FINANCIAL STATEMENTS OF COMPANIES

CH 1

"Stop being afraid of what could go wrong and focus on what could go right"

MAINTENANCE OF BOOKS OF ACCOUNTS (Sec 128 of Companies Act, 2013)

Every company shall prepare and keep at its *registered office* books of account and other relevant books and papers and financial statement for every financial year which give a *true and fair view* of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on *accrual basis* and according to the *double entry system* of accounting.
Provided further that the company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed.

PREPARATION OF FINANCIAL STATEMENTS

Under Section 129 of the Companies Act, 2013, the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 and shall be in the form or forms as may be provided for different class or classes of companies, as prescribed in Schedule III.
(As per section 133 of the Companies Act, it is mandatory to comply with accounting standards notified by the Central Government from time to time)

The Board of Directors of the company shall lay *financial statements* at every annual general meeting of a company which include:
a) Balance Sheet as at the end of the period, and
b) Profit and Loss Account for that period.
   [Note: For a Company not carrying on business for profit, an Income and Expenditure Account shall be laid at that AGM, instead of the P & L Account.]
c) Cash flow statement for the financial year
d) Statement of changes in equity, if applicable; and
e) Any explanatory note annexed to, or forming part of, any document referred above

Provided that the financial statement, with respect to One Person Company, small company, dormant company and private company (if it's a start up), may not include the cash flow statement.

Requisites of Financial Statements It shall give a true and fair view of the state of affairs of the company as at the end of the financial year.

Provisions Applicable
(1) Specific Act is Applicable
   For instance any
   a) Insurance company
   b) Banking company or
   c) Any company engaged in generation or supply of electricity or
   d) Any other class of company for which a Form of balance sheet or Profit and loss account has been prescribed under the Act governing such class of company

(2) In case of all other companies
Balance Sheet as per Form set out in Part I of Schedule III and Statement of Profit and Loss as per Part II of Schedule III

Division	Applicable to
Division I	Companies that are required to apply Accounting Standards notified under Section 133 of the Companies Act, 2013.
Division II	Companies that are required to apply Indian Accounting Standards notified under Section 133 of the Companies Act, 2013.
Division III	Non-Banking Finance Companies (NBFCs) that are required to apply Indian Accounting Standards notified under Section 133 of the Companies Act, 2013.

Points to be kept in mind while preparing final accounts:

- Requirements of Schedule III to the Companies Act;
- Other statutory requirements;
- Accounting Standards notified by Ministry of Corporate Affairs (MCA) (AS 1 to AS 29);
- Statements and Guidance Notes issued by the Institute of Chartered Accountants of India (ICAI); which are necessary for understanding the accounting treatment/ valuation/ disclosure suggested by the ICAI.

Depending upon the Total Income of the company, the figures appearing in the Financial Statements shall be rounded off as given below:

Total Income	Rounding Off
(a) Less than 100 crore rupees	To the nearest hundreds, thousands, lakhs or millions, or decimals thereof
(b) 100 crore rupees or more	To the nearest lakhs, millions or crores, or decimals thereof.

DIVIDEND (Sec 123 of Companies Act, 2013)

Dividend	Dividend to be declared / paid out of a) Profits of the company for that year or previous years but after providing depreciation as per Schedule II or b) Money provided by Central Govt. or State Govt. in pursuance of guarantee given by Govt.
General Provisions	➢ Dividend cannot be declared except out of profits. ➢ Dividend to be declared/paid out of free reserves. ➢ Capital cannot be returned to the shareholders by way of dividend. ➢ Dividend is paid to Shareholders; Preference shareholders being paid first. ➢ It is generally calculated on paid up capital i.e., Called up Capital Less Calls in Arrears ➢ No dividend on Calls in Advance ➢ Company cannot declare dividend unless previous year losses & depreciation not provided are set off against profits of current year.
Interim Dividend	The Board of Directors of a company may declare interim dividend during any financial year or at any time during the period from closure of financial year till holding of the AGM out of the surplus in the profit and loss account or out of profits of the financial year for which such interim dividend is sought to be declared or out of profits generated in the financial year till the quarter preceding the date of declaration of the interim dividend: Provided that in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.
Declaration of Dividend out of Reserves	Withdrawal from Reserves : Conditions 1) Dividend Rate cannot exceed average of previous 3 years 2) Maximum Amount that can be withdrawn from reserves $\leq$ 10% of (Paid up capital + Free Reserves) 3) Minimum Amount left in reserves after withdrawal $\geq$ 15% of (Paid up capital) The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.

Schedule III of the Companies Act, 2013

PART I – BALANCE SHEET

Name of the Company……………………
Balance Sheet as at ………………………

	PARTICULARS	Note No.	Figures as at the end of current Reporting period	Figures as at the end of previous reporting period
A.	EQUITY AND LIABILITIES			
1.	Shareholder's funds			
a	Share capital			
b	Reserves and surplus			
c	Money received against share warrants			
2.	Share application money pending allotment			
3.	Non-Current Liabilities			
a	Long-term borrowings			
b	Deferred tax liabilities (Net)			
c	Other long term liabilities			
d	Long-term provisions			
4.	Current Liabilities			
a	Short-term borrowings			
b	Trade payables			
c	Other current liabilities			
d	Short-term provisions			
	TOTAL			
B.	ASSETS			
1.	Non-Current Assets			
a	Property, Plant & Equipment & Intangible Assets			
i.	Property, Plant & Equipment			
ii.	Intangible assets			
iii.	Capital work-in-Progress			
iv.	Intangible assets under development			
b	Non-current investments			
c	Deferred tax assets (net)			
d	Long-term loans and advances			
e	Other non-current assets			
2.	Current Assets			
a	Current investments			
b	Inventories			
c	Trade receivables			
d	Cash and cash equivalents			
e	Short-term loans and advances			
f	Other current assets			
	TOTAL			

GENERAL INSTRUCTIONS FOR PREPARATION OF BALANCE SHEET

1. An asset shall be classified as current when it satisfies any of the following criteria:
   a) it is expected to be realized in, or is intended for sale or consumption in, the company's normal operating cycle;
   b) it is held primarily for the purpose of being traded;
   c) it is expected to be realized within twelve months after the reporting date; or
   d) it is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

All other assets shall be classified as non-current.

2. An operating cycle is the time between the acquisition of assets for processing and their realization in cash or cash equivalents. Where the normal operating cycle cannot be identified, it is assumed to have a duration of 12 months.

3. A liability shall be classified as current when it satisfies any of the following criteria:
   a) it is expected to be settled in the company's normal operating cycle;
   b) it is held primarily for the purpose of being traded;
   c) it is due to be settled within twelve months after the reporting date; or
   a) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

All other liabilities shall be classified as non-current.

4. A receivable shall be classified as a 'trade receivable' if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business.
5. A payable shall be classified as a 'trade payable' if it is in respect of the amount due on account of goods purchased or services received in the normal course of business.

Important Disclosures in Notes to Accounts

1) Share Capital: For each class of share capital (different classes of preference shares to be treated separately):
   a) the number and amount of shares authorised;
   b) the number of shares issued, subscribed & fully paid, and subscribed but not fully paid;
   c) par value per share;
   d) a reconciliation of the number of shares o/s at the beginning & at the end of the period;
   e) for the period of 5 years immediately preceding the date as at which the Balance Sheet is prepared:
      - Aggregate number & class of shares allotted as fully paid-up pursuant to contract(s) without payment being received in cash.
      - Aggregate number & class of shares allotted as fully paidup by way of bonus shares
      - Aggregate number and class of shares bought back.
   f) Shareholding of Promoter's

Shares held by Promoter at the end of the year				% change during the year
S.No.	Promoter Name	No. of Shares	% of total Shares	
Total				

2) Reserves and Surplus: Debit balance of statement of profit and loss shall be shown as negative figure under the head "Surplus". Similarly, balance of "Reserves & Surplus", after adjusting negative balance of surplus, if any, shall be shown under the head "Reserves and Surplus" even if the resulting figure is in the negative.

3) Current maturities of Long term borrowings shall be disclosed separately under Short term borrowings & not under Other Current Liabilities

4) Trade Payables ageing Schedule:

Particulars	O/s for following periods from due date of payment				
	Less than 1 year	1-2 years	2-3 years	More than 3 years	Total
MSME					
Others					
Disputed dues-MSME					
Disputed dues-Others					

5) PPE & Intangible Assets: A reconciliation of the gross & net carrying amounts of each class of assets at beginning & end of reporting period showing additions, disposals, amount of change due to revaluation (if change is 10% or more in the aggregate of the net carrying value of each class of PPE/ Intangible Assets) & other adjustments & related depreciation & impairment losses/reversals shall be disclosed separately.]

6) Trade Receivables ageing Schedule:

Particulars	O/s for following periods from due date of payment					
	Less than 6 months	6 months – 1 year	1-2 years	2-3 years	More than 3 years	Total
Undisputed -considered good						
Undisputed -considered doubtful						
Disputed - considered good						
Disputed - considered doubtful						

7) Additional Disclosures
   (1) Title deeds of Immovable Property not held in name of the Company.
   (2) Capital WIP/ Intangible Assets under development Ageing schedule.
   (3) Following ratios to be disclosed: (Change >25% as compared to previous year to be explained)
   (a) Current Ratio, (b) Debt-Equity Ratio, (c) Debt Service Coverage Ratio, (d) Return on Equity Ratio, (e) Inventory turnover ratio, (f) Trade Receivables turnover ratio, (g) Trade payables turnover ratio, (h) Net capital T/o ratio, (i) Net profit ratio, (j) Return on Capital employed, (k) Return on investment

CONTINGENT LIABILITIES and COMMITMENTS (to the extent not provided for)

a. Claims against the company not acknowledged as debt
b. Guarantees
c. Arrears of fixed cumulative dividends on preference shares
d. Estimated amount of contracts remaining to be executed on capital account & not provided
e. Uncalled liability on shares and other investments partly paid
f. Bills discounted not yet matured
g. Other money for which the company is contingently liable & other commitments.

PART II – STATEMENT OF PROFIT AND LOSS

Name of the Company…………………..
Profit and loss statement for the year ended ……………………..

	PARTICULARS	Note No.	Figures as at the end of current Reporting period	Figures as at the end of previous reporting period
I.	Revenue from operations			
II.	Other income			
III.	Total Income (I + II)			
IV.	Expenses:			
	Cost of materials consumed			
	Purchases of Stock-in-Trade			
	Changes in inventories of finished goods, work-in-progress and Stock-in-Trade			
	Employee benefits expense			
	Finance costs			
	Depreciation and amortization expense			
	Other expenses			
	Total Expenses			
V.	Profit before exceptional and extraordinary items and tax (III-IV)			
VI.	Exceptional items			
VII.	Profit before extraordinary items & tax (V - VI)			
VIII.	Extraordinary Items			
IX.	Profit before tax (VII- VIII)			
X	Tax expense:			
	(1) Current tax			
	(2) Deferred tax			
XI.	Profit (Loss) for the period from continuing operations (VII-VIII)			
XII.	Profit/(loss) from discontinuing operations			
XIII.	Tax expense of discontinuing operations			
XIV.	Profit/(loss) from Discontinuing operations (after tax) (XII-XIII)			
XV	Profit (Loss) for the period (XI + XIV)			
XVI.	Earnings per equity share:			
	(1) Basic			
	(2) Diluted			

Additional Information:

A Company shall disclose by way of notes additional information regarding aggregate expenditure and income on the following items:

(a) Employee Benefits Expense [showing separately
  - (i) salaries and wages,
  - (ii) contribution to provident and other funds,
  - (iii) expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP),
  - (iv) staff welfare expenses].

(b) Depreciation and amortization expense;
(c) Any item of income or expenditure which exceeds 1% of the revenue from operations or ₹ 1,00,000, whichever is higher;
(d) Interest Income;
(e) Interest Expense;
(f) Dividend Income;
(g) Net gain/ loss on sale of investments;
(h) Adjustments to the carrying amount of investments;
(i) Net gain or loss on foreign currency transaction and translation (other than considered as finance cost);
(j) Payments to the auditor as
a. auditor,
b. for taxation matters,
c. for company law matters,
d. for management services,
e. for other services,
f. for reimbursement of expenses;
(k) In case of companies covered u/s 135, amount of expenditure incurred on corporate social responsibility activities.
(l) Details of items of exceptional and extraordinary nature;
(m) Prior period items

Other Disclosures:

Corporate Social Responsibility (CSR):

Where the company covered under section 135 of the companies act, the following shall be disclosed with regard to CSR activities:-
(a) amount required to be spent by the company during the year,
(b) amount of expenditure incurred,
(c) shortfall at the end of the year,
(d) total of previous years shortfall,
(e) reason for shortfall,
(f) nature of CSR activities,
(g) details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per relevant Accounting Standard,
(h) where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year should be shown separately.

Details of Crypto Currency or Virtual Currency

Where the Company has traded or invested in Crypto currency or Virtual Currency during the financial year, the following shall be disclosed:
a) profit or loss on transactions involving Crypto currency or Virtual Currency.
b) amount of currency held as at the reporting date,
c) deposits or advances from any person for the purpose of trading or investing in Crypto Currency/ virtual currency.

QUESTIONS: SCHEDULE III OF COMPANIES ACT, 2013

Question 1

H Ltd. engaged in the business of manufacturing lotus wine. The process of manufacturing this wine takes around 18 months. Due to this reason H Ltd. has prepared its financial statements considering its operating cycle as 18 months and accordingly classified the raw material purchased and held in stock for less than 18 months as current asset. Comment on the accuracy of the decision and the treatment of the asset by H Ltd., as per the Schedule III.

Solution

As per Schedule III to the Companies Act, 2013, one of the criteria for classification of an asset as a current asset is that the asset is expected to be realised in the company's' operating cycle or is intended for sale or consumption in the company's normal operating cycle. Further, Schedule III to the Companies Act, 2013 defines that an operating cycle is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. However, when the normal operating cycle cannot be identified, it is assumed to have duration of 12 months. As per the facts given in the question, the process of manufacturing of lotus wine takes around 18 months; therefore, its realisation into cash and cash equivalents will be done only when it is ready for sale i.e. after 18 months. This means that normal operating cycle of the product is 18 months. Therefore, contention of company's management that the operating cycle of the product lotus wine is 18 months and not 12 months is correct.

Question 2

C Ltd. is a group engaged in manufacture and sale of industrial and FMCG products. One of their division also deals in Leasing of properties - Mobile Towers. The accountant showed the rent arising from the leasing of such properties as other income in the Statement of Profit and Loss. Comment whether the classification of the rent income made by the accountant is correct or not in the light of Schedule III to the Companies Act, 2013.

Solution

As per the "General Instructions for preparation of Statement of Profit and Loss" given in Schedule III to the Companies Act, 2013, "Other Income" does not include operating income. The term "Revenue from operations" has not been defined under Schedule III to the Companies Act, 2013. However, as per the Guidance Note on Schedule III to the Companies Act, 2013 this would include revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue-generating activities. Whether a particular income constitutes "Revenue from operations" or "Other income" is to be decided based on the facts of each case and detailed understanding of the company's activities. The classification of income would also depend on the purpose for which the particular asset is acquired or held.

As per the information given in the question, C Ltd. is a group engaged in manufacture and sale of industrial and FMCG products and its one of the division deals in leasing of properties - Mobile Towers. Since its one division is continuously engaged in leasing of properties, it shall be considered as its principal or ancillary revenue-generating activities. Therefore, the rent arising from such leasing shall be shown under the head "Revenue from operations" and not as "other income". Hence, the presentation of rent arising from the leasing of such properties as "other income" in the Statement of Profit and Loss is not correct. It should be shown under head "Revenue from operations".

Question 3

In the financial statements of the financial year 2022-2023, Alpha Ltd. has mentioned in the notes to accounts that during financial year, 24,000 equity shares of ₹ 10 each were issued as fully paid bonus shares. However, the source from which these bonus shares were issued has not been disclosed. Is such non-disclosure a violation of the Schedule III to the Companies Act? Comment.

Solution

As per Part I of the Schedule III, a company should, inter alia, disclose in notes to accounts for the period of 5 years immediately preceding the balance sheet date (31st March, 2023 in the instant case) the aggregate number and class of shares allotted as fully paid-up bonus shares. Schedule III does not require a company to disclose the source from which bonus shares have been issued. Therefore, non-disclosure of source from which bonus shares have been issued does not violate the Schedule III to the Companies Act.

Question 4

The management of Loyal Ltd. contends that the work in process is not valued since it is difficult to ascertain the same in view of the multiple processes involved. They opine that the value of opening and closing work in process would be more or less the same. Accordingly, the management had not separately disclosed work in process in its financial statements. Comment in line with Schedule III

Solution

Schedule III to the companies Act does not require that the amounts of WIP at the beginning and at the end of the accounting period to be disclosed in the statement of profit and loss. Only changes in inventories of WIP need to be disclosed in the statement of profit and loss. Non-disclosure of such change in the statement of profit and loss by the company may not amount to violation of Schedule III if the differences between opening and closing WIP are not material.

Question 5

Prince Ltd. presents its provisions for contingencies under "Reserves and Surplus" in Notes to Accounts in its financial statements. Whether this presentation is correct?

Solution

The ICAI's Glossary of Terms Used in Financial Statements defines the term 'Reserve' as "the portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability." 'Reserves' should be distinguished from 'provisions'. For this purpose, reference may be made to the definition of the expression `provision' in AS-29 Provisions, Contingent Liabilities and Contingent Assets. As per AS-29, a `provision' is "a liability which can be measured only by using a substantial degree of estimation". A '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." Present obligation' – "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."

Question 6

Anek Ltd. is a company that is required to present its financial statements as per the Division I of Schedule III. The company has trade receivables at the balance sheet date. What are the disclosures that are applicable with respect to trade receivables in the financial statements?

Solution

Trade Receivables, shall be sub-classified as:

(i) (a) Secured, considered good; (b) Unsecured considered good; (c) Doubtful

(ii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

(iii) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

For trade receivables outstanding, following ageing schedule shall be given:

Particulars	O/s for following periods from due date of payment					
	Less than 6 months	6 months – 1 year	1-2 years	2-3 years	More than 3 years	Total
Undisputed -considered good						
Undisputed -considered doubtful						
Disputed - considered good						
Disputed - considered doubtful						

ASSIGNMENT QUESTIONS

TOPIC 1: DIVIDEND

Question 1 *Pg no._____*

Sumo Ltd. has profit of ₹ 25 lakhs before charging depreciation. Depreciation in books was ₹ 11 lakhs & depreciation as per Section 123 comes to ₹ 17 lakhs. Compute divisible profit.

Question 2 *(ICAI Study Material)* *Pg no._____*

Due to inadequacy of profits during year ended 31st March, 2022, XYZ Ltd. proposes to declare 10% dividend out of general reserves. From the following particulars, ascertain the amount that can be utilized from general reserves, according to the Companies (Declaration of dividend out of Reserves) Rules, 2014:

	₹
17,500 9% Preference shares of ₹ 100 each, fully paid up	17,50,000
8,00,000 Equity shares of ₹ 10 each, fully paid up	80,00,000
General Reserves as on 1.4.2021	25,00,000
Capital Reserves as on 1.4.2021	3,00,000
Revaluation Reserves as on 1.4.2021	3,50,000
Net profit for the year ended 31st March, 2022	3,00,000

Average rate of dividend during the last 3 years has been 12%.

Question 3 *Pg no._____*

From the following particulars, ascertain the amount that can be utilized from general reserves, according to the Companies (Declaration of dividend out of Reserves) Rules, 2014:

5,000 8% Preference shares of ₹ 100 each	5,00,000
2,00,000 Equity shares of ₹ 10 each, fully paid up	20,00,000
General Reserves	6,00,000
Capital Reserve on revaluation	1,00,000
Security Premium	1,00,000
P&L Account (Opening Balance)	18,000
Profit for current year	1,02,000

Average dividend in previous 3 years - 15%. Company proposes to declare dividend @12%

TOPIC 2: FINANCIAL STATEMENTS

Question 4 *Pg no._____*

Sumedha 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 30.09.2021 of ₹ 1,00,000. Determine how the loan will be classified in preparation of Financial Statements of Sumedha Ltd. for the year ended 31st March, 2021 according to Schedule III.

Question 5 *Pg no._____*

Futura Ltd. had following items under "Reserves & Surplus" in Balance Sheet as on 31.03.22

	₹ (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.

Question 6

Pg no._____

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.

Question 7

Pg no._____

The following items appear in the Trial Balance of X Ltd. as at 31st March, 2022:

1.	Revenue from Operations	24,00,000
2.	Other Income	1,00,000
3.	Expenses other than interest	3,80,000
4.	General Reserve (as on 1st April,2021)	1,30,000
5.	Profit & Loss Account (as on 1st April, 2021) ₹ 3,28,000. Company declared equity dividend of 15%. Transfer Debenture Redemption Reserve @ 10% of Debentures. (Assume Corporate Tax @ 30%). Transfer 5% of Net Profit to General Reserve.	
6.	12%, 10,000 Debentures of ₹ 100 each fully paid up	
7.	14%, 5,000 Preference Shares of ₹ 100 each fully paid up	
8.	6,000 Equity Shares of ₹ 100 each	
9.	8,000 Equity Shares of ₹ 100 each, ₹ 25 paid up.	

Show the above items in Profit & Loss Statement and Balance Sheet.

Question 8

Pg no._____

The Articles of Association of S Ltd. provide the following:

(i) That 20% of the net profit of each year shall be transferred to reserve fund.
(ii) That an amount equal to 10% of equity dividend shall be set aside for staff bonus.
(iii) That the balance available for distribution shall be applied:
  a. in paying 14% on cumulative preference shares.
  b. in paying 20% dividend on equity shares.
  c. one-third of the balance available as additional dividend on preference shares and two-third as additional equity dividend.

A further condition was imposed by the articles viz. that the balance carried forward shall be equal to 12% on preference shares after making provisions (i), (ii) and (iii) mentioned above. The company has issued 13,000, 14% cumulative participating preference shares of ₹ 100 each fully paid and 70,000 equity shares of ₹ 10 each fully paid up. The profit for the year 2021 was

₹ 10,00,000 and balance brought from previous year ₹ 80,000. Provide ₹ 31,200 for depreciation and ₹ 80,000 for taxation before making other appropriations. Show net balance of profit and loss account after making above adjustments.

Question 9 *(RTP May 2018) / (RTP May 2021) (Similar)* *Pg no._____*

Kapil Ltd. has authorized capital of ₹50 lakhs divided into 5,00,000 equity shares of ₹10 each. Their books show the following balances as on 31st March, 2022:

	₹		₹
Inventory 1.4.2021	6,65,000	Bank Current Account	20,000
Discounts & Rebates	30,000	Cash in hand	8,000
Carriage Inwards	57,500	Debenture interest (for the period of 6 months ended 30.9.2021	10,000
Patterns	3,75,000	Interest (Bank Loan)	91,000
Rate, Taxes and Insurance	55,000	Calls in Arrear @ ₹ 2 per share	10,000
Furniture & Fixtures	1,50,000	Equity share capital (2,00,000 shares of ₹ 10 each)	20,00,000
Purchases	12,32,500	4% Debentures (repayable after 10 years)	5,00,000
Wages	13,68,000	Bank Overdraft	7,57,000
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, 2022 was ₹ 7,08,000. 4% Debentures amounting ₹ 5,00,000 were issued on 1.04.2021. Outstanding liabilities for wages ₹ 25,000 and business expenses ₹ 36,000. Dividend declared @ 12% on paid-up capital and it was decided to transfer to reserve @ 2.5% of profits.

Charge depreciation 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 ₹16,000 as bad debts.

Create debenture redemption reserve @ 10% of Debentures. Provide for income tax @ 30%.

You are required to prepare Statement of Profit & Loss for the year ended 31st March, 2022 and Balance Sheet as on that date

Question 10 – *(RTP May 2022) / (ICAI Study Material)* *Pg no._____*

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 cap. (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 (bal. 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:

a) The authorized share capital of the company is 80,000 shares of ₹ 10 each.
b) The company revalued the land at ₹ 9,60,000.
c) Equity share capital includes shares of ₹ 50,000 issued for consideration other than cash.
d) Suspense account of ₹ 10,000 represents cash received from the sale of some of the machinery on 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.
e) Depreciation is to be provided on plant and machinery at 10% on cost.
f) Balance at bank includes ₹ 5,000 with ABC Bank Ltd., which is not a Scheduled Bank.
g) Make provision for income tax @30%.
h) Trade receivables of ₹ 50,000 are due for more than six months.
i) Declared dividend @10% on 03.04.2021.

You are required to prepare Delta Limited's Balance Sheet as at 31.3.2021 and Statement of Profit and Loss with notes to accounts for the year ended 31.3.2021 as per Schedule Ill. Ignore previous year's figures.

Question 11 *(RTP Nov 2020) (Similar) / (ICAI Study Material)* *Pg no.______*

On 31st March, 2022 Bose and Sen Ltd. provides to you the following ledger balances after preparing its Profit and Loss Account for the year ended 31st March, 2022:

Credit Balances	₹
Equity shares capital, fully paid shares of ₹ 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 year ₹ 2,00,000)	
Loans: Unsecured (Long term)	8,47,000
Sundry Creditors for goods & expenses (Payable within 6 months)	14,00,000
Profit & Loss Account	7,00,000
Provision for Taxation	4,16,900
Dividend Payable	4,00,000
	1,33,63,000

Debit Balances	₹
Calls in arrear	7,000
Land	14,00,000
Buildings	20,50,000
Plant and Machinery	36,75,000
Furniture & Fixture	3,50,000
Stocks : Finished goods : Raw Materials	14,00,000 3,50,000
Trade Receivables	14,00,000
Advances: Short-term	2,98,900
Cash in hand	2,10,000

Balances with banks	17,29,000
Preliminary Expenses	93,100
Patents & Trade marks	4,00,000
	1,33,63,000

The following additional information is also provided :

(i) 4,20,000 fully paid equity shares were allotted as consideration for land & buildings.

(ii)

a. Cost of Building ₹ 28,00,000
b. Cost of Plant & Machinery ₹ 49,00,000
c. Cost of Furniture & Fixture ₹ 4,37,500

(iii) Trade Receivables for ₹ 3,80,000 are due for more than 6 months.

(iv) The amount of Balances with Bank includes ₹ 18,000 with a bank which is not a scheduled Bank and the deposits of ₹ 5 lakhs are for a period of 9 months.

(v) Unsecured loan includes ₹ 2,00,000 from a Bank and ₹ 1,00,000 from related parties.

(vi) Entire amount of Preliminary expenses to be written off, by adjusting from opening balance of General Reserve.

You are required to prepare the Balance Sheet of the Company as on 31st March, 2022 as required under Schedule III of the Companies Act, 2013. You are not required to give previous year figures.

Question 12

Pg no._____

The following are the balances from the Ledger of Mount View Hotel Ltd., on 31st March 2022:

	₹
Share Capital - Credit Balance on 1st January, 2022	56,685
Freehold Premises	46,800
Furniture and Fittings	8,934
Glass and China	1,101
Linen	840
Cutlery and Plate	390
Rates, Taxes and Insurance	1,713
Salaries	2,400
Wages	4,305
Stocks on 31st March, 2021 :	
Wines, ₹ 1,239 ; Spirits, ₹ 378 ; Beer, ₹ 165 ;	1,782
Minerals, ₹ 147 ; Cigars and Cigarettes, ₹ 114	261
Sundry Provisions and Stores, ₹ 183; Coal, ₹ 150	333
Purchases :	
Meat, ₹ 3,627 ; Fish and Poultry ₹ 3,960	7,587
Sundry Provisions and Stores, ₹ 5,220	5,220
Wines ₹ 1,881 ; Spirits ₹ 2,190 ; Beer ₹ 1,152	5,223
Minerals, ₹ 1,050 : Cigars and Cigarettes, ₹ 240	1,290
Laundry	951
Coal and Gas	2,160
Electric Light	1,128
General Expenses	1,710
Sales —	
Wines, ₹ 3,870 ; Spirits, ₹ 4,335 ; Beer, ₹ 1,863	10,068
Minerals, ₹ 2,160 ; Cigars and Cigarettes, ₹ 390	2,550
Meals	23,829
Rooms	9,375

Washing Charges & Charges for providing fire facility in bedrooms	801
Repairs, Renewals, and Depreciation - Premises, ₹ 348 ; Furniture and Fittings, ₹ 660 Glass and China, ₹ 609 ; Linen, ₹ 390 Cutlery and Plate	 1,008 999 207
Cash Book - Debit Balances: In Bank On hand	 7,500 2,367
Visitors Accounts unpaid	489
Sundry Creditors	3,390

Stocks on 31st March, 2022 were valued as follows -
Wines, ₹ 1,197; Spirits, ₹ 333 ; Beer, ₹ 174 ;
Minerals, ₹ 357; Cigars and Cigarettes, ₹ 69;
Sundry Provisions and Stores, ₹ 141; Coal, ₹ 99

The Manager is entitled to a commission of 5% of the net profits after charging his commission. The authorised share capital is 10,000 shares of ₹ 10 each of which 5,700 shares were issued, the whole of the amount being called up. The final call on 210 shares @ ₹ 1.50 per share was unpaid; the directors forfeited these shares at their meeting held on 15th March, 2022.

The tax liability is estimated at ₹ 4,300 and the company declared dividend at the rate of 6%. Prepare the Final Accounts for presentation to the shareholders.

Question 13 *(RTP Nov 2021) / (RTP May 2019) (Similar)* *Pg no.______*

Om Ltd. has the Authorised Capital of ₹ 15,00,000 consisting of 6,000 6% Preference shares of ₹ 100 each and 90,000 equity Shares of ₹10 each. The following was the Trial Balance of the Company as on 31st March, 2022

Particulars	Dr.	Cr.
Investment in shares at cost (non current investment)	1,50,000	
Purchases	14,71,500	
Selling Expenses	2,37,300	
Opening Inventory	4,35,600	
Salaries & Wages (including 30,000 Director's Remuneration)	1,56,000	
Cash in Hand	84,000	
Bills Receivable	1,24,500	
Interest on Bank Overdraft	29,400	
Interest on Debentures upto 30th Sept (1st Half year)	11,250	
Debtors & Creditors	1,50,300	2,63,550
Freehold Property at cost	10,50,000	
Furniture at cost less depreciation of 45,000	1,05,000	
6% Redeemable 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
Dividend Received		12,750
Profit & Loss A/c (Opening Balance)		85,500
Sales (Net)		20,11,050
Bank Overdraft (secured by hypothecation of stocks & receivables)		4,50,000
Technical know how fees (cost paid during the year)	4,50,000	
Audit Fees	18,000	
Total	44,72,850	44,72,850

1. Closing Stock was valued at ₹ 4,27,500.
2. Purchases include 15,000 worth of goods & articles distributed among valued customers.
3. Salaries and Wages include ₹ 6,000 being Wages incurred for installation of Electrical Fittings which to be recorded under "Furniture".
4. Bills Receivable include ₹ 4,500 being dishonoured bills. 50% of which had been considered irrecoverable.
5. Bills Receivable of ₹ 6,000 maturing after 31st March were discounted.
6. Depreciation on Furniture to be charged at 10% on Written Down Value.
7. Interest on Debentures for the half year ending on 31st March was due on that date.
8. Technical Knowhow Fees is to be written off over a period of 10 years.
9. Trade receivables include ₹ 18,000 due for more than six months.

You are required to prepare the Profit and Loss Statement for the year ended 31st March, 2022 and the Balance Sheet as on 31st March, 2022 as per Schedule III of the Companies Act, 2013 after taking into account the above information. Ignore taxation.

Question 14 - *(ICAI Study Material) / (RTP May 2019) / (RTP Nov 2021) (Similar)* *Pg no._____*

State under which head these accounts should be classified in Balance Sheet, as per Schedule III of the Companies Act:

(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) Long term maturity of finance lease obligation.

PRACTICE QUESTIONS

TOPIC 1: DIVIDEND

Question 1 *(RTP May 2021)* *Pg no._____*

XYZ Ltd. is having inadequacy of profits in the year ending 31-03-2022 and it proposes to declare 10% dividend out of General Reserves.

From the following particulars ascertain the amount that can be utilized from general reserves, according to the Companies (Declaration of Dividend out of Reserves) Rules, 2014:

	₹
5,00,000 Equity shares of ₹ 10 each, fully paid up	50,00,000
General Reserves	25,00,000
Revaluation Reserves	6,50,000
Net profit for the year	1,42,500

Average rate of dividend during the last five years has been 12%.

TOPIC 2: FINANCIAL STATEMENTS

Question 2 *(ICAI Study Material)* *Pg no._____*

You are required to prepare financial statements from the following trial balance of Haria Chemicals Ltd. for the year ended 31st March, 2022.

Particulars	Dr.	Particulars	Cr.
Stock	6,80,000	Equity Shares Capital (Shares of ₹ 10 each)	25,00,000
Furniture	2,00,000	11% Debentures	5,00,000
Discount	40,000	Bank loans	6,45,000
Loan to Directors	80,000	Bills payable	1,25,000
Advertisement	20,000	Creditors	1,56,000
Bad debts	35,000	Sales	42,68,000
Commission	1,20,000	Rent received	46,000
Purchases	23,19,000	Transfer fees	10,000
Plant and Machinery	8,60,000	Profit & Loss account	1,39,000
Rentals	25,000	Depreciation provision : Machinery	1,46,000
Current account	45,000		
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 & Equipments	2,45,000		
Goodwill	2,65,000		
Debtors	2,87,000		
Bills receivable	1,53,000		
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 stock on 31-3-2022: ₹ 8,23,000

(Ans: Profit 6,01,000; Balance Sheet Total 46,66,000)

Question 3 *(RTP Nov 2019) / (RTP Nov 2022)* Pg no._____

The following balance appeared in the books of Oliva Company Ltd. as on 31-03-2022

Particulars		₹	Particulars		₹
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		45,000
Purchases		12,15,000	Share Capital		3,15,000
Manufacturing Expenses		2,70,000	Secured Loans :Short-term	4,500	
Salaries and wages		40,200	:Long-term	21,000	25,500
General Charges		16,500	Unclaimed Dividend		3,000
Stores and Spare Parts Consumed		45,000	Deposits (unsecured) Short -Term	1,500	
Building		1,01,000	Long -Term	3,300	4,800
Plant and Machinery		70,400	Trade Payables		3,27,000
Furniture		10,200			
Motor Vehicles		40,800			
Interim Dividend		27,000			
Investments:					
Current	4,500				
Non Current	7,500	12,000			
Trade Receivables		2,38,500			
Cash in Bank		2,71,100			
		24,34,200			24,34,200

From the above balance and the following information, prepare the company's Profit and Loss Account for the year ended 31st March, 2022 and Company's Balance Sheet as on that date:

1. Inventory on 31st March, 2022 Raw material ₹ 25,800 & finished goods ₹ 60,000.
2. Outstanding Expenses: Manufacturing Expenses ₹ 67,500 & Salaries & Wages ₹ 4,500.
3. Interest accrued on Securities ₹ 300.
4. General Charges prepaid ₹ 2,490.
5. Provide depreciation: Building @ 2% p.a., Machinery @ 10% p.a., Furniture @ 10% p.a. & Motor Vehicles @ 20% p.a.
6. Current maturity of long term loan is ₹ 1,000.
7. The Taxation provision of 40% on net profit is considered.

(Ans: Profit 29,430; Balance Sheet Total 8,14,350)

Question 4 *(ICAI Study Material)* Pg no._____

Ring Ltd. was registered with a nominal capital of ₹ 10,00,000 divided into shares of ₹ 100 each. The following Trial Balance is extracted from the books on 31st March, 2022:

Particulars	₹	Particulars	₹
Buildings	5,80,000	Sales	10,40,000
Machinery	2,00,000	Outstanding Expenses	4,000
Closing Stock	1,80,000	Provision for Doubtful Debts (01/04/2021)	6,000

Loose Tools	46,000	Equity Share Capital	4,00,000
Purchases (Adjusted)	4,20,000	General Reserve	80,000
Salaries	1,20,000	Profit and Loss A/c (01/04/2021)	50,000
Directors' Fees	20,000	Creditors	1,84,000
Rent	52,000	Provision for depreciation:	
Depreciation	40,000	On Building 1,00,000	
Bad Debts	12,000	On Machinery 1,10,000	2,10,000
Investment	2,40,000	14% Debentures	4,00,000
Interest accrued on investment	4,000	Interest on Debentures accrued but not due	28,000
Debenture Interest	56,000	Interest on Investments	24,000
Advance Tax	1,20,000	Unclaimed dividend	10,000
Sundry expenses	36,000		
Debtors	2,50,000		
Bank	60,000		
	24,36,000		24,36,000

You are required to prepare statement of Profit and Loss for the year ending 31st March, 2022 and Balance sheet as at that date after taking into consideration the following information:

a) Closing stock is more than opening stock by ₹ 1,60,000
b) Provide to doubtful debts @ 4% on Debtors
c) Make a provision for income tax @30%.
d) Depreciation expense included depreciation of 16,000 on Building & of 24,000 on Machinery.
e) Dividend declared @ 25% on 2nd April, 2022
f) Transfer to General Reserve @10%.
g) Bills Discounted but not yet matured ₹ 20,000.

(Ans: Profit 2,12,800; Balance Sheet Total 14,60,000)

Question 5 (ICAI Study Material) / (RTP May 2023) (Similar) Pg no._____

From the following particulars furnished by Pioneer Ltd., prepare the Balance Sheet as at 31st March, 2022 as required by Schedule III of the Companies Act. Give notes at the foot of the Balance Sheet as may be found necessary –

	Dr. (₹)	Cr. (₹)
Equity Capital (Face value of ₹ 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	
General Reserve		2,10,000
Loan from State Financial Corporation		1,50,000
Stock : Finished Goods 2,00,000 Raw Materials 50,000	2,50,000	
Provision for Taxation		68,000
Sundry Debtors	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
Sundry Creditors (For Goods and Expenses)		2,00,000
	18,95,700	18,95,700

The following additional information is also provided:

(1) 2,000 equity shares were issued for consideration other than cash.

(2) Debtors of ₹ 52,000 are due for more than six months.

(3) The cost of assets:

a. Building ₹ 4,00,000

b. Plant and Machinery ₹ 7,00,000

c. Furniture ₹ 62,500

(4) The balance of ₹ 1,50,000 in the loan account with State Finance Corporation is inclusive of ₹ 7,500 for interest accrued but not due. The loan is secured by hypothecation of Plant and Machinery.

(5) Balance at Bank includes ₹ 2,000 with Perfect Bank Ltd., which is not a Scheduled Bank.

(6) Bills receivable for ₹ 2,75,000 maturing on 30th June, 2022 have been discounted.

(7) The company had contract for the erection of machinery at ₹ 1,50,000 which is still incomplete.

(Ans: Balance Sheet Total 18,94,700)

Question 6 (Inter Nov 2019) (10 Marks) *Pg no._____*

From the following particulars furnished by the Prashant Ltd., prepare the Balance Sheet as at 31st March, 2022 as required by Schedule III of the Companies Act, 2013 :

Particulars	Debit (₹)	Credit (₹)
Equity share capital (face value of ₹ 10 each)		15,00,000
Calls-in-arrears	5,000	
Land	5,50,000	
Building	4,85,000	
Plant & machinery	5,60,000	
General reserve		2,70,000
Loan from State Financial Corporation		2,10,000
Inventories	3,15,000	
Provision for taxation		72,000
Trade receivables	2,95,000	
Short-term loans & advances	58,500	
Profit & loss account		1,06,800
Cash in hand	37,300	
Cash at bank	2,85,000	
Unsecured loans		1,65,000
Trade payables		2,67,000
Total	25,90,800	25,90,800

The following additional information is also provided:

1) 10,000 equity shares were issued for consideration other than cash.

2) Trade receivables of ₹55,000 are due for more than six months.

3) The cost of building and plant & machinery is ₹5,50,000 and ₹6,25,000 respectively.

4) Loan from State Financial Corporation is secured by hypothecation of plant & machinery. Balance of 2,10,000 in this account is inclusive of 10,000 for interest accrued but not due.

5) Balance at Bank included ₹15,000 with Aakash Bank Ltd., which is not a scheduled bank.

(Ans: Balance Sheet Total 25,85,800)

Question 7 ***(RTP May 2020) (Similar) / (ICAI Study Material)*** *Pg no._____*

From the following particulars furnished by Alpha Ltd., prepare the Balance Sheet as on 31st March 2022 as required by Part I, Schedule III of the Companies Act, 2013

Particulars		Debit (₹)	Credit (₹)
Equity Share Capital (Face value of ₹ 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 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

The following additional information is also provided:

a) 10,000 Equity shares were issued for consideration other than cash.

b) Trade receivables of ₹ 2,60,000 are due for more than 6 months.

c) Cost of Assets: Building ₹ 30,00,000, Plant & Machinery ₹ 35,00,000 and Furniture ₹ 3,12,500

d) Balance of ₹ 7,50,000 in Loan Account with State Finance Corporation is inclusive of 37,500 for Interest Accrued but not Due. The loan is secured by hypothecation of Plant & Machinery.

e) Balance at Bank includes ₹ 10,000 with Omega Bank Ltd., which is not a Scheduled Bank.

f) Transfer ₹ 20,000 to general reserve is proposed by Board of directors.

g) Declared dividend of 5% on the paid up capital on 2nd April, 2022

(Ans: Balance Sheet Total 94,73,500)

Question 8 ***(ICAI Study Material)*** *Pg no._____*

On 31st March, 2022, SR Ltd. provides the following ledger balances after preparing its Profit & Loss Account for the year ended 31st March, 2022.

Particulars	Debit	Credit
Equity Share Capital, fully paid shares of ₹ 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 by hypothecation 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	
	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 ₹ 32,00,000 Plant and Machinery ₹ 30,00,000 Furniture and Fixture ₹ 16,50,000

(3) Trade Receivables for ₹ 4,86,000 due for more than 6 months.

(4) Balances with banks include ₹ 56,000, the Naya bank, which is not a scheduled bank.

(5) Loan from Public Finance Corporation repayable after 3 years.

(6) Balance of ₹ 26,30,000 in the loan account with Public Finance Corporation is inclusive of ₹ 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 ₹ 13,80,000 (Amount repayable within one year ₹ 4,80,000)
Loan taken from Directors ₹ 8,50,000

(8) Bills Receivable for ₹ 1,60,000 maturing on 15th June, 2022 has been discounted.

(9) Short term borrowings includes:
Loan from Naya bank ₹ 1,16,000 (Secured) Loan from directors ₹ 48,000

(10) Transfer of ₹ 35,000 to general reserve has been proposed by the Board of directors out of the profits for the year.

(11) Inventory of finished goods includes loose tools costing ₹ 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 2022 as required under Part - I of Schedule III of the Companies Act, 2013. You are not required to give previous year figures.

(Ans: Balance Sheet Total 1,76,09,000)

Question 9 *(ICAI Study Material)* *Pg no._____*

You are required to prepare a Statement of Profit & Loss and Balance Sheet from the following Trial Balance extracted from the books of the International Hotels Ltd., on 31st March, 2022:

	Dr. (₹)	Cr. (₹)
Authorised Capital-divided into 5,000 6% Preference Shares of ₹ 100 each and 10,000 equity Shares of ₹ 100 each		15,00,000
Subscribed Capital – 5,000 6% Preference Shares of ₹ 100 each Equity Capital		 5,00,000 8,05,000
Purchases - Wines, Cigarettes, Cigars, etc. - Foodstuffs	45,800 36,200	
Wages and Salaries	28,300	
Rent, Rates and Taxes	8,900	
Laundry	750	

Sales - Wines, Cigarettes, Cigars, etc. -Food		68,400 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	
Stock on hand, 1st April, 2021 Wines, Cigarettes. Cigars, etc Foodstuffs	 12,800 5,260	
Cash in hand	2,200	
Cash with Bankers	76,380	
Preliminary and formation expenses	8,000	
2,000 Debentures of ₹ 100 each (6%)		2,00,000
Profit and Loss Account		41,500
Sundry Creditors		42,000
Sundry Debtors	19,260	
Investments	2,72,300	
Goodwill at cost	5,00,000	
General Reserve		2,00,000
	19,75,000	19,75,000

a) Wages and Salaries outstanding 1,280

b) Stock on 31st March, 2022:-
Wines, Cigarettes and Cigars, etc. 22,500 Foodstuffs 16,400

c) Depreciation: Furniture and Fittings @ 5% p.a. : Land and Building @ 2% p.a.

The Equity capital on 1st April, 2021 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 2021. A shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ ₹ 90 per share as fully paid.

The directors declared dividend of 8% on equity shares on 02.04.2022, transferring any amount that may be required from General Reserve. Ignore Taxation.

(Ans: Profit 22,245; Balance Sheet Total 18,24,025)

Question 10 *(Inter July 2021) (20 Marks)* *Pg no._____*

The following is the Trial Balance of H Ltd., as on 31st March, 2021:

	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 (31-03-2021)	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:

(i) 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
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. Directors made 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 valuer 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.

(vi) Amortize 1/5th of Goodwill.

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.

(Ans: Profit 1,84,900; Balance Sheet Total 82,01,900)

Question 11 *(RTP May 2022)* Pg no._____

"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 the line with schedule III to the Companies Act, 2013

Question 12 *(Inter Nov 2022) (20 Marks)* Pg no._____

The following is the Trial Balance of Anmol Limited as on 31st March, 2022:

Debit Balance	Amount(₹)	Credit Balances	Amount(₹)
Purchases	82,95,000	Sales	1,25,87,000
Wages and Salaries	12,72,000	Commission	72,500
Rent	2,20,000	Equity Share Capital	10,00,000
Rates and Taxes	50,000	General Reserve	10,00,000
Selling & Distribution Expenses	4,36,000	Surplus (P&L A/c) 01.04.2021	8,75,500
Directors Fees	32,000	Securities Premium	2,50,000

Bad Debts	38,500	Term Loan from Public Sector Bank	1,02,00,000
Interest on Term Loan	8,05,000	Trade Payables	55,08,875
Land	24,00,000	Provision for Depreciation:	
Factory Building	36,80,000	On Plant & Machinery	9,37,500
Plant and Machinery	62,50,000	On Furniture and Fittings	82,500
Furniture and Fittings	8,25,000	On Factory Building	1,84,000
Trade Receivables	64,75,000	Provision for Doubtful Debts	25,000
Advance Income Tax Paid	37,500	Bills Payable	1,25,000
Stock (1st April,2021)	9,25,000		
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 and Fittings 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 and Machinery. 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 5th April, 2022.

You are required to prepare Balance Sheet as on 31st March 2022 and Statement of Profit and Loss with Note to Accounts for the year ending 31st March, 2022 as per Schedule III of the Companies Act, 2013. Ignore previous years' figures.

(Ans: Profit 3,50,962; Balance Sheet Total 1,96,03,825)

CASH FLOW STATEMENT (AS-3)

CH 2

"Winners aren't who Never fail, But People who Never quit…"

It is an additional information provided to the users of accounts in the form of a statement, which reflects the various sources from where cash was generated (inflow of cash) by an enterprise during the relevant accounting year and how these inflows were utilized (outflow of cash) by the enterprise.

Financial statements with respect to one person company, small company, dormant company and private company (if such a private company is a startup), may not include the cash flow statement.

Cash Flow Statement helps the users of accounts:
- To identify the historical changes in the flow of cash & cash equivalents.
- To determine the future requirement of cash & cash equivalents.
- To assess the ability to generate cash & cash equivalents.
- To estimate the further requirement of generating cash & cash equivalents.
- To compare the operational efficiency of different enterprises.
- To study the insolvency and liquidity position of an enterprise.
- As an indicator of amount, timing and certainty of future cash flows.
- To check the accuracy of past assessments of future cash flows
- In examining relationship between profitability & net cash flow & impact of changing prices

THE TERM 'CASH'

Meaning	Cash comprises Cash in hand and Demand Deposits with banks.
Examples	Cash in hand, Cash at Bank

THE TERM 'CASH EQUIVALENTS'

Meaning	Cash Equivalents are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.
Purpose	Cash Equivalents are held for the purpose of meeting short-term cash commitments rather than for Investment or other purposes.
Conditions to qualify	It must be readily convertible to a known amount of cash. It must be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only *when it has a short maturity of, say, 3 months or less* from the date of acquisition. Investments in shares are not normally taken as cash equivalent (unless they are in substance cash equivalent), because of uncertainties associated with them as to realisable value.
Examples	Treasury Bills, Commercial Papers, Commercial Bills, Call Money, Certificate of Deposit

TRANSACTIONS NOT CONSIDERED AS CASH FLOWS

Meaning	Transactions which represent movements between items of Cash or Cash Equivalents are not considered as Cash Flows.
Reason	These components are part of the cash management of an enterprise rather than part of its Operating, Investing and Financing Activities.
Examples	a) Cash deposited into Bank; b) Cash withdrawn from Bank; c) Purchase/Sale of Short-term Marketable Securities (neither held as Current Investments nor held as Non-current Investments).

'CASH FLOWS'

Cash Flows	Cash Flows are inflows and outflows of Cash and Cash equivalents.
Cash Inflows	Cash Inflow arises when the net effect of transaction is increase in the amount of Cash or Cash Equivalents.
Cash Outflows	Cash Outflow arises when the net effect of transaction is to decrease in the amount of Cash or Cash Equivalents.

EXAMPLES OF CASH FLOWS

CASH INFLOWS	CASH OUTFLOWS
1) Cash Sales of Goods	1) Cash Purchases of Goods
2) Cash received from Trade Debtors	2) Cash paid to Trade Creditors
3) Cash received from commission & Royalty	3) Operating Expenses paid (e.g. Salaries & Wages, Administration Exp. Selling Exp.)
4) Sale of Fixed Assets for Cash	4) Income Tax paid
5) Sale of Investments (whether Current or Non-Current) for Cash	5) Purchase of Fixed Assets for Cash
6) Loans & Advances repayment received (whether Short term or Long term)	6) Purchase of Investments (whether Short term or Long term) for Cash
7) Income received on Investments (whether Current or Non-Current)	7) Loans & Advances granted (whether Short term or Long term)
8) Issue of Equity Shares for Cash	8) Buy-back of Equity Shares for Cash
9) Issue of Preference Shares for Cash	9) Redemption of Preference Shares for Cash
10) Issue of Debentures for Cash	10) Redemption of Debentures for Cash
11) Loans taken (whether Short/Long term)	11) Loans repaid (whether Short/Long term)
	12) Interest on Debentures & Loans paid.
	13) Final Dividend on Equity Shares paid.
	14) Dividend on Preference Shares paid.
	15) Interim Dividend on Equity Shares paid.

ACTIVITIES

Operating Activities	Investing Activities	Financing Activities
Principal Revenue producing activities	Acquisition & disposal of Long Term Assets & Investments	Activities that result in change in size & composition of Owner's capital & borrowings

OPERATING ACTIVITIES

MEANING OF OPERATING ACTIVITIES

Principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

EXAMPLES OF CASH FLOWS FROM OPERATING ACTIVITIES

Cash Inflows	Cash Outflows
1) Cash Sales of Goods	1) Cash Purchases of Goods
2) Cash received from Trade Debtors	2) Cash paid to Trade Creditors
3) Cash received from Trading Commission & Royalty	3) Operating Expenses paid (e.g. Salaries & Wages, Administration Exp. Selling Exp.)
	4) Income Tax paid (Operating Activity only).

NOTES

In case of ***Financial Enterprises*** the following activities are classified as Operating Activities since they relate to the main revenue-producing activity of that enterprise:

- *Purchases and Sales of Shares & Debentures of other companies for Cash*
- *Dividend received on Shares of other companies*
- *Interest received on Debentures of other companies*
- *Loans & Advances granted*
- *Interest received on Loans & Advances granted*

Other Examples: Cash receipts and cash payments of an insurance entity for premiums and claims, annuities, and other policy benefits

INVESTING ACTIVITIES

MEANING OF INVESTING ACTIVITIES

Acquisition & disposal of long-term assets & other investments not included in cash equivalents.

EXAMPLES OF CASH FLOWS FROM INVESTING ACTIVITIES

Cash inflows	Cash outflows
1) Cash sale of fixed assets	1) Cash purchase of fixed assets
2) Cash sale of investments (whether current or non-current)	2) Cash purchase of investments (whether short term or long term)
3) Loans & advances repayment received (whether short term or long term)	3) Loans & advances granted (whether short term or long term)
4) Income received on investments (whether current or non-current)	4) Brokerage paid on purchase of investments (whether short term or long term)

FINANCING ACTIVITIES

MEANING OF FINANCING ACTIVITIES
Activities that result in changes in size and composition of the Owners' capital (including Preference share capital in case of a company) and Borrowings (whether short term or long term) of the enterprise.

EXAMPLES OF CASH FLOWS FROM FINANCING ACTIVITIES

Cash inflows	Cash outflows
1) Issue of Equity shares for cash	1) Buy-back of Equity shares for cash.
2) Issue of Preference shares for cash	2) Redemption of Preference shares for cash
3) Issue of Debentures for cash	3) Redemption of Debentures for cash
4) Loans taken (whether short term or long-term)	4) Loans repaid (whether short term or long term)
	5) Interest on Debentures and Loans paid
	6) Dividend on Shares Paid
	7) Brokerage & Underwriting Commission Paid on issue of Shares & Debentures

NON-CASH TRANSACTIONS

Meaning	Those transactions which do not involve Cash
Examples (Verification by Journal Entry)	Issue of Equity Shares or Debentures against the purchase of an Asset Asset A/c Dr To Equity Share Capital A/c / Debentures A/c
	Issue of Equity Shares on conversion of Convertible Debentures Convertible Debentures A/c Dr To Equity Share Capital A/c
Why ignored in CFS?	Non-Cash transactions are ignored while preparing Cash Flow Statement because these do not involve Cash.

Interest & Dividend Received

Normal / Non Financial Enterprise → Investing Activity

Financial Enterprise → Operating Activity

Dividend Paid → Financing Activity (Always)

STEPS INVOLVED IN THE PREPARATION OF CASH FLOW STATEMENT

Step 1: Calculate the Cash flow from Operating activities.
Step 2: Calculate the Cash flow from Investing activities
Step 3: Calculate the Cash flow from Financing activitites
Step 4: Calculate Net Increase/(Decrease) in cash & cash equivalents [Step (1 + 2 + 3)]
Step 5: Calculate the Cash and Cash Equivalents at the beginning of period
Step 6: Calculate the Cash and Cash Equivalents at the end of period [Step (4 + 5)]

HOW TO COMPUTE NET CASH FLOW FROM OPERATING ACTIVITIES (UNDER DIRECT METHOD)

Particulars	₹	₹
A. Operating Receipts in Cash (e.g.)		
Cash Sales	xxx	
Cash receipts from Debtors	xxx	
Trading Commission received	xxx	xxx
B. Opening Payments in cash (e.g.)		
Cash Purchases	xxx	
Cash paid to Suppliers	xxx	
Wages & Salaries Paid	xxx	
Office and Administration Expenses paid	xxx	
Manufacturing overheads paid	xxx	
Selling and Distribution expenses paid	xxx	xxx
C. Cash Generated from Operations before taxes (A-B)		xxx
D. Income tax paid (Net of refund of Tax)		xxx
E. Cash flow before extraordinary item (C-D)		xxx
F. Extraordinary item		xxx
G. Net cash from (used in) Operating Activities		xxx

HOW TO COMPUTE NET CASH FLOW FROM OPERATING ACTIVITIES (UNDER INDIRECT METHOD)

Particulars	₹	₹
Step 1: Calculate Net Profit before Taxation & Extraordinary item:		
Closing Balance of P & L A/c		xxx
Less: Opening Balance of P&L A/c (or Add: Opening Bal. of P&L A/c (Dr.)		xxx
Add: Dividend declared for the current year		xxx
Add: Interim Dividend paid during the current year		xxx
Add: Transfer to Reserve (or Less : Transfer from Reserve)		xxx
Add: Provision for Tax made during the Current Year		xxx
Less: Refund of Tax credited to P&L A/c		(xxx)
Less: Extraordinary Item, if any, credited to P&L A/c (e.g. Insurance proceeds from earthquake disaster settlement)		(xxx)
Add: Extraordinary Debit Items (e.g. Loss due to earthquake)		xxx
Net Profit before Taxation and Extraordinary Item		xxx
Step 2: Calculate Operating Profit before Working Capital Changes:		
Net Profit before Taxation and Extraordinary Item		xxx
Adjustments for Non-Cash and Non-Operating Items: (For Example)		
Depreciation	xxx	
Interest on Debentures & Loans (whether Short term or Long Term)	xxx	
Preliminary Expenses/Underwriting Commission/Discount on	xxx	
Issue of Debentures/Shares written off	xxx	
Goodwill/Patents/Trade Marks/Copyright amortized	xxx	
Loss on Sale of Investments (whether Current or Non Current)	xxx	
Interest income from Investments (whether current or non-current)	(xxx)	
Dividend income	(xxx)	
Rental income	(xxx)	
Profit on sale of Investments (whether current or non-current)	(xxx)	xxx
Operating profit before working capital changes		xxx

Step 3: Calculate Cash from Operations before tax & Extraordinary item:		
A. Operating profit before working capital changes		xxx
B. Add: Changes in current assets (Excluding cash and cash equivalents) & Current Liabilities (excluding bank overdraft and cash credit):	xxx	
Decrease in Inventories, Trade Receivables etc.	xxx	
Increase in Trade Payables, O/s exp. Etc.	xxx	
Increase in Inventories, Trade Receivables etc.	(xxx)	
Decrease in trade Payables, O/s Exp. etc.	(xxx)	xxx
Cash Generated from Operations		xxx
Step 4: Calculate Cash generated from Operations after tax but before extraordinary item:		
A. Cash generated from Operations		xxx
B. Less: Income taxes paid (incl. Advance tax but excl. refund of tax)		(xxx)
(Note: Income tax should be related to operating activities only)		
C. Cash flow before extraordinary item		xxx
Step 5 : Calculate Net Cash from (used in) Operating Activities :		
Cash Flow before Extraordinary Items		xxx
Add : Extraordinary Items (e.g. Insurance proceeds from earthquake disaster settlement, Govt. Grant)		xxx
Net Cash Flow from (used in) Operating Activities		xxx

Note : Negative items which are to be deducted have been shown in brackets.

CALCULATION OF CASH FLOW FROM INVESTING ACTIVITIES

Particulars	₹
A. Cash inflow from Investing Activities:	
Sale of Tangible Fixed Assets (eg. Machinery) for cash	xxx
Sale of Intangible Assets (e.g. Goodwill/Patents/Trademark/Copyright) for cash	xxx
Sale of Investments (whether current or non-current) for cash	xxx
Loans & Advances repayments received (whether short term or long term)	xxx
Incomes from Investments (whether current or non-current)	xxx
Dividend received on Shares held as investments	xxx
Interest received on Debentures held as investments	xxx
Rent received from Immovable property held as investments	xxx
B. Cash used in Investing Activities	
Purchase of Tangible Fixed Assets (e.g. Machinery) for cash	(xxx)
Purchase of Intangible Assets (e.g. Goodwill/Patents/Trademark/Copyright) for cash	(xxx)
Purchase of Investments (whether current or non-current) for cash	(xxx)
Loans & Advances granted (whether short term or long term)	(xxx)
Net Cash flow from/used in Investing Activities (if A>B)/ (If A<B)	xxx

CALCULATION OF CASH FLOW FROM FINANCING ACTIVITIES

Particulars	₹
A. Cash inflows from financing Activities:	
Issue of Equity share capital for cash	xxx
Issue of Preference share capital for cash	xxx
Issue of debentures for cash	xxx
Loans raised (whether short term or long term)	xxx

B. Cash used in financing activities	
Buy back of Equity shares	(xxx)
Redemption of preference shares for cash	(xxx)
Redemption of debentures for cash	(xxx)
Repayment of loans (whether short term or long term)	(xxx)
Interim dividend paid on Equity shares	(xxx)
Final dividend paid on Equity shares	(xxx)
Final dividend paid on preference shares	(xxx)
Interest paid on debentures & loans (whether short term or long term)	(xxx)
Net Cash flow from/used in Financing Activities (if A>B)/ (If A<B)	xxx

Note:-

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.

Cash flows arising from each of the following activities of a financial enterprise may be reported on a net basis:

(a) cash receipts & payments for acceptance & repayment of deposits with fixed maturity date

(b) placement of deposits with and withdrawal of deposits from other financial enterprises

(c) cash advances & loans made to customers and the repayment of those advances & loans

BUSINESS PURCHASE

Aggregate cash flows arising from acquisitions & disposals of subsidiaries or other business units should be presented separately and classified as cash flow from investing activities.

(a) The cash flows from disposal and acquisition should not be netted off.

(b) An enterprise should disclose, in aggregate, in respect of both acquisition and disposal of subsidiaries or other business units during the period each of the following:

  (i) The total purchase or disposal consideration; and

  (ii) The portion of the purchase or disposal consideration discharged by means of cash and cash equivalents.

IMPORTANT POINTS:

Loans/Advances given and Interests earned

For Financial enterprises	Operating cash flows
For Non-Financial enterprises	Investing cash flows
Given to Subsidiaries	Investing cash flows for all enterprises
Given to Employees	Operating cash flows for all enterprises.
Advance Payments to Suppliers	Operating cash flows for all enterprises.

Interests earned from customers for late payments are operating cash flows for non-financial enterprises.

Loans/Advances taken and interests paid

For Financial enterprises	Operating cash flows
For Non-Financial enterprises	Financing cash flows
Advance Taken from Customers	Operating cash flows

Interests paid to suppliers for late payments are operating cash flows for all enterprises.

Interests taken as part of inventory costs in accordance with AS 16 are operating cash flows

Investments made and Dividend earned

For Financial enterprises	Operating cash flows
For Non-Financial enterprises	Investing cash flows
Given to Subsidiaries	Investing cash flows for all enterprises

Tax Deducted at Source

If concerned incomes are Operating Incomes	Operating cash Outflow
If concerned incomes are Investment Incomes	Investing cash Outflow
If concerned expenses are Operating Expenses	Operating cash Inflow
If concerned expenses are Financing Expenses	Financing cash Inflow

Insurance claims received

Against loss of stock or loss of profits	Extraordinary operating cash inflows
Against loss of fixed assets	Extraordinary investing cash inflows

Exchange gains and losses

The foreign currency monetary assets (e.g. balance with bank, debtors etc.) and liabilities (e.g. creditors) are initially recognised by translating them into reporting currency by the rate of exchange transaction date. On the balance sheet date, these are restated using the rate of exchange on the balance sheet date. The difference in values is exchange gain/loss. The exchange gains and losses are recognised in the statement of profit and loss.

The exchange gains/losses in respect of cash and cash equivalents in foreign currency (e.g. balance in foreign currency bank account) are recognised by the principle aforesaid, and these balances are restated in the balance sheet in reporting currency at rate of exchange on balance sheet date. The change in cash or cash equivalents due to exchange gains and losses are however not cash flows. This being so, the net increases/decreases in cash or cash equivalents in the cash flow statements are stated exclusive of exchange gains and losses. *The resultant difference between cash and cash equivalents as per the cash flow statement and that recognised in the balance sheet is reconciled in the note on cash flow statement.*

DISCLOSURES

AS 3 requires an enterprise to disclose the amount of significant cash and cash equivalent balances held by it but not available for its use, together with a commentary by management. This may happen for example, in case of bank balances held in other countries subject to such exchange control or other regulations that the fund is practically of no use.

AS 3 encourages disclosure of additional information, relevant for understanding the financial position and liquidity of the enterprise together with a commentary by management. Such information may include:

(a) The amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities; and

(b) The aggregate amount of cash flows required for maintaining operating capacity, e.g. purchase of machinery to replace the old, separately from cash flows that represent increase in operating capacity, e.g. additional machinery purchased to increase production

ASSIGNMENT QUESTIONS

Question 1 (RTP May 2020) (Similar) / (ICAI Study Material) Pg no._____

Classify the following activities as
(a) Operating Activities, (b) Investing Activities, (c) Financing Activities (d) Cash Equivalent

a. Purchase of Machinery.
b. Proceeds from issuance of equity share capital
c. Cash Sales.
d. Proceeds from long-term borrowings.
e. Proceeds/cash receipts from Trade receivables.
f. Trading Commission received.
g. Purchase of investment.
h. Redemption of Preference Shares.
i. Cash Purchases.
j. Proceeds from sale of investment
k. Purchase of goodwill.
l. Cash paid to suppliers.
m. Interim Dividend paid on equity shares.
n. Wages and salaries paid.
o. Proceed from sale of patents.
p. Interest received on debentures held as investment.
q. Interest paid on Long-term borrowings.
r. Office and Administration Expenses paid / Selling and distribution expense paid.
s. Manufacturing Overheads paid.
t. Dividend received on shares held as investments.
u. Rent Received on property held as investment.
v. Income tax paid
w. Dividend paid on Preference shares.
x. Underwritings Commission paid.
y. Rent paid.
z. Brokerage paid on purchase of investments.
aa. Bank Overdraft
bb. Cash Credit
cc. Short-term Deposits
dd. Highly Liquid Marketable Securities (without risk of change in value)
ee. Refund of Income Tax received.

Question 2 (ICAI Study Material) Pg no._____

From the following information, calculate cash flow from operating activities:

Summary of Cash Account for the year ended March 31, 2022

Particulars	₹	Particulars	₹
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
		By Balance c/d	1,04,000
	5,96,000		5,96,000

Question 3 *(ICAI Study Material)* Pg no.____

Following summary cash account has been extracted from the company's accounting records:

Summary Cash Account

		('000)
Balance at 1.4.2021		35
Receipts from customers		2,783
Issue of shares		300
Sale of fixed assets		128
		3,246
Payments to suppliers	2,047	
Payments for Property, Plant & Equipment	230	
Payments for overheads	115	
Wages and salaries	69	
Taxation	243	
Dividends	80	
Repayments of bank loan	250	(3,034)
Balance at 31.03.2022		212

Prepare Cash Flow Statement of this company Hills Ltd. for the year ended 31st March, 2022 in accordance with AS-3 (Revised). The company does not have any cash equivalents.

Question 4 *(ICAI Study Material)* Pg no.____

The balance sheets of Sun Ltd. as at 31st March 2021 and 2020 were as:

Particulars	Notes	2021	2020
Equity and Liabilities			
1. Shareholder's funds			
(a) Share capital	1	60,000	50,000
(b) Reserve & 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 & Equipment	4	39,500	29,000
2 Current assets			
(a) Current investments		2,000	1,000
(b) Inventories		17,000	14,000
(c) Trade receivables		8,000	6,000
(d) Cash & cash equivalents	5	4,000	8,500
Total		70,500	58,500

Notes to accounts

		2021	2020
1	Share Capital		
	Equity Shares of ₹10 each	60,000	50,000
2	Reserve & surplus		
	Profit and Loss Account	5,000	4,000

3	Other current liabilities		
	Dividend Payable	-	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, 2021 disclosed:

Particulars	₹
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
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, 2021.

Question 5

Pg no._____

The following are the summarized Balance Sheet of Star Ltd. as on 31st March, 2021 and 2022:

(₹ in '000)

Liabilities	31.03.2021	31.03.2022	Assets	31.03.2021	31.03.2022
Equity share capital of ₹ 10 each	3,400	3,800	Sundry Fixed Assets:		
Profit & Loss A/c	400	540	Gross Block	3,200	4,000
Securities Premium	40	80	Less: Depreciation	(640)	(1,440)
14% Debentures	800	900	Net Block	2,560	2,560
Long term borrowings	180	240	Investment	1,200	1,400
Trade payables	360	440	Inventories	1,000	1,400
Provision for Taxation	20	40	Trade receivables	640	900
Dividend payable	300	480	Cash & Bank Balance	100	260
	5,500	6,520		5,500	6,520

The Profit and Loss account for the year ended 31st March, 2022 disclosed

	(₹ in '000)
Profit before tax	780
Less: Taxation	(160)
Profit after tax	620
Less: Dividend declared	(480)
Retained Profit	140

The following information are also available:
a) 40,000 equity shares issued at a premium of ₹ 1 per share.
b) The Company paid taxes of ₹ 1,40,000 for the year 2021-22.
c) During the period, it discarded fixed assets costing ₹ 4 lacs, (accumulated depreciation ₹ 80,000) at ₹ 40,000 only.
You are required to prepare cash flow statement as per AS 3 (Revised), using indirect method.

Question 6

Pg no._____

Surya Ltd. has provided you the following particulars. Prepare Cash Flow from Operating Activities by Indirect Method in accordance with AS 3:

Profit & Loss Account of Surya Ltd. for the year ended 31st March, 2022

Particulars	₹	Particulars	₹
To Depreciation	86,700	By Operating Profit before dep.	11,01,600
To Patents written off	35,000	By Profit on Sale on Investments	10,000
To Provision for Tax	1,25,000	By Refund of Tax	3,000
To Dividend declared	72,000	By Insurance Claim-Major Fire Settlement	1,00,000
To Transfer to Reserve	87,000		
To Net Profit	8,08,900		
	12,14,600		12,14,600

Additional information:

	31.03.2021	31.03.2022
Stock	1,20,000	1,60,000
Trade Debtors	7,500	75,000
Trade Creditors	23,735	87,525
Provision for Tax	1,18,775	1,25,000
Prepaid Expenses	15,325	12,475
Marketable Securities	11,775	29,325
Cash Balance	25,325	35,340

Question 7 *(ICAI Study Material) / (RTP May 2022) (Similar)*

Pg no._____

From the following Balance sheet of Grow More Ltd., prepare Cash Flow Statement for the year ended 31st March, 2021 :

	Particulars	Notes	31st March, 2021	31st March, 2020
	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
	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, 2021	31st March, 2020
1	Reserves and Surplus		
	General 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 of year)	2,00,000	--
3.	Other current liabilities		
	Dividend payable	-	1,00,000
4	Property, plant and equipment		
	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

a. Depreciation @ 25% was charged on the opening value of Plant and Machinery.
b. At the year end, one old machine costing ₹ 50,000 (WDV ₹ 20,000) was sold for ₹ 35,000. Purchase was also made at the year end.
c. ₹ 50,000 was paid towards Income tax during the year.
d. Construction of the building got completed on 31.03.2021 and hence no depreciation may be charged on the same.

Prepare Cash flow Statement.

Question 8 *(ICAI Study Material)* *Pg no._____*

ABC Ltd. gives you the Balance sheets as at 31st March 2020 and 31st March 2021. You are required to prepare Cash Flow Statement by using indirect method as per AS 3 for the year ended 31st March 2021:

	Particulars	Notes	31st March 2020	31st March 2021
	Equity and Liabilities			
1	Shareholders' funds			
A	Share capital		50,00,000	50,00,000
B	Reserves and Surplus		26,50,000	36,90,000
2	Non-current liabilities			
	Long term borrowings	1	-	9,00,000
3	Current liabilities			
A	Short-term borrowings (Bank loan)		1,50,000	3,00,000
B	Trade payables		8,80,000	8,20,000
C	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 and Equipment	3	21,20,000	32,80,000
2	Current assets			

A	Current Investments		11,80,000	15,00,000
B	Inventory		20,10,000	19,20,000
C	Trade receivables		22,40,000	26,40,000
D	Cash and Cash equivalents	4	15,20,000	15,20,000
E	Other Current assets (Prepaid expenses)		90,000	1,20,000
	Total		91,60,000	1,09,80,000

Notes to accounts

No.	Particulars	2020	2021
1	Long term borrowings		
	9% Debentures (issued at the end of year)	-	9,00,000
	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)	(1,90,000)
	Total	22,40,000	26,40,000

Additional Information:

a) Net profit for year ended 31st March, 2021, after charging depreciation 1,80,000 is ₹ 10,40,000.

b) Trade receivables of ₹ 2,30,000 were determined to be worthless and were written off against the provisions for doubtful debts account during the year.

Question 9 *(ICAI Study Material)* Pg no.______

Following are extracts of the Balance Sheets of Ajay Ltd.:

	Particulars	Notes	31.3.2021 ₹	31.3.2022 ₹
	Equity and Liabilities			
	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

		31.3.2021 ₹	31.3.2022 ₹
1	Share Capital		
	50,000 Equity Shares of ₹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.

Question 10 *(ICAI Study Material)* *Pg no._____*

Ryan Ltd provides you the following information at the year-end, March 31, 2022

		₹
Sales		6,98,000
Cost of Goods Sold		(5,20,000)
		1,78,000
Operating Expenses (incl. Depreciation Expense of ₹ 37,000)		(1,47,000)
		31,000
Other Income / (Expenses)		
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)
		23,000
Income tax		(7,000)
		16,000

Information Available:

	31.03.2022	31.03.2021
Plant Assets	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 2021-22

1) Purchased investments for ₹ 78,000.
2) Sold investments for ₹ 1,02,000. These investments cost ₹ 90,000.
3) Purchased plant assets for ₹ 1,20,000.
4) Sold plant assets that cost ₹ 10,000 with accumulated depreciation of ₹ 2,000 for ₹ 5,000.
5) Issued ₹ 1,00,000 of bonds at face value in an exchange for plant assets on 31st March, 2022.
6) Repaid ₹ 50,000 of bonds at face value at maturity.
7) Issued 15,000 shares of ₹ 10 each.
8) Paid cash dividends ₹ 8,000.

Prepare Cash Flow Statement as per AS-3 (Revised), using indirect method.

Question 11 *(ICAI Study Material)* *Pg no.____*

The Balance Sheet of New Light Ltd. as at 31st March, 2021 and 2020 (for the years ended) are as follows:

		Notes	31st March 2020	31st March 2021
	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 and Equipment	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
B	Other Current assets		11,10,000	11,50,000
	Total		38,00,000	41,20,000

Notes to accounts

No.	Particulars	31st March, 2020	31st March, 2021
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:

a. The company sold one property, plant and equipment for ₹ 1,00,000, the cost of which was ₹ 2,00,000 and the depreciation provided on it was ₹80,000.

b. The company also decided to write off another item of property, plant and equipment costing ₹ 56,000 on which depreciation amounting to ₹ 40,000 has been provided.
c. Depreciation on property, plant and equipment provided ₹ 3,60,000.
d. Company sold some investment at a profit of ₹ 40,000.
e. Debentures and preference share capital redeemed at 5% premium. Debentures were redeemed at the year end.
f. 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 31.3.2020 was ₹ 2,16,000. The inventory on 31.3.2021 was correctly valued at ₹ 3,00,000.

Prepare Cash Flow Statement as per revised Accounting Standard 3 by indirect method.

Question 12 *(ICAI Study Material)* Pg no.______

Ms. Jyoti of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year ended 31st March, 2022:

	(₹ 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 Profit & Loss Account	20,000
Profit on sale of Investments	100
Carrying amount of Investment sold	27,765
Interest income 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 Cash Flow Statement for year ended 31st March 2022 in accordance with AS 3. (Make necessary assumptions).

Question 13 *(RTP May 2020)* Pg no.______

The following figures have been extracted from the Books of X Limited for the year ended on 31.3.2022. You are required to prepare a cash flow statement.

a) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 20 lakhs:
   (i) Depreciation on Fixed Assets ₹ 5 lakhs.
   (ii) Discount on issue of Debentures written off ₹ 30,000.
   (iii) Interest on Debentures paid ₹ 3,50,000.
   (iv) Book value of investments ₹ 3 lakhs (Sale of Investments for ₹ 3,20,000).
   (v) Interest received on investments ₹ 60,000.

b) Compensation received ₹ 90,000 by the company in a suit filed.
c) Income tax paid during the year ₹ 10,50,000.
d) 15,000, 10% preference shares of ₹ 100 each were redeemed on 31.3.2022 at a premium of 5%. Further the company issued 50,000 equity shares of ₹ 10 each at a premium of 20% on 2.4.2021. Dividend on preference shares were paid at the time of redemption.
e) Dividends paid for the year 2020-2021 ₹ 5 lakhs and interim dividend paid ₹ 3 lakhs for the year 2021-2022.
f) Land was purchased on 2.4.2021 for ₹ 2,40,000 for which the company issued 20,000 equity shares of ₹ 10 each at a premium of 20% to the land owner as consideration.
g) Current assets & current liabilities in the beginning & at the end of years were as below:

	As on 31.03.2021	As on 31.03.2022
Inventory	12,00,000	13,18,000
Trade Receivables	2,58,000	2,53,100
Cash in hand	1,96,300	35,300
Trade payables	2,11,000	2,11,300
Outstanding expenses	75,000	81,800

Question 14 *(ICAI Study Material)* *Pg no._____*

Given below are the relevant extracts of the Balance Sheet and the Statement of Profit and Loss of ABC Ltd. along with additional information:

	Particulars	Notes	31.3.2021 (₹ in lakhs)	31.3.2020 (₹ 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
	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, 2021

	Particulars	Notes	₹ 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
	Finance cost	5	60
	Other expenses		200
IV	Total expenses		3,540
V	Profit before tax (III – IV)		710
VI	Tax expense:		
	Current tax		200
VII	Profit for the year from continuing operations		510

Appropriations:

Balance of Profit and Loss account brought forward	50
Transfer to general reserve	200
Dividend paid	330

Notes to accounts:

		2021 (₹ in lakhs)	2020 (₹ in lakhs)
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.

Question 15 *Pg no._____*

The following particulars relate to Bee Ltd., for the year ended 31st March, 2022:

a) Furniture of book value of ₹ 15,500 was disposed off for ₹ 12,000.
b) Machinery costing ₹ 3,10,000 was purchased and ₹ 20,000 were spent on its erection.
c) Fully paid 8% preference shares of the face value of ₹ 10,00,000 were redeemed at a premium of 3%. In this connection 60,000 equity shares of ₹ 10 each were issued at a premium of ₹ 2 per share. The entire money being received with applications.
d) Dividend was paid as follows:
On 8% preference shares ₹ 40,000 On equity shares for the year 2021-22 ₹ 1,10,000
e) Total sales were ₹ 32,00,000 out of which cash sales were ₹ 11,50,000.
f) Total purchases were ₹ 8,00,000 including cash purchase of ₹ 60,000.
g) Total expenses were ₹ 12,40,000 charged to Profit and Loss A/c.
h) Taxes paid were ₹ 3,30,000.
i) Cash and cash equivalents as on 31st March, 2022 were ₹ 1,25,000.

You are requested to prepare Cash Flow Statement as per AS 3 for the year ended 31st March, 2022 after taking into consideration the following also:

	On 31st March, 2021	On 31st March, 2022
Sundry Debtors	1,50,000	1,47,000
Sundry Creditors	78,000	83,000
Unpaid expenses	63,000	55,000

Question 16 *(ICAI Study Material)* *Pg no._____*

Prepare Cash flow for Gamma Ltd., for the year ending 31.3.2022 from following information:

1) Sales for the year amounted to ₹ 135 crores out of which 60% was cash sales.
2) Purchases for the year amounted to ₹ 55 crores out of which credit purchase was 80%.
3) Administrative & selling expenses amounted to ₹ 18 crores and salary paid amounted to ₹ 22 crores.
4) The Company redeemed debentures of ₹ 20 crores at a premium of 10%. Debenture holders were issued equity shares of ₹ 15 crores towards redemption and the balance was paid in cash. Debenture interest paid during the year was ₹ 1.5 crores.

5) Dividend paid during the year amounted to ₹ 11.7 crores was also paid.
6) Investment costing ₹ 12 crores were sold at a profit of ₹ 2.4 crores.
7) ₹ 8 crores was paid towards income tax during the year.
8) A new plant costing ₹ 21 crores was purchased in part exchange of an old plant. The book value of the old plant was ₹ 12 crores but the vendor took over the old plant at a value of ₹ 10 crores only. The balance was paid in cash to the vendor.
9) The following balances are also provided: (in crores)

	1.4.2021	31.3.2022
Debtors	45	50
Creditors	21	23
Bank	6	18.2

Question 17

Pg no._____

The following information was provided by XYZ Ltd. for the year ended 31st March, 2022:

(1) Gross Profit Ratio was 25% for the year, which amounts to ₹ 7,50,000.
(2) Company sold goods for cash only.
(3) Opening inventory was lesser than closing inventory by ₹ 50,000.
(4) Wages paid during the year ₹ 11,10,000.
(5) Office expenses paid during the year ₹ 70,000.
(6) Selling expenses paid during the year ₹ 30,000.
(7) Dividend paid during the year ₹ 80,000.
(8) Bank Loan repaid during the year ₹ 4,10,000 (included interest ₹ 10,000)
(9) Trade Payables on 31st March, 2021 were ₹ 1,00,000 & on 31st March, 2022 were ₹ 70,000.
(10) Amount paid to Trade payables during the year ₹ 12,20,000
(11) Income Tax paid during the year amounts to ₹ 1,10,000 (Provision for taxation as on 31st March, 2022 ₹ 60,000)·
(12) Investments of ₹ 16,40,000 sold during the year at a profit of ₹ 40,000.
(13) Depreciation on furniture amounts to ₹ 80,000.
(14) Depreciation on other tangible assets amounts to ₹ 40,000.
(15) Plant and Machinery purchased on 15th November, 2021 for ₹ 7,00,000
(16) On 31st March, 2022 ₹ 4,00,000, 7% Debentures were issued at face value in exchange for a plant.
(17) Cash and Cash equivalents on 31st March, 2021 ₹ 4,50,000.

(A) Prepare cash flow statement for the year ended 31st March, 2022, using direct method.
(B) Calculate cash flow from operating activities, using indirect method

Question 18 *(ICAI Study Material)*

Pg no._____

Prepare Cash Flow from Investing Activities of M/s. Creative Ltd. year ended 31-3-22.

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 (TDS of ₹ 8,200 was deducted on the above interest)	68,000
Book value of plant sold (loss incurred ₹ 9,600)	84,000

Question 19 *(ICAI Study Material)* *Pg no._____*

From the following Balance Sheets and information, prepare Cash Flow Statement of Ryan Ltd. by Indirect method for the year ended 31st March, 2021:

	Particulars	Notes	31st March 2021	31st March 2020
	Equity and Liabilities			
1	Shareholders' funds	1	6,00,000	7,00,000
a	Share capital	2	4,20,000	3,00,000
b	Reserves and Surplus			
2	Non-current liabilities	3	2,00,000	-
	Long term borrowings			
3	Current liabilities		1,15,000	1,10,000
a	Trade Payables	4	30,000	80,000
b	Other current liabilities			
c	Short term provision (provision for tax)		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, 2021	31st March, 2020
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	-
	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:

a. A piece of land has been sold out for ₹1,50,000 (Cost – ₹1,20,000) and the balance land was revalued. Capital Reserve consisted of profit on revaluation of land.
b. On 1st April, 2020 a plant was sold for ₹90,000 (Original Cost – ₹70,000 and W.D.V. – ₹ 50,000) and Debentures worth ₹1 lakh were issued at par as part consideration for plant of ₹4.5 lakhs acquired.
c. Part of the investments (Cost – ₹50,000) was sold for ₹70,000.
d. Pre-acquisition dividend received ₹5,000 was adjusted against cost of investment.
e. Interim dividend was declared and paid @ 15% during the current year.
f. Income-tax liability for the current year was estimated at ₹1,35,000.
g. Depreciation @ 15% has been charged on Plant and Machinery but no depreciation has been charged on Building.

Question 20 *(ICAI Study Material)* *Pg no._____*

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 charged to 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 As on 31-03-2022 ₹ 3,50,000
(vi) Accrued Interest on Investments: As on 31-03-2022 ₹ 10,500

Question 21 *(RTP May 2021)* *Pg no._____*

The following are the extracts of Balance Sheet and Statement of Profit & Loss of Supriya Ltd.

Extract of Balance Sheet

		Particulars	Notes	2022 ('000)	2021 ('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			
	a	Property, Plant and Equipment		230	128
2		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	2022 ('000)	2021 ('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

	Particulars	2022 ('000)	2021 ('000)
1	Share Capital		
	Equity Shares of ₹ 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, 2022 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, 2021 & on 31st March, 2022. Dividend amounting ₹ 80,000 was paid during the year ended 31st March, 2022.
Ignore deprecation.

Question 22 *(ICAI Study Material) (Similar)* *Pg no._____*

From the following information of XYZ Limited, calculate cash and cash equivalent as on 31-03-2022 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 01-11-2021 and maturing on15-04-2022	75,000
Short Term Investment in highly liquid Sovereign Debt Mutual fund on 01-03-2022 (having maturity period of less than 3 months)	1,00,000
Bank Balance in Foreign Currency Account in India (Conversion Rate: On the day of deposit ₹69/USD As on 31-03-2022 ₹70/USD)	$ 1,000
Debentures purchased of ₹ 10 lacs of A Ltd. which are redeemable on 31st October 2022	90,000
Shares of Alpha Ltd. purchased on 1st January, 2022	60,000

Question 23 *(ICAI Study Material)* *Pg no._____*

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

Solution

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

Question 24 *(ICAI Study Material)* *Pg no._____*

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

a) Corporate Income Tax paid amounting to ₹ 70 lakhs during the reporting period.
b) 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.
c) Fixed Deposits withdrawn by customers of State Bank of India ₹ 3 crores.

Solution

a) ₹ 70 lakhs: Operating Cash Flows
b) ₹ 8,00,000: Operating Cash Flows ₹ 75,000: Investing Cash Flows
c) ₹ 3 crores: Operating Cash Flows for State Bank of India.

Question 25 *(ICAI Study Material)* *Pg no._____*

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

Solution

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 of the 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 currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the cash flow.

PRACTICE QUESTIONS

Question 1 Pg no._____

Classify the following activities as
(i) Operating Activities, (ii) Investing Activities, (iii) Financing Activities.
a) Rent received on property held as investment.
b) Selling and distribution expense paid.
c) Income tax paid.
d) Dividend paid on Preference shares.
e) Underwriting Commission paid.
f) Rent paid.
g) Brokerage paid on purchase of investments.
h) Long term Bank loan.
i) Refund of Income Tax

Question 2 (Inter May 2018) (5 Marks) Pg no._____

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) Marketable Securities
(3) Purchase of investment
(4) Proceeds from long term borrowings
(5) Wages and Salaries paid
(6) Bank overdraft
(7) Purchase of Goodwill
(8) Interim dividend paid on equity shares
(9) Short term Deposits
(10)Underwriting commission paid

Question 3 (ICAI Study Material) Pg no._____

Classify the following activities as (a) Operating activities, (b) Investing activities (c) Financing activities (d) Cash equivalents with reference to AS 3 (Revised).
(a) Brokerage paid on purchase of investments
(b) Underwriting commission paid
(c) Trading commission received
(d) Proceeds from sale of investment
(e) Purchase of goodwill
(f) Redemption of preference shares
(g) Rent received from property held as investment
(h) Interest paid on long-term borrowings
(i) Marketable securities (having risk of change in value)
(j) Refund of income tax received

Question 4 (ICAI Study Material) Pg no._____

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 2022 in accordance with AS 3 (Revised) using the direct method.

Summary Cash Account for the year ended 31.3.2022

	₹ '000		₹ '000
Balance on 1.4.2021	50	Payment to Suppliers	2,000
Issue of Equity Shares	300	Purchase of Fixed Assets	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 31.3.2022	150
	3,250		3,250

(Ans: Operating 250; Investing (100); Financing (50))

Question 5 *(ICAI Study Material)* *Pg no._____*

Following is the cash flow abstract of Alpha Ltd. for the year ended 31st March, 2022:

Cash Flow (Abstract)

	₹		₹
Opening balance:		Payment for Account Payables	90,000
Cash	10,000	Salaries and wages	25,000
Bank	70,000	Payment of overheads	15,000
Share capital – shares issued	5,00,000	Fixed assets acquired	4,00,000
Collection on account of Trade Receivables	3,50,000	Debentures redeemed	50,000
Sale of fixed assets	70,000	Bank loan repaid	2,50,000
		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, 2022 in accordance with AS 3.

