltd.S Ltd.		
	Less: Consultancy fees received by H Ltd. from S Ltd.Selling and distribution Expenses:	100	
	H Ltd.	50	150
7.			
		200	
		100	
		(5)	295

	S Ltd.		
	Less: Commission received by S Ltd. from H Ltd.	200	
		50	
		(10)	240
			535

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Question 44 Illustration

Subsidiary B Ltd. provides the following balance sheet:

Particulars		Note No.	20X0 (Rs.)	20X1 (Rs.)
I. Equity and Liabilities				
(1) Shareholder's Funds				
(a) Share Capital		1	5,00,000	5,00,000
(b) Reserves and Surplus		7,14,000		
(2) Current Liabilities				
(a) Short term borrowings		1,70,000		
(b) Trade Payables		4,94,000		
(c) Short-term provisions		4,30,000		
Total		23,08,000		
2	2,86,000			
3	--			
	4,90,000			
4	3,10,000			
	15,86,000			
II. Assets				
(1) Non-current assets				
(a) Property, PlantEquipment	and 6	5	2,72,000	2,24,000
(b) Non-current Investment			4,00,000	
(2) Current assets				
(a) Inventories		5,97,000	7,42,000	
(b) Trade Receivables		5,94,000	8,91,000	
(c) Cash & CashEquivalents		51,000	3,000	
(d) Other current assets		72,000	48,000	
Total		15,86,000	23,08,000	

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		20X0 (Rs.)	20X1 (Rs.)
1.	Share capital		
	5,000 equity shares of Rs.10 each, fully paid upReserves and Surplus		
2.			
	General Reserves Short term borrowingsBank overdraft		
3.			
	Short term provisions		
4.	5,00,000		
	5,00,000		
	2,86,000		
	7,14,000		
	--		
	1,70,000		

	Provision for taxation Property, plant and equipment	3,10,000	4,30,000
5.			
	Cost	3,20,000	3,20,000
	Less: DepreciationTotal	(48,000)	(96,000)
	Other current AssetsPre-paid expenses	2,72,000	2,24,000
6.			
		72,000	48,000

(a) Also consider the following **information:**

(b) **B Ltd. is a subsidiary of A Ltd. Both the companies follow calendar year as the accountingyear.**

A Ltd. values inventory on weighted average basis while B Ltd. used FIFO basis. To bring **B**

Ltd.'s values in line with those of A Ltd, its value of inventory is required to be reduced by

(c) Rs.12,000 at the end of 20X0 and Rs. 34,000 at the end of **20X1.**

(d) **B Ltd. deducts 1% from Trade Receivables as a general provision against doubtful debts.**

Prepaid expenses in B Ltd. include advertising expenditure carried forward of Rs. 60,000 in 20X0andRs. 30,000 in 20X1, being part of initial advertising expenditure of Rs. 90,000 in 20X0 which is being written off over three years. Similar amount of advertising expenditure of A Ltd. has been fully written off in 20X0.

Restate the balance sheet of B Ltd. as at 31st December, 20X1 after considering the above information, for the purpose of consolidation. Would restatement be necessary to make the accounting policies adopted by A Ltd. and B Ltd. uniform.

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Answer 44

As per para 20 and 21 of AS 21, Consolidated financial statements:

Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accountingpolicies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

If a member of the group uses accounting policies other than those adopted inthe consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements when they are used in preparing the consolidated financial statements.

Accordingly, in the given case, restatement would be required to make the accounting policies of A Ltd and B Ltd uniform.

Adjusted reserves of B Ltd.:

	Rs.	Rs.
Reserves as given		**7,14,000**
Add: Provision for doubtful debts		
{[8,91,000 / 99 X 100]-8,91,000}		**9,000**
		7,23,000
Less: Reduction in value of Inventory	**34,000**	
Advertising expenditure to be written off	**30,000**	**(64,000)**
Adjusted reserves		**6,59,000**

Note: No adjustment would be required in respect of opening inventory of B Ltd as that will not have any impact on P&L.

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Restated Balance Sheet of B Ltd. as at 31st December, 20X1

Particulars		Note No.	(Rs.)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital		1	5,00,000
(b) Reserves and Surplus			
(2) Current Liabilities			
(a) Short term borrowings			
(b) Trade Payables			
(c) Short-term provision			
Total			
II. Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment			
(b) Non-current Investment			
(2) Current assets			
(a) Inventories			
(b) Trade Receivables			
	2	6,59,000	
	3	1,70,000	
		4,94,000	
	4	4,30,000	
		22,53,000	
	5	2,24,000	
		4,00,000	
	6	7,08,000	
	7	9,00,000	
(c) Cash & Cash Equivalents		3,000	
(d) Other current assets		8	18,000
	Total		22,53,000

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Notes to Accounts

			20X1 (Rs.)
1.	Share capital		
	5,000 equity shares of Rs 10 each, fully paid upReserves		5,00,000
2.	and Surplus		
	General Reserves (refer to WN)Short		6,59,000
3.	term borrowings		
	Bank overdraft		1,70,000
4.	Short term provisions Provision for		
	taxation Property, plant and equip-		4,30,000
5.	ment		
	Cost		
	Less: DepreciationTotal		3,20,000
	Inventory		(96,000)
	Actual inventory		2,24,000
6.			
			7,42,000

	Less: Change in method of valuationTotal		(34,000)
	Trade receivables		7,08,000
7.	Actual trade receivables		
	Add: Adjustment for provisionTotal		8,91,000
	Other current Assets		9,000
	Prepaid expenses		9,00,000
8.			
			48,000

Question 45 Illustration

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 20X1 for Rs. 1,40,000. The issued capital of ABC Ltd., on 1st January, 20X1 was Rs. 1,00,000 and the balance in the Profit & Loss Account was Rs. 60,000.

During the year ended 31st December, 20X1, ABC Ltd. earned a profit of Rs. 20,000 and at year end, declared and paid a dividend of Rs. 15,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd.

What is the amount of minority interest as on 1st January, 20X1 and 31st December, 20X1? Also please check whether there should be any goodwill/ capital reserve at the date of acquisition.

Answer 45

Total dividend paid is Rs. 15,000 (assumed to be out of post-acquisition profits), hence dividend re-

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ceived by XYZ will be credited to P & L.

XYZ Ltd.'s share of dividend = Rs. 15,000 X 80% = Rs. 12,000

In the books of XYZ Ltd.

		Rs.	Rs.
Bank A/c	Dr.	12,000	
To Profit & Loss A/c			12,000
(Dividend received from ABC Ltd credited to			
P&L A/c being out of post-acquisition profits –			
as explained above)			
Goodwill on consolidation (at the date of		Rs.	Rs.
acquisition):			
Cost of shares			1,40,000
Less: Face value of capital i.e. 80% of capital		80,000	
Add: Share of capital profits [60,000X 80 %]		48,000	(1,28,000)
Goodwill			12,000
Minority interest on:			
- 1st January, 20X1:			
20% of Rs. 1,60,000 [1,00,000 + 60,000]			32,000
- 31st December, 20X1:			33,000
20% of Rs. 1,65,000 [1,00,000 + 60,000 +			
20,000 – 15,000]			

Question 46 Illustration

Variety Ltd. holds 46% of the paid-up share capital of VR Ltd The shares were acquired at a market price of Rs. 17 per share. The balance of shares of VR Ltd. are held by a foreign collaborating company. A memorandum of understanding has been entered into with the foreign company providing for the following:

(a) **The shares held by the foreign company will be sold to Variety Ltd. The price per share will be calculated by capitalising the yield at 15%. Yield, for this purpose, would mean 40% of the average of pre-tax profits for the last 3 years, which were Rs. 30 lakhs, Rs. 40 lakhs and Rs. 65 lakhs.**

(b) **The actual cost of the shares to the foreign company was Rs. 5,40,000 only. The profit that would accrue to them would be taxable at an average rate of 30%. The tax payable will be deducted from the proceeds and Variety Ltd. will pay it to the Government.**

(c) **Out of the net consideration, 50% would be remitted to the foreign company immediately and the balance will be an unsecured loan repayable after two years.**

The above agreement was approved by all concerned for being given effect to on 1.4.20X1. The total assets of VR Ltd. as on 31st March, 20X1 was Rs. 1,00,00,000. It was decided to write down Property, Plant and Equipment by Rs. 1,75,000. Current liabilities of VR Ltd. as on the same date were Rs. 20,00,000.The

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paid-up share capital of VR Ltd. was Rs. 20,00,000 divided into 2,00,000 equity shares of Rs. 10 each. Find out goodwill/capital reserve to Variety Ltd. on acquiring wholly the shares of VR Ltd.

Answer 46

Computation of Purchase Consideration

(a) Yield of VR Ltd.: $\left[\frac{40}{100} \times \frac{30+40+65}{3}\right]$ = Rs. 18 Lakhs

(b) Price per share of VR Ltd.:

Capitalized Yield: $\left[\frac{18 \text{ lakhs}}{0.15}\right]$ = Rs. 120 Lakhs

No. of shares 2 lakhs

Therefore, price per share `60

(c) Purchase Consideration for 54% shares in VR Ltd.

2 lakh shares x 54% x ` 60 per shares `64.80 lakhs

(d) Discharge of Purchase Consideration:

Tax at source (` 64.80 lakhs – ` 5.40 lakhs) × $\frac{30}{100}$ Rs. 17.82 lakhs

50% of purchase consideration (net of tax) in cash `23.49 lakhs

[` (64.80 – 17.82) x 50%]

Balance – Unsecured Loan `23.49 lakhs

2. Goodwill / Capital Reserve to Variety Ltd.

	Rs. in lakhs	
Total Assets	100.00	
Less: Reduction in Value of Property, Plant and	(1.75)	
Equipment		
	98.25	
Less: Current Liabilities	(20.00)	
Net Assets of VR Ltd. on Date of Acquisition		78.25
Purchase Consideration: 54% purchased from Foreign	64.80	

Co.		
Investment: 46% existing stake	15.64	(80.44)
Goodwill on Date of Acquisition		2.19

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Question 47 Illustration

A Ltd. acquired 60% shares of B Ltd. @ Rs. 20 per share. Following is the extract of Balance Sheet of B Ltd.:

	Rs.
10,00,000 Equity Shares of Rs. 10 each	**1,00,00,000**
10% Debentures	**10,00,000**
Trade Payables	**55,00,000**
Property, Plant and Equipment	**70,00,000**
Investments	**45,00,000**
Current Assets	**68,00,000**
Loans and Advances	**22,00,000**

On the same day B Ltd. declared dividend at 20% and as agreed between both the companies Property, Plant and Equipment were to be depreciated @ 10% and investment to be taken at market value of Rs.60,00,000. Calculate the Goodwill or Capital Reserve to be recorded in Consolidated Financial Statements.

Answer 47

Since dividend is declared by B Ltd. on the date of acquisition itself, it would be out of the divisible profits of B Ltd. existing on the date of acquisition i.e., pre- acquisition profits from the perspective of A Ltd. Accordingly, as per AS 13, such pre-acquisition dividend would be reduced from the cost of investment, as seen below in the determination of Goodwill on the date of acquisition.

	Rs.	Rs.
Assets		
Property, Plant and Equipment	70,00,000	
Less: Value written off (Rs. 70 lakhs x 10%)	(7,00,000)	
	63,00,000	
Investments at Market Value	60,00,000	
Current Assets	68,00,000	
Loans and Advances	22,00,000	2,13,00,000
Less: Liabilities		
Trade Payables	55,00,000	
10% Debentures	10,00,000	(65,00,000)
Net Assets of B Ltd.		1,48,00,000
Share of A Ltd. in Net Assets of B Ltd.: 60%		88,80,000
Less: Cost of Investment in B Ltd. (60% stake):		
10,00,000 Equity Shares x 60% x Rs. 20 per share	1,20,00,000	

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Less: Pre-acquisition dividend: 6,00,000 shares x Rs. 2	(12,00,000)	(1,08,00,000)
Goodwill on Date of Acquisition		19,20,000

Question 48 Illustration

H Ltd. acquired 3,000 shares in S Ltd., at a cost of Rs. 4,80,000 on 31.7.20X1. The capital of S Ltd. consisted of 5,000 shares of Rs. 100 each fully paid. The Profit & Loss Account of this company for 20X1 showed anopening balance of Rs. 1,25,000 and profit for the year was Rs. 3,00,000. At the end of the year, it declareda dividend of 40%. Record the entry in the books of H Ltd., in respect of the dividend. Assume the profit is accruing evenly and calendar year as financial year.

Answer 48

The profits of S Ltd., have to be divided between capital and revenue profits from the point of view of the holding company:

	Capital Profit (Pre- acqui-sition) Rs.		**Revenue Profit (Post-acqui-sition) Rs.**
Balance on 1.1.20X1	1,25,000	—	
Profit for 20X1 (3,00,000 × 7/12)	1,75,000	(3,00,000×5/12)	1,25,000
Total	3,00,000		1,25,000
Proportionate share of H Ltd. (3/5)	1,80,000		75,000

Total dividend declared = Rs. 5,00,000 X 40 % = Rs. 2,00,000

H Ltd.'s share in the dividend = Rs. 2,00,000 X 3/5 = Rs. 1,20,000

There can be two situations as regards the treatment of dividend of Rs. 1,20,000:

(1) The profit for 20X1 has been utilised to pay the dividend.

The share of H Ltd in profit for the first seven months of S Ltd = Rs. 1,05,000 (i.e. Rs. 1,75,000 × 3/5)Profit for the remaining five months = Rs. 75,000 (i.e.Rs. 1,25,000 × 3/5).

The dividend of Rs. 1,20,000 will be adjusted in this ratio of 1,05,000: 75,000 = Rs. 70,000 out of profitsup to 31.7.20X1 and Rs. 50,000 out of profits after that date.

The dividend out of profits subsequent to 31.7.20X1 will be revenue income and that out of earlier profits will be capital receipt. Hence the entry will be:

		Rs.	Rs.
Bank	Dr.	1,20,000	
To Investment Account			70,000
To Profit and Loss Account			50,000

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(2) Later profits have been utilised first and then pre- acquisition profits.

In such a case, the whole of Rs. 75,000 (share of H Ltd. in profits of S Ltd., after 31.7.20X1) would be received and treated as revenue income; the remaining dividend, Rs.45,000 (Rs.1,20,000 less Rs. 75,000) would be capital receipt. The entry would be:

		Rs.	Rs.
Bank	Dr.	1,20,000	
To Investment Account			45,000
To Profit & Loss Account			75,000

Note: Point (2) discussed above can arise only if there is definiteinformation about the profits utilized. In practice, such treatment is rare.

Question 49 Illustration

A Ltd. and B Ltd. provide the following information:

		Rs. '000s
	A Ltd.	**B Ltd.**
Equity Shares	**6,000**	**5,000**
6% Preference Shares	**NIL**	**1,000**
General Reserve	**1,200**	**800**
Profit and Loss Account	**1,020**	**1,790**
Trade Payables	**3,850**	**3,410**
Dividend Payable	**600**	**500**
Goodwill	**100**	**20**
Property, Plant and Equipment	**3,850**	**2,750**
Investment	**1,620**	**1,100**
Inventory	**1,900**	**4,150**
Trade Receivables	**4,600**	**4,080**
Cash & Bank	**600**	**400**

A Ltd. purchased 3/4th interest in B Ltd. at the beginning of the year at the premium of 25%. Following other information is available:

a. **Profit & Loss Account of B Ltd. includes ₹ 1,000 thousands bought forward from the previous year.**

b. **The General Reserve balance is brought forward from the previous year.**

c. **The directors of both the companies have declared a dividend of 10% on equity share capital for the previous and current year.**

From the above information calculate Pre- and Post-acquisition Profits, Minority Interest and Cost ofControl.

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Answer 49

Calculation of Pre- and Post-Acquisition Profits:

	Pre-Acquisition Profits (₹)	Post-Acquisition Profits (₹)
Profit & Loss Account	10,00,000	7,90,000
General Reserve	8,00,000	NIL
	18,00,000	7,90,000
Less: Share of Minority Interest: (¼)	(4,50,000)	(1,97,500)
Attributable to Parent	13,50,000	5,92,500

	(Cost of Control)	(Post-acquisition
		Profits)

Calculation of Minority Interest:

Particulars	₹
Paid-up Equity Share Capital (₹ 50,00,000 x ¼)	12,50,000
Paid-up Preference Share Capital	10,00,000
Share in Reserves:	
Profit & Loss Account: ₹ 17,90,000 x ¼	4,47,500
General Reserve: ₹ 8,00,000 x ¼	2,00,000
Minority Interest	**28,97,500**

Calculation of Goodwill/Capital Reserve

	₹	₹
Cost of Investment in Subsidiary:	46,87,500	
₹ 50,00,000 x 75% x 125% (cost + 25%		
premium)		
Less: Pre-acquisition dividend	(3,75,000)	43,12,500
Less: Net Worth of B Ltd. on Date of Acquisition		
(attributable to A Ltd.):		
Paid-up Capital	37,50,000	
Pre-acquisition Reserves	13,50,000	(51,00,000)
Capital Reserve		7,87,500

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Question 50 Illustration

On 31st March, 20X1, P Ltd. acquired 1,05,000 shares of Q Ltd. for Rs. 12,00,000. The position of Q Ltd.on that date was as under:

	Rs.
Property, plant and equipment	10,50,000
Current Assets	6,45,000
1,50,000 equity shares of Rs. 10 each fully paid	15,00,000
Pre-incorporation profits	30,000
Profit and Loss Account	60,000
Trade payables	1,05,000

P Ltd. and Q Ltd. give the following information on 31st March, 20X3:

	P Ltd. Rs.	Q Ltd. Rs.
Equity shares of Rs. 10 each fully paid (before bonus issue)	45,00,000	15,00,000
Securities Premium	9,00,000	–
Pre-incorporation profits	–	30,000
General Reserve	60,00,000	19,05,000
Profit and Loss Account	15,75,000	4,20,000
Trade payables	5,55,000	2,10,000
Property, plant and equipment	79,20,000	23,10,000
Investment: 1,05,000 Equity shares in Q Ltd. at cost	12,00,000	–
Current Assets	44,10,000	17,55,000

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(a) Directors of Q Ltd. made bonus issue on 31.3.20X3 in the ratio of one equity share of Rs. 10 each fullypaid for every two equity shares held on that date. Bonus shares were issued out of post-acquisition profits by using General Reserve.Calculate as on 31st March, 20X3 (i) Cost of Control/ Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account in each of the following **cases:**

(b) **Before issue of bonus shares;** Immediately After issue of bonus shares.

Answer 50

Shareholding pattern

Particulars		Number of Shares	% of holding
a.	**P Ltd.**		
(i)	**Purchased on 31.03.20X1**	**1,05,000**	
(ii)	**Bonus Issue (1,05,000/2)**	**52,500**	
	Total	**1,57,500**	**70%**
b.	**Minority Interest**	**67,500**	**30%**

Calculations of (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit andLoss Account as on 31st March, 20X3:

(a) **Before issue of bonus shares**

(i)	**Cost of control/capital reserve**	Rs.	Rs.
	Investment in Q Ltd.		12,00,000
	Less: Face value of investments (ShareCapital)Capital profits (W.N.)	10,50,000	
	Cost of control (i.e., Goodwill)	63,000	(11,13,000)
			87,000
(ii)	**Minority Interest**		Rs.
	Share Capital		4,50,000
	Capital profits (W.N.)		27,000
	Revenue profits (W.N.)		6,79,500
			11,56,500

(iii)	**Consolidated profit and loss account – P Ltd.**		Rs.
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		15,85,500
			31,60,500

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Immediately after issue of bonus **shares**

(i)	**Cost of control/capital reserve**	Rs.	Rs.
	Face value of investments (Rs. 10,50,000 +		
	Rs.5,25,000)	15,75,000	
	Capital Profits (W.N.)	63,000	16,38,000
	Less: Investment in Q Ltd.		(12,00,000)
	Capital reserve		4,38,000
(ii)	**Minority Interest**		Rs.
	Share Capital (Rs. 4,50,000 + Rs.2,25,000)		6,75,000
	Capital Profits (W.N.)		27,000
	Revenue Profits (W.N.)		4,54,500
			11,56,500
(iii)	**Consolidated Profit and Loss Account – P Ltd.**		Rs.
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd.		
	(W.N.)		10,60,500
			26,35,500

Working Note:

Analysis of Profits of Q Ltd.

	Capital Profits (Pre-acquisition)	**Revenue Profits (Post-acquisition)**	
	(Before and after issue of bonus shares) Rs.	**Before Bonus Issue** Rs.	**After Bonus Issue** Rs.
Pre-incorporation profits	30,000		
Profit and loss account on	60,000		
31.3.20X1			
	90,000		
General reserve*		19,05,000	19,05,000

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Less: Bonus shares			(7,50,000)
			11,55,000
Profit for period of 1st			
April, 20X1 to 31st March,		3,60,000	3,60,000
20X3			
(Rs.4,20,000 – Rs.60,000)			
		22,65,000	15,15,000
P Ltd.'s share (70%)	63,000	15,85,500	10,60,500
Minority's share (30%)	27,000	6,79,500	4,54,500

*Share of P Ltd. in General reserve has been adjusted in Consolidated Profitand Loss Account.

Question 51 Illustration

(i) From the following balance sheets of H Ltd. And its subsidiary S Ltd. drawn up at 31st March, 20X1, prepare a consolidated balance sheet as at that date, having regard to the **following:**

(ii) **Reserves and Profit and Loss Account of S Ltd. stood at Rs. 25,000 and Rs. 15,000 respectively on thedate of acquisition of its 80% shares by H Ltd. on 1st April, 20X0.**

Machinery (Book-value Rs. 1,00,000) and Furniture (Book value Rs. 20,000) of S Ltd. were revalued at Rs. 1,50,000 and Rs. 15,000 respectively on 1st April, 20X0 for the purpose of fixing the price of itsshares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture**15%.]**

Balance Sheet of H Ltd. and S Ltd. as at 31st March, 20X1

Particulars	Note No.	H Ltd. (Rs.)	S Ltd. (Rs.)
I. Equity and Liabilities			
(1) Shareholder's Funds	**1**	**6,00,000**	**1,00,000**
(a) Share Capital	**2**	**3,00,000**	**1,00,000**
(b) Reserves and Surplus			
(2) Current Liabilities			
(a) Trade Payables		**1,50,000**	**57,000**
Total		**10,50,000**	**2,57,000**
II. Assets			
(1) Non-current assets			
(a) Property, Plant andEquipment	**3**	**4,50,000**	**1,07,000**
(b) Other non- currentinvestments	**4**	**6,00,000**	**1,50,000**
Total		**10,50,000**	**2,57,000**

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Notes to Accounts

		Rs.	H Ltd. (Rs.)	S Ltd. (Rs.)
1.	Share capital			
	6,000 equity shares of Rs. 100 each, fully paid		6,00,000	--
	up			
	1,000 equity shares of Rs. 100 each, fully paid			
	up		- -	1,00,000
	Total		6,00,000	1,00,000
2.	Reserves and Surplus			
	General reserves		2,00,000	75,000
	Profit and loss account			25,000
			1,00,000	
	Total		3,00,000	1,00,000
3.	Property, Plant and Equipment			
	Machinery		3,00,000	90,000
	Furniture		1,50,000	17,000
	Total		4,50,000	1,07,000
4.	Other Non-current investments			
	Non-current Investments		4,40,000	1,50,000
	Shares in S Ltd.			
	(800 shares at Rs.200 each)		1,60,000	--
	Total		6,00,000	1,50,000

Answer 51

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd.as at 31st March, 20X1

Particulars	Note No.	(Rs.)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,00,000
(b) Reserves and Surplus	2	3,44,600
(2) Minority Interest	3	48,150
(3) Current Liabilities		

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(a) Trade Payables		2,07,000
Total		**11,99,750**
II. Assets		

(1) Non-current assets		
(a) Property, Plant and Equipment	4	5,97,750
(b) Intangible assets	5	12,000
(c) Other non-current investments	6	5,90,000
Total		**11,99,750**

Working Notes:

1. Pre-acquisition profits and reserves of S Ltd.		Rs.
Reserves		25,000
Profit and Loss Account		15,000
		40,000
H Ltd.'s = 4/5 (or 80%) × 40,000		32,000
Minority Interest= 1/5 (or 20%) × 40,000		8,000
2. Profit on revaluation of assets of S Ltd.		
Profit on Machinery Rs.(1,50,000 – 1,00,000)		50,000
Less: Loss on Furniture Rs.(20,000 – 15,000)		5,000
Net Profit on revaluation		45,000
H Ltd.'s share 4/5 × 45,000		36,000
Minority Interest 1/5 × 45,000		9,000
3. Post-acquisition reserves of S Ltd.		
Post-acquisition reserves (Total reserves lessreserves pre-acquisition = Rs.75,000 – 25,000)		50,000
H Ltd.'s share 4/5 × 50,000		40,000
Minority interest 1/5 × 50,000		10,000
4. Post -acquisition profits of S Ltd.		
Post-acquisition profits (Profit & loss account balance lesspre-acquisition profits = Rs.25,000 – 15,000)		10,000
Add: Excess depreciation charged on furniture @ 15%on Rs. 5,000 i.e. (20,000 – 15,000)		750
		10,750
Less: Under depreciation on machinery @ 10%		

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on Rs.50,000 i.e. (1,50,000 – 1,00,000)	(5,000)
Adjusted post-acquisition profits	5,750
H Ltd.'s share 4/5 × 5,750	4,600
Minority Interest 1/5 × 5,750	1,150
5. Minority Interest	

Paid-up value of (1,000 – 800) = 200 shares	
held by outsiders i.e. 200 × Rs.100 (or 1,00,000 X 20%)	20,000
Add: 1/5th share of pre-acquisition profits and reserves	8,000
1/5th share of profit on revaluation	9,000
1/5th share of post-acquisition reserves	10,000
1/5th share of post-acquisition profit	1,150
	48,150
6. Cost of Control or Goodwill	
Price paid by H Ltd. for 800 shares(A)	1,60,000
Intrinsic value of the shares-	
Paid-up value of 800 shares held by H Ltd. i.e. 800 × Rs.100	80,000
(or 1,00,000 X 80%)	
Add: 4/5th share of pre-acquisition profits and reserves	32,000
4/5th share of profit on the revaluation	36,000
Intrinsic value of shares on the date of acquisition (B)	1,48,000
Cost of control or Goodwill (A – B)	12,000

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Chapter 10.2

As 23 Accounting for Investments in Associates in Consolidated FinancialStatements

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.2 TO Q.12											
Past Exams	NO	NO	NO	NO	NO	NO	NO	Q.1	NO	NO	NO	NO
MTP	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
RTP	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO

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Chapter 10.2

As 23 Accounting for Investments in Associates in Consolidated FinancialStatements

Question 1

Long Limited acquired 60% stake in Short Limited for a consideration of Rs. 112 lakhs. On the date of acquisition Short Limited's Equity Share Capital was Rs. 100 lakhs, Revenue Reserve was Rs. 40 lakhs and balance in Profit & Loss Account was Rs. 30 lakhs. From the above information you are required to calculate Goodwill / Capital Reserve in the following situations:

(i) On consolidation of Balance Sheet.

(ii) If Long Limited showed the investment in subsidiary at a carrying amount of Rs. 104 lakhs.

(iii) If the consideration paid for acquiring the 60% stake was Rs. 92 lakhs. (PYP 5 Marks, July 21)

Answer 1

	Rs.
60% of the Equity Share Capital Rs. 100 Lakhs	60
60% of Accumulated Reserve Rs. 70 Lakhs (40+30) Lakhs	42
Book value of shares of Short Ltd.	102

Goodwill / Capital Reserve computation on consolidation of balance sheet

Long Ltd. paid a positive differential of Rs. 10 Lakhs (112 - 102). This differential Rs. 10 Lakhs is called goodwill and is shown in the balance sheet under the head intangibles

(i) If Long Ltd. showed the investment in Short Ltd. at carrying amount of Rs. 104 Lakhs, then thegoodwill will be Rs. 2 Lakhs.

(ii) If the consideration paid is Rs. 92 lakhs, then there would have been capital reserve amounting Rs. 10Lakhs (102- 92).

Question 2

Identity which of the statements are correct.

An enterprise can influence the significant economic decision making by many ways like:

(i) Representation on the board of directors or governing body of the investee.

(ii) Participation in policy-making processes.

(iii) Interchange of managerial personnel.

(iv) Provision of essential technical information.

(a) Statement (i) and (ii) are correct.

(b) Statement (i), (ii) and (iii) are correct.

(c) Statement (i), (ii), (iii) and (iv) are correct.

(d) Statement (ii) and (iii) are correct.

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Ans: (c)

Question 3

A Ltd. is holding 90% share in B Ltd. and 10% shares in C Ltd., and B Ltd. is holding 11% shares in C Ltd. Identity which of the statements are incorrect.

(v) In this case, A Ltd. is parent of B Ltd.

(vi) As far as the relationship between A Ltd. and C Ltd. is concerned; A Ltd. has a total of directand indirect holding of (10% + 90% of 11%) 19.9 %in C Ltd.

(vii) C Ltd. is an associate of A Ltd.

(a) Statement (ii) is incorrect.

(b) Statement (iii) is incorrect.

(c) Statement (ii) and (iii) both are incorrect.

(d) All statements are incorrect.

Ans: (a)

Question 4

A Ltd. acquired 10% stake of B Ltd. on April 01 and further 15% on October 01 of the same year. Other information is as follows:

Cost of Investment for 10% Rs. 1,00,000 and for 15% Rs. 1,55,000

Net asset on April 01 Rs. 8,50,000 and on October 01 Rs. 10,00,000.

What is the amount of goodwill or capital reserve arising on significantinfluence?

(a) Goodwill = Rs. 10,000.

(b) Goodwill = Rs. 20,000.

(c) Capital Reserve = Rs. 10,000.

Ans: (b)

Question 5

Capital Reserve = Rs. 20,000. 4. A Ltd. acquired 10% stake of B Ltd. on April 01 and further 15% on October 01 during the same year. Other information is as follow:

Cost of Investment for 10% Rs. 1,00,000 and for 15% Rs. 1,45,000

Net asset on April 01 Rs. 8,50,000 and on October 01 Rs. 10,00,000.

What is the amount of goodwill or capital reserve arising on significantinfluence?

(a) Goodwill = Rs. 10,000.

(b) Goodwill = Rs. 20,000.

(c) Capital Reserve = Rs. 10,000.

(d) Capital Reserve = Rs. 20,000.

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Ans: (a)

Question 6

Identity which of the statements are correct.

(viii) In case an associate has made a provision for proposed dividend (i.e. dividend declared after the reporting period but it pertains to that reporting year) in its financial statements, the investor's share of the results of operations of the associate should be computed without taking into consideration the proposed dividend.

(ix) In case an associate has made a provision for proposed dividend (i.e. dividend declared after the reporting period but it pertains to that reporting year) in its financial statements, the investor's share of the results of operations of the associate should be computed after taking into consideration the proposed dividend.

(x) The potential equity shares of the investee held by the investor shouldnot be taken into account for determining the voting power of the investor.

(xi) The potential equity shares of the investee held by the investor shouldbe taken into account for determining the voting power of the investor.

(a) Statement (i) and (iii).

(b) Statement (ii) and (iv).

(c) Statement (i) only.

(d) Statement (iii) only.

Ans: (a)

Theoretical Questions Answers

Question 7

Describe the cases when AS 23 does not allow the use of equity method of accounting?

Answer 7

Equity method of accounting is to be followed by all the enterprises having significant influence on their associates except in the following cases:

a. Control is intended to be temporary because the investment is acquired and held exclusively with aview to its subsequent disposal inthe near future.

   The term 'Near Future' is explained with AS 21.Or;

b. It operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the investor.

   In both the above cases, investment of investor in the share of theinvestee is treated as investmentaccording to AS 13.

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Question 8

When is an investor required to discontinue the use of the equity method of accounting?

Answer 8

An investor should discontinue the use of the equity method from the date that:

a. It ceases to have significant influence in an associate but retains, either in whole or in part, its investment.

b. The use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.

From the date of discontinuing the use of the equity method, investments in such associates should be accounted for in accordance with AS 13,Accounting for Investments. For this purpose, the carrying amount of the investment at that date should be regarded as cost thereafter.

Question 9

Bright Ltd. acquired 30% of East India Ltd. shares for Rs. 2,00,000 on 01-06-20X1. By such an acquisition Bright can exercise significant influence over East India Ltd. During the financial year ending on 31-03- 20X1 East India earned profits Rs. 80,000 and declared a dividend of Rs. 50,000 on 12-08-20X1. East India reported earnings of Rs. 3,00,000 for the financial year ending on 31-03-20X2 (assume profits to accrueevenly) and declared dividends of Rs. 60,000 on 12-06-20X2.

Calculate the carrying amount of investment in:

Separate financial statements of Bright Ltd. as on 31-03-20X2; Consolidated financial statements of Bright Ltd.; as on 31-03-20X2;

What will be the carrying amount as on 30-06-20X2 in consolidated financial statements?

Answer 9

(i) **Carrying amount of investment in Separate Financial Statement of Bright Ltd. as on 31.03.20X2**

	Rs.
Amount paid for investment in Associate (on 1.06.20X1)	2,00,000
Less: Pre-acquisition dividend (Rs. 50,000 x 30%)	(15,000)
Carrying amount as on 31.3.20X2 as per AS 13	1,85,000

Carrying amountof investment in Consolidated Financial Statements * of Bright Ltd. as on 31.3.20X2 as per AS 23

	Rs.
Carrying amount as per separate financial statements	1,85,000
Add: Proportionate share of 10-month profit of	
investee as per equity method (30% of	
Rs.3,00,000 x 10/12)	75,000

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Carrying amount as on 31.3.20X2	2,60,000

Carrying amount of investment in Consolidated Financial Statement of BrightLtd. as on 30.6.20X2 as per AS 23

	Rs.
Carrying amount as on 31.3.20X2	2,60,000
Less: Dividend received (Rs.60,000 x 30%)	(18,000)
Carrying amount as on 30.6.20X2	2,42,000

Question 10

A Ltd. acquired 25% of shares in B Ltd. as on 31.3.20X1 for Rs. 3 lakhs. The Balance Sheet of B Ltd. as on X1 is given below:

	Rs.
Share Capital	**5,00,000**
Reserves and Surplus	**5,00,000**
	10,00,000
Fixed Assets	**5,00,000**
Investments	**2,00,000**
II. Current Assets	**3,00,000**
	10,00,000

(i) During the year ended 31.3.20X2 the following are the additional information **available:A Ltd. received dividend from B Ltd., for the year ended 31.3.20X1 at40% from theReserves.**

(ii) **B Ltd., made a profit after tax of Rs. 7 lakhs for the year ended 31.3.20X2.**

B Ltd., declared a dividend @ 50% for the year ended 31.3.20X2 on **30.4.20X2.**

(i) A Ltd. is preparing Consolidated Financial Statements in accordance with AS21 for its varioussubsidiaries. **Calculate:**

(ii) **Goodwill if any on acquisition of B Ltd.'s shares.**

(iii) **How A Ltd., will reflect the value of investment in B Ltd., in the ConsolidatedFinancialStatements?**

How the dividend received from B Ltd. will be shown in the Consolidated Financial**Statements?**

Answer 10

(i) In terms of AS 23, B Ltd. will be considered as an associate company ofA Ltd. as shares acquired represent to more than 20%.

Calculation of Goodwill (Rs. in lakhs)

Amount paid towards acquisition of stake in B Ltd. 3.00 Less: Pre-acquisition dividend (Rs.5,00,000 x 40% x 25%) 0.50 Cost of Investment in B Ltd. 2.50

Less: Share in the value of Equity of B Ltd.as at the date of investment [25% of Rs.10 lakhs (Rs.5 lakhs + Rs.5 lakhs)] (2.50)

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(ii) Goodwill NIL

A **Ltd. Consolidated**

Profit and Loss Account for the year ended 31stMarch, 20X2 (An extract)

		Rs. **in lakhs**
Other income:		
Share of profits in B Ltd.		1.75
Pre-acquisition Dividend received from		
B Ltd.	0.50	
Transfer to investment A/c	(0.50)	Nil

(iii) **A Ltd.**

Consolidated Balance Sheet as on 31.3.20X2 (An extract)

		Rs. **in lakhs**
Non-current investments		
Investment in B Ltd.		
Cost of Investment in B Ltd.	2.50	
Share of profit for year 20X1 – 20X2	1.75	
	4.25	
Add: Goodwill	NIL	4.25

Working Notes:

1. Pre-acquisition dividend received from B Ltd. amounting to Rs. 0.50 lakhs will bereduced from investment value in the books of A Ltd.
2. B Ltd. made a profit of Rs.7 lakhs for the year ended 31st March,20X2. A Ltd.'s share in the profits of Rs. 7 lakhs is Rs. 1.75 lakhs.

   Investment in B Ltd. will be increased by Rs. 1.75 lakhs and consolidated profit and loss accountof A Ltd. will be credited with Rs. 1.75 lakhs in the consolidated financial statement of A Ltd.
3. Dividend declared on 30th April, 20X2 will not be recognized in the consolidated financial statement of A Ltd.

Question 11 (Illustration)

A Ltd. acquire 45% of B Ltd. shares on April 01, 20X1, the price paid was Rs. 15,00,000. Following are the extracts of balance sheet of B Ltd. as of 1 April 20X1: Paid up Equity Share Capital Rs. 10,00,000

Securities Premium Rs. 1,00,000

Reserve & Surplus Rs. 5,00,000

B Ltd. has reported net profits of Rs. 3,00,000 and paid dividends of Rs. 1,00,000 for the year ended 31 March 20X2. Calculate the amount at which the investment in B Ltd. should be shown in the consolidated balance sheet of A Ltd. as on March 31, 20X2.

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Answer11

Calculation of Goodwill/Capital Reserve under Equity Method

Particulars		Rs.	Rs.
Investment in B Ltd.	(A)		15,00,000
Equity Shares		10,00,000	
Security Premium		1,00,000	
Reserves & Surplus		5,00,000	
Net Assets		16,00,000	
45% of Net Asset	(B)		7,20,000
Goodwill (A-B)			7,80,000

Calculation of Carrying Amount of Investment in the year ended on 31st March, 20X2

Particulars	Rs.
Investment in Associate as per AS 23:	
Share of Net Assets on 1 April 20X1	7,20,000
Add: Goodwill	7,80,000
Cost of Investment	15,00,000

Add: Profit during the year (3,00,000 x 45%)	1,35,000
Less: Dividend paid (1,00,000 x 45%)	(45,000)
Carrying Amount of Investment	15,90,000

Question 12 (Illustration)

A Ltd. acquired 40% share in B Ltd. on April 01, 20X1 for Rs. 10 lacs. On that date B Ltd. had 1,00,000 equity shares of Rs. 10 each fully paid and accumulated profits of Rs. 2,00,000. During the year 20X1-20X2, B Ltd. suffered a loss of Rs. 10,00,000; during 20X2-20X3 loss of Rs. 12,50,000 and during 20X3-20X4 again a loss of Rs. 5,00,000. Show the extract of consolidated balance sheet of A Ltd. on all the four dates recording the above events.

Answer 12

Calculation of Goodwill/Capital Reserve under Equity Method

Particulars	Rs.
Equity Shares	10,00,000
Reserves & Surplus	2,00,000
Net Assets	12,00,000
40% share of Net Assets	4,80,000
Less: Cost of Investment	(10,00,000)

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Goodwill	5,20,000

Consolidated Balance Sheet (Extract) as on April 01, 20X1: ASSETS

Investment in Associate as per AS 23	Rs.	Rs.
Share of Net Assets on April 1	4,80,000	
Add: Goodwill	5,20,000	10,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X2:

Investment in Associate as per AS 23	*Rs.*
Share of Net Assets on 1 April, 20X1	4,80,000
Add: Goodwill	5,20,000
Cost of Investment	10,00,000
Less: Loss for the year (10,00,000 x 40%)	(4,00,000)
Carrying Amount of Investment	6,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X2: ASSETS

Investment in Associate as per AS 23	*Rs.*	*Rs.*
Share of Net Assets on 1 April, 20X1	4,80,000	
Less: Share of Loss as above	(4,00,000)	
	80,000	
Add: Goodwill	5,20,000	6,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X3:

Investment in Associate as per AS 23	*Rs.*
Carrying Amount of Investment as on 31 March 20X2	6,00,000
Less: Loss for the year (12,50,000 x 40%)	(5,00,000)
Carrying Amount of Investment	1,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X3: ASSETS

Investment in Associate as per AS 23				*Rs.*	*Rs.*
Share of Net Assets on 1 April, 20X1				4,80,000	
Less: Share of Loss as above		4,00,000	+		
(Rs.5,00,000)				(4,20,000)	
Add: Goodwill					1,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X4:

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Investment in Associate as per AS 23	Rs.
Carrying Amount of Investment	1,00,000
Less: Loss for the year (5,00,000 x 40% = 2,00,000, restricted toCarrying amount of Investment in B Ltd.) -refer note below Carrying Amount of Investment	

Consolidated Balance Sheet (Extract) as on March 31, 20X4: ASSETS

Investment in Associate as per AS 23	Rs.
Investment in B Ltd.	-

If, under the equity method, an investor's share of losses of an associate equals or exceeds the carrying amount of the investment, the investor ordinarily discontinues recognising its share of further losses and the investment is reported at nil value. Additional losses are provided for to theextent that the investor has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the investor has guaranteed or to which the investor is otherwise committed. If the associate subsequently reports profits, the investor resumes including its share of those profits only after its share of the profits equals the share of net losses that have not been recognised.

- As far as possible the reporting date of the financial statements should be same for consolidated financial statement. If practically it is not possible to draw up the financial statements of one or more enterprise to such date and, accordingly, those financial statements are drawn up toreporting dates different from the reporting date of the investor, adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the consolidated financial statements.

  In any case, the difference between reporting dates of the concern and consolidated financial statement should not be more than six months.

- Accounting policies followed in the preparation of the financial statements of the investor, investee and consolidated financial statement should be uniform for like transactions and other events in similar circumstances.

  If accounting policies followed by different enterprises in the group are not uniform, then adjustments should be made in the items of the individual financial statements to bring it in line with the accounting policy of the consolidated statement.

- The carrying amount of investment in an associate should be reduced to recognise a decline, other than temporary, in the value of the investment, such reduction being determined and made for each investment individually.

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Chapter 10.3

AS 27- FINANCIAL REPORTING OF INTERESTS IN JOINT VENTURES

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.1 TO Q.12											
Past Exams	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
MTP	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
RTP	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO

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Question 1

State which of the following statements are incorrect.

(i) **The requirements relating to accounting for joint ventures in consolidated financial statements according to proportionate consolidation method, as contained in AS 27, appliesonly when consolidated financial statements are prepared by venturer.**

(ii) **The requirements relating to accounting for joint ventures in consolidated financial statements according to proportionate consolidation method, as contained in AS 27, applies irrespectivewhether consolidated financial statements are prepared by venturer or not.**

(iii) **An investor in joint venture, which does not have joint control, should report its interest in ajoint venture in its consolidated financial statements in accordance with AS 13, AS 21 and AS 23 as the case may be.**

(a) Point (i) is incorrect.

(b) Point (ii) is incorrect.

(c) Point (iii) is incorrect.

(d) None of the above.

Ans: (b)

Question 2

Identify which of the following is not a feature of a Jointly controlledoperations (JCO):

(a) Each venturer has his own separate business.

(b) There is a separate entity for joint venture business.

(c) Each venturer record only his own transactions without any separately set of books maintainedfor the joint venture business.

(d) There is a common agreement between all of them.

Ans: (b)

Question 3

Identify which of the following is/are not a feature of a Jointly controlled assets (JCA):

(iv) There is a separate legal identity.

(v) There is a common control over the joint assets.

(vi) Expenses on jointly held assets are shared by the venturers as per the contract.

(vii) In their financial statement, venturer shows only their share of the asset and total income earned by them along with total expenses incurred by them.

(a) Point no. (i) only.

(b) Point no. (i) and (iii).

(c) Point no. (iii) and (iv).

(d) Point (i) and (ii).

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Ans: (a)

Question 4

Identify which is/ are features of a Jointly controlled entity (JCE):

(viii) Venturer creates a new entity for their joint venture business.

(ix) All the venturers pool their resources under new banner and this entity purchases its own assets, create its own liabilities, expenses are incurredby the entity itself and sales are also made by this entity.

(x) The revenues and expenses of the entity is shared by the venturers inthe ratio agreed upon in the contractual agreement.

(a) Point no. (i) only.

(b) Point no. (i) and (ii).

(c) Point no. (iii).

(d) Point no. (iii).

Ans: (c)

Question 5

Identify the correct statements.

From the date of discontinuing the use of the proportionate consolidationmethod:

(xi) If interest in entity is more than 50%, investments in such joint ventures should be accountedfor in accordance with AS 21, Consolidated Financial Statements.

(xii) If interest is 20% or more but upto 50%, investments are to be accounted for in accordance with AS 23, Accounting for Investment in Associates in Consolidated Financial Statements.

(xiii) For all other cases investment in joint venture is treated as per AS 13, Accounting for Investments.

(xiv) For this purpose, the fair value of the investment at the date on whichjoint venturerelationship ceases to exist should be regarded as cost thereafter.

(a) Point no. 1 and 2.

(b) Point no. 1, 2 and 3.

(c) Point no. 1, 2, 3 and 4.

(d) None of the above.

Ans: (b)

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Theoretical Questions Answers

Question 6

Describe the cases when AS 27 does not allow the use of Proportionate consolidation method ofaccounting?

Answer 6

Proportionate consolidation method of accounting is to be followed except in the following cases:

a. Investment is intended to be temporary because the investment is acquired and held exclusivelywith a view to its subsequent disposal in the near future.

The term 'Near Future' is explained with AS 21.

Or

b. Joint venture operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the venturers.

In both the above cases, investment of venturer in the share of the investeeis treated as investment according to AS 13.

Question 7

When is a venturer required to discontinue the use of the proportionate consolidation method?

Answer 7

A venturer should discontinue the use of the proportionate consolidationmethod from the date that:

a. It ceases to have joint control in the joint venture but retains, either in whole or in part, its investment.

b. The use of the proportionate consolidation method is no longer appropriate because the joint venture operates under severe long- term restrictions that significantly impair its ability to transferfunds to the venturers.

From the date of discontinuing the use of the proportionate consolidation method,

a. If interest in entity is more than 50%, investments in such joint ventures should be accounted for in accordance with AS 21, Consolidated Financial Statement.

b. If interest is 20% or more but up to 50%, investments are to be accounted for in accordance withAS 23, Accounting for Investment in Associates in Consolidated Financial Statement.

c. For all other cases investment in joint venture is treated as per AS 13, Accounting for Investment.

d. For this purpose, the carrying amount of the investment at the date on which joint venturerelationship ceases to exist should be regarded as cost thereafter.

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Practical Questions Answers

Question 8

JVR Limited has made investments of ₹ 97.84 crores in equity shares of QSR Limited in pursuance of Joint Venture agreement till 20X1-X2 (i.e., more than 12 months). The investment has been made at par. QSRLimited has been in continuous losses for the last 2 years. JVR Limited is willing to re-assess the carryingamount of its investment in QSR Limited and wish to provide for diminution in value of investments. However, QSR Limited has a futuristic and profitable business plans and projection for the coming years. Discuss whether the contention of JVR Limited to bring down the carrying amount of investment in QSR Limited is in accordance with the Accounting Standard.

Answer 8

As per para 26 of AS 27 "Financial Reporting of Interests in Joint Ventures",in a venturer's separate financial statements, interest in a jointly controlled entity should be accounted for as an investment inaccordance with AS 13 'Accounting for Investments'.

As per para 17 of AS 13 "Accounting for Investments", long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long-term investment,the carrying amount is reduced to recognize the decline. Indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. Thetype and extent of the investor's stake in the investee are also taken into account. However, where there is a decline, other than temporary, in the carrying amounts of long- term investments, the resultant reduction in the carrying amount is charged to the profit and loss statement.

Since the investment was made in the year 20X1-20X2 i.e., more than a year,it is a long-term investment. In the given case, though the QSR Ltd. is in continuous losses for past 2 years, yet it has a futuristic and profitable business plans and projections for the coming years. Here, one of the indicators i.e. 'losses incurred to the company' may lead to diminution inthe value of the shares while the other indicator that 'the company has positive expected cash flows from its business plans' does not lead to decline in the value of shares.

Considering both the facts, in case the expectation of profitable business plans and positive cash flows is based reliable presumptions (such as tender in favour of QSR Ltd., strong order book etc.), the decline will be regarded as temporary in nature and the investment in equity shares will continue to be carried at cost only.

However, should the aforesaid presumptions be based on projections without reasonable evidence backing the claims, the decline could be regarded as non-temporary in nature in which case the write down of the carrying amount become necessary in line with AS 13, thereby implying the contention ofQSR Ltd. to be correct.

Question 9 (Illustration)

Mr. A, Mr. B and Mr. C entered into a joint venture to purchase a land, construct and sell flats. Mr. A purchased a land for ₹ 60,00,000 on 01.01.20X1 and for the purpose he took loan from a bank for ₹ 50,00,000 @ 8% interest p.a. He also paid registering fees ₹ 60,000 on the same day. Mr. B supplied thematerials for ₹ 4,50,000 from his godown and further he purchased the materials for ₹ 5,00,000 for the joint venture. Mr. C met all other expenses of advertising, labour and other incidentalexpenses which turnout to be ₹ 9,00,000. On 30.06.20X1 each of the venturer agreed to take away oneflat each to be valued at ₹ 10,00,000 each flat and rest were sold by them as follow: Mr. A for ₹ 40,00,000; Mr. B for ₹ 20,00,000 and Mr. C for ₹ 10,00,000. Loan was repaid on the same day by Mr. A along withthe interest and net proceeds were shared by the partners equally.

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You are required to prepare the draft Consolidated Profit & Loss Account and Joint Venture Account in the books of each venturer.

Answer 9

Draft Consolidated Profit & Loss Account

Particulars	₹	₹	Particulars	₹	₹
To Purchase of			By Sale of Flats:		
Land:					
Mr. A		60,00,000	Mr. A	40,00,000	
To Registration			Mr. B	20,00,000	
Fees:					
Mr. A		60,000	Mr. C	10,00,000	70,00,000
To Materials:			By Flats taken by Venturers:		
Mr. B		9,50,000	Mr. A	10,00,000	
To Other			Mr. B	10,00,000	
Expenses:			Mr. C		
Mr. C		9,00,000		10,00,000	30,00,000
To Bank					
Interest:					
Mr. A		2,00,000			
To Profits:					
Mr. A	6,30,000				
Mr. B	6,30,000				
Mr. C	6,30,000	18,90,000			
		1,00,00,000			1,00,00,000

In the Books of Mr. A Joint Venture Account

Particulars	₹	Particulars	₹
To Bank Loan (Purchase of	50,00,000	By Bank (Sale of Flats)	40,00,000
Land)			
To Bank:(Purchase of Land)		By Land & Building	10,00,000
	10,00,000		
To Bank (Registration Fees)		By Bank (Received from	14,20,000

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	60,000	Mr. B)	
To Bank (Bank Interest)	2,00,000	By Bank (Received from	4,70,000
		Mr. C)	
To Profit on JV	6,30,000		
	68,90,000		68,90,000

In the Books of Mr. B Joint Venture Account

Particulars	₹	Particulars	₹
To Purchases (Material	4,50,000	By Bank (Sale of	
Supplied)		Flats)	20,00,000
To Bank (Materials)	5,00,000	By Land & Building	10,00,000
To Profit on JV	6,30,000		
To Bank (Paid to Mr. A)	14,20,000		
	30,00,000		30,00,000

In the Books of Mr. C Joint Venture Account

Particulars	₹	Particulars	₹
To Bank (Misc. Expenses)	9,00,000	By Bank (Sale of Flats)	10,00,000
To Profit on JV	6,30,000	By Land & Building	10,00,000
To Bank (Paid to Mr. A)	4,70,000		
	20,00,000		20,00,000

Question 10 (Illustration)

A Ltd., B Ltd. and C Ltd. decided to jointly construct a pipeline to transport the gas from one place to another that was manufactured by them. For the purpose following expenditure was incurred by them: Buildings ₹ 12,00,000 to be depreciated @ 5% p.a., Pipeline for ₹ 60,00,000 to be depreciated @ 15% p.a., computers and other electronics for ₹ 3,00,000 to be depreciated @ 40% p.a. and various vehiclesof ₹ 9,00,000 to be depreciated @ 20% p.a.

They also decided to equally bear the total expenditure incurred on the maintenance of the pipeline that comes to ₹ 6,00,000 each year.

You are required to show the consolidated balance sheet and the extract of Statement of Profit & Loss and Balance Sheet for each venturer.

Answer 10

Consolidated Balance Sheet

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		Note	(₹)
I	**Equity and liabilities**		
	Shareholders' funds:		
	Share Capital	1	71,40,000
			71,40,000
II	**Assets**		
	Non-current Assets		
	Property, Plant and Equipment:	2	71,40,000
			71,40,000

Notes to Accounts

			(₹)
1.	Share capitalA Ltd.	23,80,000	
	B Ltd.	23,80,000	
	C Ltd.	23,80,000	71,40,000
2.	Property, Plant and Equipment Land & Building: A Ltd.	3,80,000	
	B Ltd.	3,80,000	
	C Ltd.	3,80,000	11,40,000
	Plant & Machinery: A Ltd.	17,00,000	
	B Ltd.	17,00,000	
	C Ltd.	17,00,000	51,00,000
	Computers: A Ltd.	60,000	
	B Ltd.	60,000	
	C Ltd.	60,000	1,80,000
	Vehicles: A Ltd.	2,40,000	
	B Ltd.	2,40,000	

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	C Ltd.	2,40,000	7,20,000

In the Books of A Ltd.

Extract of statement of Profit & Loss

Particulars	Note No.	₹
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		200,000

Extract of Balance Sheet

	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	Depreciation and amortisation expense Land & Building	20,000	
	Plant & Machinery	3,00,000	
	Computers	40,000	
	Vehicles	60,000	4,20,000
2.	Land & Building	4,00,000	
	Less: Depreciation	(20,000)	3,80,000
	Plant & Machinery	20,00,000	
	Less: Depreciation	(3,00,000)	17,00,000
	Computers	1,00,000	
	Less: Depreciation	(40,000)	60,000
	Vehicles	3,00,000	
	Less: Depreciation	(60,000)	2,40,000 23,80,000

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In the Books of B Ltd.

Extract of draft Profit & Loss Account

Particulars	Note No.	₹
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		200,000

Extract of Balance Sheet

	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	Depreciation and amortisation expense		
	Land & Building	20,000	
	Plant & Machinery	3,00,000	
	Computers	40,000	
	Vehicles	60,000	4,20,000
2.	Land & Building	4,00,000	
	Less: Depreciation	(20,000)	3,80,000
	Plant & Machinery	20,00,000	
	Less: Depreciation	(3,00,000)	17,00,000
	Computers	1,00,000	
	Less: Depreciation	(40,000)	60,000
	Vehicles	3,00,000	
	Less: Depreciation	(60,000)	2,40,000
			23,80,000

In the Books of C Ltd.

Extract of Draft Profit & Loss Account	Note No.	₹
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		200,000

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Extract of Balance Sheet

	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	Depreciation and amortisation expense		
	Land & Building	20,000	
	Plant & Machinery	3,00,000	
	Computers	40,000	
	Vehicles	60,000	4,20,000
2.	Land & Building	4,00,000	
	Less: Depreciation	(20,000)	3,80,000

	Plant & Machinery	20,00,000	
	Less: Depreciation		17,00,000
		(3,00,000)	
	Computers	1,00,000	
	Less: Depreciation	(40,000)	60,000
	Vehicles	3,00,000	
	Less: Depreciation	(60,000)	2,40,000
			23,80,000

Question 11 (Illustration)

A Ltd. a UK based company entered into a joint venture with B Ltd. in India, wherein B Ltd. will importthe goods manufactured by A Ltd. on account of joint venture and sell them in India. A Ltd. and B Ltd.agreed to share the expenses & revenues in the ratio of 5:4 respectively whereas profits are distributedequally. A Ltd. invested 49% of total capital but has equal share in all the assets and is equally liable forall the liabilities of the joint venture. Following is the trial balance of the joint venture at the end of thefirst **year:**

Particulars	Dr. (₹)	Cr. (₹)
Purchases	9,00,000	
Other Expenses	3,06,000	

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Sales		13,05,000
Property, Plant and Equipment	6,00,000	
Current Assets	2,00,000	
Unsecured Loans		2,00,000
Current Liabilities		1,00,000
Capital		4,01,000

Closing inventory was valued at ₹ 1,00,000.

You are required to prepare the Consolidated Financial Statement.

Answer 11

Consolidated Profit & Loss Account

Particulars	**Note No.**	**(₹)**
Revenue from operations	1	13,05,000
Total Revenue (A)		13,05,000
Less: Expenses		
Purchases	2	9,00,000
Other expenses	3	3,06,000
Changes in inventories of finished goods	4	(1,00,000)
Total Expenses (B)		11,06,000
Profit Before Tax (A-B)		1,99,000

Consolidated Balance Sheet

		Note No.	**(₹)**
I	**Equity and liabilities**		
	1. Shareholders' funds:		
	Share Capital	5	4,01,000
	Reserves and Surplus	6	1,99,000
	2. Non-current liabilities		
	Long term borrowings	7	2,00,000
	3. Current Liabilities	8	1,00,000
			9,00,000
II	**Assets**		
	Non-current Assets		
	Property, Plant and Equipment	9	6,00,000

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	Current Assets		
	Inventories	10	1,00,000
	Other current assets	11	2,00,000
			9,00,000

Notes to Accounts

	Particulars		(₹)
1.	**Revenue from operations**		
	Sales: A Ltd.	7,25,000	
	B Ltd.	5,80,000	13,05,000
2.	**Purchases**		
	A Ltd.	5,00,000	
	B Ltd.	4,00,000	9,00,000
3.	**Other expenses**		
	A Ltd.	1,70,000	
	B Ltd.	1,36,000	3,06,000
4.	**Closing Inventory**		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
5.	**Share Capital**		
	A Ltd.	1,96,490	
	B Ltd.	2,04,510	4,01,000
6.	**Reserves and Surplus** Profit &Loss Account:		
	A Ltd.	99,500	
	B Ltd.	99,500	1,99,000
7.	**Long Term Borrowings** UnsecuredLoans:		
	A Ltd.	1,00,000	
	B Ltd.	1,00,000	2,00,000
8.	**Current Liabilities** ALtd.	50,000	
	B Ltd.	50,000	1,00,000

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9.	**Property, Plant and Equipment** A Ltd.	3,00,000	
	B Ltd.	3,00,000	6,00,000
10.	**Inventories** A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
11.	**Other Current Assets** A Ltd.	1,00,000	
	B Ltd.	1,00,000	2,00,000

Question 12 (Illustration)

A Ltd. entered into a joint venture with B Ltd. on 1:1 basis and a new company C Ltd. was formed for the same purpose and following is the balance sheet of all the three companies:

Particulars	A Ltd.	B Ltd.	C Ltd.
Share Capital	10,00,000	7,50,000	5,00,000
Reserve & Surplus	18,00,000	16,00,000	12,00,000
Loans	3,00,000	4,00,000	2,00,000
Current Liabilities	4,00,000	2,50,000	1,00,000
Property, Plant and Equipment	30,50,000	26,25,000	19,50,000
Investment in JV	2,50,000	2,50,000	-
Current Assets	2,00,000	1,25,000	50,000

Prepare the balance sheet of A Ltd. and B Ltd. under proportionate consolidation method.

Answer 12

Balance Sheet of A Ltd.

		Note No.	(₹)
I	**Equity and liabilities**		
	1. Shareholders' funds:		
	Share Capital		10,00,000
	Reserves and Surplus	1	24,00,000
	2. Non-current liabilities	2	4,00,000
	3. Current Liabilities	3	4,50,000
	TOTAL		42,50,000

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II	**Assets**		
	Non-current Assets		
	Property, Plant and Equipment:	4	40,25,000
	Current Assets	5	2,25,000
			42,50,000

Notes to Accounts

		₹	₹
1.	Reserves and Surplus ALtd.	18,00,000	
	C Ltd.	6,00,000	24,00,000
2.	Long Term Borrowings Loans:A Ltd.	3,00,000	
	C Ltd.	1,00,000	4,00,000
3.	Current Liabilities:A Ltd.	4,00,000	
	C Ltd.	50,000	4,50,000
4.	Property, Plant and Equipment:A Ltd.	30,50,000	
	C Ltd.	9,75,000	40,25,000
5.	Current Assets:A Ltd.	2,00,000	
	C Ltd.	25,000	2,25,000

Balance Sheet of B Ltd.

		Note No.	(₹)
I	**Equity and liabilities**		
	1. Shareholders' funds:		
	Share Capital		7,50,000
	Reserves and Surplus	1	22,00,000
	2. Non-current liabilities	2	5,00,000
	3. Current Liabilities	3	3,00,000
			37,50,000

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II	**Assets** 1. Non-current Assets Property, Plant and Equipment	4	36,00,000
	2. Current Assets	5	1,50,000 37,50,000

Notes to Accounts

		₹	₹
1.	Reserves and Surplus ALtd.		
		16,00,000	
	C Ltd.	6,00,000	22,00,000
	Long Term Borrowings Loans:A Ltd.	4,00,000	
	C Ltd.	1,00,000	5,00,000
3.	Current Liabilities:		
	A Ltd.C Ltd.	2,50,000	
	Property, Plant and Equipment:A Ltd.	50,000	3,00,000
4.	C Ltd. Current Assets:		
	A Ltd.	26,25,000	
	C Ltd.	9,75,000	36,00,000
5.		1,25,000	
		25,000	1,50,000

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Balance Sheet of B Ltd.

		₹	₹
	Equity and liabilities		
	1. Shareholders' funds:		7,50,000
	Share Capital		
	Reserves and Surplus	1	22,00,000
	2. Non-current liabilities	2	5,00,000
	3. Current Liabilities	3	3,00,000
			37,50,000
ii	Assets		
	1. Non-current Assets		
	Property, Plant and Equipment	4	36,00,000
	2. Current Assets	5	1,50,000
			37,50,000

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Chapter 11.1

Preparation of Financial Statements

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.18 TO Q33											
Past Exams	NO	NO	NO	Q.2	NO	NO	Q.14	Q.13	NO	Q.15	Q.16	NO
MTP	NO	Q.2	Q.2	Q.1	Q.2 Q.3	Q . 4 Q.10	Q.2 Q.5 Q.6	Q.3 Q.7	Q.5 Q.6 Q.10	Q.2	Q.7	Q.5
RTP	Q.10	Q.5	Q.9	Q.12	Q.2	NO	Q.6 Q.10	Q.8	Q.11	Q.12	Q.2	NO

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Chapter 11.1

Preparation Financial Statements

Question 1

Future Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 2019:

	Amount Rs. in lakhs
Securities Premium Account	80
Capital Reserve	60
General Reserve	90

The company had an accumulated loss of Rs. 250 lakhs on the same date, which it has disclosed under the head "Statement of Profit and Loss" as asset in its Balance Sheet. Comment on accuracy of this treatment in line with Schedule III to the Companies Act, 2013. (MTP Oct. '19, 4 Marks, Old & New SM)

Answer 1

Note 6 (B) given under Part I of Schedule III to the Companies Act, 2013 provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative. In this case, the debit balance of profit and loss i.e. Rs. 250 lakhs exceeds the total of all the reserves i.e. Rs. 230 lakhs. Therefore, balance of 'Reserves and Surplus' after adjusting debit balanceof profit and loss is negative by Rs. 20 lakhs, which should be disclosed on the face of the balance sheet. Thus the treatment done by the company is incorrect.

Question 2

From the following particulars furnished by Alpha Ltd., prepare the Balance Sheet as on 31stMarch20X1 as required by Part I, Schedule III of the Companies Act, 2013.

Particulars		Debit Rs.	Credit Rs.
Equity Share Capital (Face value of Rs. 100 each)			50,00,000
Call in Arrears		5,000	
Land & Building		27,50,000	
Plant & Machinery		26,25,000	
Furniture		2,50,000	
General Reserve			10,50,000
Loan from State Financial Corporation			7,50,000
Inventory:			
Raw Materials	2,50,000		
Finished Goods	10,00,000	12,50,000	
Provision for Taxation			6,40,000

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Trade receivables	10,00,000	
Short term Advances	2,13,500	
Profit & Loss Account		4,33,500
Cash in Hand	1,50,000	
Cash at Bank	12,35,000	
Unsecured Loan		6,05,000
Trade payables (for Goods and Expenses)		8,00,000
Loans & advances from related parties		2,00,000

The following additional information is also provided:

(i) **10,000 Equity shares were issued for consideration other than cash,**

(ii) **Trade receivables of Rs. 2,60,000 are due for more than 6 months,**

(iii) **The cost of the Assets were: Building Rs. 30,00,000, Plant & Machinery Rs. 35,00,000 and Furniture Rs. 3,12,500**

(iv) **The balance of Rs. 7,50,000 in the Loan Account with State Finance Corporation is inclusive of Rs. 37,500 for Interest Accrued but not Due. The loan is secured by hypothecation of Plants Machinery.**

(v) **Balance at Bank includes Rs. 10,000 with Omega Bank Ltd., which is not a Scheduled Bank,**

(vi) **Transfer Rs. 20,000 to general reserve is proposed by Board of directors**

(vii) **Board of directors has declared dividend of 5% on the paid up capital. ~~The dividend distribution tax liability is Corporate Dividend Tax Rate @ 17.304 (wherein Base Rate is 15%) As per amendment (17.472%)~~.**

(MTP March '19,20 Marks, MTP Aug'18 16 Marks, MTP Apr'19 16 Marks, MTP March '18 15 Marks, MTP Oct 18 15 Marks, MTP March 21, 15 Marks, Old & New SM)(Same concept different figures and fewer adjustments MTP 15 Marks Sep'22, RTP May'20, RTP May'23, PYP Nov'19 10 Marks)

Answer 2

Alpha Ltd. Balance Sheet as on 31st March, 20X1

Particular	Notes	Rs.
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	1	49,95,000
b Reserves and Surplus *(amended)*	2	***12,33,750***
2 Non-current liabilities		
Long-term borrowings	3	13,17,500
3 Current liabilities		
a Trade Payables		8,00,000
b ***Other Current liabilities (amended)***	4	***2,87,250***
C Short term provisions	5	6,40,000

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Short term borrowings		2,00,000
		94,73,500
Assets		
1 Non-current assets		
Property, Plant & equipment		
Tangible assets	6	56,25,000
2 Current assets		
a Inventories		12,50,000
b Trade receivables		10,00,000
c Cash and bank balances		13,85,000
d Short-term loans and advances		2,13,500
e **Total**		**94,73,500**

Notes to accounts

			Rs.
1. Share Capital			
Equity share capital			
Issued & subscribed & called up			
50,000 Equity Shares of Rs. 100 each			
(of the above 10,000 shares have been issued for			
consideration other than cash)		50,00,000	
Less; Calls in arrears		(5,000)	49,95,000
	Total		**49,95,000**
2 Reserves and Surplus			
General Reserve		10,50,000	
Add: current year transfer		20,000	10,70,000
Profit & Loss balance			
Profit for the year		4,33,500	
Less; Appropriations:			
Transfer to General reserve		(20,000)	
Dividend Payable (Refer W N)		(2,49,750)	
~~DOT on dividend (Refer W N)~~ ***~~(As per amendment)~~***		~~(50,843)~~ ***~~(51,337)~~***	***1,63,750***
	Total		**12,33,750**
3 Long-term borrowings			
Secured Term Loan			

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State Financial Corporation Loan (7,50,000-37,500)			
(Secured by hypothecation of Plant and Machinery)			7,12,500
Unsecured Loan			6,05,000
	Total		**13,17,500**
4 Other current liabilities			
Interest accrued but not due on loans (SFC)			37,500
Dividend (Refer W N)		2,49,750	
~~DOT on dividend (Refer W N)~~ ~~***(as per amendment of change in rate of SHEC the DDT rate is 17.472%)***~~		~~50,843~~ ~~***(51,337)***~~	***2,49,750***
			2,87,250
5 Short-term provisions			
Provision for taxation			6,40,000
6 Tangible assets			
Land and Building		30,00,000	
Less; Depreciation		(2,50,000) (b.f.)	27,50,000
Plants Machinery		35,00,000	
Less; Depreciation		(8,75,000) (b.f.)	26,25,000
Furniture & Fittings		3,12,500	
Less; Depreciation		(62,500) (b.f.)	2,50,000
	Total		**56,25,000**
7 Inventories			
Raw Materials			2,50,000
Finished goods			10,00,000
	Total		**12,50,000**
8 Trade receivables			
Outstanding for a period exceeding six months			2,60,000
Other Amounts			7,40,000
	Total		**10,00,000**
9 Cash and bank balances			
Cash and cash equivalents			

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Cash at bank			
with Scheduled Banks		12,25,000	
with others (Omega Bank Ltd.)		10,000	12,35,000
Cash in hand			1,50,000
Other bank balances			Nil
			13,85,000

Working Note :Calculation of grossing-up of dividend

Particlars	**Rs.**
Dividend distributed Alpha Ltd. (5% of 49,95,000)	2,49,750
~~Add : Increases for the purpose of grossing up of dividend15/100-15 X 2,49,750~~	~~44,074~~
~~Gross dividend~~	~~2,93,824~~

Question 3

On 31st March, 2020, SR Ltd. provides the following ledger balances after preparing its Profit &Loss Account for the year ended 31st March, 2020.

Particulars	**Amount (Rs.)**	
	Debit	**Credit**
Equity Share Capital, fully paid shares of Rs. 50 each		**80,00,000**
Calls in arrear	**15,000**	
Land	**25,00,000**	
Buildings	**30,00,000**	
Plant & Machinery	**24,00,000**	
Furniture &Fixture	**13,00,000**	
Securities Premium		**15,00,000**
General Reserve		**9,41,000**
Profit & Loss Account		**5,80,000**
Loan from Public Finance Corporation (Secured byHypothecation of Land)		**26,30,000**
Other Long Term Loans		**22,50,000**
Short Term Borrowings		**4,60,000**
Inventories: Finished goods	**45,00,000**	
Raw materials	**13,00,000**	
Trade Receivables	**17,50,000**	
Advances: Short Term	**3,75,000**	
Trade Payables		**8,13,000**

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Provision for Taxation		3,80,000
Dividend payable		70,000
Cash in Hand	70,000	
Balances with Banks	4,14,000	
Total	1,76,24,000	1,76,24,000

The following additional information was also provided in respect of the above balances:

(1) 50,000 fully paid equity shares were allotted as consideration for land.

(2) The cost of assets were:

Building	Rs. 32,00,000
Plant and Machinery	Rs. 30,00,000
Furniture and Fixture	Rs. 16,50,000

Trade Receivables for Rs. 4,86,000 due for more than 6 months.

Balances with banks include Rs. 56,000, the Naya bank, which is not a scheduled bank.

Loan from Public Finance Corporation repayable after 3 years.

The balance of Rs. 26,30,000 in the loan account with Public Finance Corporation is inclusive of Rs. 1,34,000 for interest accrued but not due. The loan is secured by hypothecation of land.

Other long-term loans (unsecured) include:

(i) Loan Taken from Nixes Bank - Rs 13,80,000 (Amount repayable within 1 year Rs 4,80,000)

(ii) Loan taken from Directors Rs. 8,50,000

Bills Receivable for Rs. 1,60,000 maturing on 15th June, 2020 has been discounted.

Short term borrowings include:

(iii) Loan Taken from Naya Bank - Rs 1,16,000 (Secured)

(iv) Loan taken from Directors Rs. 48,000

Transfer of Rs. 35,000 to general reserve has been proposed by the Board of directors out of theprofits for the year.

Inventory of finished goods includes loose tools costing Rs. 5 lakhs (which do not meet definition of property, plant & equipment as per AS 10)

You are required to prepare the Balance Sheet of the Company as on March 31st 2020 as required under Part – I of Schedule III of the Companies Act, 2013. Ignore previous year figures.(MTP 20 Marks May '20, MTP 16 Marks Oct'21, Old & New SM)

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Answer 3

SR Ltd. Balance Sheet as on 31st March, 2020

Particulars	Notes	Figures at the end of currentreporting period (Rs.)
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	**1**	79,85,000
b Reserves and Surplus	**2**	30,21,000
2 Non-current liabilities		
a Long-term borrowing	**3**	42,66,000
3. Current liabilities		
a Short-term borrowings	**4**	4,60,000
b Trade Payables		8,13,000
c Other current liabilities	**5**	6,84,000
d Short-term provisions	**6**	3,80,000
Total		1,76,09,000
Assets		
1. **Non-current assets**		
A PPE	**7**	92,00,000
2 Current assets		
A Inventories	**8**	58,00,000
B Trade receivables	**9**	17,50,000
C Cash and cash equivalents	**10**	4,84,000
D Short-term loans and advances		3,75,000
Total		**1,76,09,000**

Notes to accounts

			Rs.
1.	**Share Capital** Equity share capital Issued, subscribed and called up 1,60,000 Equity Shares of Rs. 50 each (Out of the above 50,000shares have been issued for consideration other than cash)	80,00,000	

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	Less: Calls in arrears	(15,000)	**79,85,000**
2.	**Reserves and Surplus**		
	General Reserve	9,41,000	
	Add: Transferred from Profit and loss ac-countSecurities premium	35,000	9,76,000
	Surplus (Profit & Loss A/c)	5,80,000	15,00,000
	Less: Appropriation to General Reserve (proposed)	(35,000)	5,45,000
			30,21,000
3.	**Long-term borrowings**		
	Secured: Term Loans		
	Loan from Public Finance Corporation [repayable after 3 years(Rs. 26,30,000 - Rs. 1,34,000 for interest accrued but not due)]		24,96,000
	Secured by hypothecation of land Unsecured		
	Bank Loan (Nixes bank) 9,00,000		
	(Rs. 13,80,000 - Rs. 4,80,000 repayable within 1 year)		
	Loan from Directors 8,50,000		
	Others 20,000		17,70,000
	Total		**42,66,000**
4.	**Short-term borrowings**		
	Loan from Naya bank (Secured)	1,16,000	
	Loan from Directors	48,000	
	Others	2,96,000	**4,60,000**
5.	**Other current liabilities**		
	Loan from Nixes bank repayable within one year	4,80,000	
	Dividend payable	70,000	
	Interest accrued but not due on borrowings	1,34,000	**6,84,000**
6.	**Short-term provisions**		
	Provision for taxation		**3,80,000**
7.	**PPE**		
	Land		25,00,000
	Buildings	32,00,000	
	Less: Depreciation	(2,00,000)	30,00,000
	Plant & Machinery	30,00,000	
	Less: Depreciation	(6,00,000)	24,00,000
	Furniture & Fittings	16,50,000	
	Less: Depreciation	(3,50,000)	13,00,000

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	Total		**92,00,000**
8.	**Inventories**		
	Raw Material	13,00,000	
	Finished goods	40,00,000	
	Loose tools	5,00,000	58,00,000
	Trade receivables		
	Outstanding for a period exceeding six months		4,86,000
	Others		12,64,000
	Total		**17,50,000**
	Cash and cash equivalents		
	Balances with banks		
	with Scheduled Banks	3,58,000	
	with others banks	56,000	**4,14,000**
	Cash in hand		70,000
	Total		**4,84,000**

Note: There is a Contingent Liability amounting Rs. 1,60,000

Question 4

Medha Ltd. took a loan from bank for ₹ 10,00,000 to be settled within 5 years in 10 equal half yearly instalments with interest. First instalment is due on 30.09.20 20 of ₹ 1,00,000. Determine how the loan will be classified in preparation of Financial Statements of Medha Ltd. for the year ended 31st March, 2020 according to Schedule III.(MTP 4 Marks , Oct 20)

Answer 4

(v) As per Schedule III, a liability should be classified as current when it satisfies any of the following criteria:

(vi) it is expected to be settled in the company's normal operating cycle;

(vii) it is held primarily for the purpose of being traded;

(viii) it is due to be settled within twelve months after the reporting date; or

the company does not have an unconditional right to defer settlement of the liability for atleast twelve months after the reporting date.

In the given case, instalments due on 30.09.2020 and 31.03.2021 will be shown under the head 'other current liabilities'. Therefore, in the balance sheet as on 31.3.2020, ₹ 8,00,000 (₹ 1,00,000 x 8 instalments) will be shown under the heading 'Long term Borrowings' and ₹ 2,00,000 (₹ 1,00,000 x 2 instalments) will be shown under the heading 'Other Current Liabilities' as current maturities of loan from bank.

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Question 5

You are required to prepare a Balance Sheet as at 31st March 2020, as per Schedule III of the Companies Act, 2013, from the following information of Mehar Ltd.:

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Term Loans (Secured)	40,00,000	Investments (Non-current)	9,00,000
Trade payables	45,80,000	Profit for the year	32,00,000
Cash and Bank Balances	38,40,000	Trade receivables	49,00,000
Staff Advances	2,20,000	Miscellaneous Expenses	2,32,000
Other advances (given by Co.)	14,88,000	Loan from other parties	8,00,000
Provision for Taxation	10,20,000	Provision for Doubtful Debts	80,000
Securities Premium	19,00,000	Stores	16,00,000
Loose Tools	2,00,000	Finished Goods	30,00,000
General Reserve	62,00,000	Plant and Machinery (WDV)	2,14,00,000

Additional Information: -

1. Share Capital consists of-
   (a) 1,20,000 Equity Shares of Rs. 100 each fully paid up.
   (b) 40,000, 10% Redeemable Preference Shares of Rs. 100 each fully paid up.
2. Write off the amount of Miscellaneous Expenses in full, amounting Rs. 2,32,000.(MTP 14 Marks April 22 , April 21 & Oct '23)(Same concept different figures RTP Nov'18)

Answer 5

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Balance Sheet of Mehar Ltd. as at 31st March, 2020

			Note	₹
I	EQUITY AND LIABILITIES:			
(1)	(a)	Share Capital	1	1,60,00,000
	(b)	Reserves and Surplus	2	110,68,000
(2)	Non-current Liabilities			
		Long term Borrowings- Terms Loans (Secured)		40,00,000
(3)	Current Liabilities			
	(a)	Trade Payables		45,80,000
	(b)	Other current liabilities	3	8,00,000
	(c)	Short-term Provisions (Provision for taxation)		10,20,000
		Total		**3,74,68,000**
II	ASSETS			
(1)	Non-current Assets			
	(a)	Property, Plant and Equipment	4	214,00,000
	(b)	Non- current Investments		9,00,000
(2)	Current Assets:			
	(a)	Inventories	5	48,00,000
	(b)	Trade Receivables	6	48,20,000
	(c)	Cash and Cash Equivalents		38,40,000
	(d)	Short-term Loans and Advances	7	17,08,000
		Total		**3,74,68,000**

Notes to accounts

			(Rs.)
1.	Share Capital		
	Authorized, issued, subscribed & called up		
	1,20,000, Equity Shares of Rs. 100 each	1,20,00,000	
	40,000 10% Redeemable Preference Shares of 100 each	40,00,000	1,60,00,000

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2.	Reserves and Surplus		
	Securities Premium Account	19,00,000	
	General reserve	62,00,000	
	Profit & Loss Balance		
	Opening balance -		
	Profit for the period 32,00,000		
	Less: Miscellaneous Expenditure		
	written off (2,32,000)	29,68,000	110,68,000
3.	Other current liabilities		
	Loan from other parties		8,00,000
4.	Property, plant and equipment Plant and Machinery (WDV)		214,00,000
5.	Inventories		
	Finished Goods	30,00,000	
	Stores	16,00,000	
	Loose Tools	2,00,000	48,00,000
6.	Trade Receivables		
	Trade receivables	49,00,000	
	Less: Provision for Doubtful Debts	(80,000)	48,20,000

7.	Short term loans & Advances		
	Staff Advances*	2,20,000	
	Other Advances*	14,88,000	17,08,000

***Considered to be short** term.

Question 6

XYZ Ltd. proposes to declare 10% dividend out of General Reserves due to inadequacy of profits inthe year ending 31-03-2020.

From the following particulars ascertain the amount that can be utilized from general reserves,

according to the Companies Rules, 2014:	**(Rs.)**
8,00,000 Equity Shares of Rs. 10 each fully paid up	**80,00,000**
General Reserves	**25,00,000**
Revaluation Reserves	**6,50,000**
Net profit for the year	**1,42,500**

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Average rate of dividend during the last five years has been 12%.. (MTP 5 Marks April 21, MTP 5Marks April 22, RTP May'21)

Answer 6

Amount that can be drawn from reserves for (10% dividend on Rs. 80,00,000 i.e. Rs. 8,00,000) Profits available

Current year profit Rs. 1,42,500

Amount which can be utilized from reserves (Rs. 8,00,000 – 1,42,500) Rs.6,57,500 Conditions as per Companies (Declaration of dividend out of Reserves) Rules, 2014: **Condition I**

Since 10% is lower than the average rate of dividend (12%), 10% dividend can be declared.

Condition II

Maximum amount that can be drawn from the accumulated profits and reserves should not exceed10% of paid up capital plus free reserves ie. Rs. 10,50,000 [10% of (80,00,000 + 25,00,000)]

Condition III

The balance of reserves after drawl Rs. 18,42,500 (Rs. 25,00,000 - Rs. 6,57,500) should not fall below 15 % of its paid up capital ie. Rs. 12,00,000 (15% of Rs. 80,00,000]

Since all the three conditions are satisfied, the company can withdraw Rs. 6,57,500 from accumulatedreserve (as per Declaration and Payment of Dividend Rules, 2014).

Question 7

From the following information, prepare extract of Balance Sheet of A Limited along with notes making necessary compliance of Schedule III to the Companies Act, 2013:

		Amount (₹)
Loan Funds		
(a) Secured Loans		**18,12,000**
(b) Unsecured Loan - Short term from bank		**2,25,000**
Other information is as under:		
Secured Loans		
Term Loans from:		
Banks		**8,95,000**
Others		**9,17,000**
		18,12,000
Current Maturities of long-term loan from Bank		**1,24,000**
Current Maturities of long- term loan from Others		**85,000**

There was no interest accrued / due as at the end of the year. Current maturities of long-term loans amounting ₹ 2,09,000 is included in the value of secured loans of ₹ 18,12,000. (MTP 5 Marks April 23& MTP 5 Marks Nov 21)

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Answer 7

Extract of Balance Sheet of A Ltd

Particulars	Note No.	Amount
Non - Current Liabilities **Long term borrowings**	**1**	**16,03,000**
Current Liabilities		
Short term borrowings	**2**	**4,34,000**

Notes to Accounts

1.	**Long-Term Borrowings**	
	Term loans — Secured	
	- From banks	8,95,000
	- From other parties	9,17,000
		18,12,000
	Less: Current maturities of long-term debt (Refer Note 3)	(2,09,000)
		16,03,000
2.	**Short-Term Borrowings**	
	(Unsecured loan)	
	- from bank	2,25,000
	Current maturities of long-term debt	
	- From banks	1,24,000
	- From others	85,000
		4,34,000

Question 8

State under which head these accounts should be classified in Balance Sheet, as per Schedule III of the Companies Act, 2013:

(i) Share application money received in excess of issued share capital.

(ii) Share option outstanding account.

(iii) Unpaid matured debenture and interest accrued thereon.

(iv) Uncalled liability on shares and other partly paid investments.

(v) Calls unpaid. (RTP Nov 21, Old & New SM)

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Answer 8

(i) Current Liabilities/ Other Current Liabilities

(ii) Shareholders' Fund / Reserve & Surplus

(iii) Current liabilities/Other Current Liabilities

(iv) Contingent Liabilities and Commitments

(v) Shareholders' Fund / Share Capital

Question 9

Shweta Ltd. has the Authorized Capital of Rs. 15,00,000 consisting of 6,000 6% Preference shares of Rs. 100 each and 90,000 equity Shares of Rs.10 each. The following was the Trial Balance of the Company as on 31st March, 2018:

Particulars	Dr.	Cr.
Investment in Shares at cost	1,50,000	
Purchases	14,71,500	
Selling Expenses	2,37,300	
Inventory as at the beginning of the year	4,35,600	
Salaries and Wages	1,56,000	
Cash on Hand	36,000	
Interim Preference dividend for the half year to 30th September	18,000	
Bills Receivable	1,24,500	
Interest on Bank overdraft	29,400	
Interest on Debentures upto 30th Sep (1st half year)	11,250	
Debtors	1,50,300	
Trade payables		2,63,550
Freehold property at cost	10,50,000	
Furniture at cost less depreciation of Rs. 45,000	1,05,000	
6% Preference share capital		6,00,000
Equity share capital fully paid up		6,00,000
5% mortgage debentures secured on Freehold properties		4,50,000
Income tax paid in advance for the current year	30,000	
Dividends		12,750
Profit and Loss A/c (opening balance)		85,500
Sales (Net)		20,11,050

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Bank overdraft secured by hypothecation of stocks andreceivables		4,50,000
Technical knowhow fees at cost paid during the year	4,50,000	
Audit fees	18,000	
Total	**44,72,850**	**44,72,850**

You are required to prepare the Profit and Loss Statement for the year ended 31st March, 2018 and the Balance Sheet as on 31st March, 2018 as per Schedule III of the Companies Act, 2013 after taking into account the following –

1. **Closing Stock was valued at Rs. 4,27,500.**
2. **Purchases include Rs. 15,000 worth of goods and articles distributed among valued customers.**
3. **Salaries and Wages include Rs. 6,000 being Wages incurred for installation of Electrical Fittings which were recorded under "Furniture".**
4. **Bills Receivable include Rs. 4,500 being dishonoured bills. 50% of which had been considered irrecoverable.**
5. **Bills Receivable of Rs. 6,000 maturing after 31st March were discounted.**
6. **Depreciation on Furniture to be charged at 10% on Written Down Value.**
7. **Investment in shares is to be treated as non-current investments.**
8. **Interest on Debentures for the half year ending on 31st March was due on that date.**
9. **Provide Provision for taxation Rs.12,000.**
10. **Technical Knowhow Fees is to be written off over a period of 10 years.**
11. **Salaries and Wages include Rs. 30,000 being Director's Remuneration.**
12. **Trade receivables include Rs. 18,000 due for more than six months. (RTP May 19) (Same concept different figures & lesser adjustments Nov 21)**

Answer 9

Statement of Profit and Loss of Shweta Ltd. for the year ended 31st March, 2018

Balance sheet of Shweta Ltd. as on 31st March, 2018

	Particulars as on 31st March	Note	
I			
(1)	**Shareholders' funds:**		
	(a) Share capital	**1**	12,00,000
	(b) Reserves and surplus	**2**	66,150
(2)	**Non current liabilities:**		
	Long term borrowings	**3**	4,50,000
(3)	**Current liabilities:**		
	(a) Short term borrowings	**4**	4,50,000

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	(b) Trade payables		2,63,550
	(c) Other current liabilities	**5**	29,250
	Total		24,58,950
II	**ASSETS**		
(1)	**Non-current Assets**		
	(a) Property, Plant & Equipment		
	(i) Tangible assets	6	11,49,900
	(ii) Intangible assets	7	4,05,000
	(b) Non current investments (Shares at cost)		1,50,000
	Current Assets:		
	(a) Inventories		4,27,500
	(b) Trade receivables	8	2,72,550
	(c) Cash and Cash equivalents – Cash on hand		36,000
	(d) Short term loans and advances –Income tax (paid30,000-Provision 12,000)		18,000
	Total		24,58,950

Note: There is a Contingent liability for Bills receivable discounted with Bank Rs. 6,000.**Notes to accounts**

			(Rs.)
1.	**Share Capital**		
	Authorized		
	90,000 Equity Shares of Rs. 10 each	9,00,000	
	6,000 6% Preference shares of Rs. 100 each	6,00,000	15,00,000
	Issued, subscribed & called up		
	60,000, Equity Shares of Rs. 10 each	6,00,000	
	6,000 6% Redeemable Preference Shares of 100 each	6,00,000	12,00,000
2.	**Reserves and Surplus**		
	Balance as on 1st April, 2017	85,500	
	Add: Surplus for current year	16,650	1,02,150
	Less: Preference Dividend		36,000
	Balance as on 31st March, 2018		66,150
3.	**Long Term Borrowings**		
	5% Mortgage Debentures (Secured against Freehold Properties)		4,50,000
4.	**Short Term Borrowings**		

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	Secured Borrowings: Loans Repayable on Demand Overdraft from Banks (Secured by Hypothecation of Stocks & Receivables)		4,50,000
5.	**Other Current liabilities**		
	Interest Accrued and due on Borrowings (5%Debentures)	11,250	
	Unpaid Preference Dividends	18,000	29,250
6.	**Tangible Property, Plant & Equipment**		
	Furniture		

	Furniture at Cost Less depreciation Rs. 45,000 (as given in Trial Balance	1,05,000	
	Add: Depreciation	45,000	
	Cost of Furniture	1,50,000	
	Add: Installation charge of Electrical Fittings wrongly included under the heading Salaries and Wages	6,000	
	Total Gross block of Furniture A/c	1,56,000	
	Accumulated Depreciation Account: Opening Balance-given in Trial Balance 45,000		
	Depreciation for the year: On Opening WDV at 10% i.e. (10% x 1,05,000) 10,500		
	On additional purchase during the year at 10% i.e. (10% x 6,000) 600		
	Less: Accumulated Depreciation	56,100	99,900
	Freehold property (at cost)		10,50,000
7.	**Intangible Fixed Assets**		11,49,900
	Technical knowhow	4,50,000	
	Less: Written off	45,000	4,05,000
8.	**Trade Receivables**		
	Sundry Debtors (a) Debt outstanding for more than six months	18,000	
	(b) Other Debts (refer Working Note)	1,34,550	
	Bills Receivable (1,24,500 -4,500)	1,20,000	2,72,550
9.	**Employee benefit expenses**		
	Amount as per Trial Balance	1,56,000	
	Less: Wages incurred for installation of electrical fittings tobe capitalised	6,000	

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	Less: Directors' Remuneration shown separately	30,000	
	Balance amount		1,20,000
10.	**Finance Costs**		
	Interest on bank overdraft	29,400	
	Interest on debentures	22,500	51,900
11.	**Other Expenses**		
	Payment to the auditors	18,000	
	Director's remuneration	30,000	
	Selling expenses	2,37,300	
	Technical knowhow written of (4,50,000/10)	45,000	
	Advertisement (Goods and Articles Distributed)	15,000	
	Bad Debts (4,500 x50%)	2,250	3,47,550

Working Note

Calculation of Sundry Debtors-Other Debts	
Sundry Debtors as given in Trial Balance	1,50,300
Add Back: Bills Receivables Dishonoured	4,500

	1,54,800
Less: Bad Debts written off – 50% Rs. 4,500	(2,250)
Adjusted Sundry Debtors	1,52,550
Less: Debts due for more than 6 months (as per information given)	(18,000)
Total of other Debtors i.e. Debtors outstanding for less than 6 months	1,34,550

Question 10

Kapil Ltd. has authorized capital of Rs. 50 lakhs divided into 5,00,000 equity shares of Rs. 10 each. Their books show the following balances as on 31st March, 2017:

	Rs.		Rs.
Inventory 1.4.2016	6,65,000	Bank Current Account	20,000
Discounts & Re-batesallowed	30,000	Cash in hand	8,000
Carriage Inwards	57,500	Interest (bank overdraft)	1,11,000
Patterns	3,75,000	Calls in Arrear @ Rs. 2 per share	10,000
Rate, Taxes and Insurance	55,000	Equity share capital	20,00,000

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Furniture & Fixtures	1,50,000	(2,00,000 shares of Rs. 10 each)	
Purchases	12,32,500	Bank Overdraft	12,67,000
Wages	13,68,000		
Freehold Land	16,25,000	Trade Payables (for goods)	2,40,500
Plant & Machinery	7,50,000	Sales	36,17,000
Engineering Tools	1,50,000	Rent (Cr.)	30,000
Trade Receivables	4,00,500	Transfer fees received	6,500
Advertisement	15,000	Profit & Loss A/c (Cr.)	67,000
Commission & Brokerage	67,500	Repairs to Building	56,500
Business Expenses	56,000	Bad debts	25,500

The inventory (valued at cost or market value, which is lower) as on 31st March, 2017 was Rs. 7,08,000. Outstanding liabilities for wages Rs. 25,000 and business expenses Rs. 36,000. Dividend declared @ 12% on paid-up capital and it was decided to transfer to reserve @ 2.5% of profits. Chargedepreciation on closing written down amount of Plant & Machinery @ 5%, Engineering Tools @ 20%; Patterns @ 10%; and Furniture & Fixtures @10%. Provide 25,000 as doubtful debts after writing off Rs.16,000 as bad debts. Provide for income tax @ 30%. ~~Corporate Dividend Tax Rate @ 17.304 (wherein Base Rate is 15%).~~

You are required to prepare Statement of Profit & Loss for the year ended 31st March, 2017 and Balance Sheet as on that date. (RTP May 18)(Same concept different figures lesser adjustments RTP May'21,MTP 16 Marks Oct 20, MTP 16 Marks Mar 22)

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Answer 10

Kapil Ltd. Balance Sheet as at 31st March, 2017

		Particulars	Note No.	(Rs.)
I		**Equity and Liabilities**		
		(a)Share Capital	1	19,90,000
	(b) Reserves and Surplus ***(as per amendment)***		2	***1,08,200***
	(2)	**Current Liabilities**		
		(a) Trade Payables		2,40,500
		(b) Other Current Liabilities	3	13,28,000
		(c) Short-Term Provisions ***(as per amendment)***	4	***3,58,800***
		Total		40,25,500
II	**ASSETS**			
	(1)	**Non-Current Assets**		
		(a) Property, Plant & Equipment		
		(i) Tangible Assets	5	29,30,000
	(2)	**Current Assets**		
		(a) Inventories		7,08,000
		(b) Trade Receivables	6	3,59,500
		(c) Cash and Cash Equivalents	7	28,000
		Total		40,25,500

Kapil Ltd.Statement of Profit and Loss for the year ended 31st March, 2017

	Particulars	Note No.	(Rs.)
I	Revenue from Operations		36,17,000
II	Other Income	8	36,500
III	**Total Revenue [I + II]**		**36,53,500**
IV	Expenses:		
	Cost of purchases		12,32,500
	Changes in Inventories [6,65,000-7,08,000]		(43,000)
	Employee Benefits Expenses	9	13,93,000
	Finance Costs	10	1,11,000
	Depreciation and Amortization Expenses		1,20,000
	Other Expenses	11	4,40,000

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	Total Expenses		**32,53,500**
V	**Profit before Tax (III-IV)**		4,00,000
VI	**Tax Expenses @ 30%**		(1,20,000)
VII	**Profit for the period**		2,80,000

Notes to Accounts:

Share Capital

Authorized Capital	
5,00,000 Equity Shares of Rs. 10 each	50,00,000
Issued Capital	
2,00,000 Equity Shares of Rs. 10 each	20,00,000
Subscribed Capital and fully paid	
1,95,000 Equity Shares of Rs.10 each	19,50,000
Subscribed Capital but not fully paid	
5,000 Equity Shares of Rs.10 each Rs. 8 paid	40,000
(Call unpaid Rs.10,000)	19,90,000

Reserves and Surplus

General Reserve		7,000
Surplus i.e. Balance in Statement of Profit & Loss:		
Opening Balance	67,000	
Add: Profit for the period	2,80,000	
Less: Transfer to Reserve @ 2.5%	(7,000)	
Less: Equity Dividend [12% of (20,00,000-10,000)]	(2,38,800)	
~~Less: ***Corporate Dividend Tax (Working note) (as peramendment)***~~	~~(48,614)~~ ***(49,086)***	***101200***
		108200

Other Current Liabilities

Bank Overdraft	12,67,000
Outstanding Expenses [25,000+36,000]	61,000
	13,28,000

Short-term Provisions

Provision for Tax	1,20,000
Equity Dividend payable	2,38,800
~~***Corporate Dividend Tax (as per amendment)***~~	~~48,614~~ ***49,086***
	3,58,800

1. **Tangible Assets**

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Particulars	Value given (Rs.)	Depreciationrate	Depreciation Charged(Rs.)	Written down value at the end(Rs.)
Land	16,25,000		-	16,25,000
Plant & Machinery	7,50,000	5%	37,500	7,12,500
Furniture & Fixtures	1,50,000	10%	15,000	1,35,000
Patterns	3,75,000	10%	37,500	3,37,500
Engineering Tools	1,50,000	20%	30,000	1,20,000
	30,50,000		1,20,000	29,30,000

Trade Receivables

Trade receivables (4,00,500-16,000)	3,84,500
Less: Provision for doubtful debts	(25,000)
	3,59,500

Cash & Cash Equivalent

Cash Balance	8,000
Bank Balance in current A/c	20,000
	28,000

Other Income

Miscellaneous Income (Transfer fees)	6,500
Rental Income	30,000
	36,500

Employee benefits expenses

Wages	13,68,000
Add: Outstanding wages	25,000
	13,93,000

2. Finance Cost

Interest on Bank overdraft	1,11,000

Other Expenses

Carriage Inward	57,500
Discount & Rebates	30,000
Advertisement	15,000
Rate, Taxes and Insurance	55,000
Repairs to Buildings	56,500
Commission & Brokerage	67,500
Miscellaneous Expenses [56,000+36,000] (BusinessExpenses)	92,000

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Bad Debts [25,500+16,000]	41,500
Provision for Doubtful Debts	25,000
	4,40,000

Working Note

Calculation of grossing-up of dividend:

Particulars	Rs.
Dividend distributed by Company	2,38,800
~~Add: Increase for the purpose of grossing up of dividend 2,38,800 x[15/(100-15)]~~	~~42,141~~
~~Gross dividend~~	~~2,80,941~~
~~Dividend distribution tax @ 17.304%~~ ***~~(as per amendment @ 17.472%)~~***	~~48,614~~ ***~~49,086~~***

Question 11

(a) **Following is the trial balance of Delta limited as on 31.3.2021. (Figures in ₹ '000)**

Particulars	Debit	Particulars	Credit
Land at cost	800	Equity share capital (shares of ₹ 10 each)	500
Calls in arrears	5	10% Debentures	300
Cash in hand	2	General reserve	150
Plant & Machinery at cost	824	Profit & Loss A/c (balance on 1.4.20)	75
Trade receivables	120	Securities premium	40
Inventories (31-3-21)	96	Sales	1200
Cash at Bank	28	Trade payables	30
Adjusted Purchases	400	Provision for depreciation	150
Factory expenses	80	Suspense Account	10
Administrative expenses	45		
Selling expenses	25		
Debenture Interest	30		
	2455		2455

Additional Information :

(i) **The authorized share capital of the company is 80,000 shares of ₹ 10 each.**

(ii) **The company revalued the land at ₹ 9,60,000.**

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(iii) **Equity share capital includes shares of ₹ 50,000 issued for consideration other than cash.**

(iv) **Suspense account of ₹ 10,000 represents cash received from the sale of some of the machineryon 1.4.2020. The cost of the machinery was ₹ 24,000 and the accumulated depreciation thereon being ₹ 20,000. The balance of Plant & Machinery given in trial balance is before adjustment of sale of machinery.**

(v) **Depreciation is to be provided on plant and machinery at 10% on cost.**

(vi) **Balance at bank includes ₹ 5,000 with ABC Bank Ltd., which is not a Scheduled Bank.**

(vii) **Make provision for income tax @30%.**

(viii) **Trade receivables of ₹ 50,000 are due for more than six months.**

You are required to prepare Delta Limited's Balance Sheet as at 31.3.2021 and Statement ofProfit and Loss with notes to accounts for the year ended 31.3. 2021 as per Schedule III. Ignore previous year's figures & taxation.

(b) **"Current maturities of long term borrowing are disclosed separately under the head Other current liabilities in the balance sheet of a company." You are required to comment in line with schedule III tothe Companies Act 2013. (RTP May '22) (Same concept different figures-Old & New SM)**

Answer 11(a)

Delta Limited

Balance Sheet as at 31st March 2021

Particulars	Note No.	(₹ in '000)
A. Equity and Liabilities		
1. Shareholders' funds		
(a) Share Capital	1	495.00
(b) Reserves and Surplus	2	807.20
2. Non-Current Liabilities		
(a) Long Term Borrowings	3	300.00
3. Current Liabilities		
(a) Trade Payables		30.00
(b) Short- term provision	4	163.80
Total		1,796.00
B. Assets		
1. Non-Current Assets		
(a) Property, Plant and Equipment	5	1,550.00
2. Current Assets		
(a) Inventories		96.00

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(b) Trade Receivables	6	120.00
(c) Cash and Cash equivalents	7	30.00
Total		1,796.00

Statement of Profit and Loss for the year ended 31st March 2021

Particulars	Note No.	(₹ in '000)
I. Revenue from Operations		1200.00
II. Other Income	8	6.00
III. Total Income (I +II)		1,206.00
IV. Expenses:		
Purchases (adjusted)		400.00
Finance Costs	9	30.00
Depreciation (10% of 800)	10	80.00
Other expenses		150.00
Total Expenses		660.00
V. Profit / (Loss) for the period before tax (III – IV)		546.00
VI. Tax expenses @30%		163.80
VII Profit for the period		382.20

Notes to Accounts

	Particulars		(₹ in '000)
1	Share Capital		
	Equity Share Capital		
	Authorised		
	80,000 Shares of ₹ 10/- each		800
	Issued, Subscribed and Called-up		
	50,000 Shares of ₹ 10/- each	500	
	(Out of the above 5,000 shares have been issued forconsideration other than cash)		
	Less: Calls in arrears	(5)	495
2	Reserves and Surplus		
	Securities Premium		40.00
	Revaluation Reserve ₹ (960 – 800)		160.00
	General Reserve		150.00
	Surplus i.e. Profit & Loss Account Balance		
	Opening Balance	75.00	
	Add: Profit for the period	382.20	457.20

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3	Long-Term Borrowings		807.20
	10% Debentures		300
4.	Short – term provision		
	Provision for tax		163.80
5	Property, plant & equipment		
	Land		
	Opening Balance	800	
	Add: Revaluation adjustment	160	
	Closing Balance		960
	Plant and Machinery		
	Opening Balance	824	
	Less: Disposed off	(24)	
		800	
	Less: Depreciation ₹ (150 – 20 + 80)	(210)	
	Closing Balance		590
	Total		1,550

6	Trade receivables		
	Debits outstanding for a period exceeding six months	50	
	Other debts	70	120
7	Cash and Cash Equivalents		
	Cash at Bank With scheduled banks	23	
	With others (ABC Bank Limited)	5	
	Cash in hand	2	30
8	Other Income		
	Profit on sale of machinery		
	Sale value of machinery	10	
	Less: Book value of machinery (24 – 20)	(4)	6
9	Finance Costs		
	Debenture Interest		30
10	Other Expenses:		
	Factory expenses	80	
	Selling expenses	25	
	Administrative expenses	45	150

Current maturities of loan term borrowing are shown under 'short term borrowings' and not under 'Oth-

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er current liabilities' as per the amendment to Schedule III vide MCA notification dated 24th March, 2021. Hence the statement given in the question is not valid.

Question 12

The following balance appeared in the books of Oliva Ltd. as on 31-03-2022.

Particulars		Rs.	Particulars		Rs.
Inventory 01-04-2021			Sales		17,10,000
-Raw Material	30,000		Interest		3,900
-Finished goods	46,500	76,500	Profit and Loss A/c		21,000
Purchases of rawmaterial		12,60,000	Share Capital		3,15,000
Manufacturing Expenses		2,70,000	**Secured Loans**: Short-term Long-term	4,500 21,000	25,500
			Fixed Deposits (unsecured)		
Salaries and wages		40,200	Short -term	1,500	
General Charges		16,500	Long - term	3,300	4,800
Building		1,01,000	Trade payables		3,27,000
Plant andMachinery		70,400			
Furniture		10,200			
Motor Vehicles		40,800			
Investments: Current	4,500				
Non-Current	7,500	12,000			
Trade receivables		2,38,500			
Cash in Bank		2,71,100			
		24,07,200			24,07,200

1. **From the above balance and the following information, prepare the company's statement of Profit andLoss for the year ended 31st March, 2022 and company's Balance Sheet as on that date:**

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2. **Inventory on 31st March,2022- Raw material Rs. 25,800 and finished goods Rs. 60,000.**
3. **Outstanding Expenses: Manufacturing Expenses Rs. 67,500 & Salaries & Wages Rs. 4,500.**
4. **Interest accrued on Securities Rs. 300.**
5. **General Charges prepaid Rs. 2,490.**
6. **Provide depreciation: Building @ 2% p.a., Machinery @ 10% p.a., Furniture @ 10% p.a. & MotorVehicles @ 20% p.a.**
7. **Current maturity of long term loan is Rs. 1,000.**

The Taxation provision of 40% on net profit is considered. (RTP Nov'19, Nov'22)

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Answer 12

Oliva Ltd.

Balance Sheet as at 31.03.2022

	Particulars		Note	Amount
(1)	Equity and Liabilities			
	(i) Shareholders' funds			
	(a) Share Capital			3,15,000
	(b) Reserves and surplus		1	50,430
(2)	Non-current liabilities			
	(a) Long-term borrowings		2	23,300
(3)	Current Liabilities			
	(a) Short -term borrowings		3	7,000
	(b)Trade payables			3,27,000
	(c) Other current liability		4	72,000
	(d) Short term provision		5	19,620
II	ASSETS			8,14,350
(1)	Non-current assets			
	(a) Property, Plant & equipment		6	2,04,160
	(b) Non-current investments			7,500
(2)	Current assets			
	(a) Current investments			4,500
	(b) Inventories		7	85,800
	(c) Trade receivables			2,38,500
	(d) Cash and cash equivalents			2,71,100
	(e) Short-term loans and advances		8	2,490
	(f) Other current assets		9	300
				8,14,350

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Oliva Ltd.