(Ans: Operating 1,65,000; Investing (3,30,000); Financing 1,00,000)

Question 6 *(Inter July 2021) (5 Marks)* *Pg no._____*

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:

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 & equipment acquired	6,210
Issue of Shares	8,100	Wages and salaries	1,863
Sale of Property, Plant & equipment	3,456	Payment of Overheads	3,105
		Taxation	6,561
		Dividends	2,160
		Repayment of Bank Overdraft	6,750
		Interest paid on Bank Overdraft	1,350
		Closing Balance	4,374
	87,642		87,642

(Ans: Operating 8,235; Investing (2,646); Financing (2,160))

Question 7 *(RTP Nov 2020) (Similar)* *Pg no._____*

Prepare Cash Flow Statement of Tom & Jerry Ltd. for the year ended 31st March, 2022

Summary Cash Account

		('000)
Balance at 1.4.2021		210
Receipts from customers		16,596
Sale of Investments (Cost ₹ 90,000)		102
Issue of shares		1,800
Sale of fixed assets		768
		19,476
Payments to suppliers	12,204	
Purchase of Investments	78	
Purchase of Fixed Assets	1,380	
Wages and salaries	414	
Selling & Administration Exp.	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 at 31.03.2022		972

(Ans: Operating 1,830; Investing (588); Financing (480))

Question 8 *Pg no._____*

The following are the summarized Balance Sheets of 'X' Ltd. as on March 31, 2021 and 2022:

Liabilities	As on 31.03.2021	As on 31.03.2022
Equity share capital	10,00,000	12,50,000
Capital Reserve	-	10,000
General Reserve	2,50,000	3,00,000
Profit and Loss A/c	1,50,000	1,80,000
Long term loan from the bank	5,00,000	4,00,000
Trade Payables	5,00,000	4,00,000
Provision for Taxation	50,000	60,000
Dividend payable	1,00,000	1,25,000
	25,50,000	27,25,000
Assets	**As on 31.03.2021**	**As on 31.03.2022**
Land and Building	5,00,000	4,80,000
Machinery	7,50,000	9,20,000
Investment	1,00,000	50,000
Inventory	3,00,000	2,80,000
Trade Receivables	4,00,000	4,20,000
Cash in Hand	2,00,000	1,65,000
Cash at Bank	3,00,000	4,10,000
	25,50,000	27,25,000

Additional Information:

a) Dividend of ₹ 1,00,000 was paid during the year ended March 31, 2022.

b) Machinery during the year purchased for ₹ 1,25,000.

c) Machinery of another company was purchased for a consideration of ₹ 1,00,000 payable in equity shares.

d) Income-tax provided during the year ₹ 55,000.
e) Company sold some investment at profit of ₹ 10,000, which was credited to Capital reserve.
f) There was no sale of machinery during the year.
g) Depreciation written off on Land and Building ₹ 20,000.

From the above particulars, prepare a cash flow statement for the year ended March, 2022 as per AS 3 (Indirect method).

(Ans: Operating 1,90,000; Investing (65,000); Financing (50,000))

Question 9 (RTP May 2023) *Pg no._____*

Following is the Balance Sheet of Fox Ltd. You are required to prepare cash flow statement using Indirect Method.

Particulars	Note No.	31st March,2021	31st March,2020
(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
(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
2. Reserve and surplus	5,60,000	3,00,000
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.

(Ans: Operating (25,000); Investing (2,10,000); Financing 2,50,000)

Question 10 *(ICAI Study Material)* *Pg no._____*

From the following Balance Sheets of Mr. Zen, prepare a Cash flow statement as per AS-3 for the year ended 31.3.2022:

Ledger Balances of Mr. Zen

	As on 01.04.2021	As on 31.03.2022
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 (net block)	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 ₹ 80,000 (accumulated depreciation there on ₹ 24,000) was sold for ₹ 40,000. The provision for depreciation on 1.4.2021 was ₹ 2,00,000 and 31.3.2022 was ₹ 3,20,000. The net profit for the year ended on 31.3.2022 was ₹ 3,60,000.

(Ans: Operating 4,72,000; Investing (2,40,000); Financing (2,56,000))

Question 11 *Pg no._____*

The Balance Sheets of X Ltd. as on 31st March, 2021 and 31st March, 2022 are as follows:

Liabilities	31.03.2021	31.03.2022	Assets	31.03.2021	31.03.2022
Share Capital	5,00,000	7,00,000	Land and Buildings	80,000	1,20,000
General Reserve	50,000	70,000	Plant and Machinery	5,00,000	8,00,000
Profit and Loss A/c	1,00,000	1,60,000	Inventory	1,00,000	75,000
Trade payables	1,93,000	2,40,000	Trade receivables	1,50,000	1,60,000
O/s Expenses	7,000	5,000	Cash	20,000	20,000
	8,50,000	11,75,000		8,50,000	11,75,000

Additional Information:

a) 50,000 depreciation has been charged to Plant & Machinery during year ended 31st Mar 22.

b) A piece of Machinery costing ₹ 12,000 (Depreciation provided there on ₹ 7,000) was sold at 60% profit on book value.

Prepare Cash flow statement for year ended 31st March 2022 as per AS 3 using indirect method

(Ans: Operating 1,87,000; Investing (3,87,000); Financing 2,00,000)

Question 12 *Pg no._____*

Prepare cash flow statement of A (P) Ltd. as at 31st March, 2022 by using indirect method:

Balance Sheet

	31.03.2021	31.03.2022
Liabilities		
Share capital	12,00,000	12,00,000
Profit and loss account	8,50,000	10,00,000
Long term loans	10,00,000	10,60,000
Trade payables	3,50,000	4,00,000
	34,00,000	36,60,000
Assets		
Fixed assets	17,00,000	20,00,000
Investment in shares	2,00,000	2,00,000

Inventory	6,80,000	7,00,000
Trade receivables	7,60,000	6,90,000
Cash	60,000	70,000
	34,00,000	36,60,000

Income Statement for the year ended 31st March, 2022

	₹
Sales	40,80,000
Less: Cost of sales	(27,20,000)
Gross profit	13,60,000
Less: Operating expenses:	
Administrative expenses	(4,60,000)
Depreciation	(2,20,000)
Operating profit	6,80,000
Add: Non-operating incomes (dividend received)	50,000
	7,30,000
Less: Interest paid	(1,40,000)
Profit before tax	5,90,000
Less: Income-tax	(2,60,000)
Profit after tax	3,30,000

Statement of Retained Earnings

	₹
Opening balance	8,50,000
Add: Profit	3,30,000
	11,80,000
Less: Dividend paid	(1,80,000)
Closing balance	10,00,000

(Ans: Operating 7,40,000; Investing (4,70,000); Financing (2,60,000))

Question 13 ***(RTP Nov 2018) / (RTP Nov 2022) (Similar)*** ***Pg no.______***

Balance Sheet of Harry Ltd. for year ending 31st March, 2022 & 31st March, 2021 were as:

	2022	2021
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
Dividend Payable	4,000	2,000
	1,44,000	1,17,000
Fixed Assets (at w.d.v.)		
Building	19,000	20,000
Furniture & Fixtures	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
Bank and Cash	12,000	17,000
	1,44,000	1,17,000

The profit and loss account for the year ended 31st March, 2022 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:

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.

Prepare Cash Flow Statements as per AS-3 (revised) using indirect method.

(Ans: Operating (400); Investing (22,600); Financing 18,000)

Question 14 *Pg no._____*

The following are the summarized Balance Sheets of 'Fan' Ltd. as on March 31, 2021 and 2022:

Liabilities	As on 31.03.2021	As on 31.03.2022
Equity share capital	5,00,000	6,25,000
Capital Reserve	-	5,000
Profit and Loss A/c	2,00,000	2,40,000
Long term loan from the bank	2,50,000	2,00,000
Trade Payables	2,50,000	2,00,000
Provision for Taxation	25,000	30,000
	12,25,000	13,00,000
Assets	**As on 31.03.2021**	**As on 31.03.2022**
Land and Building	2,00,000	1,90,000
Machinery	3,75,000	4,60,000
Investment	50,000	25,000
Inventory	1,50,000	1,40,000
Trade Receivables	2,00,000	2,10,000
Cash in Hand	1,00,000	70,000
Cash at Bank	1,50,000	2,05,000
	12,25,000	13,00,000

Additional information:

a) Depreciation written off on land and building ₹ 10,000.

b) Company sold some investment at profit of ₹ 5,000, which was credited to Capital Reserve.

c) Income-tax provided during the year ₹ 27,500.

d) During the year, the company purchased a machinery for ₹ 1,12,500. They paid ₹ 62,500 in cash and issued 5,000 equity shares of ₹ 10 each at par.

Prepare cash flow statement for the year ended 31st March 2022 by using indirect method.

(Ans: Operating 32,500; Investing (32,500); Financing (25,000))

Question 15 *(RTP May 2019)* *Pg no._____*

From the following information prepare cash flow statement for year ended 31st March, 2022:

	(₹ in lacs)
Net profit before tax provision	72,000
Dividend paid	20,404
Income-tax paid	10,200

Book value of assets sold Loss on sale of asset	444 96
Depreciation debited in P & L account	48,000
Capital grant received - amortized in P & L A/c	20
Book value of investment sold Profit on sale of investment	66,636 240
Interest income from investment credited in P & L A/c	6,000
Interest expenditure debited in P & L A/c	24,000
Interest actually paid (Financing activity)	26,084
Increase in working capital [Excluding cash and bank balance]	1,34,580
Purchase of fixed assets	44,184
Expenditure on construction work	83,376
Grant received for capital projects	36
Long term borrowings from banks	1,11,732
Provision for Income-tax debited in P & L A/c	12,000
Cash and bank balance on 1.4.2021	12,000
Cash and bank balance on 31.3.2022	16,000

(Ans: Operating (6,944); Investing (54,300); Financing 65,244)

Question 16 *(Inter Nov 2020) (10 Marks)* **Pg no._____**

The following figures have been extracted from the books of Manan Jo Limited for the year ended on 31.3.2022. Prepare 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 into account 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.

(iii) Income tax paid during the year ₹ 15,75,000.

(iv) 22,500, 10% preference shares of 100 each were redeemed on 02.04.21 at 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 & current liabilities in the beginning & at the end of the years were as:

	As on 01.04.2021	As on 31.03.2022
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

(Ans: Operating 26,01,000; Investing 5,34,000; Financing (35,12,500))

Question 17 *(Inter Jan 2021) (12 Marks)* Pg no.______

Following information was extracted from books of S Ltd. for the year ended 31st March, 2022:

(1) Net profit before taking into account income tax and after talking into account the following items was ₹ 30 lakhs;
   (i) Depreciation on Property, Plant & Equipment ₹ 7,00,000
   (ii) Discount on issue of debentures written off ₹ 45,000.
   (iii) Interest on debentures paid ₹ 4,35,000
   (iv) Investment of Book value ₹3,50,000 sold for ₹3,75,000.
   (v) Interest received on Investments ₹70,000

(2) Income tax paid during the year ₹ 12,80,000

(3) Company issued 60,000 Equity Shares of ₹ 10 each at premium of 20% on 10th April, 2021.

(4) 20,000,9% Preference Shares of ₹ 100 each were redeemed on 31st March, 2022 at a premium of 5%

(5) Dividend paid during the year amounted to ₹ 11 Lakhs

(6) A new Plant costing ₹ 7 Lakhs was purchased in part exchange of an old plant on 1st January,2022. The book value of the old plant was ₹ 8 Lakhs but the vendor took over the old plant at a value of ₹ 6 Lakhs only. The balance amount was paid to vendor through cheque on 30th March, 2022.

(7) 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 31.03.2022 was ₹ 14,76,000. The inventory on 31.03.2021 was correctly valued at ₹ 13,50,000.

(8) Current Assets & Current Liabilities in the beginning & at the end of year 21-22 were as:

	As on 01.04.2021	As on 31.03.2022
Inventory	13,50,000	14,76,000
Trade receivables	3,27,000	3,13,200
Cash & Bank	2,40,700	3,70,500
Trade payables	2,84,700	2,87,300
Outstanding expenses	97,000	1,01,400

You are required to prepare a Cash Flow Statement for the year ended 31st March, 2022 as per AS 3 (revised) using the indirect method.

(Ans: Operating 26,99,800; Investing 3,45,000; Financing (29,15,000))

Question 18 Pg no.______

Prepare Cash Flow Statement for the year ended 31st March, 2022:

a) Total sales for the year were ₹ 199 crore out of which cash sales amounted to ₹ 131 crore.
b) Cash collections from credit customers during the year, totalled ₹ 67 crore.
c) Cash paid to suppliers of goods and services and to the employees of the enterprise amounted to ₹ 159 crore.
d) Fully paid preference shares of the face value of ₹ 16 crore were redeemed and equity shares of the face value of ₹ 16 crore were allotted as fully paid up at a premium of 25%.
e) ₹ 13 crore were paid by way of income tax.
f) Machine of the book value of ₹ 21 crore was sold at a loss of ₹ 30 lakhs and a new machine was installed at a total cost of ₹ 40 crore.
g) Debenture interest amounting ₹ 1 crore was paid.
h) Dividends totalling ₹ 11.7 crore was paid on equity and preference shares.
i) On 31st March, 2021 balance with bank and cash on hand totalled ₹ 9 crore.

(Ans: Operating 26; Investing (19.30); Financing (8.70))

Question 19 *(RTP May 2018) / (RTP Nov 2021)* *Pg no._____*

Prepare a Cash Flow Statement for the year ended 31st March, 2022 (Using direct method):

a) Total sales for year were ₹ 398 crores out of which cash sales amounted to ₹ 262 crores.
b) Receipts from credit customers during the year, totaled ₹ 134 crores.
c) Purchases for the year amounted to ₹ 220 crores out of which credit purchase was 80%.
d) Balance in creditors as on
   1.4.2021 ₹ 84 crores
   31.3.2022 ₹ 92 crores
e) Suppliers of other consumables and services were paid ₹ 19 crores in cash.
f) Employees of the enterprises were paid 20 crores in cash.
g) Fully paid preference share of the face value of ₹32 crores were redeemed. Equity shares of the face value of ₹20 crores were allotted as fully paid up at premium of 20%.
h) Debentures of ₹ 20 crores at a premium of 10% were redeemed. Debenture holders were issued equity shares in lieu of their debentures.
i) ₹26 crores were paid by way of income tax.
j) A new machinery costing ₹ 25 crores was purchased in part exchange of an old machinery. The book value of the old machinery was ₹13 crores. Through the negotiations, the vendor agreed to take over the old machinery at a higher value of ₹15 crores. The balance was paid in cash to the vendor.
k) Investment costing ₹ 18 cores were sold at a loss of ₹2 crores.
l) Dividends totalling ₹ 15 crores was also paid.
m) Debenture interest amounting ₹ 2 crore was paid.
n) On 31st March 2021, Balance with Bank and Cash on hand totaled ₹ 2 crores

(Ans: Operating 119; Investing 6; Financing (25))

Question 20 *(ICAI Study Material)* *Pg no._____*

Prepare cash flow statement of M/s MNT Ltd. for the year ended 31st March, 2022 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 ₹ 3,82,500.
3) Opening inventory was less than closing inventory by ₹ 35,000.
4) Wages paid during the year ₹ 4,92,500.
5) Office and selling expenses paid during the year ₹ 75,000.
6) Dividend paid during the year ₹ 30,000
7) Bank loan repaid during the year ₹ 2,15,000 (included interest ₹ 15,000)
8) Trade payables on 31st March, 2021 exceed the balance on 31st March, 2022 by ₹ 25,000.
9) Amount paid to trade payables during the year ₹ 4,60,000.
10) Tax paid during the year amounts to ₹ 65,000 (Provision for taxation as on 31.03.2022 ₹ 45,000).
11) Investments of ₹ 7,00,000 sold during the year at a profit of ₹ 20,000.
12) Depreciation on fixed assets amounts to ₹ 85,000.
13) Plant and machinery purchased on 15th November, 2021 for ₹ 2,50,000.
14) Cash and Cash Equivalents on 31st March, 2021 ₹ 2,00,000.
15) Cash and Cash Equivalents on 31st March, 2022 ₹ 6,07,500.

(Ans: Operating 1,82,500; Investing 4,70,000; Financing (2,45,000))

Question 21 *(Inter May 2019) (10 Marks)* *Pg no._____*

The following information was provided by PQR Ltd. for the year ended 31st March, 2022:

(1) Gross Profit Ratio was 25% for the year, which amounts to ₹ 3,75,000.
(2) Company sold goods for cash only.

(3) Opening inventory was lesser than closing inventory by ₹ 25,000.
(4) Wages paid during the year ₹ 5,55,000.
(5) Office expenses paid during the year ₹ 35,000.
(6) Selling expenses paid during the year ₹ 15,000.
(7) Dividend paid during the year ₹ 40,000
(8) Bank Loan repaid during the year ₹ 2,05,000 (included interest ₹ 5,000)
(9) Trade Payables on 31st March, 2021 were ₹ 50,000 and on 31st March, 2022 were ₹ 35,000.
(10) Amount paid to Trade payables during the year ₹ 6,10,000
(11) Income Tax paid during the year amounts to ₹ 55,000 (Provision for taxation as on 31st March, 2022 ₹ 30,000)·
(12) Investments of ₹ 8,20,000 sold during the year at a profit of ₹ 20,000.
(13) Depreciation on furniture amounts to ₹ 40,000.
(14) Depreciation on other tangible assets amounts to ₹ 20,000.
(15) Plant and Machinery purchased on 15th November, 2021 for ₹ 3,50,000
(16) On 31st March, 2022 ₹ 2,00,000, 7% Debentures were issued at face value in an exchange for a plant.
(17) Cash and Cash equivalents on 31st March, 2021 ₹ 2,25,000.
(A) Prepare cash flow statement for the year ended 31st March, 2022, using direct method.
(B) Calculate cash flow from operating activities, using indirect method

(Ans: Operating 2,30,000; Investing 4,90,000; Financing (2,45,000))

Question 22 *(ICAI Study Material)* Pg no._____

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.

a) Loans and Advances given to the following and interest earned on them:
   (i) to suppliers
   (ii) to employees
   (iii) to its subsidiaries companies
b) Investment made in subsidiary Smart Ltd. and dividend received
c) Dividend paid for the year
d) TDS on interest income earned on investments made
e) TDS on interest earned on advance given to suppliers
f) Insurance claim received against loss of fixed asset by fire

Discuss in the context of AS 3 Cash Flow Statement

Question 23 *(ICAI Study Material) (Similar)* Pg no._____

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

a) Interest paid by financial enterprise
b) Dividend paid
c) Tax deducted at source on interest received from subsidiary company
d) Deposit with Bank for a term of two years
e) Insurance claim received towards loss of machinery by fire

Which activity does the purchase of business falls under and whether netting off of aggregate cash flows from disposal and acquisition of business units is possible?

Question 24 *(ICAI Study Material)* Pg no._____

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 year ended on 31st March, 2022?

Question 25 *(Inter Nov 2019) (5 Marks)* Pg no.______

Prepare cash flow from investing activities as per AS 3 of M/s Subham Creative Limited for year ended 31.3.2022.

Particulars	Amount
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 from 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
Interest received on investment (TDS of ₹ 8,200 was deducted on the above interest)	73,800
Purchased debentures of X Ltd., on. 1st December, 2021 which are redeemable within 3 months	3,00,000
Book value of plant & machinery sold (loss incurred ₹ 9,600)	90,000

(Ans: Investing (1,68,200))

Question 26 *(RTP Nov 2019)* Pg no.______

Prepare a Cash Flow Statement for the year ended 31st March, 2022.

Balance Sheets as on………

Particulars	Note No.	31.03.2022	31.03.2021
EQUITY AND LIABILITES			
(1) Shareholder's Funds			
(a) Share Capital	1	3,50,000	3,00,000
(b) Reserve & Surplus	2	82,000	38,000
(2) Current Liabilities			
Trade Payables		65,000	44,000
Other Current Liabilities	3	37,000	27,000
Short Term Provisions (Provision for Tax)		32,000	28,000
Total		5,66,000	4,37,000
ASSETS			
(1) Non Current Assets			
Tangible Fixed Assets	4	2,66,000	1,90,000
Intangible Assets (Goodwill)		47,000	60,000
Non Current Investments		35,000	10,000
(2) Current Assets			
Inventories		78,000	85,000
Trade Receivables		1,08,000	75,000
Cash & Cash Equivalents		32,000	17,000
Total		5,66,000	4,37,000

Note 1: Share Capital

Particulars	31.03.2022	31.03.2021
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

Note 2: Reserve & Surplus

Particulars	31.03.2022	31.03.2021
General Reserve	30,000	20,000
Profit & Loss A/c	27,000	18,000
Capital Reserve	25,000	-
Total	82,000	38,000

Note 3: Current Liabilities

Particulars	31.03.2022	31.03.2021
Dividend Declared	37,000	27,000
Total	37,000	27,000

Note 4: Tangible Fixed Assets

Particulars	31.03.2022	31.03.2021
Land & Building	75,000	1,00,000
Machinery	1,91,000	90,000
Total	2,66,000	1,90,000

Additional Information:

a) ₹ 18,000 depreciation for the year has been written off on Plant and Machinery and no depreciation has been charged on land and building.

b) A piece of land has been sold out for ₹ 50,000 and the balance has been revalued, profit on such sale and revaluation being transferred to capital reserve. There is no other entry in Capital Reserve Account.

c) A plant was sold for ₹ 12,000 (WDV being ₹ 15,000).

d) Dividend received amounted to ₹ 2,100 which included pre acquisition dividend of ₹ 600.

e) An interim dividend of ₹ 10,000 has been paid.

f) Non-current investments given in the balance sheet represents investment in shares of other companies.

(Ans: Operating 97,500; Investing (95,500); Financing 13,000)

Question 27 *Pg no._____*

Explain the meaning of the terms 'cash' and 'cash equivalent' for the purpose of Cash Flow Statement as per AS-3.

Ruby Exports had a bank balance of USD 25,000, stated in books at ₹ 16,76,250 using the rate of exchange ₹ 67.05 per USD prevailing on the date of receipt of dollars. However, on the balance sheet date, the closing rate of exchange was ₹ 67.80, and the bank balance had to be restated at ₹ 16,95,000. Comment on the effect of change in bank balance due to exchange rate fluctuation and also discuss how it will be disclosed in Cash Flow Statement of Ruby Exports with reference to AS-3.

Question 28 *(Inter Dec 2021) (5 Marks)* *Pg no._____*

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

Liabilities	31.3.2020	31.3.2021
	(₹)	(₹)
Equity Share Capital	25,00,000	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)

Question 29 *(Inter May 2022) (5 Marks)* Pg no._____

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

a) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 40 lakhs.
b) Depreciation on Fixed Assets ₹ 10 lakhs.
c) Discount on issue of Debentures written of ₹ 60,000.
d) Interest on Debentures paid ₹ 7,00,000.
e) Book value of investments ₹ 6 lakhs (Sale of Investments for ₹ 6,40,000).
f) Interest received on investments ₹ 1,20,000.
g) Compensation received ₹ 1,80,000 by the company in a suit filed.
h) Income tax paid ₹ 21,00,000
i) Current assets and current liabilities in the beginning and at the end of the year were as detailed 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

You are required to prepare Cash Flow Statement from Operating Activities in accordance with AS-3 (revised) using the indirect method for the year ended 31st March,2022.

(Ans: Operating 34,68,000)

Question 30 *(Inter Nov 2022) (5 Marks)* Pg no._____

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

a) Dividend paid for the year.
b) TDS on interest income earned on investments made.
c) Loans and advances given to suppliers and interest earned from them.
d) Deposit with bank for a term of two years.
e) Highly liquid Marketable Securities (without risk of change in value).
f) Investments made and dividends earned on them.
g) Insurance claims received against loss of stock or loss of profits.
h) Loans and advances given to subsidiaries and interest earned from them.
i) Issue of Bonus Shares.
j) Term loan repaid.

You are required to classify the above activities in Cash Flow Statement as per 'AS-3'.

BUYBACK OF SECURITIES

CH 3

"You can't go back and change the beginning, but you can start where you are and change the ending."

TOPIC 1 INTRODUCTION: BUYBACK OF SHARES

Meaning:

Buyback means purchase of its own shares by a company. When shares are bought back by a company they have to be cancelled by the company. Thus shares bought back results in decrease in share capital of the company. A company having sufficient cash may decide to buyback its own shares.

Objectives/Advantages of Buyback:

a) To increase Earning per share if there is no dilution in company's earnings as the buyback of shares reduces the outstanding number of shares.
b) To increase promoters holding as the shares bought back are cancelled & also discourage others to make hostile bid to takeover the company (i.e. to eliminate threats by shareholders who are looking for a controlling stake)
c) To support the share price on the stock exchange when the share price in the opinion of company management is less than its worth, especially in depressed market (i.e to take the advantage of undervaluation. For instance, if a company is undervalued due to any microeconomic & macroeconomic reason, it buys its shares back at the current market price & issues those later when the prices go up)
d) To pay surplus cash to the shareholders when the company does not need it for the business.

TOPIC 1A BUYBACK OF SHARES: LEGAL PROVISIONS & JOURNAL ENTRIES

Basic Conditions:

Section 68 (2) further states that no company shall purchase its own shares or other specified securities unless—

(i) the buy-back is authorised by its articles
(ii) a special resolution has been passed in general meeting of the company authorizing the buy-back
Exception: In case the buy back is upto 10% of paid up equity + free reserves, the same may be done with the authorization of the Board Resolution
(iii) There shall be a minimum gap of 1 year in buyback offer from the date of closure of the previous buy back
(iv) All the shares or other specified securities for buy-back are fully paid-up
(v) Every buy-back shall be completed within 12 months from the date of passing the special resolution, or the resolution passed by the board of directors.

As per Section 68 (1) of the Companies Act 2013, buy back of shares can be made out of: its free reserves; or the securities premium account; or the proceeds of any shares or other specified securities.

Provided that no buyback 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 other specified securities

Note:

1) Specified securities include Employees stock option or other securities as may be notified by the Central Government from time to time.
2) Free Reserves includes Securities Premium Account

Three Test Conditions

(i) Maximum Limit of number of equity shares to be bought back must not exceed 25% of total paid up equity capital.

(ii) Maximum Limit of amount of equity shares to be bought back must not exceed 25% of (Paid up capital & Free reserves)

(iii) Debt Equity ratio must not be > 2:1 after buyback

where Debt = Secured + Unsecured Debt (both long term & short term)

Equity = Capital + Free Reserves

PROVISIONS OF SECTION 70 OF THE COMPANIES ACT 2013

(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, redemption of 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 buy-back is not prohibited if the default is remedied and a period of 3 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).

JOURNAL ENTRIES

S.No	Particulars	Journal Entry
1.	To make partly paid equity shares fully paid up	Equity Share Final Call A/c Dr. To Equity Share Capital A/c Bank A/c Dr. To Equity Share Final Call A/c
2.	To realize investments to provide cash for buyback	Bank A/c Dr. P&L A/c (Loss) Dr. To Investments A/c To P&L A/c (Profit)
3.	To issue Preference shares	Bank A/c Dr. To Preference Share Capital A/c To Securities Premium A/c

4.	To cancel the shares bought back	Equity Share Capital A/c Dr. Premium on Buyback A/c Dr. To Equity Share Buyback A/c Equity Share Buyback A/c Dr. To Bank A/c
5.	For closing the premium on buyback account	Securities Premium A/c Dr. General (Revenue) Reserve/ P&L A/c Dr. To Premium on Buyback A/c
6.	Transfer to CRR (Capital Redemption Reserve)*	General (Revenue) Reserve A/c Dr. P&L A/c Dr. Free Reserve (any) A/c Dr. To CRR A/c

*Note: CRR can be utilized for issuing fully paid bonus shares to its members.

Face Value of Equity Shares bought back	XX
Less: Face Value of shares issued	(XX)
Amount to be transferred to CRR	XX

CREATION OF CRR

Case 1:

Balance sheet

Liabilities	Lakhs	Assets	Lakhs
Share capital	10	Sundry Assets	30
P&L A/c	10		
Creditors	10		
	30		30

Case 2: Buyback of 2 Lacs: No CRR

Balance sheet

Liabilities	Lakhs	Assets	Lakhs
Share capital	~~10~~ 8	Sundry Assets	~~30~~ 28
P&L A/c	10		
Creditors	10		
	~~30~~ 28		~~30~~ 28

Case 3: Buyback of 2 Lacs: CRR Created

Balance sheet

Liabilities	Lakhs	Assets	Lakhs
Share capital	~~10~~ 8	Sundry Assets	~~30~~ 28
P&L A/c	10		
CRR			
Creditors	10		
	~~30~~ 28		~~30~~ 28

ASSIGNMENT QUESTIONS

TOPIC 1 BUYBACK OF SHARES

Question 1 Pg no.____

The Balance Sheet of X Ltd. as at 31st March, 2021 is given below:-

Liabilities	(In Lakhs)	Assets	(In Lakhs)
Paid up Share Capital		Freehold Property	200
20 Lakhs Equity shares of ₹ 10 each	200	Stock	120
Securities Premium	20	Debtors	100
General Reserve	180	Cash & Bank Balance	180
14% Redeemable Debentures	100		
Current Liabilities	100		
	600		600

It was resolved at the meeting of shareholders to buyback 20% of equity shares @ ₹ 12 per share. Pass necessary journal entries.

Question 2 Pg no.____

Sohan Ltd. provides you the following information:

Issued capital	1,00,000 equity shares of ₹ 10 each
Reserves and surplus	
Capital reserve	₹ 5,00,000
Securities premium	₹ 9,00,000
Revenue reserve	₹ 15,00,000

The company resolved to buy 10% of its equity share capital @ ₹ 60 per share. Give the necessary journal entries in the books of Sohan Ltd.

Question 3 Pg no.____

The Balance Sheet of X Ltd. as at 31st March, 2021 is as follows:-

Liabilities	₹	Assets	₹
Share Capital of ₹ 10 each	50,00,000	Property, Plant & Equipment	66,00,000
General Reserve	6,50,000	Investments	18,00,000
Securities Premium	5,40,000	Stock	11,87,000
P&L Account	3,75,000	Debtors	9,60,000
12% Debentures	25,00,000	Cash & Bank Balance	7,10,000
Term Loan	13,25,000		
Current Liabilities & Provisions	8,67,000		
	1,12,57,000		1,12,57,000

The shareholders adopted the resolution on the date of above mentioned balance sheet to:-

a) Buyback 20% of the paid up capital @ ₹ 15 each
b) Issue 13% Preference shares of ₹ 5,00,000 at a premium of 10% to finance the buyback of shares
c) Issue 10% Debentures of ₹ 2,00,000 at a premium of 10% to finance the buyback of shares
d) Maintain a balance of ₹ 3,00,000 in general reserve account
e) Sell investments worth ₹ 3,00,000 for ₹ 1,90,000.
f) Buyback expenses were ₹ 2,000

Pass necessary journal entries.

Question 4 *(ICAI Study Material)* *Pg no._____*

KG Limited furnishes the following summarized Balance Sheet as at 31st March, 2021.

	Note	Amount (Lakhs)
A. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital	1	1,200
(b) Reserves & Surplus	2	810
2. Non-current Liabilities		
(a) Long Term Borrowings	3	750
3. Current Liabilities		
(a) Trade Payables		745
(b) Other Current Liabilities		195
Total		3,700
B. Assets		
1. Non-current assets		
(a) Property, Plant & Equipment & Intangible Assets		
i. Property, Plant & Equipment	4	2,026
(b) Non Current Investments		74
2. Current Assets		
(a) Inventories		600
(b) Trade Receivables		260
(c) Cash & Cash Equivalents		740
Total		3,700

Notes to Accounts

		Amount (Lakhs)
1.	Share Capital	
	Authorised, Issued & Subscribed Capital	
	Equity shares of ₹ 10 each	1,200
2.	Reserves and Surplus	
	Securities Premium	175
	Revenue Reserve	265
	Capital Redemption Reserve	200
	Profit & Loss Account	170
		810
3.	Long Term borrowings	
	12% Debentures	750
4.	Property, Plant & Equipment	
	Land & Building	1,800
	Plant & Machinery	226
		2,026

On 1st April, 2021, 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, 2021, the company achieved the target of buy back. On 30th April, 2021 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. You are required to:

(1) Pass necessary journal entries for the above transactions.

(2) Prepare Balance Sheet of KG Limited after bonus issue of the shares

Question 5 *(ICAI Study Material)* Pg no._____

Dee Limited furnishes the following summarized Balance Sheet as at 31st March, 2021:

	Note	Amount (000)
A. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital	1	2,700
(b) Reserves & Surplus	2	9,700
2. Current Liabilities		
(a) Trade Payables		1,400
Total		13,800
B. Assets		
1. Non-current assets		
(a) Property, Plant & Equipment & Intangible Assets		
i. Property, Plant & Equipment		9,300
(b) Non Current Investments		3,000
2. Current Assets		
(a) Inventories		500
(b) Trade Receivables		200
(c) Cash & Cash Equivalents		800
Total		13,800

Notes to Accounts

		Amount (000)
1.	Share Capital	
	Authorised, Issued & Subscribed Capital	
	2,50,000 equity shares of ₹ 10 each	2,500
	2,000 10% preference shares of ₹ 100 each	200
	(Issued 2 months back for the purpose of buyback)	
		2,700
2.	Reserves and Surplus	
	Capital Reserve	1,000
	Revenue Reserve	3,000
	Securities Premium	2,200
	Profit & Loss Account	3,500
		9,700

The company passed 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. Pass necessary journal entries & prepare the Balance Sheet

Question 6 Pg no._____

The following was the summarized balance sheet of Mukta Ltd. as on 31st March, 2021:

Liabilities	(In Lakhs)	Assets	(In Lakhs)
Authorised capital:		Property, Plant & Equipment	1,12,000
Equity shares of ₹ 10 each	80,000	Investments	24,000
Issued capital:		Cash at Bank	13,200
Equity Shares -₹ 10 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, 2021, the Company redeemed all its Preference Shares at a Premium of 10% and bought back 25% of its Equity Shares at ₹ 20 per Share. In order to make Cash available, the Company sold all the Investments for ₹ 25,200 Lakhs and raised a Bank Loan amounting to ₹ 16,000 lakh on the security of Company's Plant. Pass necessary Journal Entries considering that the buy back is authorised by the articles of company and necessary resolution is passed by the company. Securities premium will be utilized to the maximum extent allowed by law.

Question 7 *(RTP May 2018)/ (RTP May 2022)* *Pg no._____*

Complicated Ltd.(unlisted company) gives following information as on 31st March, 2021:

Liabilities	Amount
Equity shares of ₹ 10 each fully paid up	13,50,000
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 (Long Term- Unsecured)	10,00,000
Current maturities of long term borrowings	16,50,000
Application money received for allotment due for refund	2,00,000
	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 ₹ 10 each, on 1st April, 2021 at ₹ 20 per share. Buy back of shares is duly authorised 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. Pass necessary journal entries towards buy back of shares and prepare the Balance Sheet after buy back of shares.

Question 8 *(ICAI Study Material)* *Pg no._____*

Extra Ltd. furnishes you with the following summarized Balance Sheet as on 31st March, 2021:

	Note	Amount (Lakhs)
A. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital	1	120
(b) Reserves & Surplus	2	118

2. Non-current Liabilities (a) Long Term Borrowings	3	4
3. Current Liabilities (a) Trade Payables		70
Total		312
B. Assets		
1. Non-current assets (a) Property, Plant & Equipment & Intangible Assets i. Property, Plant & Equipment (b) Non Current Investments		50 120
2. Current Assets (a) Cash & Cash Equivalents		142
Total		312

Notes to Accounts

		Amount (Lakhs)
1.	Share Capital Authorised, Issued & Subscribed Capital Equity shares of ₹ 10 each fully paid up 9% preference shares of ₹ 100 each fully paid up	 100 20 120
2.	Reserves and Surplus Capital Reserve Revenue Reserve Securities Premium	 8 50 60 118
3.	Long Term borrowings 10% Debentures	 4

(i) The company redeemed the preference shares at a premium of 10% on 1st April, 2021.

(ii) It also bought back 3 lakhs equity shares of ₹ 10 each at ₹ 30 per share. The payment for the above was made out of huge bank balances.

(iii) Included in its investment were “investments in own debentures” costing ₹ 2 lakhs (face value ₹ 2.20 lakhs). These debentures were cancelled on 1st April, 2021.

(iv) 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 (This was included under current liabilities). On 1.04.2021 employees exercised their options for 50,000 shares.

Pass the journal entries to record the above & Prepare Balance Sheet as at 01.04.2021.

TOPIC 2 BUYBACK OF SHARES: 3 Test Conditions

Question 9 *(ICAI Study Material)* *Pg no._____*

Following is the Balance Sheet of M/s Competent Limited as on 31st March, 2021:

	Note	Amount
A. Equity and Liabilities 1. Shareholders' Fund (a) Share Capital (b) Reserves & Surplus	 1 2	 12,50,000 18,75,000
2. Non-current Liabilities (a) Long Term Borrowings	 3	 28,75,000

3. Current Liabilities (a) Short Term Borrowings		16,50,000
Total		76,50,000
B. Assets		
1. Non-current assets (a) Property, Plant & Equipment & Intangible Assets i. Property, Plant & Equipment	4	46,50,000
2. Current Assets (a) Other Current Assets		30,00,000
Total		76,50,000

Notes to Accounts

		Amount
1.	Share Capital Authorised, Issued & Subscribed Capital Equity shares of ₹ 10 each fully paid up	12,50,000
2.	Reserves and Surplus Securities Premium Profit & Loss Account Revenue Reserve	 2,50,000 1,25,000 15,00,000 18,75,000
3.	Long Term borrowings 14% Debentures Unsecured Loans	 18,75,000 10,00,000 28,75,000
4	Property, Plant & Equipment Land & Building Plant & Machinery Furniture & Fittings	 19,30,000 18,00,000 9,20,000 46,50,000

The company wants to buy back 25,000 equity shares of ₹ 10 each, on 1st April, 2021 at ₹ 20 per share. Buy back of shares is duly authorized by its articles and necessary resolution 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 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.

Question 10 *(ICAI Study Material)* *Pg no._____*

Perrotte Ltd. (non listed company) has the following Capital Structure as on 31.03.2021:

S.No.	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 12.09.2021 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 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 09.12.2021, show the accounting entries in the company's books in each situation.

Question 11 *(Inter Dec 2021) (10 Marks)* *Pg no._____*

Mohan Ltd. furnishes the following summarised Balance Sheet as on 31st March 2021,

	Amount (₹ in Lakhs)
Equity & Liabilities:	
Shareholder's Fund	
Share Capital	
Equity Shares of 10 each fully paid up	780
6% Redeemable Preference shares of 50 each fully paid up	240
Reserve & Surplus	
Capital Reserve	58
General Reserve	625
Security Premium	52
Profit & Loss	148
Revaluation Reserve	34
Infrastructure Development Reserve	16
Non Current Liabilities	
7% Debentures	268
Unsecured Loans	36
Current Liabilities	395
Total	2652
Assets :	
Non Current Assets	
Plant and Equipment less depreciation	725
Investment at cost	720
Current Assets	1207
Total	2652

Other Information :

a) The Company redeemed Preference shares at a premium of 10% on 1st April, 2021.
b) It is also offered buyback the maximum permissible number of Equity shares of ₹10 each at ₹30 per share an 2nd April, 2021.
c) The payment for the above was made out of available account balance, which appeared as a part of the current assets.
d) The company had investment in own Debentures costing ₹60 lakhs (face value ₹75 lakhs). These Debenture were cancelled on 2nd April, 2021.
e) On 4th April 2021 company issued one fully paid up equity share of ₹10 each by way of bonus for every five equity shares held by the shareholders.

You are required to :

(i) Calculate maximum possible number of equity shares that can be bought back as per the Companies Act, 2013 and

(ii) Record the Journal Entries for the above mentioned information.

PRACTICE QUESTIONS

TOPIC 1 BUYBACK OF SHARES

Question 1 *(RTP Nov 2019)/ (RTP Nov 2022)* Pg no._____

Umesh Ltd. (a listed company) resolves to buy back 4 lakhs of its fully paid equity shares of ₹ 10 each at ₹ 22 per share from the open market. For the purpose, it issues 1 lakh 11 % preference shares of ₹ 10 each at par, the entire amount being payable with applications. The company uses ₹ 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.

(Ans: CRR 30,00,000)

Question 2 *(Inter Jan 2021) (5 Marks)* Pg no._____

The Directors of Umang Ltd. passed a resolution to buyback 5,00,000 of its fully paid equity shares of ₹ 10 each at ₹ 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 ₹ 30,00,000 for ₹ 25,00,000.

(ii) Issued 20,000, 12% preference shares of ₹ 100 each at par, the entire amount being payable with application.

(iii) Used ₹ 15,00,000 of its Securities Premium Account apart from its adequate balance in General Reserve 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 buyback of shares in the books of Umang Ltd.

(Ans: CRR 30,00,000)

Question 3 *(ICAI Study Material)* Pg no._____

M Ltd. furnishes the following summarized Balance Sheet as at 31st March, 2021:

	Note	Amount (000)
A. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital	1	5,000
(b) Reserves & Surplus	2	6,310
2. Non-current Liabilities		
(a) Long Term Borrowings	3	400
3. Current Liabilities		
(a) Trade Payables		40
Total		11,750
B. Assets		
1. Non-current assets		
(a) Property, Plant & Equipment & Intangible Assets		
i. Property, Plant & Equipment	4	2,750
(b) Non Current Investments		5,000
2. Current Assets		
(a) Inventories		1,000
(b) Trade Receivables		2,000
(c) Cash & Cash Equivalents		1,000
Total		11,750

Notes to Accounts

		Amount (000)
1.	Share Capital Authorised, Issued & Subscribed Capital 3,00,000 equity shares of ₹ 10 each 20,000 9% preference shares of ₹ 100 each	 3,000 2,000 5,000
2.	Reserves and Surplus Capital Reserve Revenue Reserve Securities Premium Profit & Loss Account	 10 4,000 500 1,800 6,310
3.	Long Term borrowings 10% Debentures	 400
4.	Property, Plant & Equipment Cost Less: Provision for Depreciation	 3,000 (250) 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. *(Ans: CRR 600)*

Question 4 *(RTP May 2019)* *Pg no._____*

Alpha Limited furnishes the following summarized Balance Sheet as at 31st March, 2021.

Liabilities	(In Lakhs)	Assets	(In Lakhs)
Equity share capital (fully paid up shares of ₹ 10 each)	2,400	Machinery	3,600
Securities premium	350	Furniture	450
General reserve	530	Investment	148
Capital redemption reserve	400	Stock	1,200
Profit & loss A/c	340	Trade receivables	500
12% Debentures	1,500	Cash at bank	1,500
Trade Payables	1,400		
Other current liabilities	478		
	7,398		7,398

On 1st April, 2021, 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 ₹ 150 lakhs.
On 5th April, 2021, the company achieved the target of buy back.
You are required to:
(1) Pass necessary journal entries for the buyback.
(2) Prepare Balance Sheet of Alpha Limited after buyback of the shares
(Ans: CRR 600 Lakhs & Balance Sheet Total 6,500 Lakhs)

Question 5 *(Inter Nov 2022) (5 Marks)* *Pg no._____*

PG Limited furnishes the following Balance Sheet as at 31st March,2022:

	Particulars	Notes	₹ (in Lakhs)
	Equity and Liabilities		
1.	Shareholders' funds		
	(a) Share Capital	1	12,000

	(b) Reserves and Surplus	2	8,100
2.	Current liabilities		
	(a) Trade Payables		7,450
	(b) Other Current Liabilities		1,950
	Total		29,500
	Assets		
1	Non-current assets		
	(a) Property, Plant and Equipment		12,760
	(b) Non-current Investments		740
2.	Current assets		
	(a) Inventories		6,000
	(b) Trade receivables		2,600
	(c) Cash and cash equivalents		7,400
	Total		29,500

Notes to accounts:

	Particulars	₹ (in Lakhs)
1.	Share Capital	
	Authorized, issued and subscribed capital	
	Equity share capital (fully paid-up shares of ₹ 10 each)	12,000
2.	Reserves and Surplus:	
	Securities premium	1,750
	General reserve	2,650
	Capital redemption reserve	2,000
	Profit and Loss account	1,700
	Total	8,100

On 1st April, 2022, 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 ₹ 750 lakhs.

On 5th April, 2022, the company achieved the target of buy-back. You are required to pass necessary journal entries for the above transactions.

(Ans: CRR 3,000 Lakhs)

Question 6 *(RTP May 2021)* *Pg no._____*

Following is the Summarized Balance Sheet of M/s. Vriddhi Infra Ltd. as on 31st March, 2021:

Equity & Liabilities	Amount	Assets	Amount
Shareholders Fund		Non Current Assets	
(a) Share Capital:		(a) PPE	
1,00,000 Equity Sh. of 10 each	10,00,000	Land & Building	21,50,000
(b) Reserve & Surplus:		Plant & Machinery	15,00,000
Securities Premiums	3,00,000	(b) Non- current Investment	2,00,000
General Reserve	2,50,000		
Profit & Loss A/c (Surplus)	1,50,000	Current Assets	
Non-Current Liabilities		(a) Trade Receivables	5,50,000
Long-Term Borrowings:		(b) Inventories	1,80,000
10% Debentures (Secured by floating charge on all assets)	20,00,000	(c) Cash and Cash Equivalents	40,000
Unsecured Loans	8,00,000		
Current Liability & Provisions			
Trade Payables	1,20,000		
	46,20,000		46,20,000

On 21st April, 2021 the Company announced the buy back of 15,000 of its equity shares @ ₹ 15 per share. For this purpose, it sold all its investment for ₹ 2.50 lakhs.
On 25th April, 2021, the company achieved the target of buy back. On 1st May, 2021 the company issued one fully paid up share of ₹ 10 each by way of bonus for every eight equity shares held by the equity shareholders.
You are requested to pass necessary Journal Entries for the above transactions.
(Ans: CRR 1,50,000 & Bonus Issue 1,06,250)

Question 7 *(Inter May 2018) (10 Marks)* *Pg no._____*

Alpha Ltd. furnishes the following summarized Balance Sheet as at 31st March, 2021:

	₹ In Lakhs	₹ In Lakhs
Equity & Liabilities		
Shareholders' Funds		
Equity share capital (fully paid up shares of ₹ 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
Total		7,400
Assets		
Non-current Assets		
Property, Plant & Equipment		4,052
Current Assets		
Current Investments	148	
Inventories	1,200	
Trade Receivables	520	
Cash and Bank	1,480	3,348
Total		7,400

(i) On 1st April, 2021, the company announced buy-back of 25% of its equity shares @ ₹ 15 per share. For this purpose, it sold all its investment for ₹ 150 lakhs.
(ii) On 10th April, 2021 the company achieved the target of buy-back.
(iii) On 30th April, 2021, the company issued one fully paid up equity share of ₹ 10 each by way of bonus for every four equity shares held by the equity shareholders by capitalization of Capital Redemption Reserve.

Pass necessary journal entries and prepare the Balance Sheet of Alpha Ltd. after bonus issue.
(Ans: CRR 600 Lakhs, Bonus Issue 450 Lakhs & Balance Sheet Total 6,502 Lakhs)

Question 8 *(RTP Nov 2018)* *Pg no._____*

The following Balance Sheet Pee Limited (a non-listed company) as at 31st March, 2021

	Amount (in ₹)	
Equity & Liabilities		
Share Capital: Authorised capital		
2,50,000 Equity shares of ₹ 10 each fully paid up	25,00,000	

5,000, 10% Preference shares of ₹ 100 each	5,00,000	30,00,000
Issued and subscribed capital:		
2,40,000 Equity shares of ₹ 10 each fully paid up	24,00,000	
3,000, 10% Preference shares of ₹ 100 each (Issued two months back for the purpose of buy back)	3,00,000	27,00,000
Reserves and surplus:		
Capital reserve	10,00,000	
Revenue reserves	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		
Property, Plant & Equipment		
Building	25,00,000	
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, 2021, the company passed a resolution to buy back 20% of its equity capital @ ₹ 60 per share. For this purpose, it sold all of its investment for ₹ 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.

(Ans: CRR 1,80,000 & Balance Sheet Total 1,06,20,000)

Question 9 *(RTP May 2020)* *Pg no._____*

The following was the Balance Sheet of C Ltd. as on 31st March, 2021

Liabilities	(in Lakhs)	Assets	(in Lakhs)
Share Capital:		Property, Plant & Equipm.	14,000
Equity shares ₹10 each Fully Paid Up	8,000	Investments	2,350
10% Redeemable Pref. Shares of ₹ 10 each Fully Paid Up	2,500	Cash at Bank	2,300
Reserves & Surplus		Other Current Assets	8,250
Capital Redemption Reserve	1,000		
Securities Premium	800		
General Reserve	6,000		
Profit & Loss Account	300		
Secured Loans: 9% Debentures	5,000		
Current Liabilities:			
Trade payables	2,300		
Sundry Provisions	1,000		
	26,900		26,900

On 1st April, 2021 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 ₹ 2,500 lakhs. You are required to
(i) pass journal entries for the above and
(ii) prepare the Company's Balance sheet immediately thereafter.
(Ans: CRR 3,300 Lakhs & Balance Sheet Total 22,700 Lakhs)

Question 10 *(ICAI Study Material)* *Pg no._____*

Anu Ltd. furnishes you with the following summarized balance sheet as at 31st March, 2021:

	Note	Amount (crores)
A. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital	1	100
(b) Reserves & Surplus	2	300
2. Current Liabilities		
(a) Trade Payables		40
Total		440
B. Assets		
1. Non-current assets		
(a) Property, Plant & Equipment & Intangible Assets		
i. Property, Plant & Equipment	3	-
(b) Non Current Investments	4	100
2. Current Assets		
(a) Trade Receivables		140
(b) Cash & Cash Equivalents		200
Total		440

Notes to Accounts

		Amount (crores)
1.	Share Capital	
	Authorised, Issued & Subscribed Capital	
	Equity shares of ₹ 10 each	25
	12% preference shares of ₹ 100 each	75
		100
2.	Reserves and Surplus	
	Capital Reserve	15
	Revenue Reserve	260
	Securities Premium	25
		300
3.	Property, Plant & Equipment	
	Cost	100
	Less: Provision for Depreciation	(100)
		Nil
4.	Non Current Investments	
	At Cost (Market Value 400 crores)	100

The company redeemed preference shares on 1st April, 2021. 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:
(i) Pass journal entries to record the above.
(ii) Prepare balance sheet as at 1.4.2021.
(Ans: CRR 80 Crores & Balance Sheet Total 340 Crores)

Question 11 *(RTP May 2023)* Pg no._____

Pay Limited provides you with the following information as at 31st March, 2022:

		(₹ in Lakhs)
Share Capital:		300
Authorised		
Issued:		
11% Redeemable preference shares of ₹ 100 each fully paid	125	
Equity shares of ₹ 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 value₹ 400 Lakhs)		200
Current assets		790

a) The company redeemed preference shares at a premium of 4% on 1st April, 2022.
b) It also bought back 2.5 lakhs equity shares of ₹ 10 each at ₹ 40 per share. The payments for the above were made out of bank balances, which appeared as a part of current assets.

You are asked to:
i. Pass journal entries to record the above.
ii. Prepare balance sheet as at 01.04.2022.
(Ans: CRR 150 Lakhs & Balance Sheet Total 770 Lakhs)

Question 12 *(Inter Nov 2019) (15 Marks) / (RTP Nov 2021)* Pg no._____

X Ltd. furnishes the following summarized Balance Sheet as at 31-03-2021.

	Amount (in ₹)	
Equity & Liabilities		
Share Capital:		
Equity Shares of ₹ 20 each fully paid up	50,00,000	
10,000, 10% Preference Shares of ₹ 100 each fully paid up	10,00,000	60,00,000
Reserves and surplus:		
Capital Reserve	1,00,000	
Securities premium	12,00,000	
Revenue Reserve	5,00,000	
Profit and loss account	20,00,000	
Dividend Equalization Fund	5,50,000	43,50,000
Non-Current Liabilities		
12% Debentures		12,50,000
Current Liabilities and Provisions		5,50,000
		1,21,50,000

Assets		
Non Current Assets		
Property, Plant & Equipment & Intangible Assets		
Property, Plant & Equipment		1,00,75,000
Current assets		
Investment	3,00,000	
Inventory	2,00,000	
Cash & Bank	15,75,000	20,75,000
		1,21,50,000

The shareholders adopted the resolution on the date of above mentioned Balance Sheet to:

(1) Buy back 25% of the paid up capital and it was decided to offer a price of 20% over market price. The prevailing market value of the company's share is ₹ 30 per share.

(2) To finance the buy-back of shares, company:

(a) Issues 3000, 14% debentures of ₹ 100 each at a premium of 20%.

(b) Issues 2500, 10% preference shares of ₹ 100 each.

(3) Sell investment worth ₹ 1,00,000 for ₹ 1,50,000.

(4) Maintain a balance of ₹ 2,00,000 in Revenue Reserve.

(5) Later the company issue three fully paid up equity share of ₹ 20 each by way of bonus share for every 15 equity share held by the equity shareholders.

You are required to pass the necessary journal entries to record the above transactions and prepare Balance Sheet after buy back.

(Ans: CRR 10,00,000, Bonus Issue 7,50,000 & Balance Sheet Total 1,05,60,000)

TOPIC 2 BUYBACK OF SHARES: 3 Test Conditions

Question 13 *(Inter May 2019) (10 Marks)* Pg no.______

Following is the summarized Balance Sheet of Super Ltd. as on 31st March, 2021.

	Amount (in ₹)	
Equity & Liabilities		
Share Capital:		
Equity Shares of ₹ 10 each fully paid up		17,00,000
Reserves and surplus:		
Revenue reserves		23,50,000
Securities premium		2,50,000
Profit and loss account		2,00,000
Infrastructure Development Reserve		1,50,000
Secured Loan		
9% Debentures		22,50,000
Unsecured Loan		8,50,000
Current Maturities of Long term borrowings		15,50,000
		93,00,000
Assets		
Non Current Assets		
Property, Plant & Equipment & Intangible Assets		
Property, Plant & Equipment		58,50,000
Current assets		
Current assets		34,50,000
		93,00,000

Super Limited wants to buy back 35,000 equity shares of ₹ 10 each fully paid up on 1st April, 2021 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

(Ans: Maximum shares as per 3 test conditions 37,500)

Question 14 *(ICAI Study Material)* *Pg no._____*

SMM Ltd. has the following capital structure as on 31st March, 2021

S.No.	Particulars	₹ in crore Situation	₹ in crore Situation
(1)	Equity Share Capital (Shares of ₹ 10 each fully paid)	1,200	1,200
(2)	Reserves and Surplus		
	General Reserve	1,080	1,080
	Securities Premium Account	400	400
	Profit & Loss Account	200	200
	Infrastructure Development Reserve (Statutory reserve)	320	320
(3)	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

(Ans: Maximum shares as per 3 test conditions Case (1) 24 crores & Case (2) Nil)

Question 15 *(Inter July 2021) (15 Marks)* *Pg no._____*

A company provides the following 2 possible Capital Structures as on 31st March, 2021:

Particulars	Situation 1 (₹)	Situation 2 (₹)
Equity Share Capital (Shares of ₹ 10 each, fully paid up)	30,00,000	30,00,000
Reserves & Surplus:		
General Reserve	12,00,000	12,00,000
Securities Premium	6,00,000	6,00,000
Profit & Loss	2,10,000	2,10,000
Statutory Reserve	4,20,000	4,20,000
Loan Funds	25,00,000	1,20,00,000

The company is planning to offer buy back of Equity Share at a price of ₹ 30 per equity share. You are required to calculate maximum permissible number of equity shares that can be bought back in both the situations as per Companies Act, 2013 and are also required to pass necessary Journal Entries in the situation where the buyback is possible.

(Ans: Maximum shares as per 3 test conditions Case (1) 41,750 & Case (2) Nil)

Question 16 *(RTP Nov 2020) / (ICAI Study Material)* *Pg no._____*

Pratham Ltd. (a non-listed company) has following Capital structure as on 31st March, 2021:

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 be bought back in the light of above information, when the offer price for buy back is ₹ 30 per share. *(Ans: Maximum shares 1,29,500)*

Question 17 *(Inter May 2022) (10 Marks)* *Pg no._____*

Quick Ltd. has the following capital structure as on 31st March,2021:

	Particulars	₹ in Crores	₹ 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 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.

(Ans: Maximum shares as per 3 test conditions Case(1) Nil Case(2) 5.25 crores & Case(3) Nil)

INTERNAL RECONSTRUCTION

CH 4

"Don't downgrade your dream just to fit your reality. Upgrade your conviction to match your destiny."

TOPIC1: INTRODUCTION

When a company has been making losses for several years, the financial position does not present a true & fair view of the state of the affairs of the company. In such a company the assets are generally overvalued, as the balance sheet consists of fictitious assets, unrepresented intangible assets & debit balance in profit & loss account.

Reconstruction is a process by which affairs of a company are reorganized by revaluation of assets, reassessment of liabilities and by writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares. Such a process is called internal reconstruction which is carried out without liquidating the company and forming a new one.

Process of Internal Reconstruction

1) Scheme Framed

2) Approval of scheme by concerned parties

3) Sanction of scheme by Court

4) Implementation of scheme
   * Passing Entries in Books
   * Writing off Losses
   * Revised values to appear in B/S

TOPIC 1A: JOURNAL ENTRIES

1.	For increase or reduction in value of assets	
	a) Increase	
	b) Decrease	
2.	For increase or reduction in liabilities:	
	a) Increase	
	b) Decrease	
3.	For payment of reconstruction expenses	
	a) At the time of payment	
4.	Settlement of contingent liability *Example*: Preference dividend in arrears, Capital commitments, etc.	
	a) If waived	
	b) If paid	
5.	If any losses or deferred revenue expenditure are appearing then such amount should be written off even if question is silent. *Example of deferred revenue expenditure*: Underwriting commission, Discount on issue of debentures, Preliminary expenses, Advertisement suspense, etc.	
	a) At the time of write off	
6.	If any intangible assets appear in the balance sheet it may be written off by giving a note. *Example*: Patents, Trademarks, Goodwill, Copyrights etc.	

	a) At the time of write off	
7.	Closing of Capital Reduction Account	
	a) Credit Balance	
	b) Debit Balance	

Notes:
1) In case of fixed assets, the amount written off under the scheme of reconstruction must be shown for 5 years.
2) After the name of company, the words "and reduced" should be added only if the court so orders.

TOPIC 2: METHODS OF INTERNAL RECONSTRUCTION

Methods of Internal Reconstruction:

Alteration of share capital	Variation of shareholder's rights	Compromise/ arrangement	Reduction of share capital	Surrenders of shares

TOPIC 2A: Alteration of Share Capital, Variation of Shareholder Rights, Compromise/Arrangements & Reduction of Share Capital

ALTERATION OF SHARE CAPITAL

1. For Increase in Share Capital

Example:

X Ltd. issued 10,000 equity shares of ₹10 each at par.	

2. For Consolidation of Shares

Example:

X Ltd. having 10,000 equity shares of ₹10 each decides to convert share capital into equity shares of 100 each.	

3. For Sub-division of Shares

Example:

X Ltd. having 1,000 equity shares of ₹100 each decides to convert share capital into equity shares of 10 each.	

4. For Conversion of shares into stock

Stock is a bundle of fully paid shares put together for convenience so that it may be divided into any amount & transferred into any fractions & subdivisions without regard to the original face value of the shares.

Example:

X Ltd. having 10,000 equity shares of 10 each decides to convert the share capital into equity stock	

5. For Conversion of stock into shares

Example:

X Ltd. having equity stock of ₹1,00,000 decides to convert the equity stock into equity share capital of ₹ 10 each.	

6. For Cancelling the unissued shares

   In this case no accounting entry is passed. The authorized share capital gets reduced by the amount of unissued shares now cancelled.

VARIATION OF SHAREHOLDERS RIGHTS

Only the specific rights are changed. There is no change in the amount of capital. For example, the company may change rate of (a) dividend on preference shares or (b) convert cumulative preference shares into non-cumulative preference shares without changing the amount of share capital.

Example:

X Ltd. has 1,000 10% preference shares of 100 each. At a meeting of preference shareholders, it was decided that the rate of dividend be reduced to 9%.	

COMPROMISE/ARRANGEMENT

A scheme of compromise and arrangement is an agreement between a company and its members and outside liabilities when the company faces financial problems. Such an arrangement therefore also involves sacrifices by shareholders, or creditors and debenture holders or by all.

Example:

In the balance sheet, sundry creditors are appearing at ₹ 4,50,000. They agreed to reduce their claims to 20% and half the balance to be satisfied by issue of equity shares of ₹10 each.	

REDUCTION OF SHARE CAPITAL

a) Liability of the shareholders is extinguished or reduced in respect of unpaid amount on the shares held by them.

Number of Shares = 10,000
Face Value = 10
Paid up Value = 8
Reduce 10 per share into 8 per share fully paid up
So Cancel the unpaid amount of 2 per share

b) Paying off excess paid-up share capital

Number of Shares = 10,000
Face & Paid up Value = 10
Pay off 2 per share to make it 8 per share fully paid up

c) Writing off the lost paid up capital

Number of shares = 1,000
Face Value = 100
Paid up Value = 100

	(a)	(b)
Write off	80	80
Face Value	20	100
Paid up	20	20

Note: If question does not specify reduction in Face value or paid up value, then assume change in Face value and paid up value.

TOPIC 2B: SHARE SURRENDER

At the time of internal reconstruction, some people may voluntarily surrender their shares to the company. Alternatively, there can be concept of compulsorily surrender in the reconstruction scheme.

Entries:

At the time of surrender	
If the surrendered shares are cancelled	
If the surrendered shares are utilized for the payment of an obligation	

ASSIGNMENT QUESTIONS

TOPIC 1 & 2A

Question 1 *(ICAI Study Material)* Pg no.____

On 31-12-2021, Z Ltd. had 20,000, ₹ 10 Equity Shares as authorised capital and the shares were all issued on which ₹ 8 was paid up. In June, 2022 the company in general meeting decided to sub-divide each share into two shares of ₹ 5 with ₹ 4 paid up. In June, 2023 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 as on 31-12-2021, 31-12-2022 and 31-12-2023.

Question 2 Pg no.____

Pass Journal Entries in the following conditions:

1) X Ltd. had 1,24,000 equity shares of ₹ 50 each on which ₹ 45 is paid up. In October, 2023 company decided to sub-divide each share into 5 shares of ₹ 10 with ₹ 9 paid up.
2) Y Ltd. had 2,10,000 equity shares of ₹ 10 each fully paid up. In December 2022 company decided to convert the issued shares into stock. But in February 2023 the company re-converted the stock into equity shares of ₹ 100 each fully paid up.
3) Z Ltd. had capital of ₹ 30,00,000 divided into 3,00,000 equity shares of ₹ 10 each on which ₹ 6 is paid up. During the year, company decided to reorganize its capital by consolidating 5 shares into one share of ₹ 50 each, ₹ 30 paid up.

Question 3 *(ICAI Study Material)* Pg no.____

The following scheme of reconstruction has been approved for Win Limited:

1. The shareholders to receive in lieu of their present holding at 1,00,000 shares of ₹ 10 each, following:
   a. New fully paid ₹ 10 Equity shares equal to 3/5th of their holding.
   b. 10% Preference shares fully paid to the extent of 1/5th of the above new equity shares.
   c. ₹ 40,000, 8% Debentures.
2. An issue of ₹ 1 lakh 12% first debentures was made and allotted, payment for the same being received in cash forthwith.
3. Goodwill which stood at ₹ 1,40,000 was completely written off.
4. Plant and machinery which stood at ₹ 2,00,000 was written down to ₹ 1,50,000.
5. 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 above reconstruction.

Question 4 *(ICAI Study Material)* Pg no.____

Parth Ltd, had laid down the following terms upon the sanction of the reconstruction plan by the court

1. Furniture & Fixtures which stood at the books at ₹ 1,50,000 to be written down to ₹ 95,000. The freehold premises which was valued at ₹ 7,00,000 showed 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 following in lieu of their present 9% 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 the years. 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 of the reconstruction process considering that balance in general reserve utilized to write off the losses as per reconstruction scheme.

Question 5 *(ICAI Study Material)* *Pg no._____*

The Balance Sheet of A & Co. Ltd. as on 31-03-2023 is as follows:

	Note	Amount
A. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital	1	11,50,000
(b) Reserves & Surplus	2	(5,35,000)
2. Non-current Liabilities		
(a) Long Term Borrowings	3	3,75,000
3. Current Liabilities		
(a) Short Term Borrowings- Bank Overdraft		1,95,000
(b) Trade Payables		3,00,000
(c) Other Current Liabilities	4	1,22,500
Total		16,07,500
B. Assets		
1. Non-current assets		
(a) Property, Plant & Equipment & Intangible Assets		
i. Property, Plant & Equipment	5	4,75,000
ii. Intangible Assets	6	1,67,500
(b) 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

		Amount
1.	Share Capital	
	Equity Share Capital	
	75,000 equity shares of ₹ 10 each	7,50,000
	Preference Share Capital	
	4,000 6% preference shares of ₹ 100 each	4,00,000
		11,50,000
2.	Reserves and Surplus	
	Debit Balance of Profit and Loss Account	(5,35,000)
3.	Long Term borrowings	
	6% Debentures (secured on Freehold property)	3,75,000
4.	Other Current Liabilities	
	Loan from Directors	1,00,000
	Interest payable on 6% debentures	22,500
		1,22,500
5.	Property, Plant & Equipment	
	Freehold property	4,25,000
	Plant	50,000
		4,75,000

6.	Intangible Assets Goodwill Patents	 1,30,000 37,500 1,67,500
7	Non Current Investments Investments at cost	 55,000

The Court approved a Scheme of re-organisation to take effect on 1-4-2023, whereby:

a) The Preference shares to be written down to ₹ 75 each and Equity Shares to ₹ 2 each.
b) 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 the remaining quarter.
c) Interest payable on debentures to be paid in cash.
d) 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 ₹ 1,30,000 secured by a floating charge on company's assets at an interest rate of 8% p.a.
e) Patents and Goodwill to be written off.
f) Stock to be written off by ₹ 65,000 and amount of ₹ 68,500 to be provided for bad debts.
g) Remaining freehold property to be re-valued at ₹ 3,87,500
h) Investments be sold for ₹ 1,40,000
i) Directors to accept settlement of their loans as to 90% thereof by allotment of equity shares of ₹ 2 each and as to 5% in cash, and balance 5% being waived.
j) There were capital commitments totalling ₹ 2,50,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.
k) 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 completion of the Scheme.

Question 6

Pg no._____

The summarized Balance Sheet of AB Ltd. as on 31st March, 2023 was as follows:

	Note	Amount	Amount
A. Equity and Liabilities			
1. Shareholders' Fund			
(a) Share Capital	1	7,50,000	
(b) Reserves & Surplus	2	(10,00,000)	(2,50,000)
2. Non-current Liabilities			
(a) Long Term Borrowings	3		5,00,000
3. Current Liabilities			
(a) Short Term Borrowings	4	5,00,000	
(b) Trade Payables		2,50,000	7,50,000
Total			10,00,000
B. Assets			
1. Non-current assets			
(a) PPE & Intangible Assets			
i. Property, Plant & Equipment	5	5,50,000	
ii. Intangible Assets	6	1,50,000	7,00,000
2. Current Assets			
(a) Inventories		1,50,000	
(b) Trade Receivables		1,25,000	
(c) Deferred revenue expenditure		25,000	3,00,000
Total			10,00,000

Notes to Accounts

		Amount	Amount
1.	Share Capital Authorised, issued & fully paid 5,000 equity shares of ₹ 100 each 2,500 8% preference shares of ₹ 100 each	 5,00,000 2,50,000	 7,50,000
2.	Reserves and Surplus Profit and Loss Account		 10,00,000
3.	Long Term borrowings 8% Debentures		 5,00,000
4.	Short Term Borrowings Loan from Directors Bank overdraft	 3,00,000 2,00,000	 5,00,000
5.	Property, Plant & Equipment Freehold property Plant	 4,00,000 1,50,000	 5,50,000
6.	Intangible Assets Goodwill Trademark	 1,00,000 50,000	 1,50,000

The following scheme of internal reconstruction was framed, approved by the Court, all the concerned parties and implemented:

a) The preference shares to be written down to ₹ 25 each and the equity shares to ₹ 20 each. Each class of shares then to be converted into shares of ₹ 100 each.
b) The debenture holders to take over freehold property (book value ₹ 2,00,000) at a valuation of ₹ 2,50,000 in part repayment of their holdings. Remaining freehold property to be revalued at ₹ 6,00,000.
c) Loan from directors to be waived off in full.
d) Stock of ₹ 50,000 to be written off, ₹ 12,500 to be provided for bad debts.
e) Profit & Loss account balance, Trademark, goodwill & deferred revenue expenditure to be written off.

Pass Journal Entries for the above-mentioned transactions.

Question 7 *(ICAI Study Material)* Pg no._____

Vaibhav Ltd. gives you the following ledger balances as on 31.3.2023:

	₹
Property, Plant & 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
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
Trade Payables	1,00,00,000
Provision for taxation	2,00,000

The following scheme of reorganization is sanctioned:

a) All the existing equity shares are reduced to ₹ 40 each.
b) All preference shares are reduced to ₹ 60 each.
c) The rate of interest on debentures is increased to 6%. 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.

d) Property, Plant & Equipment are to be written down by 20%.
e) Current assets are to be revalued at ₹ 90,00,000.
f) Investments to be brought to their market value.
g) One of the creditors of the company (included under trade payables in the above balance sheet) to whom the company owes ₹ 40,00,000 decides to forgo 40% of his claim. He is allotted 60,000 equity shares of ₹ 40 each in full & final settlement of his claim.
h) The taxation liability of the company is settled at ₹ 3,00,000.
i) It is decided to write off the debit balance of Profit and Loss account.

Pass Journal entries and prepare Balance sheet of the company after giving effect to above.

Question 8

Pg no._____

The following is the summarized Balance Sheet of Rocky Ltd. as at March 31, 2023:

	₹ In Lacs
Liabilities	
Fully paid equity shares of ₹ 10 each	500
Capital Reserve	6
12% Debentures	400
Debenture Interest Outstanding	48
Trade Creditors	165
Directors' Remuneration Outstanding	10
Other Outstanding Expenses	11
Provisions	33
	1,173
Assets	
Goodwill	15
Land and Building	184
Plant and Machinery	286
Furniture and Fixtures	41
Stock	142
Debtors	80
Cash at Bank	27
Discount on Issue of Debentures	8
Profits and Loss Account	390
	1,173

The following scheme of internal reconstruction was framed, approved by the Court, all the concerned parties and implemented:

a) All equity shares be converted into same number of fully paid equity shares of 2.50 each
b) Directors agree to forego their outstanding remuneration.
c) The debentureholders also agree to forego outstanding interest in return of their 12% debentures being converted into 13% debentures.
d) The existing shareholders agree to subscribe for cash, fully paid equity shares of ₹ 2.50 each for ₹ 125 lacs.
e) Trade creditors are given option of either to accept fully-paid equity shares of ₹ 2.50 each for the amount due to them or to accept 80% of the amount due in cash. Creditors for ₹ 65 lacs accept equity shares whereas those for ₹ 100 lacs accept ₹ 80 lacs in cash in full settlement.
f) The Assets are revalued as under:

	₹ In Lacs
Land and building	230
Plant and Machinery	220

Stock	120
Debtors	76

Pass Journal Entries for all the above-mentioned transactions.

Question 9

Pg no._____

Following is the Balance Sheet of M Ltd. as at 31st March, 2023:

Liabilities	₹	Assets	₹
15,000, 10% Pref. shares of 100 each	15,00,000	Goodwill	3,50,000
35,000 Equity shares of ₹ 100 each	35,00,000	Land & Buildings	15,00,000
Securities Premium account	1,00,000	Plant & Machinery	10,00,000
7% Debentures of ₹ 100 each	5,00,000	Stock	6,00,000
Trade Payables	12,50,000	Trade Receivables	15,00,000
Loan from Director	1,50,000	Cash at bank	1,00,000
		Profit & Loss A/c	19,50,000
	70,00,000		70,00,000

No dividend on Preference shares has been paid for the last 5 years. The following scheme of reorganization was duly approved by the court:

a) Each Equity share to be reduced to ₹ 25.
b) Each existing Preference share to be reduced to ₹ 75 and then exchanged for 1 new 13% Preference share of ₹ 50 each and 1 Equity share of ₹ 25 each.
c) Preference shareholders have forgone their right for dividend for four years. One year's dividend at the old rate is however, payable to them in fully paid equity Shares of ₹ 25.
d) The Debentureholders be given the option to either accept 90% of their claims in cash or to convert their claims in full into new 13% Preference shares of ₹ 50 each issued at par. One half (in value) of the debentureholders accepted Preference shares for their claims. The rest were paid cash.
e) Contingent liability of ₹ 1,50,000 is payable, which has been created by wrong action of one Director. He has agreed to compensate this loss out of loan given by Director to company.
f) Goodwill does not have any value in the present. Decrease the value of Plant and Machinery, Stock and Trade Receivables by ₹ 4,00,000, ₹ 1,00,000 and ₹ 1,50,000 respectively. Increase the value of Land and Buildings to ₹ 18,00,000.
g) 40,000 new Equity shares of ₹ 25 each are to be issued at par, payable in full on application. The issue was underwritten for a commission of 4%. Shares were fully taken up.
h) The total expenses incurred by the company in connection with the scheme excluding underwriting commission amounted to ₹ 15,000.

Pass necessary Journal Entries to record the above transactions.

Question 10 *(ICAI Study Material)*

Pg no._____

Following is the Balance Sheet of ABC Ltd. as at 31st March, 2023:

	Note	Amount
A. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital	1	26,00,000
(b) Reserves & 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

B. Assets		
1. Non-current assets		
(a) Property, Plant & Equipment & Intangible Assets		
i. Property, Plant & Equipment	4	11,50,000
ii. Intangible Assets	5	70,000
(b) Non Current Investments	6	68,000
2. Current Assets		
(a) Inventories		14,00,000
(b) Trade Receivables		14,39,000
(c) Cash & Cash Equivalents		10,000
Total		41,37,000

Notes to Accounts

		Amount
1.	Share Capital Equity Share Capital 2,00,000 equity shares of ₹ 10 each Preference Share Capital 6,000 8% preference shares of ₹ 100 each	 20,00,000 6,00,000 26,00,000
2.	Reserves and Surplus Debit Balance of Profit and Loss Account	 (4,05,000)
3.	Long Term borrowings 9% Debentures	 12,00,000
4.	Property, Plant & Equipment Plant & Machinery Furniture & Fixtures	 9,00,000 2,50,000 11,50,000
5.	Intangible Assets Patents & Copyrights	 70,000
6	Non Current Investments Investments (Market Value of 55,000)	 68,000

The following scheme of reconstruction was finalized:

a) Preference shareholders would give up 30% of their capital in exchange for allotment of 11% Debentures to them.

b) Debentureholders having charge on plant and machinery would accept plant and machinery in full settlement of their dues.

c) Stock equal to ₹ 5,00,000 in book value will be taken over by trade payables in full settlement of their dues.

d) Investment value to be reduced to market price.

e) The company would issue 11% Debentures for ₹ 3,00,000 to augment its working 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 company after internal reconstruction.

Question 11

Pg no.______

From the given summarised balance sheet of Maitri Ltd. as on 31-3-2023 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 Maitri Ltd

Summarised Balance Sheet of Maitri Ltd. as on 31.3.2023

Liabilities	₹	Assets	₹
Share Capital		PPE & Intangible Assets	
30,000 Equity shares of ₹ 10 each	3,00,000	Trademarks and Patents	1,10,000
40,000 8% Cumulative Preference shares ₹ 10 each	4,00,000	Goodwill at cost	36,100
Reserves and Surplus		Freehold Land	1,20,000
Securities Premium Account	10,000	Freehold Premises	2,44,000
Profit and Loss Account	(1,38,400)	Plant and Equipment	3,20,000
Secured Borrowings		Investment (marked to market)	64,000
9% Debentures (₹ 100) 1,20,000		Current Assets	
Accrued Interest 5,400	1,25,400	Inventories:	
Current liabilities		Raw materials & packing materials 60,000	
Trade payables	1,20,000	Finished goods 16,000	70,000
GST payable	50,000	Trade receivables	1,20,000
Temporary bank overdraft	2,23,100		
	10,90,100		10,90,100

Note: Preference dividends are in arrears for 4 years.

The scheme of reconstruction that received permission of Court was on the following lines:

a) The authorized capital of the Company to be re-fixed at ₹ 10 lakhs (preference capital of ₹ 3 lakhs and equity capital of ₹ 7 lakhs). Both classes of shares are of ₹ 10 each.
b) The preference shares are to be reduced to ₹ 5 each and equity shares reduced by ₹ 3 per share. Post reduction, both classes of shares to be re-consolidated into ₹ 10 shares.
c) Trade Investments are to be liquidated in open market.
d) One fresh equity shares of ₹ 10 to be issued for every ₹ 40 of preference dividends in arrears (ignore taxation).
e) Expenses for the scheme were ₹ 10,000.
f) The debenture holders took over freehold land at ₹ 2,10,000 and settled the balance after adjusting their dues.
g) Unprovided contingent liabilities were settled at ₹ 54,000 and a pending insurance claim receivable settled at ₹ 12,500.
h) The intangible assets were all to be written off along with ₹ 10,000 worth obsolete packing material and 10% of the receivables.
i) Remaining cash available as a result of the above transactions is to be utilized to pay off the bank overdraft to that extent.
j) 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.

Question 12

Pg no._____

The following was the Balance Sheet of Bhushan Developers Ltd., as on 31st March 2023:

Liabilities	₹	Assets	₹
Authorised capital:		Goodwill	10,000
20,000 Equity Shares of ₹10 each	2,00,000	Land and buildings	20,500
Issued, subscribed and paid up capital		Machinery	50,850

12,000 Shares of ₹10each 1,20,000 Less: Calls in arrear (9,000) (₹ 3 per share on 3,000 shares)	1,11,000	Stock	10,275
Sundry creditors	15,425	Book debts	15,000
Provision for taxation	4,000	Cash at bank	1,500
		Profit and Loss A/c: Balance as per last B/S 22,000 Less: Profit for the year 1,200	20,800
		Preliminary expenses	1,500
	1,30,425		1,30,425

The directors have had a valuation made of the machinery and find it overvalued by ₹10,000. It is proposed to write down this asset to its true value and to extinguish the deficiency in the Profit and loss account and to write off goodwill and preliminary expenses, by the adoption of the following course:

1. Forfeit the shares on which the call is outstanding.
2. Reduce the capital by ₹3 per share.
3. Reissue the forfeited shares at ₹5 per share.
4. Utilise the provision for taxes, if necessary.

You are requested to draft the necessary journal entries.

Question 13 *(ICAI Study Material)* *Pg no._____*

Given below is the summarized balance sheet of Rebuilt Ltd. as on 31.3.2023:

	Note	Amount
A. Equity and Liabilities 1. Shareholders' Fund (a) Share Capital (b) Reserves & Surplus	 1 2	 13,50,000 (4,51,000)
2. Non-current Liabilities (a) Long Term Borrowings	 3	 5,73,000
3. Current Liabilities (a) Trade Payables (b) Other Current Liabilities		 2,07,000 35,000
Total		17,14,000
B. Assets		
1. Non-current assets (a) Property, Plant & Equipment & Intangible Assets i. Property, Plant & Equipment ii. Intangible Assets	 4 5	 6,68,000 3,18,000
2. Current Assets (a) Inventories (b) Trade Receivables		 4,00,000 3,28,000
Total		17,14,000

Notes to Accounts

		Amount
1.	Share Capital Equity Share Capital 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 5 years)	 7,50,000 6,00,000 13,50,000

2.	Reserves and Surplus Debit Balance of Profit and Loss Account	(4,51,000)
3.	Long Term borrowings Loan	5,73,000
4.	Property, Plant & Equipment Building at cost less depreciation Plant at cost less depreciation	4,00,000 2,68,000 6,68,000
5.	Intangible Assets Trademarks & Goodwill	3,18,000

The Company is short of working capital and a scheme of reconstruction has been approved by both the classes of shareholders. A summary of the scheme is as follows:

(a) The equity shareholders have agreed that their ₹ 50 shares should be reduced to ₹ 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 and to 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.

(c) 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 shares of ₹ 10 each and 12,000 new equity shares of ₹ 2.50 each.

(d) 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.

(e) Of the cash received by the issue of new shares, ₹ 2,00,000 is to be used to reduce the loan due by the company.

(f) 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 ₹ 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 balance sheet of the company after reconstruction. Nominal capital as reduced is to be increased to ₹ 6,50,000 for preference share capital and ₹ 7,50,000 for equity share capital.

Question 14

Pg no.______

The Balance Sheet of R Ltd., at 31st March, 2023 was as follows:

Liabilities	₹	Assets	₹
Share capital Authorised:	14,00,000	Intangibles	68,000
Issued: 64,000, 8% Cum. Preference shares of ₹ 10 each, fully paid	6,40,000	Freehold premises at cost	1,40,000
64,000 Equity shares of ₹ 10 each, ₹ 7.5 paid	4,80,000	Plant & Equipment at cost less depreciation	2,40,000
Loans from directors	60,000	Investments in shares in Q Ltd. at cost	3,24,000
Sundry creditors	4,40,000	Stocks	2,48,000
Bank overdraft	2,08,000	Debtors	3,20,000
		Deferred revenue expenditure	48,000
		Profit and loss account	4,40,000
	18,28,000		18,28,000

Note: The arrears of preference dividends amount to ₹ 51,200. A scheme of reconstruction was duly approved with effect from 1st April, 2023 under the conditions stated below:

a) The unpaid amount on the equity shares would be called up.
b) The preference shareholders would forego their arrear dividends. In addition, they would accept a reduction of ₹ 2.5 per share. The dividend rate would be enhanced to 10%.
c) The equity shareholders would accept a reduction of ₹ 7.5 per share.
d) R Ltd. holds 21,600 shares in Q Ltd. This represents 15% of the share capital of that company. Q Ltd. is not a quoted company. The average net profit (after tax) of the company is ₹ 2,50,000. The shares would be valued based on 12% capitalization rate.
e) A bad debt provision at 2% would be created.
f) The other assets would be valued as under:

Intangibles	48,000
Plant	1,40,000
Freehold premises	3,80,000
Stocks	2,50,000

g) The profit and loss account debit balance and the balance standing to the debit of the deferred revenue expenditure account would be eliminated.
h) The directors would have to take equity shares at the new face value of ₹ 2.5 per share in settlement of their loan.
i) The equity shareholders, including the directors, who would receive equity shares in settlement of their loans, would take up two new equity shares for every one held.
j) The preference shareholders would take up one new preference share for every four held.
k) The authorised share capital would be restated to ₹ 14,00,000.
l) New face values of shares–preference & equity will be maintained at their reduced levels.

You are required to prepare:

a) Necessary ledger accounts to effect the above; and
b) Balance Sheet of the company after reconstruction.

Question 15 *(ICAI Study Material)* *Pg no._____*

Green Limited had decided to reconstruct the Balance Sheet since it has accumulated huge losses. Following is summarized Balance Sheet of Company on 31.3.23 before reconstruction.

	Note	Amount
A. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital	1	65,00,000
(b) Reserves & 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
B. Assets		
1. Non-current assets		
(a) Property, Plant & Equipment & Intangible Assets		
i. Property, Plant & Equipment	4	45,00,000
ii. Intangible Assets	5	20,00,000
2. Current Assets		Nil
Total		65,00,000

Notes to Accounts

		Amount
1.	Share Capital Authorized Share Capital 1,50,000 equity shares of ₹ 50 each Issued, Subscribed and Paid up Share Capital 50,000 equity shares of ₹ 50 each 1,00,000 equity shares of ₹ 50 each, 40 paid up	 75,00,000 25,00,000 40,00,000 65,00,000
2.	Reserves and Surplus Debit Balance of Profit and Loss Account	 (20,00,000)
3.	Long Term borrowings 12% First Debentures 12% Second Debentures	 5,00,000 10,00,000 15,00,000
4.	Property, Plant & Equipment Building Plant Computers	 10,00,000 10,00,000 25,00,000 45,00,000
5.	Intangible Assets Goodwill	 20,00,000

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
Sundry Creditors	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 the Court:

(a) Uncalled capital is to be called up in full and such shares and the other fully paid up shares be converted into equity shares of ₹ 20 each.

(b) Mr. X is to cancel ₹ 7,00,000 of his total debt (other than share amount) and to pay ₹ 2 lakhs to 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) and to accept new 14% First Debentures for the balance.

(d) The amount thus rendered available by the scheme shall be utilized in writing off of Goodwill, Profit and Loss A/c 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 the Balance Sheet of the reconstructed company.

Question 16

Pg no.______

The draft Balance Sheet of Moon Limited as on 31st March, 2023 was as follows:

Liabilities	₹	Assets	₹
2,50,000 Equity shares of ₹ 10 each fully paid	25,00,000	Goodwill	5,00,000
9% 10,000 Preference shares of ₹100 each fully paid	10,00,000	Patent	2,50,000
10% First debentures	3,00,000	Land and Building	15,00,000
10% Second debentures	5,00,000	Plant and Machinery	5,00,000

Debentures interest outstanding	80,000	Furniture and Fixtures	1,00,000
Trade payables	2,50,000	Computers	1,50,000
Directors' loan	50,000	Trade Investment	2,50,000
Bank Overdraft	50,000	Trade receivables	2,50,000
Outstanding liabilities	20,000	Stock	5,00,000
Provision for tax	50,000	Profit and Loss Account (Loss)	8,00,000
	48,00,000		48,00,000

Note: Preference dividend is in arrears for last three years.

A holds 10% first debentures for ₹ 2,00,000 and 10% second debentures for ₹3,00,000. He is also creditors for ₹ 50,000. B holds 10% first debentures for ₹ 1,00,000 and 10% second debentures for ₹ 2,00,000 and is also creditors for ₹ 25,000.

The following scheme of reconstruction has been agreed upon and duly approved by the court.

a) All the equity shares be converted into fully paid equity shares of ₹5 each.

b) The preference shares be reduced to ₹ 50 each and the preference shareholders agree to forego their arrears of preference dividends in consideration of which 9% preference shares are to be converted into 10% preference shares.

c) Mr. 'A' is to cancel ₹ 3,00,000 of his total debt including interest on debentures and to pay ₹ 50,000 to the company and to receive new 12% debentures for the Balance amount.

d) Mr. 'B' is to cancel ₹ 1,50,000 of his total debt including interest on debentures and to accept new 12% debentures for the balance amount.

e) Trade creditors (other than A and B) agreed to forego 50% of their claim.

f) Directors to accept settlement of their loans as to 60% thereof by allotment of equity shares and balance being waived.

g) There were capital commitments totalling ₹ 1,50,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.

h) The Directors refund ₹ 55,000 of the fees previously received by them.

i) Reconstruction expenses paid ₹5,000.

j) The taxation liability of the company is settled at ₹ 40,000 and the same is paid immediately.

k) The assets are revalued as under:

	₹
Land and building	14,00,000
Plant and Machinery	2,00,000
Stock	3,50,000
Trade receivables	1,50,000
Computers	90,000
Furniture & Fixtures	50,000
Trade Investment	2,00,000

Pass Journal entries for all transactions incl. amounts to be w/off of Goodwill, Patents, Loss in P&L A/c. Prepare Bank A/c & working of Interest on Debentures allocation between A & B

Question 17

Pg no.______

Repair Ltd. is in the hands of a receiver for debenture holders who holds a charge on all assets except uncalled capital. The following statement shows the position as regards creditors as on 30th June, 2023:

Liabilities	₹	Assets	₹
6,000 shares of ₹ 60 each, ₹ 30 paid up		Property, machinery and plant etc. (Cost ₹ 3,90,000) Estimated at	1,50,000
First debentures	3,00,000	Cash in hand of the receiver	2,70,000

Second debentures	6,00,000	Charged under debentures	4,20,000
Unsecured creditors	4,50,000	Uncalled capital	1,80,000
		Deficiency	7,50,000
	13,50,000		13,50,000

A holds the first debentures for ₹ 3,00,000 and second debentures for ₹ 3,00,000. He is also an unsecured creditor for ₹ 90,000. B holds second debentures for ₹ 3,00,000 and is an unsecured creditor for ₹ 60,000.

The following scheme of reconstruction is proposed:

a. A is to cancel ₹ 2,10,000 of the total debt owing to him, to bring ₹ 30,000 in cash and to take first debentures (in cancellation of those already issued to him) for ₹ 5,10,000 in satisfaction of all his claims.

b. B is to accept ₹ 90,000 in cash in satisfaction of all claims by him.

c. In full settlement of 75% of the claim, unsecured creditors (other than A and B) agreed to accept four shares of ₹ 7.50 each, fully paid against their claim for each share of ₹ 60. The balance of 25% is to be postponed and to be payable at the end of three years from the date of Court's approval of the scheme. The nominal share capital is to be increased accordingly.

d. Uncalled capital is to be called up in full and ₹ 52.50 per share cancelled, thus making the shares of ₹ 7.50 each.