Statement of Profit and loss for the year ended 31.03.2022

(Rs.)

	Particulars	Note	Amount
I	Revenue from operations		17,10,000
II	Other income (3,900 +300)		4,200
III	Total income (I +II)		17,14,200
IV	Expenses:		
	Cost of materials consumed	10	12,64,200
	Purchases of inventory-in-trade		--
	Changes in inventories of finished goods, work-in-progress and inventory-in-Trade	11	(13,500)
	Employee benefit expenses	12	44,700
	Finance costs		--
	Depreciation and amortization expenses		18,240
	Other expenses	13	3,51,510
	Total Expenses		16,65,150
V	Profit before exceptional and extraordinary items and tax		49,050
VI	Exceptional items		--
VII	Profit before extraordinary items and tax		49,050
VIII	Extraordinary items		--
IX	Profit before tax		49,050
X	Tax expense (40% of 49,050)		19,620
XI	Profit/Loss for the period from continuing operations		29,430

Notes to accounts

No.	Particulars		Amount	Amount
1.	Reserve & Surplus			
	Profit & Loss Account: Balance b/f		21,000	
	Net Profit for the year		29,430	50,430
2.	Long term borrowings			
	Secured loans (21,000 less current maturities 1,000)		20,000	
	Fixed Deposits: Unsecured		3,300	23,300
3.	Short term borrowings			
	Secured loans		4,500	
	Fixed Deposits -Unsecured		1,500	

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	Current maturities of long term borrowings		1,000	7,000
4.	Other current liabilities			
	Expenses Payable (67,500 + 4,500)		72,000	72,000
5.	Short term provisions			
	Provision for Income tax			19,620
6.	Property, plant and equipment			
	Building	1,01,000		
	Less: Depreciation @ 2%	(2,020)	98,980	
	Plant & Machinery	70,400		
	Less: Depreciation @10%	(7,040)	63,360	
	Furniture	10,200		
	Less: Depreciation @10%	(1,020)	9,180	
	Motor vehicles	40,800		
	Less: Depreciation @20%	(8,160)	32,640	2,04,160
7	Inventory			
	Raw Material		25,800	
	Finished goods		60,000	85,800
8.	Short term Loans & Advances			
	General Charges prepaid			2,490
9.	Other Current Assets			
	Interest accrued			300
10.	Cost of material consumed			
	Opening inventory of raw Material	30,000		
	Add: Purchases	12,60,000	12,90,000	
	Less: Closing inventory		(25,800)	12,64,200
11.	Changes in inventory of Finished Goods & WIP			
	Closing Inventory of Finished Goods		60,000	
	Less: Opening Inventory of Finished Goods		(46,500)	13,500
12.	Employee Benefit expenses			
	Salary & Wages (40,200 + 4,500)			44,700
13.	Other Expenses:			
	Manufacturing Expenses (2,70,000 + 67,500)		3,37,500	
	General Charges (16,500 – 2,490)		14,010	3,51,510

Question 13

The following is the Trial Balance of H Ltd., as on 31st March, 2021:

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	Dr.	Cr.
Equity Capital (Shares of ₹ 100 each)		8,05,000
5,000, 6% preference shares of ₹ 100 each		5,00,000
9% Debentures		4,00,000
General Reserve		40,00,000
Profit & Loss A/c (of previous year)		72,000
Sales		60,00,000
Trade Payables		10,40,000
Provision for Depreciation on Plant & Machinery		1,72,000
Suspense Account		40,000
Land at cost	24,00,000	
Plant & Machinery at cost	7,70,000	
Trade Receivables	19,60,000	
Inventories (31-03-2020)	9,50,000	
Bank	2,30,900	
Adjusted Purchases	22,32,100	
Factory Expenses	15,00,000	
Administration Expenses	3,00,000	
Selling Expenses	14,00,000	
Debenture Interest	36,000	
Goodwill	12,50,000	
	1,30,29,000	1,30,29,000

Additional Information:The authorised share capital of the company is:

5,000, 6% preference shares of ₹ 100 each 5,00,000

10,000, equity shares of ₹ 100 each 10,00,000

(i) Issued equity capital as on 1st April 2020 stood at ₹ 7,20,000, that is 6,000 shares fully paid and 2,000 shares ₹ 60 paid. The directors made a call of ₹ 40 per share on 1st October 2020. A shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ ₹ 90 per share as fully **paid.**

(ii) **On 31st March 2021, the Directors declared a dividend of 5% on equity shares, transferring any amount that may be required from General Reserve. Ignore Taxation.**

(iii) **The company on the advice of independent value wishes to revalue the land at ₹ 36,00,000.**

(iv) **Suspense account of ₹ 40,000 represents amount received for the sale of some of the machinery on 1-4-2020. The cost of the machinery was ₹ 1,00,000 and the accumulated depreciation thereon being ₹ 30,000.**

(v) **Depreciation is to be provided on plant and machinery at 10% on cost.**

Amortize 1/5th of Goodwill.

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You are required to prepare H Limited's Balance Sheet as on 31-3-2021 and Statement of Profit and Loss with notes to accounts for the year ended 31-3-2021 as per Schedule III of the Companies Act , 2013. Ignore previous years' figures & taxation. (PYP July'21,20 Marks)

Answer 13

H Ltd Balance Sheet as at 31st March 2021

Particulars	Note No	Amount in ₹
Equity and Liabilities		
I. Shareholders' Funds		
a. Share Capital	1	13,00,000
b. Reserves and Surplus	2	53,91,900
II. Non-Current Liabilities		
a. Long Term Borrowings	3	4,00,000
III. Current Liabilities		
a. Trade Payables	4	10,40,000
b. Other Current Liabilities	5	70,000
Total		82,01,900
Assets		
I. Non-Current Assets		
a. Property, Plant and Equipment	6	40,61,000
b. Intangible Assets	7	10,00,000
II. Current Assets		
a. Inventories		9,50,000
b. Trade Receivables		19,60,000
c. Cash and Cash equivalents		2,30,900
Total		82,01,900

Statement of Profit and Loss for the year ended 31st March 2021

Particulars	Note No	Amount in ₹
I. Revenue from operations		60,00,000
Total Revenue		60,00,000
II. Expenses		
Purchases (adjusted)		22,32,100
Finance Costs	8	36,000
Depreciation and Amortization	9	3,17,000
Other Expenses	10	32,30,000
Total Expenses		58,15,100

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III. Profit/(Loss) for the period		1,84,900

Notes to Accounts (Amount in ₹)

1	**Share Capital**		
	a. Authorized Capital		
	5,000, 6% Preference shares of ₹ 100/- each		5,00,000
	10,000 Equity Shares of ₹100/- each		10,00,000
			15,00,000
	b. Issued & Subscribed Capital		
	5,000, 6% Preference shares of ₹100/- each		5,00,000
	8,000, Equity shares of ₹100/- each		8,00,000
	Total		13,00,000
2	**Reserves & Surplus**		
	Capital Reserve (100 X (90-40))		5,000
	Revaluation Reserve (36,00,000-24,00,000)		12,00,000
	General Reserve		40,00,000
	Surplus	1,84,900	
	Add: Balance from previous year	72,000	
	Less:		
	Dividends declared	(70,000)	
	Profit/(Loss) carried forward to Balance Sheet		1,86,900
	Total		53,91,900
3	**Long-Term Borrowings**		
	Secured		
	9% Debentures		4,00,000
4	**Trade Payables**		10,40,000
5	**Other Current Liabilities**		
	Dividend Payable		
	Preference Dividend	30,000	
	Equity Dividend	40,000	
	Total		70,000
6	**Property, Plant and Equipment**		
	Land		
	Opening balance	24,00,000	
	Add: Revaluation Adjustment	12,00,000	
	Closing Balance		36,00,000
	Plant and Machinery		
	Opening Balance	7,70,000	

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	Less: Disposed off	(1,00,000)	
	Depreciation	(2,09,000)	
	Closing Balance		4,61,000
	Total		40,61,000
7	**Intangible Assets**		
	Goodwill	12,50,000	
	Less: Amortized (1/5the)	(2,50,000)	
	Total		10,00,000
8	**Finance Costs**		

	Debenture Interest		36,000
9	**Depreciation and Amortization**		
	Plant and Machinery	67,000	
	Goodwill	2,50,000	
	Total		3,17,000
10	**Other Expenses**		
	Factory Expenses	15,00,000	
	Selling Expenses	14,00,000	
	Administrative Expenses	3,00,000	
	Loss on sale of Plant and Machinery		
	Book Value (1,00,000-30,000) 70,000		
	Less: Sale Value (40,000)	30,000	
	Total		32,30,000

1.1.20 **Note**The inventories (31.3.20) amounting ₹ 9, 50,000 (given in the trial balance of the Question) should have been as closing inventory i.e. as on 31.3.21. In the above solution, this inventory has been considered as closing inventory i.e. for 31.3.21. If this is considered as inventory of 31.3.20, the closing inventory (as on 31.3.21) will not be available for the balance sheet as on and in that case, the balance sheet will not tally without using suspense account amounting ₹ 9,50,000.

The financial statements given in the above Answer include adjustment for dividend declared on 31st March, 2021, strictly, as per the information given in the Question. However, practically dividends are declared in the annual general meetings which take place after the reporting date.

Question 14

A company sold 20% of the Goods on Cash Basis and the balance on Credit basis.

Debtors are allowed 1.5 month's credit and their balance as on 31st March, 2021 is ₹ 1,50,000. Assume that sale is evenly spread throughout the year.

Purchases during the year ₹ 9,50,000 Closing stock is ₹ 10,000 less than the Opening Stock. Average stock maintained during the year ₹ 60,000. Direct Expenses amounted to ₹ 35,000 Calculate Credit

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sales, Total sales and Gross profit for the year ended 31 st March, 2021. (PYP 5 Marks , Dec '21)

Answer 14

Calculation of Credit Sales, Total Sales and Gross **Profit**

Credit Sales for the year ended 31st March , 2021 = Debtors X

= 1,50,000 X

= Rs. 12,00,000

Total Sales for the year ended 2020-21 = Credit Sales X

= Rs. 12,00,000 X

= Rs. 15,00,000

Trading Account for the year ended 31st March, 2021

	₹		₹
To Opening stock	65,000	By Sales	15,00,000
To Direct expenses	35,000	By Closing Stock	55,000
To Purchases	9,50,000		
To Gross profit	5,05,000		
	15,55,000		15,55,000

Working Note:Calculation of opening stock and closing stock

If closing stock is x then opening stock is x+10,000

Average stock ₹ 60,000

Average stock = Opening stock + Closing stock /2

Thus Opening stock is ₹ 65,000 and closing stock is ₹ 55,000.

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Question 15

Debit Balance	Amount (₹)	Credit Balances	Amount (₹)
Purchases	82,95,000	Sales Commis-sion	1,25,87,000
Wages and Salaries	12,72,000		72,500
Rent	2,20,000	Equity Share Capital	10,00,000
Rates and Taxes	50,000	General Reserve	10,00,000
Selling & Distribution	4,36,000	Surplus (P&L A/c) 01.04.2021	8,75,500
Expenses			
Directors Fees	32,000	Securities Premium Term	2,50,000
Bad Debts	38,500	Loan from PublicSector Bank	1,02,00,000
Interest on Term Loan	8,05,000	Trade Payables	
Land	24,00,000	Provision for Depreciation:On Plant & Machinery	55,08,875
Factory Building Plant	36,80,000		
and Machinery	62,50,000	On Furniture and FittingsOn Factory Building	9,37,500
Furniture and Fittings	8,25,000		82,500
Trade Receivables	64,75,000		1,84,000
Advance Income Tax Paid	37,500	Provision for Doubtful Debts	25,000
Stock (1st April,2021)	9,25,000	Bills Payable	1,25,000
Bank Balances	9,75,000		
Cash on Hand	1,31,875		
Total	3,28,47,875	Total	3,28,47,875

Following information is provided:

(1) The Authorized Share Capital of the Company is 2,00,000 Equity Shares of ₹ 10 each. The Company has issued 1,00,000 Equity Shares of ₹ 10 each.

(2) Rent of ₹ 20,000 and Wages of ₹ 1,56,500 are outstanding as on 31st March, 2022.

(3) Provide Depreciation @ 10% per annum on Plant and Machinery, 10% on Furniture andFittings and 5% on Factory Building on written down value basis.

(4) Closing Stock as on 31st March, 2022 is ₹ 11,37,500.

(5) Make a provision for Doubtful Debt @ 5% on Debtors.

(6) Make a provision of 25% for Corporate Income Tax.

(7) Transfer ₹ 1,00,000 to General Reserve.

(8) Term Loan from Public Sector Bank is secured against Hypothecation of Plant andMachinery. Installment of Term Loan falling due within one year is ₹ 17,00,000.

(9) Trade Receivables of ₹ 85,600 are outstanding for more than six months.

(10) The Board declared a dividend @10% on Paid up Share Capital on 5 th April, 2022.

You are required to prepare Balance Sheet as on 31st March 2022 and Statement of Profit and Loss with

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Note to Accounts for the year ending 31st March, 2022 as per Schedule III of the Companies Act, 2013. Ignore previous years' figures. (PYP 20 Marks Nov '22)

Answer 15

Balance Sheet of Anmol Ltd. as at 31st March, 2022

Particulars			Note No	₹
Equity and Liabilities				
1	Shareholders' funds			
	a	Share capital	1	10,00,000
	b	Reserves and Surplus	2	24,76,462
2	Non-current liabilities			
	a	Long-term borrowings	3	85,00,000
3	Current liabilities			
	a	Short term borrowings (Installment of term loan falling due in one year)		17,00,000
	b	Trade Payables	4	56,33,875
	c	Other current liabilities	5	1,76,500
	d	Short term provisions (provision for tax)		1,16,988
		Total		1,96,03,825
ASSETS				
1	Non-current assets			
	a	PPE	6	1,11,70,700
2	Current assets			
	a	Inventories		11,37,500
	b	Trade receivables	7	61,51,250
	c	Cash and bank balances	8	11,06,875
	d	Short term loans & advances (Advance tax paid)		37,500
				1,96,03,825

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Statement of Profit and Loss of Anmol Ltd. for theyear ended 31st March, 2022

	Particulars	Notes	Amount
I.	Revenue from operations		1,25,87,000
II.	Other income (Commission income)		72,500
III.	Total Income (I + II)		1,26,59,500
IV.	Expenses:		
	Purchases of Inventory-in-Trade		82,95,000
	Changes in inventories of finished goods work-in-progress and Inventory-in-Trade	9	(2,12,500)
	Employee benefits expense	10	14,28,500
	Finance costs (interest on term loan)		8,05,000
	Depreciation		7,80,300
	Other operating expenses	11	10,95,250
	Total expenses		1,21,91,550
V.	Profit (Loss) for the period (III - IV)		4,67,950
VI.	(-) Tax (25%)		(1,16,988)
VII.	PAT		3,50,962

Notes to **accounts**

			₹
1	Share Capital		
	Equity share capital		
	Authorized		
	2,00,000 equity shares of ₹ 10 each		20,00,000
	Issued & subscribed		
	1,00,000 equity shares of ₹ 10 each		10,00,000
2	Reserves and Surplus		
	General Reserve	10,00,000	
	Add: current year transfer	1,00,000	11,00,000
	Profit & Loss balance		
	Opening balance: Surplus P & L A/c	8,75,500	
	Profit for the year	3,50,962	
	Less: Appropriations:		
	Transfer to General reserve	(1,00,000)	11,26,462
	Securities premium		2,50,000

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3	Long-term borrowings		24,76,462
	Term loan from public sector bank (Secured by hypothecation)		1,02,00,000
	Less: Installment of Term loan falling due within one year		(17,00,000)
	Total		85,00,000
4	Trade payables		
	Trade payables	55,08,875	
	Bills payable	1,25,000	56,33,875
5	Other current liabilities		
	Rent outstanding	20,000	
	Wages and Salaries Outstanding	1,56,500	1,76,500
6	PPE (Note 2)		
	Land		24,00,000
	Factory Buildings		33,21,200
	Plant & Machinery		47,81,250
	Furniture & Fittings		6,68,250
	Total		1,11,70,700
7	Trade receivables		
	Debtors Outstanding for period exceeding 6 months	85,600	
	Other debts	63,89,400	
	Less: Provision for doubtful debt	(3,23,750)	61,51,250
8	Cash and bank balances		
	Cash and cash equivalents		
	Bank balance	9,75,000	
	Cash on hand	1,31,875	11,06,875
9	Changes in Inventories		
	Opening Inventory	9,25,000	
	Less: Closing Inventory	(11,37,500)	
	Change		(2,12,500)
10	Employee benefit expense		
	Wages and Salaries	12,72,000	
	Add: Wages and Salaries Outstanding	1,56,500	14,28,500
11	Other operating expenses		
	Rent	2,20,000	
	Add: outstanding	20,000	2,40,000

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	Rates and Taxes		50,000
	Selling & Distribution expenses		4,36,000
	Bad debts		38,500
	Provision for Doubtful Debts (3,23,750-25,000) Director's fee		2,98,750 32,000
	Total		10,95,250

Note:

The final dividend will not be recognized as a liability at the balance sheet date (even if itis declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 2022. Such dividends will be disclosed in notes only.

1. Calculation of depreciation:

	Book value	Accumulated depreciation	WDV	Current year Depreciation	Current year WDV
Land	24,00,000	-	24,00,000	-	24,00,000
Factory building	36,80,000	1,84,000	34,96,000	1,74,800	33,21,200
Plant & Machinery	62,50,000	9,37,500	53,12,500	5,31,250	47,81,250
Furniture & Fittings	8,25,000	82,500	7,42,500	74,250	66850
Total				7,80,300	1,11,70,700

Question 16

The following balances are extracted from the books of Travese Limited as on 31st March **2023:**

Particulars	**Amount (Rs.)**	
	Debit	**Credit**
7% Debentures		**48,45,000**
Plant & Machinery (at cost)	**37,43,400**	
Trade Receivable	**35,70,000**	
Land	**97,37,000**	
Debenture Interest	**3,39,150**	
Bank Interest	**13,260**	

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Sales		47,22,600
Transfer Fees		38,250
Discount received		66,300
Purchases	28,86,600	
Inventories 1.04.2022	4,97,250	
Factory Expenses	2,58,060	
Rates, Taxes and Insurance	65,025	
Repairs	1,49,685	
Sundry Expenses	1,27,500	
Selling Expenses	26,520	
Directors Fees	38,250	
Interest on Investment for the year 2022-2023		55,000
Provision for depreciation		5,96,700
Miscellaneous receipts		1,42,800

Additional information:

(i) Closing inventory on 31.03.2023 is Rs. 4,76,850,

(ii) Miscellaneous receipts represent cash received from the sale of the Plant on 01.04.2022. Thecost of the Plant wasRs. 1,65,750 and the accumulated depreciation thereon is Rs. 24865.

(iii) The Land is re-valued at 1,08,63,000.

(iv) Depreciation is to be provided on Plant & Machinery at 10% p.a. on cost.

(v) Make a provision for income tax @ 25%.

(vi) The Board of Directors declared a dividend of 10% on Equity shares on 4th April, 2023.

You are required to prepare a Statement of Profit and Loss as per Schedule III of the Companies Act, 2013 for the year ended 31.03.2023. (Ignore previous year figures) (PYP 10 Marks May '23)

Answer 16

Statement of Profit and Loss of Travese Limited. for the year ended 31st March, 2023

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	Particulars	Notes	Amount
I.	Revenue from operations	1	47,22,600
II.	Other income Total	2	1,61,465
III.	Income (I + II)		
IV.	Expenses:		48,84,065
	Purchases of Inventory-in-Trade		28,86,600
	Changes in inventories of finished goods, work-inprogress and Inventory-in-Trade	3	20,400
	Finance costs	4	3,52,410
	Depreciation and amortization expenses	5	3,57,765
	Other expenses	6	6,65,040
	Total expenses		42,82,215
	Profit (Loss) for the period (III - IV) before tax		
V.			6,01,850
VI	Provision for tax		(1,50,463)
VII	Profit for the period		
			4,51,387

Notes to accounts

			Rs.
1	Revenue from operationsSale		47,22,600

2	Other Income Transfer fees		38,250
	Discount received		66,300
	Interest on Investment		55,000

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3	Profit on sale of plant		1,915
	Total		1,61,465
	Changes in inventories of finished goods,work-in-progress and Inventory-in-Trade		
	Opening Inventory	4,97,250	
4	Less: Closing Inventory	(4,76,850)	20,400
	Total		20,400
	Finance costs		
	Interest on Debentures		3,39,150
	Bank Interest		13,260
	Total		3,52,410
5	Depreciation and Amortization expensesDepreciation on Plant & Machinery (10% x 37,43,400 - 1,65,750)		3,57,765
6	Other expenses		
	Factory expense		2,58,060
	Rent, Taxes and Insurance		65,025
	Repairs		1,49,685
	Sundry expenses		1,27,500
	Selling expenses		26,520
	Director's fees		38,250
		Total	**6,65,040**

Note:

The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of financial statements) as per accounting standards. Hence,it is not recognized in the financial statement for the year ending 31st March 2023. Such dividend willbe disclosed in notes only.

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Question 17

From the following particulars furnished by Ambience Ltd., prepare the Balance Sheet as on 31st March 2023 as required by Division I of Schedule III of the Companies Act, **2013.**

Particulars		Debit ₹	Credit ₹
Equity Share Capital (Face value of ₹ 100 each)			25,00,000
Call in Arrears		2,500	
Land & Building		13,75,000	
Plant & Machinery		13,12,500	
Furniture		1,25,000	
General Reserve			5,25,000
Loan from State Financial Corporation			3,75,000
Inventories: Raw Materials	1,25,000		
Finished Goods	5,00,000	6,25,000	
Provision for Taxation			3,20,000
Trade receivables		5,00,000	
Advances		1,06,750	
Profit & Loss Account			2,16,750
Cash in Hand		75,000	
Cash at Bank		6,17,500	
Unsecured Loan			3,02,500
Trade creditors (for Goods and Expenses)			5,00,000
		47,39,250	47,39,250

The following additional information is also provided:

(i) **5,000 Equity shares were issued for consideration other than cash.**

(ii) **Trade receivables of ₹ 1,30,000 are due for more than 6 months.**

(iii) **The cost of the Assets were:**

Building ₹ 15,00,000, Plant & Machinery ₹ 17,50,000 and Furniture ₹ 1,56,250

(iv) **The balance of ₹ 3,75,000 in the Loan Account with State Finance Corporation is inclusive of ₹18,750 for Interest Accrued but not Due. The loan is secured by hypothecation of Plant & Machinery.**

(v) **Balance at Bank includes ₹ 5,000 with Global Bank Ltd., which is not a Scheduled Bank.**

Bills Receivable for 1,60,000 maturing on 15th June, 2023 has been discounted.

Provide to doubtful debts @ 5% on trade receivables.(Nov '23)

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Answer 17

Ambience Ltd.

Balance Sheet as on 31st March, 2023

	Particulars	Notes	₹
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	24,97,500
b	Reserves and Surplus	2	7,16,750
2	Non-current liabilities		
	Long-term borrowings	3	6,58,750
3	Current liabilities		
a	Trade Payables		5,00,000
b	Other current liabilities	4	18,750
c	Short-term provisions	5	3,20,000
		Total	**47,11,750**
	Assets		
1	Non-current assets		
	Property, Plant and Equipment	6	28,12,500
2	Current assets		
a	Inventories	7	6,25,000
b	Trade receivables	8	4,75,000
c	Cash and cash equivalents	9	6,92,500
d	Short-term loans and advances		1,06,750
	Total		**47,11,750**
Contingent Liabilities and Commitments (to the extent not provided for) Contingent Liabilities: Bills discounted but not matured			**1,60,000**

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Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Issued & subscribed & called up & paid-up		
	25,000 Equity Shares of ₹ 100 each (of the above 5,000 shares have been issued for consideration other than cash)	**25,00,000**	
	Less: Calls in arrears	**(2,500)**	**24,97,500**
	Total		**24,97,500**
2	**Reserves and Surplus**		
	General Reserve		5,25,000
	Surplus (Profit & Loss A/c 2,16,750		
	Less: provision for debtors 25,000		1,91,750
	Total		**7,16,750**
3	**Long-term borrowings**		
	Secured Term Loan		
	State Financial Corporation Loan (3,75,000-18,750) (Secured by hypothecation of Plant and Machinery)		3,56,250
	Unsecured Loan		3,02,500
	Total		**6,58,750**
4	**Other current liabilities**		
	Interest accrued but not due on loans (SFC)		**18,750**
5	**Short-term provisions**		
	Provision for taxation		**3,20,000**
6	**Property, Plant and Equipment**		
	Land and Building	15,00,000	
	Less: Depreciation	(1,25,000)	13,75,000
	Plant & Machinery	17,50,000	
	Less: Depreciation	(4,37,500)	13,12,500
	Furniture & Fittings	1,56,250	
	Less: Depreciation	(31,250)	1,25,000
	Total		**28,12,500**
7	**Inventories**		
	Raw Materials		1,25,000
	Finished goods		5,00,000

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	Total		**6,25,000**
8	**Trade receivables**		
	Outstanding for a period exceeding six months		1,30,000
	Other Amounts		3,70,000
	Less: Provision for doubtful debts		(25,000)
	Total		**4,75,000**
9	**Cash and cash equivalents**		
	Cash at bank		
	with Scheduled Banks	6,12,500	
	with others (Global Bank Ltd.)	5,000	6,17,500
	Cash in hand		75,000
	Total		**6,92,500**

Question 18

Trade payables as per Schedule III will include:

a. Dues payable in respect to statutory obligation
b. Interest accrued on trade payables
c. Bills payables.
d. Bills receivables

Ans: (c)

Question 19

Securities Premium Account is shown on the liabilities side in the Balance Sheet under the heading:

a. Reserves and Surplus.
b. Current Liabilities.
c. Share Capital.
d. Share application money pending allotment

Ans: (a)

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Question 20

"Fixed assets held for sale" will be classified in the company's balance sheet as

a. Current asset
b. Non-current asset
c. Capital work- in- progress
d. Deferred tax assets

Ans: (a)

Question 21

Current maturities of long term debt will come under

e. Current Liabilities.
f. Short term borrowings.
g. Long term borrowings.
h. Short term Provisions

Ans: (b)

Question 22

Declaration of dividends for current year is made after providing for

i. Depreciation of past years only.
j. Depreciation on assets for the current year and arrears of depreciation of past years (if any).
k. Depreciation on current year only and by forgoing arrears of depreciation of past years.
l. Excluding current year depreciation

Ans: (b)

Theoretical Questions Answers

Question 23

(i) State under which head these accounts should be classified in Balance Sheet, as per Schedule III ofthe Companies Act, **2013:**

Share application money received in excess of issued share **capital.**

(ii) **Share option outstanding account.**

(iii) **Unpaid matured debenture and interest accrued thereon.**

(iv) **Uncalled liability on shares and other partly paid investments.**

(v) **Calls unpaid.**

Money received against share **warrant.**

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Answer 23

(i) Current Liabilities/ Other Current Liabilities

(ii) Shareholders' Fund / Reserve & Surplus

(iii) Current liabilities/Other Current Liabilities

(iv) Contingent Liabilities and Commitments

(v) Shareholders' Fund / Share Capital

Shareholders' Fund / Money received against share warrants

Question 24

On 31st March, 20X1 Bose and Sen Ltd. provides to you the following ledger balances after preparing its Profit and Loss Account for the year ended 31st March, 20X1:

Credit Balances:

	Rs.
Equity shares capital, fully paid shares of Rs. 10 each	70,00,000
General Reserve	15,49,100
Loan from State Finance Corporation	10,50,000
(Secured by hypothecation of Plant & Machinery Repayable	
within one yearRs. 2,00,000)	
Loans: Unsecured (Long term)	8,47,000
Sundry Creditors for goods &expenses	14,00,000
(Payable within 6 months)	
Profit & Loss Account	7,00,000
Provision for Taxation	8,16,900
	1,33,63,000

Debit Balances:

	Rs.
Calls in arrear	7,000
Land	14,00,000
Buildings	20,50,000
Plant and Machinery	36,75,000
Furniture& Fixture	3,50,000
Inventories: Finished goods	14,00,000
Raw Materials	3,50,000
Trade Receivables	14,00,000
Advances: Short-term	2,98,900

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Cash in hand	**2,10,000**
Balances with banks	**17,29,000**

Preliminary Expenses	**93,100**
Patents & Trademarks	**4,00,000**
	1,33,63,000

The following additional information is also provided in respect of the above **balances:4,20,000 fully paid equity shares were allotted as consideration for land & buildings.**

(i) **Cost of Building Rs. 28,00,000**

(ii) **Cost of Plant & Machinery Rs. 49,00,000 Cost of Furniture & Fixture Rs. 4,37,500**

(iii) **Trade receivables for Rs. 3,80,000 are due for more than 6 months.**

(iv) **The amount of Balances with Bank includes Rs. 18,000 with a bank which is not a scheduled Bank and the deposits of Rs. 5 lakhs are for a period of 9 months.**

(v) **Unsecured loan includes Rs. 2,00,000 from a Bank and Rs. 1,00,000 from related parties.**

Entire amount of Preliminary expenses to be written off, by adjusting from opening balance of General **Reserve.**

You are not required to give previous year's figures. You are required to prepare the Balance Sheetof the Company as on 31stMarch, 20X1 as required under Schedule III to the Companies Act, 2013.

Answer 24

Bose and Sen Ltd.

Balance Sheet as at 31st March, 20X1

Particulars			Notes	Figures at the end of current reporting period (Rs.)
Equity and Liabilities				
1		Shareholders' funds		
	a	Share capital	1	69,93,000
	b	Reserves and Surplus	2	21,56,000
2		Non-current liabilities		
	a	Long-term borrowings	3	16,97,000
3		Current liabilities		
	a	Trade Payables		14,00,000
	b	Short term borrowings	4	2,00,000
	c	Short-term provisions	5	8,16,900
		Total		1,32,62,900
Assets				
1		Non-current assets		

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	a	PPE	6	74,75,000
	b	Intangible assets (Patents & TradeMarks)		4,00,000
2		Current assets		
	a	Inventories	7	17,50,000
	b	Trade receivables	8	14,00,000
	c	Cash and bank balances	9	19,39,000
	d	Short-term loans and advances		2,98,900
		Total		1,32,62,900

Notes to accounts

			Rs.
1	Share Capital Equity share capital		
	Issued, subscribed and called up 7,00,000 Equity Shares of Rs. 10 each (Out of the above 4,20,000 shares have been issued forconsideration other than cash)	70,00,000	
	Less: Calls in arrears	(7,000)	69,93,000
	Total		69,93,000
2	**Reserves and Surplus**		
	General Reserve	15,49,100	
	Less: Preliminary expenses	(93,100)	14,56,000
	Surplus (Profit & Loss A/c)		7,00,000
	Total		21,56,000
3	**Long-term borrowings**		
	Secured		
	Term Loans		
	Loan from State Finance Corporation (Rs. 10,50,000 - Rs. 2,00,000) (Secured by hypothecation of Plant and Machinery)		8,50,000
	Unsecured		
	Bank Loan	2,00,000	

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	Loan from related parties	1,00,000	8,47,000
	Others	5,47,000	
	Total		16,97,000
4	Short term borrowings		
	Current maturities of long-term debt- loan Instalment repayable within one year		2,00,000
5	Short-term provisions		
	Provision for taxation		8,16,900
6	Property, plant and equipment		
	Land		14,00,000
	Buildings	28,00,000	
	Less: Depreciation	(7,50,000) (b.f.)	20,50,000
	Plant & Machinery	49,00,000	
	Less: Depreciation	(12,25,000) (b.f.)	36,75,000
	Furniture & Fittings	4,37,500	
	Less: Depreciation	(87,500) (b.f.)	3,50,000
	Total		74,75,000
7	Inventories		
	Raw Material		3,50,000
	Finished goods		14,00,000
8	Trade receivables		17,50,000
	Debts outstanding for a periodexceed-ing six months		3,80,000
	Other Debts		10,20,000
	Total		14,00,000
9	Cash and bank balances Cash and cash equivalents		
	Cash at bank with Scheduled Banks	12,11,000	
	with others	18,000	12,29,000
	Cash in hand		2,10,000
	Other bank balances	5,00,000	
	Bank deposits for period of 9 months		5,00,000
	Total		19,39,000

Question 25

From the following particulars furnished by Alpha Ltd., prepare the Balance Sheet as on 31st March20X1

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as required by Part I, Schedule III to the Companies Act, 2013.

Particulars		Debit Rs.	Credit Rs.
Equity Share Capital (Face value of Rs. 100each)			50,00,000
Call in Arrears		5,000	
Land & Building		27,50,000	
Plant & Machinery		26,25,000	
Furniture		2,50,000	
General Reserve			10,50,000
Loan from State Financial Corporation			7,50,000
Inventory: Raw Materials Finished Goods	 2,50,000 10,00,000	12,50,000	
Provision for Taxation			6,40,000
Trade receivables		10,00,000	
Short term Advances		2,13,500	
Profit & Loss Account			4,33,500
Cash in Hand		1,50,000	
Cash at Bank		12,35,000	
Unsecured Loan			6,05,000
Trade payables (for Goods and Expenses)			8,00,000
Loans & advances from related parties			2,00,000
		94,78,500	94,78,500

The following additional information is also **provided:10,000 Equity shares were issued for consideration other than cash.**

(i) **Trade receivables of Rs. 2,60,000 are due for more than 6 months**.

The cost of the Assets **were:**

(ii) Building Rs. 30,00,000, Plant & Machinery Rs. 35,00,000 and Furniture Rs. **3,12,500**

(iii) **The balance of Rs. 7,50,000 in the Loan Account with State Finance Corporation is inclusive of Rs. 37,500 for Interest Accrued but not Due. The loan is secured by hypothecation of Plant & Machinery.**

(iv) **Balance at Bank includes Rs. 10,000 with Omega Bank Ltd., which is not a Scheduled-Bank.**

(v) **Transfer Rs. 20,000 to general reserve is proposed by Board of directors.**

Board of directors declared dividend of 5% on the paid up capital on 2nd April, 20X1.

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Answer 25

Alpha Ltd.

Balance Sheet as at 31st March, 20X1

		Particulars	Notes	Rs.
1		**Equity and Liabilities**		
	a	**Shareholders' funds**	1	49,95,000
	b	Share capital	2	14,83,500
		Reserves and Surplus		
2		**Non-current assets**		
	a	Long-term borrowings	3	13,17,500
3		**Current liabilities**		
	a	Trade Payables		8,00,000
	b	Short term provision	5	6,40,000
	c	Short term borrowings (2,00,000+37,500)	4	2,37,500
		Total		**94,73,500**
1		**Assets**		
		Non-current assets	6	56,25,000
	(a)	PPE		
2		**current assets**	7	12,50,000
	(a)	Inventory	8	10,00,000
	(b)	Trade receivables	9	13,85,000
	(c)	Cash and Cash equivalents		2,13,500
	(d)	Short-term loans and advances		**94,73,500**
		Total		

Notes to accounts

			Rs.
1	Share Capital		
	Equity share capital		

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	Issued & subscribed & called up 50,000 Equity Shares of Rs. 100 each (of the above 10,000 shares have been issued for consideration other than cash)	50,00,000	
	Less: Calls in arrears	(5,000)	49,95,000
	Total		49,95,000
2	**Reserves and Surplus**		
	General Reserve	10,50,000	
	Add: current year transfer	20,000	10,70,000
	Profit & Loss balance		
	Profit for the year	4,33,500	
	Less: Appropriations:		
	Transfer to General reserve	(20,000)	4,13,500
	Total		14,83,500
3	Long-term borrowings		
	Secured Term Loan		
	State Financial Corporation Loan (7,50,000- 37,500) (Secured by hypothecation of Plant andMachinery)		7,12,500
	Unsecured Loan		6,05,000
	Total		13,17,500
4	Short term Borrowings		
	Loans and advances		2,00,000
	Interest accrued but not due on loans (SFC)		37,500
			2,37,500
5	Short-term provisions		
	Provision for taxation		6,40,000
6	Property, plant and equipment		
	Land and Building	30,00,000	
	Less: Depreciation	(2,50,000) (b.f.)	27,50,000

	Plant & Machinery	35,00,000	
	Less: Depreciation	(8,75,000) (b.f.)	26,25,000

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	Furniture & Fittings	3,12,500	
	Less: Depreciation	(62,500) (b.f.)	2,50,000
	Total		56,25,000
7	Inventories		
	Raw Materials		2,50,000
	Finished goods		10,00,000
	Total		12,50,000
8	Trade receivables		
	Outstanding for a period exceeding six months		2,60,000
	Other Amounts		7,40,000
	Total		10,00,000
9	Cash and bank balances		
	Cash and cash equivalentsCash at bank		
	with Scheduled Banks	12,25,000	
	with others (Omega Bank Ltd.)	10,000	12,35,000
	Cash in hand		1,50,000
	Other bank balances		Nil
	Total		13,85,000

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence,it has not been recognized in the financial statements for the year ended 31 March, 20X1. Such dividends will be disclosed in notes only.

Question 26

Ring Ltd. was registered with a nominal capital of Rs. 10,00,000 divided into shares of Rs. 100 each.The following Trial Balance is extracted from the books on 31st March, 20X2:

Particulars	Rs.	Particulars	Rs.
Buildings	**5,80,000**	**Sales**	**10,40,000**
Machinery	**2,00,000**	**Outstanding Expenses**	**4,000**
Closing Stock	**1,80,000**	**Provision for Doubtful**	**6,000**
Loose Tools	**46,000**	**Debts (1-4-20X1)**	
Purchases (finished goods)	**4,20,000**	**Equity Share Capital**	**4,00,000**
Salaries	**1,20,000**	**General Reserve**	**80,000**

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Directors' Fees	20,000	Profit and Loss A/c	50,000
Rent	52,000	(1-4-20X1)	
Depreciation	40,000	Creditors	1,84,000
Bad Debts	12,000	Provision for depreciation:	

Investment	2,40,000	On Building	1,00,000	
Interest accrued on investment	4,000	On Machinery	1,10,000	2,10,000
Debenture Interest	56,000	14% Debentures		4,00,000
Advance Tax	1,20,000	Interest on Debentures		28,000
Sundry expenses	36,000	accrued but not due		
Debtors	2,50,000	Interest on Investments		24,000
Bank	60,000	Unclaimed dividend		10,000
	24,36,000			24,36,000

Answer 26

(a) You are required to prepare statement of Profit and Loss for the year ending 31st March, 20X2 and Balance sheet as at that date after taking into consideration the following **information:**

(b) **Closing stock is more than opening stock by Rs. 1,60,000;**

(c) **Provide to doubtful debts @ 4% on Debtors**

(d) **Make a provision for income tax @30%.**

(e) **Depreciation expense included depreciation of Rs. 16,000 on Building and that of Rs.24,000 on Machinery.**

(f) **The directors declared a dividend @ 25% on 2nd April, 20X2 and transfer to General Reserve @ 10%.**

Bills Discounted but not yet matured Rs. **20,000.**

26 Ring Ltd. Profit and Loss Statement for the year ended31st March, 20X2

	Particulars	Note No.	(Rs. In lacs)
I	**Revenue from operations**		**10,40,000**
II	Other income (interest on investment)		24,000
III	Total income [I + II]		10,64,000
IV	Expenses:		
	Cost of purchase [4,20,000+ 1,60,000]		5,80,000
	Changes in inventories [20,000-1,80,000]		(1,60,000)
	Employee Benefits Expense		1,20,000
	Finance Costs (debenture interest)		56,000

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	Depreciation and Amortisation Expenses		40,000
	Other Expenses	8	1,24,000
	Total Expenses		7,60,000
V	Profit before Tax (III-IV)		3,04,000
VI	Tax Expenses @ 30%		(91,200)
VII	Profit for the period		2,12,800

Balance Sheet of Ring Ltd. as at 31ST March, 20X2

		Particulars	Notes	Rs.
I		**Equity and Liabilities**		
	1	**Shareholders' funds**	1	4,00,000
	a	Share capital	2	3,42,800
	b	Reserves and Surplus		
	2	**Non-current assets**		
	a	Long-term borrowings		4,00,000
	3	**Current liabilities**		
	a	Trade Payables		1,84,00,000
	b	Other Current Liabilities	3	42,000
	c	Short-Term Provisions	4	91,200
		Total		14,60,000
II		**Assets**		
	1	**Non-current assets**		
	a	PPE	5	5,70,000
	b	Non-current Investments		2,40,000
	2	**current assets**		2,26,000
	a	Inventory	6	2,40,000
	b	Trade receivables	7	2,26,000
	c	Cash and bank balances		2,40,000
	d	Short-term loans and Advances(Advance Payment of Tax)		60,000

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	e	Other Current Assets (Interest accrued on investments)		4,000
		Total		14,60,000

Note: There is a Contingent Liability for bills discounted but not yet matured amounting to Rs. 20,000.

Notes to Accounts:

1.	Share Capital		
	Authorised Capital		
	10,000 Equity Shares of Rs. 100 each		10,00,000
	Issued Capital		
	4,000 Equity Shares of Rs. 100 each		4,00,000
	Subscribed Capital and fully paid		
	4,000 Equity Shares of Rs. 100 each		4,00,000
2.	Reserve and Surplus		

	General Reserve [Rs. 80,000 + Rs. 21,280]		1,01,280
	Balance of Statement of Profit & Loss Account		
	Opening Balance	50,000	
	Add: Profit for the period	2,12,800	2,41,520
	Appropriations	2,62,800	
	Transfer to General Reserve @ 10%	(21,280)	
3.	Other Current Liabilities		3,42,800
	Unclaimed Dividend		10,000
	Outstanding Expenses		4,000
	Interest accrued on Debentures		28,000
4.	Short-Term Provision		42,000
	Provision for Tax		91,200
5	Property, plant and equipment		
	Buildings	5,80,000	
	Less: Provision for Depreciation	1,00,000	4,80,000
	Plant and Equipment	2,00,000	
	Less: Provision for Depreciation	1,10,000	90,000
6	Inventories		5,70,000
	Closing Stock of Finished Goods	1,80,000	
	Loose Tools	46,000	2,26,000
7	Trade Receivables		

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	Sundry Debtors	2,50,000	
	Less: Provision for Doubtful Debts	(10,000)	2,40,000
8.	Other Expenses		
	Rent		52,000
	Directors' Fees		20,000
	Bad Debts		12,000
	Provision for Doubtful Debts (4% of Rs. 2,50,000 lessRs. 6,000)		4,000
	Sundry Expenses		36,000
			1,24,000

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X2. Such dividends will be disclosed in notes only.

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Question 27

On 31st March, 20X1, SR Ltd. provides the following ledger balances after preparing its Profit & Loss Account for the year ended 31st March, 20X1.

	Debit	Credit
Equity Share Capital, fully paid shares of Rs. 50 each		80,00,000
Calls in arrear	15,000	
Land	25,00,000	
Buildings	30,00,000	
Plant & Machinery	24,00,000	
Furniture & Fixture	13,00,000	
Securities Premium		15,00,000
General Reserve		9,41,000
Profit & Loss Account		5,80,000
Loan from Public Finance Corporation (Secured byHy-pothecation of Land)		26,30,000
Other Long Term Loans		22,50,000
Short Term Borrowings		4,60,000
Inventories: Finished goods	45,00,000	
Raw materials	13,00,000	
Trade Receivables	17,50,000	
Advances: Short Term	3,75,000	
Trade Payables		8,13,000
Provision for Taxation		3,80,000
Unpaid Dividend		70,000
Cash in Hand	70,000	
Balances with Banks	4,14,000	
Total	1,76,24,000	1,76,24,000

(1) The following additional information was also provided in respect of the above **balanc-es:50,000 fully paid equity shares were allotted as consideration for land.**

(2) **The cost of assets were:**

Building	Rs. 32,00,000
Plant and Machinery	Rs. 30,00,000
Furniture and Fixture	Rs. 16,50,000

(3) **Trade Receivables for Rs. 4,86,000 due for more than 6 months.**

(4) **Balances with banks include Rs. 56,000, the Naya bank, which is not a scheduled bank.**

(5) **Loan from Public Finance Corporation repayable after 3 years.**

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(6) **The balance of Rs. 26,30,000 in the loan account with Public Finance Corporation is inclusive of Rs.1,34,000 for interest accrued but not due. The loan is secured by hypothecation of land.**

(7) **Other long term loans (unsecured) includes:**

Loan taken from Nixes Bank	**Rs. 13,80,000**
(Amount repayable within one year	**Rs. 4,80,000)**
Loan taken from Directors	**Rs. 8,50,000**

(8) **Bills Receivable for Rs. 1,60,000 maturing on 15th June, 20X1 has been discounted.**

(9) **Short term borrowings includes:**

Loan from Naya bank	**Rs. 1,16,000 (Secured)**
Loan from directors	**Rs. 48,000**

(10) **Transfer of Rs. 35,000 to general reserve has been proposed by the Board of directors out of the profits for the year.**

Inventory of finished goods includes loose tools costing Rs. 5 lakhs (which do not meet definition of property, plant & equipment as per **AS 10)**

You are required to prepare the Balance Sheet of the Company as on March 31st 20X1 as required under Part - I of Schedule III of the Companies Act, 2013. You are not required to give previous year figures.

Answer 27

SR Ltd.

Balance Sheet as at 31st March, 20X1

Particulars		Notes	Figures at the end of current reporting period (Rs.)
Equity and Liabilities			
1	Shareholders' funds		
a	Share capital	1	79,85,000
b	Reserves and Surplus	2	30,21,000
2	Non-current liabilities		
a	Long-term borrowings	3	42,66,000
3	Current liabilities		
a	Short-term borrowings	4	9,40,000
b	Trade Payables		8,13,000
c	Other current liabilities	5	2,04,000
d	Short-term provisions	6	3,80,000
	Total		1,76,09,000
Assets			

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1	Non-current assets		
a	PPE	7	92,00,000
2	Current assets		
a	Inventories	8	58,00,000
b	Trade receivables	9	17,50,000
c	Cash and cash equivalents	10	4,84,000
d	Short-term loans andad-vances		3,75,000
	Total		1,76,09,000

Notes to accounts

			Rs.
1.	**Share Capital**		
	Equity share capital Issued, subscribed and called up 1,60,000 Equity Shares of Rs. 50 each (Outof the above 50,000 shares have been issued for con-sideration other than cash)	80,00,000	
	Less: Calls in arrears	(15,000)	79,85,000
2.	**Reserves and Surplus**		
	General Reserve	9,41,000	
	Add: Transferred from Profit and lossAccount	35,000	9,76,000
	Securities premium		15,00,000
	Surplus (Profit & Loss A/c)	5,80,000	
	Less: Appropriation to General Reserve (proposed)	(35,000)	5,45,000
			30,21,000
3.	**Long-term borrowings**		
	Secured: Term Loans		
	Loan from Public Finance Corporation [repayable after 3years (Rs. 26,30,000 - Rs. 1,34,000 for interest accrued but not due)] (secured by hypothecation of land)		24,96,000

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	Unsecured			
	Bank Loan (Nixes bank)	9,00,000		
	(Rs. 13,80,000 - Rs. 4,80,000 repayable within 1year)			
	Loan from Directors	8,50,000		
	Others	20,000		17,70,000
	Total			42,66,000
4.	Short-term borrowings			
	Loan from Naya bank (Secured)		1,16,000	
	Loan from Nixes bank repayable within one year (Current maturity of Long term borrowing)		4,80,000	
	Loan from Directors		48,000	
	Others		2,96,000	9,40,000
5.	Other current liabilities			
	Unpaid dividend		70,000	
	Interest accrued but not borrowings Due on		1,34,000	2,04,000

6.	Short-term provisions		
	Provision for taxation		3,80,000
7.	PPE		
	Land		25,00,000
	Buildings	32,00,000	
	Less: Depreciation	(2,00,000)	30,00,000
	Plant & Machinery	30,00,000	
	Less: Depreciation	(6,00,000)	24,00,000
	Furniture & Fittings	16,50,000	
	Less: Depreciation	(3,50,000)	13,00,000
	Total		92,00,000
8.	**Inventories**		
	Raw Material	13,00,000	
	Finished goods	40,00,000	
	Loose tools	5,00,000	58,00,000
9.	Trade receivables		

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	Outstanding for a period exceeding six months		4,86,000
	Others		12,64,000
	Total		17,50,000
10.	Cash and cash equivalents		
	Balances with banks		
	with Scheduled bank	3,58,000	
	with others banks	56,000	4,14,000
	Cash in hand		70,000
	Total		4,84,000

=Note: There is a contingent liability amounting to Rs. 1,60,000

Question 28(Illustration)

Due to inadequacy of profits during the year ended 31st March, 20X2, XYZ Ltd. proposes to declare10% dividend out of general reserves. From the following particulars, ascertain the amount that canbe utilised from general reserves, according to the Companies (Declaration of dividend out of Reserves) Rules, 2014:

	Rs.
17,500 9% Preference shares of Rs. 100 each, fully paid up	**17,50,000**
8,00,000 Equity shares of Rs. 10 each, fully paid up	**80,00,000**

General Reserves as on 1.4.20X1	**25,00,000**
Capital Reserves as on 1.4.20X1	**3,00,000**
Revaluation Reserves as on 1.4.20X1	**3,50,000**
Net profit for the year ended 31st March, 20X2	**3,00,000**
Average rate of dividend during the last three years has been 12%.	

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Answer 28

Amount that can be drawn from reserves for 10% dividend		
10% dividend on Rs. 80,00,000		Rs. 8,00,000
Profits available		
Current year profit	3,00,000	
Less: Preference dividend	(1,57,500)	(1,42,500)
Amount which can be utilised from reserves		6,57,500

Question 29(Illustration)

The following is the Trial Balance of Omega Limited as on 31.3.20X2:

(Figures inRs. '000)

	Debit		Credit
Land at cost	**220**	**Equity Capital (Shares of Rs. 10 each)**	**300**
Plant & Machinery at cost	**770**	**10% Debentures**	**200**
Trade Receivables	**96**	**General Reserve**	**130**
Inventories (31.3.X2)	**86**	**Profit & Loss A/c**	**72**
Bank	**20**	**Securities Premium**	**40**
Adjusted Purchases	**320**	**Sales**	**700**
Factory Expenses	**60**	**Trade Payables**	**52**
Administration Expenses	**30**	**Provision for Depreciation**	**172**
Selling Expenses	**30**	**Suspense Account**	**4**
Debenture Interest	**20**		
Interim Dividend Paid	**18**		
	1670		**1670**

Additional Information:

(i) **The authorised share capital of the company is 40,000 shares of Rs. 10 each.**

(ii) **The company on the advice of independent valuer wish to revalue the land at Rs. 3,60,000.**

(iii) **Declared final dividend @ 10% on 2nd April, 20X2.**

(iv) **Suspense account of Rs. 4,000 represents cash received for the sale of some of the machineryon 1.4.20X1. The cost of the machinery was Rs. 10,000 and the accumulated depreciation thereon being Rs. 8,000.**

(v) **Depreciation is to be provided on plant and machinery at 10% on cost.**

You are required to prepare Omega Limited's Balance Sheet as on 31.3.20X2 and Statementof Profit and Loss with notes to accounts for the year ended 31.3.20X2 as per Schedule III. Ignore previous years' figures & taxation.

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Answer 29

Omega Limited

Balance Sheet as at 31st March, 20X2

Particulars			Note No.	(Rs. in 000)
Equity and Liabilities				
1.	**Shareholders' funds**			
	a	Share capital	1	300
	b	Reserves and Surplus	2	530
2.	**Non-Current liabilities**			
	a	Long term borrowings	3	200
3.	**Current liabilities**			
	a	Trade Payables		52
		Total		**1082**
Assets				
1.	**Non-current assets**			
	A	PPE (Property, Plant & Equipment)	4	880
2.	**Current assets**			
	A	Inventories		86
	B	Trade receivables		96
	C	Cash and bank balances		20
		Total		**1082**

Omega Limited

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

	Particulars	Notes	(Rs. in 000)
I.	Revenue from operations		700
II.	Other Income	5	2
III	**Total Income**		**702**
IV	Expenses:		
	Purchases		320
	Finance costs	6	20
	Depreciation (10% of 760*)		76
	Other expenses	7	120
	Total Expenses		**536**
V.	**Profit (Loss) for the period** (III – IV)		**166**

Notes to accounts

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				(Rs. in 000)
1.	**Share Capital**			
	Equity share capital			
	Authorised			
	40,000 shares of Rs.10 each			400
	Issued & subscribed & called up			
	30,000 shares of Rs.10 each			300
2.	**Reserves and Surplus**			
	Securities Premium Account			40
	Revaluation reserve (360 – 220)			140
	General reserve			130
	Profit & loss Balance			
	Opening balance	72		
	Profit for the period	166	238	
	Less: Appropriations			
	Interim Dividend		(18)	220
				530
3.	**Long term borrowing**			
	10% Debentures			200
4.	**PPE**			
	Land			
	Opening balance		220	
	Add: Revaluation adjustment		140	
	Closing balance			360
	Plant and Machinery			
	Opening balance		770	
	Less: Disposed off		(10)	
			760	
	Less: Depreciation (172-8+76)		(240)	
	Closing balance			520
	Total			880
5.	**Other Income**			
	Profit on sale of machinery:			
	Sale value of machinery		4	

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	Less: Book value of machinery (10-8)	(2)	2
6.	**Finance costs**		
	Debenture interest		20
7.	**Other expenses:**		
	Factory expenses	60	
	Selling expenses	30	
	Administrative expenses	30	120

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized inthe financial statements for the year ended 31 March, 20X2. Such dividends willbe disclosed in notes only.*770 (Plant and machinery at cost) – 10 (Cost of plant and machinery sold)

Question 30 (Illustration)

You are required to prepare Balance sheet and statement of Profit and Loss from the following trial balance of Haria Chemicals Ltd. for the year ended 31st March, 20X1.

Haria Chemicals Ltd. Trial Balance as at 31st March, 20X1

Particulars	Rs.	Particulars	Rs.
Inventory	6,80,000	Equity Shares	
Furniture	2,00,000	Capital (Shares of Rs. 10 each)	25,00,000
Discount	40,000	11% Debentures	5,00,000
Loan to Directors	80,000	Bank loans	6,45,000
Advertisement	20,000	Trade payables	2,81,000
Bad debts	35,000	Sales	42,68,000
Commission	1,20,000	Rent received	46,000
Materials consumed	23,19,000	Transfer fees	10,000
Plant and Machinery	8,60,000	Profit & Loss account	1,39,000
Rentals	25,000	Depreciation provision:	
Current account	45,000	Machinery	1,46,000
Cash	8,000		
Interest on bank loans	1,16,000		
Preliminary expenses	10,000		
Fixtures	3,00,000		
Wages	9,00,000		
Consumables	84,000		
Freehold land	15,46,000		
Tools & Equipment	2,45,000		

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Goodwill	**2,65,000**		
Trade receivables	**4,40,000**		
Dealer aids	**21,000**		
Transit insurance	**30,000**		
Trade expenses	**37,000**		
Distribution freight	**54,000**		
Debenture interest	**55,000**		
	85,35,000		**85,35,000**

Additional information: Closing Inventory on 31-3-20X1: Rs. 8,23,000.

Answer 30

Haria Chemicals Ltd. Balance Sheet as at 31st arch, 20X1

	ScheduleNo.(1)	***Rupees as at the end of 31st March 20X1(2)***
Equity and Liabilities		
1) Shareholders' funds :		
(a) Share Capital	1	25,00,000
(b) Reserves and Surplus	2	7,40,000
(2) Non Current Liabilities		
(a) Long term borrowings	3	11,45,000
(3) Current Liabilities		
(a) Trade payables		2,81,000
Total		**46,66,000**

(1) AssetsNon current assets

(a) PPE	4	30,05,000
(b) Intangible assets (goodwill)		2,65,000
(2) Current assets		
(a) Inventories		8,23,000
(b) Trade receivables		4,40,000
(c) Cash and bank balances	5	53,000
(d) Short term loans and advances	6	80,000
Total		**46,66,000**

Haria Chemicals Ltd. Statement of Profit and Loss for the year ended 31st March, 20X1

		Schedule	**Figures**
Revenue from operations			42,68,000

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Other income		7	56,000	
	(A)		43,24,000	
Expenses				
Cost of materials consumed			23,19,000	
Change in inventory of finished goods		8	(1,43,000)	
Employee benefit expenses		9	9,00,000	
Finance cost		10	1,71,000	
Other expenses		11	4,76,000	
	(B)		37,23,000	
Profit before tax (A – B)				6,01,000
Provision for tax				—
Profit for the period				6,01,000
Notes to Accounts				
1. Share capital				**Rs.**
Authorised:				

Equity share capital of Rs.10 each			25,00,000
Issued and Subscribed:			
Equity share capital of Rs.10 each			25,00,000
2. Reserves and Surplus			
Balance as per last balance sheet			1,39,000
Balance in profit and loss account			6,01,000
			7,40,000
3. Long term Borrowings			
11% Debentures	5,00,000		
Bank loans (assumed long-term)			6,45,000
4. PPE			11,45,000
	Gross block	**Depreciation**	**Net Block**
Freehold land	15,46,000		15,46,000
Furniture	2,00,000		2,00,000
Fixtures	3,00,000		3,00,000
Plant & Machinery	8,60,000	1,46,000	7,14,000
Tools & Equipment	2,45,000		2,45,000

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Total	31,51,000	1,46,000	30,05,000
5. Cash and bank balances			
Cash and cash equivalents			45,000
Current account balance			8,000
Cash			Nil
Other bank balances			53,00 0
6. Short-term loans and Advances			
Loan to directors			80,000
7. Other Income			
Rent received			46,000
Transfer fees			10,000
8. Changes in inventory of finished goods, WIP & Stock in trade			56,000
Opening inventory	6,80,000		
Closing inventory	(8,23,000)		(1,43,000)
9. Employee benefit expense			
Wages			9,00,000
10. Finance cost			

Interest on bank loans	1,16,000
Debenture interest	55,000
	1,71,000
11. Other Expenses	
Consumables	84,000
Preliminary expenses	10,000
Bad debts	35,000
Discount	40,000
Rentals	25,000
Commission	1,20,000
Advertisement	20,000
Dealers' aids	21,000
Transit insurance	30,000
Trade expenses	37,000
Distribution freight	54,000
	4,76,000

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You are required to prepare a Statement of Profit and Loss and Balance Sheet fromthe followingTrial Balance extracted from the books of the International Hotels Ltd.,on 31st March, 20X2:

	Dr.Rs.	Cr.Rs.
Authorised Capital-divided into 5,000 6% Preference Sharesof Rs. 100 each and 10,000 equity Shares of Rs. 100 each	15,00,000	
Subscribed Capital -		
5,000 6% Preference Shares of Rs. 100 each	5,00,000	
Equity Capital	8,05,000	
Purchases - Wines, Cigarettes, Cigars, etc.	45,800	
- Foodstuffs	36,200	
Wages and Salaries	28,300	
Rent, Rates and Taxes	8,900	
Laundry	750	
Sales - Wines, Cigarettes, Cigars, etc.		68,400
- Food		57,600
Coal and Firewood	3,290	
Carriage and Cooliage	810	
Sundry Expenses	5,840	
Advertising	8,360	
Repairs	4,250	
Rent of Rooms		48,000
Billiard		5,700
Miscellaneous Receipts		2,800
Discount received		3,300
Transfer fees		700
Freehold Land and Building	8,50,000	
Furniture and Fittings	86,300	
Inventory on hand, 1st April, 20X1Wines, Cigarettes. Cigars, etc.	12,800	
Foodstuffs	5,260	
Cash in hand	2,200	
Cash with Bankers	76,380	

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Preliminary and formation expenses		8,000	
2,000 Debentures of Rs. 100 each (6%)			2,00,000
Profit and Loss Account			41,500
Trade payables			42,000
Trade receivables		19,260	
Investments		2,72,300	
Goodwill at cost		5,00,000	
General Reserve			2,00,000
		19,75,000	19,75,000
Wages and Salaries Outstanding	1,280		
Inventory on 31st March, 20X2			
Wines, Cigarettes and Cigars, etc.	22,500		
Foodstuffs	16,400		

Depreciation : Furniture and Fittings @ 5% p.a. : Land and Building @ 2% p.a.

The Equity capital on 1st April, 20X1 stood at Rs. 7,20,000, that is 6,000 shares fully paid and 2,000 shares Rs. 60 paid. The directors made a call of Rs. 40 per share on 1st October 20X1. A shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ Rs. 90 per shareas fully paid. The Directors declared a dividend of 8% on equity shares on 2nd April, 20X2, transferring any amount that may be required from General Reserve. Ignore Taxation.

Answer 31

Balance Sheet of International Hotels Ltd. as at 31st March, 20X2

		Particulars	Note No	Rs.
Equity and Liabilities				
1	**Shareholders' funds**			
	a	Share capital	1	13,00,000
	b	Reserves and Surplus	2	2,68,745
2	**Non-current liabilities**			
	a	Long-term borrowings	3	2,00,000
3	Current liabilities			
	a	Trade Payables	4	42,000
	b	Other current liabilities	5	13,280
		Total		**18,24,025**
ASSETS				
1	**Non-current assets**			

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	i	PPE	6	9,14,985
	ii	Intangible assets (Goodwill)		5,00,000
	iii	Non-current investments		2,72,300
2	**Current assets**			
	i	Inventories	7	38,900
	ii	Trade receivables		19,260
	iii	Cash and bank balances	8	78,580
		Total		**18,24,025**

Statement of Profit and Loss of International Hotels Ltd.for the year ended 31st March,20X2

	Particulars	**Notes**	**Amount**
I.	Revenue from operations	9	1,79,700
II.	Other income	10	6,800
III.	**Total Income (I + II)**		**1,86,500**
IV.	**Expenses:**		
	Cost of materials consumed	11	25,060
	Purchases of Inventory-in-Trade	12	45,800
	Changes in inventories of finished goods work-in-progress and Inventory-in-Trade	13	(9,700)
	Employee benefits expense	14	29,580
	Other operating expenses	15	18,000
	Selling and administrative expenses	16	14,200
	Finance costs	17	12,000
	Depreciation and amortisation expense	18	21,315
	Other expenses (Preliminary expenses written off)		8,000
	Total expenses		**1,64,255**
V.	**Profit (Loss) for the period (III - IV)**		**22,245**

Notes to accounts

			Rs.
1	**Share Capital**		
	Equity share capital		
	Authorised		
	10,000 Equity shares of Rs.100 each		10,00,000
	Issued & subscribed		
	8,000 Equity Shares of Rs.100 each (A)		8,00,000

	Preference share capital		

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	Authorised		
	5,000 6% Preference shares of Rs.100 each		5,00,000
	Issued & subscribed		
	5,000 6% Preference shares of Rs.100 each	(B)	5,00,000
	Total (A + B)		**13,00,000**
2	**Reserves and Surplus**		
	Capital reserve [100 x (90 – 40)]		5,000
	General reserve	2,00,000	
			2,00,000
	Surplus (Profit & Loss A/c)	22,245	
	Add: Balance from previous year	41,500	
			63,745
	Total		**2,68,745**
3	**Long-term borrowings**		
	Secured		
	6% Debentures		2,00,000
	Total		**2,00,000**
4	**Trade Payables**		42,000
5	**Other current liabilities**		
	Wages and Salaries Outstanding	1,280	
	Interest on debentures	12,000	13,280
	Total		**13,280**
6	**PPE**		
	Freehold land & Buildings	8,50,000	
	Less: Depreciation	(17,000)	8,33,000
	Furniture and Fittings	86,300	
	Less: Depreciation	(4,315)	81,985
	Total		**9,14,985**
7	**Inventories**		
	Wines, Cigarettes & Cigars, etc.		22,500
	Foodstuffs		16,400
	Total		**38,900**
8	**Cash and bank balances**		
	Cash and cash equivalents		
	Cash at bank		76,380

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	Cash in hand		2,200
	Other bank balances		Nil
	Total		**78,580**
9	**Revenue from operations**		
	Sale of products		
	Wines, Cigarettes, Cigars etc.	68,400	1,26,000
	Food	57,600	
	Sale of services		
	Room Rent	48,000	
	Billiards	5,700	53,700
	Total		**1,79,700**
10	**Other Income**		
	Transfer fees	700	
	Miscellaneous Receipts	2,800	
	Discount received	3,300	
	Total		**6,800**
11	**Cost of materials consumed**		
	Opening Inventory	5,260	
	Add: Purchases during the year	36,200	
	Less: Closing Inventory	(16,400)	25,060
	Total		**25,060**
12	**Purchases of Inventory-in-Trade**		
	Wines, Cigarettes etc.		45,800
	Total		**45,800**
13	**Changes in inventories of finished goodswork-in-progress and Inventory-in-Trade**		
	Wines, Cigarettes etc.		
	Opening Inventory	12,800	(9,700)
	Less: Closing Inventory	(22,500)	
	Total		**(9,700)**
14	**Employee benefits expense**		
	Wages and Salaries	28,300	
	Add: Wages and Salaries Outstanding	1,280	29,580

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	Total		**29,580**
15	**Other operating expenses**		
	Rent, Rates and Taxes		8,900
	Coal and Firewood		3,290
	Laundry		750
	Carriage and Cooliage		810
	Repairs		4,250
	Total		**18,000**
16	**Selling and administrative expenses**		
	Advertising		8,360
	Sundry Expenses		5,840
	Total		**14,200**

17	**Finance costs**		
	Interest on Debentures (2,00,000 x 6%)		12,000
	Total		**12,000**
18	**Depreciation and amortisation expense**		
	Land and Buildings (8,50,000 x 2%)	17,000	
	Furniture & Fittings (86,300 x 5%)	4,315	21,315
	Total		**21,315**

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized inthe financial statements for the year ended 31 March, 20X2. Such dividends willbe disclosed in notes only.

Question 32(Illustration)

From the following particulars furnished by Pioneer Ltd., prepare the Balance Sheet as at 31st March, 20X1 as required by Schedule III of the Companies Act. Give notesat the foot of the Balance Sheet as may be found necessary -

		Debit Rs.	Credit Rs.
Equity Capital (Face value of Rs. 100)			**10,00,000**
Calls in Arrears		**1,000**	
Land		**2,00,000**	
Building		**3,50,000**	
Plant and Machinery		**5,25,000**	
Furniture		**50,000**	

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General Reserve			2,10,000
Loan from State Financial Corporation			1,50,000
Inventory :			
Finished Goods	2,00,000		
Raw Materials	50,000	2,50,000	
Provision for Taxation			68,000
Trade receivables		2,00,000	
Advances		42,700	
Dividend Payable			60,000

Profit and Loss Account		86,700
Cash Balance	30,000	
Cash at Bank	2,47,000	
Loans (Unsecured)		1,21,000
Trade payables (For Goods and Expenses)		2,00,000
	18,95,700	18,95,700
The following additional information is also provided :		

2,000 equity shares were issued for consideration other than cash.

(1) Trade receivables of Rs. 52,000 are due for more than six months.

(2) The cost of assets:

Building	Rs. 4,00,000
Plant and Machinery	Rs. 7,00,000
Furniture	Rs. 62,500

(3) The balance of Rs. 1,50,000 in the loan account with State Finance Corporationis inclusive of Rs. 7,500 for interest accrued but not due. The loan is secured by hypothecation of the Plant and Machinery.

(4) Balance at Bank includes Rs. 2,000 with Perfect Bank Ltd., which is not a Scheduled Bank.

(5) The company had contract for the erection of machinery at Rs. 1,50,000 which is still incomplete.

Answer 32

Pioneer Ltd. Balance Sheet as at 31st March, 20X1

	Particulars	Notes	Rs.
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	9,99,000

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b	Reserves and Surplus	2	2,96,700
2	**Non-current liabilities**		
a	Long-term borrowings	3	2,63,500
3	**Current liabilities**		
a	Trade Payables		2,00,000
b	Other current liabilities	4	67,500
c	Short-term provisions	5	68,000
	Total		**18,94,700**
	Assets		
1	**Non-current assets**		
a	PPE	6	11,25,000
2	**Current assets**		
a	Inventories	7	2,50,000
b	Trade receivables	8	2,00,000
c	Cash and bank balances	9	2,77,000
d	Short-term loans and advances		42,700
	Total		**18,94,700**

Notes to accounts

			Rs.
1	**Share Capital**		
	Equity share capital		
	Issued & subscribed & called up		
	10,000 Equity Shares of Rs. 100 each (Of theabove 2,000 shares have been issued for consideration other than cash)	10,00,000	9,99,000
	Less: Calls in arrears	(1,000)	
	Total		**9,99,000**
2	**Reserves and Surplus**		

	General Reserve		2,10,000
	Surplus (Profit & Loss A/c)		86,700
	Total		**2,96,700**
3	**Long-term borrowings**		
	Secured		
	Term Loans		

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	Loan from State Financial Corporation(1,50,000 – 7,500) (Secured by hypothecation of Plant andMa-chinery)		1,42,500
	Unsecured loan		1,21,000
	Total		**2,63,500**
4	**Other current liabilities**		
	Interest accrued but not due on loans (SFC)		7,500
	Dividend Payable		60,000
	Total		**67,500**
5	**Short-term provisions**		
	Provision for taxation		68,000
	Total		**68,000**
6	**PPE**		
	Land		2,00,000
	Buildings	4,00,000	
	Less: Depreciation	(50,000) (b.f.)	3,50,000
	Plant & Machinery	7,00,000	
	Less: Depreciation	(1,75,000) (b.f.)	5,25,000
	Furniture & Fittings	62,500	
	Less: Depreciation	(12,500) (b.f.)	50,000
	Total		**11,25,000**
7	**Inventories**		
	Raw Material		50,000
	Finished goods		2,00,000
	Total		**2,50,000**
8	**Trade receivables**		
	Debts outstanding for a period exceeding sixmonths		52,000
	Other Debts		1,48,000
	Total		**2,00,000**
9	**Cash and bank balances** Cash and cash equivalents		
	Cash at bank		
	with Scheduled Banks	2,45,000	
	with others (Perfect Bank Ltd.)	2,000	2,47,000
	Cash in hand		30,000

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	Other bank balances		Nil
	Total		**2,77,000**

Note: Estimated amount of contract remaining to be executed on capital account and not provided for Rs. 1,50,000. It has been assumed that the company had given this contract for purchase of machinery.

Question 33(Illustration)

Following is the trial balance of Delta limited as on 31.3.20X2.

(Figures in Rs. '000)

Particulars	Debit	Particulars	Credit
Land at cost	800	Equity share capital (shares of Rs. 10 each)	500
Calls in arrears	5	10% Debentures	300
Cash in hand	2	General reserve	150
Plant & Machinery at cost	824	Profit & Loss A/c (balance on 1.4.X1)	75
Trade receivables	120	Securities premium	40
Inventories (31-3-X2)	96	Sales	1200
Cash at Bank	28	Trade payables	30
Adjusted Purchases	400	Provision for depreciation	150
Factory expenses	80	Suspense Account	10
Administrative expenses	45		
Selling expenses	25		
Debenture Interest	30		
	2455		2455

Additional Information:

(i) The authorized share capital of the company is 80,000 shares of Rs. 10 each.

(ii) The company revalued the land at Rs. 9,60,000.

(iii) Equity share capital includes shares of Rs. 50,000 issued for consideration other than cash.

(iv) Suspense account of Rs. 10,000 represents cash received from the sale of some of the machinery on 1.4.20X1. The cost of the machinery was Rs. 24,000 and the accumulated depreciation thereon being Rs. 20,000. The balance of Plant & Machinery given in trial balance is before adjustment of sale of machinery.

(v) Depreciation is to be provided on plant and machinery at 10% on cost.

(vi) Balance at bank includes Rs. 5,000 with ABC Bank Ltd., which is not a Scheduled Bank.

(vii) Make provision for income tax @30%.

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(viii) Trade receivables of Rs. 50,000 are due for more than six months.

You are required to prepare Delta Limited's Balance Sheet as at 31.3.20X2 and Statement of Profit andLoss with notes to accounts for the year ended 31.3.20X2 as per Schedule III. Ignore previous year's figures & taxation.

Answer 33

Delta Limited
Balance Sheet as at 31st March 20X2

Particulars	Note No.	(Rs. in '000)
A. **Equity and Liabilities**		
1. **Shareholders' funds**		
(a) Share Capital		
(b) Reserves and Surplus	1	495.00
2. **Non-Current Liabilities**	2	807.20
(a) Long Term Borrowings		
3. **Current Liabilities**	3	300.00
(a) Trade Payables		
(b) Short- term provision		30.00
Total	4	163.80
B. **Assets**		1,796.00
1. **Non-Current Assets**		
(a) Property, Plant and Equipment	5	1,550.00
2. **Current Assets**		
(a) Inventories		96.00
(b) Trade Receivables	6	120.00
(c) Cash and Cash equivalents	7	30.00
Total		1,796.00

Statement of Profit and Loss for the year ended 31st March 20X2

Particulars	Note No.	(Rs. in '000)
I. Revenue from Operations		1200.00
II. Other Income	8	6.00
III. Total Income (I +II)		1,206.00
IV. Expenses:		
Purchases (adjusted)		400.00
Finance Costs	9	30.00

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Depreciation (10% of 800)		80.00
Other expenses	10	150.00
Total Expenses		660.00
V.Profit / (Loss) for the period beforetax (III –IV)		546.00
VI. Tax expenses @30%		163.80
VII Profit for the period		382.20

Notes to Accounts

	Particulars		(Rs.in '000)
1	Share Capital Equity Share CapitalAuthorised		
	80,000 Shares of Rs. 10/- each Issued,		800
		500	

	Subscribed and Called-up 50,000 Shares of Rs. 10/- each	(5)	495
2	(Out of the above 5,000 shares have been issued for consideration other than cash)		
			40.00
	Less: Calls in arrears Reserves andSur-plus Securities Premium		160.00
			150.00
	Revaluation Reserve Rs. (960 – 800) GeneralRe-serve	75.00	
	Surplus i.e. Profit & Loss AccountBal-ance	382.20	457.20
	Opening Balance Add: Profit for the period		807.20

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3	Long-Term Borrowings 10%Debentures		
	Short – term provisionPro-		300
4.	vision for tax		
	Property, plant & equipment LandOpen-		163.80
5	ing Balance		
	Add: Revaluation adjustment ClosingBalance	800	
	Plant and Machinery	160	
	Opening BalanceLess:		960
	Disposed off	824	
	Less: Depreciation Rs. (150 – 20 + 80)Clos-	(24)	
	ing Balance	800	
	Total	(210)	
	Trade receivables		590
	Debits outstanding for a periodex-		1,550
6	ceeding six months		
	Other debts	50	
	Cash and Cash Equivalents	70	120
7	Cash at Bank With scheduled banks Withoth-		
	ers (ABC Bank Limited) Cash in hand	23	
	Other Income	5	
	Profit on sale of machinery Salevalue	2	30
8	of machinery		
	Less: Book value of machinery (24– 20)Fi-	10	
	nance Costs	(4)	6
	Debenture Interest		
9			30
10	Other Expenses: Factoryex-		
	penses Selling expenses	80	
	Administrative expenses	25	
		45	150

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Chapter 11.2

Cash Flow Statement

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.10 TO Q.34											
Past Exams	NO	NO	Q.9	NO	NO	Q.3	NO	NO	NO	NO	NO	NO
MTP	NO	NO	NO	Q.1	NO	NO	NO	Q.3	NO	Q.1	Q.2 Q.3	Q.3
RTP	NO	Q.2	Q.1	Q.5	Q.3	NO	Q.4	Q.6	Q.7	Q.2	Q.8	NO

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Chapter 11.2

Cash Flow Statement

Question 1

J Ltd. presents you the following information for the year ended 31st March, 2019:

		(Rs. in lacs)
(i)	Net profit before tax provision	36,000
(ii)	Dividend paid	10,202
(iii)	Income-tax paid	5,100
(iv)	Book value of assets sold	222
	Loss on sale of asset	48
(v)	Depreciation debited to P & L account	24,000
(vi)	Capital grant received - amortized to P & L A/c	10
(vii)	Book value of investment sold	33,318
	Profit on sale of investment	120
(viii)	Interest income from investment credited to P & L A/c	3,000
(ix)	Interest expenditure debited to P & L A/c	12,000
(x)	Interest actually paid (Financing activity)	13,042
(xi)	Increase in working capital	67,290
	[Excluding cash and bank balance]	
(xii)	Purchase of Property, Plant & Equipment	22,092
(xiii)	Expenditure on construction work	41,688
(xiv)	Grant received for capital projects	18
(xv)	Long term borrowings from banks	55,866
(xvi)	Provision for Income-tax debited to P & L A/c	6,000
	Cash and bank balance on 1.4.2018	6,000
	Cash and bank balance on 31.3.2019	8,000

You are required to prepare a cash flow statement as per AS-3 (Revised). (MTP Oct'19 12 Marks, RTP May 19)(Same concept lesser adjustments MTP 12 Marks Oct'22)

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Answer 1

Cash Flow Statement as per AS 3

		Rs. in lacs
Cash flows from operating activities:		36,000
Net profit before tax provision		
Add: Non cash expenditures:		
Depreciation	24,000	
Loss on sale of assets	48	
Interest expenditure (non operating activity)	12,000	36,048
		72,048
Less: Non cash income		
Amortization of capital grant received	(10)	
Profit on sale of investments (non operating income)	(120)	
Interest income from investments (non operating income)	(3,000)	3,130
Operating profit		68,918
Less: Increase in working capital		(67,290)
Cash from operations		1,628
Less: Income tax paid		(5,100)
Net cash generated from operating activities		(3,472)
Cash flows from investing activities:		
Sale of assets (222 . 48)	174	
Sale of investments (33,318+120)	33,438	
Interest income from investments	3,000	
Purchase of Property, Plant & Equipment	(22,092)	
Expenditure on construction work	(41,688)	
Net cash used in investing activities		(27,168)
Cash flows from financing activities:		
Grants for capital projects	18	
Long term borrowings	55,866	
Interest paid	(13,042)	
Dividend paid	(10,202)	
Net cash from financing activities		32,640
Net increase in cash		2,000

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Add: Cash and bank balance as on 1.4.2018		6,000
Cash and bank balance as on 31.3.2019		8,000

Question 2

The Balance Sheet of Harry Ltd. for the year ending 31st March, 2018 and 31st March, 2017 weresummarised as follows:

	2018 (₹)	2017 (₹)
Equity share capital	1,20,000	1,00,000
Reserves:		
Profit and Loss Account	9,000	8,000
Current Liabilities:		
Trade Payables	8,000	5,000
Income tax payable	3,000	2,000
Declared Dividends	4,000	2,000
	1,44,000	**1,17,000**
Property, Plant & Equipment (at W.D.V) :		
Building	19,000	20,000
Furniture & Fixture	34,000	22,000
Cars	25,000	16,000
Long Term Investments	32,000	28,000
Current Assets:		
Inventory	14,000	8,000
Trade Receivables	8,000	6,000
Cash & Bank	12,000	17,000
	1,44,000	**1,17,000**

The Profit and Loss account for the year ended 31st March, 2018 disclosed:

	₹
Profit before tax	8,000
Income Tax	(3,000)
Profit after tax	5,000
Declared Dividends	(4,000)
Retained Profit	1,000

Further Information is available:

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1. **Depreciation on Building ₹ 1,000.**
2. **Depreciation on Furniture & Fixtures for the year ₹ 2,000.**
3. **Depreciation on Cars for the year ₹ 5,000. One car was disposed during the year for ₹ 3,400 whose written down value was ₹ 2,000.**
4. **Purchase investments for ₹ 6,000.**
5. **Sold investments for ₹ 10,000, these investments cost ₹ 2,000.**

6. **You are required to prepare Cash Flow Statement as per AS-3 (revised) using indirect method. (RTP Nov 18) (Same concept fewer adjustments MTP 15 Marks March '23, RTP Nov'22, Old & New SM)**

Answer 2

Harry Ltd.

Cash Flow Statement for the year ended 31st March, 2018

	₹	₹
Cash flows from operating activities		
Net Profit before taxation	8,000	
Adjustments for:		
Depreciation (1,000 + 2,000 +5,000)	8,000	
Profit on sale of Investment	(8,000)	
Profit on sale of car	(1,400)	
Operating profit before working capital changes	6,600	
Increase in Trade receivables	(2,000)	
Increase in inventories	(6,000)	
Increase in Trade payables	3,000	
Cash generated from operations	1,600	
Income taxes paid	(2,000)	
Net cash generated from operating activities (A)		(400)
Cash flows from investing activities		
Sale of car	3,400	
Purchase of car	(16,000)	
Sale of Investment	10,000	
Purchase of Investment	(6,000)	
Purchase of Furniture & fixtures	(14,000)	
Net cash used in investing activities (B)		(22,600)
Cash flows from financing activities		
Issue of shares for cash	20,000	

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Dividends paid*	(2,000)	
Net cash from financing activities(C)		18,000
Net decrease in cash and cash equivalents (A + B +C)		(5,000)
Cash and cash equivalents at beginning of period		17,000
Cash and cash equivalents at end of period		12,000

* Dividend declared for the year ended 31st March, 2017 amounting ₹ 2,000 must have been paid in the year 2017-18. Hence, it has been considered as cash outflow for preparation of cash flow statement of 2017-18.

Working Notes:

1. Calculation of Income taxes paid

	₹
Income tax expense for the year	3,000
Add: Income tax liability at the beginning of the year	2,000
	5,000
Less: Income tax liability at the end of the year	(3,000)
	2,000

2. Calculation of Fixed assets acquisitions

	Furniture & Fixtures (₹)	Car (₹)
W.D.V. at 31.3.2018	34,000	25,000
Add back: Depreciation for the year	2,000	5,000
Disposals	–	2,000
	36,000	32,000
Less: W.D.V. at 31. 3. 2017	(22,000)	(16,000)
Acquisitions during 2016-2018	14,000	16,000

Question 3

The following figures have been extracted from the books of Manan Limited for the year ended on31.3.2022. You are required to prepare the Cash Flow statement as per AS 3 using indirect method.

(i) **Net profit before taking into account income tax and income from law suits but after taking intoaccount the following items was ₹ 30 lakhs:**

(a) **Depreciation on Property, Plant & Equipment ₹ 7.50 lakhs.**

(b) **Discount on issue of Debentures written off ₹ 45,000.**

(c) **Interest on Debentures paid ₹ 5,25,000.**

(d) **Book value of investments ₹ 4.50 lakhs (Sale of Investments for ₹ 4,80,000).**

(e) **Interest received on investments ₹ 90,000.**

(ii) **Compensation received ₹ 1,35,000 by the company in a suit filed.**

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(iii) **Income tax paid during the year ₹ 15,75,000.**

(iv) **22,500, 10% preference shares of ₹ 100 each were redeemed on 02-04-2021 at a premium of 5%.**

(v) **Further the company issued 75,000 equity shares of ₹ 10 each at a premium of 20% on 30.3.2022(Out of 75,000 equity shares, 25,000 equity shares were issued to a supplier of machinery)**

(vi) **Dividend for FY 2020-21 on preference shares were paid at the time of redemption.**

(vii) **Dividend on Equity shares paid on 31.01.2022 for the year 2020-2021 ₹ 7.50 lakhs and interim dividend paid ₹ 2.50 lakhs for the year 2021-2022.**

(viii) **Land was purchased on 02.4.2021 for ₹ 3,00,000 for which the company issued 22,000 equity shares of ₹ 10 each at a premium of 20% to the land owner and balance in cash as consideration.**

(ix) **Current assets and current liabilities in the beginning and at the end of the years were as detailedbelow:**

	As on 01.04.2021	As on 31.3.2022
	₹	₹
Inventory	**18,00,000**	**19,77,000**
Trade receivables	**3,87,000**	**3,79,650**
Cash in hand	**3,94,450**	**16,950**
Trade payables	**3,16,500**	**3,16,950**
Outstanding expenses	**1,12,500**	**1,22,700**

(MTP 10 Marks April 23 & Nov '21 & Sep '23 , PYP 10 Marks Nov '20, RTP May 20)(Similar to Jan'21 but different figures)

Answer 3

Manan Ltd.

Cash Flow Statement

for the year ended 31st March, 2022

	Rs.	Rs.
Cash flow from Operating Activities		
Net profit before income tax and extraordinary items:		30,00,000
Adjustments for:		
Depreciation on Property, plant and equipment	7,50,000	
Discount on issue of debentures	45,000	
Interest on debentures paid	5,25,000	
Interest on investments received	(90,000)	
Profit on sale of investments		12,00,000
Operating profit before working capital changes		42,00,000
Adjustments for:		

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Increase in inventory	(1,77,000)	
Decrease in trade receivable	7,350	
Increase in trade payables	450	
Increase in outstanding expenses	10,200	(1,59,000)
Cash generated from operations		40,41,000
Income tax paid		(15,75,000)
Cash flow from ordinary items		24,66,000
Cash flow from extraordinary items:		
Compensation received in a suit filed		1,35,000
Net cash flow from operating activities		26,01,000
Cash flow from Investing Activities;		
Sale proceeds of investments	4,80,000	
Interest received on investments	90,000	
Purchase of land (3,00,000 less 2,64,000)	36,000	
Net cash flow from investing activities		5,34,000
Cash flow from Financing Activities		
Proceeds of issue of equity shares at 20% premium	6,00,000	
Redemption of preference shares at 5% premium	(23,62,500)	
Preference dividend paid	(2,25,000)	
Interest on debentures paid	(5,25,000)	
Dividend paid (7,50,000 + 2,50,000)	(10,00,000)	
Net cash used in financing activities		(35,12,500)
Net decrease in cash and cash equivalents during the year		(3,77,500)
Add: Cash and cash equivalents as on 31.3.2021		3,94,450
Cash and cash equivalents as on 31.3.2022		16,950

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Question 4

The following are the extracts of Balance Sheet and Statement of Profit and Loss of Supriya Ltd.:

Extract of Balance Sheet

		Particulars	Notes	2021(Rs. '000)	2020(Rs.'000)
		Equity and Liabilities			
1		**Shareholder's funds**			
	(a)	Share capital	1	500	200
2		**Non- current liabilities**			
	(a)	Long term loan from bank		---	250
3		**Current liabilities**			
	(a)	Trade Payables		1,000	3,047
		Assets			
1		**Non-current assets**			
2	(a)	Property, Plant and Equipment		230	128
		Current assets			
	(a)	Trade receivables		2,000	4,783
	(b)	Cash & cash equivalents (Cash balance)		212	35

Extract of Statement of Profit and Loss

	Particulars	Notes	2021 (Rs.'000)	2020 (Rs.'000)
I	Expenses:			
	Employee benefits expense		69	25
	Other expenses	2	115	110
II	Tax expense:			
	Current tax (paid during year)		243	140

Notes to accounts

		2021 (Rs.'000)	2020 (Rs.'000)
1	**Share Capital** Equity Shares of Rs.10 each, fully paid up	500	200
2	**Other expenses** Overheads	115	110

Prepare Cash Flow Statement of Supriya Ltd. for the year ended 31st March, 2021 in accordance with AS-3 (Revised) using direct method. All transactions were done in cash only. There were no outstanding/prepaid expenses as on 31st March, 2020 and on 31st March, 2021. Ignore deprecation. Dividend amounting Rs. 80,000 was paid during the year ended 31st March, 2021. (RTP May '21)

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Answer 4

Supriya Ltd.

Cash Flow Statement for the year ended 31st March, 2021(Using direct method)

		(Rs. '000)
Cash flows from operating activities		
Cash receipts from customers	2,783	
Cash payments to suppliers	(2,047)	
Cash paid to employees	(69)	
Other cash payments (for overheads)	(115)	
Cash generated from operations	552	
Income taxes paid	(243)	
Net cash from operating activities		309
Cash flows from investing activities		
Payments for purchase of Property, Plant and Equipment	(102)	
Net cash used in investing activities		(102)
Cash flows from financing activities		
Proceeds from issuance of share capital	300	
Bank loan repaid	(250)	
Dividend paid	(80)	
Net cash used in financing activities		(30)
Net increase in cash and cash equivalents		177
Cash and cash equivalents at beginning of period		35
Cash and cash equivalents at end of period		212

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Question 5

From the following information, prepare a Cash Flow Statement for the year ended 31 March, 2019.

Balance Sheets

	Particulars	Note	31.03.2019 (₹)	31.03.2018 (₹)
I	EQUITY AND LIABILITES			
	(1) Shareholder's Funds			
	(a) Share Capital	1	3,50,000	3,00,000
	(b) Reserves and Surplus	2	82,000	38,000
	(2) Non-Current Liabilities			
	(3) Current Liabilities			
	(a) Trade Payables		65,000	44,000
	(b) Other Current Liabilities	3	37,000	27,000
	(c) Short term Provisions (provision for tax)	4	32,000	28,000
	Total		5,66,000	4,37,000
	ASSETS			
II	(1) Non-current Assets			
	(a) Tangible Assets		2,66,000	1,90,000
	(b) Intangible Assets (Goodwill)		47,000	60,000
	Non-Current Investments		35,000	10,000
	(2) Current Assets			
	(a) Inventories		78,000	85,000
	(b) Trade Receivables		1,08,000	75,000
	(c) Cash & Cash Equivalents		32,000	17,000
	Total		5,66,000	4,37,000

Note 1: Share Capital

Particulars	**31.03.2019 (₹)**	**31.03.2018 (₹)**
Equity Share Capital	2,50,000	1,50,000
8% Preference Share Capital	1,00,000	1,50,000
Total	3,50,000	3,00,000

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Note 2: Reserves and Surplus

Particulars	31.03.2019 (₹)	31.03.2018 (₹)
General Reserve	30,000	20,000
Profit and Loss A/c	27,000	18,000
Capital Reserve	25,000	
Total	82,000	38,000

Note 3: Current Liabilities

Particulars	31.03.2019(₹)	31.03.2018 (₹)
Dividend declared	37,000	27,000

Note 4: Tangible Assets

Particulars	31.03.2019 (₹)	31.03.2018 (₹)
Land & Building	75,000	1,00,000
Machinery	1,91,000	90,000
Total	2,66,000	1,90,000

Additional Information:

(i) Rs.18,000 depreciation for the year has been written off on plant and machinery and no depreciationhas been charged on Land and Building.

(ii) A piece of land has been sold out for Rs.50,000 and the balance has been revalued, profit on such saleand revaluation being transferred to capital reserve. There is no other entry in Capital Reserve Account.

(iii) A plant was sold for Rs.12,000 WDV being Rs.15,000 on the date of sale (after charging depreciation).

(iv) Dividend received amounted to Rs.2,100 which included pre-acquisition dividend of Rs.600.

(v) An interim dividend of Rs.10,000 including Dividend Distribution Tax has been paid.

(vi) Non-current investments given in the balance sheet represents investment in shares of othercompanies.

(vii) Amount of provision for tax existing on 31 3.2018 was paid during the year 2018 -19. (RTP Nov 19)

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Answer 5

(viii) Cash flow Statement for the year ending 31st March, 2019

		Particulars	₹	₹
1.		**Cash flow from Operating Activities**		
	A.	**Closing balance as per Profit and Loss Account**		27,000
		Less: Opening balance as per Profit and Loss Account		(18,000)
		Add: Dividend declared during the year		37,000
		Add: Interim dividend paid during the year		10,000
		Add: Transfer to reserve		10,000
		Add: Provision for Tax		32,000
	B.	**Net profit before taxation, and extra-ordinary item**		98,000
	C.	**Add: Items to be added**		
		Depreciation	18,000	
		Loss on sale of Plant	3,000	
		Goodwill written off	13,000	34,000
	D.	**Less: Dividend Income**		(1,500)
	E.	Operating profit before working capital changes [B + C - D]		1,30,500
	F.	Add: Decrease in Current Assets and Increase in Current Liabilitie s		
		Decrease in Inventories	7,000	

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		Increase in Trade Payables	21,000	28,000
	G.	Less: Increase in Trade Receivables		(33,000)
	H	Cash generated from operations (E+F-G)		1,25,500
	I	Less: Income taxes paid		(28,000)
	J	Net Cash from (used in) operating activities		97,500
II.		**Cash Flows from investing activities:**		
		Purchase of Plant		(1,34,000)
		Sale of Land		50,000
		Sale of plant		12,000
		Purchase of investments		(25,600)
		Dividend Received		2,100
		Net cash used in investing activities		(95,500)
III.		**Cash Flows from Financing Activities:**		
		Proceeds from issue of equity share capital		1,00,000
		Redemption of preference shares		(50,000)
		Interim Dividend (inclusive of DDT) paid		(10,000)
		Final dividend (inclusive of DDT) paid		(27,000)
		Net cash from financing activities		13,000
IV.		**Net increase in cash and cash equivalents (I+II+III)**		15,000
V.		**Cash and cash equivalents at beginning of period**		17,000
VI.		**Cash and cash equivalents at end of period (IV+V)**		32,000

Land and Building Account

Particulars	₹	Particulars	₹
To Balance b/d	1,00,000	By Bank A/c (Sale)	50,000
To Capital Reserve A/c (Profit on sale/revaluation)	25,000	By Balance c/d	75,000
	1,25,000		1,25,000

Plant and Machinery Account

Particulars	₹	Particulars	₹
To Balance b/d	90,000	By Depreciation A/c	18,000
To Bank A/c (Purchase)	1,34,000	By Bank A/c (sale)	12,000
		By Profit and Loss A/c (Loss onsale)	3,000
		By Balance c/d	1,91,000
	2,24,000		2,24,000

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Investments Account

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Bank A/c (Div. received)	600
To bank A/c (Purchase	25,600	By Balance c/d	35,000
	35,600		35,600

Question 6

A company provides you the following information:

(i) Total sales for the year were Rs. 398 crores out of which cash sales amounted to Rs. 262 crores.

(ii) Receipts from credit customers during the year, aggregated Rs. 134 crores.
Purchases for the year amounted to Rs. 220 crores out of which credit purchase was 80%.
Balance in creditors as on

1.4.2020	**₹ 84 crores**
31.3.2021	**₹ 92 crores**

(iii) Suppliers of other consumables and services were paid Rs. 19 crores in cash.

(iv) Employees of the enterprises were paid 20 crores in cash.

(v) Fully paid preference shares of the face value of Rs. 32 crores were redeemed. Equity shares of the face value of Rs. 20 crores were allotted as fully paid up at premium of 20%.

(vi) Debentures of Rs. 20 crores at a premium of 10% were redeemed. Debenture holders were issuedequity shares in lieu of their debentures.

(vii) Rs. 26 crores were paid by way of income tax.

(viii) A new machinery costing Rs. 25 crores was purchased in part exchange of an old machinery. The book value of the old machinery was Rs. 13 crores. Through the negotiations, the vendor agreed to take over the old machinery at a higher value of Rs. 15 crores. The balance was paid in cash to the vendor.

(ix) Investment costing Rs. 18 cores were sold at a loss of Rs. 2 crores.

(x) Dividends amounting Rs. 15 crores (including dividend distribution tax of Rs. 2.7 crores) was also paid.

(xi) Debenture interest amounting Rs. 2 crore was paid.

(xii) On 31st March 2016, Balance with Bank and Cash on hand was Rs. 2 crores.

On the basis of the above information, you are required to prepare a Cash Flow Statement for the year ended 31st March, 2017 (Using direct method). (RTP May 18) (Same concepts fewer adjustments RTP Nov 21)

Answer 6

Cash flow statement (using direct method) for the year ended 31st March, 2017

	(Rs. in crores)	(Rs. in crores)

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Cash flow from operating activities		
Cash sales	262	
Cash collected from credit customers	134	
Less: Cash paid to suppliers for goods & services and toem-ployees (Refer Working Note)	(251)	
Cash from operations	145	
Less: Income tax paid	(26)	
Net cash generated from operating activities		119
Cash flow from investing activities		
Net Payment for purchase of Machine (25 – 15)	(10)	
Proceeds from sale of investments	16	
Net cash used in investing activities		6
Cash flow from financing activities		
Redemption of Preference shares	(32)	
Proceeds from issue of Equity shares	24	
Debenture interest paid	(2)	
Dividend Paid	(15)	
Net cash used in financing activities		(25)
Net increase in cash and cash equivalents		100
Add: Cash and cash equivalents as on 1.04.2016		2
Cash and cash equivalents as on 31.3.2017		102

Working Note:Calculation of cash paid to suppliers of goods and services and to employees

	(Rs. in crores)
Opening Balance in creditors Account	84
Add: Purchases (220x .8)	176
Total	260
Less: Closing balance in Creditors Account	92
Cash paid to suppliers of goods	168
Add: Cash purchases (220x .2)	44
Total cash paid for purchases to suppliers (a)	212
Add: Cash paid to suppliers of other consumables and services (b)	19
Add: Payment to employees (c)	20
Total cash paid to suppliers of goods & services and to employees [(a)+(b) + (c)]	251

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Question 7

From the following details relating to the accounts of Omega Ltd. prepare Cash Flow Statement forthe year ended 31st March, 2021:

	31.03.2021(₹)	31.03.2020 (₹)
Share Capital	14,00,000	11,20,000
General Reserve	5,60,000	3,50,000
Profit and Loss Account	1,40,000	84,000
Debentures	2,80,000	-
Provision for taxation	1,40,000	98,000
Trade payables	9,80,000	11,48,000
Plant and Machinery	9,80,000	7,00,000
Land and Building	8,40,000	5,60,000
Investments	1,40,000	-
Trade receivables	7,00,000	9,80,000
Inventories	5,60,000	2,80,000
Cash in hand and at Bank	2,80,000	2,80,000

Depreciation @ 20% was charged on the opening value of Plant and Machinery.

(i) **At the year end, one old machine costing 70,000 (WDV 28,000) was sold for ₹ 49,000. Purchase of machinery was also made at the year end.**

(ii) **₹ 70,000 was paid towards Income tax during the year.**

(iii) **Land & Building is not subject to any depreciation. Expenses on renovation of building amount ₹ 2,80,000 were incurred during the year. Prepare Cash Flow Statement. (RTP May '22)**

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Answer 7

Omega Ltd.

Cash Flow Statement for the year ended 31st March, 2021

Cash Flow from Operating Activities		
Increase in balance of Profit and Loss Account	56,000	
Provision for taxation	1,12,000	
Transfer to General Reserve	2,10,000	
Depreciation	1,40,000	
Profit on sale of Plant and Machinery	(21,000)	
Operating Profit before Working Capital changes	4,97,000	
Increase in Inventories	(2,80,000)	
Decrease in Trade receivables	2,80,000	
Decrease in Trade payables	(1,68,000)	
Cash generated from operations	3,29,000	
Income tax paid	(70,000)	
Net Cash from operating activities		2,59,000
Cash Flow from Investing Activities		
Purchase of plant & machinery	(4,48,000)	
Expenses on building	(2,80,000)	
Increase in investments	(1,40,000)	
Sale of old machine	49,000	
Net Cash used in investing activities		(8,19,000)
Cash Flow from Financing activities		
Proceeds from issue of shares	2,80,000	
Proceeds from issue of debentures	2,80,000	
Net cash from financing activities		5,60,000
Net increase in cash or cash equivalents		NIL
Cash and Cash equivalents at the beginning of the year		2,80,000
Cash and Cash equivalents at the end of the year		2,80,000

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Working Notes: Provision for taxation account

		₹			₹
To	Cash (Tax Paid)	70,000	By	Balance b/d	98,000
To	Balance c/d	1,40,000	By	Profit and Loss A/c	1,12,000
				(Balancing figure)	
		2,10,000			2,10,000

Plant and Machinery account

		₹			₹
To	Balance b/d	7,00,000	By	Depreciation	1,40,000
To	Profit and Loss A/c (profit	21,000			
	on sale of machine)				
To	Cash (Balancing figure)	4,48,000	By	Cash (sale of machine)	49,000
		_____	By	Balance c/d	9,80,000
		11,69,000			11,69,000

Question 8

Following is the Balance Sheet of Fox Ltd. You are required to prepare cash flow statement usingIndirect Method.

Particulars	Note No.	31st March,2021 (Rs.)	31st March,2020 (Rs.)
(I) Equity and Liabilities			
1. Shareholders' Funds			
(a) Share capital	1	5,60,000	3,00,000
(b) Reserve and Surplus	2	35,000	25,000
2. Current Liabilities			
(a) Trade payables		1,50,000	60,000
(b) Short-term provisions (Provision for taxation)		8,000	5,000
Total		7,53,000	3,90,000

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(II) Assets			
1. Non-current assets			
(a) Property, Plant and Equipment		3,50,000	1,80,000
2. Current assets			
(a) Inventories		1,20,000	50,000
(b) Trade receivables		1,00,000	25,000
(c) Cash and cash equivalents		1,05,000	90,000
(d) Other current assets		78,000	45,000
Total		7,53,000	3,90,000

Notes to Accounts

Particulars	31st March,2021 (₹)	31st March,2020 (₹)
1. Share capital		
(a) Equity share capital	**4,10,000**	**2,00,000**
(b) Preference share capital	**1,50,000**	**1,00,000**
	5,60,000	**3,00,000**
2. Reserve and surplus		
Surplus in statement of profit and loss at the beginning of the year	**25,000**	
Add: Profit of the year	**20,000**	
Less: Dividend	**(10,000)**	
Surplus in statement of profit and loss at the end of the year	**35,000**	**25,000**

Additional Information:

1. **Dividend paid during the year ₹ 10,000**
2. **Depreciation charges during the year ₹ 40,000. (RTP May 23)**

Answer 8

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Fox Ltd.

Cash Flow Statement for the year ended 31st March 2021

	₹	₹
Cash flows from operating activities		
Net Profit (35,000 less 25,000)	10,000	
Add: Dividend	10,000	
Provision for tax	8,000	
Net profit before taxation and extraordinary items	28,000	
Adjustment for:		
Depreciation	40,000	
Operating profit before working capital changes		68,000
Increase in trade receivables	(75,000)	
Increase in inventories	(70,000)	
Increase in other current assets	(33,000)	
Increase in trade payables	90,000	(88,000)
Cash used in operating activities		(20,000)
Less: Tax paid*		(5,000)
Net cash used in operating activities		(25,000)
Cash flows from investing activities		
Purchase of PPE	(2,10,000)	
Net cash used in investing activities		(2,10,000)
Cash flows from financing activities		
Issue of equity shares for cash	2,10,000	
Issue of preference shares	50,000	
Dividends paid	(10,000)	
Net cash generated from financing activities		2,50,000
Net increase in cash and cash equivalents		15,000
Cash and cash equivalents at beginning of period		90,000
Cash and cash equivalents at end of period		1,05,000

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*Provision for tax of last year considered to be paid in the current year.Working **Note:**

	₹
Property, plant and equipment acquisitions	
W.D.V. at 31.3.2021	3,50,000
Add back:	
Depreciation for the year	40,000
	3,90,000
Less: W.D.V. at 31.12.2020	1,80,000
Acquisitions during 2020-2021	2,10,000

Question 9

The following information was provided by PQR Ltd. for the year ended 31st March, 2019:

(1) Gross Profit Ratio was 25% for the year, which amounts to Rs. 3,75,000.

(2) Company sold goods for cash only.

(3) Opening inventory was lesser than closing inventory by Rs. 25,000.

(4) Wages paid during the year Rs. 5,55,000.

(5) Office expenses paid during the year Rs. 35,000.

(6) Selling expenses paid during the year Rs. 15,000.

(7) Dividend paid during the year Rs. 40,000 (including dividend distribution tax).

(8) Bank Loan repaid during the year Rs. 2,05,000 (included interest Rs. 5,000)

(9) Trade Payables on 31st March, 2018 were Rs. 50,000 and on 31st March, 2019 were Rs. 35,000.

(10) Amount paid to Trade payables during the year Rs.6,10,000

(11) Income Tax paid during the year amounts to Rs. 55,000 (Provision for taxation as on 31stMarch, 2019 Rs. 30,000).

(12) Depreciation on furniture amounts to Rs. 40,000.

(13) Depreciation on other tangible assets amounts to Rs. 20,000.

(14) Plant and Machinery purchased on 15th November, 2018 for Rs. 3,50,000.

(15) On 31st March, 2019 Rs. 2,00,000, 7% Debentures were issued at face value in an exchangefor a plant.

(16) Cash and Cash equivalents on 31st March, 2018 Rs. 2,25,000.

(A) Prepare cash flow statement for the year ended 31st March, 2019, using direct method.