Assuming that the scheme is duly approved by all parties interested & by the Court, give necessary journal entries

Question 18 *(RTP May 2020)* Pg no._____

The following is the Balance Sheet of Star Ltd. as on 31st March, 2023:

	Amount	Amount
A. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital		
10,000 equity shares of ₹ 100 each fully paid		10,00,000
9,000, 7% pref. shares of ₹ 100 each fully paid		9,00,000
(b) Reserves & Surplus		
Profit & Loss Account		(2,00,000)
2. Non-current Liabilities		
(a) Long Term Borrowings		
"A" 6% Debentures (Secured on Bombay Works)		3,00,000
"B" Debentures (Secured on Chennai Works)		3,50,000
3. Current Liabilities		
(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		
1. Non-current assets		
Property, Plant & Equipment		
Bombay Works	9,50,000	
Chennai Works	7,75,000	17,25,000
2. Investment		
Investments for Workman's Compensation Fund		15,000

3. Current Assets		
(a) Inventories	4,50,000	
(b) Trade Receivables	2,50,000	
(c) Cash at Bank	50,000	18,50,000
Total		24,90,000

A reconstruction scheme was prepared and duly approved. The salient features of the scheme were as follows:

a) Paid up value of 7% Preference Share to be reduced to ₹ 80, but the rate of dividend being raised to 9%.
b) Paid up value of Equity Shares to be reduced to ₹ 10.
c) The directors to refund ₹ 50,000 of the fees previously received by them.
d) Debenture holders forego their interest of ₹ 26,000 which is included among the Sundry Creditors.
e) The preference shareholders agreed to waive their claims for preference share dividend, which is in arrears for the last three years.
f) "B" 6% Debenture holders agreed to take over the Chennai Works at ₹ 4,25,000 and to accept an allotment of 1,500 equity shares of ₹ 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 ₹ 10 each fully paid at par to Star Ltd.
g) The Chennai Worksmen's compensation fund disclosed that there were actual liabilities of ₹ 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.
h) Stock was to be written off by ₹ 1,90,000 and a provision for doubtful debts is to be made to the extent of ₹ 20,000.
i) Chennai works completely written off.
j) Any balance of the Capital Reduction Account is to be applied as two-third to write off the value of 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.

TOPIC 2B: SHARE SURRENDER

Question 19

Pg no._____

Following is the summarized Balance Sheet of Ravi Limited as on March 31, 2023:

Liabilities	₹	Assets	₹
Issued Equity share capital		Patents	4,00,000
30,000 shares of ₹ 100 each fully paid	30,00,000	Plant and Machinery	30,00,000
20,000 7% cumulative preference shares of ₹ 100 each fully paid	20,00,000	Building	5,50,000
General Reserve	6,00,000	Trade Receivables	23,50,000
Loan from director	4,40,000	Inventory	16,30,000
Trade Payables	24,60,000	Cash	1,20,000
Outstanding Expenses	3,20,000	Bank Balance	2,30,000
Dividend Payable	3,00,000	Profit & Loss A/c	8,40,000
	91,20,000		91,20,000

Note: The arrears of preference dividend amount to ₹ 2,80,000.

The company had suffered losses since last 3 years due to bad market conditions and hope for a better position in the future.

The following scheme of reconstruction has been agreed upon and duly approved by all concerned:

1) Equity shares to be converted into 3,00,000 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% preference shares.
4) Trade payables agree to reduce their claim by one fourth in consideration of their getting shares of ₹ 5,00,000 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 by	4,00,000
Plant & Machinery by	4,00,000
Inventory by	3,40,000

8) Trade receivables to the extent of ₹ 17,00,000 are considered good.
9) Revalued figures for building is accepted at ₹ 7,00,000.
10) Dividend payable is paid to the equity shareholders.
11) Any surplus after meeting the losses should be utilized in writing down the value of the plant further.
12) Expenses of reconstruction amounted to ₹ 60,000.
13) Further 40,000 equity shares were issued to the existing members for increasing the working capital. The issue was fully subscribed and paid up.

You are required to pass the Journal Entries for giving effect to the above arrangement.

Question 20 *(ICAI Study Material)* *Pg no.______*

The Balance Sheet of Revise Ltd. as on 31-03-2023 is as follows:

	Note	Amount
A. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital	1	10,00,000
(b) Reserves & Surplus	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
B. Assets		
1. Non-current assets		
(a) Property, Plant & Equipment & Intangible Assets		
i. Property, Plant & 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

		Amount
1.	Share Capital Equity Share Capital 10,000 equity shares of ₹ 100 each	10,00,000
2.	Reserves and Surplus Debit Balance of Profit and Loss Account	(6,00,000)
3.	Long Term borrowings 12% Debentures	2,00,000
4.	Other Current Liabilities Interest payable on debentures	24,000
5.	Short Term Provisions Provision for taxation	24,000
6.	Property, Plant & Equipment Machinery	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% preference shares 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 equity shares 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.

Pass journal entries giving effect to the above and the resultant Balance Sheet.

PRACTICE QUESTIONS

TOPIC 1 & 2A

Question 1 *(ICAI Study Material)* *Pg no._____*

C Ltd. had ₹ 5,00,000 authorized capital on 31-12-2021 divided into shares of ₹ 100 each out of which 4,000 shares were issued and fully paid up. In June 2022 the Company decided to convert the issued shares into stock. But in June, 2023 the Company re-converted the stock into shares of ₹ 10 each fully paid up. Pass entries and show how Share Capital will appear in Notes to Balance Sheet as on 31-12-2021, 31-12-2022 and 31-12-2023.

Question 2 *(Inter July 2021) (5 Marks)* *Pg no._____*

Sapra Limited has laid down the following terms upon the sanction of reconstruction scheme by court.

(i) The shareholders to receive in lieu of their present holding at 7,50,000 shares of ₹10 each, the following:
   a. New fully paid ₹ 10 Equity Shares equal to 3/5th of their holding.
   b. Fully paid ₹ 10, 6% Preference Shares to the extent of 2/5th of the above new equity shares.
   c. 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 to be 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 write off the losses 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.

Question 3 *Pg no._____*

Pass journal entries for the following transactions:

a) Conversion of 2 lakh fully paid equity shares of ₹ 10 each into stock of ₹ 1,00,000 and balance has 12% fully convertible Debenture.
b) Consolidation of 40 lakh fully paid equity shares of ₹ 2.50 each into 10 lakh fully paid equity share of ₹ 10 each.
c) Sub-division of 10 lakh fully paid 11% preference shares of ₹ 50 each into 50 lakh fully paid 11% preference shares of ₹ 10 each.
d) Conversion of 12% preference shares of ₹ 5,00,000 into 14% preference shares ₹ 3,00,000 and remaining balance as 12% Non-cumulative preference shares.

Question 4 *(RTP Nov 2022)* *Pg no._____*

M/s Planet Limited has decided to reconstruct Balance Sheet since it has accumulated huge losses. Following is balance sheet of company as on 31st March, 2023 before reconstruction:

	Note	₹ (In Lacs)
A. Equity and Liabilities		
1. Shareholders' Fund		
Share Capital	1	2,100
Reserves & Surplus	2	(783)

2. Non-Current Liabilities Long Term Borrowings	3	1,050
3. Current Liabilities Trade Payables Other Liabilities	4 5	153 36
Total		2,556
B. Assets		
1. Non-Current assets Property, Plant & Equipment & Intangible Assets Property, Plant & Equipment	6	1,125
2. Current Assets Current Investments Inventories Trade Receivables Cash & Cash Equivalents	7 8 9 10	300 450 675 6
Total		2,556

Notes to Accounts

		Amount
1.	Share Capital Authorised, 300 lakh shares of ₹ 10 each 12 lakh, 8% Preference Shares of ₹ 100 each Issued, Subscribed & paid up 150 lakh Equity Shares of ₹ 10 each, full paid up 6 lakh 8% Preference Shares of ₹ 100 each, fully paid up Total	 3,000 1,200 4,200 1,500 600 2,100
2.	Reserves and Surplus Debit Balance of Profit and Loss Account	(783)
3.	Long Term borrowings 6% Debentures (Secured by Freehold Property) Directors' Loan	 600 450 1,050
4.	Trade Payables Sundry Creditors for Goods	153
5.	Other Current Liabilities Interest Accrued and Due on 6% Debentures	36
6.	Property, Plant & Equipment Freehold property Plant & Machinery	 825 300 1,125
7.	Current Investment Investment in Equity Instruments	300
8.	Inventories Finished Goods	450
9.	Trade Receivables Sundry Debtors 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 the consent of respective shareholders:

a) Preference Shares are to be written down to ₹ 75 each and Equity Shares to ₹ 2 each.
b) Preference Shares Dividend in arrears for 3 years to be waived by 2/3rd and for balance 1/3 rd, Equity Shares of ₹ 2 each to be allotted.
c) Debenture holders agreed to take one Freehold Property at its book value of ₹ 450 lakh in part payment of their holding. Balance Debentures to remain as liability of the company.
d) Interest accrued and due on Debentures to be paid in cash.
e) Remaining Freehold Property to be valued at ₹ 550 lakh.
f) All investments sold out for ₹ 425 lakh.
g) 70% of Directors' loan to be waived and for the balance, Equity Shares of ₹ 2 each to be allowed.
h) 40% of Trade Receivables and 80% of Inventories to be written off.
i) Company's contractual commitments amounting to ₹ 900 lakh have been settled by paying penalty of ₹ 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
(c) Prepare Notes to Accounts on Share Capital and Property, Plant & Equipment to Balance Sheet, immediately after the implementation of scheme of internal reconstruction.

(Ans: Capital Reserve 432 Lakhs)

Question 5 *(ICAI Study Material)* *Pg no._____*

The following is the Balance Sheet of Weak Ltd. as on 31st March, 2023:

	Note	Amount
A. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital	1	1,50,00,000
(b) Reserves & 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
B. Assets		
1. Non-current assets		
(a) PPE & Intangible Assets		
i. Property, Plant & 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

		Amount	Amount
1.	Share Capital 1,00,000 equity shares of ₹ 100 each 50,000 12% cumulative preference shares of ₹ 100 each	 1,00,00,000 50,00,000	 1,50,00,000
2.	Reserves and Surplus Profit and Loss Account		 (6,00,000)
3.	Long Term borrowings		

	40,000,10% Debentures of ₹ 100 each		40,00,000
4.	Short Term Provisions Provision for taxation		1,00,000
5.	Non Current Investments Investments (Market Value of ₹ 9,50,000)		10,00,000

The following scheme of reorganization is sanctioned:

a) All the existing equity shares are reduced to ₹ 40 each.

b) All preference shares are reduced to ₹ 60 each.

c) 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.

d) 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 & final settlement of his claim.

e) Property, Plant & Equipment are to be written down by 30%.

f) Current assets are to be revalued at ₹ 45,00,000.

g) The taxation liability of the company is settled at ₹ 1,50,000.

h) Investments to be brought to their market value.

i) It is decided to write off the debit balance of Profit and Loss account.

Pass Journal entries and prepare Balance sheet of the company after giving effect to above.

(Ans: Capital Reserve 50,000 Balance Sheet Total 1,40,50,000)

Question 6 *Pg no._____*

Vinod Limited decided to reconstruct its business as it has accumulated huge losses. The following is the Balance Sheet of the company as on 31-03-2023 before reconstruction:

Liabilities	₹	Assets	₹
6,00,000 Equity Shares of ₹ 10 each fully paid up	60,00,000	Goodwill	10,40,000
3,20,000, 6% Preference Shares of ₹ 10 each fully paid up	32,00,000	Patents	3,00,000
6% Debentures (Secured against Land & Building)	30,00,000	Land & Building	34,00,000
Bank Overdraft	11,60,000	Plant & Machinery	4,00,000
Trade Payables	24,00,000	Investments (at Cost)	4,40,000
Provision for Income Tax	4,00,000	Trade Receivables	34,80,000
		Inventory	34,00,000
		Profit & Loss A/c	37,00,000
	1,61,60,000		1,61,60,000

Following scheme of Reconstruction approved by all interested parties and Court:

a) All Equity Shares are reduced to ₹ 3 each and Preference Shares to ₹ 7 each.

b) Debentureholders agree to take over part of Land& Building, Book value of which is 14 Lacs towards their 50% claim. Rate of interest of balance 50% debentures increased to 9%.

c) Goodwill and Patent will be written off.

d) 10% of trade receivables to be provided for bad debts.

e) Inventory to be written off by ₹ 5,20,000.

f) 50% of balance Land & Building sold for ₹ 12,00,000 and remaining Land & Building valued at ₹ 12,00,000.

g) Investments to be sold for ₹ 4,00,000

h) There are pending contracts amounting to ₹ 20,00,000. These contracts are to be cancelled on payment of penalty @ 5% of pending contract amount.

i) The Income Tax Liability of the company is settled at ₹ 6,12,000. Provision for Income Tax will be raised accordingly.
j) 1/3 of trade payables decided to forgo their claim.
k) After making all the above adjustments, balance amount available through scheme, will be utilised to write off the value of Plant & Machinery to that extent.

You are required to pass the Journal Entries and Draw up Balance Sheet of the company after reconstruction.

(Ans: P&M w/off 2,00,000 Balance Sheet Total 77,52,000)

Question 7 *(Inter Nov 2018) (10 Marks) / (RTP Nov 2021)* *Pg no._____*

The summarized Balance Sheet of SK Ltd. as on 31st March, 2023 is given below.

	Amount ('000)
Liabilities	
Equity Shares of ₹ 10 each	35,000
8%, Cumulative Preference Shares of ₹ 100 each	17,500
6% Debentures of ₹ 100 each	14,000
Sundry Creditors	17,500
Provision for taxation	350
Total	84,350
B. Assets	
Assets	
Property, Plant & Equipment	43,750
Investments (Market value ₹ 3325 thousand)	3,500
Current Assets (Including Bank Balance)	35,000
Profit and Loss Account	2,100
Total	84,350

Following Scheme of Internal Reconstruction is approved & put into effect on 31st March, 2023

(i) Investments are to be brought to their market value.
(ii) The Taxation Liability is settled at ₹ 5,25,000 out of current Assets.
(iii) The balance of Profit and Loss Account to be written off.
(iv) All the existing equity shares are reduced to ₹ 4 each.
(v) All preference shares are reduced to ₹ 60 each.
(vi) The rate of interest on debentures is increased to 9%. The Debenture holders surrender their existing debentures of ₹ 100 each and exchange them for fresh debentures of ₹ 80 each. Each old debenture is exchanged for one new debenture.
(vii) Balance of Current Assets left after settlement of taxation liability are revalued at ₹ 1,57,50,000.
(viii) Property, Plant & Equipment are written down to 80%.
(ix) One of the creditors of the Company for ₹ 70,00,000 gives up 50% of his claim. He is allotted 8,75,000 equity shares of ₹ 4 each in full and final settlement of his claim.

Pass journal entries for the above transactions.

(Ans: Capital Reserve 4,375)

Question 8 *(ICAI Study Material)* *Pg no._____*

The following is the summarized Balance Sheet of X Ltd. as on 31st March, 2023:

	Note	Amount
A. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital	1	36,00,000
(b) Reserves & Surplus	2	(14,40,000)

2. Non-current Liabilities (a) Long Term Borrowings	3	6,00,000
3. Current Liabilities (a) Short Term Borrowings- Bank Overdraft (b) Trade Payables		6,00,000 3,00,000
Total		36,60,000
B. Assets		
1. Non-current assets (a) Property, Plant & Equipment & Intangible Assets i. Property, Plant & Equipment ii. Intangible Assets	 4 5	 30,00,000 90,000
2. Current Assets (a) Inventories (b) Trade Receivables (c) Cash & Cash Equivalents		 2,60,000 2,80,000 30,000
Total		36,60,000

Notes to Accounts

		Amount
1.	Share Capital Equity Share Capital 24,000 equity shares of ₹ 100 each Preference Share Capital 12,000 10% preference shares of ₹ 100 each	 24,00,000 12,00,000 36,00,000
2.	Reserves and Surplus Debit Balance of Profit and Loss Account	 (14,40,000)
3.	Long Term borrowings 10% Debentures	 6,00,000
4.	Property, Plant & Equipment Land & Building Plant & Machinery	 12,00,000 18,00,000 30,00,000
5.	Intangible Assets Goodwill	 90,000

On the above date, the company adopted the following scheme of reconstruction:

a) The equity shares are to be reduced to shares of ₹ 40 each fully paid and the preference shares to be reduced to fully paid shares of ₹ 75 each.

b) The debenture holders took over inventories and trade receivables in full satisfaction of their claims.

c) Land & Building to be appreciated by 30% and Plant & machinery to be depreciated by 30%.

d) The debit balance of profit and loss account and intangible assets are to be eliminated.

e) Expenses of reconstruction amounted to ₹ 5,000.

Give journal entries incorporating the above scheme of reconstruction and prepare the reconstructed Balance Sheet.

(Ans: Capital Reserve 85,000 Balance Sheet Total 28,45,000)

Pg no.______

Question 9

The Balance Sheet of M/s Clean Ltd. as on 31st March, 2023 was summarized as follows:

Liabilities	₹	Assets	₹
Share capital		Land & Building	75,00,000
Equity Shares of ₹ 50 each, fully paid up	60,00,000	Plant & Machinery	22,00,000
9% Preference Shares of ₹ 10 each, fully paid up	40,00,000	Trade Investment	16,50,000
7% Debentures (secured by plant & machinery)	23,00,000	Inventories	9,50,000
8% Debentures	17,00,000	Trade Receivable	18,00,000
Trade Payables	6,00,000	Cash and Bank Balances	3,60,000
Provision for Tax	75,000	Profit & Loss Account	2,15,000
	1,46,75,000		1,46,75,000

The Board of Directors of the company decided upon the following scheme of reconstruction duly approved by all concerned parties:

a) The equity shareholders agreed to receive in lieu of their present holding of 1,20,000 shares of ₹ 50 each as under:
   1. New fully paid equity shares of ₹ 10 each equal to 2/3rd of their holding.
   2. 9% preference shares of ₹ 8 each to the extent of 25% of the above new equity share capital.
   3. ₹ 2,80,000, 10% debentures of ₹ 80 each.

b) The preference shareholders agreed that their ₹ 10 shares should be reduced to ₹ 8 by cancellation of ₹ 2 per share. They also agreed to subscribe for two new equity shares of ₹ 10 each for every five preference shares held.

c) The taxation liability of the company is settled at ₹ 66,000 and the same is paid immediately.

d) One of the trade creditors of the company to whom the company owes ₹ 1,00,000 decides to forgo 30% of his claim. He is allotted equity shares of ₹ 10 each in full satisfaction of his balance claim.

e) Other trade creditors of ₹ 5,00,000 are given option of either to accept fully paid 9% preference shares of ₹ 8 each for the amount due to them or to accept 80% of the amount due to them in cash in full settlement of their claim. Trade creditors for ₹ 3,50,000 accepted preference shares option and rest of them opted for cash towards full settlement of their claim.

f) Company's contractual commitments amounting to ₹ 6,50,000 have been settled by paying 4% penalty of contract value.

g) Debenture holders having charge on plant and machinery accepted plant and machinery in full settlement of their dues.

h) The rate of interest on 8% debentures is increased to 10%. The debenture holders surrender their existing debenture of ₹ 50 each and agreed to accept 10% debentures of ₹ 80 each for every two debentures held by them.

i) The land and building to be depreciated by 5%.

j) The debit balance of profit and loss account is to be eliminated.

k) 1/4th of trade receivables and 1/5th of inventory to be written off.

Pass Journal Entries and prepare Balance Sheet after completion of the reconstruction scheme in the books of M/s Clean Ltd. as per Schedule III to the Companies Act, 2013.

(Ans: Capital Reserve 47,73,000 Balance Sheet Total 1,26,33,000)

Question 10 *(ICAI Study Material) / (RTP May 2021)* *Pg no._____*

Recover Ltd decided to reorganize its capital structure owing to accumulated losses & adverse market condition. The Balance Sheet of company as on 31st March 2023 is as follows:

		Particulars	Notes	Amount
		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	50,000
3		Current liabilities		
	A	Trade Payables		80,000
	B	Short term Borrowings – Bank overdraft		90,000
	C	Other Current Liabilities- Interest payable on Debentures		5,000
				5,05,000
		Assets		
1		Non-current assets		
	A	Property, Plant Equipment & Intangible Assets		
		a) Property, Plant Equipment	4	3,35,000
		b) Intangible Assets	5	50,000
	B	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	
	Equity share capital:	
	20,000 Equity Shares of ₹ 10 each	2,00,000
	Preference share capital:	
	15,000 8% Cumulative Preference Shares of ₹ 10 each (preference dividend has been in arrears for 4 years)	1,50,000
		3,50,000
2	Reserves and surplus	
	Profit and loss account (debit balance)	(70,000)
		(70,000)
3	Long-term borrowings	
	Secured 10% Debentures (secured on the freehold property)	50,000
		50,000
4	Property, Plant and Equipment	
	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	
	Non-Trade investments at cost	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, & equity shares to ₹ 1 per share.
ii. 1 new equity share of ₹ 1 was issued for arrears of preferred dividend for past 4 years.
iii. The debenture holders took over the freehold property at an agreed figure of ₹ 75,000 and paid 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 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.
(Ans: Capital Reserve 30,800 Balance Sheet Total 3,06,300)

Question 11 (Inter Nov 2019) (15 Marks) / (RTP May 2023) Pg no._____

Following is the summarized Balance Sheet of Fortunate Ltd. as on 31st March, 2023.

Particulars	Amount
Liabilities	
Authorized and Issued Share Capital	
(a) 15,000 8% Preference shares of ₹ 50 each	7,50,000
(b) 18,750 Equity shares of ₹ 50 each	9,37,500
Profit and Loss Account	(5,63,750)
Loan	7,16,250
Trade Payables	2,58,750
Other Liabilities	43,750
Total	21,42,500
Assets	
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
Total	21,42,500

(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 ₹ 50 shares should be reduced to ₹ 5 by cancellation of ₹ 45.00 per share. They have also agreed to subscribe for three new equity shares of ₹ 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 ₹ 50 preference share, 4 new 6% preference shares of ₹ 10 each, plus 3 new equity shares of ₹ 5.00 each, all credited as fully paid.
(iii) Lenders to the company for ₹ 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 ₹ 10 each and 7,500 new equity shares of ₹ 5.00 each.

(iv) The directors have agreed to subscribe in cash for 25,000 new equity shares of ₹ 5.00 each in addition to any shares to be subscribed by them under (i) above.
(v) Of the cash received by the issue of new shares, ₹ 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 ₹ 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 ₹ 8,12,500 for preference share capital and ₹ 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.

(Ans: Trademarks & Goodwill w/off 1,61,250; Balance Sheet Total 20,93,750)

Question 12 *(RTP May 2018 / RTP Nov 2019)* *Pg no.____*

M/s Platinum Limited has decided to reconstruct Balance Sheet since it has accumulated huge losses. The following is the Balance Sheet of the company as on 31st March, 2023 before reconstruction:

Liabilities	₹	Assets	₹
Share Capital		Goodwill	22,00,000
50,000 shares of ₹ 50 each fully paid up	25,00,000	Land & Building	42,70,000
1,00,000 shares of ₹ 50 each ₹ 40 paid up	40,00,000	Machinery	8,50,000
Capital Reserve	5,00,000	Computers	5,20,000
8% Debentures of ₹ 100 each	4,00,000	Stock	3,20,000
12% Debentures of ₹ 100 each	6,00,000	Trade Debtors	10,90,000
Trade Creditors	12,40,000	Cash at Bank	2,68,000
Outstanding Expenses	10,60,000	Profit & Loss Account	7,82,000
	1,03,00,000		1,03,00,000

Following is the interest of Mr. Shiv and Mr. Ganesh in M/s Platinum Limited:

	Mr. Shiv	Mr. Ganesh
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:
(1) Uncalled capital is to be called up in full and then all the shares to be converted into Equity Shares of ₹ 40 each.
(2) The existing shareholders agree to subscribe in cash, fully paid up equity shares of 40 each for ₹ 12,50,000.
(3) Trade Creditors are given option of either to accept fully paid equity shares of ₹ 40 each for the amount due to them or to accept 70% of the amount due to them in cash in full settlement of their claim. Trade Creditors for ₹ 7,50,000 accept equity shares and rest of them opted for cash towards full and final settlement of their claim.
(4) Mr. Shiv agrees to cancel debentures amounting to ₹ 2,00,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due. He also agree to subscribe further 15% Debentures in cash amounting to ₹ 1,00,000.
(5) Mr. Ganesh agrees to cancel debentures amounting to ₹ 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 ₹ 51,84,000, Machinery at ₹ 7,20,000, Computers at ₹ 4,00,000, Stock at ₹ 3,50,000 and Trade Debtors at 10% less to as they are appearing in Balance Sheet as above.
(7) Outstanding Expenses are fully paid in cash.
(8) Goodwill and 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.

(Ans: Existing Capital Reserve utilized; Balance Sheet Total 88,50,000)

Question 13 (RTP Nov 2018 / RTP Nov 2020/ RTP May 2022) *Pg no._____*

The summarized balance sheet of Z Limited as on 31st March, 2023 is as under

	Amount
A. Equity and Liabilities	
1. Shareholders' Fund	
(a) Share Capital	
5,00,000 equity shares of ₹ 10 each fully paid	50,00,000
20000, 9% preference shares of ₹ 100 each fully paid	20,00,000
(b) Reserves & Surplus	
Profit & Loss Account	(14,60,000)
2. Non-current Liabilities	
(a) Long Term Borrowings 10% Secured Debentures	16,00,000
3. Current Liabilities	
Trade Payables	5,00,000
Loan From Director	1,00,000
Bank Overdraft	1,00,000
Provision for Tax	1,00,000
Interest due on Debentures	1,60,000
Total	81,00,000
B. Assets	
1. Non-current assets	
Property, Plant & Equipment & Intangible Assets	
(a) Property, Plant & Equipment	
Land & Building	30,00,000
Plant & Machinery	12,50,000
Furniture & Fixtures	2,50,000
(b) Intangible Assets	
Goodwill	10,00,000
Patents	5,00,000
2. Current Assets	
(a) Trade Investments	5,00,000
(b) Trade Receivables	5,00,000
(c) Inventories	10,00,000
(d) 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 ₹ 1,00,000 and ₹ 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.

a) All the equity shares to be converted into fully paid equity shares of ₹ 5.00 each.

b) The Preference shares be reduced to ₹ 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.
c) Mr. Y and Mr. Z agreed to cancel 50% each of their respective total debt including interest on debentures. Mr. Y and Mr. Z also agreed to pay ₹ 1,00,000 and ₹ 60,000 respectively in cash and to receive new 12% debentures for the balance amount.
d) Trade payables, other than Mr. Y and Mr. Z also agreed to forgo their 50% claims.
e) Directors also waived 60% of their loans and accepted equity shares for the balance.
f) Capital commitments of ₹ 3.00 lacs were cancelled on payment of ₹ 15,000 as penalty.
g) Directors refunded ₹ 1,00,000 of the fees previously received by them.
h) Reconstruction expenses paid ₹ 15,000.
i) The taxation liability of the company was settled for ₹ 75,000 and was paid immediately.
j) 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 pass journal entries for all the above mentioned transactions including amounts to be written off of Goodwill, Patents. Loss in Profit and Loss account and Discount on issue of debentures. And also prepare Bank Account and Reconstruction A/c.

(Ans: Capital Reserve 7,75,000)

Question 14 *(RTP May 2018 (Similar))* Pg no._____

Proficient Infosoft Ltd. is in the hand of Receiver for Debenture Holders who holds a charge on all asset except uncalled capital. The following statement shows position as regards creditors as on 30 June,2023

Liabilities	₹	Assets	₹
8,000 shares of ₹ 100 each, ₹ 60 paid up		Property (Cost ₹ 3,80,800) Estimated at	1,08,000
First debentures	3,60,000	Plant & Machinery (Cost ₹ 2,87,200) estimated at	72,000
Second debentures	7,80,000	Cash in hand of the receiver	3,24,000
Unsecured creditors	5,40,000		5,04,000
		Uncalled capital	3,20,000
			8,24,000
		Deficiency	8,56,000
	16,80,000		16,80,000

A holds the first debentures for ₹ 3,60,000 and second debentures for ₹ 3,60,000. He is also an unsecured trade payable for ₹ 1,08,000. B holds second debentures for ₹ 3,60,000 and is an unsecured trade payable for ₹ 72,000.

The following scheme of reconstruction is proposed.

a) A is to cancel ₹ 2,52,000 of the total debt owing to him; to bring ₹ 36,000 in cash and to take first debentures (in cancellation of those already issued to him) for ₹ 6,12,000 in satisfaction of all his claims.
b) B to accept ₹1,08,000 in cash in satisfaction of all claims by him.
c) In full settlement of 60% of the claim, unsecured trade payable (other than A and B) agreed to accept three shares of ₹25 each, fully paid against their claim for each ₹100.

The balance of 40% is to be postponed and to be payable at the end of three years from the date of Court's approval of the scheme. The nominal share capital is to be increased accordingly.

d) Uncalled capital is to be called up in full & ₹75 per share cancelled, thus making the shares of ₹ 25 each.

Assuming that the scheme is duly approved by all parties interested and by the Court, give necessary journal entries.

(Ans: Capital Reserve 62,000)

Question 15 (Inter Nov 2022) (20 Marks) Pg no._____

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
Total		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
Total		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:

a) The preference shares are converted from 6% to 8% but revalued in a manner in which the total return on them remains unaffected.
b) The value of equity shares is brought down to ₹ 8 per share.
c) The arrears of dividend on preference shares are cancelled.
d) The debit balance of Goodwill account is written off entirely.

e) Land and Building and Plant and Machinery are revalued at 85% and 80% of their respective book values.
f) Book debts amounting to ₹ 14,400 are to be treated as bad and hence to be written off.
g) 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.
h) The balance of total capital reduction is to be utilized in writing down Patents.
i) 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.

(Ans: Patents w/off 24,000 and Balance sheet total 16,00,000)

TOPIC 2B: SHARE SURRENDER

Question 16 Pg no._____

The business of P Ltd. was being carried on continuously at losses. The following are the extracts from the Balance Sheet of the Company as on 31st March, 2023.

Liabilities	₹	Assets	₹
Auth., Issued & Subscribed Capital:		Goodwill	50,000
30,000 Equity Shares of ₹ 10 each fully paid	3,00,000	Plant	3,00,000
2,000 8% Cumulative Pref. Shares of ₹ 100 each fully paid	2,00,000	Loose Tools	10,000
Securities Premium	90,000	Debtors	2,50,000
Unsecured Loan (From Director)	50,000	Stock	1,50,000
Sundry creditors	3,00,000	Cash	10,000
Outstanding Expenses (including Directors' remuneration ₹ 20,000)	70,000	Bank	35,000
		Preliminary Expenses	5,000
		P&L Account	2,00,000
	10,10,000		10,10,000

Note:
1) Dividends on Cumulative Preference Shares are in arrears for 3 years.
2) Unsecured loans (from director) is assumed to be of less than 12 months hence, treated as short term borrowings.(ignoring interest)

Following scheme of reconstruction has been agreed upon and duly approved by the Court.
a) Equity shares to be converted into 1,50,000 shares of ₹ 2 each.
b) Equity shareholders to surrender to the Company 90 per cent of their holding.
c) Preference shareholders agree to forego their right to arrears to dividends in consideration of which 8% Preference Shares are to be converted into 9% Pref. Shares.
d) Sundry creditors agree to reduce their claim by one fifth in consideration of their getting shares of ₹ 35,000 out of the surrendered equity shares.
e) Directors agree to forego the amounts due on account of unsecured loan and Director's remuneration.
f) Surrendered shares not otherwise utilised to be cancelled.
g) Assets to be reduced as under:

Goodwill by	₹ 50,000
Plant by	₹ 40,000
Tools by	₹ 8,000
Sundry Debtors by	₹ 15,000
Stock by	₹ 20,000

h) Any surplus after meeting the losses should be utilised in writing down the value of the plant further.
i) Expenses of reconstruction amounted to ₹ 10,000.
j) Further 50,000 Equity shares were issued to the existing members for increasing the working capital. The issue was fully subscribed and paid-up.

A member holding 100 equity shares opposed the scheme and his shares were taken over by the Director on payment of ₹ 1,000 as fixed by the Court.

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.

(Ans: Plant further w/off 17,000 Balance Sheet Total 7,45,000)

Question 17 Pg no._____

The summarised Balance Sheet of Preet Limited as on 31st March 2023, was as follows:

Liabilities	₹	Assets	₹
Authorised and subscribed capital:		Property, Plant & Equipment:	
20,000 Equity shares of ₹ 100 each	20,00,000	Machineries	7,00,000
Unsecured loans:		Current Assets:	
15% Debentures	6,00,000	Inventory	5,06,000
Accrued interest	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

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:

a) Each share be sub-divided into 10 fully paid up equity share of ₹ 10 each.
b) After sub-division, each shareholder shall surrender to the company 50% of his holding for the purpose of reissue to debentureholders and trade payables as necessary.
c) Out of shares surrendered 20,000 shares of ₹ 10 each shall be converted into 10% Preference shares of ₹ 10 each fully paid up.
d) The claims of debentureholders shall be reduced by 50%. In consideration of the reduction, the debenture-holder shall receive Preference Shares of ₹ 2,00,000 which are converted out of shares surrendered.
e) Trade Payables claim shall be reduced by 25%. Remaining Trade Payables are to be settled by the issue of equity shares of ₹ 10 each of 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.

Pass Journal Entries giving effect to the above and the resultant Balance Sheet.

(Ans: Capital Reserve 11,000 Balance Sheet Total 17,06,000)

AMALGAMATION (AS 14)

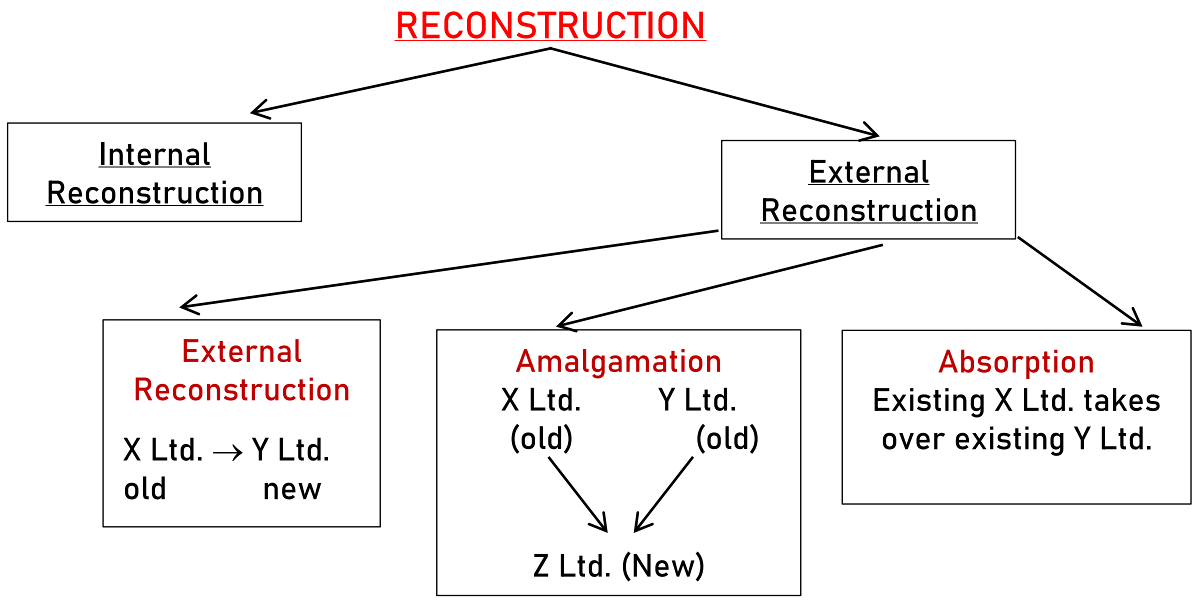
CH 5

"Go confidently in the direction of your dreams, Live the life you've imagined".

Amalgamation refers to the process of merger of two or more companies into a single entity or where one company takes over the other by outright purchase.
Therefore, the term 'amalgamation' contemplates two kinds of activities:

(i) 2 or more companies join to form a new company (Popularly known as Amalgamation)
(ii) absorption and blending of one by the other (Popularly known as Absorption).

This arrangement is sought by companies to receive various advantages such as economies of large-scale production, avoiding competition, increasing efficiency, expansion, increase in market share, etc.



Basis	Internal Reconstruction	External Reconstruction
Liquidation	The existing company is not liquidated	The existing company is liquidated
Formation	No new company is formed but only the rights of shareholders and creditors are changed	A new company is formed to take over the liquidated company
Reduction of Capital	There is certain reduction of capital & sometimes outside liabilities like debenture holders may have to reduce their claims	There is no reduction of capital. In fact there is fresh share capital of the company
Legal Position	Regulated as per provisions of Sec 61 & 66 of the Companies Act, 2013.	Regulated by Sec 232 of the Companies Act, 2013.
Legal Formalities	It requires court's confirmation and other legal procedures before it can be implemented	It can be affected without the court's interference and less time-consuming process.

Basis	Amalgamation	Absorption	External Reconstruction
Meaning	2 or more companies are wound up and a new company is formed to take over their business	An existing company takes over the business of one or more existing companies	A newly formed company takes over the business of an existing company
Minimum no. of companies involved	Atleast 3	Atleast 2	Only 2
No. of new resultant company	Only 1	No new resultant company is formed	Only 1
Objective	To cut competition & reap the economies in the larger scale	To cut competition & reap the economies in the larger scale	To reorganize the financial structure of the company

TOPIC 2A: PURCHASE CONSIDERATION (AS -14)

Purchase consideration is the aggregate of shares and other securities issued (i.e. any long term security from the left side of the balance sheet including equity shares, preference shares, debentures etc.) and payments made in the form of cash and other assets (anything from the asset side) by the transferee company to the shareholders of transferor company.

Purchase Consideration

[Value at which business is purchased]

Shares & Other securities issued $\boxed{\text{AND/OR}}$ Cash/Other Assets given $\boxed{\text{BY}}$ Purchasing Company $\boxed{\text{TO}}$ Shareholders of Transferor Company

Shares & Other securities issued ↓
- Equity shares
- Preference shares
- Debentures

Cash/Other Assets given ↓
- Cash
- Other Assets

Shareholders of Transferor Company ↓
- Equity Shareholders
- Preference shareholders

METHODS OF COMPUTATION OF PURCHASE CONSIDERATION:

Net Payment Method

To shareholders of Old/Transferor co.

Net Assets Method

Net Assets = Assets (-) Outsider Liabilities

(At taken over values)

Does not include capital, Reserves & surplus, losses, etc.

TOPIC 2B: TYPES OF AMALGAMATION

Amalgamation in the Nature of Merger (Pooling of interest method)

As per AS-14 the following 5 conditions are to be fulfilled: -

1. All assets and liabilities are transferred.
2. Assets and liabilities are transferred at same value i.e. book value.
   Exception - 'Purchasing co.' can change value of assets or liabilities to follow same accounting policy.
3. Purchase consideration is discharged by issue of equity shares only to the equity shareholders of transferor company.
   Exception - 'Purchasing company' can pay cash for fractional part of the shares.
4. Same business is intended to be carried on by the purchasing company
5. Shareholders holding atleast 90% of face value of shares in the 'vendor company' becomes the shareholders in the purchasing company.

Amalgamation in the Nature of Purchase (Purchase method)

If any of the 5 conditions discussed above (in merger) is violated, then it is called amalgamation in the nature of purchase.

TOPIC 3: BOOKS OF PURCHASING / TRANSFEREE COMPANY

1. Record the acquisition of business from Vendor Company

Business Purchase A/c	Dr.	(with the Purchase Consideration)
To Liquidator of Vendor Company A/c		

2. Taking over Assets & Liabilities of Vendor Company

A. Nature of Purchase		
Assets A/c	Dr.	(Individually at taken over value)
Goodwill A/c	Dr.	(Difference)
To Liabilities A/c		(Individually at taken over value)
To Business Purchase A/c		(with the Purchase Consideration)
To Capital Reserve A/c		(Difference)
B. Nature of Merger		
Assets A/c	Dr.	(Individually at book value)
To Liabilities A/c		(Individually at book value)
To Reserves A/c		(All at book value & adjustment to be made in it)
To Business Purchase A/c		(with the Purchase Consideration)

3. Making Payment to Vendor Company

Liquidator of Vendor Company A/c	Dr.
Discount on Issue of Debentures A/c	Dr.
To Equity share capital	
To Preference share capital	
To Debentures	
To Securities Premium	
To Bank A/c	
(Only for Equity Shareholders and Preference shareholders)	

4. Record Issue of Debentures to discharge existing Debenture holders of Vendor Company

Debentures of Vendor Company A/c Dr. Discount on Issue of Debentures A/c Dr. To Debentures To Securities Premium

5. Record Reimbursement of Liquidation expenses of the Vendor Company

A. Nature of Purchase
Goodwill/Capital Reserve A/c Dr. To Bank A/c
B. Nature of Merger
P&L /General Reserve A/c Dr. To Bank A/c

6. Eliminate unrealized profit included in the unsold stock/ stock reserve

A. Nature of Purchase
Goodwill/Capital Reserve A/c Dr. To Stock A/c
B. Nature of Merger
P&L /General Reserve A/c Dr. To Stock A/c

7. Elimination of Inter-company owing

Liability A/c Dr. To Asset A/c i.e. Creditors A/c Dr. To Debtors A/c Bills Payable A/c Dr. To Bills Receivable A/c

8. Record the Statutory Reserves of Vendor Company *(Only in case of Purchase Method)*

Amalgamation Adjustment Reserve A/c Dr. To Statutory Reserve A/c

Note:
Statutory reserves are those reserves which are required to be maintained for specific number of years in the balance sheet as per requirements of any statute like Income Tax Act, Custom Act, Excise Act etc.
Examples of Statutory Reserves are:

- Investment Allowance Reserve
- Export Profit Reserve
- Foreign Project Reserve
- Shipping Reserve

Disclosure:
To be disclosed under the head 'Reserves & Surplus' on the Equity & Liabilities Side of the Balance Sheet.

TOPIC 4: BOOKS OF TRANSFEROR /VENDOR /OLD COMPANY

While closing the books, the general principles of closures shall apply. AS-14 does not deal with the books of vendor company. Also the accounting treatment in the books of vendor is exactly same whether it is in nature of merger or purchase.

1. Transfer of Assets to Realisation Account

Realisation A/c Dr. To Sundry Assets A/c

- By Name of Individual Assets
- To be transferred at BOOK VALUE
- Do not transfer the following.
  - Miscellaneous expenditure
  - P & L debit balance
- Cash to be transferred only if taken over. If written 'Purchasing company takes over vendor company', assume that cash and all assets are taken over.
- Asset not taken over shall also be transferred here.
- If any asset is such which is having corresponding provision, then gross value is to be transferred.

2. Transfer of Outsider's Liabilities to Realisation Account

Liabilities A/c Dr. To Realisation A/c

- By Name of Individual Liabilities
- To be transferred at BOOK VALUE
- Do not transfer the following
  - Equity share capital
  - Preference share capital
  - Reserves and surplus
- Liabilities not taken over shall also be transferred
- Any provision appearing on asset side is to be debited in this entry

3. Making Purchase Consideration Due

Purchasing Company A/c Dr. To Realisation A/c (With amount of Purchase Consideration)

4. Receiving Purchase Consideration (Discharge of Purchase Consideration)

Cash/Bank A/c Dr. Equity Shares of 'P' Co. A/c Dr. Preference Shares of 'P' Co. A/c Dr. Debentures of 'P' Co. A/c Dr. To Purchasing Company Account

5. Realize those assets which have not been taken over by Purchasing Company

Cash/Bank A/c Dr. To Realisation A/c

6. Paying off the liabilities which have not been taken over by Purchasing Company

Realisation A/c Dr. To Cash/Bank A/c

7. Liquidation/Realisation Expenses:

Case 1: If expenses borne and paid by vendor company
Realisation A/c Dr. To Cash/Bank A/c
Case 2: If expenses are to be reimbursed by the purchasing company
a) On Payment by Vendor Company: Purchasing Company A/c Dr. (With Agreed Amount) Realisation A/c Dr. (With Excess) To Cash/Bank A/c (With the total) b) On Reimbursement Cash/Bank A/c Dr. To Purchasing Company A/c

8. Discharge the Claims of Preference Shareholders

A: Making Claim Due
Preference Share Capital A/c Dr. (With Book Value) Realisation A/c Dr. (With Difference) To Preference Shareholders A/c (With amount actually payable) To Realisation A/c (With Difference)
B: Making Payment
Preference Shareholders A/c Dr. To Cash/Bank A/c To Equity Shares of ‘P’ Co. To Preference Shares of ‘P’ Co. To Debentures of ‘P’ Co.

9. Ascertainment of Profit/Loss on Realisation Account

A: If Profit
Realisation A/c Dr. To Equity Shareholders A/c
B: If Loss
Equity Shareholders A/c Dr. To Realisation A/c

10. Transferring Equity Share Capital, Accumulated Profits/Reserves & Losses to Equity Shareholders Account

A: For Transfer of Equity Share Capital, Accumulated Profits & Reserves
Equity Share Capital A/c Dr. Reserves and Surplus A/c Dr. (All including Statutory Reserves) To Equity Shareholders A/c
B: For Transfer of Accumulated Losses
Equity Shareholders A/c Dr. To Misc. Expenditure A/c To P & L A/c (Dr. balance)

11. Make Final Payment to Equity Shareholders

Equity Shareholders A/c Dr. To Cash/Bank A/c To Equity Shares of 'P' Co. To Preference Shares of 'P' Co. To Debentures of 'P' Co.

TOPIC 5: INTRINSIC VALUE METHOD

Intrinsic Value

(Variation of Net Assets Method)

No. of shares of New Co. × Intrinsic value of New Co. = No. of shares of Old Co. × Intrinsic value of Old Co.

$$\text{No. of shares of New Co.} \Rightarrow \text{No. of Shares of Old Co.} \times \frac{\text{I.V. of Old Co.}}{\text{I.V. of New Co.}}$$

Where

$$\text{Intrinsic Value} = \frac{\text{Net Assets available for ESH}}{\text{No. of Equity shares}}$$

ASSIGNMENT QUESTIONS

TOPIC 2A: PURCHASE CONSIDERATION

Question 1 Pg no._____

Following is the balance sheet of BX Ltd. as on 31st March, 2020

A. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital		
12% preference shares of ₹ 100 each fully paid-up	15,00,000	
Equity shares of ₹ 10 each fully called-up and paid-up	35,00,000	50,00,000
(b)Reserves & Surplus		
General reserve	11,00,000	
Securities premium	9,00,000	20,00,000
2. Non-Current Liabilities		
13% Debentures		25,00,000
3. Current Liabilities		15,00,000
Total		1,10,00,000
B. Assets		
1. Non-Current assets		
(a) Property, Plant & Equipment	55,00,000	
(b) Investments	25,00,000	80,00,000
2. Current Assets		30,00,000
Total		1,10,00,000

PQR Ltd. agreed to takeover assets & liabilities of BX Ltd. on the following terms & conditions:

(A) Discharge 13%debentures at a premium of 10% by issuing 14%debentures of PQR Ltd.

(B) Revalue — Property, Plant & Equipment at 10% above the book value; investments at par value; current assets at a discount of 10%; and current liabilities at book value.

You are required to calculate the purchase consideration as per the net assets method.

Question 2 *(ICAI Study Material)* Pg no._____

S. Ltd. is absorbed by P. Ltd. S. Ltd. gives the following information on the date of absorption:

Sundry Assets	13,00,000
Share Capital: 2,000 7% Preference shares of ₹ 100 each (fully paid-up)	2,00,000
5,000 Equity shares of ₹ 100 each (fully paid-up)	5,00,000
Reserves	3,00,000
6% Debentures	2,00,000
Trade payables	1,00,000

P. Ltd. has agreed:

a) to issue 9% Preference shares of ₹ 100 each, in the ratio of 3 shares of P. Ltd. for 4 preference shares in S. Ltd.

b) to issue to the debenture-holders in S. Ltd. 8% Mortgage Debentures at ₹ 96 in lieu of 6% Debentures in S. Ltd. which are to be redeemed at a premium of 20%.

c) to pay ₹ 20 per share in cash and to issue six equity shares of ₹ 100 each (market value ₹ 125) in lieu of every five shares held in S. Ltd.; and

d) to assume the liability to trade payables. Calculate Purchase Consideration.

Question 3 *(RTP May 2021)* Pg no._____

Astha Ltd. is absorbed by Nistha Ltd.; the consideration being the takeover of liabilities, the payment of cost of absorption not exceeding ₹ 10,000 (actual cost ₹ 9,000); the payment of the 9% debentures of ₹ 50,000 at a premium of 20% through 8% debentures issued at a premium of 25% of face value and the payment of ₹15 per share in cash and allotment of three 11% preference shares of ₹ 10 each and four equity shares of ₹10 each at a premium of 20% fully paid for every five shares in Astha Ltd.
The number of shares of the vendor company are 1,50,000 of ₹ 10 each fully paid. Calculate purchase consideration as per AS 14.

Question 4 *(ICAI Study Material)* Pg no._____

Following is the balance sheet of A Ltd. as on 31st March, 2021

	Particulars	Notes	₹ (000)
	Equity and Liabilities		
1	Shareholders' funds		
	Share capital	1	22,50
	Reserves and Surplus	2	9,00
2	Non-current liabilities		
	Long-term borrowings	3	7,00
3	Current liabilities		
	Trade Payables		5,00
	Total		43,50
	Assets		
1	Non-current assets		
	Property, Plant and Equipment	4	32,50
	Non-current investments	5	6,00
2	Current assets		
	Inventories		2,00
	Trade receivables		2,00
	Cash and Cash equivalents		1,00
	Total		43,50

Notes to accounts

	Share Capital	₹ in ('000)
1	Equity share capital	
	1,50,000 Equity Shares of ₹ 10 each	15,00
	7,500, 14% Preference Shares of ₹ 100 each	7,50
		22,50
2	Reserves and Surplus	
	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 and conditions:

a. Discharge 15% debentures at a premium of 10% by issuing 15% debentures of X Ltd.
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% preference shares of Rs.100 each.
e. Issue 3 equity shares of ₹ 10 each for every 2 equity shares in B Ltd. & pay balance in cash

Calculate Purchase consideration.

TOPIC 3: BOOKS OF PURCHASING / TRANSFEREE COMPANY

Question 5 *(ICAI Study Material)* Pg no._____

The following were the summarized Balance Sheets of P Ltd. and V Ltd. as at 31st March, 2020:

	P Ltd.	V Ltd.
	₹ (in lakhs)	₹ (in lakhs)
Liabilities		
Equity Share Capital (Fully paid shares of ₹ 10 each)	15,000	6,000
Securities Premium	3,000	-
Foreign Project Reserve	-	310
General Reserve	9,500	3,200
Profit and Loss Account	2,870	825
12% Debentures	-	1,000
Bills Payable	120	-
Sundry Creditors	1,080	463
Sundry Provisions	1,830	702
	33,400	12,500
Assets		
Land and Buildings	6,000	-
Plant and Machinery	14,000	5,000
Furniture, Fixtures and Fittings	2,304	1,750
Stock	7,862	4,041
Debtors	2,120	1,020
Cash at Bank	1,114	609
Bills Receivable	-	80
	33,400	12,500

All the bills receivable held by V Ltd. were P Ltd.'s acceptances.

On 1st April 2020, P Ltd. took over V Ltd in an amalgamation in the nature of merger. It was agreed that in discharge of consideration for the business P Ltd. would allot three fully paid equity shares of ₹ 10 each at par for every two shares held in V Ltd. It was also agreed that 12% debentures in V Ltd. would be converted into 13% debentures in P Ltd. of the same amount and denomination. Expenses of amalgamation amounting to ₹ 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.

Question 6 Pg no._____

Hari Ltd. and Narayan Ltd. are to be amalgamated into Hari Narayan Ltd. The new company is to take over all the assets & liabilities of the amalgamating companies.

Assets & Liabilities of Hari Ltd. are to be taken over at book values in exchange of shares in Hari Narayan Ltd. Three shares in the new company are to be issued at a premium of 20% for every two shares of Hari Ltd.

The approved scheme for Narayan Ltd. is as follows:

1. 10% Preference shareholders are to be allowed two 15% Preference shares of ₹ 100 each in Hari Narayan Ltd. for three Preference shares held in Narayan Ltd.
2. The Debentures of Narayan Ltd. are to be paid off at 5% discount by the issue of debentures of Hari Narayan Ltd. at par.
3. The Equity shareholders of Narayan Ltd. are to be allowed as many shares at par in Hari Narayan Ltd. as will cover the balance on their account and for this purpose, plant and machinery is to be valued less by 15% and obsolete stock forming 10% of the overall stock value is to be treated as worthless.

The summarised Balance Sheets of the two companies prior to amalgamation are as follows:

Liabilities	Hari Ltd.	Narayan Ltd.	Assets	Hari Ltd.	Narayan Ltd.
Equity shares of ₹10 each	6,40,000	12,50,000	Plant & Machinery	12,80,000	20,00,000
10% Preference shares of ₹ 100 each	-	7,50,000	Trade Receivables	1,52,000	1,25,000
General Reserves	8,80,000	-	Inventory	1,00,000	1,50,000
Secured Debentures	-	5,00,000	Cash & Bank	1,08,000	1,00,000
Trade payables	1,20,000	2,25,000	Profit & Loss A/c	-	3,50,000
	16,40,000	27,25,000		16,40,000	27,25,000

You are required to show the Journal Entries of the amalgamated company.

Question 7 *(ICAI Study Material)* Pg no._____

The following are the Balance Sheets of P Ltd. and Q Ltd. as at 31st March, 20X1:

	Particulars	Notes	P Ltd	Q Ltd
	Equity and Liabilities			
1	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

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 & Equipment of both companies are to be revalued at 15% above book value. Both companies are to pay 10% Equity dividend, Preference dividend having been already 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 of Q Ltd.
(ii) 10% Preference Shareholders of Q Ltd. will be paid at 10% discount by issue of 10% Preference Shares of ₹ 100 each at par in P Ltd.
(iii) 12% Debentureholders of Q Ltd. are to be paid at 8% premium by 12% Debentures in P Ltd. issued at a discount of 10%.
(iv) ₹ 30,000 is to be paid by P Ltd. to Q Ltd. for Liquidation expenses. Sundry Creditors of Q Ltd. include ₹ 10,000 due to P Ltd.
(v) Inventory in Trade & Debtors are taken over at 5% lesser than their book value by P Ltd.

Prepare: (a) Absorption entries in the books of P Ltd.
(b) Statement of consideration payable by P Ltd

Question 8

Pg no.______

The financial position of 2 companies M/s. Abhay Ltd. & M/s. Asha Ltd. as on 31-3-2020 is as follows:

Balance Sheet as on 31-3-2020

	Abhay Ltd. (₹)	Asha Ltd. (₹)
Sources of Funds		
Share Capital – Issued and Subscribed 15,000 equity shares @ ₹ 100, fully paid 10,000 equity shares @ ₹ 100, fully paid	 15,00,000 	 10,00,000
General Reserve	2,75,000	1,25,000
Profit & Loss	75,000	25,000
Securities Premium	1,50,000	50,000
Contingency Reserve	45,000	30,000
12% Debentures, @ ₹ 100 fully paid		2,50,000
Sundry Creditors	55,000	35,000
	21,00,000	15,15,000

Application of Funds		
Land and Buildings	8,50,000	5,75,000
Plant and Machinery	3,45,000	2,25,000
Goodwill		1,45,000
Inventory	4,20,000	2,40,000
Sundry Debtors	3,05,000	2,85,000
Bank	1,80,000	45,000
	21,00,000	15,15,000

They decided to merge & form new company M/s Abhilasha Ltd. as on 1-4-2020 on the following terms:

(1) Goodwill to be valued at 2 years purchase of the super profits. The normal rate of return is 10% of the combined share capital and general reserve. All other reserves are to be ignored for the purpose of goodwill. Average profits of M/s. Abhay Ltd. is ₹ 2,75,000 and M/s. Asha Ltd. is ₹ 1,75,000.

(2) Land and Buildings, Plant and machinery and Inventory of both companies to be valued at 10% above book value and a provision of 10% to be provided on Sundry Debtors.

(3) 12% debentures to be redeemed by the issue of 12% preference shares of M/s. Abhilasha Ltd. (face value of ₹ 100) at a premium of 10%.

(4) Sundry creditor to be taken over at book value. There is an unrecorded liability of ₹ 15,500 of M/s. Asha Ltd. as on 1-4-2020.

(5) The bank balance of both companies to be taken over by M/s. Abhilasha Ltd. after deducting liquidation expenses of ₹ 60,000 to be borne by M/s. Abhay Ltd. & M/s. Asha Ltd. in the ratio of 2:1.

You are required to :

(i) Compute the basis on which shares of M/s. Abhilasha Ltd. are to be issued to shareholders of existing company assuming that nominal value per share of M/s. Abhilasha Ltd. is ₹ 100.

(ii) Draw Balance Sheet of M/s. Abhilasha Ltd. as on 1-4-2020 after the amalgamation.

Question 9

Pg no._____

X Ltd. and Y Ltd. were amalgamated on and from 1st April, 2020 and formed a new company Z Ltd. to takeover the business of X Ltd. and Y Ltd.

The summarized Balance Sheets of X Ltd. and Y Ltd., as on 31st March, 2020 are as follows:

	(₹ in Crores)			(₹ in Crores)	
Liabilities	X Ltd.	Y Ltd.	Assets	X Ltd.	Y Ltd.
Equity share capital (₹ 10 per share)	50	45	Land & Building	38	25
10% Preference share capital (₹ 100 each)	20	14	Plant & Machinery	24	17
Revaluation Reserve	10	6	Investments	10	6
General reserve	12	8	Stock	22	15
Investment allowance reserve	5	4	Debtors	25	20
Profit and loss account	8	6	Bills receivable	5	4
15% Debentures (₹ 100 each)	4	5	Cash at Bank	16	13
Trade creditors	19	7			
Bills payables	12	5			
	140	100		140	100

Additional Information:

(1) Z Ltd. will issue 6 equity shares for 10 equity shares of X Ltd. & 2 equity shares for 5 equity shares of Y Ltd. The shares are issued @ ₹ 30 each having face value of ₹ 10 per share.

(2) Preference shareholders of two companies are issued equivalent number of 15% preference shares of Z Ltd. at a price of ₹ 120 per share (face value ₹ 100).

(3) 15% Debentureholders of X Ltd. and Y Ltd. are discharged by Z Ltd. issuing such number of its 18% Debentures of ₹ 100 each so as to maintain the same amount of interest.

(4) Investment allowance reserve is to be maintained for 4 more years.

Prepare Balance Sheet of Z Ltd. after amalgamation. The amalgamation took place in the nature of purchase.

Question 10 *(ICAI Study Material)* *Pg no._____*

Neel Ltd. and Gagan Ltd. amalgamated to form a new company on 1.04.2020.
Following is the Draft Balance Sheet of Neel Ltd. and Gagan Ltd. as at 31.3.2020:

	Note	Neel	Gagan
A. Equity and Liabilities 1. Shareholders' Fund (a) Share Capital		7,75,000	8,55,000
2. Current Liabilities		6,23,500	5,57,600
Total		13,98,500	14,12,600
B. Assets			
1. Non-current assets (a) PPE & Intangible Assets i. Property, Plant & Equipment	1	12,35,000	12,54,000
2. Current Assets		1,63,500	1,58,600
Total		13,98,500	14,12,600

Notes to Accounts

		Neel	Gagan
1.	Property, Plant & Equipment Building Plant & Machinery	 7,50,000 4,85,000 12,35,000	 6,40,000 6,14,000 12,54,000

Following are the additional information:

(i) The assets of Neel Ltd. and Gagan Ltd. are to be revalued as under:

	Neel	Gagan
Plant & Machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000

(ii) The purchase consideration is to be discharged as under

a. Issue 24,000 equity shares of ₹ 25 each fully paid up in the proportion of their profitability in the preceding 2 years

b. Profits for the preceding 2 years are given below:

	Neel	Gagan
1st Year	2,62,800	2,75,125
2nd Year	2,12,200	2,49,875
	4,75,000	5,25,000

c. Issue 12% preference shares of ₹ 10 each fully paid up at par to provide income equivalent to 8% return on net assets in the business as on 31.3.2020 after revaluation of assets of Neel Ltd. and Gagan Ltd. respectively.

You are required to compute the

(i) equity and preference shares issued to Neel Ltd. and Gagan Ltd.,

(ii) Purchase consideration

TOPIC 3 & 4: BOOKS OF PURCHASING COMPANY & VENDOR COMPANY

Question 11 *(ICAI Study Material)* *Pg no._____*

Wye Ltd. acquires business of Z Ltd. whose summarized balance sheet on 31st Dec., 2019 is as:

	Note	Amount
A. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital	1	12,00,000
(b) Reserves & Surplus	2	1,58,000
2. Non-current Liabilities		
(a) Long Term Borrowings	3	2,00,000
3. Current Liabilities		
(a) Trade Payables		1,20,000
(b) Other Current Liabilities (Interest payable on debentures)		12,000
Total		16,90,000
B. Assets		
1. Non-current assets		
(a) Property, Plant & Equipment & Intangible Assets		
i. Property, Plant & Equipment	4	10,00,000
ii. Intangible Assets	5	2,90,000
2. Current Assets		
(a) Inventories		1,50,000
(b) Trade Receivables		1,80,000
(c) Cash & Cash Equivalents		70,000
Total		16,90,000

Notes to Accounts

		Amount
1.	Share Capital	
	Equity Share Capital (₹ 100 each)	8,00,000
	6% Preference Share Capital (₹ 100 each)	4,00,000
		12,00,000
2.	Reserves and Surplus	
	Capital Reserve	1,00,000
	Profit & Loss A/c	50,000
	Workmen Compensation Reserve	
	(Expected liability 5,000)	8,000
		1,58,000
3.	Long Term borrowings	
	6% Debentures	2,00,000
4.	Property, Plant & Equipment	
	Land & Building	4,00,000
	Plant & Machinery	6,00,000
		10,00,000
5.	Intangible Assets	
	Goodwill	2,40,000
	Patents	50,000
		2,90,000

Wye Ltd. was to take over all assets (except cash) and liabilities (except for interest due on debentures) and to pay following amounts:

(i) ₹ 2,00,000 7% Debentures (₹ 100 each) in Wye Ltd. for the existing debentures in Zed Ltd.; for the purpose, each debenture of Wye Ltd. is to be treated as worth ₹ 105.
(ii) For each preference share in Zed Ltd. ₹ 10 in cash and one 9% preference share of ₹ 100 each in Wye Ltd.
(iii) For each equity share in Zed Ltd. ₹ 20 in cash and one equity share in Wye Ltd. of ₹ 100 each having the market value of ₹ 140.
(iv) Expense of liquidation of Zed Ltd. are to be reimbursed by Wye Ltd. to the extent of ₹ 10,000. Actual expenses amounted to ₹ 12,500.

Wye Ltd. valued Land & building at ₹ 5,50,000 Plant & Machinery at ₹ 6,50,000 and patents at ₹ 20,000. Pass the necessary journal entries in the books of both the companies.

Question 12

Pg no._____

The following was the Balance Sheet of V Ltd. as on 31st March, 2020:

	Note	₹ (In Lacs)
A. Equity and Liabilities		
1. Shareholders' Fund		
Share Capital	1	1,150
Reserves & Surplus	2	(87)
2. Non-Current Liabilities		
Long Term Borrowings	3	630
3. Current Liabilities		
Trade Payables		170
Total		1,863
B. Assets		
1. Non-Current assets		
Property, Plant & Equipment & Intangible Assets		
Property, Plant & Equipment	4	1,152
2. Current Assets		
Inventories		380
Trade Receivables		256
Cash & Cash Equivalents	5	75
Total		1,863

Notes to Accounts

		Amount
1.	Share Capital: Issued, Subscribed & paid up	
	80 lakh Equity Shares of ₹ 10 each, full paid up	800
	35 lakh 12% Cumulative Preference Shares of ₹10each, fully paid up	350
	Total	1,150
2.	Reserves and Surplus	
	Debit Balance of Profit and Loss Account	(87)
3.	Long Term borrowings	
	10% Secured Cumulative Debentures of ₹ 100 each, fully paid up	600
	Outstanding Debenture Interest	30
		630
4.	Property, Plant & Equipment	
	Land & Buildings	445
	Plant & Machinery	593
	Furniture, Fixtures and Fittings	114
		1,152

5.	Cash and Cash Equivalents Balance at Bank Cash in hand	 69 6 75

On 1st April, 2020, P Ltd. took over the entire business of V Ltd. on the following terms: V Ltd.'s equity shareholders would receive 4 fully paid equity shares of P Ltd. of ₹ 10 each issued at a premium of ₹ 2.50 each for every five shares held by them in V Ltd. Preference shareholders of V Ltd. would get 35 lakhs 13% Cumulative Preference Shares of ₹ 10 each fully paid up in P Ltd., in lieu of their present holding.

All the debentures of V Ltd. would be converted into equal number of 10.5% Secured Cumulative Debentures of ₹ 100 each, fully paid up after the take over by P Ltd., which would also pay outstanding debenture interest in cash.

Expenses of amalgamation would be borne by P Ltd. Expenses came to be ₹ 2 lakhs. P Ltd. discovered that its creditors included ₹ 7 lakhs due to V Ltd. for goods purchased.

Also P Ltd.'s stock included goods of the invoice price of ₹ 5 lakhs earlier purchased from V Ltd., which had charged profit @ 20% of the invoice price.

You are required to:

(i) Prepare Realisation A/c in the books of V Ltd.

(ii) Pass journal entries in the books of P Ltd. assuming it to be an amalgamation in the nature of merger.

Question 13 Pg no._____

P Ltd. and Q Ltd. were carrying on the business of manufacturing of auto components. Both companies decided to amalgamate and a new company PQ Ltd. is to be formed with an Authorized Capital of ₹ 10,00,000 divided into 1,00,000 equity shares of ₹ 10 each.

P Limited

Balance Sheet as at 31.03.2020

	Amount (₹)
A. Equity and Liabilities 1. Shareholders' Fund (a) Share Capital (b) Reserves & Surplus Profit & Loss A/c	 1,40,000 30,000
2. Non-Current Liabilities 8 % Secured Debentures	 1,10,000
3. Current Liabilities Trade Payables	 54,000
Total	3,34,000
B. Assets	
1. Non-Current assets (a) Property, Plant & Equipment (Tangible) Building at cost less Depreciation Plant & Machinery at cost less Depreciation	 1,00,000 25,000
2. Current Assets (a) Inventories (b) Trade Receivables (c) Cash & Cash Equivalents	 1,35,000 44,000 30,000
Total	3,34,000

Q Limited
Balance Sheet as at 31.03.2020

	Amount (₹)
A. Equity and Liabilities	
1. Shareholders' Fund	
(a) Share Capital	2,50,000
(b) Reserves & Surplus	
General Reserve	1,20,000
Profit & Loss A/c	35,000
2. Current Liabilities	
Trade Payables	1,40,000
Total	5,45,000
B. Assets	
1. Non-Current assets	
(b) Property, Plant & Equipment (Tangible)	
Building at cost less Depreciation	1,90,000
Plant & Machinery at cost less Depreciation	80,000
Furniture & Fixture at cost less depreciation	25,000
2. Current Assets	
(a) Inventories	50,000
(b) Trade Receivables	1,42,000
(c) Cash & Cash Equivalents	58,000
Total	5,45,000

The assets and liabilities of the existing companies are to be transferred at book value with the exception of some items detailed below:

(i) Goodwill of P Ltd. was worth ₹ 50,000 and of Q Ltd. was worth ₹ 1,50,000.
(ii) Furniture & Fixture of Q Ltd. was valued at ₹ 35,000.
(iii) The debtors of P Ltd. are realized fully and bank balance of P Ltd. are to be retained by the liquidator and the sundry creditors are to be paid out of the proceeds thereof.
(iv) The debentures of P Ltd. are to be discharged by issue of 8% debentures of PQ Ltd. at premium of 10%.

You are required to:

(i) Compute the basis on which shares in PQ Ltd. will be issued at par to the shareholders of the existing companies.
(ii) Draw up a Balance Sheet of PQ Ltd. as at 1st April, 2020, the date of completion of amalgamation,
(iii) Write up journal entries including bank entries for closing the books of P Ltd.

Question 14

Pg no._____

Exe Limited was wound up on 31.3.2020 and its Balance Sheet as on that date was given below:

Balance Sheet of Exe Limited as on 31.3.2020

Liabilities	₹	Assets	₹
Share capital:		Property, Plant & Equipment	9,64,000
1,20,000 Equity shares of ₹10 each	12,00,000	Current Assets:	
Reserves and surplus:		Stock	7,75,000
Profit prior to incorporation	42,000	Sundry debtors 1,60,000	
Contingency reserve	2,70,000	Less: Provision for bad and doubtful debt 8,000	1,52,000
Profit and loss A/c	2,52,000	Bills receivable	30,000

Current liabilities:		Cash at bank	3,29,000
Bills payable	40,000		
Sundry creditors	2,26,000		
Provisions:			
Provision for income tax	2,20,000		
	22,50,000		22,50,000

Wye Limited took over the following assets at values shown as under:
Property, Plant & Equipment ₹12,80,000, Stock ₹7,70,000 and Bills Receivable ₹30,000.
Purchase consideration was settled by Wye Limited as under:
₹ 5,10,000 of the consideration was satisfied by the allotment of fully paid 10% Preference shares of ₹100 each. The balance was settled by issuing equity shares of ₹10 each at ₹ 8 per share paid up.
Sundry debtors realised ₹ 1,50,000. Bills payable was settled for ₹38,000. Income tax authorities fixed the taxation liability at ₹2,22,000. Creditors were finally settled with the cash remaining after meeting liquidation expenses amounting to ₹ 8,000.
You are required to:

(i) Calculate the number of equity shares and preference shares to be allotted by Wye Limited in discharge of purchase consideration.
(ii) Prepare the Realisation account, Cash/Bank account, Equity shareholders account and Wye Limited account in the books of Exe Limited.
(iii) Pass journal entries in the books of Wye Limited.

Question 15

Pg no._____

The summarized Balance Sheet of Srishti Ltd. as on 31st March, 2020 was as follows:

Liabilities	Amount (₹)	Assets	Amount (₹)
Equity Shares of ₹10 fully paid	30,00,000	Goodwill	5,00,000
Export Profit Reserves	8,50,000	Property, Plant & Equipment	30,00,000
General Reserves	50,000	Stock	10,40,000
Profit and loss Account	5,50,000	Debtors	1,80,000
9% Debentures	5,00,000	Cash & Bank	2,80,000
Trade Creditors	1,00,000	Preliminary Expenses	50,000
	50,50,000		50,50,000

ANU Ltd. agreed to absorb the business of SRISHTI Ltd. with effect from 1st April, 2020.

a. The purchase consideration settled by ANU Ltd. as agreed:
   i. 4,50,000 equity Shares of 10 each issued by ANU Ltd. by valuing its share @ 15 per share.
   ii. Cash payment equivalent to ₹ 2.50 for every share in SRISHTI Ltd.
b. The issue of such an amount of fully paid 8% Debentures in ANU Ltd. at 96% as is sufficient to discharge 9% Debentures in SRISHTI Ltd. at a premium of 20%.
c. ANU Ltd. will take over Property, Plant & Equipment at 100% more than book value, Stock at ₹ 7,10,000 and Debtors at their face value subject to a provision of 5% for doubtful Debts.
d. The actual cost of liquidation of SRISHTI Ltd. was ₹ 75,000. Liquidation cost of SRISHTI Ltd. is to be reimbursed by ANU Ltd. to the extent of ₹ 50,000.
e. Statutory Reserves are to be maintained for 1 more year.

You are required to:

(i) Close the books of SRISHTI Ltd. by preparing Realisation Account, ANU Ltd. Account, Shareholders Account and Debenture Account, and
(ii) Pass Journal Entries in the books of ANU Ltd. regarding acquisition of business.

Question 16 (RTP Nov 2018) (Similar) / (ICAI Study Material) *Pg no.______*

The financial position of two companies Hari Ltd. and Vayu Ltd. as at 31st March, 2021 was as under:

	Particulars	Notes	Hari Ltd.	Vayu Ltd.
	Equity and Liabilities			
1	Shareholders' funds			
a	Share capital	1	11,00,000	4,00,000
b	Reserves and Surplus	2	70,000	70,000
2	Non-current liabilities			
a	Long term provisions	3	50,000	20,000
3	Current liabilities			
a	Trade Payables		1,30,000	80,000
	Total		13,50,000	5,70,000
	Assets			
1	Non-current assets			
a	Property, Plant and Equipment	4	8,00,000	2,50,000
b	Intangible assets	5	50,000	25,000
2	Current assets			
a	Inventories		2,50,000	1,75,000
b	Trade receivables		2,00,000	1,00,000
c	Cash and Cash equivalents		50,000	20,000
	Total		13,50,000	5,70,000

Notes to accounts

		Hari Ltd.	Vayu Ltd.
1	Share Capital		
	Equity shares of ₹ 10 each	10,00,000	3,00,000
	9% Preference Shares of ₹ 100 each	1,00,000	--
	10% Preference Shares of ₹ 100 each	--	1,00,000
		11,00,000	4,00,000
2	Reserves and Surplus		
	General reserve	70,000	70,000
		70,000	70,000
3	Long term Provisions		
	Retirement gratuity fund	50,000	20,000
		50,000	20,000
4	Property, plant and Equipment		
	Land and Building	3,00,000	1,00,000
	Plant and machinery	5,00,000	1,50,000
		8,00,000	2,50,000
5	Intangible assets		
	Goodwill	50,000	25,000
		50,000	25,000

Hari Ltd. absorbs Vayu Ltd. on the following terms:

a. 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of Hari Ltd.

b. Goodwill of Vayu Ltd. is valued at ₹ 50,000, Buildings are valued at ₹ 1,50,000 and the Machinery at ₹ 1,60,000.

c. Inventory to be taken over at 10% less value and Provision for Doubtful Debts to be created @ 7.5%.
d. Equity Shareholders of Vayu Ltd. will be issued necessary Equity Shares @ 5% premium.

Prepare necessary Ledger Accounts to close the books of Vayu Ltd. and show the acquisition entries in the books of Hari Ltd. Also draft the Balance Sheet after absorption as at 31st March, 2021.

Question 17 *(RTP Nov 2019)* Pg no._____

The following is the summarized Balance Sheet of A Ltd. as at 31st March, 2020:

Liabilities	₹	Assets	₹
8,000 Equity shares of ₹ 100 each	8,00,000	Goodwill	1,30,000
10% debentures	4,00,000	Buildings	3,40,000
Loans	1,60,000	Machinery	6,40,000
Sundry creditors	3,20,000	Stock	2,20,000
General Reserve	80,000	Sundry debtors	2,60,000
		Cash at bank	1,36,000
		Share Issue Expenses	34,000
	17,60,000		17,60,000

B Ltd. agreed to absorb A Ltd. on the following terms and conditions:

(1) B Ltd. would take over all assets, except bank balance at their book values less 10%. Goodwill is to be valued at 4 year's purchase of super profits, assuming that the normal rate of return be 8% on the combined amount of share capital and general reserve.

(2) B Ltd. is to take over creditors at book value.

(3) The purchase consideration is to be paid in cash to the extent of ₹ 6,00,000 and the balance in fully paid equity shares of ₹ 100 each at ₹ 125 per share.

The average profit is ₹ 1,24,400. The liquidation expenses amounted to ₹ 16,000. B Ltd. sold prior to 31st March, 2020 goods costing ₹ 1,20,000 to A Ltd. for ₹ 1,60,000. ₹ 1,00,000 worth of goods are still in stock of A Ltd. on 31st March, 2020. Creditors of A Ltd. include ₹ 40,000 still due to B Ltd.

Show Ledger Accounts to close books of A Ltd. & prepare Balance Sheet of B Ltd. after takeover.

Question 18 *(ICAI Study Material)* Pg no._____

The following are the summarised Balance Sheets of X Ltd. and Y Ltd :

	X Ltd.	Y Ltd.
Liabilities		
Share Capital	1,00,000	50,000
Profit & Loss A/c	10,000	(10,000)
Creditors	25,000	5,000
Loan from X Ltd.	-	15,000
	1,35,000	60,000
Assets		
Sundry Assets	1,20,000	60,000
Loan to Y Ltd.	15,000	-
	1,35,000	60,000

A new company XY Ltd. is formed to acquire the sundry assets and creditors of 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.

Question 19 *Pg no._____*

The Abridged Balance Sheet (Draft) of Cyber Ltd. as on 31st March, 2020 is as under:

Liabilities	₹	Assets	₹
24,000, Equity shares of ₹ 10 each	2,40,000	Goodwill	5,000
5000, 8% cumulative preference shares of ₹ 10 each	50,000	Property, Plant & Equipment	2,57,000
8% Debentures	1,00,000	Inventories	50,000
Interest accrued on debentures	8,000	Trade receivables	60,000
Trade payables	1,00,000	Bank	1,000
		Profit & Loss Account	1,25,000
	4,98,000		4,98,000

The following scheme is passed and sanctioned by the court:

(i) A new company Mahal Ltd is formed with ₹ 3 lacs divided into 30,000 Equity shares of ₹10 each

(ii) The new company will acquire the assets & liabilities of Cyber Ltd. on the following terms:

a. Old company's debentures are paid by similar debentures in new company and for outstanding accrued interest, shares of equal amount are issued at par.

b. The trade payables are paid for every ₹ 100, ₹ 16 in cash and 10 shares issued at par.

c. Preference shareholders are to get equal number of equity shares at par. For arrears of dividend amounting to ₹ 12,000, 5 shares are issued at par for each ₹ 100 in full satisfaction.

d. Equity shareholders are issued one share at par for every three shares held.

e. Expenses of ₹ 8,000 are to be borne by the new company.

(iii) Current Assets are to be taken at book value (except Inventory, which is to be reduced by ₹ 3,000). Goodwill is to be eliminated; balance of purchase consideration being attributed to fixed assets.

(iv) Remaining shares of the new company are issued to public at par and are fully paid.

You are required to show:

(a) In the old company's books:

a. Realisation Account b. Equity Shareholder's Account

(b) In the new company's books:

a. Bank Account b. Summarised Balance Sheet

TOPIC 5: INTRINSIC VALUE METHOD

Question 20 *Pg no._____*

Y Ltd. decides to absorb X Ltd. X Ltd. gives you following information on the date of absorption:

	₹
Net assets	2,90,000
Profit & Loss Account (Dr. Balance)	70,000
Share Capital: 3,000 Equity shares of ₹ 100 each (fully paid)	3,00,000
Preference shares	60,000

Y Ltd. agrees to take over the net assets of X Ltd. The terms of the purchase consideration payable is as follows:

1) An equity share in X Ltd., for purposes of absorption, is valued @ ₹ 70. Y Ltd. shall issue equity shares at value of 120 each for the equity shareholders of X Ltd.

2) Y Ltd. agrees to pay ₹ 60,000 in cash for payment to preference shareholders.

Calculate purchase consideration to be paid by Y Ltd. and how will it be discharged?

Question 21 Pg no._____

Below are summarized balance sheets of Vasudha Ltd. & Vaishali Ltd as at 31st March, 2020

Liabilities	Vasudha Ltd.	Vaishali Ltd.	Assets	Vasudha Ltd.	Vaishali Ltd.
Share capital:			Factory Building	2,10,000	1,60,000
Equity shares of ₹ 10 each	5,40,000	4,03,300	Debtors	2,86,900	1,72,900
General Reserves	86,000	54,990	Stock	91,500	82,500
Profit & Loss A/c	66,000	43,500	Goodwill	50,000	35,000
Sundry Creditors	44,400	58,200	Cash at Bank	98,000	1,09,590
	7,36,400	5,59,990		7,36,400	5,59,990

Goodwill of Vasudha Ltd. and Vaishali Ltd. is to be valued at ₹ 75,000 & ₹ 50,000 respectively. Factory Building of Vasudha Ltd is worth ₹1,95,000 and of Vaishali Ltd ₹ 1,75,000. Stock of Vaishali has been shown at 10% above of its cost. It is decided that Vasudha Ltd will absorb Vaishali Ltd, by taking over its entire business by issue of shares at the Intrinsic Value.
Prepare balance sheet of Vasudha Ltd after takeover assuming assets & liabilities of Vaishali Ltd. were incorporated in Vasudha Ltd at fair value and assets & liabilities of Vasudha Ltd. have been carried at carrying values only.

Question 22 *(ICAI Study Material)* Pg no._____

Let us consider the Balance Sheet of X Ltd. as at 31st March, 2021:

	Particulars	Notes	₹ (000)
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	100,00
b	Reserves and Surplus	2	12,50
2	Non-current liabilities		
a	Long-term borrowings	3	40,00
3	Current liabilities		
a	Trade Payables		20,00
	Total		172,50
	Assets		
1	Non-current assets		
a	Property, Plant and Equipment	4	105,50
b	Non-current investments	5	5,00
2	Current assets		
a	Inventories		23,00
b	Trade receivables		24,00
c	Cash and Cash equivalents		15,00
	Total		172,50

Notes to accounts

		₹ in ('000)
1	Share Capital:	
	7,50,000 Equity Shares of ₹ 10 each	75,00
	25,000, 14% Preference Shares of ₹ 100 each	25,00
		100,00
2	Reserves and Surplus	
	General reserve	12,50
		12,50

3	Long-term borrowings	
	Secured: 14% Debentures	40,00
		40,00
4	Property, plant and Equipment	
	Land and Building	50,00
	Plant and machinery	45,00
	Furniture	10,50
		105,50
5	Non-current investments	
	Investments at cost	5,00
		5,00

Other Information:

a. Y Ltd. takes over X Ltd. on 10th April, 2021.

b. Debenture holders of X Ltd. are discharged by Y Ltd. at 10% premium by issuing 15% own debentures of Y Ltd.

c. 14% Preference Shareholders of X Ltd. are discharged at a premium of 20% by issuing necessary number of 15% Preference Shares of Y Ltd. (Face value ₹ 100 each).

d. Intrinsic value per share of X Ltd. is ₹ 20 & that of Y Ltd. ₹ 30. Y Ltd. will issue equity shares to satisfy the equity shareholders of X Ltd. on the basis of intrinsic value. However, entry should be made at par value only. The nominal value of each equity share of Y Ltd. is ₹ 10.

Compute the purchase consideration.

Question 23

Pg no._____

Following are the summarized Balance Sheets of A Ltd. and B Ltd. as at 31.3.2020:

	A Ltd. (₹)	B Ltd. (₹)
Liabilities		
Share capital: Equity shares 10 each (fully paid up)	10,00,000	6,00,000
Securities premium	2,00,000	-
General reserve	3,00,000	2,50,000
Profit and loss account	1,80,000	1,60,000
10% Debentures	5,00,000	-
Secured loan	-	3,00,000
Trade payables	2,60,000	1,70,000
	24,40,000	14,80,000
Assets		
Land & Building	9,00,000	4,50,000
Plant & Machinery	5,00,000	3,80,000
Investment	80,000	-
Inventory	5,20,000	3,50,000
Trade receivables	4,10,000	2,60,000
Cash at Bank	30,000	40,000
	24,40,000	14,80,000

The companies agree on a scheme of amalgamation on the following terms:

(i) A new company is to be formed by name AB Ltd.

(ii) AB Ltd. to take over all the assets and liabilities of the existing companies.

(iii) For the purpose of amalgamation, the shares of the existing companies are to be valued as under: A Ltd. = ₹ 18 per share B Ltd. = ₹ 20 per share

(iv) A contingent liability of A Ltd. of ₹ 60,000 is to be treated as actual existing liability.

(v) The shareholders of A Ltd. and B Ltd. are to be paid by issuing sufficient number of shares of AB Ltd. at a premium of ₹ 6 per share.

(vi) The face value of shares of AB Ltd. are to be of ₹ 10 each.
You are required to:
(i) Calculate purchase consideration (i.e., number of shares to be issued to A Ltd. & B Ltd.).
(ii) Pass journal entries in the books of A Ltd. for the transfer of assets and liabilities.
(iii) Prepare the Balance Sheet of AB Ltd.

Question 24 *(ICAI Study Material)* *Pg no._____*

The following Balance Sheets are given as at 31st March, 2021:

	Particulars	Best Ltd. (in lakhs)	Better Ltd. (in lakhs)
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital (shares of ₹ 100 each, fully paid)	20	10
b	Reserves and Surplus	10	8
2	Current liabilities	20	2
	Total	50	20
	Assets		
1	Non-current assets		
a	Property, Plant and Equipment	25	15
b	Non-current investments	5	-
2	Current assets	20	5
	Total	50	20

The following further information is given:
a. Better Limited issued bonus shares on 1st April, 2021, in the ratio of one share for every two held, out of Reserves and Surplus.
b. It was agreed that Best Ltd. will take over the business of Better Ltd., on the basis of the latter's Balance Sheet, consideration taking the form of allotment of shares in Best Ltd.
c. The value of shares in Best Ltd. was considered to be ₹ 150 and the shares in Better Ltd. were valued at ₹ 100 after the issue of the bonus shares. The allotment of shares is to be made on the basis of these values.
d. Liabilities of Better Ltd., included ₹ 1 lakh due to Best Ltd., for purchases from it, on which Best Ltd., made profit of 25% of the cost. The goods of ₹ 50,000 out of the said purchases, remained in stock on the date of the above Balance Sheet.

Make the closing ledger in the Books of Better Ltd. and the opening journal entries in the Books of Best Ltd., and prepare the Balance Sheet as at 1st April, 2021 after the takeover.

Question 25 *(ICAI Study Material)* *Pg no._____*

K Ltd. and L Ltd. amalgamate to form a new company LK Ltd. The financial position of these two companies as at the date of amalgamation was as under:

	Particulars	Notes	K Ltd.	L Ltd.
1	Equity and Liabilities			
	Shareholders' funds			
a	Share capital	1	12,00,000	6,00,000
b	Reserves and Surplus	2	3,71,375	1,97,175
2	Non-current liabilities			
a	Long-term borrowings	3	2,00,000	2,00,000
3	Current liabilities			
a	Trade Payables		1,00,000	2,10,000
	Total		18,71,375	12,07,175

	Particulars	Notes	K Ltd.	L Ltd.
	Assets			
1	Non-current assets			
a	Property, Plant and Equipment	4	11,30,000	8,20,000
b	Intangible assets	5	80,000	-
2	Current assets			
a	Inventories		2,25,000	1,40,000
b	Trade receivables		2,75,000	1,75,000
c	Cash and Cash equivalents	6	1,61,375	72,175
	Total		18,71,375	12,07,175

Notes to accounts

		K Ltd.	L Ltd.
1	Share Capital		
	Equity shares of ₹ 100 each	8,00,000	3,00,000
	7% Preference Shares of ₹ 100 each	4,00,000	3,00,000
		12,00,000	6,00,000
2	Reserves and Surplus		
	General reserve	-	1,00,000
	Profit and loss account	3,71,375	97,175
		3,71,375	1,97,175
3	Long-term borrowings		
	5% Debentures	2,00,000	-
	Secured loan	-	2,00,000
		2,00,000	2,00,000
4	Property, plant and Equipment		
	Land and Building	4,50,000	3,00,000
	Plant and machinery	6,20,000	5,00,000
	Furniture and fittings	60,000	20,000
		11,30,000	8,20,000
5	Intangible assets		
	Goodwill	80,000	-
		80,000	-
6	Cash and Cash Equivalents		
	Cash at Bank	1,20,000	55,000
	Cash in hand	41,375	17,175
		1,61,375	72,175

The terms of amalgamation are as under:

(A)

1) The assumption of liabilities of both the Companies.
2) Issue of 5 Preference shares of ₹ 20 each in LK Ltd. @ ₹ 18 paid up at premium of ₹ 4 per share for each preference share held in both the Companies.
3) Issue of 6 Equity shares of ₹ 20 each in LK Ltd. @ ₹ 18 paid up at a premium of ₹ 4 per share for each equity share held in both the Companies. In addition, necessary cash should be paid to the Equity Shareholders of both the Companies as is required to adjust the rights of shareholders of both the Companies in accordance with the intrinsic value of the shares of both the Companies.
4) Issue of such amount of fully paid 6% debentures in LK Ltd. as is sufficient to discharge the 5% debentures in K Ltd. at a discount of 5% after takeover.