(B) Calculate cash flow from operating activities, using indirect method. (PYP May '19, 10 Marks)

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Answer 9

PQR Ltd. Cash Flow Statement for the year ended 31st March, 2019

(Using direct method)

Particulars	₹	₹
Cash flows from Operating Activities		
Cash sales (₹ 3,75,000/25%)		15,00,000
Less: Cash payments for trade payables	(6,10,000)	
Wages Paid	(5,55,000)	
Office and selling expenses ₹ (35,000 + 15,000)	(50,000)	(12,15,000)
Cash generated from operations before taxes		2,85,000
Income tax paid		(55,000)
Net cash generated from operating activities (A)		2,30,000
Cash flows from Investing activities		
Sale of investments ₹ (8,20,000 + 20,000)	8,40,000	
Payments for purchase of Plant & machinery	(3,50,000)	
Net cash used in investing activities (B)		4,90,000
Cash flows from financing activities		
Bank loan repayment (including interest)	(2,05,000)	
Dividend paid (including dividend distribution tax)	(40,000)	
Net cash used in financing activities (C)		(2,45,000)
Net increase in cash (A+B+C)		4,75,000
Cash and cash equivalents at beginning of the period		2,25,000
Cash and cash equivalents at end of the period		7,00,000

'Cash Flow from Operating Activities' by indirect method

		₹
Net Profit for the year before tax and extraordinary items		2,80,000
Add: Non-Cash and Non-Operating Expenses:		
Depreciation		60,000
Interest Paid		5,000
Less: Non-Cash and Non-Operating Incomes:		
Profit on Sale of Investments		(20,000)
Net Profit after Adjustment for Non-Cash Items		3,25,000
Less: Decrease in trade payables	15,000	
Increase in inventory	25,000	(40,000)
Cash generated from operations before taxes		2,85,000

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Working Note:

Calculation of net profit earned during the year

	Rs.	Rs.
Gross profit		3,75,000
Less: Office expenses, selling expenses	50,000	
Depreciation	60,000	
Interest paid	5,000	(1,15,000)
		2,60,000
Add: Profit on sale of investments		20,000
Net profit before tax		2,80,000

Question 10

While preparing cash flow statement, conversion of debt to equity

a. Should be shown as a financing activity.

b. Should be shown as an investing activity.

c. Should not be shown as it is a non-cash transaction.

Ans: (c)

Question 11

Which of the following would be considered a 'cash-flow item from an "investing" activity'?

a. Cash outflow to the government for taxes.

b. Cash outflow to purchase bonds issued by another company.

c. Cash outflow to shareholders as dividends.

Ans: (b)

Question 12

All of the following would be included in a company's operating activities except:

a. Income tax payments

b. Collections from customers or Cash payments to suppliers

c. Dividend payments.

Ans: (c)

Question 13

Hari Uttam, a stock broking firm, received Rs. 1,50,000 as premium for forward contracts entered for purchase of equity shares. How will you classify this amount in the cash flow statement of the firm?

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a. Operating Activities.

b. Investing Activities.

c. Financing Activities.

Ans: (a)

Question 14

As per AS 3 on Cash Flow Statements, cash received by a manufacturing company from sale of sharesof ABC Company Ltd. should be classified as

a. Operating activity.

b. Financing activity.

c. Investing activity.

Ans: (c)

Theoretical Questions Answers

Question 15

What is the significance of cash flow statement? Explain in brief.

Answer 15

Cash flow statement provides information about the changes in cash and cash equivalents of an enterprise. It identifies cash generated from trading operations and is very useful tool of planning.

Question 16

Explain the difference between direct and indirect methods of reporting cash flows from operatingactivities with reference to AS 3.

Answer 16

(a) As per Para 18 of AS 3 (Revised) on Cash Flow Statements, an enterprise should report cash flows fromoperating activities using either:

(b) The direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or the indirect method, whereby net profit or loss is adjusted for the effects of transactions of anon-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

Practical Questions Answers

Question 17

Classify the following activities as (a) Operating activities, (b) Investing activities (c) Financing

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(a) activities (d) Cash equivalents with reference to AS 3 **(Revised).**

(b) **Brokerage paid on purchase of investments**

(c) **Underwriting commission paid**

(d) **Trading commission received**

(e) **Proceeds from sale of investment**

(f) **Purchase of goodwill**

(g) **Redemption of preference shares**

(h) **Rent received from property held as investment**

(i) **Interest paid on long-term borrowings Marketable securities (having risk of change in value)**

(j) **Refund of income tax received**

Answer 17

Classification of activities with reference to AS 3

a.	Brokerage paid on purchased of investments	Investing Activities
b.	Underwriting Commission paid	Financing Activities
c.	Trading Commission received	Operating Activities
d.	Proceeds from sale of investment	Investing Activities
e.	Purchase of goodwill	Investing Activities
f.	Redemption of Preference shares	Financing Activities
g.	Rent received from property held asinvest-ment	Investing Activities
h.	Interest paid on long term borrowings	Financing Activities
i.	Marketable securities	Not a Cash equivalent
j.	Refund of Income tax received	Operating activities

Question 18

How will you disclose following items while preparing Cash Flow Statement of Gagan Ltd. as per AS-3 for the year ended 31st March, 20X2?

(i) **10% Debentures issued:**

As on 01-04-20X1 Rs. 1,10,000As on 31-03-20X2 Rs. 77,000Debentures were redeemed at 5% premium at the end of the year. Premiumwas charged to the Profit & Loss Account for the year.

(ii) **Unpaid Interest on Debentures:As on 01-04-20X1 Rs.275**

As on 31-03-20X2 Rs.1,175

(iii) **Debtors of Rs.36,000 were written off against the Provision for Doubtful DebtsA/c duringthe year.**

10% Bonds (Investments): As on 01-04-20X1 Rs. 3,50,000As on 31-03-20X2 Rs. 3,50,000

(iv) **Accrued Interest on Investments:As on 31-03-20X2 Rs.10,500**

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Answer18

Cash Flow Statement of M/s Gagan Ltd. for the year ended March 31, 20X2

A	Cash Flow from Operating Activities	
	Net Profit as per Profit & Loss A/c	xxxxx
	Add: Premium on Redemption of Debentures	1,650
	Add: Interest on 10% Debentures	11,000
	Less: Interest on 10% Investments	(35,000)
B	Cash Flow from Investing Activities	
	Interest on Investments [35,000-10,500]	24,500
C	Cash Flow from Financing Activities	
	Interest on Debentures paid [11,000 - (1,175 - 275)] - outflow	(10,100)
	Redemption of Debentures [(1,10,000 - 77,000) at 5% premium] - outflow	(34,650)

Note: Debtors written off against provision for doubtful debts does not require any furtheradjustment in Cash Flow Statement.

Question 19

From the following Balance sheet of Grow More Ltd., prepare Cash Flow Statement for the year ended 31st March, 20X1 :

		Particulars	***Notes***	**31st March, *20X1***	**31st March, *20X0***
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**		**10,00,000**	**8,00,000**
	B	**Reserves and Surplus**	**1**	**3,00,000**	**2,10,000**
2		**Non-current liabilities**			
		Long term borrowings	**2**	**2,00,000**	**-**
3		**Current liabilities**			
	A	**Trade Payables**		**7,00,000**	**8,20,000**
	B	**Other current liabilities**	**3**	**-**	**1,00,000**
	C	**Short term provision (provision for tax)**		**1,00,000**	**70,000**
		Total		**23,00,000**	**20,00,000**

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		Assets			
1		Non-current assets			
	A	Property, plant and Equipment	4	13,00,000	9,00,000
	B	Non-Current Investments		1,00,000	-
2		Current assets			
	A	Inventories		4,00,000	2,00,000
	B	Trade receivables		5,00,000	7,00,000
	C	Cash and Cash equivalents		-	2,00,000
		Total		23,00,000	20,00,000

Notes to accounts

No.	Particulars	31st March, *20X1*	31st March, *20X0*
1	Reserves and Surplus		
	Revenue reserve	2,00,000	1,50,000
	Profit and Loss account	1,00,000	60,000
	Total	3,00,000 2,10,000	
2	Long term borrowings		
	Debentures (issued at end ofyear)	2,00,000	--
3.	Other current liabilities		
	Dividend payable	-	1,00,000
4	Property, plant andequipment		
	Plant and machinery	7,00,000	5,00,000
	Land and building	6,00,000	4,00,000
	Net carrying value	13,00,000	9,00,000

Depreciation @ 25% was charged on the opening value of Plant and Machinery.

(i) **At the year end, one old machine costing Rs. 50,000 (WDV Rs.**

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20,000) was sold for Rs. 35,000. Purchase was also made at the year end.

(ii) Rs. 50,000 was paid towards Income tax during the year.

(iii) Construction of the building got completed on 31.03.20X1 and hence no depreciation may be

Answer 19

charged on the same. Prepare Cash flow Statement.

Cash Flow Statement of Grow More Ltd for the year ended 31st March, 20X1 Cash Flow fromOperating Activities

		Rs.
Increase in balance of Profit and Loss Account(1,00,000 – 60,000)	40,000	
Provision for taxation (W.N.1)	80,000	
Transfer to General Reserve (2,00,000 – 1,50,000)	50,000	
Depreciation (W.N.2)	1,25,000	
Profit on sale of Plant and Machinery	(15,000)	
Operating Profit before Working Capital changes	2,80,000	
Increase in Inventories	(2,00,000)	
Decrease in Trade receivables	2,00,000	
Decrease in Trade payables	(1,20,000)	
Cash generated from operations	1,60,000	
Income tax paid	(50,000)	
Net Cash generated from operating activities		1,10,000

Cash Flow from Investing Activities

Purchase of fixed assets	(3,45,000)	
Expenses on building (6,00,000 – 4,00,000)	(2,00,000)	
Increase in investments	(1,00,000)	
Sale of old machine	35,000	
Net Cash used in investing activities		(6,10,000)

Cash Flow from Financing activities

Proceeds from issue of shares(10,00,000 – 8,00,000)	2,00,000	
Proceeds from issue of debentures	2,00,000	3,00,000

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Dividend paid	(1,00,000)	
Net cash generated from financing activities		
Net increase in cash or cash equivalents		NIL
Cash and Cash equivalents at the beginning of theyear		2,00,000
Cash and Cash equivalents at the end of the year		Ni

Working Notes:

1. **Provision for taxation account**

		Rs.			Rs.
To	Cash (Paid)	50,000	By	Balance b/d	70,000
To	Balance c/d	1,00,000	By	Profit and LossA/c	80,000
				(Balancingfigure)	
		1,50,000			1,50,000

Plant and Machinery account

		Rs.			Rs.
To	Balance b/d	5,00,000	By	Depreciation	1,25,000
To	Profit and Loss A/c	15000			
	(profit on sale of				
	machine)				

To	Cash (Balancing figure)	3,45,000	By	Cash (sale of machine)	35,000
			By	Balance c/d	7,00,000
		8,60,000			8,60,000

Question 20

From the following Balance Sheets and information, prepare Cash Flow Statement of Ryan Ltd. by Indirect method for the year ended 31st March, 20X1:

		Particulars	*Notes*	*31st March 20X1* Rs.	*31st March 20X0* Rs.
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**	**1**	**6,00,000**	**7,00,000**
	B	**Reserves and Surplus**	**2**	**4,20,000**	**3,00,000**

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2		Non-current liabilities			
		Long term borrowings	3	2,00,000	-
3		Current liabilities			
	A	Trade Payables		1,15,000	1,10,000
	B	Other current liabilities	4	30,000	80,000
	C	Short term provision (provision fortax)		95,000	60,000
		Total		14,60,000	12,50,000
		Assets			
1		Non-current assets			
	A	Property, plant and Equipment	5	9,15,000	7,00,000
	B	Non-Current Investments		50,000	80,000
2		Current assets			
	A	Inventories		95,000	90,000
	B	Trade receivables		2,50,000	2,25,000
	C	Cash and Cash equivalents		50,000	90,000
	D	Other Current assets		1,00,000	65,000
		Total		14,60,000	12,50,000

Notes to accounts

No.			31st March, *20X1*	31st March, *20X0*
1.	Share capital			
	Equity share capital		6,00,000	5,00,000
	10% Redeemable Preference share capital		--	2,00,000
	Total		6,00,000	7,00,000
2	Reserves and Surplus			
	Capital redemption reserve		1,00,000	-

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	Capital reserve		70,000	-
	General reserve		1,50,000	2,50,000
	Profit and Loss account		1,00,000	50,000
	Total		4,20,000	3,00,000
3	Long term borrowings			
	9% Debentures		2,00,000	--
4.	Other current liabilities			
	Dividend payable		-	60,000
	Liabilities for expenses		30,000	20,000
	Total		30,000	80,000
5	Property, plant and equipment			
	Plant and machinery		7,65,000	5,00,000
	Land and building		1,50,000	2,00,000
	Net carrying value		9,15,000	7,00,000

Additional Information:

(i) **A piece of land has been sold out for Rs.1,50,000 (Cost – Rs.1,20,000) and the balance land was revalued. Capital Reserve consisted of profit on revaluation of land.**

On 1st April, 20X0 a plant was sold for Rs.90,000 (Original Cost – Rs.70,000 **and**

(ii) W.D.V. – Rs. 50,000) and Debentures worth Rs.1 lakh were issued at par as partconsideration for plant of Rs.4.5 lakhs **acquired.**

(iii) **Part of the investments (Cost – Rs.50,000) was sold for Rs.70,000.**

(iv) **Pre-acquisition dividend received Rs.5,000 was adjusted against cost of investment.**

(v) **Interim dividend was declared and paid @ 15% during the current year.**

(vi) **Income-tax liability for the current year was estimated at Rs.1,35,000.**

Depreciation @ 15% has been charged on Plant and Machinery but nodepreciation hasbeen charged on **Building.**

Answer20

Cash Flow Statement of Ryan Limited For the year ended 31st March, 20X1

	Rs.	*Rs.*
Cash flow from operating activities NetProfit before taxation (W.N.1)	2,75,000	
Adjustment for		
Depreciation (W.N.3)	1,35,000	

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Profit on sale of land	(30,000)	
Profit on sale of plant (W.N.3)	(40,000)	
Profit on sale of investments (W.N.4)	(20,000)	
Interest on debentures (2,00,000 X 9%)	18,000	
Operating profit before working capital changes	3,38,000	
Increase in inventory	(5,000)	

Increase in trade receivables	(25,000)	
Increase in Other current assets (W.N.9)Increase in Trade payables	(35,000) 5,000	
Increase in liabilities for expenses	10,000	
Cash generated from operations	2,88,000	
Income taxes paid (W.N.8)	(1,00,000)	
Net cash generated from operating activities		1,88,000
Cash flow from investing activities		
Proceeds from sale of land (W.N.2)	1,50,000	
Proceeds from sale of plant (W.N.3)	90,000	
Proceeds from sale of investments (W.N.4)	70,000	
Purchase of plant (W.N.3)	(3,50,000)	
Purchase of investments (W.N.4)	(25,000)	
Pre-acquisition dividend received (W.N.4)	5,000	
Net cash used in investing activities		(60,000)
Cash flow from financing activities		
Proceeds from issue of equity shares(6,00,000 – 5,00,000)	1,00,000	
Proceeds from issue of debentures(2,00,000 – 1,00,000)	1,00,000	
Redemption of preference shares	(2,00,000)	
Dividends paid	(1,50,000)	
Interest paid on debentures	(18,000)	
Net cash used in financing activities		(1,68,000)
Net decrease in cash and cash equivalents		(40,000)
Cash and cash equivalents at the beginning of the year		90,000
Cash and Cash equivalents at the end of the year		50,000

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Working Notes:1.

	Rs.
Net profit before taxation	
Retained profit	1,00,000
Less: Balance as on 31.3.20X0	(50,000)
	50,000
Provision for taxation	1,35,000
Dividend	90,000
	2,75,000

Land and Building Account

		Rs.			Rs.
To	Balance b/d	2,00,000	By	Cash (Sale)	1,50,000
To	Profit and Loss A/c (Profiton sale)	30,000	By	Balance c/d	1,50,000
To	Capital reserve (Revaluation profit)	70,000			
		3,00,000			3,00,000

Plant and Machinery Account

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

Investments Account

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

Capital Reserve Account

		Rs.			Rs.
To	Balance c/d	70,000	By	Profit on revaluation of land	70,000
		70,000			70,000

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General Reserve Account

		Rs.			Rs.
To	Capital redemption reserve	1,00,000	By	Balance b/d	2,50,000
To	Balance c/d	1,50,000			
		2,50,000			2,50,000

Dividend payable Account

		Rs.			Rs.
To	Bank (Balancing figure)	1,50,000	By	Balance b/d	60,000
To	Balance c/d	-	By	Profit and lossac-count	90,000
		1,50,000			1,50,000

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Provision for Taxation Account

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

Other Current Assets Account

		Rs.			Rs.
To	Balance b/d	65,000			1,00,000
To	Bank (Balancing figure)	35,000	By	Balance c/d	
		1,00,000			1,00,000

Question 21

The Balance Sheet of New Light Ltd. as at 31st March, 20X1 and 20X0 (for the years ended) are asfollows:

			Notes	Rs. 31st March 20X0	Rs. 31st March 20X1
		Equity and Liabilities			
1		Shareholders' funds			
	A	Share capital	1	16,00,000	18,80,000
	B	Reserves and Surplus	2	8,40,000	11,00,000
2		Non-current liabilities			
		Long term borrowings	3	4,00,000	2,80,000
3		Current liabilities			
	A	Other current liabilities	4	6,00,000	5,20,000
	B	Short term provision (provision for tax)		3,60,000	3,40,000
		Total		38,00,000	41,20,000
		Assets			
1		Non-current assets			
	A	Property, plant andEquipment	5	22,80,000	26,40,000
	B	Non-Current Investments		4,00,000	3,20,000
2		Current assets			
	A	Cash and Cash equivalents		10,000	10,000

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	B	Inventory		2,16,000	3,00,000
	C	Other Current assets		8,94,000	8,50,000
		Total		38,00,000	41,20,000

Notes to accounts

No.	Particulars		31st March, *20X0*	31st March, *20X1*
1.	Share capital			
	Equity share capital		12,00,000	16,00,000
	10% Preference share capital		4,00,000	2,80,000
	Total		16,00,000	18,80,000
2	Reserves and Surplus			
	General reserve		6,00,000	7,60,000
	Profit and Loss account		2,40,000	3,40,000
	Total		8,40,000	11,00,000
3	Long term borrowings			
	9% Debentures		4,00,000	2,80,000
	Total		4,00,000	2,80,000
4.	Other current liabilities			
	Dividend payable		1,20,000	-
	Current Liabilities		4,80,000	5,20,000
	Total		6,00,000	5,20,000
5	Property, plant and equipment			
	Property, plant and equipment		32,00,000	38,00,000
	Less: Depreciation		(9,20,000)	(11,60,000)
	Net carrying value		22,80,000	26,40,000

Additional **information:**The company sold one property, plant and equipment for Rs. 1,00,000, the cost of which was Rs. 2,00,000 and the depreciation provided on it was Rs.80,000.

(i) The company also decided to write off another item of property, plant and equipment costing Rs. 56,000 on which depreciation amounting to Rs. 40,000 hasbeen provided.

(ii) Depreciation on property, plant and equipment provided Rs. 3,60,000.

(iii) Company sold some investment at a profit of Rs.40,000.

(iv) Debentures and preference share capital redeemed at 5% premium. Debentures were redeemed at the year end.

Company decided to value inventory at cost, whereas previously the practice was to value inventory at cost less 10%. The inventory according to books on 31.3.20X0 was Rs. 2,16,000. The inventory on 31.3.20X1 was correctly valued at Rs.3,00,000.

Prepare Cash Flow Statement as per revised Accounting Standard 3 by indirect method.

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Answer 21

New Light Ltd.

Cash Flow Statement for the year ended 31st March, 20X1

A.	**Cash Flow from operating activities**	*Rs.*	*Rs.*
	Profit after appropriation		
	Increase in profit and loss A/c after inventory adjustment [Rs.3,40,000 – (Rs.2,40,000 + Rs.24,000)]	76,000	
	Transfer to general reserve	1,60,000	
	Provision for tax	3,40,000	
	Net profit before taxation and extraordinary item	5,76,000	
	Adjustments for:		
	Depreciation	3,60,000	
	Loss on sale of property, plant and equipment	20,000	
	Decrease in value of property, plantand equipment	16,000	
	Profit on sale of investment Premium on redemption of preference share capital	(40,000) 6,000	
	Interest on debentures	36,000	
	Premium on redemption of debentures	6,000	
	Operating profit before working capital changes	9,80,000	
	Increase in current liabilities (Rs.5,20,000 –Rs.4,80,000)	40,000	
	Increase in other current assets [Rs.11,50,000 – (Rs. 11,10,000 + Rs.24,000)]	(16,000)	
	Cash generated from operations	10,04,000	6,44,000
	Income taxes paid	(3,60,000)	
	Net Cash generated from operating activities		
B.	**Cash Flow from investing activities**		
	Purchase of property, plant and equipment(W.N.3)	(8,56,000)	
	Proceeds from sale of property, plantand equipment (W.N.3)	1,00,000	
	Proceeds from sale of investments (W.N.2)	1,20,000	(6,36,000)
	Net Cash used in investing activities		

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C.	Cash Flow from financing activities		
	Proceeds from issuance of share capital	4,00,000	
	Redemption of preference share capital (Rs.1,20,000 + Rs.6,000)	(1,26,000)	
	Redemption of debentures (Rs. 1,20,000 + Rs. 6,000)	(1,26,000)	
	Dividend paid	(1,20,000)	(8,000)
	Interest on debentures	(36,000)	
	Net Cash generated from financing activities		
	Net increase/decrease in cash and cash equivalent during the year		Nil
	Cash and cash equivalent at the beginning of theyear		10,000
	Cash and cash equivalent at the end of the year		10,000

Working **Notes:**

Revaluation of inventory will increase opening inventory by Rs. 24,000.2,16,000/90 x 10 = Rs.24,000

Therefore, opening balance of other current assets would be as follows:Rs.11,10,000 + Rs.24,000 = Rs.11,34,000

Due to under valuation of inventory, the opening balance of profit and lossaccount be increased by Rs.24,000.

The opening balance of profit and loss account after revaluation of inventorywill be Rs. 2,40,000 + Rs.24,000 = Rs.2,64,000 Investment Account

		Rs.			*Rs.*
To	Balance b/d	4,00,000	By	Bank A/c (balancing figure being investmentsold)	1,20,000
To	Profit and Loss A/c (Profit on sale of investment)	40,000	By	Balance c/d	3,20,000
		4,40,000			4,40,000

Property, Plant and Equipment Account

		Rs.			*Rs.*	*Rs.*
To	Balance b/d	32,00,000	By	Bank A/c (sale of assets)	1,00,000	
To	Bank A/c	8,56,000	By	Accumulated		

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	(balancing figure being assets purchased)		By	depreciation A/c Profit and loss A/c(loss on sale of assets)	80,000 20,000	2,00,000
			By	Accumulated		
				depreciation A/c	40,000	
			By	Profit and loss A/c		
				(assets written off)	16,000	56,000
			By	Balance c/d		38,00,000
		40,56,000				40,56,000

Accumulated Depreciation Account

		Rs.			Rs.
To	Property, plant and equipment A/c	80,000	By	Balance b/d	9,20,000
To	Property, plantand equipment A/c	40,000	By	Profit and loss A/c(de-preciation for the year)	3,60,000
To	Balance c/d	11,60,000			
		12,80,000			12,80,000

Question 22

ABC Ltd. gives you the Balance sheets as at 31st March 20X0 and 31st March 20X1. You are requiredto prepare Cash Flow Statement by using indirect method as per AS 3 for the year ended 31st March20X1:

		Particulars	***Notes***	***Rs.*** ***31st March 20X0***	***Rs.*** ***31st March 20X1***
		Equity and Liabilities			
1		**Shareholders' funds**			
		Share capital		**50,00,000**	**50,00,000**
		Reserves and Surplus		**26,50,000**	**36,90,000**
2		**Current liabilities**			
		Long term borrowings	**1**	**-**	**9,00,000**

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3		Long term borrowings			
		Short-term borrowings(Bank loan)		1,50,000	3,00,000
		Trade payables		8,80,000	8,20,000
		Other current liabilities	2	4,80,000	2,70,000
		Total		91,60,000	1,09,80,000
		Assets			
1		Non-current assets			
	A	Property, plant andEquipment	3	21,20,000	32,80,000
2		Current assets			
	A B	Current InvestmentsInventory		11,80,000 20,10,000	15,00,000 19,20,000
	C	Trade receivables	4	22,40,000	26,40,000
	D	Cash and Cash equivalents		15,20,000	15,20,000
	E	Other Current assets (Prepaidexpenses)		90,000	1,20,000
		Total		91,60,000	1,09,80,000

Notes to accounts

No.	Particulars		*Rs.20X0*	*20X1*
1	Long term borrowings			
	9% Debentures (issued at the endofyear)		-	9,00,000

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	Total		-	9,00,000
2.	Other current liabilities			
	Dividend payable		1,50,000	-
	Liabilities for expenses		3,30,000	2,70,000
	Total		4,80,000 2,70,000	
3	Property, plant and equipment			
	Plant and machinery		27,30,000	40,70,000
	Less: Depreciation		(6,10,000)	(7,90,000)
	Net carrying value		21,20,000 32,80,000	
4	Trade receivables			
	Gross amount		23,90,000	28,30,000
	Less: Provision for doubtful debts		(1,50,000) 22,40,000	(1,90,000) 26,40,000
	Total			

Additional Information:

(i) **Net profit for the year ended 31st March, 20X1, after charging depreciation Rs. 1,80,000 is Rs. 10,40,000.**

(ii) **Trade receivables of Rs. 2,30,000 were determined to be worthless and werewritten off against the provisions for doubtful debts account during the year.**

Answer 22

Cash Flow Statement of ABC Ltd. for the year ended 31.3.20X1

Cash flows from Operating Activities	*Rs.*	*Rs.*
Net Profit	10,40,000	
Add: Adjustment For Depreciation (Rs.7,90,000 – Rs.6,10,000)	1,80,000	
Add: Adjustment for Provision for Doubtful Debts (Rs.4,20,000 – Rs.1,50,000)	2,70,000	
Operating Profit Before Working Capital Changes	14,90,000	

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Add: Decrease in Inventories(Rs. 20,10,000 – Rs.19,20,000)	90,000	
Less: Increase in Current Assets	15,80,000	
Trade Receivables (Rs. 30,60,000 – Rs.23,90,000) 6,70,000		
Prepaid Expenses (Rs. 1,20,000 – Rs.90,000) 30,000		
Decrease in Current Liabilities:		
Trade Payables (Rs. 8,80,000 – Rs. 8,20,000) 60,000		
Expenses Outstanding (Rs. 3,30,000 – Rs.2,70,000) 60,000	(8,20,000)	
Net Cash generated from Operating Activities		7,60,000
Cash Flows from Investing Activities		
Investment in Current Investments	(3,20,000)	
Purchase of Plant & Machinery(Rs. 40,70,000 – Rs. 27,30,000)	(13,40,000)	
Net Cash Used in Investing Activities		(16,60,000)
Cash Flows from Financing Activities		
Bank Loan Raised (Rs. 3,00,000 – Rs. 1,50,000)	1,50,000	
Issue of Debentures	9,00,000	
Payment of Dividend	(1,50,000)	
Net Cash Used in Financing Activities		9,00,000
Net Increase in Cash During the Year		-
Add: Cash and Cash Equivalents as on 1.4.20X0		15,20,000
Cash and Cash Equivalents as on 31.3.20X1		15,20,000

Note:

1. Bad debts amounting Rs. 2,30,000 were written off against provision for doubtful debts account during the year. In the above solution, Bad debts have been added back in the balances of provision for doubtful debts and trade receivables as on 31.3.20X1. Alternatively, the adjustment of writing off bad debts may be ignored and the solution can be given on the basis offigures of trade receivables and provision for doubtful debts as appearing inthe balance sheet on 31.3.20X1.
2. Current investments (i.e. Marketable securities) may not be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value as per the requirements of AS 3 and hence those have been considered as investing activities.

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Question 23(Illustration)

Intelligent Ltd., a non-financial company has the following entries in its Bank Account. It has sought your advice on the treatment of the same for preparing Cash Flow Statement.

(i) **Loans and Advances given to the following and interest earned on them:**

(1) **to suppliers**

(2) **to employees**

(3) **to its subsidiaries companies**

(ii) **Investment made in subsidiary Smart Ltd. and dividend received**

(iii) **Dividend paid for the year**

(iv) **TDS on interest income earned on investments made**

(v) **TDS on interest earned on advance given to suppliers**

(vi) **Insurance claim received against loss of fixed asset by fireDiscuss in the context of AS 3 Cash Flow Statement.**

Answer23

(i) **Loans and advances given and interest earned**

1) to s uppliers	Operating Cash flow
2) to employees	Operating Cash flow
3) to its s ubsidiary ompanies	Investing Cash flow

Investment made in subsidiary company and dividend received

Investing Cash flow

(ii) **Dividend paid for the year**

Financing Cash Outflow

(iii) **TDS on interest income earned on investments made**

Investing Cash Outflow

(iv) **TDS on interest earned on advance given to suppliers**

Operating Cash Outflow

(v) **Insurance claim received of amount loss of fixed asset by fire**

Extraordinary item to be shown under a separate heading as 'Cash inflow frominvesting activi-ties'.

Question 24(Illustration)

Following are extracts of the Balance Sheets of Ajay Ltd.:

	Particulars	Notes	31.3.20X1 Rs.	31.3.20X2 Rs.
	Equity and Liabilities			

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	Shareholder's funds			
(a)	Share capital	1	5,00,000	5,00,000
(b)	Reserve & surplus	2	50,000	90,000
	Non-current liabilities			
(a)	Long-term borrowings	3	5,00,000	7,50,000
	Current liabilities			
(a)	Other current liabilities	4	---	5,000
	Assets			
	Non-current assets			
(a)	Intangible assets	5	2,05,000	1,80,000

Notes to accounts

		31.3.20X1 Rs.	31.3.20X2 Rs.
1	**Share Capital**		
	50,000 Equity Shares of Rs.10 each	5,00,000	5,00,000
2	**Reserve & surplus**		
	Profit & Loss A/c	50,000	90,000
3	**Long-term borrowings**		
	10% Debentures	5,00,000	7,50,000
4	**Other current liabilities**		
	Unpaid interest	---	5,000
5	**Intangible assets**		
	Goodwill	2,05,000	1,80,000

You are required to show the related items in Cash Flow Statement.

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Answer 24

An Extract of Cash Flow Statement for the year ending 31.3.20X2

	Rs.
Cash flows from operating activities: Closing balance as per Profit & Loss A/c	90,000
Less: Opening balance as per Profit & Loss Alc	(50,000)
Add: Goodwill amortisation	25,000
Add: Interest on Debentures (Refer Note 1)	75,000
Net Cash from Operating Activities	1,40,000

Note 1: Interest has been computed on the closing balance of debentures as on 31.3.20X2 assumingthat all the additions/ deletions were made, if any, at the beginning of the year.

Cash flows from financing activities:

Proceeds from debentures (Refer Working Note)	2,50,000
Interest paid on Debentures [less unpaid]	(70,000)
Net Cash from Financing Activities	1,80,000

Working Note:

10% Debentures Account

Particulars	Rs.	Particular	Rs.
To Balance c/d	7,50,000	By Balance b/d	5,00,000
		By Bank A/c (Bal. fig.)	2,50,000
	7,50,000		7,50,000

Question 25(Illustration)

From the following information, calculate cash flow from operating activities:Summary of Cash Account for the year ended March 31, 20X1

Particulars	Rs.	Particulars	Rs.
To Balance b/d	1,00,000	By Cash Purchases	1,20,000
To Cash sales	1,40,000	By Trade payables	1,57,000
To Trade receivables	1,75,000	By Office & Selling Expenses	75,000
To Trade Commission	50,000	By Income Tax	30,000
To Sale of Investment	30,000	By Investment	25,000
To Loan from Bank	1,00,000	By Repayment of Loan	75,000
To Interest & Dividend	1,000	By Interest on loan	10,000

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		By Balance c/d	1,04,000
	5,96,000		5,96,000

Answer 25

Cash Flow Statement of ..... for the year ended March 31, 20X1(Direct Method)

Particulars	Rs.	Rs.
Operating Activities:		
Cash received from sale of goods	1,40,000	
Cash received from Trade receivables	1,75,000	
Trade Commission received	50,000	3,65,000
Less: Payment for Cash Purchases	1,20,000	
Payment to Trade payables	1,57,000	
Office and Selling Expenses	75,000	
Payment for Income Tax	30,000	(3,82,000)
Net Cash Flow used in Operating Activities		(17,000)

Question 26(Illustration)

The following summary cash account has been extracted from the company's accounting records: Summary Cash Account

Dividends	**80**	
Repayments of bank loan	**250**	
Balance at 31.3.20X2		**212**

Prepare Cash Flow Statement of this company Hills Ltd. for the year ended 31stMarch, 20X2 inaccordance with AS-3 (Revised). The company does not have any cash equivalents.

Answer 26

Hills Ltd. Cash Flow Statement for the year ended 31st March, 20X2(Using direct method)

		(Rs. '000)
Cash flows from operating activities		
Cash receipts from customers	2,783	
Cash payments to suppliers	(2,047)	
Cash paid to employees	(69)	
Other cash payments (for overheads)	(115)	
Cash generated from operations	552	
Income taxes paid	(243)	

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Net cash from operating activities		309
Cash flows from investing activities		
Payments for purchase of fixed assets	(230)	
Proceeds from sale of fixed assets	128	
Net cash used in investing activities		(102)
Cash flows from financing activities		
Proceeds from issuance of share capital	300	
Bank loan repaid	(250)	
Dividend paid	(80)	
Net cash used in financing activities		(30)
Net increase in cash and cash equivalents		177
Cash and cash equivalents at beginning of period		35
Cash and cash equivalents at end of period		212

Question 27(Illustration)

Prepare cash flow statement of M/s MNT Ltd. for the year ended 31st March, 20X1 with the help of the following information:

(1) **Company sold goods for cash only.**

(2) **Gross Profit Ratio was 30% for the year, gross profit amounts to Rs. 3,82,500.**

(3) **Opening inventory was lesser than closing inventory by Rs. 35,000.**

(4) **Wages paid during the year Rs. 4,92,500.**

(5) **Office and selling expenses paid during the year Rs. 75,000.**

(6) **Dividend paid during the year Rs. 30,000.**

(7) **Bank loan repaid during the year Rs. 2,15,000 (included interest Rs. 15,000).**

(8) **Trade payables on 31st March, 20X0 exceed the balance on 31st March, 20X1 by Rs. 25,000.**

(9) **Amount paid to trade payables during the year Rs. 4,60,000.**

(10) **Tax paid during the year amounts to Rs. 65,000 (Provision for taxation as on 31.03.20X1Rs. 45,000).**

(11) **Investments of Rs. 7,00,000 sold during the year at a profit of Rs. 20,000.**

(12) **Depreciation on fixed assets amounts to Rs. 85,000.**

(13) **Plant and machinery purchased on 15th November, 20X0 for Rs. 2,50,000.**

(14) **Cash and Cash Equivalents on 31st March, 20X0Rs. 2,00,000.**

(15) **Cash and Cash Equivalents on 31st March, 20X1Rs. 6,07,500**

Answer 27

M/s MNT Ltd.

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Cash Flow Statement for the year ended 31st March, 20X1(Using direct method)

Particulars	Rs.	Rs.
Cash flows from Operating Activities		
Cash sales (Rs. 3,82,500/.30)		12,75,000
Less: Cash payments for trade payables	(4,60,000)	
Wages Paid	(4,92,500)	
Office and selling expenses	(75,000)	(10,27,500)
Cash generated from operations before taxes		2,47,500
Income tax paid		(65,000)
Net cash generated from operating activities (A)		1,82,500
Cash flows from investing activities		
Sale of investments (7,00,000 + 20,000)	7,20,000	
Payments for purchase of Plant & machinery	(2,50,000)	
Net cash used in investing activities (B)		4,70,000
Cash flows from financing activities		
Bank loan repayment (including interest)	(2,15,000)	
Dividend paid	(30,000)	
Net cash used in financing activities (C)		(2,45,000)
Net increase in cash (A+B+C)		4,07,500
Cash and cash equivalents at beginning of the period		2,00,000
Cash and cash equivalents at end of the period		6,07,500

Question28(Illustration)

Ryan Ltd provides you the following information at the year-end, March 31, 20X1:

	Rs.	Rs.
Sales		**6,98,000**
Cost of Goods Sold		**(5,20,000)**
Operating Expenses		**1,78,000**
(including Depreciation Expense of Rs. 37,000)		**(1,47,000)**
Other Income / (Expenses):		**31,000**

Interest Expense paid	**(23,000)**	
Interest Income received	**6,000**	
Gain on Sale of Investments	**12,000**	
Loss on Sale of Plant	**(3,000)**	
		(8,000)

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		23,000
Income tax		(7,000)
		16,000

Information available:

	31st March 20X1	31st March 20X0
	Rs.	Rs.
Plant	7,15,000	5,05,000
Less: Accumulated Depreciation	(1,03,000)	(68,000)
	6,12,000	4,37,000
Investments (Long term)	1,15,000	1,27,000
Inventory	1,44,000	1,10,000
Trade receivables	47,000	55,000
Cash	46,000	15,000
Prepaid expenses	1,000	5,000
Share Capital	4,65,000	3,15,000
Reserves and surplus	1,40,000	1,32,000
Bonds	2,95,000	2,45,000
Trade payables	50,000	43,000
Outstanding liabilities	12,000	9,000
Income taxes payable	3,000	5,000

Analysis of selected accounts and transactions during 20X0-X1

1. Purchased investments for Rs. 78,000.
2. Sold investments for Rs. 1,02,000. These investments cost Rs. 90,000.
3. Purchased plant assets for Rs. 1,20,000.
4. Sold plant assets that cost Rs.10,000 with accumulated depreciation of Rs. 2,000for Rs.5,000.
5. Issued Rs. 1,00,000 of bonds at face value in an exchange for plant as-sets on31st March,20X1.
6. Repaid Rs. 50,000 of bonds at face value at maturity.
7. Issued 15,000 shares of Rs. 10 each.
8. Paid cash dividends Rs. 8,000.

Prepare Cash Flow Statement as per AS-3 (Revised), using indirect method.

Answer 28

Ryan Ltd. Cash Flow Statement for the year ending 31st March, 20X1

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	Rs.	Rs.
Cash flows from operating activities		
Net profit before taxation	23,000	
Adjustments for:		
Depreciation	37,000	
Gain on sale of investments	(12,000)	
Loss on sale of plant assets	3,000	
Interest expense	23,000	
Interest income	(6,000)	
Operating profit before working capital changes	68,000	
Decrease in trade receivables	8,000	
Increase in inventory	(34,000)	
Decrease in prepaid expenses	4,000	
Increase in trade payables	7,000	
Increase in outstanding liabilities	3,000	
Cash generated from operations	56,000	
Income taxes paid*	(9,000)	
Net cash generated from operating activities		47,000
Cash flows from investing activities		
Purchase of plant	(1,20,000)	
Sale of plant	5,000	
Purchase of investments	(78,000)	
Sale of investments	1,02,000	
Interest received	6,000	
Net cash used in investing activities		(85,000)
Cash flows from financing activities		
Proceeds from issuance of share capital	1,50,000	
Repayment of bonds	(50,000)	
Interest paid	(23,000)	
Dividends paid	(8,000)	
Net cash from financing activities		69,000
Net increase in cash and cash equivalents		31,000
Cash and cash equivalents at the beginning of theperiod		15,000
Cash and cash equivalents at the end of the period		46,000

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*Working Note:	Rs.
Income taxes paid:	
Income tax expense for the year	7,000
Add: Income tax liability at the beginning of the year	5,000
	12,000
Less: Income tax liability at the end of the year	(3,000)
	9,000

Question 29 (Illustration)

The balance sheets of Sun Ltd. as at 31st March 20X1 and 20X0 were as:

		Particulars	Notes	Rs. 31st March 20X0	Rs. 31st March 20X1
		Equity and Liabilities			
1		Shareholders' funds			
	(a)	Share capital	1	60,000	50,000
	(b)	Reserves and Surplus	2	5,000	4,000
2		Current liabilities			
	(a)	Trade Payables		4,000	2,500
	(b)	Other current liabilities	3	-	1,000
	(c)	Short term provision (provision for tax)		1,500	1,000
		Total		70,500	58,500
		Assets			
1		Non-current assets			
	(a)	Property, plant andEquip-ment	4	39,500	29,000
2		Current assets			
		Current Investments		2,000	
	(a)	Inventory			

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	(b)	Trade receivables	5	2,000	1,000
	(c)	Cash and Cash		17,000	14,000
	(d)	equivalents		8,000	6,000
				4,000	8,500
		Total		70,500	58,500

Notes to accounts

		20X1 Rs.	20X0 Rs.
1	Share Capital		
	Equity Shares of Rs.10 each	60,000	50,000
2	Reserve & surplus		
	Profit and Loss Account	5,000	4,000
3	Other current liabilities		
	Dividend Payable 14	-	1,000

4	Property, plant and equipment (at WDV)		
	Building	10,000	10,000
	Fixtures	17,000	11,000
	Vehicles	12,500	8,000
	Total	39,500	29,000
5	Cash and cash equivalents		
	Cash and Bank	4,000	8,500

The profit and loss statement for the year ended 31st March, 20X1 disclosed:

Particulars	Rs.
Profit before tax	4,500
Tax expense: Current tax	(1,500)
Profit for the year	3,000
Declared dividend	(2,000)
Retained Profit	1,000

Further information is available:

	Fixtures	Vehicles
	Rs.	Rs.

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Depreciation for the year	**1,000**	**2,500**
Disposals:		
Proceeds on disposal of vehicles	**—**	**1,700**
Written down value	**—**	**(1,000)**
Profit on disposal		**700**

Prepare a Cash Flow Statement for the year ended 31st March, 20X1.

Answer 29

Sun Ltd. Cash Flow Statement for the year ended 31st March, 20X1

	Rs.	Rs.
Cash flows from operating activities		
Net Profit before taxation	4,500	
Adjustments for:		
Depreciation	3,500	
Profit on sale of vehicles (1,700 – 1,000)	(700)	
Operating profit before working capital changes	7,300	
Increase in Trade receivables	(2,000)	
Increase in inventories	(3,000)	
Increase in Trade payables	1,500	
Cash generated from operations	3,800	
Income taxes paid (**W.N.1**)	(1,000)	
Net cash generated from operating activities		2,800
Cash flows from investing activities		
Sale of vehicles	1,700	
Purchase of current investments	(1,000)	
Purchase of vehicles (**W.N.3**)	(8,000)	
14 Purchase of fixtures (**W.N.3**)	(7,000)	
Net cash used in investing activities		(14,300)
Cash flows from financing activities		
Issue of shares for cash	10,000	
Dividends paid **(W.N.2)**	(3,000)	
Net cash generated from financing activities		7,000
Net decrease in cash and cash equivalents		(4,500)
Cash and cash equivalents at beginning ofperiod(See Note)		8,500

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Cash and cash equivalents at end of period (SeeNote)		4,000
Note to the Cash Flow Statement		
Cash and Cash Equivalents	31.3.20X1	31.3.20X0
Bank and Cash	4,000	8,500
Cash and cash equivalents	4,000	8,500

Working Notes:

			Rs.
1.	**Income taxes paid**		
	Income tax expense for the year		1,500
	Add: Income tax liability at the beginning of the year		1,000
			2,500
	Less: Income tax liability at the end of the year		(1,500)
			1,000
2.	**Dividend paid**		
	Declared dividend for the year		2,000
	Add: Amount payable at the beginning of the year		1,000
			3,000
	Less: Amount payable at the end of the year		-
			3,000
3.	**Property, plant and equipment acquisitions**	Fixtures	Vehicles
		Rs.	Rs.
	W.D.V. at 31.3.20X1	17,000	12,500
	Add back:		
	Depreciation for the year	1,000	2,500
	Disposals	—	1,000
		18,000	16,000
	Less: W.D.V. at 31.12.20X0	(11,000)	(8,000)
	Acquisitions during 20X0-20X1	7,000	8,000

Note: Current investments may not be readily convertible to a known amount of cash and may not be subject to an insignificant risk of changes in value as per the requirements of AS 3 and hence those have been considered as investing activities.

Question 30 (Illustration)

Ms. Jyoti of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year ended 31st March, 20X1:

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	(Rs. in lakhs)
Net Profit	**25,000**
Dividend paid	**8,535**
Provision for Income tax	**5,000**
Income tax paid during the year	**4,248**
Loss on sale of assets (net)	**40**
Book value of the assets sold	**185**
Depreciation charged to the Statement of Profit and Loss	**20,000**
Profit on sale of Investments	**100**
Carrying amount of Investment sold	**27,765**
Interest income received on investments	**2,506**
Interest expenses of the year	**10,000**
Interest paid during the year	**10,520**
Increase in Working Capital (excluding Cash & Bank Balance)	**56,081**
Purchase of Fixed assets	**14,560**
Investment in joint venture	**3,850**
Expenditure on construction work in progress	**34,740**
Proceeds from calls in arrear	**2**
Receipt of grant for capital projects	**12**
Proceeds from long-term borrowings	**25,980**
Proceeds from short-term borrowings	**20,575**
Opening cash and bank balance	**5,003**
Closing cash and bank balance	**6,988**

Prepare the Cash Flow Statement for the year ended 31 March 20X1 in accordancewith AS 3.(Make necessary assumptions)

Answer 30

Star Oils Limited Cash flow Statement for the year ended 31st March, 20X1

		(Rs. in lakhs)
Cash flows from operating activities		
Net profit before taxation (25,000 + 5,000)	30,000	
Adjustments for :		
Depreciation	20,000	
Loss on sale of assets (Net)	40	
Profit on sale of investments	(100)	

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Interest income on investments	(2,506)	
Interest expenses	10,000	

Operating profit before working capital changes	57,434	
Changes in working capital (Excluding cash and bankbalance)	(56,081)	(2,895)
Cash generated from operations	1,353	
Income taxes paid	(4,248)	
Net cash used in operating activities		
Cash flows from investing activities		
Sale of assets (W.N.1)	145	
Sale of investments (27,765 + 100)	27,865	
Receipt of grant for capital projects Interestincome on investments	12 2,506	
Purchase of fixed assets	(14,560)	
Investment in joint venture	(3,850)	
Expenditure on construction work-in progress	(34,740)	
Net cash used in investing activities		(22,622)
Cash flows from financing activities		
Proceeds from calls in arrear	2	
Proceeds from long-term borrowings	25,980	
Proceed from short-term borrowings	20,575	
Interest paid	(10,520)	
Dividend (including dividend tax) paid	(8,535)	27,502
Net increase in cash and cash equivalents		1,985
Cash and cash equivalents at the beginning of theperiod		5,003
Cash and cash equivalents at the end of the period		6,988

Working note:

1.	Book value of the assets sold	185
	Less : Loss on sale of assets	(40)
	Proceeds on sale	145

Question 31 (Illustration)

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statementfor the year ended 31st March, 20X1 in accordance with AS 3 (Revised) using the direct method. The company does not

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have any cash equivalents.

Summary Cash Account for the year ended 31 3.20X1

	Rs.'000		Rs.'000
Balance on 1.4.20X0	50	Payment to Suppliers	2,000
Issue of Equity Shares	300	Purchase of Fixed Asset	200
Receipts from Customers	2,800	Overhead expense	200
Sale of Fixed Assets	100	Wages and Salaries	100
		Taxation	250
		Dividend	50
		Repayment of Bank Loan	300
		Balance on 31.3.20X1	150
	3,250		3,250

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Answer 31

X Ltd.Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

	Rs. '000	Rs. '000
Cash flows from operating activities		
Cash receipts from customers	2,800	
Cash payments to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payments for overheads	(200)	
Cash generated from operations	500	
Income tax paid	(250)	
Net cash generated from operating activities		250
Cash flows from investing activities		
Payments for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	100	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	
Dividend paid	(50)	
Net cash used in financing activities		(50)
Net increase in cash		100
Cash at the beginning of the year		50
Cash at the end of the year		150

Question 32 (Illustration)

Given below are the relevant extracts of the Balance Sheet and the Statement of Profitand Loss of ABC Ltd. along with additional information:

Extract of Balance sheet

		Particulars	Notes	31.3.20X1 (Rs. in lakhs)	31.3.20X0 (Rs. in lakhs)
		Equity and Liabilities			
1		Current liabilities			
	(a)	Trade Payables		250	230
	(b)	Short term Provisions	1	200	180
	(c)	Other current liabilities	2	70	50

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		Assets			
1		Current assets			
	(a)	Inventories		200	180
	(b)	Trade Receivables		400	250
	(c)	Other current assets	3	195	180

Statement of Profit and Loss of ABC Ltd.for the year ended 31st March, 20X1

	Particulars	Notes	Rs. in lakhs
I	Revenue from operations		4,150
II	Other income	4	100
III	Total income (I + II)		4,250
	Expenses:		
	Purchases of Stock-in-Trade		2,400
	Change in inventories of finished goods		(20)
	Employee benefits expense		800
	Depreciation expense		100
IV	Finance cost	5	60
	Other expenses		200
	Total expenses		3,540
V	Profit before tax (III – IV)		710
VI	Tax expense: Current tax		200
VII	Profit for the year fromcontinuing operations		510

Appropriations

Balance of Profit and Loss account brought forward	50
Transfer to general reserve	200
Dividend paid	330

Notes to accounts:

		20X1 (Rs. in lakhs)	20X0 (Rs. in lakhs)

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1	Short term Provisions:Provision for Tax	200	180
2	Other current liabilities:		
	Outstanding wages	50	40
	Outstanding expenses	20	10
	Total	70	50
3	Other current assets:		
	Advance tax	195	180
4	Other income: Interest and dividend		
		100	
5	Finance cost:Interest	60	

Compute cash flow from operating activities using both direct and indirect method.

Answer 32

Cash Flows from Operating Activities

	Rs. in lakhs	Rs. in lakhs
Using Direct MethodCash Receipts:		
Cash sales and collection from Trade receivables		4,000
Sales + Opening Trade receivables – Closing Trade receivables (A)	4,150 + 250 - 400	
Cash payments:		
Cash purchases & payment to Trade payables		
Purchases + Opening Trade payables –Closing Trade payables	2,400 + 230 - 250	2,380
Wages and salaries paid	800 + 40 - 50	790
Cash expenses	200 + 10 – 20	190
Taxes paid – Advance tax		195
(B)		3,555
Cash flow from operating activities (A – B)		445
Using Indirect Method		
Profit before tax		710
Add: Non-cash items : Depreciation		100
Add: Interest : Financing cash inflow		60

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Less: Interest and Dividend : Investment cashoutflow			(100)
Less: Tax paid			(195)
Working capital adjustments			
Trade receivables	250 - 400	(150)	
Inventories	180-200	(20)	
Trade payables	250 - 230	20	
Outstanding wages	50- 40	10	
Outstanding expenses	20-10	10	(130)
Cash flow from operating activities			445

Question 33 (Illustration)

Prepare Cash flow for Gamma Ltd., for the year ending 31.3.20X1 from the following information:

(1) **Sales for the year amounted to Rs. 135 crores out of which 60% was cash sales.**

(2) **Purchases for the year amounted to Rs. 55 crores out of which credit purchase was 80%.**

(3) **Administrative and selling expenses amounted to Rs. 18 crores and salary paid amountedto Rs. 22 crores.**

(4) **The Company redeemed debentures of Rs. 20 crores at a premium of 10%. Debenture holders were issued equity shares of Rs. 15 crores towards redemption and the balance was paid in cash. Debenture interest paid during the year was Rs. 1.5 crores.**

(5) **Dividend paid during the year amounted to Rs. 11.7 crores.**

(6) **Investment costing Rs. 12 crores were sold at a profit of Rs. 2.4 crores.**

(7) **Rs. 8 crores was paid towards income tax during the year.**

(8) **A new plant costing Rs. 21 crores was purchased in part exchange of an old plant. The book value of the old plant was Rs. 12 crores but the vendor took over theold plant at a value of Rs. 10 crores only. The balance was paid in cash to the vendor.**

(9) **The following balances are also provided:**

	Rs. in crores 1.4.20X0	**Rs. in crores 31.3.20X1**
Debtors	**45**	50
Creditors	**21**	23
Bank	**6**	18.2

Answer 33

Gamma Ltd. Cash Flow Statement for the year ended 31st March, 20X1(Using direct method)

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Particulars	Rs. in crores	Rs. in crores
Cash flows from operating activities		
Cash sales (60% of 135)	81	
Cash receipts from Debtors	49	
[45+ (135x40%) - 50]		
Cash purchases (20% of 55)	(11)	
Cash payments to suppliers	(42)	
[21+ (55x80%) – 23]		
Cash paid to employees	(22)	
Cash payments for overheads (Adm. and selling)	(18)	
Cash generated from operations	37	
Income tax paid	(8)	
Net cash generated from operating activities		29
Cash flows from investing activities		
Sale of investments (12+ 2.40)	14.4	
Payments for purchase of fixed assets (21 – 10)	(11)	
Net cash generated from investing activities		3.4
Cash flows from financing activities		
Redemption of debentures (22-15)	(7)	
Interest paid	(1.5)	
Dividend paid	(11.7)	
Net cash used in financing activities		(20.2)
Net increase in cash		12.2
Cash at beginning of the period		6.0
Cash at end of the period		18.2

Question 34 (Illustration)

From the following information of Mr. Zen, prepare a Cash flow statement as per AS-3 for the yearended 31.3.20X1:

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Ledger balances of Mr. Zen as of 20X0 and 20X1

	As on 1.4.20X0	As on 1.4.20X1
	Rs.	Rs.
Zen's Capital A/c	10,00,000	12,24,000
Trade payables	3,20,000	3,52,000
Mrs. Zen's loan	2,00,000	--
Loan from Bank	3,20,000	4,00,000
Land	6,00,000	8,80,000
Plant and Machinery	6,40,000	4,40,000
Inventories	2,80,000	2,00,000
Trade receivables	2,40,000	4,00,000
Cash	80,000	56,000

Additional information:

A machine costing Rs. 80,000 (accumulated depreciation there on Rs.24,000) was soldfor Rs. 40,000. The provision for depreciation on 1.4.20X0 was Rs. 2,00,000 and 31.3.20X1 was Rs. 3,20,000. The net profit for the year ended on 31.3.20X1 was Rs. 3,60,000.

Answer 34

Cash Flow Statement of Mr. Zen as per AS 3for the year ended 31.3.20X1

			Rs.
(i)	**Cash flow from operating activities**		
	Net Profit (given)		3,60,000
	Adjustments for		
	Depreciation on Plant & Machinery (W.N.2)	1,44,000	
	Loss on Sale of Machinery (W.N.1)	16,000	1,60,000
	Operating Profit before working capitalchanges		5,20,000
	Decrease in inventories	80,000	
	Increase in trade receivables	(1,60,000)	
	Increase in trade payables	32,000	(48,000)
	Net cash generated from operating activities		4,72,000
(ii)	**Cash flow from investing activities**		
	Sale of Machinery (W.N.1)	40,000	
	Purchase of Land (8,80,000 – 6,00,000)	(2,80,000)	
	Net cash used in investing activities		(2,40,000)
(iii)	**Cash flow from financing activities**		
	Repayment of Mrs. Zen's Loan	(2,00,000)	

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Drawings (W.N.3)	(1,36,000)	
Loan from Bank	80,000	
Net cash used in financing activities		(2,56,000)
Net decrease in cash		(24,000)
Opening balance as on 1.4.20X0		80,000
Cash balance as on 31.3.20X1		56,000

Working Notes:

1. **Plant & Machinery A/c**

	Rs.		**Rs.**
To Balance b/d (6,40,000 + 2,00,000)	8,40,000	By Cash – Sales	40,000
		By Provision forDepreciation A/c	24,000
		By Profit & Loss A/c – Loss on Sale (80,000 – 64,000)	16,000
		By Balance c/d (4,40,000+3,20,000)	7,60,000
	8,40,000		8,40,000

Provision for depreciation on Plant and Machinery A/c

	Rs.		**Rs.**
To Plant and Machinery A/c	24,000	By Balance b/d	2,00,000
To Balance c/d	3,20,000	By Profit & Loss A/c(Bal. fig.)	1,44,000
	3,44,000		3,44,000

To find out Mr. Zen's drawings:

	Rs.
Opening Capital	10,00,000
Add: Net Profit	3,60,000
	13,60,000
Less: Closing Capital	(12,24,000)
Drawings	1,36,000

Note: Students may note that in case there is an increase in the amount of debentures/loans during the year and the interest is required to be computed, then in such a case, students may choose either to compute interest on the closing balance of the debentures or may compute interest on opening balance for full year (in case of no repayment) and proportionate interest on additions. Suitable note for assumption may be given in the solution for this.

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Chapter 12

Buy back of securities

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.17 TO Q.32											
Past Exams	Q.6	NO	Q.7	Q.13	NO	NO	Q.12 Q.14	Q.3	Q.15	Q.6	Q.1	NO
MTP	Q.3	Q.3 Q.4	Q.3	Q.2	NO	Q.2	NO	Q.2 Q.5	Q.6	Q.7	Q.5 Q.8	Q.2 Q.8
RTP	Q.4	Q.10	Q.6	Q.9	Q.2	Q.8	Q.6	Q.13	Q.4	Q.9	Q.11	NO

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Chapter 12

Buy back of securities

Question 1

What are the conditions to be fulfilled by a Joint Stock Company to buy-back itsequity shares as per Companies Act, 2013? Explain in brief. (Old & New SM) (PYP 5 Marks May '23)

Answer 1

Section 68 to 70 of the Companies Act, 2013 lays down the provisions for a company to buy-back its own equity shares. The Companies Act, 2013 under Section 68 (1) permits companies to buy-back theirown shares and other specified securities out of:

(i) Its free reserves; or

(ii) The securities premium account; or

(iii) The proceeds of the issue of any shares or other specified securities.

Note: No buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. For example, if equity shares are to be bought-back, then, preference shares may be used for the purpose. The other important provisions relating to the buy-back are:

(1) Section 68 (2) further states that no company shall purchase its own shares or other specified securities unless—

(a) the buy-back is authorised by its articles;

(b) a special resolution has been passed in general meeting of the company authorising the buy- back; However, the above provisions do not apply where the buy-back is ten percent or less ofthe paid-up equity capital + free reserves and is authorized by a board resolution passed at a duly convened meeting of the directors. Hence, in case the buy-back is up to 10% of paid up equity + free reserves, the same may be done with the authorization of the Board Resolution without the necessity of its being authorized by the articles of association of the company and by a special resolution of its members passed at a general meeting of the company.

(c) the buy-back must be equal or less than twenty-five per cent of the total paid-up capital and free reserves of the company: (Resource Test)

(d) Further, the buy-back of shares in any financial year must not exceed25% of its total paid-up capital and free reserves: (Share Outstanding Test)

(e) the ratio of the debt owed by the company (both secured and unsecured) after such buy-back is not more than twice the total of its paid-up capital and its free reserves: (Debt-Equity Ratio Test) **Note:** Central Government may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies. Debt here should include both long-term debt as well as short term debt.

(f) all the shares or other specified securities for buy-back are fully paid-up;

(g) the buy-back of the shares or other specified securities listed on any recognised stock exchangeis in accordance with the regulations madeby the Securities and Exchange Board

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of India in this behalf;

(h) the buy-back in respect of shares or other specified securities other than those specified in clause (f) is in accordance with the guidelines as may be prescribed. Provided that no offer of the buy-back under this sub section shall be made within a period of one year reckoned from the date of closure of a previous offer of buy-back if any. This means that there cannot be morethan one buy- back in one year.

(2) The notice of meeting at which special resolution is supposed to be passed must be accompanied byan explanatory statement stating-

(a) a full and complete disclosure of all material facts;

(b) the necessity of the buy-back;

(c) the class of security intended to be purchased under the buy-back;

(d) the amount to be invested under the buy-back;

(e) the time limit for completion of the buy-back.

(3) Every buy-back shall be completed within twelve months from the date of passing the specialresolution, or the resolution passed by the board of directors.

(4) The buy-back may be—

(a) from the existing

(b) security holders on a proportionate basis; or

(c) from the open market; or

(d) by purchasing the securities issued to employees of the company pursuant to a scheme ofstock option or sweat equity.

(5) Where a company has passed a special resolution under clause (b) of Sub- section (2) to buy-back its own shares or other securities under this section, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board of India a declaration of solvency in the form as may be prescribed and verified by an affidavit to the effect that the Board of Directors has made a full inquiryinto the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the Board of Directors. It must be signed by at least two directorsof the company, one of whom shall be the managing director, if any:

Note: No declaration of solvency shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.

(6) Where a company buys-back its own securities, it shall extinguish and physically destroy the securities so bought-back within seven days of the last date of completion of buy-back.

(7) Where a company completes a buy-back of its shares or other specified securities under this section, itshall not make further issue of same kind of shares (including allotment of further shares under clause

(a) of Sub-section (1) of Section (62) or other specified securities within a period of six months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stockoption scheme, sweat equity or conversion of preference shares or debentures into equity shares.

(8) Where a company buy-back its securities under this section, it shall maintain a register of the securitiesso bought, the consideration paid for the securities bought-back, the date of can-

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cellation of securities,the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.

(9) A company shall, after the completion of the buy-back under this section, file with the Registrar and theSecurities and Exchange Board of India, a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed, provided that no return shall be filed withthe Securities and Exchange Board of India by a company whose shares are not listed on any recognisedstock exchange.

(10) If a company makes default in complying with the provisions of this section or any regulations made bySEBI in this regard, the company may be punishable with a fine which shall not be less than Rs One Lakhbut which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for upto 3 years or with a fine of not less than one lakh rupees but whichmay extend to three lakh rupees or with both.

(11) Section 69 (1) states that where a company purchases its own shares out of the free reserves or securities premium account, a sum equal to the nominal value of shares so purchased shall betransferred to the Capital Redemption Reserve Account and details of such account shall be disclosed in the Balance Sheet.

(12) The shares or other specified securities which are proposed to be bought- back must be fully paid-up.

(13) The Capital Redemption Reserve Account may be applied by the company in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

(14) Premium (excess of buy-back price over the par value) paid on buy-back should be adjusted against freereserves and/or securities premium account. Revaluation reserve represents unrealized profit and hence it cannot be used for buy-back of securities.

(1) No company shall directly or indirectly purchase its own shares or other specified securities—

(a) through any subsidiary company including its own subsidiary companies; or

(b) through any investment company or group of investment companies; or

(c) if a default is subsisting, in repayment of deposit or interest payable thereon, redemptionof debentures or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institutions or bank. Provided that the buy–back is not prohibited if the default is remedied and a periodof three years has elapsed since the cessation of the default.

(2) In accordance with schedule III, no company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with provisions of Sections 92 (filling of annual return), 123 (payment of dividend within 30 days of declaration),

127 (failure to distribute dividend) and 129 (preparation of financial statement of the company).

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Question 2

The following was the summarized balance sheet of Bhoomi Ltd. as on 31st March, 2020:

Equity & liability	Rs (in lakhs)	Assets	Rs (in lakhs)
Authorised Capital:		Property, plant and equipment	1,12,000
Equity shares of Rs 10 each	80,000	Investments	24,000
Issued Capital		Cash at Bank	13,200
Equity Shares of Rs10 each Fully Paid up	64,000	Trade Receivables	66,000
10% Redeemable Preference Shares of 10 each, Fully Paid Up	20,000		
Reserves & Surplus:			
Capital Redemption Reserve	8,000		
Securities Premium	6,400		
General Reserve	48,000		
Profit & Loss Account	2,400		
9% Debentures	40,000		
Trade Payables	26,400		
	2,15,200		2,15,200

On 1st April,2020 the Company redeemed all its Preference Shares at a Premium of 10% and bought back 25% of its Equity Shares at Rs20 per Share. In order to make Cash available, the Company sold all the Investments for Rs25,000 Lakhs and raised a Bank Loan amounting to Rs16,000 lakh on the Security of the Company's Plant. Give the necessary Journal Entries considering that the buy back is authorised by the articles of company and necessary resolution is passed by the company for this. The amount of Securities premium may be utilized to the maximum extent allowed by law. (MTP 8 Marks Oct '20, Oct'21 & Oct '23, MTP 12 Marks Oct'19)(Same concept different figures RTP May'20)

Answer 2

Journal entries In the books of Bhoomi Ltd.

		Dr.	Cr.

			Rs in lakhs	
1	Bank A/c	Dr.	25,000	
	To Investments A/c			24,000
	To Profit and Loss A/c			1,000
	(Being Investments sold and, profit being credited to Profit and Loss Account)			
2	10% Redeemable Preference Share Capital A/c	Dr.	20,000	

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	Premium payable on Redemption of Preference Shares A/c	Dr.	2,000	
	To Preference Shareholders A/c			22,000
	(Being amount payable on redemption of Preference shares,at a Premium of 10%)			
3	Securities Premium A/c	Dr.	2,000	
	To Premium payable on Redemption of Preference Shares A/c			2,000
	(Being Securities Premium utilised to provide Premium on Redemption of Preference Shares)			
4	Equity Share Capital A/c	Dr.	16,000	
	Premium payable on Buyback A/c	Dr.	16,000	
	To Equity Share buy back A/c			32,000
	(Being the amount due on buy-back)			
5	Securities Premium A/c (6,400 – 2,000)	Dr.	4,400	
	General Reserve A/c (balancing figure)	Dr.	11,600	
	To Premium payable on Buyback A/c			16,000
	(Being premium on buyback provided first out of Securities Premium and the balance out of General Reserves.)			
6	Bank A/c	Dr.	16,000	
	To Bank Loan A/c			16,000
	(Being Loan taken from Bank to finance Buyback)			
7	Preference Shareholders A/c	Dr.	22,000	
	Equity Shares buy back A/c	Dr.	32,000	
8	To Bank A/c			54,000
	(Being payment made to Preference Shareholders and Equity Shareholders)			
	General Reserve Account	Dr.	36,000	
	To Capital Redemption Reserve Account			36,000
	(Being amount transferred to Capital Redemption Reserve Account to the extent of face value of preference shares re-deemed and equity Shares bought back) (20,000 + 16,000)			

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Question 3

SMM Ltd. has the following capital structure as on 31st March, 2017: Rs. in crore

Particulars	Situation	Situation
(i) Equity share capital (shares of Rs. 10 each)	1,200	1,200
(ii) Reserves: General Reserves	1,080	1,080
Securities Premium	400	400
Profit & Loss	200	200
Infrastructure Development Reserve (Statutory Reserve)	320	320
(iii) Loan Funds	3,200	6,000

The company has offered buy back price of Rs. 30 per equity share.You are required to calculate maximum permissible number of equity shares that can be bought back in both situations and also required to pass necessary Journal Entries. (MTP 10 Marks, Apr 19 & Mar 18, MTP 12 Marks Aug 18, Mar 19) (Same concept different figures PYP 15 Marks July'21)

Answer 3

Statement determining the maximum number of shares to be bought back

Number of shares (in crores)

Particulars	When loan fund is crores	
	Rs.3,200crores	Rs. 6,000 crores
Shares Outstanding Test (W.N.1)	30	30
Resources Test (W.N.2)	**24**	**24**
Debt Equity Ratio Test (W.N.3)	**32**	Nil
Maximum number of shares that can be bought back [least of the above]	24	Nil

Journal Entries for the Buy Back

(applicable only when loan fund is Rs. 3,200 crores)

		Rs. in crores	
		Debit	**Credit**
(a) Equity Share buyback account	Dr.	720	
To Bank Account (Being payment for buy back of 24 crores equity shares of 10 each @ Rs. 30 per share)			720
(b) Equity share capital account	Dr.	**240**	

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Premium Payable on buyback account	Dr	**480**	
To Equity Share buyback account (Being cancellation of shares bought back)			720
Securities Premium account		**400**	
General Reserve / Profit & Loss A/c	Dr.	**80**	
To Premium Payable on buyback account (Being Premium Payable on buyback account charged to securities premium and general reserve/Profit & Loss A/c			**480**
(c).General Reserve / Profit & Loss A/c	Dr	**240**	
To Capital redemption reserve account (Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)			**240**

Working Notes:

1. **Shares Outstanding Test**

Particulars	**(Shares in crores**
Number of shares outstanding	120
25% of the shares outstanding	30

Resources Test

Particulars	**(Rs. in crores)**
Paid up capital	1,200
Free reserves (Rs. in crores) (1,080 + 400 +200)	1,680
Shareholders' funds (Rs. in crores)	2,880
25% of Shareholders fund (Rs. in crores)	Rs. 720 crores
Buy back price per share	Rs. 30
Number of shares that can be bought back	24 crores shares

Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds Post Buy Back

Particulars	**When loan fund is**	
	Rs. 3,200 crores	**Rs. 6,000 crores**
(a) Loan funds (Rs.)	3,200	6,000
(b) Minimum equity to be maintained after buy back in the ratioof 2:1 (Rs.) (a/2)	1,600	3,000
(c) Present equity shareholders fund (Rs.)	2,880	2,880

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(d) Future equity shareholders fund (Rs.) (see W.N.4)	2,560 (2,880-320)	N.A.
(e) Maximum permitted buy back of Equity (Rs.) [(d) – (b)]	960	Nil
(f) Maximum number of shares that can be bought back @ Rs. 30per share	32 crore shares	Nil
As per the provisions of the Companies Act, 2013, company	Qualifies	Does not Qualify

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'

Then

Equation 1 : (Present Equity- Transfer to CRR)- Minimum Equity to be maintained = MaximumPermitted Buy Back

= (2,880 – x) – 1,600 = y

= 1280 – x =y (1)

Equation 2: Maximum Permitted Buy Back X Nominal Value Per Share/Offer Price Per Share

$= (\frac{y}{30} \times 10) = X$ or 3x =y (2)

by solving the above two equations we getx= Rs. 320y = Rs. 960

Question 4

Following is the summarized Balance Sheet of Complicated Ltd. as on 31st March, 2016:

Liabilities	Amount (Rs.)
Equity shares of Rs. 10 each, fully paid up	12,50,000
Bonus shares of Rs. 10 each, fully paid up	1,00,000
Share option outstanding Account	4,00,000
Revenue Reserve	15,00,000
Securities Premium	2,50,000
Profit & Loss Account	1,25,000
Capital Reserve	2,00,000
Unpaid dividends	1,00,000
12% Debentures (Secured)	18,75,000
Advance from related parties (Unsecured)	10,00,000
Current maturities of long term borrowings	16,50,000
Application money received for allotment due for refund	2,00,000

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	86,50,000
Property, Plant & Equipment	**46,50,000**
Current Assets	**40,00,000**
	86,50,000

The Company wants to buy back 25,000 equity shares of Rs. 10 each, on 1st April, 2016 at Rs. 20 per share. Buy back of shares is duly authorized by its Articles and necessary resolution has been passed by the Company towards this. The buy -back of shares by the Company is also within the provisions ofthe Companies Act, 2013. The payment for buy back of shares will be made by the Company out of sufficientbank balance available shown as part of Current Assets. You are required to prepare the necessary journal entries towards buy back of shares and prepare the Balance Sheet after buy back ofshares. (MTP 15 Marks Oct 18)(Same amount different figures RTP May'18, May'22, Old & New SM)

Answer 4

As per the information given in the Question, buy -back of 25,000 shares @ Rs. 20, as desired by the company, is within the provisions of the Companies Act, 2013.

Journal Entries for buy-back of shares

	Debit	Credit
(a) Equity Share buyback account Dr.	5,00,000	
To Bank Account (Being buy back of 25,000 equity shares of Rs. 10 each @Rs. 20 per share)		5,00,000
(b) Equity share capital account Dr.	2,50,000	
Securities premium account	2,50,000	
To Equity shares buy-back account (Being cancellation of shares bought back)		5,00,000
(c)Revenue reserve account	2,50,000	
To Capital redemption reserve account (Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought backthrough free re-serves)		2,50,000

Balance Sheet of Complicated Ltd.as on 1st April, 2016

Particulars	Note No	Amount Rs.
EQUITY AND LIABILITIES		
1 Shareholders' funds		
(a) Share capital	1	11,00,000
(a) Reserves and Surplus	2	22,25,000
2 Non-current liabilities		

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(a) Long-term borrowings	3	28,75,000
3 Current liabilities		
(a) Other current liabilities	4	19,50,000
Total		81,50,000
ASSETS		
1 Non-current assets		
(a) Property, Plant & Equipment		46,50,000
2 **Current** assets (40,00,000-5,00,000)		35,00,000
Total		81,50,000

Notes to Accounts

2.	Reserves and Surplus			
	Profit and Loss A/c		1,25,000	
	Revenue reserves	15,00,000		
	Less: Transfer to CRR	(2,50,000)	12,50,000	
	Securities premium	2,50,000		
	Less: Utilization for share buy-back	(2,50,000)	-	
	Share Option Outstanding Account		4,00,000	
	Capital Reserve		2,00,000	
	Capital Redemption Reserve		2,50,000	22,25,000
3.	Long-term borrowings			
	Secured			
	12% Debentures		18,75,000	
4.	Unsecured loans		10,00,000	28,75,000
	Other Current Liabilities			
	Current maturities of long term borrowings		16,50,000	
	Unpaid dividend		1,00,000	
	Application money received for allotment due for refund		2,00,000	19,50,000

Question 5

SM Limited gives the following information as on 31st March, 2023:

		Rs
Share capital		
(60,000 Equity Shares of Rs 10 Each)		**6,00,000**

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Reserve & Surplus:		
Security premium	**Rs 70,000**	
General reserve	**Rs 63,000**	
Profit and Loss	**Rs 1,40,000**	**2,73,000**
Non-current liability:		
9% debentures (secured)		**3,00,000**
Current Liabilities:		
Term loan		**40,000**
Creditors		**65,000**
Provision for taxation		**15,000**
Property plant and equipment		**6,00,000**
Non-current investment		**1,50,000**
Current assets:		
Stock	**Rs 2,00,000**	
Debtors	**Rs 2,60,000**	
Bank	**Rs 83,000**	**5,43,000**

The shareholders adopted the resolution on 31st March, 2020 to:

(i) Buy back 25% of the paid up capital @ Rs 15 each.

(ii) Issue 10% debentures of Rs 60,000 at a premium of 10% to finance the buyback of shares.

(iii) Maintain a balance of Rs 20,000 in General Reserve.

(iv) Sell investments worth Rs 1,00,000 for Rs 80,000.

(v) Buy back expenses were Rs 2,000.

You are required to pass necessary journal entries to record the above transactions and prepareLedger account of Bank. (MTP 8 Marks Nov '21 & April '23)

Answer 5

In the books of SM Limited Journal Entries

	Particulars	Dr.	Cr.
		Rs	Rs
1.	Equity share capital A/c (15,000 x Rs10) Dr.	1,50,000	
	Premium on buyback A/c (15,000 x Rs5) Dr.	75,000	
	ity shares buy back or Equity Shareholders A/c (15,000 x Rs15) (Being the amount due to equity shareholders on buy back)		2,25,000
2.	Equity shares buy back/Equity shareholders A/c Dr.	2,25,000	
	To Bank A/c		2,25,000

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	(Being the payment made on account of buy back of 15,000 Equity Shares as per the Companies Act)		
3.	Bank A/c Dr.	66,000	
	To 10 % Debentures A/c		60,000
	To Securities Premium A/c		6,000
	(Being 14 % debentures issued to finance buy back)		
4.	Buyback Expenses A/c Dr.	2,000	
	To Bank A/c		2,000
	(Buyback expenses paid)		
5.	Bank A/c Dr.	80,000	
	Profit and Loss A/c (Loss on sale of investment) Dr.	20,000	
	To Investment A/c		1,00,000
	(Being investment sold at loss)		
6.	General reserve Dr.	43,000	
	Profit and Loss A/c Dr.	1,07,000	
	To Capital redemption reserve A/c		1,50,000
	(Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve accountas per the law)		
7.	Securities Premium Dr.	75,000	
	Profit and Loss A/c Dr	2,000	
	To Premium on buyback		75,000
	To Buyback Expenses A/c		2,000
	(Being premium on buyback and buyback expenses charged tosecurities premium and profit and loss account)		

Bank Account

Particulars	Amount (Rs)	Particulars	Amount (Rs)
To Balance b/d To	83,000	By Equity Shareholders A/c	2,25,000
Investment A/c	80,000	By Expenses on buy back of shares	2,000
To 10% Debentures and Securities premium	66,000	By Balance c/d	2,000
Total	2,29,000	Total	2,29,000

Note: It may be noted that as per the provisions of the Companies Act, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. Issue of debentures has been excluded for the purpose of "specified securities" and the entire amount of Rs 1,50,000 has been credited to CRR while solving the Question.

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Question 6

Alpha Ltd. furnishes the following information as at 31st March, 2021:

	Rs In lakhs	Rs In lakhs
Shareholders' Funds		
Equity share capital (fully paid up shares of Rs 10 each)		2,400
Reserves and Surplus		
Securities Premium	350	
General Reserve	530	
Capital Redemption Reserve	400	
Profit & Loss Account	340	1,620
Non-current Liabilities		
12% Debentures		1,500
Current Liabilities		
Trade Payables	1,490	
Other Current Liabilities	390	1,880
Non-current Assets		
Property, plant and equipment		4,052
Current Assets		
Current Investments	148	
Inventories	1,200	
Trade Receivables	520	
Cash and Bank	1,480	3,348

On 1st April, 2021, the company announced buy-back of 25% of its equity shares @ Rs 15 per share. For this purpose, it sold all its investment for Rs 150 lakhs.On 10th April, 2021 the company achieved the target of buy-back.

On 30th April, 2021, the company issued one fully paid up equity share of Rs 10 each by way of bonus for every four equity shares held by the equity shareholders by capitalization of Capital Redemption Reserve. Premium (excess of buy-back price over the par value) paid on buy-back should be adjusted against securities premium account. You are required to pass necessary journal entries and preparethe Balance Sheet of Alpha Ltd. after bonus issue. (MTP 12 Marks Mar'22, PYP 10 Marks May '18) (Same concept different figures RTP May'21, RTP May'19, PYP 5 Marks Nov'22)

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Answer 6

In the books of Alpha Limited Journal **Entries**

Date	Particulars	Dr.	Cr.
2021	(Rs in lakhs)		
April 1	Bank A/c Dr.	150	
	To Investment A/c		148
	To Profit on sale of investment		2
	(Being investment sold on profit)		
April 10	Equity share capital A/c Dr.	600	
	Securities premium A/c Dr.	300	
	To Equity shares buy back A/c		900
	(Being the amount due to equity shareholders on buy back)		
	Equity shares buy back A/c Dr.	900	
	To Bank A/c		900
	(Being the payment made on account of buy back of Rs 60 LakhEquity Shares)		
April 10	General reserve A/c Dr.	530	
	Profit and Loss A/c Dr.	70	
	To Capital redemption reserve (CRR) A/c		600
	(Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemp-tion reserveaccount as per the law)		
April 30	Capital redemption reserve A/c Dr.	450	
	To Bonus shares A/c (W.N.1) (Being the utilization of capital redemption reserve to issue bonus shares)		450
	Bonus shares A/c Dr.	450	
	To Equity share capital A/c		450
	(Being issue of one bonus equity share for every four equityshares held)		
	Profit on sale of Invest-ment Dr. To Profit and Loss A/c	2	2
	(Profit on sale transfer to Profit and Loss A/c)		

Note: For transferring amount equal to nominal value of buy back shares from free reserves to capital redemption reserve account, the amount of Rs 340 lakhs from P & L A/c and the balance from general reserve may also be utilized. The combination of different set of amounts (from General Reserve and

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Profit and Loss Account) aggregating Rs 600 lakhs may also be considered for the purpose of transfer to CRR.**Balance Sheet (After buy back and issue of bonus shares)**

Particulars	Note No	Amount (Rs in Lakhs)
I. Equity and Liabilities		
(1) Shareholder's Funds	1	2,250
(a) Share Capital		
(b) Reserves and Surplus	2	872
(2) Non-Current Liabilities		
(a) Long-term borrowings - 12% Debentures		1,500
(3) Current Liabilities		
(a) Trade payables		1,490
(b) Other current liabilities		390
Total		6,502
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment		4,052
(2) Current assets		
(a) Current investments		
(b) Inventory		1,200
(c) Trade receivables		520
(d) Cash and cash equivalents (W.N. 2)		730
Total		6,502

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Notes to Accounts

			Rs In lakhs
1.	Share Capital		
	Equity share capital (225 lakh fully paid up shares of Rs 10each)		2,250
2.	Reserves and Surplus		

	General Reserve	530		
	Less: Transfer to CRR	(530)	-	
	Capital Redemption Reserve	400		
	Add: Transfer due to buy-back of shares from P/L	70		
	Add: Transfer due to buy-back of shares from Gen. res. 530			
	Less: Utilisation for issue of bonus shares	(450)	550	
	Securities premium	350		
	Less: Adjustment for premium paid on buy back	(300)	50	
	Profit & Loss A/c	340		
	Add: Profit on sale of investment	2		
	Less: Transfer to CRR	(70)	272	872

1. Working **Notes:**Amount of equity share capital = 2,400 - 600 (buyback) + 450 (Bonus shares) = 2,250
2. Cash at bank after issue of bonus shares

	Rs in lakhs
Cash balance as on 1st April, 2021	1480
Add: Sale of investments	150
	1630
Less: Payment for buy back of shares	(900)
	730

Question 7

Super Ltd. gives the following information as on 31st March, 2022.

Liabilities	**In ₹**
Equity Shares of ₹ 10 each fully paid up	**17,00,000**
Revenue Reserve	**23,50,000**
Securities Premium	**2,50,000**
Profit & Loss Account	**2,00,000**
Infrastructure Development Reserve	**1,50,000**

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9% Debentures	**38,00,000**
Unsecured Loan	**8,50,000**
Property, plant & equipment	**58,50,000**
Current Assets	**34,50,000**

Super Limited wants to buy back 35,000 equity shares of ₹ 10 each fully paid up on 1st April, 2022 at **₹ 30 per share.**

Buy Back of shares is fully authorised by its articles and necessary resolutions have been passed by the company towards this. The payment for buy back of shares will be made by the company out of sufficient bank balance available as part of the Current Assets. Comment with calculations, whether the Buy Back of shares by the company is within the provisions of the Companies Act, 2013. (MTP 10 Marks Oct'22, PYP 10 Marks May '19)

Answer 7

Determination of maximum no. of shares that can be bought back as per the Companies Act, 2013

1. **Shares Outstanding Test**

Particulars	(Shares)
Number of shares outstanding	1,70,000
25% of the shares outstanding	42,500

Resources Test: Maximum permitted limit 25% of Equity paid up capital + Free Reserves

Particulars	
Paid up capital (₹)	17,00,000
Free reserves (₹) (23,50,000 + 2,50,000 + 2,00,000)	28,00,000
Shareholders' funds (₹)	45,00,000
25% of Shareholders fund (₹)	11,25,000
Buy back price per share	₹ 30
Number of shares that can be bought back (shares)	37,500
Actual Number of shares proposed for buy back	35,000

Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Shareholder's Funds post Buy Back

	Particulars	₹
(a)	Loan funds (₹) (38,00,000+8,50,000)	46,50,000
(b)	Minimum equity to be maintained after buy back in the ratio of 2:1 (₹) (a/2)	23,25,000
(c)	Present equity/shareholders fund (₹)	45,00,000
(d)	Future equity/shareholders fund (₹) (see W.N.) (45,00,000 – 5,43,750)	39,56,250
(e)	Maximum permitted buy back of Equity (₹) [(d) – (b)]	16,31,250

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(f)	Maximum number of shares that can be bought back @ ₹ 30 per share	54,375 shares
(g)	Actual Buy Back Proposed	35,000 Shares

Summary statement determining the maximum number of shares to be bought back

Particulars	Number of shares
Shares Outstanding Test	42,500
Resources Test	37,500
Debt Equity Ratio Test	54,375
Maximum number of shares that can be bought back [least of the above]	37,500

Company qualifies all tests for buy-back of shares and it can buy back maximum 37,500 shares on 1st April,2022.

However, company wants to buy-back only 35,000 equity shares @ ₹ 30. Therefore, buy-back of 35,000 shares, as desired by the company is within the provisions of the Companies Act, 2013.

Working Note:

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Then

$$(45,00,000 - x) - 23,25,000 = y \qquad (1)$$

$$\left(\frac{y}{30} \times 10\right) = x \text{ Or } 3x = y \qquad (2)$$

by solving the above equation, we get

$$x = ₹\ 5,43,750$$

$$y = ₹\ 16,31,250$$

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Question 8

Pratham Ltd. (a non-listed company) has the following Capital structure as on 31st March, 2022:

Particulars	₹	₹
Equity Share Capital (shares of ₹ 10 each fullypaid		30,00,000
Reserves & Surplus		
General Reserve	32,50,000	
Security Premium Account	6,00,000	
Profit & Loss Account	4,30,000	
Revaluation Reserve	6,20,000	49,00,000
Loan Funds		42,00,000

You are required to compute by Debt Equity Ratio Test, the maximum number of shares that can be bought back in the light of above information, when the offer price for buy back is ₹ 30 per share.. (MTP 15 Marks March '23, Old & New SM, RTP Nov 20)(MTP 10 Marks Sep '23)

Answer 8

Debt Equity Ratio Test

	Particulars	₹
(a)	Loan funds	42,00,000
(b)	Minimum equity to be maintained after buy back inthe ratio of 2:1 (₹ in crores)	21,00,000
(c)	Present equity shareholders fund (₹ in crores)	72,80,000
(d)	Future equity shareholder fund (₹ in crores) (See Note 2)	59,85,000 (72,80,000-12,95,000)
(e)	Maximum permitted buy back of Equity (₹ in crores)[(d) – (b)] (See Note 2)	38,85,000 (by simultaneous equation)
(f)	Maximum number of shares that can be bought back@ ₹ 30 per share (shares in crores) (See Note 2)	1,29,500 (by simultaneous equation)

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Working Note:

1. **Shareholders' funds**

Particulars	₹
Paid up capital	30,00,000
Free reserves (32,50,000 +6,00,000+4,30,000)	42,80,000
	72,80,000

As per section 68 of the Companies Act, 2013, amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x'

and maximum permitted buy-back of equity is 'y'.

Equation 1 :(Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained = Maximum permissible buy-back of equity

(72,80,000 –x)-21,00,000 = y (1)

Since 51,80,000 – x = y

Equation 2 : $\left(\frac{\text{Maximum buy–back}}{\text{Offer price for buy–back}} \text{ X Nominal Value}\right)$

= Nominal value of the shares bought –back to be transferred to CRR

$X = \left(\frac{y}{30} X10\right) = X$

3x = y (2)

x = ₹ 12,95,000 crores and y = ₹ 38,85,000 crores

Question 9

Umesh Ltd. resolves to buy back 4 lakhs of its fully paid equity shares of Rs. 10 each at Rs. 22 per share. This buyback is in compliance with the provisions of the Companies Act and does not exceed 25% of Company's paid up capital in the financial year. For the purpose, it issues 1 lakh 11 % preference shares of Rs. 10 each at par, the entire amount being payable with applications. The company uses Rs. 16 lakhs of its balance in Securities Premium Account apart from its adequate balance in General Reserve to fulfill the legal requirements regarding buy-back. Give necessary journal entries to record the above transactions. (RTP Nov 19, Nov'22)

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Answer 9

Journal Entries in the books of Umesh Ltd.

			Rs.	Rs.
1.	Bank A/c	Dr.	10,00,000	
	11% Preference share application & allotment A/c			10,00,000
	(Being receipt of application money on preference shares)			
2.	11% Preference share application & allotment A/c	Dr.	10,00,000	
	To 11% Preference share capital A/c			10,00,000
	(Being allotment of 1 lakh preference shares)			
3.	General reserve A/c	Dr.	**30,00,000**	
	To Capital redemption reserve A/c			**30,00,000**
	(Being creation of capital redemption reserve for buy backof shares)			
4.	Equity share capital A/c	Dr.	**40,00,000**	
	Premium payable on buyback A/c	Dr.	**48,00,000**	
	To Equity shareholders/Equity shares buy back A/c			**88,00,000**
	(Amount payable to equity shareholder on buy back)			
5.	Equity shareholders/ Equity shares buy back A/c	Dr.	**88,00,000**	
	To Bank A/c			**88,00,000**
	(Being payment made for buy back of shares)			
6.	Securities Premium A/c	Dr.	**16,00,000**	
	General reserve A/c		**32,00,000**	
	To Premium payable on buyback A/c			**48,00,000**
	(Being premium on buyback charged from securities premium and general reserve)			

Working Notes:

1. **Calculation of amount used from General Reserve Account**

	Rs.Rs.
Amount paid for buy back of shares (4,00,000 shares x Rs. 22)	88,00,000
Less: Proceeds from issue of Preference Shares (1,00,000 shares x Rs.10)	(10,00,000)
Less: Utilization of Securities Premium Account	(16,00,000)

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Balance used from General Reserve Account			62,00,000
* Used under Section 68 for buy back	32,00,000		
Used under Section 69 for transfer to CRR (W.N 2)		30,00,000	
		62,00,000	

Amount to be transferred to Capital Redemption Reserve account

	Rs.
Nominal value of shares bought back (4,00,000shares x Rs.10)	40,00,000
Less: Nominal value of Preference Shares issuedfor such buy back (1,00,000 shares x Rs.10)	(10,00,000)
Amount transferred to Capital RedemptionReserve Account	30,00,000

Question 10

The following summarized Balance Sheet Pee Limited (a non-listed company) furnishes as at 31st March, 2017:

Equity & Liabilities **Share capital:**	**Rs.**	**Rs.**
Authorised capital		
2,50,000 Equity shares of Rs. 10 each fully paid up	**25,00,000**	
5,000, 10% Preference shares of Rs. 100 each	**5,00,000**	**30,00,000**
Issued and subscribed capital:		
2,40,000 Equity shares of Rs. 10 each fully paid up	**24,00,000**	
3,000, 10% Preference shares of Rs. 100 each	**3,00,000**	**27,00,000**
(Issued two months back for the purpose of buy back)		
Reserves and surplus:		
Capital reserve	**10,00,000**	
Revenue reserve	**25,00,000**	
Securities premium	**27,00,000**	
Profit and loss account	**35,00,000**	**97,00,000**
Current liabilities		
Trade payables	**13,00,000**	
Other current Liabilities	**3,00,000**	**16,00,000** **1,40,00,000**
Assets		
Tangible assets		
Building	**25,00,000**	

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Machinery	**31,00,000**	
furniture	**20,00,000**	**76,00,000**
Non-current Investments	**30,00,000**	
Current assets		
Inventory	**12,00,000**	
Trade receivables	**7,00,000**	
cash and bank balance	**15,00,000**	**34,00,000**
		1,40,00,000

On 1st April, 2017, the company passed a resolution to buy back 20% of its equity capital @ Rs. 60 per share. For this purpose, it sold all of its investment for Rs. 25,00,000.

The company achieved its target of buy-back. You are required to:

(a) **Give necessary journal entries and**

(b) **Give the Balance Sheet of the company after buy back of shares. (RTP Nov 18, Old & New SM)**

Answer 10

Journal Entries in the books of Pee Limited

	Particulars		**Dr.**	**Cr.**
(i)	Bank Account	Dr.	25,00,000	
	Profit and Loss Account	Dr.	5,00,000	
	To Investment Account			30,00,000
	(Being the investments sold at loss for the purpose of buy back)			
(ii)	Equity Share capital account	Dr.	4,80,000	
	Premium payable on buy back Account	Dr.	24,00,000	
	To Equity shares buy back Account			28,80,000
	(Being the amount due on buy back)			
(iii)	Securities Premium Account	Dr.	24,00,000	
	To Premium payable on buy back Account			24,00,000
	(Being the premium payable on buy back adjusted against			
	securities premium account)			
(iv)	Revenue Reserve Account	Dr.	1,80,000	
	To Capital Redemption Reserve Account			1,80,000
	(Being the amount equal to nominal value of equity shares bought back out of free reserves transferred to capital			

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	redemption reserve account (4,80,000-3,00,000)			
(v)	Equity shares buy-back Account	Dr.	28,80,000	
	To Bank Account			28,80,000
	(Being the payment made on buy back)			

Balance Sheet of Pee Limited as on 1st April, 2017(After buy back of shares)

	Particulars	Note No	(Rs.)
I.	Equity and Liabilities		
(1)	Shareholder's Funds		
	(a) Share Capital	1	22,20,000
	(b) Reserves and Surplus	2	68,00,000
(2)	Current Liabilities		16,00,000
	Total		1,06,20,000
II.	Assets		
(1)	Non-current assets		
	(a) Fixed assets		76,00,000
(2)	Current assets		30,20,000
	Total		1,06,20,000

Notes to Accounts

1	**Share Capital**		**(Rs.)**
	Authorised capital:		30,00,000
	Issued and subscribed capital:		
	1,92,000 Equity shares of Rs. 10 each fully paid up	1,92,0000	
	3,000 10% Preference shares of Rs. 100 each fully paid up	3,00,000	22,20,000
	Reconciliation of share capital		
	Opening no. of shares	2,40,000	
	Buy back of shares during the year	48,000	1,92,000
			Pa

	During the year the company has buy back of 48,000 shares		
2	Reserves and Surplus		
	Capital reserve	10,00,000	
	Capital redemption reserve	1,80,000	
	Securities Premium 27,00,000		
	Less: Premium payable on buy back of shares 24,00,000	3,00,000	
	Revenue reserve 25,00,000		
	Less: Transfer to Capital redemption reserve 1,80,000	23,20,000	

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	Profit and loss A/c	35,00,000		
	Less: Loss on investment	5,00,000	30,00,000	68,00,000

Question 11

Pay Limited provides you with the following information as at 31st March, 2022:

	(Rs. in Lakhs)	
Share Capital:		
Authorised		**300**
Issued:		
11% Redeemable preference shares of Rs. 100 each fully paid	**125**	
Equity shares of Rs. 10 each fully paid	**175**	**300**
Reserves and surplus:		
Capital reserve	**35**	
Securities premium	**105**	
Revenue reserves	**460**	
Profit and loss account	**50**	**650**
Current liabilities and provisions		**50**
Fixed assets: cost	**100**	
Less: Accumulated depreciation	**(90)**	**10**
Non-current investments at cost (Market valueRs. 400 Lakhs)		**200**
Current assets		**790**

Answer 11

(i) **The company redeemed preference shares at a premium of 4% on 1st April, 2022.**

(ii) **It also bought back 2.5 lakhs equity shares of Rs. 10 each at Rs. 40 per share. The payments for the above were made out of the bank balances, which appeared as a part of currentassets.**

You are asked to:

(1) **Pass journal entries to record the above.**

(2) **Prepare balance sheet as at 01.04.2022. (RTP May '23)**

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(3)

(i) **Journal entries in the books of Pay Ltd.** **Rs. in lakhs**

	Particulars		Debit	Credit
1st	11% Preference share capital A/c	Dr.	125	
April, 2022	Premium payable on Redemption ofPrefer-ence Shares	Dr.	5	
	To Preference shareholders A/c(Being preference share capital account transferred to shareholders account)			130
	Preference shareholders A/c	Dr.	130	
	To Bank A/c (Being payment made to shareholders)			130
	Shares buy back A/c	Dr.	100	
	To Bank A/c			100
	(Being 2.5 lakhs equity shares bought back @ Rs. 40 per share)			
	Equity share capital A/c (2.5 lakh x Rs. 10)	Dr.	25	
	Premium payable on buy- back A/c (2.5 lakhxRs. 30)	Dr.	75	
	To Shares buy back A/c (Being cancellation of shares bought back)			100
	Revenue reserve A/c	Dr.	150	
	To Capital Redemption Reserve A/c (125 + 25)			150
	(Being creation of capital redemption reserveto the extent of the face value of preference shares re-deemed and equity shares bought back)			
	Securities Premium	Dr.	80	
	To Premium payable on Redemption ofPref. Shares			5
	To Premium payable on buy- back A/c			75
	(Being premium on preference shares redeemed* and equity shares bought back charged to securi-ties premium account)			

(ii) *Securities premium utilized for premium on preference shares redeemed assuming that the company is not governed under section 133 of the Companies Act. Alternatively, it may not be utilized assuming otherwise.

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(iii) **Balance Sheet of Pay Ltd as at 1.4.2022**

Particulars	Note No	Rs. In lakhs
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	150
(b) Reserves and Surplus	2	570
(2) Current Liabilities		50
Total		770
II. Assets		
(1) Non-current assets		
(a) Property, plant and Equipment	3	10
(b) Non-current investments -Investmentat cost Market value Rs. 400 crores)		200
(2) Current assets	4	560
Total		770

Notes to Accounts

1.	Share Capital		Rs. In lakhs
	Authorised, Issued and Subscribed:		
	Equity shares of Rs. 10 each		150
2.	Reserves and Surplus		
	Capital reserve	35	
	Capital redemption reserve	150	
	Securities premium 105		
	Less: Utilisation for buy back and redemption of shares (80)	25	
	Revenue Reserve 460		
	Less: transfer to Capital redemption reserve (150)	310	
	Profit and Loss Account balance	50	570
3.	Property, plant and equipment		
	Cost	100	
	Less: Provision for depreciation	(90)	10
4.	Current assets		
	Current assets as on 31.3.2022	790	
	Less: Bank payment for redemption and buy back	(230)	560

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Question 12

The Directors of Umang Ltd. passed a resolution to buyback 5,00,000 of its fully paid equity shares of Rs. 10 each at Rs. 15 per share. This buyback is in compliance with the provisions of the Companies Act, 2013.

For this purpose, the company

(i) Sold its investments of Rs. 30,00,000 for Rs . 25,00,000.

(ii) Issued 20,000, 12% preference shares of Rs. 100 each at par, the entire amount being payable withapplication.

(iii) Used Rs. 15,00,000 of its Securities Premium Account apart from its adequate balance in GeneralReserve to fulfill the legal requirements regarding buy-back.

(iv) The company has necessary cash balance for the payment to shareholders.

You are required to pass necessary Journal Entries (including narration) regarding buy- back of shares in the books of Umang Ltd. (PYP 5 Marks Jan 21)

Answer 12

Journal Entries in the books of Umang Ltd.

			Dr. Rs.	Cr. Rs.
1.	Bank A/c	Dr.	25,00,000	
	Profit and Loss A/c	Dr.	5,00,000	
	To Investment A/c			30,00,000
	(Being investment sold for the purpose of buy-back of EquityShares)			
2.	Bank A/c	Dr.	20,00,000	
	To 12% Pref. Share capital A/c			20,00,000
	(Being 12% Pref. Shares issued for ` 20,00,000)			Pa

3.	Equity share capital A/c	Dr.	50,00,000	
	Premium payable on buy-back	Dr.	25,00,000	
	To Equity shares buy-back A/cEquity shareholders A/c			75,00,000
	(Being the amount due on buy-back of equity shares)			
4.	Equity shares buy-back A/c/ Equity shareholders A/c	Dr.	75,00,000	
	To Bank A/c			75,00,000
	(Being payment made for buy-back of equity shares)			
5.	Securities Premium A/c General	Dr.	15,00,000	
	Reserve A/c	Dr.	10,00,000	

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	To Premium payable on buy-back (Being premium payable on buy-back charged fromSecurities premium)			25,00,000
6.	General Reserve A/c	Dr.	30,00,000	
	To Capital Redemption Reserve A/c (Being creation of capital redemption reserve to the extent of the equity shares bought back after deducting fresh pref. shares issued)			30,00,000

Question 13

X Ltd. furnishes the following summarized Balance Sheet as at 31-03-2018.

Liabilities	(in Rs.)	(in Rs.)
Share Capital		
Equity Share Capital of Rs. 20 each fully paid up	50,00,000	
10,000, 10% Preference Shares of Rs. 100 each fully paid up	10,00,000	60,00,000
Reserves & Surplus		
Capital Reserve	1,00,000	
Security Premium	12,00,000	
Revenue Reserve	5,00,000	
Profit and Loss	20,00,000	
Dividend Equalization Fund	5,50,000	43,50,000
Non-Current Liabilities		
12% Debenture		12,50,000
Current Liabilities and Provisions		5,50,000
Total		1,21,50,000
Assets		
Fixed Assets		
Tangible Assets		1,00,75,000
Current Assets		
Investment	3,00,000	
Inventory	2,00,000	
Cash and Bank	15,75,000	20,75,000
Total		1,21,50,000

The shareholders adopted the resolution on the date of the above mentioned Balance Sheet to:

(1) **Buyback 25% of the paid up capital and i was decided to offer a price of 20% over market price.**

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The prevailing market value of the company's share is Rs. 30 per share.

(2) **To finance the buy back of share company :**

(a) **Issue 3000, 14 % debenture of 100 each at a premium of 20%**

(b) **Issue 2500, 10 % preference share of Rs. 100 each**

(3) **Sell investment worth Rs. 1,00,000 for Rs. 1,50,000.**

(4) **Maintain a balance of Rs. 2,00,000 in Revenue Reserve.**

(5) **Later the company issue three fully paid up equity share of Rs. 20 each by way of bonus shareforevery 15 equity share held by the equity share-holder.**

You are required to pass the necessary journal entries to record the above transactions and prepare Balance Sheet after buy back. (PYP 15 Marks, Nov'19, RTP Nov'21)

Answer 13

In the books of X Limited Journal Entries

	Particulars	Dr. Rs.	Cr. Rs.
1.	Bank A/c Dr.	3,60,000	
	To 14 % Debenture A/c		3,00,000
	To Securities Premium A/c		60,000
	(Being 14 % debentures issued to finance buy back)		
2.	Bank A/c Dr.	2,50,000	
	To 10% preference share capital A/c (Being 10% preference share issued to finance buy back)		2,50,000
3.	Bank A/c Dr.	1,50,000	
	To Investment A/c		1,00,000
	To Profit on sale of investment (Being investment sold on profit)		50,000
4.	Equity share capital A/c (62,500 x Rs.20) Dr.	12,50,000	
	Securities premium A/c(62,500 x Rs.16) Dr.	10,00,000	
	To Equity shares buy back A/c (62,500 x Rs.36)		22,50,000
	(Being the amount due to equity shareholders on buy back)		
5.	Equity shares buy back A/c Dr.	22,50,000	
	To Bank A/c		22,50,000
	(Being the payment made on account of buy back of 62,500Equity Shares as per the Companies Act)		
6.	Revenue reserve Dr.	3,00,000	
	Securities premium Dr.	2,60,000	

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	Profit and Loss A/c	Dr.	4,40,000	
	To Capital redemption reserve A/c*			10,00,000
	(Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve account as per the law) [12,50,000 less 2,50,000]			
7.	Capital redemption reserve A/c	Dr.	7,50,000	
	To Bonus shares A/c (W.N.1) (Being the utilization of capital redemption reserve to issue 37,500 bonus shares)			7,50,000
8.	Bonus shares A/c	Dr.	7,50,000	
	To Equity share capital A/c			7,50,000
	(Being issue of 3 bonus equity share for every 15equity shares held)			

*Alternatively, entry for combination of different amounts (from Revenue reserve, Securities premium and profit and Loss account.) may be passed for transferring the required amount to CRR.

Note: It may be noted that as per the provisions of the Companies Act, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. Issue of debentures has been excluded for the purpose of "specified securities" and the entire amount of Rs. 10,00,000 (after deducting only pref.share capital) has been credited to CRR while solving the question.

Balance Sheet (After buy back and issue of bonus shares)

Particulars	Note No	Amount Rs.
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	57,50,000
(b) Reserves and Surplus	2	27,10,000

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(2) Non-Current Liabilities	3	
(a) Long-term borrowings		15,50,000
(3) Current Liabilities		
(a) Trade payables		-
(b) current liabilities & Provisions		5,50,000
Total		1,05,60,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment		1,00,75,000
(2) Current assets		
(a) Investments		2,00,000
(b) Inventory		2,00,000
(c) Cash and cash equivalents (W.N. 2)		85,000
Total		1,05,60,000

Notes to Accounts

				Rs.
1.	Share Capital			
	Equity share capital (Fully paid up shares of Rs. 20 each)			
	(2,50,000-62,500+37,500 shares)		45,00,000	
	10% preference shares @ Rs. 100 each (10,00,000 + 2,50,000)		12,50,000	
2.	Reserves and Surplus			
	Capital Reserve		1,00,000	57,50,000
	Revenue reserve		2,00,000	
	Securities premium	12,00,000		
	Add: Premium on debenture	60,000		
	Less: Adjustment for premium paid on buy back	(10,00,000)		
	Less: Transfer to CRR	(2,60,000)	Nil	

	Capital Redemption Reserve		
	Transfer due to buy-back of shares from P&L		

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		10,00,000		
	Less: Utilisation for issue of bonus shares	(7,50,000)	2,50,000	
	Profit & Loss A/c	20,00,000		
3	Add: Profit on sale of investment	50,000		
	Less: Transfer to CRR	(4,40,000)	16,10,000	
	Dividend equalization reserve	(5,50,000)	5,50,000	27,10,000
	Long-term borrowings - 12% Debentures 12,50,000			
	- 14% Debentures	3,00,000		15,50,000

Working **Notes:**1. Amount of bonus shares = [(2,50,000 -25%)3/15] x 20 = 37,500 x 20=7,50,000

2. Cash at bank after issue of bonus shares

	Rs.
Cash balance as on 30.3.2018	15,75,000
Add: Issue of debenture	3,60,000
Add: issue of preference shares	2,50,000
Add: Sale of investments	1,50,000
	23,35,000
Less: Payment for buy back of shares	(22,50,000)
	85,000

Question 14

Mohan Ltd. furnishes the following summarised Balance Sheet on 31st March 2021. (Rs. in Lakhs)

	Amount
Equity and Liabilities:	
Shareholders' fund	
Share Capital	
Equity Shares of Rs. 10 each fully paid up	**780**
6% Redeemable Preference shares of Rs. 50 each fully Paid up	**240**
Reserves and Surplus	
Capital Reserves	**58**
General Reserve	**625**
Securities Premium	**52**
Profit & Loss	**148**
Revaluation Reserve	**34**
Infrastructure Development Reserve	**16**

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Non-current liabilities	
7% Debentures	**268**
Unsecured Loans	**36**
Current Liabilities	**395**
	2652
Assets:	
Non-current Assets	

Plant and Equipment less depreciation	**725**
Investment at cost	**720**
Current Assets	**1207**
	2652

(1) Other **Information:The company redeemed preference shares at a premium of 10% on 1st April,2021.**

(2) **It also offered to buy back the maximum permissible number of equity shares of Rs. 10 each at Rs. 30 per share on 2nd April 2021.**

(3) **The payment for the above was made out of available bank balance, which appeared as a part of the current assets.**

(4) **The company had investment in own debentures costing Rs. 60 lakhs (face value Rs.75 lakhs). These debentures were cancelled on 2nd April 2021.**

On 4th April 2021 company issued one fully paid-up equity share of Rs. 10 each by way of bonus for every five equity shares held by the **shareholders.**

(a) You are required **to:**

(b) **Calculate maximum possible number of equity shares that can be bought back as per the Companies Act, 2013 and**

Record the Journal Entries for the above-mentioned information. (PYP 10 Marks **Dec'21)**

Answer 14

(i)Statement determining the maximum number of shares to be bought back

Number of shares (in lakhs)

Particulars	When loan fund is Rs. 304 lakhs'
Shares Outstanding Test (W.N.1)	19.5
Resources Test (W.N.2)	11.175
Debt Equity Ratio Test (W.N.3)	29.725
Maximum number of shares that can be bought back [least of the above]	11.175

Thus, the company can buy 11,17,500 Equity shares at Rs. 30 each.