(B)

1) The assets and liabilities are to be taken at book values inventory and trade receivables for which provisions at 2% and 2 ½ % respectively to be raised.
2) The trade receivables of K Ltd. Include ₹ 20,000 due from L Ltd.

(C) The LK Ltd. is to issue 15,000 new equity shares of ₹ 20 each, ₹ 18 paid up at premium of ₹ 4 per share so as to have sufficient working capital.

Prepare ledger accounts in the books of K Ltd. and L Ltd. to close their books.

Question 26 *(RTP Nov 2022)* *Pg no._____*

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. (₹)	Myth Ltd. (₹)
(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
(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 (₹)	Myth Limited (₹)
1	Share Capital		
	Equity shares of ₹ 10 each	10,00,000	4,00,000
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
		11,35,000	4,13,000
3	Non- Current Liabilities		
	14% Debentures	---	1,50,000
4	Current Liabilities		
	Trade Payables	90,000	1,42,000
	Other Current Liabilities	50,000	40,000
		1,40,000	1,82,000
5	Current Assets		
	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 (₹)	Myth Limited (₹)
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.

TOPIC 6: THEORY QUESTIONS

Question 1

Briefly explain the methods of accounting for amalgamation as per Accounting Standard-14.

Solution

As per AS 14 on 'Accounting for Amalgamations', there are two main methods of accounting for amalgamations:

(i) 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'.

(ii) 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

Where assets and liabilities are restated on the basis of their fair values, the determination of fair values may be influenced by the intentions of the transferee company.

Question 2 *(Inter Jan 2021) (5 Marks)*

List the conditions to be fulfilled as per Accounting Standard 14 for an amalgamation to be in the nature of merger, in the case of companies.

Solution

An amalgamation should be considered to be an amalgamation in the nature of merger if the following conditions are satisfied:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

Question 3

Briefly describe the disclosure requirements for amalgamation including additional disclosure, if any, for different methods of amalgamation as per AS 14. Or
What disclosures should be made in first financial statements following the amalgamation?

Solution

The disclosure requirements for amalgamations have been prescribed in paragraphs 43 to 46 of AS 14 on Accounting for Amalgamation.
For all amalgamations, the following disclosures should be made in the first financial statements following the amalgamation

a. names and general nature of business of the amalgamating companies;
b. the effective date of amalgamation for accounting purpose;
c. the method of accounting used to reflect the amalgamation; and
d. particulars of the scheme sanctioned under a statute.

For amalgamations accounted under the pooling of interests method, the following additional disclosures should be made 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; and
b. the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

For amalgamations, accounted under the purchase method, the following additional disclosures should be made in the first financial statements following the amalgamation;

a. consideration for the amalgamation and a description of the consideration paid or contingently payable; and
b. the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortization of any goodwill arising on amalgamation.

Question 4

A Ltd. is amalgamating with B Ltd. They are undecided on the method of accounting to be followed. You are required to advice the management of B Ltd. on the method of accounting that can be adopted under AS-14.

Solution

An amalgamation may be either – an amalgamation in the nature of merger, or an amalgamation in the nature of purchase. The selection of method of accounting for amalgamation (pooling of interests or purchase method) is to be judged after considering the intentions of the both the companies.
If genuine pooling of all assets, liabilities, shareholders' interest is intended; separate businesses of both the companies are continued and their amalgamation scheme satisfies all the conditions necessary for merger as specified in AS 14 Accounting for Amalgamations, pooling of interests method is adopted.
However, if B Ltd. or A Ltd. wants to acquire the other company, then purchase method needs to be adopted. In that case, the shareholders of the acquired company don't continue to have proportional share in equity of the combined company and the business of the acquired company is not intended to be continued. The object of purchase method is to account for the amalgamation by applying same principles as are applied in the normal purchase of assets.
Thus choice of accounting method depends on the fact whether B Ltd. wants to continue its business or not.

Question 5 *(ICAI Study Material)*

X Co. Ltd. having share capital of ₹ 50 lakhs divided into equity shares of ₹ 10 each was taken over by Y Co. Ltd. Y Co. Ltd. issued 11 equity shares of ₹ 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 under the 'Pooling of interests method' of amalgamation as per AS 14.

Solution

Purchase consideration = 5,00,000 × 11/10 = 55,000 shares of ₹ 10 each	55,00,000
Less: Share capital of X Co. Ltd.	(50,00,000)
Difference Adjusted through General Reserve	5,00,000

Question 6

How are the balances in profit and loss account treated in the books of transferee company?

Solution

(i) When amalgamation is in the nature of merger

Balance in Profit and Loss Account of the transferor company is

a. Aggregated with the corresponding balance appearing in financial statements of the transferee company; Or
b. Transferred to the general reserve, if any.

(ii) When amalgamation is in the nature of purchase

Balance in profit and loss account of the transferor company, whether debit or credit, loses its identity.

Question 7 *(Inter May 2019) (5 Marks)*

Distinguish between Amalgamation, Absorption and External Reconstruction of Company

Solution

Basis	Amalgamation	Absorption	External Reconstruction
Meaning	2 or more companies are wound up and a new company is formed to take over their business	An existing company takes over the business of one or more existing companies	A newly formed company takes over the business of an existing company
Minimum no. of companies involved	Atleast 3	Atleast 2	Only 2
No. of new resultant company	Only 1	No new resultant company is formed	Only 1
Example	A Ltd. and B Ltd. amalgamate to form C Ltd.	A Ltd. takes over the business of another existing company B Ltd.	B Ltd. is formed to take over business of an existing company A Ltd

PRACTICE QUESTIONS

TOPIC 2A: PURCHASE CONSIDERATION

Question 1 *(RTP Nov 2020)* *Pg no._____*

Som Ltd. agreed to takeover Dove Ltd. on 1st April. Terms & conditions were as follows:

a) Som Ltd. issued 56,000 equity shares of ₹ 100 each at a premium of ₹ 10 per share to the equity shareholders of Dove Ltd.
b) Cash payment of ₹ 1,00,000 was made to equity shareholders of Dove Ltd.
c) 20,000 fully paid preference shares of ₹ 70 each issued at par to discharge the preference shareholders of Dove Ltd.

You are required to calculate amount of purchase consideration as per provisions of AS-14

(Ans: 76,60,000)

Question 2 *Pg no._____*

A Ltd. decides to absorb B Ltd. The draft Balance Sheet of B Limited is as follows:

Liabilities	
Share Capital:	
5,000 9% Preference shares of ₹ 100 each (Fully paid up)	5,00,000
12,500 Equity shares of ₹ 100 each (Fully paid up)	12,50,000
Reserves	7,50,000
6% Debentures	5,00,000
Trade payables	2,50,000
Total	32,50,000
Assets	
Sundry Assets	32,50,000
Total	32,50,000

A Ltd. has agreed:

(i) To pay ₹ 20 per share in cash to equity shareholders of B Ltd. and will issue six equity shares of ₹ 100 each (Market value ₹ 125) in lieu of every five equity shares held in B Ltd.
(ii) To issue 9% Preference shares of ₹ 100 each, in the ratio of 3 shares of A Ltd. for 4 Preference shares in B Ltd.
(iii) To issue 8% debentures at ₹ 96 in lieu of 6% debentures in B Ltd. which are to be redeemed at a premium of 20%. You are required to calculate the purchase consideration.

(Ans: 25,00,000)

Question 3 *(Inter Dec 2021) (5 Marks)* *Pg no._____*

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 ₹ 9,000); 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 Ltd. 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.

(Ans: 43,50,000)

Question 4 *(ICAI Study Material)* *Pg no._____*

A Ltd. take over B Ltd. on April 01, 2021 and discharges consideration for the business as follows:

(i) Issued 42,000 fully paid equity shares of ₹ 10 each at par to equity shareholders of B Ltd.
(ii) Issued fully paid up 15% preference shares of ₹ 100 each to discharge the preference shareholders (₹ 1,70,000) of B Ltd. at a premium of 10%.
(iii) It is agreed that the debentures of B Ltd. (₹ 50,000) will be converted into equal number and amount of 13% debentures of A Ltd.

Determine the amount of Purchase Consideration as per AS 14. *(Ans: 6,07,000)*

Question 5 *(Inter Nov 2022) (5 Marks)* Pg no._____

Star Limited agreed to take over Moon Limited on 1st April,2022. The terms and conditions of takeover were as follows:

a) Star Limited issued 70,000 Equity shares of ₹ 100 each at a premium of ₹ 10 per share to the equity shareholders of Moon Limited.
b) Cash payment of ₹ 1,25,000 was made to the equity shareholders of Moon Limited.
c) 25,000 fully paid Preference shares of ₹ 70 each issued at par to discharge the preference shareholders of Moon Limited.

You are required:

i. to give the meaning of "consideration for the amalgamation' as per AS-14, and
ii. Calculate the amount of purchase consideration.

(Ans: Purchase Consideration 95,75,000)

TOPIC 3: BOOKS OF PURCHASING / TRANSEREE COMPANY

Question 6 *(Inter Nov 2018) (5 Marks)/ (ICAI Study Material)* Pg no._____

On 1st April, 2020, Tina Ltd. take over the business of Rina Ltd. and discharged purchase consideration as follows:

a) Issued 50,000 fully paid Equity shares of ₹ 10 each at a premium of ₹ 5 per share to the equity shareholders of Rina Ltd.
b) Cash payment of ₹ 50,000 was made to equity shareholders of Rina Ltd.
c) Issued 2,000 fully paid 12% Preference shares of ₹ 100 each at par to discharge the preference shareholders of Rina Ltd.
d) Debentures of Rina Ltd. (₹ 1,20,000) will be 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.

(Ans: 10,00,000)

Question 7 *(ICAI Study Material)* Pg no._____

Consider the following summarized balance sheets of X Ltd. and Y Ltd. as at 31st March, 2020

	Note	X Ltd. (000)	Y Ltd. (000)
A. Equity and Liabilities			
1. Shareholders' Fund			
(a) Share Capital	1	72,00	47,00
(b) Reserves & Surplus	2	15,50	10,50
2. Non-current Liabilities			
(a) Long Term Borrowings	3	5,00	3,50
3. Current Liabilities			
(a) Trade Payables		4,50	3,50
(b) Other Current Liabilities		2,00	1,50
Total		99,00	66,00

B. Assets			
1. Non-current assets (a) PPE & Intangible Assets i. Property, Plant & Equipment (b) Non Current Investments	 4 5	 63,25 7,00	 36,00 5,00
2. Current Assets (d) Inventories (e) Trade Receivables (f) Cash & Cash Equivalents		 12,50 9,00 7,25	 9,50 10,30 5,20
Total		99,00	66,00

Notes to Accounts

		X Ltd. (000)	Y Ltd. (000)
1.	Share Capital Equity Share Capital (₹ 10 each) 14% Preference Share Capital (₹ 100 each)	 50,00 22,00 72,00	 30,00 17,00 47,00
2.	Reserves and Surplus General Reserve Export Profit Reserve Investment Allowance Reserve Profit & Loss Account	 5,00 3,00 - 7,50 15,50	 2,50 2,00 1,00 5,00 10,50
3.	Long Term borrowings 13% Debentures of 100 each	 5,00	 3,50
4.	Property, Plant & Equipment Land & Building Plant & Machinery Furniture	 25,00 32,50 5,75 63,25	 15,50 17,00 3,50 36,00
5	Non Current Investments Investments at cost	 7,00	 5,00

X Ltd. takes over Y Ltd. on 1st April, 2020. X Ltd. discharges purchase consideration as below:

(i) Issued 3,50,000 equity shares of ₹ 10 each at par to the equity shareholders of Y Ltd.

(ii) Issued 15% preference shares of ₹ 100 each to discharge the preference shareholders of Y Ltd. at 10% premium.

(iii) The debentures of Y Ltd. will be converted into equivalent number of debentures of X Ltd. The statutory reserves of Y Ltd. are to be maintained for 2 more years.

Show the balance sheet of X Ltd. after amalgamation on the assumption that:

(a) the amalgamation is in the nature of merger.

(b) the amalgamation is in the nature of purchase

(Ans (i) Purchase Consideration 5370 & Balance Sheet Total 16,500 (ii) Capital Reserve 380)

Question 8 *(ICAI Study Material)* *Pg no._____*

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 Express Ltd.	Fast Express Ltd.
	Equity and Liabilities			
1	Shareholders' funds			

a	Share capital	1	20,00,000	10,00,000
b	Reserves and Surplus	2	1,00,000	2,60,000
2	Non-current liabilities			
a	Long term provisions	3	1,00,000	--
3	Current liabilities			
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			
a	Inventories		3,00,000	40,000
b	Trade receivables		2,40,000	40,000
c	Cash and Cash equivalents	6	3,20,000	20,000
	Total		22,60,000	13,00,000

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

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.

(Ans: Balance Sheet Total 35,60,000)

Question 9 Pg no._____

X Co. Ltd. having share capital of ₹50 lakhs divided into equity shares of ₹10 each was taken over by Y Co. Ltd. X Co. Ltd. has General Reserve of ₹10,00,000 and Profit and Loss account Cr. ₹5,00,000. Y Co. Ltd. issued 11 equity shares of ₹10 each for every 10 shares of X Co. Ltd. How the Journal entry would be passed in the books of Y Co. Ltd. for the shares issued under the 'pooling of interest method' of amalgamation. *(Ans: Purchase Consideration 55,00,000)*

Question 10 *(Inter May 2019) (10 Marks) / (RTP May 2013)* Pg no._____

Following are the summarized Balance Sheet of VT Ltd. and MG Ltd. as on 31st March, 2020:

Particulars	VT Ltd.	MG Ltd.
Equity & Liabilities		
Equity share of ₹ 10 each	12,00,000	6,00,000
10% Pref. Shares of ₹ 100 each	4,00,000	2,00,000
Reserves and Surplus	6,00,000	4,00,000
12% Debentures	4,00,000	3,00,000
Trade Payables	5,00,000	3,00,000
	31,00,000	18,00,000
Assets	VT Ltd.	MG Ltd.
Property, Plant & Equipment	14,00,000	5,00,000
Investment	1,60,000	1,60,000
Inventory	4,80,000	6,40,000
Trade Receivables	8,40,000	4,20,000
Cash at Bank	2,20,000	80,000
	31,00,000	18,00,000

Details of Trade receivables and trade payables are as under:

	VT Ltd.	MG Ltd.
Trade receivables		
Debtors	7,20,000	3,80,000
Bills Receivable	1,20,000	40,000
	8,40,000	4,20,000
Trade payables		
Sundry Creditors	4,40,000	2,50,000
Bills Payable	60,000	50,000
	5,00,000	3,00,000

Property, Plant & Equipment of both companies are to be revalued at 15% above book value. Both companies are to pay 10% equity dividend, Preference dividend having been already paid. After the above transactions are given effect to, VT Ltd. will absorb MG Ltd. on following terms:

(i) VT Ltd. will issue 16 Equity Shares of ₹ 10 each at par against 12 Shares of MG Ltd.
(ii) 10% Preference Shareholders of MG Ltd. will be paid at 10% discount by issue of 10% Preference Shares of ₹ 100 each, at par, in VT. Ltd.
(iii) 12% Debenture holders of MG Ltd. are to be paid at 8% premium, by 12% Debentures in VT Ltd., issued at a discount of 10%.
(iv) Inventory in Trade and Debtors are taken over at 5% lesser than their book value.
(v) ₹ 60,000 is to be paid by VT Ltd. to MG Ltd. for Liquidation expenses.
(vi) Sundry Debtors of MG Ltd. includes ₹ 20,000 due from VT Ltd.

You are required to prepare:

(1) Journal entries in the books of VT Ltd.
(2) Statement of consideration payable by VT Ltd.

(Ans: Purchase Consideration 9,80,000 & Capital Reserve 1,61,000)

Question 11 *(ICAI Study Material)* *Pg no._____*

A Ltd. and B Ltd. were amalgamated on and from 1st April, 2021. A new company C Ltd. was formed to take over the business of the existing companies. A Ltd. and B Ltd. have the following ledger balances as on 31st March, 2021:

	A Ltd. (₹ in lakhs)	B Ltd. (₹ 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 ₹ 100 each	800	750
12% Preference shares of ₹ 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 (₹ 100 each)	60	30
Trade Payables	420	190

Additional Information:

a. 10% Debenture holders of A Ltd. and B Ltd. are discharged by C Ltd. issuing such number of its 15% Debentures of ₹ 100 each so as to maintain the same amount of interest.

b. Preference shareholders of the two companies are issued equivalent number of 15% preference shares of C Ltd. at a price of ₹ 150 per share (face value of ₹ 100).

c. 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 @ ₹ 30 each, having a face value of ₹ 10 per share.

d. Investment allowance reserve is to be maintained for 4 more years.

Prepare the Balance Sheet of C Ltd. as on 1st April, 2021 after the amalgamation has been carried out on the basis of Amalgamation in the nature of purchase.

(Ans: Purchase Consideration 1,650 Lakhs & 1,200 Lakhs & Balance Sheet Total 3,520 Lakhs)

Question 12 *(Inter Nov 2020) (15 Marks)* *Pg no._____*

High Ltd. and Low Ltd. were amalgamated on and from, 1st April, 2020. A new company Little Ltd. was formed to take over the business of the existing Companies. The summarized Balance sheets of High Ltd. and Low Ltd. as on 31st March, 2020 are as under:

	(₹ In Lakhs)			(₹ In Lakhs)	
Liabilities	High Ltd.	Low Ltd.	Assets	High Ltd.	Low Ltd.
Share Capital:			PPE:		
Equity Shares of ₹ 100 each	1000	850	Land and Building	670	385
14% Pref. shares of 100 each	320	175	Plant & Machinery	475	355
Reserves and Surplus			Investments	95	80
Revaluation Reserve	225	110	Current Assets, Loans & Advances		
General Reserve	360	240	Stock	415	389

Investment Allowance Reserve	80	40	Sundry Debtors	322	213
Profit and Loss Account	85	82	Bills Receivable	35	-
Secured Loans			Cash and Bank	303	166
13% Debentures (₹ 100 each)	100	56			
Unsecured Loans (Public Deposits)	50	-			
Current Liabilities & Provisions					
Sundry Creditors	65	35			
Bills Payable	30	-			
	2315	1588		2315	1588

Other Information:

(1) 13% Debenture holders of High Ltd. & Low Ltd. are discharged by Little Ltd. by issuing such number of its 15% Debentures of 100 each so as to maintain same amount of interest.

(2) Preference Shareholders of the two companies are issued equivalent number of 15% Preference shares of Little Ltd. at a price of ₹ 125 per share (Face Value ₹ 100)

(3) Little Ltd. will issue 4 Equity Shares for each Equity Share of High Ltd. & 3 equity shares for each Equity Share of Low Ltd. The shares are to be issued at ₹ 35 each having a face value of ₹ 10 per share

(4) Investment Allowance Reserve is to be maintained for two more years.

Prepare the Balance sheet of Little Ltd. as on 1st April, 2020 after the amalgamation has been carried out in basis of in the nature of Purchase.

(Ans: Purchase Consideration 1800 Lakhs & 1111.25 Lakhs & Balance Sheet Total 3,903 Lakhs)

Question 13 *(Inter Dec 2021) (15 Marks)* *Pg no._____*

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:

	Particulars	Note No.	Dark Ltd. (₹ in Lakhs)	Fair Ltd. (₹ in Lakhs)
I	Equity & Liabilities			
	(1) Shareholder's Funds			
	(a) Share Capital	1	1,650	1,425
	(b) Reserve & Surplus	2	630	495
	(2) Non-Current Liabilities			
	(a) Long term Borrowings			
	10% Debentures of 100 each		90	45
	(3) Current Liabilities			
	(a) Trade Payables		630	285
	Total		3000	2250
II	Assets			
	(1) Non-Current Assets			
	(a) Property, Plant & Equipment		1,350	975
	(b) Non-Current Investments		225	75
	(2) Current Assets			
	(a) Inventories		525	375
	(b) Trade Receivables		450	525
	(c) Cash & Cash Equivalents		450	300
	Total		3,000	2,250

Notes to Accounts:

		Dark Ltd. (₹ in Lakhs)	Fair Ltd. (₹ in Lakhs)
1	Share Capital		
	Equity shares of 100 each	1,200	1,125
	14% Preference shares of 100 each	450	300
		1,650	1,425
2	Reserves & Surplus		
	Revaluation Reserve	225	150
	General Reserve	255	225
	Investment Allowance Reserve	75	75
	Profit & Loss Account	75	45
		630	495

Additional Information:

i. Bright Ltd. will issue 5 equity shares for each equity share of Dark Ltd. and 4 equity shares for each equity share of Fair Ltd. The shares are to be issued @ ₹35 each having a face value of ₹10 per share.

ii. Preference shareholders of the two companies are issued equivalent number of 16% Preference Shares of Bright Ltd. at the price of ₹ 160 per share (face value ₹100)

iii. 10% Debentureholders of Dark Ltd. & Fair Ltd. are discharged by Bright Ltd., issuing such number of 16% Debentures of ₹ 100 each so as to maintain the same amount of interest.

iv. Investment Allowance Reserve is to be maintained for 4 more years.

v. Liquidation expenses are for the Dark Ltd. ₹ 6,00,000 and for Fair Ltd. ₹ 3,00,000. It is decided that these expenses would be born by Bright Ltd.

vi. All the assets & liabilities of Dark Ltd. and Fair Ltd. are taken over at Book value.

vii. Authorised equity share capital of Bright Ltd. is ₹ 15,00,00,000 divided into equity shares ₹10 each. After issuing required number of share to the Liquidators of Dark Ltd. and Fair Ltd., Bright Ltd. issued balance shares to the Public. The issue was fully subscribed.

You are required to prepare Balance sheet of Bright Ltd. as at 1st April 2021 after amalgamation has been carried out on the basis of amalgamation in the nature of purchase.

(Ans: Purchase Consideration 2820 Lakhs & 2055 Lakhs & Balance Sheet 7449.375 Lakhs)

Question 14 *(ICAI Study Material)* *Pg no._____*

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 ₹ 4,00,000 divided into 80,000 equity shares of ₹ 5 each.

On 31st December, 2019, summarized Balance Sheets of Sun and Neptune were as follows

	Sun (₹)	Neptune (₹)
Share Capital	3,65,000	3,52,500
Current Liabilities	5,97,000	1,80,250
Property, Plant & Equipment	6,35,000	3,65,000
Current Assets	3,27,000	1,67,750

Additional Information:

(a) Revalued figures of Property, Plant & Equipment and Current Assets were as follows:

	Sun (₹)	Neptune (₹)
Property, Plant & Equipment	7,10,000	3,90,000
Current Assets	2,99,500	1,57,750

(b) The Trade receivables and Trade payables—include ₹ 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 profitability of their respective business based on the average net profit during the last three years which were as follows:

		Sun (₹)	Neptune (₹)
2017	Profit	4,49,576	2,73,900
2018	(Loss)/Profit	(2,500)	3,42,100
2019	Profit	3,77,924	3,59,000

(ii) 15% debentures in Jupiter Ltd., at par to provide an income equivalent to 8% return on capital employed in their respective business as on 31st December, 2019 after revaluation of assets.

You are requested 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.

(Ans: Purchase Consideration 3,57,500 & 3,58,500 & Balance Sheet Total 15,13,900)

TOPIC 3&4: BOOKS OF PURCHASING COMPANY & VENDOR COMPANY

Question 15 *(Inter Jan 2021) (20 Marks)* *Pg no._____*

Galaxy Ltd. and Glory Ltd., are two companies engaged in the same business of chemicals. To mitigate competition, 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:

			Galaxy Ltd.	Glory Ltd.
(I)		Equity & Liabilities		
	(1)	Shareholders' fund		
		Share Capital		
		Equity shares of ₹ 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
	(2)	Non-current Liabilities		
		Secured Loan		
		6% Debentures	-	3,30,000
	(3)	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

Assets and Liabilities are to be taken at book value, with the following exceptions:

(i) 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 ₹ 2,52,000.
(iii) Goodwill is to be valued at:
Galaxy Ltd. ₹ 4,48,000 Glory Ltd. ₹ 1,68,000
(iv) Liquidator of Glory Ltd. is appointed for collection from trade debtors and payment to trade creditors. He retained the cash balance and collected ₹ 1,10,000 from debtors and paid ₹ 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.

You are required to:
(2) Compute the number of shares to be issued to the shareholders of Galaxy Ltd. and Glory Ltd, assuming the nominal value of each share in Glorious Ltd. is ₹ 10.
(3) Prepare Balance Sheet of Glorious Ltd., as on 1st April, 2020 and also prepare notes to the accounts as per Schedule III of the Companies Act, 2013.

(Ans: Purchase Consideration 19,60,000 & 7,20,000 & Balance Sheet Total 34,30,000)

Question 16 *Pg no._____*

The Balance Sheet of Reckless Ltd. as on 31st March, 2020 is as follows:

		₹
Assets:		
Freehold premises		2,20,000
Machinery		1,77,000
Furniture & fittings		90,800
Stock		3,87,400
Trade Receivables	95,000	
Less : Provision for doubtful debts	(4,000)	91,000
Cash in hand		2,300
Cash at bank		1,56,500
		11,25,000
Liabilities:		
60,000 Equity shares of ₹ 10 each		6,00,000
Pre-incorporation profit		21,000
Contingency reserve		1,35,000
Profit and loss account		1,26,000
Trade Payables		1,33,000
Provision for income-tax		1,10,000
		11,25,000

Trade receivables consist of debtors amounting ₹ 80,000 and bill receivables worth ₹ 15,000. Trade payables consist of creditors amounting to ₹ 1,13,000 and acceptances worth ₹ 20,000. Careful Ltd. decided to take over Reckless Ltd. from 31st March, 2020 with the following assets at value noted against them:

	₹
Bills receivable	15,000
Freehold premises	4,00,000
Furniture and fittings	80,000
Machinery	1,60,000
Stock	3,45,000

⅒ of the consideration was satisfied by the allotment of fully paid preference shares of ₹ 100 each at par which carried 13% dividend on cumulative basis. The balance was paid in the form of Careful Ltd.'s equity shares of ₹ 10 each, ₹ 8 paid up.

Sundry Debtors realised ₹ 79,500. Acceptances were settled for ₹ 19,000. Income-tax authorities fixed the taxation liability at ₹ 1,11,600. Creditors were finally settled with the cash remaining after meeting liquidation expenses amounting to ₹ 4,000.

You are required to :

a) Calculate the number of equity shares and preference shares to be allotted by Careful Ltd. in discharge of consideration.
b) Prepare the important ledger accounts in the books of Reckless Ltd.; and
c) Pass journal entries in the books of Careful Ltd. with narration

(Ans: Purchase Consideration 10,00,000 Payment to Creditors 1,03,700 & Realisation Profit 1,18,000)

Question 17

Pg no._____

The following was the Balance Sheet of Rashmi Limited as on 31st March, 2020:

Balance Sheet as at 31.03.2020

	Note No.	Amount (₹)
A. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital	1	18,00,000
(b) Reserves & Surplus	2	8,40,000
2. Non-Current Liabilities		
Long term Borrowings	3	2,85,000
3. Current Liabilities		
Trade Payables		75,000
Total		30,00,000
B. Assets		
3. Non-Current assets		
(a) Property, Plant & Equipment & Intangible Assets		
(i) Property, Plant & Equipment	4	18,00,000
(ii) Intangible Assets		1,40,000
(b) Non Current Investments	5	1,60,000
4. Current Assets		
(a) Inventories		6,24,000
(b) Trade Receivables		1,08,000
(c) Cash & Cash Equivalents		1,68,000
Total		30,00,000

Note No.	Particulars		Amount
1.	Share Capital: Issued, Subscribed and Paid up		
	1,80,000 share of ₹ 10 each fully paid up		18,00,000
	Total		18,00,000
2.	Reserve and Surplus:		
	General Reserve		4,10,000
	Profit & Loss A/c	1,30,000	
	Less: Preliminary Exp.	(30,000)	1,00,000
	Export Profit Reserve		2,50,000
	Investment Allowance Reserve		80,000
	Total		8,40,000
3.	Long term Borrowing:		
	9% Secured Debenture of ₹ 100 each fully paid up		2,85,000
	Total		2,85,000

4.	Property, Plant & Equipment:	
	Freehold Property	12,40,000
	Plant & Machinery	5,60,000
	Total	18,00,000
5.	Non-Current Investments:	
	Other Investments (Current Market value ₹ 1,30,000)	1,60,000
	Total	1,60,000

On 1st April, 2020 Nitin Ltd. agreed to absorb the business of Rashmi Ltd. on the following terms and conditions:

(i) The purchase consideration would be settled by Nitin Ltd. as under:

(1) 3,00,000 equity shares of 10 each issued by Nitin Ltd. by valuing its share at 12 per share

(2) Cash payment equivalent to ₹ 5 for every share in Rashmi Ltd.

(ii) The issue of such an amount of fully paid 10% debentures in Nitin Ltd. at 95% as is sufficient to discharge 9% debenture in Rashmi Ltd. at a premium of 25%.

(iii) Nitin Ltd. will takeover the Freehold property at 120% more than the book value and Plant & Machinery at 10% less than the book value. Inventories at ₹ 5,20,000 and Trade receivables at their book value subject to a provision of 8% for doubtful debts. Investments will be taken over at current market value. Nitin Ltd. will take over trade payables at book value.

(iv) Liquidation expenses are to be reimbursed by Nitin Ltd. to the extent of ₹ 30,000. The cost of liquidation: ₹ 50,000.

(v) Statutory reserves are to be maintained for 2 more years.

You are required to:

(a) Prepare the Realisation Account, Nitin Ltd. Account, Shareholders Accounts and Debenture Account in the book of Rashmi Ltd. and

(b) Write up journal entries in the books of Nitin Ltd. regarding acquisition of business.

(Ans: Purchase Consideration 45,00,000 Realisation Profit 18,60,000 Goodwill (bal. fig.) 8,01,890)

Question 18 (Inter May 2018 (20 Marks) / RTP Nov 2020) Pg no._____

The financial position of X Ltd. and Y Ltd. as on 31st March, 2020 was as under:

	X Ltd.	Y Ltd.
Equity and Liabilities		
Equity Shares of ₹ 10 each	30,00,000	9,00,000
9% Preference Shares of ₹ 100 each	3,00,000	-
10% Preference Shares of ₹ 100 each	-	3,00,000
General Reserve	2,10,000	2,10,000
Retirement Gratuity Fund (long term)	1,50,000	60,000
Trade Payables	3,90,000	2,40,000
Total	40,50,000	17,10,000
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
Total	40,50,000	17,10,000

X Ltd. absorbs Y Ltd. on the following terms:

a) 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of X Ltd.
b) Goodwill of Y Ltd. on absorption is to be computed based on two times of average profits of preceding three financial years (2018-19 : ₹ 90,000; 2017-18 : ₹ 78,000 and 2016-17: ₹ 72,000). The profits of 2016 -17 included credit of an insurance claim of ₹ 25,000 (fire occurred in 2015-16 and loss by fire ₹ 30,000 was booked in Profit and Loss Account of that year). In the year 2017 -18, there was an embezzlement of cash by an employee amounting to ₹ 10,000.
c) Land & Buildings are valued at ₹ 5,00,000 and the Plant & Machinery at ₹ 4,00,000.
d) Inventories are to be taken over at 10% less value and Provision for Doubtful Debts is to be created @ 2.5%.
e) There was an unrecorded current asset in the books of Y Ltd. whose fair value amounted to ₹ 15,000 and such asset was also taken over by X Ltd.
f) The trade payables of Y Ltd. included ₹ 20,000 payable to X Ltd.
g) Equity Shareholders of Y Ltd. will be issued Equity Shares @ 5% premium.

You are required to
a) Prepare Realisation A/c in the books of Y Ltd.
b) Show journal entries in the books of X Ltd.
c) Prepare the Balance Sheet of X Ltd. after absorption as at 31st March, 2020.

(Ans: Purchase Consideration 15,90,000 Realisation Profit 1,50,000 Balance Sheet Total 59,20,000)

Question 19 *(ICAI Study Material)* *Pg no.______*

The following are the summarized Balance Sheets of A Ltd. and B Ltd. as on 31.3.2020:

	(₹ Thousands)	
Liabilities	A Ltd.	B Ltd.
Share capital:		
Equity shares of 100 each fully paid up	2,000	1,000
Reserves	1,000	-
Profit & Loss (Dr. balance)	-	(800)
10% Debentures	500	-
Loans from Banks	250	450
Bank overdrafts	-	50
Trade payables	300	300
Total	4,050	1,000
Assets		
Property, Plant & Equipment	2,700	850
Non Current Investments	700	-
Trade receivables	400	150
Cash at bank	250	-
Total	4,050	1,800

B Ltd. has acquired the business of A Ltd. The following scheme of merger was approved:
(i) Banks agreed to waive off the loan of ₹ 60 thousands of B Ltd.
(ii) B Ltd. will reduce its shares to ₹ 10 per share and then consolidate 10 such shares into one share of ₹ 100 each (new share).
(iii) Shareholders of A Ltd. will be given one share (new) of B Ltd. in exchange of every share held in A Ltd.
(iv) Trade payables of B Ltd. includes ₹ 100 thousands payable to A Ltd.

Pass necessary entries in the books of B Ltd. and prepare Balance Sheet after merger

(Ans: Capital Reduction (bal. fig.) 160 Purchase Consideration 2,000 Balance Sheet total 4,950)

Question 20 *(ICAI Study Material)* Pg no._____

Following are summarised Balance Sheets of Yes Ltd. and No Ltd. as on 31st October, 2019:

	Yes Ltd.	No Ltd.
	₹ (in crores)	₹ (in crores)
Equity & Liabilities: Share capital: Authorised	25	5
Issued and Subscribed: Equity Shares of ₹ 10 each fully paid	12	5
Reserves and surplus	88	10
Unsecured loan from Yes Ltd.	-	10
Current Liabilities	33	15
	133	40
Assets:		
Property, Plant & Equipment: Cost Less: Depreciation Written down value	70 50 20	30 24 6
Investments at cost: 30 lakhs equity shares of 10 each Long-term loan to No. Ltd.	3 10	
Current Assets	100	34
	133	40

On that day Yes Ltd. absorbed No Ltd. The members of No Ltd. are to get one equity 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. Pass journal entries in the books of the two companies to give effect to the above if the amalgamation is in the nature of merger.
(Ans: Purchase Consideration 1.20 crores)

Question 21 *(RTP May 2021)* Pg no._____

Mohan Ltd. gives you the following information as on 31st March, 2020:

Share Capital:	
Equity shares of ₹ 10 each	3,00,000
6,000, 9% cumulative preference shares of ₹ 10 each	60,000
Profit and Loss Account (Dr. balance)	1,70,000
10% Debentures of ₹ 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 ₹ 4,00,000 divided into 40,000 Equity Shares of ₹ 10 each. The new company will acquire the assets and liabilities of Mohan Ltd. on the following terms:

(i)

a. Mohan Ltd.'s debentures are paid by similar debentures in new company & for outstanding accrued interest on debentures, equity shares of equal amount are issued at par.
b. The trade payables are paid by issue of 12,000 equity shares at par in full and final settlement of their claims.

c. Preference shareholders are to get equal number of equity shares issued at par. Dividend on preference shares is in arrears for 3 years. Preference shareholders to forgo dividend for 2 years. For balance dividend, equity shares of equal amount are issued at par.
d. Equity shareholders are issued 1 share at par for every 3 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. Property, plant & equipment is taken over at ₹ 3,08,400.

(iii) Remaining equity shares of the new company are issued to public at par fully paid up.

(iv) Expenses of ₹ 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.

You are required to prepare:

(a) Realisation account and Equity Shareholders' account in the books of Mohan Ltd.

(b) Bank Account and Balance Sheet with notes to accounts in the books of Ravi Ltd.

(Ans: Real. Loss 30,000; Purchase Consideration 1,65,400 & Balance sheet total 6,00,000)

TOPIC 5: INTRINSIC VALUE METHOD

Question 22

Pg no._____

Summarized Balance Sheet of A Limited and B Limited as at 31st March, 2020 are as follows:

Liabilities	A Ltd.	B Ltd.	Assets	A Ltd.	B Ltd.
Equity share of ₹ 10 each	20,00,000	12,00,000	Sundry Assets	30,00,000	18,00,000
General reserve	4,00,000	2,20,000			
Trade payables	6,00,000	3,80,000			
	30,00,000	18,00,000		30,00,000	18,00,000

Sundry assets of B Ltd. includes long term investment of ₹ 4,00,000, the market value of which is now ₹ 4,80,000. A Ltd. absorbed B Ltd. on the basis of intrinsic value of the shares. The purchase consideration is to be discharged in fully paid-up equity shares. A sum of ₹ 1,00,000 is owed by A Ltd. to B Ltd., also included in the Inventory of A Ltd. is ₹ 1,20,000 goods supplied by B Ltd. at cost plus 20%.

Give Journal entries in the books of both the companies, if entries are made at intrinsic value. Also prepare Balance Sheet of A Ltd. after absorption.

(Ans: Purchase Consideration 15,00,000 Balance Sheet total 47,60,000)

Question 23 (Inter May 2022) (20 Marks)

Pg no._____

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	
Inventories	10,40,000	7,00,000
Trade Receivables	8,20,000	5,20,000

Cash and Bank	3,00,000	3,00,000
	71,80,000	43,80,000

B Ltd. is to declare & 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 ₹ 12 per share respectively and agreed by respective shareholders of the companies.
c) 10% Debentures of A Ltd. to be issued 12% Debentures of Z Ltd. at par in consideration of their holdings.
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. ₹ 30,000 respectively 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.

(Ans: Purchase Consideration 54,00,000 & 28,80,000 Balance Sheet total 1,22,20,000)

Question 24 (RTP May 2020) Pg no._____

P Ltd. and Q Ltd. agreed to amalgamate and form a new company called PQ Ltd. The summa rized balance sheets of both the companies on the date of amalgamation stood as below:

Liabilities	P Ltd.	Q Ltd.	Assets	P Ltd.	Q Ltd.
Share Capital:			Goodwill	1,00,000	80,000
Equity Shares of ₹ 100 each	8,20,000	3,20,000	Land & Building	4,50,000	3,40,000
9% Pref. Share of ₹100 each	3,80,000	2,80,000	Plant & Machinery	6,20,000	4,50,000
8% Debentures	2,00,000	1,00,000	Furniture & Fittings	1,00,000	50,000
General Reserve	1,50,000	50,000	Debtors	3,25,000	1,50,000
Profit & Loss Account	3,52,000	2,05,000	Stock	2,33,000	1,05,000
Creditors	88,000	1,60,000	Cash at Bank	1,08,000	95,000
Unsecured Loan	-	1,75,000	Cash in hand	54,000	20,000
	19,90,000	12,90,000		19,90,000	12,90,000

PQ Ltd. took over the assets and liabilities of both the companies at book value after creatin g provision @ 5% on Stock and Debtors respectively and depreciating Furniture & Fittings by @ 10%, Plant and Machinery by @ 10%. The debtors of P Ltd. include ₹ 25,000 due from Q Ltd.

PQ Ltd. will issue:

(1) 5 Preference shares of ₹ 20 each @ ₹ 18 paid up at premium of ₹ 4 per share for each preference share held in both the Companies.
(2) 6 Equity shares of ₹ 20 each @ ₹ 18 paid up at a premium of ₹ 4 per share for each equity share held in both the Companies.
(3) 6% debentures to discharge the 8% debentures of both the companies
(4) 20,000 new equity shares of ₹ 20 each for cash @ ₹ 18 paid up at premium of ₹ 4 per share

PQ Ltd. will pay necessary cash to the Equity Shareholders of both the Companies in order to adjust the rights as per the intrinsic value of the shares of both the Companies
Prepare ledger accounts in the books of P Ltd. and Q Ltd. to close their books
(Ans: Purchase Consideration 16,02,100 & 7,92,250 Realisation Loss 1,37,900 & 90,750)

Question 25 *(RTP May 2019)* *Pg no._____*

P Ltd. and Q Ltd. decided to amalgamate as on 01.04.2020 Their summarised Balance Sheets as on 31.03.2020 were as follows:

Liabilities	P Ltd. ₹ ('000)	Q Ltd. ₹ ('000)
Share capital: Equity shares 10 each (fully paid up)	300	280
9% Preference share Capital (₹ 100 each)	60	40
Investment allowance Reserve	10	4
Profit and Loss Account	68	68
10% Debentures	100	60
Trade Payables	50	30
Tax provision	14	8
	602	490
Assets		
Building	120	100
Plant and Machinery	160	140
Investments	80	50
Trade receivables	90	70
Inventories	72	80
Cash and Bank	80	50
	602	490

From the following information, you are required to prepare the Balance Sheet as on 01.04.2020 of a new company, R Ltd., which was formed to take over the business of both the companies and took over all the assets and liabilities:

a) 50 % Debenture are to be converted into Equity Shares of the New Company.
b) Investments are non- current in nature.
c) Fixed Assets of P Ltd. were valued at 10% above cost and that of Q Ltd. at 5% above cost.
d) 10% of trade receivables were doubtful for both companies. Inventories to be carried at cost
e) Preference shareholders were discharged by issuing equal number of 9% preference shares at par.
f) Equity shareholders of both the transferor companies are to be discharged by issuing Equity shares of ₹ 10 each of the new company at a premium of ₹ 5 per share.

Give your answer on the basis that amalgamation is in the nature of purchase.
(Ans: Purchase Consideration 4,57,000 & 3,97,000 Balance Sheet total 11,15,985)

Question 26 *(RTP May 2018)* *Pg no._____*

Given below are the Balance Sheet of two companies as on 31st December, 2019.

A Limited

Liabilities	₹	Assets	₹
<u>Share Capital:</u>		Patent	1,00,000
Issued and fully paid up		Building	5,40,000
50,000 8% Cumulative Preference Shares of ₹ 10 each	5,00,000	Plant and Machinery	15,10,000
1,50,000 Equity shares of 10 each	15,00,000	Furniture	75,000
General Reserve	7,65,000	Investment	1,55,000
Profit and Loss account	1,25,000	Stock	3,58,000

Sundry Creditors	60,000	Sundry Debtors	72,000
		Cash and Bank	1,40,000
	29,50,000		29,50,000

B Limited

Liabilities	₹	Assets	₹
Share Capital:		Goodwill	62,000
Issued and fully paid up		Motor Car	1,26,000
50,000 Equity shares of 10 each	5,00,000	Furniture	58,000
Profit and Loss account	45,000	Stock	2,40,000
Sundry Creditors	31,000	Sundry Debtors	70,000
		Cash and Bank	20,000
	5,76,000		5,76,000

It has been agreed that both these companies should be wound up and new company AB Ltd. should be formed to acquire assets of both companies on the following terms & conditions:

a) AB Ltd. is to have an authorized capital of ₹ 36,00,000 divided into 60,000, 8% cumulative preference shares of ₹ 10 each and 3,00,000 equity shares of ₹ 10 each.

b) AB Ltd. to purchase the whole of the assets of A Ltd. (except cash and Bank balances) for ₹ 28,25,000 to be settled as to ₹ 5,75,000 in cash and as to the balance by issue of 1,80,000 equity shares, credited as fully paid, to be treated as valued at ₹ 12.50 each.

c) AB Ltd. is to purchase the whole of the assets of B Ltd. (except cash and bank balances) for ₹ 4,91,000 to be settled as to ₹ 16,000 in cash and as to the balance by issue of 38,000 equity shares, credited as fully paid, to be treated as valued at ₹ 12.50 each.

d) A Ltd. and B Ltd. both are to be wound up, the two liquidators distributing the shares in AB Ltd. in kind among the equity shareholders of the respective companies.

e) The creditors of A Ltd. and B Ltd. are considered to be paid by the liquidators of the respective companies and not taken over by AB Ltd.

f) The liquidator of A Ltd. is to pay the preference shareholders ₹ 12 in cash for every share held in full satisfaction of their claims.

g) AB Ltd. is to make a public issue of 60,000, 8% cumulative preference shares at a premium of 10% and 30,000 equity shares at the issue price of ₹ 12.50 per share, all amount payable in full on application.

It is estimated that the cost of liquidation (including the liquidators' remuneration) will be ₹ 10,000 in case of A Ltd. and ₹ 5,000 in case of B Ltd. and that the preliminary expenses of AB Ltd. will amount to ₹ 24,000· exclusive of the underwriting commission of ₹ 38,900 payable on the public issue.

You are required to prepare the initial Balance Sheet of AB Ltd. on the basis that all assets other than goodwill are taken over at the book value and preliminary expenses and underwriting commission are to be written off.

(Ans: Purchase Consideration 28,25,000 & 4,91,000 Balance Sheet total 37,36,000)

Question 27 *(RTP May 2018 / RTP Nov 2021)* *Pg no.______*

P Ltd. & Q Ltd. agreed to amalgamate their business. The scheme envisaged a share capital equal to the combined capital of P Ltd. & Q Ltd. for the purpose of acquiring the assets, liabilities and undertakings of the two companies in exchange for share in PQ Ltd. The Balance Sheets of P Ltd. & Q Ltd. as on 31st March, 2020 (the date of amalgamation) are given below:

Summarized Balance Sheet as at 31-03-2020

Equity & Liabilities	P Ltd.	Q Ltd.	Assets	P Ltd.	Q Ltd.
Shareholder Funds:			Non Current Assets:		
Share Capital	6,00,000	8,40,000	Fixed Assets (excluding Goodwill)	7,20,000	10,80,000

Reserves	10,20,000	6,00,000	Current Assets:		
Current Liabilities:			Inventories	3,60,000	6,60,000
Bank Overdraft	-	5,40,000	Trade Receivables	4,80,000	7,80,000
Trade Payables	2,40,000	5,40,000	Cash at Bank	3,00,000	-
	18,60,000	25,20,000		18,60,000	25,20,000

The consideration was to be based on the net assets of the companies as shown in the above balance sheet, but subject to an additional payment to P Ltd. for its goodwill to be calculated as its weighted average of net profits for the 3 years ended 31st March, 2020. The weights for this purpose for the years 2017-18, 2018-19 and 2019-20 were agreed as 1, 2 & 3 respectively. The profit has been: 2017-18 ₹ 3,00,000; 2018-19 ₹ 5,25,000 and 2019-20 ₹ 6,30,000

The shares of PQ Ltd. were to be issued to P Ltd. & Q Ltd. at a premium & in proportion to the agreed net assets value of these companies.

In order to raise working capital, PQ Ltd. increased its authorized capital by ₹ 12,00,000 and proceeded to issue 72,000 shares of ₹ 10 each at the same rate of premium as issued for discharging purchase consideration to P Ltd. & Q Ltd. You are required to:

(a) Calculate the number of shares issued to P Ltd. & Q Ltd.

(b) Prepare the Balance sheet of PQ Ltd. as per Schedule III after recording its journal entries

(Ans: Purchase Consideration 21,60,000 & 14,40,000 Balance Sheet total 61,80,000)

Question 28 *(Inter July 2021) (10 Marks)* Pg no._____

The summarized Balance Sheets of Black Limited and White Limited as on 31st March, 2020 is as follows:

Particulars	Notes	Black Limited (₹ In 000)	White Limited (₹ 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

Note No.	Particulars	Black Limited (₹ in 000)	White Limited (₹ in 000)
1.	Share Capital Equity Shares of ₹100 each	6,000	3,600
	Reserves and Surplus		
2.	General Reserve	360	180
	Profit and Loss Account	720	480
	Total	1,080	660

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 ₹ 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 ₹ 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 ₹ 2,40,000 and Property Plant and Equipment are valued at ₹ 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:

a) Compute No. of shares to be issued by Black Limited to White Limited against purchase consideration.
b) Calculate balance of Net Current Assets of Black Ltd. & White Ltd. as on 1st July, 2020
c) Give balance of Profit or Loss of Black Limited as on 1st July, 2020
d) Give balance of Property Plant and Equipment as on 1st July, 2020 after takeover.

[Ans: a) 45,000 shares; b) 34,50,000 & 18,00,000; c) 6,00,000 d) 59,70,000]

Question 29 *(RTP May 2022)*

Pg no.______

The following are Balance Sheets of Aakash Limited and Ganga Limited as at March 31, 2021:

	Particulars	Note No.	Aakash Limited (₹)	Ganga Limited (₹)
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
(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 (₹)	Ganga Limited (₹)
1.	Share Capital		
	Authorized, Issued, Subscribed & Paid up :		
	6,00,000 Equity Shares of ₹ 10 each	60,00,000	-
	20,000 Preference Shares of ₹ 100 each	20,00,000	-
	2,00,000 Equity Shares of ₹ 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:

(i) All Current Assets of two companies, except pledged inventory are taken over by AakashGanga 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.
(ii) Property, Plant and Equipment of both the companies are taken over at book value by AakashGanga Limited.
(iii) Secured Loans include ₹ 32,00,000 accrued interest in case of Ganga Limited.
(iv) 4,00,000 Equity Shares of ₹ 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.
(v) Preference Shareholders in Aakash Limited are issued Equity Shares in AakashGanga Ltd. worth ₹ 4,00,000 in lieu of their present holdings.
(vi) 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.
(vii) Unsecured Loans are taken over by AakashGanga Limited at 25% of loan amounts.
(viii) Employees are issued fully paid Equity Shares in AakashGanga Limited in full settlement of their dues.
(ix) 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.

(Ans: Balance Sheet total 5,90,20,000)

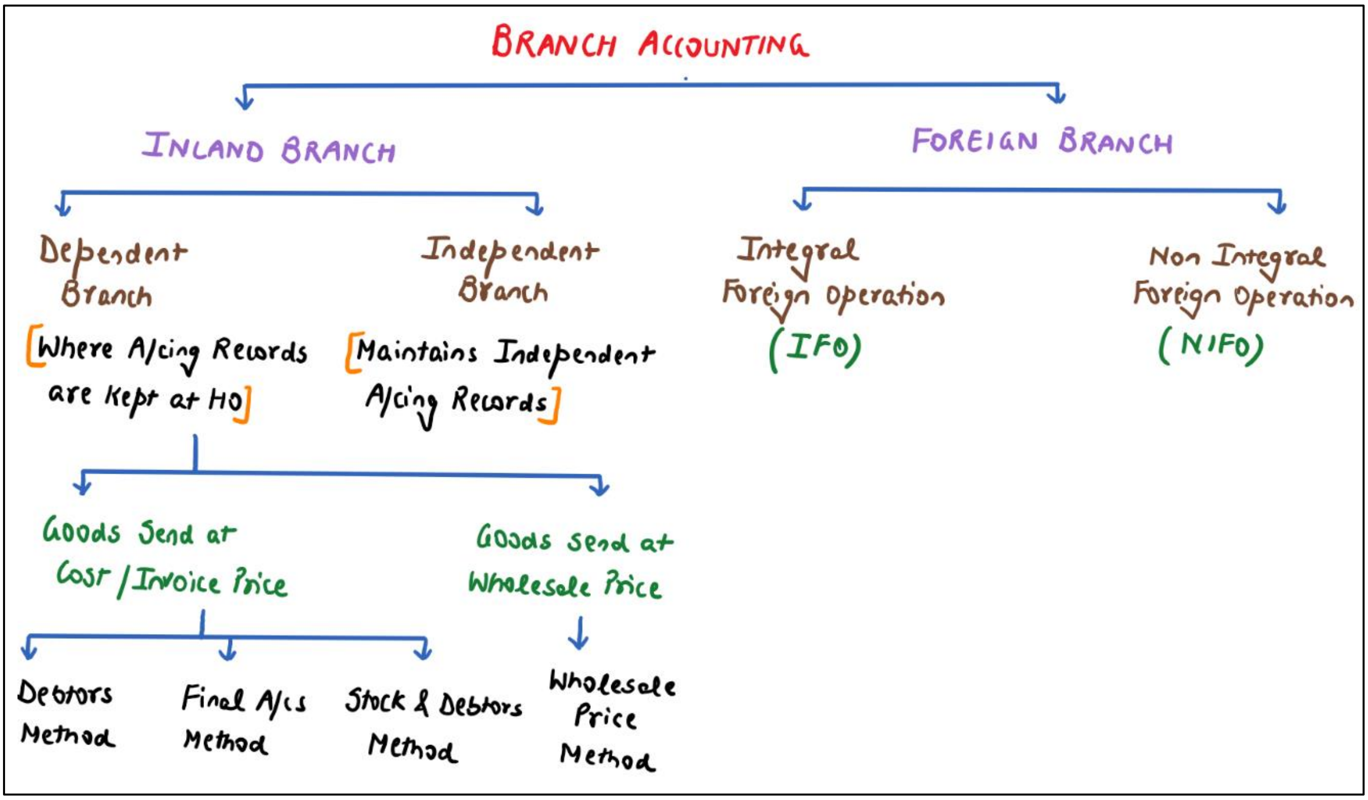
BRANCH ACCOUNTING

CH 6

"To succeed in your mission, you must have single-minded devotion to your goal."

MEANING

A Branch can be described as any establishment carrying on either the same or substantially same activity as that carried on by Head Office.
Branch offices are of a great utility in the sense that they allow business to be expanded closer to the clients and hence they facilitate face to face interaction with customers.



Difference between Branch and Department

Branch: Establishment at location different from Head Office to carry either same or substantially same activity as carried on by Head Office

Department: Division of a large organization dealing with a various kind of activity at the same location.

Let's take an example of a CA Firm working in the field of Auditing, Taxation & Finance having office at Mumbai, Chennai and Delhi practicing such fields. The CA firm has various branches in different cities, i.e., Delhi, Mumbai and Chennai, also it has various department of Auditing, Taxation and Finance at one particular branch (location).

DISTINCTION B/W BRANCH & DEPARTMENTAL ACCOUNTS

BASIS	BRANCH ACCOUNTS	DEPARTMENTAL ACCOUNTS
Maintenance of Accounts	Branch accounts may be maintained either at branch or at head office.	Departmental accounts are maintained at one place only.
Allocation of common expenses	No allocation problem arises since the expenses in respect of each branch can be identified.	Common expenses are distributed among departments concerned on some equitable basis considered suitable in the case.
Reconciliation	Reconciliation of head office and branch accounts is necessary in case of independent branches at the end of the accounting year.	No such problem arises.
Conversion of foreign currency figures	At the time of finalization of accounts, conversion of figures of foreign branch is necessary.	No such problem arises in departmental accounts.

DEPENDENT BRANCH

DEBTORS METHOD

BRANCH ACCOUNT

Particulars	Amount	Particulars	Amount
To Balance b/d		By Balance b/d	
Stock (At Invoice Price)	xx	Creditors	xx
Debtors	xx	O/s Expenses	xx
Cash in hand	xx	By Stock Reserve (on Opening stock)	xx
Fixed Assets	xx	By Goods sent to branch (Loading)	xx
Prepaid expenses	xx	By Goods Returned to H.O. (At I.P.)	xx
To Goods sent to branch (At I.P.)	xx	By Bank (Remittances to H.O.)	
To Goods ret. to H.O. (Loading)	xx	• Cash Sales xx	
To Bank (Cash sent by H.O. to branch for expenses/Purchase of fixed assets)	xx	• Collection from Debtors xx • Recovery from Insurance Co. xx • Expenses paid by branch (xx)	xx
To Stock Reserve (on Closing stock)	xx	By Balance c/d	
To Balance c/d		Stock (At I.P.)	xx
Creditors	xx	Debtors	xx
O/s Expenses	xx	Cash in hand	xx
To Net Profit (Bal. Fig.)*	xx	Fixed Assets	xx
		Prepaid expenses	xx
		By Net Loss (Bal. Fig.)*	xx
	XXX		XXX

*Any one of these

1) Sales Return by Debtor

Branch A/c

	X

Memo. Debtors A/c

	By Sales Return ✓

2) Sales Return by Debtors directly to HO

Debtors ⟶ Branch ⟶ HO

Branch A/c

	By Goods Returned to HO ✓

Memo. Debtors A/c

	By Sales Return ✓

3) Discount Allowed, Bad debts etc.

Branch A/c : No Effect

Memo. Debtors A/c: Written on Cr. side

4) Normal / Abnormal Loss

Branch A/c : No Effect

Shown in Memo. Stock A/c

Note:

1) If Insurance claim Received:
Remittance to HO will increase or Closing cash will increase

2) If Insurance claim not received:
Insurance claim Receivable shown under closing assets.

FINAL ACCOUNTS METHOD

BRANCH TRADING AND P&L A/C

Particulars	Amount	Particulars	Amount
To Opening stock (at cost)	xx	By Sales	
To Goods sent to branch xx		Cash xx	
(-) Returns (xx)	xx	Credit xx	
To Direct Expenses	xx	(-) Sales Return (xx)	xx
To Gross Profit (Bal. Fig.)	xx	By Abnormal Loss	xx
		By Closing stock (at cost)	xx
	XXX		XXX
To Indirect expenses	xx	By Gross Profit	xx
To Abnormal Loss	xx	By Discount received	xx
To Net Profit (Bal. Fig.)	xx		
	XXX		XXX

STOCK & DEBTORS METHOD

Branch Stock Account (At Invoice Price)

Particulars	Amount	Particulars	Amount
To Balance b/d	xx	By Goods sent to branch (returns)	xx
To Goods sent to branch	xx	By Bank (Cash Sales)	xx
To Branch Debtors A/c (Returns)	xx	By Branch Debtors A/c (Credit Sale)	xx
To Surplus transferred to Branch adjustment [SP > IP]	xx	By Shortage/Abnormal Loss	xx
		By Branch Adjustment (Normal loss)	xx
		By Balance c/d	xx
	XXX		XXX

Note In case of Branch Stock Account, if Balance figure is on credit side then:
Case 1: Closing stock not given → then balance figure will be considered as Closing Stock.
Case 2: Closing stock is given → then consider balance figure to be shortage/abnormal loss and separate the same accordingly in Branch adjustment & Branch P&L account.

Branch Adjustment Account

Particulars	Amount	Particulars	Amount
To Goods sent to branch-Returns (Loading)	xx	By Stock Reserve (Opening stock)	xx
To Stock Reserve (Closing stock)	xx	By Goods sent to branch (Loading)	xx
To Abnormal Loss (Loading)	xx	By Surplus transferred from Branch Stock A/c	xx
To Branch Stock (Normal loss)	xx		
To Branch P&L {Gross Profit}	xx		
	XXX		XXX

Branch Expenses Account

Particulars	Amount	Particulars	Amount
To Bank A/c (expenses) [like printing & stationery, salaries, rent & rates, etc.)	xx	By Branch P & L A/c	xx
	XXX		XXX

Branch P & L Account

Particulars	Amount	Particulars	Amount
To Branch Expenses A/c	xx	By Branch Adjustment (G.P.)	xx
To Branch Debtors A/c Discount Bad Debts	xx	By Branch Cash a/c (Claim received from insurance Co.)	xx
To Abnormal Loss (Cost)	xx		
To Net Profit (Bal. Fig.)	xx		
	XXX		XXX

Goods Sent to Branch Account

Particulars	Amount	Particulars	Amount
To Branch stock A/c	xx	By Branch stock A/c	xx
To Branch Adjustment A/c	xx	By Branch Adjustment A/c	xx
To Purchases/Trading A/c (Bal. Fig.)	xx		
	XXX		XXX

Branch Debtors Account

Particulars	Amount	Particulars	Amount
To Balance b/d	xx	By Branch stock A/c (Returns)	xx
To Branch stock A/c (Credit Sales)	xx	By Branch P&L A/c (Discount, Bad Debts, etc.)	xx
		By Bank A/c (Collection)	xx
		By Balance c/d	xx
	XXX		XXX

Reasons/Objectives for sending goods on invoice price by Head Office to the Branch

a) To keep secret from the branch manager, cost price of the goods & profit made, so that branch manager may not start a rival and competitive business with the concern;

b) To have effective control on stock i.e stock at any time must be equal to opening stock plus goods received from head office minus sales made at branch.

c) To dictate pricing policy to its branches, as well as save work at branch because prices have already been decided.

WHOLESALE PRICE METHOD

TRADING AND P&L A/C

Particulars	Head Office	Branch	Particulars	Head Office	Branch
To Opening stock	√	√	By Goods sent to Branch	√	×
To Purchases	√	×	By Sales	√	√
To Goods Received from Head Office	×	√	By Closing Stock	√	√
To Gross Profit	√	√		×	
	XXX	XXX		XXX	XXX
To Indirect expenses	√	√	By Gross Profit	√	√
To Stock Reserve	√	×			
To Net Profit	√	√			
	XXX	XXX		XXX	XXX

INDEPENDENT BRANCH

Features of Accounting System

1. Branch maintains its entire book of accounts under double entry system.
2. Branch opens in its books a Head Office Account to record all the transactions that takes place between Head Office & Branch.
3. Head Office maintains a Branch account to record these transactions.
4. Branch prepares its trial balance, Trading & P & L a/c at the end of accounting period & sends copy of these statements to Head Office for incorporation.
5. After receiving final statement from branch, Head Office reconciles between the two – Branch A/c in Head Office Books & Head Office A/c in Branch Books.
6. Head Office prepares necessary entries to incorporate Branch trial balance in its books.

JOURNAL ENTRIES

S.No.	Transaction	Books of H.O.	Books of Branch
1	Goods Dispatched by Head Office		
2	Remittance by Branch to Head Office		
3	Head Office sending cash to Branch		
4	Direct purchases by Branch		
5	Purchases by Branch but payment by Head Office		
6	Sales by Branch		
7	Collection from Debtors by branch		
8	Collection from Debtors directly by Head Office		
9	Expenses incurred at Branch		
10	Expenses of Branch paid by Head Office		
11	Head Office expenses charged to Branch (Allocation to Branch)		

12	Transfer of goods from one branch to another		
13	*Fixed Assets maintained at Branch*		
a)	Fixed Asset purchased by Branch		
b)	Fixed Asset purchased by Branch paid by Head Office		
c)	Depreciation on the above		
14	*Fixed Asset A/c maintained at HO*		
a)	Fixed asset purchased at Branch & recorded at Head Office Books		
b)	Branch Fixed Asset recorded in HO books & payment by HO		
c)	Depreciation on the above		
15	Goods in Transit		
16	Cash in Transit		

<u>Question</u>

Particulars	Head Office		Branch	
	Dr.	Cr.	Dr.	Cr.
Goods sent to Branch		1,50,000		
Goods Received from Branch			1,40,000	
Branch Account	1,12,000			
Head Office Account				78,500

Reasons for Disagreement:
On analysis, the following were revealed:
1. ₹ 15,000 remitted by branch has not been received, hence not recorded in H.O books
2. Direct collection of ₹ 10,500 from branch customer by H.O not informed to branch. Hence not recorded by branch.
3. ₹ 14,500 paid by branch to H.O suppliers not recorded at H.O
4. H.O expenditure allocation to the branch ₹ 12,000 not recorded in the branch.
5. ₹7,500 being interest on F.D of H.O received by branch not recorded in H.O books.

Question
Mumbai Branch incurred an expenditure on advertisement of 10,000 on account of Chennai Branch.

FOREIGN OPERATIONS

AS-11

IFO → Integral foreign Operations

NIFO → Non-Integral foreign Operations

IFO	It is a foreign operation, the activities of which are integral part of those of the reporting enterprise. The business of IFO is carried on as if it were an extension of the reporting enterprises operations.
NIFO	It is a foreign operation that is not an integral foreign operation. The business of NIFO is carried on in substantially independent way by accumulating cash & other monetary items, incurring expenses, generating income & arranging borrowing in its own local currency.

INDICATORS OF NON-INTEGRAL FOREIGN OPERATIONS

- Control by reporting enterprises - While the reporting enterprise may control the foreign operation, the activities of foreign operation are carried independently without much dependence on reporting enterprise.
- Transactions with the reporting enterprises are not a high proportion of the foreign operation's activities.
- Activities of foreign operation are mainly financed by its operations or from local borrowings. In other words, it raises finance independently and is in no way dependent on reporting enterprises.
- Foreign operation sales are mainly in currencies other than reporting currency.
- All expenses by foreign operations are primarily paid in local currency, not in the reporting currency.
- Day-to-day cash flow of the reporting enterprises is independent of the foreign enterprises cash flows.
- Sales prices of the foreign enterprises are not affected by the day-to-day changes in exchange rate of the reporting currency of the foreign operation.
- There is an active sales market for the foreign operation product.

Monetary Items and Non-monetary Items:

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money. Cash, receivables and payables are examples of monetary items.

Non-monetary items are assets and liabilities other than monetary items. Fixed assets, investments in equity shares, inventories are examples of non-monetary assets.

Conversion Rates

	Particulars	IFO	NIFO
1.	Opening Stock		
2.	Expenses & Incomes		
3.	Monetary Items (Cash, Bank, Debtors, Creditors, Loan, B/R, B/P)		
4.	Closing Stock		
5.	Non-Monetary Items (Fixed Assets & Depreciation on it)		
6.	Goods received from Head Office /Remittance to HO and Head Office account balance		
7.	Difference in Trial Balance (Exchange Difference)		

CHANGE IN CLASSIFICATION

Integral to Non-Integral

(i) Translation procedure applicable to non-integral shall be followed from the date of change.

(ii) Exchange difference arising on the translation of non-monetary assets at the date of re-classification is accumulated in foreign currency translation reserve.

Non-Integral to Integral

(i) Translation procedure as applicable to integral should be applied from the date of change.

(ii) Translated amount of non-monetary items at the date of change is treated as historical cost.

(iii) Exchange difference lying in foreign currency translation reserve is not to be recognized as income or expense till the disposal of the operation even if the foreign operation becomes integral.

ASSIGNMENT QUESTIONS

TOPIC 1: DEPENDENT BRANCH: DEBTORS METHOD & FINAL ACCOUNTS METHOD

Question 1 Pg no._____

Ronaldo opened in 2020 a branch at Nagpur. It invoiced goods to branch at cost plus 25%

	Amount (₹)
Goods sent to branch (Invoice Price)	50,000
Cash sent to the Branch for expenses	8,000
Sales- Cash - Credit	22,000 23,000
Cash received from debtors	20,000
Bad Debts written off	600
Stock on 31st December (invoice price)	4,800

Prepare Branch Account in the books of Head Office.

Question 2 Pg no._____

Pawan, of Delhi has a branch at Jaipur. Goods are invoiced to the branch at cost plus 25%. The branch is instructed to deposit the receipts everyday in the head office account with the bank. All the expenses are paid through cheque by the head office except petty cash expenses which are paid by the Branch. From the following information, you are required to prepare Branch Account in books of Head office:

Stock at invoice price on 1.4.2020	1,64,000
Stock at invoice price on 31.3.2021	1,92,000
Debtors as on 1.4.2020	63,400
Debtors as on 31.3.2021	84,300
Furniture & fixtures as on 1.4.2020	46,800
Cash sales	8,02,600
Credit sales	7,44,200
Goods invoiced to branch by head office	12,56,000
Expenses paid by head office	2,64,000
Petty expenses paid by the branch	20,900
Furniture acquired by the branch on 1.10.2020 (payment was made by the branch from cash sales & collection from debtors)	5,000

Depreciation to be provided on branch furniture & fixtures @ 10% p.a. on WDV basis.

Question 3 Pg no._____

Fanna Cloth Mills opened a branch at Mumbai on 1st April, 2020. The goods were invoiced to the branch at selling price which was 125% of the cost to the head office. The following are the particulars of transactions relating to branch during the year ended 31st March,21

	₹	₹
Goods sent to branch at cost to head office		42,12,600
Sales: Cash Credit	18,76,050 26,61,450	 45,37,500
Cash collected from debtors		23,55,000
Discount allowed to debtors		23,550
Returns from debtors		15,000

Spoiled cloth in bales written off at invoice price		7,500
Cheques sent to branch for: Rent Salaries Other Expenses	1,08,000 2,70,000 52,500	4,30,500

Prepare Branch Account based on invoice price under Debtors method for ascertaining profit.

Question 4 *(RTP Nov 2019)* *Pg no.*_____

From the following particulars relating to Pune branch for the year ending December 31, 2021, prepare Branch Account in the books of Head office.

		₹
Stock at Branch on January1, 2021		10,000
Branch Debtors on January 1, 2021		4,000
Branch Debtors on Dec. 31, 2021		4,900
Petty cash at branch on January 1, 2021		500
Furniture at branch on January 1, 2021		2,000
Prepaid fire insurance premium on January 1, 2021		150
Salaries outstanding at branch on January 1, 2021		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 form 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 Salaries Petty Cash Insurance up to March 31, 2022	 2,000 2,400 1,000 600	6,000
Goods returned by the Branch		1,000
Goods returned by the debtors		2,000
Stock on December 31,2021		5,000
Petty Cash spent by branch		850
Provide depreciation on furniture 10% p.a.		

Goods costing ₹ 1,200 were destroyed on account of fire and a sum of ₹ 1,000 was received from the Insurance Company.

Question 5 *(ICAI Study Material)* *Pg no.*_____

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 ₹ 10,000 necessary for meeting immediate requirements of cash. On 31st March, 2020 the assets at the branch were as follows:

	₹ ('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, 2021 the invoice price of goods dispatched by the head office to the branch amounted to ₹ 1 crore 32 lakhs. Out of the goods received by it, branch sent back to head office goods invoiced at ₹ 72,000. Other transactions at branch during the year were as follows:

	₹ ('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, 2021 the branch purchased new furniture for ₹ 1 lakh for which payment was made by head office through a cheque.

On 31st March, 2021 branch expenses amounting to ₹ 6,000 were outstanding and cash in hand was again ₹ 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, 2021.

Question 6 *(ICAI Study Material)* *Pg no._____*

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 & prepare Branch Trading and P&L Account in the books of Head Office.

	₹		₹
Opening balance (1-1-2021) Impress Cash Sundry Debtors Stock: Transferred from H.O. Direct Purchases	 2,000 25,000 24,000 16,000	Bad Debts Discount to Customers Remittances to H.O. (recd. By HO)	1,000 2,000 1,65,000
Cash Sales	45,000	Remittances to H.O. (not recd. by H.O. so far)	 5,000
Credit Sales	1,30,000	Branch Exp. directly paid by HO	30,000
Direct Purchases Returns from Customers Goods sent to branch from H.O Transfer from H.O. for Petty Cash Exp.	45,000 3,000 60,000 4,000	Closing Balance (31-12-2021) Stock: Direct Purchase Transfer from H.O Debtors Imprest Cash Petty cash expenses	 10,000 15,000 ? ? 4,000

Question 7 *(ICAI Study Material)* *Pg no._____*

Sell Well who carried on a retail business opened a branch X on January 1st, 2021 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 2021	Feb 2021	March 2021
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 and remitted 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, 2021 amounted to ₹ 53,400 at invoice to branch. Record these transactions in the Head Office books, showing balances as on 31st March, 2021 and the branch gross profit for the three months ended on that date.

Question 8 *(ICAI Study Material)* *Pg no._____*

Arnold of Delhi, trades in Ghee and Oil. It has a branch at Lucknow. He dispatches 25 tins of Oil @ ₹ 1,000 per tin and 15 tins of Ghee @ ₹ 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
		₹	₹
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:	01-01-2021	31-12-2021
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:	01-01-2021	31-12-2021
Stock : Ghee	17,000	13,250
: Oil	27,000	44,750
Debtors	75,750	-
Cash on Hand	7,540	12,350
Furniture & Fittings	6,250	5,625
Plant/Machinery	-	

Addition to Plant/Machinery on 1-1-2021 ₹ 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 ₹ 2,000 p.m. General expenses incurred by H.O. ₹ 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)

Question 9 *(RTP May 2018 / RTP May 2021)* *Pg no._____*

Alpha Ltd. has a retail shop under the supervision of a manager. The ratio of gross profit to selling price is constant at 25 per cent throughout the year to 31st March, 2021. 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 in 25 per cent of any ascertained deficiency of branch stock. All goods were supplied to the branch in head office. From the under mentioned figures, calculate the commission due to manager for the year end 31st March, 2021.

	₹		₹
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		

TOPIC 2: DEPENDENT BRANCH: STOCK & DEBTORS METHOD

Question 10 *(ICAI Study Material)* *Pg no._____*

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. Following details relates to calendar year 2021. Branch does not maintain any books of account, but sends weekly returns to the Head Office:

	₹
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., 2021	60,000
Sales in the year – Cash – Credit	2,00,000 3,60,000
Sundry Debtors at Cochin as on 1st Jan. 2021	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. 2021 at invoice price	1,20,000

Prepare Branch accounts in the books of Head Office by Stock & Debtors method.

Question 11 *Pg no._____*

Concept, with its Head Office at Mumbai has a branch at Nagpur. Goods are invoiced to the Branch at cost plus 33-1/3%. The following information is given in respect of the branch for the year ended 31st March, 2021:

	₹
Goods sent to Branch (Invoice price)	4,80,000
Stock at Branch on 1.4.2020 (Invoice price)	24,000
Cash sales	1,80,000
Return of goods by customers to the Branch	6,000
Branch expenses (paid in cash)	53,500
Branch debtors balance on 1.4.2020	30,000
Discount allowed	1,000
Bad debts	1,500
Collection from Debtors	2,70,000
Branch debtors cheques returned dishonoured	5,000
Stock at Branch on 31.3.2021 (Invoice price)	48,000
Branch debtors balance on 31.3.2021	36,500

Prepare, under Stock & Debtors system, the following Ledger Accounts in the books of the Head Office:

(i) Nagpur Branch Stock Account
(ii) Nagpur Branch Debtors Account
(iii) Nagpur Branch Adjustment Account.

Also compute shortage of Stock at Branch, if any

Question 12

Pg no._____

Yuvraj Singh, a cloth trader of Kolkata opened a Branch at Kanpur on 1-4-2020. The goods were sent by Head Office to the Branch and invoiced at selling price to the Branch, which is 125% of the cost price of Head Office.

The following are the particulars relating to the transactions of the Kanpur Branch

	₹	₹
Goods sent to Branch (at cost to H.O.)		4,50,000
Sales—Cash —Credit		2,10,000 3,20,000
Cash collected from Debtors		2,85,000
Return from Debtors		10,000
Discount Allowed		8,500
Cash sent to Branch for Freight	30,000	
for Salaries	8,000	
for other expenses	12,000	50,000
Spoiled clothes written off at invoice price		10,000
Normal loss estimated at		15,000

Prepare Branch Stock Account, Branch Debtors Account and Branch Adjustment Account showing the net profit of the Branch.

Question 13 *(ICAI Study Material)*

Pg no._____

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, 2021:

	₹
Cost of goods sent to Branch at cost	2,00,000
Goods received by Branch till 31-12-2021 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	01-01-2021	31-12-2021
	₹	₹
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 head office and determine the Profit and Loss of the Branch for the year ended 31st December, 2021 by Stock & Debtors method.

Question 14

Pg no._____

Red and White of Mumbai started a branch at Bangalore on 1.4.2020 to which goods were sent at 20% above cost. The branch makes both cash sales and credit sales. Branch expenses are met from branch cash and balance money remitted to H.O. The branch does not maintain double entry books of account and necessary accounts relating to branch are maintained in H.O. Following further details are given for the year ending on 31.3.2021:

	₹
Cost of goods sent to branch	1,00,000
Goods received by branch till 31.3.2021 at Invoice price	1,08,000
Credit sales for the year	1,16,000
Closing debtors on 31.3.2021	41,600
Bad debts written off during the year	400
Cash remitted to H.O.	86,000
Closing cash on hand at branch on 31.3.2021	4,000
Cash remitted by H.O. to branch during the year	6,000
Closing stock in hand at branch at invoice price	12,000
Expenses incurred at branch	24,000

Draw up the necessary Ledger Accounts like Branch Debtors Account, Branch Stock Account, Goods sent to Branch Account, Branch Cash Account, Branch Expenses Account and Branch Adjustment A/c for ascertaining gross profit and Branch Profit and Loss A/c for ascertaining Branch profit.

Question 15 *(Inter Nov 2022) (10 Marks)*

Pg no._____

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:

	₹
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

i. On 1st April, 2021 the Stock in trade at the Branch at Selling Price amounted to ₹ 60,000 and the Debtors were ₹ 40,000.

ii. 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.

iii. The Closing Stock at Selling Price was ₹ 72,900.

iv. The expenses relating to the Branch for the year ended 31st 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.

TOPIC 3: DEPENDENT BRANCH: WHOLESALE PRICE METHOD

Question 16 *(ICAI Study Material)* Pg no._____

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, 2021:

	Head Office (₹)	Branch (₹)
Opening stock (as on 1.4.2020)	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, 2021.

Question 17 Pg no._____

Jhaveri Sons have their Head Office at Calcutta and a branch at Agra. The goods are sent to Branch at 20% less than the list price which is cost plus 100%

From the following particulars ascertain the profit made by the branch as well as the Head Office on wholesale basis:

	Head Office (₹)	Branch (₹)
Opening Stock (Cost/Invoice Price)	40,000	20,000
Purchases	4,00,000	-
Expenses	60,000	12,000
Goods destroyed by accident at invoice price	-	2,000
Sales at list Price	3,40,000	1,60,000
Goods sent to branch at invoice price	1,60,000	1,60,000

Question 18 *(ICAI Study Material)* Pg no.____

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 31.3.2021:

	₹
Stock at the outlet 1.4.20	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 31.3.21	36,000

Prepare following accounts in the books of Rahul Limited for the year ended 31.3.21

(a) Outlet Stock Account.

(b) Outlet Profit & Loss Account.

(c) Stock Reserve Account

TOPIC 4: INDEPENDENT BRANCH

Question 19 *(ICAI Study Material)* Pg no.____

Goods worth ₹ 50,000 sent by head office but branch has received till closing date goods for worth ₹ 40,000 only. Pass journal entry in books of H.O. & branch for goods in transit.

Question 20 *(ICAI Study Material)* Pg no.____

Give Journal Entries in the books of Branch A to rectify or adjust the following:

(i) Head Office expenses ₹ 3,500 allocated to the Branch, but not recorded in the Branch Books.

(ii) Depreciation of branch assets, whose accounts are kept by the Head Office not provided earlier for ₹ 1,500.

(iii) Branch paid ₹ 2,000 as salary to a H.O. Inspector, but the amount paid has been debited by the Branch to Salaries account.

(iv) H.O. collected ₹ 10,000 directly from a customer on behalf of the Branch, but no intimation to this effect has been received by the Branch.

(v) A remittance of ₹ 15,000 sent by the Branch has not yet been received by the Head Office.

(vi) Branch A incurred advertisement expenses of ₹ 3,000 on behalf of Branch B.

Question 21 Pg no.____

Show what journal entries would be passed by the Jaipur Head Office to record the following transactions in their Books on 31st March, 2021, the closing date:

(a) A remittance of ₹ 35,000 made by Sikar Branch to Head Office on 29thMarch, 2021 and received by the Head Office on 5th April, 2021.

(b) Goods of ₹ 63,000 sent by the Head Office to the Bikaner Branch on 28th March, 2021 and received by the later on 4th April, 2021.

(c) Sikar Branch paid ₹ 30,000 as salary to a visiting Head Office Official.

Question 22 *(ICAI Study Material)* Pg no.____

Pass necessary Journal entries in the books of an independent Branch of a Company, wherever required, to rectify or adjust the following:

(i) Income of ₹2,800 allocated to Branch by HeadOffice but not recorded in Branch books
(ii) Branch paid ₹ 3,000 as salary to a Head Office Manager, but the amount paid has been debited by the Branch to Salaries Account.
(iii) Branch incurred travelling expenses of ₹ 5,000 on behalf of other Branches, but not recorded in the books of Branch.
(iv) A remittance of ₹ 1,50,000 sent by the Branch has not received by Head Office on the date of reconciliation of Accounts.
(v) Head Office allocates ₹ 75,000 to the Branch as Head Office expenses, which has not yet been recorded by the Branch.
(vi) Head Office collected ₹ 30,000 directly from a Branch Customer. The intimation of the fact has been received by the Branch only now.
(vii) Goods dispatched by the Head office amounting to ₹ 10,000, but not received by the Branch till date of reconciliation. The Goods have been received subsequently.

Question 23 *(ICAI Study Material)* *Pg no._____*

Show adjustment Journal entry in the books of Head Office at the end of April, 2021 for incorporation of inter-branch transactions assuming that only Head Office maintains different branch a/cs in its books.

A. Delhi Branch:
(1) Received goods from Mumbai – ₹ 35,000 and ₹ 15,000 from Kolkata.
(2) Sent goods to Chennai – ₹ 25,000, Kolkata – ₹ 20,000.
(3) Bill Receivable received – ₹ 20,000 from Chennai.
(4) Acceptances sent to Mumbai – ₹ 25,000, Kolkata – ₹ 10,000.

B. Mumbai Branch (apart from the above):
(5) Received goods from Kolkata – ₹ 15,000, Delhi – ₹ 20,000.
(6) Cash sent to Delhi – ₹ 15,000, Kolkata – ₹ 7,000.

C. Chennai Branch (apart from the above):
(7) Received goods from Kolkata – ₹ 30,000.
(8) Acceptances and Cash sent to Kolkata – ₹ 20,000 and ₹10,000 respectively.

D. Kolkata Branch (apart from the above):
(9) Sent goods to Chennai – ₹ 35,000.
(10) Paid cash to Chennai – ₹15,000.
(11) Acceptances sent to Chennai – ₹15,000.

Question 24 *Pg no._____*

L Ltd. has its head office at Mumbai and two branches at Pune and Goa. The branches purchase goods independently. The Pune branch makes a profit of 33-1/3% on cost which the 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 following particulars, prepare the Trading and Profit and Loss Account of each of the branches and find out the profit or loss made by each of them after taking into account the reserve for unrealised profits:

Particulars	Pune Branch	Goa Branch
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 Adm. Expenses	13,250	7,000
Selling and Distribution Expenses	15,000	10,000

Information:
a. Opening stock at Pune Branch includes goods of ₹ 10,000 taken from Goa Branch,
b. Opening stock at Goa Branch includes goods of ₹ 17,000 taken from Pune Branch at cost to receiving branch,
c. The Pune Branch sales includes transfer of goods to Goa Branch at selling price ₹ 20,000
d. The sales of Goa Branch include transfer of goods to Pune Branch at selling price ₹ 15,000.
e. Closing stock at Pune Branch includes goods received from Goa Branch ₹ 5,000.
f. Closing stock at Goa Branch includes goods of ₹ 4,000 received from Pune Branch.

Question 25 *(ICAI Study Material)* *Pg no._____*

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 rent and 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., 2021 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., 2021 for the entire business

	H.O.		Branch	
	₹	₹	₹	₹
Raw materials purchased	35,000			
Direct wages	1,08,500			
Factory overheads	39,000			
Stock on 1-1-2021 Raw materials Finished goods	 1,800 13,000		 9,200	
Debtors	37,000			
Cash	22,000		1,000	
Administrative Salaries	13,900		4,000	
Salesmen's 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) On 28th Dec., 2021 the branch remitted ₹ 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 branch invoiced at ₹ 1,500 and these too have not yet been entered into the branch books. It is the company'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., 2021 was valued at ₹ 2,300.
(3) You are advised that:
  a. there were no stock losses incurred at the H.O. or at the branch.
  b. it is KP's practice to value finished goods stock at the H.O. at factory cost.
  c. there were no opening or closing stock of work-in-progress.
(4) Branch employees are entitled to a bonus of ₹ 156 under a bilateral agreement.

Question 26 *(ICAI Study Material)* *Pg no._____*

The following Trial balances as at 31st December, 2021 have been extracted from the books of Major & Co. 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.

	Head Office		Branch	
	Dr.	Cr.	Dr.	Cr.
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., 2021 (Note 2)		693		
Revenue Account		43,210		10,250
Branch Account	31,536			
Head Office Account				22,645
	2,28,470	2,28,470	42,616	42,616

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, 2021.
3. Includes goods received from Head Office at invoice price ₹ 4,565.
4. Goods invoiced by Head Office to Branch at ₹ 3,641 were in transit at 31st December, 2021, as was also a remittance of ₹ 3,500 from the Branch.
5. At 31st December, 2021, the following transactions were reflected in the Head Office books but unrecorded in the Branch books.

The purchase price of lorry, ₹ 2,500, which reached the Branch on December 25th; a sum received on December 30, 2021 from one of the Branch debtors, ₹ 750.

You are required:

(i) to record the foregoing in the appropriate ledger accounts in both sets of books;
(ii) to prepare a Balance Sheet as at 31st December, 2021 for the undertaking as a whole.

Question 27 *(ICAI Study Material)* *Pg no._____*

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, 2021.

Head Office Trial Balance

	₹	₹
Share Capital (Authorised: 10,000 Equity Shares of ₹ 100 each):		
Issued: 8,000 Equity Shares		8,00,000

Profit & Loss Account - 1-1-2021		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 2021		52,200
Cash Balance	62,730	
Branch Current Account	1,33,710	
	9,99,410	9,99,410

Branch Trial Balance

	₹	₹
Fixed Assets	95,000	
Profit for 2021		31,700
Stock	50,460	
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 Current Account in two sets of books is accounted for as follows:
Cash remitted by the Branch on 31st December, 2021, but received by the Head Office on 1st January 2022 - ₹ 3,000.
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) - ₹ 1,700.
Give the Branch Current Account in Head Office books after incorporating Branch Trial Balance through journal.

Question 28 *(RTP May 2020 / ICAI Study Material)* *Pg no._____*

On 31st March, 2021 Kanpur Branch submits the following Trial Balance to its Head Office at Lucknow

	₹ In Lacs
Debit Balances	
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, 2020	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, 2021 was valued at ₹ 62 lacs. On 29th March, 2021 the Head Office dispatched goods costing ₹ 10 lacs to its branch. Branch did not receive these goods before 1st April, 2021. Hence, the figure of goods received from Head Office does not include these goods. Also the head office has charged the branch ₹ 1 lac for centralised 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
(iii) Pass Journal Entries in the books of Head Office to incorporate whole of the Branch Trial Balance

Question 29 *(ICAI Study Material)* *Pg no._____*

AFFIX of Kolkata has a branch at Delhi to which the goods are supplied from Kolkata but cost thereof is not recorded in the Head Office books. On 31st March, 2021 Branch Balance Sheet was as follows:

Liabilities	₹	Assets	₹
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 30-9-2021, the following transactions took place at Delhi.

	₹		₹
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 of ₹ 2,000)	6,400	Building Account (further payment)	4,000
General Expenses	1,600	Discount earned	1,200
Fire Insurance (paid for 1 year)	3,200	Cash paid to Creditors	60,000
Remittance to H.O.	38,400	Cash in Hand	1,600
		Cash at Bank	28,000

Set out the Head Office Account in Delhi books and the Branch Balance Sheet as on 30-9-2021. Also give journal entries in the Delhi books.

Question 30 *(ICAI Study Material)* *Pg no._____*

Messrs Ramchand & Co., Hyderabad have 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 year and 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 Assets Account in the Head Office Books.

Trial Balance of the Delhi Branch as on 31-12-2021

Debit	₹	Credit	₹
Head office opening balance on 1-1-21	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
Opening Stock (H.O. goods at invoice prices)	4,000	Sundry Creditors	3,000
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, 2021, were as under: Furniture ₹ 5,000; Sundry Debtors ₹ 9,500; Cash ₹ 1,000, Creditors ₹ 30,000. The closing stock at branch of the head office goods at invoice price is ₹ 3,000 and that of purchased goods at cost is ₹ 1,000. Depreciation is to be provided at 10 per cent on branch assets

TOPIC 5: FOREIGN BRANCH

Question 31 *Pg no._____*

ABC Ltd. has head office at Delhi (India) and branch at New York (U.S.A). New York branch is an integral foreign operation of ABC Ltd. New York branch furnishes you with its trial balance as on 31st March, 2021 and the additional information given thereafter:

	Dr. ($)	Cr. ($)
Stock on 1st April, 2020	150	
Purchases and sales	400	750
Sundry Debtors and creditors	200	150
Bills of exchange	60	120
Sundry expenses	540	
Bank balance	210	
Delhi head office A/c		540
	1,560	1,560

The rates of exchange may be taken as follows:

- on 1.4.2020 @ ₹ 40 per US $
- on 31.3.2021 @ ₹ 42 per US $
- average exchange rate for the year @ ₹ 41 per US $.

New York branch account showed a debit balance of ₹ 22,190 on 31.3.2021 in Delhi books and there were no items pending reconciliation.

You are asked to prepare trial balance of New York branch in ₹ in the books of ABC Ltd.

Question 32 *(ICAI Study Material)* *Pg no._____*

A business having the Head Office in Kolkata has a branch in UK. The following is the trial balance of Head Office and Branch as at 31.03.2022:

Account Name	Dr.	Cr.
Fixed Assets (Purchased on 01.04.2019)	5,000	
Debtors	1,600	
Opening Stock	400	
Goods received from Head Office Account (Recorded in HO books as ₹ 4,02,000)	6,100	
Sales		20,000
Purchases	10,000	
Wages	1,000	
Salaries	1,200	
Cash	3,200	
Remittances to Head Office (Recorded in HO books as ₹ 1,91,000)	2,900	
Head Office Account (Recorded in HO books as ₹ 4,90,000)		7,400
Creditors		4,000

- Closing stock at branch is £ 700 on 31.03.2022.
- Depreciation @ 10% p.a. is to be charged on fixed assets.
- Prepare the trial balance after been converted in Indian Rupees.
- Exchange rates of Pounds on different dates are as follow:
  01.04.2019– ₹ 61; 01.04.2021– ₹ 63 31.03.2022 – ₹ 67

Question 33

Pg no._____

DM Delhi has a branch in London which is an integral foreign operation of DM. At the end of year 31st March, 2021, the branch furnishes the following trial balance in U.K. Pound:

	Dr. (Pound)	Cr. (Pound)
Fixed assets (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

In head office books, the branch account stood as shown below:

London Branch A/c

	₹		₹
To Balance b/d	20,10,000	By Bank	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 are given:

(a) Fixed assets are to be depreciated @ 10% p.a.

(b) On 31st March, 2021 :

a. Expenses outstanding - £ 400
b. Prepaid expenses - £ 200
c. Closing stock - £ 8,000

(c) Rate of Exchange :

a. 1st April, 2017 - ₹ 70 to £ 1
b. 1st April, 2020 - ₹ 76 to £ 1
c. 31st March, 2021 - ₹ 77 to £ 1
d. Average - ₹ 75 to £ 1

You are required to prepare:

(1) Trial balance, incorporating adjustments of outstanding and prepaid expenses, converting U.K. pound into Indian rupees.

(2) Trading and profit and loss account for the year ended 31st March, 2021 and the Balance Sheet as on that date of London branch as would appear in the books of Delhi head office of DM.

Question 34

Pg no._____

Moon Star has a branch at Verginia (USA). The Branch is a non-integral foreign operation of the Moon Star. The trial balance of the Branch as at 31st March, 2021 is as follows:

Particulars	Dr. (US $)	Cr. (US $)
Office equipments	48,000	
Furniture and Fixtures	3,200	
Stock (April 1, 2020)	22,400	
Purchases	96,000	
Sales		1,66,400
Goods sent from H.O	32,000	
Salaries	3,200	
Carriage inward	400	
Rent, Rates & Taxes	800	
Insurance	400	
Trade Expenses	400	
Head Office Account		45,600
Sundry Debtors	9,600	
Sundry Creditors		6,800
Cash at Bank	2,000	
Cash in Hand	400	
	2,18,800	2,18,800

The following further information's are given:

(1) Salaries outstanding $ 400.

(2) Depreciate office equipment and furniture & fixtures @10% p.a. at written down value.

(3) The Head Office sent goods to Branch for ₹15,80,000

(4) The Head Office shows an amount of ₹ 20,50,000 due from Branch.

(5) Stock on 31st March, 2021 -$21,500.

(6) There were no transit items either at the start or at the end of the year.

(7) On April 1, 2019 when the fixed assets were purchased the rate of exchange was ₹ 43 to one $. On April 1, 2020, the rate was 47 per $. On March 31, 2021 the rate was ₹ 50 per $. Average rate during the year was ₹ 45 to one $.

Prepare:

(a) Trial balance incorporating adjustments given converting dollars into rupees.

(b) Trading, Profit and Loss Account for the year ended 31st March, 2021 and Balance Sheet as on date depicting the profitability and net position of the Branch as would appear in the books of Moon Star for the purpose of incorporating in the main Balance Sheet

Question 35 *(RTP May 2023)* *Pg no._____*

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, 2021 is as follows:

Particulars	Dr. (US $)	Cr. (US $)
Office equipment (Cost)	56,400	
Opening Accumulated Depreciation (Office equipment)		5,400
Furniture and Fixtures (Cost)	36,000	
Opening Accumulated Depreciation (Furniture and Fixtures)		6,840
Opening Stock as on 1st April, 2020	24,500	
Purchases	96,500	
Sales		1,76,250
Salaries	4,250	
Carriage Inward	256	
Rent, Rates & Taxes	956	
Sundry debtors	12,560	
Sundry creditors		8,650
Cash at bank	2,540	
Cash in Hand	500	
Head office Account		37,322
	2,34,462	2,34,462

Following further information are given:

(i) Salaries outstanding as on 31st March, 2021 is US$ 600.

(ii) Depreciate office equipment and furniture & fixtures @ 10% at written down value.

(iii) Closing stock as on 31st March, 2021 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, 2021. 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 1/04/2020.

(vi) One furniture of carrying value of US $ 450 as on 01/04/2020 (cost: US $ 500 and Accumulated depreciation: US $ 50) has been sold for US $ 405 on 31/03/2021 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 passed for this sale of furniture in the above trial balance.

The rate of exchange on different dates are:

Date	1 US $ is equivalent to
1st April, 2020	64
31st December, 2020	70
31st March, 2021	75
Average for the year	72

You are required to prepare the trial Balance after incorporating adjustments given and converting US $ into rupees.

Question 36 *(ICAI Study Material)* Pg no._____

On 31st December, 2021 the following balances appeared in the books of Chennai Branch of an English firm having its HO office in New York:

	Amount (In ₹)	Amount (In ₹)
Stock on 1st Jan., 2021	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, 2021 was ₹ 6,37,500.

Branch account in New York books showed a debit balance of $ 13,400 on 31st December, 2021 and Furniture appeared in the Head Office books at $ 1,750.

The rate of exchange for 1 $ on 31st December, 2020 was ₹ 52 and on 31st December, 2021 was ₹ 51. The average rate for the year was ₹ 50.

Prepare in the Head Office books the Profit and Loss a/c and the Balance Sheet of the Branch assuming integral foreign operation.

Question 37 *(ICAI Study Material)* Pg no._____

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, 2021 and the additional information given thereafter:

	Dr.	Cr.
	Rupees in thousands	
Stock on 1st April, 2020	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	-
Bank balance	420	-
New York office a/c	-	1,620
	3,360	3,360

Additional information:

(a) Computers were acquired from a remittance of US $ 6,000 received from New York head office and paid to the suppliers. Depreciate Computers at 60% for the year.

(b) Unsold stock of Mumbai branch was worth ₹ 4,20,000 on 31st March, 2021.

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

a. on 1.4.2020 @ ₹ 40 per US $
b. on 31.3.2021 @ ₹ 42 per US $
c. Average exchange rate for the year @ ₹ 41 per US $

d. 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, 2021 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 31.3.2021 in New York books and there were no items pending reconciliation.

Question 38

Pg no._____

ABCD Ltd., Delhi has a branch in New York, USA, which is an integral foreign operation of the company. At the end of 31st March, 2021, the following ledger balances have been extracted from the books of the Delhi office and the New York Branch:

Particulars	Delhi (₹ '000)		New York (\$ '000)	
	Debit	Credit	Debit	Credit
Share Capital		1,250		
Reserves and Surplus		940		
Land	475			
Building (cost)	1,000			
Buildings Depreciation Reserve		200		
Plant & Machinery (cost)	2,000		100	
Plant & Mach. Depreciation Reserve		500		20
Trade receivables/payables	500	270	60	20
Stock (01-04-2020)	250		25	
Branch Stock Reserve		65		
Cash & Bank Balances	125		4	
Purchases/Sales	275	600	25	125
Goods sent to Branch		1,500	30	
Managing Director's salary	50			
Wages & Salaries	100		18	
Rent			6	
Office Expenses	25		12	
Commission receipts		275		100
Branch/H.O. Current A/c	800			15
Total	5,600	5,600	280	280

The following information is also available:

(1) Stock as at 31-03-2021
   a. Delhi – ₹ 2,00,000
   b. New York – \$ 10 (all stock received from Delhi)

(2) Head Office always sent goods to the Branch at cost plus 25%.

(3) Provision is to be made for doubtful debts at 5%.

(4) Depreciation is to be provided on Buildings at 10% and on Plant and Machinery at 20% on written down values.

You are required:

(a) To convert the branch Trial Balance into rupees, using following rates of exchange:

Opening rate 1 \$	= ₹ 50	Closing rate 1 \$	= ₹ 55
Average rate 1 \$	= ₹ 52	For Fixed assets 1 \$	= ₹ 45

(b) To prepare the Trading and Profit & Loss Account for the year ended 31st March, 2021, showing to the extent possible, Head Office and Branch results separately

Question 39 *(ICAI Study Material)* *Pg no._____*

Washington branch of XYZ Mumbai sent following trial balance as on 31st December, 2021:

	$	$
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, 2021	11,200	-
Goods from H.O.	64,000	
Expenses	5,000	-
	1,10,200	1,10,200

In the books of head office, the Branch A/c stood as follows:

Washington Branch A/c

	₹		₹
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 branch at cost plus 10% & branch sells goods at invoice price plus 25%. Machinery was acquired on 31st Jan., 2017, when $ 1.00 = ₹ 40. Rates of exchange were:

1st January, 2021	$ 1.00 = ₹ 46
31st December, 2021	$ 1.00 = ₹ 48
Average	$ 1.00 = ₹ 47

Machinery is depreciated @ 10% and the branch manager is entitled to a commission of 5% on the 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 Branch Trading & Profit and Loss A/c and the Branch A/c in the books of head office.

PRACTICE QUESTIONS

TOPIC 1: DEPENDENT BRANCH: DEBTORS METHOD & FINAL ACCOUNTS METHOD

Question 1 *(ICAI Study Material)* Pg no._____

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, 2021.

	₹		₹
Balances as on 1.1.2021:		Bad Debts	600
Stock	7,000	Goods returned by customers	500
Debtors	12,600	Salaries & Wages	6,200
Petty Cash,	200	Rent & Rates	1,200
Goods sent from H.O.	26,000	Sundry Expenses	800
Goods returned to H.O	1,000	Cash received from Debtors	28,500
Cash Sales	17,500	Balances as on 31.12.2021:	
Credit Sales	28,400	Stock	6,500
Allowances to customers	200	Debtors	9,800
Discount to customers	1,400	Petty Cash	100

Prepare:
(a) Branch Account (Debtors Method),
(b) Memorandum Branch Trading and Profit & Loss Account and
(c) Branch Stock Account, Branch Debtors Account, Branch Expenses Account & Branch P&L Account as per Stock & Debtors Method.
(Ans: Net Profit 9,400)

Question 2 Pg no._____

LMN is having branch at Mumbai. Goods are invoiced to the branch at 25% profit on sale. All expenses are paid by head office except petty expenses, which are met by the Branch. Prepare branch account in the books of head office:

	₹
Stock as on 1st April, 2020 (Invoice price)	40,000
Sundry Debtors as on 1st April, 2020	25,000
Cash in hand as on 1st April, 2020	1,000
Office furniture as on 1st April, 2020	4,000
Goods invoiced from the head office (invoice price)	1,80,000
Goods return to head office	6,000
Goods return by debtors	1,250
Cash received from Debtors	65,000
Cash sales	1,20,000
Credit sales	70,000
Discount allowed to debtors	300
Expenses paid by Head Office	
Salary	4,000
Staff Welfare	750

Telephone Expenses	1,200
Other Misc. Expenses paid by branch	700
Stock as on 31st March, 2021 (at invoice price)	35,000
Depreciation to be provided on branch furniture	10% p.a.

(Ans: Net Profit 47,150)

Question 3 Pg no._____

XYZ is having its Branch at Kolkata. Goods are invoiced to the branch at 20% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the Branch Manager. From the following particulars prepare branch account in the books of Head Office.

	₹		₹
Stock on 1st April 2020 (invoice price) Sundry Debtors on 1st April, 2020 Cash in hand as on 1st April, 2020 Office furniture on 1st April, 2020	30,000 18,000 800 3,000	Expenses paid by head office: Rent Salary Stationery & Printing	 1,800 3,200 800
Goods invoiced from the head office (invoice price)	1,60,000	Petty expenses paid by the branch	600
Goods return to Head Office	2,000	Discount allowed to debtors	160
Goods return by debtors	960	Credit sales	60,000
Cash received from debtors	60,000	Depreciation to be provided on branch furniture at 10% p.a	
Cash Sales	1,00,000	Stock on 31st March, 2021 (at invoice price)	28,000

(Ans: Net Profit 24,180)

Question 4 Pg no._____

M/s X has a branch at Delhi and the goods are invoiced to branch at a profit of 20% on invoice price. Head Office paid all the branch expenses from its bank account, except petty cash expenses which were met by the branch. Branch expenses directly paid by M/s X on behalf of Delhi branch amounted to ₹ 20,000. Following information is available of the transactions at Delhi branch for the year ended 31st December, 2021:

	As on 01-01-2021	As on 31-12-2021
Stock, at invoice price	80,000	1,00,000
Debtors	24,000	22,000
Petty cash	3,000	5,000

Transactions during the year ended 31st December, 2021:

	₹
Goods sent to branch, at invoice price	8,40,000
Goods returned by branch to head office, at invoice price	30,000
Cash sales	3,10,000
Credit sales	3,60,000
Cash sent for petty expenses	12,000
Bad debts at Delhi branch	2,000
Goods returned by debtors	2,000

Prepare Delhi Branch A/c (on cost basis) in the books of M/s X under Debtors System

(Ans: Net Profit 4,000)

Question 5 *(RTP May 2022)* *Pg no._____*

Mr. Chena Swami of Chennai trades in Refined Oil and Ghee. It has a branch at Salem. He despatches 30 tins 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 to expenditure directly paid by Head Office.

Following are the other details:

		Chennai HO	Salem B.O.
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 HO)	
Balance as on:	**01-04-2020**	**31-03-2021**
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 Branch Office)	
Balance as on:	**01-04-2020**	**31-03-2021**
Stock : Refined Oil	22,500	19,500
: Ghee	40,000	90,000
Debtors	1,80,000	?
Cash on Hand	25,690	?
Furniture & Fixtures	23,800	21,420

Additional information:

a) Addition to Building on 01-04-2020 ₹ 2,41,600 by H.O.

b) Rate of depreciation: Furniture & Fixtures @ 10% & Building @ 5% (already adjusted in above figure)

c) The Branch Manager is entitled to 10% commission on Branch profits after charging his commission.

d) The General Manager is entitled to a salary of ₹ 20,000 per month.

e) 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.

(Ans: Branch Profit 2,06,300 & Total Profit 8,61,520)

Question 6 *(ICAI Study Material)* *Pg no._____*

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, 2021:

	₹
Cost of goods sent to Branch at cost	2,00,000
Goods received by Branch till 31-12-2021 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	01-01-2021	31-12-2021
Stock	25,000 (Cost)	28,000 (Invoice Price)
Debtors	32,750	26,000
Cash in Hand	5,000	2,500

Prepare Branch Account in the books of the head office and determine the Profit and Loss of the Branch for the year ended 31st December, 2021 by Debtors method.

(Ans: Net Profit 16,250)

TOPIC 2: DEPENDENT BRANCH: STOCK & DEBTORS METHOD

Question 7 *(ICAI Study Material)* *Pg no._____*

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 2021, 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.

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, 2021	4,50,000
Sales during the year – Cash	15,00,000
Credit	27,00,000
Sundry Debtors at Bangalore as on 1st January, 2021	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, 2021 at invoice price	9,00,000

(Ans: Net Profit 2,67,000)

Question 8 *(Inter Nov 2020) (10 Marks) / (RTP Nov 2021) (Similar)* *Pg no._____*

Vijay & 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 head office. Following further details are given for the year ended 31st March, 2021:

	Amount (₹)
Goods received from Head office at Invoice Price	8,40,000
Goods returned to Head office at Invoice Price	60,000
Cash sales for the year 2020-21	1,85,000
Credit Sales for the year 2020-21	6,25,000
Stock at Branch as on 01-04-2020 at Invoice price	72,000
S. Debtors at Patna branch as on 01-04-2020	96,000
Cash received from Debtors	4,38,000
Discount allowed to Debtors	7,500
Goods returned by customers at Patna Branch	14,000
Bad debts written off	5,500
Amount recovered from Bad debts previously written off as Bad	1,000
Rent Rates & Taxes at Branch	24,000
Salaries & wages at Branch	72,000
Office Expenses (at Branch)	9,200
Stock at Branch as on 31-03-2021 at cost price	1,25,000

Prepare necessary ledger accounts in the books of Head office by following Stock and Debtors method and ascertain Branch profit.

(Ans: Net Profit 93,800)

Question 9

Pg no._____

Using the Stock and Debtors system, find out the profit or loss made at the Kolkata Branch in 2021.

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

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

(Ans: Net Profit 10,880)

Question 10 *(Inter May 2018) (10 Marks)*

Pg no._____

Ayan Ltd. invoices goods to its branch at cost plus 33 1/3%. 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.

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 invoiced at ₹ 48,000 to Branch on 31.03.2021 but not received by Branch before close of the year).	24,00,000
Return of goods to head office (invoice Price)	1,20,000
Credit Sales at Branch	1,20,000
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, 2021

(Ans: Net Profit 5,52,000)

Question 11 *(Inter Dec 2021) (10 Marks)* Pg no._____

Delta Ltd. has branch at Kanpur. Goods are invoiced from the Head office to the Branch at cost plus 50%. Branch remits all cash received to Head office and all the 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 31st March, 2021. Following information related to branch is given:

Particulars	₹	Particulars	₹
Stock on 1st April 2020 (Invoice price)	31,200	Surplus in stock (Invoice price)	600
Debtors on 1st April 2020	17,400	Goods returned by Debtors	3,000
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

(Ans: Net Profit 14,700)

Question 12 *(Inter May 2022) (10 Marks)* Pg no._____

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 31st March,2022.

Particular		Amount ₹
Stock on 1st April,2021 (invoice price)		12,000
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.
(Ans: Net Profit 49,500)

TOPIC 3: DEPENDENT BRANCH: WHOLESALE PRICE METHOD

Question 13 *Pg no._____*

N Limited has retail branch at Noida. Goods are sold to customers at cost plus 100%. The wholesale price is cost plus 80%. Goods are invoiced to Noida at wholesale price.
From the following particulars, find out the profit made by the Head Office and Noida Branch for the year ended 31st March, 2021 using invoice method.

	Head Office (₹)	Noida (₹)
Opening stock (as on 1.4.2020)	50,000	-
Purchases	3,00,000	-
Goods sent to branch (invoice value)	1,08,000	-
Sales	3,06,000	1,00,000
Expenses	90,000	4,000

Sales at Head Office are made only on wholesale basis and sales at branch are made only to customers. Stock at branch is valued at invoice price.
(Ans: Net Profit 86,000 & 6,000)

Question 14 *Pg no._____*

M/s. Sandeep having Head Office at Delhi has a Branch at Kolkata. The Head Office does wholesale trade only at cost plus 80%. The Goods are sent to Branch at the wholesale price viz. cost plus 80%.
The Branch at Kolkata wholly engaged in retail trade and the goods are sold at cost to Head Office plus 100%.
Following details are furnished for the year ended 31st March, 2021:

	Head Office	Kolkata Branch
Opening Stock (As on 01.04.2020)	1,25,000	
Purchases	21,50,000	
Goods sent to Branch (cost to H.O. plus 80%)	7,38,000	
Sales	23,79,600	7,30,000
Office Expenses	50,000	4,500
Selling Expenses	32,000	3,300
Staff Salary	45,000	8,000

You are required to prepare Trading and Profit & Loss Account of the Head Office and Branch for the Year ended 31st March, 2021.
(Ans: Net Profit 12,22,600 & 57,200)

Question 15 *Pg no._____*

From the following details of Western Branch Office of M/s. XYZ Corp. for the year ending 31st March, 2021, 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 01-04-2020	3,45,000
Goods sent during the year by HO to BO	16,10,000
Sales during the year	21,00,000
Expenses incurred at the branch	45,000

(Ans: Closing Stock 2,30,000; Stock reserve 45,000 & 30,000)

Question 16 *(ICAI Study Material)* *Pg no._____*

Following is the information of the Jammu branch of Best New Delhi for the year ending 31st March, 2021 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:

a. Stock as on 01.04.2020 (invoice price) 2,20,000
b. Goods sent during the year (invoice price) 11,00,000
c. Sales during the year 12,00,000
d. Expenses incurred at the branch 45,000

Ascertain

(i) the profit earned by the branch during the year

(ii) branch stock reserve in respect of unrealized profit.

(Ans: Net Profit 1,95,000)

TOPIC 4: INDEPENDENT BRANCH

Question 17 *(ICAI Study Material)* *Pg no._____*

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 31.3.2021, it was found that the goods dispatched by head office for ₹ 2,00,000 was received by the branch only to the extent of ₹ 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?

Question 18 *Pg no._____*

Global Limited has a branch which closes its books of account every year on 31stMarch. This is an independent branch which maintains books of account for recording their transactions.

You are required to show journal entries in the books of branch on 31stMarch, 2021 to rectify or adjust the following:

(a) Head Office allocates ₹ 1,35,000 to the branch as head office expenses, which have not yet been recorded by branch.

(b) Depreciation of branch fixed assets, whose accounts are kept by head office in its books, not yet recorded in the branch books, ₹ 1,15,000.

(c) Branch paid ₹ 1,40,000 as salary to an official from head office on visit to branch and debited the amount to its Salaries Account.

(d) Head Office collected ₹ 1,30,000 directly from a branch customer on behalf of the branch, but no intimation was received earlier by the branch. Now the branch learns about it.

(e) It is learnt that a remittance of ₹ 1,50,000 sent by the branch has not been received by head office till date.

Question 19 *Pg no._____*

Give Journal Entries in the books of Head Office to rectify or adjust the following:

(i) Goods sent to Branch ₹12,000 stolen during transit. Branch manager refused to accept any liability

(ii) Branch paid ₹ 15,000 as salary to the officer of Head Office on his visit to the branch.

(iii) On 28th March, 2021, the H.O. dispatched goods to the Branch invoiced at ₹ 25,000 which was not received by Branch till 31st March, 2021.

(iv) A remittance of ₹ 10,000 sent by the branch on 30th March, 2021, received by the Head Office on 1st April, 2021.

(v) Head Office made payment of ₹ 25,000 for purchase of goods by Branch and wrongly debited its own purchase account.

(vi) Depreciation ₹ 11,250 in respect of Branch Shop whose account is kept in HO Books.

(vii) Expenses ₹ 5,600 to be charged to the Branch for work done on its behalf by the Head Office.

Question 20 *(RTP Nov 2018)* *Pg no._____*

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 the Branch to Salaries Account.

(ii) A remittance of ₹ 1,50,000 sent by the Branch has not received by Head Office on the date of reconciliation of Accounts.

(iii) Branch assets accounts retained at head office, depreciation charged for the year ₹ 15,000 not recorded 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 been received by the Branch.

(vi) Goods dispatched by the Head office amounting to ₹ 50,000, but not received by the Branch till date of reconciliation.

(vii) Branch incurred advertisement expenses of ₹ 10,000 on behalf of other Branches, but not recorded in the books of Branch.

(viii) Head office made payment of ₹ 16,000 for purchase of goods by branch, but not recorded in branch books.

Question 21 *(Inter Jan 2021) (5 Marks) / (ICAI Study Material)* *Pg no._____*

Give Journal Entries in the books of Branch to rectify or adjust the following:

a) Branch paid ₹ 5,000 as salary to H.O supervisor, but the amount paid by branch has been debited to salary account in the books of branch.

b) Asset Purchased by branch for ₹ 25,000, but the Asset was retained in H.O. Books.

c) A remittance of ₹ 8,000 sent by the branch has not been received by H.O.

d) H.O. collected ₹ 25,000 directly from the customer of Branch but fails to give the intimation to branch.

e) Remittance of funds by H.O. to branch ₹ 5,000 not entered in branch books.

Question 22 *Pg no._____*

Head Office passes adjustment entry at the end of each month to adjust the position arising out of inter branch transactions during the month. From the following inter branch transactions in January, 2021 make entry in the books of Head Office:

a) Bombay Branch
   (i) Received goods ₹ 6,000 from Calcutta Branch, ₹ 4,000 from Patna Branch
   (ii) Sent Goods to ₹ 10,000 to Patna, ₹ 8,000 to Calcutta
   (iii) Received B/R ₹ 6,000 from Patna
   (iv) Sent Acceptance ₹ 4,000 to Calcutta, ₹ 2,000 to Patna
b) Madras Branch (Apart from the above)
   (v) Received goods ₹ 10,000 from Calcutta, ₹ 4,000 from Bombay
   (vi) Cash Sent ₹ 2,000 to Calcutta, ₹ 6,000 to Bombay
c) Calcutta Branch (Apart from the above)
   (vii) Sent Goods to Patna ₹ 6,000
   (viii) Paid B/P ₹ 4,000 to Patna, ₹ 4,000 cash to Patna

Question 23 — *Pg no._____*

Show adjustment Journal entry along with working notes in the books of Head Office at the end of April, 2021 for incorporation of inter-branch transactions assuming that only Head Office maintains different branch account in its books.

A. Delhi Branch:
   (1) Received goods from Mumbai – ₹ 1,40,000 and ₹ 60,000 from Kolkata.
   (2) Sent goods to Chennai – ₹ 1,00,000, Kolkata – ₹ 80,000.
   (3) Bill Receivable received – ₹ 80,000 from Chennai.
   (4) Acceptances sent to Mumbai – ₹ 1,00,000, Kolkata – ₹ 40,000.
B. Mumbai Branch (apart from the above):
   (5) Received goods from Kolkata – ₹ 60,000, Delhi – ₹ 80,000.
   (6) Cash sent to Delhi – ₹ 60,000, Kolkata – ₹ 28,000.
C. Chennai Branch (apart from the above):
   (7) Received goods from Kolkata – ₹ 1,20,000.
   (8) Acceptances and Cash sent to Kolkata – ₹ 80,000 and ₹40,000 respectively.
D. Kolkata Branch (apart from the above):
   (9) Sent goods to Chennai – ₹ 1,40,000.
   (10) Paid cash to Chennai – ₹ 60,000.
   (11) Acceptances sent to Chennai – ₹ 60,000.

Question 24 *(Inter July 2021) (10 Marks)* — *Pg no._____*

Manohar of Mohali has a branch at Noida to which the goods are supplied from Mohali but the cost thereof is not recorded in Head Office books. On 31st March, 2020 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		2,50,000

During the 6 months ending on 30-09-2020, following transactions took place at Noida:

	₹		₹
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 one year)	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.

(Ans: Head Office balance 2,58,800)

TOPIC 5: FOREIGN BRANCH

Question 25 Pg no._____

Ganesh Ltd. has head office at Delhi (India) and branch at New York (U.S.A). New York branch is an integral foreign operation of Ganesh Ltd. New York branch furnishes you with its trial balance as on 31st March, 2021 & the additional information given thereafter:

	Dr. ($)	Cr. ($)
Stock on 1st April, 2020	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 head office A/c		1,080
	3,120	3,120

The rates of exchange may be taken as follows:

- on 1.4.2020 @ ₹ 40 per US $
- on 31.3.2021 @ ₹ 42 per US $
- average exchange rate for the year @ ₹ 41 per US $.

New York branch account showed debit balance of ₹ 44,380 on 31.3.2021 in Delhi books & there were no items pending reconciliation. Prepare trial balance of New York in ₹ in books of Ganesh Ltd

Question 26 *(Inter Nov 2019) (5 Marks)* Pg no._____

Karan Enterprises having its Head Office in Mangalore, Karnataka has a branch in Greenville, USA. Following is the trial balance of Branch as at 31-3-2021:

Particulars	Amount ($) Dr.	Amount ($) Cr.
Fixed assets	8,000	
Opening inventory	800	
Cash	700	
Goods received from Head Office	2,800	
Sales		24,050
Purchases	11,800	
Expenses	1,800	
Remittance to head office	2,450	
Head office account		4,300
	28,350	28,350

(i) Fixed assets were purchased on 1st April, 2017.

(ii) Depreciation at 10% p.a. is to be charged on fixed assets on straight line method. ·

(iii) Closing inventory at branch is $ 700 as on 31-3-2021.
(iv) Goods received from Head Office (HO) were recorded at ₹1,85,500 in HO books.
(v) Remittances to HO were recorded at ₹1,62,000 in HO books.
(vi) HO account is recorded in HO books at ₹2,84,500.
(vii) Exchange rates of US Dollar at different dates can be taken as
1-4-2017 ₹63 1-4-2020 ₹65 and 31-3-2021 ₹67
Prepare trial balance after been converted into Indian rupees in accordance with AS-11.
(Ans: Exchange Loss 23,800)

Question 27

Pg no._____

Omega has a branch at Washington. Its Trial Balance as at 30th Sep., 2021 is as follows:

	Dr. (US $)	Cr. (US $)
Plant and machinery	1,20,000	-
Furniture and fixtures	8,000	-
Stock, Oct. 1, 2020	56,000	-
Purchases	2,40,000	-
Sales	-	4,16,000
Goods from Omega (H.O.)	80,000	-
Wages	2,000	-
Carriage inward	1,000	-
Salaries	6,000	-
Rent, rates and taxes	2,000	-
Insurance	1,000	-
Trade expenses	1,000	-
Head Office A/c	-	1,14,000
Trade debtors	24,000	-
Trade creditors	-	17,000
Cash at bank	5,000	-
Cash in hand	1,000	-
	5,47,000	5,47,000

The following further information is given:
(1) Wages outstanding – $ 1,000.
(2) Depreciate Plant and Machinery and Furniture and Fixtures @ 10 % p.a.
(3) The Head Office sent goods to Branch for ₹ 39,40,000.
(4) The Head Office shows an amount of ₹ 43,00,000 due from Branch.
(5) Stock on 30th September, 2021 – $ 52,000.
(6) There were no in transit items either at the start or at the end of the year.
(7) On September 1, 2019, when fixed assets were purchased, the rate of exchange was ₹ 38 to one $.
On October 1, 2020, the rate was ₹ 39 to one $.
On September 30, 2021, the rate was ₹ 41 to one $.
Average rate during the year was ₹ 40 to one $.

You are asked to prepare:
(a) Trial balance incorporating adjustments given under 1 to 4 above, converting dollars into rupees.
(b) Trading and Profit and Loss Account for the year ended 30th September, 2021 and Balance Sheet as on that date depicting the profitability and net position of the Branch as would appear in India for the purpose of incorporating in the main Balance Sheet.
(Ans: Exchange Gain 7,00,000 & Net Profit 27,01,600)

Question 28 *Pg no._____*

Omega Ltd., an Indian company has a branch at New York (USA). The trial balance of the Branch as at 31st March, 2021 is as follows:

Particulars	Dr. (US $)	Cr. (US $)
Fixed Assets	51,200	
Opening Stock	22,400	
Purchases/Sales	96,000	1,66,400
Goods sent from H.O	32,000	
Carriage inward	400	
Branch Expenses	4,800	
Head Office Account		45,600
Sundry Debtors/Creditors	9,600	6,800
Cash at Bank	2,400	
	2,18,800	2,18,800

The following further information is given below:

1) Expenses outstanding $ 400.
2) Depreciate Fixed Assets @ 10% p.a. at written down value.
3) The Head Office sent goods to Branch for ₹ 15,80,000.
4) The head office shown an amount of ₹ 20,50,000 due from Branch.
5) Closing Stock $ 21,500.
6) There were no transit items either at the start or at the end of the year.
7) On April 1, 2019 when the fixed assets were purchased the rate of exchange was ₹ 43 to one $. On April 1, 2020, the rate was ₹ 47 per $. On March 31, 2021, the rate was ₹ 50 per $. Average Rate during the year was ₹ 45 to one $.

Convert the USA Branch trial balance in ₹ assuming that Branch is an Integral Foreign Operation of the Company. Calculate Foreign Exchange gains/loss & show its Accounting Treatment as per AS11.

(Ans: Exchange Gain 1,08,400)

Question 29 *(RTP May 2019)* *Pg no._____*

M/s ABC & Co. has head office at New York (U.S.A.) and branch in Bangalore (India). Bangalore branch is an integral foreign operation of ABC & Co. Bangalore branch furnishes you with its trial balance as on 31st March, 2021 and the additional information given thereafter:

	Dr.	Cr.
	Rupees in thousands	
Stock on 1st April, 2020	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	-
Bank balance	420	-
New York office a/c	-	1,620
	3,360	3,360

Additional information:

(a) Computers were acquired from a remittance of US $ 6,000 received from New York head office and paid to the suppliers. Depreciate computers at 60% for the year.

(b) Unsold stock of Bangalore branch was worth ₹ 4,20,000 on 31st March, 2021.

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

- On 01.04.2020 @ ₹ 55 per US $
- On 31.03.2021 @ ₹ 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, 2021 and the balance sheet as on that date of Bangalore branch as would appear in the books of New York head office of ABC & Co. You are informed that Bangalore branch account showed a debit balance of US $ 29845.35 on 31.3.2021 in New York books and there were no items pending reconciliation.

(Ans: Net Loss 13,778.68)

Question 30 *(Inter May 2019) (8 Marks)* Pg no._____

M/s Ravi & Co. has head office at New York and branch at Delhi (India). Delhi branch is an integral foreign operation of M/s Ravi & Co. Delhi branch furnishes you with its Trial Balance as on 31st March, 2021 and the additional information thereafter:

	Dr.	Cr.
	Rupees in thousands	
Stock on 1st April, 2020	600	-
Purchases and Sales	1,600	2,400
Sundry Debtors and Creditors	800	600
Bills of Exchange	240	480
Wages	1,120	-
Rent, rates and taxes	720	-
Sundry Expenses	320	-
Computers	600	-
Bank Balance	520	-
Singapore Office a/c	-	3,040
Total	6,520	6,520

Additional information:

(a) Computers were acquired from remittance of US dollar 12,000 received from US Head Office & paid to suppliers. Depreciate Computers at the rate of 40% for the year.

(b) Closing Stock of Delhi branch was ₹ 15,60,000 on 31st March, 2021.

(c) The Rates of Exchange may be taken as follows:

(i) on 1.4.2020 @ ₹ 50 per US Dollar

(ii) on 31.3.2021 @ ₹ 52 per US Dollar

(iii) average Exchange Rate for the year @ ₹ 51 per US Dollar

(iv) conversion in US Dollar shall be made upto two decimal accuracy.

(d) Delhi Branch Account showed a debit balance of US Dollar 59,897.43 on 31.3.2021 in the Head Office books and there were no items pending for reconciliation.

In the books of Head office, you are required to prepare:

(1) Revenue statement for the year ended 31st March, 2021 (in US Dollar)

(2) Balance Sheet as on that date (in US Dollar)

(Ans: Net Loss 13,466.67)

Question 31 *(RTP Nov 2020) (Similar)/ (RTP Nov 2022)* *Pg no._____*

M & S Co. of Lucknow has a branch in Canberra, Australia. At the end of 31st March 2021, the following ledger balances have been extracted from the books of the Lucknow office and the Canberra.

Particulars	(₹ '000)		(Aust. Dollars in '000)	
	Debit	Credit	Debit	Credit
Capital		2,000		
Reserves and Surplus		1,000		
Land	500			
Building (cost)	1,000			
Buildings Depreciation Reserve		200		
Plant & Machinery (cost)	2,500		200	
Plant & Machinery Depreciation Reserve		600		130
Trade receivables/payables	280	200	60	30
Stock (01-04-2020)	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
Total	4,880	4,880	390	390

The following information is also available:

(i) Stock as at 31st March, 2021
Lucknow ₹ 1,50,000 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 written down value.

You are required to:

(1) Convert the Branch Trial Balance into rupees by using the following exchange rates:

Opening rate 1 A $ = ₹ 50
Closing rate 1 A $ = ₹ 53
Average rate 1 A $ = ₹ 51.00
For Fixed Assets 1 A $ = ₹ 46.00

(2) Prepare Trading and Profit and Loss Account for the year ended 31st March 2021 showing to the extent possible H.O. results and Branch results separately

(Ans: Exchange Loss 208 & Net Profit Combined 4,668.625)

Question 32 *(ICAI Study Material)* *Pg no._____*

S & M Ltd., Bombay, have a branch in Sydney, Australia. Sydney branch is an integral foreign operation of S & M Ltd. At the end of 31st March, 2021, the following ledger balances have been extracted from the books of the Bombay Office and the Sydney Office:

	Bombay (₹thousands)		Sydney (Australian 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 (1.4.2020)	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**

The following information is also available:

(1) Stock as at 31.3.2021:

a. Bombay ₹ 1,50,000

b. Sydney A $ 3,125

You are required to convert the Sydney Branch Trial Balance into rupees;

(use the following rates of exchange :

Opening rate A $ = ₹ 20

Closing rate A $ = ₹ 24

Average rate A $ = ₹ 22

For Fixed Assets A $ = ₹ 18

(Ans: Exchange Loss 216)

Pg no.______

Question 33

The Washington branch of ABC India sent the following trial balance as on 31st December, 2021.

Particulars	$	$
Head office A/c	-	13,680
Sales	-	50,400
Debtors and creditors	2,880	2,040
Machinery	14,400	-
Cash at bank	720	-
Stock, 1 January, 2021	6,720	-
Goods from H.O.	38,400	-
Expenses	3,000	-
	66,120	**66,120**

In the books of head office, the Branch A/c stood as follows:

Washington Branch A/c

Particular	₹	Particular	₹
To Balance b/d To Goods sent to branch	4,86,000 23,55,600	By Cash By Balance c/d	23,25,600 5,16,000
	28,41,600		28,41,600

Goods are sent to the branch at cost plus 10% and the branch sells goods at invoice price plus 25%. Machinery was acquired on 31st January, 2016, when \$ 1.00 = ₹ 46.

Exchange rate per US\$ were:

1st January, 2021	₹ 64
31st December, 2021	₹ 66
Average Rate	₹ 65

Machinery is depreciated @ 10% on written down value basis. The branch manager is entitled to a commission of 5% on the profits of the branch.

You are required to prepare in the books of Head Office:

a) Branch Trading & Profit & Loss A/c in dollars.
b) Convert the Trial Balance of branch into Indian currency.
c) Branch Trading & Profit and Loss Account in Rupees
d) Branch Account

(Ans: Exchange Loss 45,960 & Net Profit 4,81,308)

Question 34 *(RTP May 2020) / (ICAI Study Material)* Pg no._____

"Assets and liabilities and income and expenditure items in respect of dependent foreign branches (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 Liabilities Account and the Loss, if any, is charged to statement of Profit and Loss." Comment.

AS 13: ACCOUNTING FOR INVESTMENTS

CH 7

"If People are not Laughing at your Goals, your Goals are too Small."
-Azim Premji

<table>
<tr><td>Meaning</td><td colspan="2">Investments are assets held by an enterprise for:
✓ Earning income by way of dividends, interest, and rentals,
✓ Capital appreciation, or
✓ Other benefits
to the investing enterprise.
<u>Note:</u> Assets held as stock-in-trade are not 'investments'.</td></tr>
<tr><td>Non Applicability</td><td colspan="2">This Standard does not deal with:
❖ Bases for recognition of interest, dividends and rentals earned on investments which are covered by AS:9 on Revenue Recognition
❖ Operating or finance leases
❖ Investments of retirement benefit plans and life insurance enterprises
❖ mutual funds and venture capital funds and/or the related asset management companies, banks and public financial institutions</td></tr>
<tr><td>Forms of Investments</td><td colspan="2">→ Some investments have no physical existence and are represented merely by certificates or similar documents (e.g., shares) while others exist in a physical form (e.g., buildings).
→ For some investments, an active market exists from which a market value can be established. For such investments, market value generally provides the best evidence of fair value. For other investments, an active market does not exist and other means are used to determine fair value.</td></tr>
<tr><td>Investment Properties</td><td colspan="2">An investment property is an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise. <u>An enterprise holding investment properties should account for them in accordance with cost model as prescribed in AS 10.</u></td></tr>
<tr><td rowspan="2">Classification of Investments</td><td>Current Investment</td><td>It 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.</td></tr>
<tr><td>Long Term Investment</td><td>It is an investment other than a current investment.</td></tr>
<tr><th colspan="3">COST OF INVESTMENTS</th></tr>
<tr><td>Direct Purchase</td><td colspan="2">The cost of an investment includes acquisition charges such as brokerage, fees and duties.</td></tr>
<tr><td>In exchange for share /Other Securities</td><td colspan="2">Cost of Investment is
➢ Fair Market Value (FMV) of Securities issued or
➢ Fair Market Value (FMV) of the Investment acquired
whichever is more clearly evident.</td></tr>
</table>

<table>
<tr><td><u>Note</u>
PARA 13</td><td>When right shares offered are subscribed for, the cost of the right shares is added to the carrying amount of the original holding. If rights are not subscribed for but are sold in the market, the sale proceeds are taken to the profit and loss statement. However, 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.</td></tr>
<tr><td colspan="2">CARRYING AMOUNT OF INVESTMENTS</td></tr>
<tr><td>Current Investments</td><td>Lower of Cost and Fair value.
Lower can be on Individual basis or category wise (i.e. equity shares, debentures, preference shares etc.) but not on global/overall basis.
However, the more prudent and appropriate method is to carry investments individually at the lower of cost and fair value.

Any reduction to fair value is debited to profit and loss account, however, if fair value of investment is increased subsequently, the increase in value of current investment up to the cost of investment is credited to the P&L A/c (and excess portion, if any, is ignored).</td></tr>
<tr><td>Long Term Investments</td><td>Usually Carried at cost.
Valuation determined on Individual investment basis.
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 P&L A/c.
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.

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.</td></tr>
</table>

<table>
<tr><td colspan="2">RECLASSIFICATION OF INVESTMENTS</td></tr>
<tr><td>Reclassified from Long Term to Current</td><td>Reclassified from Current to Long Term</td></tr>
<tr><td>Transfers are made at the lower of cost and carrying amount at the date of transfer</td><td>Transfers are made at the lower of cost and fair value at the date of transfer.</td></tr>
<tr><td colspan="2">DISPOSAL OF INVESTMENTS</td></tr>
<tr><td colspan="2">On disposal of an investment, the difference between the carrying amount and the disposal proceeds, net of expenses, is recognised in the profit and loss statement.</td></tr>
<tr><td colspan="2">DISCLOSURE REQUIREMENTS</td></tr>
<tr><td colspan="2">Following disclosures in financial statements in relation to investments are appropriate: -
(i) The accounting policies for the determination of carrying amount of investments.
(ii) The amounts included in profit and loss statement for:
a. Interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long term and current investments. Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes Paid.</td></tr>
</table>

	b. Profits and losses on disposal of current investments and changes in carrying amount of such investments. c. Profits and losses on disposal of long term investments and changes in the carrying amount of such investments.
(iii)	Significant restrictions on the right of ownership, realizability of investments or the remittance of income and proceeds of disposal.
(iv)	The aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments.
(v)	Other disclosures as specifically required by relevant statute governing the enterprise.

Valuation of Investments

	Cost	Market/ Fair value
Inv. in Equity shares		
A1	40	45
A2	50	48
A3	60	54
Inv. in Mutual Funds		
MF1	30	25
MF2	40	50

Investment
(Assets held for the purpose of earning Income)

- **Revenue Nature**
  - Dividend (Shares)
  - Interest (Deb./Bonds)
  - Rentals (Investment Property)
- **Capital Nature**
  - Capital Appreciation (Investment Property)

Classification of Investments
[On the basis of Period of Holding]

- **Current Investment / Short term Investment**
  [Intention to hold ≤ 1 Year]
  → Valued at Lower of Cost $\boxed{\text{or}}$ Market value / Fair value
- **Non Current Investment / Long Term Investment**
  [> 1 Year]
  → Valued at Cost [Unless there is permanent decline]

Classification of Investments
[On the basis of Income]

- **Fixed Income Bearing Scrips / Securities (FIBS)**
  → Debentures, Bonds, Govt. securities
- **Variable Income Bearing Scrips / Securities (VIBS)**
  → Equity shares

Fixed Income Bearing Scrips / Securities (FIBS)
(Journal Entries)

1) Purchase of Investment

Investment A/c – Dr
Interest on Inv. A/c – Dr
To Bank A/c

2) Receipt of Interest

Bank A/c – Dr
To Interest on Inv. A/c

3) Sale of Investment

Bank A/c – Dr
To Investment A/c
To Interest on Inv. A/c

4) Profit / (Loss) on Sale

Profit: Investment A/c – Dr
To P&L A/c

Loss: P&L A/c – Dr
To Investment A/c

Notes:

1) Interest is always calculated on Face Value

2) Transaction can be Ex-interest or Cum-interest

Ex-interest : Excluding Interest
Cum-interest : Including Interest

3) Cost of Investment

Purchase cost	xx
+ Brokerage / Commission	xx
+ Stamp Duty	xx
	xx

4) Incidental Expenses like brokerage, commission, etc.

Purchase : + Sale : –

Variable Income Bearing Scrips / Securities (VIBS)

1) Original Shares

Investor A → Company X Ltd.

No. of shares 100000
Face value 10
Issue Price 20

A

Inv. in Equity Shares of X Ltd. A/c – Dr 1L X 20
  To Bank A/c 1L X 20

X Ltd.

Bank A/c – Dr 1L X 20
  To Equity Share Cap. A/c 1L X 10
  To Securities Premium A/c 1L X 10

2) Bonus Shares : Shares issued free of cost

Original shares 100000
Bonus Scheme 1 for every 2
Bonus Shares = $1L \times \frac{1}{2}$ = 50000 shares

A

No Entry for Bonus Issue. Only no. of Shares will increase which reduces cost / Share

X Ltd.

Reserves & Surplus A/c – Dr 50000 X 10
  To Equity Share cap. A/c 50000 X 10

3) Right Shares : Offer given to existing shareholders to purchase shares at concessional rate. Shareholders can subscribe shares or they can sell their rights to outsiders.

Original shares = 100000

Right Issue = 1 for every 4 @ 15/share

Right Shares = $1L \times \frac{1}{4}$ = 25000 shares

(A)

Right Entitlement = 25000

Subscribe
15000 @ 15/sh.

Inv. in Eq. sh. - Dr 15000X15
To Bank A/c 15000X15

Sale of Rights
10000 @ 2/right
20000 trfd. to P&L A/c as per PARA 13 of AS-13

(X Ltd.)

Bank A/c - Dr 25000 X 15
To Equity share cap. A/c 25000 X 10
To Securities Premium A/c 25000 X 5

Note : Person (B) purchasing right from A

Total Cost of Investment to B = 17 per share

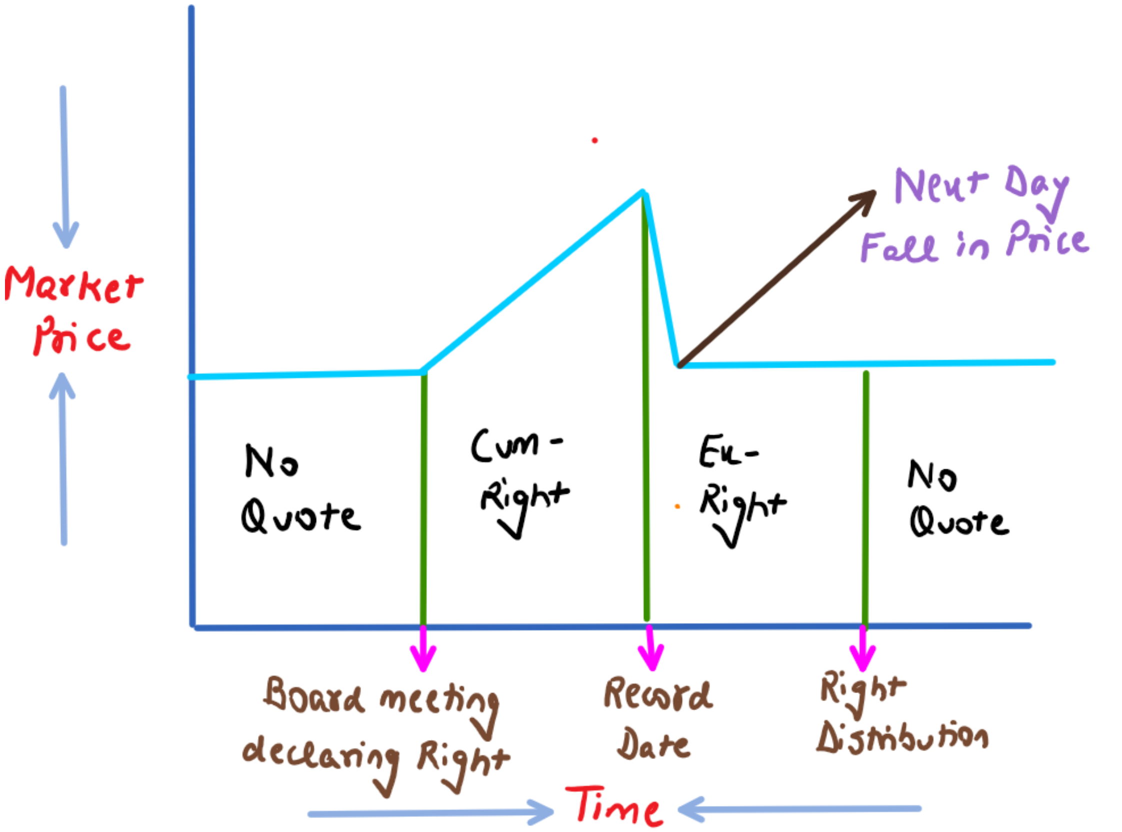
2 paid to A

15 paid to X Ltd.

Inv. in Equity shares of X Ltd. A/c - Dr 10000 X 17
To Bank A/c 10000 X 17

CUM RIGHT PURCHASE: (Exception to Para 13 of AS 13)

PARA 13 of AS 13: When right shares offered are subscribed for, the cost of the right shares is added to the carrying amount of the original holding. If rights are not subscribed for but are sold in the market, the sale proceeds are taken to the profit and loss statement. However, 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.



Example:

Cum Right Price of Share = 12000

Ex-Right Price of Share = 10000

So sale of right upto maximum of 2000 will be credited to Investment A/c. (Cost of Investment will reduce)

Any excess will be profit on sale of right. (tfd. to P&L A/c)

Case 1: Right Sale = 3000 → 2000 Credited to Investment A/c; 1000 credited / tfd. to P&L A/c

Case 2: Right Sale = 1500 → 1500 Credited to Investment A/c

ASSIGNMENT QUESTIONS

TOPIC 1: FIXED INCOME BEARING SCRIPS / SECURITIES

Question 1 Pg no._____

Mr. Tushil purchased 1,000 nos. 10% debentures of ₹ 100 each on 1st April, 2021 at ₹ 96 cum-interest, the previous interest date being 31st December, 2020.
Compute cost of investment & pass journal entry.

Question 2 *(ICAI Study Material)* Pg no._____

Mr. Purohit furnishes the following details relating to his holding in 8% Debentures (₹ 100 each) of P Ltd., held as Current assets:

1.4.2021	Opening balance – Face value ₹ 1,20,000, Cost ₹ 1,18,000
1.7.2021	100 Debentures purchased ex-interest at ₹ 98
1.10.2021	Sold 200 Debentures ex-interest at ₹ 100
1.1.2022	Purchased 50 Debentures at ₹ 98 ex-interest
1.2.2022	Sold 200 Debentures ex-interest at ₹ 99

Due dates of interest are 30th September and 31st March.
Mr. Purohit closes his books on 31.3.2022.
Brokerage at 1% is to be paid for each transaction (at ex-interest price). Show Investment account as it would appear in his books. Market value of 8% Debentures of P Limited on 31.3.2022 is ₹ 99. Assume FIFO method.

Question 3 *(RTP Nov 2020) (Similar) / ICAI Study Material* Pg no._____

In 2020, M/s. Wye 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, 2021, M/s. Bull & Bear purchased 10,000 of these debentures at ₹ 101 ex-interest price, also paying brokerage @ 1% of ex-interest amount of the purchase. On 1st March, 2022 firm sold all of these debentures at ₹ 103 ex-interest price, again paying brokerage @ 1 % of ex-interest amount. Prepare Investment Account in books of M/s. Bull & Bear for the period 1st Dec, 2021 to 1st Mar, 2022.

Question 4 *(ICAI Study Material)* Pg no._____

Following information is presented by Mr. Z, relating to his holding in 9% Central Government Bonds.
Opening balance (face value) ₹ 1,20,000, Cost ₹ 1,18,000 (Face value of each unit is ₹ 100).

1.3.2021	Purchased 200 units, ex-interest at ₹ 98.
1.7.2021	Sold 500 units, ex-interest out of original holding at ₹ 100.
1.10.2021	Purchased 150 units at ₹ 98, cum interest.
1.11.2021	Sold 300 units, ex-interest at ₹ 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.

Question 5 Pg no._____

Mitthan holds 2,000, 15% Debentures of ₹ 100 each in Seema Industries Ltd. as on April 1, 2021 at a cost of ₹ 2,10,000. Interest is payable on June, 30 and December, 31 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 required to prepare the Investment Account showing value of holdings on March 31, 2022 at cost, using FIFO Method

Question 6 *(RTP May 2023)* *Pg no._____*

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 1st 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 30th June and 31st December and was credited by the bank on the same date. 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.

Question 7 *Pg no._____*

Prepare Investment A/c in the above question assuming weighted average method is being followed.

TOPIC 2: VARIABLE INCOME BEARING SCRIPS / SECURITIES

Question 8 *(ICAI Study Material)* *Pg no._____*

Mr. X purchased 500 equity shares of ₹100 each in Omega Company Limited for ₹ 62,500 inclusive of brokerage and stamp duty. Some years later the company decided to capitalise its profit and to issue to the holders of equity shares one equity share as Bonus for every equity share held by them. Prior to capitalization, the shares of Omega Company Limited were quoted at ₹ 175 per share. After the capitalization, the shares were quoted at ₹ 92.50 per share. Mr. X sold the Bonus shares and received ₹90 per share. Show Investment A/c in X's books on average cost basis.

Question 9 *(ICAI Study Material)* *Pg no._____*

On 1.4.2021, Mr. Krishna Murty purchased 1,000 equity shares of ₹ 100 each in TELCO Ltd. @ ₹ 120 each from a Broker, who charged 2% brokerage. He incurred 50 paise per ₹ 100 as cost of shares transfer stamps. On 31.1.2022 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 & ₹ 90 per share respectively. On 31.3.2022 Mr. Krishna Murty sold bonus shares to a Broker, who charged 2% brokerage.
Prepare Investment Account in the books of Mr. Krishna Murty, who held shares as Current assets & closing value shall be made at Cost or Market value whichever is lower.

Question 10 *(ICAI Study Material)* *Pg no._____*

On 1st April, 2021, Rajat has 50,000 equity shares of P Ltd. at a book value of ₹ 15 per share (face value ₹ 10 each).

He provides you the further information:
On 20th June, 2021 he purchased another 10,000 shares of P Ltd. at ₹ 16 per share.
On 1st August, 2021, P Ltd. issued one equity bonus share for every six shares held by the shareholders.
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 ₹ 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 ₹ 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.

Question 11 *Pg no.____*

On 1st January 2021, Singh had 20,000 equity shares in X Ltd. Face value of the shares was ₹ 10 each but their book value was ₹ 16 per share. On 1st June 2021, Singh purchased 5,000 more equity shares in the company at a premium of ₹ 4 per share.
On 30th June, 2021, the directors of X Ltd. announced a bonus and rights issue. Bonus was declared at the rate of one equity share for every five shares held and these shares were received on 2nd August, 2021. The terms of the rights issue were:

a) Rights shares to be issued to the existing holders on 10th August, 2021.
b) Rights issue would entitle the holders to subscribe to additional equity shares in the Company at the rate of one share per every three held at ₹ 15 per share-the whole sum being payable by 30th September, 2021.
c) Existing shareholders may, to the extent of their entitlement, either wholly in part, transfer their rights to outsiders.
d) Singh exercised his option under the issue for 50% of his entitlements and the balance of rights he sold to Ananth for a consideration of ₹ 1.50 per share.
e) Dividends for the year ended 31st March, 2021, at the rate of 15% were declared by the Company and received by Singh on 20th October, 2021.
f) On 1st November, 2021, Singh sold 20,000 equity shares at a premium of ₹ 3 per share.

The market price of share on 31-12-2021 was ₹ 13. Show the Investment Account as it would appear in Singh's books on 31-12-2021 and the value of shares held on that date.

Question 12 *(RTP May 2020)* *Pg no.____*

Meera carried out the following transactions in the shares of Kumar Ltd.:

(a) On 1st April, 2021 she purchased 40,000 equity shares of ₹ 1 each fully paid up for ₹ 60,000.
(b) On 15th May 2021, Meera sold 8,000 shares for ₹ 15,200.
(c) At a meeting on 15th June 2021, the company decided:
   (i) To make a bonus issue of one fully paid-up share for every four shares held on 1st June 2021, and
   (ii) To give its members the right to apply for one share for every five shares held on 1st June 2021 at a price of ₹ 1.50 per share of which 75 paise is payable on or before 15th July 2021 and the balance, 75 paise per share, on or before 15th September, 2021.

The shares issued under (i) and (ii) were not to rank for dividend for the year ending 31st December 2021.

(a) Meera received his bonus shares and took up 4000 shares under the right issue, paying the sum thereon when due and selling the rights of the remaining shares at 40 paise per share; the proceeds were received on 30th September 2021.
(b) On 15th March 2022, he received a dividend from Kumar Ltd. of 15 per cent in respect of the year ended 31st Dec 2021.
(c) On 30th March he received ₹ 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 2022 transferring any profits or losses on these transactions to Profit and Loss account. Apply average cost basis. Expenses and tax to be ignored.

Question 13 *(Inter May 2018) (10 Marks)* *Pg no._____*

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
01.01.2021	600	Buy @ ₹ 20 per share
15.03.2021	900	Buy @ ₹ 25 per share
20.05.2021	1000	Buy @ ₹ 23 per share
25.07.2021	2500	Bonus Shares received
20.12.2021	1500	Sale @ ₹ 22 per share
01.02.2022	1000	Sale @ ₹ 24 per share

Addition information:

1) On 15.09.2021 dividend @ ₹ 3 per share was received for the year ended 31.03.2021.
2) On 12.11.2021 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 the premium 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 31.03.2021 and 31.03.2022.

Question 14 *Pg no._____*

A Limited purchased 5,000 equity shares (face value ₹ 100 each) of Allianz Limited for ₹ 105 each on 1st April, 2021. The shares were quoted cum dividend. On 15th May, 2021, Allianz Limited declared & paid dividend of 2% for year ended 31st March, 2021.

On 30th June, 2021 Allianz Limited issued bonus shares in ratio of 1:5. On 1st October, 2021 Allianz Limited issued rights share in the ratio of 1:12 @ 45 per share.

A limited subscribed to half of the rights issue and the balance was sold at ₹ 5 per right entitlement. The company declared interim dividend of 1% on 30th November, 2021.

Right shares were not entitled to dividend.

The company sold 3,000 shares on 31st December, 2021 at ₹ 95 per share. The company A Ltd. incurred 2% as brokerage while buying and selling shares.

You are required to prepare Investment Account in books of A Ltd. for the year ended 31st March, 2022.

TOPIC 3: COMBINED: INVESTMENT IN FIXED & VARIABLE BEARING SCRIPS

Question 15 *Pg no._____*

The following transactions of Nidhi took place during the year ended 31st March 2022:

Apr 1	Purchased ₹ 12,00,000, 8% bonds at ₹ 80.50 cum-interest. Interest is payable on 1st November and 1st May.
Apr 12	Purchased 1,00,000 equity shares of ₹ 10 each in X Ltd. for ₹ 40,00,000
May 1	Received half-year's interest on 8% bonds.
May 15	X Ltd. made a bonus issue of three equity shares for every two held. Nidhi sold 1,25,000 bonus shares for ₹ 20 each
Oct 1	Sold ₹ 3,00,000, 8% bonds at ₹ 81 ex- interest
Nov 1	Received half-year's bond interest.

Dec 1	Received 18% interim dividend on equity shares (including bonus shares) in X Ltd.

Prepare relevant investment account in the books of Nidhi for the year ended 31st March, 2022.

Question 16 *(Inter July 2021) (20 Marks)* Pg no.______

Mr. Z has made following transactions during the financial year 2020-21:

Investment 1: 8% Corporate Bonds having face value ₹ 100.

Date	Particulars
1.06.2020	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 8,000 equity shares at a book value of ₹ 190 per share
01.05.2020	Purchased 7,000 equity shares@ ₹ 230 on cum right basis; Brokerage of 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 per share. The remaining rights were subscribed.
15.09.2020	Dividend @ ₹ 6 per share for the year ended 31.03.2020 was received on 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 incurred extra.
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 G Ltd. as Long term Investment. On 15th May 2021, shares were quoted in the stock exchange @ ₹ 180.

You are required to:

a) Prepare Investment Accounts in the books of Mr. Z for the year 2020-21, assuming that the average cost method is followed.

b) Profit and loss Account for the year 2020-21, based on the above information.

c) Suggest values at which investment in equity shares should be reclassified in accordance with AS 13.

Question 17 *(RTP May 2019)* Pg no.______

A Ltd. purchased on 1st April, 2021 8% convertible debenture in C Ltd. of face value of ₹ 2,00,000 @ ₹ 108. On 1st July, 2021 A Ltd. purchased another ₹ 1,00,000 debenture @ ₹ 112 cum interest.

On 1st October, 2021 ₹ 80,000 debenture was sold @ ₹ 105. On 1st December, 2021, C Ltd. give option for conversion of 8% convertible debentures into equity share of ₹ 10 each. A Ltd. receive 5,000 equity shares in C Ltd. in conversion of 25% debenture held on that date. The market price of debenture and equity share in C Ltd. at the end of year 2021 is ₹ 110 and ₹ 15 respectively.

Interest on debenture is payable each year on 31st March, and 30th September. The accounting year of A Ltd. is calendar year. Prepare investment account in the books of A Ltd. on average cost basis.

TOPIC 4: CUM RIGHT PURCHASE

Question 18 *(RTP Nov 2020)* Pg no._____

Mr. X acquires 200 shares of a company on cum right basis for ₹ 60,000. He subsequently receives an offer 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?

Solution

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 market value ₹ 50,000 and ₹ 5,000 would be credited to the Profit & Loss account.

Question 19 *(RTP May 2021)* Pg no._____

On 1st April, 2021 Mr. Shyam had an opening balance of 1000 equity shares of X Ltd ₹ 1,20,000 (face value ₹100 each). On 5.04.2021 he further purchased 200 cum-right shares for ₹ 135 each. On 8.04.2021 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 ₹ 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 ₹ 3,400.

On 10.10.2021 Shyam sold 350 shares for ₹ 140 each.

On 31.03.2022, the market price of each share is ₹ 125 each.

You are required to prepare the Investment account in the books of Mr. Shyam for the year ended 31.03.2022 assuming that the shares are being valued at average cost.

PRACTICE QUESTIONS

TOPIC 1: FIXED INCOME BEARING SCRIPS / SECURITIES

Question 1 — *Pg no._____*

The following information is presented by Mr. Akash relating to his holding in 9% Government Bonds:

Opening balance as on 01.01.2021 (Face value) ₹ 60,000, Cost ₹ 59,000 (Face value of each unit is ₹ 100).

Date	Particulars
1.3.2021	Purchased 100 units, ex-interest at ₹ 100.
1.7.2021	Sold 250 units, ex-interest out of original holding at ₹ 100.
1.10.2021	Purchased 75 units at ₹ 98, cum interest.
1.11.2021	Sold 150 units, ex-interest at ₹ 99 out of original holdings.

Interest dates are 30th September and 31st March. Mr. Akash closes his books every year by 31st December.

Show the investment account as it would appear in his books. Mr. Akash was following FIFO method.

(Ans: Closing Balance Nominal 37,500 Amount 37,017; Interest tfd to P&L A/c 4,969)

Question 2 *(RTP May 2022)* — *Pg no._____*

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

Date	Particulars
1-4-2021	Opening balance 4000 debentures costing ₹ 98 each
1-6-2021	Purchased 2000 debentures @ ₹ 120 cum interest
1-9-2021	Sold 3000 debentures @ ₹ 110 cum interest
1-12-2021	Sold 2000 debentures @ ₹ 105 ex interest
31-1-2022	Purchased 3000 debentures @ ₹ 100 ex interest
31-3-2022	Market value of the investments ₹ 105 each

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

Mr. Wise closes his books on 31-3-2022. He incurred 2% brokerage for all his transactions.

Show investment account in the books of Mr. Wise assuming FIFO method is followed.

(Ans: Closing Balance Nominal 4,00,000 Amount 4,20,000; Interest tfd to P&L A/c 45,000)

Question 3 *(Inter Nov 2019) (10 Marks)* — *Pg no._____*

Mr. Harsh provides the following details relating to his holding in 10% debentures (face value of ₹ 100 each) of Exe Ltd., held as current assets:

1.4.2021	Opening balance – 12,500 debentures, cost ₹ 12,25,000
1.6.2021	Purchased 9,000 debentures @ ₹ 98 each ex-interest
1.11.2021	Purchased 12,000 debentures @ ₹ 115 each cum-interest
31.1.2022	Sold 13,500 debentures @ ₹ 110 each cum-interest
31.3.2022	Market value of debentures @ ₹ 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 31.3.2022. Show investment account as it would appear in his books assuming FIFO method is followed.

(Ans: Closing Balance Nominal 20,00,000 Amount 21,45,640; Interest tfd to P&L A/c 2,27,500)

Question 4 *(RTP May 2018) / (RTP Nov 2022)* Pg no._____

Muskaan purchased 5,000, 13.5% Debentures of Face Value of ₹ 100 each of Shorya Ltd. on 1st May 2021 @ ₹ 105 on cum interest basis. The interest on these instruments is payable on 31st & 30th of March & September respectively. On August 1st 2021 she 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. The market value of the debentures as at the close of the year was ₹ 106.

Prepare the Debenture Investment Account in the books of Muskaan for the year ended 31st Dec. 2021 on Average Cost Basis.

(Ans: Closing Balance Nominal 5,50,000 Amount 5,60,542; Interest tfd to P&L A/c 52,313)

TOPIC 2: VARIABLE INCOME BEARING SCRIPS / SECURITIES

Question 5 Pg no._____

On 01-04-2021, Mr. T. Shekharan purchased 5,000 equity shares of ₹ 100 each in V Ltd.₹ 120 each from a broker, who charged 2% brokerage. He incurred 50 paisa per ₹ 100 as cost of shares transfer stamps. On 31-01-2022 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 ₹ 90 per share respectively. On 31-03-2022, Mr. T. Shekharan sold bonus shares to a broker, who charged 2% brokerage.

Show the Investment Account in the books of T. Shekharan, who held the shares as Current Assets and closing value of investments shall be made at cost or market value whichever is lower.

(Ans: Closing Balance No. of Shares 5,000 Amount 4,10,000)

Question 6 Pg no._____

On 1st April 2021, Hasan has 20,000 equity shares of Vayu Ltd., at a book value of ₹ 20 per share (face value of ₹ 10 each).

He provides the following information:

(i) On 10th June 2021, he purchased another 5,000 shares in Vayu Ltd., @ ₹ 15 per share.

(ii) On 1st August 2021 Vayu Ltd., issued 1 bonus share for every 5 shares held by the shareholders.

(iii) On 31st August 2021, directors of Vayu Ltd. announced rights issue which entitle the shareholders to subscribe 2 shares for every 6 shares held @ of ₹ 15 per share. The shareholders can transfer their rights in full or in part.

Hasan sold 1/4th of his right shares holding to Harsh for a consideration of ₹ 3 per share and subscribed the rest on 31st of October 2021. Prepare Investment A/c in the books of Hasan as on 31st October, 2021

(Ans: Closing Balance No. of Shares 37,500 Amount 5,87,500)

Question 7 *(ICAI Study Material)* Pg no._____

On 1st April, 2021, 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, 2021, 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, 2021.

On 31st August, 2021 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, 2021, 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 31st October, 2021, Vijay received dividends from X Ltd. @ 20% for the year ended 31st March, 2021. Dividend for the shares acquired by him on 22nd June, 2021 to be adjusted against the cost of purchase.
On 15th November, 2021 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, 2022 assuming the shares are being valued at average cost.
(Ans: Closing Balance No. of Shares 30,000 Amount 4,02,000; Dividend tfd to P&L A/c 60,000)

Question 8 *(Inter Nov 2020) (10 Marks)* Pg no._____

On 1st April, 2021 Mr. H had 30,000 equity shares of ABC Ltd. at a book value of ₹ 18 per share (Nominal value 10 per share). On 10th June, 2021, 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, 2021.
(ii) Right shares were to be issued to the existing equity shareholders on 31st August, 2021. The company decides to issue one right share for every five equity share held at 20% premium and the due date for payment will be 30th September, 2021. 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, 2021 was declared by ABC Ltd. at the rate of 20% and received by Mr. H on 31st October, 2021. On 15th January, 2022 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, 2022, assuming the shares are valued at average cost.
(Ans: Closing Balance No. of Shares 28,000 Amount 3,77,200; Dividend tfd to P&L A/c 60,000)

Question 9 *(Inter Jan 2021) (10 Marks)* Pg no._____

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, 2021. On 1st September, 2021, 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 of two equity shares for every five shares held on 30th September, 2021.
(ii) Right shares are to be issued to the existing shareholders on 1st December, 2021. 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, 2021.
(iii) Existing shareholders were entitled to transfer their rights 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, 2021 at the rate of 20% was declared by K Ltd. and received by P Ltd. on 20th January, 2022.
(vi) On 1st February, 2022, P Ltd. sold half of its shareholdings at a premium of ₹ 4 per share.
(vii) The market price of share on 31st March, 2022 was ₹ 13 per share.
You are required to prepare the Investment account of P Ltd. for the year ended 31st March, 2022 and determine the value of shares held on that date, assuming the investment as current investment. Consider average cost basis for ascertainment of cost for equity share sold.
(Ans: Closing Balance No. of Shares 8,000 Amount 84,500; Dividend tfd to P&L A/c 16,000)

Question 10 *(ICAI Study Material)* *Pg no._____*

On 1.4.2021 Sundar had 25,000 equity shares of X Ltd. at a book value of ₹15 per share (Face value ₹10). On 20.6.2021, he purchases further 5,000 shares of X Ltd at ₹ 16 per share.
Directors of X Ltd. announced a bonus and rights issue. No dividend was payable on these issues. The terms of issue were as follows:
Bonus–basis 1:6 (16.8.2021)
Rights–basis 3:7 (31.8.2021) price ₹15 per share
Due date for payment - 30.9.2021
Rights are transferable in full or in part. Accordingly, Sundar sold 1/3 of his entitlement to Sekhar for a consideration of ₹2 per share. Dividend at 20% for year ending 31.3.2021 was declared by X Ltd & received the same on 31.10.2021. Dividends for the share acquired by him on 20.6.2021 are to be adjusted against the cost of purchase.
On 15.11.2021 Sundar sold 25,000 equity shares at premium of ₹5 per share.
Prepare the Investment A/c and Profit &Loss Account in the books of Sundar assuming that he closes his books on 31.12.2021 and shares are valued at average cost.
(Ans: Closing Balance No. of Shares 20,000 Amount 2,64,444; Dividend tfd to P&L A/c 50,000)

Question 11 *(ICAI Study Material)* *Pg no._____*

On 1st April, 2021 XY Ltd. has 15,000 equity shares of ABC Ltd. at a book value of ₹ 15 per share (face value ₹ 10 per share). On 1st June, 2021, XY Ltd. acquired 5,000 equity shares of ABC Ltd. for ₹ 1,00,000. ABC Ltd. announced a bonus and right issue.
Bonus was declared, at the rate of one equity share for every five shares held, on 1st July 2021.
Right shares are to be issued to the existing shareholders on 1st September 2021. The company will issue one right share for every 6 shares at 20% premium. No dividend was payable on these shares. Dividend for the year ended 31.3.2021 were declared by ABC Ltd. @ 20%, which was received by XY Ltd. on 31st October 2021.
<u>XY Ltd</u>

- Took up half the right issue
- Sold the remaining rights for ₹ 8 per share
- Sold half of its shareholding on 1st Jan, 2022 at ₹ 16.50 per share. Brokerage being 1%.

You are required to prepare Investment account of XY Ltd. for the year ended 31st March 2022 assuming the shares are being valued at average cost.
(Ans: Closing Balance No. of Shares 13,000 Amount 1,69,500; Dividend tfd to P&L A/c 30,000)

Question 12 *(Inter May 2022) (5 Marks)* *Pg no._____*

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 subscribe 1 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.
(Ans: Closing Balance No. of Shares 17,500 Amount 1,92,500; Loss on Valuation 9,386)

Question 13 *(Inter Nov 2022) (10 Marks)* Pg no._____

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. Saurabh on 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)
(Ans: Closing Balance No. of Shares 13,500 Amount 90,804; Dividend tfd to P&L A/c 5,000)

TOPIC 3: COMBINED: INVESTMENT IN FIXED & VARIABLE BEARING SCRIPS

Question 14 *(Inter Nov 2018) (10 Marks) / (RTP Nov 2021) (Similar)* Pg no._____

Following transactions of Nisha took place during the financial year 2021-22

1st April, 2021	Purchased 9,000 8% bonds of ₹ 100 each at ₹ 80.50 cuminterest. Interest is payable on 1st November and 1st May.
1st May, 2021	Received half year's interest on 8% bonds.
10 July, 2021	Purchased 12,000 equity shares of ₹ 10 each in Moon Limited for ₹ 44 each through a broker, who charged brokerage @ 2%.
1st Oct 2021	Sold 2,250 8% bonds at ₹ 81 Ex-interest.
1st Nov, 2021	Received half year's interest on 8% bonds.
15th Jan, 2022	Moon Limited made a rights issue of one equity share for every four Equity shares held at ₹ 5 per share. Nisha exercised the option for 40% of her entitlements and sold the balance rights in the market at ₹ 2.25 per share.
15th Mar, 2022	Received 18% interim dividend on equity shares of Moon Limited.

Prepare separate investment account for 8% bonds and equity shares of Moon Limited in the books of Nisha for the year ended on 31st March, 2022. Assume that the average cost method is followed.

(Ans: Bonds: Closing Balance Nominal 6,75,000 Amount 5,20,875 & Interest tfd to P&L A/c 63,000
Shares: Closing Balance No. of Shares 13,200 Amount 5,44,560; Dividend tfd to P&L A/c 23,760)

Question 15 *(Inter Dec 2021) (10 Marks)* Pg no._____

During the year ended 31st March 2021, Purple Ltd. entered into the following transactions:

1st April, 2020	Purchased ₹ 4,00,000, 10% Govt. Loan (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 Oct, 2020	Sold 80,000 10%, Govt. Loan at 75 ex-interest
15th Jan, 2021	XY Ltd. made a bonus issue of four equity shares for every three shares held. Purple Ltd. sold all of the bonus shares for ₹10 each.
1st Mar, 2021	Received Dividend @ 22% on shares in XY Ltd. for the year ended 31st December, 2020.

Prepare Investment Accounts in the books of Purple Ltd.

(Ans: Govt. Loan: Closing Balance Nominal 3,20,000 Amount 2,10,666 & Interest tfd to P&L A/c 35,999
Shares: Closing Balance No. of Shares 6,000 Amount 52,350 & Dividend tfd to P&L A/c 4,950)

Question 16 *(RTP Nov 2019)* Pg no._____

A Pvt. Ltd. follows the calendar year for accounting purposes. The company purchased 5,000 nos. of 13.5% Convertible Debentures of Face Value of ₹ 100 each of P Ltd. on 1st May 2021 @ ₹ 105 on cum interest basis. The interest on these instruments is payable on 31st March & 30th 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 31st December, 2021 the company received 10,000 equity shares of ₹ 10 each in P Ltd. on conversion of 20% of its holdings. The market value of the debentures and equity shares as at the close of the year were ₹ 106 and ₹ 9 respectively. Prepare the Debenture Investment Account & Equity Shares Investment Account in the books of A Pvt. Ltd. for the year 2021 on Average Cost Basis.

(Ans: Debentures: Closing Balance Nominal 4,40,000 Amount 4,48,434 & Interest tfd to P&L A/c 52,313 Shares: Closing Balance No. of Shares 1,00,000 Amount 90,000)

TOPIC 4 CUM RIGHT PURCHASE

Question 17 *(ICAI Study Material)* Pg no._____

Mr. X acquires 200 shares of a company on cum right basis for ₹ 70,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at ₹ 107 each. He does not subscribe but sells all the rights for ₹ 12,000. The market value of the shares after their becoming ex-rights has also gone down to ₹ 60,000. What should be the accounting treatment in this case?

AS 13: CASE Study- ASSIGNMENT QUESTIONS

Question 1

Give your comments on the following situations, each being independent of the other.

1) Current Investments are valued at ₹ 60 Lakhs, being the cost of acquisition, fair value of these investments on the Balance Sheet date is ₹ 48 Lakhs.
2) Current investments were acquired at a cost of ₹ 86 lakhs whereas their fair market value as on the Balance Sheet Date was ₹ 90 lakhs. Due to insufficiency of profits from operations, the Company would like to recognize the profit on these investments for 'improving' its Financial Statements.

Solution

1) As per AS 13 "Accounting for Investments", current investments should be carried at cost or fair value, whichever is lower. Here, the current Investment should be carried at fair value of ₹ 48 Lakhs, being the lower of ₹ 60 Lakhs (cost) or ₹ 48 Lakhs (fair value). The difference of ₹ 12 Lakhs should be charged to profit and loss account.
2) Current investment should be carried at cost or fair value, whichever is lower. In the given case, the current investments should be carried at cost of ₹ 86 Lakhs, being the lower of ₹ 86 Lakhs (cost) or ₹ 90 Lakhs (fair value).

Question 2

M/s Naren Garments Company Limited invested in the shares of another company on 1st November, 2021 at a cost of ₹ 3,00,000. It also earlier purchased Gold of ₹ 3,50,000 and Silver of ₹ 1,50,000 on 1st April, 2021. Market value as on 31st March, 2022 of above investments are as follows:

	₹
Shares	2,50,000
Gold	5,00,000
Silver	2,80,000

How above investments will be shown in the books of accounts of M/s Naren Garments Company Limited for the year ending 31st March, 2022 as per provisions of AS 13?

Solution

As per AS 13 'Accounting for Investments', for investment in shares - if the investment is purchased with an intention to hold for short-term period then it will be shown at the realizable value of ₹ 2,50,000 as on 31st March, 2022.

If equity shares are acquired with an intention to hold for long term period then it will continue to be shown at cost in the Balance Sheet of the company. However, provision for diminution shall be made to recognize a decline, if other than temporary, in the value of the investments.

As per the standard, investment acquired for long term period shall be shown at cost. Gold and silver are generally purchased with an intention to hold it for long term period until and unless given otherwise. Hence the investment in Gold and silver (purchases on 1st April 2021 shall continue to be shown at cost as on 31st March 2022 i.e. ₹ 3,50,000 and ₹1,50,000 respectively, though their realizable values have been increased. If held as short term then it should be valued at lower of cost or fair value (Market price)

Question 3

Albert Ltd. has made the following investments:

(a) Purchased the following equity shares from stock exchange on 1st June, 2021:

	Cost
Scrip X	1,80,000
Scrip Y	50,000
Scrip Z	1,70,000
	4,00,000

(b) Purchased government securities at a cost of ₹ 5,00,000 on 1st April, 2021. How will you treat these investments as per applicable AS in the books of the company for the year ended on 31st March, 2022, if the values of these investments are as follows

Shares	₹	₹
Scrip X	1,90,000	
Scrip Y	40,000	
Scrip Z	70,000	3,00,000
Government securities		7,00,000

Solution

As per AS 13 'Accounting for Investments', current investments should be carried at lower of cost and fair value determined either on an individual investment basis or by category of investment, but not on an overall (or global) basis.

Also as per standard, long-term investments are carried at cost except 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.

a) If the investment in shares is intended to be held as current investment then
Scrip X should be valued at cost i.e. ₹1,80,000 (lower of cost and fair value),
Scrip Y should be valued at fair value i.e. ₹ 40,000 (lower of cost and fair value) and
Scrip Z should be valued at fair value i.e. ₹ 70,000 (lower of cost and fair value).
The total loss of ₹ 1,10,000 on scrip's purchased on 1st June, 2021 is to be charged to profit and loss account for the year ended 31st March, 2022.

If investment is intended to be held as long term investment, then it will continue to be shown at cost in the balance sheet of the company. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of investments, such reduction being determined and made for each investment individually.

b) Value of government securities (purchased on 1st April, 2021) is to be shown at cost of ₹ 5,00,000 in the balance sheet as on 31.3.2022

Question 4

The Investment portfolio of XYZ Ltd. as on 31.03.2022 consisted of the following:

		(₹ In Lacs)	
	Current Investments	Cost	Fair Value as on 31.03.2022
1	1000 Equity Shares of A Ltd.	5	7
2	500 Equity Shares of B Ltd.	10	15
3	1000 Equity Shares of C Ltd.	15	12
		30	34

Give your comments on below:

(i) The company wants to value the above portfolio at ₹ 30 lakhs being lower of cost or fair market value.

(ii) Company wants to transfer 1000 Equity Shares of C Ltd. from current investments to long term investments on 31.03.2022 at cost of ₹ 15 lakhs.

Solution

As per AS 13 "Accounting for Investments", Valuation of current investments on overall (or global) basis is 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 ₹ 27 Lacs (A Ltd. shares at ₹ 5 lacs; B Ltd. shares at ₹ 10 lacs and C Ltd. shares at ₹ 12 lacs). The company's decision to value the portfolio at ₹ 30 lacs is not appropriate.

(ii) Moreover, 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. Hence, the company has to make transfer of 1,000 equity shares of C Ltd.at ₹ 12 lacs (fair value) and not ₹ 15 lacs (cost) as the fair value is less than cost.

Question 5 *(ICAI Study Material)*

ABC Ltd. wants to re-classify its investments in accordance with AS-13. Decide and state on the amount of transfer, based on the following information:

a) A portion of Current Investments purchased for ₹ 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 ₹ 25 lakhs.

b) Another portion of current investments purchased for ₹ 15 lakhs, to be reclassified as long term investments. The market value of these investments as on the date of balance sheet was ₹ 6.5 lakhs

c) Certain long-term investments no longer considered for holding purposes, to be reclassified as current investments. The original cost of these was ₹18 lakhs but had been written down to ₹ 12 lakhs to recognize permanent decline as per AS 13.

Solution

As per AS 13, 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.

a) In the first case, the market value of the investment is ₹ 25 lakhs, which is higher than its cost i.e. ₹ 20 lakhs. Therefore, the transfer to long term investments should be carried at cost i.e. ₹ 20 lakhs.

b) In the second case, the market value of the investment is ₹ 6.5 lakhs, which is lower than its cost i.e. ₹ 15 lakhs. Therefore, the transfer to long term investments should be carried in the books at the market value i.e. ₹ 6.5 lakhs. The loss of ₹ 8.5 lakhs should be charged to profit and loss account.

As per AS 13, 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.

c) In the third case, the book value of the investment is ₹ 12 lakhs, which is lower than its cost i.e. ₹ 18 lakhs. Here, the transfer should be at carrying amount and hence this reclassified current investment should be carried at ₹ 12 lakhs.

Question 6 *(RTP May 2020) (Similar) / (ICAI Study Material)*

Bluechip Equity Investments Ltd, wants to reclassify its investments in accordance with AS13

a) Long term investments in Company A, costing ₹ 8.5 lakhs are to be re-classified as current. The company had reduced the value of these investments to ₹ 6.5 lakhs to recognize a permanent decline in value. The fair value on date of transfer is ₹ 6.8 lakhs.

b) Long term investments in Company B, costing ₹ 7 lakhs are to be re-classified as current. The fair value on date of transfer is ₹ 8 lakhs and book value is ₹ 7 lakhs.
c) Current investment in Company C, costing ₹ 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 ₹ 12 lakhs.
d) Current investment in Company D, costing ₹ 15 lakhs are to be re-classified as long term. The market value on date of transfer is ₹ 14 Lakhs.

Solution

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. 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:
a) 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 ₹ 6.5 lakhs in the books
b) The carrying / book value of the long term investment is same as cost i.e. ₹ 7 lakhs. Hence this long term investment will be reclassified as current investment at book value of ₹ 7 lakhs only.
c) In this case, reclassification of current investment into long-term investments will be made at ₹ 10 lakhs as cost is less than its market value of ₹ 12 lakhs.
d) In this case, market value is ₹ 14 lakhs which is lower than cost of ₹ 15 lakhs. The reclassification of current investment as long-term investments will be made at ₹ 14 lakhs

Question 7 *(Inter May 2019) (5 Marks)*

On 15th June, 2021, 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, 2020 are to be reclassified as current investments. The original cost of these investments was ₹ 14 lakhs but had been written down by ₹ 2 lakhs (to recognise 'other than temporary' decline in value). The market value of these investments on 15th June, 2021 was ₹ 11 lakhs.
2) Another portion of long term investments purchased on 15th January, 2020 are to be re-classified as current investments. The original cost of these investments was ₹ 7 lakhs but had been written down to ₹ 5 lakhs (to recognize 'other than temporary' decline in value). The fair value of these investments on 15th June, 2021 was ₹ 4.5 lakhs.
3) A portion of current investments purchased on 15th March, 2021 for ₹ 7 lakhs are to be re-classified as long term investments, as the company has decided to retain them. The market value of these investments on 31st March, 2021 was ₹ 6 lakhs and fair value on 15th June 2021 was ₹ 8.5 lakhs,
4) Another portion of current investments purchased on 7th December, 2020 for ₹ 4 lakhs are to be re-classified as long term investments. The market value of these investments was: on 31st March, 2021 ₹ 3.5 lakhs on 15th June, 2021 ₹ 3.8 lakhs

Solution

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:
1) 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 ₹ 12 lakhs in the books.

2) In this case also, carrying amount of investment on the date of transfer is less than cost; hence this re-classified current investment should be carried at ₹ 5 lakhs in the books.
3) In this case, reclassification of current investment into long-term investments will be made at ₹ 7 lakhs as cost is less than its fair value of ₹ 8.5 lakhs on the date of transfer.
4) In this case, market value (considered as fair vale) is ₹ 3.8 lakhs on the date of transfer which is lower than the cost of ₹ 4 lakhs. The reclassification of current investment into long-term investments will be made at ₹ 3.8 lakhs.

Question 8 *(RTP Nov 2020) / (ICAI Study Material)*

X Ltd. on 1-1-2022 had made an investment of ₹ 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 realizable value of all such investment on 31-3-2022 became ₹ 200 lakhs as Y Ltd. lost a case of copyright.
How will you recognize the reduction in financial statements for the year ended on 31-3-2022 assuming that this reduction in value is not temporary in nature?

Solution

X Ltd. invested ₹ 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. ₹ 300 lakhs and remaining as temporary (current) investment i.e. ₹ 300 lakhs. Irrespective of the fact that investment has been held by X Ltd. only for 3 months (from 1.1.2022 to 31.3.2022), 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 31.3.2022 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 to 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 recognise the decline.
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 performance of the company in long run. Accordingly, it will be appropriate to reduce the carrying amount of long term investment by ₹ 200 lakhs and show the investments at ₹ 100 lakhs, since the downfall in the value of shares is other than temporary. The reduction of ₹ 200 lakhs in the carrying value of long term investment will be charged to the Statement of profit and loss.

Question 9 *(ICAI Study Material)*

An unquoted long-term investment is carried in the books at cost of ₹ 2 lacs. The published accounts of unlisted company received in May, 2021 showed that the company has incurred cash losses with decline market share and the long-term investment may not fetch more than ₹ 20,000. How you will deal with it in preparing the financial statements of investing company for the year ended 31.3.2021?