Working Notes:

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1. **Shares Outstanding Test**

Particulars	(Shares in lakh)
Number of shares outstanding	78
25% of the shares outstanding	19.5

Resources Test

Particulars	
Paid up capital (Rs. in lakh)	780
Free reserves (Rs. in lakh) (625+52+148-24-240*)	561
Shareholders' funds (Rs. in lakh)	1341
25% of Shareholders fund (Rs. in lakh)	335.25
Buy-back price per share	30
Number of shares that can be bought back	11.175
*Amount transferred to CRR is excluded from free reserves.Premium on re-demption also reduced.	

Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

	Particulars	Rs. In lakh
(a)	Loan funds (Rs.)	304
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (Rs.) (a/2)	152
(c)	Present equity shareholders fund (Rs.)	1341
(d)	Future equity shareholders fund (Rs.) (see W.N.4)	1043.75 (1341-297.25)
(e)	Maximum permitted buy-back of Equity (Rs.) [(d) – (b)]	891.75
(f)	Maximum number of shares that can be bought back @ Rs. 30 per share	29.725
	As per the provisions of the Companies Act,2013, company	Qualifies

Alternatively, when current liabilities are considered as part of loan funds, in that case Debt Equity Ratio Test will be done as follows:

	Particulars	Rs. in lakh
(a)	Loan funds (Rs.)	699
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (Rs.) (a/2)	349.5
(c)	Present equity shareholders fund (Rs.)	1341
(d)	Future equity shareholders fund (Rs.) (see W.N.4)	1093.125 (1341-247.875)

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(e)	Maximum permitted buy-back of Equity (Rs.) [(d) – (b)]	743.625
(f)	Maximum number of shares that can be bought back @ Rs. 30 per share	24.7875
	As per the provisions of the Companies Act, 2013, company	Qualifies

Amount transferred to CRR and maximum equity to be bought back will be calculated bysimultaneous equation method

Suppose amount transferred to CRR account is 'x' and maximum permitted buy- back of equity is 'y' Then
Equation 1: (Present Equity- Transfer to CRR) - Minimum Equity to be maintained = Maximum Permitted Buy-Back

= (1341 – x) – 152 = y

= 1189 – x =y (1)

Equation 2: Maximum Permitted Buy-Back x Nominal Value Per Share/Offer Price Per Sharey/30 x 10 = x
or 3x = y (2)

by solving the above two equations we get x = Rs. 297.25 and y = Rs. 891.75

Alternatively, when current liabilities are considered as part of loan funds, in that case

Equation 1: (Present Equity- Transfer to CRR)- Minimum Equity to be maintained = Maximum Permitted Buy-Back

= (1341 – x) – 349.5 = y

= 991.5 – x =y (1)

Equation 2: Maximum Permitted Buy-Back X Nominal Value Per Share/Offer Price Per Sharey/30 x 10 = x
or 3x = y (2)

by solving the above two equations we get x = 247.875 and y = 743.625

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(ii) Journal Entries for Buy Back (Rs. in lakhs)

Date	Particulars		Debit	Credit
2021 1st April	6% Redeemable preference share capital A/c	Dr.	240	
	Premium on redemption of preference shares A/c	Dr.	24	
	To Preference shareholders A/c			264
	(Being preference share capital transferred to shareholders account)			
	Preference shareholders A/c	Dr.	264	
	To Bank A/c			264
	(Being payment made to shareholders)			
	General Reserve or P&L A/c*	Dr.	24	
	To Premium on redemption of preference shares A/c			24
	(Being premium on redemption of preference sharesadjusted through securities premium)			
2nd April	Equity shares buy-back A/c	Dr.	335.25	
	To Bank A/c			335.25
	(Being 11.175 lakhs equity shares of Rs. 10 each boughtback @ Rs. 30 per share)			
	Equity share capital A/c	Dr.	111.75	
	Securities Premium A/c	Dr.	52	
	General Reserve or P&L A/c	Dr.	171.50	
	To Equity Shares buy-back A/c			335.25
	(Being cancellation of shares bought back)			
	General reserve A/c	Dr.	351.75	
	To Capital redemption reserve A/c			351.75
	(Being creation of capital redemption reserve account to the extent of the face value of preference shares redeemed and equity shares bought back as per the law ie. 240+ 111.75 lakhs)			
2nd April	7% Debentures A/c	Dr.	75	
	To Investment (own debentures) A/c			60
	To Profit on cancellation of own debentures A/c			15
	(Being cancellation of own debentures costing Rs. 60 lakhs, face value being Rs. 75 lakhs and the balance being profit on cancellation of debentures)			

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4th April	Capital Redemption Reserve	Dr.	133.65	
	To Bonus Shares A/c			133.65
	(Being issue of one bonus equity share for every five equity shares held)			
	Bonus shares A/c Dr.		133.65	
	To Equity share capital A/c			133.65
	(Being bonus shares issued)			

Working Note: Bonus Share to be issued =66.825 (78 - 11.175) lakh shares divided by 5 = 13.365 lakh shares.

Note: *Securities premium has not been utilized for the purpose of premium payable on redemption of preference shares assuming that the company referred in the question is governed by Section 133 of the Companies Act, 2013 and complies with the Accounting Standards prescribed for them. Alternative entry considering otherwise is also possible by utilizing securities premium amount.

Question 15

Quick Ltd. has the following capital structure as on 31st March,2021:

		₹ in Crores	
(1)	**Share Capital:**		**462**
	(Equity Shares of ₹ 10 each, fully paid)		
(2)	**Reserves and Surplus:**		
	General Reserve	**336**	
	Securities Premium Account	**126**	
	Profit and Loss Account	**126**	
	Statutory Reserve	**180**	
	Capital Redemption Reserve	**87**	
	Plant Revaluation Reserve	**33**	**888**
(3)	**Loan Funds:**		
	Secured	**2,200**	
	Unsecured	**320**	**2,520**

On the recommendations of the Board of Directors, on 16th September, 2021, the shareholders of the company have approved a proposal to buy-back of equity shares. The prevailing market value of the company's share is ₹ 20 per share and in order to induce the existing shareholders to offer their shares for buy-back, it was decided to offer a price of 50% over market value. The company had sufficient balance in its bank account for the buy-back of shares.

You are required to compute the maximum number of shares that can be bought back in the light of the above information and also under a situation where the loan funds of the company were either ₹ 1,680 Crores or ₹ 2,100 Crores.

Assuming that the entire buy-back is completed by 31st December,2021, Pass the necessary accounting entries (narrations not required) in the books of the company in each situation (PYP 10 Marks May'22)

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Answer 15

Statement determining the maximum number of shares to be bought back Number of shares

Particulars	When loan fund is		
	₹ 2,520 crores	₹ 1,680 crores	₹ 2,100 crores
Shares Outstanding Test (W.N.1)	11.55	11.55	11.55
Resources Test (W.N.2)	8.75	8.75	8.75
Debt Equity Ratio Test (W.N.3)	Nil	5.25	Nil
Maximum number of shares that canbe bought back [least of the above]	Nil	5.25	Nil

Journal Entries for the Buy-Back (applicable only when loan fund is ₹ 1,680 crores)

₹ in crores

	Particulars		Debit	Credit
(a)	Equity share buy-back account	Dr.	157.5	
	To Bank account			157.5
(b)	Equity share capital account (5.25 x ₹ 10)	Dr.	52.5	
	Securities premium account (5.25 x ₹ 20)	Dr.	105	
	To Equity share buy-back account			157.5
(c)	General reserve account	Dr.	52.5	
	To Capital redemption reserve account			52.5

Working **Notes:Shares Outstanding Test**

Particulars	(Shares in crores)
Number of shares outstanding	46.2
25% of the shares outstanding	11.55

Resources Test

Particulars	
Paid up capital (₹ in crores)	462
Free reserves (₹ in crores) (336+126+126)	588
Shareholders' funds (₹ in crores)	1,050
25% of Shareholders fund (₹ in crores)	₹ 262.5 crores
Buy-back price per share	₹ 30
Number of shares that can be bought back (shares in crores)	8.75 crores shares

Debt Equity Ratio Test

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	Particulars ₹ 2,520 crores ₹ 1,680 crores	When loan fund is		
		₹ 2,100 crores		
(a)	Loan funds (₹ in crores)	2,520	1,680	2,100
(b)	Minimum equity to be maintained after buy- back in the ratio of 2:1 (₹ in crores)	1,260	840	1,050
(c)	Present equity shareholders fund (₹in crores)	1,050	1,050	1,050
(d)	Futureequity shareholder fund (₹ in crores) (See Note 2)	N.A.	997.5 (1,050-52.5)	N.A.
(e)	Maximum permitted buy-back of Equity (₹ in crores) [(d) – (b)] (See Note 2)	Nil	157.5 (by simultane-ous equation)	Nil
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) (See Note 2)	Nil	5.25 (by si-multaneous equation)	Nil

Note:

1. Under Situations 1 & 3 the company does not qualify for buy-back of shares as per the provisions ofthe Companies Act, 2013.
2. As per section 68 of the Companies Act, 2013, the ratio of debt owed by the company should not bemore than twice the capital and its free reserve after such buy-back.

   Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneousequation method.

   Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x'

   and maximum permitted buy-back of equity is 'y'.

   Then

   Equation 1: (Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained= Maximum permissible buy-back of equity(1,050 –x)-840 = y

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maintained= Maximum permissible buy-back of equity

(1,050 –x)-840 = y

Since 210 – x = y

Equation 2=[$\frac{\text{Maximum buy–back}}{\text{Offer price for buy–back}}$ x Nominal Value]

= Nominal value of the shares bought –back to be transferred to CRR

$=\frac{y}{30} \times 10$

Or 3x = y (2)

by solving the above two equations we get

x = ₹ 52.5 crores y = ₹ 157.5 crores

3. Statutory reserves, capital redemption reserve and plant revaluation reserves are not free reserves.
4. For calculation of debt -equity ratio both secured and unsecured loans have been considered.

Question 16

The following information from Balance Sheet of Z Ltd. as on 31st March ,2023:

	₹ Lakhs
Share Capital:	
Equity shares of ₹ 10 each Fully Paid Up	**16,000**
10% Redeemable Pref. Shares of ₹ 10 each Fully Paid Up	**5,000**
Reserves & Surplus	
Capital Redemption Reserve	**2,000**
Securities Premium	**1,600**
General Reserve	**12,000**
Profit & Loss Account	**600**
Secured Loans:	
9% Debentures	**10,000**
Current Liabilities:	
Trade payables	**4,600**

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Sundry Provisions	2,000
Fixed Assets	28,000
Investments	4,700
Cash at Bank	4,600
Other Current Assets	16,500

On 1st April, 2023 the Company redeemed all its Preference Shares at a Premium of 10% and bought back 10% of its Equity Shares at ₹ 20 per Share. In order to make cash available, the Company sold all the Investments for ₹ 5,000 lakhs.

You are required to pass journal entries for the above and prepare the Company's Balance sheet immediately after buyback of equity shares and redemption of preference shares.(Nov '23)

Answer 16

(i) **Journal Entries in the books of Z Ltd.** **(₹ in lakhs)**

	Particulars			
1	Bank A/c To Investments A/cTo Profit and Loss A/c (Being investment sold on profit for the purpose ofbuy-back)	Dr.	5,000	 4,700 300
2	10% Redeemable Preference Share Capital A/c Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c (Being redemption of preference share capital atpremium of 10%)	Dr. Dr.	5,000 500	 5,500
3	Profit and Loss A/c To Premium on Redemption of PreferenceShares A/c (Being premium on redemption of preference sharesadjusted through securities premium)	Dr.	500	 500
4	Equity Share CapitalA/c Premium on buyback To Equity buy-back A/c (Being Equity Share bought back, Share Capital cancelled, and Premium on Buyback accounted for)	Dr. Dr.	1,600 1,600	 3,200
5	Securities Premium A/c (1,600) To Premium on Buyback A/c (Being premium on buyback provided out ofsecurities premium)	Dr.	1,600	 1,600

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6	Preference Shareholders A/cEquity buy-back A/c To Bank A/c (Being payment made to preference shareholdersand equity shareholders)		5,500 3,200	8,700
7	General Reserve Account To Capital Redemption Reserve Account (Being amount transferred to capital redemption reserve account towards face value of preferenceshares re-deemed and equity shares bought back)		6,600	6,600

Balance Sheet of C Ltd. (after Redemption and Buyback)

(₹ **Lakhs)**

	Particulars	**NoteNo**	**Amount**
	EQUITY AND LIABILITIES		₹
(I)	Shareholders' Funds:		
	(a) Share Capital	1	14,400
	(b) Reserves and Surplus	2	14,400
(2)	Non-Current Liabilities:		
	(a) Long Term Borrowings	3	10,000
(3)	Current Liabilities:		
	(a) Trade payables		4,600
	(b) Short Term Provisions		2,000
	Total		45,400
(II)	ASSETS		
(1)	Non-Current Assets		
	PPE		28,000
	Current Assets:		
	(a) Cash and Cash equivalents (W N)		900
	(b) Other Current Assets		16,500
			45,400

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Notes to Accounts

		₹ in Lakhs		
1.	Share Capital			
	1,440 lakh Equity Shares of ₹ 10 each Fully Paid up (160 lakh Equity Shares boughtback)			14,400
2.	Reserves and Surplus			
	General Reserve	12,000		
	Less: Transfer to CRR	(6,600)	5,400	
	Capital Redemption Reserve	2,000		
	Add: Transfer due to buy-back of sharesfrom Gen. res.	6,600	8,600	
	Securities premium	1,600		
	Less: Adjustment for premium paid onbuy back	(1,600)		
	Profit & Loss A/c	600		
	Add: Profit on sale of investment	300		
	Less: Adjustment for premium paid onredemp-tion of preference shares	(500)	400	14,400
3.	Long-term borrowings			
	Secured			
	9 % Debentures			10,000

Working Note:

Bank Account

	Amount (₹ Lakhs)			Amount (₹ Lakhs)
To balance b/d	4,600		By Preference Shareholders	5,500
To Investment A/c (sale Proceeds)	5,000		A/c By Equity buy back A/c	3,200
			By Balance c/d (Balancingfigure)	900
		9,600		9,600

Question 17

As per section 68(1) of the Companies Act, buy-back of own shares by thecompany, shall not exceed

(a) 25% of the total paid-up capital and free reserves of the company.

(b) 20% of the total paid-up capital and free reserves of the company.

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(c) 15% of the total paid-up capital and free reserves of the company.

Ans: (a)

Question 18

The companies are permitted to buy-back their own shares out of

	(a) (b)	Free reserves and Securities premium Proceeds of the issue of any shares.
	(c)	Both (a) and (b)

Ans: (c)

Question 19

When a company purchases its own shares out of free reserves; a sum equal to nominal value of shares so purchased shall be transferred to

(d) Revenue redemption reserve.

(e) Capital redemption reserve.

(f) Buy-back reserve

Ans: (b)

Question 20

State which of the following statements is true?

(d) Buy-back is for more than twenty-five per cent of the total paid-up capi-taland free reservesof the company.

(e) Partly paid shares cannot be bought back by a company.

(f) Buy-back of equity shares in any financial year shall exceed twenty-five percent of its totalpaid-up equity capital in that financial year.

Ans: (b)

Question 21

Premium (excess of buy-back price over the par value) paid on buy-back should be adjusted against

	(a) (b)	Free reserves. Securities premium.
	(c)	Both (a) and (b).

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Ans: (c)

Question 22

Advantages of Buy-back of shares include to

(g) Encourage others to make hostile bid to take over the company.

(h) Decrease promoters holding as the shares which are bought back arecancelled.

(i) Discourage others to make hostile bid to take over the company as thebuy-back will increase the promoters holding.

Ans: (c)

Theoretical Questions Answers

Question 23

What are the conditions to be fulfilled by a Joint Stock Company to buy-back its equity shares as perCompanies Act, 2013? Explain in brief.

Answer 23

Section 68 to 70 of the Companies Act, 2013 lays down the provisions for a company to buy-back itsown equity shares.

The Companies Act, 2013 under Section 68 (1) permits companies to buy-back theirown shares andother specified securities out of:

(i) its free reserves; or

(ii) the securities premium account; or

(iii) the proceeds of the issue of any shares or other specified securities.

Note: No buy-back of any kind of shares or other specified securities shall be made out of the proceedsof an earlier issue of the same kind of shares or same kind of other specified securities. For example, ifequity shares are to be bought-back, then, preference shares may be used for the purpose.

The other important provisions relating to the buy-back are:

(1) Section 68 (2) further states that no company shall purchase its own shares or other specified securitiesunless—

(a) the buy-back is authorised by its articles;

(b) a special resolution has been passed in general meeting of the company authorising the buy-back;

However, the above provisions do not apply where the buy-back is ten percent or less of the paid- up equity capital + free reserves and is authorized by a board resolution passed at a duly convened meeting of the directors. Hence, in case the buy-back is up to 10% of paid up equity

+ free reserves, the same may be done with the authorization of the Board Resolution without the necessity of its being authorized by the articles of association of the company and by a specialresolution of its members passed at a general

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meeting of the company.

(c) the buy-back must be equal or less than twenty-five per cent of the total paid-up capital and free reserves of the company: (Resource Test)

(d) Further, the buy-back of shares in any financial year must not exceed25% of its total paid-up capital and free reserves: (Share Outstanding Test)

(e) the ratio of the debt owed by the company (both secured and unsecured) after such buy-back isnot more than twice the total of its paid-up capital and its free reserves: (Debt-Equity Ratio Test)

Note: Central Government may prescribe a higher ratio of the debt than that specified under thisclause for a class or classes of companies. Debt here should include both long-term debt as well as short term debt.

(f) all the shares or other specified securities for buy-back are fully paid-up;

(g) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations madeby the Securities and Exchange Board of India in this behalf;

(h) the buy-back in respect of shares or other specified securities other than those specified in clause

(f) is in accordance with the guidelines as may be prescribed.

Provided that no offer of the buy-back under this sub section shall be made within a period of one year reckoned from the date of closure of a previous offer of buy-back if any. This means that there cannot be more than one buy- back in one year.

(2) The notice of meeting at which special resolution is supposed to be passed must be accompanied by an explanatory statement stating-

(a) A full and complete disclosure of all material facts;

(b) the necessity of the buy-back;

(c) the class of security intended to be purchased under the buy-back;

(d) the amount to be invested under the buy-back;

(e) the time limit for completion of the buy-back.

(3) Every buy-back shall be completed within twelve months from the date of passing the special resolution, or the resolution passed by the board of directors.

(4) The buy-back may be—

(a) from the existing security holders on a proportionate basis; or

(b) from the open market; or

(c) by purchasing the securities issued to employees of the company pursuant to a scheme of stockoption or sweat equity.

(5) Where a company has passed a special resolution under clause (b) of Sub- section (2) to buy-back its own shares or other securities under this section, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board of India a declaration of solvency in the form as may be prescribed and verified by an affidavit to the effect that the Board of Directors has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the Board of

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Directors. It must be signed by at least two directorsof the company, one of whom shall be the managing director, if any:

Note: No declaration of solvency shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.

(6) Where a company buys-back its own securities, it shall extinguish and physically destroy the securitiesso bought-back within seven days of the last date of completion of buy-back.

(7) Where a company completes a buy-back of its shares or other specified securities under this section, itshall not make further issue of same kind of shares (including allotment of further shares under clause

(a) of Sub-section (1) of Section (62) or other specified securities within a period of six months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme, sweat equity or conversion of preference shares or debentures into equity shares.

(8) Where a company buy-back its securities under this section, it shall maintaina register of the securitiesso bought, the consideration paid for the securities bought-back, the date of cancellation of securities,the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.

(9) A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board of India, a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed, provided that no return shall be filed withthe Securities and Exchange Board of India by a company whose shares arenot listed on any recognisedstock exchange.

(10) If a company makes default in complying with the provisions of this section or any regulations made bySEBI in this regard, the company may be punishable with a fine which shall not be less than Rs One Lakh but whichmay extend to three lakh rupees and every officer of the company who is in defaultshallbe punishable with imprisonment for upto 3 years or with a fineof not less than one lakh rupees but which may extend to three lakh rupeesor with both.

(11) Section 69 (1) states that where a company purchases its own shares out ofthe free reserves or securities premium account, a sum equal to the nominal value of shares so purchased shall be transferred to the CapitalRedemption Reserve Account and details of such account shall be disclosed in the BalanceSheet.

(12) The shares or other specified securities which are proposed to be bought- back must be fully paid-up.

(13) The Capital Redemption Reserve Account may be applied by the company in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

(14) Premium (excess of buy-back price over the par value) paid on buy-backshould be adjusted against free reserves and/or securities premium account. Revaluation reserve represents unrealized profit and hence it cannot be used for buy-back of securities.

(1) No company shall directly or indirectly purchase its own shares or other specified securities—

(a) through any subsidiary company including its own subsidiary companies; or

(b) through any investment company or group of investment companies; or

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(c) if a default is subsisting, in repayment of deposit or interest payable thereon, redemption of debentures or preference shares or payment of dividend to any shareholder or repayment of anyterm loan or interest payable thereon to any financial institutions or bank. Provided that the buy– back is not prohibited if the default is remedied and a period of three years has elapsed since thecessation of the default.

(2) In accordance with schedule III, no company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with provisions of Sections 92 (filling of annual return), 123 (payment of dividend within 30 days of declaration), 127 (failure todistribute dividend) and 129 (preparation of financial statement of the company).

Question 24

SMM Ltd. has the following capital structure as on 31st March, 20X1: ₹ in crore

	Particulars	Situation I	Situation II
(i)	Equity share capital (shares of ₹10 each)	1,200	1,200
(ii)	Reserves:		
	General Reserves	1,080	1,080
	Securities Premium	400	400
	Profit & Loss	200	200
	Infrastructure Development Reserve (Statutory Reserve)	320	320
(iii)	Loan Funds	3,200	6,000

The company has offered buy-back price of ₹ 30 per equity share. You are required to calculate maximum permissible number of equity shares that can be bought back in both situations and also required to pass necessary Journal Entries.

Answer 24

Statement determining the maximum number of shares to be bought back Number of shares (in crores)

Particulars	When loan fund is	
	₹ 3,200 crores	₹ 6,000 crores
Shares Outstanding Test (W.N.1)	30	30
Resources Test (W.N.2)	24	24
Debt Equity Ratio Test (W.N.3)	32	Nil
Maximum number of shares that can be-boughtback [least of the above]	24	Nil

Journal Entries for the Buy-Back (applicable only when loan fund is ₹3,200 crores)

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	Particulars		Debit	Credit
(a)	Equity shares buy-back account	Dr.	720	
	To Bank account			720
	(Being payment for buy-back of 24 crores equity shares of ₹10 each @ ₹30 per share)			
(b)	Equity share capital account	Dr.	240	
	Premium Payable on buy-back account	Dr.	480	
	To Equity share buy-back account			720
	(Being cancellation of shares bought back)			
	Securities Premium account General Reserve / Profit & Loss A/c To Premium Payable on buy-back account (Being Premium Payable on buy-back account charged to securities premium and general reserve/Profit & Loss A/c)	Dr. Dr.	400 80	480
(c)	General Reserve / Profit & Loss A/c	Dr.	240	
	To Capital redemption reserve account			240
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)			

Working Notes:

Shares Outstanding **Test**

Particulars	(Shares in crores)
Number of shares outstanding	120
25% of the shares outstanding	30

Resources Test

Particulars	
Paid up capital (₹in crores)	1,200
Free reserves (₹in crores) (1,080 + 400 +200)	1,680
Shareholders' funds (₹in crores)	2,880
25% of Shareholders fund (₹in crores)	₹720 crores
Buy-back price per share	₹30
Number of shares that can be bought back	24 crores shares

Debt Equity Ratio Test: Loans cannot be in excess of twice the EquityFunds post Buy-Back

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Particulars		When loan fund is	
		₹3,200 crores	₹6,000 crores
(a)	Loan funds (₹)	3,200	6,000
(b)	Minimum equity to bemaintained after buy-back in the ratio of 2:1 (₹) (a/2)	1,600	3,000
(c)	Present equity shareholdersfund (₹)	2,880	2,880
(d)	Future equity shareholdersfund (₹)	2,560 (2,880-	N.A.
	(see W.N.4)	320)	
(e)	Maximum permitted buy-backof Equity (₹) [(d) – (b)]	960	Nil
(f)	Maximum number of sharesthat can be bought back @ ₹30 per share	32 crore shares	
			Nil
	As per the provisions of the Companies Act, 2013, company	Qualifies	Does not Qualify

Amount transferred to CRR and maximum equity to be bought back willbe calculated bysimultaneous equation method

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y' Then

Equation 1: (Present Equity- Transfer to CRR)- Minimum Equity to bemaintained =Maximum Permitted Buy-Back

= (2,880 – x) – 1,600 = y

= 1280 – x =y (1)

Equation 2: Maximum Permitted Buy-Back X Nominal Value PerShare/Offer Price Per Share

y/30 x 10 = x or

3x = y (2)

by solving the above two equations we get

x= ₹ 320y = ₹960

Question 25

KG Limited furnishes the following Balance Sheet as at 31st March, 20X1:

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	1,200
	B	Reserves and Surplus	2	810

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2		**Non-current liabilities**		
		Long term borrowings	3	750
3		**Current liabilities**		
	A	Trade Payables		745
	B	Other Current Liabilities		195
		Total		3,700
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	2,026
	B	Non-current Investments		74
2		**Current assets**		
	A	Inventories		600
	B	Trade receivables		260
	C	Cash and Cash equivalents		740
		Total		3,700

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital		
	Equity share capital (fully paid up shares of ₹10 each)		1,200
2	**Reserves and Surplus**		
	Securities premium		175
	General reserve		265
	Capital redemption reserve		200
	Profit & loss A/c		170
	Total		810
3	**Long term borrowings**		
	12% Debentures		750
4	**Property, plant and equipment**		
	Land and Building		1,800
	Plant and machinery		226
	Net carrying value		2,026

On 1st April, 20X1, the company announced the buy-back of 25% of its equity shares @ ₹15 per share. For this purpose, it sold all of its investments for ₹75 lakhs.On 5th April, 20X1, the company achieved

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the target of buy-back. On 30th April, 20X1 the company issued one fully paid up equity share of ₹ 10 by way of bonus for every four equity shares held by the equity shareholders.

(1) You are required **to:**

(2) **Pass necessary journal entries for the above transactions.**

Prepare Balance Sheet of KG Limited after bonus issue of the shares.

Answer 25

In the books of KG Limited

Journal Entries

Date	Particulars		Dr.	Cr.
20X1		(₹ in lakhs)		
April 1	Bank A/c	Dr.	75	
	To Investment A/c			74
	To Profit on sale of investment			1
	(Being investment sold on profit)			
April 5	Equity share capital A/c	Dr.	300	
	Securities premium A/c	Dr.	150	
	To Equity shares buy-back A/c			450
	(Being the amount due to equity shareholders onbuy-back)			
	Equity shares buy-back A/c	Dr.	450	
	To Bank A/c			450
	(Being the payment made on account of buy-back of30Lakh Equity Shares)			
April 5	General reserve A/c	Dr.	265	
	Profit and Loss A/c	Dr.	35	
	To Capital redemption reserve A/c			300
	(Being amount equal to nominal value of buy-backshares from free reserves transferred to capital redemption reserve account as per the law)			
April 30	Capital redemption reserve A/c	Dr.	225	
	To Bonus shares A/c (W.N.1)			225
	(Being the utilization of capital redemption reserve toissue bonus shares)			
	Bonus shares A/c	Dr.	225	
	To Equity share capital A/c			225
	(Being issue of one bonus equity share for every fourequity shares held)			

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Balance Sheet (After buy-back and issue of bonus shares)

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	1,125
	B	Reserves and Surplus	2	436
2		**Non-current liabilities**		
		Long term borrowings	3	750
3		**Current liabilities**		
	A	Trade Payables		745
	B	Other Current Liabilities		195
		Total		3,251
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment		2,026
2		**Current assets**		
	A	Inventories	4	600
	B	Trade receivables		260
	C	Cash and Cash equivalents		365
		Total		3,251

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹10 each)		1,125
2	**Reserves and Surplus**		
	General Reserve	265	
	Less: Transfer to CR	(265)	-
	Capital Redemption Reserve	200	
	Add: Transfer due to buy-back of shares from P/L	35	
	Add; Transfer due to buy-back of shares from General Reserve	265	
	Less: Utilisation for issue of bonus shares	(225)	275
	Securities premium	175	
	Less: Adjustment for premium paid on buy-back	(150)	25

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	Profit & Loss A/c	170	
	Add: Profit on sale of investment	1	
	Less: Transfer to CRR	(35)	136
	Total		436
3	**Long term borrowings**		
	12% Debentures		750
4	**Property, Plant and Equipment**		
	Land and Building		1,800
	Plant and machinery		226
	Net carrying value		2,026

Working **Notes:**Amount of bonus shares = 25% of (1,200 – 300) lakhs = ₹225 lakhs

Cash at bank after issue of bonus shares

Partic-ulars	₹ in lakhs
Cash balance as on 1st April, 20X1	740
Add: Sale of investments	75
	815
Less: Payment for buy-back of shares	(450)
	365

Note: In the given solution, it is possible to adjust transfer to capital redemption reserve account or capitalization of bonus shares from any other free reserves or securities premium (to the extent available) also.

Question 26

Following is the Balance Sheet of Competent Limited as at 31st March, 20X1:

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	12,50,000
	B	Reserves and Surplus	2	18,75,000
2		**Non-current liabilities**		
		Long term borrowings	3	28,75,000

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3		**Current liabilities**		
	A	Other Current Liabilities		16,50,000
		Total		76,50,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment	4	46,50,000

2		**Current assets**		
	A	Other Current Assets		30,00,000
		Total		76,50,000

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹10 each)		12,50,000
2	**Reserves and Surplus**		
	Securities premium		2,50,000
	Profit and loss account		1,25.000
	Revenue reserve		15,00,000
	Total		18,75,000
3	**Long term borrowings**		
	14% Debentures		18,75,000
	Unsecured Loans		10,00,000
	Total		28,75,000
4	**Property, plant and equipment**		
	Land and Building		19,30,000
	Plant and machinery		18,00,000
	Furniture and fitting		9,20,000
	Net carrying value		46,50,000

The company wants to buy-back 25,000 equity shares of ₹ 10 each, on 1st April,20X1 at ₹ 20 pershare. Buy-back of shares is duly authorized by its articles and necessary resolution has been passed by the company towards this. The payment for buy-back of shares will be made by the company out of sufficient bank balance available shown as part of Current Assets.

Comment with your calculations, whether buy-back of shares by company is within the provisions of the Companies Act, 2013. If yes, pass necessary journal entries towards buy-back of shares and prepare the Balance Sheet after buy-back of shares.

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Answer 26

Determination of Buy-back of maximum no. of shares as per the Companies Act, 2013

1. **Shares Outstanding Test**

Particulars	**(Shares)**
Number of shares outstanding	1,25,000
25% of the shares outstanding	31,250

Resources Test: Maximum permitted limit 25% of Equity paid up capital +FreeReserves

Particulars	
Paid up capital (₹)	12,50,000
Free reserves (₹) (15,00,000 + 2,50,000 + 1,25,000)	18,75,000
Shareholders' funds (₹)	31,25,000

25% of Shareholders fund (₹)	7,81,250

Buy-back price per share	₹20
Number of shares that can be bought back (shares)Actual	39,062
Number of shares for buy-back	25,000

Debt Equity Ratio Test: Loans cannot be in excess of twice the EquityFunds postBuy-Back

	Particulars	**₹**
(a)	Loan funds (₹) (18,75,000+10,00,000+16,50,000)	45,25,000
(b)	Minimum equity to be maintained after buy-backinthe ratio of 2:1 (₹) (a/2)	22,62,500
(c)	Present equity/shareholders fund (₹)	31,25,000
(d)	Future equity/shareholders fund (₹) (see W.N.)(31,25,000 – 2,87,500)	28,37,500
(e)	Maximum permitted buy-back of Equity (₹) [(d) – (b)]	5,75,000
(f)	Maximum number of shares that can be boughtback @ ₹20 per share	28,750 shares
(g)	Actual Buy-Back Proposed	25,000 Shares

As per Section 68 (2) (d) of the Companies Act 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserves after such buy-back. Further under Section 69 (1), on buy-back of shares out of free reserves a sum equal to the nominal value of the share bought back shall be transferred to Capital Redemption Reserve (CRR). As per section 69 (2) utilization of CRR is restricted to fully paying up unissued shares of the Company which are to be issued as fully paid- up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buy-back has to be excluded from the present equity.

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Summary statement determining the maximum number of shares to be bought back

Particulars	Number of shares
Shares Outstanding Test	31,250
Resources Test	39,062
Debt Equity Ratio Test	28,750
Maximum number of shares that can be boughtback[least of the above]	28,750

Company qualifies all tests for buy-back of shares and came to the conclusion that it can buy maximum 28,750 shares on 1st April, 20X1. However, company wants to buy-back only 25,000 equity shares @ ₹ 20. Therefore, buy-back of 25,000 shares, as desired by the company is within the provisions of the Companies Act, 2013.

Journal Entries for buy-back of shares

	Particulars		Debit (₹)	Credit (₹)
(a)	Equity shares buy-back account	Dr.	5,00,000	
	To Bank account			5,00,000
	(Being buy-back of 25,000 equity shares of ₹ 10 each @ ₹20 per share)			
(b)	Equity share capital account	Dr.	2,50,000	
	Securities premium account	Dr.	2,50,000	
	To Equity shares buy-back account			5,00,000
	(Being cancellation of shares bought back)			
(c)	Revenue reserve account	Dr.	2,50,000	
	To Capital redemption reserve account			2,50,000
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)			

Balance Sheet of M/s. Competent Ltd.as at 31st March, 20X1

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	10,00,000
	B	Reserves and Surplus	2	16,25,000
2		**Non-current liabilities**		

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		Long term borrowings	3	28,75,000
3		**Current liabilities**		
	A	Other Current Liabilities		16,50,000
		Total		71,50,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	46,50,000
2		**Current assets**		
	A	Other Current Assets (30,00,000 – 5,00,000)		25,00,000
		Total		71,50,000

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹10 each)		10,00,000
2	**Reserves and Surplus**		
	Profit and Loss A/c		1,25,000
	Revenue reserves	15,00,000	
	Less: Transfer to CRR	(2,50,000)	12,50,000
	Securities premium	2,50,000	
	Less: Utilization for share buy-back	(2,50,000)	-
	Capital Redemption Reserves		2,50,000
	Total		16,25,000
3	**Long term borrowings**		
	14% Debentures		18,75,000
	Unsecured Loans		10,00,000
	Total		28,75,000
4	**Property, plant and equipment**		
	Land and Building		19,30,000
	Plant and machinery		18,00,000
	Furniture and fitting		9,20,000
	Net carrying value		46,50,000

Working Note

Amount transferred to CRR and maximum equity to be bought back will becalculated by simultaneous

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equation method.

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Then

$(31,25,000 - x) - 22,62,500 = y$ (1)

$(\frac{y}{20} X10) = X$ or $2x = y$ (2)

by solving the above equation, we get

x = ₹2,87,500 y = ₹5,75,000

Question 27(Illustration)

M Ltd. furnishes the following Balance Sheet as at 31st March, 20X1:

		Particulars	Notes	₹ (in 000)
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	5,000
	B	Reserves and Surplus	2	6,310
2		**Non-current liabilities**		
		Long term borrowings	3	400
3		**Current liabilities**		
	A	Trade Payables		40
		Total		11,750
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment	4	2,750
	B	Non-Current Investments (at cost)		5,000
2		**Current assets**		
	A	Inventories		1,000
	B	Trade receivables		2,000
	C	Cash and Cash equivalents		1,000
		Total		11,750

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Notes to accounts

No.	Particulars		₹ in ('000)
1	**Share Capital**		
	Authorized, Issued and Subscribed Capital:		
	3,00,000 Equity shares of ₹ 10 each fully paid up		3,000
	20,000 9% Preference Shares of 100 each		2,000
	Total		5,000
2	**Reserves and Surplus**		
	Capital reserve		10
	Revenue reserve		4,000
	Securities premium		500
	Profit and Loss account		1,800
	Total		6,310
3	**Long term borrowings**		
	10% Debentures		400
4	**Property, Plant and Equipment (PPE)**		
	PPE: Cost		3,000
	Less: Provision for depreciation		(250)
	Net carrying value		2,750

The company passed a resolution to buy-back 20% of its equity capital @ ₹ 15 per share. For this purpose, **it sold its investments of ₹30 lakhs for ₹ 25 lakhs. You are required to pass necessary Journal entries.**

Answer 27

Journal Entries in the books of M Ltd. ₹ in '000

	Particulars		Dr.	Cr.
1.	Bank A/c	Dr.	2,500	
	Profit and Loss A/c	Dr.	500	
	To Investment A/c			3,000
	(Being investment sold for the purpose of buy-backof Equity Shares)			
2.	Equity share capital A/c	Dr.	600	
	Premium payable on buy-back	Dr.	300	
	To Equity shares buy-back A/c			900
	(Being the amount due on buy-back of equity shares)			
3.	Equity shares buy-back A/c	Dr.	900	
	To Bank A/c			900

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	(Being payment made for buy-back of equity shares)			
4.	Securities Premium A/c	Dr.	300	
	To Premium payable on buy-back			300
	(Being premium payable on buy-back charged from Securities premium)			
5.	Revenue reserve A/c	Dr.	600	
	To Capital Redemption Reserve A/c			600
	(Being creation of capital redemption reserve to the extent of the equity shares bought back)			

Question 28(Illustration)

Anu Ltd. (a non-listed company) furnishes you with the following balance sheet as at 31st March, 20X1:

(in crores ₹)

		Particulars		Notes	₹
1		**Equity and Liabilities**			
		Shareholders' funds			
		Share capital		1	100
	A	Reserves and Surplus		2	300
	B	**Current liabilities**			
2		Trade Payables			
					40
	A				440
			Total		
		Assets			
1		**Non-current assets**			
	A	Property, plant and equipment		3	-
	B	Non-Current Investments		4	100
2		**Current assets**			
	A	Trade receivables			140
	B	Cash and Cash equivalents			200
			Total		440

Notes to accounts

No.	Particulars		₹

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1	**Share Capital**		
	Authorized, issued and subscribed share capital:		
	12% Redeemable preference shares of ₹ 100 each, fullypaid up		75
	Equity shares of ₹ 10 each, fully paid up		25
	Total		100
2	**Reserves and Surplus**		
	Capital reserve		15
	Securities premium		25
	Revenue reserves		260
	Total		300
3	**Property, Plant and Equipment**		
	PPE Cost		100
	Less: Provision for depreciation		(100)
	Net carrying value		NIL
4	**Non-Current Investments**		
	Non-current investments at cost (Market value ₹ 400 Cr.)		100

The company redeemed preference shares on 1st April, 20X1. It also bought back 50 lakhs equity shares of ₹ 10 each at ₹ 50 per share. The payments for the above were made out of the huge bank balances, which appeared as a part of current assets. You are asked to:

Pass journal entries to record the above.

(ii) Prepare balance sheet as at 1.4.20X1.

Answer28

Journal entries in the books of Anu Ltd. ₹ in crores

	Particulars		**Dr.**	**Cr.**
1st April, 20X1	12% Preference share capital A/c	Dr.	75	
	To Preference shareholders A/c (Being preference share capital accounttransferred to shareholders account)			75
	Preference shareholders A/c	Dr.	75	
	To Bank A/c (Being payment made to shareholders)			75
	Shares buy-back A/c	Dr.	25	
	To Bank A/c			25
	(Being 50 lakhs equity shares bought back @ ₹50per share)			

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	Equity share capital A/c (50 lakhs x ₹10)	Dr.	5	
	Securities premium A/c (50 lakhs x ₹40)	Dr.	20	
	To Shares buy-back A/c (Being cancellation of shares bought back)			25
	Revenue Reserve A/c	Dr.	80	
	To Capital Redemption Reserve A/c (75+5)			80
	(Being creation of capital redemption reserve to the extent of the face value of preference shares redeemed and equity shares bought back)			

Balance Sheet of Anu Ltd as at 1.4.20X1 (in crores ₹)

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	20
	B	Reserves and Surplus	2	280
2		**Current liabilities**		
	A	Trade Payables		40
		Total		340
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	3	-
	B	Non-Current Investments	4	100
2		**Current assets**		
	A	Trade receivables		140
	B	Cash and Cash equivalents	5	100
		Total		340

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Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed share capital		
	200 lakhs Equity shares of ₹10 each fully paid		20
	Total		20
2	**Reserves and Surplus**		
	Capital reserve		15
	Capital redemption reserve		80
	Securities premium	25	
	Less: Utilization for buy-back of shares	(20)	5
	Revenue Reserve	260	
	Less: transfer to Capital redemption reserve	(80)	180
	Total		280
3	**Property, plant and Equipment**		
	PPE: cost		100
	Less: Provision for depreciation		(100)
	Net carrying value		-
4	**Non-Current Investments**		
	Non-current investments at cost		100
	(Market value ₹400 Crores)		
5	**Cash and Cash Equivalents**		
	Cash and Cash Equivalents as on 31.3.20X1		200
	Less: Bank payment for redemption and buy-back		(100)
	Total		100

Question 29 (Illustration)

Dee Limited (a non-listed company) furnishes the following Balance Sheet as at 31st March, 20X1:

(in thousand ₹)

		Particulars	Notes	₹
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	2,700
	B	Reserves and Surplus	2	9,700
2		Current liabilities		

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	A	Trade Payables		1,400
		Total		13,800
		Assets		
1		Non-current assets		
	A	Property, plant and Equipment		9,300
	B	Non-Current Investments		3,000
2		Current assets		
	A	Inventories		500
	B	Trade receivables		200
	C	Cash and Cash equivalents		800
		Total		13,800

Notes to accounts

No.	Particulars		₹
1	Share Capital		
	Authorized, issued and subscribed capital:		
	2,50,000 Equity shares of ₹ 10 each fully paid up		2,500
	2,000, 10% Preference shares of ₹ 100 each		200
	(Issued two months back for the purpose of buy-back)		
	Total		2,700
2	Reserves and Surplus		
	Capital reserve		1,000
	Revenue reserve		3,000
	Securities premium		2,200
	Profit and loss account		3,500
	Total		9,700

The company passed a resolution to buy-back 20% of its equity capital @ ₹ 50 per share. For this purpose,

it sold all of its investment for ₹ 22,00,000.

You are required to pass necessary journal entries and prepare the Balance Sheet.

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Answer 29

Journal Entries in the books of Dee Limited (in thousand ₹)

	Particulars		Dr.	Cr.
(i)	Bank Account	Dr.	2,200	
	Profit and Loss Account	Dr.	800	
	To Investment Account			3,000
	(Being the investments sold at loss for the purpose of buy-back)			
(ii)	Equity Share buy-back Account	Dr.	2,500	
	To Bank Account			2,500
	(Being the payment made on buy-back)			
(iii)	Equity Share Capital Account	Dr.	500	
	Premium Payable on Buy-Back Account ToEquity Shares Buy-Back Account	Dr.	2,000	2,500
	(Being the buy-back amount allocated to equity share capital)			
(iv)	Securities premium Account	Dr.	2,000	
	To Premium payable on buy-back Account			2,000
	(Being the premium payable on buy-back adjustedagainstsecu-rities premium account)			
(v)	Revenue reserve Account	Dr.	300	
	To Capital Redemption Reserve Account			300
	(Being the amount equal to nominal value of equity shares bought back out of free reserves transferred to capital redemp-tion reserve account)			

Balance Sheet of Dee Limited as at 1st April, 20X1(Afterbuy-back of shares)(in thousand ₹)

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	2,200
	B	Reserves and Surplus	2	6,900
2		**Current liabilities**		
	A	Trade Payables		1,400
		Total		10,500
		Assets		

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1		**Non-current assets**		
	A	Property, plant and Equipment		9,300
2		**Current assets**		
	A	Inventories		500
	B	Trade receivables		200
	C	Cash and Cash equivalents		500
		Total		10,500

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	2,50,000 Equity shares of ₹10 each fully paid up		2,000
	2,000, 10% Preference shares of ₹100 each		200
	(Issued two months back for the purpose of buy-		
	back)		
	Total		2,200
			Pa

2	**Reserves and Surplus**		
	Capital reserve		1,000
	Capital redemption reserve		300
	Securities Premium	2,200	
	Less: Premium payable on buy-back of shares	(2,000)	200
	Revenue reserve	3,000	
	Less: Transfer to Capital redemption reserve	(300)	2,700
	Profit and loss A/c	3,500	
	Less: Loss on investment	(800)	2,700
	Total		6,900

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Question 30(Illustration)

Perrotte Ltd. (a non-listed company) has the following Capital Structure as on 31.03.20X1:

	Particulars	(₹	in crores)
(1)	Equity Share Capital (Shares of ₹ 10 each fully paid)	-	330
(2)	Reserves and Surplus		
	General Reserve	240	-
	Securities Premium Account	90	-
	Profit & Loss Account	90	-
	Infrastructure Development Reserve	180	600
(3)	Loan Funds		1,800

The Shareholders of Perrotte Ltd., on the recommendation of their Board of Directors, have approved on 12.09.20X1 a proposal to buy-back the maximum permissible number of Equity shares considering the large surplus funds available at the disposal of the company. The prevailing market value of the company's shares is ₹ 25 per share and in order to induce the existing shareholders to offer their shares for buy-back, it was decided to offer a price of 20% over market.

You are also informed that the Infrastructure Development Reserve is created to satisfy Income-tax Act requirements. You are required to compute the maximum number of shares that can be bought back in the light of the above information and also under a situation where the loan funds of the company were either ₹ 1,200 crores or ₹ 1,500 crores.

Assuming that the entire buy-back is completed by 09.12.20X1, show the accounting entries in the company's books in each situation.

Answer 30

Statement determining the maximum number of shares to be bought back Number of shares

Particulars	When loan fund is		
	₹ 1,800 crores	₹ 1,500 crores	₹ 1,200 crores
Shares Outstanding Test (W.N.1)	8.25	8.25	8.25
Resources Test (W.N.2)	6.25	6.25	6.25
Debt Equity Ratio Test (W.N.3)	Nil	3.75	Nil
Maximum number of shares that can be bought back [least of the above]	Nil	3.75	Nil

Journal Entries for the Buy-Back (applicable only when loan fund is ₹ 1,200 crores)

₹ in crores

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	Particulars		Debit	Credit
(a)	Equity share buy-back account	Dr.	112.5	
	To Bank account			112.5
	(Being buy-back of 3.75 crores equity shares of ₹10each @ ₹30per share)			
(b)	Equity share capital account	Dr.	37.5	
	Securities premium account	Dr.	75	
(c)	To Equity share buy-back account			112.5
	(Being cancellation of shares bought back)			
	General reserve account	Dr.	37.5	
	To Capital redemption reserve account			37.5
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal valueof share capital bought back out of redeemed through free reserves)			

Working Notes:

1. **Shares Outstanding Test**

Particulars	(Shares in crores)
Number of shares outstanding	33
25% of the shares outstanding	8.25

Resources Test

Particulars	
Paid up capital (₹in crores)	330
Free reserves (₹in crores)	420
Shareholders' funds (₹in crores)	750
25% of Shareholders fund (₹in crores)	₹187.5 crores
Buy-back price per share	₹30
Number of shares that can be bought back (shares in crores)	6.25 crores shares

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Debt Equity Ratio Test

	Particulars	When loan fund is		
		₹ 1,800 crores	₹ 1,200 crores	₹ 1,500 crores
(a)	Loan funds (₹in crores)	1,800	1,200	1,500
(b)	Minimum equity to be maintained **after** buy-back in the ratio of 2:1 (₹in crores)	900	600	750
(c)	Present equity shareholders fund(₹ in crores)	750	750	750
(d)	Future equity shareholder fund(₹in crores) **(See Note 2)**	N.A.	712.5 (750-37.5)	N.A.
(e)	Maximum permitted buy-back of Equity (₹ in crores) [(d) – (b)] **(See Note 2)**	Nil	112.5 (by simultaneous equation)	Nil
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) **(See Note 2)**	Nil	3.75 (by simultaneous equation)	Nil

Note:

Under Situations 1 & 3 the company does not qualify for buy-back of shares as per the provisions of the Companies Act, 2013.

As per section 68 of the Companies Act, 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserveafter such buy-back. In the question, it is stated that the company has surplus funds to dispose of therefore, it is presumed that buy- back is outof free reserves or securities premium and hence a sumequal to the nominal value of the share bought back shall be transferred to Capital Redemption Reserve (CRR). Utilization of CRR is restricted to issuance of fully paid-up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buy-back has to be excluded from present equity.

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount equivalent to nominal value of bought back shares transferred to CRRaccount is 'x' and maximum permitted buy-back of equity is 'y'.

Then

Equation 1 : (Present equity – Nominal value of buy-back transfer to CRR)

– Minimum equity to be maintained= Maximumpermissible buy-back ofequity

(750 –x)-600 = y (1)

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Since 150 – x = y

Maximumbuy-back

Equation 2: $\left[\frac{\text{Maximumbuy-back}}{\text{Offer price for buy-back}} \times \text{Nominal Value}\right]$

= Nominal value of the shares bought –back to be transferred to CRR

$= (\frac{y}{30} \times 10) = X$

[here (30 = 25% x 120]

Or 3x = y (2)

by solving the above two equations we get

x = ₹ 37.5 crores y = ₹112.5 crores

Question 31(Illustration)

Extra Ltd. (a non-listed company) furnishes you with the following Balance Sheet as at 31st March, 20X1:

(in lakhs ₹)

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	120
	B	Reserves and Surplus	2	118
2		**Non-current liabilities**		
		Long term borrowings	3	4
3		**Current liabilities**		
	A	Trade Payables		70
		Total		312
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment		50
	B	Non-current Investments		120
2		**Current assets**		
	A	Cash and Cash equivalents		142
		Total		312

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Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity shares of ₹ 10 each fully paid		100
	9% Redeemable preference shares of ₹ 100 each fullypaid		20
	Total		120
2	**Reserves and Surplus**		
	Capital reserves		8
	Revenue reserves		50
	Securities premium		60
	Total		118
3	**Long term borrowings**		
	10% Debentures		4

The company redeemed the preference shares at a premium of 10% on 1st April, 20X1.

(i) It also bought back 3 lakhs equity shares of ₹ 10 each at ₹ 30 per share. The

1. payment for the above was made out of huge bank balances.

(ii) Included in its investment were "investments in own debentures" costing ₹ 2

2. lakhs (face value ₹ 2.20 lakhs). These debentures were cancelled on 1st April, 20X1.

(iii) The company had 1,00,000 equity stock options outstanding on the above- mentioned date, to the employees at ₹ 20 when the market price was ₹30 (Thiswas included under current liabilities) On 1.04.20X1 employees exercised their options for 50,000 shares.

(iv) Pass the journal entries to record the above.

(v) Prepare Balance Sheet as at 01.04.20X1.

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Answer 31

(₹ in lakhs)

Date	Particulars		Debit	Credit
20X1	9% Redeemable preference share capital A/c	Dr.	20.00	

1st April	Premium on redemption of preference shares A/c	Dr.	2.00	
	To Preference shareholders A/c			22.00
	(Being preference share capital transferred to shareholders account)			
	Preference shareholders A/c	Dr.	22.00	
	To Bank A/c			22.00
	(Being payment made to shareholders)			
	Equity shares buy-back A/c	Dr.	90.00	
	To Bank A/c			90.00
	(Being 3 lakhs equity shares of ₹ 10 eachbought back @ ₹ 30 per share)			
	Equity share capital A/c	Dr.	30.00	
	Securities premium A/c	Dr.	60.00	
	To Equity Shares buy-back A/c			90.00
	(Being cancellation of shares bought back)			
	Revenue reserve A/c	Dr.	50.00	
	To Capital redemption reserve A/c			50.00
	(Being creation of capital redemption reserve account to the extent of the face value of preference shares redeemed and equity shares bought back as per the law)			

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	10% Debentures A/c	Dr.	2.20	
	To Investment (own debentures) A/c			2.00
	To Profit on cancellation of own debenturesA/c			0.20
	(Being cancellation of own debentures costing ₹2 lakhs, face value being ₹2.20 lakhs and the balance being profit on cancellationofdeben-tures)			
	Bank A/c	Dr.	10.00	
	Employees stock option outstanding (Current liabilities) A/c	Dr.	5.00	
	To Equity share capital A/c			5.00
	To Securities premium A/c			10.00
	(Being the allotment to employees, of 50,000 shares of ₹ 10 each at a premium of 20 per share in exercise of stock options by employees)			
	Securities premium A/c	Dr.	2.00	
	To Premium on redemption of preferenceshares A/c			2.00
	(Being premium on redemption of preference shares adjusted through securities premium)			

Balance Sheet of Extra Ltd. as at 01.04.20X1 (in lakhs ₹)

		Particulars	Notes	₹
1		**Equity and Liabilities**		
		Shareholders' funds		
	A	Share capital	1	75.00
	B	Reserves and Surplus	2	66.20
2		**Non-current liabilities**		
		Long term borrowings	3	1.80
3		**Current liabilities**		
	A	Other Current Liabilities	4	65.00
		Total		208
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment		50.00
	B	Non-current Investments	5	118.00
2		**Current assets**		

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	A	Cash and Cash equivalents	6	40.00
		Total		208

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Equity shares of ₹10 each fully paid		100
	Less: Cancellation of bought back shares		(30)
	Add: Shares issued against ESOP		5
	Total		75
2	**Reserves and Surplus**		
	Capital Reserve		
	Opening balance	8.00	
	Add: Profit on cancellation of debentures	0.20	8.20
	Revenue reserves		
	Opening balance	50.00	
	Less: Creation of Capital Redemption Reserve	(50.00)	-
	Securities Premium		
	Opening balance	60.00	
	Less: Adjustment for cancellation of equity shares	(60.00)	
	Less: Adjustment for premium on redemptionof preference shares	(2.00)	
	Add: Shares issued against ESOP at premium	10.00	8.00
	Capital Redemption Reserve		50.00
	Total		66.20
3	**Long term borrowings**		
	10% Debentures		4.00
	Less: Cancellation of own debentures		(2.20)

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	Total		1.80
4.	**Other Current liabilities**		
	Opening balance		70.00
	Less: Adjustment for ESOP outstanding		(5.00)
	Total		65.00
5.	**Non-current investments**		
	Opening balance		120.00
	Less: Investment in own debentures		(2.00)
	Total		118.00
6.	**Cash and Cash Equivalents**		
	Opening balance		142.00
	Less: Payment to preference shareholders		(22.00)
	Less: Payment to equity shareholders		(90.00)
	Add: Share price received against ESOP		10.00
	Total		40.00

Question 32(Illustration)

Pratham Ltd. (a non-listed company) has the following Capital structure as on 31st March, 20X1:

Particulars	**₹**	**₹**
Equity Share Capital (shares of ₹ 10 each fully paid		**30,00,000**
Reserves & Surplus		
General Reserve	**32,50,000**	
Security Premium Account	**6,00,000**	
Profit & Loss Account	**4,30,000**	
Revaluation Reserve	**6,20,000**	**49,00,000**
Loan Funds		**42,00,000**

You are required to compute by Debt Equity Ratio Test, the maximum number of shares that can bebought back in the light of above information, when the offer price for buy-back is ₹ 30 per share.

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Answer 32

Debt Equity Ratio Test

	Particulars	₹
(a)	Loan funds	42,00,000
(b)	Minimum equity to be maintained after-buy-back in the ratio of 2:1 (₹in crores)	21,00,000
(c)	Present equity shareholders fund (₹in crores)	72,80,000
(d)	Future equity shareholder fund (₹ in crores) (See Note 2)	59,85,000 (72,80,000-12,95,000)
(e)	Maximum permitted buy-back of Equity(₹in crores) [(d) – (b)] (See Note 2)	38,85,000 (by simultaneous equation)

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(f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) (See Note 2)	1,29,500 (by simultaneous equation)

Working Note:

Shareholders' funds

Particulars	₹
Paid up capital	30,00,000
Free reserves (32,50,000 +6,00,000+4,30,000)	42,80,000
	72,80,000

As per section 68 of the Companies Act, 2013, amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount equivalent to nominal value of bought back shares transferred to CRRaccount is 'x' and maximum permitted buy-back of equity is 'y'.

Equation 1 : (Present equity – Nominal value of buy-back transfer to CRR) – Minimumequity to be maintained = Maximum permissible buy-back of equity.

(72,80,000 –x)-21,00,000 = y (1)

Since 51,80,000 – x = y

Equation 2 : $\left(\frac{\text{Maximum buy-back}}{\text{Offer price for buy-back}} \text{ X Nominal Value}\right)$

Nominal value of the shares bought –back to be transferred to CRR

$= \left(\frac{y}{30} \times 10\right) = x$

3x = y (2)

x = ₹ 12,95,000 crores and y

= ₹ 38,85,000 crores

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Chapter 13

Amalgamation of Companies

Attempts Cover-age	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.32 TO Q.57											
Past Exams	Q.17	Q.28	Q.1	NO	NO	Q.24	Q.23 Q.24 Q.26 Q.29	Q.22	Q.25	Q.30	Q.12	NO
MTP	NO	Q.9 Q.10	Q.10	Q.8	Q.10	Q.11 Q.27	Q.10 Q.26 Q.28	Q.12 Q.13	Q.10 Q.11	Q.14 Q.15 Q.27	Q.12 Q.13 Q.30	Q.11 Q.24
RTP	Q.19	Q.11	Q.9	Q.13	Q.18	Q.17 Q.30	Q.16 Q.29	Q.19	Q.20	Q.21	Q.1	NO

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Chapter 13

Amalgamation of Companies

Question 1 (Illustration)

The following are the Balance Sheets of P Ltd. and Q Ltd. as at 31st March, 20X1:

		Particulars	Notes	₹ P Ltd	₹ Q Ltd
1		**Equity and Liabilities**			
		Shareholders' funds			
	A	Share capital	1	8,00,000	4,00,000
	B	Reserves and Surplus		3,00,000	2,00,000
2		**Non-current liabilities**			
	A	Long-term borrowings	2	2,00,000	1,50,000
3		**Current liabilities**			
	A	Trade Payables		2,50,000	1,50,000
		Total		15,50,000	9,00,000
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment		7,00,000	2,50,000
	B	Non-current investments		80,000	80,000
2		**Current assets**			
	A	Inventories		2,40,000	3,20,000
	B	Trade receivables		4,20,000	2,10,000
	C	Cash and Cash equivalents		1,10,000	40,000
		Total		15,50,000	9,00,000

Notes to accounts

			P Ltd.	Q Ltd.
1	**Share Capital**			
	Equity shares of ₹ 10 each		6,00,000	3,00,000
	10% Preference Shares of ₹ 100 each		2,00,000	1,00,000
			8,00,000	4,00,000
2	**Long term borrowings**			
	12% Debentures		2,00,000	1,50,000
			2,00,000	1,50,000

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Details of Trade receivables and trade payables are as under:

	P Ltd. (₹)	Q Ltd. (₹)
Trade receivables		
Debtors	3,60,000	1,90,000
Bills Receivable	60,000	20,000
	4,20,000	2,10,000
Trade payables		
Sundry Creditors	2,20,000	1,25,000
Bills Payable	30,000	25,000
	2,50,000	1,50,000

Property, plant and equipment of both the companies are to be revalued at 15% above book value. Both the companies are to pay 10% Equity dividend, but Preference dividend having beenalready paid. After the above transactions are given effect to, P Ltd. will absorb Q Ltd. on the following terms:

(i) 8 Equity Shares of ₹ 10 each will be issued by P Ltd. at par against 6 shares ofQ Ltd.

(ii) 10% Preference Shareholders of Q Ltd. will be paid at 10% discount by issue of10%Preference Shares of ₹ 100 each at par in P Ltd.

(iii) 12% Debenture holders of Q Ltd. are to be paid at 8% premium by 12%Debentures in PLtd. issued at a discount of 10%.

(iv) ₹ 30,000 is to be paid by P Ltd. to Q Ltd. for Liquidation expenses. SundryCreditors of Q Ltd. include ₹ 10,000 due to P Ltd.

(v) Inventory in Trade and Debtors are taken over at 5% lesser than their book-value by PLtd.

Prepare:

(a) Journal entries in the books of P Ltd.

(b) Statement of consideration payable by P Ltd. (Old & New SM) (Same conceptdifferent figures RTP May '23, PYP 10 Marks May '19)

Answer 1

(a) Journal Entries in the Books of P Ltd.

₹		Dr.	Cr.
		₹	
Property, Plant and Equipment	Dr.	1,05,000	
To Revaluation Reserve			1,05,000
(Revaluation of PPE at 15% above book value)			
Reserve and Surplus	Dr.	60,000	
To Equity Dividend			60,000

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(Declaration of equity dividend @ 10%)			
Equity Dividend	Dr.	60,000	
To Bank Account			60,000
(Payment of equity dividend)			
Business Purchase Account	Dr.	4,90,000	
To Liquidator of Q Ltd.			4,90,000
(Consideration payable for the business taken overfrom QLtd.)			
Property, Plant and Equipment (115% of ₹ 2,50,000)	Dr.	2,87,500	
Inventory (95% of ₹ 3,20,000)	Dr.	3,04,000	
Debtors	Dr.	1,90,000	
Bills Receivable	Dr.	20,000	
Investment	Dr.	80,000	
Cash at Bank	Dr.	10,000	
(₹ 40,000 –₹ 30,000 dividend paid)			
To Provision for Bad Debts (5% of ₹ 1,90,000)			9,500
To Sundry Creditors			1,25,000

To 12% Debentures in Q Ltd.			1,62,000
To Bills Payable			25,000
To Business Purchase Account			4,90,000
To Capital Reserve (Balancing figure)			80,000
(Incorporation of various assets and liabilities taken over from Q Ltd. at agreed values and difference ofnet assetsand purchase consideration being credited to capital reserve)			
Liquidator of Q Ltd.	Dr.	4,90,000	
To Equity Share Capital			4,00,000
To 10% Preference Share Capital			90,000
(Discharge of consideration for Q Ltd.'s business)			
12% Debentures in Q Ltd. (₹ 1,50,000 × 108%)	Dr.	1,62,000	
Discount on Issue of Debentures	Dr.	18,000	
To 12% Debentures			1,80,000
(Allotment of 12% Debentures to debenture holdersof QLtd. at a discount of 10%)			
Sundry Creditors of Q Ltd.	Dr.	10,000	
To Sundry Debtors of P Ltd.			10,000
(Cancellation of mutual owing)			

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Goodwill	Dr.	30,000	
To Bank			30,000
(Being liquidation expenses reimbursed to Q Ltd.)			
Capital Reserve	Dr.	30,000	
To Goodwill			30,000
(Being goodwill set off)			

(b) Statement of Consideration payable by P Ltd. for 30,000 shares (paymentmethod)

Shares to be allotted $\frac{30,000}{6} \times 8 = 40,000$ shares of P Ltd.

Issued 40,000 shares of ₹ 10 each i.e.₹ 4,00,000 (i)

For 10% preference shares, to be paid at 10% discount

Rs. $\frac{1,00,000 \times 90}{100}$ ₹ 90,000 (ii)

Consideration amount [(i) + (ii)] ₹ 4,90,000

Question 2 Illustration

Following is the balance sheet of A Ltd. as on 31st March, 20X1

		Particulars		Notes	Rs. (000)
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital		1	22,50
	B	Reserves and Surplus		2	9,00
2		**Non-current liabilities**			
	A	Long-term borrowings		3	7,00
3	A	**Current liabilities**			
		Trade Payables			5,00
			Total		43,50
	A	**Assets**			
1	B	**Non-current assets**			
		Property, Plant and Equipment		4	32,50
		Non-current investments		5	6,00
2	a b c	**Current assets**			
		Inventories			2,00
		Trade receivables			2,00
		Cash and Cash equivalents			1,00
			Total		43,50

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Notes to accounts

1	**Share Capital**		**Rs. in ('000)**
	Equity share capital		
	1,50,000 Equity Shares of Rs. 10 each		15,00
	7,500 14% Preference Shares of Rs. 100 each		7,50
2	**Reserves and Surplus**		22,50
	General reserve		9,00
3	**Long-term borrowings**		
	Secured		
	15% Debentures		7,00
4	**Property, plant and Equipment**		
	Land and Building		32,50
5	**Non-current investments**		
	Investments at cost		6,00

B Ltd agreed to take over the assets and liabilities on the following terms andconditions:

(a) Discharge 15% debentures at a premium of 10% by issuing 15% deben-turesof XLtd.

(b) PPE at 10% above the book value and investments at par value.

(c) Current assets at a discount of 10% and Current liabilities at book value.

(d) Preference shareholders are discharged at a premium of 10% by issuing 15%prefer-ence shares of Rs.100 each.

(e) Issue 3 equity shares of Rs. 10 each for every 2 equity shares in B Ltd. and paythe balance in cash. Calculate Purchase consideration. (New SM)

Answer 2

Calculation of Purchase Consideration (Net Asset value Method)

PARTICULARS	(Rs. in '000's)

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Value of assets taken over: Property, Plant and EquipmentNon-Current Investments Current Assets	35,75 6,00 4,50
Total Assets (A) Less: **Liabilities taken over:**	46,25
15% DebenturesCurrent Liabilities Total Liabilities (B)	7,70 5,00 12,70
Purchase consideration (A -B) Mode of Purchase Consideration In the form of 15% Preference sharesIn the form of Equity shares	33,55 8,25
In the form of Cash (Balance)	22,50 2,80
Total	**33,55**

Question 3

The following are the Balance Sheets of Yes Ltd. and No Ltd. as at 31st March, 20X1:

		Particulars	**Notes**	**₹ Yes Ltd(in crores)**	**₹ No Ltd(in crores)**
1		**Equity and LiabilitiesShareholders' funds**			
	A	Share capital	1	12	5
	B	Reserves and Surplus		88	10
2		**Non-current liabilities**			
		Long term borrowings	2	--	10
3		**Current liabilities**		33	15
		Total		133	40
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment	3	20	6
	B	Non-current investments	4	13	--
2		**Current assets**		100	34
		Total		133	40

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Notes of accounts

		Yes Ltd.	No Ltd.
1	**Share Capital**		
	Equity share capital		
	Authorized share capital	25	5
	Issued and subscribed:		
	Equity shares of ₹10 each fully paid	12	5
		12	5
2	**Long term borrowings**		
	Unsecured loan from Yes Ltd.	--	10
		--	10
3	**Property, Plant and Equipment**		
	Gross value	70	30
	Depreciation	(50)	(24)
		20	6
4	**Non-current investments**		
	30 lakhs equity shares of ₹10 each	3	--
	Long term loan to No Ltd.	10	--
		13	--

On that day Yes Ltd. absorbed No Ltd. The members of No Ltd. are to get oneequity share of Yes Ltd. issued at a premium of ₹ 2 per share for every five equity shares held by them in No Ltd. The necessary approvals are obtained.You are asked to pass journal entries in the books of the two companies to giveeffect to the aboveif the amalgamation is in the nature of merger.(Old & New SM)

Answer 3

Journal Entries in the books of No Ltd.

(Rupees in crores)

		Dr.	Cr.
Realization Account	Dr.	64.00	
To Property, plant and equipmentAccount			30.00
To Current Assets Account			34.00
(Being the assets taken over by Yes Ltd.transferred to			
Provision for depreciation Account	Dr.	24.00	
Current Liabilities Account	Dr.	15.00	

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Unsecured Loan from Yes Ltd. Account	Dr.	10.00	
To Realization Account			49.00
(Being the transfer of liabilities andprovision to Realization Account)			
Yes Ltd. To Realization Account	Dr.	1.2	
(Being the amount of consideration duefrom Yes Ltd. credited to Realization Account)			1.2
Equity Shareholders Account		13.80	
Shareholders Account			13.80
To Realization Account			

(Being the loss on Realization transferredto equity share -			
Equity Share Capital Account	Dr.	5.00	
Reserves and Surplus Account	Dr.	10.00	
To Equity Shareholders Account			15.00
(Being the amount of share capital,reserves and surplus credited to equity shareholdersaccount)			
Equity shares of Yes Ltd.		1.20	
To Yes Ltd.			1.20
(Being the receipt of 10 lakhs equityshares of ₹10 each at ₹12 per share for allotmentto shareholders			
Equity shareholders Account		1.20	
To Equity shares of Yes Ltd.			1.20
Being the distribution of equity sharesreceived from Yes Ltd. to shareholders			

Journal Entries in the books of Yes Ltd.(Rupees in crores)

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Business Purchase Account Dr.		1.20	
To Liquidator of No Ltd. Account			1.20
Being the amount of purchase consideration agreed under approved scheme of amalgamation- W.N. 1			

Property, plant and equipment	Dr.	6.00	
Current Assets	Dr.	34.00	
To Current Liabilities			15.00
To Unsecured Loan (from Yes Ltd.)			10.00
To Business Purchase Account			1.20
To Reserve & Surplus A/c			10.00
To Profit & loss A/c*			3.80
Bing the assets and liability taken overand the surplus transferred profit and loss account	Dr.	1.20	
Liquidator of No Ltd.	Dr.	120	
To Equity Share Capital Account			100
To Securities Premium Account			0.2

(Being the allotment to shareholders of No Ltd. 10 lakhs equity shares of ₹10 each at apremium of ₹2 per share)			
Unsecured Loan (from Yes Ltd.)	Dr.	10.00	
To Loan to No. Ltd.			10.00
(Being the cancellation of unsecured loangiven to No Ltd.)			

*As amalgamation in the nature of merger so balancing figure will be transferred to Profit &Loss accountWorking Note:

Purchase Consideration	Rs. In crores
50lakhs X Rs. 12 i.e. , 10 lakhs equity Shares at Rs. 12 per share 5	1.20

Number of equity shares of ₹10 each to be issued [

1.20 crores12

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]= 10 lakhs

Question 4

The following are the Balance Sheets of X Ltd. and Y Ltd :]

		Particulars	Notes	₹ X Ltd.	₹ Y Ltd.
1		Equity and Liabilities Shareholders' funds			
	A	Share capital	1	1,00,000	50,000
	B	Reserves and Surplus	2	10,000	(10,000)
2		Non-current liabilities			
	A	Long term borrowings	3	--	15,000
3		Current liabilities			
	A	Trade Payables		25,000	5,000
		Total		135,000	60,000
		Asset			
1		Non-current assets			
	A	Property, Plant and Equipment		1,20,000	60,000
	B	Non-current investments	4	15,000	--
				135,000	60,000

Notes to **accounts**

1	Share Capital	X Ltd.	Y Ltd.
	Equity share capital	1,00,000	50,000
		1,00,000	50,000
2	Reserves and Surplus		
	Profit and loss A/c	10,000	--
	Profit and loss A/c (debit balance)	--	(10,000)
		10,000	(10,000)
3	Long term borrowings		

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	Loan from X Ltd.	--	15,000
4	Non-current investments		
	Loan to Y Ltd.	15,000	--
		15,000	--

A new company XY Ltd. is formed to acquire the sundry assets and trade payablesof X Ltd. and Y Ltd. and for this purpose, the sundry assets of X Ltd. are revalued at ₹ 1,00,000. The debt due to X Ltd. is also to be discharged in shares of XY Ltd.Show the Ledger Accounts to close the books of X Ltd. (Old & New SM)

Answer 4

Books of X Ltd.

Realization Account

	Rs.		Rs.
To Sundry Assets	1,20,000	By Trade payables	25,000
		By XY Ltd. (Purchase consideration)	75,000
		By Shareholders (Loss on realization)	20,000
	1,20,000		1,20,000

XY Ltd.

	₹		₹
To Realization Account	75,000	By Shares in XY Ltd.	75,000

Question 5

Super Express Ltd. and Fast Express Ltd. were in competing business. They decided to form a new company named Super Fast Express Ltd. The balance sheets of both the companies were as under:

		Particulars	Notes	Super ExpressLtd. ₹	FastExpress Ltd. ₹
1		**Equity and Liabilities Shareholders' funds**			
	A	Share capital	1	20,00,000	10,00,000
	B	Reserves and Surplus	2	1,00,000	1,00,000
2		**Non-current liabilities**			
	A	Long term provisions	3	1,00,000	
2		**Current liabilities**			--

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	A	Trade Payables		60,000	40,000
		Total		22,60,000	13,00,000
		Assets			
1		**Non-current assets**			
	A	Property Plant and Equipment	4	14,00,000	11,00,000
	B	Intangible assets	5	--	1,00,000
2		**Current assets**			
		Inventories		3,00,000	40,000
		Trade receivables		2,40,000	40,000
		Cash and Cash equivalents	6	3,20,000	20,000

Notes to accounts

		Super Express Ltd. ₹	**Fast Express Ltd.₹**
1	**Share Capital**		
	Equity shares of ₹100 each	20,00,000	10,00,000
2	**Reserves and Surplus**		
	Insurance reserve	1,00,000	--
	Employee profit sharing reserve	--	60,000
	Reserve account	--	1,00,000
	Surplus	--	1,00,000
		1,00,000	2,60,000
3	**Long term provisions**		
	Provident fund	1,00,000	--
	Total	1,00,000	--
4	**Property, Plant and Equipment**		
	Land and Building	10,00,000	6,00,000
	Plant and machinery	4,00,000	5,00,000
		14,00,000	11,00,000
5	**Intangible assets**		
	Goodwill	--	1,00,000
		--	1,00,000
6.	**Cash and Cash Equivalents**		
	Cash at Bank	2,20,000	10,000
	Cash in hand	1,00,000	10,000
		3,20,000	20,000

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The assets and liabilities of both the companies were taken over by the new company at their book values. The companies were allotted equity shares of ₹ 100 each in lieu of purchase consideration amounting to ₹ 30,000 (20,000 for Super- Fast Express Ltd and 10,000 for Fast Express Ltd.).Prepare opening balance sheet of Super Fast Express Ltd. considering pooling method. (Old & NewSM)

Answer 5

Balance Sheet of Super Fast Express Ltd

	Particulars	Notes	₹
	Equity and Liabilities		
1	**Shareholders' funds**		
a	Share capital	1	30,00,000
b	Reserves and Surplus	2	3,60,000
2	**Non-current liabilities**		
a	Long-term provisions	3	1,00,000
3	**Current liabilities**		
a	Trade Payables		1,00,000
	Total		35,60,000
	Assets		
1	Non-current assets		
a	Property, Plant and Equipment	4	25,00,000
b	Intangible assets	5	1,00,000
2	**Current assets**		
	Inventories		3,40,000
	Trade receivables		2,80,000
	Cash and cash equivalents	6	3,40,000
	Total		35,60,000

Notes to Accounts

		₹
1	**Share Capital**	
	Equity share capital	
	Issued, subscribed and paid up	
	30,000 Equity shares of ₹100 each	30,00,000
	Total	30,00,000
2	**Reserves and Surplus**	
	Reserve account	1,00,000
	Surplus	1,00,000
	Insurance reserve	1,00,000

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	Employees profit sharing account	60,000
	Total	3,60,000
3	**Long-term provisions**	
	Provident fund	1,00,000
	Total	1,00,000
4	**Property, Plant and Equipment**	
	Buildings	16,00,000
	Machinery	9,00,000
	Total	25,00,000
5	**Intangible assets**	
	Goodwill	1,00,000
	Total	1,00,000
6	**Cash and cash equivalents**	
	Balances with banks	2,30,000
	Cash on hand	1,10,000
	Total	3,40,000

Question 6

The following were the Balance Sheets of P Ltd. and V Ltd. as at 31st March, 20X1:

		Particulars	Notes	Rs. P Ltd(Rs in Lakhs)	Rs. V Ltd(Rs in Lakhs)
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	15,000	6,000
	B	Reserves and Surplus	2	15,370	4,335
2		**Non-current liabilities**			
		Long term borrowings	3	--	1,000
3		**Current liabilities**			
	A	Trade Payables		1,200	463
	B	Short term provisions		1,830	702
		Total		33,400	12,500

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		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment	4	22,304	6,750
2		**Current assets**			
	A	Inventories		7,862	4,041
	B	Trade receivables		2,120	1,100
	C	Cash and Cash equivalents		1,114	609
		Total		33,400	12,500

Notes to accounts

			Rs. P Ltd (Rs. in-Lakhs)	**Rs. V Ltd (Rs. in-Lakhs)**
1	**Share Capital**		15,000	6,000
2	**Reserves and Surplus**			
	Securities premium		3,000	--
	Foreign project reserve		--	310
	General reserve		9,500	3,200
	Profit and loss account		2,870	825
3	**Long term borrowings**		15,370	4,335
	12% debentures		--	1,000
4	**Property, Plant and Equipment**		--	1,000
	Land and Building		6,000	--
	Plant and machinery		14,000	5,000
	Furniture and fixtures		2,304	1,750
			22,304	6,750

All the bills receivable held by V Ltd. were P Ltd.'s acceptances.On 1st April 20X1, P Ltd. took over V Ltd in an amalgamation in the nature of merger. It was agreedthat in discharge of consideration for the business P Ltd. would allot three fully paid equity sharesof Rs. 10 each at par for every two shares held in V Ltd. It was also agreed that 12% debenturesin V Ltd. would be converted into 13% debentures in P Ltd. of the same amount and denomination.

Details of trade receivables and trade payables as **under:**

P Ltd. V Ltd.

(Rs. in lakhs) (Rs. in lakhs)

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Trade **payables**

Bills Payable	120	-
Trade Creditors	1,080	463
	1,200	463
Trade receivables		
Trade debtors	2,120	1,020
Bills Receivable	—	80
	2,120	1,100

Expenses of amalgamation amounting to Rs. 1 lakh were borne by P Ltd.

You are required to: (i) pass journal entries in the books of P Ltd. and (ii) prepare P Ltd.'s Balance Sheet immediately after the merger. (New SM)

Answer 6

Books of P Ltd.

Journal Entries

		Dr.	Cr.
		(Rs. in Lacs)	(Rs. in Lacs)
Business Purchase A/c	Dr.	9,000	
To Liquidator of V Ltd			9,000
(Being business of V Ltd. taken over for Consideration settled as peragreement)			

Plant and Machinery	Dr.	5,000

Furniture & Fittings	Dr.	1750
Inventory	Dr.	4,041
Debtors	Dr.	1,020
Cash at Bank	Dr.	609
Bills Receivable	Dr.	80

To Foreign Project Reserve	310
To General Reserve (3,200 - 3,000)	200
To Profit and Loss A/c (825)	825

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To Liability for 12% Debentures	1,000
To Creditors	463
To Provisions	702
To Business Purchase	9,000

(Being assets & liabilities taken over from VLtd.)

Liquidator of V Ltd. A/c Dr. 9,000

To Equity Share Capital A/c 9,000

(Purchase consideration discharged in theform of equity shares)

Goodwill A/c Dr. 1

To Bank A/c 1

(Liquidation expenses paid by P Ltd debited to Goodwill A/c)

Profit and loss A/c		Dr.	1	
To Goodwill A/c				1
(being the Goodwill charged to Profit and loss account)				
Liability for 12% Debentures A/c		Dr.	1,000	
To 13% Debentures A/c				1,000

(12% debentures discharged by issue of13% debentures)

Bills Payable A/c Dr. 80

To Bills Receivable A/c 80

(Cancellation of mutual owing on account of bills)

Balance Sheet of P Ltd. as at 1st April, 20X1 (after merger)

2	**Non-current liabilities**		
A	Long-term borrowings	3	1,000
3	**Current liabilities**		
A	Trade Payables (1,543 + 40)		1,583
B	Short-term provisions		2,532
	Total		45,819
	Assets		
1	**Non-current assets**		
A	Property, Plant and Equipment	4	29,054
2	**Current assets**		
A	Inventories		11,903

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B	Trade receivables		3,140
C	Cash and cash equivalents		1,722
	Total		45,819

Notes to accounts

		Rs.
1.	**Share Capital**	
	Equity share capital	
	Authorized, issued, subscribed and paid up	
	24 crores equity shares of Rs.10 each	24,000
	(Of the above shares, 9 crores shares have been issued for consideration other than cash)	
	Total	24,000
2.	**Reserves and Surplus**	
	General Reserve	9,700
	Securities Premium	3,000
	Foreign Project Reserve	310
	Profit and Loss Account	3,694
	Total	16,704
3.	**Long-term borrowings**	
	Secured	
	13% Debentures	1,000
4.	**Property, Plant and Equipment**	
	Land & Buildings	6,000
	Plant & Machinery	19,000
	Furniture & Fittings	4,054
	Total	29,054

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Working Note:

Computation of purchase consideration

The purchase consideration was discharged in the form of three equityshares of Ltd. for every two equity shares held in V Ltd.

3 Purchase consideration = Rs.6,000 lacs × 2 = Rs.9,000 lacs.

Question 7

Sun and Neptune had been carrying on business independently. They agreed to amalgamate and form a new company Jupiter Ltd. with an authorised share capital of Rs. 4,00,000 divided into 80,000 equity shares of Rs. 5 each. On 31st March, 20X3 the respective information of Sun and Neptune were as follows:

	Sun (Rs.)	Neptune (Rs.)
Share capital	3,65,000	3,52,500
Current liabilities	5,97,000	1,80,250
Property, Plant and Equipment	6,35,000	3,65,000
Current assets	3,27,000	1,67,750

Additional Information:

(a) **Revalued figures of non-current and Current assets were as follows:**

	Sun (Rs.)	Neptune (Rs.)
Property, Plant and Equipment	7,10,000	3,90,000
Current Assets	2,99,500	1,57,750

The debtors and creditors include Rs. 43,350 owed by Sun to Neptune.

The purchase consideration is satisfied by issue of the following sharesand debentures.

(i) **60,000 equity shares of Jupiter Ltd. to Sun and Neptune in the proportion to the profit-ability of their respective business based on the average net profit during the lastthree years which were as follows:**

	Sun (Rs.)	Neptune (Rs.)
20X1 Profit	4,49,576	2,73,900
20X2 (Loss)/Profit	(2,500)	3,42,100
20X3 Profit	3,77,924	3,59,000

15% debenture in Jupiter Ltd. at par to provide an income equivalent to 8% return business as on capital employed in their respective business as on 31st March, 20X3 after revaluation of assets.

You are required to:

(1) **Compute the amount of debentures and shares to be issued to Sun and Neptune.**

(2) **A Balance sheet of Jupiter Ltd. showing the position immediately after amalgamation.**

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(New SM)

Answer 7

1) Computation of Amount of Debentures and Shares to be issued: Sun Neptune

(i) Average Net Profit

Rs. (4,49,576-2,500+3,77,924)/3 = 2,75,000

Rs. (2,73,900+,3,42,100+3,59,000)/3 = 3,25,000

Equity Shares Issued

Ratio of distributionSun:

Neptune 275 325

(a) Number Sun: 27,500

Neptune: 32,500

60,000

(b) Amount

27,500 shares of Rs. 5 each = 1,37,500

32,500 shares of Rs. 5 each = 1,62,500

(iii)	Capital Employed (after revaluation of	assets) Rs.	Rs.
	Property, plant and equipment	7,10,000	3,90,000
	Current Assets	2,99,500	1,57,750
		10,09,500	5,47,750
	Less: Current Liabilities	(5,97,000)	(1,80,250)
		4,12,500	3,67,500
	(iv) Debentures Issued		
	8% Return on capital employed	33,000	29,400

15% Debentures to be issued to provideequivalent income:

$$\text{Sun} : 33{,}000 \times \frac{100}{15} \quad 2{,}20{,}000$$

$$\text{Neptune: } 29{,}400 \times \frac{100}{15} = 1{,}96{,}000$$

(2) Balance Sheet of Jupiter Ltd.

As at 31st March 20X3 (after amalgamation)

Particulars	Note No	Rs.

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I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	3,00,000
(b) Reserves and Surplus	2	64,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	4,16,000
(3) Current Liabilities		
(a) Other current liabilities		7,33,900
Total		15,13,900
II. Assets		
(1) Non-current assets		
(a) PPE		11,00,000
(2) Current assets		
(a) Other current assets		4,13,900
Total		**15,13,900**

Notes to Accounts

		Rs.
1	Share Capital	
	Authorized	
	80,000 Equity Shares of Rs.5 each	4,00,000
	Issued and Subscribed	
	60,000 Equity Shares of Rs.5 each	3,00,000
	(all the above shares are allotted as fully paid-up pursuant to a contract without payment being received in cash)	
2	Reserve and Surplus	
	Capital Reserve	64,000
3	Long-term borrowings	
	Secured Loans	
	15% Debentures	4,16,000

Working Notes:

	Rs.	Sun	Neptune	Total
		Rs.	Rs.	
(1)	Purchase Consideration			
	Equity Shares Issued	1,37,500	1,62,500	3,00,000

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	15% Debentures Issued	2,20,000	1,96,000	4,16,000
		3,57,500	3,58,500	7,16,000
(2)	Capital Reserve			
(a)	Net Assets taken over			
	Property, plant & equipment	7,10,000	3,90,000	11,00,000
	Current Assets	2,99,500	1,14,400*	4,13,900
		10,09,500	5,04,400	15,13,900
	Less: Current Liabilities	(5,53,650**)	(1,80,250)	(7,33,900)
		4,55,850	3,24,150	7,80,000
(b)	Purchase Consideration	3,57,500	3,58,500	7,16,000
(c)	Capital Reserve [(a) - (b)]	98,350		
(d)	Goodwill [(b) - (a)]		34,350	
(e)	Capital Reserve [Final Figure(c) -(d)]			64,000

*1,57,750−43,350= 1,14,400

** 5,97,000−43,350= 5,53,650

Question 8

The following is the summarized Balance Sheet of 'A' Ltd. as on 31.3.2019:

Liabilities	Rs.	Assets	Rs.
14,000 Equity shares of Rs. 100 each, fully paid-up	**14,00,000**	**Sundry assets**	**18,00,000**
General reserve	**10,000**		
10% Debentures	**2,00,000**		
Trade payables	**1,40,000**		
Bank overdraft	**50,000**		
	18,00,000		**18,00,000**

B Ltd. agreed to take over the business of 'A' Ltd. Calculate purchase consideration under Net Assets method on the basis: Market value of 75% of the sundry assets is estimated to be 12% more than the book value and that of the remaining 25% at 8% less than the book value. The liabilities are taken over at book values. There is an unrecorded liability of Rs. 25,000. (MTP 5 Marks Oct 19)

Answer 8

Calculation of Purchase Consideration under Net Assets Method

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		Rs.	Rs.
Sundry assets			
	$18,00,000 \times \frac{75}{100} \times \frac{112}{100} =$	15,12,000	
	$18,00,000 \times \frac{75}{100} \times \frac{112}{100} =$	4,14,000	19,26,000
Less:	Liabilities:		
	10% Debentures	2,00,000	
	Trade payables	1,40,000	
	Bank overdraft	50,000	
	Unrecorded liability	25,000	(4,15,000)
Purchase consideration			15,11,000

Question 9

P Ltd. and Q Ltd. decided to amalgamate as on 01.04.2016 Their summarized Balance Sheets as on31.03.2016 were as follows:

(Rs.in '000)

Particulars	P Ltd.	Q Ltd.
Source of Funds:		
Equity share capital (Rs.10 each)	**300**	**280**
9% preference share Capital (Rs.100 each)	**60**	**40**
Investment allowance Reserve	**70**	**60**
Profit and Loss Account	**8**	**12**
10 % Debentures	**100**	**60**
Trade Payables	**50**	**30**
Tax provision	**14**	**8**
Total	**602**	**490**
Application of Funds:		
Building	**120**	**100**
Plant and Machinery	**160**	**140**
Investments	**80**	**50**
Trade receivables	**90**	**70**
Inventories	**72**	**80**
Cash and Bank	**80**	**50**
Total	**602**	**490**

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From the following information, you are required to prepare the Balance Sheet as on 01.04.2016 of a new company, R Ltd., which was formed to take over the business of both the companies and took overall the assets and **liabilities:50 % Debenture are to be converted into Equity Shares of the New Company.**

(i) **Investments are non - current in nature.**

(ii) **Fixed Assets of P Ltd. were valued at 10% above cost and that of Q Ltd. at 5% above cost.**

(iii) **10 % of trade receivables were doubtful for both the companies. Inventories to be carried at cost.**

(iv) **Preference shareholders were discharged by issuing equal number of 9% preference shares at par.**

Equity shareholders of both the transferor companies are to be discharged by issuing Equity sharesof Rs.10 each of the new company at a premium of Rs. 5 per share.

Give your Answer on the basis that amalgamation is in the nature of purchase. (MTP 15 Marks Oct'18, RTP May 19)

Answer 9

M/s R Ltd. Balance Sheet as at 1.4.2016

		Particulars	Notes	Rs. in'000
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	6,55,980
	b	Reserves and Surplus	2	2,77,990
2		**Non-current liabilities**		
	a	Long-term borrowings	3	80,000
3		**Current liabilities**		
	a	Trade Payables	4	80,000
	b	Short term provision	5	22,000
		Total		11,15,970
		Assets		
1		**Non-current assets**		
	a	Fixed assets		
		Tangible assets	6	5,60,000
	b	Non-current investments	7	1,30,000
2		**Current assets**		
	a	Inventory	8	1,52,000
	b	Trade receivables	9	1,44,000
	c	Cash and cash equivalents	10	1,29,970
		Total		11,15,970

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Note to accounts

		Rs. in'000
1.	**Share Capital**	
	Equity share capital	
	55,598 Equity shares of Rs.10 each, fully paid up (W.N.2)	5,55,980
	Preference share capital	
	9% Preference share capital (Share of Rs.100 each) (W.N.2)	1,00,000
		6,55,980
2.	**Reserves and Surplus**	
	Securities premium (W.N.2)	2,77,990
	Investment allowance reserve (Rs.70,000+ Rs.60,000)	1,30,000
	Amalgamation adjustment reserve	(1,30,000)
		2,77,990
3.	**Long-term borrowings**	
	Secured	
	10% Debentures (50% of Rs.1,60,000)	80,000
4.	**Trade Payables** (Rs.50,000+ Rs.30,000)	80,000
5.	**Short term provisions**	
	Provision for tax (Rs.14,000+ Rs.8,000)	22,000
6.	**Tangible assets**	
	Building (Rs.1,32,000+Rs.1,05,000)	2,37,000
	Plant and machinery (Rs.1,76,000+Rs.1,47,000)	3,23,000
		5,60,000
7.	Non – current Investments (Rs.80,000+ Rs.50,000)	1,30,000
8.	**Inventory**	
	Stock (Rs. 72,000+ Rs. 80,000)	1,52,000
9.	**Trade receivables**	
	Trade receivables (90% of (Rs.90,000+ Rs.70,000)	1,44,000
10.	**Cash and cash equivalents**	
	Cash and Bank (Rs. 80,000+ Rs. 50,000 – Rs. 30)	1,29,970

Working Notes:

1. **Calculation of value of equity shares issued to transferor companies**

	P Ltd. (Rs.)	Q Ltd. (Rs.)
Assets taken over:		

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Building	1,32,000	1,05,000
Plant and machinery	1,76,000	1,47,000
Investments	80,000	50,000
Inventories	72,000	80,000
Trade receivables	81,000	63,000
Cash & Bank	80,000	50,000
	6,21,000	4,95,000

Less: Liabilities:

10% Debentures	1,00,000		60,000	
Trade payables	50,000		30,000	
Tax Provision	14,000	1,64,000	8,000	98,000
		4,57,000		3,97,000
Less: Preference Share Capital		60,000		40,000
		3,97,000		**3,57,000**

Number of shares issued to equity shareholders, debenture holders and preferenceshareholders

	P Ltd.	Q Ltd.	Total
Equity shares issued @ Rs.15 per			
share (including Rs.5 premi-um)			
Rs.3,97,000/15	26,466 shares		
Rs.3,57,000/15		23,800 shares	50,266 shares
Equity share capital @ Rs.10	Rs.2,64,660	Rs.2,38,000	Rs.5,02,660
Securities premium @ Rs.5	Rs.1,32,330	Rs.1,19,000	Rs.2,51,330
	Rs.3,96,990	Rs.3,57,000	Rs.7,53,990

50% of Debentures are converted into equity shares @ Rs. 15 per share

1,00,000/2 = 50,000/15 60,000/2 = 30,000/15	3,332 shares	2,000 shares	5,332 shares
Equity share capital @ Rs.10	Rs.33,320	Rs.20,000	Rs.53,320
Security premium@ Rs.5	Rs.16,660 Rs.49,980	Rs.10,000 Rs.30,000	Rs.26,660 Rs. 79,980
9% Preference share capi-talissued	Rs.60,000	Rs.40,000	Rs.1,00,000

Question 10

Robert Ltd. and Diamond Ltd. give the following information as at 31.03.2020:

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	Robert Ltd.(Rs. in lakhs)	Diamond Ltd. (Rs. in lakhs)
Equity Share Capital (Fully paid shares of Rs. 10 each)	22,500	9,000
Securities Premium	4,500	-
Foreign Project Reserve	-	465
General Reserve	14,250	4,800
Profit and Loss Account	4,305	1,162.5
12% Debentures	-	1,500
Trade payables	1,800	694.5
Provisions	2,745	1,053
Land and Buildings	9,000	-
Plant and Machinery	21,000	7,500
Furniture, Fixtures and Fittings	3,456	2,550
Inventory	11,793	6,061.5
Trade receivables	3,180	1,650
Cash at Bank	1,671	913.5

All the bills receivable held by Diamond Ltd. were Robert Ltd.'s acceptances.

On 1st April 2020, Robert Ltd. took over Diamond Ltd. in an amalgamation in the nature of merger. It was agreed that in discharge of consideration for the business, Robert Ltd. would allot three fully paid equity shares of Rs. 10 each at par for every two shares held in Diamond Ltd. It was also agreed that 12% debentures in Diamond Ltd. would be converted into 13% debentures in Robert Ltd. of the same amount and denomination.

Details of trade receivables and trade payables are as under:

Particulars	Robert Ltd.	Diamond Ltd.
		(Rs. in lakhs)
Trade Payables:		
Creditors	1,620	694.5
Bills Payable	180	-
	1,800	694.5
Trade receivables:		
Debtors	3,180	1,530
Bills Receivables	-	120
	3,180	1,650

Expenses of amalgamation amounting to Rs. 1.5 lakhs were borne by Robert Ltd. You are required **to:**

(i) **Pass journal entries in the books of Robert Ltd. and**

Prepare Robert Ltd.'s Balance Sheet immediately after the merger. (MTP 16 Marks Apr'22, MTP 20 Marks March 21 & May '20)(Same concept different figures MTP 20 Marks Apr'19, MTP 15 Marks Aug18, Old & New SM)

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Answer 10

Books of Robert Ltd. Journal Entries

		(Rs. in Lacs)	(Rs. in Lacs)
Business Purchase A/c	Dr.	13,500	
To Liquidator of Diamond Ltd.			13,500
(Being business of Diamond Ltd. taken over for consideration settled as per agreement)			
Plant and Machinery	Dr.	7,500	
Furniture & Fittings	Dr.	2,550	
Inventory	Dr.	6,061.5	
Debtors	Dr.	1,530	
Cash at Bank	Dr.	913.5	
Bills Receivable	Dr.	120	
To Foreign Project Reserve			465
To General Reserve Rs. (4,800 - 4,500)			300
To Profit and Loss A/c			1,162.5
To Liability for 12% Debentures			1,500
To Creditors			694.5
To Provisions			1,053
To Business Purchase A/c			13,500
(Being assets & liabilities taken over from Diamond Ltd.)			
Liquidator of Diamond Ltd. A/c	Dr.	13,500	
To Equity Share Capital A/c			13,500
(Purchase consideration discharged in the form of equi-tyshares)			
Profit & Loss A/c	Dr.	1.5	
To Bank A/c			1.5
(Liquidation expenses paid and charged to P& L A/c)			
Liability for 12% Debentures A/c	Dr.	1,500	
To 13% Debentures A/c			1500
(12% debentures discharged by issue of 13% debentures)			
Bills Payable A/c	Dr.	120	
To Bills Receivable A/c			120
(Cancellation of mutual owing on account of bills)			

Balance Sheet of Robert Ltd. as at 1st April, 2020 (after merger)

Particulars	Notes	Rs. (in lakhs)

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	Equity and Liabilities		
1	Shareholders' funds		
A	Share capital	1	36,000
B	Reserves and Surplus	2	24,981
2	Non-current liabilities		
A	Long-term borrowings	3	1,500
3	Current liabilities		
A	Trade Payables (1,800+694.5-120)		2,374.5
B	Short-term provisions (2,745+1,053)		3,798
	Total		68,653.5
	Assets		
1	Non-current assets		
A	Property, Plant & Equipment	4	43,506
2	Current assets		
A	Inventories (11,793+6,061.5)		17,854.5
B	Trade receivables (3,180+1,650-120)		4,710
C	Cash and cash equivalents (1,671+913.5-1.5)		2,583
	Total		68,653.5

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Notes to Accounts

		Rs.
1.	Share Capital	
	Equity share capital	
	Authorized, issued, subscribed and paid-up: 36 crores equity shares of Rs. 10 each (out of these shares, 13.5 crores shares have been is-suedfor consideration other than cash)	36,000
2.	Reserves and Surplus	
	General Reserve	14,550
	Securities Premium	4,500
	Foreign Project Reserve	465
	Profit and Loss Account Rs. (4,305 +1,162.5-1.5)	5,466
	Total	24,981
3.	Long-term borrowings	
	Secured	
	13% Debentures	1,500
4.	PPE	
	Land & Buildings	9,000
	Plant & Machinery	28,500
	Furniture & Fittings	6,006
	Total	**43,506**

Working Note:

Computation of purchase consideration

Purchase consideration was discharged in the form of three equity shares of Robert Ltd. for every two equity shares held in Diamond Ltd.

Purchase consideration = Rs. 9,000 lacs × 3/2 = Rs. 13,500 lacs

Question 11

Two companies named Alex Ltd. and Beta Ltd. provide you the following summary of ledgerbalances as on 31st March, 2020:

	Alex Ltd. (Rs.)	Beta Ltd. (Rs.)
Goodwill	**1,40,000**	**70,000**
Building	**8,40,000**	**2,80,000**
Machinery	**14,00,000**	**4,20,000**
Inventory	**7,00,000**	**4,90,000**
Trade receivables	**5,60,000**	**2,80,000**
Cash at Bank	**1,40,000**	**56,000**

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Equity Shares of Rs. 10 each	**28,00,000**	**8,40,000**
8% Preference Shares of Rs. 100 each	**2,80,000**	**–**
10% Preference Shares of Rs. 100 each	**–**	**2,80,000**
General Reserve	**1,96,000**	**1,96,000**
Retirement Gratuity fund	**1,40,000**	**56,000**
Trade payables	**3,64,000**	**2,24,000**

(a) Beta Ltd. is absorbed by Alex Ltd. on the following **terms:10% Preference Share-holders are to be paid at 10% premium by issue of 8% Preference Shares of Alex Ltd.**

(b) **Goodwill of Beta Ltd. is valued at Rs. 1,40,000, Buildings are valued at Rs. 4,20,000 and theMachinery at Rs. 4,48,000.**

(c) **Inventory to be taken over at 10% less value and Provision for Doubtful Debts to be created @7.5%.**

(i) **Equity Shareholders of Beta Ltd. will be issued Equity Shares of Alex Ltd. @ 5% premium. You arerequired to:**

(ii) **Prepare necessary Ledger Accounts to close the books of Beta Ltd.**

(iii) **Show the acquisition entries in the books of Alex Ltd.**

Also draft the Balance Sheet after absorption as at 31st March, 2020. (MTP 16 Marks Oct 20,Mar 22 & Oct '23, RTP Nov 18) (Same concept different figures Old & New SM)

Answer 11

In the Books of Beta Ltd. Realization Account

		Rs.			Rs.
To	Sundry Assets	15,96,000	By	Retirement Gratuity Fund	56,000
To	Preference Shareholders (Premium on Redemption)	28,000	By	Trade payables (Purchase Con-sideration)	2,24,000
To	Equity Shareholders		By	Alex Ltd.	14,84,000
	(Profit on Realisation)	1,40,000			
		17,64,000			17,64,000

Equity Shareholders Account

		Rs.			Rs.
To	Equity Shares of Alex Ltd.	11,76,000	By	Share Capital	8,40,000
			By	General Reserve	1,96,000
			By	Realisation Account (Profit on Realisation)	1,40,000
		11,76,000			11,76,000

Preference Shareholders Account

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		Rs.			Rs.
To	8% Preference	3,08,000	By	Preference Share Capital	2,80,000

	Shares of AlexLtd.		By	Realisation Account (Premium on Redemption of Preference Shares)	28,000
		3,08,000			3,08,000

Alex Ltd. Account

		Rs.			Rs.
To	Realisation Account	14,84,000	By	8% Preference Shares	3,08,000
			By	Equity Shares	11,76,000
		14,84,000			14,84,000

In the Books of Alex Ltd. Journal Entries

		Dr.	Cr.
		Rs.	Rs.
Business Purchase A/c	Dr.	14,84,000	
To Liquidators of Beta Ltd. Account			14,84,000
(Being business of Beta Ltd. taken over)			
Goodwill Account	Dr.	1,40,000	
Building Account	Dr.	4,20,000	
Machinery Account	Dr.	4,48,000	
Inventory Account	Dr.	4,41,000	
Trade receivables Account	Dr.	2,80,000	
Bank Account	Dr.	56,000	
To Retirement Gratuity Fund Account			56,000
To Trade payables Account			2,24,000
To Provision for Doubtful Debts Account			21,000
To Business Purchase A/c			14,84,000
(Being Assets and Liabilities taken over as peragreed valuation).			
Liquidators of Beta Ltd. A/c	Dr.	14,84,000	
To 8% Preference Share Capital A/c			3,08,000
To Equity Share Capital A/c			11,20,000
To Securities Premium A/c			56,000
(Being Purchase Consideration satisfied as above).			

Balance Sheet of Alex Ltd. (after absorption) as at 31st March, 2020

Particulars	Notes	Rs.

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	Equity and Liabilities		
1	**Shareholders' funds**		
A	Share capital	1	45,08,000
B	Reserves and Surplus	2	2,52,000
2	**Non-current liabilities**		
A	Long-term provisions		1,96,000
3	**Current liabilities**		
A	Trade Payables		5,88,000
B	Short term provision		21,000
	Total		55,65,000

	Assets		
1	**Non-current assets**		
A	Property, Plant and Equipment (PPE)	3	31,08,000
B	Intangible assets		2,80,000
2	**Current assets**		
A	Inventories		11,41,000
B	Trade receivables		8,40,000
C	Cash and cash equivalents		1,96,000
	Total		55,65,000

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Notes to accounts:

		Rs.
1	**Share Capital**	
	Equity share capital	
	3,92,000 Equity Shares of Rs. 10 each fully paid (Out of above 1,12,000 Equity Shares were issued in consideration other than forcash)	39,20,000
	Preference share capital	
	5,880 8% Preference Shares of Rs. 100 each (Out of above 3,080 Preference Shares were issued in consideration other than for cash)	5,88,000
	Total	45,08,000
2	**Reserves and Surplus**	
	Securities Premium	56,000
	General Reserve	1,96,000
	Total	2,52,000
3	**PPE**	
	Buildings	12,60,000
	Machinery	18,48,000
	Total	31,08,000

Working Notes:

Purchase Consideration:	**Rs.**
Goodwill	1,40,000
Building	4,20,000
Machinery	4,48,000
Inventory	4,41,000
Trade receivables	2,59,000
Cash at Bank	56,000
Less: Liabilities:	
Retirement Gratuity	(56,000)
Trade payables	(2,24,000)
Net Assets/ Purchase Consideration	14,84,000
To be satisfied as under:	
Preference Shareholders of Beta Ltd.	2,80,000
Add: 10% Premium	28,000
Satisfied by issue of 3,080 no. of 8% Preference Shares of Alex Ltd.	3,08,000
Equity Shareholders of Beta Ltd. to be satisfied by issue of 1,12,000Equity Shares of Alex Ltd. at 5% Premium	11,76,000

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Total	14,84,000

Question 12

Sun and Neptune (both companies) had been carrying on business independently. They agreed to amalgamate and form a new company Jupiter Ltd. with an authorised share capital of Rs. 4,00,000 divided into 80,000 equity shares of Rs. 5 each. On 31st March, 2021 Sun and Neptune provide the following information:

	Sun (Rs.)	Neptune (Rs.)
Property, Plant & Equipment	6,35,000	3,65,000
Current Assets	3,27,000	1,67,750
	9,62,000	5,32,750
Less: Current Liabilities	(5,97,000)	(1,80,250)
Representing Capital	3,65,000	3,52,500

Additional Information:

(a) **Revalued figures of Property, Plant & Equipment and Current assets were as follows:**

	Sun (Rs.)	Neptune (Rs.)
Property, Plant & Equipment	7,10,000	3,90,000
Current Assets	2,99,500	1,57,750

The debtors and creditors include Rs. 43,350 owed by Sun to Neptune.

The purchase consideration is satisfied by issue of the following shares and debentures.

(i) **60,000 equity shares of Jupiter Ltd. to Sun and Neptune in the proportion to the profitabilityof their respective business based on the average net profit during the last three years which were as follows:**

	Sun (Rs.)	Neptune (Rs.)
2019 Profit	4,49,576	2,73,900
2020 (Loss)/Profit	(2,500)	3,42,100
2021 Profit	3,77,924	3,59,000

(ii) **15% debentures in Jupiter Ltd. at par to provide an income equivalent to 8% return business as on capital employed in their respective business as on 31 st March, 2021 after revaluation of assets.**

You are required to :

(1) **Compute the amount of debentures and shares to be issued to Sun and Neptune.**

(2) **A Balance sheet of Jupiter Ltd. showing the position immediately after amalgamation.**

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(MTP 16 Marks Oct '21 & April '23, Old & New SM)(PYP 20 Marks May '23)

Answer 12

(1) **Computation of Amount of Debentures and Shares to be issued:**

(i) **Average Net Profit**

Rs. (4,49,576-2,500+3,77,924)/3 = 2,75,000

Rs. (2,73,900+,3,42,100+3,59,000)/3 = 3,25,000

Equity Shares Issued

a. Ratio of distribution

Sun	:	Neptune
275	:	325

Number

Sun	:	27,500
Neptune	:	32,500
		60,000

Amount

		Sun	Neptune
		Rs.	Rs.
	27,500 shares of Rs. 5 each	1,37,500	
	32,500 shares of Rs. 5 each		1,62,500
(iii)	**Capital Employed (after revaluation ofassets)**	Rs.	Rs.
	Property, Plant & Equipment	7,10,000	3,90,000
	Current Assets	2,99,500	1,57,750
		10,09,500	5,47,750
	Less: Current Liabilities	-5,97,000	-1,80,250
		4,12,500	3,67,500
(iv)	**Debentures Issued**		
	8% Return on capital employed	33,000	29,400
	15% Debentures to be issued to provideequiva-lent income:		
	Sun: 33,000 × 100/15	2,20,000	
	Neptune: 29,400 × 100/15		1,96,000

Balance Sheet of Jupiter Ltd. As at 31st March 2021 (after amalgamation)

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Particulars	Note No	Rs.
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	3,00,000
(b) Reserves and Surplus	2	64,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	4,16,000
(3) Current Liabilities		
(a) Other current liabilities		7,33,900
Total		15,13,900
II. Assets		
(1) Non-current assets		
(a) Property, Plant & Equipment		11,00,000
(2) Current assets		
(a) Other current assets		4,13,900
Total		**15,13,900**

Notes to Accounts

		Rs.
1	Share Capital	
	Authorized	
	80,000 Equity Shares of Rs. 5 each	4,00,000
	Issued and Subscribed	
	60,000 Equity Shares of Rs. 5 each	3,00,000
	(all the above shares are allotted as fully paid-up pursuant to a contract without payment being received in cash)	
2	Reserve and Surplus	
	Capital Reserve	64,000
3	Long-term borrowings	
	Secured Loans	
	15% Debentures	4,16,000

Working **Notes:**

Rs.		Sun	Neptune	Total
		Rs.	Rs.	
(1)	Purchase Consideration			
	Equity Shares Issued	1,37,500	1,62,500	3,00,000

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	15% Debentures Issued	2,20,000	1,96,000	4,16,000
		3,57,500	3,58,500	7,16,000
(2)	Capital Reserve			
(a)	Net Assets taken over			
	Property, Plant & Equipment	7,10,000	3,90,000	11,00,000
	Current Assets	2,99,500	1,14,400*	4,13,900
		10,09,500	5,04,400	15,13,900
	Less: Current Liabilities	(5,53,650**)	(1,80,250)	(7,33,900)
		4,55,850	3,24,150	7,80,000
(b)	Purchase Consideration	3,57,500	3,58,500	7,16,000
(c)	Capital Reserve [(a) - (b)]	98,350		
(d)	Goodwill [(b) - (a)]		34,350	
(e)	Capital Reserve [Final Figure(c) -(d)]			64,000

***1,57,750–43,350= 1,14,400**

** 5,97,000–43,350= 5,53,650

Question 13

A Ltd. gives the following information on 31st March, 2022:

	Rs.
8,000 Equity shares of Rs. 100 each	**8,00,000**
10% Debentures	**4,00,000**
Loans	**1,60,000**
Trade payables	**3,20,000**
General Reserve	**80,000**
Building	**3,40,000**
Machinery	**6,40,000**
Inventory	**2,20,000**
Trade receivables	**2,60,000**
Bank	**1,36,000**
Patent	**1,30,000**
Profit & Loss account (Dr. balance)	**34,000**

B Ltd. agreed to absorb A Ltd. on the following terms and conditions:

(1) B Ltd. would take over all assets, except bank balance and Patent 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

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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 Rs. 6,00,000 and the balance in fully paid equity shares of Rs. 100 each at Rs. 125 per share.

The average profit is Rs. 1,24,400. The liquidation expenses amounted to Rs. 16,000. B Ltd. sold prior to 31st March, 2021 goods costing Rs. 1,20,000 to A Ltd. for Rs. 1,60,000. Rs. 1,00,000 worth of goodsare still in Inventory of A Ltd. on 31st March, 2021. Trade payables of A Ltd. include Rs. 40,000 still due to B Ltd. Show the Realisation A/c, Bank A/c, B Ltd. A/c and Equity shareholders A/c to close the books of A Ltd. and prepare the Balance Sheet of B Ltd. as at 1st April, 2021 after the takeover from the available information. (MTP 16 Marks Nov '21 & March '23, RTP Nov'19)

Answer 13

Books of A Limited Realization Account

		Rs.			Rs.
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	Patent	1,30,000			
To	Bank (Exp.)	16,000			
		16,06,000			16,06,000

Bank Account

To	Balance b/d	1,36,000	By	Realization (Exp	16,000
To	B Ltd.		By	10% Debentures	4,00,000
			By	Loans	1,60,000
			By	Equity shareholders	1,60,000
		7,36,000			7,36,000
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 Rs. 125 each	6,10,000
		12,10,000			12,10,000
Equity Share Holders Account					
To	Realization Account	76,000	By	Equity share capital	8,00,000

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To	Realization Account	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, 2021 (An extract)[1]

	Particulars	Notes	Rs.
	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**		
	Property, Plant and Equipment	4	8,82,000
	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

[1] In the absence of the particulars of assets and liabilities (other than those of A Ltd.), the completeBalance Sheet of B Ltd. after takeover cannot be prepared.Notes to Accounts

			Rs.
1	**Share Capital**		
	Equity share capital		
	4,880 Equity shares of Rs. 100 each (Shares have been issuedfor consideration other than cash)		4,88,000
	Total		4,88,000
2	**Reserves and Surplus (an extract)**		
	Securities Premium		1,22,000

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	Profit and loss account	.....	
	Less: Unrealized profit	(15,000)	(15,000)
	Total		1,07,000
3	**Trade payables**		
	Opening balance	3,20,000	
	Less: Inter-company transaction cancelled uponamalgamation	(40,000)	2,80,000
4	**Property, Plant and Equipment**		
	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	2,34,000	
	Less: Intercompany transaction cancelled uponamalgamation	(40,000)	1,94,000

Working Notes:

1. Valuation of Goodwill	Rs.
Average profit	1,24,400
Less: 8% of Rs. 8,80,000	(70,400)
Super profit	54,000
Value of Goodwill = 54,000 x 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	2,34,000
Total Assets	15,30,000
Less: Trade payables	(3,20,000)
Net Assets	12,10,000

Out of this Rs. 6,00,000 is to be paid in cash and remaining i.e., (12,10,000 – 6,00,000)Rs. 6,10,000 in shares of Rs. 125. Thus, the number of shares to be allotted 6,10,000/125 = 4,880shares.

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3. Unrealized Profit on Inventory	Rs.
The Inventory of A Ltd. includes goods worth Rs. 1,00,000 which was soldby B Ltd. on profit. Unrealized profit on this Inventory will be 40,000 / 1,60,000 X 10,000	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 Rs. 1,00,000.	(10,000)
Amount of unrealized profit	15,000

Question 14

Black Limited and White Limited have been carrying their business independently from 01/04/2022. Because of synergy in business, they amalgamated on and from 1 st April, 2022 and formed a new company Grey Limited to take over the business of Black Limited and White Limited. The information of Black Limited and White Limited as on 31st March, 2022 are as follows:

	Black Ltd. (₹)	White Ltd. (₹)
Share Capital:		
Equity share of ₹ 10 each	**15,00,000**	**14,50,000**
10% Preference shares of ₹ 100 each	**2,00,000**	**1,40,000**
Revaluation Reserve	**1,00,000**	**2,00,000**
General Reserve	**1,65,000**	**85,000**
Profit & Loss Account:		
Opening balance (Credit balance)	**1,50,000**	**1,20,000**
Profit for the Year	**2,00,000**	**1,30,000**
15% Debentures of ₹ 100 each (Secured)	**4,00,000**	**5,00,000**
Trade payables	**3,10,000**	**1,20,000**
Land and Buildings	**3,20,000**	**7,40,000**
Plant and Machinery	**18,00,000**	**14,00,000**
Investments	**1,00,000**	**60,000**
Inventory	**2,20,000**	**1,50,000**
Trade Receivables	**4,25,000**	**2,65,000**
Cash at Bank	**1,60,000**	**1,30,000**

Additional Information:

(i) **The authorized capital of the new company will be ₹ 54,00,000 divided into 2,00,000 equity shares of ₹ 25 each, and 4,000 preference shares of ₹ 100 each.**

(ii) **Trade payables of Black Limited includes ₹ 15,000 due to White Limited and trade receivables of White Limited shows ₹ 15,000 receivable from Black Limited.**

(iii) **Land & Buildings and inventory of Black Limited and White Limited are to be revalued as under:**

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	Black Ltd. (₹)	White Ltd. (₹)
Land and Buildings	5,20,000	10,40,000
Inventory	1,80,000	1,25,000

The purchase consideration is to be discharged as under:

(a) **Issue 1,80,000 equity shares of ₹ 25 each fully paid up in proportion of their profitability in the preceding two financial years.**

(b) **Preference shareholders of two companies are issued equivalent number of 12% preference shares of Grey Limited at a price of ₹ 120 per share (face value ₹ 100).**

(c) **15% Debenture holders of Black Limited and White Limited are discharged by Grey Limited issuing such number of its 18% Debentures of ₹ 100 each so as to maintain the same amount of interest.**

You are required to prepare the Balance Sheet of Grey Limited after amalgamation. The amalgamation took place in the nature of purchase. (MTP 15 Marks Sep'22)

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Answer 14

Balance Sheet of Grey Ltd. as at 1st April, 2022

Particulars	Note No.	(₹)
I. **Equity and Liabilities**		
(1) Shareholder's Funds		
(a) Share Capital	1	48,40,000
(b) Reserves and Surplus	2	1,85,000
(2) Non-Current Liabilities		
Long-term borrowings	3	7,50,000
(3) Current Liabilities		
Trade payables		4,15,000
Total		**61,90,000**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	4	47,60,000
(b) Non-current investments		1,60,000
(2) Current assets		
(a) Inventory		3,05,000
(b) Trade receivables		6,75,000
(c) Cash and bank balances		2,90,000
Total		**61,90,000**

Notes to Accounts:

		(₹)	(₹)
1.	**Share Capital**		
	Authorized:		
	2,00,000 equity shares of ₹ 25 each		50,00,000
	4,000 preference share of ₹ 100 each		4,00,000
	Issued, subscribed, and paid up share capital:		
	1,80,000 Equity shares of ₹ 25 each	45,00,000	
	3,400 Preference shares of ₹ 100 each	3,40,000	
	(all the above shares are allotted as fully paid-up pursuant tocontracts without payment being received in cash)		48,40,000

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2.	**Reserves and surplus**		
	Securities Premium (3,400 x ₹ 20)	68,000	
	Capital Reserve	1,17,000	1,85,000
3.	**Long-term borrowings**		
	18% Debentures		7,50,000
4.	**Property, plant and equipment**		
	Land and Building Plant and Machinery	15,60,000	
		32,00,000	47,60,000

Working Notes:

	Black Ltd.	(₹)		
		Grey Ltd.		
1.	**Computation of Purchase consideration**			
	(a) **Preference shares:**			
	Shares at ₹ 120 each	2,40,000		1,68,000
	(b) **Equity shares:**			
	Preceding 2 years profitability			
	Year 1	1,50,000		1,20,000
	Year 2	2,00,000		1,30,000
		3,50,000		2,50,000
	Shares (in ratio 35: 25)			
	1,05,000 shares at ₹ 25	26,25,000		
	75,000 shares at ₹ 25			18,75,000
	Amount of purchase consideration (a + b)	28,65,000		20,43,000
2.	**Net Assets Taken Over**			
	Assets taken over:			
	Land and Building	5,20,000		10,40,000
	Plant and Machinery	18,00,000		14,00,000
	Investments	1,00,000		60,000
	Inventory	1,80,000		1, 25,000
	Trade receivables	4,25,000		2,50,000
	Cash and bank	1,60,000		1,30,000
		31,85,000		30,05,000
	Less: Liabilities taken over:			
	Debentures 3,33,333		4,16,667	
	Trade payables 2,95,000		1,20,000	
		6,28,333		5,36,667

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	Net assets taken over	25,56,667	24,68,333
	Purchase consideration	28,65,000	20,43,000
	Goodwill	3,08,333	
	Capital reserve		4,25,333
Net amount of capital reserve			₹ 1,17,000
3.		**Black Limited**	**White Limited**
	Existing Debentures	₹ 4,00,000 x	₹ 5,00,000 x 15%

		15%	
		= ₹ 60,000	= ₹ 75,000
	Debentures to be issued in Grey Limited @	₹ 60,000 x 100/18	₹ 75,000x100/18
	18% to maintain the same amount of interest	= ₹ 3,33,333	= ₹ 4,16,667

Question 15

A Limited and B Limited are carrying on business of same nature. On 31 st March, 2021 the information given by both these companies is as follows:

	A Ltd.(₹)	B Ltd. (₹)
Share Capital		
- Equity Shares 10 each (Fully Paid)	**12,00,000**	**7,20,000**
- 10% Preference Shares of ₹ 100 each	**6,00,000**	**-**
- 8% Preference Shares of ₹ 100 each	**-**	**5,00,000**
General Reserve	**3,00,000**	**2,50,000**
Investment Allowance Reserve	**-**	**60,000**
Security Premium	**2,40,000**	**-**
Export Profit Reserve	**1,80,000**	**1,20,000**
Profit & Loss Account	**2,16,000**	**1,92,000**
9% Debentures (₹ 10 each)	**3,00,000**	**2,00,000**
Secured Loan	**-**	**3,60,000**
Sundry Creditors	**3,12,000**	**2,04,000**
Bills Payable	**75,000**	**1,00,000**
Other Current Liabilities	**50,000**	**75,000**
Land and Building	**10,80,000**	**8,40,000**
Plant and Machinery	**6,00,000**	**5,60,000**
Office Equipment	**3,45,000**	**2,10,000**

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Investments	96,000	3,00,000
Stock in Trade	6,30,000	4,20,000
Sundry Debtors	4,90,000	3,20,000
Bills Receivables	60,000	70,000
Cash at Bank	1,72,000	61,000

A Limited take over B Limited on the above date, both companies agreeing on a scheme of Amalgamation on the following terms:

(a) **A Limited will issue 80,000 Equity Shares of ₹ 10 each at par to the Equity Shareholders of B Limited.**

(b) **A Limited will issue 10% Preference Shares of ₹ 100 each to discharge the Preference Shareholders of B Limited at 15% premium in such a way that the existing dividend quantum of the preference shareholders of B Limited will not get affected. Accordingly, ₹ 5,00,000 pref. shares are discharged at ₹ 5,75,000 (5,00,000X 115%) by issue of 4,000 preference shares of ₹ 100 each at premium of ₹**

43.75 each.

(c) **The Debentures of B Limited will be converted into equivalent number of Debentures of A Limited.**

(d) **All the Bills Receivable of A Limited were accepted by B Limited.**

(e) **A contingent liability of B Limited amounting to ₹ 72,000 to be treated as actual liability in trade**

payables.

(f) **Expenses of Amalgamation amounted to ₹ 12,000 were borne by A Limited.**

You are required to pass opening Journal Entries in the books of A Limited and prepare the openingBalance Sheet of A Limited as on 1st April, 2021 after amalgamation, assuming that the amalgamation is in the nature of Merger.(MTP 20 Marks Oct'22)

Answer 15

Journal Entries in the books of A Ltd.

Particulars		Debit	Credit
	₹	₹	
Business purchase A/c (W.N.1)	Dr.	13,75,000	
To Liquidator of B Ltd.			13,75,000
(Being business of B Ltd. taken over)			
Land & Building A/c	Dr.	8,40,000	
Plant and machinery A/c	Dr.	5,60,000	
Office equipment A/c	Dr.	2,10,000	
Investments A/c	Dr.	3,00,000	
Inventory A/c	Dr.	4,20,000	

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Debtors A/c	Dr.	3,20,000	
Bills receivables A/c	Dr.	70,000	
Bank A/c	Dr.	61,000	
To General reserve A/c (W.N.2) (2,50,000-1,55,000)			95,000
To Export profit reserve A/c			1,20,000
To Investment allowance reserve A/c			60,000
To Profit and loss A/c			1,20,000
To Liability for 9% Debentures A/c (₹ 100 each)			2,00,000
To Secured Loan			3,60,000
To Trade creditors A/c			2,76,000
To Bills payables A/c			1,00,000
To Other current liabilities A/c			75,000
To Business purchase A/c			13,75,000
(Being assets and liabilities taken over)			
Liquidator of B Ltd.	Dr.	13,75,000	
To Equity share capital A/c			8,00,000
To 10% Preference share capital A/c			4,00,000
To Securities premium A/c			1,75,000
(Being purchase consideration discharged)			
General Reserve* A/c	Dr.	12,000	
To Cash at bank			12,000
(Being expenses of amalgamation paid)			
Liability for 9% Debentures in B Ltd. A/c	Dr.	2,00,000	
To 9% Debentures A/c			2,00,000
(Being debentures in B ltd. discharged by issuing own 9% debentures)			
Bills payables A/c	Dr.	60,000	
To Bill receivables A/c			60,000
(Cancellation of mutual owing on account of bills of exchange)			

*Alternatively, profit & loss A/c may be debited in place of general reserve A/c.

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Opening Balance Sheet of A Ltd. (afterabsorption) as at 1st April, 2021

	Particulars	Notes	₹
1	Equity and Liabilities Shareholders' funds		
ab2	Share capital	1	30,00,000
a3	Re-serves and Surplus	2	14,94,000
ab	Non-current liabilities		
	Long-term borrowings	3	8,60,000
	Current liabilities		
1	Trade Payables	4	7,03,000
ab2	Other current liabilities	5	1,25,000
abc	Total		61,82,000
	Assets		
	Non-current assets		
	PPE	6	36,35,000
	Investments	7	3,96,000
	Current assets		
	Inventories	8	10,50,000
	Trade receivables	9	8,80,000
	Cash and cash equivalents	10	2,21,000
	Total		61,82,000

Notes to accounts

			₹
1	Share Capital		
	Equity share capital		
	2,00,000 Equity shares of ₹ 10 each (Out of above, 80,000 shares were issued forconsideration other than cash)		20,00,000
	Preference share capital		
	10,000 10% Preference shares of ₹ 100 each (Out of above, 4,000 shares were issued for consideration other than cash)		10,00,000
	Total		30,00,000

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2	Reserves and Surplus		
	General Reserve		
	Opening balance	3,00,000	
	Add: Adjustment under scheme of amalgamation	95,000	
	Less: Amalgamation expense paid	(12,000)	3,83,000
	Securities premium (2,40,000+1,75,000)		4,15,000
	Export profit reserve		
	Opening balance	1,80,000	
	Add: Adjustment under scheme of amalgamation	1,20,000	3,00,000
	Investment allowance reserve		60,000
	Profit and loss account		
	Opening balance	2,16,000	
	Add: Adjustment under scheme of amalgamation	1,20,000	3,36,000
	Total		14,94,000

3	Long-term borrowings		
	Secured		
	9% Debentures	3,00,000	
	Add: Adjustment under scheme of amalgamation	2,00,000	
	Secured loan	3,60,000	8,60,000
4	Trade payables		
	Creditors: Opening balance	3,12,000	
	Add: Adjustment under scheme of amalgamation	2,76,000	5,88,000
	Bills Payables: Opening balance	75,000	
	Add: Adjustment under scheme of amalgamation	1,00,000	
	Less: Cancellation of mutual owning upon amalgamation	(60,000)	1,15,000
			7,03,000
5	Other current liabilities		
	Opening balance	50,000	
	Add: Adjustment under scheme of amalgamation	75,000	1,25,000
6	PPE		
	Land & Building- Opening balance	10,80,000	
	Add: Adjustment under scheme of amalgamation	8,40,000	19,20,000
	Plant and machinery- Opening balance	6,00,000	
	Add: Adjustment under scheme of amalgamation	5,60,000	11,60,000
	Office equipment- Opening balance	3,45,000	

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	Add: Adjustment under scheme of amalgamation	2,10,000	5,55,000
	Total		36,35,000
7	Investments		
	Opening balance	96,000	
	Add: Adjustment under scheme of amalgamation	3,00,000	3,96,000
8	Inventories		
	Opening balance	6,30,000	
	Add: Adjustment under scheme of amalgamation	4,20,000	10,50,000
9	Trade receivables		
	Debtors: Opening balance	4,90,000	
	Add: Adjustment under scheme of amalgamation	3,20,000	8,10,000
	Bills Payables: Opening balance	60,000	
	Add: Adjustment under scheme of amalgamation	70,000	
	Less: Cancellation of mutualowning upon amalgamation	(60,000)	70,000
	Total		8,80,000
10	Cash and cash equivalents		
	Opening balance	1,72,000	
	Add: Adjustment under scheme of amalgamation	61,000	
	Less: Amalgamation expense paid	(12,000)	2,21,000

Working Notes:Calculation of purchase consideration

	₹
Equity shareholders of B Ltd. (80,000 x ₹ 10)	8,00,000
Preference shareholders of B Ltd. (5,00,000 x 115%)	5,75,000
Purchase consideration would be	13,75,000

Amount to be adjusted from general reserve

The difference between the amount recorded as share capital issued and the amount of share capital of transferor company should be adjusted in General Reserve.

Thus, General reserve will be adjusted as follows:

	₹
Purchase consideration	13,75,000
Less: Share capital issued (₹ 7,20,000 + ₹ 5,00,000)	(12,20,000)
Amount to be adjusted from general reserve	1,55,000

Calculation of balances of Profit & Loss and Sundry Creditors of B Limited to be taken over by A Limited

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	P&L (₹)	Creditors (₹)
Balance as per Balance Sheet of B Limited	1,92,000	2,04,000
Less / Add: Contingent Trade Payable treated as Actual Liability	(72,000)	72,000
Taken by A Limited	1,20,000	2,76,000

Question 16

Mohan Ltd. gives you the following information as on 31st March, 2020:

	Rs.
Share capital:	
Equity shares of Rs. 10 each	**3,00,000**
6,000, 9% cumulative preference shares of Rs. 10 each	**60,000**
Profit and Loss Account (Dr. balance)	**1,70,000**
10% Debentures of Rs. 100 each	**2,00,000**
Interest payable on Debentures	**20,000**
Trade Payables	**1,50,000**
Property, Plant and Equipment	**3,40,000**
Goodwill	**10,000**
Inventory	**80,000**
Trade Receivables	**1,10,000**
Bank Balance	**20,000**

A new company Ravi Ltd. is formed with authorised share capital of Rs. 4,00,000 divided into 40,000 Equity Shares of Rs. 10 each. The new company will acquire the assets and liabilities of Mohan Ltd. on the following **terms:**

- (a) Mohan Ltd.'s debentures are paid by similar debentures in new company and for outstanding accrued interest on debentures, equity shares of equal amount are issued at par.
- The trade payables are paid by issue of 12,000 equity shares at par in full and final settlement of their claims.

Preference shareholders are to get equal number of equity shares issued at par. Dividend **on**

(a) preference shares is in arrears for three years. Preference shareholders to forgo dividend fortwo years. For balance dividend, equity shares of equal amount are issued at **par.**

(i) Equity shareholders are issued one share at par for every three shares held in Mohan Ltd.

(ii) Current Assets are to be taken at book value (except inventory, which is to be reduced by 10%).Goodwill is to be eliminated. The Property, plant and equipment is taken over at Rs. 3,08,400.

(iii) Remaining equity shares of the new company are issued to public at par fully paid up.

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Expenses of Rs. 5,000 to be met from bank balance of Mohan Ltd. This is to be adjusted from the bank balance of Mohan Ltd. before acquisition by Ravi Ltd.

(a) You are required to **prepare:**

(b) Realization account and Equity Shareholders' account in the books of Mohan Ltd. Bank Account and Balance Sheet with notes to accounts in the books of Ravi Ltd. (RTP May 21)

Answer 16

(i) In the books of Mohan **Ltd.**

(ii) Realisation Account

		Rs.			Rs.
To	Goodwill	10,000	By	10% Debentures	2,00,000
To	Property, plant and equipment	3,40,000	By	Interest accrued on debentures	20,000
To	Inventory	80,000	By	Trade payables	1,50,000
To	Trade receivables	1,10,000	By	Ravi Ltd. (Purchase consideration) (W.N. 1)	1,65,400
To	Bank (20,000 - 5,000)	15,000	By	Equity shareholders A/c (loss on realization) (Bal. fig.)	25,000
To	Preference share holders A/c (W.N.2)	5,400			
		5,60,400			5,60,400

Equity shareholders' Account

		Rs.			Rs.
To	Profit & loss A/c	1,70,000	By	Equity Share capital	3,00,000
To	Expenses*	5,000			
To	Equity shares in Ravi Ltd.	1,00,000			
To	Realization A/c	25,000			
		3,00,000			3,00,000

*Alternatively, expenses may be routed through Realization account. **In the books of Ravi Ltd.**

(iii) Bank Account

		Rs.			Rs.
To	Business Purchase	15,000	By	Balance c/d (Bal. fig.)	1,09,600
To	Equity shares application & allotment A/c (W.N. 3)	94,600			
		1,09,600			1,09,600

Balance Sheet as at 31st March, 2020

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Particulars	Note No.	Rs.
I. Equity and Liabilities		
(1) Shareholder's Funds		
Share Capital	1	4,00,000
(2) Non-Current Liabilities		
Long-term borrowings	2	2,00,000
Total		6,00,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment		3,08,400
(2) Current assets		
(a) Inventories		72,000
(b) Trade receivables		1,10,000
(c) Cash and cash equivalents		1,09,600
Total		6,00,000

Notes to Accounts

		Rs.
1.	Share Capital	
	Authorised share capital	
	40,000 equity shares of Rs. 10 each	4,00,000
	Issued and Subscribed	
	40,000 shares of Rs. 10 each fully paid up	4,00,000
	(out of the above, 30,540 (W.N.3) shares have been allotted as fully paid-up pursuant to contract without payment being received in cash)	
2.	**Long Term Borrowings**	
	10% Debentures	2,00,000

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Working Notes:

Calculation of Purchase consideration

	Rs.
Payment to preference shareholders	
6,000 equity shares @ Rs. 10	60,000
For arrears of dividend: (6,000 x Rs. 10) x 9%	5,400
Payment to equity shareholders	
(30,000 shares x 1/3) @ Rs. 10	1,00,000
Total purchase consideration	1,65,400

Preference shareholders' Account in books of Mohan Ltd.

		Rs.			Rs.
To	Equity Shares in Ravi Ltd.	65,400	By	Preference Share capital	60,000
			By	Realization A/c (Bal. fig.)	5,400
		65,400			65,400

Calculation of number of Equity shares issued to public

Authorized equity shares		40,000
Less: Equity shares issued for		
Interest accrued on debentures	2,000	
Trade payables of Mohan Ltd.	12,000	
Preference shareholders of Mohan Ltd.	6,000	
Arrears of preference dividend	540	
Equity shareholders of Mohan Ltd.	10,000	(30,540)
Number of equity shares issued to public at par for cash		9,460

Question 17

X Ltd. and Y Ltd. give the following information of assets, equity and liabilities as on 31st March, 2018:

	X Ltd. (Rs.)	Y Ltd. (Rs.)
Equity and Liabilities		
Equity Shares of Rs. 10 each	**30,00,000**	**9,00,000**
9% Preference Shares of Rs. 100 each	**3,00,000**	**-**
10% Preference Shares of Rs. 100 each	**-**	**3,00,000**
General Reserve	**2,10,000**	**2,10,000**
Retirement Gratuity Fund (long term)	**1,50,000**	**60,000**

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Trade Payables	3,90,000	2,40,000
Assets		
Goodwill	1,50,000	75,000
Land & Buildings	9,00,000	3,00,000
Plant & Machinery	15,00,000	4,50,000
Inventories	7,50,000	5,25,000
Trade Receivables	6,00,000	3,00,000
Cash and Bank	1,50,000	60,000

X Ltd. absorbs Y Ltd. on the following terms:

(i) 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of X Ltd.

(ii) Goodwill of Y Ltd. on absorption is to be computed based on two times of average profits of precedingthree financial years (2016-17 : Rs. 90,000; 2015-16 : Rs. 78,000 and 2014-15: Rs. 72,000). The profits of 2014 -15 included credit of an insurance claim of

Rs. 25,000 (fire occurred in 2013-14 and loss by fire Rs. 30,000 was booked in Profit and Loss Account of that year). In the year 2015 -16, there was an embezzlement of cash by an employee amounting to Rs. 10,000.

(iii) Land & Buildings are valued at Rs. 5,00,000 and the Plant & Machinery at Rs. 4,00,000.

(iv) Inventories are to be taken over at 10% less value and Provision for Doubtful Debts is to be created @ 2.5%.

(v) There was an unrecorded current asset in the books of Y Ltd. whose fair value amounted to Rs. 15,000and such asset was also taken over by X Ltd.

(vi) The trade payables of Y Ltd. included Rs. 20,000 payable to X Ltd.

(vii) Equity Shareholders of Y Ltd. will be issued Equity Shares @ 5% premium. You are required to:

(i) Prepare Realizations A/c in the books of Y Ltd.

(ii) Show journal entries in the books of X Ltd.

(iii) Prepare the Balance Sheet of X Ltd. after absorption as at 31st March,2018. (RTP Nov 20, PYP 20 Marks May 18)

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Answer 17

In the Books of Y Ltd.Realization Account

			Rs.			Rs.
To	Sundry Assets:			By	Retirement Gratuity Fund	60,000
	Goodwill	75,000				
	Land & Building	3,00,000		By	Trade payables	2,40,000
	Plant & Machinery	4,50,000		By	X Ltd. (Purchase	15,90,000
	Inventory	5,25,000			Consideration)	
	Trade receivables	3,00,000				
	Bank	60,000	17,10,000			
To	Preference Shareholders		30,000			
	(Premium on Redemption)					
To	Equity Shareholders					
	(Profit on Realisation)		1,50,000			
			18,90,000			18,90,000

In the Books of X Ltd.

Journal Entries

		Dr.	Cr.
		Rs.	Rs.
Business Purchase A/c	Dr.	15,90,000	
To Liquidators of Y Ltd. Account			15,90,000
(Being business of Y Ltd. taken over)			
Goodwill Account	Dr.	1,50,000	
Land & Building Account	Dr.	5,00,000	
Plant & Machinery Account	Dr.	4,00,000	
Inventory Account	Dr.	4,72,500	
Trade receivables Account	Dr.	3,00,000	
Bank Account	Dr.	60,000	
Unrecorded assets Account	Dr.	15,000	
To Retirement Gratuity Fund Account			60,000
To Trade payables Account			2,40,000

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To Provision for Doubtful Debts Account			7,500
To Business Purchase A/c			15,90,000
(Being Assets and Liabilities taken over as per agreed valuation).			
Liquidators of Y Ltd. A/c	Dr.	15,90,000	
To 9% Preference Share Capital A/c			3,30,000
To Equity Share Capital A/c			12,00,000
To Securities Premium A/c			60,000

(Being Purchase Consideration satisfied as above)			

Balance Sheet of X Ltd. (after absorption) as at31st March, 2018

	Particulars	Notes	Rs.
	Equity and Liabilities		
1	Shareholders' funds		
A	Share capital	1	48,30,000
B	Reserves and Surplus	2	2,70,000
2	Non-current liabilities		
A	Long-term provisions	3	2,10,000
3	Current liabilities		
A	Trade Payables	4	6,10,000
B	Short term provision	5	7,500
	Total		59,27,500
	Assets		
1	Non-current assets		
	Property, Plant and Equipment	6	33,00,000
	Intangible assets	7	3,00,000
2	Current assets		
A	Inventories	8	12,22,500
B	Trade receivables	9	8,80,000
C	Other current Assets	10	15,000
D	Cash and cash equivalents	11	2,10,000
	Total		59,27,500

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Notes to accounts

		Rs.
1	Share Capital	
	Equity share capital	
	4,20,000 Equity Shares of Rs. 10 each fully paid (Out of above 1,20,000 Equity Shares were issued at 5% premium in considerationother than for cash)	42,00,000
	Preference share capital	
	6,300 9% Preference Shares of Rs. 100 each (Out of above 3,300 Preference Shares were issued in consideration other than forcash)	6,30,000
	Total	48,30,000
2	Reserves and Surplus	
	Securities Premium	60,000
	General Reserve	2,10,000
	Total	2,70,000
3	Long-term provisions	
	Retirement Gratuity fund	2,10,000
4	Trade payables (3,90,000 + 2,40,000 - 20,000*) * Mutual Owings eliminated.	6,10,000
5	Short term Provisions	
	Provision for Doubtful Debts	7,500

6	Property, Plant and Equipment	
	Land & Buildings	14,00,000
	Plant & Machinery	19,00,000
	Total	33,00,000
7	Intangible assets	
	Goodwill (1,50,000 +1,50,000)	3,00,000
8	Inventories (7,50,000 + 4,72,500)	12,22,500
9	Trade receivables (6,00,000 + 3,00,000 - 20,000)	8,80,000
10	Other current Assets	15,000
11	Cash and cash equivalents (1,50,000 +60,000)	2,10,000

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Working Notes:Computation of goodwill **Rs.**

Profit of 2016-17	90,000
Profit of 2015-16 adjusted (Rs. 78,000 + 10,000)	88,000
Profit of 2014-15 adjusted (Rs. 72,000 – 25,000)	47,000
	2,25,000
Average profit	75,000

Goodwill to be valued at 2 times of average profits = Rs. 75,000 x 2 = Rs. 1,50,000

Purchase Consideration:		Rs.
Goodwill		1,50,000
Land & Building		5,00,000
Plant & Machinery		4,00,000
Inventory		4,72,500
Trade receivables		3,00,000
Unrecorded assets		15,000
Cash at Bank		60,000
		18,97,500
Less: Liabilities:		
Retirement Gratuity	60,000	
Trade payables	2,40,000	
Provision for doubtful debts	7,500	(3,07,500)
Net Assets/ Purchase Consideration		15,90,000
To be satisfied as under:		
10% Preference Shareholders of Y Ltd.		3,00,000
Add: 10% Premium		30,000
9% Preference Shares of X Ltd.		3,30,000
Equity Shareholders of Y Ltd. to be satisfied by issue of1,20,000 equity Shares of X Ltd. at 5% Premium		12,60,000
Total		**15,90,000**

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Question 18

P Ltd. and Q Ltd. agreed to amalgamate and form a new company called PQ Ltd. The summarized balance sheets of both the companies on the date of amalgamation stood as below:

Liabilities	P Ltd. Rs.	Q Ltd. Rs.	Assets	P Ltd. Rs.	Q Ltd. Rs.
Equity Shares (Rs. 100 each)	8,20,000	3,20,000	Land & Building	4,50,000	3,40,000
9% Pref. Shares (Rs. 100 each)	3,80,000	2,80,000	Furniture & Fittings	1,00,000	50,000
8% Debentures	2,00,000	1,00,000	Plant & Machinery	6,20,000	4,50,000
General Reserve	1,50,000	50,000	Trade receivables	3,25,000	1,50,000
Profit & Loss A/c	3,52,000	2,05,000	Inventory	2,33,000	1,05,000
Unsecured Loan	-	1,75,000	Cash at bank	2,08,000	1,75,000
Trade payables	88,000	1,60,000	Cash in hand	54,000	20,000
	19,90,000	12,90,000		19,90,000	12,90,000

(i) PQ Ltd. took over the assets and liabilities of both the companies at book value after creating provision @ 5% on inventory and trade receivables respectively and depreciating Furniture & Fittings by @ 10%,Plant and Machinery by @ 10%. The trade receivables of P Ltd. include Rs. 25,000 due from Q Ltd. PQ Ltd. will **issue:5 Preference shares of Rs. 20 each @ Rs. 18 paid up at a premium of Rs. 4 per share for each pref. shareheld in both the companies.**

(ii) **6 Equity shares of Rs. 20 each @ Rs. 18 paid up a premium of Rs. 4 per share for each equity shareheld in both the companies.**

(iii) **6% Debentures to discharge the 8% debentures of both the companies.**

20,000 new equity shares of Rs. 20 each for cash @ Rs.18 paid up at a premium of Rs.4 per share. PQ Ltd. will pay cash to equity shareholders of both the companies in order to adjust their rights as per the intrinsic value of the shares of both the companies.

You are required to prepare ledger accounts in the books of P Ltd. and Q Ltd. to close their books. (RTP May 20)

Answer 18

In the Books of P Ltd. Realization Account

	Rs.		Rs.
To Land & Building	4,50,000	By 8% Debentures	2,00,000
To Plant & Machinery	6,20,000	By Trade Payables	88,000
To Furniture & Fitting	1,00,000	By PQ Ltd.	16,02,100

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To Trade receivables	3,25,000	(Purchase consideration)	
To Inventory/Stock	2,33,000	By Equity Shareholders A/c	1,37,900
To Cash at Bank	2,08,000	(loss)	
To Cash in Hand	54,000		
To Preference shareholders	38,000		
(excess payment)			
	20,28,000		**20,28,000**

Equity Shareholders Account

	Rs.		Rs.
To Realization A/c (loss)	1,37,900	By Share capital	8,20,000
To Equity Shares in PQ Ltd.	10,82,400	By Profit & Loss A/c	3,52,000
To Cash	1,01,700	By General Reserve	1,50,000
	13,22,000		**13,22,000**

9% Preference Shareholders Account

To	Preference Shares in	4,18,000	By Pref. Share	3,80,000
	PQ Ltd.		capitalBy	38,000
		4,18,000	Realization A/c	**4,18,000**

PQ Ltd. Account

To	Realization A/c	16,02,100	By Shares in PQ Ltd.		
			For Equity	10,82,400	15,00,400
			For Pref.	4,18,000	
			By Cash		
					1,01,700
		16,02,100			**16,02,100**

8% Debentures holders Account

	Rs.		Rs.
To 6% Debentures	2,00,000	By 8% Debentures	2,00,000

Books of Q Ltd.

Realization Account

		Rs.			Rs.
To	Land & Building	3,40,000	By	8% Debentures	1,00,000
To	Plant & Machinery	4,50,000	By	Trade payables	1,60,000
To	Furniture & Fittings	50,000	By	Unsecured loan	1,75,000
To	Trade receivables	1,50,000	By	PQ Ltd. (Purchase	
To	Inventory	1,05,000		consideration)	7,92,250
To	Cash at bank	1,75,000	By	Equity Shareholders A/c	90,750

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To	Cash in hand	20,000		Loss	
To	Pref. shareholders	28,000			
		13,18,000			13,18,000

Equity Shareholders Account

	Rs.		Rs.
To Equity shares in PQ Ltd.	4,22,400	By Share Capital	3,20,000
To Realization	90,750	By Profit & Loss A/c	2,05,000
To Cash	61,850	By General Reserve	50,000
	5,75,000		**5,75,000**

9% Preference Shareholders Account

	Rs.		Rs.
To Preference Shares in PQ Ltd	3,08,000	By Share capital	2,80,000
		By Realization A/c	28,000
	3,08,000		**3,08,000**

Q Ltd. Account

	Rs.			Rs.
To Realization A/c	7,92,250	By Equity shares in PQ Ltd.		
		For Equity	4,22,400	
		Preference	3,08,000	7,30,400
		By Cash		61,850
	7,92,250			**7,92,250**

8% Debentures holders Account

	Rs.		Rs.
To 6% Debentures	1,00,000	By 8% Debentures	1,00,000

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Working Notes:

Purchase consideration

	P Ltd. Rs.	Q Ltd. Rs.
Payable to preference shareholders:		
Preference shares at Rs. 22 per share	4,18,000	3,08,000
Equity Shares at Rs. 22 per share	10,82,400	4,22,400
Cash [See W.N. (ii)]	1,01,700	61,850
	16,02,100	**7,92,250**

Value of Net Assets

		P Ltd. Rs.		Q Ltd. Rs.
Land & Building		4,50,000		3,40,000
Plant & Machinery less 10% Depreciation		5,58,000		4,05,000
Furniture & Fittings less 10% Depreciation		90,000		45,000
Trade receivables less 5%		3,08,750		1,42,500
Inventory less 5%		2,21,350		99,750
Cash at Bank		2,08,000		1,75,000
Cash in hand		54,000		20,000
		18,90,100		12,27,250
Less: Debentures	2,00,000		1,00,000	
Trade payables	88,000		1,60,000	
Secured Loans	–	(2,88,000)	1,75,000	(4,35,000)
			16,02,100	7,92,250
Payable in shares			15,00,400	7,30,400
Payable in cash*			1,01,700	(61,850)

	P	Q
Plant & Machinery	6,20,000	4,50,000
Less: Depreciation 10%	62,000	45,000
	5,58,000	4,05,000
Furniture & Fixtures	1,00,000	50,000
Less: Depreciation 10%	10,000	5,000
	90,000	45,000

*This cash is paid to equity shareholders of both the companies for adjustment of their rights as

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perintrinsic value of both companies.

Question 19

P Ltd. and Q Ltd. agreed to amalgamate their business. The scheme envisaged a share capital, equal to the combined capital of P Ltd. and Q Ltd. for the purpose of acquiring the assets, liabilities and undertakings of the two companies in exchange for share in PQ Ltd. The Summarized Balance Sheets ofP Ltd. and Q Ltd. as on 31st March, 2017 (the date of amalgamation) are given below:

Summarized balance sheets as at 31-03-2017

Liabilities	P Ltd. Rs.	Q Ltd. Rs.	Assets	P Ltd. Rs.	Q Ltd. Rs.
Equity & liabilities:			Assets:		
Shareholders Fund			Non-current Assets:		
a. Share Capital	6,00,000	8,40,000	Property, Plant & Equipment		
b. Reserves	10,20,000	6,00,000	(excluding Goodwill)	7,20,000	10,80,000
Current Liabilities			Current Assets		
Bank Overdraft	-	5,40,000	a. Inventories	3,60,000	6,60,000
Trade payables	2,40,000	5,40,000	b. Trade receivables	4,80,000	7,80,000
			c. Cash at Bank	3,00,000	-
	18,60,000	25,20,000		18,60,000	25,20,000

(i) The consideration was to be based on the net assets of the companies as shown in the above BalanceSheets, but subject to an additional payment to P Ltd. for its goodwill to be calculated as its weightedaverage of net profits for the three years ended 31st March, 2017. The weights for this purpose for the years 2014-15, 2015-16 and 2016-17 were agreed as 1, 2 and 3 respectively. The profit had been: 2014-15 Rs. 3,00,000; 2015-16 Rs. 5,25,000 and 2016-17 Rs. 6,30,000. The shares of PQ Ltd. were to be issuedto P Ltd. and Q Ltd. at a premium and in proportion to the agreed net assets value ofthese companies. In order to raise working capital, PQ Ltd proceeded to issue 72,000 shares of Rs. 10 each at the same rate of premium as issued for discharging purchase consideration to P Ltd. and Q Ltd.You are required to **:**

(ii) **Calculate the number of shares issued to P Ltd. and Q Ltd; and**

(iii) **Prepare required journal entries in the books of PQ Ltd.; and**

Prepare the Balance Sheet of PQ Ltd. as per Schedule III after recording the necessary journal entries. (RTP May 18, Nov 21)

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Answer 19

(i) Calculation of number of shares issued to P Ltd. and Q Ltd.:

Amount of Share Capital as per balance sheet		Rs.
P Ltd.		6,00,000
Q Ltd.		8,40,000
		14,40,000

Share of P Ltd. = Rs. 14,40,000 x [21,60,000/ (21,60,000 + 14,40,000)]

= Rs. 8,64,000 or 86,400 shares

Securities premium = Rs. 21,60,000 – Rs. 8,64,000 = Rs. 12,96,000Premiumper share = Rs. 12,96,000 / Rs. 86,400 = Rs. 15

Issued 86,400 shares @ Rs. 10 each at a premium of Rs.15 per share Share of Q Ltd. = Rs. 14,40,000 x [14,40,000/ (21,60,000 + 14,40,000)]

= Rs. 5,76,000 or 57,600 shares

Securities premium = Rs. 14,40,000 – Rs. 5,76,000 = Rs. 8,64,000Premium per share = Rs. 8,64,000 / Rs. 57,600 = Rs. 15

Issued 57,600 shares @ Rs. 10 each at a premium of Rs. 15 per share

(ii) Journal Entries in the books of PQ Ltd.

Particulars		Dr. Amount (Rs.)	Cr. Amount (Rs.)
Business purchase account	Dr.	36,00,000	
To Liquidator of P Ltd. account			21,60,000
To Liquidator of Q Ltd. account			14,40,000
(Being the amount of purchase consideration payable			
to liquidator of P Ltd. and Q Ltd. for assets taken over)			

Goodwill	Dr.	5,40,000	
Property, Plant & Equipment account	Dr.	7,20,000	
Inventory account	Dr.	3,60,000	
Trade receivables account	Dr.	4,80,000	
Cash at bank	Dr.	3,00,000	
To Trade payables account			2,40,000
To Business purchase account			21,60,000
(Being assets and liabilities of P Ltd. taken over)			
Property, Plant & Equipment account	Dr.	10,80,000	

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Inventory account	Dr.	6,60,000	
Trade receivables account	Dr.	7,80,000	
To bank overdraft account			5,40,000
To Trade payables account			5,40,000
To Business purchase account			14,40,000
(Being assets and liabilities of Q Ltd. taken over)			
Liquidator of P Ltd. Account	Dr.	21,60,000	
To Equity share capital account (86,400 x Rs. 10)			8,64,000
To Securities premium (86,400 x Rs. 15)			12,96,000
(Being the allotment of shares as per agreement for			
discharge of purchase consideration)			
Liquidator of Q Ltd. account	Dr.	14,40,000	
To Equity share capital account (57,600 x Rs. 10)			5,76,000
To Securities premium (57,600 x Rs. 15)			8,64,000
(Being the allotment of shares as per agreement for discharge			
of purchase consideration)			
Bank A/c		18,00,000	
To Equity share capital account			7,20,000
To Securities premium(Equity share capital issued to raise working capital)			10,80,000

Balance Sheet of PQ Ltd. on 31st March, 2017 after amalgamation

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		Shareholders' funds		
	a	Share capital	1	21,60,000
	b	Reserves and Surplus	2	32,40,000
2		Current liabilities		
	a	Trade payables (2,40,000 + 5,40,000)		7,80,000
		Total		61,80,000
		Assets		
1		Non-current assets		
	a	Fixed assets		
2		Tangible assets (7,20,000 + 10,80,000)		18,00,000
		Intangible assets (goodwill)	4	5,40,000

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		Current assets		
	a	Inventories (3,60,000 + 6,60,000)		10,20,000
	b	Trade receivables (4,80,000 +7,80,000)		12,60,000
	c	Cash and cash equivalents	3	15,60,000
		Total		61,80,000

Notes to accounts

		Rs.
1	**Share Capital**	
	Issued, subscribed and paid up share capital	
	2,16,000 Equity shares of Rs. 10 each	21,60,000
	(Out of the above 1,44,000 shares issued for non-cashconsideration	
	under scheme of amalgamation)	
2	**Reserves and Surplus**	
	Securities premium	32,40,000
	(@ Rs. 15 for 2,16,000 shares)	
3	**Cash and cash equivalents**	
	Cash at Bank	15,60,000
4	**Intangible Assets**	
	Goodwill	5,40,000

Working Notes:

Calculation of goodwill of P Ltd.

Particulars	Amount Rs.	Weig ht	Weighted amount Rs.
2014-15	3,00,000	1	3,00,000
2015-16	5,25,000	2	10,50,000
2016-17	6,30,000	3	18,90,000
Total (a+b+c)	14,55,000	6	32,40,000
weighted Average = [Total weighted amount/			
Total of weight][Rs. 32,40,000/6]Goodwill			5,40,000

Calculation of Net assets

	P Ltd. Rs.	Q Ltd. Rs.
Assets		
Goodwill	5,40,000	
Property, Plant & Equipment	7,20,000	10,80,000
Inventory	3,60,000	6,60,000

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Trade receivable	4,80,000	7,80,000
Cash at bank	3,00,000	
Less: Liabilities		
Bank overdraft	5,40,000	
Trade payables	2,40,000	5,40,000
Net assets or Purchase consideration	21,60,000	14,40,000
New authorized capital		
= Rs. 14,40,000 + Rs. 12,00 000 = Rs. 26,40,000		
Cash and Cash equivalents **Rs.**		

P Ltd. Balance	3,00,000		
Cash received from Fresh issue (72,000 X Rs.25)	18,00,000		
	21,00,000		
Less: Bank Overdraft	5,40,000		
	15,60,000*		

*The balance of cash and equivalents has been shown after setting off overdraft amount.

Question 20

The following are the Balance Sheets of Aakash Limited and Ganga Limited as at March 31, 2021:

Particulars	Note No.	Aakash Limited (Rs.)	Ganga Limited (Rs.)
I. Equity and Liabilities:			
(1) Shareholder's Funds:			
(a) Share Capital	**1**	**80,00,000**	**20,00,000**
(b) Reserves and Surplus	**2**	**(3,24,00,000)**	**56,00,000**
(2) Non-Current Liabilities:			
(a) Secured Loans	**3**	**3,20,00,000**	**1,60,00,000**
(b) Unsecured Loans	**4**	**1,72,00,000**	**-**
(3) Current Liabilities:			
(a) Trade Payables		**56,00,000**	**36,00,000**
(b) Other Current Liabilities	**5**	**2,04,00,000**	**56,00,000**
Total		**5,08,00,000**	**3,28,00,000**
II. Assets:			
(1) Non-Current Assets:			
Property, Plant & Equipment		**68,00,000**	**1,36,00,000**

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(2) Current Assets:			
(a) Inventories		3,68,00,000	-
(b) Other Current Assets		72,00,000	1,92,00,000
Total		5,08,00,000	3,28,00,000

Notes to Accounts:

		Aakash Limited(Rs.)	Ganga Limited (Rs.)
1.	Share Capital		
	Authorized, Issued, Subscribed & Paid up :		
	6,00,000 Equity Shares of Rs.10 each	60,00,000	-
	20,000 Preference Shares of Rs. 100 each	20,00,000	-
	2,00,000 Equity Shares of Rs. 10 each	-	20,00,000
		80,00,000	20,00,000
2.	Reserves and Surplus		
	General Reserve	8,00,000	56,00,000
	Surplus	(3,32,00,000)	-
		(3,24,00,000)	56,00,000
3.	Secured Loans (Secured Loans of Aakash Limited are secured against pledge of Inventories)	3,20,00,000	1,60,00,000
4.	Unsecured Loans	1,72,00,000	-
5.	Other Current Liabilities		
	Statutory Liabilities	1,44,00,000	20,00,000
	Liability to Employees	60,00,000	36,00,000
		2,04,00,000	56,00,000

Both the companies go into liquidation and a new company 'AakashGanga Limited' is formed to take over their business. The following information is **given:All Current Assets of two companies, except pledged inventory are taken over by Aakash Ganga Limited. The realizable value of all the Current Assets (including pledged inventory) is 80% of book value in case of Aakash Limited and 70% for Ganga Limited.**

(i) **Property, Plant and Equipment of both the companies are taken over at book value by AakashGanga Limited.**

(ii) **Secured Loans include Rs. 32,00,000 accured interest in case of Ganga Limited.**

(iii) **4,00,000 Equity Shares of Rs. 10 each are allotted by AakashGanga Limited at par against cash payment of entire face value to the shareholders of Aakash Limited and Ganga Limited in the ratio of shares held by them in Aakash Limited and Ganga Limited.**

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(iv) **Preference Shareholders in Aakash Limited are issued Equity Shares in Aakash-Ganga Ltd. worth Rs. 4,00,000 in lieu of their present holdings.**

(v) **Secured Loan agree to continue the balance amount of their loans to AakashGanga Limited after adjusting realizable value of pledged asset in case of Aakash Limited and after waiving 50% of interest due in the case of Ganga Limited.**

(vi) **Unsecured Loans are taken over by AakashGanga Limited at 25% of loan amounts.**

(vii) **Employees are issued fully paid Equity Shares in AakashGanga Limited in full settlement of their dues.**

Statutory Liabilities are taken over by AakashGanga Limited at full value and Trade Payables are taken over at 80% of the **book value.**

You are required to prepare the opening Balance Sheet of AakashGanga Limited as at 1.4.2021. (RTPMay 22)

Answer 20

Balance sheet of Aakash Ganga Ltd. as at 1st April, 2021

Particulars	Note No.	(Rs.)
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	1,40,00,000
(2) Non-Current Liabilities		
(a) Long term borrowings	2	2,12,60,000
(3) Current Liabilities		
(a) Trade Payables	3	73,60,000
(b) Other current liabilities	4	1,64,00,000
Total		5,90,20,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant & Equipment	5	2,04,00,000
(b) Intangible assets	6	1,54,20,000
(2) Current assets		
(a) Cash and cash equivalents		40,00,000
(b) Other current assets	7	1,92,00,000
Total		5,90,20,000

Notes to Accounts

			(Rs.)
1.	Share Capital		
	Issued, subscribed & Paid up:		

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	14,00,000 equity shares of Rs. 10 each, fully paid up (W.N.4)		1,40,00,000
	(of the above 10,00,000 shares have been issued for consideration other than cash)		
2.	Long Term borrowings		
	Secured Loans		
	Aakash Limited 25,60,000		
	Ganga Limited 1,44,00,000	1,69,60,000	
	Unsecured Loans	43,00,000	2,12,60,000
3.	Trade Payables (W.N.1)		
	Aakash Limited	44,80,000	
	Ganga Limited	28,80,000	73,60,000
4.	Other current liabilities		
	Statutory Liabilities		
	Aakash Limited	1,44,00,000	
	Ganga Limited	20,00,000	1,64,00,000
5.	Property, Plant & Equipment		
	Aakash Limited	68,00,000	
	Ganga Limited	1,36,00,000	2,04,00,000
6.	Intangible assets		
	Goodwill (W.N.3)		1,54,20,000
7.	Other Current Assets		
	Aakash Limited	57,60,000	
	Ganga Limited	1,34,40,000	1,92,00,000

Working Notes:

Value of total liabilities taken over by AakashGanga Ltd. **(Rs.)**

	Aakash Limited		Ganga Limited	
Current liabilities				
Statutory liabilities	1,44,00,000		20,00,000	
Liability to employees	60,00,000		36,00,000	
Trade payables @ 80%	44,80,000	2,48,80,000	28,80,000	84,80,000
Secured loans				
Given in Balance Sheet	3,20,00,000		1,60,00,000	

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Interest waived	-		16,00,000	1,44,00,000
Value of Inventory (80% of Rs. 3,68,00,000)	2,94,40,000	25,60,000		
Unsecured Loans (25% of Rs.1,72,00,000)		43,00,000		-
		3,17,40,000		2,28,80,000

Assets taken over by AakashGanga Ltd. (Rs.)

	Aakash Limited	Ganga Limited
	Rs.	Rs.
Property, Plant & Equipment	68,00,000	1,36,00,000
Current Assets (80% and 70% respectively of book value)	57,60,000	1,34,40,000
	1,25,60,000	2,70,40,000

Goodwill / Capital Reserve on amalgamation (Rs.)

Liabilities taken over (W.N. 1)		3,17,40,000	2,28,80,000
Equity shares to be issued to Preference Shareholders		4,00,000	-
	A	3,21,40,000	2,28,80,000
Less: Total assets taken over (W.N. 2)	B	(1,25,60,000)	(2,70,40,000)
	A-B	1,95,80,000	(41,60,000)
		Goodwill	Capital Reserve
Net Goodwill (1,95,80,000- 41,60,000)		1,54,20,000	

Equity shares issued by AakashGanga Ltd.

(i)	For Cash		40,00,000
	For consideration other than cash		
(ii)	In Discharge of Liabilities to Employees	96,00,000	
(iii)	To Preference shareholders	4,00,000	1,00,00,000
			1,40,00,000
	No. of shares @ Rs. 10		14,00,000

Journal Entries in the Books of Z Ltd.

			Rs.	Rs.
(i)	Equity Share Capital (Rs. 10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (Rs. 5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000

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	(Being conversion of 5,00,000 equity shares of Rs. 10 each fully paid into same number of fully paid equity shares of Rs. 5 each as per scheme ofreconstruction.)			
(ii)	9% Preference Share Capital (Rs. 100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (Rs. 50 each)A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of Rs. 100 each into same number of 10% preference share of Rs. 50 each and claims of preference dividends settled as per scheme of reconstruction.)			
(iii)	10% Secured Debentures A/c	Dr.	9,60,000	
	Trade payables A/c	Dr.	1,00,000	
	Interest on Debentures payable A/c	Dr.	96,000	
	Bank A/c	Dr.	1,00,000	
	To Patent A/c			5,00,000
	To Profit and Loss A/c			14,60,000
	To Plant and Machinery A/c			6,50,000
	To Furniture & Fixture A/c			1,00,000
	To Trade Investment A/c			50,000
	To Inventory A/c			2,50,000
	To Trade Receivables A/c			1,00,000
	To Capital Reserve (bal. fig.)			7,75,000
	(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction, balance of reconstruction A/c transfer to Capital Reserve.)			

Bank Account

		Rs.			Rs.
To	Reconstruction (Y)	1,00,000	By	Balance b/d (overdraft)	1,00,000
To	Reconstruction(Z)	60,000	By	Reconstruction A/c	15,000
To	Reconstruction A/c (refund of earlier fees by directors)	1,00,000		(capital commitment penalty paid)	

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		By	Reconstruction A/c (reconstruction expenses paid)	15,000
	2,60,000	Provision for tax A/c (tax paid)	75,000	
	By	Balance c/d	55,000	
	By		2,60,000	

Reconstruction Account

		Rs.			Rs.
To	Bank (penalty)	15,000	By	Equity Share	
To	Bank (reconstruction expenses)	15,000		Capital A/c	25,00,000
To	Goodwill	11,00,000	By	9% Pref. Share	
To	Patent	5,00,000		Capital A/c	10,00,000
To	P & L A/c	14,60,000	By	Mr. Y (Settlement)	5,78,000
To	P & M	6,50,000	By	Mr. Z (Settlement)	3,82,000
To	Furniture and Fixtures	1,00,000	By	Trade Payables A/c	1,70,000
To	Trade investment	50,000	By	Director's loan	60,000
To	Inventory	2,50,000	By	Bank	1,00,000
To	Trade Receivables	1,00,000	By	Provision for tax	25,000
To	Capital Reserve (bal. fig.)	7,75,000	By	Land and Building	2,00,000
		50,15,000			50,15,000

Question 21

The balance sheets of Truth Limited and Myth Limited as at 31.03.2021 is given below. Myth Limited is to be amalgamated with Truth Limited from 1.04.2021. The amalgamation is to be carried out in the nature of purchase

Particulars	Note No.	Truth Ltd. (Rs.)	Myth Ltd. (Rs.)
(1) Equity and Liabilities			
1. Shareholders' Funds			
(a) Share Capital	**1**	**10,00,000**	**4,00,000**
(b) Reserves and Surplus	**2**	**11,35,000**	**4,13,000**
2. Non -Current Liabilities	**3**	**-**	**1,50,000**
3. Current Liabilities	**4**	**1,40,000**	**1,82,000**
Total		**22,75,000**	**11,45,000**

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(2) Assets			
1. Non -Current Assets			
(a) Property, Plant & Equipment		15,75,000	6,80,000
(b) Investments		1,87,500	1,00,000
2. Current Assets	5	5,12,500	3,65,000
Total		22,75,000	11,45,000

Note No.	Particulars	Truth Limited (Rs.)	Myth Limited (Rs.)
1	Share Capital	10,00,000	4,00,000
	Equity shares of Rs. 10 each		
2	Reserves & Surplus		
	General Reserve	5,05,000	2,30,000
	Profit & Loss A/c	4,45,000	1,58,000
	Export Profit Reserve	1,85,000	25,000
3	Non- Current Liabilities	11,35,000	4,13,000
	14% Debentures	---	1,50,000
4	Current Liabilities		
	Trade Payables	90,000	1,42,000
	Other Current Liabilities	50,000	40,000
5	Current Assets	1,40,000	1,82,000
	Inventory	2,15,000	85,000
	Trade Receivables	2,02,500	1,75,000
	Cash and Cash equivalents	95,000	1,05,000
		5,12,500	3,65,000

Truth Limited would issue 12% debentures to discharge the claim of the debenture holders of Myth Limited so as to maintain their present annual interest income. Non-trade investment, which constitute 80% of their respective total investments yielded income of 20% to Truth Limited and 15% to Myth Limited. This income is to be deducted from profits while computing average profit for the purpose of calculating goodwill. Profit before tax of both the companies during the last 3 years were as follows:

	Truth Limited (Rs.)	Myth Limited (Rs.)
2018-2019	8,20,000	2,55,000
2019-2020	7,45,000	2,15,000
2020-2021	6,04,000	2,14,000

Goodwill is to be calculated on the basis of simple average of three years profit by using Capitalization method taking 18% as normal rate of return. Ignore taxation. Purchase consideration is to be discharged by Truth Limited on the basis of intrinsic value per share. Prepare Balance Sheet of Truth Limited after the amalgamation. (RTP Nov'22)

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Answer 21

Balance Sheet of Truth Ltd. (after amalgamated with Myth Ltd.) as at 1.4.2021

Particulars	NoteNo.	(Rs.)
I. Equity and liabilities		
(1) Shareholder's funds		
(a) Share capital	1	13,13,750
(b) Reserves and surplus	2	20,76,250
(2) Non-current liabilities		
12% Debentures	3	1,75,000
(3) Current liabilities		
(a) Trade payables	4	2,32,000
(b) Other current liabilities	5	90,000
Total		38,87,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	6	22,55,000
(b) Intangible assets (Goodwill) [WN 1]		4,67,000
(c) Non-current investments	7	2,87,500
(2) Current assets		
(a) Inventories (2,15,000 + 85,000)		3,00,000
(b) Trade receivables (2,02,500 + 1,75,000)		3,77,500
(c) Cash & cash equivalents (95,000 + 1,05,000)		2,00,000
Total		38,87,000

Notes to Accounts

		(Rs.)	(Rs.)
1.	Share Capital		
	1,31,375 Equity Shares of Rs.10 each [1,00,000 + 31,375]		13,13,750
	(of the above shares, 31,375 shares were issued to the vendors otherwise than for cash)		
2.	Reserves and surplus		
	General Reserve	5,05,000	
	Profit and Loss A/c	4,45,000	
	Securities Premium [31,375 x 30]	9,41,250	
	Export profit reserve 1,85,000		

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	Add: Balance of Myth Ltd. 25,000	2,10,000	
	Amalgamation Adjustment Reserve	(25,000)	20,76,250
3.	Long Term Borrowings		
	12% Debentures issued to Myth Ltd.		1,75,000
4.	Trade payables		
	Trade payables	90,000	
	Add: Taken over	1,42,000	2,32,000

5	Other Current Liabilities		
	Truth Ltd.	50,000	
	Myth Ltd.	40,000	90,000
6.	Property, Plant & Equipment		
	Truth Ltd.	15,75,000	
	Myth Ltd.	6,80,000	22,55,000
7.	Investment		2,87,500
	Truth Ltd.	1,87,500	
	Myth Ltd.	1,00,000	

Working Notes:Valuation of Goodwill

Capital Employed

	Truth Ltd.		Myth Ltd.	
	Rs.	Rs.	Rs.	Rs.
Assets as per Balance Sheet		22,75,000		11,45,000
Less: Non-trade Investment		(1,50,000)		(80,000)
		21,25,000		10,65,000
Less: Liabilities:				
14% Debentures	-		1,50,000	
Trade payables	90,000		1,42,000	
Other current liabilities	50,000	(1,40,000)	40,000	(3,32,000)
Capital Employed		19,85,000		7,33,000

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Average Profit before Tax

		Truth Ltd.		Myth Ltd.
2018-2019		8,20,000		2,55,000
2019-2020		7,45,000		2,15,000
2020- 2021		6,04,000		2,14,000
Total profit of 3 years (a)		21,69,000		6,84,000
Simple Average [(a)/3]		7,23,000		2,28,000
Less: Non-trading income*		(30,000)		(12,000)
(iii) Goodwill		6,93,000		2,16,000
Capitalised value of average profit	[(6,93,000 / 18) x 100]	38,50,000	[(2,16,000 / 18) x 100]	12,00,000
Less: Capital Employed [From (i) above]		(19,85,000)		(7,33,000)
Goodwill		18,65,000		4,67,000

*** For Truth Ltd. = 1,87,500 x 80% x 20% = 30,000; and**

Myth Ltd. = 1,00,000 x 80% x 15% = 12,000

(1) **Intrinsic Value per Share**

	Truth Ltd.		Myth Ltd.	
		Rs.		Rs.
Goodwill [W.N. 1]	18,65,000		4,67,000	
Other Assets	22,75,000	41,40,000	11,45,000	16,12,000
Less: Liabilities				
12% Debentures	-		1,75,000**	
Trade payables	90,000		1,42,000	
Provision for Tax	50,000	(1,40,000)	40,000	(3,57,000)
Net Assets		40,00,000		12,55,000
Intrinsic value per share [Net Assets / No. of Shares]		40,00,000 / 1,00,000		12,55,000 / 40,000
		= Rs. 40		= Rs. 31.375

$$** \ 1,50,000 \times \frac{14\%}{12\%} = 1,75,000$$

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Purchase Consideration & manner of its discharge

Intrinsic Value of Myth Ltd. [a]	Rs. 31.375 per share
No. of shares [b]	40,000 shares
Purchase Consideration c= [a x b]	Rs. 12,55,000
Intrinsic Value of Truth Ltd. [d]	Rs. 40 per share
No. of shares to be issued [c / d]	31,375 shares

Question 22

The summarized Balance Sheets of Black Limited and White Limited as on 31st March, 2020 is as follows:

Particulars	Notes	Black Limited (Rs. In 000)	White Limited (Rs. In 000)
Equity and Liabilities			
Shareholders' Funds			
(a) Share Capital	1	6,000	3,600
(b) Reserves and Surplus	2	1,080	660
Current Liabilities			
Trade payables		600	360
Total		7,680	4,620
Assets			
Non-current assets			
Property, Plant and Equipment		3,600	2,400
Current assets			
(a) Inventories		960	720
(b) Trade receivables		1,680	1,080
(c) Cash and Cash Equivalents		1,440	420
Total		7,680	4,620

NoteNo.	Particulars	Black Limited (Rs. in 000)	White Limited (Rs. in 000)
1.	Share Capital Equity Shares of Rs. 100 each	6,000	3,600
	Reserves and Surplus		
2.	General Reserve	360	180
	Profit and Loss Account	720	480
	Total	1,080	660

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Black Limited takes over White Limited on 1st July, 2020.

No Balance Sheet of White Limited is available as on that date. It is, however estimated that White Limited earned profit of Rs. 2,40,000 after charging proportionate depreciation @ 10% p.a. on Property Plant and Equipment, during April-June, 2020.

Estimated profit of Black Limited during these 3 months was Rs. 4,80,000 after charging proportionate deprecation @ 10% p.a. on Property Plant and Equipment

Both the companies have declared and paid 10% dividend within this 3 months' period.

Goodwill of White Limited is valued at Rs. 2,40,000 and Property Plant and Equipment are valued at Rs. 1,20,000 above the depreciated book value on the date of takeover.

Purchase consideration is to be satisfied by Black Limited by issuing shares at par. Ignore income tax. You are required to:

(i) Compute No. of shares to be issued by Black Limited to White Limited against purchase consideration.

(ii) Calculate the balance of Net Current Assets of Black Limited and White Limited as on 1st July, 2020.

(iii) Give balance of Profit or Loss of Black Limited as on 1st July, 2020

(iv) Give balance of Property Plant and Equipment as on 1st July, 2020 after takeover. (PYP 10 Marks July 21)

Answer 22

(i) No. of shares issued by Black Ltd. to White Ltd. against purchase consideration

White Ltd.	Rs.	Rs.
Goodwill		2,40,000
Property, plant and equipment	24,00,000	
Less: Depreciation [24,00,000 10 % 3/12]	(60,000)	
	23,40,000	
Add: Appreciation	1,20,000	24,60,000
Inventory		7,20,000
Trade receivables		10,80,000
Cash and Bank balances	4,20,000	
Add: Profit after depreciation 2,40,000		
Add: Depreciation (non-cash) 60,000	3,00,000	
Less: Dividend [36,00,000 10%]	(3,60,000)	3,60,000
		48,60,000
Less: Trade payables		(3,60,000)
Purchase Consideration		45,00,000
Number of shares to be issued by Black Ltd. @ Rs. 100 each		45,000 shares

Calculation of Net Current Assets as on 01.07.2020

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	Rs.	Black Ltd. Rs.		White Ltd. Rs.
Current assets:				
Inventory		9,60,000		7,20,000
Trade receivables		16,80,000		10,80,000
Cash and Bank	14,40,000		4,20,000	
Less: Dividend	(6,00,000)		(3,60,000)	
Add: Profit after depreciation	4,80,000		2,40,000	
Add: Depreciation being non cash	90,000	14,10,000	60,000	3,60,000
		40,50,000		21,60,000
Less: Trade payables		(6,00,000)		(3,60,000)
		34,50,000		18,00,000

Profit and Loss Account balance of Black Ltd. as on 1.07.2020

	Rs.
P & L A/c balance as on 31.03.2020	7,20,000
Less: Dividend paid	(6,00,000)
	1,20,000
Add: Estimated profit for 3 months after charging depreciation	4,80,000
	6,00,000

Property, plant and equipment as on 01.07.2020

Property, plant and equipment of Black Ltd. as on 31.03.2020		36,00,000
Less: Depreciation for 3 months [36,00,000 x 10% x 3/12]		(90,000)
Property, plant and equipment of White Ltd. Taken over as on 31.03.2020	24,00,000	35,10,000
Less: Proportionate depreciation for 3 months on fixed assets	(60,000)	
	23,40,000	
Add: Appreciation above the estimated book value	1,20,000	24,60,000
Total Property, plant and equipment as on 1.7.2020		59,70,000

Question 23

Galaxy Ltd. and Glory Ltd., are two companies engaged in the same business of chemicals. To mitigatecompetition, a new company Glorious Ltd, is to be formed to which the assets and liabilities of the existing companies, with certain exception, are to be transferred. The summarized Balance Sheet of Galaxy Ltd. and Glory Ltd. as at 31st March, 2020 are as follows:

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			Galaxy Ltd.	Glory Ltd.
			Rs.	Rs.
(I)	**Equity & Liabilities**			
	(1) Shareholders' fund			
	Share Capital			
	Equity shares of Rs. 10 each		8,40,000	4,55,000
	Reserves & Surplus			
	General Reserve		4,48,000	40,000
	Profit & Loss A/c		1,12,000	72,000
	(1) Non-current Liabilities Secured Loan			
	6% Debentures		-	3,30,000
	(1) Current Liabilities			
	Trade Payables		4,20,000	1,83,000
		Total	18,20,000	10,80,000

(II) Assets			
(1) Non-current assets Property, Plant & Equipment			
Freehold property, at cost		5,88,000	3,36,000
Plant & Machinery, at cost less depreciation		1,40,000	84,000
Motor vehicles, at cost less depreciation		56,000	-
(2) Current Assets			
Inventories		3,36,000	4,38,000
Trade Receivables		4,62,000	1,18,000
Cash at Bank		2,38,000	1,04,000
	Total	18,20,000	10,80,000

(i) Assets and Liabilities are to be taken at book value, with the following **exceptions:The Debentures of Glory Ltd. are to be discharged, by the issue of 8% Debentures of Glorious Ltd. at a premium of 10%.**

(ii) **Plant and Machinery of Galaxy Ltd. are to be valued at Rs. 2,52,000.**

(iii) **Goodwill is to be valued at : Galaxy Ltd. Rs. 4,48,000 Glory Ltd. Rs. 1,68,000**

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Liquidator of Glory Ltd. is appointed for collection from trade debtors and payment to trade creditors.He retained the cash balance and collected Rs. 1,10,000 from debtors and paid Rs. 1,80,000 to trade creditors. Liquidator is entitled to receive 5% commission for collection and 2.5% for payments. The balance cash will be taken over by new company.

(1) You are required to :

(2) **Compute the number of shares to be issued to the shareholders of Galaxy Ltd. and Glory Ltd, assumingthe nominal value of each share in Glorious Ltd. is Rs . 10.**

Prepare Balance Sheet of **Glorious Ltd., as on 1st April, 2020 and also prepare notes to the accounts as per Schedule III of the Compa**nies Act, 2013. (PYP 20 Marks , Jan 21)

Answer 23

(i) **Calculation of Purchase consideration (or basis for issue of shares of Glorious Ltd.**

	Galaxy Ltd.	Glory Ltd.
Purchase Consideration:	Rs.	Rs.
Goodwill	4,48,000	1,68,000
Freehold property	5,88,000	3,36,000
Plant and Machinery	2,52,000	84,000
Motor vehicles	56,000	-
Inventory	3,36,000	4,38,000
Trade receivables	4,62,000	-
Cash at Bank	2,38,000	24,000
	23,80,000	10,50,000

Less: Liabilities:		
6% Debentures (3,00,000 x 110%)	-	(3,30,000)
Trade payables	(4,20,000)	
Net Assets taken over	19,60,000	7,20,000
To be satisfied by issue of shares of Glorious. Ltd. @ Rs. 10 each	1,96,000	72,000

Balance Sheet of Glorious Ltd. as at 1st April, 2020

			Particulars		Note No	Amount
						Rs.
			EQUITY AND LIABILITIES			
1			Shareholders' funds			

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	(a)		Share capital		1	26,80,000
	(b)		Reserves and surplus		2	30,000
2			Non-current liabilities			
	(a)		Long-term borrowings		3	3,00,000
3			Current liabilities			
	(a)		Trade payables			4,20,000
				Total		34,30,000
			ASSETS			
1			Non-current assets			
	(a)	i	Property, plant and equipment		4	13,16,000
		ii	Intangible assets		5	6,16,000
2			Current assets			
	(a)		Inventories		6	7,74,000
	(b)		Trade receivables			4,62,000
	(c)		Cash and cash equivalents		7	2,62,000
				Total		34,30,000

Notes to accounts:

	Secured 8% 3,000 Debentures of Rs.100 each		
4.	Property Plant and Equipment		
	Freehold property		
	Galaxy Ltd.	5,88,000	
	Glory Ltd.	3,36,000	9,24,000
	Plant and Machinery		
	Galaxy Ltd.	2,52,000	
	Glory Ltd.	84,000	3,36,000
	Motor vehicles - Galaxy Ltd.		56,000
			13,16,000
5	Intangible assets		
	Goodwill		
	Galaxy Ltd.	4,48,000	
	Glory Ltd.	1,68,000	6,16,000
6	Inventories		
	Galaxy Ltd.	3,36,000	
	Glory Ltd.	4,38,000	7,74,000

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7	Cash and cash equivalents		
	Galaxy Ltd.	2,38,000	
	Glory Ltd.(As per working note)	24,000	2,62,000

Question 24

Dark Ltd. and Fair Ltd. were amalgamated on and from 1st April, 2021. A new company Bright Ltd. was formed to take over the business of the existing companies. The balance Sheets of Dark Ltd. and Fair Ltd. as at 31st March, 2021 are given below:

(Rs. In Lakhs)

	Particulars	Note No.	Dark Ltd.	Fair Ltd.
1	Equity and Liabilities			
	(1) Shareholders' Funds			
	Share Capital	1	1,650	1,425
	Reserves and Surplus	2	630	495
	(2) Non-Current Liabilities Long TermBorrowings: 10% Debentures of 100 Rs. each		90	45
	(3) Current Liabilities Trade Payables		630	285
	Total		3,000	2,250
II	Assets			
	(1) Non Current Assets (a) Property, Plant and Equipment		1,350	975
	(b) Non Current Investments		225	75
	(2) Current Assets			
	(a) Inventories		525	375
	(b) Trade Receivables		450	525
	(c) Cash and Cash Equivalents		450	300
	Total		3,000	2,250

Notes to Accounts

		Dark Ltd. (Rs in Lakh)	Fair Ltd. (Rs in Lakh)
1	Share Capital		
	Equity Shares of Rs. 100 each	1, 200	1,125

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	14% Preference Shares of Rs. 100 each	450	300
		1,650	1,425
2	Reserves and Surplus		
	Revaluation Reserve	225	150
	General Reserve	255	225
	Investment Allowance Reserve	75	75
	Profit and Loss Account	75	45
		630	495

Additional Information:

(i) Bright Limited will issue 5 equity shares for each equity share of Dark Limited and 4 equity sharesfor each equity share of Fair Limited. The shares are to be issued @ Rs. 35 each having a face value of

Rs. 10 per share.

(ii) Preference shareholders of the two companies are issued equivalent number of 16% preferenceshares of Bright Limited at a price of Rs. 160 per share (face value Rs. 100).

(iii) 10% Debenture holders of Dark Limited and Fair Limited are discharged by Bright Limited, issuingsuch number of its 16% Debentures of Rs. 100 each so as to maintain the interest.

(iv) Investment allowance reserve is to be maintained for 4 more years.

(v) Liquidation expenses are for Dark Limited Rs. 6,00,000 and for Fair Limited Rs. 3,00,000. It is decided that these expenses would be borne by Bright Limited.

(vi) All the assets and liabilities of Dark Limited and Fair Limited are taken over at book value.

(vii) Authorized equity share capital of Bright Limited is Rs. 15,00,00,000 divided into equity share of Rs. 10 each. After issuing required number of shares to the liquidators of Dark Limited and Fair Limited, Bright Limited issued balance shares to public. The issue was fully subscribed.

You are required to prepare Balance Sheet of Bright Limited as at 1st April, 2021 after amalgamation has been carried out on the basis of Amalgamation in the nature of purchase (PYP 15 Marks Dec'21) (Same concept different figures PYP 15 Marks Nov'20)(MTP 15 Marks Sep '23)

Answer 24

Balance Sheet of Bright Ltd. as at 1st April, 2021

Particulars	Note No.	(Rs. in lakhs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	2,250
(b) Reserves and Surplus	2	4,200
(2) Non-Current Liabilities		

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Long-term borrowings	3	84.375
(3) Current Liabilities		
Trade payables	4	915
Total		7449.375
II. Assets		
(1) Non-current assets		
(a) i. Property, plant and equipment	5	2,325
ii. Intangible assets	6	633.375
(b) Non-current investments	7	300
(2) Current assets		
(a) Inventories	8	900
(b) Trade receivables	9	975
(c) Cash and cash equivalents	10	2316
Total		7449.375

Notes to Accounts

		(Rs. in lakhs)	(Rs. in lakhs)
1.	Share Capital		
	Authorized Share Capital		
	1,50,00,000 Equity shares of Rs.10 each	1500	
	7,50,000 16% Preference Share of 100 each	750	
	Issued: 1,50,00,000 Equity shares of Rs. 10 each (Out of which 1,05,00,000 Shares were Issued for consideration other than cash)	1500	
	7,50,000 16% Preference Shares of 100 each (Issued for consideration other than cash)	750	2,250
2.	Reserves and surplus		
	Securities Premium Account (1,50,00,000 shares ×Rs. 25) 3750		
	(7,50,000 shares × Rs. 60) 450	4,200	
	Investment Allowance Reserve	150	
	Amalgamation Adjustment Reserve	(150)	4,200
3.	Long-term borrowings		
	16% Debentures (56,25,000+28,12,500) (W.N. 3)		84.375
4.	Trade payables		
	Dark Ltd.	630	
	Fair Ltd.	285	915

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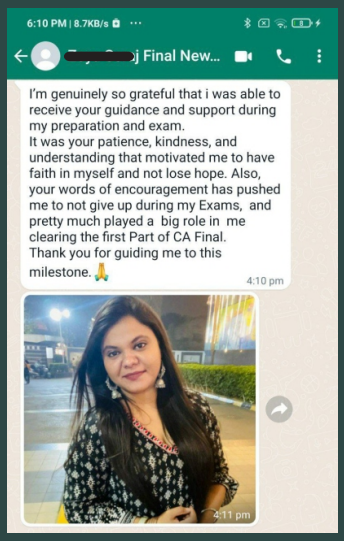

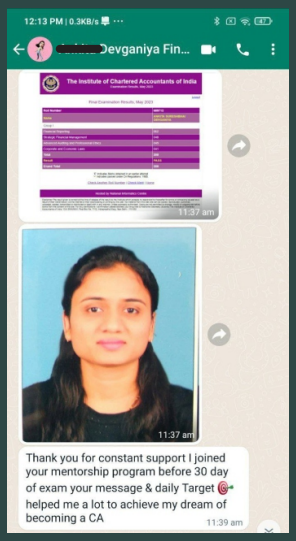

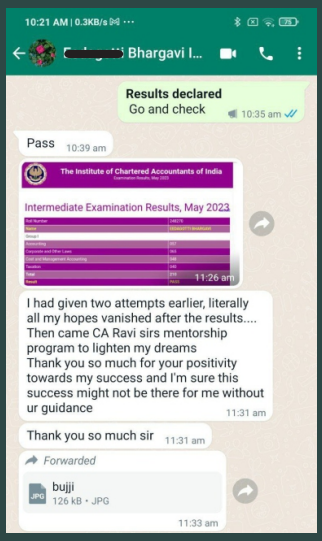

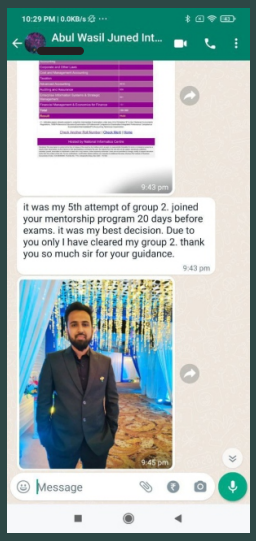

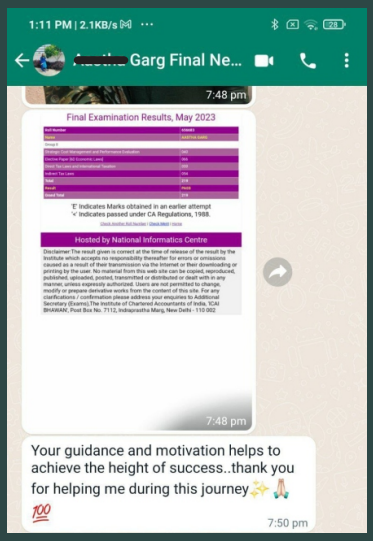

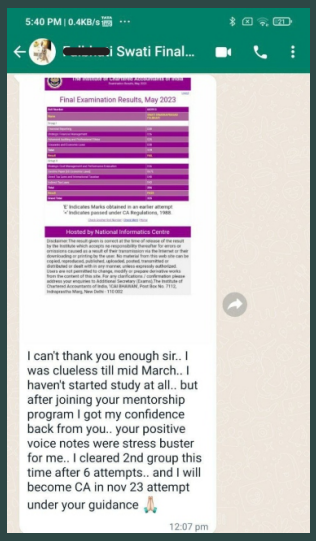

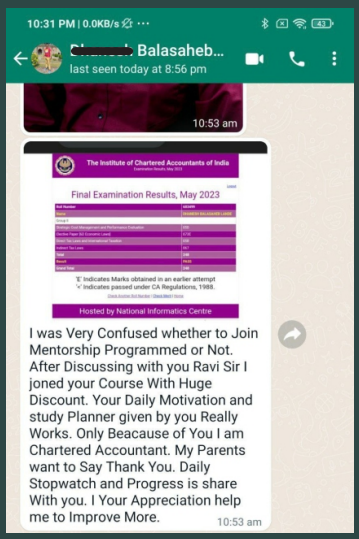

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5.	Property, plant & equipment		
	Land and Building	1350	
	Plant and Machinery	975	2,325
6.	Intangible assets		
	Goodwill [W.N. 2] 624.375		
	Add: liquidation exp. (6+3) 9.00		633.375
7.	Non-current Investments		
	Investments (225+75)		300

8.	Inventories		
	Dark Ltd.	525	
	Fair Ltd.	375	900
9	Trade receivables		
	Dark Ltd.	450	
	Fair Ltd.	525	975
10	Cash & cash equivalents		
	Dark Ltd.	450	
	Fair Ltd.	300	
	Liquidation Expenses (6+3)	(9)	
	Shares issued for cash (45 lakh shares x Rs.35)	1575	2316

Working Notes:

	Dark Ltd.	(Rs. in lakhs)		
		Fair Ltd.		
(1)	Computation of Purchase consideration (a) Preference shareholders: $\left(\frac{4,50,00,000}{100}\right)$			

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	i.e. 4,50,000 shares × Rs. 160 each $(\frac{3,00,00,000}{100})$	720		
	i.e. 3,00,000 shares × Rs. 160 each (b) Equity shareholders: (12,00,00,000X 5) / 100	2,100	480	
	i.e. 60,00,000 shares x Rs. 35 each (11,25,00,000X4 / (100)) i.e. 45,00,000 shares × Rs. 35 each			
	Amount of Purchase Consideration Net	2,820		1,575
	Assets Taken Over			2,055
(2)	Assets taken over: Property Plant & Equity	1,350		975
	Non-Current Investments	225		75
	Inventory	525		375
	Trade receivables	450		525
	Cash and bank	450		300
	Less: Liabilities taken over:	3,000		2,250
	10% Debentures 56.25		28.125	
	Trade payables 630	(686.25)	285	(313.125)

	Net assets taken over		2,313.75		1936.875
	Purchase consideration		2,820		2055.00
	Goodwill		506.25		118.125
	Total goodwill				624.375

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Issue of Debentures

Debentures	` 90,00,000	` 45,00,000
Interest 10%	` 9,00,000	` 4,50,000
	$(\frac{9,00,000 \times 100}{16})$ = 56,25,000	$(\frac{4,50,000 \times 100}{16})$ = 28,12,500

NOTE: In the above solution Rs. 35 has been considered as the issue price of Equity shares for public issue also. Alternative considering this as Rs. 10 also possible. In that case, the balance of cash and cash equivalents will be Rs. 1,191 lakhs and securities premium will be Rs. 3,075 lakhs in place of the balances givenin the balance sheet in the above solution.

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Question 25

The summarized Balance Sheet of A Ltd. and B Ltd. as at 31st March,2022 are as under:

	A Ltd. (in ₹)	B Ltd. (in ₹)
Equity shares of ₹10 each, fully paid up	30,00,000	24,00,000
Securities Premium Account	4,00,000	
General Reserve	6,20,000	5,00,000
Profit and Loss Account	3,60,000	3,20,000
Retirement Gratuity Fund Account	1,00,000	
10% Debentures	20,00,000	
Unsecured Loan (including loan from A Ltd.)	6,00,000	8,20,000
Trade Payables	1,00,000	3,40,000
	71,80,000	43,80,000
Land and Buildings	28,00,000	21,00,000
Plant and Machinery	20,00,000	7,60,000
Long term advance to B Ltd.	2,20,000	7,00,000
Inventories	10,40,000	5,20,000
Trade Receivables	8,20,000	3,00,000
Cash and Bank	3,00,000	
	71,80,000	43,80,000

B Ltd. is to declare and pay ₹ 1 per equity share as dividend, before the following amalgamation takes place with Z Ltd. **Z Ltd. was incorporated to take over the business of both A Ltd. and B Ltd.**

(a) **The authorized share capital of Z Ltd. is ₹ 60 lakhs divided into ₹ 6 lakhs equity shares of ₹ 10 each.**

(b) **As per Registered Valuer the value of equity shares of A Ltd. is ₹ 18 per share and of B Ltd. is ₹ 12per share respectively and agreed by respective share-holders of the companies.**

(c) **10% Debentures of A Ltd. to be issued 12% Debentures of Z Ltd. at par in consideration of theirholdings.**

(d) **A contingent liability of A Ltd. of ₹ 2,00,000 is to be treated as actual liability.**

(e) **Liquidation expenses including Registered Valuer fees of A Ltd.₹ 50,000 and B Ltd.₹ 30,000respectively to be borne by Z Ltd.**

(f) **The shareholders of A Ltd. and B Ltd. is to be paid by issuing sufficient number of fully paid up equity shares of ₹ 10 each at a premium of ₹ 10 per share.**

Assuming amalgamation in the nature of purchase, you are required to pass the necessary journal entries (narrations not required) in the books of Z Ltd. and Prepare Balance Sheet of Z Ltd. immediately after amalgamation of both the companies.(PYP 20 Marks May'22)

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Answer 25

Journal Entries in the books of Z Ltd.

		₹	₹
Business Purchase A/c	Dr.	54,00,000	
To Liquidator of A Ltd. A/c			54,00,000
Land & Building A/c	Dr.	28,00,000	
Plant & Machinery A/c	Dr.	20,00,000	
Long term advance to B Ltd. A/c	Dr.	2,20,000	
Inventories A/c	Dr.	10,40,000	
Trade Receivables A/c	Dr.	8,20,000	
Cash and Bank A/c	Dr.	3,00,000	
Goodwill A/c	Dr.	12,20,000	
To Retirement Gratuity Fund A/c			1,00,000
To 10% Debentures A/c			20,00,000
To Unsecured Loan A/c			6,00,000
To Trade Payables A/c			1,00,000
To Other liabilities A/c			2,00,000
To Business Purchase A/c			54,00,000
10% Debentures A/c	Dr.	20,00,000	
To 12% Debentures A/c			20,00,000
Liquidator of A Ltd. A/c	Dr.	54,00,000	
To Equity Share Capital A/c			27,00,000
To Securities Premium A/c			27,00,000
Business Purchase A/c	Dr.	28,80,000	
To Liquidator of B Ltd. A/c			28,80,000
Land and Building A/c	Dr.	21,00,000	
Plant & Machinery A/c	Dr.	7,60,000	
Inventories A/c	Dr.	7,00,000	
Trade Receivables A/c	Dr.	5,20,000	
Cash and Bank (less dividend) A/c	Dr.	60,000	
To Unsecured Loan A/c			8,20,000
To Trade Payables A/c			3,40,000
To Business Purchase A/c			28,80,000
To Capital Reserve A/c			1,00,000
Liquidators of B Ltd. A/c	Dr.	28,80,000	
To Equity Share Capital A/c			14,40,000

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To Securities Premium A/c			14,40,000
Unsecured Loans A/c	Dr.	2,20,000	
To Long term Advance to B Ltd. A/c			2,20,000
*Capital Reserve A/c	Dr.	1,00,000	
To Cash and Bank A/c (Liquidation expenses)			80,000

To Goodwill A/c			20,000

Note:

1. The journal entries for A Ltd. and B Ltd. have been given separately in the above solution.Alternatively, the entries may be given as combined for both companies.
2. *Alternatively, following set of entries may be given in place of the last entry given in the abovesolution:

Goodwill A/c	Dr.	50,000	
To Cash & Bank A/c (Liquidation expenses of A Ltd.)			50,000
Capital Reserve A/c	Dr.	30,000	
To Cash and Bank A/c (Liquidation expenses of B Ltd.)			30,000
Capital Reserve A/c	Dr.	70,000	
To Goodwill A/c			70,000

Balance Sheet of Z Ltd. as at 31st March, 2022

	Particulars	Note No.	(₹)
I.	Equity and Liabilities		
(1)	Shareholder's Funds		
(a)	Share Capital	1	41,40,000
(b)	Reserves and Surplus	2	41,40,000
(2)	Non-Current Liabilities		
	(a) Long-term borrowings	3	20,00,000
	(b) Long term provisions	4	1,00,000
(3)	Current Liabilities		
(a)	Short-term borrowings1	5	12,00,000
(b)	Trade payables	6	4,40,000
	(a) Other liability		2,00,000
	Total		1,22,20,000
II.	Assets		
(1)	Non-current assets		
(a) i.	Property, plant and equipment	7	76,60,000

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ii.	Intangible assets (Goodwill 12,20,000-20,000)		12,00,000
(2)	Current assets		
(a)	Inventories	8	17,40,000
(b)	Trade receivables	9	13,40,000
(c)	Cash and cash equivalents	10	2,80,000
	Total		1,22,20,000
ii.	Intangible assets (Goodwill 12,20,000-20,000)		12,00,000
(2)	Current assets		
(a)	Inventories	8	17,40,000
(b)	Trade receivables	9	13,40,000
(c)	Cash and cash equivalents	10	2,80,000
	Total		1,22,20,000

[1] Unsecured loans have been considered as short-term borrowings. Alternatively, it may beconsidered as long-term borrowings and presented accordinglyNotes to Accounts

		(₹)	(₹)
1.	Share Capital		
	Authorized Share Capital		
	6,00,000 Equity shares of ₹ 10 each		60,00,000
	Issued: 4,14,000 Equity shares of ₹ 10 each (all these shares were Issued for consideration other than cash)		41,40,000
2.	Reserves and surplus		
	Securities Premium Account (4,14,000 shares × ₹ 10)		41,40,000
3.	Long-term borrowings		
	12% Debentures		20,00,000
4	Long term Provisions		
	Retirement gratuity fund		1,00,000
5.	Short-term borrowings		
	Unsecured loans		
	A Ltd. 6,00,000		
	B Ltd. 8,20,000	14,20,000	
	Less: Mutual	(2,20,000)	12,00,000
6.	Trade payables		
	A Ltd.	1,00,000	

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	B Ltd.	3,40,000	4,40,000
7.	Property, plant & equipment		
	Land and Building		
	A Ltd.	28,00,000	
	B Ltd.	21,00,000	49,00,000
	Plant and Machinery		
	A Ltd.	20,00,000	
	B Ltd.	7,60,000	27,60,000
8.	Inventories		76,60,000
	A Ltd.	10,40,000	
	B Ltd.	7,00,000	17,40,000
9	Trade receivables		
	A Ltd.	8,20,000	
	B Ltd.	5,20,000	13,40,000
10	Cash & cash equivalents		
	A Ltd.	3,00,000	
	B Ltd. [3,00,000-2,40,000(dividend)]	60,000	
		3,60,000	

	Less: Liquidation Expenses	(80,000)	2,80,000

Working Note:Calculation of amount of Purchase Consideration

	A Ltd.	B Ltd.
Existing shares	3,00,000	2,40,000
Agreed value per share	₹ 18	₹ 12
Purchase consideration	54,00,000	28,80,000
No. of shares to be issued of ₹ 20 each (including ₹ 10 premium)	2,70,000	1,44,000
Face value of shares at ₹ 10	27,00,000	14,40,000
Premium of shares at ₹ 10	27,00,000	14,40,000

Question 26

What are the conditions, which, according to AS 14 on Accounting forAmalgamations, must be satisfied for an amalgamation in the nature of merger? (Old & New SM, MTP 4 Marks Apr'21, Mar'22, Old & New SM, PYP 5 Marks Jan 21)

Answer 26

Amalgamation in the nature of merger is an amalgamation where there is a genuine pooling not only of assets and liabilities of the transferor and transferee companies but also of the

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shareholders' interests and of the businesses of thecompanies. The accounting treatment of such amalgamations should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the respective figures of the transferor and transferee companies.

Amalgamation in the nature of merger is an amalgamation, as per para 3(e) of AS-14, which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets andliabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity sharesof 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 thetransferee 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 thetransferee 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 uniformityof accounting policies. For example, if transferor company is following weighted average method for inventory valuation, the book value of the inventory of the transferor company will be revised by applying the FIFOmethod (if the transferee company follows FIFO method for inventory valuation).

If any one or more of the above conditions are not satisfied in an amalgamation,such amalgamation is called **amalgamation in the nature of purchase**.

Question 27

Distinguish between (i) the pooling of interest's method and (ii) the purchase method of recording transactions relating to amalgamation. (Old & New SM, MTP 4 Marks Oct 20, Oct'21)

Answer 27

Pooling of Interest Method

Under pooling of interest's method, the assets, liabilities and reserves of the Transferor Company will be taken over by Transferee Company at existing carrying amounts unless any adjustment is required due to different accounting policiesfollowed by these companies. As a result, the difference between the amount recorded as share capital issued(plus any additional consideration in the form of cash or other assets) and the amount of share capital of Transferor Company should be adjusted in the reservesof the financial statements of Transferee company (recorded as deduction from the reserves where the capital issued is more than the capital of the transferor company).

In simple terms, where in case of pooling method- the amount to be adjustedagainst the reserves- can be computed in the following 3 steps-

Step I- Equity Share capital + Preference share capital issued+ any other additionalconsideration in formof cash and other assets by the Transferee Company.

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Step II- Existing Equity share capital + Existing Preference share capital in the booksof Transferor Company. Step III- Step I- Step II= amount to be adjusted from the reserves of Transferee-company.

Purchase Method

Assets and Liabilities: the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assetsand liabilities on the basis of their fair values at the date of amalgamation.

Difference between the Purchase Consideration and Net Assets transferred: Any excess of the amount of purchase consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognized as goodwill in the financial statement of the transferee company. Any shortfall should be shown as capital reserve. Goodwill should be amortized over period of five years unless a somewhat longer period can be justified.

In simple terms, where in case of purchase method- the amount to be transferredto capital reserve or tobe recorded as Goodwill- can be computed in the following 3 steps-

Step I- Find out the **Net assets** amount using the following formula- Total assets- Outside liabilities (Non-current liabilities + Current Liabilities)

Step II- Compute the purchase consideration using any of the methods as given under Purchaseconsideration computation.

Step III- (a) If Step I- Step II= Positive amount- then it is capital reserve- since the assets received more thanthe amount paid as purchase consideration to acquire them.

(b) If Step I- Step II= Negative amount- then it is to be recorded as Goodwill (intangible asset) - since the amount paid for acquiring business is more than the Net assets, which is technically due to its goodwill.

Question 28

On 1st April, 2021, Bimal Ltd. take over the business of Vimal Ltd. and discharged purchase consideration as follows:

(a) Issued 50,000 fully paid Equity shares of Rs. 10 each at a premium of Rs. 5 per share to the equity shareholders of Vimal Ltd.

(b) Cash payment of Rs. 50,000 was made to equity shareholders of Vimal Ltd.

(c) Issued 2,000 fully paid 12% Preference shares of Rs. 100 each at par to discharge the preference shareholders of Vimal Ltd.

(d) Debentures of Vimal Ltd. (Rs.1,20,000) will be converted into equal number and amount of 10% debentures of Bimal Ltd.

Calculate the amount of Purchase consideration as per AS 14 and pass Journal Entry relating to discharge of purchase consideration in the books of Bimal Ltd. (MTP 5 Marks April 21, PYP 5 Marks Nov '18)

Answer 28

Particulars	Rs.
Equity Shares (50,000 x 15)	7,50,000

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Cash payment	50,000
12% Preference Share Capital	2,00,000
Purchase Consideration	10,00,000

As per AS 14, consideration for the amalgamation means the aggregate of the shares and other securitiesissued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. Thus, payment to debenture holders are not covered by the term 'consideration'.**Journal entry relating to discharge of consideration in the books of Bimal Ltd.**

Liquidation of Vimal Ltd.A/c	10,00,000	
To Equity share capital A/c		5,00,000
To 12% Preference share capital A/c		2,00,000
To Securities premium A/c		2,50,000
To Bank/Cash A/c		50,000
(Discharge of purchase consideration)		

Question 29

Moon Limited is absorbed by Sun Limited; the consideration, being the takeover of liabilities, the payment of cost of absorption not exceeding ₹ 10,000 (actual cost ₹ 9000); the payment of 9% Debentures of ₹ 50,000 at a premium of 20% through 8% debentures issued at a premium of 25% of face value; the payment of ₹ 18 per share in cash; allotment of two 11% preference shares of ₹ 10/- each and one equity share of ₹ 10/- each at a premium of 30% fully paid for every three shares in Moon Limited respectively. The number of shares of the vendor company is 1,50,000 of ₹ 10/- each fully paid. Calculate purchase consideration as per AS-14. (PYP 5 Marks Dec '21) (Same concept different figures RTP May'21)

Answer 29

As per AS 14 "Accounting for Amalgamations", the term consideration has been defined as 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.

Purchase consideration will be:		
	₹	Form
Equity shareholders: 1,50,000 × ₹ 18	27,00,000	Cash
1,50,000 × 2/3 × ₹ 10	10,00,000	11% Pref. shares
1,50,000 × 1/3 × ₹ 13	6,50,000	Equity shares
	43,50,000	
Note:		

According to AS 14, 'consideration' excludes the any amount payable to debenture- holders. The liability in respect of debentures of vendor company will be taken by transferee company, whichwill then be settled by issuing new debentures.

1. Liquidation expenses will also not form part of purchase consideration.

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Question 30

Star Limited agreed to take over Moon Limited on 1st April,2022. The terms and conditions of takeover were as follows:

(i) **Star Limited issued 70,000 Equity shares of ₹ 100 each at a premium of ₹ 10 per share to theequity shareholders of Moon Limited.**

(ii) **Cash payment of ₹ 1,25,000 was made to the equity shareholders of Moon Limited.**

(iii) **25,000 fully paid Preference shares of ₹ 70 each issued at par to discharge the preferenceshareholders of Moon Limited.**

You are required:

to give the meaning of "consideration for the amalgamation' as per AS-14, and

(i) **Calculate the amount of purchase consideration. (PYP 5 Marks Nov 22) (Same concept differentfigures MTP 5 Marks March '23, RTP Nov '20)**

Answer 30

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.

Computation of Purchase consideration	(₹)	Form
For Preference Shareholders of MoonLtd. (25,000 × ₹ 70)	17,50,000	25,000 Preference
For equity shareholders of Moon Ltd.(70,000 × ₹ 110)	77,00,000	70,000 Equity shares of Star Ltd.
	1,25,000	Cash
Total Purchase consideration	95,75,000	

Question 31

The following information from Balance Sheet of X Ltd. as at 31st March, 2023:

	₹
4,000 Equity shares of ₹ 100 each	**4,00,000**
10% Debentures	**2,00,000**
Loans	**80,000**
Trade payables	**1,60,000**
General Reserve	**40,000**
Building	**1,70,000**
Machinery	**3,20,000**
Inventory	**1,10,000**
Trade receivables	**1,30,000**
Bank	**68,000**

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Patent	65,000
Share issue Expenses	17,000

Answer 31

Y Ltd. agreed to absorb X Ltd. on the following terms and conditions:

(1) Y Ltd. would take over all assets, except bank balance and Patent at their book valuesless 10%. Goodwill is to be valued at 4 year's purchase of super profits, assuming thatthe normal rate of return be 8% on the combined amount of share capital and generalreserve.

(2) Y Ltd. is to take over trade payables at book value.

(3) The purchase consideration is to be paid in cash to the extent of ₹ 3,00,000 and the balance in fully paid equity shares of ₹ 100 each at ₹ 125 per share.

The average profit is ₹ 62,200. The liquidation expenses amounted to ₹ 8,000. Y Ltd. sold prior to 31st March, 2023 goods costing ₹ 60,000 to X Ltd. for ₹ 80,000. ₹ 50,000 worth of goods are still in Inventory of X Ltd. on 31st March, 2023. Trade payables of X Ltd. include

₹ 20,000 still due to Y Ltd.