Solution

Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. AS 13 'Accounting for Investments' 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 these bases, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to ₹ 20,000 in the financial statements for the year ended 31st March, 2021.

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.

Question 10 *(RTP Nov 2019) / (RTP Nov 2021)*

Sabka Bank has classified its total investment on 31-3-2022 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 amortised 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. Comment whether the policy of the bank is in accordance with AS 13?

Solution

As per AS 13 'Accounting for Investments', the accounting standard is not applicable to Bank, Insurance Company, Mutual Funds. In this case Sabka Bank is a bank, therefore, AS 13 does not apply to it. For banks, the RBI has issued guidelines for classification and valuation of its investment and Sabka Bank should comply with those RBI Guidelines/Norms. Therefore, though Sabka 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 11 *(ICAI Study Material)*

Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without providing for any dimunition 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.

Solution

The accounting treatment 'at cost' under the head 'Long Term Investments' in the financial statements of the company without providing for dimunition 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.

AS 13: CASE Study- PRACTICE QUESTIONS

Question 1 *(Inter May 2019) (1 Marks)*

State whether the following statement is '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 realisable and is intended to be held for not more than six months from the date on which such investment is made.

Solution

False: A current investment is an investment that is by its nature readily realizable and is intended to be held for not more than 1 year from the date on which such investment is made.

Question 2 *(RTP May 2023) / (RTP Nov 2018) (Similar)*

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.

Solution

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 of cost (₹ 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 3 *(ICAI Study Material)*

M/s Innovative Garments Manufacturing Company Limited invested in the shares of another company on 1st October, 2021 at a cost of ₹ 2,50,000. It also earlier purchased Gold of ₹ 4,00,000 and Silver of ₹ 2,00,000 on 1st March, 2019. Market value as on 31st March, 2022 of above investments are as follows: 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, 2022 as per the provisions of Accounting Standard 13 "Accounting for Investments"?

Solution

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 of cost (₹ 2,50,000) and market value (₹ 2,25,000) as on 31 March 2022, i.e., ₹ 2,25,000.
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 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, 2019) should continue to be shown at cost (since there is no 'other than temporary' diminution) as on 31st March, 2022, i.e., ₹ 4,00,000 and ₹ 2,00,000 respectively, though their market values have been increased.

Question 4 *(Inter Nov 2020) (5 Marks)*

A Limited invested in the shares of XYZ Ltd. on 1st December, 2021 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, 2021.
Market value as on 31st March, 2022 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, 2022 as per the provisions of AS 13 (Revised)?

Solution

As per AS 13 '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 1 year) until & unless given otherwise. Hence, investment in Gold & Silver (purchased on 1st April, 2021) should continue to be shown at cost (since there is no 'other than temporary' diminution) as on 31st March, 2022. Thus Gold at ₹ 1,00,000 & Silver at ₹ 30,00,000 respectively will be shown in the books.

Question 5 *(RTP Nov 2022)*

Mother Mart Ltd wants to reclassify its investment in accordance with AS 13. Decide treatment to be given in each of the following cases assuming that 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 ₹ 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 ₹ 30 lakhs.
(ii) Another portion of current investments purchased for ₹ 20 lakhs has to be reclassified as long-term investments. The market value of these investments as on the date of the balance sheet was ₹ 12.5 lakhs.

(iii) One portion of long-term investments, no longer considered for holding purposes, to be reclassified as current investments. The original cost of these was ₹ 15 lakhs, but had been written down to ₹ 11 lakhs to recognize permanent decline as per AS 13.

Solution

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.

(i) In the first case, the market value of the investments is ₹ 30 lakhs, which is higher than its cost i.e. ₹ 25 lakhs. Therefore, the transfer to long term investments should be made at cost i.e. ₹ 25 lakhs

(ii) In the second case, the market value of the investment is ₹ 12.5 lakhs, which is lower than its cost i.e. ₹ 20 lakhs. Therefore, the transfer to long term investments should be made in the books at the market value i.e. ₹ 12.5 lakhs. The loss of ₹ 7.50 lakhs (20-12.5) should be charged to Profit and Loss account.

(iii) In the third case, the book value of the investments is ₹ 11 lakhs, which is lower than its cost, i.e. ₹ 15 lakhs. As the transfer should be at carrying amount, hence this reclassified current investment should be carried at ₹ 11 lakhs.

Question 6 *(Inter Jan 2021) (5 Marks)*

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.

(iv) 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.

Solution

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 ₹ 12 lakhs as cost is 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., ₹ 16.5 lakhs.

Question 7 *(RTP May 2018) / (RTP May 2019)*

How you will deal with following in the financial statement of the Paridhi Electronics Ltd. as on 31.3.22 with reference to AS-13?

a) Paridhi Electronics Ltd. invested in the shares of another unlisted company on 1st May 2018 at a cost of ₹ 3,00,000 with the intention of holding more than a year. The published accounts of unlisted company received in January, 2022 reveals that the company has incurred cash losses with decline market share and investment of Paridhi Electronics Ltd. may not fetch more than ₹ 45,000.

b) Also Paridhi Electronics Ltd. has current investment (X Ltd.'s shares) purchased for ₹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 ₹ 2.5 lakhs.

Solution

a) As per AS 13, "Accounting for investments" Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise 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. On this basis, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of shares to ₹ 45,000 in the financial statements for the year ended 31st March, 2022 and charge the difference of loss of ₹ 2,55,000 to Profit and Loss account.

b) As per AS 13 'Accounting for Investments', where investments are reclassified from current to long-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 ₹ 2.50 lakhs, which is lower than its cost i.e. ₹5 lakhs. Therefore, the transfer to long term investments should be made at cost i.e. ₹2.50 lakhs. The loss of ₹ 2.50 lakhs should be charged to profit and loss account.

Question 8 *(RTP May 2021)*

Paridhi Electronics Ltd. invested in the shares of Dhansukh Ltd. on 1st May 2021 at a cost of ₹ 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, 2022 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 above in the financial statements of the Paridhi Electronics Ltd. as on 31.3.22 with reference to AS 13?

Solution

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 ₹ 10,00,000 ie. ₹7,50,000 as current investment and remaining ₹ 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 ₹ 7,50,000 in the financial statements for the year ended 31st March, 2022 and charge the difference of loss of ₹ 2,50,000 to profit and loss account

Question 9 (Inter Dec 2021) (5 Marks)

Mr. Mohan has invested some money in various Mutual funds. Following information in this regard is given:

Mutual Funds	Date of purchase	Purchase cost (₹)	Brokerage Cost (₹)	Stamp duty (₹)	Market value as on 31.03.2021 (₹)
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:

a) Classify his investment in accordance with AS-13 (revised).

b) Value of Investment in mutual fund as on 31.03.2021

Solution

As per AS 13 "Accounting for 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.

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 10 (RTP May 2022)

Pg no._____

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. JVR 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 AS.

Solution:

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 11 *(Inter Nov 2022) (5 Marks)*

a) 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.

b) 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 AS 13 'Accounting for Investments'?

Solution:

(a) Investments classified as long term investments should be carried in financial statements at cost. However, provision for diminution should 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.
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 carrying amount of the investments.

(b) 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 31st March,2022.

AS 21: CONSOLIDATED FINANCIAL STATEMENTS

CH 8

"What you do makes a difference, and you have to decide what kind of difference you want to make."

Holding Company	As per *Section 2(46) of the Companies Act, 2013,* "Holding company", in relation to one or more other companies, means a company of which such companies are subsidiary companies.
Subsidiary Company	*Section 2(87) of the Companies Act, 2013* defines "subsidiary company" as a company in which the holding company – (i) controls the composition of the Board of Directors; or (ii) exercises or controls more than 50% of total voting power either at its own or together with 1 or more of its subsidiary companies Section 19 prohibits a subsidiary company from holding shares in the holding company. According to this section, no company shall, either by itself or through its nominees, hold any shares in its holding company and no holding company shall allot or transfer its shares to any of its subsidiary companies and any such allotment or transfer of shares of a company to its subsidiary company shall be void. *However, a subsidiary may continue to be a member of its holding company when:* a) the subsidiary company holds such shares as legal representative of a deceased member of the holding company; or b) the subsidiary company holds such shares as a trustee; or c) the subsidiary company is a shareholder even before it became a subsidiary company of the holding company.
Purpose of Preparing the Consolidated Financial Statements	*Section 129 (3) of the Companies Act, 2013* mandated the companies having one or more subsidiaries, to prepare Consolidated Financial Statements. According to this section, where a company has one or more subsidiaries, it shall, in addition to separate financial statements will prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own. *Accounting Standard (AS) 21* also lays down the accounting principles and procedures for preparation and presentation of consolidated financial statements. Consolidated financial statements are presented by the parent (holding company) to provide financial information about the economic activities of the group as a single economic entity. AS 21 is mandatory if an enterprise presents consolidated financial statements. In other words, the accounting standard does not mandate an enterprise to present consolidated financial statements but, if the enterprise presents consolidated financial statements for complying with the requirements of any statute or otherwise, it should prepare and present consolidated financial statements in accordance with AS 21.

Non Applicability of AS 21	This Standard does not deal with: (a) methods of accounting for amalgamations and their effects on consolidation, including goodwill arising on amalgamation (see AS 14), (b) accounting for investments in associates and (c) accounting for investments in joint ventures
Exclusion From Preparation Of Consolidated Financial Statements	As per AS 21, a subsidiary should be excluded from consolidation when: • control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future; or • it operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent. Investments in such subsidiaries should be accounted for in accordance with AS 13, Accounting for Investments. The reasons for not consolidating a subsidiary should be disclosed in the consolidated financial statements.
Consolidation of subsidiary which is a LLP or a Partnership Firm	Under AS 21, as per the definition of subsidiary, an enterprise controlled by the parent is required to be consolidated. The term 'enterprise' includes a company and any enterprise other than a company. Therefore, LLPs and partnership firms are required to be consolidated. Accordingly, in the given case, holding company is required to consolidate its subsidiary which is an LLP or a partnership firm.
Advantages of Consolidation	a) Single source document: From consolidated financial statements, the users of accounts can get an overall picture of the Group. Consolidated profit and loss account gives the overall profitability of the group. b) Intrinsic value of share: Intrinsic share value of the holding company can be calculated directly from the Consolidated Balance Sheet. c) Acquisition of subsidiary: The minority interest data of the consolidated financial statement indicates that the amount payable to the outside shareholders of the subsidiary company at book value which is used as the starting point of bargaining at the time of acquisition of a subsidiary by the holding company. d) Evaluation of holding company in the market: The overall financial health of the holding company can be judged using consolidated financial statements. Those who want to invest in the shares of the holding company or acquire it, need such consolidated statement for evaluation.
Components Of Consolidated Financial Statements	*As per AS 21,* consolidated financial statements normally include a) Consolidated Balance Sheet b) Consolidated Statement of Profit and Loss Account c) Consolidated Cash Flow Statement (in case parent presents cash flow statement) and d) Notes and statements and explanatory schedules that form the integral part thereof.

Consolidation Procedures	The various steps involved in the consolidation process are as follows: 1) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary are eliminated. In case cost of acquisition exceeds or is less than the acquirer's interest, goodwill or capital reserve is calculated retrospectively. 2) intragroup transactions, including sales, expenses and dividends, are eliminated, in full 3) unrealised profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full 4) 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; 5) minority interest in the net income of consolidated subsidiaries for the reporting period are identified and adjusted against the income of the group in order to arrive at the net income attributable to the owners of the parent; and 6) minority interests in the net assets of consolidated subsidiaries are identified and presented in the consolidated balance sheet separately from liabilities and the parent shareholders' equity.
Calculation Of Goodwill/ Capital Reserve (Cost Of Control)	*Goodwill* = Cost of Investment - Parent's share in the equity of the subsidiary on date of investment *Capital Reserve* = Parent's share in the equity of the subsidiary on date of investment – Cost of investment
Minority Interests	Minority interest is that part of the net results of operations and of net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiaries, by the holding (parent) company. In short, It represents claims of the outside shareholders of a subsidiary. The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity 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 profit, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.
Consolidated Profit & Loss Account	All the revenue items are to be added on line by line basis and from the consolidated revenue items, inter-company transactions should be eliminated. If there remains any unrealized profit in the inventory of goods, of any of the Group Company, such unrealized profit should be eliminated from the value of inventory to arrive at the consolidated profit.

Consolidated Cash Flow Statement	All the items of Cash flow from operating activities, investing activities and financing activities are to be added on line by line basis and from the consolidated items, inter-company transactions should be -eliminated.
Uniform Accounting Policies	AS 21 states that consolidated financial statements shall be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If any company in the same group uses accounting policies other than those adopted in 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. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, the fact should be disclosed together with the proportions of items to which different accounting policies have been applied.
Alignment of Reporting Dates	The financial statements used in the consolidation should be drawn up to the same reporting date. If it is not practicable to draw up the financial statements of one or more subsidiaries to such date and, accordingly, those financial statements are drawn up to different reporting dates, adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the parent's financial statements. In any case, the difference between reporting dates should not be more than six months.

ASSIGNMENT QUESTIONS

TOPIC 1 CONSOLIDATED BALANCE SHEET

Question 1 *(ICAI Study Material)* Pg no._____

Prepare Consolidated balance sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 2021

	H Ltd.	S Ltd.
Property, Plant & Equipment	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 10 each)	1,50,000	1,00,000
Profit and Loss Account	50,000	40,000
Trade Payables	1,00,000	60,000

H Ltd. acquired the shares of S Ltd. on 01.07.2020 and Balance of Profit & Loss Account of S Ltd. on 01.04.2020 was 30,000

Question 2 Pg no._____

From the following balance sheets of Exe Ltd. and Wye Ltd. as on 31st March, 2020, work out: (i) Net amount due to minority interest and (ii) Cost of control

Balance Sheets of Exe Ltd. & Wye Ltd. as on 31st March, 2020

Equities & Liabilities	Exe Ltd. (₹)	Wye Ld. (₹)
Shares of ₹100 each	15,00,000	5,00,000
General Reserve	1,50,000	1,00,000
Profit & Loss Account	2,00,000	75,000
Creditors	1,87,500	1,20,000
	20,37,500	7,95,000
Assets		
Sundry Assets	14,77,500	7,95,000
4,000 Shares of ₹100 each	5,60,000	
	20,37,500	7,95,000

The assets of Wye Ltd. included equipments worth ₹ 1,50,000 which was revalued at ₹ 1,25,000. The investments of Exe Ltd. were in shares of Wye Ltd. and the same were acquired on 31st March, 2020.

Question 3 *(RTP May 2020) (Similar) / (ICAI Study Material)* Pg no._____

From the following summarized balance sheets of H Ltd. and its subsidiary S Ltd. drawn up at 31st March, 2020, prepare a consolidated balance sheet as at that date, having regard to the following:

a) Reserves and Profit and Loss Account of S Ltd. stood at ₹25,000 and ₹ 15,000 respectively on the date of acquisition of its 80% shares by H Ltd. on 1st April, 2019.

b) Machinery (Book-value ₹ 1,00,000) and Furniture (Book value ₹ 20,000) of S Ltd. were revalued at ₹ 1,50,000 and ₹ 15,000 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%.]

Summarised Balance Sheet of H Ltd. as on 31st March, 2020

	Note No.	H Ltd.	S Ltd.
Equity & Liabilities			

(1) Shareholders' Funds			
(a) Share Capital	1	6,00,000	1,00,000
(b) Reserves and Surplus	2	3,00,000	1,00,000
(2) Current Liabilities			
(a) Trade Payables		1,50,000	57,000
		10,50,000	2,57,000
Assets			
(1) Non-Current Assets			
(a) PPE & Intangible Assets			
i. Property, Plant & Equipment	3	4,50,000	1,07,000
(b) Non Current Investments	4	6,00,000	1,50,000
		10,50,000	2,57,000

Notes to Accounts:

		H Ltd.	S Ltd.
1.	Share Capital		
	6,000 equity shares of 100 each, fully paid up	6,00,000	
	1,000 equity shares of 100 each, fully paid up		1,00,000
		6,00,000	1,00,000
2.	Reserves & Surplus		
	General Reserve	2,00,000	75,000
	Profit and Loss A/c	1,00,000	25,000
		3,00,000	1,00,000
3.	Property, Plant & Equipment		
	Machinery	3,00,000	90,000
	Furniture	1,50,000	17,000
		4,50,000	1,07,000
4.	Non Current Investments		
	Non Current Investments	4,40,000	1,50,000
	Shares in S Ltd.: 800 shares at ₹ 200 each	1,60,000	
		6,00,000	1,50,000

Question 4

Pg no._____

Balance sheets of H Ltd. and S Ltd. as at 31st March, 2021 are given below:

Equities & Liabilities	H Ltd. ₹	S Ltd. ₹
Shareholder's Funds		
Share Capital of ₹ 10 each, fully paid	5,00,000	2,00,000
General Reserve	1,00,000	50,000
Profit & Loss Account	60,000	35,000
Current Liabilities:		
Creditors	80,000	60,000
	7,40,000	3,45,000
Assets		
Property, Plant & Equipment	3,00,000	1,00,000
60% Shares in S Ltd., at cost	1,62,400	-
Current Assets	2,77,600	2,39,000
Preliminary Expenses	-	6,000
	7,40,000	3,45,000

H Ltd. acquired the shares on 1st April, 2020 and on that date general reserve and profit and loss account of S Ltd. showed balances of ₹ 40,000 and ₹8,000 respectively. No part of preliminary expenses was written off during the year ended 31st March, 2021.
Prepare a consolidated balance sheet of H Ltd. and its subsidiary S Ltd. as on 31st March, 2021.

Question 5 *(RTP May 2019) / (ICAI Study Material)* *Pg no._____*

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 ₹2,00,000 in each case:

Case	Subsidiary Company	% shares owned	Cost	Date of acquisition 01.01.2020		Consolidation Date 31.12.2020	
				Share Capital	Profit & Loss A/c	Share Capital	Profit & Loss A/c
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

Question 6 *(Inter July 2021) (5 Marks)* *Pg no._____*

Long Limited acquired 60% stake in Short Limited for a consideration of ₹ 112 lakhs. On the date of acquisition Short Limited's Equity Share Capital was ₹ 100 lakhs, Revenue Reserve was ₹ 40 lakhs and balance in Profit & Loss Account was ₹ 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 ₹ 104 lakhs.
(iii) If the consideration paid for acquiring the 60% stake was ₹ 92 lakhs.

Question 7 *Pg no._____*

On 31st March, 2020 the balance sheet of H Ltd. and its subsidiary S Ld. stood as follows:

	H Ltd.	S Ltd.
EQUITIES & LIABILITIES		
Shareholder's Funds:		
Equity Share Capital	8,00,000	2,00,000
General Reserve	1,50,000	70,000
Profit & Loss Account	90,000	55,000
Current Liabilities:		
Creditors	1,20,000	80,000
	11,60,000	4,05,000
ASSETS		
Property, Plant & Equipment	5,50,000	1,00,000
75% Shares in S Ltd. (at cost)	2,80,000	-
Stock	1,05,000	1,77,000
Other Current Assets	2,25,000	1,28,000
	11,60,000	4,05,000

Draw consolidated balance sheet as at 31st March, 2020 after considering the following:
(1) H Ltd. acquired the shares on 31st July, 2019.

(2) S Ltd. earned a profit of ₹ 45,000 for the year ended 31st March, 2020.
(3) In January, 2020 S Ltd. sold to H Ltd. goods costing ₹ 15,000 for ₹ 20,000. On 31st March, 2020 half of these goods were lying as unsold in godown of H Ltd.

Give your working notes.

Question 8 (RTP Nov 2021) / (ICAI Study Material) Pg no._____

On 31st March, 2021, P Ltd. acquired 1,05,000 shares of Q Ltd. for ₹ 12,00,000. The position of Q Ltd. on that date was as under:

	₹
Property, plant and equipment	10,50,000
Current Assets	6,45,000
1,50,000 equity shares of ₹ 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, 2023:

	P Ltd. ₹	Q Ltd. ₹
Equity shares of ₹ 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

Directors of Q Ltd. made bonus issue on 31.3.2023 in the ratio of one equity share of ₹ 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, 2013:-

(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.

Question 9 (ICAI Study Material) Pg no._____

A Ltd acquired 1,600 ordinary shares of ₹100 each of B Ltd on 1st July, 2021. On 31st December, 2021, 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, 2021

Particulars	Note No.	A Ltd. (₹)	B Ltd. (₹)
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		47,100	17,400
b) Short term borrowings	3	80,000	
Total		9,24,300	3,99,400
Assets			
(1) Non-current assets			

(a) Property, Plant and Equipment	4	3,90,000	3,15,000
(b) Non-current Investments	5	3,40,000	--
(2) Current assets			
(a) Inventories		1,20,000	36,400
(b) Trade receivables		59,800	40,000
(c) Cash & Cash equivalents	6	14,500	8,000
Total		9,24,300	3,99,400

Notes to Accounts

		A Ltd. ₹	B Ltd. ₹
1.	Share Capital		
	5,000 shares of ₹ 100 each, fully paid up	5,00,000	-
	2,000 shares of ₹ 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
	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 ₹30,000 on 1st January, 2021 out of which a dividend of 10% was paid on 1st August, 2021; A Ltd. credited the dividend received to its Profit & Loss Account. The Plant & Machinery which stood at ₹ 1,50,000 on 1st January, 2021 was considered as worth ₹ 1,80,000 on 1st July, 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 December, 2021.

Question 10 *(ICAI Study Material)* *Pg no._____*

On 31st March, 2021, the Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

Particulars	Note No.	H Ltd. (₹ in Lacs)	S Ltd. (₹ in Lacs)
Equity and Liabilities			
(1) Shareholder's Funds			
a) Share Capital	1	12,000	4,800
b) Reserves and Surplus	2	5,499	3,000
(2) Current Liabilities			
a) Trade payables	3	1,833	1,014
b) Short term provisions	4	855	394
c) Other current liabilities (Dividend payable)		1,200	-
Total		21,387	9,208

Assets			
(1) Non-current assets			
a) Property, Plant and Equipment	5	9,468	5,486
b) 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 and advances	7	520	
Total		21,387	9,208

Notes to Accounts

		H Ltd. (₹ in lacs)	S Ltd. (₹ in lacs)
1	Share Capital		
	Authorized share capital:		
	Equity shares of ₹ 10 each, fully paid up	15,000	6,000
	Issued and Subscribed:		
	Equity shares of ₹ 10 each, fully paid up	12,000	4,800
2	Reserves and surplus		
	General Reserve	2,784	1,380
	Profit and Loss Account:	2,715	1,620
	Total	5,499	3,000
3	Trade Payables		
	Creditors	1,461	854
	Bills Payable	372	160
		1,833	1,014
4	Short term provisions		
	Provision for Taxation	855	394
5	Property, plant and equipment		
	Land and Buildings	2,718	-
	Plant and Machinery	4,905	4,900
	Furniture and Fittings	1,845	586
	Total	9,468	5,486
6	Trade receivables		
	Debtors	2,600	1,363
	Bills Receivable	360	199
	Total	2,960	1,562
7	Short term loans and advances		
	Sundry Advances	520	--

The following information is also provided to you:

a. H Ltd. purchased 180 lakh shares in S Ltd. on 31st March, 2020 when the balances of General Reserve and Profit and Loss Account of S Ltd. stood at ₹ 3,000 lakh and ₹ 1,200 lakh respectively.

b. On 1st April, 2020, S Ltd. declared a dividend @ 20% for the year ended 31st March, 2020. H Ltd. credited the dividend received by it to its Profit and Loss Account.

c. On 1st January, 2021, 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, 2020.

d. On 31st March, 2021, 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 ₹ 45 lakh of these acceptances in hand, the rest having been endorsed in favour of its trade payables.

e. On 31st March, 2021, S Ltd.'s inventory included goods which it had purchased for ₹ 100 lakh from H Ltd. which made a profit @ 25% on cost.

Prepare Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 2021.

Question 11 *(Inter Nov 2020) (15 Marks)* Pg no._____

H Limited acquired 64000 Equity Shares of ₹ 10 each in S Ltd. as on 1st October, 2019. The Balance Sheets of the two companies as on 31st March, 2020 were as under:

	H Ltd.	S Ltd.
Equity & Liabilities		
Equity Share Capital: Shares of ₹ 10 each	20,00,000	8,00,000
General Reserve (1st April, 2019)	9,60,000	4,20,000
Profit and Loss Account	2,28,800	3,28,000
Preliminary Expenses (1st April, 2019)	-	(20,000)
Bank Overdraft	3,00,000	-
Bills Payable	-	52,000
Trade Payables	1,66,400	80,000
Total	36,55,200	16,60,000
Assets:		
Land and Building	7,20,000	7,60,000
Plant & Machinery	9,60,000	5,40,000
Investment in Equity Shares of S Ltd.	12,27,200	-
Inventories	4,56,000	1,68,000
Trade Receivables	1,76,000	1,60,000
Bills Receivable	59,200	-
Cash in Hand	56,800	32,000
Total	36,55,200	16,60,000

Additional Information:

(1) The Profit & Loss Account of S Ltd. showed credit balance of ₹ 1,20,000 on 1st April, 2019. S Ltd. paid a dividend of 10% out of the same on 1st November, 2019 for the year 2018-19. The dividend was correctly accounted for by H Ltd.

(2) The Plant & Machinery of S Ltd. which stood at ₹ 6,00,000 on 1st April, 2019 was considered worth ₹ 5,20,000 on the date of acquisition by H Ltd. S Ltd. charges depreciation @ 10% per annum on Plant & Machinery.

Prepare consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31st March, 2020.

Question 12 *(RTP Nov 2018)* Pg no._____

The Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2020 are as follows:

	X Ltd. (in Lakhs)	Y Ltd. (in Lakhs)
Liabilities		
Share Capital:		
Authorized	20,000	8,000
Issued and Subscribed:		
Equity Shares of ₹ 10 each, fully paid up	15,000	6,000
15% preference shares of ₹ 10 each, fully paid up	4,000	1,000
General Reserve	2,500	1,450
Profit and Loss Account	2,750	1,250
Trade Payables	1,646	1,027
	25,896	10,727

Assets		
Land and Buildings	3,550	1,510
Plant and Machinery	5,275	3,600
Furniture and Fittings	1,945	655
Investment in Y Ltd.: 450 Lakh Equity share in Y Ltd. purchased on 1st April, 2019	6,800	-
Inventory	4,142	2,520
Trade Receivables	3,010	1,882
Cash and Bank Balances	1,174	560
	25,896	10,727

The following information is also given to you

(a) 10% dividend on Equity shares was declared by Y Ltd. on 31st May, 2019 for the year ended 31st March, 2019. X Ltd. credited the dividend received to its Profit & Loss Account.

(b) Credit Balance of Profit & Loss account of Y Ltd. as on 1st April, 2019 was ₹ 650 Lakhs.

(c) General Reserve of Y Ltd. stood at same ₹ 1,450 Lakhs as on 1st April, 2019.

(d) Y Ltd.'s Plant & machinery showed a balance of ₹ 4,000 Lakh on 1st April 2019. At the time of purchase of shares in Y Ltd., X Ltd. revalued Y's Ltd. Plant & Machinery upward by ₹ 1,000 Lakh.

(e) Included in Trade Payables of Y Ltd. are ₹ 50 Lakh for goods supplied by X Ltd.

(f) On 31st March, 2020, Y's ltd. inventory included goods for ₹ 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 on 31st March, 2020 giving working notes. (Ignoring dividend on preference shares)

Question 13 *(ICAI Study Material)* *Pg no._____*

H Ltd. acquired 3,000 shares in S Ltd., at a cost of ₹4,80,000 on 31.7.2020. The capital of S Ltd. consisted of 5,000 shares of ₹ 100 each fully paid. The Profit & Loss Account of this company for 2020 showed an opening balance of ₹1,25,000 and profit for the year was ₹ 3,00,000. At the end of the year, it declared a dividend of 40%. Record entry in the books of H Ltd., in respect of the dividend. Assume the profit is accruing evenly & calendar year as financial year.

Question 14 *(ICAI Study Material)* *Pg no._____*

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 2020 for ₹ 1,40,000. The issued capital of ABC Ltd., on 1st January, 2020 was ₹ 1,00,000 and the balance in the Profit & Loss Account was ₹ 60,000. During the year ended 31st December, 2020, ABC Ltd. earned a profit of ₹ 20,000 and at year end, declared and paid a dividend of ₹ 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, 2020 and 31st December, 2020?

Also compute Goodwill/Capital reserve at the date of acquisition.

Question 15 *(ICAI Study Material)* *Pg no._____*

Exe Ltd. acquires 70% of equity shares of Zed Ltd. as on 31st March, 2020 at cost of ₹ 70 lakhs. The following information is available from balance sheet of Zed Ltd. as on 31st March, 2020:

	₹ in Lakhs
Property, Plant & 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 & Equipment Up by 20% Investments Down by 10%
Zed Ltd. declared and paid dividend @ 20% on its equity shares as on 31st March, 2020 (Face value ₹ 10 per share). Exe Ltd. purchased the shares of Zed Ltd. @ ₹20 per share.
Calculate the amount of goodwill/capital reserve on acquisition of shares of Zed Ltd.

Question 16 *(ICAI Study Material)* *Pg no._____*

A Ltd. and B Ltd. provide the following information:

	₹ (in '000s)	
	A Ltd.	B Ltd.
Equity Shares	6,000	5,000
6% Preference Shares	Nil	1,000
General Reserve	1,200	800
Profit & Loss Account	1,020	1,790
Trade Payables	3,850	3,410
Dividend Payable	600	500
Goodwill	100	20
Property, Plant & Equipment	3,850	2,750
Investments	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 of Control.

Question 17 *(ICAI Study Material)* *Pg no._____*

A Ltd. acquired 70% of equity shares of B Ltd. on 1.4.2013 at cost of ₹ 10,00,000 when B Ltd. had an equity share capital of ₹ 10,00,000 and reserves and surplus of ₹ 80,000. In the four consecutive years, B Ltd. fared badly and suffered losses of ₹ 2,50,000, ₹ 4,00,000, ₹ 5,00,000 and ₹ 1,20,000 respectively. Thereafter in 2017-18, B Ltd. experienced turnaround and registered an annual profit of ₹ 50,000. In the next two years i.e. 2018-19 and 2019-20, B Ltd. recorded annual profits of ₹ 1,00,000 and ₹ 1,50,000 respectively. Show the minority interests and cost of control at the end of each year for the purpose of consolidation.

Question 18 *(RTP May 2018)* *Pg no._____*

From the following summarised Balance Sheets of A Ltd. and its subsidiary B Ltd., prepare Consolidated Balance Sheet:

Balance Sheet as on 31st March, 2020

Equity & Liabilities	A Ltd.	B Ltd.	Assets	A Ltd.	B Ltd.
Equity shares of ₹ 10 each fully paid	1,00,000	20,000	Sundry Assets	93,000	32,000
Profit on sale of shares	3,000	-	Shares in B Ltd	18,000	-

			1,200 shares at 15 each		
Profit and Loss A/c					
Brought forward	6,000	7,200			
For the year	2,000	4,800			
	1,11,000	32,000		1,11,000	32,000

A Ltd. bought in earlier year 1,600 equity shares in B Ltd. @ ₹ 15 when the Profit & Loss A/c balance in B Ltd. was ₹4,400. A Ltd. sold 400 shares @ ₹22.50, credited difference between the sale proceeds and cost to "Profit on sale of investment account" on 30th September, 2019 and crediting the balance to the investment account. Profit during the year accrued uniformly.

Question 19 *(ICAI Study Material)* *Pg no._____*

Consider the following summarized balance sheets of subsidiary B Ltd.:

Equity & Liabilities	2019 Amount in ₹	2020 Amount in ₹
Share Capital		
Issued and subscribed 5,000 Equity Shares of ₹100 each	5,00,000	5,00,000
Reserve and Surplus		
General Reserve	2,86,000	7,14,000
Current Liabilities and Provisions		
Trade Payables	4,90,000	4,94,000
Bank Overdraft	-	1,70,000
Provision for Taxation	3,10,000	4,30,000
	15,86,000	23,08,000
Assets		
Property, Plant & Equipment (Cost)	3,20,000	3,20,000
Less: Accumulated Depreciation	(48,000)	(96,000)
	2,72,000	2,24,000
Investment at Cost	-	4,00,000
Current Assets		
Inventory	5,97,000	7,42,000
Trade Receivable	5,94,000	8,91,000
Prepaid expenses	72,000	48,000
Cash at Bank	51,000	3,000
	15,86,000	23,08,000

Also consider the following information:

a) B Ltd. is a subsidiary of A Ltd. Both the companies follow calendar year as accounting year.
b) 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 ₹ 12,000 at the end of 2019 and ₹ 34,000 at the end of 2020.
c) B Ltd. deducts 1% from Trade Receivables as a general provision against doubtful debts.
d) Prepaid expenses in B Ltd. include advertising expenditure carried forward of ₹ 60,000 in 2019 and ₹ 30,000 in 2020, being part of initial advertising expenditure of ₹ 90,000 in 2019 which is being written off over three years. Similar amount of advertising expenditure of A Ltd. has been fully written off in 2019.

Restate the balance sheet of B Ltd. as on 31st December, 2020 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.

Question 20 *(ICAI Study Material)* *Pg no._____*

Variety Ltd. holds 46% of the paid-up share capital of VR Ltd. The shares were acquired at a market price of ₹ 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 ₹ 30 lakhs, ₹ 40 lakhs and ₹ 65 lakhs.

(b) The actual cost of the shares to the foreign company was ₹ 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 ₹ 1,00,00,000. It was decided to write down Property, Plant and Equipment by ₹ 1,75,000. Current liabilities of VR Ltd. as on the same date were ₹ 20,00,000. The paid-up share capital of VR Ltd. was ₹ 20,00,000 divided into 2,00,000 equity shares of ₹ 10 each.
Find out goodwill/capital reserve to Variety Ltd. on acquiring wholly the shares of VR Ltd.

TOPIC 2 CONSOLIDATED PROFIT & LOSS ACCOUNT

Question 21 *(RTP May 2018) (Similar) / (ICAI Study Material)* *Pg no._____*

H Ltd and its subsidiary S Ltd provide the following information for the year ended 31st March, 2023:

	H Ltd. (₹ in lacs)	S Ltd. (₹ 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 ₹ 120 lacs at cost plus 20%. Inventory of S Ltd. includes such goods valuing ₹ 24 lacs. Administrative expenses of S Ltd. include ₹ 5 lacs paid to H Ltd. as consultancy fees. Selling and distribution expenses of H Ltd. include ₹ 10 lacs paid to S Ltd. as commission.
H Ltd. holds 80% of equity share capital of ₹ 1,000 lacs in S Ltd. prior to 2021-2022. H Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by S Ltd. for the year 2021-2022.
Prepare a consolidated statement of profit and loss.

Question 22

Pg no._____

The Trial Balances of H Ltd. and S Ltd. as on 31.12.2020 were as under:

	H Ltd.		S Ltd.	
	Dr.	Cr.	Dr.	Cr.
Equity Share Capital (Share of Rs. 100 each)		10,00,000		2,00,000
7% Preference Share Capital (Rs. 100 each)		-		2,00,000
Reserves		3,00,000		1,00,000
6% Debentures		2,00,000		2,00,000
Trade Receivables /Trade Payables	80,000	90,000	50,000	60,000
P&L A/c balance		20,000		15,000
Purchases/Sales	5,00,000	9,00,000	6,00,000	9,50,000
Wages & Salaries	1,00,000		1,50,000	
Debenture Interest	12,000		12,000	
General Expenses	80,000		60,000	
Preference-Dividend up to 30.6.2020		3,500	7,000	
Inventory (31.12.2020)	1,00,000		50,000	
Cash at Bank	13,500		6,000	
Investment in S Ltd.	5,28,000		-	
Property, Plant & Equipment	11,00,000		7,90,000	
	25,13,500	25,13,500	17,25,000	17,25,000

Investment in S Ltd. were acquired on 1.4.2020 and consisted of 80% of Equity Capital and 50% of Preference Capital. Depreciation on Property, Plant & Equipment is written off @ 10% p.a (computed on the basis of useful life. After acquiring control over S Ltd., H Ltd. supplied to it goods at cost plus 20%, the total invoice value of such goods being Rs. 60,000; 1/4 of such goods were still in Inventory at the end of the year. Prepare the Consolidated Profit and Loss Account for the year ended on 31.12.2020.

PRACTICE QUESTIONS

TOPIC 1 CONSOLIDATED BALANCE SHEET

Question 1 *(ICAI Study Material)* Pg no._____

Prepare Consolidated balance sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 2021 from the following information

	H Ltd.	S Ltd.
Property, Plant & Equipment	5,00,000	3,00,000
Investments (2,000 equity shares of S Ltd.)	2,20,000	-
Current Assets	1,55,000	1,00,000
Share Capital (Fully paid equity shares of 10 each)	5,00,000	2,50,000
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 31.03.2021

(Ans: Capital Reserve 60,000; Minority Interest 70,000; Balance Sheet Total 10,55,000)

Question 2 *(Inter Nov 2022) (15 Marks)* Pg no._____

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 1st July, 2021 and Balance of profit and loss account of S Ltd. on 1st April, 2021 was ₹ 60,000. Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31st March, 2022.

(Ans: Goodwill 66,500; Minority Interest 84,000; Balance Sheet Total 8,14,500)

Question 3 *(ICAI Study Material)* Pg no._____

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, 2021

	Note No.	Virat Ltd.	Anushka Ltd.
Equity & Liabilities			
(1) Shareholders' 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 Liabilities			
(a) Long Term Borrowings		2,00,000	1,00,000
(3) Current Liabilities			
(a) Trade Payables		1,00,000	1,00,000
		10,00,000	7,00,000

Assets			
(1) Non-Current Assets			
(a) PPE & Intangible Assets			
i. Property, Plant & Equipment		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
		10,00,000	7,00,000

Notes to Accounts:

		Virat Ltd.	Anushka Ltd.
1.	Share Capital		
	60,000 equity shares of 10 each, fully paid up	6,00,000	
	40,000 equity shares of 10 each, fully paid up		4,00,000
		6,00,000	4,00,000
2.	Reserves & Surplus		
	General Reserve	1,00,000	1,00,000
		1,00,000	1,00,000
3.	Non Current Investments		
	Shares in Anushka Ltd	3,20,000	-
		3,20,000	-

(Ans: Cost of Control Nil; Minority Interest 1,00,000; Balance Sheet Total 13,80,000)

Question 4 *(Inter Nov 2019) (5 Marks) / RTP Nov 2020 /ICAI Study Material)* *Pg no._____*

From the following data, determine Minority interest on the date of acquisition and on the date of consolidation in each case:

Case	Subsidiary Company	% shares owned	Cost	Date of acquisition 01.01.2019		Consolidation Date 31.12.2019	
				Share Capital	Profit & Loss A/c	Share Capital	Profit & Loss A/c
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
Case E	N	100%	1,00,000	40,000	40,000	40,000	65,000

(Ans: Acq: 22,500; 50,000; 18,000; 4,750; Nil Cons: 23,500; 40,000; 18,000; 5,750; Nil)

Question 5 *(Inter May 2018) (20 Marks) / (RTP Nov 2019)* *Pg no._____*

The following summarised Balance Sheets of H Ltd. and its subsidiary S Ltd. were prepared as on 31st March, 2020:

	H Ltd.	S Ltd.
Equity & Liabilities		
Shareholders' Funds		
Equity Shares of ₹ 10 each, fully paid up	12,00,000	2,00,000
Reserves and Surplus		
General Reserve	4,35,000	1,55,000

Profit and Loss Account	2,80,000	65,000
Current Liabilities		
Trade Payables	3,22,000	1,23,000
	22,37,000	5,43,000
Assets		
Non-Current Assets		
Property, Plant & Equipment		
Machinery	6,40,000	1,80,000
Furniture	3,75,000	34,000
Non-Current Investments		
Shares in S Ltd. - 16,000 shares @ ₹ 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
	22,37,000	5,43,000

H Ltd. acquired the 80% shares of S Ltd. on 1st April, 2019. On the date of acquisition, General Reserve and Profit Loss Account of S Ltd. stood at ₹ 50,000 and ₹ 30,000 respectively. Machinery (book value ₹ 2,00,000) and Furniture (book value ₹ 40,000) of S Ltd. were revalued at ₹ 3,00,000 and ₹ 30,000 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% and Furniture 15%). Trade Payables of H Ltd. includes ₹ 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 ₹ 55,000 purchased from S Ltd. You are required to prepare Consolidated Balance Sheet as at 31st March, 2020.

(Ans: Goodwill 24,000; Minority Interest 99,300; Balance Sheet Total 25,25,500)

Question 6 *(RTP May 2022)* Pg no.______

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

	Beta Ltd.	Gamma Ltd.
Share Capital		
Shares of ₹ 100 each	15,00,000	2,50,000
Reserves and Surplus		
Reserves	5,00,000	1,87,500
Profit and Loss Account	2,50,000	62,500
Current Liabilities		
Trade Payables	3,75,000	1,42,500
Non-Current Assets		
Property, Plant & 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 @ ₹200 each	4,00,000	-

Other information:

Reserves and Profit and Loss Account of Gamma Ltd. stood at ₹62,500 and ₹37,500 respectively on the date of acquisition of its 80% shares by Beta Ltd. on 1st April, 2020. Machinery (Book-value ₹ 2,50,000) and Furniture (Book value ₹ 50,000) of Gamma Ltd. were revalued at ₹ 3,75,000 and ₹ 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%.]
Ans: Goodwill 30,000; Minority Interest 1,20,375; Balance Sheet Total 29,99,375)

Question 7 *(Inter Jan 2021) (20 Marks)* *Pg no._____*

On 31st March, 2020 summarised Balance Sheets of H Ltd. & subsidiary S Ltd. stood as follows:

	H Ltd.	S Ltd.
Equity & Liabilities		
Shareholders' Funds		
Equity Shares of ₹ 10 each, fully paid up	13,40,000	2,40,000
Reserves and Surplus	4,80,000	1,80,000
Profit and Loss Account	2,40,000	60,000
Secured Loans		
12% Debentures	1,00,000	-
Current Liabilities		
Trade Payables	2,00,000	1,22,000
Bank Overdraft	1,00,000	-
Bills Payable	60,000	14,800
	25,20,000	6,16,800
Assets		
Non-Current Assets		
Property, Plant & Equipment		
Machinery	7,20,000	2,16,000
Furniture	3,60,000	40,800
Non-Current Investments		
Shares in S Ltd. - 19,200 shares @ ₹ 20 each	3,84,000	-
Current Assets		
Inventories	6,00,000	2,00,000
Trade Receivables	3,00,000	90,000
Bills Receivables	1,00,000	30,000
Cash at Bank	56,000	40,000
	25,20,000	6,16,800

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 ₹ 60,000 and ₹ 36,000 respectively.

(b) Machinery (Book value ₹ 2,40,000) and Furniture (Book value ₹ 48,000) of S Ltd were revalued at ₹ 3,60,000 and ₹ 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, 2020, Bills payable of ₹ 12,000 shown in S Ltd.'s Balance Sheet had been accepted in favour of H Ltd.

Prepare Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2020.
(Ans: Goodwill 28,800; Minority Interest 1,15,560; Balance Sheet Total 28,67,400)

Question 8 *(Inter May 2022) (15 Marks)* *Pg no._____*

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 paid up)	6,50,000	3,00,000
Reserves and Surplus		
General Reserve	60,000	30,000
Profit and loss account	1,50,000	90,000
(2) Current Liabilities		
Trade payables	1,15,000	75,000
Due to White Ltd.	-	30,000
	9,75,000	5,25,000
(II) Assets:		
(1) Non-current assets		
Property, Plant and Equipment	5,80,000	3,51,000
Investments		
Shares in Black Ltd. (2,250 shares)	2,70,000	
(2) 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.

(iii) Profits during the year 2020-2021 were earned evenly.

(iv) 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

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.

(Ans: Capital Reserve 7,500; Minority Interest 1,05,000; Balance Sheet Total 12,00,000)

Question 9 *(RTP Nov 2022)*

Pg no._____

On 31st March, 2022, H Ltd. and S Ltd. give the following information:

	H Ltd. (₹ in 000's)	S Ltd. (₹ in 000's)
Equity Share Capital – Authorised	5,000	3,000
Issued and subscribed in Equity Shares of ₹ 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. On that date the following balances stood in the books of S Ltd.:

General Reserve ₹ 1,500 thousand; Profit and Loss Account ₹ 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 ₹ 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 ₹ 50 thousand from H Ltd., which had made a profit of 25% on cost.

e) Details of Trade payables and Trade receivables:

	H Ltd. (₹ in 000's)	S Ltd. (₹ in 000's)
Trade payables		
-Bills Payable	124	80
-Sundry creditors	487	427
	611	507
Trade receivables		
-Debtors	700	683
-Bills Receivables	120	95
	820	778

Prepare a consolidated Balance Sheet as at 31st March, 2022.

(Ans: Capital Reserve 679.80; Minority Interest 1,560; Balance Sheet Total 10,223)

Question 10 *(ICAI Study Material)* *Pg no._____*

Hemant Ltd. purchased 80% shares of Power Ltd. on 1st January, 2020 for ₹ 2,10,000. The issued capital of Power Ltd., on 1st January, 2020 was ₹ 1,50,000 and the balance in the Profit & Loss Account was ₹ 90,000. During the year ended 31st December, 2020, 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, 2020 and 31st December, 2020? Also compute goodwill/ capital reserve at the date of acquisition.

(Ans: Goodwill 18,000; Minority Interest 01.01.20: 48,000 & 31.12.20: 49,500)

Question 11 *(ICAI Study Material)* *Pg no._____*

King Ltd. acquires 70% of equity shares of Queen Ltd. as on 31st March, 2020 at a cost of ₹ 140 lakhs. The following information is available from the balance sheet of Queen Ltd. as on 31st March, 2020:

	₹ in Lakhs
Property, Plant & 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.

(Ans: Capital Reserve 53.90 Lakhs)

Question 12 *(ICAI Study Material)* *Pg no._____*

A Ltd. acquired 60% shares of B Ltd. @ ₹ 20 per share. Following is the extract of Balance Sheet of B Ltd.:

	₹
10,00,000 Equity Shares of ₹ 10 each	1,00,00,000
10% Debentures	10,00,000
Trade Payables	55,00,000
Property, Plant & Equipment	70,00,000
Investments	45,00,000
Current Assets	68,00,000
Loans & 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 ₹ 60,00,000. Calculate the Goodwill or Capital Reserve to be recorded in Consolidated Financial Statements

(Ans: Goodwill 19,20,000)

Question 13 *(RTP May 2021)* *Pg no._____*

A Ltd. acquired 70% equity shares of B Ltd. @ ₹20 per share (Face value - ₹10) on 31st March, 2021 at a cost of ₹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

	₹ in Lakhs
Property, Plant & Equipment	360
Investments	90
Current Assets	140
Loans & Advances	30
15% Debentures	180
Current Liabilities	100

(Ans: Capital Reserve 98 Lakhs)

Question 14 *(Inter May 2019) (10 Marks) / (RTP May 2023)* *Pg no._____*

H Ltd. acquire 70% of equity share of S Ltd. as on 1st January, 2013 at a cost of ₹ 5,00,000 when S Ltd. had an equity share capital of ₹ 5,00,000 and reserves and surplus of ₹ 40,000. Both the companies follow calendar year as the accounting year.

In the four consecutive years, S Ltd. performed badly and suffered losses of ₹ 1,25,000, ₹ 2,00,000, ₹ 2,50,000 and ₹ 60,000 respectively. Thereafter in 2017, S Ltd. experienced turnaround and registered an annual profit of ₹ 25,000. In the next two years i.e. 2018 and 2019, S Ltd. recorded annual profits of ₹ 50,000 and ₹ 75,000 respectively.

Show the Minority Interests and Cost of Control at the end of each year for the purpose of consolidation.

(Ans: Goodwill 1,22,000; Minority Interest 1,62,000; 1,24,500; 64,500; Nil, Nil, Nil, Nil, 16,500)

Question 15 *(Inter Nov 2019) (10 Marks)* *Pg no._____*

Consider the following summarized Balance Sheets of subsidiary MNT Ltd.

Liabilities	2018-19 Amount in ₹	2019-20 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
	15,88,000	23,08,000
Assets		
Property, Plant & 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
	15,88,000	23,08,000

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 2018-2019 and increased by ₹ 12,000 at the end of 2019-2020. (Inventory of 2018-19 has been sold out during the year 2019-20)
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 2018-19 and ₹ 12,500 in 2019-20 being part of initial Sales Promotion expenditure of ₹37,500 in 2018-19, which is being written off over three years. Similar nature of Sales Promotion expenditure of LTC Ltd. has been fully written off in 2018-19.

Restate the balance sheet of MNT Ltd. as on 31st March, 2020 after considering the above information for the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by LTC Ltd. and MNT Ltd. uniform.

(Ans: Adjusted Revenue Reserve 5,11,500; Balance Sheet Total 23,14,500)

TOPIC 2 CONSOLIDATED PROFIT & LOSS ACCOUNT

Question 16 *(Inter Nov 2018) (10 Marks)* *Pg no._____*

The Profit and Loss Accounts of A Ltd. and its subsidiary B Ltd. for the year ended 31st March, 2020 are given below:

Incomes	₹ in Lakhs	
	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
Dividend paid	1,800	225
Balance of Profit	1,800	225

The following information is also given:

a) A Ltd sold goods of ₹ 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)

b) Administrative expenses of B Ltd include ₹ 8 Lakhs paid to A Ltd as consultancy fees.

c) Selling and distribution expenses of A Ltd include ₹15 Lakhs paid to B Ltd as commission.

d) A Ltd holds 72% of the Equity Capital of B Ltd. The Equity Capital of B Ltd prior to 2018-19 is ₹1,500 Lakhs

Prepare a consolidated Profit and Loss Account for the year ended 31st March, 2020.

(Ans: Profit after tax 4,044 Lakhs)

Question 17 *(Inter Dec 2021) (15 Marks)* *Pg no._____*

Moon Ltd. and its Subsidiary Star Ltd. provided the following information for the year ended 31st March ,2021.

Particulars	Moon Ltd. (₹)	Star Ltd. (₹)
Equity Share Capital	2,00,00,000	60,00,000
Finished Goods Inventory as on 01.04.2020	42,00,000	30,10,000
Finished Goods Inventory as on 31.03.2021	85,75,000	37,62,500
Dividend Income	16,80,000	4,37,500
Other Non-Operating Income	3,50,000	1,05,000
Raw Material Consumed	1,39,30,000	47,25,000
Selling & Distribution Expenses	33,25,000	15,75,000
Production Expenses	31,50,000	14,00,000
Loss on sale of Investments	2,62,500	Nil
Sales & other Operating Income	3,32,50,000	1,90,75,000
Wages & Salaries	1,33,00,000	24,50,000
General & Administrative Expenses	28,00,000	12,25,000
Royalty Paid	Nil	50,000
Depreciation	3,15,000	1,40,000
Interest Expense	1,75,000	52,500

Other Information:

- On 1st September, 2018 Moon Ltd. acquired 50,000 equity shares of ₹ 100 each fully paid up in the Star Ltd.
- Star Ltd paid Dividend of 10% for the year ended 31st March, 2020. The Dividend was correctly accounted for by Moon Ltd.
- Moon Ltd sold goods of ₹ 17,50,000 to Star Ltd. at the profit of 20% on selling price. Inventory of Star Ltd includes goods of ₹ 7,00,000 received from the Moon Ltd.

- Selling & Distribution expense of Star Ltd. include ₹ 2,12,500 paid to the Moon Ltd. as Brokerage Fees.
- General & Administrative Expense of Moon Ltd. includes ₹ 2,80,000 paid to Star Ltd. as consultancy fees.
- Star Ltd. used some resources of Moon Ltd. and Star Ltd. paid ₹ 50,000 to Moon Ltd as royalty.

Prepare Consolidated Statement of P&L of Moon Ltd. and its Subsidiary Star Ltd. for the year ended 31.03.2021 as per Schedule III to the Companies Act, 2013.

(Ans: Profit before tax 1,10,10,000)

Question 18 *(Inter July 2021) (15 Marks)* *Pg no.______*

The Trial Balances of X Limited and Y Limited as on 31st March, 2021 were as under:

	X Limited (₹ In 000)		Y Limited (₹ In 000)	
	Dr.	Cr.	Dr.	Cr.
Equity Share capital (Share of ₹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
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 upto 30.09.2020		7	14	
Inventory (as on 31.03.2021)	200		100	
Cash at Bank	27		12	
Investment in Y Limited	1,056		-	
Fixed Assets	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 ₹ 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 Fixed Assets.

You are required to prepare the Consolidated Statement of Profit and Loss for the year ended on 31st March, 2021.

(Ans: Profit tfd to Consolidated Balance Sheet 1,95,100)

Question 19 *(RTP Nov 2020) (Part b) / (ICAI Study Material)* *Pg no.______*

Suggest the accounting treatment for the below mentioned transactions in the consolidated financial statements of A Ltd giving reference of the relevant guidance/standard.

a. A Ltd holds 80% of the equity capital and voting power in B Ltd. A Ltd sells inventories costing ₹ 180 lacs to B Ltd at a price of ₹ 200 lacs. The entire inventories remain unsold with B Ltd at the financial year end i.e. 31 March 2019.

b. A Ltd holds 75% of the equity capital and voting power in B Ltd. A Ltd purchases inventories costing ₹ 150 lacs from B Ltd at a price of ₹ 200 lacs. The entire inventories remain unsold with A Ltd at the financial year end i.e. 31 March 2019.

FRAMEWORK FOR PREPARATION & PRESENTATION OF FINANCIAL STATEMENTS

CH 9

The Accounting Standards Board (ASB) of the ICAI issued framework in July, 2000 which provides the fundamental basis for development of new standards as also for review of existing standards.

PURPOSE OF FRAMEWORK

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

- Enterprises in preparation of their financial statements in compliance with the accounting standards (AS) and in dealing with the topics not yet covered by any AS.
- Accounting Standard Board (ASB) in its task of development and review of AS.
- ASB in promoting harmonization of regulations, accounting standards & procedures relating to preparation & presentation of financial statements by providing basis for reducing the number of alternative accounting treatments permitted by accounting standards.
- Auditors in forming an opinion as to whether financial statements conform to the AS.
- Users in interpretation of financial statements.

COMPONENTS OF FIANANCIAL STATEMENTS

Balance sheet	Portrays value of economics resources controlled by an enterprise.
Statement of P&L	Presents the results of operations of an enterprise.
Cash flow statement	Shows the way an enterprise generates cash and uses it.
Notes & other statements	Presents supplementary information explaining different items

USERS OF FINANCIAL STATEMENTS

Investors	Analysis of performance, profitability, financial position of Co.
Employees	Knowledge of stability, continuity, growth
Suppliers, creditors	Determination of credit worthiness
Customers	Analysis of stability, profitability.
Government	Evaluation of entity's performance & contribution to social objectives.
Lenders	Determine whether their loans and interest will be paid when due.
Public	Determine contribution to the local economy and public at large

FUNDAMENTAL ACCOUNTING ASSUMPTIONS

Accrual	Transactions are recognized as and when they occur, without considering receipt /payment of cash.
Going concern	Enterprise will continue in operation in foreseeable future and will not liquidate.
Consistency	Using same accounting policies for similar transactions in all accounting periods.

QUALITATIVE CHARACTERISTICS OF FINANCIAL STATEMENTS

Inter Nov 2020 (5 Marks)

Understandability	Information presented in financial statements should be readily understandable by the users with reasonable knowledge of business and economic activities.
Relevance	Financial statements should contain relevant information only. Information, which is likely to influence the economic decisions by the users, is called relevant.
Reliability	Information must be reliable; that is to say, they must be free from material error and bias.
Comparability	Financial statements should permit both inter-firm and intra-firm comparison.
True and Fair view	Financial statements should show a true and fair view of the performance, financial position and cash flows of an enterprise.

ELEMENTS OF FINANCIAL STATEMENTS

Inter May 2018 (5 Marks)

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

* Example: *(RTP May 2020) / (RTP May 2023)*

A Ltd. has entered into a binding agreement with P Ltd. to buy a custom-made machine ₹ 40,000. At the end of 2021-22, before delivery of the machine, A Ltd. had to change its method of production. The new method will not require the machine ordered and it will be scrapped after delivery. The expected scrap value is nil.

A liability is recognised when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured.

In the given case, A Ltd. should recognise a liability of ₹ 40,000 to P Ltd. When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognised as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognised as an expense.

The accounting entry is suggested below:

P&L A/c Dr. 40,000
To P Ltd. 40,000

(Loss due to change in production method)

(2 separate entries can also be passed instead of 1 entry)

MEASUREMENT BASIS OF ELEMENTS IN FINANCIAL STATEMENTS

Inter Dec 2021 (5 Marks)

Measurement is the process of determining money value at which an element can be recognized in the balance sheet or statement of profit & loss. Framework for Preparation 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 & loss.

Historical cost	Acquisition price
Current Cost	Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
Realisable (Settlement) Value	For assets, amount currently realisable on sale of the asset in an orderly disposal. For liabilities, this is the undiscounted amount expected to be paid on settlement of liability in the normal course of business.
Present Value	Assets are carried at present value of future net cash flows generated by the concerned assets in the normal course of business. Liabilities 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.

Example 1 **(Historical cost)**

Mr. X purchased a machine on 1st January, 2016 at ₹ 7,00,000. As per historical cost basis, he has to record it at ₹ 7,00,000 i.e. the acquisition price. As on 1.1.2021, Mr. X found that it would cost ₹ 25,00,000 to purchase that machine. Mr. X also took loan from a bank as on 2016 ₹ 5,00,000 @ 18% p.a repayable at the end of 15th year together with interest.
As per historical cost, the liability is recorded at ₹ 5,00,000 at the amount or proceeds received in exchange for obligation and asset is recorded at ₹ 7,00,000.

Example 2 **(Current cost)**

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

Example 3 **(Present Value)**

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

CAPITAL MAINTENANCE

Financial capital maintenance	At historical cost	Opening & closing assets are stated at historical costs.
	At current purchasing power	Restatement at closing prices using average price indices.
Physical capital maintenance	Restatement at closing prices using specific price indices.	

Example 1 (Financial Capital Maintenance at historical cost)

A trader commenced business on 01/01/2021 with ₹ 12,000 represented by 6,000 units of a certain product at ₹ 2 per unit. During the year 2021 he sold these units at ₹ 3 per unit and had withdrawn ₹ 6,000. Thus:

Opening Equity = ₹ 12,000 represented by 6,000 units at ₹ 2 per unit.
Closing Equity = ₹ 12,000 (₹ 18,000 – ₹ 6,000) represented entirely by cash.
Retained Profit = ₹ 12,000 – ₹ 12,000 = Nil

The trader can start year 2022 by purchasing 6,000 units at ₹ 2 per unit once again for selling them at ₹ 3 per unit. The whole process can repeat endlessly if there is no change in purchase price of the product.

Example 2 (Financial Capital Maintenance at current purchasing power)

In the previous example (Example 1), suppose that the average price indices at the beginning and at the end of year are 100 and 120 respectively.

Opening Equity = ₹ 12,000 represented by 6,000 units at ₹ 2 per unit.
Opening equity at closing price = (₹ 12,000 / 100) x 120 = ₹ 14,400 (6,000 x ₹ 2.40)
Closing Equity at closing price = ₹ 12,000 (₹ 18,000 – ₹ 6,000) represented entirely by cash.
Retained Profit = ₹ 12,000 – ₹ 14,400 = (-) ₹ 2,400

The negative retained profit indicates that the trader has failed to maintain his capital. The available fund ₹ 12,000 is not sufficient to buy 6,000 units again at increased price ₹ 2.40 per unit. In fact, he should have restricted his drawings to ₹ 3,600 (₹ 6,000 – ₹ 2,400).
Had the trader withdrawn ₹ 3,600 instead of ₹ 6,000, he would have left with ₹ 14,400, the fund required to buy 6,000 units at ₹ 2.40 per unit.

Example 3 (Physical Capital Maintenance)

In the previous example (Example 1) suppose that the price of the product at the end of year is ₹ 2.50 per unit. In other words, the specific price index applicable to the product is 125.

Current cost of opening stock = (₹ 12,000 / 100) x 125 = 6,000 x ₹ 2.50 = ₹ 15,000
Current cost of closing cash = ₹ 12,000 (₹ 18,000 – ₹ 6,000)
Opening equity at closing current costs = ₹ 15,000
Closing equity at closing current costs = ₹ 12,000
Retained Profit = ₹ 12,000 – ₹ 15,000 = (-) ₹ 3,000

The negative retained profit indicates that the trader has failed to maintain his capital. The available fund ₹ 12,000 is not sufficient to buy 6,000 units again at increased price ₹ 2.50 per unit. The drawings should have been restricted to ₹ 3,000 (₹ 6,000 – ₹ 3,000).
Had the trader withdrawn ₹ 3,000 instead of ₹ 6,000, he would have left with ₹ 15,000, the fund required to buy 6,000 units at ₹ 2.50 per unit.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)*

Mohan started a business on 1st April 2021 with ₹ 12,00,000 represented by 60,000 units of ₹ 20 each. During the financial year ending on 31st March, 2022, he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate maximum amount, which can be withdrawn by Mohan in the year 2021-22 if Financial Capital is maintained at historical cost.

Solution

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

Question 2 *(ICAI Study Material)*

Balance sheet of a trader on 31st March, 2021 is given below

Liabilities	Amount	Assets	Amount
Capital	60,000	Property, Plant & 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 costs	10,000
		Bank	5,000
	1,30,000		1,30,000

Additional information:

a) The remaining life of Property, Plant & Equipment is 5 years. The pattern of use of the asset is even. The net realisable value of Property, Plant & Equipment on 31.03.22 was ₹ 60,000.
b) The trader's purchases and sales in 2021-22 amounted to ₹ 4 lakh and ₹ 4.5 lakh respectively.
c) The cost and net realisable value of stock on 31.03.22 were ₹ 32,000 & ₹ 40,000 respectively.
d) Expenses (including interest on loan) for the year amounted to ₹ 14,900.
e) Deferred cost is amortised equally over 4 years.
f) Debtors on 31.03.22 is ₹ 25,000, of which ₹ 2,000 is doubtful. Collection of another ₹ 4,000 depends on successful re-installation of certain product supplied to the customer.
g) Closing trade payable is ₹ 12,000, which is likely to be settled at 5% discount.
h) Cash balance on 31.03.22 is ₹ 37,100.
i) There is an early repayment penalty for the loan ₹ 2,500.

Prepare the Profit and Loss Accounts and Balance Sheets of the trader in two cases (i) assuming going concern (ii) not assuming going concern

Solution

Profit and Loss Account for the year ended 31st March, 2022

	Case (i)	Case (ii)		Case (i)	Case (ii)
To Opening Stock	30,000	30,000	By Sales	4,50,000	4,50,000
To Purchases	4,00,000	4,00,000	By Closing Stock	32,000	40,000
To Expenses	14,900	14,900	By Trade payables	-	600
To Depreciation	13,000	5,000			
To Provision for doubtful debts	2,000	6,000			

To Deferred cost	2,500	10,000			
To Loan penalty	-	2,500			
To Net Profit (b.f.)	19,600	22,200			
	4,82,000	4,90,600		4,82,000	4,90,600

Balance Sheet as at 31st March, 2022

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

Question 3 *(Inter May 2019) (5 Marks)/ (RTP May 2022) / (RTP Nov 2022)*

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

Liabilities	Amount	Assets	Amount
Capital	3,00,000	Property, Plant & Equipment	360,000
Profit and Loss Account	1,25,000	Stock	1,50,000
10% Loan	2,10,000	Debtors	1,00,000
Creditors	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 & Equipment is 8 years. The pattern of use of asset is even. The net realisable value of Property, Plant & 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) Cost & net realizable value of stock on 31.03.2022 were ₹2,00,000 & ₹2,50,000 respectively.

(4) Expenses for the year amounted to ₹ 78,000.

(5) Deferred Expenses are amortized equally over 5 years.

(6) Sundry Debtors on 31.03.22 are 1,50,000 of which 5,000 is doubtful. Collection of another 25,000 depends on successful re-installation of certain product supplied to the customer;

(7) Closing Sundry Creditors are ₹ 75,000, likely to be settled at 10% discount.

(8) Cash balance as on 31.03.2022 is ₹ 4,22,000.

(9) There is an early repayment penalty for the loan of ₹ 25,000.

You are required to prepare: (Not assuming going concern)

(1) Profit & Loss Account for the year 2021-22.

(2) Balance Sheet as on 31st March, 2022.

Solution

Profit and Loss Account for the year ended 31st March, 2022 (not assuming going concern)

	Amount		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 cost	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	Property, Plant & Equipment	3,25,000
Profit and Loss Account	5,14,500	Stock	2,50,000
10% Loan	2,35,000	Trade receivables (less provision)	1,20,000
Trade payables	67,500	Deferred costs	Nil
		Bank	4,22,000
	11,17,000		11,17,000

*Assumed that ₹ 78,000 includes interest on 10% loan amount for the year.

Question 4 *(ICAI Study Material)*

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.

Solution

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

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

Question 5

Mr. Roy is engaged in Trading of Item I and II. Following Data are available from his Accounting records for Accounting period (1st April, 2021 to 31st March, 2022)

(i) Purchased item I on cash for ₹ 60,000 in F.Y. 2021-22.
(ii) Purchased item II on credit for ₹ 4,500 in F.Y. 2021-22.
(iii) Sold item II for ₹ 5,000 in cash in F.Y. 2021-22.
(iv) He also sold item I for ₹ 60,000 in cash and ₹ 15,000 on credit in F.Y. 2021-22.
(v) Payment for Item II purchase was done on 20th April 2022 for ₹ 4,300 as full and final payment
(vi) Paid Insurance ₹ 2,400 for one year as on 1 st July, 2021
(vii) Wages to worker is payable for the month of March, 2022 ₹ 200.

Prepare Profit & Loss A/c of trader by applying cash basis and accrual basis of accounting

Solution

Cash basis of accounting
Profit and Loss Account for the period 2021-22

Particulars	₹	Particulars	₹
To Purchase	60,000	By Sale	65,000
To Insurance	2,400		
To Net Profit	2,600		
	65,000		65,000

Accrual basis of accounting
Profit and Loss Account for the period 2021-22

Particulars	₹	Particulars	₹
To Purchase	64,500	By Sale	80,000
To Wages*	200	By Discount Received**	200
To Insurance (2,400 less prepaid 600)	1,800		
To Net Profit	13,700		
	80,200		80,200

*Considered that there was no payment of wages during the year. This worker was hired only in month of March.
** This discount was known and determined in the year 2021-22 (till 31st March, 2022).

PRACTICE QUESTIONS

Question 1 *(RTP Nov 2019) / (RTP May 2021)*

Aman started a business on 1st April 2021 with ₹ 24,00,000 represented by 1,20,000 units of ₹ 20 each. During the financial year ending on 31st March, 2022, he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Aman in the year 2021-22 if Financial Capital is maintained at historical cost.

Solution

Particulars	₹
Closing equity (₹ 30 x 60,000 units)	36,00,000 represented by cash
Opening equity	1,20,000 units x ₹ 20 = 24,00,000
Permissible drawings to keep Capital intact	12,00,000 (36,00,000 – 24,00,000)

Question 2 *(Inter Jan 2021) (5 Marks)*

Explain how financial capital is maintained at historical cost?
Kishore started a business on 1st April, 2021 with ₹ 15,00,000 represented by 75,000 units of ₹ 20 each. During the financial year ending on 31st March, 2022, he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Kishore in the year 2021-22 if Financial Capital is maintained at historical cost.

Solution

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 which can be withdrawn by Kishore in year 2021-22 if Financial capital is maintained at historical cost

Particulars	₹
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 2021-22 if Financial capital is maintained at historical cost.

Question 3 *(Inter July 2021) (5 Marks)*

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.

Solution

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 units x ₹ 25	₹ 1,50,000

Current cost of closing cash (₹ 1,80,000 – ₹ 60,000)	₹ 1,20,000
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 should have 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	₹ 1,50,000
Retained 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 4 *(ICAI Study Material)*

Balance Sheet of Anurag Trading Co. on 31st March, 2021 is given below:

Liabilities	Amount	Assets	Amount
Capital	50,000	Property, Plant & Equipment	69,000
Profit and Loss Account	22,000	Stock	36,000
10% Loan	43,000	Trade Receivables	10,000
Trade Payables	18,000	Deferred Expenses	15,000
		Bank	3,000
	1,33,000		1,33,000

Additional Information:

a) Remaining life of Property, Plant & Equipment is 5 years with even use. The net realizable value of Property, Plant & Equipment as on 31st March, 2022 was ₹ 64,000.

b) Firm's sales and purchases for the year 2021-22 amounted to ₹ 5 lacs and ₹ 4.50 lacs respectively.

c) The cost and net realizable value of the stock were ₹ 34,000 and ₹ 38,000 respectively.

d) General Expenses for the year 2021-22 were ₹ 16,500.

e) Deferred Expenditure is normally amortised equally over 4 years starting from F.Y. 2020-21 i.e. ₹ 5,000 per year.

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

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

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

Prepare Profit & Loss Account for the year ended 31st March, 2022 by assuming it is not a Going Concern.

Solution

Profit and Loss Account for the year ended 31st March, 2022 (not assuming going concern)

	Amount		Amount
To Opening Stock	36,000	By Sales	5,00,000
To Purchases	4,50,000	By Closing Stock	38,000
To Expenses*	16,500	By Trade payables	500
To Depreciation	5,000		
To Provision for doubtful debts	4,000		
To Deferred cost	15,000		

To Loan penalty	2,000		
To Net Profit (b.f.)	10,000		
	5,38,500		5,38,500

*Assumed that General Expenses includes interest on 10% loan amount for the year.

Question 5 *(Inter Nov 2020) (5 Marks)*

Following is the Balance Sheet of M/s. S Traders as on 31st March, 2021:

Liabilities	Amount	Assets	Amount
Capital	1,50,000	Fixed Assets	1,05,000
Profit and Loss Account	56,000	Stock	76,000
11% Bank Loan	80,000	Debtors	68,000
Trade Payables	52,000	Deferred Expenses	24,000
		Cash & Bank	65,000
	3,38,000		3,38,000

Additional Information:

(i) Remaining life of Fixed Assets is 6 years with even use. The net realizable value of Fixed Assets as on 31st March, 2022 is ₹ 90,000.

(ii) Firm's Sales & Purchases for the year ending 31st March, 2022 amounted to ₹ 7,80,000 and ₹ 6,25,000 respectively.

(iii) The cost & net realizable value of the stock as on 31st March, 2022 was, ₹ 60,000 and ₹ 66,000 respectively.

(iv) General expenses (including interest on Loan) for the year 2021-22 were ₹ 53,800.

(v) Deferred expenditure is normally amortised equally over 5 years starting from the Financial year 2020-21 i.e. ₹ 6,000 per year.

(vi) Debtors on 31st March, 2022 is ₹ 65,000 of which ₹ 5,000 is doubtful. Collection of another ₹ 10,000 debtors depends on successful re-installation of certain products supplied to the customer.

(vii) Closing Trade payable ₹ 48,000, which is likely to·be settled at 5% discount.

(viii) There is a prepayment penalty of ₹ 4,000 for Bank loan outstanding.

(ix) Cash & Bank balances as on 31st March, 2022 is ₹ 1,65,200.

Prepare Profit & Loss Account for the year ended 31st March, 2022 and Balance Sheet as on 31st March, 2022 assuming the firm is not a going concern

Solution

Profit and Loss Account for the year ended 31st March, 2022 (not assuming going concern)

	Amount		Amount
To Opening Stock	76,000	By Sales	7,80,000
To Purchases	6,25,000	By Closing Stock	66,000
To General Expenses	53,800	By Trade payables	2,400
To Depreciation	15,000		
To Provision for doubtful debts	15,000		
To Deferred expenses	24,000		
To Loan penalty	4,000		
To Net Profit (b.f.)	35,600		
	8,48,400		8,48,400

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

Liabilities	Amount	Assets	Amount
Capital	1,50,000	Fixed Assets	90,000
Profit and Loss Account 56,000+35,600	91,600	Stock	66,000
11% Loan	84,000	Trade receivables (less provision)	50,000
Trade payables	45,600	Deferred costs	Nil
		Cash & Bank	1,65,200
	3,71,200		3,71,200

Question 6 *(Inter Dec 2021) (5 Marks)*

Mrs. A is showing the consolidated aggregate opening balance of equity, liabilities and assets of ₹ 6 lakh, 4 lakh and 10 lakh 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 balance sheet in the form of Assets – Liabilities = Equity after each transaction.

Solution

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

Transactions	Assets	–	Liabilities	=	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 7 *(Inter Nov 2022) (5 Marks)*

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:

(a) A liability of ₹ 50,000 was finally settled at a discount of 2%.

(b) Dividend earned @ 15% on 1,000 (F.V 100 each) Equity shares held @ ₹ 12,000.

(c) Rent of the premises paid ₹ 20,000.

(d) Mr. Mohanty withdrew ₹ 10,000 for personal purposes and also withdrew Goods worth ₹ 5,000 for personal purposes.

(e) ₹ 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.

Solution

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

Transactions	Assets	–	Liabilities	=	Equity
	₹ lakh		₹ lakh		₹ 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
(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 bill receivables with corresponding increase in cash)

Question 8 *(ICAI Study Material)*

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

Solution

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.

INTRODUCTION TO ACCOUNTING STANDARDS

CH 10

Generally Accepted Accounting Principles (GAAP)	• GAAP refer to a common set of accepted accounting principles, standards, and procedures that business reporting entity must follow when it prepares and present its financial statements. • It's a combination of authoritative standards (set by policy boards) & the commonly accepted ways of recording & reporting accounting information • At international level such authoritative standards are known as International Financial Reporting Standards (IFRS) and in India we have authoritative standards named as AS and IND-AS.
Meaning of AS	Accounting standards are written policy documents issued by expert accounting body or by government with the support of other regulatory bodies [*e.g. MCA issuing AS for companies in consultation with NFRA (National Financial Reporting Authority)]* covering the aspects of recognition, measurement, presentation and disclosure of accounting transactions in the financial statements.
Issues dealt by AS	➢ Recognition of events and transactions in the financial statements. ➢ Measurement of these transactions and events. ➢ Presentation of these transactions & events in financial statements in a manner that is meaningful and understandable to the reader. ➢ The disclosure requirements which should be there to enable public at large, the stakeholders and potential investors in particular, to get an insight in to what these financial statements are trying to reflect and thereby facilitating them to take prudent and informed business decisions.
Objectives	➢ The primary objective is to establish standards which have to be complied with to ensure that the financial statements are prepared in accordance with generally accepted accounting principles. ➢ To provide standard for the diverse accounting policies and principles. ➢ To eliminate the non-comparability of financial statements. ➢ To increase/improve the reliability of the financial statements. ➢ To provide standards which are transparent for users.
Benefits	➢ Standardization of alternative accounting treatment (Reduce/ eliminate the confusing variations in the accounting treatments used to prepare the financial statements) ➢ Requirement for additional disclosures. (disclosures which are not statutorily required) ➢ Comparability of financial statements.
Limitations	➢ Difficulties in making choice between different treatments. ➢ Lack of flexibilities ➢ Restricted scope (accounting standards cannot override the statute)

Standards setting process	ICAI has constituted the Accounting Standard Board (ASB) in 1977. ASB is responsible for setting accounting standards. Although ASB is a body constituted by council of ICAI, it is independent in the formulation of accounting standards and council of ICAI is not empowered to make any modifications in the draft AS formulated by ASB without consulting with the ASB.
Process	➢ Identification of area (where standardization is required) ➢ Constitution of study groups (for research) ➢ Preparation of draft and its circulation ➢ Ascertainment of views of different bodies on draft (like SEBI, CBDT, C&AG) ➢ Finalization of exposure draft ➢ Comments reviewed on exposure draft (public comments) ➢ Modification of the draft ➢ Issue of AS • For Non Corporate Entities by ICAI • For Corporate Entities by Ministry of Corporate Affairs in consultation with NFRA

NEED FOR CONVERGENCE TOWARDS GLOBAL STANDARDS

Each country has its own set of rules and regulations for accounting and financial reporting. Therefore, when an enterprise decides to raise capital from the markets other than the country in which it is located, the rules and regulations of that other country will apply and this in turn will require that the enterprise is in a position to understand the differences between the rules governing financial reporting in the foreign country as compared to its own country of origin.
International analysts and investors would like to compare financial statements based on similar accounting standards, and this has led to the growing support for an internationally accepted set of accounting standards for cross-border filings.

Few aspects which required the need for convergence are : Raising funds from international markets, Comparability of financial statements, Uniformity, Comparability, Transparency etc. and Global Investment.

SIGNIFICANCE:

- Global Standards facilitate cross border flow of money, global listing in different stock markets and comparability of financial statements.
- The convergence of financial reporting and Accounting Standards is a valuable process that contributes to the free flow of global investment and achieves substantial benefits for all capital market stakeholders.
- It improves the ability of investors to compare investments on a global basis and, thus, lower 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.

INTERNATIONAL FINANCIAL REPORTING STANDARDS AS GLOBAL STANDARDS

The term International Financial Reporting Standards (IFRS) comprises IFRS issued by IASB; IAS issued by International Accounting Standards Committee (IASC); Interpretations issued by the Standard Interpretations Committee (SIC) and Interpretations issued by the IFRS Interpretations Committee of the IASB.
International Financial Reporting Standards (IFRSs) are considered a "principles based" set of standards. In fact, they establish broad rules rather than dictating specific treatments.

BECOMING IFRS COMPLIANT

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

Convergence with IFRS will result in following benefits:

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

ISSUE OF IND AS

The Government of India in consultation with the ICAI decided to converge and not to adopt IFRS issued by the IASB. The decision of convergence rather than adoption was taken after the detailed analysis of IFRS requirements and extensive discussion with various stakeholders.

Accordingly, while formulating IFRS converged Indian Accounting Standards (Ind AS), efforts have been made to keep these Standards, as far as possible, in line with the corresponding IAS/IFRS and departures have been made where considered absolutely essential.

Indian Accounting Standards (Ind AS) are IFRS converged standards issued by the Central Government of India under the supervision and control of Accounting Standards Board (ASB) of ICAI and in consultation with NFRA. NFRA recommends these standards to the MCA and MCA has to spell out the AS applicable for companies in India.
Ind AS are named and numbered in the same way as the corresponding International Financial Reporting Standards (IFRS).

In July 2014, the Finance Minister of India at that time, Shri Arun Jaitely ji, in his Budget Speech, announced an urgency to converge the existing accounting standards with the International Financial Reporting Standards (IFRS) through adoption of the new Indian Accounting Standards (Ind AS) by the Indian companies

The Ministry of Corporate Affairs (MCA) has issued the Companies (Indian Accounting Standards) Rules, 2015 vide Notification dated February 16, 2015 covering the revised roadmap of implementation of Ind AS for companies other than Banking companies, Insurance Companies and NBFCs and Indian Accounting Standards (Ind AS).
As per the Notification, Indian Accounting Standards (Ind AS) converged with International Financial Reporting Standards (IFRS) shall be implemented on voluntary basis from 1st April, 2015 and mandatorily from 1st April, 2016. Separate roadmaps have been prescribed for implementation of Ind AS to Banking, Insurance companies and NBFCs respectively.

CARVE OUTS/INS IN IND AS

- Various terminology related changes have been made to make it consistent with the terminology used in law, e.g., 'statement of profit and loss' in place of 'statement of comprehensive income' and 'balance sheet' in place of 'statement of financial position'.
- Removal of options in accounting principles and practices in Ind AS vis-a-vis IFRS, have been made to maintain consistency and comparability of the financial statements to be prepared by following Ind AS. However, these changes will not result into carve outs.
- Certain changes have been made considering the economic environment of the country, which is different as compared to the economic environment presumed to be in existence by IFRS. These differences are due to differences in economic conditions prevailing in India. These differences which are in deviation to the accounting principles and practices stated in IFRS, are commonly known as 'Carve-outs'.
- Additional guidance given in Ind AS over and above what is given in IFRS, is termed as 'Carve in'

ROADMAP FOR IMPLEMENTATION OF INDAS:

For Companies other than Banks, NBFCs and Insurance Companies

Phase I: 1st April 2015 or thereafter (with Comparatives): Voluntary Basis for any company (other than Banks, NBFCs and Insurance companies) and its holding, subsidiary, Joint venture (JV) or Associate Company.

1st April 2016: Mandatory Basis

(a) Companies listed/in process of listing on Stock Exchanges in India or Outside India having net worth of INR 500 crore or more;
(b) Unlisted Companies having net worth of INR 500 crore or more;
(c) Parent, Subsidiary, Associate and JV of above.

Phase II: 1st April 2017: Mandatory Basis

(a) All companies which are listed/or in process of listing on Stock Exchanges in India or outside India not covered in Phase I (other than companies listed on SME Exchanges);
(b) Unlisted companies having net worth of INR 250 crore or more but less than INR 500 crore;
(c) Parent, Subsidiary, Associate and JV of above.

Special Points to Consider:-

- Companies listed on SME exchange are not required to apply Ind AS. Such companies shall continue to apply existing ASs unless they choose otherwise.
- Once Ind AS are applicable, an entity shall be required to follow the Ind AS for all the subsequent financial statements i.e. there is no looking back once the Ind AS are adopted by companies.
- Companies not covered by the above roadmap shall continue to apply Accounting Standards notified in Companies (Accounting Standards) Rules, 2006.

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

Non-Banking Financial Companies (NBFCs)	
Phase I:	From 1st April, 2018 (with comparatives)
	NBFCs (whether listed or unlisted) having net worth INR 500 crores or more
	Holding, Subsidiary, JV & Associate companies of above NBFC other than those already covered under corporate roadmap shall also apply from said date
Phase II:	From 1st April, 2019 (with comparatives)
	NBFCs whose equity and/or debt securities are listed or are in the process of listing on any stock exchange in India or outside India and having net worth less than INR 500 crores
	NBFCs that are unlisted having net worth INR 250 crores or more but less than INR 500 crores
	Holding, Subsidiary, JV and Associate companies of above companies other than those already covered under corporate roadmap shall also apply Ind AS from the said date.
• Applicable to both Consolidated and Individual Financial Statements	
• NBFC having net worth below INR 250 crores and not covered under the above provisions shall continue to apply ASs specified in Annexure to Companies (Accounting Standards) Rules, 2006.	
• Adoption of Ind AS is allowed only when required as per the roadmap	
• Voluntary adoption of Ind AS is not allowed.	
Scheduled Commercial banks (excluding RRBs)	
➢ Scheduled Commercial Banks (SCBs) excluding Regional Rural Banks (RRBs) were initially required to implement Ind AS from 1 April 2018. However, RBI (Reserve Bank of India) vide a press release dated 5 April 2018, deferred the implementation of Ind AS by one year i.e. to be effective from 1 April 2019 instead of 1 April 2018. ➢ Further, the RBI through a notification dated 22 March 2019, deferred the Ind AS implementation till further notice. Urban Cooperative banks (UCBs) and Regional Rural banks (RRBs) are not required to apply Ind AS.	
Insurers/Insurance companies	
➢ MCA had outlined the road map for implementation of Ind AS by insurers/insurance companies from 1 April 2018. ➢ IRDAI (Insurance Regulatory and Development Authority of India) deferred the implementation of Ind AS in the insurance sector in India for a period of two years whereby the effective date was deferred to 1st April 2020. IRDAI, vide circular dated 21 January 2020, has deferred implementation of Ind AS in the insurance sector till further notice.	

APPLICABILITY OF ACCOUNTING STANDARDS

CH 10

Enterprises to which Accounting Standards apply

Accounting Standards apply in respect of any enterprise (whether organized in corporate, cooperative or other forms) engaged in commercial, industrial or business activities, whether or not profit oriented and even if established for charitable or religious purposes.

AS however, do not apply to 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 AS would be permissible only if no part of the activity of such enterprise is commercial, industrial or business in nature.

Even if a very small proportion of activities of an enterprise were considered to be commercial, industrial or business in nature, the AS would apply to all its activities including those, which are not commercial, industrial or business in nature

LEGAL PROVISION: COMPANIES ACT 2013

- Section 129 (1) of the Companies Act, 2013 requires companies to present their financial statements in accordance with the accounting standards notified under Section 133 of the Companies Act, 2013.
- Also, the auditor is required by Section 143(3)(e) to report whether, in his opinion, the financial statements of the company audited, comply with the accounting standards referred to in Section 133 of the Companies Act, 2013.
- As per Section 133 of the Companies Act, 2013, the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the ICAI in consultation with and after examination of the recommendations made by the National Financial Reporting Authority (NFRA)

Criteria for classification of Non-company entities by ICAI

For the purpose of applicability of Accounting Standards, Non-company entities are classified into four categories, viz., Level I, Level II, Level III and Level IV.
Level I entities are large size entities, Level II entities are medium size entities, Level III entities are small size entities and Level IV entities are micro entities. Level IV, Level III and Level II entities are referred to as Micro, Small and Medium size entities (MSMEs).

Level	Criterion
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: (i) Entities whose 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 entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds ₹ 250 crore in the immediately preceding accounting year. (iv) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of ₹ 50 crore at any time during the immediately preceding accounting year. (v) 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: (i) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds ₹ 50 crore but does not exceed ₹ 250 crore in the immediately preceding accounting year. (ii) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of ₹ 10 crore but not in excess of ₹ 50 crore at any time during the immediately preceding accounting year. (iii) Holding and subsidiary entities of any one of the above.
Level III Entities	Non-company entities which are not Level I and Level II entities but fall in any one or more of the following categories are classified as Level III entities: (i) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds ₹ 10 crore but does not exceed ₹ 50 crore in the immediately preceding accounting year. (ii) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of ₹ 2 crore but not in excess of ₹ 10 crore at any time during the immediately preceding accounting year. (iii) Holding and subsidiary entities of any one of the above.
Level IV Entities	Non-company entities which are not covered under Level I, Level II and Level III are considered as Level IV entities

Additional Requirements:

(1) MSME which avails the exemptions or relaxations given to it shall disclose (by way of a note to its 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.

(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 be revised merely by reason of its having ceased to be covered in Level II or Level III or Level IV, as the case may be. The fact that the entity was covered in Level II or Level III or Level IV, as the case may be, in the previous period and it had availed of the exemptions or relaxations available to that Level of entities shall be disclosed in the notes to the financial statements. The fact that previous period figures have not been revised shall also be disclosed in the notes to the financial statements.

(3) Where an entity has been covered in Level I & 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 2 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.

(4) 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.

(5) 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.

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

(7) In respect of Accounting Standard (AS) 15, Employee Benefits, exemptions/ relaxations are available to Level II and Level III entities, under two subclassifications, 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 subclassifications.

EXEMPTIONS or RELAXATIONS FOR NON-COMPANY ENTITIES FALLING IN LEVEL II / LEVEL III AND LEVEL IV

	Level II	Level III	Level IV
AS not Applicable	AS 3, AS 17, AS 20, AS 21, AS 23, AS 25, AS 27	AS 3, AS 17, AS 18, AS 20, AS 21, AS 23, AS 24, AS 25, AS 27	AS 3, AS 14, AS 17, AS 18, AS 20, AS 21, AS 23, AS 24, AS 25, AS 27, AS 28
AS applicable with Disclosure Exemptions	AS 19, AS 28, AS 29	AS 10, AS 11, AS 19, AS 28, AS 29	AS 10, AS 11, AS 13, AS 19, AS 26, AS 29
Applicable with Exemptions	AS 15	AS 15	AS 15, AS 22

AS 21, 23, 25 & 27 is applicable only if a Non-company entity is required or elects to prepare and present consolidated financial statements or interim financial report.