Show the necessary Ledger Accounts to close the books of X Ltd. and prepare the BalanceSheet of Y Ltd. as at 1st April, 2023 after the takeover.(Nov '23)

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Books of X Limited

Realization Account

		₹			₹
To	Building	1,70,000	By	Trade payables	1,60,000
To	Machinery	3,20,000	By	Y Ltd.	6,05,000
To	Inventory	1,10,000	By	Equity Shareholders (Loss)	38,000
To	Trade receivables	1,30,000			
To	Patent	65,000			
To	Bank (Exp.)	8,000			
		8,03,000			8,03,000

				Bank Account	
To	Balance b/d	68,000	By	Realisation (Exp.)	8,000
To	Y Ltd.	3,00,000	By	10% Debentures	2,00,000
			By	Loan	80,000
			By	Equity shareholders	80,000
		3,68,000			3,68,000

10% Debentures Account

To	Bank	2,00,000	By	Balance b/d	2,00,000
		2,00,000			2,00,000

Loan Account

To	Bank	80,000	By	Balance b/d	80,000
		80,000			80,000

Share Issue Expenses Account

To	Balance b/d	17,000	By	Equity shareholders	17,000
		17,000			17,000

General Reserve Account

To	Equity shareholders	40,000	By	Balance b/d	40,000
		40,000			40,000

Y Ltd. Account

To	Realisation A/c	6,05,000		By Bank	3,00,000
				By Equity share in Y Ltd. (2,440shares at ₹ 125 each)	3,05,000
		6,05,000			6,05,000

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Equity Shares in Y Ltd. Account

To	Y Ltd.	3,05,000	By	Equity shareholders	3,05,000
		3,05,000			3,05,000

Equity Share Holders Account

To	Realisation	38,000	By	Equity share capital	4,00,000
To	Shareissue Expenses	17,000	By	General reserve	40,000
To	Equity shares in B Ltd.	3,05,000			
To	Bank	80,000			
		4,40,000			4,40,000

Y LtdBalance Sheet as on 1st April, 2023 (An extract)*

	Particulars	Notes	₹
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	2,44,000
b	Reserves and Surplus	2	53,500
2	Current liabilities		
a	Trade Payables	3	1,40,000
b	Bank overdraft		3,00,000
	Total		7,37,500
	Assets		
1	Non-current assets		
a	Property, Plant and Equipment	4	4,41,000
	Intangible assets	5	1,08,000
2	Current assets		
a	Inventories	6	91,500
b	Trade receivables	7	97,000
			7,37,500

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Notes to Accounts

			₹
1	Share Capital		
	Equity share capital		
	2,440 Equity shares of ₹ 100 each (Shares have beenissued for consideration other than cash)		2,44,000
	Total		2,44,000
2	Reserves and Surplus (an extract)		
	Securities Premium		61,000
	Profit and loss account	.....	
	Less: Unrealised profit	(7,500)	(7,500)
	Total		53,500
3	Trade payables		
	Opening balance	1,60,000	
	Less: Inter-company transaction cancelled uponamal-gamation	(20,000)	1,40,000
4	Property, Plant and Equipments		
	Buildings		1,53,000
	Machinery		2,88,000
	Total		4,41,000
5	Intangible assets		
	Goodwill		1,08,000
6	Inventories		
	Opening balance	99,000	
	Less: Cancellation of profit upon amalgamation	(7,500)	91,500
7	Trade receivables		
	Opening balance	1,17,000	
	Less: Intercompany transaction cancelled uponamal-gamation	(20,000)	97,000

Working Notes:

1.	Valuation of Goodwill	₹
	Average profit	62,200
	Less: 8% of ₹ 4,40,000	(35,200)
	Super profit	27,000
	Value of Goodwill = 27,000 x 4	1,08,000

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2.	Net Assets for purchase consideration	
	Goodwill as valued in W.N.1	1,08,000
	Building	1,53,000
	Machinery	2,88,000
	Inventory	99,000
	Trade receivables (1,30,000-13,000)	1,17,000
	Total Assets	7,65,000
	Less: Trade payables	(1,60,000)
	Net Assets	6,05,000
	Out of this ₹ 3,00,000 is to be paid in cash and remaining i.e., (6,05,000 – 3,00,000) ₹ 3,05,000 in shares of ₹ 125. Thus, the number of shares to beallotted 3,05,000/125 = 2,440 shares.	
3.	Unrealised Profit on Inventory	₹
	The Inventory of X Ltd. includes goods worth ₹ 50,000 which wassold by Y Ltd. on profit. Unrealized profit on this Inventory will be[20,000/80,000 x 50,000]	12,500
	As Y Ltd purchased assets of X Ltd. at a price 10% less than the book value, 10% need to be adjusted from the Inventory i.e., 10% of ₹ 50,000.	(5,000)
	Amount of unrealized profit	7,500

***In the absence of the particulars of assets and liabilities (other than those of X Ltd.), the complete Balance Sheet of Y Ltd. after takeover cannot be prepared.**

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Chapter 14

Accounting for Reconstruction of Companies

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.16 TO Q.35											
Past Exams	NO	Q.6	NO	Q.11	NO	NO	NO	Q.12	NO	Q.13	Q.14	NO
MTP	Q.3	NO	Q.2	Q.1	Q.4	Q.5	Q.3 Q.4	NO	Q.4 Q.5	NO	NO	NO
RTP	Q.1	Q.9	Q.3	Q.1	Q.8	Q.9	Q.7	Q.6	Q.9	Q.10	Q.11	Q.15

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Chapter 14

Accounting for Reconstruction of Companies

Question 1

M/s Xylem Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses.The following is the summarized Balance Sheet of the company as on 31st March, 2019 before reconstruction:

Liabilities (Rs.)	Amount	Assets	Amount (Rs.)
Share Capital		Land & Building	42,70,000
50,000 shares of Rs. 50		Machinery	8,50,000
each fully paid up	25,00,000	Computers	5,20,000
1,00,000 shares of Rs. 50		Inventories	3,20,000
each Rs. 40 paid up	40,00,000	Trade receivables	10,90,000
Capital Reserve	5,00,000	Cash at Bank	2,68,000
8% Debentures of Rs. 100	4,00,000	Profit & Loss Account	29,82,000
each			
12% Debentures of Rs. 100	6,00,000		
each			
Trade payables	12,40,000		
Outstanding Expenses	10,60,000		
	1,03,00,000		1,03,00,000

Following is the interest of Mr. A and Mr. B in M/s Xylem Limited:

	Mr. A	Mr. B
8% Debentures	3,00,000	1,00,000
12% Debentures	4,00,000	2,00,000
Total	7,00,000	3,00,000

The following scheme of internal reconstruction was framed and implemented, as approved by the court and concerned parties:

(1) **Uncalled capital is to be called up in full and then all the shares to be converted into Equity Shares of Rs. 40 each.**

(2) **The existing shareholders agree to subscribe in cash, fully paid up equity shares of 40 each for Rs. 12,50,000.**

(3) **Trade payables are given option of either to accept fully paid equity shares of Rs. 40 each for theamount due to them or to accept 70% of the amount due to them in cash in full settlement of their claim. Trade payables for Rs. 7,50,000 accept equity shares and rest of them opted for cashtowards full and final settlement of their claim.**

(4) **Mr. A agrees to cancel debentures amounting to Rs. 2,00,000 out of total debentures due**

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to himand agree to accept 15% Debentures for the balance amount due. He also agree to subscribe further 15% Debentures in cash amounting to Rs. 1,00,000.

(5) Mr. B agrees to cancel debentures amounting to Rs. 50,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due.

(6) Land & Building to be revalued at Rs. 51,84,000, Machinery at Rs. 7,20,000, Computers at Rs. 4,00,000,Inventories at Rs. 3,50,000 and Trade receivables at 10% less to as they are appearing in Balance Sheetas above.

(7) Outstanding Expenses are fully paid in cash.

(8) Profit & Loss A/c will be written off and balance, if any, of Capital Reduction A/c will be adjusted against Capital Reserve.

You are required to pass necessary Journal Entries for all the above transactions and draft the company's Balance Sheet immediately after the reconstruction.

(b) A Liquidator is entitled to receive remuneration at 2% on the assets realized, 3% on the amount distributed to Preferential Creditors and 3% on the payment made to Unsecured Creditors. The assets were realized for Rs. 25,00,000 against which payment was made as follows:

Liquidation expenses	Rs. 25,000
Secured Creditors	Rs. 10,00,000
Preferential Creditors	Rs. 75,000

The amount due to Unsecured Creditors was Rs. 15,00,000. You are asked to calculate the total Remuneration payable to Liquidator. Calculation shall be made to the nearest multiple of a rupee. (MTP October 2019 15 Marks, RTP May 18, RTP Nov'19)

Answer 1

Journal Entries

		Rs.	Rs.
Bank A/c	Dr	10,00,000	
To Equity share capital A/c (Being money on final call received)			10,00,000
Equity share capital (Rs. 50) A/c	Dr	75,00,000	
To Equity share capital (Rs. 40) A/c			60,00,000
To Capital Reduction A/c			15,00,000
(Being conversion of equity share capital of Rs. 50 each intoRs. 40 each as per reconstruction scheme)			
Bank A/c	Dr.	12,50,000	
To Equity Share Capital A/c			12,50,000
(Being new shares allotted at Rs. 40 each)			
Trade payables A/c	Dr.	12,40,000	

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To Equity share capital A/c			7,50,000
To Bank A/c (4,90,000 x 70%)			3,43,000
To Capital Reduction A/c			1,47,000
(Being payment made to trade payables in shares or cash to			
the extent of 70% as per reconstruction scheme)			
8% Debentures A/c	Dr.	3,00,000	
12% Debentures A/c	Dr.	4,00,000	
To A A/c			7,00,000
(Being cancellation of 8% and 12% debentures of A)			
A A/c	Dr.	8,00,000	
To 15% Debentures A/c			6,00,000
To Capital Reduction A/c			2,00,000
(Being issuance of new 15% debentures and balance			
Transferred to capital reduction account as			
per reconstruction scheme)			
Bank A/c	Dr.	1,00,000	
To A A/c			1,00,000
(Being new debentures subscribed by A)			
8% Debentures A/c	Dr.	1,00,000	
12% Debentures A/c Dr.		2,00,000	
To B A/c			3,00,000
(Being cancellation of 8% and 12% debentures of B)			
B A/c	Dr.	3,00,000	
To 15% Debentures A/c			2,50,000
To Capital Reduction A/c			50,000
(Being issuance of new 15% debentures and balance			
Transferred to capital reduction account as			
per reconstruction scheme)			
Land and Building	Dr		
.(51,84,000 – 42,70,000)		9,14,000	

Inventories Dr.		30,000	
To Capital Reduction A/c			9,44,000
(Being value of assets appreciated)			
Outstanding expenses A/c	Dr.	10,60,000	
To Bank A/c			10,60,000

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(Being outstanding expenses paid in cash)			
Capital Reduction A/c	Dr.	33,41,000	
To Machinery A/c			1,30,000
To Computers A/c			1,20,000
To Trade receivables A/c			1,09,000
To Profit and Loss A/c			29,82,000
(Being amount of Capital Reduction utilized in writing			
off P & L A/c (Dr.) balance and downfall in value of oth-erassets)			
Capital Reserve A/c	Dr.	5,00,000	
To Capital Reduction A/c			5,00,000
(Being debit balance of capital reduction account adjusted			
Against capital reserve)			

Balance Sheet of Xylem Ltd. (as reduced) as on 31.3.2019

Particulars		Notes	Rs.
	Equity and Liabilities		
1	**Shareholders' funds**		
a	Share capital	1	80,00,000
2	**Non-current liabilities**		
a	Long-term borrowings	2	8,50,000
	Tota		**88,50,000**
	Assets	3	
1	**Non-current assets**		
a	**Property, Plant and Equipment**		
	Tangible assets		**63,04,000**
2	**Current assets**		
a	**Inventories**		**3,50,000**
b	**Trade receivables**		**9,81,000**
c	**Cash and cash equivalents**		**12,15,000**
	Tota		**88,50,000**

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Notes to accounts

			Rs.
1	**Share Capital**		
	2,00,000 Equity shares of Rs. 40		80,00,000
2	**Long-term borrowings**		
	Secured		
	15% Debentures (assumed to be secured)		8,50,000
3	**Tangible assets**		
	Land & Building	51,84,000	
	Machinery	7,20,000	
	Computers	4,00,000	63,04,000

Working Notes:

1. **Cash at Bank Account**

	Particulars	Rs.		Particulars	Rs.
To	Balance b/d	2,68,000	By	Trade payables A/c	3,43,000
To	Equity Share capital A/c	10,00,000	By	Outstanding expenses A/c	10,60,000
To	Equity Share Capital A/c	12,50,000	By	Balance c/d (bal. fig.)	12,15,000
To	A A/c	1,00,000			
		26,18,000			26,18,000

2. **Capital Reduction Account**

	Particulars	Rs.		Particulars	Rs.
To	Machinery A/c	1,30,000	By	Equity Share Capital A/c	15,00,000
To	Computers A/c	1,20,000	By	Trade payables A/c	1,47,000
To	Trade receivables A/c	1,09,000	By	A A/c	2,00,000
To	Profit and Loss A/c	29,82,000	By	B A/c	50,000
By	Land & Building	9,14,000			
By	Inventories	30,000			
			By	Capital Reserve A/c	5,00,000
		33,41,000			**33,41,000**

(b) Calculation of Total Remuneration payable to Liquidator

Amount in Rs.

2% on Assets realised	25,00,000 x 2%	50,000
3% on payment made to Preferential creditors	75,000 x 3%	2,250

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3% on payment made to Unsecured creditors (Refer W.N)		39,255
Total Remuneration payable to Liquidator		91,505

Working Note:

Liquidator's remuneration on payment to unsecured creditors = Cash available for unsecured creditors after all payments including liquidation expenses, payment to secured creditors, preferential creditors & liquidator's remuneration

= Rs. 25,00,000 – Rs. 25,000 – Rs. 10,00,000 – Rs. 75,000 – Rs. 50,000 – Rs. 2,250 = Rs. 13,47,750.

Liquidator's remuneration on payment to unsecured creditors = 3/103 x Rs. 13,47,750 = Rs. 39,255.

Question 2

The shareholders of Lili Ltd. decided on a corporate restructuring exercise necessitated because of economic recession. From the given summarised balance sheet as on 31-3-2017 and the information supplied, you are required to prepare (i) Journal entries reflecting the scheme of reconstruction, (ii) Capital reduction account, (iii) Cash account in the books of Lili Ltd.

Summarized Balance Sheet of Lili Ltd. as on 31.3.2017

Liabilities	Rs.	Assets	Rs.
Share Capital		Property, Plant & Equipment	
30,000 Equity shares of Rs. 10 each	3,00,000	Trademarks and Patents	1,10,000
40,000 8% Cumulative Preference		Goodwill at cost	36,100
shares Rs. 10 each	4,00,000	Freehold Land	1,20,000
Reserves and Surplus		Freehold Premises	2,44,000
Securities Premium Account	10,000	Plant and Equipment Investment	3,20,000
Profit and Loss Account	(1,38,400)	Investment (marked to market)	64,000

Secured Borrowings		Current Assets	
9% Debentures (Rs. 100) 1,20,000		Inventories:	
Accrued Interest 5,400	1,25,400	Raw materials and packingmaterials 60,000	
Current liabilities Trade payables	1,20,000	Finished goods 16,000	76,000
Tax payable	50,000		

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Temporary bank overdraft	2,23,100	Trade receivables	1,20,000
	10,90,100		10,90,100

Note: Preference dividends are in arrears for 4 years.

The scheme of reconstruction that received the permission of the Court was on the following lines:

(1) **The authorized capital of the Company to be re-fixed at Rs. 10 lakhs (preference capital of Rs. 3lakhs and equity capital of Rs. 7 lakhs). Both classes of shares are of Rs. 10 each.**

(2) **The preference shares are to be reduced to Rs. 5 each and equity shares reduced by Rs. 3 per share. Post reduction, both classes of shares to be re-consolidated into Rs. 10 shares.**

(3) **Trade Investments are to be liquidated in open market.**

(4) **One fresh equity shares of Rs.10 to be issued for every Rs.40 of preference dividends in arrears (ignore taxation).**

(5) **Expenses for the scheme were Rs. 10,000.**

(6) **The debenture holders took over freehold land at Rs. 2,10,000 and settled the balance after adjustingtheir dues.**

(7) **Unprovided contingent liabilities were settled at Rs. 54,000 and a pending insurance claim receivablesettled at Rs. 12,500.**

(8) **The intangible assets were all to be written off along with Rs. 10,000 worth obsolete packing material and 10% of the receivables.**

(9) **Remaining cash available as a result of the above transactions is to be utilized to pay off the bank overdraft to that extent.**

(10) **The Equity shareholders agree that they will bring in necessary cash to liquidate the balance outstanding on the overdraft account by subscribing the fresh shares. The equity shares will be issued at par for this purpose.**

(MTP 15 Marks Mar 19)

Answer 2

(i) In the books of Lili Ltd. Journal Entries

				Dr	Cr
	2017			Rs	Rs
1.	March 31	Equity Share Capital A/c (Rs.10)	Dr.	3,00,000	
		To Capital Reduction A/c			90,000
		To Equity Share Capital A/c (Rs.7)			2,10,000
		(Being reduction of equity shares of Rs.10 each to shares of Rs. 7 each as per Reconstruction Scheme dated...)			
2		8% Cum. Preference Share Capital A/c (Rs. 10)	Dr.	4,00,000	
		To Capital Reduction A/c			2,00,000

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		To Preference Share Capital A/c (Rs. 5)			2,00,000
		(Beingreduction of preference shares of Rs.10 each to shares of Rs.5 each as per reconstruction scheme)			

3.		Equity Share Capital A/c (30,000 x Rs.7)	Dr.	2,10,000	
		Preference Share Capital A/c (40,000 x Rs.5)	Dr.	2,00,000	
		To Equity Share Capital A/c(21,000 x Rs.10)			2,10,000
		To Preference Share Capital A/c(20,000 x Rs.10) (Being post reduction, both classes of shares reconsolidated into Rs.10 each) s			2,00,000
4.		Cash Account	Dr	64,000	
		To Trade Investments (Being trade investments liquidated in the open market)			64,000
5.		Capital Reduction Account	Dr	32,000	
		To Equity Share Capital Account			32,000
		(Being arrears of preference dividends of 4 years satisfied by the issue of 3,200 equity shares of Rs.10 each)			
6.		Capital Reduction Account	Dr	10,000	
		To Cash Account			10,000
		(Being expenses of reconstruction scheme paid in cash)			
7.		9% Debentures Account	Dr	1,20,000	
		Accrued Interest Account	Dr	5,400	
		To Debenture holders Account			1,25,400
		(Being amount due to debenture holders)			
8.		Debenture holders Account	Dr	1,25,400	
		Cash Account (2,10,000 – 1,25,400)	Dr	84,600	
		To Freehold Land			1,20,000
		To Capital Reduction Account (2,10,000 – 1,20,000)			90,000
		(Being Debenture holders took over freehold land at Rs.2,10,000 and settled the balance)			

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9.		Capital Reduction Account	Dr	54,000	
		To Cash Account			54,000
		(Being contingent liability of Rs.54,000 paid)			
10		Cash Account	Dr	12,500	
		To Capital Reduction Account			12,500
		(Being pending insurance claim received)			
11		Capital Reduction Account	Dr	1,68,100	
		To Trademarks and Patents			1,10,000
		To Goodwill			36,100
		To Raw materials & Packing materials			10,000
		To Trade receivables			12,000
		(Being intangible assets written off along with raw materials and packing materials worth Rs.10,000 and 10% of trade receivables)			
12		Cash Account	Dr	1,26,000	
		To Equity Share Capital Account			1,26,000
		(Being 12,600 shares issued to existing shareholders)			
13		Bank Overdraft Account	Dr	2,23,100	
		To Cash Account			2,23,100
		(Being cash balance utilized to pay off bank overdraft)			
14		Capital Reduction Account	Dr	1,28,400	
		To Capital reserve Account			1,28,400
		(Being balance of capital reduction account transferred to capital reserve account)			

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Capital Reduction Account

Particulars	Rs	Particulars	Rs.
To Equity share capital	32,000	By Preference share capital	2,00,000
To Cash (contingent liability settled)	54,000	By Equity share capital	90,000
To Trademarks and Patents	1,10,000	By Freehold land	90,000
To Goodwill	36,100	By Cash	
To Raw material and		(insurance claim)	12,500
Packing materials	10,000		
To Trade receivables	12,000		
To Cash account	10,000		
To Capital reserve account	1,28,400		
	3,92,500		**3,92,500**

Cash Account

Particulars	Rs	Particulars	Rs
To Investment	64,000	By Capital reduction	
To 9% Debenture holders		(Contingent liability)	54,000
(2,10,000-1,25,400)	84,600	By Expenses	10,000
To Capital reduction (insurance claim)	12,500	By Temporary bank overdraft	
		- From available cash	
		(64,000+84,600+12,500	
		-54,000-10,000)	97,100
To Equity share capital 12,600		- From proceeds of equity	
shares @ Rs. 10 each	1,26,000	share capital	
		(2,23,100–97,100) 1,26,000	2,23,100
	2,87,100		**2,87,100**

Note: Shares issued to existing equity shareholders for bringing cash for payment of balance of bankoverdraft = Rs. 2,23,100 – Rs. 97,100 = Rs. 1,26,000

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Question 3

The Balance Sheet of Lion Limited as on 31-03-2018 is given below:

Particulars	Note No.	Amount (Rs. in lakh)
Equity & Liabilities		
Shareholders' Funds		
Shares' Capital	1	1,400
Reserves & Surplus	2	(522)
Non-Current Liabilities		
Long term Borrowings	3	700
Current Liabilities		
Trade Payables	4	102
Other Liabilities	5	24
Total		1704
Assets		
Non-Current Assets		
Fixed Assets		
Tangible Assets	6	750
Current Assets		
Current Investments	7	200
Inventories	8	300
Trade Receivables	9	450
Cash & Cash Equivalents	10	4
Total		1704

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Notes to **Accounts:**

		Rs. in Lakhs
(1) Share Capital		
Authorised :		
200 lakh shares of Rs. 10 each		2,000
8 lakh, 8% Preference Shares of Rs. 100 each		800
		2,800
Issued, Subscribed and paid up:		
100 lakh Equity Shares of Rs. 10 each, full paid up		1,000
4 lakh 8% Preference Shares of Rs. 100 each, fully paid up		400
	Total	1400
(2) Reserves and Surplus		
Debit balance of Profit & Loss A/c		(522)
(3) Long Term Borrowings		
6% Debentures (Secured by Freehold Property)		400
Directors' Loan		300
		700
(4) Trade Payables		
Trade payables for Goods		102
(5) Other Current Liabilities		
Interest Accrued and Due on 6% Debentures		24
(6) Tangible Assets		
Freehold Property		550
Plant & Machinery		200
		750
(7) Current Investment		
Investment in Equity Instruments		200
(8) Inventories		
Finished Goods		300
(9) Trade Receivables		
Trade receivables for Goods		450

(10) Cash and Cash Equivalents		
Balance with Bank		4

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective shareholders:

(1) **Preference Shares are to be written down to Rs. 80 each and Equity Shares to Rs. 2 each.**

(2) **Preference Shares Dividend in arrears for 3 years to be waived by 2/3rd and for balance**

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1/3rd, Equity Shares of Rs. 2 each to be allotted.

(3) Debenture holders agreed to take one Freehold Property at its book value of Rs. 300 lakhin part payment of their holding. Balance Debentures to remain as liability of the company.

(4) Interest accrued and due on Debentures to be paid in cash.

(5) Remaining Freehold Property to be valued at Rs. 400 lakh.

(6) All investments sold out for Rs. 250 lakh.

(7) 70% of Directors' loan to be waived and for the balance, Equity Shares of Rs. 2 each to beallowed.

(8) 40% of Trade receivables and 80% of Inventories to be written off.

(9) Company's contractual commitments amounting to Rs. 600 lakh have been settled by paying5% penalty of contract value.

(a) You are required to :

(b) Pass Journal Entries for all the transactions related to internal reconstruction;

(c) Prepare Reconstruction Account; and

Prepare notes on Share Capital and Tangible Assets to Balance Sheet, immediately after theimplementation of scheme of internal reconstruction.

(MTP 15 Marks Mar 18, MTP 16 Marks Apr 21, RTP May 19)

Answer 3

Journal Entries in the books of Lion Ltd.

Particulars		Debit (Rs. in lakhs)	Credit (Rs. in lakhs)
8% Preference share capital A/c (Rs. 100 each)	Dr	400	
To 8% Preference share capital A/c (Rs. 80 each)			320
To Capital Reduction A/c			80
(Being the preference shares of Rs. 100 each reduced to			
Rs. 80 each as per the approved scheme)			
Equity share capital A/c (Rs. 10 each)	Dr	1,000	
To Equity share capital A/c (Rs. 2 each)			200
To Capital Reduction A/c			800
(Being the equity shares of Rs. 10 each reduced to Rs. 2 each)			
Capital Reduction A/c	Dr	32	
To Equity share capital A/c (Rs. 2 each)			32
(Being 1/3rd arrears of preference share dividend of 3 years to			

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be satisfied by issue of 16 lakhs equity shares of Rs. 2 each)			
6% Debentures A/c	Dr	300	
To Freehold property A/c			300
(Being claim of Debenture holders settled in part			
by transfer of freehold property)			
Accrued debenture interest A/c	Dr	24	
To Bank A/c			24
(Being accrued debenture interest paid)			
Freehold property A/c	Dr	150	
To Capital Reduction A/c			150
(Being appreciation in the value of freehold property)			

Bank A/c	Dr	250	
To Investments A/c			200
To Capital Reduction A/c			50
(Being investment sold at profit)			
Director's loan A/c	Dr	300	
To Equity share capital A/c (Rs. 2 each)			90
To Capital Reduction A/c			210
(Being director's loan waived by 70% and balance being			
discharged by issue of 45 lakhs equity shares of Rs. 2 each)			
Capital Reduction A/c	Dr	972	
To Profit and loss A/c			522
To Trade receivables A/c (450 x 40%)			180
To Inventories-in-trade A/c (300x 80%)			240
To Bank A/c (600 x 5%)			30
(Being certain value of various assets, penalty on cancel-lation of contract, profit and loss account debit balance written of through Capital Reduction Account)			

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(x)

Capital Reduction A/c To Capital reserve A/c (Being balance transferred to capital reserve account as per thescheme)	286	286

Capital Reduction Account

Dr.	(Rs. in lakhs)		Cr. (Rs. in lakhs)
To Equity Share Capital	32	By Preference Share Capital	80
To Trade receivables	180	By Equity Share Capital	800
To Finished Goods	240	By Freehold Property	150
To Profit & Loss A/c	522	By Bank	50
To Bank A/c	30	By Director's Loan	210
To Capital Reserve	286		
	1,290		**1,290**

Notes to Balance Sheet

	(Rs. in lakhs)	(Rs. in lakhs)
1. Share Capital		
Authorised:		
200 lakhs Equity shares of Rs. 2 each		400
8 lakhs 8% Preference shares of Rs. 80 each		640
		1,040
Issued:		
161 lakhs equity shares of Rs. 2 each		322
4 lakhs Preference Shares of Rs. 80 each		320
		642
2. Tangible Assets		
Freehold Property	550	
Less: Utilized to pay Debenture holders	(300)	
	250	
Add: Appreciation	150	400
Plant and Machinery		200
		600

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Question 4

The Paid-up capital of S Limited amounted to Rs. 5,00,000 Equity Shares of Rs. 10 each. Due to continuous losses incurred by the company, the following scheme of re-construction has been approved for S Limited on 1st April, 2020:

(i) In lieu of present holding the Equity Shareholders are to receive:

(a) Fully Paid Equity Shares equal to 3/5th of their holding.

(b) 8% Preference Shares fully paid to the extent of 20% of the above new Equity Shares.

(c) 10% Second Debentures of Rs. 40,000.

(ii) An issue of 8% Debentures First Debentures of Rs. 1,00,000 was made and fully sub-scribed for cash,

(iii) The Assets were reduced as follows:-

(a) Building from Rs. 2,00,000 to Rs. 1,50,000

(b) Plant & Machinery from Rs. 1,50,000 to Rs. 1,30,000

(c) Goodwill from Rs. 30,000 to Nil.

Show the Journal Entries in the books of S Limited to give effect of the scheme of Re-construction. (MTP5 Marks March 21, May 20, Apr 22) (Same concept different figures MTP 5 Marks Sep'22, Old & New SM)

Answer 4

Journal Entries in the books of S Ltd.

2020		Rs	Dr Rs	Cr
April 1	Equity Share Capital A/c (Rs. 10)	Dr.	5,00,000	
	To Equity Share Capital A/c			3,00,000
	To 8% Preference Equity Share Capital A/c			60,000
	To 10% Second Debentures A/c			40,000
	To Capital Reduction /Reconstruction A/c			1,00,000
	(Being reduction of equity shares to 3/5 shares, issue of preference shares and debenturesas per Reconstruction Scheme dated...)			
	Capital Reduction / Reconstruction A/c	Dr.	1,00,000	
	To Building A/c			50,000
	To Plant and Machinery A/c			20,000
	To Goodwill A/c			30,000

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	(Being value of building and plant and machinery reduced and goodwill written off completely.)			
	Bank A/c	Dr.	1,00,000	
	To 8% First Debentures A/c			1,00,000
	(Being Rs. 1,00,000 debentures issued)			

Question 5

The summarised Balance Sheet of Preeti Limited as on 31st March 2019, was as follows:

Liabilities	(Rs.)	Assets	(Rs.)
Authorized and subscribed capital:		**Property, plant andequipment:**	
20,000 Equity shares of Rs. 100 each fullypaid	**20,00,000**	**Machineries**	**7,00,000**
Unsecured loans:		**Current Assets:**	
15% Debentures	**6,00,000**	**Inventory**	**5,06,000**
Interest payable thereon	**90,000**	**Trade receivables**	**4,60,000**
Current Liabilities:		**Bank**	**40,000**
Trade payables	**1,04,000**	**Profit & loss A/c**	**11,60,000**
Provision for income tax	**72,000**		
	28,66,000		**28,66,000**

(i) It was decided to reconstruct the company for which necessary resolution was passed and sanctions were obtained from the appropriate authorities. Accordingly, it was decided that:Each share be sub-divided into 10 fully paid up equity shares of Rs. 10 each.

(ii) After sub-division, each shareholder shall surrender to the company 50% of his holding for the purpose of reissue to debenture holders and trade payables as necessary.

(iii) Out of shares surrendered 20,000 shares of Rs. 10 each shall be converted into 10% Preference shares of Rs. 10 each fully paid up.

(iv) The claims of the debenture holders shall be reduced by 50%. In consideration of the reduction, the debenture holder shall receive Preference Shares of Rs. 2,00,000 which are converted out of shares surrendered.

(v) Trade payables claim shall be reduced by 25%. Remaining trade payables are to be settled by the issue of equity shares of Rs. 10 each out of shares surrendered.

(vi) Balance of Profit and Loss account to be written off.

The shares surrendered and not re-issued shall be **cancelled.**

Pass Journal Entries giving effect to the above. (MTP 8 Marks Oct 20, MTP 5 Marks Mar 22) (Same concept different figures Old & New SM)

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Answer 5

In the books of Preeti Limited Journal Entries

(i)	Equity Share Capital (Rs. 100) A/c	Dr	20,00,000	
	To Share Surrender A/c			10,00,000
	To Equity Share Capital (Rs. 10) A/c			10,00,000
	(Sub-division of 20,000 equity shares of Rs. 100 each into2,00,000 equity shares of Rs. 10 each and surrender o 1,00,000 of such sub-divided shares as per capital reduction scheme)			
(ii)	15% Debentures A/c	Dr	3,00,000	
	Interest payable A/c (proportionate 50%)	Dr	45,000	
	To Reconstruction A/c			3,45,000
	(Transferred 50% of the claims of the debenture holders toReconstruction A/c in consideration of which 10% Preference shares are being issued, out of share surrenderA/c as per capital reduction scheme)			
(iii)	Trade payables A/c	Dr	1,04,000	
	To Reconstruction A/c			1,04,000
	(Transferred claims of the trade payables to Reconstruction A/c, 25% of which is reduction and equity shares are issued in consideration of the balance amount)			

(iv)	Share Surrender A/c	Dr	10,00,000	
	To 10% Preference Share Capital A/c			2,00,000
	To Equity Share Capital A/c			78,000
	To Reconstruction A/c			7,22,000
	(Issued preference and equity shares to discharge theclaims of the debenture holders and the trade payable respectively as per scheme and the balance in sharesurrender account is transferred to reconstruction account)			
(v)	Reconstruction A/c	Dr	11,71,000	
	To Profit & Loss A/c			11,60,000
	To Capital Reserve A/c			11,000

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	(Adjusted debit balance of profit and loss account against reconstruction account and the balance is transferred to Capital Reserve account)			

Note: Alternative set of correct journal entries may be given for transfer of surrendered shares to tradepayables and debenture holders.

Question 6

Shine Ltd. provides the following information as on 31st March, 2021: (Rs.in '000)

	Amount
Equity Shares of Rs. 10 each	**35,000**
8%, Cumulative Preference Shares of Rs. 100 each	**17,500**
6% Debentures of Rs. 100 each	**14,000**
Sundry Creditors	**17,500**
Provision for taxation	**350**
Property, Plant and Equipment	**43,750**
Investments (Market value Rs. 3325 thousand)	**3,500**
Current Assets (Including Bank Balance)	**35,000**
Profit and Loss Account (Dr. balance)	**2,100**

The following Scheme of Internal Reconstruction is approved and put into effect on 31st March, 2021.

(i) All the existing equity shares are reduced to Rs. 4 each.

(ii) All preference shares are reduced to Rs. 60 each.

(iii) The rate of interest on debentures is increased to 9%. The Debenture holders surrender their existing debentures of Rs. 100 each and exchange them for fresh debentures of Rs. 80 each. Each old debenture is exchanged for one new debenture.

(iv) Investments are to be brought to their market value.

(v) The Taxation Liability is settled at Rs. 5,25,000 out of current Assets.

(vi) The balance of Profit and Loss Account to be written off and balance of Current Assets left after settlement of taxation liability are revalued at Rs.1,57,50,000.

(vii) One of the creditors of the Company for Rs. 70,00,000 gives up 50% of his claim. He is allotted 8,75,000 equity shares of Rs. 4 each in full and final settlement of his claim.

(viii) Property, plant and equipment to be written down to 80%.

You are required to give journal entries for the above transactions and prepare capital reduction account. (RTP Nov 21) (Same concept different figures PYP 10 Marks Nov'18, Old & New SM)

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Answer 6

Journal Entries in the books of Shine Ltd.

		Rs. '000	Rs. '000
(i)	Equity share capital (Rs. 10) A/c Dr.	35,000	
	To Equity Share Capital (Rs. 4) A/c		14,000
	To Capital Reduction A/c		21,000
	(Being conversion of equity share capital of Rs. 10 each into Rs. 4 each as per reconstruction scheme)		
(ii)	8% Cumulative Preference Share capital (Rs. 100) A/c Dr.	17,500	
	To 8% Cumulative Preference Share Capital (Rs. 60) A/c		10,500
	To Capital Reduction A/c		7,000
	(Being conversion of 6% cumulative preference shares capitalof Rs. 100 each into Rs. 60 each as per reconstruction scheme)		
(iii)	6% Debentures (Rs. 100) A/c Dr.	14,000	
	To 9% Debentures (Rs. 80) A/c		11,200
	To Capital Reduction A/c		2,800
	(Being 9% debentures of Rs. 80 each issued to existing 6% debenture holders. The balance transferred to capital reductionaccount as per reconstruction scheme)		
(iv)	Sundry Creditors A/c Dr.	7,000	
	To Equity Share Capital (Rs. 4) A/c		3,500
	To Capital Reduction A/c		3,500
	(Being a creditor of Rs. 70,00,000 agreed to surrender his claimby 50% and was allotted 8,75,000 equity shares of Rs. 4 each in full settlement of his dues as per reconstruction scheme)		
(v)	Provision for Taxation A/c Dr.	350	
	Capital Reduction A/c Dr.	175	
	To Liability for Taxation A/c		525
	(Being conversion of the provision for taxation into liability fortaxation for settlement of the amount due)		
(vi)	Liability for Taxation A/c Dr.	525	
	To Current Assets (Bank A/c)		525
	(Being the payment of tax liability)		

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(vii)	Capital Reduction A/c Dr.	34,125	
	To P & L A/c		2,100
	To PPE A/c		8,750
	To Current Assets A/c		18,725
	To Investments A/c		175
	To Capital Reserve A/c (Bal. fig.)		4,375
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Property, Plant & Equipment, Current Assets, Investments and the Balance transferred to Capital Reserve)		

Capital Reduction Account

To Liability for taxation A/c	175	By Equity share capital	21,000
To P & L A/c	2,100	By 8% Cumulative preferences	7,000
To Property, Plant & Equipment	8,750	Share capital	
To Current assets	18,725	By 6% Debentures	2,800
To Investment	175	By Sundry creditors	3,500
To Capital Reserve (Bal. fig.)	4,375		
	34,300		34,300

Question 7

Recover Ltd decided to reorganize its capital structure owing to accumulated losses and adverse market condition. The Balance Sheet of the company as on 31st March 2020 is as **follows-**

		Particulars	Notes	Rs
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	**1**	**3,50,000**
	B	**Reserves and surplus**	**2**	**(70,000)**
2		**Non-current liabilities**		
	A	**Long-term borrowings**	**3**	**55,000**
3		**Current liabilities**		
	A	**Trade Payables**		**80,000**
	B	**Short term Borrowings – Bank overdraft**		**90,000**

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		Assets		5,05,000
1		Non-current assets		
	A	Property, Plant Equipment	4	3,35,000
	B	Intangible assets	5	50,000
	C	Non-current investments	6	40,000
2		Current assets		
	A	Inventories		30,000
	B	Trade receivables		50,000
				5,05,000

Notes to accounts:

1	Share Capital		Rs.
	Equity share capital:		
	20,000 Equity Shares of Rs. 10 each		2,00,000
	Preference share capital:		
	15,000 8% Cumulative Preference Shares of Rs. 10 each(preference dividend has been in arrears for 4 years)		1,50,000
2	Reserves and surplus		3,50,000
	Securities premium		10,000
	Profit and loss account (debit balance)		(80,000)
3	Long-term borrowings		(70,000)
	Secured		
	9% Debentures (secured on the freehold property		50,000
	Accrued interest on 9% debentures		5,000
4	Property, Plant and Equipment		55,000
	Freehold property		1,20,000
	Leasehold property		85,000
	Plant and machinery		1,30,000
			3,35,000
5	Intangible assets		
	Goodwill		50,000
6	Non-current investments		50,000
	Non-Trade investments at cost		40,000
			40,000

Subsequent to approval by court of a scheme for the reduction of capital, the following steps were taken:

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i. **The preference shares were reduced to Rs. 2.5 per share, and the equity shares to Rs. 1 per share.**

ii. **One new equity share of Rs. 1 was issued for the arrears of preferred dividend for past 4 years.**

iii. **The balance on Securities Premium Account was utilized and was transferred to capital reduction account.**

iv. **The debenture holders took over the freehold property at an agreed figure of Rs. 75,000 and paidthe balance to the company after deducting the amount due to them.**

v. **Plant and Machinery was written down to Rs. 1,00,000.**

vi. **Non-trade Investments were sold for Rs. 32,000.**

vii. **Goodwill and obsolete stock (included in the value of inventories) of Rs. 10,000 were written off.**

viii. A contingent liability of which no provision had been made was settled at Rs. 7,000 and of this amount, Rs. 6,300 was recovered from the **insurance.**

You are required (a) to show the Journal Entries, necessary to record the above transactions in the company's books and (b) to prepare the Balance Sheet, after completion of the scheme. (RTP May 21)(New SM)

Answer 7

In the books of Recover Ltd

Journal entries

Particulars		Dr	Cr
	Rs	Rs	
8% Cumulative Preference share capital (Rs. 10) A/c	Dr	1,50,000	
To 8% Cumulative Preference share capital (Rs.2.5)A/c			37,500
To Capital reduction (Rs. 7.5) A/c			1,12,500
(Preference shares being reduced to shares of Rs. 2.5 pe share and remaining transferred to capital reductionac-count as per capital reduction scheme)			
Equity share capital A/c (Rs.10)	Dr	2,00,000	
To Equity Share capital A/c (Rs. 1)			20,000
To Capital reduction A/c (Rs. 9)			1,80,000
(Equity shares reduced to Rs. 1 per share with the remaining amount transferred to capital reduction ac as a part of the internal reconstruction scheme.)			
Capital reduction A/c	Dr.	48,000	
To Equity share capital A/c			48,000
(Equity shares of Rs. 1 issued in lieu of the arrears of prefer-ence dividend for 4 years as a part of the internalrecon-struction scheme)			

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Securities Premium A/c	Dr.	10,000	
To Capital reduction A/c			10,000
(Amount from the securities premium utilized towards the capital reduction a/c as a part of the internal reconstruction scheme)			
9% Debentures A/c	Dr.	50,000	
Accrued interest on debentures A/c	Dr	5,000	
Bank A/c	Dr.	20,000	
Capital reduction A/c	Dr.	45,000	
To Freehold property A/c			1,20,000
(Debenture holders being paid by the sale of property which is sold at a loss debited to the capital reduction account. Amount received in excess being refunded to company by debenture holders as a part of the internal reconstruction scheme.)			
Capital reduction A/c	Dr.	90,000	
To Plant and Machinery Ac			30,000
To Goodwill A/c			50,000
To Inventory A/c			10,000
(The assets written off as a part of the internal reconstruction scheme)			
Bank A/c	Dr.	32,000	
Capital reduction A/c	Dr.	8,000	
To Investments A/c			40,000
(Investments sold at a loss debited to capital reduc-tionaccount as a part of the internal reconstruction scheme)			
Contingent Liability A/c	Dr.	7,000	
To Bank A/c			7,000
(Contingent liability paid as a part of the internal reconstruction scheme)			
Bank A/c	Dr	6,300	
Capital reduction A/c	Dr	700	
To Contingent Liability A/c			7,000
(The insurance company remitting part of the contingen-cypayment amount)			
Capital reduction A/c	Dr	80,000	
To Profit and loss A/c			80,000

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(Accumulated losses written off to capital reduction ac-countas a part of the internal reconstruction scheme).			
Capital reduction A/c	Dr	30,800	
To Capital reserve A/c			30,800
(The balance in capital reduction account transferred tocapital reserve as a part of the internal reconstruc-tion scheme)			

Balance sheet of Recover Ltd. as at 31st March 2020 (and reduced)

		Particulars	Notes	Rs
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	1,05,500
	B	Reserves and surplus	2	30,800
2		**Non-current liabilities**		
	A	Long-term borrowings		-
3		**Current liabilities**		
	A	Trade Payables		80,000
	B	Bank Overdraft		90,000
		Tota		**3,06,300**
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	3	1,85,000
2		**Current assets**		
	A	Inventories		20,000
	B	Trade receivables		50,000
	C	Cash and cash equivalents		51,300
		Tota	4	**3,06,300**

Notes to **accounts:**

1	**Share Capital**	**Rs.**
	Equity share capital	
	68,000 Equity Shares of Rs. 1 each	68,000
	Preference share capital	
	15,000 8% Cumulative Preference Shares of Rs. 2.5 each	37,500
2	**Reserves and surplus**	1,05,500

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	Capital reserve	30,800
3	**Property, Plant and Equipment**	
	Leasehold property	85,000
	Plant and machinery	1,00,000
4	**Cash and cash equivalents** Bank A/c (20,000+32,000-7000+6,300)	1,85,000

Question 8

The following is the Balance Sheet of Star Ltd. as on 31st March, 2019: Rs.

				Rs
A.	**Equity & Liabilities**			
	1	**Shareholders' Fund:**		
		(a)	**Share Capital:**	
			9,000 7% Preference Shares of Rs. 100 each fully paid	9,00,000
			10,000 Equity Shares of Rs. 100 each fully paid	10,00,000
		(b)	**Reserve & Surplus:**	
			Profit & Loss Account	(2,00,000)
	2	**Non-current liabilities:**		
			"A" 6% Debentures (Secured on Bombay Works)	3,00,000
			"B" 6% Debentures (Secured on Chennai Works)	3,50,000
	3	**Current Liabilities and Provisions:**		
		(a)	Workmen's Compensation Fund:	
			Bombay Works	10,000
			Chennai Works	5,000
		(b)	Trade Payables	1,25,000
			Total	24,90,000
B.	**Assets:**			
	Non- current Assets:			
	1	**PPE:**		
			Bombay Works	9,50,000
			Chennai Works	7,75,000
	2	**Investment:**		
			Investments for Workman's Compensation Fund	15,000
	3	**Current Assets:**		
		(a)	Inventories	4,50,000

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		(b)	Trade Receivables	2,50,000
		(c)	Cash at Bank	50,000
				24,90,000

A reconstruction scheme was prepared and duly approved. The salient features of the scheme were asfollows:

(i) Paid up value of 7% Preference Share to be reduced to Rs. 80, but the rate of dividend being raisedto 9%.

(ii) Paid up value of Equity Shares to be reduced to Rs. 10.

(iii) The directors to refund Rs. 50,000 of the fees previously received by them.

(iv) Debenture holders forego their interest of Rs. 26,000 which is included among the trade payables.

(v) The preference shareholders agreed to waive their claims for preference share dividend, which is in arrears for the last three years.

(vi) "B" 6% Debenture holders agreed to take over the Chennai Works at Rs. 4,25,000 and to accept an allotment of 1,500 equity shares of Rs. 10 each at par, and upon their forming a company called Zia Ltd. (to take over the Chennai Works) they allotted 9,000 equity shares of Rs. 10 each fully paid at par to Star Ltd.

(vii) The Chennai Worksmen's compensation fund disclosed that there were actual liabilities of Rs. 1,000 only. As a consequence, the investments of the fund were realized to the extent of the balance. Entire investments were sold at a profit of 10% on book value and the proceeds were utilized for part payment of the creditors.

(viii) Inventory was to be written off by Rs. 1,90,000 and a provision for doubtful debts is to be made to theextent of Rs. 20,000.

(ix) Chennai works completely written off.

(x) Any balance of the Capital Reduction Account is to be applied as two-third to write off the valueof Bombay Works and one-third to Capital Reserve.

Pass necessary Journal Entries in the books of Star Ltd. after the scheme has been carried into effect. (RTP May 20)

Answer 8

In the books of Star Ltd. Journal Entries

Particulars		Amount	Amount
		Rs.	Rs.
(i) 7% Preference share capital (Rs. 100)	Dr.	9,00,000	
To 9% Preference share capital (Rs. 80)			7,20,000
To Capital reduction A/c			1,80,000
(Being preference shares reduced to Rs.80 and also			
rate of dividend raised from 7% to 9%)			
(ii) Equity share capital A/c (Rs. 100 each)	Dr.	10,00,000	
To Equity share capital A/c (Rs. 10 each)			1,00,000

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	To Capital reduction A/c			9,00,000
	(Being reduction of nominal value of one share of			
	Rs. 100 each to Rs. 10 each)			
(iii)	Bank A/c	Dr.	50,000	
	To Capital reduction A/c			50,000
	(Being directors refunded the fee amount)			
(iv)	Trade payables A/c (Interest on debentures)	Dr.	26,000	
	To Capital reduction A/c			26,000
	(Being interest forgone by the debenture holders)			
(v)	No entry required			
(vi) a	'B' 6% Debentures A/c	Dr.	3,50,000	
	To Debentures holders A/c			3,50,000
	(Being amount due to Debentures holders)			
b	Debentures holders A/c	Dr.	4,40,000	
	To Chennai Works A/c			4,25,000
	To Equity share capital A/c			15,000
	(Being Chennai works taken over and equity shares			
	issued to 'B' 6% Debenture holders)			
c	Equity share of Zia ltd. A/c	Dr.	90,000	
	To Debentures holders A/c			90,000
	(Being 9,000 equity shares of Zia Ltd. issued by			
	Debentures holders)			
(vii) a	Chennai Works – Workmen Compensation Fund	Dr.	4,000	
	To Capital reduction A/c			4,000
	(Being difference due to reduced amount of			
	actual liability transferred to capital reduction			
	account)			
b	Bank A/c	Dr.	15,400	
	To Investment for Workmen			
	Compensation Fund			14,000
	To Capital reduction A/c			1,400
	(Being investment for Workmen Compensation			
	Fund sold @ 10% profit)			
c	Trade Payables A/c	Dr.	15,400	
	To Bank A/c			15,400
	(Being part payment made to trade payables)			

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(viii) Capital reduction A/c	Dr.	2,10,000	
To Provision for Doubtful Debts A/c			20,000
To Inventory A/c			1,90,000
(Being assets revalued)			
(ix) Capital reduction A/c	Dr.	5,50,000	
To Profit & Loss A/c			2,00,000
To PPE – Chennai Works			3,50,000
(Being assets revalued and losses written off)			
(x) Capital reduction A/c	Dr.	4,01,400	
To PPE – Bombay Works			2,67,600
To Capital reserve A/c			1,33,800
(Being assets revalued and remaining amount			
transferred to capital reserve account)			

Question 9

The summarized balance sheet of Z Limited as on 31st March, 2017 is as under:

Liabilities Share Capital:	**Amount in Rs.**
5,00,000 Equity shares of Rs. 10 each fully paid up	50,00,000
9%, 20,000 Preference shares of Rs. 100 each fully paid up	20,00,000
Reserves and Surplus:	
Profit and Loss Account	(14,60,000)
Non-Current Liabilities:	
10% Secured Debentures	16,00,000
Current Liabilities:	
Interest due on Debentures	1,60,000
Trade Payables	5,00,000
Loan from Directors	1,00,000
Bank Overdraft	1,00,000
Provision for Tax	1,00,000
Total	**81,00,000**
Assets:	
Non-Current Assets:	
Property, Plant & Equipment:	

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(a) Tangible Assets:	
Land & Buildings	30,00,000
Plant & Machinery	12,50,000
Furniture & Fixtures	2,50,000
(b) Intangible Assets:	
Goodwill	10,00,000
Patents	5,00,000
Current Assets:	
Trade Investments	5,00,000
Trade Receivables	5,00,000
Inventory	10,00,000
Discount on issue of debentures	1,00,000
Total	**81,00,000**

Note: Preference dividend is in arrears for last 2 years.

Mr. Y holds 60% of debentures and Mr. Z holds 40% of debentures. Moreover Rs. 1,00,000 and Rs. 60,000 were also payable to Mr. Y and Mr. Z respectively as trade payable.

The following scheme of reconstruction has been agreed upon and duly approved.

(xi) **All the equity shares to be converted into fully paid equity shares of Rs. 5.00 each.**

(xii) **The Preference shares be reduced to Rs. 50 each and the preference shareholders agreed to forego their arrears of preference dividends, in consideration of which 9% preference shares are to be converted into 10% preference shares.**

(xiii) **Mr. Y and Mr. Z agreed to cancel 50% each of their respective total debt including interest ondebentures. Mr. Y and Mr. Z also agreed to pay Rs. 1,00,000 and Rs. 60,000 respectively in cash and to receive new 12% debentures for the balance amount.**

(xiv) **Persons relating to trade payables, other than Mr. Y and Mr. Z also agreed to forgo their 50% claims.**

(xv) **Directors also waived 60% of their loans and accepted equity shares for the balance.**

(xvi) **Capital commitments of Rs. 3.00 lacs were cancelled on payment of Rs. 15,000 as penalty.**

(xvii) **Directors refunded Rs. 1,00,000 of the fees previously received by them.**

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(xviii) **Reconstruction expenses paid Rs. 15,000.**

(xix) **The taxation liability of the company was settled for Rs 75,000 and was paid immediately.**

(x)	**The Assets were revalued as under:**	
	Land and Building	**32,00,000**
	Plant and Machinery	**6,00,000**
	Inventory	**7,50,000**
	Trade Receivables	**4,00,000**
	Furniture and Fixtures	**1,50,000**
	Trade Investments	**4,50,000**

You are required to prepare necessary journal entries for all the above-mentioned transactions including amounts to be written off of Goodwill, Patents, Loss in Profit and Loss account arid Discount on issue of debentures. And also, prepare Bank Account and Reconstruction Account. (RTP Nov 18) (Same concept different figures- RTP May'22 & Nov'20)

Answer 9

Journal Entries in the Books of Z Ltd.

			Dr. Rs.	Cr. Rs.
(i)	Equity Share Capital (Rs. 10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (Rs. 5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of Rs. 10 each fully paid into same number of fully paid equity shares of Rs. 5 each as per scheme ofreconstruction.)			
(ii)	9% Preference Share Capital (Rs. 100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (Rs. 50 each) A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of Rs. 100 each into same number of 10% preference share of Rs. 50 each and claims of preference dividends settledas per scheme of reconstruction.)			
(iii)	10% Secured Debentures A/c	Dr.	9,60,000	
	Trade payables A/c	Dr.	1,00,000	
	Interest on Debentures Outstanding A/c	Dr.	96,000	
	Bank A/c	Dr.	1,00,000	
	To 12% Debentures A/c			6,78,000
	To Reconstruction A/c			5,78,000

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	(Being Rs. 11,56,000 due to Y (including trade payables cancelled and 12% debentures allotted for the amoun after waving 50% as per scheme of reconstruction.)			
(iv)	10% Secured Debentures A/c	Dr.	6,40,000	
	Trade Payables	Dr.	60,000	
	Interest on debentures outstanding A/c	Dr.	64,000	
	Bank A/c	Dr.	60,000	
	To 12% debentures A/c			4,42,000
	To Reconstruction A/c			3,82,000

	(Being Rs. 7,64,000 due to Z (including trade payables cancelled and 12% debentures allotted for the amoun after waving 50% as per scheme of reconstruction.)			
(v)	Trade payables A/c	Dr.	1,70,000	
	To Reconstruction A/c			1,70,000
	(Being remaining trade payables sacrificed 50% of theirclaim.)			
(vi)	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (Rs. 5) A/c			40,000
	To Reconstruction A/c			60,000
	(Being Directors' loan claim settled by issuing 12,000 equity shares of Rs. 5 each as per scheme ofreconstruction.)			
(vii)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment made towards penalty of 5% for cancellation of capital commitments of Rs. 3 Lakhs.)			
(viii)	Bank A/c	Dr.	1,00,000	
	To Reconstruction A/c			1,00,000
	(Being refund of fees by directors credited toreconstruction A/c)			
(ix)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment of reconstruction expenses)			
(x)	Provision for Tax A/c	Dr.	1,00,000	
	To Bank A/c			75,000
	To Reconstruction A/c			25,000

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	(Being payment of tax liability in full settlement against provision for tax)			
(xi)	Land and Building A/c	Dr.	2,00,000	
	To Reconstruction A/c			2,00,000
	(Being appreciation in value of Land & Building recorded)			
(xii)	Reconstruction A/c	Dr.	49,85,000	
	To Goodwill A/c		10,00,000	
	To Patent A/c		5,00,000	
	To Profit and Loss A/c		14,60,000	
	To Discount on issue of Debentures A/c		1,00,000	
	To Plant and Machinery A/c		6,50,000	
	To Furniture & Fixture A/c		1,00,000	
	To Trade Investment A/c		50,000	
	To Inventory A/c		2,50,000	
	To Trade Receivables A/c		1,00,000	
	To Capital Reserve (bal. fig.)		7,75,000	
	(Being writing off of losses and reduction in the value of			
	assets as per scheme of reconstruction, balance of reconstruction A/c transfer to Capital Reserve.)			

Bank Account

	Rs.		Rs.
To Reconstruction (Y)	1,00,000	By Balance b/d	1,00,000
To Reconstruction(Z)	60,000	By Reconstruction A/c	15,000
To Reconstruction A/c		(capital commitment penaltypaid)	
(refund of earlier fees by directors)	1,00,000	By Reconstruction A/c	
		(reconstruction expenses paid)	15,000
		By Provision for tax A/c(taxpaid)	75,000
		By Balance c/d	55,000
	2,60,000		**2,60,000**

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Reconstruction Account

	Rs		Rs.
To Bank (penalty)	15,000	By Equity Share	
To Bank (reconstruction expenses)	15,000	Capital A/c	25,00,000
To Goodwill	10,00,000	By 9% Pref. Share	
To Patent	5,00,000	Capital A/c	10,00,000
To P & L A/c	14,60,000	By Mr. Y (Settlement)	5,78,000
To Discount on issue of debentures	1,00,000	By Mr. Z (Settlement)	3,82,000
To P & M	6,50,000	By Trade Payables A/c	1,70,000
To Furniture and Fixtures	1,00,000	By Director's loan	60,000
To Trade investment	50,000	By Bank	1,00,000
To Inventory	2,50,000	By Provision for tax	25,000
To Trade Receivables	1,00,000	By Land and Building	2,00,000
To Capital Reserve (bal. fig.)	7,75,000		
	50,15,000		**50,15,000**

Question 10

Planet Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the balance sheet of the company as on 31 st March, 2022 before reconstruction:

Particulars	Note No.	Amount (Rs. In lakh)
Equity & Liabilities		
Shareholders' Funds		
Share Capital	**1**	**2,100**
Reserves & Surplus	**2**	**(783)**
Non-Current Liabilities		
Long term Borrowings	**3**	**1,050**
Current Liabilities		
Trade Payables	**4**	**153**
Other Liabilities	**5**	**36**
Total		**2,556**
Assets		
Non-Current Assets:		
PPE	**6**	**1,125**
Current Investments	**7**	**300**
Inventories	**8**	**450**
Trade Receivables	**9**	**675**

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Cash & Cash Equivalents	10	6
Total		2,556

Notes to Accounts:

		Rs. In lakh
(1)	Share capital	
	Authorised:	
	300 lakh Equity shares of Rs. 10 each	3,000
	12 lakh, 8% preference Shares of Rs. 100 each	1,200
		4,200
	Issued, Subscribed and Paid up:	
	150 Lakh Equity Shares of Rs. 10 each, fully paid up	1,500
	6 lakh 8% Preference Shares of Rs. 100 each, fully paid up	600
(2)	Reserves and Surplus	2,100
	Debit balance of Profit & Loss A/c	(783)
(3)	Long term borrowings	
	6% Debentures (Secured by freehold property)	600
	Director's Loan	450
(4)	Trade payables	1,050
	Trade payables for Goods	153
(5)	Other Liabilities	
	Interest Accrued and Due on 6% Debentures	36
(6)	PPE	
	Freehold Property	825
	Plant & machinery	300
(7)	Current Investment	1,125
	Investment in Equity Instruments	300
(8)	Inventories	
	Finished Goods	450
(9)	Trade Receivables	
	Trade receivables for Goods	675
(10)	Cash and Cash equivalents	
	Balance with bank	6

The Board of Directors of the company decided upon the following scheme of reconstruction with theconsent of respective shareholders:

(1) Preference Shares are to be written down to Rs. 75 each and Equity Shares to Rs. 2 each.

(2) Preference Shares Dividend in arrears for 3 years to be waived by 2/3rd and for bal-

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ance 1/3rd, Equity Shares of Rs. 2 each to be allotted.

(3) Debenture holders agreed to take one Freehold Property at its book value of Rs. 450 lakh in part payment of their holding. Balance Debentures to remain as liability of the company.

(4) Interest accrued and due on Debentures to be paid in cash.

(5) Remaining Freehold Property to be valued at Rs. 550 lakh.

(6) All investments sold out for Rs. 425 lakh.

(7) 70% of Directors' loan to be waived and for the balance, Equity Shares of Rs. 2 each to be alloted.

(8) 40% of Trade receivables and 80% of Inventories to be written off.

(9) Company's contractual commitments amounting to Rs. 900 lakh have been settled by paying penalty of Rs. 72 lakhs.

You are required to:

(a) Pass Journal Entries for all the transactions related to internal reconstruction;

(b) Prepare Capital Reduction Account, Bank Account; and

Prepare Notes to Accounts on Share Capital and PPE, immediately after the implementation of internal reconstruction. (RTP Nov'22)

Answer 10

a) Journal Entries related to internal reconstruction in the books of Planet Ltd.

(Rs. in lakhs)

	Particulars		Debit Rs.	Credit Rs.
i	8% Preference share capital A/c (Rs. 100 each)	Dr.	600	
	To 8% Preference share capital A/c (Rs. 75 each)			450
	To Capital reduction A/c			150
	(Being the preference shares of Rs. 100 each reduced to Rs. 75 each as per the approved scheme)			
ii	Equity share capital A/c (Rs. 10 each)	Dr.	1,500	
	To Equity share capital A/c (Rs. 2 each)			300
	To Capital reduction A/c			1,200
	(Being the equity shares of Rs. 10 each reduced to Rs. 2 each)			
iii	Capital reduction A/c	Dr	48	
	To Equity share capital A/c (Rs. 2 each)			48
	(Being 1/3rd of arrears of preference share dividend of three years to be satisfied by issue of 24 lakh equity shares of Rs. 2 each)			

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iv	6% Debentures A/c	Dr	450	
	To Freehold property A/c			450
	(Being claim settled in part by transfer of freehold property)			
v	Accrued debenture interest A/c	Dr	36	
	To Bank A/c			36
	(Being accrued debenture interest paid)			
vi	Freehold property A/c	Dr	175	
	To Capital reduction A/c			175
	(Being appreciation (550-375) in the value of freeholdprop-erty)			
vii	Bank A/c	Dr	425	
	To Investment A/c			300
	To Capital reduction A/c			125
	(Being investment sold on profit)			
viii	Director's loan A/c	Dr	450	
	To Equity share capital A/c (Rs. 2 each)			135
	To Capital reduction A/c			315
	(Being director's loan waived by 70% and balance being discharged by issue of 67.5 lakh equity shares of Rs. 2 each)			
ix	Capital Reduction A/c	Dr	1,485	
	To Profit and loss A/c			783
	To Trade receivables A/c (675 x 40%)			270
	To Inventories-in-trade A/c (450 x 80%)			360
	To Bank A/c			72
x	(Being various assets, penalty on cancellation of contract, profit and loss account debit balance written off through capital reduction account)	Dr.	432	
	Capital Reduction A/c			
	To Capital reserve A/c			432
	(Being balance transferred to capital reserve account as per the scheme)			

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Capital Reduction Account

(Rs. in lakhs)

To	Equity Share Capital	48	By	8% Pref. Share Capital	150
To	P & L A/c	783	By	Equity Share Capital	1,200
To	Trade Receivables	270	By	Freehold property	175
To	Inventories	360	By	Bank (profit on sale of investment)	125
To	Bank	72	By	Director's loan	315
To	Capital Reserve	432			
		1,965			1,965

Bank Account

(Rs. in lakhs)

To	Balance b/d	6	By	Accrued debenture interest	36
To	Investments	300	By	Capital Reduction Account (Penalty on cancellation of contract)	72
To	Capital reduction	125	By	Balance c/d	323
		431			431

Note to Accounts on Share Capital and PPE after implementation of internal reconstruction

Share Capital	(Rs. in lakhs)
Authorised:	
300 lakh shares of Rs. 2 each	600
12 lakh, 8% Preference shares of Rs. 75 each	900
Issued, subscribed and paid up:	1,500
241.5 lakh Equity shares of Rs. 2 each	483
(out of which 91.5 lakh shares have been issued for consideration other thancash)	450
6 lakh, 8% Preference shares of Rs.75 each fully paid up	
Total	933
PPE	
Freehold property 825	
Less: Utilised to pay Debenture holders (450)	
Add: Appreciation 175	550
Plant and machinery	300
Total	850

Working Note:

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Calculation of number of equity shares issued

To equity shareholders	150 Lakh
To Preference shareholders (in lieu of arrear of preference dividend)	24 Lakh
To Directors	67.5 Lakh
	241.5 Lakh

Question 11

The following information is being provided by Fortunate Ltd. as on 31st March, 2022.

Particulars	Amount (Rs.)
Authorized and Issued Share Capital	
(a) 15,000 8% Preference shares of Rs. 50 each	**7,50,000**
(b) 18,750 Equity shares of Rs. 50 each	**9,37,500**
Profit and Loss Account (Dr. balance)	**5,63,750**
Loan	**7,16,250**
Trade Payables	**2,58,750**
Other Liabilities	**43,750**
Building at cost less depreciation	**5,00,000**
Plant at cost less depreciation	**3,35,000**
Trademarks and goodwill at cost	**3,97,500**
Inventory	**5,00,000**
Trade Receivables	**4,10,000**

(Note: Preference shares dividend is in arrear for last five years).

The Company is running with the shortage of working capital and not earnings profits. A scheme of reconstruction has been approved by both the classes of shareholders. The summarized scheme of reconstruction is as follows:

(i) **The equity shareholders have agreed that their Rs. 50 shares should be reduced to**

Rs. 5 by cancellation of Rs. 45.00 per share. They have also agreed to subscribe for three new equity shares of Rs. 5.00 each for each equity share held.

(ii) **The preference shareholders have agreed to forego the arrears of dividends and to accept for each Rs. 50 preference share, 4 new 6% preference shares of Rs. 10 each, plus 3 new equity shares of**

Rs. 5.00 each, all credited as fully paid.

(iii) **Lenders to the company for Rs. 1,87,500 have agreed to convert their loan into shares and for this purpose they will be allotted 15,000 new preference shares of Rs. 10 each and 7,500 new equity shares of Rs. 5.00 each.**

(iv) **The directors have agreed to subscribe in cash for 25,000 new equity shares of**

Rs. 5.00 each in addition to any shares to be subscribed by them under (i) above.

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(v) **Of the cash received by the issue of new shares, Rs. 2,50,000 is to be used to reduce the loan due by the company.**

(vi) **The equity share capital cancelled is to be applied:**

(a) **To write off the debit balance in the Profit and Loss A/c, and**

(b) **To write off Rs. 43,750 from the value of plant.**

Any balance remaining is to be used to write down the value of trademarks and goodwill. The nominal capital, as reduced, is to be increased to Rs. 8,12,500 for preference share capital and Rs. 9,37,500 for equity share capital.

You are required to pass journal entries to show the effect of above scheme and prepare the Balance Sheet of the Company after reconstruction. (RTP May '23, PYP 15 Marks Nov '19) (Same concept different figures Old & New SM)

Answer 11

In the books of Fortunate Ltd.

Journal Entries

	Particulars		Debit	Credit
		(Rs.)	(Rs.)	
1.	Equity share capital A/c (Rs. 50)	Dr	9,37,500	
	To Equity share capital A/c (Rs. 5)			93,750
	To Capital reduction A/c*			8,43,750
	(Being equity capital reduced to nominal value of Rs. 5 each)			
2.	Bank A/c	Dr	2,81,250	
	To Equity share capital			2,81,250
	(Being 3 right shares against each share wasissued and subscribed)			
3.	8% Preference share capital A/c (Rs. 50)	Dr	7,50,000	
	Capital reduction A/c	Dr	75,000	
	To 6% Preference share capital (Rs. 10)			6,00,000
	To equity share capital (Rs. 50)			2,25,000
	(Being 8% preference shares of Rs. 50 eachconverted to 6% preference shares of Rs. 10 each and also given to them 3 equity shares for everyshare held)			
4.	Loan A/c	Dr	1,87,500	
	To 6% Preference share capital A/c (15,000 x Rs. 10)			1,50,000
	To Equity share capital A/c (7,500 x Rs. 5)			37,500

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	(Being loan to the extent of Rs. 1,50,000 convertedinto share capital)			
5.	Bank A/c (25,000 x Rs.5)	Dr	1,25,000	
	To Equity share application A/c			1,25,000
	(Being shares subscribed by the directors)			
6.	Equity share application A/c	Dr	1,25,000	
	To Equity share capital A/c			1,25,000
	(Being application money transferred to capitalA/c)			
7.	Loan A/c	Dr	2,50,000	
	To Bank A/c			2,50,000
	(Being loan repaid)			
8.	Capital reduction A/c	Dr	7,68,750	
	To Profit and loss A/c			5,63,750
	To Plant A/c			43,750
	To Trademarks and Goodwill A/c (Bal. fig.)			1,61,250
	(Being losses and assets written off to the extentre-quired)			

Balance sheet of Fortunate Ltd. (and reduced) as on 31.3.2022

		Particulars	Notes	Rs.
		Equity and Liabilities		
1.	a	Shareholders' funds Share capital	1	15,12,500
2.		Non-current liabilities		
	a	Long-term borrowings (7,16,250 – 1,87,500 – 2,50,000)		2,78,750
3.		Current liabilities		
	a	Trade Payables		2,58,750
	b	Other current liabilities		43,750
		Tota		20,93,750
		Assets		
1.		Non-current assets		
	a	Property, Plant and Equipment	2	7,91,250
	b	Intangible assets	3	2,36,250
2.		Current assets		
	a	Inventories		5,00,000

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	b	Trade receivables		4,10,000
	c	Cash and cash equivalents	4	1,56,250
		Tota		20,93,750

Notes to accounts:

			Rs.
1.	Share Capital		
	Authorized capital:		
	81,250 Preference shares of Rs. 10 each	8,12,500	
	1,87,500 Equity shares of Rs. 5 each	9,37,500	17,50,000
	Issued, subscribed and paid up:		
	1,52,500 equity shares of Rs. 5 each	7,62,500	
	75,000, 6% Preference shares of Rs. 10 each	7,50,000	15,12,500
2.	Property, Plant and Equipment		
	Building at cost less depreciation	5,00,000	
	Plant at cost less depreciation	2,91,250	7,91,250
3.	Intangible assets		
	Trademarks and goodwill		2,36,250
4.	Cash and cash equivalents		
	Bank (2,81,250+1,25,000-2,50,000)		1,56,250

Note: *In place of Capital Reduction Account, Reconstruction Account or Internal Reconstruction Account may also be used.

Question 12

Sapra Limited has laid down the following terms upon the sanction of the reconstruction scheme by the court.

(i) The shareholders to receive in lieu of their present holding at 7,50,000 shares of ₹ 10 each, thefollowing:

- **New fully paid ₹ 10 Equity Shares equal to 3/5th of their holding.**
- **Fully paid ₹ 10, 6% Preference Shares to the extent of 2/5th of the above new equity shares.**
- **7% Debentures of ₹ 250,000.**

(ii) Goodwill which stood at ₹ 2,70,000 is to be completely written off.

(iii) Plant & Machinery to be reduced by ₹ 1,00,000, Furniture to be reduced by ₹ 88,000 and Building tobe appreciated by ₹ 1,50,000.

(iv) Investment of ₹ 6,00,000 to be brought down to its existing market price of ₹ 1,80,000.

(v) Write off Profit & Loss Account debit balance of ₹ 2,25,000.

In case of any shortfall, the balance of General Reserve of ₹ 42,000 can be utilized to

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write off thelosses under reconstruction scheme.

You are required to show the necessary Journal Entries in the books of Sapra Limited of the above reconstruction scheme considering that balance in General Reserve is utilized to write off the losses. (PYP 5 Marks July 21)

Answer 12

Journal Entries

		₹	₹
Equity Share Capital (old) A/c	Dr	75,00,000	
To Equity Share Capital (₹ 10) A/c			45,00,000
To 6% Preference Share Capital (₹ 10) A/c			18,00,000
To 7% Debentures A/c			2,50,000
To Capital Reduction A/c			9,50,000
(Being new equity shares, 6% Preference Shares, 7% Debentures issued and the balance trans-ferredto Reconstruction account as per the Scheme)			
Building A/c	Dr	1,50,000	
Capital Reduction A/c	Dr	9,53,000	
To Goodwill Account			2,70,000
To Plant and Machinery Account			1,00,000
To Furniture Account			88,000
To Investment A/c			4,20,000
To Profit & Loss A/c			2,25,000
(Being Capital Reduction Account utilized for writing off ofGoodwill, Plant and Machinery, furniture, investment and Profit & Loss as per the scheme)			
General reserve A/c	Dr	3,000	
To Capital Reduction A/c			3,000
(Being general reserve utilized to write off the balance in Capital reduction A/c)			

Note: In place of Capital Reduction Account, Reconstruction Account or Internal Reconstruction Accountmay also be used in the above journal entries.

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Question 13

The following is the Balance Sheet of Purple Limited as at 31st March, 2022:

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	15,00,000
(b) Reserves & Surplus	2	(3,00,000)
(2) Current Liabilities		
(a) Trade Payables		2,20,000
(b) Short Term Borrowings – Bank Overdraft		2,00,000
Tota		16,20,000
II. Assets		
(1) Non-Current Assets		
(a) Property, Plant and Equipment	3	10,20,000
(b) Intangible Assets	4	1,20,600
(2) Current Assets		
(a) Inventories		1,70,000
(b) Trade Receivables		3,01,800
(c) Cash and cash equivalents		7,600
Tota		16,20,000

Notes to Accounts

	₹	₹
(1) Share Capital		
90,000 Equity Shares of ₹ 10 each fully paid	9,00,000	
6% Preference Share Capital	6,00,000	15,00,000
(2) Reserves & Surplus		
Profit & Loss account		(3,00,000)
(3) Property, Plant and Equipment		
Land and Building	5,40,000	
Plant and Machinery	4,80,000	10,20,000
(4) Intangible Assets		
Goodwill	84,600	
Patents	36,000	1,20,600

Dividends on preference shares are in arrears for 3 years.

On the above date, the company adopted the following scheme of reconstruction:

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(i) The preference shares are converted from 6% to 8% but revalued in a manner in which the total returnon them remains unaffected.

(ii) The value of equity shares is brought down to ₹ 8 per share.

(iii) The arrears of dividend on preference shares are cancelled.

(iv) The debit balance of Goodwill account is written off entirely.

(v) Land and Building and Plant and Machinery are revalued at 85% and 80% of their respective book values.

(vi) Book debts amounting to ₹ 14,400 are to be treated as bad and hence to be written off.

(vii) The company expects to earn a profit at the rate of ₹ 90,000 per annum from the current year which would be utilized entirely for reducing the debit balance of Profit and loss accounts for 3 years. The remaining balance of the said account would be written off at the time of capital reduction process.

(viii) The balance of total capital reduction is to be utilized in writing down Patents.

(ix) A secured loan of ₹ 4,80,000 bearing interest at 12% per annum is to be obtained by mortgaging tangible fixed assets for repayment of bank overdraft and for providing additional funds for working capital.

You are required to give journal entries incorporating the above scheme of reconstruction, capital reduction account and prepare the reconstructed Balance Sheet. (PYP 20 Marks Nov '22)

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Answer 13

	Particulars (₹)		Debit (₹)	Credit
1.	6% Preference share capital A/c	Dr.	6,00,000	
	To 8% Preference share capital A/c			4,50,000
	To Capital reduction A/c			1,50,000
	(Being 6% preference shares converted to 8%preference shares so that return to pref shareholders remains unaffected)			

2.	Equity share capital A/c (₹ 10)	Dr	9,00,000	
	To Equity share capital A/c (₹ 8)			7,20,000
	To Capital reduction A/c			1,80,000
	(Being equity capital reduced to nominal value of ₹ 8 each)			
3.	Capital Reduction A/c	Dr	3,30,000	
	To Goodwill A/c			84,600
	To Land and Building A/c			81,000
	To Plant and Machinery A/c			96,000
	To Trade Receivables A/c (Book debts)			14,400
	To Patents A/c (Bal. fig.)			24,000
	To Profit and loss A/c			30,000
	(Being losses and assets written off to the extentrequired)			
4.	Bank A/c	Dr	4,80,000	
	To Bank Loan A/c			4,80,000
	(Being Loan taken)			
5.	Bank overdraft A/c	Dr	2,00,000	
	To Bank A/c			2,00,000
	(Being Bank overdraft repaid)			

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Capital Reduction Account

	Particulars	₹		Particulars	₹
To	Goodwill A/c	84,600	By	Equity Share Capital A/c	1,80,000
To	Land & Building A/c	81,000	By	6% Preference Share Capital A/c	1,50,000
To	Plant and Machinery A/c	96,000			
To	Trade receivables (Book Debts) A/c	14,400			
To	Profit & Loss A/c	30,000			
To	Patents A/c (Bal. fig.)	24,000			
		3,30,000			3,30,000

Balance Sheet of Purple Ltd. (and reduced) as at 31.3.2022

		Particulars	Notes	₹
		Equity and Liabilities		
1		Shareholders' funds		
	a	Share capital	1	11,70,000
	b	Reserves and surplus	2	(2,70,000)
2		Current liabilities		
	a	Short term borrowings (Secured Bank Loan)		4,80,000
	b	Trade Payables		2,20,000
		Tota		16,00,000
		Assets		
1		Non-current assets		
	a	Property, plant and equipment	3	8,43,000
	b	Intangible assets	4	12,000
2		Current Assets	5	
	a	Inventory		1,70,000
	b	Trade receivables		2,87,400
	c	Cash and cash equivalents (7,600+4,80,000-2,00,000)		2,87,600
		Tota		16,00,000

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Notes to Accounts:

			₹
1.	Share Capital		
	Authorized		
	Issued, subscribed and paid up:		
	90,000 equity shares of ₹ 8 each fully paid	7,20,000	
	8% Preference share capital*	4,50,000	11,70,000
2.	Reserves and Surplus		
	Profit and Loss Account (Dr. balance)		(2,70,000)
3.	Property plant and equipment		
	Land and Building	4,59,000	
	Plant and Machinery	3,84,000	8,43,000
4.	Intangible assets		
	Patent ₹ (36,000 - 24,000)		12,000
5.	Trade Receivables		
	Sundry Debtors	3,01,800	
	Less: Bad debts	(14,400)	2,87,400

Note: *Face value of preference share is not given in the question (pre and post reconstruction)and hence any suitable value of preference share may be assumed.

Working Notes:

1. Calculation of new Preference Shares

Rate of return : 6% on Preference Shares

Dividend : Rate of return :	(6/100) x ₹ 6,00,000 8% on Preference Shares	= ₹ 36,000
Dividend :	(8/100) x X =	₹ 36,000
	X = (36,000/8) x 100 =	₹ 4,50,000
New Preference Share Capital	=	₹ 4,50,000
Old Preference Share Capital	=	₹ 6,00,000
(6,00,000 – 4,50,000)	=	₹ 1,50,000 Amount taken to Capital Reduction A/c.

2. Since the company expects to earn a profit of ₹ 90,000 p.a. consecutively for three years and it shall be used to write-off debit balance of P & L account, hence ₹ 2,70,000 being loss shall be shown in the Balance Sheet under Reserve & Surplus head and ₹ 30,000 shall be written-

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off from Capital Reduction A/c.

3. Calculation of Amount written off on Land & Building and Plant & Machinery Land & Building Plant & MachineryReduced by:

= (85/100) x 5,40,000

= (80/100) x 4,80,000 = ₹ 4,59,000 = ₹ 3,84,000

Land & Building = (5,40,000 - 4,59,000) = ₹ 81,000

Plant & Machinery = (4,80,000 - 3,84,000) = ₹ 96,000

Question 14

X Ltd. had Rs. 1,00,000 equity share capital divided into 1,000 shares of Rs. 100 each out of which Rs. 80 per share was called up and paid up. It has 1,500 cumulative preference shares of Rs. 100 each fully paid up.Intangible assets include Goodwill of Rs. 80,000 and patents of Rs. 27,800. Preference dividends are in arrears of Rs. 33,000.

You are required to show the entries (Ignore dates) under each of the following conditions:

(i) If X Ltd. resolves to subdivide the equity shares into 10,000 equity shares of Rs. 10 each of which Rs.8 per share is called up and paid up.

(ii) If X Ltd. resolves to convert its 1,000 equity shares of Rs. 100 each (assume fully - paid) into Rs.1,00,000 worth of stock.

(iii) The preference shares are to be converted into 11% unsecured debentures of Rs. 100 each(including arrears of dividends).

(iv) Patents and Goodwill to be written-off. (PYP 5 Marks May '23)

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Answer 14

Journal Entries in the books of X Ltd.

			Rs.	Rs.
(i)	Equity Share Capital (Rs. 100) A/c To Equity Share Capital (Rs. 10) A/c (Being the sub-division of 1,000 shares of Rs. 100 each with Rs. 80 paid up into 10,000 shares Rs. 10 each with Rs. 8 paid up by resolution in general meeting dated ...)	Dr.	80,000	80,000
(ii)	Equity Share Capital (Rs. 100) A/c To Equity Stock A/c (Being conversion of 1,000 fully paid Equity Shares of Rs. 100 into Rs. 1,00,000 Equity Stock as perresolution in general meeting dated...)	Dr.	1,00,000	1,00,000
(iii) (iv)	Cumulative Preference Share Capital A/c Capital Reduction (Reconstruction) A/c To 11% Debentures (Unsecured) (Being 1,500 cumulative preference shares of Rs. 100 each fully paid up converted into 11% debentures of Rs. 100 each (including arrears of dividends amounting Rs. 33,000)	Dr. Dr.	1,50,000 33,000	1,83,000
	Capital Reduction (Reconstruction) A/c To GoodwillTo Patents (Writing off patents, goodwill)	Dr.	1,07,800	80,000 27,800

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Question 15

Following information from Balance Sheet of Ruby Limited as on 31st March, 2023.

	Amount ₹
Authorised and Issued equity share capital:	
60,000 shares of ₹ 100 each fully paid	60,00,000
40,000 7% cumulative preference shares of ₹ 100 each fully paid	40,00,000
General Reserve	12,00,000
Loan from Director	8,80,000
Trade Payables	49,20,000
Outstanding expenses	6,40,000
Bank loan	6,00,000
Patent	8,00,000
Plant & machinery	60,00,000
Building	11,00,000
Trade receivables	47,00,000
Inventory	32,60,000
Cash	2,40,000
Bank Balance	4,60,000
Profit and Loss account	16,80,000

Note: The arrears of preference dividend amount to ₹ 5,60,000.

The company had suffered losses since last 3 years due to bad market conditions and hopefor a better position in the future.

The following scheme of reconstruction has been agreed upon and duly approved by allconcerned:

(1) Equity shares to be converted into 6,00,000 shares of ₹ 10 each.

(2) Equity shareholders to surrender to the company 80 percent of their holdings.

(3) Preference shareholders agree to forgo their right on arrears of dividends in consideration of which 7% preference shares are to be converted into 8% preferenceshares.

(4) Trade payables agree to reduce their claim by one fourth in consideration of their getting shares of ₹ 10,00,000 out of the surrendered equity shares.

(5) Directors agree to forego the amounts due on account of loan.

(6) Surrendered shares not otherwise utilized to be cancelled.

(7) Assets to be reduced as under:

	₹
Patent to	Nil

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Plant & Machinery by	**8,00,000**
Inventory by	**6,80,000**

(8) **Trade receivables to the extent of ₹ 34,00,000 are considered good.**

(9) **Revalued figures for building is accepted at ₹ 14,00,000.**

(10) **Bank loan is paid.**

(11) **Any surplus after meeting the losses should be utilized in writing down the value ofthe plant further.**

(12) **Expenses of reconstruction amounted to ₹ 1,20,000.**

Further 80,000 equity shares were issued to the existing members for increasing theworking capital. The issue was fully subscribed and paid up.

You are required to pass the Journal Entries for giving effect to the above arrangement and also to draw up the resultant Balance Sheet of the Company.(RTP Nov **'23)**

Answer 15

Books of Ruby Ltd.

Journal Entries

Particulars		Debit (₹)	Credit (₹)
Equity Share Capital (₹ 100 each) a/c	Dr	60,00,000	
To Equity share capital (₹ 10 each) A/c			60,00,000
(Sub division of equity share into ₹ 10 each)			
Equity Share Capital (₹ 10) A/c	Dr.	48,00,000	
To Share surrendered A/c			48,00,000
(Surrender of 80% of share holding by equity shareholders)			
7% Cumulative preference share capital A/c	Dr.	40,00,000	
To 8% cumulative preference share capitalA/c			40,00,000
(Conversion of 7% Cumulative Preference sharecapital into 8% Cumulative Preference share capital. They also forgo their right to arrears ofdividends)			
Shares Surrendered A/c	Dr.	10,00,000	
To Equity share capital A/c			10,00,000
(Surrendered share issued against trade payables under reconstruction scheme)			
Bank loan A/c	Dr.	6,00,000	
Expenses of reconstruction A/c	Dr.	1,20,000	
To Bank A/c			7,20,000

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(Bank loan and reconstruction expenses paid)			
Share surrendered A/c	Dr.	38,00,000	
To Capital Reduction A/c			38,00,000

(Cancellation of unissued surrendered shares) (48,00,000-10,00,000)			
Loan from Director A/c	Dr.	8,80,000	
Trade Payables A/c	Dr.	12,30,000	
Building A/c	Dr.	3,00,000	
To Capital reduction A/c			24,10,000
(Amount sacrificed by directors and trade payablesand appreciation in value of building)			
Capital reduction A/c	Dr.	62,10,000	
To Patent A/c			8,00,000
To Trade receivables A/c			13,00,000
To Inventory A/c			6,80,000
To Profit and Loss A/c			16,80,000
To Expenses on Reconstruction A/c			1,20,000
To Plant A/c (bal. fig) (8,00,000+8,30,000)			16,30,000
(Various assets and expenses written off)			
Bank A/c	Dr.	8,00,000	
To Share application money A/c			8,00,000
(Application money received on full and finalpay-ment)			
Share application money A/c Dr. To Share capital A/c (Being 80,000 equity shares of ₹ 10 each issued andfully paid up)		8,00,000	8,00,000

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Note: Cancellation of preference dividend need not be journalised. On cancellation, it ceasesto be contingent liability and hence no further disclosure required.Balance Sheet of Ruby Ltd. (and Reduced) as at 31st March, 2023

	Particulars	Note	Amount (₹)
I.	EQUITY AND LIABILITIES		
	1. Shareholders' funds		
	a. Share capital	1	70,00 000
	b. General reserve		12,00 000
	2. Current liabilities		
	a. Trade payables (49,20,000-12,30,000)		36,90,000
	b. Other current liabilities (outstanding expenses)		6,40,000
	Total		125,30,000
II.	ASSETS		
	1. Non-current assets		
	i. Property, Plant and Equipments	2	57,70,000
	ii. Intangible assets	3	-
	2. Current assets		
	a. Inventories (32,60,000- 6,80,000)		25,80,000
	b. Trade receivables (47,00,000 -13,00,000)		34,00,000
	c. Cash and cash equivalents	4	7,80,000
	Total		125,30,000

(1) Notes to the financial **statementsShare capital**

	Particulars	Amount (₹)
a.	Authorised	
	6,00,000 equity shares of ₹ 10 each	60,00,000
	40,000 8% cumulative preference shares of ₹ 100each	40,00,000
b.	Issued, subscribed and fully paid up	
	3,00,000 equity shares of ₹ 10 each (of the above, 1,00,000 shares were issued as fully paid up for consideration other than cash under the scheme ofreconstruction)	30,00,000
	40,000 8% cumulative preference shares of ₹ 100 each	40,00,000
	Total	70,00,000

Property, Plant and Equipments

Particulars	₹

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Plant (60,00,000-16,30,000)	43,70,000
Building (11,00,000 + 3,00,000)	14,00,000
Total	57,70,000

Intangible assets

Particulars	₹
Patent (8,00,000-8,00,000)	-

Cash and cash equivalents

	Particulars	₹
a.	Balance with bank (4,60,000-6,00,000-1,20,000+8,00,000)	5,40,000
b.	Cash on hand	2,40,000
	Total	7,80,000

Question 16

When the object of reconstruction is usually to re-organise capital or to compound with creditors or to effect economies then such type of reconstruction is called

(a) Internal reconstruction with liquidation

(b) Internal reconstruction without liquidation of the company

(c) External reconstruction

Ans: (b)

Question 17

The accumulated losses under scheme of internal reconstruction are written off against

(d) Capital Reduction account

(e) Share Capital account

(f) Shareholders' account

Ans: (a)

Question 18

A process of reconstruction, which is carried out without liquidating the company and forming a newone is called

(g) Internal reconstruction.

(h) External reconstruction.

(i) Amalgamation.

Ans: (a)

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Question 19

Reconstruction is a process by which affairs of a company are reorganized by

(j) Revaluation of assets and Reassessment of liabilities.

(k) Writing off the losses already suffered by reducing the paid up value ofshares and/or varying the rights attached to different classes of shares.

(l) Both (a) and (b).

Ans: (c)

Question 20

For reduction of the share capital, the permission has to be sought from

(m) Court.

(n) Controller.

(o) State government.

Ans: (a)

Question 21

In case of internal reconstruction

(p) Only one company is liquidated.

(q) Two or more companies are liquidated.

(r) No company is liquidated.

Ans: (c)

Theoretical Questions Answers

Question 22

What are the methods of internal reconstruction generally followed by companies?

Answer 22

Methods of Internal reconstruction:

- Sub-division or consolidation of shares into smaller or higher Denominationand Conversion of share into stock or vice-versa
- Variation of shareholders' rights
- Reduction of share capital
- Compromise, arrangements etc.
- Surrender of Shares.

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Question 23

Parth Ltd, had laid down the following terms upon the sanction of the reconstruction plan by thecourt-

1. **Furniture and Fixtures which stood at the books at ₹ 1,50,000 to be written down to ₹ 95,000. The freehold premises which was valued at ₹ 7,00,000showed an appreciation of ₹55,000.**
2. **Plant and machinery showed fall in value of ₹ 89,000, to be recorded in the books. Investment at ₹ 2,00,000 was brought down to the existing market value at ₹ 1,05,000.**
3. **Debenture holders accepted to receive the following in lieu of their present9% debentures of ₹ 2,50,000-**
   a. **1/5th of the total to be paid in cash to them.**
   b. **To take over the land and buildings of value ₹ 72,000.**
   c. **To forgo the remaining unpaid portion as a policy of reconstruction.**

Write off the profit and loss A/c debit balance at ₹ 70,000 which had been accumulated over theyears. In case of any shortfall, the balance of the General reserve of ₹ 1,50,000 can be utilized to write off the losses under reconstruction scheme. Show the necessary journal entries as part ofthe reconstruction process considering that balance in general reserve utilized to write off thelosses as per reconstruction scheme.

Answer23

Journal entries in the books of Parth Ltd.

		Dr.	Cr.
		₹	₹
Reconstruction A/c	Dr.	2,39,000	
To Furniture and Fixtures A/c			55,000
To Plant and machinery A/c			89,000
To Investment A/c			95,000
(Writing off overvalued assets as per Reconstruction Scheme dated.)			
Freehold premises A/c	Dr.	55,000	
To Reconstruction A/c			55,000
(Being the increase in the premises credited toreconstruction account as per reconstruction scheme)			

9% Debentures A/c	Dr.	2,50,000	
To Bank A/c			50,000
To Land and building A/cToReconstruction A/c			72,000
			1,28,000
(Being the debenture holders claim settled partly and foregone partly as per reconstruction scheme)			

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Reconstruction A/c To Profit and loss A/c (Being the loss written off as per reconstructionscheme)	Dr.	70,000	70,000
General reserve A/c To Reconstruction A/c (Being the balance in general reserve utilized to writeoff thelosses as per reconstruction scheme)	Dr.	1,26,000	1,26,000

Question 24

(i) The following scheme of reconstruction has been approved for Win **Limited:**

(a) **The shareholders to receive in lieu of their present holding at 1,00,000 sharesof ₹ 10 each,the following:**

(b) **New fully paid ₹ 10 Equity shares equal to 3/5th of their holding.**

(c) **10% Preference shares fully paid to the extent of 1/5th of the above new equity shares.**

(ii) **₹ 40,000, 8% Debentures.**

(iii) **An issue of ₹ 1 lakh 10% first debentures was made and allotted, payment forthe same being received in cash forthwith.**

(iv) **Goodwill which stood at ₹ 1,40,000 was completely written off.**

(v) **Plant and machinery which stood at ₹ 2,00,000 was written down to ₹ 1,50,000.**

Freehold property which stood at ₹ 1,50,000 was written down by ₹ **50,000.**

You are required to draw up the necessary Journal entries in the Books of Win Limited for the abovereconstruction. Suitable narrations to Journal entries should form part of your Answer.

Answer 24

Journal Entries

		₹	₹
Equity Share Capital (old) A/c	Dr.	10,00,000	
To Equity Share Capital (₹ 10) A/c			6,00,000
To 10% Preference Share Capital A/c			1,20,000
To 8% Debentures A/c			40,000
To Capital Reduction A/c			2,40,000
Bank A/c (Being new equity shares, 10% Preference Shares, 8% Debentures issued and the balance transferred to Reconstruction account as per the Scheme)	Dr.	1,00,000	
To 10% First Debentures A/c			1,00,000

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(Being allotment of 10% first Debentures)			
Capital Reduction A/c	Dr.	2,40,000	
To Goodwill Account			1,40,000
To Plant and Machinery Account			50,000
To Freehold Property Account			50,000
(Being Capital Reduction Account utilized for writing offof Goodwill, Plant and Machinery and Freehold property as per the scheme)			

Question 25

Green Limited had decided to reconstruct the Balance Sheet since it has accumulatedhuge losses. The following is the Balance Sheet of the Company as at 31.3.20X1 beforereconstruction:

		Particulars		Notes	₹
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capita		1	65,00,000
	B	l Reserves and Surplus		2	(20,00,000)
2		**Non-current liabilities**			
	A	Long-term borrowings		3	15,00,000
3		**Current liabilities**			
	A	Trade Payables			5,00,000
			Total		65,00,000
		Assets			
1		**Non-current assets**			
	A	Property, plant and equipment		4	45,00,000
	B	Intangible assets		5	20,00,000
2		**Current assets**			Nil
		Total			65,00,000

Notes to accounts

		₹
1	**Share Capital**	
	Equity share capital	

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	Authorized share capital	
	1,50,000 Equity shares of ₹ 50 each	75,00,000
	Issued, subscribed and paid up capital	
	50,000 Equity Shares of ₹ 50 each	25,00,000
	1,00,000 Equity shares of ₹ 50 each, ₹ 40 paid up	40,00,000
2	**Reserves and Surplus**	65,00,000
	Debit balance of Profit and loss Account	(20,00,000)
3	**Long-term borrowings**	(20,00,000)
	Secured: 12% First debentures	5,00,000
	12% Second debentures	10,00,000
4	**Property, Plant and Equipment**	15,00,000
14	Building	10,00,000

	Plant	10,00,000
	Computers	25,00,000
5	**Intangible assets**	45,00,000
	Goodwill	20,00,000
		20,00,000

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The following is the interest of Mr. X and Mr. Y in Green Limited:

	Mr. X	Mr. Y
	₹	₹
12% First Debentures	3,00,000	2,00,000
12% Second Debentures	7,00,000	3,00,000
Trade payables	2,00,000	1,00,000
	12,00,000	6,00,000
Fully paid up ₹ 50 shares	3,00,000	2,00,000
Partly paid up shares (₹ 40 paid up)	5,00,000	5,00,000

The following Scheme of Reconstruction is approved by all parties interested and also by theCourt:

(a) Uncalled capital is to be called up in full and such shares and the other fully paid up shares beconverted into equity shares of ₹ 20 each.

(b) Mr. X is to cancel ₹ 7,00,000 of his total debt (other than share amount) andto pay ₹ 2 lakhsto the company and to receive new 14% First Debentures for the balance amount.

(c) Mr. Y is to cancel ₹ 3,00,000 of his total debt (other than equity shares) andto accept new

14% First Debentures for the balance.

(d) The amount thus rendered available by the scheme shall be utilised in writing off of Goodwill,Profit and Loss A/c Loss and the balance to write off the value of computers.

You are required to draw the Journal Entries to record the same and also show theBalanceSheet of the reconstructed company.

Answer 25

Journal Entries in books of Green Limited

		Dr. ₹	Cr. ₹
Bank Account	Dr.	10,00,000	
To Equity Share Capital Account			10,00,000

10,00,000(Balance of ₹ 10 per share on 1,00,000 equity shares called up as per reconstruction scheme)

(Reduction of equity shares of ₹ 50 each to shares of ₹ 20 each as per reconstruction scheme)

12% First Debentures Account	Dr.	3,00,000	
12% Second Debentures Account	Dr.	7,00,000	
Trade payables Account To X	Dr.	2,00,000	12,00,000

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(The total amount due to X, transferred to his account

Bank Account	Dr.	2,00,000	
To X			2,00,000
(The amount paid by X under the reconstruction scheme)			
12% First Debentures Account	Dr.	2,00,000	
12% Second Debentures Account	Dr.	3,00,000	
Trade payables Account	Dr.	1,00,000	
To Y			6,00,000
(The total amount due to Y, transferred to his account)			
Y	Dr.	6,00,000	
To 14% First Debentures Account			3,00,000
To Capital Reduction Account			3,00,000
(The amount due to Y discharged by issue of14% first debentures)			
X	Dr.	14,00,000	
To 14% First Debentures Account			7,00,000
To Capital Reduction Account			7,00,000

(The cancellation of ₹ 7,00,000 out of total debt of Mr. X and issue of 14% first debentures for the balance amount as per reconstruction scheme)

Capital Reduction Account	Dr.	55,00,000	
To Goodwill Account			20,00,000
To Profit and Loss Account			20,00,000
To Computers Account			15,00,000

(The balance amount of capital reduction account utilised in writing off goodwill, profit and loss account, and computers—Working Note)

Balance Sheet of Green Limited (and reduced)as at 31st March, 20X1

	Particulars	Notes	₹
	Equity and Liabilities		
1	**Shareholders' funds**		
a	Share capital	1	30,00,000
2	**Non-current liabilities**		
a	Long-term borrowings	2	10,00,000
3	**Current liabilities**		
a	Trade Payables		2,00,000

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	Total		42,00,000
	Assets		
1	**Non-current assets**		
a	Property, plant and equipment	3	30,00,000
2	**Current assets**		
	Cash and cash equivalents		12,00,000
	Total		42,00,000

Notes to accounts

		₹
1.	**Share Capital**	
	Equity share capital	
	Issued, subscribed and paid up	
	1,50,000 equity shares of ₹ 20 each	30,00,000
	Total	30,00,000
2.	**Long-term borrowings**	
	Secured	
	14% First Debentures	10,00,000
	Total	10,00,000
3.	**Property, Plant and Equipment**	
	Building	10,00,000
	Plant	10,00,000
	Computers	10,00,000
	Total	30,00,000

Working Note:

Capital Reduction Account

	₹		₹
To Goodwill A/c	20,00,000	By Equity Share Capital A/c	45,00,000
To P & L A/c	20,00,000	By X	7,00,000
To Computers (Bal. Fig.)	15,00,000	By Y	3,00,000
	55,00,000		55,00,000

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Question 26

The following is the Balance Sheet of Weak Ltd. as at 31.3.20X1:

		Particulars	Notes	₹
1		**Equity and Liabilities**		
		Shareholders' funds		
	A	Share capital	1	1,50,00,000
	B	Reserves and Surplus	2	(6,00,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	40,00,000
3		**Current liabilities**		
	A	Trade Payables		50,00,000
	B	Short term provisions	4	1,00,000
		Total		2,35,00,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment		1,25,00,000
	B	Non-current investment	5	10,00,000
2		**Current assets**		1,00,00,000
		Total		2,35,00,000

Notes to accounts

		₹
1	**Share Capital**	
	Equity share capital	
	1,00,000 Equity Shares of ₹ 100 each	1,00,00,000
	50,000, 12% Cumulative Preference shares of ₹ 100 each	50,00,000
2	**Reserves and Surplus**	1,50,00,000

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	Debit balance of Profit and loss Account	(6,00,000)
3	**Long-term borrowings**	(6,00,000)
	40,000, 10% debentures of ₹100 each	40,00,000
4	**Short term provisions**	40,00,000
	Provision for taxation	1,00,000
5	**Non-current investments**	1,00,000
	Investments (market value of ₹ 9,50,000)	10,00,000
		10,00,000

The following scheme of reorganization is sanctioned:

(i) All the existing equity shares are reduced to ₹ 40 each.

(ii) All preference shares are reduced to ₹ 60 each.

(iii) The rate of interest on debentures is increased to 12%. The debenture holders surrender their existing debentures of ₹ 100 each and exchange the same for fresh debentures of ₹ 70 each for every debenture held by them.

(iv) One of the creditors of the company to whom the company owes ₹ 20,00,000 decides to forgo 40% of his claim. He is allotted 30,000 equity shares of ₹ 40 each in full satisfaction of his claim.

(v) Property, plant and equipment are to be written down by 30%.

(vi) Current assets are to be revalued at ₹ 45,00,000.

(vii) The taxation liability of the company is settled at ₹ 1,50,000.

(viii) Investments to be brought to their market value.

(ix) It is decided to write off the debit balance of Profit and Loss account.

Pass Journal entries and show the Balance sheet of the company after giving effectto theabove.

Answer26

Journal Entries in the books of Weak Ltd.

		₹	₹
(i)	Equity share capital (₹ 100) A/c Dr.	1,00,00,000	
	To Equity Share Capital (₹ 40) A/c		40,00,000
	To Capital Reduction A/c		60,00,000
	(Being conversion of equity share capital of ₹ 100 each into ₹ 40 each as per reconstruction scheme)		

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(ii)	12% Cumulative Preference Share capital (₹ 100) A/c Dr.	50,00,000	
	To 12% Cumulative Preference ShareCapital (₹ 60) A/c		30,00,000
	To Capital Reduction A/c		20,00,000
	(Being conversion of 12% cumulative preference share capital of ₹ 100 each into ₹ 60 each as per reconstruction scheme)		

(iii)	10% Debentures A/c Dr.	40,00,000	
	To 12% Debentures A/c		28,00,000
	To Capital Reduction A/c		12,00,000
	(Being 12% debentures issued to 10% debenture- holders for 70% of their claims. The balance transferred to capital reduction account as per reconstruction scheme)		
(iv)	Trade payables A/c Dr.	20,00,000	
	To Equity Share Capital A/c		12,00,000
	To Capital Reduction A/c		8,00,000
	(Being a creditor of ₹ 20,00,000 agreed to surrender his claim by 40% and was allotted 30,000 equity shares of ₹ 40 each in full settlement of his dues as per reconstruction scheme)		
(v)	Provision for Taxation A/c Dr.	1,00,000	
	Capital Reduction A/c Dr.	50,000	
	To current assets(bank A/c) A/c		1,50,000
	(Being liability for taxation settled)		
(vi)	Capital Reduction A/c Dr.	99,00,000	
	To P & L A/c		6,00,000
	To Property, plant and equipment A/c		37,50,000

	To Current Assets A/c		55,00,000
	To Investments A/c		50,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Property, plant and equipment, Current Assets, Investments through capital reduction account)		
(vii)	Capital Reduction A/c Dr	50,000	
	To capital Reserve A/c		50,000
	(Being balance in capital reduction accounttransferred to capital reserve account)		

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Balance Sheet of Weak Ltd. (and reduced) as at 31.3.20X1

	Particulars	Notes	₹
	Equity and Liabilities		
1	**Shareholders' funds**		
a	Share capital	1	82,00,000
b	Reserves and Surplus	2	50,000
2	**Non-current liabilities**		
a	Long-term borrowings	3	28,00,000
3	**Current liabilities**		
a	Trade Payables		30,00,000
	Total		1,40,50,000
	Assets		
1	**Non-current assets**		
a	Property, plant and equipment	4	87,50,000
b	Investments	5	9,50,000
2	**Current assets**	6	43,50,000
	Total		1,40,50,000

Notes to accounts

		₹	₹
1.	**Share Capital**		
	Equity share capital		
	Issued, subscribed and paid up		
	1,30,000 equity shares of ₹ 40 each		52,00,000
	Preference share capital		
	Issued, subscribed and paid up		
	50,000 12% Cumulative Preference shares of ₹ 60 each		30,00,000
	Total		82,00,000
2.	**Reserves and Surplus**		
	Capital Reserve		50,000
3.	**Long-term borrowings**		
	Secured		
	12% Debentures		28,00,000
4.	**Property, plant and Equipment**		

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	Total PPE	1,25,00,000	
	Adjustment under scheme of reconstruction	(37,50,000)	87,50,000
5.	**Investments**	10,00,000	
	Adjustment under scheme of reconstruction	(50,000)	9,50,000
6.	**Current assets**	45,00,000	
	Adjustment under scheme of reconstruction	(1,50,000)	43,50,000

Working Note:

Capital Reduction Account

	₹		₹
To Current Asset	50,000	By Equity share capital	60,00,000
To P & L A/c	6,00,000	By 12% Cumulative preference share capital	20,00,000
To Property, plant and equipment	37,50,000	By 10% Debentures	12,00,000
To Current assets	55,00,000	By Trade payables	8,00,000
To Investment	50,000		
To Capital Reserve (bal. fig.)	50,000		
	1,00,00,000		1,00,00,000

Question 27

The following is the Balance Sheet of X Ltd. as at 31st March, 20X1:

		Particulars	**Notes**	**₹**
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	36,00,000
	B	Reserves and Surplus	2	(14,40,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	6,00,000
3		**Current liabilities**		
	A	Trade Payables		3,00,000
	B	Short term borrowings - Bank overdraft		6,00,000
		Total		36,60,000
		Assets		

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1		**Non-current assets**		
	A	Property, plant and equipment		30,00,000
	B	Intangible assets		90,000
2		**Current assets**		
	A	Inventories		2,60,000
	B	Trade receivables		2,80,000
	c	Cash and cash equivalents		30,000
		Total		36,60,000

Notes to accounts

		₹
1	**Share capital**	
	24,000 Equity Shares of ₹ 100 each	24,00,000
	12,000, 10% Preference Shares of ₹ 100 each	12,00,000
	Total	36,00,000
2	**Reserves and Surplus**	
	Debit balance of Profit and loss Account	(14,40,000)
		(14,40,000)
3	**Long-term borrowings**	
	10% debentures	6,00,000
		6,00,000
4.	**Property, plant and Equipment**	
	Land and Building	12,00,000
	Plant and Machinery	18,00,000
		30,00,000
5	**Intangible assets**	
	Goodwill	90,000
		90,000

On the above date, the company adopted the following scheme of reconstruction:

(i) The equity shares are to be reduced to shares of ₹ 40 each fully paid and thepreference shares to be reduced to fully paid shares of ₹ 75 each.