LIST OF ACCOUNTING STANDARDS (AS) IN INDIA

AS	AS TITLE	AS	AS TITLE
1	Disclosure of Accounting Policies	16	Borrowing Costs
2	Valuation of Inventories	17	Segment Reporting
3	Cash Flow Statements	18	Related Party Disclosures
4	Events Occurring after Bal. Sheet Date	19	Leases
5	Net P/L for the period, Prior Period Items & Changes in A/cing Policies	20	Earnings Per Share
6	~~Depreciation Accounting~~ -Withdrawn-	21	Consolidated Financial Statements
7	Construction Contracts	22	Accounting for Taxes on Income
8	-Withdrawn-	23	Accounting for Investment in Associates in CFS
9	Revenue Recognition	24	Discontinuing Operations
10	Property, Plant & Equipment	25	Interims Financial Reporting
11	Effects of changes in Foreign Exchange Rates	26	Intangible assets

12	Accounting for Government Grants	27	Financial Reporting of Interest in Joint Ventures
13	Accounting for Investments	28	Impairment of assets
14	Accounting for Amalgamation	29	Provisions, Contingent Liabilities and Contingent Assets
15	Employee Benefits		

CRITERIA FOR CLASSIFICATION OF COMPANIES AS PER COMPANIES (ACCOUNTING STANDARDS) RULES, 2021

Company	Criterion
SMC	Small and Medium-Sized Company (SMC) as defined in Clause 2(e) of the Companies (Accounting Standards) Rules, 2021: "Small and Medium Sized Company" (SMC) means, a company- (i) 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; (ii) which is not a bank, financial institution or an insurance company; (iii) whose turnover (excluding other income) does not exceed ₹ 250 crore in the immediately preceding accounting year; (iv) which does not have borrowings (including public deposits) in excess of ₹ 50 crore at any time during immediately preceding accounting year; and (v) which is not a holding or subsidiary company of a company which is not a small and medium-sized company. Explanation: For the purposes of clause 2(e), a company shall qualify as a Small and Medium Sized Company, if the conditions mentioned therein are satisfied as at the end of the relevant accounting period
Non-SMCs	Companies not falling within the definition of SMC are considered as Non- SMCs.

Same Additional requirements for Companies as was for non Companies

AS not applicable to SMC's in their entirety
AS 17 Segment Reporting AS 21* Consolidated Financial Statements AS 23* Accounting for Investments in Associates in Consolidated Financial Statements AS 25* Interim Financial Reporting AS 27* Financial Reporting of Interests in Joint Ventures *Applicable to only certain Non SMC's
AS in respect of which relaxations from certain requirements given to SMCs
AS 15 Employee Benefits AS 19 Leases AS 20 Earnings Per Share AS 28 Impairment of Assets AS 29 Provisions, Contingent Liabilities and Contingent Assets

Question 1

M/s Omega & Co. (a partnership firm), had a turnover of ₹ 1.25 crores (excluding other income) and borrowings of ₹ 0.95 crores in the previous year. It wants to avail the exemptions available in application of Accounting Standards to non-corporate entities for the year ended 31.3.2021. Advise the management of M/s Omega & Co in respect of the exemptions of provisions of ASs, as per the directive issued by the ICAI.

Solution

The question deals with the issue of Applicability of Accounting Standards to a noncorporate entity. For availment of the exemptions, first of all, it has to be seen that M/s Omega & Co. falls in which level of the non-corporate entities. Its classification will be done on the basis of the classification of non-corporate entities as prescribed by the ICAI. According to the ICAI, non-corporate entities can be classified under 4 levels viz Level I, Level II, Level III and Level IV entities.

Non-corporate entities which meet following criteria are classified as Level IV entities:

(i) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) does not exceed rupees 10 crores in the immediately preceding accounting year.

(ii) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) does not exceed ₹ 2 crores at any time during immediately preceding accounting year

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

As the turnover of M/s Omega & Co. is less than ₹ 10 crores and borrowings less than ₹ 2 crores, it falls under Level IV non-corporate entities.

In this case, AS 3, AS 14, AS 17, AS 18, AS 20, AS 21, AS 23, AS 24, AS 25, AS 27 and AS 28 will not be applicable to M/s Omega & Co. Relaxations from certain requirements in respect of AS 10, AS 11, AS 13, AS 15, AS 19, AS 22, AS 26 and AS 29 are also available to M/s Omega & Co.

Question 2

Comment whether the following Companies can be classified as a Small and Medium Sized Company (SMC) as per the Companies (Accounting Standards), Rules, 2021:

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

b) B Pvt. Ltd., has a turnover of ₹ 45 crores, other income of ₹ 7 crores & bank borrowings of ₹ 9 crores.

Solution

a) As per the definition of SMC, a company will be a SMC, if it is not holding or subsidiary company of another company which is not a SMC. Since A Pvt. Ltd., is a subsidiary of another Company which is listed, on London Stock Exchange (and is therefore not a SMC), A Pvt. Ltd., cannot be a SMC. The turnover and borrowings are not relevant in this case.

b) As per the definition of SMC, a company will be a SMC if its turnover does not exceed ₹ 250 crores or borrowings do not exceed ₹ 50 crore. For calculating this turnover, other income is not to be included. Since B Pvt. Ltd., has a turnover of ₹ 45 crores and borrowing of ₹ 9 crores, it will satisfy the definition and can be classified as SMC.

Question 3 *(ICAI Study Material)*

A company was classified as Non-SMC in 2021-22. In 2022-23 it has been classified as SMC. The management desires to avail the exemption or relaxations available for SMCs in 2022-23. However, the accountant of the company does not agree with the same. Comment.

Solution

As per Companies (Accounting Standards) Rules, 2021, an existing company, which was previously not an SMC and subsequently becomes an SMC, shall not be qualified for exemption or relaxation in respect of accounting standards available to an SMC until the company remains an SMC for two consecutive accounting periods. Therefore, the management of the company cannot avail the exemptions available with the SMCs for the FY 2022-23.

Question 4 *(ICAI Study Material)*

XYZ Ltd., with a turnover of ₹ 50 crores during the previous year and borrowings of ₹ 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 31.3.2021. Advise the management on the exemptions that are available as per the Companies (AS) Rules, 2021.

Solution

The question deals with the issue of Applicability of Accounting Standards for corporate & non-corporate.

The companies can be classified under two categories viz SMCs and Non SMCs under the Companies (AS) Rules, 2021.
Since, XYZ Ltd.'s turnover of ₹ 50 crores does not exceed ₹ 250 crores & borrowings of ₹ 1 crore is less than ₹ 50 crores, it is a small and medium sized company (SMC)
In this case, AS 3, AS 17, AS 21, AS 23, AS 27 will not be applicable to XYZ Ltd. Relaxations from certain requirements in respect of AS 15, AS 19, AS 20, AS 28 and AS 29 are also available to XYZ Ltd.

Question 5 *(RTP May 2022)*

A company with a turnover of ₹ 225 crores and borrowings of ₹ 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.

Solution:

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, 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 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-sized company.

Since, XYZ Ltd.'s turnover was ₹ 225 crores which does not exceed ₹ 250 crores but borrowings of ₹ 51 crore are more than ₹ 50 crores, it is not a small and medium sized company (SMC). The exemptions available to SMC are not available to this company.

Question 6 *(RTP May 2022)*

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.

Solution:

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 apply to 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 of the 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 in nature, the Accounting Standards would apply to all its activities including those, which are not commercial, industrial or business in nature.

DISCLOSURE OF ACCOUNTING POLICIES

Objectives

- *Disclosure of significant accounting policies followed in preparing and presenting financial statements.*
- *Manner in which accounting policies are disclosed in financial statements*

Accounting Policies

Meaning	These are: → Specific accounting principles (Eg: AS 2 – Lower of Cost or NRV) and → Methods of applying those principles (Eg: AS 2 FIFO or Weighted Average) adopted by the enterprise in the preparation & presentation of financial statements.
Notes	• There is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which the enterprises operate make alternative accounting policies acceptable. • Choice of the appropriate accounting policies in these specific circumstances of each enterprise requires considerable judgement by the management of the enterprise.

Fundamental Accounting Assumptions

Name	Going concern	It is assumed that an enterprise will continue its operations in the foreseeable future and neither there is intention, nor there is need to materially curtail the scale of operations.
	Consistency	It is assumed that accounting policies are consistent from one period to another.
	Accrual	Under this basis of accounting, transactions are recognised as soon as they occur, whether or not cash or cash equivalent is actually received or paid.
Notes	• If the above said assumptions are followed in financial statements, specific disclosure is not required. • If a fundamental accounting assumption is not followed, the fact should be disclosed. • Disclosure is necessary if not followed.	

Considerations in the selection of Accounting Policies

Primary consideration	Financial statements should present true and fair view of →The state of affairs of the enterprise as at the balance sheet date and →The profit or loss for the period ended on that date	
Secondary consideration	Prudence	While recognizing the incomes, expenses and losses the principle of prudence should be followed. The income should be recognized only when it is certain to be received. (Profits are not anticipated) The provision should be created for all the known liabilities and losses.

<table>
<tr><td rowspan="2"></td><td>Substance over form</td><td>It implies that suitable changes may be made in the legal form of presentation to disclose the substance in a true and fair manner. Example:
a) Agreement to Sell
b) Hire Purchase Transaction</td></tr>
<tr><td>Materiality</td><td>Any item of financial statements which can influence the decision of user is termed as material item & all material items should be disclosed in the financial statements.
Example: A company should disclose by way of notes additional information regarding any item of income or expenditure which exceeds 1% of the revenue from operations or 1,00,000 whichever is higher. (Sch III)</td></tr>
<tr><td colspan="3">Disclosure of Accounting Policies</td></tr>
<tr><td>Points to note</td><td colspan="2">➢ All the accounting policies need to be disclosed at one place
➢ These should form an integral part of the financial statements.
➢ These are usually disclosed in “Notes to Accounts”</td></tr>
<tr><td>Examples (Areas in which different accounting policies may be adopted)</td><td colspan="2">• Valuation of Inventory
• Treatment of Goodwill
• Valuation of Investment
• Treatment of Retirement benefit
• Valuation of Fixed assets
• Treatment of Contingent liabilities.
• Treatment of Expenditure during construction
• Conversion or translation of Foreign currency items.</td></tr>
<tr><td colspan="3">Change in an Accounting Policy</td></tr>
<tr><td>When change can be done?</td><td colspan="2">Accounting policy may be changed only if
→ Required by Statute
→ For Compliance with an Accounting Standard
→ For better presentation or true and fair view of the financial statements</td></tr>
<tr><td>Points to note</td><td colspan="2">• Any change in an accounting policy 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
• The amount by which any item 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.
• Any change in policy which does not affect the current period but can have material effect in the later periods, then such fact should be disclosed.</td></tr>
<tr><td>Disclosure requirement</td><td colspan="2">• Old policy
• New policy
• Reason for change in policy
• Impact of such change</td></tr>
</table>

ASSIGNMENT QUESTIONS

Question 1

X Limited has sold its building for ₹ 50 lakhs to the purchaser who has paid the full price. Company has given possession to the purchaser. The book value of the building is ₹ 35 lakhs. As at 31st March, 2022, documentation and legal formalities are pending. The company has not recorded the sale. It has shown the amount received as advance. Do you agree with this accounting treatment done by X Ltd.? What accounting treatment should the buyer give in its financial statements?

Solution

Although legal title has not been transferred, the economic reality & substance is that rights and beneficial interest in the immovable property have been transferred. Therefore, recording of disposal by the transferor would in substance represent the transaction entered into.

In view of this, X Ltd. should record the sales and recognize the profit of ₹ 15 lakhs in its Statement of Profit and Loss. It should remove building account from its balance sheet.

Further, in its 'Notes to Accounts', X Ltd. should disclose the following:

"Building has been sold and full consideration has been received and possession of the same has been handed over to the buyer. However, documentation and legal formalities are pending as on 31.3.2022."

The buyer should recognize the building as an asset in his balance sheet and charge depreciation on it. The buyer should disclose in his notes to account that possession has been received however documentation and legal formalities are pending.

Question 2 *(RTP May 2020) (Similar) / (ICAI Study Material)*

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 & 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 facts need not to be indicated.

(v) There is no single list of accounting policies which are applicable to all circumstances

Solution

(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 fundamental accounting assumptions; 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.

(iii) 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 significant accounting policies as such should form part of the financial statements and they should be disclosed in one place.

(iv) 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.

(v) 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 *(ICAI Study Material) / (RTP May 2023) (Similar)*

In the books of M/s Prashant Ltd. closing inventory as on 31.03.2022 amounts to ₹ 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 2021-22. On the basis of weighted average method, closing inventory as on 31.03.2022 amounts to ₹ 1,47,000. Realisable value of the inventory as on 31.03.2022 amounts to ₹ 1,95,000.
Discuss disclosure requirement of change in accounting policy as per AS-1.

Solution

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 change in accounting policy in the following manner:
'The company values its inventory at lower of cost and net realisable value. Since net realisable 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. 2021-22, 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'.

Question 4 *(RTP May 2018) / (RTP May 2021) (Similar) / (ICAI Study Material)*

Jagannath Ltd. had made a rights issue of shares in 2021. In the offer document to its members, it had projected a surplus of ₹ 40 crores during the accounting year to end on 31st March, 2022. 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 (₹ 50 crores) instead of the hitherto method of valuation of inventory at prime cost (₹ 30 crores).

(ii) 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 ₹ 600 crores.

(iii) Provide for permanent fall in the value of investments - which fall had taken place over the past five years - the 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 2021-2022.

Solution

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:

1) 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 ₹ 50 crores and the profit for the year is increased by ₹ 20 crores.
2) 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 ₹ 12 crores than would have been the case if the old policy were to continue.
3) The company has decided to provide ₹ 10 crores for the permanent fall 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 5 *(ICAI Study Material)*

ABC Financial Services Ltd. 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. ABC Financial Services Ltd. 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 from the due date to date of repayment was mentioned in 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 Profit and Loss Account. State whether the treatment done by the company is correct or not as per relevant accounting Standard.

Solution

AS 1 recognizes '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 recognized only when realized 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 of the 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 or on 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 of repayment is not correct.

Question 6 *(Inter Nov 2018) (5 Marks) / (RTP May 2020) (Similar)*

HIL Ltd. was making provision for non-moving stocks based on no issues having occurred for the last 12 months upto 31.03.2021. The company now wants to make provision based on technical evaluation during the year ending 31.03.2022.

Total value of stock ₹ 120 lakhs

Provision required based on technical evaluation ₹ 3.00 lakhs.

Provision required based on 12 months no issues ₹ 4.00 lakhs.

You are requested to discuss the following points in the light of Accounting Standard (AS)-1:

(i) Does this amount to change in accounting policy?

(ii) Can the company change the method of accounting?

Solution

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 ₹ 4 lakhs to ₹ 3 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 HIL Ltd. for the year 2021-22 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 ₹ 1 lakh."

PRACTICE QUESTIONS

Question 1 *(Inter Dec 2021) (5 Marks)*

a) 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.

b) In the Books of Kay Ltd., Closing stock as on 31st March, 2021 amounts to ₹ 1,24,000 (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 2020-2021. On the basis of weighted average method, closing stock as on 31st March, 2021 amounts to ₹ 1,15,000. Realisable value of the inventory as on 31st March, 2021 amounts to ₹ 1,54,000.

Discuss Disclosure Requirements of change in accounting policy in above cases as per AS 1.

Solution

a) 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 amount of provision maybe changed in case more prudent estimate canbe 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."

b) 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 company 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 inventory at lower of cost & 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. 2020-21, 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 & value of inventory by ₹ 9,000."

Question 2 *(Inter May 2022) (5 Marks)*

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

a) 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.

b) If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.
c) All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.
d) 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 facts need not to be indicated.

Solution

a) 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.
b) 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.
c) 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 in one place.
d) 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 3 – *(ICAI Study Material)*

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?

Solution

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 the financial statements reflect a true and fair view of the state of affairs of the enterprise as at the balance sheet date and of the profit or loss for 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.

To mitigate 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.

VALUATION OF INVENTORIES

AS 02

Meaning of Inventories	These are the assets: → Held for sale in the ordinary course of business (Finished goods/Stock in trade) → In the process of production for such sale (Work –in-Progress) → In the form of material or supplies to be consumed in the production process or in the rendering of services (raw material, stores and spares*, etc.) * *Inventories do not include spare parts, servicing equipment & standby equipment which meet the definition of property, plant and equipment as per AS 10. Such items are accounted for in accordance with AS 10.*
Common Classification of Inventories	(a) Raw materials & components (b) Work-in progress (c) Finished goods (d) Stock-in- trade (in respect of goods acquired for trading) (e) Stores and spares (f) Loose tools (g) Others (specify nature).
Non - Applicability	This standard does not apply to: • WIP arising under construction contracts • WIP of service providers • Shares, debentures & other financial instruments held as stock in trade • Producers' inventories of livestock, agricultural and forest products, and mineral oils, ores and gases to the extent that they are measured at net realisable value in accordance with well established practices in those industries, e.g. where sale is assured under a forward contract or a government guarantee or where a homogenous market exists and there is negligible risk of failure to sell.
Measurement (PARA 5)	Inventories should be valued at lower of cost and net realizable value

Cost of Inventories

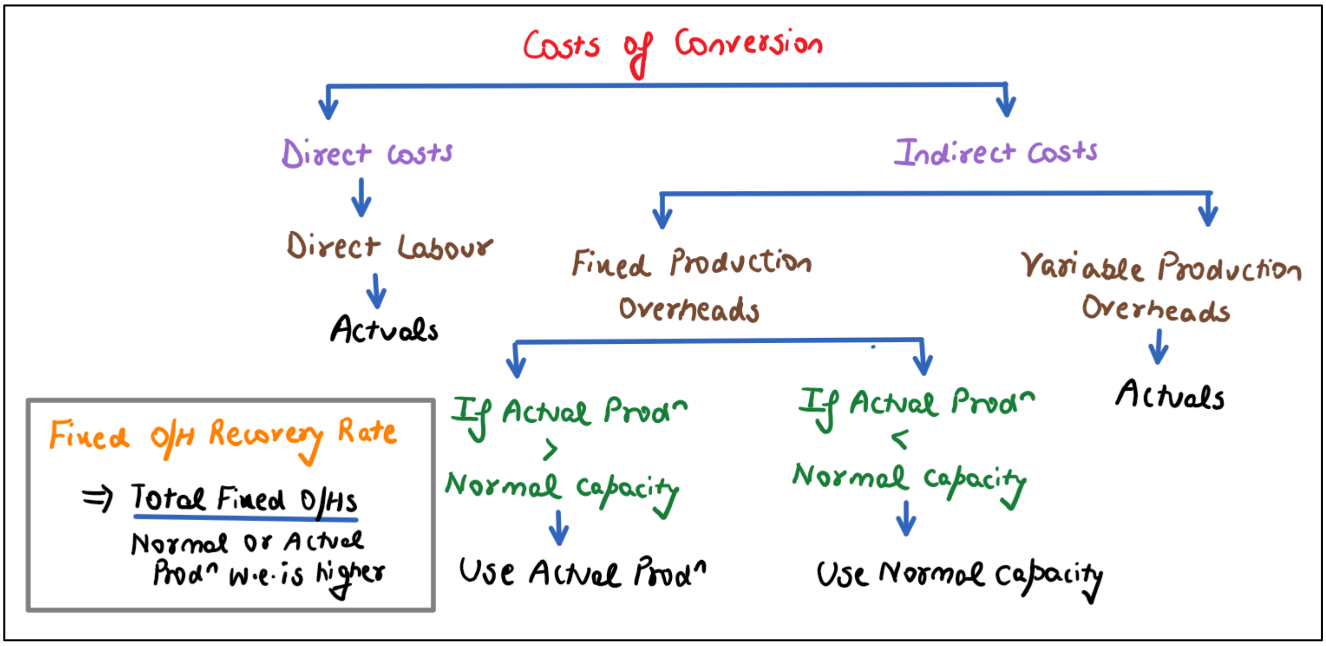
Cost of Purchase | Conversion cost | Other cost incurred in bringing the inventory to their present location and condition

A. COST OF PURCHASE

Basic Purchase Price	XX
Add Duties and Taxes (non refundable)	XX
Add Freight inwards	XX
Add Other expenditure directly attributable to the acquisition (Note)	XX
Less Trade discount and rebates	(XX)
Cost of Purchase	XX

Note: Examples of expenditure directly attributable for purchases are- (a) Costs of Containers (b) Transit Insurance, (c) Buying Commission where purchase of material is possible only through buying agents

B. COST OF CONVERSION



ABC Ltd. has a plant with the capacity to produce 1 lac unit of a product per annum and the expected fixed overhead is ₹ 18 lacs. Fixed overhead on the basis of normal capacity is ₹ 18 (18 lacs/1 lac).

Case 1:

Actual production is 1 lac units. Fixed overhead on the basis of normal capacity and actual overhead will lead to same figure of ₹ 18 lacs.
Therefore, it is advisable to include this on normal capacity.

Case 2:

Actual production is 90,000 units. Fixed overhead is not going to change with the change in output and will remain constant at ₹ 18 lacs, therefore, overheads on actual basis is ₹ 20 per unit (18 lacs/ 90 thousands).
Hence by valuing inventory at ₹ 20 each for fixed overhead purpose, it will be overvalued and the losses of ₹ 1.8 lacs will also be included in closing inventory leading to a higher gross profit then actually earned.
Therefore, it is advisable to include fixed overhead per unit on normal capacity to actual production (90,000 x 18) ₹ 16.2 lacs and rest ₹ 1.8 lacs should be transferred to P&L Account.

Case 3:

Actual production is 1.2 lacs units. Fixed overhead is not going to change with the change in output and will remain constant at ₹ 18 lacs, therefore, overheads on actual basis is ₹ 15 (18 lacs/ 1.2 lacs).
Hence by valuing inventory at ₹ 18 each for fixed overhead purpose, we will be adding the element of cost to inventory which actually has not been incurred. At ₹ 18 per unit, total fixed overhead comes to ₹ 21.6 lacs whereas, actual fixed overhead expense is only ₹ 18 lacs.
Therefore, it is advisable to include fixed overhead on actual basis (1.2 lacs x 15) ₹ 18 lacs.

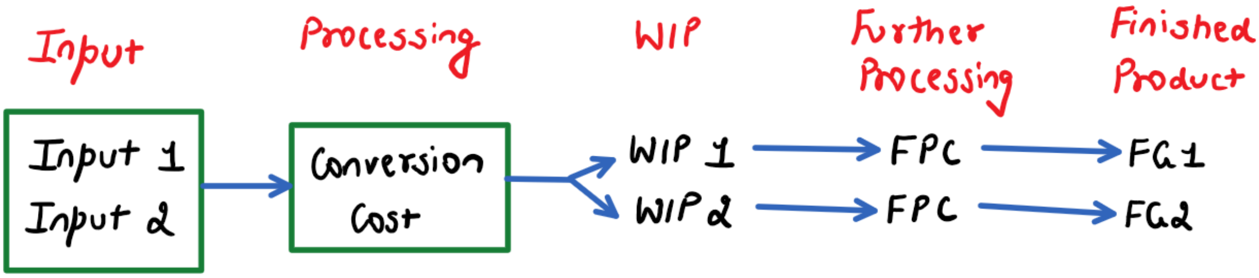
COST OF CONVERSION IN CASE OF PRODUCTION PROCESS RESULTING IN MORE THAN ONE PRODUCT BEING PRODUCED SIMULTANEOUSLY

(NOT SEPARATELY IDENTIFIABLE)

CASE 1: JOINT PRODUCT:

When the cost of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis.

Allocation may be based for e.g., Relative sales value of each product either at the stage in production process when the products become separately identifiable or at the completion of production.



Basis of Allocation of Conversion Cost

At the stage in Production process	At the completion of Production
↓	↓
On the relative sales value of WIP 1 and WIP 2	On the relative sales value of FG 1 and FG 2

CASE 2: MAIN PRODUCT AND BY PRODUCT:

- Most by products as well as scrap or waste materials, by their nature are immaterial.
- In such a case, they are measured at NRV and such value is deducted from the cost of main product.

C. OTHER COST

Other costs are included in cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.

Example: Cost of designing products for specific customers.

EXCLUSIONS FROM THE COST OF INVENTORIES (PARA 13)

- Abnormal amount of wasted materials, labour or other production cost (Abnormal loss)
- Storage cost unless those are necessary in the production process prior to a further production stage.
- Administrative overheads that do not contribute to bringing the inventories to their present location and condition.
- Selling and distribution cost
- Interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are therefore usually not included in cost of inventory *(Para 12)*

COST FORMULAS

For items that are not ordinarily interchangeable	For other items
Specific identification of cost method: Specific costs are attributed to identified items of inventory	FIFO: Inventory which were purchased or produced first are sold or consumed first. or Weighted Average method: Weighted average of cost of similar items

TECHNIQUES FOR MEASUREMENT OF COST
(May Be Used For Convenience if Results Approximate Actual Cost)

Standard Cost method	Retail method
Takes into account normal levels of consumption of materials and supplies, labour, efficiency and capacity utilization	• Often used in the retail trade for measuring inventories of large numbers of rapidly changing items that have similar margins. • Inventory is determined by reducing from sales value of inventory the appropriate GP %

Example

Calculate cost of inventories using adjusted selling price/retail method:

Sales = 2,00,000 Purchases = 2,00,000 Closing Stock at selling price = 50,000

NET REALISABLE VALUE (NRV)

Estimated Selling Price	XX
Less: Estimated selling expenses	(XX)
Less: Estimated cost of completion	(XX)
NRV	XX

- NRV is to be seen on each and every balance sheet date.
- Inventories should be usually written down to NRV on an item by item basis (individual basis) and not on global basis.
- In case of firm/committed contract of sale, NRV shall be calculated at the contract price.

Example

X Ltd deals in 2 products A & B neither similar nor interchangeable. At the end of year, the Historical Cost and NRV of items of closing stock are given below. Determine the value of closing stock.

Items	Historical Cost	Net Realizable Value
Item 1	50,000	45,000
Item 2	20,000	24,000

Example

Closing Stock: 3,000 units. Cost per Unit 40. Selling Price per Unit 45.

There is firm contract for 1,000 units @ 37 per unit.

VALUATION OF MATERIALS AND OTHER SUPPLIES *(PARA 24)*

If finished product in which such raw material is to be used is expected to be sold at or above cost price [$SP_{FG} \geq CP_{FG}$]	Other cases [$SP_{FG} < CP_{FG}$]
Value Raw Material at Cost Price.	Value Raw Material at Lower of Cost price or Replacement price [CP or RP ↓]

DISCLOSURE REQUIREMENTS:

- ❖ Accounting policies
- ❖ Cost formula used
- ❖ Total carrying amount of inventories
- ❖ Classification of amount of inventories

ASSIGNMENT QUESTIONS

Question 1 Pg no.____

Cost of a partly finished unit at end of 2021-22 is ₹ 150. The unit can be finished next year by a further expenditure of ₹ 100.The finished unit can be sold at ₹ 250 subject to payment of 4% brokerage on selling price. What is the value of inventory?

Question 2 Pg no.____

A company had 5,000 units of stock "A", costing @ ₹ 50 each on 31.3.2022. Out of this stock, 3,000 units are to be supplied under a firm contract at ₹ 45 each. Show how the valuation will be done of such stock when

(i) the general selling price is ₹ 49 each.
(ii) the general selling price is ₹ 52 each.

Question 3 Pg no.____

The closing inventory at cost of a company amounted to ₹ 2,84,700. The following items were included at cost in the total:

(a) 400 coats, which had cost ₹ 80 each and normally sold for ₹ 150 each. Owing to a defect in manufacture, they were all sold after the balance sheet date at 50% of their normal price. Selling expenses amounted to 5% of the proceeds.
(b) 800 skirts, which had cost ₹ 20 each. These too were found to be defective. Remedial work in April cost ₹ 5 per skirt and selling expenses for the batch totaled ₹ 800. They were sold for ₹ 28 each. What should the inventory value be according to AS 2 after considering the above items?

Question 4 *(ICAI Study Material)* Pg no.____

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.

Question 5 *(RTP May 2019) / (RTP Nov 2021) (Similar) / (ICAI Study Material)* Pg no.____

On 31st March 2021 a business firm finds that cost of a partly finished unit on that date is ₹ 530. The unit can be finished in 2021-22 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, 2021 for preparation of final accounts.

Assume that partly finished goods cannot be sold in semi finished form and its NRV is zero without processing it further.

Question 6 *(Inter May 2022) (5 Marks)* Pg no.____

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:

(i) Sales for the month of June 2021 was ₹30,40,000.
(ii) General overheads cost ₹4,00,000.
(iii) Inventory at beginning 10,000 litres @ ₹ 92 per litre.

(iv) Purchases-June 1, 2021, 20,000 litres @ ₹ 90 per litre, June 30, 2021, 10,000 litres @ ₹ 95 per litre.

(v) Closing inventory 13,000 litres.

You are required to compute the following by FIFO method as per AS 2:

a) Value of Inventory on 30th June, 2021.
b) Amount of cost of goods sold for June,2021.
c) Profit/Loss for the month of June,2021.

Question 7 *(RTP May 2022)* Pg no._____

On the basis of information given below, find value of inventory (by periodic inventory method) as per AS 2, to be considered while preparing Balance Sheet as on 31st Mar, 2022 on weighted Average Basis.

Details of Purchases:

Date of Purchase	Unit (Nos)	Purchase cost per unit
01-03-2022	20	108
08-03-2022	15	107
17-03-2022	30	109
25-03-2022	15	107

Details of Issue of Inventory:

Date of Issue	Unit (Nos)
03-03-2022	10
12-03-2022	20
18-03-2022	10
24-03-2022	20

Net realizable value of inventory as on 31st March, 2022 is ₹ 107.75 per unit. What will be the value of Inventory as per AS 2?

Question 8 Pg no._____

ABC Pvt. Limited ordered 10,000 kg. of certain material at ₹ 100 per kg. The purchase price includes GST ₹ 10 per kg., in respect of which full credit is admissible. Freight, Loading and Unloading incurred amounted to ₹ 40,800. Normal Transit Loss is 2%. Enterprise, actually received 9760 kg. & consumed 9500 kg. Determine cost of inventory and allocation of material cost as per AS-2.

Question 9 *(ICAI Study Material)* Pg no._____

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 year end. State with reference to Accounting Standard, how will you value the inventories in this case?

Question 10 Pg no._____

A Ltd. purchased 1,00,000 MT at ₹ 100 each of raw material and introduced it in the production process and get 85,000 MT as output. Normal wastage is 5%. In the process, company incurred the following expenses:

Direct Labour ₹ 10,00,000

Direct Variable Overheads ₹ 1,00,000

Direct Fixed Overheads ₹ 1,00,000 (Including interest ₹ 40,625)

Of the above 80,000 MT was sold during the year and remaining 5,000 MT remained in closing inventory. Due to fall in demand in market the selling price for the finished goods on the closing day was estimated to be ₹ 105 per MT. Calculate the value of closing inventory.

Question 11 Pg no._____

In a manufacturing process of Vijoy Limited, one by-product BP emerges besides two main products MP1 and MP2 apart from scrap. Details of cost of production process are here under:

Item	Unit	Amount (₹)	Output (Unit)	Closing inventory
Raw material	15,000	1,60,000	MP1- 6,250	800
Wages	-	82,000	MP2- 5,000	200
Fixed overhead	-	58,000	BP-1,600	-
Variable overhead	-	40,000	-	-

Average market price of MP1 and MP2 is ₹ 80 per unit and ₹ 50 per unit respectively, by-product is sold @ ₹ 25 per unit. On By-product separate processing charges of ₹ 4,000 and packing charges of ₹ 6,000 incurred and also ₹ 6,000 was realised from sale of scrap.
Calculate the value of closing inventory of MP1 and MP2.

Question 12 Pg no._____

Z Limited ordered 13,000 kg. of chemicals at ₹ 90 per kg. The purchase price includes GST of ₹ 5 per kg, in respect of which full credit is admissible. Freight incurred amounted to ₹ 30,000. Normal transit loss is 4%. The company actually received 12,400 kg and consumed 10,000 kg. The company has received trade discount in the form of cash amounting to ₹ 1 per kg. The chemicals were delivered in containers. The containers were not reusable, hence sold for ₹ 500. The administrative expenses incurred to bring the chemicals were ₹ 10,000.
Compute the value of inventory and allocate the material cost as per AS-2

Question 13 *(ICAI Study Material)* Pg no._____

A trader purchased certain articles for ₹ 85,000. He sold some of articles for ₹ 1,05,000. The average percentage of gross markup is 25% on cost. Opening stock of inventory at cost was ₹ 15,000.

Question 14 Pg no._____

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

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

Total Fixed overhead for the year was ₹ 2,00,000 on normal capacity of 20,000 units.
Calculate the value of the closing stock, when
(i) Net Realizable Value of the Finished Goods Y is ₹ 400.
(ii) Net Realizable Value of the Finished Goods Y is ₹ 300.

Question 15 *(ICAI Study Material)* Pg no._____

Mr. Mehul gives the following information relating to items forming part of inventory as on 31-3-2022. His factory produces Product X using Raw material A.

a) 600 units of Raw material A (purchased @ ₹ 120). Replacement cost of raw material A as on 31-3-2022 is ₹ 90 per unit.

b) 500 units of partly finished goods in process of producing X & cost incurred till date ₹ 260 per unit. These units can be finished next year by incurring additional cost of ₹ 60 per unit.

c) 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 31-3-2022. Also calculate the value of total inventory as on 31-3-2022.

Question 16 *(RTP May 2020)* Pg no._____

Calculate the closing inventory considering the following data:

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
Fixed Overheads			75,000
Sales		10,000	2,80,000
Closing Inventory	Raw Materials	900	
	Finished Goods	1,200	

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.

Solution

Calculation of cost of closing inventory

Particulars	₹
Purchase costs (10,200*10)	1,02,000
Direct Labour	76,500
Fixed Overheads (75,000/15,000*10,200)	51,000
Cost of Production	2,29,500
Cost of closing inventory per unit (2,29,500/10,200)	22.50
Net realizable value per unit	20.00

Since net realizable 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 replacement cost ₹ 9.50.

Therefore, value of closing inventory

Finished Goods: 1,200*20 = 24,000

Raw Materials: 900*9.50 = 8,550

32,550

Question 17 Pg no._____

The company X Ltd, has to pay for delay in cotton clearing charges. The company up to 31.3.2021 has included such charges in the valuation of closing stock. This being in the nature of interest, X Ltd. decided to exclude such charges from closing stock for the year 2021-22. This would result in decrease in profit by ₹ 5 lakhs. Comment.

Solution

As per AS 2, interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are therefore, usually not included in the cost of inventories. However, X Ltd. was in practice to charge the cost for delay in cotton clearing in the closing stock. As X Ltd. decided to change this valuation procedure of closing stock, this treatment will be considered as a change in accounting policy and such fact to be disclosed as per AS 1. Therefore, any change in amount mentioned in financial statement, which will affect the financial position of the company should be disclosed properly as per AS 1, AS 2 and AS 5.

Also a note should be given in the annual accounts that, had the company followed earlier system of valuation of closing stock, the profit before tax would have been higher by ₹ 5 lakhs.

Question 18

*Pg no.*_____

Alpha Ltd. sells beer to customers; some of the customers consume the beer in the bars run by Alpha Limited. While leaving the bars, the consumers leave the empty bottles in the bars 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:

a) Decide whether the inventory of empty bottles is an asset of the company;
b) 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 shown at realizable value with corresponding credit to 'Other Income'?

Solution

a) Tangible objects or intangible rights carrying probable future benefits, owned by an enterprise are called assets. 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.
b) As per AS 2 "Valuation of Inventories", 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. Hence inventory of empty bottles cannot be considered as scrap and should be valued as inventory in accordance with AS 2.

Question 19 *(RTP May 2018)*

*Pg no.*_____

A private limited company manufacturing fancy terry towels had valued its closing inventory of inventories of finished goods at the realisable 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 goods had not been transferred to the foreign buyers. Comment on the valuation of the inventories by the company

Solution

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 realisable 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 realisable value and not at net realisable 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 20 ***(RTP May 2022)*** *Pg no._____*

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.

Solution:

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.

PRACTICE QUESTIONS

Question 1 *(ICAI Study Material)* Pg no.______

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 2021-22, the Historical Cost and Net Realizable Value of the items of closing stock are determined as follows:

	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?

Solution

As per para 5 of AS 2 on 'Valuation of Inventories', inventories should be valued at lower of cost and net realizable value. Inventories should be written down to net realizable value on an item-by-item basis in the given case.

	Historical Cost (₹ In Lakhs)	Net Realisable Value (₹ In Lakhs)	Valuation of closing stock (₹ in lakhs)
A	40	28	28
B	32	32	32
C	16	24	16
	88	84	76

Hence, closing stock will be valued at ₹ 76 lakhs.

Question 2 Pg no.______

Best Ltd. deals in five products, P, Q, R, S, and T which are neither similar nor interchangeable. At the time of closing of its accounts for the year ending 31st March 2022, the historical cost and net realizable value of the items of the closing stock are determined as follows:

Items	Historical cost	Net realizable value
P	5,70,000	4,75,000
Q	9,80,000	10,32,000
R	3,16,000	2,89,000
S	4,25,000	4,25,000
T	1,60,000	2,15,000

What will be the value of closing stock for the year ending 31st March, 2022 as per AS 2.

Solution

As per para 5 of AS 2 on 'Valuation of Inventories', inventories should be valued at lower of cost and net realizable value. Inventories should be written down to net realizable value on an item-by-item basis in the given case.

Items	Historical cost	Net realizable value	Value of Closing Stock
P	5,70,000	4,75,000	4,75,000
Q	9,80,000	10,32,000	9,80,000
R	3,16,000	2,89,000	2,89,000
S	4,25,000	4,25,000	4,25,000
T	1,60,000	2,15,000	1,60,000
			23,29,000

Question 3 *(Inter May 2019) (1 Mark)* Pg no._____

State whether the following statements is 'True' or 'False'. Also give reason for your answer. As per provisions of AS-2, inventories should be valued at the lower of cost and selling price.

Solution

False: Inventories should be valued at the lower of cost and net realizable value (not selling price) as per AS 2.

Question 4 *(RTP Nov 2019) / (ICAI Study Material) (Similar)* Pg no._____

Hello Limited purchased goods at the cost of ₹ 20 lakhs in October. Till the end of financial year, 75% of the stocks were sold. The company wants to disclose closing stock at ₹ 5 lakhs. The expected sale value is ₹ 5.5 lakhs and a commission at 10% on sale is payable to the agent. What is the correct value of closing stock?

Solution

As per para 5 of 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 ₹ 5 lakhs.
The net realizable value is (5,50,000 – 5,50,000 × 10%) = ₹ 4,95,000.
So, the stock should be valued at ₹ 4,95,000.

Question 5 Pg no._____

The closing inventory at cost of XYZ Ltd. amounted to ₹ 9,56,700. 350 Shirts, which had cost ₹ 380 each and normally sold for ₹ 750 each are included in this amount of ₹ 9,56,700. Owing to a defect in manufacture, they were all sold after the Balance Sheet date at 50% of their normal price. Selling expenses amounted to 5% of the proceeds. What should be the closing inventory value?

Solution

Calculation of value of closing inventory

Value of closing inventory (given)	9,56,700
Less: Adjustment to bring the stock of shirts at NRV (W.N 1)	(8,313)
Revised value of clo sing inventory as per AS 2	9,48,387

Working Notes 1: Valuation of Shirts as per AS 2

Cost price (per shirt)	380
NRV per shirt :	
Sale price (per shirt) ₹ 750 × 50% = 375.00	
Less: Selling expenses (5% of ₹ 375) = (18.75)	
NRV (per shirt) = 356.25	356.25
As per AS 2, inventories are valued at cost or NRV whichever is less	356.25
Difference of cost and NRV	23.75
Therefore, value of inventory of shirts to be reduced by ₹ 8,313 (approx) (₹ 23.75 x 350 shirts)	

Question 6 *(RTP Nov 2022) (Similar)* Pg no._____

The closing stock of finished goods at cost of a company amounted to ₹ 4,50,000. The following items were included at cost in the total:

(a) 100 coats, which had cost ₹ 2,200 each and normally sold for ₹ 4,000 each. Owing to a defect in manufacture, they were all sold after the balance sheet date at 50% of their normal selling price.
(b) 200 skirts, which had cost ₹ 50 each. These too were found to be defective. Remedial work in April cost ₹ 2 per skirt and selling expenses for the batch totaled ₹ 200. They were sold for ₹ 55 each.
(c) Shirts which had cost ₹ 50,000, their net realizable value at Balance sheet date was ₹ 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?

Solution

Valuation of closing stock

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
   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 skirts and shirts as their NRV is more than their cost which was included in value of inventory.
   a. For Skirts Cost = 50*200 = 10,000 NRV = 55-2-1 (200/200) = 52*200 = 10400
   b. For Shirts Cost = 50,000 NRV = 55,000 (word NRV is written so its after Commission)

Question 7 *(RTP May 2021)* *Pg no.______*

The inventory of Rich Ltd. as on 31st March, 2022 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 ₹ 40, ₹ 30 and ₹ 20 respectively, Each unit is sold at ₹ 110, selling expenses amounts to 10% of selling costs.

Product – B: Material cost and wages cost of each unit are ₹ 45 and ₹ 35 respectively and normal selling rate is ₹ 150 each, however due to defect in the manufacturing process 800 units of Product-B were expected to be sold at ₹ 70.

You are requested to value closing inventory according to AS 2 after considering the above.

Solution

According to AS 2 'Valuation of Inventories', inventories should be valued at the lower of cost and net realizable value.

Product – A

Material cost	40 * 200 = 8,000	
Wages cost	30 * 200 = 6,000	
Overhead	20 * 200 = 4,000	
Total cost		18,000
Realizable value [200 x (110-11)]		19,800
Hence inventory value of Product –A		18,000

Product – B

Material cost	45 * 800 = 36,000	

Wages cost	35 * 800 = 28,000	
Total cost		64,000
Realizable value [800 x 70]		56,000
Hence inventory value of Product –B		56,000

Total Value of closing inventory i.e. Product A + Product B (18,000+ 56,000) = 74,000

Question 8 *(RTP May 2023)* *Pg no._____*

An enterprise ordered 20000 kg of certain material at ₹ 110 per unit. The purchase price includes GST at ₹ 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. You are required to calculate cost of material per Kg & Allocation of material cost?

Solution

Purchase price (20,000 Kg. x ₹ 110)	22,00,000
Less: GST Credit (20,000 Kg. x ₹ 12)	(2,40,000)
	19,60,000
Add: Freight	1,17,600
Total material cost	20,77,600
Number of units normally received = 98% of 20,000 Kg.	19,600 kg
Normal cost per Kg. (20,77,600/19,600)	106

	Kg	₹ /Kg.	₹
Materials consumed	18,000	106	19,08,00
Cost of inventory	1,500	106	1,59,000
Abnormal loss	100	106	10,600
Total material cost	19,600		20,77,600

Note: Abnormal losses are recognised as separate expense

Question 9 *(ICAI Study Material)* *Pg no._____*

Capital Cables Ltd., has a normal wastage of 4% in the production process. During the year 2021-22 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 the treatment of abnormal loss and abnormal loss and also find out the amount of abnormal loss if any.

Solution

As per para 13 of AS 2, 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 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 [150 units @ ₹ 156.25 (₹ 18,00,000/11,520)]	₹ 23,437.50

Amount ₹ 23,437.50 will be charged to the Profit and Loss statement.

Question 10 *(Inter May 2019) (5 Marks)* Pg no._____

Wooden Plywood Limited has a normal wastage of 5% in the production process. During the year 2021-22, the Company used 16,000 MT of Raw material costing ₹ 190 per MT. At the end of the year, 950 MT of wastage was in stock. The accountant wants to know how this wastage is to be treated in the books. You are required to:
(1) Calculate the amount of abnormal loss.
(2) Explain the treatment of normal loss and abnormal loss. [In the context of AS-2 (Revised)]

Solution

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 16,000 MT @ ₹ 190 = ₹ 30,40,000
Normal Loss (5% of 16,000 MT) 800 MT (included in calculation of cost of inventories)
Net quantity of material 15,200 MT

Abnormal Loss in quantity (950 - 800) 150 MT
Abnormal Loss ₹ 30,000 [150 units @ ₹ 200 (₹ 30,40,000/15,200)]
Amount of ₹ 30,000 (Abnormal loss) will be charged to the Profit and Loss statement.

Question 11 *(RTP Nov 2018) / (RTP Nov 2020) (Similar)* Pg no._____

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, 2022.

	₹ 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 overhead	80

Additional Information:
(i) Total fixed overhead for the year was ₹ 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 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
(a) Net realizable value of Chemical Y is ₹ 800 per unit
(b) Net realizable value of Chemical Y is ₹ 600 per unit

Solution

(a) When Net Realizable Value of the Chemical Y is ₹ 800 per unit
NRV is greater than the cost of Finished Goods Y i.e. ₹ 660 (Refer W.N.)
Hence, Raw Material and Finished Goods are to be valued at cost.

Value of Closing Stock:

	Qty.	Rate	Amount
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

(b) When Net Realizable Value of the Chemical Y is ₹ 600 per unit
NRV is less than the cost of Finished Goods Y i.e. ₹ 660.
Hence, Raw Material is to be valued at replacement cost and Finished Goods are to be valued at NRV since NRV is less than the cost.
Value of Closing Stock:

	Qty.	Rate	Amount
Raw Material X	1,000	300	3,00,000
Finished Goods Y	2,400	600	14,40,000
Total Value of Closing Stock			17,40,000

Working Note:
Statement showing cost calculation of Raw material X and Chemical Y

Raw material X	₹ per unit
Cost price	380
Add: Unloading charges	20
Add: Freight inward	40
Cost	440
Chemical Y	₹ per unit
Material consumed	440
Direct labour	120
Variable overhead	80
Fixed overheads (4,00,000/20,000)	20
Cost	660

Question 12

Pg no.______

U.S.A Ltd. purchased raw material @ ₹ 400 per kg. Company does not sell raw material but uses it 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 stock.
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?

Solution

As per Para 24 of AS 2, 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 stock of raw material at ₹ 30,00,000 (10,000 kg. @ ₹ 300 per kg.).

Question 13 *(Inter Nov 2019) (5 Marks)* Pg no.______

Mr. Rakshit gives the following information relating to items forming part of inventory as on 31st March, 2022. His factory produces product X using raw material A.

a) 800 units of raw material A (purchased @ ₹140 per unit). Replacement cost of raw material A as on 31st March, 2022 is ₹190 per unit.
b) 650 units of partly finished goods in the process of producing X and cost incurred till date ₹310 per unit. These units can be finished next year by incurring additional cost of ₹50 per unit.
c) 1,800 units of finished product X and total cost incurred ₹360 per unit.

Expected selling price of product X is ₹350 per unit.
In the context of AS-2, determine how each item of inventory will be valued as on 31st March, 2022. Also, calculate the value of total inventory as on 31st March, 2022.

Solution

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 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 X is ₹350 and total cost per unit for production is ₹360.

Hence the valuation will be done as under:

a) 800 units of raw material will be valued at cost 140.
b) 650 units of partly finished goods will be valued at 300 per unit i.e. lower of cost (₹310) or Net realizable value ₹300 (Estimated selling price ₹ 350/unit less additional cost of ₹50).
c) 1,800 units of finished product X will be valued at NRV of ₹350 per unit since it is lower than cost ₹360 of product X.

Valuation of Total Inventory as on 31.03.2022:

Particulars	Units	Cost (₹)	NRV/ Replacement cost ₹	Value = units x cost or NRV whichever is less (₹)	₹
Raw material A	800	140	190	1,12,000	(800 x 140)
Partly finished goods	650	310	300	1,95,000	(650 x 300)
Finished goods X	1800	360	350	6,30,000	(1,8 Pg no.______
Value of Inventory				9,37,000	

Question 14 *(Inter Jan 2021) (5 Marks)*

Mr. Jatin gives the following information relating to the items forming part of the inventory as on 31.03.2021. 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 on 31.03.2021 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 31.03.2021. Also calculate the value of total Inventory as on 31.03.2021.

Solution

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 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 product is 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 realizable value ₹ 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.

Particulars	Units	Cost (₹)	NRV/ Replacement cost ₹	Value = units x cost or NRV whichever 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

Question 15 Pg no._____

CC Ltd., a Pharmaceutical Company, while valuing its finished stock at the year end wants to include interest on Bank Overdraft as an element of cost, for the reason that overdraft has been taken specifically for the purpose of financing current assets like inventory and for meeting day to day working expenses". State your comments on this treatment.

Solution

As per AS 2 "Valuation of Inventories", cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. However, it makes clear that interest and other borrowing costs are usually not included in the cost of inventories because generally such costs are not related in bringing the inventories to their present location and condition.

Therefore, the proposal of CC Ltd. to include interest on bank overdraft as an element of cost is not acceptable because it does not form part of cost of production

Question 16 Pg no._____

Hema Ltd. is in the business of manufacturing computers. During the year ended 31st March, 2022 the company manufactured 550 computers, it has the policy of valuing finished stock of goods at a standard cost of ₹ 1.8 lakhs per computer.

The details of the cost are as under:

	(₹ in lakhs)
Raw material consumed	400
Direct Labour	250
Variable production overheads	150
Fixed production overheads (including interest of ₹ 100 lakhs)	290

Compute the value of cost per computer for the purpose of closing stock and also comment on the policy of valuation of inventory adopted by Hema Ltd.

Solution

As per AS 2 'Valuation of Inventories', for inclusion in the cost of inventory, allocation of fixed production overheads is based on the normal capacity of the production facilities.
In this, case finished stock has been valued at a standard cost of ₹ 1.8 lakhs per computer which incidentally synchronizes with the value computed on the basis of absorption costing as under:

	(₹ in lakhs)
Raw material consumed	400
Direct Labour	250
Variable production overheads	150
Fixed production overheads (290 - 100)	190
Total cost	990

Number of computers produced = 550 computers (Assumed to be normal production)
Cost per computer ₹ 990 lakhs/550 computers = ₹ 1.80 lakhs
Policy of the company to value closing stock on the basis of standard costing is not as per AS 2. As per AS 2, the techniques of standard cost method may be used for convenience if the result approximates to the actual cost. However, standard cost should be regularly reviewed, if necessary, and be revised in the light of the current conditions. In the instant case, the cost of inventory can be conveniently calculated
as per absorption costing. Therefore, there is no reason to adopt standard costing method.

Question 17 *(Inter July 2021) (5 Marks)* Pg no._____

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
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 value of closing inventory as at 31st March, 2021 as per AS 2.

Solution

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

Question 18 *(RTP May 2022)* Pg no._____

"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'.

Solution:

As per AS 2 "Valuation of Inventories", certain costs are excluded from the cost of the inventories and are recognised as expenses in the period in which incurred. Examples of such costs are: (a) abnormal amount of wasted materials, labour, or other production costs; (b) storage costs, unless those costs are necessary in the production process prior to a further production stage; (c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and (d) selling and distribution costs

Question 19 *(Inter Nov 2022) (5 Marks)* Pg no._____

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 31st March,2022	750
	Price Per Unit in ₹
Cost Price	150
Freight inward	10
Replacement Cost	152

Closing balance of Finished Good 'B' in units on 31st March,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.

Solution

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 are written down below cost if the selling price of finished product containing the material does not exceed the 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 or net 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).

CONTINGENCIES AND EVENTS OCCURRING AFTER BALANCE SHEET DATE

AS 04

CONTINGENCY	
Meaning	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
Contingent Losses	The accounting treatment of a contingent loss is determined by the expected outcome of the contingency. If it is likely that a contingency will result in a loss to the enterprise, then it is prudent to provide for that loss in the financial statements. The estimation of the amount of a contingent loss to be provided for in the financial statements, may be based on judgement made, by management
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.
EVENTS OCCURRING AFTER BALANCE SHEET DATE	
Meaning	These are those significant events, both favorable and unfavorable that occur between the balance sheet date and the date on which the financial statements are approved by the board of directors, in the case of company, and the corresponding approving authority, in case of any other entity.

TYPES OF EVENTS (PARA 8)

Adjusting events	Non-Adjusting events
↓	↓
Those which provide further/additional evidence to assist estimation of amounts relating to <u>conditions that existed at the balance sheet date</u>	Those which are indicative of conditions that arose subsequent to balance sheet date or events which <u>do not relate to conditions existing at balance sheet date</u>
Require adjustments to assets and liabilities as at balance sheet date	No accounting treatment: No adjustment of assets & liabilities <u>(Refer note)</u>
<u>Example:</u> an adjustment may be made for loss on trade receivable account which is confirmed by insolvency of customer which occurs after the b/sheet date	<u>Example:</u> Ordinary decline in market value of investments between the balance sheet date and date on which financial statements are approved does not require any adjustment.

<u>Note:</u> Non adjusting events may be of such significance that they may require a disclosure in the report of approving authority i.e. report of BOD to enable users of financial statements to make proper evaluations and decisions.

<u>Example</u>: Material changes and commitments affecting the financial position of enterprise.

EXCEPTION TO THE RULE OF "NO ACCOUNTING TREATMENT FOR NON ADJUSTING EVENTS"

Fundamental accounting assumption of GOING CONCERN is not appropriate
Deterioration in operating results and financial position
Unusual changes affecting the existing or sub-stratum of the enterprise after the balance sheet date (eg. Destruction of major production plant by fire after the balance date)
Assets and liabilities should be adjusted i.e. financial statements should be prepared by not following fundamental accounting assumption of GOING CONCERN *In case the going concern assumption is not valid (based on events occurring after the balance sheet date), the financial statements are prepared on a liquidation basis.*

SPECIAL CASE: PROPOSED DIVIDEND

There are events which, although they take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature.

For example, if dividends are declared after the balance sheet date but before the financial statements are approved for issue, 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. No liability for proposed dividends must be created now. Such proposed dividends are to be disclosed in the notes.

DISCLOSURE REQUIREMENTS

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

- The nature of the event;
- An estimate of the financial effect, or a statement that such an estimate cannot be made.

ASSIGNMENT QUESTIONS

Question 1

MEC Limited could not recover an amount of ₹ 8 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company for the year ended 31-3-2020 were finalized by making a provision @ 25% of the amount due from that debtor. In May 2020, the debtor became bankrupt and nothing is recoverable from him. Do you advise the company to provide for the entire loss of ₹ 8 lakhs in books of account for the year ended 31-3-2020?

Solution

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

As per the information given in the question, the company was aware that the debtor was already in a great financial difficulty at the time of closing of accounts. Bankruptcy of the debtor in May 2020 is only an additional information to the condition existing on the balance sheet date. Also the effect of a debtor becoming bankrupt is material as total amount of ₹ 8 lakhs will be a loss to the company. Therefore, the company is advised to provide for the entire amount of ₹ 8 lakhs in the books of account for the year ended 31st March, 2020.

Question 2 *(ICAI Study Material)*

In X Co. Ltd., theft of cash of ₹ 5 lakhs by the cashier in January, 2020 was detected in May, 2020. The accounts of the company were not yet approved by the Board of Directors of the company.

Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.2020. Decide.

Solution

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 amounts 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, 2020.

Question 3

State with reasons, how the following events would be dealt with in the financial statements of Pradeep Ltd. for the year ended 31st March, 2020:

(i) An agreement to sell a land for ₹ 30 lakh to another company was entered into on 1st March, 2020. The value of land is shown at ₹ 20 lakh in the Balance Sheet. However, the Sale Deed was registered on15th April, 2020.

(ii) The negotiation with another company for acquisition of its business was started on 2nd February, 2020. Pradeep Ltd. invested ₹ 40 lakh on 12th April, 2020.

Solution

(1) According to AS 4, assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In the given case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 1st March, 2020 i.e. before the balance sheet date. Registration of the sale deed on 15th April, 2020, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of land is necessary in the financial statements of Pradeep Ltd. for the year ended 31st March, 2020.

(2) AS 4 defines "Events occurring after the balance sheet date" as those significant events, both favorable and unfavorable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 2020. Applying provisions of the standard which clearly state that/disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 40 lakhs in April, 2020 in the acquisition of another company should be disclosed in report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

Question 4 *(RTP Nov 2019) / (ICAI Study Material) (Similar)*

An earthquake destroyed a major warehouse of PQR Ltd. on 30.4.2020. The accounting year of the company ended on 31.3.2020. The accounts were approved on 30.6.2020. The loss from earthquake is estimated at ₹ 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.

Solution

Para 8 of AS 4, 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. 31.3.2020.

However, according to 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.

Case 1: If going concern assumption is not Valid

Since the fire occurred after 31/03/20, the loss on fire is not a result of any condition existing on 31/03/20. 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 its financial statements in the following manner:

“Major fire occurred in the warehouse on 30th April, 2020 which has made impossible for the enterprise to start operations again. Therefore, the financial statements have been prepared on liquidation basis.”

Case 2: If going concern assumption is still Valid

The fact of earthquake together with an estimated loss of ₹ 25 lakhs should be disclosed in Report of Directors for the financial year 2019-2020 to enable users of financial statements to make proper evaluations and decisions.

Question 5

Neel Limited has its corporate office in Mumbai and sells its products to stockists all over India. On 31st March, 2020 the company wants to recognize receipt of cheques bearing date 31st March, 2020 or before, as "Cheques in Hand" by reducing "Trade Receivables". The "Cheques in Hand" is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques are presented to the bank in the month of April 2020 and are also realized in the same month in normal course after deposit in the bank.

State with reasons, whether each of the following is an adjusting event and how this fact is to be disclosed by the company, with reference to the relevant accounting standard

(i) Cheques collected by the marketing personnel of the company from the stockists on or before 31st March, 2020.

(ii) Cheques sent by the stockists through courier on or before 31st March, 2020.

Solution

(1) Cheques collected by the marketing personnel of the company is an adjusting event as the marketing personnels are employees of the company and therefore, are representatives of the company. Handing over of cheques by the stockist to the marketing employees discharges the liability of the stockist. Therefore, cheques collected by the marketing personnel of the company on or before 31st March, 2020 require adjustment from the stockists' accounts i.e. from 'Trade Receivables A/c' even though these cheques (dated on or before 31st March, 2020) are presented in the bank in the month of April, 2020 in the normal course. Hence, collection of cheques by the marketing personnel is an adjusting event as per AS 4 'Contingencies and Events Occurring after the Balance Sheet Date'. Such 'cheques in hand' will be shown in the Balance Sheet as 'Cash and Cash equivalents' with a disclosure in the Notes to accounts about the accounting policy followed by the company for such cheques.

(2) Even if the cheques bear the date 31st March or before and are sent by the stockists through courier on or before 31st March, 2020, it is presumed that the cheques will be received after 31st March. Collection of cheques after 31st March, 2020 does not represent any condition existing on the balance sheet date i.e. 31st March. Thus, the collection of cheques after balance sheet date is not an adjusting event. Cheques that are received after the balance sheet date should be accounted for in the period in which they are received even though the same may be dated 31st March or before as per AS 4. Moreover, the collection of cheques after balance sheet date does not represent any material change affecting financial position of the enterprise, so no disclosure in the Director's Report is necessary.

Question 6 *(ICAI Study Material)*

A company has filed a legal suit against the debtor from whom ₹ 15 lakh is recoverable as on 31.3.2020. The chances of recovery by way of legal suit are not good as per legal opinion given by the counsel in April, 2020. Can the company provide for full amount of ₹ 15 lakhs as provision for doubtful debts?

Solution

As per AS 4, assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. In the given case, company should make the provision for doubtful debts, as legal suit has been filed on 31st March, 2020 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, 2020.

Question 7 *(ICAI Study Material)*

During the year 2019-2020, 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, 2020. On 18th May, 2020, the Court decided in favour of the party alleging infringement of the trademark and ordered Raj Ltd. to pay the aggrieved party a sum of ₹ 14 lakhs. The financial statements were prepared by the company's management on 30th April, 2020, and approved by the board on 30th May, 2020.
Should Raj Ltd. adjust its financial statements for the year ended 31st March, 2020?

Solution

As per para 8 of 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 Raj Ltd. was sued by a competitor for infringement of a trademark during the year 2019-20 for which the provision was also made by it, the decision of the Court on 18th May, 2020, 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, 2020, it would be considered as post reporting period i.e. event occurred after the approval of the financial statements. In that case, no adjustment in the financial statements of 2019-20 would have been required.

Question 8 *(ICAI Study Material)*

A Limited Company closed its accounting year on 30.6.20 and the accounts for that period were considered and approved by the board of directors on 20th August, 2020. The company was engaged in laying pipe line for an oil company deep beneath the earth. While doing the boring work on 1.9.2020 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 30.6.20.

Solution

AS 4 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 above mentioned definition and requirements given in AS 4.
In this case the incidence, which was expected to push up cost became evident after the date of approval of the accounts. So that was not an 'event occurring after the balance sheet date'.

Question 9

A company deals in petroleum products. The sale price of petrol is fixed by the government. After the Balance Sheet date, but before the finalisation of the company's accounts, the government unexpectedly increased the price retrospectively.

Can the company account for additional revenue at the close of the year? Discuss in line with provisions of AS 4.

Solution

According to para 8 of AS 4, the unexpected increase in sale price of petrol by the government after the balance sheet date cannot be regarded as an event occurring after the Balance Sheet date, which requires an adjustment at the Balance Sheet date, since it does not represent a condition present at the balance sheet date. The revenue should be recognized only in the subsequent year with proper disclosures.

Question 10

F Ltd. has finalized their financial statements for the year ending 31st March, 2020 and approved by their approving authority on 30th June, 2020.

(a) A major fire broke out in the night of 31st May, 2020 destroying factory premises. Loss of property estimated to be ₹ 25 lakhs.

(b) Negotiations with another company started in April 2020 for acquisition of two manufacturing units which may involve additional investments of ₹ 50 lakhs.

(c) Foreign exchange loss during the period 1st April, 2020 and 1st June 2020 has resulted that assets being reduced by ₹ 30 lakhs.

You are requested to state how to deal with the above information's in the annual accounts.

Solution

For the information given, the following will be recommended treatment with reference to the provisions of AS 4: Contingencies and Events Occurring After the Balance Sheet Date.

a. 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, the event would appear to be of such significance as to require a disclosure in the report of the approving authority to enable users of the financial statements to make proper evaluation and decision, hence, such disclosure is recommended.

b. AS 4 defines events occurring after the balance sheet date as those significant event- both favorable and unfavorable – that occur between the balance sheet date and the date on which the financial statements are approved by the approving authority. Accordingly, negotiation for acquisitions of two manufacturing units which started on 30th April, 2020 should be disclosed in the Board's Report. No adjustments of assets and liabilities are required, as the negotiation does not affect the determination and the conditions of the amounts stated in the financial statements for the year ended 31st March, 2020.

c. The foreign exchange loss due to changes in exchange rates during the period 1st April 2020 and 1st June 2020, is a non adjusting event since it does not relate to the conditions existing at the balance sheet date. The amount of loss appears material and may be of such significance that requires disclosure in the report of the approving authority

Question 11 *(RTP May 2018 / RTP May 2020) (Similar)*

With reference to AS 4 "Contingencies and events occurring after the balance sheet date", state whether the following events will be treated as contingencies, adjusting events or non-adjusting events occurring after balance sheet in case of a company which follows April to March as its financial year.

(a) A major fire has damaged the assets in a factory on 5th April, 5 days after the year end. However, the assets are fully insured and the books have not been approved by the Directors.
(b) A suit against the company's advertisement was filed by a party on 10th April, 10 days after the year end claiming damages of ₹ 20 lakhs.
(c) It sends a proposal to purchase an immovable property for ₹ 30 lakhs in March. The book value of the property is ₹ 20 lakhs as on year end date. However, the deed was registered as on 15th April.
(d) The terms and conditions for acquisition of business of another company have been decided by March end. But the financial resources were arranged in April and amount invested was ₹ 40 lakhs.
(e) Theft of cash of ₹ 2 lakhs by the cashier on 31st March but was detected the next day after the financial statements have been approved by the Directors.

Solution

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

(i) Fire has occurred after the balance sheet date and also the loss is totally insured. Therefore, the event becomes immaterial and the event is non-adjusting in nature.
(ii) The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of ₹ 20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a non-adjusting event.
(iii) In the given case, proposal for deal of immovable property was sent before the closure of the books of accounts. This is a non-adjusting event as only the proposal was sent and no agreement was effected in the month of March i.e. before the balance sheet date.
(iv) As the term and conditions of acquisition of business of another company had been decided by the end of March, acquisition of business is an adjusting event occurring after the balance sheet date. Adjustment to assets and liabilities is required since the event affects the determination and the condition of the amounts stated in the financial statements for the financial year ended on 31st March.
(v) Since the financial statements have been approved before detection of theft by the cashier of ₹ 2,00,000, it becomes a non-adjusting event and no disclosure is required in the report of the Approving Authority.

Question 12 *(RTP May 2019)*

The Board of Directors of M/s. New Graphics Ltd. in its Board Meeting held on 18th April, 2020, considered and approved the Audited Financial results along with Auditors Report for the Financial Year ended 31st March, 2020 and recommended a dividend of ₹ 2 per equity share (on 2 crore fully paid up equity shares of ₹ 10 each) for the year ended 31st March, 2020 and if approved by the members at the forthcoming Annual General Meeting of the company on 18th June, 2020, the same will be paid to all the eligible shareholders
Discuss on the accounting treatment and presentation of the said proposed dividend in the annual accounts of the company for the year ended 31st March, 2020 as per the applicable Accounting Standard and other Statutory Requirements

Solution

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 ₹ 4 crores recommended by New Graphics Ltd. in its Board meeting on 18th April, 2020 shall not be accounted for in the books for the year 2019-20 irrespective of the fact that it pertains to the year 2019-20 and will be paid after approval in the Annual General Meeting of the members / shareholders

Question 13 *(RTP May 2022) (Similar)*

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 ₹ 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 realisable 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 machines during this month at a price of ₹ 4,000 per machine.

(ii) A fire has broken out in the company's godown on 15 April 2020. The company has estimated a loss of ₹ 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 ₹ 7,50,000 which is being carried in the books at ₹ 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 ₹ 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.

(v) A suit against the company's advertisement was filed by a party on 10th April, 2020 10 days after the year end claiming damages of ₹ 20 lakhs.

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

Solution

Events occurring after the balance sheet date are 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 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 statements for the year ended at 31 March 2020:

(a) 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 statements w.r.t. net realisable value at the end of the reporting period. Accordingly, inventory should be written down to ₹ 4,000 per machine. Total value of inventory in the books will be 50 machines x ₹ 4,000 = ₹ 2,00,000.

(b) 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.

(c) 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 recognised with respect to it in the financial statements of 2019-2020. However, a disclosure for the same should be given by the entity.

(d) 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 violation of the conditions took place in the financial year 2019-2020 and the company must be aware of it.

(e) The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of ₹ 20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a non-adjusting event.

Question 14 *(ICAI Study Material)*

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?

Solution

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 on the 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.

PRACTICE QUESTIONS

Question 1 (RTP Nov 2018) / (ICAI Study Material)

While preparing its final accounts for the year ended 31st March, 2020, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2020 a debtor for ₹ 20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2020 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2020?

Solution

As per AS 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.

A debtor for ₹ 20,00,000 suffered heavy loss due to earthquake in the last week of February, 2020 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, 2020 (after the balance sheet date) is only an additional information related to the condition existing on the balance sheet date. However, bankruptcy of debtors is an adjusting event

Accordingly, full provision for bad debts amounting ₹ 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 2020. Since the company has already made 5% provision of its total debtors, additional provision amounting ₹ 19,00,000 shall be made (20,00,000 x 95%).

Question 2

A Company entered into an agreement to sell its immovable property to another company for ₹ 35 lakhs. The property was shown in the Balance Sheet at ₹ 7 lakhs. The agreement to sell was concluded on 15th February, 2020 and sale deed was registered on 30th April, 2020. You are required to state, with reasons, how this event would be dealt with in the financial statements for the year ended 31st March, 2020.

Solution

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

In the given case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 15th February 2020 i.e. before the balance sheet date. Registration of the sale deed on 30th April, 2020, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of immovable property is necessary in the financial statements for the year ended 31st March, 2020.

Question 3 (ICAI Study Material)

In preparing the financial statements of R Limited for the year ended 31st March, 2020 you come across the following information. How you would deal with this in the financial statements?

The company invested ₹ 100 lakhs in April, 2020 before approval of financial statements by Board of Directors in the acquisition of another company doing similar business, negotiations for which had just started.

Solution

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, 2020.

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, 2020 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 4

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

Explain briefly how the loss should be treated in the final accounts for the previous year.

Solution

The loss due to break out of fire is an example of event occurring after the balance sheet date. The event being in the nature of a fire which is unpredictable does not relate to conditions existing at the balance sheet date. It has not affected the financial position as on the date of balance sheet and therefore requires no specific adjustments in the financial statements.

However, AS 4 states that disclosure is generally made of events occurring after balance sheet date i.e. in subsequent periods that represent unusual changes affecting the existence or substratum of the enterprise after the balance sheet date. As per the information given in the question, the earthquake has caused major destruction; therefore fundamental accounting assumption of going concern is called upon.

Considering that going concern assumption is still valid, the fact of earthquake together with an estimated loss should be disclosed.

Question 5 *(Inter Nov 2018) (5 Marks)*

The accounting year of Dee Limited ended on 31st March, 2020 but the accounts were approved on 30th April, 2020. On 15th April, 2020 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).

Solution

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, 2020 but before approval of financial statement of 30.4.2020. 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 31/03/20, the loss on fire is not a result of any condition existing on 31/03/20. 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 its financial statements in the following manner:

"Major fire occurred in the factory and office premises on 15th April, 2020 which has made impossible for the enterprise to start operations again. Therefore, the financial statements have been prepared on liquidation basis."

Question 6 *(RTP Nov 2020)*

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 loss of ₹ 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

Solution

The event is a non adjusting event since it occurred after the year end & does not relate to the conditions existing at the year end. However it is necessary to consider the validity of 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 note to the financial statements.

Question 7

X Oil Ltd. closed the books of accounts on March 31, 2020 for which financial statement was finalized by the Board of Directors on September 04, 2020. During the month of December 2019, company undertook the project of laying a pipeline across the country and during May 2020 engineers realized that due to unexpected heavy rain, the total cost of the project will be inflated by ₹ 50 lakhs. How this should be provided for in the balance sheet of 2019-20 in accordance to AS 4?

Solution

This event occurred after March 31, 2020 but before September 04, 2020 is an event occurring after the balance sheet date. But this event is not affecting financial position on the date of balance sheet therefore it can be disclosed in the directors' report

Question 8 *(Inter May 2019) (5 Marks)*

The financial statements of PQ Ltd. for the year 2019-20 approved by the Board of Directors on 15th July, 2020. The following information was provided:

(a) A suit against the company's advertisement was filed by a party on 20th April, 2020, claiming damages of ₹ 25 lakhs.

(b) The terms and conditions for acquisition of business of another company have been decided by March, 2020. But the financial resources were arranged in April, 2020 and amount invested was ₹ 50 lakhs.

(c) Theft of cash of ₹ 5 lakhs by the cashier on 31st March, 2020 but was detected on 16th July, 2020.

(d) Company sent a proposal to sell an immovable property for ₹ 40 lakhs in March, 2020. The book value of the property was ₹ 30 lakhs on 31st March, 2020. However, the deed was registered on 15th April, 2020.

(e) A, major fire has damaged the assets in a factory on 5th April, 2020. However, the assets are fully insured.

With reference to AS-4 "Contingencies and events occurring after the balance sheet date", state whether the above mentioned events will be treated as contingencies, adjusting events or non-adjusting events occurring after the balance sheet date.

Solution

(a) Suit filed against the company is a contingent liability but it was not existing as on balance sheet date as the suit was filed on 20th April after the balance Sheet date. As per AS 4, 'Contingencies' used in the Standard 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 statements and will be a non-adjusting event.

(b) In the given case, terms and conditions for acquisition of business were finalised and carried out before the closure of the books of accounts but transaction for payment of financial resources was effected in April, 2020. This is clearly an event occuring after the balance sheet date. Hence, necessary adjustment to assets and liabilities for acquisition of business is necessary in the financial statements for the year ended 31st March 2020.

(c) Only those significant events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustment to assets and liabilities existing on the balance sheet date or may require disclosure. In the given case, theft of cash was detected on 16th July, 2020 after approval of financial statements by the Board of Directors, hence no treatment is required.

(d) 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 also not started) on the balance sheet date. Therefore, no adjustment to assets for sale of immovable property is required in the financial statements for the year ended 31st March, 2020.

(e) The condition of fire occurrence was not existing on the balance sheet date. Only the disclosure regarding event of fire and loss being completely insured may be given in the report of approving authority.

Question 9

State with reasons, how the following events would be dealt with in the financial statements of Hari Ltd. for the year ended 31st March, 2019 (accounts were approved on 25th July, 2019):

(1) Negotiations with another company for acquisition of its business was started on 21st January, 2019. Hari Ltd. invested ₹ 40 lakh on 22nd April, 2019.

(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 2019, 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, 2019 the debtor became bankrupt.

(3) During the year 2018-2019, Hari Ltd. was sued by a competitor for ₹ 13 lakhs for infringement 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, 2019. On 26th May, 2019, the Court decided 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, 2019. However the same comes to the notice of Company management during August, 2019.

(5) Cheques dated 31st March, 2019 collected in the month of April, 2019. All cheques are presented to the bank in the month of April, 2019 and are also realized in the same month in the normal course after deposit in the bank.

Solution

(1) 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, 2019 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.

(2) 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 amounts relating 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, 2019 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, 2019 (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 2019.

(3) 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 by a competitor for infringement of a trademark during the year 2018-19 for which the provision was also made by it, the decision of the Court on 26th May, 2019, for payment of the penalty will constitute as 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.

(4) 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 the provisions 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, 2019. 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 2020, in a manner, that its impact on current profit or loss can be perceived.

(5) 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.

Question 10 *(RTP May 2021)*

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 were approved 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?

Solution

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 11 *(RTP Nov 2021)*

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. The following material events took place:

a. A major property was sold (it was included in the balance sheet at ₹ 25,00,000) for which contracts had been exchanged on 15th March, 2020. The sale was completed on 15th May, 2020 at a price of ₹ 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 ₹ 10 million would be fully covered by the insurance company.
c. A claim for damage amounting to ₹ 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 ultimately prove 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.

Solution

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 ₹ 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 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 a note to the financial statements.
c. On the basis of evidence provided, the claim against the company will not succeed. Thus, ₹ 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 made for legal fee expected to be incurred to the extent that they are not expected to be recovered

Question 12 *(Inter July 2021) (5 Marks)*

Surya Limited follows the financial year from April to March. It has provided the following information.

(a) A suit against the Company's Advertisement was filed by a party on 5th April, 2021, claiming damages of ₹ 5 lakhs.
(b) Company sends a proposal to sell an immovable property for ₹ 45 lakhs in March 2021. The book value of the property is ₹ 30 lakhs as on year end date. However, the Deed was registered on 15th April, 2021.
(c) The terms and conditions for acquisition of business of another company have been decided by the end of March 2021, but the financial resources were arranged in April 2021. The amount invested was ₹ 50 lakhs.
(d) Theft of cash amounting to ₹ 4 lakhs was done by the Cashier in the month of March 2021 but was detected on the next day after the Financial Statements have been approved by the Directors.

Keeping in view the provisions of AS-4, state with reasons whether the above events are to be treated as Contingencies, Adjusting Events or Non-Adjusting Events occurring after Balance Sheet date.

Solution

(a) 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 5th 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. However, it may be disclosed with the nature of contingency, being a contingent liability. This event does not pertain to conditions on the balance sheet date. Hence, it will have no effect on financial statement and will be a non-adjusting event.

(b) In this case, 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, 2021. There was just a proposal before 31st March, 2021 and hence sale cannot be shown in the financial statements for the year ended 31st March, 2021. Sale of immovable property is an event occurring after the balance sheet date is a non-adjusting event.

(c) 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, 2021.
Hence, it is an adjusting event and necessary adjustment to assets and liabilities for acquisition of business is necessary in the financial statements for the year ended 31st March 2021.

(d) 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 after approval of financial statements, no adjustment is required. Hence it is non-adjusting event.

Question 13 *(Inter Dec 2021) (5 Marks)*

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 company were approved by board of directors on 10.07.2021):

a) Equity Dividend for the year 2020-21 was declared at the rate of 7% on 15.05.2021.
b) On 05.03.2021, ₹ 53,000 cash was collected from a customer but not deposited by the cashier. This fraud was detected on 22.06.2021.
c) One building got damaged due to occurrence of fire on 23.05.221. Loss was estimated to be ₹ 81,00,000.

Solution

a) 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 year ended 31st March, 2021 and declaration of dividend is non-adjusting event.
b) As per AS 4 '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 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 ₹ 53,000 should be adjusted in the accounts of the company for the year ended 31st March, 2021 as it is adjusting event.

c) AS 4 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 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 ₹ 81 lakhs should be disclosed in the report of the approving authority for financial year 2020-21 to enable users of financial statements to make proper evaluations and decisions.

Question 14 *(Inter Nov 2022) (5 Marks)*

MN Limited operates its business into various segments. Its financial year ended on 31st March, 2022 and financial statements were approved by their approving authority on 15th June, 2022. The following material events took place:

a) On 7th April, 2022, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of ₹ 15 crores would be fully covered by the insurance company.

b) A claim for damage amounting to ₹ 12 crores 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 ultimately prove to be baseless. But it is still estimated that it would involve a considerable expenditure on legal fees.

c) A major property was sold (it was included in the balance sheet at ₹ 37,50,000) for which contracts had been exchanged on 15th March, 2022. The sale was completed on 15th May, 2022 at a price of ₹ 39,75,000.

You are required to state with reasons, how each of the above items should be dealt with in the financial statements of MN Limited for the year ended 31st March, 2022 as per AS 4.

Solution:

Treatment as per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date.

a) 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 note in the financial statements.

b) On the basis of evidence provided, the claim against the company will not succeed. Thus, 12 crores should not be provided in the account but should be disclosed by means of a contingent liability with full details of the facts as per AS 29. Provision can be made for legal fee expected to be incurred to the extent that they are not expected to be recovered if the amount can be ascertained.

c) 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 would be reflected in the financial statements ended on 31 3.2022 and the profit on sale of property ₹ 2,25,000 would be considered.

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

AS 05

- Net profit or Loss for the period
  - Ordinary activity
  - Extra-ordinary item
- Prior Period items
- Changes in Accounting estimates
- Changes in Accounting policies

NET PROFIT OR LOSS FOR THE PERIOD		
General rule	All items of income & expense which are recognized in a period should be included in the determination of Net Profit or loss for the period including extra-ordinary items, effects of changes in accounting estimates.	
Profit or loss from ordinary activity	Meaning	These are the principle revenue producing and generating activities and incidental items. Any activities which are undertaken by an enterprise as part of its business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities. <u>For example:</u> Profit on sale of merchandise, loss on sale of unsold inventory at the end of the season.
	Requirement under AS-5 (PARA 12)	The <u>nature and amount</u> of such items is to be disclosed separately if they are of <u>such size, nature or incidence</u> that their disclosure is relevant to explain the performance of enterprise for the period.
	Example	➢ Writing down of inventories to NRV or vice-versa ➢ Disposal of fixed assets ➢ Disposal of long-term investments ➢ Legislative changes having retrospective effect ➢ Litigation settlements ➢ Restructuring of activities of an enterprise & reversal of provisions for the costs of restructuring.
Extra-ordinary Items	Meaning	These are the activities which are not ordinary. These are irregular & infrequent in nature. Only on rare occasions, an event or transactions gives rise to an extra-ordinary item.
	Requirement under AS-5 (PARA 8)	Should be disclosed in the Statement of P&L as a part of Net Profit or loss for the period.

<table>
<tr><td rowspan="2"></td><td></td><td>Their <u>nature and amount</u> should always be separately disclosed in the statement of P&L in a manner that its <u>impact on current profit or loss can be perceived</u>.</td></tr>
<tr><td>Example</td><td>➢ Loss by earthquake, flood etc.
➢ Attachment of property of the enterprise (confiscation of property by tax officials)
➢ Government grant becoming refundable.</td></tr>
<tr><th colspan="3">PRIOR PERIOD ITEM</th></tr>
<tr><td>Meaning</td><td colspan="2">These are the items of incomes and expenses which arise in the current period as a result of error or omissions in the preparation of financial statements of one or more previous periods.</td></tr>
<tr><td>Reasons</td><td colspan="2">These may occur due to:
✓ Mathematical mistakes
✓ Mistakes in applying accounting policies
✓ Due to over sight</td></tr>
<tr><td>Requirement as per AS-5 (PARA 15)</td><td colspan="2">Their <u>nature and amount</u> is to be separately disclosed in the Statement of P&L in such a manner that their impact on the current profit or loss can be perceived.</td></tr>
<tr><td>Example</td><td colspan="2">➢ Revenue expenditure treated as capital expenditure or vice –versa
➢ Wrong totaling of stock.</td></tr>
<tr><th colspan="3">CHANGE IN ACCOUNTING ESTIMATES</th></tr>
<tr><td>Meaning of Accounting estimate</td><td colspan="2">As a result of uncertainties inherent in business activities, many financial statement items cannot be measured with precisions but can only be estimated.
The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.</td></tr>
<tr><td>Example</td><td colspan="2">➢ Estimate of bad debts
➢ Useful life of depreciable assets
➢ Estimates of inventory obsolescence</td></tr>
<tr><td>When change in accounting estimates occur</td><td colspan="2">✓ As a result of new information
✓ As a result of more experience
✓ As a result of subsequent development
✓ If changes occur regarding the circumstances on which the estimate was based</td></tr>
<tr><td>Notes</td><td colspan="2">✓ It is not a prior period item
✓ The revision of the estimate by its nature does not bring the adjustments within the definitions of an extraordinary item or prior period item.
✓ 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</td></tr>
</table>

	✓ The nature and amount of a change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods, should be disclosed. If it is impracticable to quantify the amount, this fact should be disclosed *(Para 27)*
CHANGE IN ACCOUNTING POLICY	
General rule	Accounting policy once adopted should not be changed i.e. these should be applied consistently.
When is change recommended	A change in accounting policy should be made only if adoption of different accounting policy is required → By Statute i.e. by Law or → For Compliance with an Accounting standard or → If it is considered that change would result in more appropriate presentation of financial statements.
Disclosure requirements	✓ Any change in accounting policy having material effect is to be disclosed. ✓ If the effect of such change is material it should be shown in financial statement of the period in which such change is made. ✓ Where effect of change is not ascertainable, fact should be disclosed. ✓ If the impact of such change is not material in current period but is expected in later periods, then the fact of change is to be disclosed.
Notes	Sometimes it is difficult to distinguish between a change in accounting policy and a change in accounting estimate. In such cases, the change is treated as “change in accounting estimate” with appropriate disclosure. *The following are not changes in accounting policies*: ○ The adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, e.g., introduction of formal retirement gratuity scheme by an employer in place of adhoc ex-gratia payments to employees on retirement. ○ The adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial.

ASSIGNMENT QUESTIONS

Question 1

Give two examples on each of the following items:
a) Change in Accounting Policy
b) Change in Accounting Estimate
c) Extra Ordinary Items
d) Prior Period Items.

Solution

a) Examples of Changes in Accounting Policy:
(i) Change of method to value fixed assets from Cost to Revaluation model.
(ii) Change in cost formula in measuring the cost of inventories.

b) Examples of Changes in Accounting Estimates:
(i) Change in estimate of provision for doubtful debts on sundry debtors.
(ii) Change in estimate of useful life of fixed assets.

c) Examples of Extraordinary items:
(i) Loss due to earthquakes / fire / strike
(ii) Attachment of property of the enterprise by government

d) Examples of Prior period items:
(i) Applying incorrect rate of depreciation in one or more prior periods.
(ii) Omission to account for income or expenditure in one or more prior periods.

Question 2 *(ICAI Study Material)*

The company finds that the inventory sheets of 31.3.2019 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 Pure Ltd. for the year ended 31st March, 2020.

Solution

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 as per AS 5. Separate disclosure of this item as a prior period item is required as per Para 15 of AS 5.

Question 3 *(ICAI Study Material)*

Fuel surcharge is billed by the State Electricity Board at provisional rates. Final bill for fuel surcharge of ₹ 5.30 lakhs for the period October, 2012 to September, 2018 has been received and paid in February, 2019. However, the same was accounted in the year 2019-20. Comment on the accounting treatment done in the said case.

Solution

The final bill having been paid in February, 2019 should have been accounted for in the annual accounts of the company for the year ended 31st March, 2019. 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 2019, this material charge has arisen in the current period i.e., year ended 31st March, 2020. 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 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 thereof is made as and when final bill is received may be mentioned as an accounting policy.'

Question 4 *(Inter May 2018 (5 Marks) / RTP May 2019)*

PQR Ltd. is in the process of finalizing its accounts for the year ended 31st March, 2020. The company seeks your advice on the following:

(i) Goods worth ₹ 5,00,000 were destroyed due to flood in September, 2017. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2017-18. In March, 2020, the claim was passed and the company received a payment of ₹ 3,50,000 against the claim. Explain the treatment of such receipt in final account for the year ended 31st March, 2020.

(ii) Company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2019-20. 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 31.03.2020. 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?

Solution

(i) 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 2017-18. Hence, claim received in the financial year 2019-20 is a prior period item and should be separately disclosed in the statement of Profit and Loss.

(ii) In the given case, a limited company created 2.5% provision for doubtful debts for the year 2019-2020. 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 considered 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 & loss account for the year ending 31st March, 2020

Question 5

S.T.B. Ltd. makes provision for expenses worth ₹ 7,00,000 for the year ending March 31, 2019, but the actual expenses during the year ending March 31, 2020 comes to ₹ 9,00,000 against provision made during the last year. State with reasons whether difference of ₹ 2,00,000 is to be treated as prior period item as per AS-5.

Solution

As per AS 5, as a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

Estimates may have to be revised, if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.

As per the standard, the effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. Thus, revision of an estimate by its nature i.e. the difference of ₹ 2 lakhs, is not a prior period item.

Therefore, in the given case expenses amounting ₹ 2,00,000 (i.e. ₹ 9,00,000 – ₹ 7,00,000) relating to the previous year recorded in the current year, should not be regarded as prior period item.

Question 6

X Co. Ltd. signed an agreement with its employees union for revision of wages in June, 2020. The wage revision is with retrospective effect from 1.4.2016. The arrear wages upto 31.3.2020 amounts to ₹ 80 lakhs. Arrear wages for the period from 1.4.2020 to 30.06.2020 (being the date of agreement) amounts to ₹ 7 lakhs. Decide whether a separate disclosure of arrear wages is required.

Solution

It is given that revision of wages took place in June, 2020 with retrospective effect from 1.4.2016. The arrear wages payable for the period from 1.4.2016 to 31.3.2020 cannot be taken as an error or omission in the preparation of financial statements of earlier years and hence this expenditure cannot be taken as a prior period item.

Additional wages liability of ₹ 87 lakhs (from 1.4.2016 to 30.6.2020) should be included in current year's wages. It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item.

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

However, wages payable for the current year (from 1.4.2020 to 30.6.2020) amounting ₹ 7 lakhs is not a prior period item hence need not be disclosed separately. This may be shown as current year's wages.

Question 7

An extract from the statement profit and loss of a company for 2019-20 is given below:

	₹ '000	₹ '000
Sales		3,000
Opening stock	500	
Production cost	2,800	
	3,300	
Less: Closing Stock	(600)	(2,700)
Gross Profit		300

Expenses		(250)
Profit before tax		50
Tax		(20)
Profit after tax		30

Closing stock includes stock damaged in a fire in 2018-19. On 31/03/19, estimated net realisable value of this stock was ₹ 15,000. The revised estimate of net realisable value included in closing stock of 2019-20 is ₹ 5,000. Rewrite statement of profit & loss if necessary to comply with requirements of AS 5.

Question 8

Closing Stock for the year ending on 31st March, 2020 is ₹ 1,50,000 which includes stock damaged in a fire in 2018-19. On 31st March, 2019, the estimated net realizable value of the damaged stock was ₹ 12,000. The revised estimate of net realizable value of damaged stock included in closing stock at 2019-20 is ₹ 4,000. Find the value of closing stock to be shown in Profit and Loss Account for the year 2019-20, using provisions of Accounting Standard 5.

Solution

The fall in estimated net realisable value of damaged stock ₹ 8,000 is the effect of change in accounting estimate. As per AS 5, the effect of a change in accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. It is presumed that the loss by fire in the year ended 31.3.2019, i.e. difference of cost and NRV was shown in the profit and loss account as an extra-ordinary item. Therefore, in the year 2019-20, revision in accounting estimate should also be classified as extra-ordinary item in the profit and loss account and closing stock should be shown excluding the value of damaged stock.