(ii) The debenture holders took over Inventories and Trade receivables in full-

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satisfaction of their claims.

(iii) The Land and Building to be appreciated by 30% and Plant and machinery to bedepreciated by 30%.

(iv) The debit balance of profit and loss account and intangible assets are to beeliminated.

(v) Expenses of reconstruction amounted to ₹ 5,000.

Give journal entries incorporating the above scheme of reconstruction and prepa-rethereconstructed Balance Sheet

Answer27

In the books of X Ltd. Journal Entries

31st March, 20X1			₹	₹
(i)	Equity Share Capital A/c (₹ 100)	Dr.	24,00,000	
	To Equity Share Capital A/c (₹ 40)			9,60,000
	To Capital Reduction A/c			14,40,000
	(Being 24,000 equity shares of ₹ 100 eachreduced to ₹ 40 each fully paid up)			
(ii)	10% Preference Share Capital A/c (₹ 100)	Dr.	12,00,000	
	To 10% Preference Share Capital A/c(₹ 75)			9,00,000
	To Capital Reduction A/c			3,00,000
	(Being 12,000 Preference shares of ₹ 100 eachre-duced to ₹ 75 each fully paid up)			
(iii)	10% Debentures A/c	Dr.	6,00,000	
	To Inventories A/c			2,60,000
	To Trade receivables A/c			2,80,000
	To Capital Reduction A/c			60,000
	(Being debenture holders given Inventories and Trade receivables in full settlement of their claims)			
(iv)	Land & Building A/c	Dr.	3,60,000	
	To Capital Reduction A/c			3,60,000
	(Being Land & Building appreciated by 30%)			
(v)	Capital reduction A/c	Dr.	5,000	
	To Cash A/c			5,000
	(Being expenses of reconstruction paid)			
(vi)	Capital Reduction A/c	Dr.	20,70,000	
	To Goodwill A/c			90,000
	To Profit and Loss A/c			14,40,000

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	To Plant & Machinery A/c			5,40,000
	(Being various losses written off, assets written down through Capital Reserve A/c)			
(vii)	Capital Reduction	Dr.	85,000	
	To Capital Reserve A/c (Bal. Fig.)			85,000
	(Being balance in Capital Reduction A/ctrans-ferred to Capital Reserve A/c)			

Balance Sheet (And Reduced) of X Ltd.as at 31st March, 20X1

	Particulars	Notes No.	₹
	Equity and Liabilities		
1	**Shareholders' funds**		
a	Share capital	1	18,60,000
b	Reserves and Surplus	2	85,000
2	**Current liabilities**		
a	Trade Payables		3,00,000
b	Short term borrowings		6,00,000
	Total		28,45,000
	Assets		
1	**Non-current assets**		
a	Property, plant and equipment	3	28,20,000
2	**Current assets**		
	Cash and cash equivalents (30,000 -5,000)		25,000
	Total		28,45,000

Notes to accounts

1.	**Share Capital**		₹
	Equity share capital		
	24,000 equity shares of ₹ 40 each fully paid up		9,60,000
	Preference share capital		
	12,000, 10% Preference shares of ₹ 75 eachfully paid up		9,00,000
	Total		18,60,000
2.	**Reserves and Surplus**		
	Capital Reserve		85,000
3.	**Property, plant and Equipment**		
	Land and Building	15,60,000	

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	Plant and Machinery	12,60,000	
	Total		28,20,000

Question 28 (Illustration)

On 31-12-20X1, B Ltd. had 20,000, ₹ 10 Equity Shares as authorized capital and the shares were all issued on which ₹ 8 was paid up. In June, 20X2 the company in general meeting decided to sub-divide each share into two shares of ₹ 5 with ₹ 4 paid up. In June, 20X3 the company in general meeting resolved to consolidate 20 shares of ₹ 5, ₹ 4 per share paid up into one share of ₹ 100 each, ₹ 80 paid up.

Pass entries and show how share capital will appear in notes to Balance Sheet ason 31-12-20X1, 31- 12-20X2 and 31-12-20X3.

Answer 28

Journal Entries

20X2			₹	₹
June	Equity Share Capital (₹ 10) A/c	Dr.	1,60,000	
	To Equity Share Capital (₹ 5) A/c			1,60,000
	(Being the sub-division of 20,000 shares of ₹ 10 each with ₹ 8 paid up into 40,000 shares ₹ 5 each with ₹ 4 paid up by resolution in general meeting dated)			
20X3	Equity Share Capital (₹ 5) A/c	Dr.	1,60,000	
June	To Equity Share Capital (₹ 100) A/c			1,60,000
	(Being consolidation of 40,000 shares of ₹ 5 with ₹ 4 paid up into 2,000 ₹ 100 shareswith ₹ 80 paid up)			

Notes to Balance Sheet

Liabilities:	₹
As on 31-12-20X1	
1. Share Capital	
Authorized:	
20,000 Equity Shares of ₹ 10 each	2,00,000

Issued, Subscribed and Paid up:	
20,000 Equity Shares of ₹ 10 each ₹ 8 per share paid up	1,60,000
As on 31-12-20X2	
1. Share Capital	
Authorized:	

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40,000 Equity Shares of ₹ 5 each	2,00,0000
Issued, Subscribed and Paid up:	
40,000 Equity Shares of ₹ 5 each ₹ 4 per share paid up	1,60,000
As on 31-12-20X3	₹
1. Share Capital	
Authorized:	
2,000 Equity Shares of ₹ 100 each	2,00,000
Issued, Subscribed and Paid up:	
2,000 Equity Shares of ₹ 100 each ₹ 80 per share paid up	1,60,000

Note: Some accountants prefer not to make any entry as the amount remainssame. Even when an entry is passed it applies only to the called-up portion, and not to uncalled or unissued portion of share capital.

Question 29 (Illustration)

C Ltd. had ₹ 5,00,000 authorized capital on 31-12-20X1 divided into shares of ₹ 100 each out of which4,000 shares were issued and fully paid up. In June 20X2 the Company decided to convert the issuedshares into stock. But in June, 20X3 theCompany re-converted the stock into shares of ₹ 10 each, fullypaid up. Pass entries and show how Share Capital will appear in Notes to Balance Sheet as on 31-12-20X1, 31-12-20X2 and 31-12-20X3.

Answer 29

Journal Entries

			₹	₹
20X2				
June	Equity Share Capital A/c	Dr.	4,00,000	
	To Equity Stock A/c			4,00,000
	(Being conversion of 4,000 fully paid Equity Shares of ₹ 100 into ₹ 4,00,000 Equity Stock asper resolution in general meeting dated...)			
20X3				
June	Equity Stock A/c	Dr.	4,00,000	
	To Equity Share Capital A/c			4,00,000
	(Being re-conversion of ₹ 4,00,000 Equity Stock into 40,000 shares of ₹ 10 fully paid Equity Shares as per resolution in General Meeting dated...)			

Notes to Balance Sheet

	₹

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As on 31-12-20X1	

Share Capital	
Authorized	
5,000 Equity Shares of ₹ 100 each	5,00,000
Issued and Subscribed	
4,000 Equity Shares of ₹ 100 each fully called up	4,00,000
As on 31-12-20X2	₹
Share Capital	
Authorized	
5,000 Equity Shares of ₹ 100 each	5,00,000
Issued and Subscribed	
Equity Stock- 4,000 Equity Shares of ₹ 100 converted into Stock	4,00,000
As on 31-12-20X3	₹
Share Capital	
Authorized	
50,000 Equity Shares of ₹ 10 each	5,00,000
Issued and Subscribed	
40,000 Equity Shares of ₹ 10 each fully called up	4,00,000

Question 30 (Illustration)

The Balance Sheet of A & Co. Ltd. as at 31-3-20X2 is as follows:

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	11,50,000
	B	Reserves and Surplus	2	(5,35,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	3,75,000
3		**Current liabilities**		
	A	Trade Payables		3,00,000
	B	Short term borrowings - Bank Overdraft		1,95,000
	C	Other current liabilities	4	1,22,500
		Total		16,07,500

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		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	5	4,75,000
	B	Intangible assets	6	1,67,500
	C	Non-current investments	7	55,000
2		**Current assets**		
	A	Inventories		4,25,000
	B	Trade receivables		4,85,000
		Total		16,07,500

Notes to accounts

		₹
1	Share Capital	
	Equity share capital:	
	75,000 Equity Shares of ₹ 10 each	7,50,000
	Preference share capital:	
	4,000 6% Cumulative Preference Shares of ₹ 100 each	4,00,000
2	Reserves and Surplus	11,50,000
	Debit balance of Profit and loss Account	(5,35,000)
3	Long-term borrowings	(5,35,000)
	Secured	
	6% Debentures (secured on the freehold property)	3,75,000
4	Other current liabilities	3,75,000
	Loan from directors	1,00,000
	Interest payable on 6% debentures	22,500
5	Property plant and Equipment	1,22,500
	Freehold property	4,25,000
	Plant	50,000
6	Intangible assets	4,75,000
	Goodwill	1,30,000

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	Patents	37,500
7	Non-current investments	1,67,500
	Investments at cost	55,000
		55,000

(i) The Court approved a Scheme of re-organization to take effect on 1-4-20X2, whereby:The Preference shares to be written down to ₹ 75 each and Equity Shares to ₹ 2 each.

(ii) Of the Preference Share dividends which are in arrears for four years, three fourths to be waived and Equity Shares of ₹ 2 each to be allotted for theremaining quarter.

(iii) Interest payable on debentures to be paid in cash.

Debenture-holders agreed to take over freehold property, book value ₹ 1,00,000 at a valuation of ₹ 1,20,000 in part repayment of their holdings and to provide additional cash of

(iv) ₹ 1,30,000 secured by a floating charge on company's assets at an interest rate of 8% p.a.

(v) Patents and Goodwill to be written off.

(vi) Inventory to be written off by ₹ 65,000.

(vii) Amount of ₹ 68,500 to be provided for bad debts.

(viii) Remaining freehold property after giving to debenture holders, to be re-valuedat ₹ 3,87,500.

(ix) Investments be sold for ₹ 1,40,000.

(x) Directors to accept settlement of their loans as to 90% thereof by allotment ofequity sharesof ₹ 2 each and as to 5% in cash, and balance 5% being waived.

(xi) There were capital commitments totalling ₹ 2,50,000. These contracts are to becancelled onpayment of 5% of the contract price as a penalty. Ignore taxation and cost of the scheme.

You are requested to show Journal entries reflecting the above transactions (including cash transactions) and prepare the Balance Sheet of the company after completionof the Scheme.

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Answer 30

Journal of A & Co. Ltd.

	₹			Dr.	Cr.
	₹				
20X2	Equity Share Capital A/c (₹ 10)		Dr.	7,50,000	
April 1	To Capital Reduction A/c				6,00,000
	To Equity Share Capital A/c (₹ 2)				1,50,000
	(Reduction of equity shares of ₹ 10 each to sharesof ₹ 2 each as per Reconstruction Scheme dated...)				
"	6% Cum. Preference Share Capital A/c (₹ 100)		Dr.	4,00,000	
		To Capital Reduction A/c			1,00,000
		To Pref. Share Capital A/c (₹ 75)			3,00,000
	(Reduction of preference shares of ₹ 100 each toshares of ₹ 75 each as per reconstruction scheme)				
"	Capital Reduction Account		Dr.	24,000	
		To Equity Share Capital Account			24,000
	(Arrears of preference dividends satisfied by theissue of equity shares, 25% of the amount due, ₹ 96,000)				
"	Freehold Property A/c		Dr.	82,500	
		To Capital Reduction A/c			82,500
	(Appreciation in the value of property:				
		Book value	Revalued Figure		
		₹ 1,00,000	₹ 1,20,000		
		₹ 3,25,000	₹ 3,87,500		
	Total	₹ 4,25,000	₹ 5,07,500		
	Profit on revaluation: ₹ 82,500)				
"	6% Debentures A/c		Dr.	1,20,000	
		To Freehold Property A/c			1,20,000
	(Claims of debenture-holders, in part, in-respect ofprincipal discharged by transfer of freehold property vide Scheme of-Reconstruction)				

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"	Interest payable A/c	Dr.	22,500	
	To Bank A/c			22,500
	(Debenture interest paid)			
"	Bank A/c	Dr.	1,30,000	
	To 8% Debentures A/c			1,30,000
	(8% Debentures issued for cash)			

"	Bank A/c	Dr.	1,40,000	
	To Investment A/c			55,000
	To Capital Reduction A/c			85,000
	(Sale of Investment for ₹ 1,40,000 cost being ₹ 55,000; profit credited to Capital Reduction Account)			
"	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital A/c			90,000
	To Bank A/c			5,000
	To Capital Reduction A/c			5,000
	(Directors' loan discharged by issue of equity shares of ₹ 90,000, cash payments of ₹ 5,000 and surrender of ₹ 5,000, vide Scheme of Reconstruction)			
"	Capital Reduction A/c	Dr.	8,48,500	
	To Patents			37,500
	To Goodwill			1,30,000
	To Inventory			65,000
	To Provision for Doubtful Debts			68,500
	To Bank			12,500
	To Profit & Loss Account			5,35,000
	(Writing off patents, goodwill, profit and loss account and reducing the value of stock, making the required provision for doubtful debts and payment for cancellation of capital commitments)			

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Note: Penalty charges for cancellation of the contract amounts to ₹ 12,500 (2,50,000X5%) being paid in cash.**Balance Sheet of A & Co. Ltd. (And Reduced) as at 1st April, 20X2**

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	5,64,000
2		**Non-current liabilities**		
	A	Long-term borrowings	2	3,85,000
3		**Current liabilities**		
	A	Trade Payables		3,00,000
		Total		12,49,000
		Assets		5,64,000
1		**Non-current assets**		
	A	Property, plant and equipment	3	4,37,500
	B	Intangible assets	4	-
2		**Current assets**		
	A	Inventories		3,60,000
	B	Trade receivables	5	4,16,500
	c	Cash and cash equivalents		35,000
		Total		12,49,000

Notes to accounts

1	**Share Capital**		
	Equity share capital		
	1,32,000 Equity shares of ₹ 2 each (of the above57,000 shares have been issued for considerationother than cash)		2,64,000
	Preference share capital		
	4,000 6% Preference shares of ₹ 75 each		3,00,000
	Total		5,64,000
2	**Long-term borrowings** Secured		
	6% Debentures		2,55,000
	8% DebenturesTotal		1,30,000

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	Total		3,85,000
3	**Property, plant and equipment**		
	Freehold property	4,25,000	
	Add: Appreciation under scheme of Reconstruction	82,500	
	Less: Disposed of	(1,20,000)	3,87,500
	plant		50,000
	Net carrying value		4,37,500
4	**Intangible assets**		
	Goodwill	1,30,000	
	Less: Written off under scheme of Reconstruction	(1,30,000)	
	Net carrying value		NIL
	Patents	37,500	
	Less: Written off under scheme of Reconstruction	(37,500)	
	Net carrying value	-	
	Trade Receivables	4,85,000	
	Less: Provision for doubtful debts		4,16,500

Question 31 (Illustration)

		Particulars	Notes	₹
1		**Equity and Liabilities**		
		Shareholders' funds		
	A	Share capital	1	13,50,000
	B	Reserves and Surplus	2	(4,51,000)
2		**Non-current liabilities**		
	A	Long-term borrowings (Loan)	3	5,73,000
3		**Current liabilities**		
	A	Trade Payables		2,07,000
	B	Other current liabilities		35,000
		Total		17,14,000
		Assets		
1		**Non-current assets**		

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	A	Property, plant and equipment	4	6,68,000
	B	Intangible assets	5	3,18,000
2		**Current assets**		
	A	Inventories		4,00,000
	B	Trade receivables		3,28,000
		Total		17,14,000

Notes to accounts

		₹
1	**Share Capital**	
	Equity share capital	7,50,000
	15,000 Equity Shares of ₹ 50 each	
	Preference share capital	
	12,000, 7% Cumulative Preference Shares of ₹ 50 each	
	(Preference dividend is in arrears for five years)	6,00,000
	Total	13,50,000
2	**Reserves and Surplus**	
	Debit balance of Profit and loss Account	(4,51,000
		(4,51,000
3	**Long-term borrowings**	
	Loan	5,73,000
		5,73,000
4	**Property, plant and Equipment**	
	Building at cost less depreciation	4,00,000
	Plant at cost less depreciation	2,68,000
		6,68,000
5	**Intangible assets**	
	Trademarks and Goodwill at cost	3,18,000
		3,18,000

The Company is not earning profits, short of working capital and a scheme of reconstruction has been approved by both the classes of shareholders. A summaryof the scheme is as follows:

(a) The equity shareholders have agreed that their ₹ 50 shares should be reducedto ₹ 2.50 by cancellation of ₹ 47.50 per share. They have also agreed to subscribe for three new equity shares of ₹ 2.50 each for each equity share held.

(b) The preference shareholders have agreed to cancel the arrears of dividends andto accept for each ₹ 50 share, 4 new 5% preference shares of ₹ 10 each, plus 6 new equity shares of ₹ 2.50 each, all credited as fully paid.

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Lenders to the company for ₹ 1,50,000 have agreed to convert their loan into share and for this purpose they will be allotted 12,000 new preference sharesof ₹ 10 each and 12,000 new equity shares of ₹ 2.50 each.

(c) The directors have agreed to subscribe in cash for 40,000, new equity shares of ₹ 2.50 each in addition to any shares to be subscribed by them under (a) above.

(d) Of the cash received by the issue of new shares, ₹ 2,00,000 is to be used toreduce the loan due by the company.

(e) The equity share capital cancelled is to be applied:

i. to write off the debit balance in the profit and loss A/c; and

ii. to write off ₹ 35,000 from the value of plant.

Any balance remaining is to be used to write down the value of trademarks and goodwill. Show by journal entries how the financial books are affected by the scheme and prepare the balancesheet of the company after reconstruction. The nominal capital as reduced is to be increased to ₹ 6,50,000 for preference share capital and ₹ 7,50,000 for equity share capital.

Answer 31

In the books of Rebuilt Ltd. Journal Entries

	Particulars		**Debit (₹)**	**Credit (₹)**
1.	Equity share capital A/c (₹ 50)	Dr.	7,50,000	
	To Equity share capital A/c (₹ 2.50)			37,500
	To Capital reduction A/c (Being equity capital reduced to nominal valueof ₹ 2.50 each)			7,12,500
2	Bank A/c	Dr.	1,12,500	
	To Equity share capital			1,12,500
3.	7% Preference share capital A/c (₹ 50)	Dr. .	6,00,000	
	Capital reduction A/c	Dr	60,000	
	To 5% Preference share capital (₹ 10) To			4,80,000
	equity share capital (₹ 50)			80,0001,
	(Being 7% preference shares of ₹ 50 each converted to 5% preference shares of ₹ 10 each			
	and also given to them 6 equity shares for every share held			
4.	Loan A/c	Dr.	1,50,000	

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	To 5% Preference share capital A/cTo			1,20,000
	Equity share capital A/c			30,000
	Being loan to the extent of ₹ 1,50,000convertedinto share capital			
5.	Bank A/c	Dr.	1,00,000	
	To Equity share application money A/c(Being shares subscribed by the directors)			1,00,000
6.	Equity share application money A/cTo	Dr.	1,00,000	
	Equity share capital A/c (Being application money transferred to capital A/c)			1,00,000
7.	Loan A/c	Dr.	2,00,000	
	Loan A/c (Being loan repaid			2,00,000
8	Capital reduction A/c	Dr.	6,52,500	
	To Profit and loss A/cTo			4,51,000
	Plant A/c			35,000
	To Trademarks and Goodwill A/c (Bal.fig.) (Being losses and assets written off to the extent required)			1,66,500

Balance sheet of Rebuilt Ltd. (and reduced)as at 31.3.20X1

		Particulars		Notes	₹
		Equity and Liabilities			
1		**Shareholders' funds**			
	a	Share capital		1	10,60,000
2		**Non-current liabilities**			
	a	Long-term borrowings			2,23,000
3		**Current liabilities**			
	a	Trade Payables			2,07,000

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	b	Other current liabilities			35,000
			Total		15,25,000
		Assets			
1		**Non-current assets**			
	a	Property, plant and equipment		2	6,33,000
	b	Intangible assets		3	1,51,500
2		**Current assets**			
	a	Inventories			4,00,000
	b	Trade receivables			3,28,000
	c	Cash and cash equivalents		4	12,500
		Total			15,25,000

Notes to accounts

			₹
1.	**Share Capital**		
	Authorized capital:		
	65,000 Preference shares of ₹ 10 each	6,50,000	
	3,00,000 Equity shares of ₹ 2.50 each	7,50,000	14,00,000
	Issued, subscribed and paid up:		
	1,80,000 equity shares of ₹ 2.5 each	4,60,000	
	60,000, 5% Preference shares of ₹ 10 each	6,00,000	10,60,000
2.	**Property plant and equipment**		
	Building at cost less depreciation	4,00,000	
	Plant at cost less depreciation	2,33,000	6,33,000
3.	**Intangible assets**		
	Trademarks and goodwill		1,51,500
4.	**Cash and cash equivalents**		
	Bank (1,12,500+1,00,000-2,00,000)		12,500

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Question 32 (Illustration)

Vaibhav Ltd. gives the following ledger balances as at 31st March 20X1:

	₹
Property, Plant and Equipment	2,50,00,000
Investments (Market-value ₹ 19,00,000)	20,00,000
Current Assets	2,00,00,000
P & L A/c (Dr. balance)	12,00,000
Share Capital: Equity Shares of ₹ 100 each	2,00,00,000

6%, Cumulative Preference Shares of ₹ 100 each	1,00,00,000
5% Debentures of ₹ 100 each	80,00,000
Creditors	1,00,00,000
Provision for taxation	2,00,000

(i) The following scheme of Internal Reconstruction is sanctioned:All the existing equity shares are reduced to ₹ 40 each.

(ii) All preference shares are reduced to ₹ 60 each.

(iii) The rate of Interest on Debentures increased to 6%. The Debenture holders surrender theirexisting debentures of ₹ 100 each and exchange the same for fresh debentures of ₹ 70 each for every debenture held by them.

(iv) Property, Plant and Equipment is to be written down by 20%.

(v) Current assets are to be revalued at ₹ 90,00,000.

(vi) Investments are to be brought to their market value.

(vii) One of the creditors of the company to whom the company owes ₹ 40,00,000 decides to forgo 40% of his claim. The creditor is allotted with60000 equity shares of ₹ 40 each in full and final settlement of his claim.

(viii) The taxation liability is to be settled at ₹ 3,00,000.

(ix) It is decided to write off the debit balance of Profit & Loss A/c.

Pass journal entries and show the Balance Sheet of the company after giving effectto the above.

Answer 32

Journal Entries in the books of Vaibhav Ltd.

		₹	₹
(i)	Equity share capital (₹ 100) A/c Dr.	2,00,00,000	
	To Equity Share Capital (₹ 40) A/c		80,00,000
	To Capital Reduction A/c		1,20,00,000

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	(Being conversion of equity share capital of ₹ 100 each into ₹40 each as per reconstruction scheme)		
(ii)	6% Cumulative Preference Share capital (₹ 100) A/c Dr.	1,00,00,000	
	To 6% Cumulative Preference ShareCapital (₹ 60)A/c		60,00,000
	To Capital Reduction A/c		40,00,000
	(Being conversion of 6% cumulative preferenceshares capital of ₹ 100 each into ₹ 60 each as per reconstruction scheme)		
(iii)	5% Debentures (₹ 100) A/c Dr.	80,00,000	
	To 6% Debentures (₹ 70) A/c		56,00,000
	To Capital Reduction A/c		24,00,000
	(Being 6% debentures of ₹ 70 each issued to existing 5% debenture holders. The balance transferred to capital reduction account as per reconstruction scheme)		

(iv)	Sundry Creditors A/c Dr.	40,00,000	
	To Equity Share Capital (₹ 40) A/c		24,00,000
	To Capital Reduction A/c		16,00,000
	(Being a creditor of ₹ 40,00,000 agreed to surrender his claim by 40% and was allotted 60,000 equity shares of ₹ 40 each in full settlement of his dues as per reconstruction scheme)		
(v)	Provision for Taxation A/c Dr.	2,00,000	
	Capital Reduction A/c Dr.	1,00,000	
	To Liability for Taxation A/c		3,00,000
	(Being conversion of the provision for taxationinto liability for taxation for settlement of the amount due)		
(vi)	Capital Reduction A/c Dr.	199,00,000	
	To P & L A/c		12,00,000
	To Property, Plant and Equipment A/c		50,00,000
	To Current Assets A/c		110,00,000
	To Investments A/c		1,00,000
	To Capital Reserve A/c (Bal. fig.)		26,00,000

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	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, PPE, Current Assets, Investments and the Balance transferredto Capital Reserve)		
(vii)	Liability for Taxation A/c Dr.	3,00,000	
	To Current Assets (Bank A/c)		3,00,000
	(Being the payment of tax liability)		

Balance Sheet of Vaibhav Ltd. (and reduced) as at 31st March, 20X1

	Particulars	Notes	₹
	Equity and Liabilities		
1	**Shareholders' funds**		
a	Share capital	1	164,00,000
b	Reserves and Surplus	2	26,00,000
2	**Non-current liabilities**		
	Long-term borrowings	3	56,00,000
3	**Current liabilities**		
	Trade Payables (1,00,00,000 less 40,00,000)		60,00,000
	Total		3,06,00,000
	Assets		
1	**Non-current assets**		
a	Property, plant and equipment	4	2,00,00,000
b	Investments	5	19,00,000
2	**Current assets**	6	87,00,000
	Total		3,06,00,000

Notes to accounts

			₹
1.	**Share Capital**		
	Equity share capital		
	Issued, subscribed and paid up		
	2,60,000 equity shares of ₹ 40 each (of the above 60,000 shares have been issuedfor consideration other than cash)		1,04,00,000
	Preference share capital		
	Issued, subscribed and paid up		

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	1,00,000 6% Cumulative Preference shares of ₹ 60 each		60,00,000
	Total		1,64,00,000
2.	**Reserves and Surplus**		
	Capital Reserve		26,00,000
3.	**Long-term borrowings**		
	Secured		
	6% Debentures		56,00,000
4.	**Property, Plant and Equipment**		
	Carrying value	2,50,00,000	
	Adjustment under scheme of reconstruction	(50,00,000)	2,00,00,000
5.	**Investments**	20,00,000	
	Adjustment under scheme of reconstruction	(1,00,000)	19,00,000
6.	**Current assets**		
		2,00,00,000	
	Adjustment under scheme of reconstruction	(1,10,00,000)	
		90,00,000	
	Taxation liability paid	(3,00,000)	87,00,000

Working Note:

Capital Reduction Account

To	Liability for taxation A/c	1,00,000	By	Equity share capital	1,20,00,000
To	P & L A/c Property,	12,00,000	By	6% Cumulative preferences	
To	plantequipment and	50,00,000			
To	Current assets	1,10,00,000		Share capital	40,00,000
To	Investment	1,00,000	By	5% Debentures	24,00,000
To	Capital Reserve (Bal. fig.)	26,00,000	By	Sundry creditors	16,00,000
		2,00,00,000			2,00,00,000

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Question 33 (Illustration)

Following is the Balance Sheet of ABC Ltd. as at 31st March, 20X1:

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	26,00,000
	B	Reserves and Surplus	2	(4,05,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	12,00,000
3		**Current liabilities**		
	A	Trade Payables		5,92,000
	B	Short term borrowings - Bank overdraft		1,50,000
		Total		41,37,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	11,50,000
	B	Intangible assets	5	70,000
2	C	Non-current investment	6	68,000
		Current assets		
	A	Inventory		14,00,000
	B	Trade receivables		14,39,000
	C	Cash and cash equivalents		10,000
		Total		41,37,000

Notes to accounts:

		₹
1	**Share Capital**	
	Equity share capital:	
	2,00,000 Equity Shares of ₹ 10 each	20,00,000
	6,000, 8% Preference shares of ₹ 100 each	6,00,000

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		26,00,000
2	**Reserves and Surplus**	
	Debit balance of Profit and loss A/c	(4,05,000)
		(4,05,000
3	**Long-term borrowings**	
	9% debentures	12,00,000
		12,00,000
4	**Property, Plant and Equipment**	
	Plant and machinery	9,00,000
	Furniture and fixtures	2,50,000
		11,50,000

5	**Intangible assets**	
	Patents and copyrights	70,000
		70,000
6	**Non-current investments**	
	Investments (market value of ₹ 55,000)	68,000
		68,000

(i) **The following scheme of reconstruction was finalized:Preference shareholders would give up 30% of their capital in exchange forallotment of 11% Debentures to them.**

(ii) **Debenture holders having charge on plant and machinery would accept plantandmachinery in full settlement of their dues.**

(iii) **Inventory equal to ₹ 5,00,000 in book value will be taken over by trade payablesinfull settlement of their dues.**

(iv) **Investment value to be reduced to market price.**

(v) **The company would issue 11% Debentures for ₹ 3,00,000 and augment itsworking capital requirement after settlement of bank overdraft.**

Pass necessary Journal Entries in the books of the company. Prepare Capital Reduction account and Balance Sheet of the company after internal reconstruction.

Answer 33

In the Books of ABC Ltd. Journal Entries

Particulars		**₹**	**₹**
8% Preference share capital A/c	Dr.	6,00,000	
To 11% Debentures A/c			4,20,000
To Capital reduction A/c			1,80,000
[Being 30% reduction in liability of preference sharecapital and issue of 11% debentures]			
9% Debentures A/c	Dr.	12,00,000	

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To Plant & machinery A/c			9,00,000
To Capital reduction A/c			3,00,000
[Settlement of debenture holders by allotment ofplant & machinery]			
Trade payables A/c	Dr.	5,92,000	
To Inventory A/c			5,00,000
To Capital reduction A/c			92,000
[Being settlement of creditors by giving Inventories]			
Bank A/c	Dr.	3,00,000	
To 11% Debentures A/c			3,00,000
[Being fresh issue of debentures]			
Bank overdraft A/c	Dr.	1,50,000	
To Bank A/c			1,50,000
[Being settlement of bank overdraft]			
Capital reduction A/c	Dr.	5,72,000	
To Investment A/c			13,000
To Profit and loss A/c			4,05,000
To Capital reserve A/c			1,54,000
[Being decrease in investment and profit and loss account (Dr. bal.); and balance of capital reduction account transferred to capital reserve]			

Capital Reduction Account

		₹			₹
To	Investments A/c	13,000	By	Preference share capital A/c	1,80,000
To	Profit and loss A/c	4,05,000	By	9% Debenture holders A/c	3,00,000
To	Capital reserve A/c	1,54,000	By	Trade payables A/c	92,000
		5,72,000			5,72,000

Balance Sheet of ABC Ltd. (And Reduced)As at 31st March 20X1

Particulars	Note No	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	20,00,000
(b) Reserves and Surplus	2	1,54,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	7,20,000

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Total		28,74,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	4	2,50,000
(b) Intangible assets	5	70,000
(c) Non-current investments	6	55,000
(2) Current assets		
(a) Inventories (₹ 14,00,000 – ₹ 5,00,000)		9,00,000
(b) Trade receivables		14,39,000
(c) Cash and cash equivalents		
Cash at Bank (W. N.)		1,60,000
Total		28,74,000

Notes to Accounts

		₹
1.	**Share Capital**	
	2,00,000 Equity shares of ₹ 10 each fully paid-up	20,00,000
2.	**Reserve and Surplus**	
	Capital Reserve	1,54,000

3.	**Long Term Borrowings**	
	11% Debentures (₹ 4,20,000 + ₹ 3,00,000)	7,20,000
4.	**Property, Plant and Equipment**	
	Plant & machinery 9,00,000	
	Less: Adjustment on scheme of reconstruction 9,00,000	-
	Furniture & fixtures	2,50,000
5	**Intangible assets**	
	Patents & copyrights	70,000
		3,20,000
6.	**Non-Current Investments**	
	Investments (₹ 68,000 – ₹ 13,000)	55,000

Working Note:

Cash at bank = Opening balance + 11% Debentures issued – Bank overdraft paid

= ₹ 10,000 + ₹ 3,00,000 – ₹ 1,50,000 = ₹ 1,60,000

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Question 34 (Illustration)

The Balance Sheet of Revise Limited as at 31st March, 20X1 was as follows :

		Particulars		Notes	₹
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital		1	10,00,000
	B	Reserves andsurplus		2	(6,00,000)
2		**Non-current liabilities**			
	A	Long-term borrowings		3	2,00,000
3		**Current liabilities**			
	A	Trade Payables			72,000
	B	Other current liabilities		4	24,000
	C	Short term provisions		5	24,000
			Total		7,20,000
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment		6	1,00,000
2		**Current assets**			
	A	Inventory			3,20,000
	B	Trade receivables			2,70,000
	C	Cash and cash equivalents			30,000
					7,20,000

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	10,000 Equity Shares of ₹ 100 each		10,00,000

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			10,00,000
2	**Reserves and Surplus**		
	Debit balance of Profit and loss Account		(6,00,000
			(6,00,000)
3	**Long-term borrowings**		
	12% debentures		2,00,000
			2,00,000
4	**Other current liabilities**		
	Interest payable on debentures		24,000
			24,000
5	**Short term provisions**		
	Provision for taxation		24,000
			24,000
6	**Property, Plant and Equipment**		
	Machinery		1,00,000
			1,00,000

It was decided to reconstruct the company for which necessary resolution was passed and sanctions were obtained from appropriate authorities. Accordingly, it was decided that:

(a) **Each share is sub-divided into ten fully paid up equity shares of ₹ 10 each.**

(b) **After sub-division, each shareholder shall surrender to the company 50% of his holding, for the purpose of re-issue to debenture holders and trade payables as necessary.**

(c) **Out of shares surrendered, 10,000 shares of ₹ 10 each shall be converted into 12% preferenceshares of ₹ 10 each, fully paid up.**

(d) **The claims of the debenture-holders shall be reduced by 75 per cent. In consideration of the reduction, the debenture holders shall receive preference shares of ₹ 1,00,000 which are converted out of shares surrendered.**

(e) **Trade payables claim shall be reduced to 50 per cent, it is to be settled by the issue of equityshares of ₹ 10 each out of shares surrendered.**

(f) **Balance of profit and loss account to be written off.**

(g) **The shares surrendered and not re-issued shall be cancelled.**

You are required to show the journal entries giving effect to the above and theresultant BalanceSheet

Answer 34

		Dr.	Cr.
		₹	₹
Equity Share Capital (₹ 100) A/c	Dr.	10,00,000	

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To Share Surrender A/c			5,00,000
To Equity Share Capital (₹ 10) A/c			5,00,000
(Subdivision of 10,000 equity shares of ₹ 100 each into 1,00,000 equity shares of ₹ 10 each and surrender of 50,000 of such subdivided shares as per capitalreduction scheme)			
12% Debentures A/c	Dr.	1,50,000	
Interest payable A/c	Dr.	18,000	
To Reconstruction A/c			1,68,000
(Transferred 75% of the claims of the debenture holders to reconstruction account in consideration of which 12% preference shares are being issued out of share surrender account as per capital reduction scheme)			
Trade payables A/c	Dr.	72,000	
To Reconstruction A/c			72,000
(Transferred claims of the trade payables to reconstruction account, 50% of which is being clear reduction and equity shares are being issued in consideration of the balance)			
Share Surrender A/c	Dr.	5,00,000	
To 12% Preference Share Capital A/c			1,00,000
To Equity Share Capital A/c			36,000
To Reconstruction A/c			3,64,000
(Issued preference and equity shares to discharge the claims of the debenture holders and the trade payables respectively as a per scheme and the balance in share surrender account is being transferred to reconstruction account)			
Reconstruction A/c	Dr.	6,04,000	
To Profit and Loss A/c			6,00,000
To Capital Reserve A/c			4,000
(Adjusted debit balance of profit and loss account against the reconstruction account and the balance in the latter is being transferred to capital reserve)			

Balance Sheet of Revise Limited (and reduced) as at...

Particulars	Note No.	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,36,000
(b) Reserves and Surplus	2	4,000

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(2) Non-Current Liabilities		
(a) Long-term borrowings	3	50,000
(3) Current Liabilities		
(a) Other current liabilities	4	6,000
(b) Short-term provisions	5	24,000
Total		7,20,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	6	1,00,000
(2) Current assets		
(a) Inventories		3,20,000
(b) Trade receivables		2,70,000
(c) Cash and cash equivalents		30,000
Total		7,20,000

Notes to Accounts

		₹
1	**Share Capital**	
	Equity Share Capita Equity Share Capital Issued Capital: 53,600 Equity Shares of ₹ 10 each	**5,36,000**
	Preference Share CapitalPrefer- ence Shares	1,00,000
	(Of the above shares all are allotted as fully paid up pursuant to capital reduction scheme by conversion of equity shares without payment being received in cash)	
		6,36,000
2	**Reserve and Surplus**	
	Capital Reserve	4,000
	Long-term borrowings	
	Unsecured Loans	
	12% Debentures	50,000
4	**Other current liabilities** Interest	
	Interest payable on debentures	6,000
5	**Short-term provisions**	
	Provision for Income-tax	24,000

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6	**Property, plant and Equipment**	
	Machinery	1,00,000

Question 35 (Illustration)

Recover Ltd. decided to reorganize its capital structure owing to accumulated losses and adversemarket condition. The Balance Sheet of the company as on 31 st March 20X1 is as follows-

		Particulars	Notes	₹
1		Equity and Liabilities		
		Shareholders' funds Sharecapital		
		Reserves and surplus		
	A	Non-current liabilities Long-term borrowingsCurrent	1	3,50,000
	B	liabilities	2	(70,000)
2		Trade Payables		
	A	Short term Borrowings – Bankover-	3	50,000
3	A	draft		
	B	Other Current Liabilities (Interestpay-		80,000
	C	able on Debentures)		
				90,000
				5,000
				5,05,000
1		Assets		
		Non-current assets		
	A	Property, Plant Equipment		
	B	Intangible assets	4	3,35,000
	C	Non-current investments	5	50,000
		Current assets	6	40,000
2	A	Inventories Trade re-		
	B	ceivables		30,000
				50,000
				5,05,000

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Notes to accounts:

			₹
1	Share Capital		
	Equity share capital:		
	20,000 Equity Shares of ₹ 10 eachPrefer-ence share capital:		2,00,000
	15,000 8% Cumulative Preference Shares of ₹ 10each (preference dividend has been in arrears for4 years)		1,50,000
			3,50,000
2	Reserves and surplus		
	Profit and loss account (debit balance)		(70,000)
			(70,000)
3	Long-term borrowingsSecured		
	10% Debentures (secured on thefreehold property)		50,000
			50,000
4	Property, Plant and EquipmentFreehold property		
	Leasehold property Plant and machinery		1,20,000
			85,000
			1,30,000
			3,35,000
5	Intangible assets		
	Goodwill		50,000
			50,000
6	Non-current investments		
	Non-Trade investments at cost		40,000
			40,000

Subsequent to approval by court of a scheme for the reduction of capital, the following steps were **taken:**

i. **The preference shares were reduced to ₹ 2.5 per share, and the equity shares to ₹ 1 per share.**

ii. **One new equity share of ₹ 1 was issued for the arrears of preferred dividend for past 4 years.**

iii. **The debenture holders took over the freehold property at an agreed** figure **of ₹ 75,000 andpaid the balance to the company after deducting the amount due to them.**

iv. **Plant and Machinery was written down to ₹ 1,00,000.**

v. **Non-trade Investments were sold for ₹ 32,000.**

vi. **Goodwill and obsolete stock (included in the value of inventories) of ₹ 10,000 were written off.**

vii. **A contingent liability of which no provision had been made was settled at ₹ 7,000 and of this**

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amount, ₹ 6,300 was recovered from the insurance.

You are required (a) to show the Journal Entries, necessary to record the above transactions in the company's books and (b) to prepare the Balance Sheet, after completion of the scheme.

Answer: 35

Journal entries in the books of Recover Ltd

Particulars		Dr. ₹	Cr. ₹
8% Cumulative Preference share capital (₹ 10) A/c	Dr.	1,50,000	
To 8% Cumulative Preference share capital (₹2.5) A/c			37,500
To Reconstruction (₹ 7.5) A/c			1,12,500
(Preference shares being reduced to shares of ₹ 2.5 per share and remaining transferred tore-construction account as per internal reconstruction scheme)			
Equity share capital A/c (₹10)	Dr.	2,00,000	
To Equity Share capital A/c (₹ 1)			20,000
To Reconstruction A/c (₹ 9)			1,80,000
(Equity shares reduced to ₹ 1 per share with the remaining amount transferred to reconstruction account as a part of the internal reconstruction scheme)			
Reconstruction A/c	Dr.	48,000	
To Equity share capital A/c			48,000
(Equity shares of ₹ 1 issued in lieu of the arrears of preference dividend for 4 years as a part of the internal reconstruction scheme)			
10% Debentures A/c	Dr.	50,000	
Interest payable on debentures A/c	Dr	5,000	
Bank A/c	Dr.	20,000	

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Reconstruction A/c To Freehold property A/c (Debenture holders being paid by the sale of property, which is sold at a loss debited to the reconstruction account. Amount received in excess being refunded to company by debenture holders as a part of the internal reconstruction scheme)	Dr.	45,000	 1,20,000
Reconstruction A/c To Plant and Machinery Ac To Goodwill A/c To Inventory A/c (The assets written off as a part of the internal reconstruction scheme)	Dr.	90,000	 30,000 50,000 10,000
Bank A/c Reconstruction A/c To Investments A/c (Investments sold at a loss debited to reconstruction account as a part of the internal reconstruction scheme)	Dr. Dr.	32,000 8,000	 40,000
Contingent Liability A/c To Bank A/c (Contingent liability paid as a part of the internal reconstruction scheme)	Dr.	7,000	 7,000
Bank A/c Reconstruction A/c To Contingent Liability A/c (The insurance company remitting part of the contingency payment amount)	Dr. Dr.	6,300 700	 7,000
Reconstruction A/c To Profit and loss A/c (Accumulated losses written off to reconstruction account as a part of the internal reconstruction scheme)	Dr.	70,000	 70,000

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Reconstruction A/c	Dr.	30,800	
To Capital reserve A/c			30,800
(The balance in reconstructionaccount transferred to capital reserve as a part of the internal reconstruction scheme)			

Balance sheet of Recover Ltd. as at 31st March 20X1 (and reduced)

		Particulars	Notes	₹
		Equity and Liabilities		
		Shareholders' funds		
1	A	Share capital	1	1,05,500
	B	Reserves and surplus	2	30,800
2		Non-current liabilities		
	A	Long-term borrowings		-
		Current liabilities		80,000
3	A	Trade Payables		90,000
	B	Short term borrowings - Bank Overdraft		
		Total		3,06,300
1		Assets		
		Non-current assets		
	A	Property, Plant and Equipment	3	1,85,000
2		Current assets		
	A	Inventories		20,000
	B	Trade receivables		50,000
	C	Cash and cash equivalents	4	51,300
		Total		3,06,300

Notes to accounts:

		₹
1	Share Capital	
	Equity share capital	
	68,000 Equity Shares of ₹ 1 each	68,000
	Preference share capital	
	15,000 8% Cumulative Preference Shares of ₹ 2.5 each	37,500
		1,05,500
2	Reserves and surplus	
	Capital reserve	30,800
3	Property, Plant and Equipment	

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	Leasehold property	85,000
	Plant and machinery	1,00,000
		1,85,000
4	Cash and cash equivalents	
	Bank A/c (20,000+32,000-7000+6,300)	51,300

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Chapter 15

Accounting for Branches including Foreign Branches

Attempts Coverage	MAY 2018	NOV 2018	MAY 2019	NOV 2019	MAY 2020	NOV 2020	MAY 2021	NOV 2021	MAY 2022	NOV 2022	MAY 2023	NOV 2023
Study Mat.	Q.26 TO Q.65											
Past Exams	Q.18	NO	Q.10	NO	NO	Q.12	Q.19 Q.21	NO	Q.22	Q.23	Q.24	NO
MTP	Q.2	Q.3 Q.10	Q.2 Q.3	Q.1	Q.4	Q.5 Q.6	Q.7 Q.9	Q.4 Q.8	Q.5 Q.6 Q.7	Q.9 Q.10	Q.8 Q.11	Q.9 Q.20
RTP	Q.13	Q.15	Q.11	Q.14	Q.11	Q.1	Q.13	Q.12	Q.16	Q.1	Q.17	Q.25

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Chapter 15

Accounting for Branches including Foreign Branches

Question 1

M & S Co. of Lucknow has a branch in Canberra, Australia (as an integral foreign operation of M & S Co.). At the end of 31st March 2019, the following ledger balances have been extracted from the books of the Lucknow office and the Canberra.

	Lucknow office (Rs. Inthousand)		Canberra Branch (Aust. Dollars inthousand)	
	Dr.	Cr.	Dr.	Cr.
Capital		2,000		
Reserves & Surplus		1,000		
Land	500			
Buildings (Cost)	1,000			
Buildings Dep. Reserves		200		
Plant and Machinery (Cost)	2,500		200	
Plant and Machinery Dep.				
Reserves		600		130
Debtors/Creditors	280	200	60	30
Stock as on 1- 4-2018	100		20	
Branch Stock Reserve		4		
Cash & Bank Balances	10		10	
Purchases/Sales	240	520	20	123
Goods sent to Branch		100	5	
Managing Partner's Salary	30			
Wages and Salary	75		45	
Rent			12	
Office Expenses Commission Re-ceipts	25	256	18	100
Branch/HO Current Ac-count	120			7
	4,880	4,880	390	390

The following information is also available:

(i) Stock as at 31st March, 2019

Lucknow Rs. 1,50,000

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Canberra A$ 3125 (all stock are out of purchases made at Abroad)

(ii) Head Office always sent goods to the Branch at cost plus 25%

(iii) Provision is to be made for doubtful debts at 5%

(iv) Depreciation is to be provided on Buildings at 10% and on Plant and Machinery at 20% on writtendownvalue.

You are required to:

(1) Convert the Branch Trial Balance into rupees by using the following exchange rates:

Opening rate	**1 A $ = Rs. 50**
Closing rate	**1 A $ = Rs. 53**
Average rate	**1 A $ = Rs. 51.00**
For Property, Plant &Equipment	**1 A $ = Rs. 46.00**

Prepare Trading and Profit and Loss Account for the year ended 31st March 2019 showing to theextent possible H.O. results and Branch results separately. [MTPOct.'19, 12 Marks, RTP Nov '22, Old & New SM) (Same concept fewer adjustments RTP Nov'20)

Answer 1

M & S Co. Ltd. Canberra, Australia Branch Trial Balance As on 31st Mar 2019

	($ 'thousands)			(Rs. ' thousands)	
	Dr.	**Cr.**	**Conversion**	**Dr.**	**Cr.**
			rate per $		
Plant & Machinery (cost)	200		Rs. 46	9,200	
Plant & Machinery Dep. Reserve		130	Rs. 46		5,980
Trade receivable/payable	60	30	Rs. 53	3,180	1,590
Stock (1.4.2018)	20		Rs. 50	1,000	
Cash & Bank Balances	10		Rs. 53	530	
Purchase / Sales	20	123	Rs. 51	1,020	6,273
Goods received from H.O.	5		Actual	100	
Wages & Salaries	45		Rs. 51	2,295	
Rent	12		Rs. 51	612	
Office expenses	18		Rs. 51	918	
Commission Receipts		100	Rs. 51		5,100
H.O. Current A/c		7	Actual	_____	120

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				18,855	19,063
Foreign Exchange Loss (bal. fig.)	___	___		208	
	390	**390**		**19,063**	**19,063**
Closing stock	3.125		53	165.625	

Trading and Profit & Loss Account for the year ended 31st March, 2019 (Rs.'000)

		H.O.	Branch	Total			H.O.	Branch	Total
To	Opening Stock	100	1,000.000	1,100.000	By	Sales	520	6,273.000	6,793.000
To To	Purchases Goods received	240	1,020.000	1,260.000	By	Goods sent to Branch	100	-	100.000
	from Head Office	-	100.000	100.000	By	Closing Stock	150	165.625	315.625
To	Wages & Salaries	75	2,295.000	2,370.000					
To	Gross profit c/d	355	2,023.625	2,378.625					
		770	6,438.625	7,208.625			770	,438.625	7,208.625
To	Rent	-	612.000	612.000	By	Gross profit b/d	355	,023.625	2,378.625
To	Office expenses	25	918.000	943.000	By	Commis-sionre-ceipts	256	,100.000	5,356.000
To	Provision for doubtful debts@ 5%	14	159.000	173.000					
To	Depreciation	460	644.000	1,104.000					
To	(W. N.) Balance c/d	112	4,790.625	4,902					
				.625					
		611	**7,123 .625**	**7,734 .625**			**611**	**- ,123.625**	**7,734.625**
To	Managing Partner's Salary		30.000		By	Balance b/d		4,902.625	
To	Exchange Loss		208.000		By	Branch stock		4,000	

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				reserve	
To	Balance c/d	4,668.625			
		4,906.625			**4,906.625**

Working Note: **Calculation of Depreciation**		
	H.O	**Branch**
	Rs.'000	**Rs.'000**
Building . Cost	1,000	
Less: Dep. Reserve	(200)	
	800	
Depreciation @ 10% (A)	80	
Plant & Machinery Cost	2,500	9,200
Less: Dep. Reserve	(600)	(5,980)
	1,900	3,220
Depreciation @ 20% (B)	380	644
Total Depreciation (A+B)	460	644

Note: As the closing stock of Branch does not consist any stock transferred from M& S Co., there is no needtocreate closing stock reserve. But the opening branch stock reserve has to be reversed in the P&L A/c.

Question 2

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, you are required to prepare branch account in the books of Head Office.

	Rs.		**Rs.**
Stock on 1st April 2017 (invoiceprice)	**30,000**	**Discount allowed to debtors**	**160**
Sundry Debtors on 1st April, 2017	**18,000**	**Expenses paid by head office:**	
Cash in hand as on 1st April, 2017	**-**	**Rent**	**1,800**
Office furniture on 1st April, 2017	**3,000**	**Salary**	**3,200**
Goods invoiced from the head		**Stationery & Printing**	**800**

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office (invoice price)	1,60,000		
Goods returned to Head Office	2,000	Petty expenses paid by the branch	600
(invoice price)			
Goods returned by debtors	960	Depreciation to be provid-ed onbranch	
Cash received from debtors	60,000	furniture at 10% p. a.	

Cash Sales	1,00,000	Stock on 31st March, 2018	
Credit sales	60,000	(at invoice price)	28,000

(MTP March '19 8 Marks, MTP March '18 10 Marks)

Answer 2

In the books of Head Office – Kolkata Branch Account (at invoice)

		Rs.			Rs.
To Balance b/d			By Stock reserve (opening)		6,000
Stock		30,000	By Remittances:		
Debtors		18,000	Cash Sales	1,00,000	
Furniture		3,000	Cash from Debtors	60,000	
To Goods sent to branch		1,60,000	Less: Petty expenses	(600)	1,59,400
			By Goods sent to branch (loading)	32,000	
To Goods returned by branch(loading)		400	By Goods returned by branch (Return toH.O.)		2,000
To Bank (expenses			By Balance c/d		
paid by H.O.)			Stock		28,000
Rent	1,800		Debtors		16,880
Salary	3,200		Furniture (3,000-300)		2,700
Stationary &					
printing	800	5,800			
To Stock reserve (closing)		5,600			
To Profit transferred to					
General Profit & Loss A/c		24,180			
		2,46,980			2,46,980

Working Note:

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Debtors Account

	Rs.		Rs.
To Balance c/d	18,000	By Cash account	60,000
To Sales account (credit)	60,000	By Sales return account	960
		By Discount allowed account	160
		By Balance c/d	16,880
	78,000		78,000

Note: In the absence of opening cash balance, remittance to Head Office has been made after payment ofpetty expenses.

Question 3

On 31st December, 2016 the following balances appeared in the books of Kolkata Branch of an Englishfirm having its HO office in New York:

	Amount in Rs.	Amount in Rs.
Stock on 1st Jan, 2016	2,34,000	
Purchases and Sales	15,62,500	23,43,750
Debtors and Creditors	7,65,000	5,10,000
Bills Receivable and Payable	2,04,000	1,78,500
Salaries and Wages	1,00,000	-
Rent, Rates and Taxes	1,06,250	-
Furniture	91,000	-
Bank A/c	5,68,650	
New York Account		5,99,150
	36,31,400	36,31,400

Stock on 31st December, 2016 was Rs. 6,37,500.Branch account in New York books showed a debit balance of $ 13,400 on 31st December, 2016 andFurniture appeared in the Head Office books at $ 1,750.

The rate of exchange on 31st December, 2015 was Rs. 52 and on 31st December, 2016 was Rs. 51. The average rate for the year was Rs. 50.

Prepare in the Head Office books the Profit and Loss a/c and the Balance Sheet of the Branch. (MTP April

'19 Oct'18 ,10 Marks, Old & New SM)

Answer 3

In the books of English Firm (Head Office in New York) Kolkata Branch Profit and Loss Account for the yearended 31st December, 2016

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	$		$
To Opening Stock	4,500	By Sales	46,875
To Purchases	31,250	By Closing stock (6,37,500 / 51)	12,500
To Gross profit c/d	23,625		
	59,375		59,375
To salaries	2,000	By Gross profit b/d	23,625
To Rent, rates and taxes	2,125		
To exchange translation loss	2,000		
To Net Profit c/d	17,500		
	23,625		**23,625**

Balance Sheet of Kolkata Branch as on 31st December, 2016

Liabilities		$	Assets	$
Head office A/c	13,400		Furniture	1,750
Add : Net profit	17,500	30,900	Closing Stock	12,500
Trade creditors		10,000	Trade Debtors	15,000
Bills Payable		3,500	Bill Receivable	4,000
			Cash at Bank	11,150
		44,400		**44,400**

Working Note: Require for calculation of Exchange Translation Loss Kalkata Branch Trail Balance (converted in $) as on 31st December, 2016

	Dr.	Cr.	Conversion	Dr.	Cr.
	Rs.	Rs.	rate	$	$
Stock on 1st Jan., 2016	2,34,000		52	4,500	
Purchases & Sales	15,62,500	23,43,750	50	31,250	46,875
Debtors & creditors	7,65,000	5,10,000	51	15,000	10,000
Bills Receivable and BillsPayable	2,04,000	1,78,500	51	4,000	3,500
Salaries and wages	1,00,000		50	2,000	
Rent, Rates and Taxes	1,06,250		50	2,125	
Furniture	91,000			1,750	
Bank A/c	5,68,650		51	11,150	
New York Account		5,99,150			13,400
Exchange translation loss (bal.fig.)				2,000	

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	36,31,400	36,31,400		73,775	73,775

Question 4

From the following details of Western Branch Office of M/s. XYZ Corp. for the year ending 31st March,2020, ascertain branch stock reserve in respect of unrealized profit in opening stock and closing stock:

(i) **Goods are sent to the branch at invoice price and branch also maintains stock at the same price.**

(ii) **Sale price is cost plus 40%.**

(iii) **Invoice price is cost plus 15%.**

(iv) **Other information from accounts of branch:**

Opening Stock as on 01-04-2019	**3,45,000**
Goods sent during the year by Head Office toBranch	**16,10,000**
Sales during the year	**21,00,000**
Expenses incurred at the branch	**45,000**

(MTP 4 Marks Oct'21, May '20)

Answer 4

Branch Stock Reserve in respect of unrealized profit on opening stock = Rs. 3,45,000 x (15/115) = Rs. 45,000 on closing stock = Rs. 2,30,000 x (15/115) = Rs. 30,000

Working Note:	**Rs.**
Cost Price	100
Invoice Price	115
Sale Price	140
Calculation of closing stock at invoice price	Rs.
Opening stock at invoice price	3,45,000
Goods received during the year at invoice price	16,10,000
	19,55,000
Less: Cost of goods sold at invoice price [21,00,000 X (115/140)]	(17,25,000)
Closing stock	2,30,000

Question 5

L Ltd. has its head office at Mumbai and two branches at Pune and Goa. The branches purchase goods independently. Pune branch makes a profit of one third on cost and Goa branch makes a profit of 20% on sales. Goods are also supplied by one branch to another at the respective sales price. From the

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following particulars, prepare the Trading and Profit and Loss Account of Pune branch and find out the profit or loss made by it considering the reserve for unrealised profits:

Particulars	Pune Branch Rs.	Goa Branch Rs.
Opening Stock	40,000	30,000
Purchases (Including Inter Branch transfers)	2,00,000	2,50,000
Sales	2,80,000	2,95,625
Chargeable Expenses	15,000	27,500
Closing Stock	30,000	43,500
Office and Administration Expenses	13,250	7,000
Selling and Distribution Expenses	15,000	10,000

Information:

(i) **Opening stock at Pune Branch includes goods of Rs. 10,000 (invoice price) taken from Goa Branch,**

(ii) **Opening stock at Goa Branch includes goods of invoice price Rs. 17,000 taken from Pune Branch,**

(iii) **The Pune Branch sales includes transfer of goods to Goa Branch at selling price Rs. 20,000**

(iv) **The sales of Goa Branch include transfer of goods to Pune Branch at selling price Rs. 15,000.**

(v) **Closing stock at Pune Branch includes goods received from Goa Branch (invoice price Rs. 5,000.**

(vi) **Closing stock at Goa Branch includes goods of Rs. 4,000 (invoice price)**

(MTP 6 Marks Mar 22,Oct 20)

Answer 5

Pune Branch Trading and Profit and Loss Account

Particulars		Rs.	Particulars		Rs.
To	Opening Stock (including Rs.10,000 from Goa Branch)	40,000	By	Sales (including Rs.20,000 toGoa Branch)	2,80,000
To	Purchases	2,00,000	By	Closing Stock (including Rs.5,000 from Goa Branch)	30,000
To	Chargeable Expenses	15,000			
To	Gross Profit c/d (before making adjustment forunrealised profit)	55,000			
		3,10,000			3,10,000

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To	Stock Reserve (for unrealised profit in Closing Stock lying atGoa Branch) (Rs.4,000 x 25/100)	1,000	By	Gross Profit b/d	55,000
To	Office & Adm. Expenses	13,250	By	Stock Reserve (for unrealised profit in Opening Stock lying at Goa Branch) (Rs. 17,000 x 25/100)	4,250
To	Selling & DistributionExpenses	15,000			
	To Net Profit	30,000			
		59,250			59,250

Question 6

Ganesh Ltd. has head office at Delhi (India) and branch at New York. New York branch is an integralforeign operation of Ganesh Ltd. New York branch furnishes you with its trial balance as on 31st March, 2020 and the additional information given thereafter:

	Dr. ($)	Cr. ($)
Stock on 1st April, 2019	**300**	**-**
Purchases and sales	**800**	**1,500**
Sundry Debtors and creditors	**400**	**300**
Bills of exchange	**120**	**240**
Sundry expenses	**1,080**	**-**
Bank balance	**420**	**-**
Delhi office A/c	**–**	**1,080**
	3,120	**3,120**

The rates of exchange may be taken as follows:

- **on 1.4.2019 @ Rs. 40 per US $**
- **on 31.3.2020 @ Rs. 42 per US $**
- **average exchange rate for the year @ Rs. 41 per US $.**

New York branch account showed a debit balance of Rs. 44,380 on 31.3.2020 in Delhi books and there were no items pending reconciliation. You are asked to prepare trial balance of New York in Rs. in the books of Ganesh Ltd. (MTP 4 Marks Mar'22, Oct 20)

Answer 6

In the books of Ganesh Ltd. New York Branch Trial Balance in (Rs.) as on 31st March, 2020

	Conversion rate per US $	Dr.	Cr.
	(Rs.)	Rs.	Rs.

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Stock on 1.4.19	40	12,000	
Purchases and sales	41	32,800	61,500
Sundry debtors and creditors	42	16,800	12,600
Bills of exchange	42	5,040	10,080
Sundry expenses	41	44,280	
Bank balance	42	17,640	
Delhi office A/c	-		44,380
		1,28,560	1,28,560

Question 7

DM Delhi has a branch in London which is an integral foreign operation of DM. At the end of the year 31st March, 2021, the branch furnishes the following trial balance in U.K. Pound:

Particulars	£	£
	Dr.	**Cr.**
Property, Plant & Equipment (Acquired on 1st April, 2017)	**24,000**	
Stock as on 1st April, 2020	**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**

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In head office books, the branch account stood as shown below:London Branch A/c

Particulars	Amount Rs.	Particulars	Amount Rs.
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) **Property, Plant & Equipment are to be depreciated @ 10% p.a. on WDV.**

(b) **On 31st March, 2021:**

Expenses outstanding	-	£ 400
Prepaid expenses	-	£ 200
Closing stock	-	£ 8,000
(c) Rate of Exchange:		

1st April, 2017	-	**Rs. 70 to £ 1**
1st April, 2020	-	**Rs. 76 to £ 1**
31st March, 2021	-	**Rs. 77 to £ 1**
Average	-	**Rs. 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; and (2) Trading and profit and loss account for the year ended 31st March, 2021 of London branch as would appear in the books of Delhi head office of DM. (MTP 8 Marks April 22, April 21)

Answer 7

Trial Balance of London Branch as on 31st March, 2021

Particulars	U.K. Pound	Rate Per U.K. Pound	Dr. (Rs.)	Cr. (Rs.)
Property, Plant & Equipment	24,000	70	16,80,000	
Stock (as on 1st April, 2020)	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	

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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) = Rs. 6,16,000 Trading and Profit & Loss A/c for the year ended 31st March, 2021

Particulars		Amount (Rs.)	Particulars			Amount (Rs.)
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				78,16,000
To	Gross Profit	11,38,800				
		78,16,000	By	**Gross Profit**		11,38,800
To	Expenses	3,75,000	By	Profit due to Ex-change differ-ence		12,400
To	Depreciation	1,68,000				
To	Net Profit	6,08,200				
		11,51,200				11,51,200

Working Note:

Since London Branch is an integral foreign operation. Hence, (1) Property, Plant & Equipment (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 8

Pass necessary Journal entries in the books of an independent Branch of a Company, wherever required,to rectify or adjust the following:

(i) Branch incurred travelling expenses of Rs. 4,000 on behalf of other Branches, but not recorded in thebooks of Branch.

(ii) Goods dispatched by the Head office amounting to Rs. 8,000, but not received

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by the Branch till date ofreconciliation. The Goods have been received subsequently.

(iii) Provision for doubtful debts, whose accounts are kept by the Head Office, not provided earlier for Rs.2,000.

(iv) Branch paid Rs. 2,000 as salary to a Head Office Manager, but the amount paid has been debited by theBranch to Salaries Account.(MTP 4 Marks , Nov '21 & April '23)

Answer 8

Journal Entries in Books of Branch

	Dr.		Amount in Rs.	
			Cr.	
(i)	Head Office Account	Dr.	4,000	
	To Cash Account (Being expenditure incurred on account of other branch, now recorded in books)			4,000
(ii)	Goods –in- transit Account	Dr.	8,000	
	To Head Office Account (Being goods sent by Head Office still in- transit)			8,000
(iii)	Provision for Doubtful Debts A/c		2,000	
	To Head Office Account (Being the provision for doubtful debts not provided earlier, nowprovided for)			2,000
(iv)	Head Office Account		2,000	
	To Salaries Account (Being rectification of salary paid on behalf of Head Office)			2,000

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Question 9

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, 2022 is as follows:

Particulars	US $	
	Dr.	Cr.
Office equipments	48,000	
Furniture and Fixtures	3,200	
Stock (April 1, 2021)	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 is 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 Rs.15,80,000.**

(4) **The Head Office shows an amount of Rs. 20,50,000 due from Branch.**

(5) **Stock on 31st March, 2022 -$21,500.**

(6) **There were no transit items either at the start or at the end of the year.**

(7) **On April 1, 2020 when the fixed assets were purchased the rate of exchange was**

(8) **Rs. 43 to one $. On April 1, 2021, the rate was 47 per $. On March 31, 2022 the rate was Rs. 50per $. Average rate during the year was Rs. 45 to one $.**

Prepare Trial balance incorporating adjustments given converting dollars into rupees and Trading, Profit and Loss Account for the year ended 31st March, 2022 of the Branch as would appear in the books of Moon Star for the purpose of incorporating in the main Balance Sheet. (MTP 8 Marks March 21 & Oct '23, MTP 12 Marks Sep '22)

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Answer 9

In the books of Moon Star Trial Balance (in Rupees) of Virginia (USA) Branch as on 31st March, 2022

	Dr.	Cr.	Conversion	Dr.	Cr.
	US $	US $	rate	Rs.	Rs.
Office Equipment	43,200		50	21,60,000	
Depreciation on Office Equipment	4,800		50	2,40,000	
Furniture and fixtures	2,880		50	1,44,000	
Depreciation on furniture and fixtures	320		50	16,000	
Stock (1st April, 2021)	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 difference (bal. fig.) transferred to foreign currency translation reserve account					4,66,800
	2,19,200	2,19,200		1,03,64,800	1,03,64,800

Trading and Profit and Loss Account of Virginia Branch forthe year ended 31st March, 2022

	Rs.		Rs.
To Opening stock	10,52,800	By Sales	74,88,000
To Purchases	43,20,000	By Closing stock	10,75,000

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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

Question 10

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

Patna branch furnishes you with its trial balance as on 31st March, 2022 and the additional informationgiven thereafter:

	Dr.	Cr.
	(Rupees in thousands)	
Stock on 1st April, 2021	**300**	
Purchases and Sales	**800**	**1,200**
Sundry Debtors & Creditors	**400**	**300**
Bills of Exchange	**120**	**240**
Wages & Salaries	**560**	**-**
Rent, Rates & Taxes	**360**	**-**
Sundry Charges	**160**	**-**
Plant	**240**	**-**
Bank Balance	**420**	**-**
U.S.A. Office A/c	**-**	**1,620**
	3,360	**3,360**

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Information:

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

(b) **Unsold stock of Patna branch was worth ₹ 4,20,000 on 31st March, 2022.**

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

- **On 01.04.2021 @ ₹ 55 per US $**
- **On 31.03.2022 @ ₹ 60 per US $**
- **Average exchange rate for the year @ ₹ 58 per US $**
- **Conversion in $ shall be made up to two decimal accuracy.**

You are asked to prepare in US dollars the revenue statement for the year ended 31st March, 2022 andthe balance sheet as on that date of Patna branch as would appear in the books of USA head office of Heera & Co. You are informed that Patna branch account showed a debit balance of US $ 29845.35 on 31.3.2022 in USA books and there were no items pending reconciliation. (MTP 12 Marks Oct '22 & Aug. '18, 12 Marks) (Same concept different figures PYP May'19 8 Marks, Old & New SM)

Answer 10

M/s Heera & Co. Patna Branch Trial Balance in (US $) as on 31st March, 2022

	Conversion rate per US $ (₹)	Dr. US $	Cr. US $
Stock on 1.4.21	55	5,454.55	–
Purchases and sales	58	13,793.10	20,689.66
Sundry debtors and creditors	60	6,666.67	5,000.00
Bills of exchange	60	2,000.00	4,000.00
Wages and salaries	58	9,655.17	-
Rent, rates and taxes	58	6,206.90	-
Sundry charges	58	2,758.62	-
Plant	–	6,000.00	-
Bank balance	60	7,000.00	-
USA office A/c	–	-	29,845.35
		59,535.01	59,535.01

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Trading and Profit & Loss Account for the year ended 31st March,2022

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

Balance Sheet of Patna Branch as on 31st March, 2022

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

Question 11

On 31st March, 2022 Chennai Branch submits the following Trial Balance to its Head Office at Lucknow:

Debit Balances	₹ in lacs
Furniture and Equipment	**18**
Depreciation on furniture	**2**
Salaries	**25**
Rent	**10**
Advertising	**6**
Telephone, Postage and Stationery	**3**
Sundry Office Expenses	**1**

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Stock on 1st April, 2021	**60**
Goods Received from Head Office	**288**
Debtors	**20**
Cash at bank and in hand	**8**
Carriage Inwards	**7**
Credit Balances	**448**
Outstanding Expenses	**3**
Goods Returned to Head Office	**5**
Sales	**360**
Head Office	**80**
	448

Additional Information:Stock on 31st March, 2022 was valued at ₹ 62 lacs. On 29th March, 2022 the Head Office dispatched goodscosting ₹ 10 lacs to its branch. Branch did not receive these goods before 1st April, 2022. Hence, the figureof goods received from Head Office does not include these goods. Also the head office has charged the branch ₹ 1 lac for centralized services for which the branch has not passed the entry. You are required to :(i) pass Journal Entries in the books of the Branch to make the necessary adjustments and (ii) prepare Final Accounts of the Branch including Balance Sheet. (MTP 12 Marks March '23, RTP May '19, RTP May'20, Old & New SM)

Answer 11

Books of Branch

Journal Entries

			(₹ in lacs)
		Dr.	Cr.
Goods in Transit A/c	Dr.	10	
To Head Office A/c			10
(Goods dispatched by head office but not received by branch before 1st April, 2022)			
Expenses A/c	Dr.	1	
To Head Office A/c			1
(Amount charged by head office for centralised services)			

(i) Trading and Profit & Loss Account of the Branch for the year ended 31st March, 2022

		₹ in lacs		₹ in lacs
To Opening Stock		60	By Sales	360
To Goods received from			By Closing Stock	62
Head Office	288			
Less : Returns	(5)	283		
To Carriage Inwards		7		

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To Gross Profit c/d	72		
	422		422

To Salaries	25	By Gross Profit b/d	72
To Depreciation on Furniture	2		
To Rent	10		
To Advertising	6		
To Telephone, Postage & Stationery	3		
To Sundry Office Expenses	1		
To Head Office Expenses	1		
To Net Profit Transferred to			
Head Office A/c	24		
	72		72

Balance Sheet as on 31st March, 2022

Liabilities	₹ in lacs		Assets	₹ in lacs	
Head Office	80		Furniture & Equipment	20	
Add : Goods in transit	10		Less : Depreciation	(2)	18
Head Office Expenses	1		Stock in hand		62
Net Profit	24		Goods in Transit		10
		115	Debtors		20
Outstanding Expenses		3	Cash at bank and in hand		8
		118			118

Question 12

Lal & Co. of Jaipur has a branch in Patna to which goods are sent @ 20% above cost. The branch makes both cash & credit sales. Branch expenses are paid direct from Head office and the branch has to remit all cash received into the bank account of Head office. Branch doesn't maintain any books of accounts but sends monthly returns to the head office.

Following further details are given for the year ended 31st March, 2020:

	Amount (₹)
Goods received from Head office at Invoice Price	**4,20,000**
Goods returned to Head office at Invoice Price	**30,000**
Cash sales for the year 2019-20	**92,500**
Credit Sales for the year 2019-20	**3,12,500**

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Stock at Branch as on 01-04-2019 at Invoice price	36,000
Sundry Debtors at Patna branch as on 01-04-2019	48,000
Cash received from Debtors	2,19,000
Discount allowed to Debtors	3,750
Goods returned by customer at Patna Branch	7,000
Bad debts written off	2,750
Amount recovered from Bad debts previously written off as Bad	500
Rent, Rates & taxes at Branch	12,000
Salaries & wages at Branch	36,000
Office Expenses (at Branch)	4,600
Stock at Branch as on 31-03-2020 at cost price	62,500

Prepare necessary ledger accounts in the books of Head office by following Stock and Debtors method and ascertain Branch profit. (RTP Nov 21, PYP 10 Marks Nov 20)

Answer 12

Branch Stock Account

			₹				₹	₹	₹
1.4.19	To	Balance b/d	36,000	31.3.20	By	Sales:			
		(opening							
		stock)							
31.3.20	To	Goods Sent	4,20,000			Cash		92,500	
		to Branch A/c				Credit	3,12,500		
	To	Branch P&L	47,000			Less: Return	(7,000)	3,05,500	3,98,000
					By	Goods			30,000
						sent to			
						branch -			
						returns			
					By	Balance			75,000
						c/d			
						(closing			
						stock)			
			5,03,000						5,03,000

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1.4.20	To	Balance b/d	75,000						

Branch Debtors Account

			₹				₹
1.4.19	To	Balance b/d	48,000	31.3.20	By	Cash	2,19,000
31.3.20	To	Sales	3,12,500		By	Returns	7,000
					By	Discounts	3,750
					By	Bad debts	2,750
					By	Balance c/d	1,28,000
			3,60,500				3,60,500
1.4.20	To	Balance b/d	1,28,000				

Branch Expenses Account

			₹				₹
31.3.20	To	Salaries & Wages	36,000	31.3.20	By	Branch P&L A/c	59,100
	To	Rent, Rates & Taxes	12,000				
	To	Office Expenses	4,600				
	To	Discounts	3,750				
	To	Bad Debts	2,750				
			59,100				59,100

Branch Profit & Loss Account for year ended 31.3.20

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			₹				₹
31.3.20	To	Branch Expens-esA/c	59,100	31.3.20	By	Branch stock	47,000
	To	Net Profit transferred to			By	Branch Stock Adjust-ment account	58,500
		General P & L A/c			By	Bad debts	
			46,900			recovered	500
			1,06,000				106,000

Branch Stock Adjustment Account for year ended **31.3.20**

			₹				₹
31.3.20	To	Goods sent tobranch (30,000x1/6) -returns	5,000	31.3.20	By	Balance b/d (36,000x1/6)	6,000
	To	Branch P & L A/c	58,500		By	Goods sent to branch (4,20,000x1/6)	70,000
	To	Balance c/d (75,000x1/6)	12,500				
			76,000				76,000

Question 13

Alpha Ltd. has a retail shop under the supervision of a manager. The ratio of gross profit at selling price is constant at 25 per cent throughout the year to 31 st March, 2020.

Branch manager is entitled to a commission of 10 per cent of the profit earned by his branch, calculated before charging his commission but subject to a deduction from such commission equal to 25 per cent of any ascertained deficiency of branch stock. All goods were supplied to the branch from head office. The following details for the year ended 31st March, 2020 are given as follows:

	Rs.		Rs.
Opening Stock (at cost)	**74,736**	**Chargeable expenses**	**49,120**
Goods sent to branch (at cost)	**2,89,680**	**Closing Stock (Selling Price)**	**1,23,328**
Sales	**3,61,280**		
Manager's commission paid on account	**2,400**		

From the above details, you are required to calculate the commission due to manager for the year

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ended 31st March, 2020. (RTP May'21, May 18)

Answer 13

In the books of Alpha Ltd.

Step 1: Calculation of Deficiency Branch stock account (at invoice price)

Particulars	Rs.	Particulars	Rs.
To Opening Stock (Rs. 74,736 + 1/3 ofRs. 74,736)	99,648	By Sales	3,61,280
To Goods sent to Branch A/c (Rs.2,89,680 + 1/3 of Rs. 2,89,680)	3,86,240	By Closing Stock	1,23,328
		By Deficiency at sale price[Balancing figure]	1,280
	4,85,888		4,85,888

Step 2: Calculation of Net Profit before CommissionBranch account

Particulars	Rs.	Particulars	Rs.
To Opening Stock [Rs.74,736 + 1/3 of Rs. 74,736]	99,648	By Sales	3,61,280
To Gross sent to Branch A/c (Rs. 2,89,680 + 1/3 of Rs. 2,89,680)	3,86,240	By Closing Stock	1,23,328
To Expenses	49,120	By Stock Reserve A/c	24,912
To Stock Reserve A/c [Rs. 1,23,328 x 25/100]	30,832	By Goods sent to BranchA/c	96,560
To Net Profit – subject to manager's commission	40,240		
	6,06,080		6,06,080

Step 3: Calculation of Commission still due to manager

		Rs.
A	Calculation at 10% profit before charging his commission [Rs. 40,240x 10/100]	4,024
B	Less: 25% of cost of deficiency in stock [25% of (75% of Rs. 1,280)]	(240)
C	Commission for the year [A-B]	3,784
D	Less: Paid on account	(2,400)
E	Balance due (C-D)	1,384

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Question 14

From the following particulars relating to Pune branch for the year ending December 31, 2018, prepareBranch Account in the books of Head office.

		₹
Stock at Branch on January 1, 2018		10,000
Branch Debtors on January 1, 2018		4,000
Branch Debtors on Dec. 31, 2018		4,900
Petty cash at branch on January 1, 2018		500
Furniture at branch on January 1, 2018		2,000
Prepaid fire insurance premium on January 1, 2018		150
Salaries outstanding at branch on January 1, 2018		100
Good sent to Branch during the year		80,000
Cash Sales during the year		1,30,000
Credit Sales during the year		40,000
Cash received from debtors		35,000
Cash paid by the branch debtors directly to the Head Office		2,000
Discount allowed to debtors		100
Cash sent to branch for Expenses:		
Rent	2,000	
Salaries	2,400	
Petty Cash	1,000	
Annual Insurance up to March 31, 2019	600	6,000
Goods returned by the Branch		1,000
Goods returned by the debtors		2,000
Stock on December 31,2018		5000
Petty Cash spent by branch		850
Provide depreciation on furniture 10% p.a.		

Goods costing Rs.1,200 were destroyed due to fire and a sum of Rs.1,000 was received from the InsuranceCompany (RTP Nov 19)

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Answer 14

Pune Branch Account

Particulars		₹	Particulars	₹	₹
To Opening Balance			By Opening Balance:		
Stock		10,000	Salaries outstanding		100
Debtors		4,000	By Remittances:		
Petty Cash		500	Cash sales	1,30,000	
Furniture		2,000	Cash received fromdebtors	35,000	
Prepaid Insurance		150	Cash paid by debt-orsdirectly to H.O.	2,000	
To Goods sent to Branch Account		80,000	Received fromInsurance Company	1,000	1,68,000
To Bank (expenses)			By Goods sent to branch		1,000
Rent	2,000		(return of goods by		
Salaries	2,400		the branch to H.O.)		
Petty Cash	1,000		By Closing Balances:		
Insurance	600	6,000	Stock		5,000
To Net Profit		78,950	Petty Cash		650
			Debtors		4,900
			Furniture (2,000 – 10% depreciation)		1,800
			Prepaid insurance (1/4 x Rs.600)		150
		1,81,600			1,81,600

Working Note:

Calculation of petty cash balance at the end:	₹
Opening balance	500
Add: Cash received form the Head Office	1,000
Total Cash with branch	1,500
Less: Spent by the branch	850
Closing balance	650

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Question 15

Pass necessary Journal entries in the books of an independent Branch of M/s TPL Sons, wherever required, to rectify or adjust the following transactions:

(i) Branch paid ₹ 5,000 as salary to a Head Office Manager, but the amount paid has been debited by theBranch to Salaries Account.

(ii) A remittance of ₹ 1,50,000 sent by the Branch has not received by Head Office on the date ofreconciliation of Accounts.

(iii) Branch assets accounts retained at head office, depreciation charged for the year ₹ 15,000 notrecorded by Branch.

(iv) Head Office expenses ₹ 75,000 allocated to the Branch, but not yet been recorded by the Branch.

(v) Head Office collected ₹ 60,000 directly from a Branch Customer. The intimation of the fact has not beenreceived by the Branch.

(vi) Goods dispatched by the Head office amounting to ₹ 50,000, but not received by the Branch till date ofreconciliation.

(vii) Branch incurred advertisement expenses of ₹ 10,000 on behalf of other Branches, but not recorded inthe books of Branch.

(viii) Head office made payment of ₹ 16,000 for purchase of goods by branch, but not recorded in branchbooks. (RTP Nov 18, Old & New SM)

Answer 15

Books of BranchJournal Entries

			Amounts₹	
			Dr.	Cr.
(i)	Head Office Account	Dr.	5,000	
	To Salaries Account (Being rectification of salary paid on behalf of Head Office)			5,000
(ii)	No entry in Branch Books is required.			
(iii)	Depreciation A/c	Dr.	15,000	
	To Head Office Account			15,000
	(Being depreciation of assets accounted for)			
(iv)	Expenses Account	Dr.	75,000	
	To Head Office Account (Being allocated expenses of Head Office recorded)			75,000
(v)	Head Office Account	Dr.	60,000	
	To Debtors Account (Being adjustment entry for collection from Branch Debtorsdirectly by Head Office)			60,000
(vi)	Goods in-transit Account	Dr.	50,000	

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	To Head Office Account (Being goods sent by Head Office still in-transit)			50,000
(vii)	Head Office Account	Dr.	10,000	
	To expenses Account (Being expenditure incurred, wrongly recorded in books)			10,000
(vii)	Purchases account A/c	Dr.	16,000	
	To Head Office Account (Being purchases booked)			16,000

Question 16

Mr. Chena Swami of Chennai trades in Refined Oil and Ghee. It has a branch at Salem. He despatches 30tins of Refined Oil @ ₹ 1,500 per tin and 20 tins of Ghee @ ₹ 5,000 per tin on 1st of every month. The Branch has incurred expenditure of ₹ 45,890 which is met out of its collections; this is in addition toexpenditure directly paid by Head Office.

Following are the other details:

	Chennai H.O.	Salem B.O.
	Amount (₹)	Amount (₹)
Purchases:		
Refined Oil	**27,50,000**	
Ghee	**48,28,000**	
Direct Expenses	**6,35,800**	
Expenses paid by H.O.		**76,800**
Sales:		
Refined Oil	**24,10,000**	**5,95,000**
Ghee	**38,40,500**	**14,50,000**
Collection during the year		**20,15,000**
Remittance by Branch to Head Office		**19,50,000**

Chennai H.O.		
Balance as on	01-04-2020 Amount (₹)	31-03-2021 Amount (₹)
Stock:		
Refined Oil	44,000	8,90,000
Ghee	10,65,000	15,70,000
Building	5,10,800	7,14,780
Furniture & Fixtures	88,600	79,740
Salem Brach Office		

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Balance as on	01-04-2020 Amount (₹)	31-03-2021 Amount (₹)
Stock:		
Refined Oil	22,500	19,500
Ghee	40,000	90,000
Sundry Debtors	1,80,000	?
Cash in hand	25,690	?
Furniture & Fixtures	23,800	21,420

Additional information:

(i) **Addition to Building on 01-04-2020 ₹ 2,41,600 by H.O.**

(ii) **Rate of depreciation: Furniture & Fixtures @ 10% and Building @ 5% (already adjusted in the abovefigure)**

(iii) **The Branch Manager is entitled to 10% commission on Branch profits (after charging his commission).**

(iv) **The General Manager is entitled to a salary of ₹ 20,000 per month.**

(v) **General expenses incurred by Head Office is 1,86,000.**

You are requested to prepare Branch Account in the Head Office books and also prepare Chena Swami's Trading and Profit & loss Account (excluding branch transactions) for the year ended 31st March, 2021. (RTP May '22) (Same concept different figures Old & New SM)

Answer 16

In the books of Mr. Chena Swami Salem Branch Account

		₹		₹
To	Balance b/d Opening stock:		By Bank (Remittance to H.O.)	19,50,000
	Ghee	40,000	By Balance c/d	
	Refined Oil	22,500	Closing stock:	
	Debtors	1,80,000	Refined oil	19,500
	Cash on hand	25,690	Ghee	90,000
	Furniture & fittings	23,800	Debtors (W.N. 1)	2,10,000
To	Goods sent to Branch A/c		Cash on hand (W.N. 2)	44,800
	Refined Oil (30 x ₹ 1,500x12)	5,40,000	Furniture & fittings	21,420
	Ghee (20 x ₹ 5,000 x12)	12,00,000		
To	Bank (Expenses paid by H.O.)	76,800		
To	Manager's commission in profits			

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	10% (2,26,930x10/110)	20,630		
To	Net Profit transferred			
	to General P & L A/c	2,06,300		
		23,35,720		**23,35,720**

Mr. Chena Swami Trading and Profit and Loss account for the year ended 31st March, 2021 (Excluding branch transactions)

		₹			₹
To	Opening Stock:		By	Sales:	
	Refined Oil	44,000	Refined Oil		24,10,000
	Ghee	10,65,000	Ghee		38,40,500
To	Purchases:		By	Closing Stock:	
	Refined Oil 27,50,000		Refined Oil		8,90,000
	Less: Goods sent to Branch (5,40,000)	22,10,000	Ghee		15,70,000
	Ghee 48,28,000				
	Less: Goods sent to Branch (12,00,000)	36,28,000			
To	Direct Expenses	6,35,800			
To	Gross Profit	11,27,700			
		87,10,500			87,10,500
To	Manager's Salary	2,40,000	By	Gross Profit	11,27,700
To	General Expenses	1,86,000	By	Branch Profit transferred	2,06,300
To	Depreciation				
	Furniture (88,600 - 79,740)	8,860			
	Building (5,10,800 + 2,41,600 - 7,14,780)	37,620			
To	Net profit	8,61,520			
		13,34,000			**13,34,000**

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Working Notes:

(1) **Debtors Account**

	₹		₹
To Balance b/d	1,80,000	By Cash Collections	20,15,000
To Sales made during		By Balance c/d	2,10,000
the year:		(Bal. Figure)	
Refined oil	5,95,000		
Ghee	14,50,000		
	22,25,000		**22,25,000**

Branch Cash Account

	₹		₹
To Balance b/d	25,690	By Remittance	19,50,000
To Collections	20,15,000	By Exp.	45,890
		By Balance c/d (Bal. Figure)	44,800
	20,40,690		**20,40,690**

Question 17

PQR has a branch at Houston (USA). Business of the Branch is carried out substantially independent by way of accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowing in its local currency. The trial balance of the Branch as at 31st March, 2022 is as follows:

	US$	
Particulars	**Debit**	**Credit**
Office equipment (Cost)	**56,400**	
Opening Accumulated Depreciation (Officeequip-ment)		**5,400**
Furniture and Fixtures (Cost)	**36,000**	
Opening Accumulated Depreciation		**6,840**
(Furniture and Fixtures)		
Opening Stock as on 1st April, 2021	**24,500**	
Purchases	**96,500**	
Sales		**1,76,250**
Salaries	**4,250**	
Carriage inward	**256**	
Rent, Rates & Taxes	**956**	
Trade receivables	**12,560**	

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Trade payables		**8,650**
Cash at bank	**2,540**	
Cash in hand	**500**	
Head office Account		**37,322**
Total	**2,34,462**	**2,34,462**

Following further information are given:

(i) **Salaries outstanding as on 31st March, 2022 is US$ 600.**

(ii) **Depreciate office equipment and furniture & fixtures @ 10% at written down value.**

(iii) **Closing stock as on 31st March, 2022 is US $, 24,650.**

(iv) **You are informed that the Head office is showing receivable from the Branch as ₹ 23,75,614 as on 31st March, 2022. No transaction in respect of the Branch is pending in Head office.**

(v) **Office equipment (cost) includes one office equipment of US $ 2,400 purchased on 1/04/2021.**

(vi) **One furniture of carrying value of US $ 450 as on 01/04/2021 (cost: US $ 500 and Accumulated depreciation: US $ 50) has been sold for US $ 405 on 31/03/2022 to Mr. M at no profit no loss. Mr. M has not paid the amount till the finalization of branch account. No entry has been passedfor this sale of furniture in the above trial balance.**

(vii) **The rate of exchange on different dates are:**

Date	1 US $ is equivalent to
1st April, 2021	**₹ 64**
31st December, 2021	**₹ 70**
31st March, 2022	**₹ 75**
Average for the year	**₹ 72**

You are required to prepare the trial Balance after incorporating adjustments given and converting US $into rupees. (RTP May 23)

Answer 17

In the books of PQR Trial Balance (in Rupees) of Houston (USA) Branch – Non-Integral foreign operation as on 31st March, 2022

	Dr.	Cr.	Conver-sion	Dr.	Cr.
	US $	US $	rate	₹	₹
Office Equipment	56,400		75	42,30,000	
Depreciation on Office Equipment (Accumulated)		10,500	75		7,87,500
(5,400+5,100)					
Depreciation	8,016		75	6,01,200	
Furniture and fix-tures(36,000-500)	35,500		75	26,62,500	

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Depreciation on furniture andfixtures (Accumulated)		9,661	75		7,24,575
(6,840-50-45 +2,916)					
Stock (1st April, 2021)	24,500		64	15,68,000	
Purchases	96,500		72	69,48,000	
Sales		1,76,250	72		126,90,000
Carriage inward	256		72	18,432	
Salaries (4,250+600)	4,850		72	3,49,200	
Rent, rates and taxes	956		72	68,832	
Salaries payable		600	75		45,000
Head Office A/c		37,322			23,75,614
					(given)
Trade receivables	12,560		75	9,42,000	
Trade payables		8,650	75		6,48,750

Cash at bank	2,540		75	1,90,500	
Cash in hand	500		75	37,500	
Mr. M	405		75	30,375	
(Receivable for sale of					
furniture)					
Exchange gain (bal. fig.)					3,75,100
	2,42,983	**2,42,983**		**176,46,539**	**176,46,539**

Closing stock 24,650 US$ x ₹ 75 =₹18,48,750.

Question 18

Ayan Ltd. invoices goods to its branch at cost plus 33 % . From the following particulars prepare Branch Stock Account, Branch Stock Adjustment Account and Branch Profit and Loss Account as they would appear in the books of head office.

	Rs.
Stock at commencement at Branch at invoice Price	**3,60,000**
Stock at close at Branch at Invoice Price	**2,88,000**
Goods sent to Branch during the year at invoice price (including goods in-voiced **at Rs. 48,000 to Branch on 31.03.2018 but not received by Branch before close o f the year).**	**24,00,000**
Return of goods to head office (invoice Price)	**1,20,000**
Credit Sales at Branch	**1,20,000**

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Invoice value of goods pilfered	**24,000**
Normal loss at Branch due to wastage and deterioration of stock (at invoice price)	**36,000**
Cash Sales at Branch	**21,60,000**

Ayan closes its books on 31st March, 2018. (PYP May '18, 10 Marks)

Answer 18

In the books of Head Office Branch Stock Account

Particular	Rs.	Particular	Rs.
To Balance b/d	3,60,000	By Bank A/c (cash Sales)	21,60,000
To Goods sent to Branch A/c	24,00,000	By Branch Debtors A/c (Credit Sales)	1,20,000
To Branch Adjustment	36,000	By Goods sent to Branch A/c (Re-turnsto H.O.)	1,20,000
A/c balancing fig. (Sur-plus)***		By Branch Adjustment A/c*(Rs.24,000x 25/100)	6,000
		By Branch P&L A/c* (Cost of Abnor-malLoss)	18,000
		By Branch Adjustment A/c**(in-voiceprice of normal loss	36,000
		By Balance c/d:	
		In hand	2,88,000
		In transit	48,000
	27,96,000		**27,96,000**

***Alternative, combined posting for the amount of Rs.24,000 may be passed through Goods preferred account.**

**** Alternatively, it may first be transferred to normal Loss account which may ultimately be closed bytransfer to Branch Adjustment account. The final amount of net profit will however remain same.**

***** It has been considered that the surplus may be due to sale of goods by branch at price high**invoice price.

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Branch Stock Adjustment Account

Particulars	Rs.	Particulars	Rs.
To Branch Stock A/c	6,000	By Stock Reserve A/c	90,000
(Loading on Abnormal Loss)		(Rs. 3,60,000x25/100)	
To Branch Stock A/c	36,000	By Goods Sent to Branch A/c	5,70,000
(Normal Loss)		(Rs.24,00,000 - Rs.1,20,000) x 25/100	
To Stock Reserve A/c	84,000	By Branch Stock A/c (Surplus)	36,000
(Rs.3,36,000x25/100)			
To Gross Profit t/f to P & LA/c	5,70,000		
	6,96,000		**6,96,000**

Branch Profit and Loss Account

Particulars	Rs.	Particulars	Rs.
To Branch Stock A/c	18,000	By Branch Adjustment A/c	5,70,000
(Cost of Abnormal Loss)		(Gross Profit)	
To Net Profit t/f to General P&LA/c	5,52,000		
	5,70,000		**5,70,000**

Question 19

Give Journal Entries in the books of Branch to rectify or adjust the following:

(1) Branch paid ₹ 5,000 as salary to H.O supervisor, but the amount paid by branch has been debitedto salary account in the books of branch.

(2) Asset Purchased by branch for ₹ 25,000, but the Asset account was retained in H.O Books.

(3) A remittance of ₹8,000 sent by the branch has not been received by H.O.

(4) H.O collected ₹ 25,000 directly from the customer of Branch but fails to give the intimation tobranch.

(5) Remittance of funds by H.O to branch ₹5,000 not entered in branch books. (PYP 5 Marks Jan 21)

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Answer 19

Journal Entries in Books of Branch A

	Particulars	Dr. Amount ₹	Cr. Amount ₹
(i)	Head office account Dr.	5,000	
	To Salaries account (Being the rectification of salary paid on behalf of H.O.)		5,000
(ii)	Head office account Dr.	25,000	
	To Bank / Liability A/c (Being Asset purchased by branch but Asset account retained at head office books)		25,000
(iii)	No Entry in Branch Books		
(iv)	Head office account Dr.	25,000	
	To Debtors account (Being the amount of branch debtors collected by H.O.)		25,000
(v)	Bank A/c Dr.	5,000	
	To Head Office (Remittance of Funds by H.O. to Branch)		5,000

Question 20

Manohar of Mohali has a branch at Noida to which the goods are supplied from Mohali but the cost thereof is not recorded in the Head Office books. On 31st March, 2020 the Branch Balance Sheet was as follows:

Liabilities	₹	Assets	₹
Creditors Balance	62,000	Debtors Balance	2,24,000
Head Office	1,88,000	Building Extension A/c	
		Closed by transfer to H.O. A/c	-
		Cash at Bank	26,000
	2,50,000		2,00,000

During the six months ending on 30-09-2020, the following transactions took place at Noida:

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	₹		₹
Sales	2,78,000	Manager's salary	16,400
Purchases	64,500	Collections from debtors	2,57,000
Wages Paid	24,000	Discounts allowed	16,000
Salaries (inclusive of advance of 5,000)	15,600	Discount earned	4,600
General Expenses	7,800	Cash paid to creditors	88,500
Fire Insurance (Paid for oneyear)	11,200	Building Account (further payment)	14,000
Remittance to H.O.	52,900	Cash in Hand	5,600
		Cash at Bank	47,000

Set out the Head Office Account in Noida Books and the Branch Balance Sheet as on 30.09.2020. Also give journal entries in the Noida books. (PYP July '21,10 Marks) (Same concepts different figures Old & New SM)(MTP 10 Marks Sep '23)

Answer 20

Journal Entries in the Books of Noida Branch

Particulars		Debit (₹)	Credit (₹)
Salary Advance A/c	Dr.	5,000	
To Salaries A/c			5,000
(Being the amount paid as advance adjusted by debit to SalaryAdvance A/c)			
Prepaid Insurance A/c (11,200 X 6/12)	Dr.	5,600	
To Fire Insurance A/c			5,600
(Being the six months premium transferred to the PrepaidInsurance A/c)			
Head Office A/c	Dr.	1,44,900	
To Purchases A/c			64,500
To Wages A/c			24,000
To Salaries A/c (15,600 – 5000)			10,600
To General Expenses A/c			7,800
To Fire Insurance A/c (11,200 X 6/12)			5,600
To Manager's Salary A/c			16,400
To Discount Allowed A/c			16,000
(Being the transfer of various revenue accounts to the HO A/cfor closing the accounts)			
Sales A/c	Dr.	2,78,000	
Discount Earned A/c	Dr.	4,600	

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To Head Office A/c			2,82,600
(Being the transfer of various revenue accounts to HO)			
Head Office A/c	Dr.	14,000	
To Building A/c			14,000
(Being the transfer of amounts spent on building extension toHO A/c)			

Head Office **Account**

2020	Particulars	Amount (₹)	2020	Particulars	Amount (₹)
Sept 30	To Cash Remittance	52,900	April 1	By Balance b/d	1,88,000
	To Sundries* (Revenue)	1,44,900		By Sundries* (Revenue)	2,82,600
	To Building A/c	14,000			
	To Balance c/d	2,58,800			
	Total	4,70,600		Total	4,70,600

*** Instead of using Sundries (Revenue) A/c, the concerned revenue accounts can be posted in the ledger.**

Balance Sheet of Noida Branch As at 30thSept 2020

Liabilities	Amt (₹)	Assets	Amt (₹)
Creditors	33,400	Debtors	2,29,000
Head Office A/c	2,58,800	Salary Advance	5,000
		Prepaid Insurance	5,600
		Building Extension A/c transferred to HO	
		Cash in Hand	5,600
		Cash at Bank	47,000
Total	2,92,200	Total	2,92,200

Working Notes

Cash and Bank Account

Particulars	Amt (₹)	Particulars	Amt (₹)
To Balance b/d	26,000	By Wages	24,000
To Collection from debtors	2,57,000	By Salaries	15,600
		By Insurance	11,200
		By General Expenses	7,800
		By HO A/c	52,900
		By Manager's Salary	16,400
		By Creditors	88,500

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		By Building A/c	14,000
		By Balance c/d	
Total		- Cash in Hand	5,600
		- Cash at bank	47,000
	2,83,000	Total	2,83,000

Debtors Account

Particulars	Amt (₹)	Particulars	Amt (₹)
To Balance b/d	2,24,000	By Cash Collection	2,57,000
To Sales A/c	2,78,000	By Discount (Allowed)	16,000
		By Balance c/d	2,29,000
Total	5,02,000	Total	5,02,000

Creditors Account

Particulars	Amt (₹)	Particulars	Amt (₹)
To Cash A/c	88,500	By Balance b/d	62,000
To Discount (Earned)	4,600	By Purchases	64,500
To Balance c/d	33,400		
Total	1,26,500	Total	1,26,500

Note: Since the date of payment of fire insurance has not been mentioned in the Question, it is assumed that itwas paid on 01 April 2020. Alternative Answer considering otherwise also possible.

Question 21

Delta Ltd. Has a branch at Kanpur. Goods are invoiced from head office to Branch at cost plus 50%. Branchremits all cash received to head office and all expenses are met by head office. Prepare necessary Ledger accounts in the books of Delta Ltd. Under Stock and Debtors system to show profit earned at the branch for the year ending 31 st March, 2021.

Following information related to Branch is given:

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Stock on 1st April, 2020 (Invoice price)	**31,200**	**Goods returned by Debtors**	**3,000**
Debtors on 1st April, 2020	**17,400**	**Surplus in stock (Invoice price)**	**600**
Goods invoiced at cost	**72,000**	**Expenses at Branch**	**13,400**
Sales at Branch: Cash sales	**20,000**	**Discount allowed to Debtors**	**700**
Credit sales	**68,200**	**Debtors on 31st March, 2021**	**14,300**

(PYP 10 Marks, Dec '21)

Answer 21

Books of Delta Ltd.

Kanpur Branch Stock Account

	₹		₹
To Balance b/d – Opening Stock	31,200	By Bank A/c – Cash Sales	20,000
To Branch Debtors A/c – Sales Return	3,000	By Branch Debtors A/c - Credit Sales	68,200
To Goods sent to Branch A/c(72,000 +50% of 72,000)	1,08,000	By Balance c/d - Closing stock	54,600
To Surplus in stock	600		
	1,42,800		1,42,800

Kanpur Branch Stock Adjustment Account

	₹		₹
To Branch Profit and Loss Account	28,400	By Balance b/d (1/3 of ₹ 31,200)	10,400
To Balance c/d (1/3 of 54,600)	18,200	By Goods sent to Branch A/c(1/3 of ₹ 1,08,000)	36,000
		By Surplus in stock	200
	46,600		46,600

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Goods Sent to Branch Account

	₹		₹
To Kanpur Branch Stock Adjustment A/c	36,000	By Kanpur Branch Stock A/c	1,08,000
To Purchases A/c	72,000		
	1,08,000		1,08,000

Branch Debtors Account

	₹		₹
To Balance b/d	17,400	By Bank (Bal fig.)	67,600
To Branch Stock A/c	68,200	By Branch Expenses A/c (Dis-countallowed)	700
		By Branch Stock - Sales Returns	3,000
		By Balance c/d	14,300
	85,600		85,600

Branch Expenses Account

	₹		₹
To Bank A/c (expenses)	13,400	By Branch Profit & Loss A/c (Transfer)	14,100
To Branch Debtors A/c (Discount allowed)*	700		
	14,100		14,100

Branch Profit & Loss Account for the year ending 31st March 2021

	₹		₹
To Branch Expenses A/c	14,100	By Branch Adjustment A/c	28,400
To Net Profit	14,700	By surplus in stock (Cost)	400
	28,800		28,800

Note: * Discount allowed to debtors may be shown in Branch Profit and Loss account directly instead oftransferring it through Branch Expenses account.

Question 22

Walkaway Footwears has its head office at Nagpur and Branch at Patna. It invoiced goods to its branch at 20% less than the list price which is cost plus 100%, with instruction that cash sales were to be made at invoice price and credit sales at catalogue price (i.e. list price).

The following information was available at the branch for the year ended 31 st March,2022.

(Figures in ₹)

Stock on 1st April,2021 (invoice price)	**12,000**

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Debtors on 1st April, 2021		**10,000**
Goods received from head office (invoice price)		**1,32,000**
Sales:		
Cash	**46,000**	
Credit	**1,00,000**	**1,46,000**
Cash received. from debtors		**85,000**
Expenses at branch		**17,500**
Debtors on 31st March, 2022		**25,000**
Stock on 31st March,2022 (invoice price)		**17,600**
Remittances to head office		**1,20,000**

You are required to prepare Branch Stock Account, Branch Adjustment Account, Branch Profit & Loss Account and Branch Debtors Account for the year ended 31st March,2022. (PYP 10 Marks May 22)

Answer 22

(a) **In the books of walkaway footwears**

Patna Branch Stock Account

		Particulars	Amount (₹)			Particulars	Amount (₹)
1.1.21	To	Balance b/d	12,000	31.12.21	By	Bank A/c (Cash sales)	46,000
31.12.21	To	Goods sent to branch A/c	1,32,000		By	Branch debtors A/c (credit sales)	1,00,000
	To	Branch adjustment A/c	20,000	31.12.21	By	Shortage in stock A/c	400
		(Surplus overinvoice price)			By	Balance c/d	17,600
			1,64,000				1,64,000

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Patna Branch Adjustment Account

		Particulars	Amount (₹)			Particulars	Amount (₹)
31.12.21	To	Stock reserve - ₹17,600x 60/160 (closing stock)	6,600	31.12.21	By	Stock reserve – ₹12,000x 60/160 (Opening stock)	4,500
	To	Shortage (400x 60/160)	150		By	Goods sent to branch A/c	49,500
	To	Branch profit & loss A/c (Gross profit)	67,250			(₹1,32,000x 60/160)	
					By	Branch stock A/c	20,000
			74,000				74,000

Branch Profit & Loss Account

	Particulars	Amount (₹)		Particulars	Amount (₹)
To	Branch expenses A/c	17,500	By	Branch adjustment A/c	67,250
To	Shortage in stock A/c	250		(Gross Profit)	
To	Net profit (transferred to Profit & Loss A/c)	49,500			
		67,250			67,250

Branch Debtors Account

		Particulars	Amount (₹)			Particulars	Amount (₹)
1.1.21	To	Balance b/d	10,000	31.12.21	By	Bank A/c	85,000
31.12.21	To	Branch stock A/c	1,00,000		By	Balance c/d (bal. fig.)	25,000
			1,10,000				1,10,000

Question 23

Modern Stores of Delhi operates a branch at Nagpur. The Head office affects all purchases and the branch is charged at cost plus 60%. All the cash received by Nagpur Branch is remitted to Delhi. The Branch expenses are met by the Branch out of an Imprest Account which is reimbursed by the Delhi Head Office every month. The Branch maintains a Sales Ledger and certain essential subsidiary records, but otherwise all branch transactions are recorded at Delhi.

The following branch transactions took place during the year ended 31st March, 2022:

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	₹
Goods received from Delhi at Selling Price	1,50,000
Cash Sales	69,000
Goods returned to Delhi at Selling Price	3,000
Credit Sales (Net of returns)	63,000
Authorized Reduction in Selling Price of Goods Sold	1,500
Cash Received from Debtors	48,000
Debtors written off as irrecoverable	2,000
Cash Discount allowed to Debtors	1,500

On 1st April, 2021 the Stock in trade at the Branch at Selling Price amounted to ₹ 60,000 and the Debtors were ₹ 40,000.

A consignment of goods sent to the Branch on 27th March,2022 with a Selling Price of ₹ 1,800 was not received until 5th April,2022 and had not been accounted for in stock.

- **The Closing Stock at Selling Price was ₹ 72,900.**
- **The expenses relating to the Branch for the year ended 31 st March,2022 amounted to 18,000.**

You are required to prepare the Branch Stock Account, Branch Debtors Account, Branch Adjustment Account and Branch Profit and Loss Account maintained at Delhi under Stock and Debtors method. Any stock unaccounted for is to be regarded as normal wastage. (PYP 10 Marks Nov '22)

Answer 23

Books of Modern Store Delhi Nag-purBranch Stock A/c

Particulars	₹	Particulars	₹
To Opening stock	60,000	By Bank A/c (Cash Sales)	69,000
To Goods sent to branch A/c	1,50,000	By Branch Debtors A/c (Credit sales)	63,000
To Goods sent to branch A/c	1,800	By Goods sent to branch A/c (Return)	3,000
		By Branch adjustment A/c (Reduction in selling price)	1,500
		By Branch adjustment A/c (Normal Loss)	600
		By Closing stock (including stock in transit of ₹ 1,800)	74,700
	2,11,800		2,11,800

Branch Debtors A/c

Particulars	₹	Particulars	₹
To Bal. b/d	40,000	By Cash/Bank A/c	48,000

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To Branch Stock (Sales)	63,000	By Branch P&L A/c (Bad debts)	2,000
		By Branch P&LA/c (Discount)	1,500
		By Bal. c/d	51,500
	103,000		103,000

Branch Adjustment A/c

Particulars	₹	Particulars	₹
To Branch Stock Account (Reduction in selling price)	1,500	By Stock reserve A/c (60,000 X 60/160)	22,500
To Branch Stock Account (Normal loss*)	600	By Goods sent to branch A/c (Loading) (1,51,800 X 60/160)	56,925
To Goods sent to branch A/c (loading on returns) (3,000 X 60/160)	1,125		
To Branch P&L A/c	48,187		
To Stock reserve A/c (74,700 X 60/160)	28,013**		
	79,425		79,425

Note: * Alternatively, the loading of ₹ 225 on normal loss may be charged to Branch AdjustmentA/c and cost ₹375 thereof may be charged to Branch P&L A/c.

**** rounded off. Alternatively may be rounded off as ₹ 28,012.**

Branch P&L A/c

Particulars	₹	Particulars	₹
To Branch expenses A/c	18,000	By Branch Adjustment A/c	48,187
To Bad debts A/c	2,000		
To Discount A/c	1,500		
To Net Profit	26,687		
	48,187		**48,187**

Question 24

Artis Limited has a branch at Seattle USA. Its Trial Balance as on 31thDecember 2022 is as follows:

	Dr. in US $	Cr. In US $
Stock as on 01.01.2022	**22,000**	
Purchases	**1,00,000**	

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Sales		**1,30,500**
Goods from H.O.	**30,000**	
Salaries	**4,000**	
Head Office A/c.		**27,000**
Sundry Debtors	**2,200**	
Sundry Creditors		**1,500**
Cash at Bank & Hand	**800**	
Total	**1,59,000**	**1,59,000**

The following information is **given:**

i) **Salaries outstanding are $ 500.**

ii) **The Head Office sent goods to Branch for Rs. 24,00,000.**

iii) **The Head Office shows an amount of Rs. 21,90,000 due from Branch.**

iv) **The exchange rates were as below:**

- **On 1st January 2022 -Rs. 79 to 1$**
- **On 31st December 2022-Rs. 83 to 1 $**
- **Average rate during the year was Rs. 79.50 to 1 $**

You are required to prepare the Seattle Branch Trial Balance incorporating adjustments given above, converting dollars into rupees. (PYP 5 Marks May '23)

Answer 24

Seattle Branch Trial balance (in Rs.)

Particulars	Rate as per Rs.	Debit Rs.	Credit Rs.
Stock (01-01-2022)	79.00	17,38,000	
Purchases	79.50	79,50,000	
Sales	79.50		1,03,74,750
Goods from HO	Given	24,00,000	
Salaries ($ 4,000 + $ 500 = $ 4,500 x Rs.79.50)1	79.50	3,57,750	
Head Office A/c	Given		21,90,000
Sundry Debtors	83.00	1,82,600	
Sundry Creditors	83.00		1,24,500
Cash at Bank & Hand	83.00	66,400	
Salaries Outstanding ($ 500 x Rs. 83)	83.00		41,500
Exchanggain		**36,000**	
Total		**1,27,30,750**	**1,27,30,750**

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The amount of outstanding salary amounting $ 500 (included in the salaries) may be converted at Rs. 83 andthe salary paid during the year at Rs.79.50. In that case the amount of salaries including outstanding salary debited in the trial balance will be for Rs. 3,59,500 [(4,000 X 79.5 =3,18,000) + (500 x 83= 41,500). In this case,the amount of exchange gain will be computed as Rs. 34,250.

Question 25

Treadmill invoices goods to its branch at cost plus 20%. The branch sells goods for cash as well as on credit. The branch meets its expenses out of cash collected from its debtors and cash sales and remits the balance of cash to head office after withholding ₹ 20,000 necessary for meeting immediate requirements of cash. On 31st March, 2022 the assets at the branch were as follows:

	₹ ('000)
Cash in Hand	**20**
Trade Debtors	**768**
Stock, at Invoice Price	**2,160**
Furniture and Fittings	**1,000**

During the accounting year ended 31st March, 2023 the invoice price of goods dispatched by the head office to the branch amounted to ₹ 2 crore 64 lakhs. Out of the goods received by it, the branch sent backto head office goods invoiced at ₹ 1,44,000. Other transactions at the branch during the year were as follows:

	(₹ '000)
Cash Sales	**19,400**
Credit Sales	**6,280**
Cash collected by Branch from Credit Customers	**5,684**
Cash Discount allowed to Debtors	**116**
Returns by Customers direct to Head office (at invoice price)	**204**
Bad Debts written off	**74**
Expenses paid by Branch	**1,684**

On 1st January, 2023 the branch purchased new furniture for ₹ 2 lakh for which payment was made by head office through a cheque.

On 31st March, 2023 branch expenses amounting to ₹ 12,000 were outstanding and cash in hand was again ₹ 20,000. Furniture is subject to depreciation @ 16% per annum on diminishing balance method.

Prepare Branch Account in the books of head office for the year ended 31st March, 2023. (RTP Nov '23)

Answer 25

In the Head Office Books Branch Accountfor the year ended 31st March, 2023

Profit)			Trade debtors	970
			Stock	2,736
			Furniture and fittings	1,032
	33,208			33,208

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Working Notes:

1) Invoice price and cost

Let cost be	100
So, invoice price	120
Loading	20
Loading: Invoice price	= 20 : 120 = 1 : 6

2) Invoice price of closing stock in branch

Branch Stock Account

	₹ '000		₹ '000
To Balance b/d	2,160	By Goods sent to branch	144
To Goods sent to branch	26,400	By Branch Cash	19,400
		By Branch debtors	6,280
		By Balance c/d (Bal fig)	2,736
	28,560		28,560

Note: adjustment regarding returns by Customers direct to Head office has not been made inbranch stock account.

3) **Closing balance of branch debtors**

Branch Debtors Account

	₹ '000		₹ '000
To Balance b/d	768	By Branch cash	5,684
To Branch stock	6,280	By Branch expenses discount	116
		By Goods sent to Branch (Returns)	204
		By Branch expenses	
		(Bad debts)	74
		By Balance c/d (Bal fig)	970
	7,048		7,048

4) Closing balance of furniture and fittings

Branch Furniture and Fittings Account

	₹ '000		₹ '000
To Balance b/d	1,000	By Depreciation (160+8)	168
To Bank	200	By Balance c/d	1,032
	1,200		1,200

Note: Since the new furniture was purchased on 1st Jan 2023 depreciation will be for 3 months.

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5) Remittance by branch to head office

Branch Cash Account

	₹ '000		₹ '000
To Balance b/d	20	By Branch expenses	1,684
To Branch stock	19,400	By Remittances to H.O.	23,400
To Branch debtors	5,684	By Balance b/d	20
	25,104		25,104

Question 26

If goods are invoiced to branches at cost, trading results of branch can be ascertained by

a. Debtors method.

b. Stock and debtor's method.

c. Either (a) or (b).

Ans: (c)

Question 27

Under branch trading and profit loss account method

d. H.O prepares profit and loss account.

e. Each branch is treated separate entity.

f. Both (a) and (b).

Ans: (c)

Question 28

Goods may be invoiced to branch at

g. Cost or Selling price.

h. Wholesale price.

i. Both (a) and (b).

Ans: (c)

Question 29

Under debtor's method, opening balance of debtors is

j. Debited to branch account.

k. Credited to branch account.

l. Debited to H.O account.

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Ans: (c)

Question 30

Cost of goods returned by branch will have the following effect

m. Goods sent to branch account will be debited.

n. Branch stock account will be credited.

o. (a) and (b).

Ans: (c)

Theoretical Questions Answers

Question 31

Why goods are marked on invoice price by the head office while sending goods to the branch?

Answer 31

Goods are marked on invoice price to achieve the following objectives:

(i) To keep secret from the branch manager, the cost price of the goods and profit made, so that thebranch manager may not start a rival and competitive business with the concern; and

(ii) To have effective control on stock i.e. stock at any time must be equal to opening stock plus goodsreceived from head office minus sales made at branch.

(iii) To dictate pricing policy to its branches, as well as save work at branch because prices have alreadybeen decided.

Question 32

Differentiate Branch Accounts with Departmental accounts.

Answer 32

Branch accounts may be maintained either at branch or at head office and no allocation problem arises since the expenses in respect of each branch can be identified However, Departmental accounts are maintained at one place only. Common expenses are distributed among the departments concerned on some equitable basis considered suitable in the case. For details, refer Para 2 of the Chapter to know the differences.

Question 33

Goods worth Rs 50,000 sent by head office but the branch has received till the closing date goods for worth Rs 40,000 only. Give journal entry in the books of H.O. and branch for goods in transit.

Answer 33

Journal entry in the books of Head Office No entry Journal entry in the books of Branch

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		Rs	Rs
Goods-in-transit account	Dr.	10,000	
To Head Office account (Being goods sent by head office is still in transit)			10,000

Question 34

Alphs having head office in Mumbai has a branch in Nagpur. The branch at Nagpur is an independent branch maintaining separate books of account. On 31.3.20X1, it was found that the goods dispatched by head office for Rs 2,00,000 was received by the branch only to the extent of Rs 1,50,000. The balance goods are in transit. What is the accounting entry to be passed by the branch for recording the goods in transit, in its books?

Answer 34

Nagpur branch must include the inventory in its books as goods in transit.
The following journal entry must be made by the branch:
Goods in transit A/c Dr. 50,000 To Head office A/c 50,000 [Being Goods sent by Head office is still in transit on the closing date]

Question 35

Show adjustment journal entry in the books of head office at the end of April, 20X1 for incorporation of inter-branch transactions assuming that only head office maintains different branch accounts in itsbooks.

A. Delhi branch:

(1) Received

(5) – Rs15,000.

(2) Acceptances sent goods from Mumbai – Rs 35,000 and Rs 15,000 from Kolkata.

(3) Sent goods to Chennai – Rs 25,000, Kolkata – Rs 20,000.

(4) Bill Receivable received – Rs 20,000 from Chennai.

(5) Acceptances sent to Mumbai – Rs 25,000, Kolkata – Rs 10,000.

B. Mumbai Branch (apart from the above) :

(6) Received goods from Kolkata – Rs 15,000, Delhi – Rs 20,000.

(7) Cash sent to Delhi – Rs 15,000, Kolkata – Rs 7,000.

C. Chennai Branch (apart from the above) :

(8) Received goods from Kolkata – Rs 30,000.

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(9) **Acceptances and Cash sent to Kolkata – Rs 20,000 and Rs10,000 respectively.**

D. **Kolkata Branch (apart from the above) :**

(10) **Sent goods to Chennai –35,000.**

(11) **Paid cash to Chennai to Chennai – Rs15,000.**

Answer35

(a) **Journal entry in the books of Head Office**

Date	Particulars	Dr.	Cr.
		Rs	Rs
30th April, 20X1	Mumbai Branch Account	Dr. 3,000	
	Chennai Branch Account Dr.	70,000	
	To Delhi Branch Account		15,000
	To Kolkata Branch Account		58,000
	(Being adjustment entry passed by head office in respect of inter-branch transactions for themonth of April, 20X1)		

Working Note:

Inter – Branch transactions

		Delhi	Mumbai	Chennai	Kolkata
		Rs	Rs	Rs	Rs
A.	Delhi Branch				
(1)	Received goods	50,000 (Dr.)	35,000 (Cr.)		15,000 (Cr.)
(2)	Sent goods	45,000 (Cr.)		25,000 (Dr.)	20,000 (Dr.)
(3)	Received Bills receivable	20,000 (Dr.)		20,000 (Cr.)	
(4)	Sent acceptance	35,000 (Cr.)	25,000 (Dr.)		10,000 (Dr.)
B.	Mumbai Branch				
(5)	Received goods	20,000 (Cr.)	35,000 (Dr.)		15,000 (Cr.)
(6)	Sent cash	15,000 (Dr.)	22,000 (Cr.)		7,000 (Dr.)
C.	Chennai Branch				
(7)	Received goods			30,000 (Dr.)	30,000 (Cr.)
(8)	Sent cash and acceptances			30,000 (Cr.)	30,000 (Dr.)
D.	Kolkata Branch				
(9)	Sent goods			35,000 (Dr.)	35,000 (Cr.)
(10)	Sent cash			15,000 (Dr.)	15,000 (Cr.)

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(11)	Sent acceptances			15,000 (Dr.)	15,000 (Cr.)
		15,000 (Cr.)	3,000 (Dr.)	70,000 (Dr.)	58,000 (Cr.)

Question 36

Give Journal Entries in the books of Branch A to rectify or adjust the following:

(i) Head Office expenses Rs 3,500 allocated to the Branch, but not recorded in the BranchBooks.

(ii) Depreciation of branch assets, whose accounts are kept by the Head Office not providedearlier for Rs 1,500.

(iii) Branch paid Rs 2,000 as salary to a H.O. Inspector, but the amount paid has been debitedby the Branch to Salaries account.

(iv) H.O. collected Rs 10,000 directly from a customer on behalf of the Branch, but nointimation to this effect has been received by the Branch.

(v) A remittance of Rs 15,000 sent by the Branch has not yet been received by the Head Office.

(vi) Branch A incurred advertisement expenses of Rs 3,000 on behalf of Branch B.

Answer 36

Books of Branch A Journal Entries

	Particulars Amount	Rs	Dr. Amount Rs	Cr.
(i)	Expenses account	Dr.	3,500	
	To Head office account			3,500
	Being the allocated expenditure by the head office recorded in branch books)			
(ii)	Depreciation account	Dr.	1,500	
	To Head office account			1,500
	(Being the depreciation provided)			
(iii)	Head office account	Dr.	2,000	
	To Salaries account			2,000
	(Being the rectification of salary paid on behalf of H.O.)			
(iv)	Head office account	Dr.	10,000	
	To Debtors account			10,000
	(Being the adjustment of collection from branchdebtors)			
(v)	No entry in branch books			

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(vi)	Head Office account	Dr.	3,000	
	To Cash account			3,000
	(Being the expenditure on account of Branch B,re-corded in books)			

Note: Entry (vi) Inter branch transactions are routed through Head Office.

Question 37

Widespread invoices goods to its branch at cost plus 20%. The branch sells goods for cash as well as on credit. The branch meets its expenses out of cash collected from its debtors and cash sales and remits the balance of cash to head office after withholding Rs 10,000 necessary for meeting immediate requirements of cash. On 31st March, 20X1 the assets at the branch were as **follows:**

	Rs ('000)
Cash in Hand	**10**
Trade Debtors	**384**
Stock, at Invoice Price	**1,080**
Furniture and Fittings	**500**

During the accounting year ended 31st March, 20X2 the invoice price of goods dispatched by the head office to the branch amounted to Rs 1 crore 32 lakhs. Out of the goods received by it, the branch sent back to head office goods invoiced at Rs 72,000. Other transactions at the branch during the year were as follows:

	(Rs '000)
Cash Sales	**9,700**
Credit Sales	**3,140**
Cash collected by Branch from Credit Customers	**2,842**
Cash Discount allowed to Debtors	**58**
Returns by Customers	**102**
Bad Debts written off	**37**
Expenses paid by Branch	**842**

On 1st January, 20X2 the branch purchased new furniture for Rs 1 lakh for which payment was made by head office through a cheque. On 31st March, 20X2 branch expenses amounting to Rs 6,000 wereout-standing and cash in hand was again Rs 10,000. Furniture is subject to depreciation @ 16% per annum on diminishing balance method Prepare Branch Account in the books of head office for the year ended 31st March, 20X2.

Answer 37

In the Head Office Books Branch Account

for the year ended 31st March, 20X2

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	Rs '000	Rs'000	
To Balance b/d		By Balance b/d	
Cash in hand	10	1 Stock reserve Rs 1,080 × 6	180

Trade debtors	384	By Goods sent to branch A/c(Returns to H.O.)	72
Stock	1,080		
Furniture and fittings	500	By Goods sent to branch A/c(Loading on net goods sentto branch –	
To Goods sent to branchA/c	13,200	$[13,128 \times \frac{1}{6}]$	2,188
To Bank A/c (Payment forfurniture)	100	Bank A/c (Remittance frombranch to H.O.) (W.N.5)	11,700
To Balance c/d reserve $[1470 \times \frac{1}{6}]$	245	By Balance c/d	
		Cash in hand	10
To Net profit transferred toGeneral P/L account	1,096	Trade debtors (W.N.3)	485
		Stock (W.N.1)	1,470
To Balance c/d - Outstanding expenses	6	Furniture and fittings (W.N.4)	516
	16,621		16,621

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Working Notes:

Invoice price and **cost**

Let cost be	100
So, invoice price	120
Loading	20

1. Loading: Invoice price = 20 : 120 = 1 : 6

2. **Memorandum Branch Stock Account**

	Rs '000		Rs '000
To Balance b/d	1,080	By Goods sent to branch	72
To Goods sent to branch	13,200	By Branch Cash	9,700
To Branch debtors	102	By Branch debtors	3,140
		By Balance c/d	1,470
	14,382		14,382

3. **Memorandum Branch Debtors Account**

	Rs '000		Rs '000
To Balance b/d	384	By Branch cash	2,842
To Branch stock	3,140	By Branch expenses discount	58
		By Branch stock (Returns)	102
		By Branch expenses	
		(Bad debts)	37
		By Balance b/d	485
	3,524		3,524

4. **Memorandum Branch Furniture and Fittings Account**

	Rs '000		Rs '000
To Balance b/d	500	By Depreciation [(500x16%)+(100x16%x3/12)]	84
To Bank	100	By Balance c/d	516
	600		600

Note: Since the new furniture was purchased on 1st Jan 20X2 depreciation will be for 3months.

5. **Memorandum Branch Cash Account**

	Rs '000		Rs '000
To Balance b/d	10	By Branch expenses	842
To Branch stock	9,700	By Remittances to H.O. (b.f)	11,700
To Branch debtors	2,842	By Balance b/d	10
	12,552		12,552

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Question 38

On 31st March, 20X2 Kanpur Branch submits the following Trial Balance to its Head Office at Lucknow :

Debit Balances	Rs in lacs
Furniture and Equipment	18
Depreciation on furniture	2
Salaries	25
Rent	10
Advertising	6
Telephone, Postage and Stationery	3
Sundry Office Expenses	1
Stock on 1st April, 20X1	60
Goods Received from Head Office	288
Debtors	20
Cash at bank and in hand	8
Carriage Inwards	7
	448
Credit Balances	
Outstanding Expenses	3
Goods Returned to Head Office	5
Sales	360
Head Office	80
	448

Additional Information:

Stock on 31st March, 20X2 was valued at Rs 62 lacs. On 29th March, 20X2 the Head Office dispatched goods costing Rs 10 lacs to its branch. Branch did not receive these goods before 1st April, 20X2. Hence, the figure of goods received from Head Office does not include these goods. Also, the head office has charged the branchRs 1 lac for centralized services for which the branch has not passed the entry. You are required to:

(i) Pass Journal Entries in the books of the Branch to make the necessary adjustments

(ii) Prepare Final Accounts of the Branch including Balance Sheet, and

Pass Journal Entries in the books of the Head Office to incorporate the whole of the Branch Trial Balance.

Answer 38

(i) Books of Branch Journal Entries

			(Rs in lacs)
		Dr.	Cr.
Goods in Transit A/c	Dr.	10	

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To Head Office A/c			10
(Goods dispatched by head office but not received by branch before 1st April, 20X2)			
Expenses A/c	Dr.	1	
To Head Office A/c			1
(Amount charged by head office for centralised services)			

(ii) Trading and Profit & Loss Account of the Branch for the year ended 31st March, 20X2

	Rs in lacs		Rs in lacs
To Opening Stock	60	By Sales	360
To Goods received from		By Closing Stock including transit	72
Head Office 288+10			
Less: Returns (5)	293		
To Carriage Inwards	7		
To Gross Profit c/d	72		
	432		432
To Salaries	25	By Gross Profit b/d	72
To Depreciation on Furniture	2		
To Rent	10		
To Advertising	6		
To Telephone, Postage & Stationery	3		
To Sundry Office Expenses	1		
To Head Office Expenses (centralised services)	1		
To Net Profit Transferred to			
Head Office A/c	24		
	72		72

Balance Sheet as on 31st March, 20X2

Liabilities	Rs in lacs		Assets	Rs in lacs	
Head Office	80		Furniture & Equipment	20	
Add: Goods in transit	10		Less: Depreciation	(2)	18
Head Office Expenses	1		Stock in hand		62
Net Profit	24		Goods in Transit		10

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		115	Debtors		20
Outstanding Expenses		3	Cash at bank and in hand		8
		118			118

Books of Head Office Journal Entries

		Dr.	Rs	Rs
		Dr.		
Branch Trading Account		Dr.	365	
To Branch Account				365

(The total of the following items in branch trial balance debitedto branch trading account:				
	Rs in lacs			
Opening Stock	60			
Goods received from Head Office	288			
Goods purchased but not received	10			
Carriage Inwards	7)			
Branch Account		Dr.	437	
To Branch Trading Account				437
(Total sales, closing stock and goods returned to Head Office credited to branch trading account, individual amount being as follows:				
	Rs in lacs			
Sales	360			
Closing Stock	62			
Goods in transit	10			
Goods returned to Head Office	5)			
Branch Trading Account		Dr.	72	
To Branch Profit and Loss Account				72
(Gross profit earned by branch credited to Branch Profit and Loss Account)				
Branch Profit and Loss Account		Dr.	48	
To Branch Account				48
(Total of the following branch expenses debited to Branch Profit& Loss Account:				
	Rs in lacs			

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Salaries	25			
Rent	10			
Advertising	6			
Telephone, Postage & Stationery	3			
Sundry Office Expenses	1			
Head Office Expenses	1			
Depreciation on furniture	2)			
Branch Profit & Loss Account		Dr.	24	
To Profit and Loss Account				24
(Net profit at branch credited to general Profit & Loss A/c)				
Branch Furniture & Equipment		Dr.	18	
Branch Stock		Dr.	62	
Branch Debtors		Dr.	20	
Branch Cash at Bank and in Hand		Dr.	8	
Goods in Transit		Dr.	10	
To Branch				118

(Incorporation of different assets at the branch in H.O. books)			
Branch	Dr.	3	
To Branch Outstanding Expenses			3
(Incorporation of Branch Outstanding Expenses in H.O. books)			

Question 39

M/s Marena, Delhi has a branch at Bangalore to which office goods are invoiced at cost plus 25%. The branch sells 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. From the following details, relating to calendar year 20X1, prepare the accounts in the Head Office Ledger and ascertainthe Branch Profit under Stock and Debtors Method'. Branch does not maintain any books of account, but sends weekly returns to the Head Office.

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	Rs
Goods received from Head Office at invoice price	45,00,000
Returns to Heads Office at invoice price	90,000
Stock at Bangalore as on 1st January, 20X1	4,50,000
Sales during the year - Cash	15,00,000
- Credit	27,00,000
Sundry Debtors at Bangalore as on 1st January, 20X1	5,40,000
Cash received from Debtors	24,00,000
Discount allowed to Debtors	45,000
Bad Debts in the year	30,000
Sales returns at Bangalore Branch	60,000
Rent, Rates and Taxes at Branch	1,35,000
Salaries, Wages and Bonus at Branch	4,50,000
Office Expenses	45,000
Stock at Branch on 31st December, 20X1 at invoice price	9,00,000

Answer39

Bangalore Branch Stock Account

Particulars		Amount (Rs)	Particulars		Amount (Rs)
To	Balance b/d Goods sent to	4,50,000	By	Goods sent to branch A/c (Returns)	90,000
	branch A/c	45,00,000	By	Bank A/c (Cash sales)	15,00,000
To	Branch debtors A/c (Returns)	60,000	By	Branch debtors A/c (credit sales)	27,00,000
To	Branch adjustment A/c (Surplus over invoice price)*	1,80,000	By	Balance c/d	9,00,000
		51,90,000			51,90,000

***Alternatively, this may directly be transferred to Branch P&L A/c without routing it throughBranch Adjustment Account.**

Bangalore Branch Adjustment Account

Particulars		Amount (Rs)	Particulars		Amount (Rs)
To	Stock reserve - 20%	1,80,000	By	Stock reserve - 20%	90,000
	of Rs 9,00,000 (closing			of Rs 4,50,000	
	stock)			(Opening stock)	

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To	Branch profit & loss A/c (Gross profit)	9,72,000	By	Goods sent to branch A/c – 20% of	8,82,000
				Rs 44,10,000	
				(45,00,000 – 90,000)	
			By	Branch stock A/c	1,80,000
		11,52,000			11,52,000

Branch Profit & Loss Account

Particulars		Amount (Rs)	Particulars		Amount (Rs)
To	Branch expenses A/c	6,30,000	By	Branch adjustment A/c	9,72,000
To	Branch debtors A/c (Discount)	45,000		(Gross Profit)	
To	Branch Debtors A/c (Bad debts)	30,000			
To	Net profit (transferred to Profit & Loss A/c)	2,67,000			
		9,72,000			9,72,000

Particulars		Amount (Rs)	Particulars		Amount (Rs)
To	Bank A/c (Rent, rates & taxes)	1,35,000	By	Branch profit and loss A/c (Transfer)	6,30,000
To	Bank A/c (Salaries, wages& bonus)	4,50,000			
To	Bank A/c (Office expenses)	45,000			
		6,30,000			6,30,000

Branch Debtors Account

Particulars		Amount (Rs)	Particulars		Amount (Rs)
To	Balance b/d	5,40,000	By	Bank A/c	24,00,000
To	Branch stock A/c	27,00,000	By	Branch profit and loss A/c (Bad debts and discount)	75,000

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			By	Branch stock A/c (Sales returns)	60,000
			By	Balance c/d (bal. fig.)	7,05,000
		32,40,000			32,40,000

Goods sent to Branch Account

Particulars		Amount (Rs)	Particulars		Amount (Rs)
To	Branch stock A/c	90,000	By	Branch stock A/c	45,00,000
To	Branch adjustment A/c	8,82,000			
To	Purchases A/c	35,28,000			
		45,00,000			45,00,000

Question 40

Beta, having head office at Mumbai has a branch at Nagpur. 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 Nagpur is wholly engaged in retail trade and the goods are sold at cost to H.O. plus 100%.

Following details are furnished for the year ended 31st March, 20X1:

	Head Office (Rs)	Branch (Rs)
Opening stock	**2,25,000**	
Purchases	**25,50,000**	
Goods sent to branch (Cost to H.O. plus 80%)	**9,54,000**	
Sales	**27,81,000**	**9,50,000**
Office expenses	**90,000**	**8,500**
Selling expenses	**72,000**	**6,300**
Staff salary	**65,000**	**12,000**

You are required to prepare Trading and Profit and Loss Account of the head office and branch for the year ended 31st March, 20X1.

Answer 40

Trading and Profit and Loss A/c For the year ended 31st March 20X1

	Head office Rs	Branch Rs		Head office Rs	Branch Rs

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To Opening stock	2,25,000	-	By Sales	27,81,000	9,50,000
To Purchases	25,50,000	-	By Goods sent to branch	9,54,000	_
To Goods received from head office	-	9,54,000	By Closing stock (W.N.1 & 2)	7,00,000	99,000
To Gross profit c/d	16,60,000	95,000			
	44,35,000	10,49,000		44,35,000	10,49,000
To Office expenses	90,000	8,500	By Gross profit b/d	16,60,000	95,000
To Selling expenses	72,000	6,300			
To Staff salaries	65,000	12,000			
To Branch Stock Reserve (W.N.3)	44,000	_			
To Net Profit	13,89,000	68,200			
	16,60,000	95,000		16,60,000	95,000

Working Notes:

(1)	Calculation of closing stock of head office:	Rs
	Opening Stock of head office	2,25,000
	Goods purchased by head office	25,50,000
		27,75,000
	Less: Cost of goods sold [37,35,000 x 100/180]	(20,75,000)
		7,00,000
(2)	Calculation of closing stock of branch:	Rs

	Goods received from head office [At invoice value]	9,54,000
	Less: Invoice value of goods sold [9,50,000 x 180/200]	(8,55,000)
		99,000
(3)	Calculation of unrealized profit in branch stock:	
	Branch stock Rs 99,000	
	Profit included 80% of cost	
	Hence, unrealized profit would be = Rs 99,000 x 80/180	Rs 44,000

Question 41

(i) Pass necessary Journal entries in the books of an independent Branch of a business entity to rectifyor adjust **the following:**

(ii) **Income of Rs 2,800 allocated to the Branch by Head Office but not recorded in the Branch books.**

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(iii) **Branch paid Rs3,000 as salary to a Head Office Manager, but the amount paid has beendebited by the Branch to Salaries Account.**

(iv) **Branch incurred travelling expenses of Rs5,000 on behalf of other Branches, this was notrecorded in the books of Branch.**

(v) **A remittance of Rs 1,50,000 sent by the Branch has not received by Head Office on the dateof reconciliation of Accounts.**

(vi) **Head Office allocates Rs75,000 to the Branch as Head Office expenses, which has not yetbeen recorded by the Branch.**

(vii) **Head Office collected Rs30,000 directly from a Branch Customer. The intimation of the fact has been received by the Branch only now, not recorded till now.**

Goods dispatched by the Head office amounting to Rs10,000, but not received by the Branch till date of reconciliation. The Goods have been received **subsequently.**

Answer 41

Books of Branch Journal Entries

			Amount in Rs
Sr. No	Particulars	Dr.	Cr.
(i)	Head Office Account Dr. To Income Account (Being the income allocated by the Head office not recorded earlier, now recorded)	2,800	2,800
(ii)	Head Office Account Dr. To Salaries Account (Being rectification of salary paid on behalf of Head Office)	3,000	3,000
(iii)	Head Office Account Dr. To Cash Account (Being expenditure incurred on account of other branch, now recorded in books)	5,000	5,000
(iv)	No entry in Branch Books is required.		
(v)	Expenses Account Dr. To Head Office Account (Being allocated expenses of Head Office recorded)	75,000	75,000
(vi)	Head Office Account Dr. To Debtors Account (Being adjustment entry for collection from Branch Debtors directly by Head Office)	30,000	30,000

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(vii)	Goods -in- transit AccountTo Head Office Account (Being goods sent by Head Office still in-transit)	Dr.	10,000	10,000

Question42

The Washington branch of XYZ Mumbai sent the following trial balance as on 31st December, 20X1:

	$	$
Head office A/c	_	**22,800**
Sales	_	**84,000**
Debtors and creditors	**4,800**	**3,400**
Machinery	**24,000**	_
Cash at bank	**1,200**	_
Stock, 1 January, 20X1	**11,200**	_
Goods from H.O.	**64,000**	_
Expenses	**5,000**	_
	1,10,200	**1,10,200**

Answer 42

In the books of head office,

the Branch A/c stood as follows:

Washington Branch A/c

		Rs			Rs
To	**Balance b/d**	**8,10,000**	**By**	**Cash**	**28,76,000**
To	**Goods sent to branch**	**29,26,000**	**By**	**Balance c/d**	**8,60,000**
		37,36,000			**37,36,000**

Goods are sent to the branch at cost plus 10% and the branch sells goods at invoice price plus 25%. Machinery was acquired in past, when $ 1.00 = Rs 40. Rates of exchange were:

1st January, 20X1	**$ 1.00**	**=**	**Rs 46**
31st December, 20X1	**$ 1.00**	**=**	**Rs48**
Average	**$ 1.00**	**=**	**Rs 47**

Machinery is depreciated @ 10% and the branch manager is entitled to a commission of 5% on the

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profits of the branch.

You are required to:

(i) Prepare the Branch Trading & Profit & Loss A/c in dollars.

(ii) Convert the Trial Balance of branch into Indian currency and prepare BranchTrading & Profit and Loss A/c and the Branch A/c in the books of head office.

(i) In the Books of Head Office

Branch Trading and Profit & Loss A/c (in Dollars) for the year ended 31stDecember, 20X1for the year ended 31st December, 20X1

	Particulars	$		Particulars	$
To	Opening stock	11,200	By	Sales	84,000
To	Goods from H.O.	64,000	By	Closing stock (W.N.2)	8,000
To	Gross profit c/d	16,800			
		92,000			92,000
To	Expenses	5,000	By	Gross profit b/d	16,800
To	Depreciation (24,000 x 10%)	2,400			
To	Manager's commission (W.N.1)	470			
To	Net profit c/d	8,930			
		16,800			16,800

(a) Converted Branch Trial Balance (into Indian Currency)

Particulars	Rate per $	Dr. (Rs)	Cr. (Rs)
Machinery	40	9,60,000	_
Stock January 1, 20X1	46	5,15,200	_
Goods from head office	Actual	29,26,000	_
Sales	47	_	39,48,000
Expenses	47	2,35,000	_
Debtors & creditors	48	2,30,400	1,63,200
Cash at bank	48	57,600	_
Head office A/c	Actual	_	8,60,000
Difference in exchange rate (b.f.)		47,000	_
		49,71,200	49,71,200
Closing stock $ 8,000 (W.N. 2)	48		Rs 3,84,000

(b) Branch Trading and Profit & Loss A/c for the year ended 31st December, 20X1

		Rs			Rs
To	Opening stock	5,15,200	By	Sales	39,48,000

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To	Goods from head office	29,26,000	By	Closing stock (W.N.2)	3,84,000
To	Gross profit c/d	8,90,800			
		43,32,000			**43,32,000**
To	Expenses	2,35,000	By	Gross profit b/d	8,90,800
To	Depreciation @ 10% on Rs 9,60,000	96,000			
To	Exchange difference	47,000			
To	Manager's commission (W.N.1)	22,560			
To	Net Profit c/d	4,90,240			
		8,90,800			8,90,800

(c) Branch Account

		Rs				Rs
To	Balance b/d	8,60,000	By	Machinery	9,60,000	
To To	Net profit Creditors	4,90,240 1,63,200		Less: Depreciation	(96,000)	
						8,64,000
To	Outstanding		By	Closing stock		3,84,000
	commission	22,560	By	Debtors		2,30,400
			By	Cash at bank		57,600
		15,36,000				15,36,000

Working Notes:

1. **Calculation of manager's commission @ 5% on profit**
2. **Calculation of closing stock**

	$
Opening stock	11,200
Add: Goods from head office	64,000
	75,200
Less: Cost of goods sold (at invoice price) i.e. $100 \frac{100}{125} \times 84,000 =$	(67,200)
Closing stock	8,000

Closing stock in Rupees = $8,000 x Rs 48 = Rs 3,84,000.

Note: Manager is entitled to commission on profits earned at the end of the year.

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Question 43 Illustration

Buckingham Bros, Bombay have a branch at Nagpur. They send goods at cost to their branch at Nagpur. However, direct purchases are also made by the branch for which payments are made at head office. All the daily collections are transferred from the branch to the head office.

From the following, prepare Nagpur branch account in the books of head office by Debtors method:

	Rs		Rs
Opening balance (1-1-20X1) Imprest Cash	2,000	Bad Debts	1,000
Sundry Debtors	25,000	Discount to Customers	2,000
Stock: Transferred from H.O.	24,000	Remittances to H.O.	
Direct Purchases	16,000	(received by H.O.)	1,65,000
Cash Sales	45,000	Remittances to H.O.	
Credit Sales	1,30,000	(not received by H.O. so far)	5,000
Direct Purchases	45,000	Branch Exp. directly paid by H.O.	30,000
Returns from Customers	3,000	Closing Balance (31-12-20X1)	
Goods sent to branch from H.O.	60,000	Stock: Direct Purchase	10,000
Transfer from H.O. for Petty	4,000	Transfer from H.O.	15,000
Cash expenses		Debtors	?
		Imprest Cash	?
		Petty Cash expenses	4,000

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Answer 43

In the Books of Buckingham Bros,

Bombay Nagpur Branch Account

Particulars	Rs	Particulars		Rs
To Opening Branch Assets-		By Bank –		
		Remittances received		
		from branch		
Stock (24,000+16,000)	40,000	Cash Sales	45,000	
Debtors	25,000	Cash from Debtors *	1,20,000	
		Cash in transit *	5,000	1,70,000
Imprest Cash	2,000	By Closing Branch Assets		
To Goods sent to Branch A/c	60,000	Stock (15,000 +10,000)		25,000
To Creditors (Direct urchases)	45,000	Debtors (W.N. 1) Imprest Cash (W.N. 2)		24,000 2,000
To Bank (Sundry exp.)	30,000			
To Bank (Petty cash exp.) To Net Profit transferred to General Profit & Loss A/c	4,000 15,000			
	2,21,000			2,21,000

Working Notes:

1. **Memorandum Debtors A/c**

Particulars		Rs	Particulars		Rs
To	To Bal b/d	25,000	By	By Sales Return	3,000
To	To Sales	130,000	By	By Bad Debts	1,000
			By	By Discount	2,000
			By	By Cash *	125,000
			By	By Bal c/d	24,000
		155,000			155,000

2. **Memorandum Petty Cash**

Particulars	Rs	Particulars	Rs
To Bal b/d	2,000	By Expenses (metby Branch)	4,000
To Transfer from H.O.	4,000	By Bal c/d	2,000
	6,000		6,000

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Collection from Debtors = Total Remittances (1,65,000+5,000) – Cash Sales (45,000) =Rs 1,25,000

Stock and Debtors method

If it is desired to exercise a more detailed control over the working of a branch, the accounts of the branch are maintained under Stock and Debtors Method. According to this method, the following accounts are maintained by the Head Office:

Account	Purpose
1. Branch Stock Account (or Branch Trading Account) 2. Branch Debtors Account	Ascertainment of shortage or surplus Ascertainment of closing balance of debtors
3. Branch Expenses Account	Ascertainment of total expenses incurred
4. Goods sent to Branch Account 5. Branch Cash / Bank Account 6. Branch Fixed Asset Account	Ascertainment of cost of goods sent to branch Know about cash flow at branch (eg: where branch is allowed to incur expenses locally) Control over branch Fixed Assets
7. Branch Profit and Loss Account	Calculation of net profit or loss

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	Cash A/c
(c)	Any asset (e.g. furniture) provided by H.O.	Branch Asset (Furniture) A/c	Asset A/c
(d)	Cost of goods returned by the branch	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	Branch Stock A/c	Branch Debtors A/c

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	to the Branch		
(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.	Cash A/c	Branch Cash A/c
(k)	Branch Expenses directly paid by H.O.	Branch Expenses A/c	Cash A/c
(l)	Expenses met by Branch	Branch Expenses A/c	Branch Cash A/c

(a) Closing Stock: Credit the Branch Stock Account with the value of closing stock at cost.It will be carried down as opening balance (debit) for the next accounting period. The Balance of the Branch Stock Account, (after adjustment therein the value of closing stock), if in credit, will represent the gross profit on sales and vice versa.Other Steps:

(b) Transfer Balance of Branch Stock Account to the Branch Profit and Loss Account.

(c) Transfer Balance of Branch Expenses Account to the debit of Branch Profit & Loss Account.

(d) The balance in the Branch P&L A/c will be transferred to the (H.O.) Profit & Loss Accoun

(e) The credit balance in the Goods sent to Branch Account is afterwards transferred to the Head Office Purchase Account or Trading Account (in case of manufacturing concerns), it being the value of goods transferred to the Branch.

Branch Trading and Profit and Loss Account (Final Accounts Method)

In this method, Trading and Profit and Loss accounts are prepared considering each branch as a separate entity. The main advantage of this method is that, it is easy to prepare and understand. It also gives complete information of all transactions whichare ignored in the other methods. It should be noted that Branch Trading and Profit and Loss account is merely a memorandum account and therefore, the entries madethere in do not have double entry effect.

Question 44 Illustration

From the information given in the illustration 1(a), prepare Nagpur Branch Trading and Profit and Loss Account in the books of head office.

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Answer44

Buckingham Bros. Bombay

Nagpur Branch-Trading and Profit and Loss Account for the year ending 31st December, 20X1

Particulars	Rs	Particulars	Rs	Rs
To Opening Stock	40,000	By Sales		
To Goods transferred from Head Office	60,000	Cash	45,000	
		Credit sales	1,30,000	
To Purchases	45,000		1,75,000	
To Gross Profit c/d	52,000	Less: Returns	(3,000)	1,72,000
		By Closing Stock		25,000
	1,97,000			1,97,000
To Expenses	30,000	By Gross Profit b/d		52,000
To Discounts	2,000			
To Bad Debts	1,000			
To Petty Cash Expenses	4,000			
To Net Profit transferredto General P&L A/c	15,000			
	52,000			52,000

The students may note that Gross Profit and Net Profit earned by the branch are ascertainable in this method and also evaluating the performance of the branch is very much easier in this method than in the 'Debtors method'.Solving Illustration by all three methods

Given below is a simple problem, the solution whereto has been prepared in all the three methods so asto show the distinguishing features of these methods.

Question 45: Illustration 2

The Bombay Traders invoiced goods to its Delhi branch at cost. Head Office paid all the branch expenses from its bank account, except petty cash expenses which were met by the Branch. All the cash collected by the branch was banked on the same day to the credit of the Head Office. The following is a summary of the transactions entered into at the branch during the year ended December 31, **20X1.**

	Rs		Rs
Balances as on 1.1.20X1:			
Stock	**7,000**	**Bad Debts**	**600**
Debtors	**12,600**	**Goods returned by customers**	**500**

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Petty Cash,	200	Salaries & Wages	6,200
Goods sent from H.O.	26,000	Rent & Rates	1,200
Goods returned to H.O.	1,000	Sundry Expenses	800
Cash Sales	17,500	Cash received from Sundry	
Credit Sales	28,400	Debtors	28,500
Allowances to customers	200	Balances as on 31.12.20X1:	
Discount to customers	1,400	Stock	6,500
		Debtors	9,800
		Debtors	100

Prepare: (a) Branch Account (Debtors Method), (b) Branch Stock Account, Branch Profit & Loss Account, Branch Debtors and Branch Expenses Account by adopting the Stock and Debtors Method and (c) Branch Trading and Profit & Loss Account to prove the results as disclosed by the Branch Account.

Answer 45

(a) Debtors Method

Delhi Branch Account

20X1		Rs	Rs	20X1		Rs	Rs
Jan. 1	To Opening branch assets:			Dec31	24 Bank		
	Stock	7,000			Cash Sales	17,500	
	Debtors	12,600			Cash from sundry	28,500	46,000
	Petty cash	200	19,800		Debtors		

Dec. 31	To	Goods sent to Branch A/c		26,000		By	Goods sent toBranch A/c –		

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	To	Bank:					Returns to H.O.		1,000
		Salaries & Wages	6,200			By	Closing branchas-sets		
		Rent & Rates	1,200				Stock	6,500	
		Sundry Exp.	800	8,200			Debtors	9,800	
							Petty Cash	100	16,400
	To	Net profit ts/f to General P&L A/c		9,400					
				63,400					63,400
Jan. 1, 20X2	To	Balance b/d		16,400					

Stock and Debtors Method

Branch Stock Account

20X1			Rs	20X1				Rs
Jan. 1	To	Balance b/d -	7,000	Dec. 31	By	Sales:		
		Opening						
		Stock						
Dec.	To	Goods Sent	26,000			Cash	17,500	
31		to Branch A/c				Credit	28,400	
	To	Branch P&L A/c	19,900			Less: Return	(500)	45,400
					By	Goods sent to		1,000
						Branch A/c -		
						Return		
					By	Balance c/d - Closing Stock		6,500
			52,900					**52,900**
20X2 Jan. 1	To	Balance b/d - Opening Stock	6,500					

Delhi Branch Debtors Account

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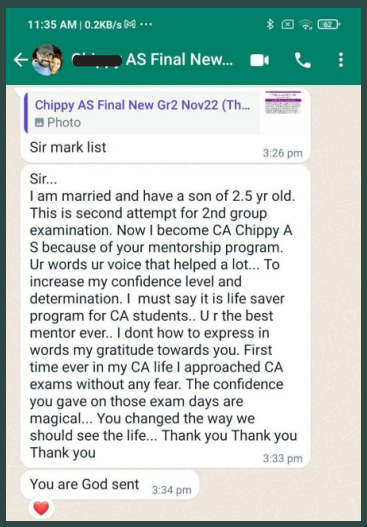

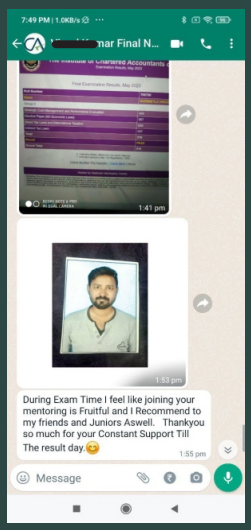

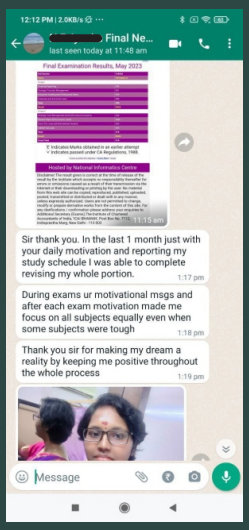

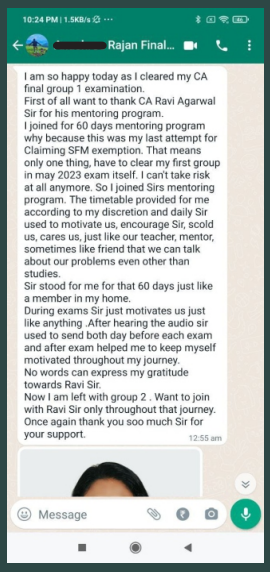

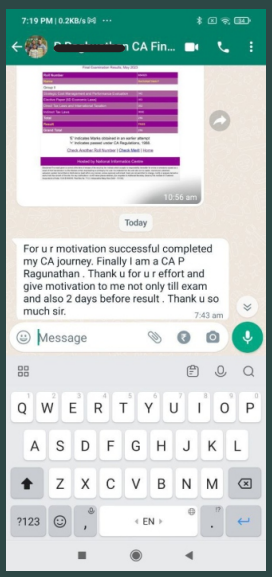

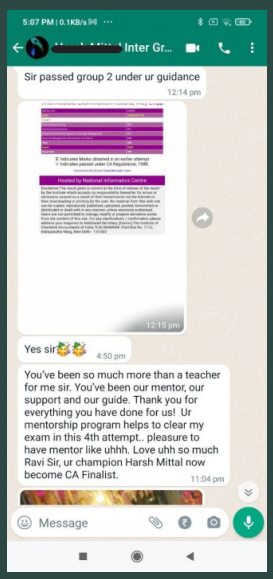

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20X1			Rs	20X1			Rs
Jan. 1	To	Balance b/d	12,600	Dec. 31	By	Cash	28,500
Dec. 31	To	Sales	28,400		By	Returns	500
					By	Allowances	200
					By	Discounts	1,400
					By	Bad debts	600
					By	Balance c/d	9,800
			41,000				41,000
20X2 Jan. 1	To	Balance b/d	9,800				

Delhi Branch Expenses Account

20X1			Rs	20X1			Rs
Dec. 31	To	Salaries & Wages	6,200	Dec. 31	By	Branch P&L A/c	10,500
	To	Rent & Rates	1,200				
	To	Sundry Expenses	800				
	To	Petty Cash expenses 200-100)	100				
	To	Allowance to customers	200				
	To	Discount	1,400				
	To	Bad Debts	600				
			10,500				10,500

Delhi Branch Profit & Loss Account

20X1			Rs	20X1			Rs
Dec. 31	To	Branch Exp. A/c	10,500	Dec.31	By	Gross Profit b/d	19,900
	To	Net Profit ts/f to General P & L A/c	9,400				
			19,900				19,900

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(a) Branch Trading and Profit and Loss Account

		Rs	Rs				Rs	Rs
To	Stock		7,000	By	Sales:			
To	Goods sent				Cash		17,500	
	from H.O.	26,000			Credit	28,400		
	Less: Returns to H.O.	(1,000)	25,000		Less: returns	(500)	27,900	45,400
To	Gross profit c/d		19,900	By	Closing Stock			6,500
			51,900					51,900
To	Salaries & Wages		6,200	By	Gross Profit b/d			19,900
To	Rent & Rates		1,200					
To	Sundry Exp.		800					
To	Petty Cash Exp.		100					
To	Allowances to Customers		200					
To	Discounts		1,400					
To	Bad Debts		600					
To	Net Profit		9,400					
			19,900					19,900

Question 46: Illustration

Harrison of Chennai has a branch at New Delhi to which goods are sent @ 20% above cost. The branch makes both cash and credit sales. Branch expenses are met partly from H.O. and partly by the branch. The statement of expenses incurred by the branch every month is sent to head office for recording.

Following further details are given for the year ended 31st December, 20X1:

			Rs
Cost of goods sent to Branch at cost			**2,00,000**
Goods received by Branch till 31-12-20X1 at invoice price			**2,20,000**
Credit Sales for the year @ invoice price			**1,65,000**
Cash Sales for the year @ invoice price			**59,000**
Cash Remitted to head office			**2,22,500**
Expenses paid by H.O.			**12,000**
Bad Debts written off			**750**
Balances as on	**1-1-20X1**	**31-12-20X1**	
	Rs		**Rs**

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Stock	**25,000 (Cost)**	**28,000 (invoice price)**	
Debtors	**32,750**		**26,000**
Cash in Hand	**5,000**		**2,500**

Show necessary ledger accounts in the books of the head office and determine the Profit or Loss of the Branch for the year ended 31st December, 20X1.

Answer 46

Books of Harrison Branch Stock Account

	Rs		Rs
To Balance b/d – Op Stock	30,000	By Branch Debtors (Sales)	1,65,000
To Goods Sent to Branch A/c	2,40,000	By Branch Cash	59,000
To Branch Adjustment A/c	2,000	By Balance c/d	
(Balancing Figure – Excessof Sale over Invoice Price)		Goods in Transit (Rs 2,40,000 – Rs 2,20,000)	20,000
		Closing Stock at Branch	28,000
	2,72,000		2,72,000

Branch Debtors Account

	Rs		Rs
To Balance b/d	32,750	By Bad debts written off	750
To Branch Stock A/c (Sales)	1,65,000	By Branch Cash (bal. fig.)	1,71,000
		By Balance c/d	26,000
	1,97,750		1,97,750

Branch Cash Account

	Rs		Rs
To Balance b/d	5,000	By Bank Remittance to H.O.	2,22,500
To Branch Stock	59,000	By Branch Expenses	10,000
To Branch Debtors	1,71,000	[met by Branch (Bal. fig.)]	
		By Balance c/d	2,500
	2,35,000		2,35,000

Branch Adjustment Account

	Rs		Rs

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		By Stock Reserve opening (25,000 × 20%)	5,000
To Branch P &L - Gross Profit (Bal. fig.)	39,000	By Goods sent to Branch A/c	40,000
To Stock Reserve (on closing stock (48,000 × 1/6)	8,000	By Branch Stock A/c	2,000
	47,000		47,000

Branch Expenses

	Rs		Rs
To Cash (H.O) To Branch Cash	12,000 10,000	By Branch P&L A/c	22,000
	22,000		22,000

Branch Profit and Loss Account

	Rs		Rs
To Branch Expenses	22,000	By Gross Profit (from Branch Adjustment A/c)	39,000
To Branch Debtors (bad debts)	750		
To Net Profit	16,250		
	39,000		39,000

Goods Sent to Branch Account

	Rs		Rs
To Branch Adjustment A/c	40,000	By Branch to Stock A/c	2,40,000
To Purchase A/c - Transfer	2,00,000		
	2,40,000		2,40,000

(ii) Debtors Method

Under this method, the principal accounts that will be maintained are:

1. The Branch Account;
2. The Goods Sent to Branch Account; and
3. The Stock Reserve Account.
4. Entries in these accounts will be made in the following manner:

	Transaction	Account debited	Account credited

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(a)	Goods sent to Branch at selling price	Branch A/c	Goods Sent to BranchA/c
(b)	'Loading being the difference between selling price and cost of goods	Goods Sent to Branch A/c	Branch A/c
(c)	Returns to H.O. at selling price	Goods Sent to Branch A/c	Branch A/c
(d)	'Loading' in respect of goods returned to H.O.	Branch A/c	Goods Sent to BranchA/c
(e)	'Loading' included in the opening stock to reduce it	Stock Reserve A/c	Branch A/c
(f)	Closing stock at selling price	Branch Stock A/c	Branch A/c
(g)	'Loading' included in closing stock to reduce it to cost	Branch A/c	Stock Reserve A/c

It will be observed that entries in the Branch Account in respect of goods sent to a branch or returned by it, as well as those for the opening and closing stock, will be at selling price. In consequence, the Branch Account is maintained at selling price. Hence, the Branch Account will not correctly show the trading profit of the Branch unless these amounts are adjusted to cost. Such an adjustment is effected by making contra entries in 'Goods Sent to Branch A/c' and 'Stock Reserve Account'. In respect of closingstock at branch for the purpose of disclosure in the Balance Sheet, the credit balance in the 'Stock Reserve Account' at the end of the year will be deducted from the value of the closing stock, so as to reduce it to its cost; it will be carried forward as a separate balance to the following year, for being transferred to the credit of the Branch Account.

Question 47: Illustration

Take figures from Illustration 3 (a) and prepare branch account following debtors' method.

Answer 47

Books of Harrison New Delhi Branch Account

	Rs		Rs
To Balance B/d			
Stock	30,000	By Stock Reserve	5,000
Debtors	32,750		
Cash	5,000		
To Goods Sent to Branch A/c (2,00,000 + 20%)	2,40,000	By Goods Sent to Branch A/c	40,000

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To Cash (Exp. paid by H.O.)	12,000	By Cash – Remittance from branch :	2,22,500
To Net Profit ts/f to H.O. Profit & Loss A/c (Balancing Figure)	16,250	By Balancec/d Debtors	26,000
To Stock reserve (48,000X20/120)	8,000	Stock (including Transit – W.N 2)	48,000
		Cash	2,500
	3,44,000		3,44,000

Working Note:

Closing Stock = Stock at branch + Stock in Transit (Goods sent by HO – Goods Received by Branch) = Rs 28,000 + (Rs 2,40,000 - Rs 2,20,000) = Rs 48,000.

Question 48: Illustration

Sell Well who carried on a retail business opened a branch X on January 1st, 20X1 where all sales were on credit basis. All goods required by the branch were supplied from the Head Office and were invoiced to the branch at 10% above cost.

The following were the transactions:

	Jan. 20X1	Feb. 20X1	March 20X1
	Rs	Rs	Rs
Goods sent to Branch (Purchase Price)	**40,000**	**50,000**	**60,000**
Sales as shown by the branch monthly report	**38,000**	**42,000**	**55,000**
Cash received from Debtors andremit-ted to H.O.	**20,000**	**51,000**	**35,000**
Returns to H.O. (Invoice price to Branch)	**1,200**	**600**	**2,400**

The stock of goods held by the branch on March 31, 20X1 amounted to Rs 53,400 at invoice to branch.Record these transactions in the Head Office books, showing balances as on 31st March, 20X1and the branch gross profit for the three months ended on that date.

All workings should form part of your solution.

Answer 48

Books of Sell Well Branch Account

	Rs			Rs
To Goods sent to Branch A/c(1,50,000+10%)	1,65,000	By Goods sent to Branch-Loading		15,000

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To Goods sent to Branch A/c(4,200 X 10/110)	382	By Goods sent to Branch- returns		4,200
To Stock Reserve (53,400 X 10/110)	4,855	By Bank		1,06,000
To Net Profit (Bal fig) ts/f to General P&L A/c	37,363	By Balance c/d - Closing Branch Assets Stock	53,400	
		Debtors (Sales-Collection	29,000	82,400
	2,07,600			2,07,600

Working Note:

Memorandum Branch Debtors Account

	Rs		Rs
To Balance b/d	---	By Cash/Bank	1,06,000
To Sales	1,35,000	By Balance c/d	29,000
	1,35,000		1,35,000

Goods Sent to Branch Account

	Rs		Rs
To Branch A/c – Loading	15,000	By Branch A/c	1,65,000
To Branch A/c – Returns To Purchases A/c	4,200 1,46,182	By Branch A/c – Loading on returns	382
	1,65,382		1,65,382

Trading and Profit and Loss Account (Final Accounts) Method All items of memorandum Branch Tradingand Profit and Loss Account are to be converted into cost price if the goods are invoiced to branch at selling price. Other points will remain same as already discussed in Para 5.1 for this method if goods areinvoiced at cost.

Question 49: Illustration

Following is the information of the Jammu branch of Best New Delhi for the year ending 31st March, 20X2 from the following:

(1) Goods are invoiced to the branch at cost plus 20%.

(2) The sale price is cost plus 50%. **(3) Other information:**	
	Rs
Stock as on 01.04.20X1(invoice price)	**2,20,000**

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Goods sent during the year (invoice price)	**11,00,000**
Sales during the year	**12,00,000**
Expenses incurred at the branch	**45,000**

Ascertainthe profit earned by the branch during the year.

branch stock reserve in respect of unrealized **profit.**

Answer 49

(i) Calculation of profit earned by the branch In the books of Jammu Branch Trading Account andProfit and Loss Account

Particulars	Amount	Particulars	Amount
	Rs		Rs
To Opening stock	2,20,000	By Sales	12,00,000
To Goods received by Head office	11,00,000	By Closing stock (Refer W.N.)	3,60,000
To Expenses	45,000		
To Net profit (Bal fig)	1,95,000		
	15,60,000		15,60,000

(ii) Stock reserve in respect of unrealized profit = Rs 3,60,000 x (20/120) = Rs 60,000

Working Note:

	Rs	
Cost Price	100	
Invoice Price	120	
Sale Price	150	
Calculation of closing stock at invoice price	Rs	
Opening stock at invoice price	2,20,000	
Goods received during the year at invoiceprice	11,00,000	
	13,20,000	
Less: Cost of goods sold at invoice price	(9,60,000)	[12,00,000 x (120/150)]
Closing stock	3,60,000	

Question 50: Illustration

Hindustan Industries Mumbai has a branch in Cochin to which office goods are invoiced at cost plus 25%. The branch sells 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. From the following details, relating to calendar year 20X1, prepare the accounts in the Head Office Ledger and ascertain the Branch Profit. Branch does not maintain any books of account, but sends weekly returns to the Head Office:

	Rs

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Goods received from Head Office at invoice price	**6,00,000**
Returns to Head Office at invoice price	**12,000**
Stock at Cochin as on 1st Jan., 20X1	**60,000**
Sales in the year - Cash	**2,00,000**
Credit	**3,60,000**
Sundry Debtors at Cochin as on 1st Jan. 20X1	**72,000**
Cash received from Debtors	**3,20,000**
Discount allowed to Debtors	**6,000**
Bad debts in the year	**4,000**

Sales returns at Cochin Branch	**8,000**
Rent, Rates, Taxes at Branch	**18,000**
Salaries, Wages, Bonus at Branch	**60,000**
Office Expenses	**6,000**
Stock at Branch on 31st Dec. 20X1 at invoice price	**1,20,000**

Prepare Branch accounts in books of head office by Stock and debtors method.

Answer 50

Books of Hindustan Industries, Mumbai Cochin Branch Stock Account

	Rs		Rs
To Balance b/d – Op Stock	60,000	By Bank A/c – Cash Sales	2,00,000
To Branch Debtors A/c – Sales Return	8,000	By Branch Debtors A/c -Credit Sales	3,60,000
To Goods sent to BranchA/c	6,00,000	By Goods sent to Branch(Returns to H.O.)	12,000
To Branch Adjustment A/c (Excess of Selling Priceover Invoice Price)	24,000	By Balance c/d - Closingstock	1,20,000
	6,92,000		6,92,000

Cochin Branch Stock Adjustment Account

	Rs		Rs
To Goods sent to Branch A/c (1/5 of Rs 12,000) (on returns)	2,400	By Balance b/d (1/5 of Rs 60,000)	12,000
To Branch P & L A/c (Profit on sale) – Bal fig	1,29,600	By Goods sent to Branch A/c (1/5 of Rs 6,00,000)	1,20,000

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To Balance c/d (1/5 ofRs 1,20,000)	24,000	By Branch Stock	24,000
	1,56,000		1,56,000

Goods Sent to Branch Account

	Rs		Rs
To Cochin Branch Stock Adjustment A/c	1,20,000	By Cochin Branch Stock A/c	6,00,000
To Cochin Branch Stock A/c (Returns)	12,000	By Cochin Branch Stock Adj. A/c	2,400
To Purchases A/c	4,70,400		
	6,02,400		6,02,400

Branch Debtors Account

	Rs		Rs
To Balance b/d	72,000	By Bank	3,20,000
To Branch Stock A/c	3,60,000	By Branch P&L A/c Discount	6,000
		By Branch P&L A/c - Bad Debts	4,000
		By Branch Stock - Sales Returns	8,000
		By Balance c/d	94,000
	4,32,000		4,32,000

Branch Expenses Account

	Rs		Rs
To Bank A/c (Rent, Rates & Taxes)	18,000	By Branch Profit & Loss A/c (Transfer)	84,000
To Bank A/c (Salaries & Wages)	60,000		
To Bank A/c (office exp.)	6,000		
	84,000		84,000

Branch Profit & Loss Account for the year ending 31st Dec. 20X1

	Rs		Rs

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To Branch Expenses A/c	84,000	By Branch Stock Adj. A/c	1,29,600
To Branch Debtors A/c	6,000		
To Branch Debtors A/c	4,000		
To Net Profit transferred to			
Profit & Loss A/c	35,600		
	1,29,600		1,29,600

Question 51: Illustration

Arnold of Delhi, trades in Ghee and Oil. It has a branch at Lucknow. He dispatches 25 tins of Oil @ Rs 1,000 per tin and 15 tins of Ghee @ Rs 1,500 per tin on 1st of every month. The branch incurs some expenditure which is met out of its collections; this is in addition to expenditure directly paid by Head Office.

Following are the other details:

		Delhi	Lucknow
		Rs	Rs
Purchases	Ghee	14,75,000	-
	Oil	29,32,000	-
Direct expenses		3,83,275	-
Expenses paid by H.O.		-	14,250
Sales	Ghee	18,46,350	3,42,750
	Oil	27,41,250	3,15,730
Collection during the year (including Cash Sales)		-	6,47,330
Remittance by Branch to Head Office		-	6,13,250

		(Delhi)	
Balance as on:		1-1-20X1	31-12-20X1
Stock:	Ghee	1,50,000	3,12,500
	Oil	3,50,000	4,17,250
Debtors		7,32,750	-
Cash on Hand		70,520	55,250
Furniture & Fittings		21,500	19,350
Plant/Machinery		3,07,250	7,73,500

		(Lucknow)	
Balance as on:		1-1-20X1	31-12-20X1
Stock:	Ghee	17,000	13,250
	Oil	27,000	44,750

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Debtors	**75,750**	**?**
Cash on Hand	**7,540**	**12,350**
Furniture & Fittings	**6,250**	**5,625**
Plant/Machinery	**-**	

Addition to Plant/Machinery on 1-1-20X1 Rs 6,02,750.

Rate of Depreciation: Furniture / Fittings @ 10% and Plant / Machinery @ 15% (already adjusted in the above figures). The Branch Manager is entitled to 10% commission after charging such commission whereas, the General Manager is entitled to 10% commission on overall company profits after charging such commission. General Manager is also entitled to a salary of Rs 2,000 p.m. General expenses incurred by H.O. Rs 24,000. Prepare Branch Account in the head office books and also prepare the Arnold's Trading and Profit and Loss A/c (excluding branch transactions).

Answer 51

In the books of Arnold Lucknow Branch Account

		Rs		Rs
To	Balance b/d -Opening Branch Assets		By Bank (Remittance) By Closing Branch Assets	6,13,250
	Opening stock:		Closing stock:	
	Ghee	17,000	Ghee	13,250
	Oil	27,000	Oil	44,750
	Debtors	75,750	Debtors (W.N. 1)	86,900
	Cash on hand	7,540	Cash on hand (W.N. 2)	12,350
	Furniture & fittings	6,250	Furniture & fittings	5,625
To	Goods sent to Branch A/c			
	Ghee (15 x 1500 x 12)	2,70,000		
	Oil (25 x 1000 x 12)	3,00,000		
To	Bank (Expenses paid)	14,250		
To	Branch Manager commission			
	(Rs 58,335 × 1/11)	5,303		
To	Net Profit transferred			
	to General P & L A/c	53,032		
		7,76,125		7,76,125

Arnold Trading and Profit and Loss account for the year ended 31st December, 20X1 (Excluding branch transactions)

	Rs		Rs
To Opening Stock:		By Sales:	
Ghee	1,50,000	Ghee	18,46,350

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Oil	3,50,000	Oil	27,41,250
To Purchases:		By Closing Stock:	
Ghee 14,75,000		Ghee	3,12,500
Less: Goods sent to Branch (2,70,000)	12,05,000	Oil	4,17,250
Oil 29,32,000			
Less: Goods sent to Branch (3,00,000)	26,32,000		
To Direct Expenses	3,83,275		
To Gross Profit c/d	5,97,075		
	53,17,350		53,17,350
To Manager's Salary	24,000	By Gross Profit b/d	5,97,075
To General Expenses	24,000	By Branch Profittransferred	53,032
To Depreciation:			
Furniture @10% 2,150			
Plant & Machinery @ 15% (W.N.3) 1,36,500	1,38,650		
To General Manager's Commission @ 10% (i.e., 4,63,457 × 1/11)	42,132		

To Net profit	4,21,325		
	6,50,107		6,50,107

Working **Notes:Memorandum Branch Debtors Account**

	Rs		Rs
To Balance b/d	75,750	By Cash Collections (including Cash Sales)	6,47,330
To Sales (including Cash Sales)		By Balance c/d	86,900
Ghee	3,42,750		
Oil	3,15,730		
	7,34,230		7,34,230

Memorandum Branch Cash Account

	Rs		Rs
To Balance b/d	7,540	By Remittance	6,13,250
To Collections	6,47,330	By Exp. (Balance fig.)	29,270
		By Balance c/d	12,350

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	6,54,870		6,54,870

Depreciation on Plant & Machinery

3,07,250 x 15% + 6,02,750 x 15% = Rs1,36,500

Question 52: Illustration

M/s Rahul operates a number of retail outlets to which goods are invoiced at wholesale price which is cost plus 25%. These outlets sell the goods at the retail price which is wholesale price plus 20%. Following is the information regarding one of the outlets for the year ended 31.3.20X2:

	Rs
Stock at the outlet 1.4.20X1	**30,000**
Goods invoiced to the outlet during the year	**3,24,000**
Gross profit made by the outlet	**60,000**
Goods lost by fire	**?**
Expenses of the outlet for the year	**20,000**
Stock at the outlet 31.3.20X2	**36,000**

You are required to prepare the following accounts in the books of Rahul Limited for the year ended 31.3.20X2:

(a) **Outlet Stock Account.**

(b) **Outlet Profit & Loss Account.**

(c) **Stock Reserve Account.**

Answer 52

Outlet Stock Account

	Rs		Rs
To Balance b/d	30,000	By Sales (Working Note 1)	3,60,000
To Goods sent to outlet	3,24,000	By Goods lost by fire (b.f.)	18,000
To Gross Profit c/d	60,000	By Balance c/d	36,000
	4,14,000		4,14,000

Outlet Profit & Loss Account

	Rs		Rs
To Expenses	20,000	By Gross Profit b/d	60,000
o Goods lost by fire (W.N.2)	18,000		
To Profit transferred	22,000		
	60,000		60,000

Stock Reserve Account

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	Rs		Rs
To HO P & L A/c – Transfer	6,000	By Balance b/d	6,000
To Balance c/d (Stock Res.required)	7,200	By HO P&L A/c (W.N. 3)	7,200

Retail sales value =60,000 × $\frac{150}{25}$ =Rs.3,6,00,000

2) **Goods lost by fire**

Opening Stock + Goods Sent + Gross Profit – Sales – Closing Stock 30,000 + 3,24,000 + 60,000 – 3,60,000 – 36,000 = Rs 18,000

3) **Stock Reserve**

Opening Stock==30,000 × $\frac{25}{125}$ =Rs.6,000

Closing Stock==36,000 × $\frac{25}{125}$ =Rs.7,200

Question 53: Illustration

Give Journal Entries in the books of an independent Branch to rectify or adjust the following:

(i) **Branch paid Rs 5,000 as salary to H.O supervisor, but the amount paid by branch has beendebited to salary account in the books of branch.**

(ii) **Asset Purchased by branch for Rs 25,000, but the Asset account was retained in H.O Books.**

(iii) **A remittance of Rs8,000 sent by the branch has not been received by H.O.**

(iv) **H.O collected Rs 25,000 directly from the customer of Branch but fails to give the intimation to branch.**

(v) **Remittance of funds by H.O to branch Rs 5,000 not entered in branch books.**

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Answer 53

Journal Entries in Books of Branch

	Particulars		Dr.	Cr.
		Amount	Amount	
		Rs	Rs	
(i)	Head office account	Dr.	5,000	
	To Salaries account			5,000
	(Being the rectification of salary paid on behalf ofH.O.)			
(ii)	Head office account	Dr.	25,000	
	To Bank / Liability A/c			25,000
	(Being Asset purchased by branch but Asset account retained at head office books)			
(iii)	No Entry in Branch Books			
(iv)	Head office account	Dr.	25,000	
	To Debtors account			25,000
	(Being the amount of branch debtorscollected by H.O.)			
(v)	Bank A/c	Dr.	5,000	
	To Head Office			5,000
	(Remittance of Funds by H.O. to Branch)			

Question 54: Illustration

The following Trial balances as at 31st December, 20X1 have been extracted from the books of Major Ltd. and its branch at a stage where the only adjustments requiring to be made prior to the preparation of a Balance Sheet for the undertaking as a whole are to be done.

	Head Office		Branch	
	Dr.	Cr.	Dr.	Cr.
	Rs	Rs	Rs	Rs
Share Capital		**1,50,000**		
Fixed Assets	**75,125**		**18,901**	
Current Assets	**1,21,809**		**23,715**	**(Note 3)**
Current Liabilities		**34,567**		**9,721**
Stock Reserve, 1st Jan., 20X1				
(Note 2)		**693**		
Revenue Account		**43,210**		**10,250**
Branch Account	**31,536**			

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Head Office Account				**22,645**
	2,28,470	**2,28,470**	**42,616**	**42,616**

You are required to record the following in the appropriate ledger accounts in both sets of books.Note:

1. **Goods transferred from Head Office to the Branch are invoiced at cost plus 10% and both Revenue Accounts have been prepared on the basis of the prices charged.**
2. **Relating to the Head Office goods held by the Branch on 1st January, 20X1.**
3. **Includes goods received from Head Office at invoice price Rs 4,565.**
4. **Goods invoiced by Head Office to Branch at Rs 3,641 were in transit at 31st December, 20X1, as was also a remittance of Rs 3,500 from the Branch.**

At 31st December, 20X1, the following transactions were reflected in the Head Officebooks but unrecorded in the Branch books.

The purchase price of lorry, Rs 2,500, which reached the Branch on December 25th; asum received on December 30, 20X1 from one of the Branch debtors, Rs 750.

Answer 54

H.O. Books Branch Account

20X1		Rs	20X1		Rs
Dec. 31	To Balance b/d	31,536	Dec. 31	By Cash in transit By Balance c/d	3,500 28,036
		31,536			31,536

Cash in transit Account

20X1		Rs	20X1		Rs
Dec. 31	To Branch A/c	3,500	Dec. 31	By Balance c/d	3,500

Stock Reserve Account

20X1		Rs	20X1		Rs
Dec. 31	To Balance c/d	746	Jan. 1	By Balance b/d	693
	(4,565+3,641) x 10/110			By Revenue A/c (b.f.)	53
		746			746

Revenue Account

20X1		Rs	20X1		Rs
Dec. 31	To Stock Reserve To	53	Dec. 31	By Balance b/d	43,210

	Balance c/d	43,157			
		43,210			43,210

Branch Books Head Office Account

20X1		Rs	20X1		Rs

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Dec. 31	To Current Assets	750	Dec. 31	By Balance b/d	22,645
				By Goods in transit	3,641
	To Balance c/d	28,036		By Motor Vehicle	2,500
		28,786			28,786

Goods in Transit Account

20X1		Rs	20X1		Rs
Dec. 31	To Head Office	3,641	Dec. 31	By Balance c/d	3,641

Motor Vehicle Account

20X1		Rs	20X1		Rs
Dec. 31	To Head Office	2,500	Dec. 31	By Balance c/d	2,500

Sundry Current Assets A/c

20X1		Rs	20X1		Rs
Dec. 31	To Balance b/d	23,715	Dec. 31	By H.O. (Remittance by Debtor)	750
				By Balance c/d	22,965
		23,715			23,715

Question 55: Illustration 11

KP manufactures a range of goods which it sells to wholesale customers only from its head office. In addition, the H.O. transfers goods to a newly opened branch at factory cost plus 15%. The branch then sells these goods to the general public on only cash basis. The selling price to wholesale customers is designed to give a factory profit which amounts to 30% of the sales value. The selling price to the general public is designed to give a gross margin (i.e., selling price less cost of goods from H.O.) of 30% of the sales value.KP operates from rented premises and leases all other types of fixed assets. The rentand hire charges for these are included in the overhead costs shown in the trial balances.

From the information given below, you are required to prepare for the year ended 31st Dec., 20X1 in columnar form.

(a) A Profit & Loss account for (i) H.O. (ii) the branch (iii) the entire business.

(b) Balance Sheet as on 31st Dec., 20X1 for the entire business.

	H.O.		Branch	
	Rs	Rs	Rs	Rs

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Raw materials purchased	35,000			
Direct wages	1,08,500			
Factory overheads	39,000			
Stock on 1-1-20X1				
Raw materials	1,800			
Finished goods	13,000		9,200	
Debtors	37,000			
Cash	22,000		1,000	
Administrative Salaries	13,900		4,000	
Salesmen Salaries	22,500		6,200	
Other administrative &				
selling overheads	12,500		2,300	
Inter-unit accounts	5,000			2,000

Capital		50,000		
Sundry Creditors		13,000		
Provision for unrealized profit in stock		1,200		
Sales		2,00,000		65,200
Goods sent to Branch		46,000		
Goods received from H.O.			44,500	
	3,10,200	3,10,200	67,200	67,200

(1) Note:On 28th Dec., 20X1 the branch remitted Rs 1,500 to the H.O. and this has not yet been recorded in the H.O. books. Also, on the same date, the H.O. dispatched goods to the branchinvoiced at Rs 1,500 and these too have not yet been entered into the branch books. It is thecompany's policy to adjust items in transit in the books of the recipient.

(2) The stock of raw materials held at the H.O. on 31st Dec., 20X1 was valued atRs 2,300.

- You are advised that:
- there were no stock losses incurred at the H.O. or at the branch.
- it is KP's practice to value finished goods stock at the H.O. at factory cost.

(3) there were no opening or closing stock of work-in-progress.

Branch employees are entitled to a bonus of Rs 156 under a bilateral agreement.

Answer 55

In the books of KP Trading and Profit & Loss Account for the year ended 31st Dec., **20X1**

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	H.O.	Branch	Total		H.O.	Branch	Total
	Rs	Rs	Rs		Rs	Rs	Rs
To Opening stock of finished goods	13,000	9,200	22,200	By Sales	2,00,000	65,200	2,65,200
To Material consumed (W.N.1)	34,500	-	34,500				
To Wages	1,08,500	-	1,08,500	By Goods Sent to Branch	46,000	-	-
To Factory Overheads	39,000	-	39,000				
To Goods from H.O.		46,000		By Closingstock including transit (W.N.2)	15,000	9,560	24,560
						(Bal Fig)	
To Gross Profitc/d (W.N.3)	66,000 (Bal Fig)	19,560	85,560				
	2,61,000	**74,760**	**2,89,760**		**2,61,000**	**74,760**	**2,89,760**
To Admn. Salaries	13,900	4,000	17,900	By Gross Profit b/d	66,000	19,560	85,560
To Salesmen Salaries	22,500	6,200	28,700				
To Other Admn. &selling Overheads	12,500	2,300	14,800				
To Stock Reserve (W.N.4)	47	-	47				
To Bonus to Staff	-	156	156				
To Net Profit	17,053	6,904	23,957				
	66,000	19,560	85,560		66,000	19,560	85,560

Balance Sheet as on 31st Dec., 20X1

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			H.O.	Branch	To-tal		H.O.	Branch	To-tal
		Rs	Rs	Rs	Rs		Rs	Rs	Rs
Capital			50,000	-	50,000	Fixed Assets	-	-	-
Profit:	H.O.	17,053				Current Assets:			
	Branch	6,904	23,957		23,957	Raw material	2,300		2,300
Trade Credi-tors			13,000		13,000	Finished Goods	15,000	9,560	23,313*
Bonus Pay-able			1,247	156	156	(Less Stock Res.)			
H.O. Account *				10,404		Debtors	37,000	-	37,000
Stock Re-serve (W.N.4)						Cash (in-cludingtran-sit item)	23,500	1,000	24,500
						Branch A/c	10,404**		
			88,204	10,560	87,113		88,204	10,560	87,113

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*9,560 × 100/115 i.e., (8,313 + 15,000) = Rs 23,313 or (15,000 + 9,560) – 1,247 (Stock reserve)

** **(5,000 + 6,904) – 1500 = Rs** 10,404.

(1) Working **Notes:**

Material consumed

Opening raw material + Raw Material Purchased – Closing raw material

(2) = 1,800 + 35,000 - 2,300 = 34,500

(a) Closing stock at head office

Calculation of total factor cost = Material consumed + Wages + Factory overhead

(b) = 34,500 + 1,08,500 + 39,000 = 1,82,000

Cost (factory cost) of goods sold = Sales – Gross profit

(c) = 2,00,000 – 2,00,000 x 30% = 1,40,000

Stock transferred to branch = 46,000 x 100/115 = 40,000

(3) **(d)** Closing stock = 13,000 (Opening Stock) + 1,82,000 – 1,40,000 – 40,000 = 15,000

Gross profit of Branch = Sales x Gross profit ratio

(4) = 65,200 x 30% = 19,560

Closing stock reserve = 9,560 x 15/115 = 1,247

Charge to profit and loss = 1,247 – 1,200 (existing) = 47

Question 56: Illustration

AFFIX of Kolkata has a branch at Delhi to which the goods are supplied from Kolkata but the cost thereof is not recorded in the Head Office books. On 31st March, 20X1 the Branch Balance Sheet was as follows:

Liabilities	Rs	Assets	Rs
Creditors Balance	40,000	Debtors Balance	2,00,000
Head Office	1,68,000	Building Extension A/c closed by transfer to H.O. A/c	—
		Cash at Bank	8,000
	2,08,000		2,08,000

During the six months ending on 30-9-20X1, the following transactions took place at Delhi.

	Rs		Rs
Sales	2,40,000	Manager's Salary	4,800
Purchases	48,000	Collections from Debtors	1,60,000
Wages paid	20,000	Discounts allowed	8,000
Salaries (inclusive of advance		Discount earned	1,200
of Rs 2,000)	6,400	Cash paid to Creditors	60,000

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General Expenses	**1,600**	**Building Account (further payment)**	**4,000**
Fire Insurance (paid for one year)	**3,200**	**Cash in Hand**	**1,600**
Remittance to H.O.	**38,400**	**Cash at Bank**	**28,000**

Set out the Head Office Account in Delhi books and the Branch Balance Sheet as on 30-9-20X1. Also give journal entries in the Delhi books.

Answer 56

Journal Entries

20X1		Dr.	Cr.
30 Sept.		Rs	Rs
Salary Advance A/c	Dr.	2,000	
To Salaries A/c			2,000
(The amount paid as advance adjusted by debit to Salary Advance Account)			
Prepared Insurance A/c (3,200 x 6/12)	Dr.	1,600	
To Fire Insurance A/c			1,600
(Six months premium transferred to the Prepaid Insurance A/c)			
Head Office Account	Dr.	88,400	
To Purchases A/c			48,000
To Wages A/c			20,000
To Salaries A/c (6,400 – 2,000)			4,400
To General Expenses A/c			1,600
To Fire Insurance A/c (3,200 x 6/12)			1,600
To Manager's Salary A/c			4,800
To Discount Allowed A/c			8,000
(Transfer of various revenue accounts (Dr.) to the H.O. Account for closing the accounts)			
Sales Accounts	Dr.	2,40,000	
Discount Earned A/c	Dr.	1,200	
To Head Office A/c			2,41,200
[Revenue accounts (Cr.) transferred to H.O.]			
Head Office Account	Dr.	4,000	
To Building Account			4,000
(Transfer of amounts spent on building extension to H.O. A/c)			

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Head Office Account

20X1		Rs	20X1		Rs
Sep. 30	To Cash-remittance	38,400	April 1	By Balance b/d	1,68,000
	To Sundries (Revenue A/cs)	88,400	Sep. 30	By Sundries(Revenue A/cs)	2,41,200
	To Building A/c	4,000			
	To Balanced c/d	2,78,400			
		4,09,200			4,09,200

Balance Sheet of Delhi Branch as on Sept. 30, 20X1

Liabilities	Rs	Assets	Rs
Creditors Balances	26,800	Debtors Balances	2,72,000
Head Office Account	2,78,400	Salary Advance	2,000
		Prepaid Insurance	1,600
		Building Extension A/c	
		transferred to H.O.	—
		Cash in Hand	1,600
		Cash at Bank	28,000
	3,05,200		3,05,200

Cash and Bank Account

		Rs			Rs
To	Balance b/d	8,000	By	Wages	20,000
To	Collection from Debtors	1,60,000	By	Salaries	6,400
			By	Insurance	3,200
			By	General Exp.	1,600
			By	H.O. A/c	38,400
			By	Manager's Salary	4,800
			By	Creditors	60,000
			By	Building A/c	4,000
			By	Balance c/d	
			By	Cash in Hand 1,600	
			By	Cash at Bank 28,000	29,600
		1,68,000			1,68,000

Debtors Account

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	Rs		Rs
To Balance b/d	2,00,000	By Cash Collection	1,60,000
To Sales	2,40,000	By Discount (allowed)	8,000
		By Balance c/d	2,72,000
	4,40,000		4,40,000
To Balance b/d	2,72,000		

Creditors Account

	Rs		Rs
To Cash	60,000	By Balance b/d	40,000
To Discount (earned)	1,200	By Purchases	48,000
To Balance c/d	26,800		
	88,000		88,000
		By Balance b/d	26,800

Question 57: Illustration

Ring Bell Ltd. Delhi has a Branch at Bombay where a separate set of books is used. The following is the trial balance extracted on 31st December, 20X1.

Head Office Trial Balance

	Rs	Rs
Share Capital (Authorised: 10,000 Equity Shares of Rs 100 each):		
Issued: 8,000 Equity Shares		**8,00,000**
Profit & Loss Account - 1-1-20X1		**25,310**
General Reserve		**1,00,000**
Fixed Assets	**5,30,000**	
Stock	**2,22,470**	
Debtors and Creditors	**50,500**	**21,900**
Profit for 20X1		**52,200**
Cash Balance	**62,730**	
Branch Current Account	**1,33,710**	
	9,99,410	**9,99,410**

Branch Trial Balance

	Rs	Rs
Fixed Assets	**95,000**	
Profit for 20X1		**31,700**
Stock	**50,460**	

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Debtors and Creditors	**19,100**	**10,400**
Cash Balance	**6,550**	
Head Office Current Account		**1,29,010**
	1,71,110	**1,71,110**

The difference between the balances of the Current Account in the two sets of books is accounted for as follows:

(a) Cash remitted by the Branch on 31st December, 20X1, but received by the Head Office on 1st January 20X2 - Rs 3,000.

(b) Stock stolen in transit from Head Office and charged to Branch by the Head Office, but not credited to Head Office in the Branch books as the Branch Manager declined to admit any liability (not covered by insurance) - Rs 1,700.

Give the Branch Current Account in Head Office books after incorporating Branch Trial Balance through journal.

Answer 57

The Branch Current Account in the Head Office Books and Head Office Current Account in the Branch Books do not show the same balances. Therefore, in order to reconcile them, the following journal entries will be passed in the Head Office books:

Journal Entries

Journal Entries

			Dr.	Cr.
20X1			Rs	Rs
Dec., 31	Cash in Transit A/c	Dr.	3,000	
	To Branch Current A/c			3,000
	(Cash sent by the Branch on 31st Dec., 20X1 but received at H.O. on 1st Jan., 20X2)			
	Loss by theft A/c	Dr.	1,700	
	To Branch Current A/c			1,700
	(Stock lost in transit from H.O. to Branch)			

In order to incorporate, in the H.O. books, the given Branch trial balance which has been drawn up afterpreparing the Branch Profit & Loss Account, the following journal entries will be necessary:

Journal Entries

20X1			Rs	Rs
Dec. 31	Branch Current Account	Dr.	31,700	31,700
	To Profit & Loss Account			
	(Branch Profit for the year)			

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	Branch Fixed Assets	Dr.	95,000	
	Branch Stock	Dr.	50,460	
	Branch Debtors	Dr.	19,100	
	Branch Cash	Dr.	6,550	
	To Branch Current Account (Branch assets brought into H.O. Books			1,71,110
	Branch Current A/c	Dr.	10,400	
	To Branch Creditors (Branch creditors brought Books) Into H.O.			10,400

Branch Current Account

	Rs		Rs
To Balance b/d	1,33,710	By Cash in transit	3,000
To Profit & Loss A/c	31,700	By Loss of theft	1,700
To Branch Creditors	10,400	By Sundry Branch Assets	1,71,110
	1,75,810		1,75,810

Profit and Loss Account for 20X1

	Rs		Rs
To Loss by Theft	1,700	By Balance b/d	25,310
To Balance c/d	1,07,510	By Year's Profit: H.O.	52,200
		Branch	31,700
	1,09,210		1,09,210

Question 58: Illustration

Messrs. Ramchand & Co., Hyderabad has a branch in Delhi. The Delhi Branch deals not only in the goods from Head Office but also buys some auxiliary goods and deals in them. They, however, do not prepare any Profit & Loss Account but close all accounts to the Head Office at the end of the yearand open them afresh on the basis of advice from their Head Office. The fixed assets accounts are also maintained at the Head Office. The goods from the Head Office are invoiced at selling prices to give a profit of 20 per cent on the sale price. The goods sent from the branch to Head Office are at cost. From the following prepare Branch Trading and Profit & Loss Account and Branch fixed Assets Account in the Head Office Books.

Trial Balance of the Delhi Branch as on 31-12-20X1

Debit	Rs	Credit	Rs
Head office opening balance on 1-1-20X1	15,000	Sales	1,00,000
Goods from H.O.	50,000	Goods to H.O.	3,000
Purchases	20,000	Head Office Current A/c	15,000

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Opening Stock		**Sundry Creditors**	**3,000**
(H.O. supplies goods at invoice prices)	**4,000**		
Opening Stock of other goods	**500**		
Salaries	**7,000**		
Rent	**3,000**		
Office expenditure	**2,000**		
Cash on Hand	**500**		
Cash at Bank	**4,000**		
Sundry Debtors	**15,000**		
	1,21,000		**1,21,000**

The Branch balances as on 1st January, 20X1, were as under: Furniture Rs 5,000; Sundry Debtors Rs 9,500; Cash Rs 1,000, Creditors Rs 30,000. The closing stock at branch of the head office goods at invoice price is Rs 3,000 and that of purchased goods at cost is Rs 1,000. Depreciation is to be provided at 10 per cent on branch assets.

Answer 58

Delhi Branch Trading and Profit & Loss Account for the year ended 31st Dec., 20X1

			Rs				Rs
To	Opening Stock:			By	Sales		1,00,000
	Head office Goods	3,200		By	Goods from Branch		3,000
	(4,000 x 80%)			By	Closing Stock:		
	Others	500	3,700		Head Office goods (3,000 x 80%)	2,400	
To	Goods to Branch (50,000 x 80%)		40,000		Others	1,000	3,400
To	Purchases		20,000				
To	Gross Profit c/d		42,700				
			1,06,400				1,06,400
To	Salaries		7,000	By	Gross profit b/d		42,700
To	Rent		3,000				
To	Office Expenses		2,000				
To	Dep.on furni-ture@ 10%		500				

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To	Net profit		30,200				
			42,700				42,700

Branch (Fixed) Assets Account (In Head Office Books)

20X1			Rs	20X1			Rs
Jan. 1	To	Balance b/d	5,000	Dec. 31	By	Delhi Branch A/c	500
20X2					By	(Depreciation) Balance c/d	4,500
			5,000				5,000
Jan. 1	To	Balance b/d	4,500				

Note: Furniture A/c is maintained in Head office books; it is not a part of either opening or closing balance.

Question 59: Illustration

On 31st December, 20X2 the following balances appeared in the books of Chennai Branch of an English firm having its HO office in New York:

	Amount inRs	Amount inRs
Stock on 1st Jan., 20X2	**2,34,000**	
Purchases and Sales	**15,62,500**	**23,43,750**
Debtors and Creditors	**7,65,000**	**5,10,000**
Bills Receivable and Payable	**2,04,000**	**1,78,500**
Salaries and Wages	**1,00,000**	**-**
Rent, Rates and Taxes	**1,06,250**	**-**
Furniture	**91,000**	**-**
Bank A/c	**5,68,650**	
New York Account	**-**	**5,99,150**
	36,31,400	**36,31,400**

Stock on 31st December, 20X2 was Rs 6,37,500. Branch account in New York books showed a debit balance of $ 13,400 on 31st December, 20X2 and Furniture appeared in the Head Office books at $ 1,750. The rate of exchange for 1 $ on 31st December, 20X1 was Rs 52 and on 31st December, 20X2 was Rs 51. The average rate for the year was Rs 50. Prepare in the Head Office books the Profit and Loss a/c and the Balance Sheet of the Branch assuming integral foreign operation.

Answer 59

In the books of English Firm (Head Office in New York) Chennai Branch Profit and Loss Account for the year ended 31st December, 20X2

	$		$

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To Opening stock	4,500	By Sales	46,875
To Purchases	31,250	By Closing stock	12,500
To Gross profit c/d	23,625	(6,37,500 / 51)	
	59,375		59,375
To Salaries	2,000	By Gross profit b/d	23,625
To Rent, rates and taxes	2,125		
To Exchange translation loss	2,000		
To Net Profit c/d	17,500		
	23,625		23,625

Balance Sheet of Chennai Branch as on 31st December, 20X2

Liabilities	$	$	Assets	$
Head Office A/c	13,400		Furniture	1,750
Add: Net profit	17,500	30,900	Closing Stock	12,500
Trade creditors		10,000	Trade Debtors	15,000
Bills Payable		3,500	Bills Receivable	4,000
			Cash at bank	11,150
		44,400		44,400

Working Note:

Calculation of Exchange Translation Loss Chennai Branch Trial Balance (converted in $) as on 31stDecember, 20X2

	Dr.	Cr.	Conversion	Dr.	Cr.
	Rs	Rs	Rate	($)	($)
Stock on 1st Jan., 20X2	2,34,000		52	4,500	
Purchases & Sales	15,62,500	23,43,750	50	31,250	46,875
Debtors & creditors	7,65,000	5,10,000	51	15,000	10,000
Bills Receivable and Bills Payable	2,04,000	1,78,500	51	4,000	3,500
Salaries and wages	1,00,000		50	2,000	
Rent, Rates and Taxes	1,06,250		50	2,125	
Furniture	91,000			1,750	
Bank A/c	5,68,650		51	11,150	
New York Account		5,99,150			13,400
Exchange translation loss (bal. fig.)				2,000	
	36,31,400	36,31,400		73,775	73,775

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Question 60: Illustration

S & M Ltd., Bombay, have a branch in Sydney, Australia. Sydney branch is an integral foreign operationof S & M Ltd. At the end of 31st March, 20X2, the following ledger balances have been extracted from the books of the Bombay Office and the Sydney Office:

	Bombay (Rs thousands)		Sydney (Auster dollars thousands)	
	Debit	Credit	Debit	Credit
Share Capital	–	2,000	–	–
Reserves & Surplus	–	1,000	–	–
Land	500	–	–	–
Buildings (Cost)	1,000	–	–	–
Buildings Dep. Reserve	–	200	–	–
Plant & Machinery (Cost)	2,500	–	200	–
Plant & Machinery Dep. Reserve	–	600	–	130
Debtors / Creditors	280	200	60	30
Stock (1.4.20X1)	100	–	20	–
Branch Stock Reserve	–	4	–	–
Cash & Bank Balances	10	–	10	–
Purchases / Sales	240	520	20	123
Goods sent to Branch	–	100	5	–
Managing Director's salary	30	–	–	–
Wages & Salaries	75	–	45	–
Rent	–	–	12	–
Office Expenses	25	–	18	–
Commission Receipts	–	256	–	100
Branch / H.O. Current A/c	120	–	–	7
	4,880	4,880	390	390

(1) The following information is also **available:**

Stock as at **31.3.20X2:**

Bombay Rs 1,50,000Sydney A $ 3,125

You are required to convert the Sydney Branch Trial Balance into rupees; (use the following ratesof exchange:

Opening rate, A $ = Rs 20

Closing rate A $ = Rs 24

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Average rate **A $ = Rs 22**

For Fixed Assets A $ = Rs **18**

Answer 60

Sydney Branch Trial Balance (in Rupees) As on 31st March, **20X2**

Conversion	Rate per A$	Dr.	Cr.
Plant & Machinery (cost)	Rs 18	36,00	
Plant & Machinery Dep. Reserve	Rs 18		23,40
Debtors / Creditors	Rs 24	14,40	7,20
Stock (1.4.20X1)	Rs 20	4,00	
Cash & Bank Balances	Rs 24	2,40	
Purchase / Sales	Rs 22	4,40	27,06
Goods received from H.O.	–	1,00	
Wages & Salaries	Rs 22	9,90	
Rent	Rs 22	2,64	
Office expenses	Rs 22	3,96	
Commission Receipts	Rs 22		22,00
H.O. Current A/c			1,20
		78,70	80,86
Exchange loss (balancing figure)		2,16	
		80,86	80,86

Question 61: Illustration

M/s Carlin has head office at New York (U.S.A.) and branch at Mumbai (India). Mumbai branch is an integral foreign operation of Carlin & Co. Mumbai branch furnishes you with its trial balance as on 31st March, 20X2 and the additional information given thereafter:

	Dr.	Cr.
	Rupees in thousands	
Stock on 1st April, 20X1	**300**	**–**
Purchases and sales	**800**	**1,200**
Sundry Debtors and creditors	**400**	**300**
Bills of exchange	**120**	**240**
Wages and salaries	**560**	**–**
Rent, rates and taxes	**360**	**–**
Sundry charges	**160**	**–**
Computers	**240**	

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Bank balance	420	–
New York office a/c	–	1,620
	3,360	3,360

(a) Additional **information:Computers were acquired from a remittance of US $ 6,000 received from New York headoffice and paid to the suppliers. Depreciate computers at 60% for the year.**

(b) **Unsold stock of Mumbai branch was worth Rs 4,20,000 on 31st March, 20X2.**

- **The rates of exchange may be taken as follows:**
- **on 1.4.20X1 @ Rs 40 per US $**
- **on 31.3.20X2 @ Rs 42 per US $**
- **average exchange rate for the year @ Rs 41 per US $ conversion in $ shall be made upto two decimal accuracy.**

You are asked to prepare in US dollars the revenue statement for the year ended 31st March, 20X2 and the balance sheet as on that date of Mumbai branch as would appear in the books of New York head office of Carlin & Co. You are informed that Mumbai branch account showed a debit balance of US $ 39609.18 on 31.3.20X2 in New York books and there were no items pending reconciliation.

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Answer 61

M/s Carlin Mumbai Branch Trial Balance in (US $) as on 31st March, 20X2

	Conversion rate per US $ (Rs)	Dr. US $	Cr. US $
Stock on 1.4.X1	40	7,500.00	–
Purchases and sales	41	19,512.20	29,268.29
Sundry debtors and creditors	42	9,523.81	7,142.86
Bills of exchange	42	2,857.14	5,714.29
Wages and salaries	41	13,658.54	–
Rent, rates and taxes	41	8,780.49	–
Sundry charges	41	3,902.44	–
Computers	–	6,000.00	–
Bank balance	42	10,000.00	–
New York office A/c	–	–	39,609.18
		81,734.62	81,734.62

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

	US $		US $
To Opening Stock	7,500.00	By Sales	29,268.29
To Purchases	19,512.20	By Closing stock (4,20,000/42)	10,000.00
To Wages and salaries	13,658.54	By Gross Loss c/d	1,402.45
	40,670.74		40,670.74
To Gross Loss b/d	1,402.45	By Net Loss	17,685.38
To Rent, rates and taxes	8,780.49		
To Sundry charges	3,902.44		
To Depreciation on computers	3,600.00		
(US $ 6,000 × 0.6)			
	17,685.38		17,685.38

Balance Sheet of Mumbai Branch as on 31st March, 20X2

Liabilities		US $	Assets	US $	US $
York Office A/c	39,609.18		Computers	6,000.00	
Less: Net Loss	(17,685.38)	21,923.80	Less: Depreciation	(3,600.00)	2,400.00
Sundry creditors		7,142.86	Closing stock		10,000.00
Bills payable		5,714.29	Sundry debtors		9,523.81
			Bank balance		10,000.00

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			Bills receivable		2,857.14
		34,780.95			34,780.95

Question 62: Illustration

Buckingham Bros, Bombay have a branch at Nagpur. They send goods at cost to their branch at Nagpur. However, direct purchases are also made by the branch for which payments are made at head office. All the daily collections are transferred from the branch to the head office.

From the following, prepare Nagpur branch account in the books of head office by Debtors method:

	₹		₹
Opening balance (1-1-20X1) Imprest Cash	*2,000*	*Bad Debts*	*1,000*
Sundry Debtors	*25,000*	*Discount to Customers*	*2,000*
Stock: Transferred from H.O.	*24,000*	*Remittances to H.O. (received by H.O.)*	*1,65,000*
Direct Purchases	*16,000*	*Remittances to H.O. (not received by H.O. so far)*	*5,000*
Cash Sales	*45,000*	*Branch Exp. directly paid by H.O.*	*30,000*
Credit Sales	*1,30,000*	*Closing Balance (31-12-20X1)*	
Direct Purchases	*45,000*	*Stock: Direct Purchase*	*10,000*
Returns from Customers	*3,000*	*Transfer from H.O.*	*15,000*
Goods sent to branch from H.O.	*60,000*	*Debtors*	*?*
Transfer from H.O. for Petty Cash expenses	*4,000*	*Imprest Cash*	*?*
		Petty Cash expenses	*4,000*

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Answer 62

In the Books of Buckingham Bros, Bombay Nagpur Branch Account

Particulars	₹	*Particulars*		₹
To Opening Branch Assets-		By Bank – Remittances received from branch		
Stock (24,000+16,000)	40,000	Cash Sales	45,000	
Debtors	25,000	Cash from Debtors *	1,20,000	
		Cash in transit *	5,000	1,70,000
Imprest Cash	2,000	By Closing Branch Assets		
To Goods sent to Branch A/c	60,000	Stock (15,000 +10,000)		25,000
To Creditors (Direct Purchases)	45,000	Debtors (W.N. 1)		24,000
		Imprest Cash (W.N. 2)		2,000
To Bank (Sundry exp.)	30,000			
To Bank (Petty cash exp.)	4,000			
To Net Profit transferred to General Profit & Loss A/c	15,000			
	2,21,000			2,21,000

Working Notes:Memorandum Debtors **A/c**

	Particulars	₹		Particulars	₹
To	To Bal b/d	25,000	By	By Sales Return	3,000
To	To Sales	130,000	By	By Bad Debts	1,000
			By	By Discount	2,000
			By	By Cash *	125,000
			By	By Bal c/d	24,000
		155,000			155,000

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Memorandum Petty Cash

Particulars	₹	Particulars	₹
To Bal b/d	2,000	By Expenses (metby Branch)	4,000
To Transfer from H.O.	4,000	By Bal c/d	2,000
	6,000		6,000

* Collection from Debtors = Total Remittances (1,65,000+5,000) – Cash Sales (45,000) = ₹1,25,000

Question 63: Illustration

From the information given in the illustration 32, prepare Nagpur Branch Trading and Profit and Loss Account in the books of head office.

Answer 63

Buckingham Bros. Bombay

Nagpur Branch-Trading and Profit and Loss Accountfor the year ending 31st December, 20X1

Particulars	₹	*Particulars*	₹	₹
To Opening Stock	40,000	By Sales		
To Goods transferredfrom	60,000	Cash	45,000	
Head Office		Credit sales	1,30,000	
To Purchases	45,000		1,75,000	
To Gross Profit c/d	52,000	*Less:* Returns	(3,000)	1,72,000
		By Closing Stock		25,000
	1,97,000			1,97,000
To Expenses	30,000	By Gross Profit b/d		52,000
To Discounts	2,000			
To Bad Debts	1,000			
To Petty Cash Expenses	4,000			
To Net Profittransferred	15,000			
to General P&L A/c				
	52,000			52,000

The students may note that Gross Profit and Net Profit earned by the branch are ascertainable in this method and also evaluating the performance of the branch is very much easier in this method than inthe 'Debtors method'.

Solving Illustration by all three methods

Given below is a simple problem, the solution whereto has been prepared in all the three methods soas to show the distinguishing features of these methods.

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Question 64: Illustration

Harrison of Chennai has a branch at New Delhi to which goods are sent @ 20% above cost. The branch makes both cash and credit sales. Branch expenses are met partly from H.O. and partly by the branch. The statement of expenses incurred by the branch every month is sent to head office for recording. Following further details are given for the year ended 31st December, 20X1:

		₹
Cost of goods sent to Branch at cost		2,00,000
Goods received by Branch till 31-12-20X1 at invoice price		2,20,000
Credit Sales for the year @ invoice price		1,65,000
Cash Sales for the year @ invoice price		59,000
Cash Remitted to head office		2,22,500
Expenses paid by H.O.		12,000
Bad Debts written off		750
Balances as on	1-1-20X1	31-12-20X1
	₹	₹
Stock	25,000 (Cost)	28,000 (invoice price)
Debtors	32,750	26,000
Cash in Hand	5,000	2,500

Show necessary ledger accounts in the books of the head office and determine the Profit or Loss of theBranch for the year ended 31st December, 20X1.

Answer 64

Books of Harrison Branch Stock Account

	₹		₹
To Balance b/d – Op Stock	30,000	By Branch Debtors (Sales)	1,65,000
To Goods Sent to Branch A/c	2,40,000	By Branch Cash	59,000
To Branch Adjustment A/c (Balancing Figure –Excess of Sale over Invoice Price)	2,000	By Balance c/d Goods in Transit (₹2,40,000 – ₹2,20,000)	20,000
		Closing Stock at Branch	28,000
	2,72,000		2,72,000

Branch Debtors Account

	₹		₹

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To Balance b/d	32,750	By Bad debts written off	750
To Branch Stock A/c (Sales)	1,65,000	By Branch Cash (bal. fig.)	1,71,000
		By Balance c/d	26,000
	1,97,750		1,97,750

Branch Cash Account

	₹		₹
To Balance b/d	5,000	By Bank Remittance toH.O.	2,22,500
To Branch Stock	59,000	By Branch Expenses [met by Branch (Bal.fig.)]	10,000
To Branch Debtors	1,71,000		2,500
	2,35,000	By Balance c/d	2,35,000

Branch Adjustment Account

	₹		₹
To Branch P &L - GrossProfit (Bal. fig.)	39,000	By Stock Reserve opening (25,000 × 20%)	5,000
To Stock Reserve (on closing stock (48,000 ×1/6)	8,000	By Goods sent to BranchA/c	40,000
		By Branch Stock A/c	2,000
	47,000		47,000

Branch Expenses

	₹		₹
To Cash (H.O) To Branch Cash	12,000 10,000	By Branch P&L A/c	22,000
	22,000		22,000

Branch Profit and Loss Account

	₹		₹

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To Branch Expenses	22,000	By Gross Profit (from Branch Adjustment A/c)	39,000
To Branch Debtors (bad debts)To Net Profit	750 16,250		
	39,000		39,000

Goods Sent to Branch Account

	₹		₹
To Branch Adjustment A/cToPurchase A/c - Transfer	40,000 2,00,000	By Branch to Stock A/c	2,40,000
	2,40,000		2,40,000

Question65: Illustration

Take figures from Illustration 34 and prepare branch account following debtors' method.

Answer 65

Books of Harrison New Delhi Branch Account

	₹		₹
To Balance B/d Stock Debtors Cash	30,000	By Stock Reserve	5,000
To Goods Sent to Branch A/c (2,00,000 + 20%)	32,750		
To Cash (Exp. paid by H.O.)	5,000		
To Net Profit ts/f to H.O.Profit & Loss A/c (Balancing Figure)	2,40,000		40,000
	12,000	By Goods Sent to BranchA/c	2,22,500
	16,250	By Cash – Remittance from branch By Balance c/dDebtors	26,000
To Stock reserve (48,000X20/120)	8,000	Stock (including Transit – W.N 2)	48,000
		Cash	2,500
	3,44,000		3,44,000

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Working Note:

Closing Stock = Stock at branch + Stock in Transit (Goods sent by HO – Goods Received by Branch) = ₹ 28,000 + (₹2,40,000 - ₹2,20,000) = ₹48,000.

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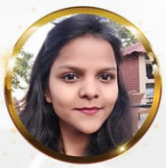
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