Value of closing stock for the year 2019-20 will be as follows:

Closing Stock (including damaged goods)	1,50,000
Less: Revised value of damaged goods	(4,000)
Closing stock (excluding damaged goods)	1,46,000

Question 9

X Limited was making provisions up to 31-3-2019 for non-moving inventories based on no issues for the last 12 months. Based on a technical evaluation the company wants to make provisions during the year 31-03-2020 in the following manner:

Total value of inventory ₹ 3 crores

Provision required based on 12 months ₹ 8 lakhs.

Provision required based on technical evaluation ₹ 7.50 lakhs.

Does this amount to change in accounting policy?

Can the company change the method of provision?

Solution

Basis of provisioning whether on no issues or on technical evaluation is the basis of making estimates and cannot be considered as Accounting Policy. As per AS 5, due to 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. An estimate may have to be revised if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.

The basis of change in provisioning is a guideline and the better way of estimating the provision for non-moving inventory on account of change. Hence, it is not a change in accounting policy.

Further, the company should be able to demonstrate satisfactorily that having regard to circumstances provision made on the basis of technical evaluation provides more satisfactory results than provision based on 12 months issue. If that is the case, then the company can change the method of provision.

Question 10 *(RTP May 2018)/ (RTP Nov 2022)*

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 ₹10 Lakhs by selling the said land. There was a fire in the factory and a part of the unused factory shed valued at ₹ 8 Lakhs was destroyed. The loss from fire was set off against the profit from sale of land and profit of ₹2 lakhs was disclosed as net profit from sale of assets. Do you agree with the treatment and disclosure? If not, state your views.

Solution

As per para 8 of AS 5, Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss 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 can be 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 11 *(RTP May 2020) / (ICAI Study Material)*

Explain whether the following will constitute change in accounting policy or not as per AS 5.

(i) Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement.
(ii) 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.

Solution

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.
(i) Accordingly, introduction of formal retirement gratuity scheme by an employer in place of adhoc ex-gratia payments to employees on retirement is not change in accounting policy.
(ii) Similarly, adoption of 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.

Question 12 *(RTP Nov 2018) / (RTP Nov 2019) / (RTP Nov 2020) (Similar)/ (RTP May 2022)*

The Accountant of Mobile Limited has sought your opinion with relevant reasons, whether the following transactions 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;
(a) 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%.
(b) 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.
(c) 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.
(d) 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.
(e) During the year ended 31st March, 2020, there was change in cost formula in measuring the cost of inventories

Solution

(a) In the given case, Mobile limited created 2% provision for doubtful debts till 31st March, 2019. Subsequently in 2019-20, the company revised the estimates based on the changed circumstances 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.
(b) 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.
(c) 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.
(d) 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.
(e) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

Question 13

During the course of the last three years, a company owning and operating Helicopters lost four Helicopters. The company's accountant felt that after the crash, the maintenance provision created in respect of the respective helicopters was no longer required, and proposed to write it back to the Profit and Loss account as a prior period item. Is the company's proposed accounting treatment correct? Discuss

Solution

The balance amount of maintenance provision written back to profit and loss account, no longer required due to crash of the helicopters, is not a prior period item because there was no error in the preparation of previous periods' financial statements. The balance amount left in the provision created earlier is not as a result of error in the past. So it will not be considered as prior period item. Such write back of provision is not an ordinary feature of the business, it shall be considered as an extra-ordinary item.

As per paragraph 8 of AS 5, extraordinary items should be disclosed in the Statement of Profit and Loss as a part of net profit or loss 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 can be perceived. Hence, the amount so written-back (if material) should be disclosed as an extraordinary item as per AS 5 rather than as prior period items.

Question 14 *(Inter Jan 2021) (5 Marks) / (RTP May 2023)*

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 amount of PPE.
(iii) Government grant receivable as compensation for expenses incurred in previous accounting period.
(iv) Treating operating lease as finance lease.
(v) Capitalisation 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.

Solution

(i) Change in Accounting Estimates
(ii) Change in Accounting Policy
(iii) Extra -ordinary Items
(iv) Prior- period Items
(v) Prior-period Items (as interest on working capital loans is not eligible for capitalization)
(vi) Ordinary Activity
(vii) Change in Accounting Estimates
(viii) Extra -ordinary Items
(ix) Prior- period Items
(x) Change in Accounting Estimates

Question 15 *(ICAI Study Material)*

From the past 5 financial years, an old outstanding balance of ₹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 ₹ 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.

Solution

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 of financial 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 amount written off is not treated as a prior period item. Hence, adjusting the amount ₹50,000 written off as a prior period item on the basis that sundry balances were recognized in prior period(s) is not in line with AS 5.

Question 16 *(ICAI Study Material)*

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 it for 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?

Solution

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 recur frequently 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. Recognizing such payments as an extra-ordinary item is contrary to AS 5.

PRACTICE QUESTIONS

Question 1 (Inter May 2019) (2 Marks)

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

(1) 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.

(2) 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.

Solution

(1) 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

(2) 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 2

A limited company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2019-2020. Subsequently on a review of the credit period allowed and financial capacity of the customers, the company decided to increase the provision to 8% on debtors as on 31.3.2020. The accounts were not approved by the Board of Directors till the date of decision.

While applying the relevant accounting standard can this revision be considered as an extraordinary item or prior period item?

Solution

As per AS 5, the preparation of financial statements involves making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revise an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate, by its nature, does not bring the adjustment within the definitions of a prior period item or an extraordinary item.

In the given case, a limited company created 2.5% provision for doubtful debts for the year 2019-2020. Subsequently in 2020 the company revised the estimates based on the changed circumstances and wants to create 8% provision. As per AS-5, this change in estimate is neither a prior period item nor an extraordinary item.

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

Question 3

A company created a provision of ₹ 75,000 for staff welfare while preparing the financial statements for the year 2019-20. On 31st March, in a meeting with staff welfare association, it was decided to increase the amount of provision for staff welfare to ₹ 1,00,000. The accounts were approved by Board of Directors on 15th April, 2020. Explain the treatment of such revision in financial statements for the year ended 31st March, 2020.

Solution

As per AS 5, the change in amount of staff welfare provision amounting ₹ 25,000 is neither a prior period item nor an extraordinary item. It is a change in estimate, which has been occurred in the year.

As per the provisions of the standard, normally, all items of income and expense which are recognized in a period are included in the determination of the net profit or loss for the period. This includes extraordinary items and the effects of changes in accounting estimates. However, the effect of such change in accounting estimate should be classified using the same classification in the statement of profit and loss, as was used previously, for the estimate.

Question 4 *(ICAI Study Material)*

(i) During the year 2019-2020, a medium size manufacturing company wrote down its inventories to net realisable value by ₹ 5,00,000. Is a separate disclosure necessary?

(ii) A company signed an agreement with the Employees Union on 1.10.2019 for revision of wages with retrospective effect from 30.9.2018. This would cost the company an additional liability of ₹ 5,00,000 per annum. Is a disclosure necessary for the amount paid in 2019-20?

Solution

(i) 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 give to 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.

(ii) It is given that revision of wages took place on 1st October, 2019 with retrospective effect from 30.9.2018. Therefore wages payable for the half year from 1.10.2019 to 31.3.2020 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 5 *(Inter May 2022) (5 Marks)*

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 to charge ₹ 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.

Solution
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 determined 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 & 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 6

Priya Ltd had to pay delayed cotton clearing charges over and above the negotiated price for taking delayed delivery of cotton from the supplier's godown. Upto 2018-19, the company has regularly included such charges in the valuation of closing stock. This charge, being in the nature of interest, the company has decided to exclude it from closing stock valuation. This would result in decrease of profit by ₹ 8.60 lakhs. What will be its treatment in the financial statements for year ended 31st March, 2020?

Solution
AS 5 states that a change in an accounting policy should be made only if
a) It is required by statute, or
b) for compliance with an accounting standard, or
c) if it is considered that the change would result in a more appropriate presentation of the financial statements of an enterprise.

Therefore the change in the method of stock valuation is justified in view of the fact that the change is in line with the recommendations of AS 2 'Valuation of Inventories' and would result in more appropriate preparation of the financial statements. Accordingly, cost formula used for inventory valuation will exclude the delayed clearing charges being in the nature of interest. Due to change in the cost formula, the value of inventory and resulting profit will decrease by ₹ 8.60 lakhs. Appropriate disclosures should be made in the financial statements for this change.

Question 7

Shama was working with ABC Ltd. drawing monthly salary of ₹ 25,000 per month. She went on maternity leave with pay for 7 months i.e. from 1-01-2019 to 31-7-19. Her salary for 3 months was not provided for in financial statements for F.Y. 2018-19 due to omission. When she joined after leave period, the whole salary for 7 months was paid to her.
You are required to:

(i) Pass the necessary journal entries in F.Y. 2019-20 to record the above transaction as per accounting standard-5 and state reason for the same.

(ii) Would the treatment have been different, if Shama was terminated on 01-01-2019 and was reinstated in service by the court w.e.f. 01-08-2019 with instruction to pay Shama salary for the intervening period i.e. 1-01-2019 to 31-07-2019

Solution

As per AS 5"Net Profit or Loss for the Period", Prior Period Items and Changes in Accounting Policies, the term 'prior period items', refers to 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 nature and amount of prior period items should be separately disclosed in the statement of profit and loss so that their impact on the current profit or loss can be perceived. Hence, in this case salary paid to Shama for 3 months i.e 1.1.2019 to 31.3.2019 ₹ 75,000 will be classified as prior period item in FY 2019-20 and following journal entry shall be passed:

(i) Journal entry in FY 2019-20

		Dr. (₹)	Cr. (₹)
Salary A/c (₹ 25,000 x 4)	Dr.	1,00,000	
Prior period item (₹ 25,000 x 3)	Dr.	75,000	
To Bank A/c			1,75,000

(Salary related to 7 months paid out of which 3'months' salary is prior period item)

Alternative Entry

Salary A/c (prior period item) Dr. 75,000
To Bank A/c 75,000
(Salary related to 3 months i.e. January, 2019 to March 2019 paid in 2019-2020)

Salary A/c Dr. 1,00,000
To Bank A/c 1,00,000
(Salary related to 4 months paid on 1.8.2019 for April to July, 2019)

(ii) AS 5 inter alia states that the term 'prior period items' does not include other adjustments necessitated by circumstances, which though related to prior periods, are determined in the current period. Accordingly, in the second case though Shama was terminated on 1.1.2019 i.e. in 2018-2019, yet she was reinstated due to court's order in 2019-2020, with the instruction by the court to pay the salary for the intervening period i.e. with retrospective effect from January, 2019. The adjustment of salary of ₹ 75,000 (for January 2019 to March, 2019) would not be considered as prior period item and will be accounted for in the books as current year expense. Thus the entire amount of Salary of ₹ 1,75,000 for January, 2019 to July, 2019 is a current year expense only.

Salary A/c (₹ 25,000 x 7) Dr. 1,75,000
To Bank A/c 1,75,000
(Salary related to 7 months paid i.e. for the period 1.1.2019 to 31.7.2019)

Question 8 *(RTP Nov 2021)*

a) There was a major theft of stores valued at ₹ 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 financial statements of R Ltd. for the year ended 31st March, 2021.

b) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organisation. Such employees will get pension of ₹ 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.

Solution

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.

Question 9 *(ICAI Study Material)*

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 the new 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?

Solution

No. As per AS 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" 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.

Question 10 *(Inter Nov 2022) (5 Marks)*

The Accountant of Shiva Limited had sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policies or change in Accounting Estimates for the year ended 31st March, 2021. Please advise him in the following situations in accordance with the provisions of AS 5:

a) Provision for doubtful debts was created @3% till 31st March, 2020. From the Financial year 2020-2021, the rate of provision has been changed to 4%.
b) During the year ended 31st March,2021, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.
c) Till 31st March, 2020 the furniture was depreciated on straight line basis over a period of 5 years. From the Financial year 2020-2021, the useful life of furniture has been changed to 3 years.
d) 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.
e) During the year ended 31st March 2021, there was change in cost formula in measuring the cost of inventories.

Solution:

a) In the given case, company has created 3% 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 4% 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.
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. 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 neither be treated as change in an accounting policy nor change in accounting estimate.
c) Change in useful life of furniture from 5 years to 3 years is a change in accounting estimate and is not a change in accounting policy.
d) 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 neither a change in accounting policy nor a change in accounting estimate.
e) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

CONSTRUCTION CONTRACT

AS 07

<table>
<tr><td>Objective</td><td colspan="2">To prescribe accounting for revenue and costs associated with construction contracts</td></tr>
<tr><td>Scope</td><td colspan="2">Accounting for construction contracts in the financial statements of <u>contractors</u> (not contractee)</td></tr>
<tr><td>Meaning of construction contract</td><td colspan="2">It is a contract specifically negotiated for
→ construction of an asset
<u>Example</u>: Bridge, Building, Dam, etc.
→ Combination of assets that are closely interrelated or interdependent in terms of design, technology, function or ultimate purpose or use.
<u>Example</u>: Refineries, Other complex pieces of plant or equipment etc.

Construction contracts also include:
(a) contracts for rendering of services which are directly related to construction of the asset, for eg., those for the services of project managers & architects;
(b) contracts for destruction or restoration of assets, and the restoration of the environment following the demolition of assets.</td></tr>
<tr><td rowspan="2">Types of construction Contracts:</td><td>Fixed price contract</td><td>In this contract, the contractor agrees to fixed contract price or fixed rate per unit of output. It may be with or without escalation clause</td></tr>
<tr><td>Cost plus contract</td><td>In this contact, the contractor is reimbursed for the cost incurred plus percentage of these costs or fixed fee.<table><tr><td>Cost incurred (allowable/defined cost)</td><td>XX</td></tr><tr><td>+ % of cost or fixed fee</td><td><u>XX</u></td></tr><tr><td></td><td>XX</td></tr></table></td></tr>
<tr><td>Contract revenue</td><td colspan="2">It means the revenue which is agreed upon between the contractor and contractee<table><tr><td>Initial contract revenue</td><td>XX</td></tr><tr><td>+/- Variations (alteration in job like change in specifications)*</td><td>XX</td></tr><tr><td>+ Incentive payments (price for timely completion of job)**</td><td>XX</td></tr><tr><td>+ Price escalation (extra compensation for increased cost)</td><td>XX</td></tr><tr><td>+ Claims (losses in contract due to contractee like customer caused delays, error in specification or design etc.</td><td>XX</td></tr><tr><td>Any penalty (from delays caused by contractor)</td><td>(XX)</td></tr><tr><td>Contract Revenue</td><td>XX</td></tr></table>
* included in contract revenue when it is probable that the customer will approve the variation and amount of revenue arising from the variation;
**included in contract revenue when the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded;
<u>These should be included in contract revenue if it is probable that they will result in revenue & they are capable of being measured.</u></td></tr>
</table>

<table>
<tr><td rowspan="6">Contract cost</td><td colspan="2">It means the expenses incurred at site along with the apportioned contract cost</td></tr>
<tr><td>Direct cost</td><td>Relate directly to specific contract
Example: Site labour cost, cost of material used, depreciation of plant and equipment, etc.</td></tr>
<tr><td>Allocated cost</td><td>Attributable to contract in general and can be allocated
Example: Insurance of machinery, salary of supervisor who is supervising more than 1 contract, etc.</td></tr>
<tr><td>Specific cost</td><td>Specifically chargeable to customer under the terms of contract
Example: General administration cost and development cost for which reimbursement is specified under contract</td></tr>
<tr><td>Note</td><td>Direct cost may be reduced by any incidental income that is not included in contract revenue
Example: Income from sale of surplus material and disposal of plant & equipment at the end of contract.</td></tr>
<tr><td>Exclusions</td><td>*Example*:
• general administration & research & development costs for which reimbursement is not specified in the contract
• selling costs
• depreciation of idle plant and equipment that is not used on a particular contract</td></tr>
<tr><td rowspan="3">Recognition of contract revenue and expenses</td><td>When to recognize</td><td>When the outcome of construction contract can be estimated reliably</td></tr>
<tr><td>Conditions</td><td>❖ Total contract revenue can be measured reliably
❖ It is probable that economic benefits associated with contract will flow to the enterprise
❖ Contract cost can be clearly identified and measured reliably.</td></tr>
<tr><td>Basis of recognition</td><td>By reference to the stage of completion of the contract activity at the reporting date.
Methods to determine stage of completion of contract
1. % completion = $\frac{Cost\ till\ date}{Total\ estimated\ cost} \times 100$
2. Survey of work performed (Certification by surveyor)
3. Completion of a physical proportion of the contract work. (Eg. Contract to place tiles)</td></tr>
<tr><td>Computation of Profit</td><td colspan="2">Contract Revenue x Stage of Completion (%) = XXX
Less: Contract Costs till date = (XXX)
Total Profit till date = XXX
Less: Profit recognized till last year = (XXX)
Profit for the Current Year = XXX</td></tr>
<tr><td>Recognition of expected losses</td><td>Para 35</td><td>When it is probable that
Total contract cost will exceed Total contract revenue,
Expected loss should be recognized as expense immediately.</td></tr>
</table>

	Para 36	Amount of such loss is determined irrespective of ❖ Whether or not work has commenced on the contract. ❖ Stage of completion of contract activity ❖ Amount of profits expected to realize on other contracts which are not treated as single construction contract
When outcome of construction contract cannot be estimated reliably	❖ Revenue should be recognized only to the extent of contract costs incurred of which recovery is probable; and ❖ Contract costs should be recognised as expense in the period in which they are incurred.	
Combining & Segmenting Construction Contracts (CONDITIONS)	Separate	❖ separate proposals have been submitted ❖ separate negotiations have been carried out ❖ costs and revenue of each asset can be separately identified
	Combining	❖ they are negotiated as a single package; ❖ they are closely interrelated and ❖ they will be performed in sequence i.e. concurrently
Construction of an additional asset	It should be treated as a separate construction contract when: ➢ the asset differs significantly in design, technology or function from the asset covered by the original contract; or ➢ the price of the asset is negotiated without regard to the original contract price	
Treatment of Costs Relating to Future Activity	The contract costs that relate to future activity on the contract are however recognised as an asset provided it is probable that they will be recovered. Such costs represent an amount due from the customer and are often classified as contract work in progress.	
Uncollectable Contract Revenue	When an uncertainty arises about the collectability of an amount already included in contract revenue, and already recognised in the statement of profit and loss, the uncollectable amount or the amount in respect of which recovery has ceased to be probable is recognised as an expense rather than as an adjustment of the amount of contract revenue	
Change in estimates	The percentage of completion method is applied on a cumulative basis in each accounting period to the current estimates of contract revenue and contract cost. Therefore, the effect of a change in estimates is accounted for as change in accounting estimate as per AS-5 (Prospective effect).	
Disclosure requirements	❖ Amount of contract revenue recognized ❖ Method used to determine such revenue ❖ Method used to determine stage of completion of contract in progress. ❖ Following to be disclosed for contract in progress: • Aggregate cost incurred • Profit recognized till date • Advance received • Amount of retention • Progress Billings An enterprise should also present: a) the gross amount due from customers for contract work as an asset & b) the gross amount due to customers for contract work as a liability	

ASSIGNMENT QUESTIONS

Question 1 *(RTP May 2020) / (ICAI Study Material)* *Pg no._____*

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 a 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 upto the reporting date	2,093	6,168*	8,100**
Estimated profit for whole contract	950	1,000	1,000

*Includes ₹ 100 lacs for standard materials stored at the site to be used in year 3 to complete the work.

**Excludes ₹ 100 lacs for standard material brought forward from year 2.

The variation in cost and revenue in year 2 has been approved by customer.

Compute year wise amount of revenue, expenses, contract cost to complete and profit or loss to be recognized in the Statement of Profit and Loss as per AS-7 (revised)

Question 2 *(RTP May 2018) / (RTP Nov 2018) / (RTP Nov 2020)* *Pg no._____*

Uday Constructions undertake to construct a·bridge for the Government of Uttar Pradesh. The construction commenced during the financial year ending 31.03.2020 and is likely to be completed by the next financial year. The contract is for a fixed price of ₹ 12 crores with an escalation clause. The costs to complete the whole contract are estimated at ₹ 9.50 crores of rupees.

You are given the following information for the year ended 31.03.2020:

Cost incurred upto 31.03.2020, ₹ 4 crores

Cost estimated to complete the contract ₹ 6 crores

Escalation in cost by 5% and accordingly the contract price· is increased by 5%.

You are required to ascertain the state of completion and state the revenue and profit to be recognized for the year as per AS-7.

Question 3 *(ICAI Study Material)* *Pg no._____*

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 to be 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 costs incurred 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.

Question 4 *(Inter July 2021) (5 Marks)* Pg no._____

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 at the end of the period.

(iii) Labour Expense for workers engaged at site 16 Lakhs (out of which 1 Lakh is still unpaid)

(iv) Specific Contract Costs - ₹ 5 Lakhs

(v) SubContract Costs for work executed 7 Lakhs, Advances paid to subcontractors 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 be recognized as per AS-7.

Solution

Computation of contract cost

	₹ Lakh	₹ Lakh
Material cost incurred on the contract (net of closing stock)	(21- 4)	17
Add: Labour cost incurred on contract (incl. outstanding amount)		16
Specified contract cost	given	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 (₹ 85,00,000 x 56.25%) = ₹ 47,81,250 Contract costs = ₹45,00,000

Question 5 *(ICAI Study Material)* Pg no._____

AB contactors enters into a contract on 1st January 2021 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 2023). 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 in 2 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 2022, 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.

Question 6 *(RTP Nov 2021)* *Pg no._____*

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 ₹ 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.

Solution

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 7 *(ICAI Study Material)* *Pg no._____*

X Ltd. commenced a construction contract on 01/04/19. The fixed contract price agreed was ₹ 2,00,000. The company incurred ₹ 81,000 in 2019-20 for 45% work and received ₹ 79,000 as progress payment from the customer. The cost incurred in 2020-21 was ₹ 89,000 to complete the rest of work. Prepare P&L Account extract and Customer's Account for 2 years.

Question 8 *(ICAI Study Material)* *Pg no._____*

On 1st December, 2019, Vishwakarma Construction Co. Ltd. undertook a contract to construct a building for ₹ 85 lakhs. On 31st March, 2020 the company found that it had already spent ₹ 64,99,000 on construction. Prudent estimate of additional cost for completion was ₹ 32,01,000. Calculate total estimated loss on contract and what amount should be charged to revenue in the final accounts for the year ended 31st March, 2020 as per provisions of Accounting Standard 7 (Revised)?

Question 9 *(ICAI Study Material)* *Pg no._____*

Show Profit & Loss A/c (Extract) in books of a contractor in respect of the following data

Information for Year 1	₹ ('000)
Contract price (Fixed)	600
Cost incurred to date	390
Estimated cost to complete	260

Assume that the contract period is 2 years. The contract is 100% completed by Year 2. Actual costs incurred is the same as total estimated costs to complete (Cost incurred to date plus estimated cost to complete).

Question 10 *(ICAI Study Material)* *Pg no._____*

Akar Ltd. Signed on 01/04/19, a construction contract for ₹ 1,50,00,000.

Following particulars are extracted in respect of contract, for the period ending 31/03/20.

- 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 31.3.20.
- ❖ 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 to be taken to Profit & Loss Account and any provision for foreseeable loss as per AS-7.

Question 11 *Pg no._____*

On 31st October, 2019, Bharat Construction Co. Ltd. undertook a contract to construct a Flyover for ₹ 215 crores. On 31st March, 2020, company found that its work certified is for ₹ 100 crores and work to be certified is for ₹ 35 crores. Prudent estimate of additional cost for completion was ₹ 90 crores. What amount should be charged to Revenue in the final accounts for the year ended 31st March, 2020 as per provisions of Accounting Standard 7 (revised).

Question 12 *Pg no._____*

PRZ & Sons Ltd. are Heavy Engineering contractors specializing in construction of dams. From the records of the company, following data is available for year ended 31st March, 2020:

	₹ (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 this data and applying the relevant Accounting Standard you are required to:

(i) Compute the amount of profit/loss for the year ended 31st March, 2020.

(ii) Arrive at the contract work in progress as at the end of financial year 2019-20.

(iii) Determine the amount of revenue to be recognized out of the total contract value

Question 13 *(ICAI Study Material)* *Pg no._____*

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, 2020.

	₹ (in Lakhs)
Total Contract Price	1,000
Work Certified	500
Work not Certified	105
Estimated further Cost to Completion	495
Progress Payment Received	400
To be Received	140

Firm seeks your advice & assistance in presentation of accounts as per AS 7

Question 14 *Pg no._____*

An amount of ₹9,90,000 was incurred on a contract work upto 31-3-2020. Certificates have been received to date to the value of ₹12,00,000 against which ₹10,80,000 has been received in cash. The cost of work done but not certified amounted to ₹22,500. It is estimated that by spending and additional amount of ₹60,000 (including provision for contingencies) the work can be completed in all respects in another two months. The agreed contract price of work is ₹ 12,50,000. Compute a conservative estimate of the profit to be taken to the Profit and Loss Account as per AS-7.

Question 15 *(ICAI Study Material)* *Pg no._____*

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.

Solution

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.

Question 16 *(ICAI Study Material)* *Pg no._____*

X Ltd. commenced a construction contract on 01/04/19. The contract price agreed was reimbursable cost plus 10%. The company incurred ₹ 1,00,000 in 2019-20, of which ₹ 90,000 is reimbursable. The further non-reimbursable costs to be incurred to complete the contract are estimated at ₹ 5,000. The other costs to complete the contract could not be estimated reliably. Show the P&L A/c extract.

Question 17 *Pg no._____*

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 ₹ 490 lakhs. The agreement lays down values for each of the four outlets (88 + 132 + 160 + 110 lakhs) in addition to individual completion time. Comment whether X Ltd., will treat it as a single contract or four separate contracts.

Solution

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 to accept 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 can be 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 contract accounts have to be recorded and maintained in the books of X Ltd. For each contract, principles of revenue and cost recognition have to be applied separately and net income will be determined for each asset as per AS -7.

PRACTICE QUESTIONS

Question 1 Pg no.______

M/s Action Construction Company Ltd. undertook a fixed price construction contract to construct a building within 3 years time for ₹ 10,000 lakhs.
A summary of the financial data during the construction period is as follows:

	Amount (In Lacs)		
	Year 1	Year 2	Year 3
Initial Amount for revenue agreed in contract	10,000	10,000	10,000
Variation in Revenue (+)	-	500	1,000
Contracts costs incurred up to the reporting date	2,415	6,375	8,500
Estimated profit for whole contract	1,950	2,000	2,500

The variation in cost and revenue in year 2 and 3 has been approved by customer.
Determine the stage of completion of contract and amount of revenue expenses and profit or loss to be recognised in the statement of Profit & Loss for three years as per AS-7 (Revised).

Solution

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are computed below:

	Amount (In Lacs)		
	Up to the reporting date	Recognized in previous years	Recognized in current year
Year 1			
Revenue (10,000 x 30%)	3,000		3,000
Expenses (8,050 x 30%)	2,415		2,415
Profit	585		585
Year 2			
Revenue (10,500 x 75%)	7,875	3,000	4,875
Expenses (8,500 x 75%)	6,375	2,415	3,960
Profit	1,500	585	915
Year 3			
Revenue (11,000 x 100%)	11,000	7,875	3,125
Expenses (8,500 x 100%)	8,500	6,375	2,125
Profit	2,500	1,500	1,000

Working Note - Calculation of stage of completion of contract

	Year 1	Year 2	Year 3
Revenue after considering variations	10,000	10,500	11,000
Less: Estimated profit for whole contract	1,950	2,000	2,500
Estimated total cost of the contract (A)	8,050	8,500	8,500
Actual cost incurred upto the reporting date (B)	2,415	6,375	8,500
Degree of completion (B/A)	30%	75%	100%

Question 2 *(ICAI Study Material)* Pg no.______

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?

Solution

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 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 should not recognize any revenue of this contract.

Question 3 *(RTP May 2021)* *Pg no._____*

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 ₹ 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.

Solution

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 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 (Sky Limited) should not recognize any revenue of this contract. Therefore, the accountant's contention for recognizing ₹ 50 lakhs as revenue is not correct.

Question 4 *Pg no._____*

M/s Highway Constructions undertook the construction of a highway on 01.04.2019. The contract was to be completed in 2 years. The contract price was estimated at ₹ 150 crores. Up to 31.03.2020 the company incurred ₹ 120 crores on the construction. The engineers involved in the project estimated that a further ₹ 45 crores would be incurred for completing the work. What amount should be charged to revenue for the year 2019-20 as per the provisions of Accounting Standard 7 "Construction Contracts"? Show the extract of the Profit & Loss A/c in the books of M/s. Highway Constructions.

Solution

Statement showing the amount to be charged to Revenue as per AS 7

	₹ in crores
Cost of construction incurred upto 31.03.2020	120
Add: Estimated future cost	45
Total estimated cost of construction	165
Degree of completion (120/165 x 100)	72.73%
Revenue recognized (72.73% of 150)	109 (approx.)
Total foreseeable loss (165 – 150)	15
Less: Loss for the current year (120 – 109)	11
Loss to be provided for	4

Profit & Loss A/c (Extract)

	₹ in crores		₹ in crores
To Construction costs	120	By Contract Price	109
To Provision for loss	4	By Net Loss	15
	124		124

Question 5 *(RTP Nov 2019)/ (RTP Nov 2022)* *Pg no._____*

On 1st December, 2019, "Sampath" Construction Company Limited undertook a contract to construct a building for ₹ 108 lakhs. On 31st March, 2020 the company found that it had already spent ₹ 83.99 lakhs on the construction. A prudent estimate of additional cost for completion was ₹ 36.01 lakhs. What is the provision for foreseeable loss, which must be made in the Final Accounts for year ended 31st March, 2020 based on AS 7?

Solution

Calculation of foreseeable loss for the year ended 31st March, 2020
(as per AS 7 "Construction Contracts")

	₹ in Lakhs
Cost incurred till 31st March, 2020	83.99
Prudent estimate of additional cost for completion	36.01
Total cost of construction	120.00
Less: Contract price	(108.00)
Foreseeable loss	12.00

According to 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, amount of ₹ 12 lakhs is required to be provided for in the books of Sampath Construction Company for the year ended 31st March, 2020.

Question 6 *Pg no._____*

Shyan Limited commenced a construction contract on 01-04-2018. The company expended ₹500 crores in 2018-19 for 40% work. The total estimated cost of the project is ₹ 1,250 crores. Compute (i) Revenue, (ii) Expense, (iii) Provision for loss & (iv) Profit or loss to be recognized in the statement of Profit and Loss A/c as per AS-7 for the year ending 31-03-2019 if:

(1) It is fixed price contract of ₹ 1,200 crores.
(2) It is cost plus contract of 20%.

Solution

1. If it is a fixed price contract of ₹ 1,200 crores

   Percentage of completion till date to total estimated cost of construction = 40%

i	Revenue (₹1,200 crores x 40%)	480
ii	Expenses	500
iii	Provision for loss (Refer Working note)	30
iv	Loss	50

2. If it is a cost-plus contract of 20%

i	Revenue (₹500 crores x 120%)	600
ii	Expenses	500
iii	Provision for loss (Refer Working note)	Nil
iv	Profit	100

Working Note: Calculation of provision for loss in case of fixed price contract

Amount of foreseeable loss	Amount (in crores)
Total cost of construction	1,250
Less: Total contract price	(1,200)
Amount of foreseeable loss	50
Loss for current year [500 – 480 (₹1,200 crores x 40%)]	(20)
Expected loss to be recognized immediately	30

According to 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.

Question 7 (RTP May 2022) Pg no._____

B Ltd. undertook a construction contract for ₹ 50 crores in April, 2019. The cost of construction was initially estimated at ₹ 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated the cost of completion of the contract at ₹ 53 crores. Can the company provide for the expected loss in the book of account for the year ended 31st March, 2020?

Solution

As per Para 35 of AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Therefore, The foreseeable loss of ₹ 3 crores (₹ 53 crores less ₹ 50 crores) should be recognised as an expense immediately in the year ended 31st March, 2020. The amount of loss is determined irrespective of

a) Whether or not work has commenced on the contract;
b) Stage of completion of contract activity; or
c) The amount of profits expected to arise on other contracts which are not treated as single construction contract.

Question 8 Pg no._____

Five Star Construction Limited commenced a construction contract on 1st April, 2019. The Fixed Contract price agreed was ₹ 50,00,000. The company incurred ₹ 21,00,000 in 2019-20 for 40% work and received ₹ 19,00,000 as progress payment from the customer. The company estimated that a further ₹ 31,50,000 would incurred to complete it. What amount should be charged to revenue for the year 2019-20 as per AS 7?

Show the extract of Profit & Loss A/c for the year 2019- 20 in the books of the company.

Solution

	₹
Total expected loss to be provided for Contract Price –Total Cost = 50,00,000 – (21,00,000 + 31,50,000)	2,50,000
Calculation for 2019-20 on 40% work	
Contract Revenue	20,00,000
Contract Cost	21,00,000
Loss on contract	1,00,000
Expected loss recognized as per AS 7	2,50,000
Further provision required in respect of Expected Loss (₹2,50,000 - ₹1,00,000)	1,50,000

Profit & Loss A/c (Extract) for the year ended 31st March 2020

	₹		₹
To Construction costs (for 40% work)	21,00,000	By Contract Revenue	20,00,000
To Provision for loss	1,50,000	By Net Loss	2,50,000
	22,50,000		22,50,000

Question 9 *(Inter May 2018) (5 Marks)* *Pg no.______*

Sarita Construction Co. obtained a contract for construction of a dam. The following details are available in records of company for the year ended 31st March, 2020:

	₹ In Lakhs
Total Contract Price	12,000
Work Certified	6,250
Work not certified	1,250
Estimated further cost to completion	8,750
Progress payment received	5,500
Progress payment to be received	1,500

Applying the provisions of Accounting Standard 7 "Accounting for Construction Contracts" you are required to compute:

(i) Profit/Loss for the year ended 31st March, 2020.
(ii) Contract work in progress as at end of financial year 2019-20.
(iii) Revenue to be recognized out of the total contract value.
(iv) Amount due from/to customers as at the year end.

Solution

(i) Profit/Loss for the year ended 31st March, 2020.

Amount of foreseeable loss	
Total cost of construction (6,250 + 1,250 + 8,750)	16,250
Less: Total contract price	(12,000)
Total foreseeable loss to be recognised as expense	4,250

According to AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Loss for the year ended, 31st March, 2020 amounting ₹ 4,250 will be recognized.

(ii) Contract work in progress as at end of financial year 2019-20.

Contract work-in-progress i.e. cost incurred to date are ₹ 7,500 lakhs	
Work certified	6,250
Work not certified	1,250
	7,500

(iii) Proportion of total contract value recognised as revenue
Cost incurred till 31.3.20 is 46.15% (7,500/16,250 x 100) of total costs of construction.
Proportion of total contract value recognised as revenue:
46.15% of ₹ 12,000 lakhs = ₹ 5,538 lakhs

(iv) Amount due from/to customers at year end
(Contract costs + Recognised profits – Recognised Losses) – (Progress payments received + Progress payments to be received)
= (7,500 + Nil – 4,250) – (5,500 + 1,500) ₹ in lakhs = [3,250 – 7,000] ₹ in lakhs
Amount due to customers = ₹ 3,750 lakhs

Question 10 *(Inter Nov 2020) (5 Marks)* *Pg no._____*

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 work was 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.

Solution

Year 1	₹
Actual expenditure	8,60,000
Future estimated expenditure	10,00,000
Total Expenditure	18,60,000

% of work completed = $\frac{8,60,000 \times 100}{18,60,000}$ = 46.24% (rounded off)

Revenue to be recognized = 20,00,000 x 46.24% = ₹ 9,24,800

Year 2	₹
Expenditure incurred in Year 1	8,60,000
Actual expenditure in Year 2	4,75,000
Future estimated expenditure	4,00,000
	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 = 6,14,200

Year 3
Whole contract got completed therefore total contract value less revenue recognized up to year 2 will 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 11 *(Inter May 2022) (5 Marks)* *Pg no._____*

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	35,000
Work Certified	17,500
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)	3,815
Estimated further cost to completion	17,325

Progress Payment Received	14,000
Payment to be Received	4,900
Escalation in cost is by 8% and accordingly the contract price is increased by 8%	

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.

Solution

Calculation of total estimated cost of construction

	(₹ in '000)	(₹ in '000)
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 till date / 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 31st March, 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 31st March, 2022 = Cost incurred till date – Revenue to be recognized for the year ended 31st March, 2022

= ₹ 21,175 thousand – ₹ 20,790 thousand = ₹ 385 thousand

Provision for loss to be made at the end of 31st March, 2022

	(₹ in '000)	(₹ in '000)
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 31st March, 2022		315

Question 12 *(ICAI Study Material)* Pg no._____

XYZ Construction Ltd., a construction company undertakes the construction of an industrial complex. It has separate proposals raised for each unit to be constructed in the industrial complex. Since each unit is subject to separate negotiation, it is able to identify the costs and revenues attributable to each unit. Should XYZ Construction Ltd. treat construction of each unit as a separate construction contract according to AS 7?

Solution

As per AS 7 '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 to accept or reject that part of the contract relating to each asset; and
c) the costs and revenues of each asset can be identified.
Therefore, XYZ Construction Ltd. is required to treat construction of each unit as a separate construction contract.

Question 13 *(RTP May 2019)* Pg no._____

GTI Ltd. negotiates with Bharat Oil Corporation Ltd. (BOCL), for construction of "Retail Petrol & Diesel Outlet Stations". Based on proposals submitted to different Regional Offices of BOCL, the final approval for one outlet each in Region X, Region Y, Region Z is awarded to GTI Ltd. A single agreement is entered into between two. The agreement lays down values for each of the three outlets i.e. ₹102 lacs, ₹150 lacs, ₹130 lacs for Region X, Region Y, Region Z respectively. Agreement also lays down completion time for each Region.
Comment whether GTI Ltd. will treat it as single contract or three separate contracts with reference to AS-7?

Solution

As per AS 7 'Construction Contracts', when a contract covers 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 to accept 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 Offices, which can be 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 single agreement for contracts.

Therefore, three separate contract accounts must be recorded and maintained in the books of GTI Ltd. For each contract, principles of revenue and cost recognition must be applied separately and net income will be determined for each asset as per AS 7.

Question 14 *(Inter May 2019) (5 Marks) / (RTP May 2021) / (RTP May 2023)* Pg no._____

(i) AP Ltd., a construction contractor, undertakes the construction of commercial complex for Kay Ltd. AP Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreement is entered into between the two parties. The agreement lays down the value of each of the 3 units, i.e. ₹ 50 Lakh ₹ 60 Lakh and ₹ 75 Lakh respectively. Agreement also lays down the completion time for each unit. Comment, with reference to AS- 7, whether AP Ltd., should treat it as a single contract or three separate contracts.

(ii) On 1st December, 2019, GR Construction Co. Ltd. undertook a contract to construct a building for ₹ 45 lakhs. On 31st March, 2020, the company found that it had already spent ₹ 32.50 lakhs on the construction. Additional cost of completion is estimated at ₹ 15.10 lakhs. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2020 as per provisions of AS-7?

Solution

(i) As per AS 7 '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 to accept or reject that part of the contract relating to each asset; and
   c) the costs and revenues of each asset can be identified.

AP 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, Mr. AP 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.

(ii)

	₹ 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 = (32.50/47.60)×100 = 68.28%
Proportion of total contract value recognised as revenue = Contract price x percentage of completion = ₹ 45 Lakhs x 68.28% = ₹ 30.73 Lakhs

Amount of foreseeable loss	₹ 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 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.

Question 15 *(ICAI Study Material)* *Pg no.*_____

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.

Solution

Usually, construction contracts are long term nature i.e., the contracts are entered 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 financial substance of the transaction.

REVENUE RECOGNITION

AS 09

Objective	AS 9 deals with the basis for recognition of revenue in the Statement of P&L. Recognition means timing of recording the revenue in the P&L A/c of enterprise.
Scope of AS 9	❖ Revenue from Sale of goods. ❖ Revenue from Rendering of services ❖ Revenue from Interest, Royalties and Dividend
Non Applicability	❖ Revenue arising from Construction contracts (AS 7) ❖ Revenue arising from Hire purchase and lease agreements (AS 19) ❖ Revenue arising from Government grants and other similar subsidies (AS 12) ❖ Revenue of Insurance company arising under insurance contracts
Other examples of scope exclusions	Revenue does not include the following: ❖ Realized gains on disposal of non-current assets. Example: Gain on sale of fixed assets under AS 10. ❖ Unrealized gains on holding of Non- current assets Example: Appreciation in the value of fixed assets under AS 10. ❖ Unrealized holding gains resulting from change in value of current assets. ❖ Realized/unrealized gains resulting from changes in foreign exchange rates and adjustments arising on translation of foreign currency financial statement (AS11)
Meaning of Revenue	Revenue is the gross inflow of : ➢ Cash ➢ Receivables or ➢ Other consideration arising in the course of ordinary activities of an enterprise from the • Sale of goods, • Rendering of services and • Use by others of enterprise resources yielding interest; royalties and dividends. *Exception* – In an agency relationship, revenue is the amount of commission and not the gross inflow of cash, receivables or other considerations. *Note: Trade Discounts & volume rebates to be deducted while determining revenue*
Examples	Entity XY sells a machine being used at its factory at a price of ₹ 2 lakh. The carrying value of the machine is ₹ 1.80 lakh. The sale of the machine does not increase the revenue of XY but is an example of a capital receipt since transaction does not take place in the normal course of business. *Such gain on sale of ₹ 20,000 (₹ 2 lakhs – ₹ 1.80 lakhs) is recognised as a part of profit & loss statement under Gain/(Loss) on disposal of asset.*

<table>
<tr><td></td><td colspan="2">ST Ltd is a real-estate developer and builder. It is into the business of buying and selling properties. In 2022, ST Ltd purchased a unit of land for ₹ 150 crore. It sold off that land after few months at a price of ₹ 240 crore.
In the above case, the sale of land is a transaction that happens in the ordinary course of business (as he is a real estate developer and builder – properties will be an item of inventory in the financial statements) for ST Ltd. Hence, it should recognise a revenue of ₹ 240 crore when the land is sold

DL Ltd, a pharma company, has been conducting research on new medicine since last 2 years to increase the immunity levels of the people consuming it without any side effects. During the current year, it decides to sell the outcome of the research undertaken so far to another competitor, GH Ltd for ₹ 50 crore. DL has already incurred ₹30 crore on the ongoing research.
In the above example, the sale of the research findings does not represent an increase in revenue. This is because DL Ltd's business is not to sell these research findings in the ordinary course of business. The amount of ₹ 50 crore will be a part of Other Income in the profit & loss statement.

Trip Deal is a website that allows people to book airlines tickets. As a part of the business, it agrees to buys 100 tickets from an airline on a particular date and resells those tickets to customers. However, Trip Deal bears the loss for any unsold tickets.
In the above example, the risks and rewards relating to tickets are borne by Trip Deal. Hence, sales made for the tickets will be fully recognized as part of its revenue. Any unsold tickets will be charged as loss by the entity.</td></tr>
<tr><td colspan="3">**CONDITIONS FOR RECOGNITION**</td></tr>
<tr><td>Sale of goods
(PARA 11)</td><td colspan="2">✓ The seller of goods has transferred to buyer the property in goods for a price or all significant risks and rewards of ownership have been transferred to the buyer.
✓ The seller retains no effective control of the goods transferred to a degree usually associated with ownership.
✓ No significant uncertainty regarding consideration</td></tr>
<tr><td>Rendering of services
(PARA 12)</td><td colspan="2">✓ Service is performed as per the terms of the contract i.e. either as per completed service contract method (*For Eg: Installation of machinery or repair service*) or proportionate completion method.
✓ No significant uncertainty regarding consideration</td></tr>
<tr><td rowspan="4">Use of resource of the enterprise by others
(PARA 13)</td><td>Interest</td><td>On a <u>time proportion basis</u> taking into account the amount outstanding and the rate applicable</td></tr>
<tr><td>Royalty</td><td>On an <u>accrual basis</u> in accordance with the terms of relevant agreement i.e. when the conditions attached have been complied with.</td></tr>
<tr><td>Dividend</td><td>When the owners right to receive payment is established i.e.
• In case of Final Dividend, date when it is declared at an AGM
• In case of Interim Dividend, date it is declared in Board Meeting</td></tr>
<tr><td colspan="2">Revenue should be recognised when no significant uncertainty as to measurability or collectability exists.</td></tr>
</table>

SOME IMPORTANT POINTS	
Delivery is delayed at buyer's request	When delivery is delayed at buyer's request and buyer takes title and accepts billing, revenue should be recognized when ➢ There is every expectation that delivery will be made ➢ Item must be on hand, identified & ready for delivery at time sale is recognized.
Delivery subject to installation, inspection etc.	Revenue should normally not be recognised until the customer accepts delivery and installation and inspection are complete. *However, in case the installation is simple (for example, a refrigerator needs to be plugged to a power connection after delivery to customer's place), revenue is recognized when the customer has agreed to purchase the goods.*
Goods on Approval basis	Revenue should not be recognized until ➢ The goods have been formally accepted by the buyer ➢ Buyer has done an act adopting the transaction ➢ Time period for rejection has lapsed
Guaranteed Sales	In the case of retail sales offering a guarantee of "money back if not completely satisfied" it may be appropriate to recognise the sale but to make a suitable provision for returns based on previous experience.
Consignment	Revenue is to be recognized when goods are sold by consignee to third party
Cash on delivery	Revenue should not be recognised until cash is received by the seller or his agent
Sale to distributors or others for resale	Revenue from such sales can generally be recognized 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.
Subscriptions for publications	Revenue should be recognised either on straight line basis over time or, where items delivered vary in value, revenue should be based on sales value of item delivered.
For Advertising agencies	Amount will be recognized when advertisement appears before the public.
Artistic Performances, banquets, etc.	Revenue from artistic performances, banquets and other special events should be recognised when the event takes place
Tuition Fees	Revenue should be recognised over the period of instruction
Insurance Agent Comm.	Revenue should be recognized on the effective commencement or renewal dates of the related policies.
Installation Fees	In cases where installation fees are other than incidental to the sale of a product, they should be recognised as revenue only when the equipment is installed and accepted by the customer.

Membership Fees	➢ If the membership fee permits only membership and all other services or products are paid for separately, or if there is a separate annual subscription, the fee should be recognised when received. ➢ If the membership fee entitles the member to services or publications to be provided during the year, it should be recognised on a systematic and rational basis having regard to the timing and nature of all services provided ➢
Price revisions	Income can be recognized when there is certainty of collection
Sale and Repurchase Agreement	For transactions, where seller concurrently agrees to repurchase the same goods at 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. <u>Example</u> On 1st January 2023, M/s KJ sells goods at invoice value of ₹ 5 lakhs to M/s TH. At the time of sale, M/s KJ has agreed to repurchase these goods back from M/s TH on 31st March at a price of ₹ 6 Lac. You are required to do the accounting for above transactions in the books of M/s KJ.

→ When the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition should be postponed to the extent of uncertainty involved. *(PARA 10)*

→ When the uncertainty regarding collection arises subsequent to the sale or rendering of services, then provision should be created instead of reducing the amount originally recorded.

ASSIGNMENT QUESTIONS

Question 1

The stages of production and sale of a producer are as follow:

Date	Activity	Cost to Date (₹)	Net Realisable Value (₹)
20.1.20	Raw Materials	10,000	8,000
25.1.20	WIP 1	12,000	13,000
27.1.20	WIP 2	15,000	19,000
25.2.20	Finished Product	17,000	30,000
12.3.20	Ready for Sale	17,000	30,000
27.3.20	Sale Agreed and invoice raised	19,000	30,000
02.4.20	Delivered and paid for	19,000	30,000

Explain the stage on which you think revenue will be recognized and state how much would be net profit on a unit of this product according to AS 9?

Solution

According to AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

a) 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

b) no significant uncertainty exists regarding the amount of the consideration that will be derived from the 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 27.3.2020 when sales are agreed upon at a price and goods are allocated for delivery purpose. The amount of net profit ₹ 11,000 (30,000 – 19,000) would be recognized in the books for the year ending 31st March, 2020.

Question 2 *(ICAI Study Material)*

During the year ended 31st March 2023, 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, 2023. The dividend was proposed on 10th April, 2023. Whether the above treatment is as per the relevant Accounting Standard?

Solution

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, 2023, while it is declared on 15th June, 2023. Thus, the right to receive the payment of dividend gets established on 15th June, 2023.

The recognition of ₹ 100 lakhs on accrual basis in the financial year 2022-2023 is not correct as per AS 9 'Revenue Recognition'.

Question 3

Arjun Ltd. sold farm equipments through its dealers. One of the conditions at the time of sale is payment of consideration in 14 days and in the event of delay interest is chargeable @ 15% per annum. The Company has not realized interest from the dealers in the past. However, for the year ended 31.3.2020, it wants to recognise interest due on the balances due from dealers. The amount is ascertained at ₹ 9 lakhs. Decide, whether the income by way of interest from dealers is eligible for recognition as per AS 9?

Solution

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 inverted. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made.

In this case, the company never realized interest for the delayed payments make by the dealers. Hence, it has to recognize the interest only if the ultimate collection is certain. The interest income hence is not to be recognized.

Question 4 *(RTP May 2020) / (ICAI Study Material)*

Given the following information of M/s. Paper Products Ltd:-

a) Goods of ₹ 60,000 were sold on 20-3-2020 but at the request of the buyer these were delivered on 10-4-2020.
b) On 15-1-2020 goods of ₹ 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-2020.
c) ₹ 1,20,000 worth of goods were sold on approval basis on 1-12-2019. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-2020 and no approval or disapproval received for the remaining goods till 31-3-2020.
d) 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.

You are required to advise the accountant of M/s. Paper Products Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS-9 and also determine the total revenue to be recognized for the year ending 31-3-2020.

Solution

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 case (a):

The sale is complete but delivery has been postponed at buyer's request. M/s Paper Products Ltd. should recognize the entire sale of ₹ 60,000 for the year ended 31st March, 2020.

In case (b):

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.

In case (c):

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, in case (c) revenue should be recognized for the total sales amounting ₹ 1,20,000 as the time period for rejecting the goods had expired.

In case (d):
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.
Thus total revenue amounting ₹ 10,41,000 (60,000 + 1,20,000+ 1,20,000+7,41,000) will be recognized for the year ended 31st March, 2020 in the books of M/s Paper Products Ltd.

Question 5

Victory Ltd. purchased goods on credit from Lucky Ltd. for ₹ 250 crores for export. The export order was cancelled. Victory Ltd. decided to sell the same goods in the local market with a price discount. Lucky Ltd. was requested to offer a price discount of 15%. The Chief Accountant of Lucky Ltd. wants to adjust the sales figure to the extent of the discount requested by Victory Ltd. Discuss whether this treatment is justified.

Solution
Lucky Ltd. had sold goods to Victory Ltd on credit worth for ₹ 250 crores and the sale was completed in all respects. Victory Ltd.'s decision to sell the same in the domestic market at a discount does not affect the amount recorded as sales by Lucky Ltd. The price discount of 15% offered by Lucky Ltd. after request of Victory Ltd. was not in the nature of a discount given during the ordinary course of trade because otherwise the same would have been given at the time of sale itself. It is the special discount which is being allowed at the request of the buyer. Therefore, it would be appropriate to make a separate provision rather than to adjust the amount of revenue originally recorded. Therefore, such discount should be written off to the profit and loss account and not shown as deduction from the sales figure.

Question 6

X Limited sold goods worth ₹ 13 Lakhs to Mr. Y. Mr. Y asked for a Trade Discount amounting to ₹ 1,06,000 and the same was agreed to by X Limited. Such discount was allowed in the ordinary course of business. The sale was effected and goods were dispatched. On receipt of goods, Mr. Y has found that goods worth ₹ 1,34,000 are defective. Mr. Y returned defective goods to X Limited and made payment amount to ₹ 10,60,000. The Accountant of X Limited booked the sale for ₹ 10,60,000. Discuss the contention of the Accountant with reference to relevant Accounting Standard.

Solution
As per AS 9, "Revenue Recognition" is the inflow of cash, receivable or other consideration arising in the course of ordinary activities of an enterprise from the sale of Goods. However, the above is subject to trade discount and volume rebates received in the course of carrying on business which shall be deducted in ascertaining revenue since they represent a reduction of cost.
In the given case, trade discount is to be deducted from ₹ 13,00,000 and gross sale shall be recognized at (₹ 13,00,000 - ₹ 1,06,000) = ₹ 11,94,000 and goods returned ₹ 1,34,000 are to be recorded in the form of sales return. Thus, the contention of Accountant to book sale of ₹ 10,60,000 is not correct.

Question 7 *(RTP Nov 2019) / (ICAI Study Material)*

The Board of Directors decided on 31.3.2020 to increase the sale price of certain items retrospectively from 1st January, 2020. In view of this price revision with effect from 1st January 2020, the company has to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 2020 to 31st March, 2020. Accountant cannot make up his mind whether to include ₹ 15 lakhs in the sales for 2019-2020. Advise.

Solution

As per para 10 of AS 9 'Revenue Recognition', the additional revenue on account of increase in sales price with retrospective effect, as decided by Board of Directors, of ₹ 15 lakhs to be recognised as income for financial year 2019-20, only if the company is able to assess the ultimate collection with reasonable certainty. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

Question 8

Sarita Publications publishes a monthly magazine on the 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 made in February 2020. The magazine was published on its scheduled date. It received ₹ 2,40,000 on 10.3.2020 and ₹ 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?

Solution

As per para 12 of 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'.

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 seen by public and hence revenue is recognized on that date. In this case, it is 15.03.2020, the date of publication of the magazine.

Hence, ₹ 3,00,000 (₹ 2,40,000 + ₹ 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. ₹ 60,000 is treated as amount due from advertisers as on 31.03.2020 and ₹ 2,40,000 will be treated as payment received against 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 ₹ 3,00,000 will be recognized for the year ended 31.03.2021 after the magazine is published on 02.04.2020. The amount received from sale of advertising space on 10.03.2020 of ₹ 2,40,000 will be considered as an advance from advertisers for the year ended 31st March, 2020.

Question 9

A Ltd. entered into a contract with B Ltd. to dispatch goods valuing ₹ 25,000 every month for 4 months upon receipt of entire payment. B Ltd. accordingly made the payment of ₹ 1,00,000 and A Ltd. started dispatching the goods. In third month, due to a natural calamity, B Ltd. requested A Ltd. not to dispatch goods until further notice though A Ltd. is holding the remaining goods worth ₹ 50,000 ready for dispatch. A Ltd. accounted ₹ 50,000 as sales and transferred the balance to Advance Received against Sales. Comment upon the treatment of balance amount with reference to the provisions of Accounting Standard 9.

Solution

As per para 11 of AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when following conditions are fulfilled:

a) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks & rewards of ownership have been transferred to buyer & seller retains no effective control of the goods transferred to a degree usually associated with ownership

b) 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 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. A Ltd. should recognize the entire sale of ₹ 1,00,000 (₹ 25,000 x 4) and no part of the same is to be treated as Advance Receipt against Sales.

Question 10 *(ICAI Study Material)*

A Ltd. has sold its building for ₹ 50 lakhs to B Ltd. and has also given the possession to B Ltd. The book value of the building is ₹ 30 lakhs. As on 31st March, 2020, the documentation and legal formalities are pending. The company has not recorded the sale and has shown the amount received as advance. Do you agree with this treatment?

Solution

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. In accordance with AS 9, at the Balance Sheet date what was pending was merely a formality to register the deed. It is clear that significant risk and rewards of ownership had passed before the balance sheet date.

A Ltd. should record the sale and recognise the profit of ₹ 20 lakhs in its profit and loss account. The building should be eliminated from the balance sheet.

Question 11 *(ICAI Study Material)*

A claim lodged with the Railways in March, 2018 for loss of goods of ₹ 2,00,000 had been passed for payment in March, 2020 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 ended 31st March, 2020.

Solution

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 properly recognised. In this case 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 against a claim of ₹ 2,00,000. So this transaction cannot be taken as a Prior Period Item.

In the light of AS 5, it will not be treated as extraordinary item. However, AS 5 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. Accordingly, the nature and amount of this item should be disclosed separately.

Question 12 *(RTP Nov 2021)*

Shipra Ltd., has been successful jewelers 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.

Solution

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 arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

Effect of Uncertainty- In the case of the jewelry 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 policy in its financial statements separately for both Jewelry and Apparels business.

Question 13 *(ICAI Study Material)*

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 orders were delivered to the customer in stipulated time. How much revenue should be recognised by restaurants and how much revenue should be recognised by Zigato for the year?

Solution

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 not undertake responsibility for the same.

Therefore, the restaurant undertakes the principal's responsibility to prepare the food 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.

Question 14 *(ICAI Study Material)*

AB sells goods to CD on 1st March 2023. 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 2023, 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 collect the amount from CD due to poor financial conditions. Explain how the recognition of revenue be done by AB?

Solution

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 recognised by AB on 5th of

May 2023. The inventory transferred to CD until that date is required to be shown as its own inventory [inventory lying with customers].

Question 15 *(ICAI Study Material)*

AB sells goods to CD on 1st January 2023 for ₹ 2 lakhs. After the sale was made, CD is 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 and has gone under liquidation on 15th of March 2023. 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 2023?

Solution

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 2023 and recognise a receivable for the same amount. Later, since CD went into liquidation, AB should write off the receivables and book a loss in his books.

Accounting in the books of AB

Question 16 *(RTP May 2021)*

Tonk Tanners is engaged in manufacturing of leather shoes. They provide you the following information for the year 2019-20:

a) On 31st December, 2019 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, 2020.

b) On 10th January, 2020, Tonk Tanners supplied shoes worth ₹ 4,50,000 to Shani Shoes and concurrently agrees to re-purchase the same goods on 11th April. 2020.

c) On 21st March, 2020 shoes worth ₹ 1,60,000 were sold to Shoe Shine but due to refurbishing of their showroom being underway, on their request, shoes were delivered on 12th April2020

You are required to advise the accountant of Tonk Tanners, when amount is to be recognised as revenue in 2019 -20 in above cases in the context of AS 9

Solution

a) 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 made to the third party by Mohan Shoes; although the goods are held by Mohan Shoes. Hence, in the year 2019-2020, the sale will be recognized for the amount of goods sold by Mohan Shoes to the third party i.e. for ₹ 3,20,000 x 75% = ₹ 2,40,000.

b) 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 recognised as revenue in the year 2019-2020. Hence, sale of ₹ 4,50,000 to Shani Shoes should not be recognized as revenue.

c) Delivery is delayed at buyer's request

On 21st March, 2020, 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 2019-2020 irrespective of the fact that the delivery is delayed on the request of Shoe Shine.

Question 17 *(RTP May 2022)*

A 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 Finance Officer wants to account/recognize license fee as income for 12 months during current year & 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.

Solution

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 usually determined 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, revenue should 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 fee as a percentage on the turnover of the tenant (though on annual basis) is the income related to common financial 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 18 *(ICAI Study Material)*

For the year ended 31st March 2023, KY Enterprises has entered into following transactions.

On 31 March 2023, KY supplied two machines to its customer ST. Both machines were accepted by ST on 31 March 2023. 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 2023 by ST's employees.

Machine 2 being more specialised in nature requires an installation process which is more complicated, requiring significant assistance from KY. Machine 2 was installed between 2 and 5 April 2023. Details of costs and sales prices are as follows:

	Machine 1	Machine 2
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 the year ended 31st March 2023?

Solution

Machine 1: As the installation process is simple, revenue from Machine 1 will be recognized on 31 March 2023.

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 2023, the revenue arising from sale of the machine needs to be recognized for the year ending 31 March 2023. This is because acceptance of the machine indicates that the risks and rewards pursuant to the ownership are transferred to 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 2023. Assuming that there is no further approval/acceptance required from the buyer for the Machine sold, revenue from sale of Machine 2 can be recognized for the year ending 31 March 2023.

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 cannot be 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 2023 once the installation process gets completed.

PRACTICE QUESTIONS

Question 1 *(RTP May 2018)*

A manufacturing company has following stages of production & sale in manufacturing Fine paper rolls:

Date	Activity	Cost to Date (₹)	Net Realisable Value (₹)
15.1.20	Raw Materials	1,00,000	80,000
20.1.20	Pulp (WIP 1)	1,20,000	1,20,000
27.1.20	Rough & Thick Paper (WIP 2)	1,50,000	1,80,000
15.2.20	Fine paper Rolls	1,80,000	3,50,000
20.2.20	Ready for Sale	1,80,000	3,50,000
15.3.20	Sale Agreed and invoice raised	2,00,000	3,50,000
02.4.20	Delivered and paid for	2,00,000	3,50,000

Explain the stage on which you think revenue will be generated and state how much would be net profit for year ending 31.3.2020 on this product according to AS-9.

Solution

As per AS 9 "Revenue Recognition", in a transaction involving sale of goods, performance should be regarded as being achieved when following conditions have been fulfilled:

a) 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

b) no significant uncertainty exists regarding the amount of the consideration that will be derived from the 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 15.3.2020 when sales are agreed upon at a price & goods are allocated for delivery purpose through invoice. The amount of net profit ₹ 150,000 (3,50,000 – 2,00,000) would be recognized in the books for the year ending 31st March, 2020.

Question 2 *(ICAI Study Material)*

Y Co. Ltd., used certain resources of X Co. Ltd. In return X Co. Ltd. received ₹ 10 lakhs and ₹ 15 lakhs as interest and royalties respective from Y Co. Ltd. during the year 2019-20. You are required to state whether and on what basis these revenues can be recognised by X Co. Ltd.

Solution

As per para 13 of AS 9 on Revenue Recognition, revenue arising from the use by others of enterprise resources yielding interest and royalties should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognised on the following bases:

a) Interest: on time proportion basis taking into account amount outstanding & rate applicable.

b) Royalties: on an accrual basis in accordance with the terms of the relevant agreement.

Question 3

M/s Umang 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 @ 12% p.a. from the agent. The company has not realized interest from the agent in the past. For the year ended 31st March, 2020 interest due from agent (because of delay in payment) amounts to ₹ 1,72,000.

The accountant of M/s Umang Ltd. booked ₹ 1,72,000 as interest income in the year ended 31st March, 2020. Discuss the contention of accountant with reference to Accounting Standard-9.

Solution

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 that the 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 ₹ 1,72,000 should not be recognized in the books for the year ended 31st March, 2020. Thus, the contention of accountant is incorrect

Question 4 *(Inter May 2019) (5 Marks)*

Given below are the following information of B.S. Ltd.

(i) Goods of ₹ 50,000 were sold on 18-03-2020 but at the request of the buyer these were delivered on 15-04-2020.

(ii) On 13-01-2020 goods of ₹ 1,25,000 are sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-03-2020.

(iii) ₹ 1,00,000 worth of goods were sold on approval basis on 01-12-2019. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-01-2020 and no approval or disapproval received for the remaining goods till 31-03-2020.

You are required to advise accountant of B.S. Ltd., with valid reasons, amount to be recognized as revenue for the year ended 31st March, 2020 in above cases in the context of AS-9

Solution

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. B.S. Ltd. should recognize the entire sale of ₹ 50,000 for the year ended 31st March, 2020.

Case (ii)

In case of consignment sale revenue should not be recognized until the goods are sold to a third 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 sales amounting ₹ 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 recognized for the year ended 31st March, 2020 in the books of B.S. Ltd.

Question 5 *(RTP Nov 2018) / (RTP Nov 2020)*

Fashion Limited is engaged in manufacturing of readymade garments. They provide you the following information on 31st March, 2020:

a) On 15th January, 2020 garments worth ₹ 4,00,000 were sent to Anand on consignment basis of which 25% garments unsold were lying with Anand as on 31st March, 2020.
b) Garments worth ₹ 1,95,000 were sold to Shine boutique on 25th March, 2020 but at the request of Shine Boutique, these were delivered on 15th April, 2020.
c) On 1st November, 2019 garments worth ₹ 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, 2019 and no approval or disapproval received for the remaining goods till 31st March, 2020.

You are required to advise the accountant of Fashion Limited, the amount to be recognised as revenue in above cases in the context of AS 9.

Solution

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 (a):

25% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 3,00,000 (75% of ₹ 4,00,000) for the year ended on 31.3.20. In case of consignment sale, revenue should not be recognized until the goods are sold to a third party.

Case (b):

The sale is complete but delivery has been postponed at buyer's request. Fashion Ltd. should recognize the entire sale of ₹1,95,000 for the year ended 31st March, 2020.

Case (c):

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 accepting 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 ₹ 2,50,000 as the time period for rejecting the goods had expired.

Thus total revenue amounting ₹ 7,45,000 (3,00,000+1,95,000+2,50,000) will be recognized for the year ended 31st March, 2020 in the books of Fashion Ltd.

Question 6

In the year 2020-21, XYZ supplied goods on Consignment basis to ABC – a retail outlet worth ₹ 10,00,000. As per the terms, ABC will only pay XYZ for the goods which are sold by them to the third party. Rest of the goods can be returned back to XYZ and ABC will not have any further liability for these goods. During the year 2020-21, ABC has sold goods worth ₹ 5,50,000 only and rest of the goods are still lying in its store which may get sold by next year. Advise XYZ, how much revenue it can recognize in its books for period 2020-21

Solution
As per AS 9, For consignment risk and rewards are not transferred to the customer on just delivery of the goods and no revenue should be recognized until the goods are sold to a third party. Therefore, XYZ can recognize revenue of ₹ 5,50,000 only.

Question 7

Goods worth ₹ 6,62,500 were sold on 31.10.2020 by X Ltd. to Y Ltd. Y Ltd. requested for a trade discount of 8% which was agreed by X Ltd. The sale was effected and goods were dispatched, However, on receipt of the goods, Y Ltd. found that goods worth ₹ 77,500 were damaged. Consequently, Y Ltd. returned the damaged goods to X Ltd. and made the due payment amounting to ₹ 5,32,000. The accountant of X Ltd. booked the sale for ₹ 5,32,000. Discuss the above treatment by the accountant with reference to applicable Accounting Standard.

Solution
As per AS 9 'Revenue Recognition', revenue is the gross inflow of cash, receivable or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods. However, trade discounts and volume rebates given in the ordinary course of business should be deducted in determining revenue. Revenue from sales should be recognized at the time of transfer of significant risks and rewards. If the delivery of the sales is not subject to approval from customers, then the transfer of significant risks and rewards would take place when the sale is affected and goods are dispatched.

In the given case, if trade discount allowed by X Ltd. is given in the ordinary course of business, X Ltd. should record the sales at ₹ 6,09,500 (after deducting 8% trade discount from 6,62,500) and goods returned worth ₹ 77,500 are to be recorded in the form of sales return.

However, when trade discount allowed by X Ltd. is not in the ordinary course of business, X Ltd. should record the sales at gross value of ₹ 6,62,500. Discount of ₹ 53,000 in price and return of goods worth ₹ 77,500 are to be adjusted by suitable provisions. X Ltd. might have sent the credit note of ₹ 1,30,500 to Y Ltd. to account for these adjustments.

In both the cases, the contention of the accountant to book the sales for ₹ 5,32,000 is not correct.

Question 8 *(RTP May 2019)*

Raj Ltd. entered into an agreement with Heena Ltd. to dispatch goods valuing ₹ 5,00,000 every month for next 6 months on receipt of entire payment. Heena Ltd. accordingly made the entire payment of ₹ 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 ₹ 15,00,000 ready for dispatch. Raj Ltd. accounted ₹ 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 the provision of AS-9.

Solution
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:

- 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
- 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 recognize the entire sale of ₹ 30,00,000 (₹ 5,00,000 x 6) and no part of the same is to be treated as Advance Received against Sales.

Question 9

Khetan Ltd. has received two lakh subscriptions during the current year under its new scheme whereby customers are required to pay a sum of ₹ 4,500 for which they will be entitled to receive a magazine for a period of 3 years. Khetan wants to treat the entire amount as revenue for the current year. Comment

Solution

As per AS 9 'Revenue Recognition', revenue received or billed should be deferred and recognised 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.

Accordingly, in the given case the accounting treating adopted by Khetan Ltd. to treat the entire amount as revenue for the current year is not in accordance with AS 9. The revenue should be recognized on a straight line basis over the period of 3 years.

Question 10 *(Inter Nov 2019) (5 Marks)/ (RTP May 2022)*

Indicate in each case whether revenue can be recognized and when it will be recognized as per AS-9.
(1) Trade discount and volume rebate received.
(2) Where goods are sold to distributors or others for resale.
(3) Where seller concurrently agrees to repurchase the same goods at a later date.
(4) Insurance agency commission for rendering services.
(5) On 11-03-2019 cloths worth ₹ 50,000 were sold to X mart, but due to refurbishing of their showroom being underway, on their request, clothes were delivered on 12-04-2019.

Solution

(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 recognized 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.
(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 sale is 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 has not been completed so long as there is every expectation that delivery will be made and items were ready for delivery to the buyer at the time.

Question 11 *(Inter Dec 2021) (5 Marks)*

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-purchase the 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.

Solution

(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 & 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.

Question 12 *(RTP Nov 2022)*

When revenue will be recognized in the following situation:

(1) Where the purchaser makes a series of installment payments to the seller and the seller deliver the goods only when the final payment is received.

(2) Where seller concurrently agrees to repurchase the same goods at a later date.

(3) Where goods are sold to distributors, dealers or others for resale.

(4) Commissions on service rendered as agent on insurance business

Solution

(1) Revenue from sales where the purchaser makes a series of instalment payments to the seller, and the seller 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.

(2) For sale where seller concurrently agrees to repurchase the same goods at a later date, such transactions are in substance a financing agreement. In such a situation, the resulting cash inflow should not be recognised as revenue.

(3) 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.

(4) Commissions 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 effective commencement or renewal dates of the related policies.

Question 13

XY Ltd sells goods worth ₹ 50 lakh on 20 February 2023 to AB Ltd. AB Ltd is facing storage capacity constraints at their warehouse. AB Ltd instructs XY Ltd to hold the goods at XY Ltd's warehouse and arrange for delivery on 15 March 2023. However, all the risks and rewards associated with the sold goods are deemed transferred to AB Ltd. When XY Ltd. can recognise the revenue?

Solution

In the current scenario, delivery of goods sold is delayed at the request of buyer. XY Ltd can recognize revenue for sale of goods to AB Ltd on 20 February 2023 provided that goods sold to AB Ltd are held in XY Ltd's warehouse separately and are not clubbed with other inventory.

Question 14 *(ICAI Study Material)*

GH manufactures and sells televisions. The televisions are shipped to the customer by sea. In order to transfer risk related to the shipment of the televisions, GH also gets an insurance coverage for the goods while they are in 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 goods arrive at the customer's premises one month later. When should Entity GH recognize revenue in its books?

Solution

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 received from the goods' damage or destruction will be repaid to GH. Further, the legal title does not pass until the goods arrive at the customer's premises.

Question 15 *(Inter Nov 2022) (5 Marks)*

Indicate in each case whether revenue can be recognized and when it will be recognized as per AS-9.

a) Delivery is delayed at buyer's request but buyer takes title and accepts billing.
b) Instalment Sales.
c) Trade discounts and volume rebates.
d) Insurance agency commission for rendering services.
e) Advertising commission.

Solution:

a) 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.

b) 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.

c) 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.

d) Insurance agency commissions for rendering services: Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

e) 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.

PROPERTY, PLANT & EQUIPMENT

AS 10

Meaning	Property, plant and equipment (PPE) are tangible items that: a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and b) are expected to be used during more than a period of 12 months. Example: Building, Plant & Machinery, Furniture, etc.
"Administrative purposes": The term 'Administrative purposes' has been used in wider sense to include all business purposes. Thus, PPE would include assets used for: ▪ Selling & distribution ▪ Finance & accounting ▪ Personnel & other functions of Enterprise	
Items of PPE may also be acquired for safety or environmental reasons. The acquisition of such PPE, although not directly increasing the future economic benefits of any particular existing item of PPE, may be necessary for an enterprise to obtain the future economic benefits from its other assets. Example: A chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the enterprise is unable to manufacture and sell chemicals	
Non Applicability	❖ biological assets (*other than bearer plants*) related to agricultural activity. This AS applies to bearer plants but it does not apply to the produce on bearer plants; and ❖ wasting assets including mineral rights, expenditure on exploration for & extraction of minerals, oil, natural gas and similar non-regenerative resources. *AS 10 applies to PPE used to develop or maintain the assets described above*
OTHER DEFINITIONS	
Biological Asset	It is a living animal or plant. AS on "Agriculture" is under formulation, which will cover accounting for livestock. Till the time, the AS on "Agriculture" is issued, accounting for livestock meeting the definition of PPE, will be covered as per AS 10.
Bearer Plant	is a plant that a) is used in the production or supply of agricultural produce; b) is expected to bear produce for more than a period of 12 months; and c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.
The following are not Bearer Plants: (a) Plants cultivated to be *harvested as* Agricultural produce Example: Trees grown for use as lumber (b) Plants cultivated to produce Agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales Example: Trees which are cultivated both for their fruit and their lumber (c) Annual crops Example: Maize and wheat	

Note: When bearer plants are no longer used to bear produce they might be cut down and sold as scrap. For example - use as firewood. Such incidental scrap sales would not prevent the plant from satisfying the definition of a Bearer Plant.	
Agricultural Produce	is the <u>harvested product of Biological Assets</u> of the enterprise
Agricultural Activity	is the <u>management</u> by an enterprise of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets
RECOGNITION CRITERIA FOR PPE	
The cost of an item of PPE should be recognised as an asset if, and only if: a) It is probable that future economic benefits associated with the item will flow to the enterprise, and b) The cost of the item can be measured reliably Notes: • It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies and to apply the criteria to the aggregate value. • An enterprise may decide to expense an item which could otherwise have been included as PPE, because the amount of the expenditure is not material.	
TREATMENT OF SPARE PARTS, STAND BY EQUIPMENT & SERVICING EQUIPMENT	
Case I	If they meet the definition of PPE as per AS 10: ▪ Recognised as PPE as per AS 10
Case II	If they do not meet the definition of PPE as per AS 10: ▪ Such items are classified as Inventory as per AS 2
TREATMENT OF SUBSEQUENT COSTS	
COST OF DAY-TO-DAY SERVICING	
Meaning	Costs of day-to-day servicing are primarily the costs of labour and consumables and may include the cost of small parts. The purpose of such expenditures is often described as for the 'Repairs and Maintenance' of the item of PPE.
Accounting Treatment	An enterprise does not recognise in the carrying amount of an item of PPE the costs of day-to-day servicing of the item. Rather, these costs are recognised in the Statement of Profit and Loss as incurred.
REPLACEMENT OF PARTS OF PPE	
Meaning	Parts of some items of PPE may require replacement at regular intervals. Examples: ○ A furnace may require relining after a specified number of hours of use. ○ Aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. ○ Major parts of conveyor system, such as, conveyor belts, wire ropes, etc., may require replacement several times during the life of conveyor system ○ Replacing the interior walls of a building
Accounting Treatment	An enterprise recognises in the carrying amount of an item of PPE cost of replacing part of such an item when that cost is incurred if the recognition criteria are met Note: The carrying amount of those parts that are replaced is derecognised in accordance with the de- recognition provisions of this Standard.

REGULAR MAJOR INSPECTIONS

Accounting Treatment

When each major inspection is performed, its cost is recognised in the carrying amount of the item of PPE as a replacement, if the recognition criteria are satisfied.

Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognized

Note: If it is not practicable for enterprise to determine the carrying amount of the replaced part/inspection then 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.

MEASUREMENT OF PPE (At Recognition: Cost Model)

Cash / Direct purchase

Cost of PPE include the following:

Purchase price	XX
Add : Import duties	XX
Add : Other Non-refundable taxes & duties	XX
Add: 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*	XX
Add: Decommissioning, Restoration and similar Liabilities**	XX
Less: Trade discount & rebates	(XX)
Cost of PPE	XX

* Examples of directly attributable costs are:

- Costs of employee benefits (as defined in AS 15) arising directly from construction or acquisition of the item of PPE
- Costs of site preparation
- Initial delivery and handling costs
- Installation and assembly costs
- Costs of testing whether the asset is functioning properly, after deducting net proceeds from selling any items produced while bringing asset to that location & condition (such as samples produced when testing equipment)
- Professional fees

**Decommissioning, Restoration and similar Liabilities:

Initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as 'Decommissioning, Restoration & similar Liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

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

- costs of opening a new facility or business, such as, inauguration costs;
- costs of introducing a new product or service (including costs of advertising and promotional activities);
- costs of conducting business in a new location or with a new class of customer (including costs of staff training); and
- administration and other general overhead costs

<table>
<tr><td></td><td>The following costs are not included in the carrying amount of an item of PPE:
1) 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.
2) Initial operating losses, such as those incurred while demand for the output of an item builds up. and
3) Costs of relocating or reorganizing part or all of the operations of an enterprise.

Example: Income may be earned through using a building site as a car park until construction starts because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in the Statement of Profit & Loss and included in their respective classifications of income & expense.</td></tr>
<tr><td>Self constructed assets</td><td>➢ If an enterprise makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of constructing an asset for sale (see AS 2). Therefore, any internal profits are eliminated in arriving at such costs.
➢ Cost of abnormal amounts of wasted material, labour, or other resources incurred in self constructing an asset is not included in the cost of asset.
➢ AS 16 Borrowing Costs, establishes criteria for the recognition of interest as a component of the carrying amount of a self-constructed item of PPE.</td></tr>
<tr><td colspan="2">MEASUREMENT OF COST
(Cost of an item of PPE is the cash price equivalent at the recognition date)</td></tr>
<tr><td>If payment is deferred beyond normal credit</td><td>Total payment - Cash price equivalent
▪ Is recognised as Interest over the period of credit
▪ unless such interest is capitalised in accordance with AS 16</td></tr>
<tr><td>In Exchange for Non-monetary Asset</td><td>Cost of such an item of PPE is measured at fair value unless:
a) Exchange transaction lacks commercial substance; Or
b) Fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable.

Note:
• If the acquired item(s) is/are not measured at fair value, its/their cost is measured at the carrying amount of the asset(s) given up.</td></tr>
<tr><td>Purchase for Consolidated Price</td><td>Where several items of PPE are purchased for a consolidated price, the consideration is apportioned to the various items on the basis of their respective fair values at the date of acquisition.

Note: In case the fair values of the items acquired cannot be measured reliably, these values are estimated on a fair basis as determined by competent valuers</td></tr>
</table>

<table>
<tr><th colspan="2">MEASUREMENT AFTER RECOGNITION</th></tr>
<tr><td colspan="2">An enterprise should choose
Either Cost model, Or Revaluation model
as its accounting policy and should apply that policy to an entire class of PPE.
If an item of PPE is revalued, the entire class of PPE to which that asset belongs should be revalued.

Class of PPE: A class of PPE is a grouping of assets of a similar nature and use in operations of an enterprise.
Examples of separate classes:
(a) Land (b) Land and Buildings (c) Machinery (d) Ships (e) Aircraft (f) Motor Vehicles (g) Furniture and Fixtures (h) Office Equipment (i) Bearer plants</td></tr>
<tr><td>Cost Model</td><td>After recognition as an asset, an item of PPE should be carried at:
Cost – Any Accumulated Depreciation – Any Accumulated Impairment losses</td></tr>
<tr><td>Revaluation Model</td><td>After recognition as an asset, an item of PPE whose fair value can be measured reliably should be carried at a revalued amount.<table><tr><td>Fair value at the date of the revaluation</td><td>XX</td></tr><tr><td>Less: Any subsequent accumulated depreciation</td><td>(XX)</td></tr><tr><td>Less: Any subsequent accumulated impairment losses</td><td>(XX)</td></tr><tr><td>Carrying value</td><td>XX</td></tr></table></td></tr>
<tr><td>Frequency of Revaluations</td><td>• Revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using Fair value at the Balance Sheet date.
• The frequency of revaluations depends upon the changes in fair values of the items of PPE being revalued.

When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required.
A. Items of PPE experience significant and volatile changes in Fair value
Annual revaluation shall be done.
B. Items of PPE with only insignificant changes in Fair value
Revaluation shall be done at an interval of 3 or 5 years</td></tr>
<tr><td>Determination of Fair Value</td><td>• Fair value of items of PPE is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers.
• If there is no market-based evidence of fair value because of the specialised nature of the item of PPE and the item is rarely sold, except as part of a continuing business, an enterprise may need to estimate fair value using an income approach.

Example: Based on
▪ Discounted cash flow projections, Or
▪ A depreciated replacement cost approach
which aims at making a realistic estimate of the current cost of acquiring or constructing an item that has the same service potential as the existing item.</td></tr>
</table>

ACCOUNTING TREATMENT OF REVALUATIONS

When an item of PPE is revalued, carrying amount of that asset is adjusted to the revalued amount.
At the date of the revaluation, the asset is treated in one of the following ways:

Technique 1

Gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset.
Example: PPE is revalued to ₹ 1,500 consisting of ₹ 2,500 Gross cost and ₹ 1,000 Depreciation based on observable market data.
Details of the PPE before and after revaluation are as follows:

Particulars	Cost/ Revalued Cost	Accumulated depreciation	Net book value
PPE before revaluation	1,000	400	600
Fair Value			1,500
Revaluation Gain			900
Allocated proportionately to cost & depreciation (gain)	1,500	600	900
PPE after revaluation	2,500	1,000	1,500

The increase on revaluation is ₹ 900 (i.e., ₹ 1,500 – ₹ 600).

Technique 2

Accumulated depreciation is eliminated against Carrying amount of asset

Particulars	Cost/ Revalued Cost	Accumulated depreciation	Net book value
PPE before revaluation	1,000	400	600
PPE after revaluation	1,500		1,500
Revaluation Gain	500	400	

The increase on revaluation is ₹ 900 (i.e., ₹ 500 + ₹ 400).

REVALUATION: Increase or Decrease

First Revaluation	Upward	Use Revaluation Surplus (R/S)
	Downward	Use P & L A/c

Subsequent Revaluation

Case	1st	2nd	1st	2nd
1	↑	↑	R/S	R/S
2	↓	↓	P & L	P & L
3	↑	↓	R/S	Use R/S 1st
4	↓	↑	P & L	Use P&L 1st

- An increase in the carrying amount of an asset arising on revaluation should be credited directly to owners' interests under the heading of revaluation surplus However, the increase should be recognised in the statement of profit and loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in the statement of profit and loss.
- 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 directly to 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.

<table>
<tr><td rowspan="1">Treatment of Revaluation Surplus</td><td colspan="2">The revaluation surplus included in owners' interests in respect of an item of PPE may be transferred to the Revenue Reserves when the asset is derecognised.
Case I : When whole surplus is transferred:
When the asset is: ▪ Retired Or ▪ Disposed of
Case II : Some of the surplus may be transferred as asset is used by an enterprise:
In such a case, the amount of the surplus transferred would be:
Dep. (based on Revalued Carrying amount) – Dep. (based on Original Cost)
Transfers from Revaluation Surplus to the Revenue Reserves are not made through the Statement of Profit and Loss</td></tr>
<tr><td colspan="3">DEPRECIATION</td></tr>
<tr><td>Component Method of Depreciation</td><td colspan="2">Each part of an item of PPE with a cost that is significant in relation to the total cost of the item should be depreciated separately.
Example: It may be appropriate to depreciate separately the airframe and engines of an aircraft</td></tr>
<tr><td>Depreciable Amount</td><td colspan="2">Depreciable amount is: Cost of asset or other amount substituted for cost i.e. Revalued amount - Residual value
The depreciable amount of an asset should be allocated on a systematic basis over its useful life</td></tr>
<tr><td rowspan="3">Useful Life</td><td>Based on period</td><td>The period over which a depreciable asset is expected to be used by the enterprise</td></tr>
<tr><td>Based on units</td><td>The number of production or similar units expected to be obtained from the use of the asset by the enterprise</td></tr>
<tr><td><u>Notes</u></td><td>• Useful life means economic life of the asset and is generally shorter than its physical life.
• It is estimated after considering the following factors:
✓ Expected physical wear and tear.
✓ Pre-determined by legal or contractual limits such as expiry dates of related leases.
✓ Obsolescence such as technological changes, improvement in production method etc.
✓ No of shifts in which the asset is to be used.</td></tr>
<tr><td>Review of Residual Value and Useful Life of an Asset</td><td colspan="2">Residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate.

Note: Depreciation is recognised even if Fair value of the Asset exceeds its Carrying Amount. Repair & maintenance of an asset do not negate the need to depreciate it</td></tr>
<tr><td>Commence--ment of Depreciation</td><td colspan="2">Depreciation of an asset begins when it is available for use,
i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management.</td></tr>
<tr><td>Cessation of Depreciation</td><td colspan="2">I. Depreciation ceases to be charged when asset's residual value exceeds its carrying amount
The residual value of an asset may increase to an amount equal to or greater than its carrying amount. If it does, depreciation charge of the asset is zero unless and until its residual value subsequently decreases to an amount below its carrying amount.</td></tr>
</table>

<table>
<tr><td></td><td>II. Depreciation of an asset ceases at the earlier of:
▪ The date that the asset is retired from active use & is held for disposal, and
▪ The date that the asset is derecognised
Therefore, depreciation does not cease when the asset becomes idle or is retired from active use (but not held for disposal) unless the asset is fully depreciated. However, under usage methods of depreciation, the depreciation charge can be zero while there is no production.</td></tr>
<tr><td colspan="2">LAND AND BUILDINGS
Land & buildings are separable assets & accounted separately, even when they are acquired together</td></tr>
<tr><td>A. Land</td><td>Land has an unlimited useful life and therefore is not depreciated.
Exceptions: Quarries and sites used for landfill.
Depreciation on Land:
I. If land itself has a limited useful life:
It is depreciated in a manner that reflects the benefits to be derived from it
II. If cost of land includes the costs of site dismantlement, removal and restoration
That portion of the land asset is depreciated over the period of benefits obtained by incurring those costs.</td></tr>
<tr><td>B. Buildings</td><td>Buildings have a limited useful life and therefore are depreciable assets.
An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building</td></tr>
<tr><td colspan="2">DEPRECIATION METHOD</td></tr>
<tr><td colspan="2">The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise. The method selected is applied consistently from period to period <u>unless</u>:
▪ There is a change in expected pattern of consumption of those future economic benefits; Or
▪ That method is changed in accordance with statute to best reflect the way asset is consumed</td></tr>
<tr><td>Straight-line Method</td><td>Results in a constant charge over the useful life.
Straight Line Depreciation = $\frac{\text{(Cost Less Residual Value)}}{\text{Useful Life}}$</td></tr>
<tr><td>Diminishing Balance Method</td><td>Results in a decreasing charge over the useful life.
Depreciation Amount for each year is computed by applying a fixed % on the Opening Balance of the Asset (i.e. Diminishing Balance of the Asset.)</td></tr>
<tr><td>Units of Production Method</td><td>Results in a charge based on the expected use or output</td></tr>
<tr><td colspan="2">REVIEW OF DEPRECIATION METHOD</td></tr>
<tr><td colspan="2">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.
Depreciation Method based on Revenue:
A depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate.</td></tr>
</table>

CHANGES IN EXISTING DECOMMISSIONING, RESTORATION & OTHER LIABILITIES	
Cost of PPE may undergo changes subsequent to its acquisition/construction on account of: ▪ Changes in Liabilities ▪ Price Adjustments ▪ Changes in Duties ▪ Changes in initial estimates of amounts provided for Dismantling, Removing, Restoration & ▪ Similar factors The above are included in the cost of the asset.	
RETIREMENT	
Meaning	Asset is retired from active use & held for disposal
Treatment	❖ It is to be recorded in the books at Carrying Amount or NRV, whichever is lower. ❖ Any expected loss is recognized immediately in the P&L statement.
DE-RECOGNITION	
When	The carrying amount of an item of PPE should be derecognised: ▪ On disposal o By sale o By entering into a finance lease, or o By donation, or ▪ When no future economic benefits are expected from its use or disposal
Treatment	The gain or loss arising from derecognition of an item of property, plant and equipment should be included in the statement of profit and loss when the item is derecognized
DISCLOSURE	
General Disclosures	The financial statements should disclose, for each class of PPE: ❖ The measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount; ❖ The depreciation methods used; ❖ The useful lives or the depreciation rates used. In case useful lives or the depreciation rates used are different from those specified in the statute governing the enterprise, it should make a specific mention of that fact; ❖ The gross carrying amount & accumulated depreciation (aggregated with accumulated impairment losses) at the beginning & end of the period; and ❖ A reconciliation of the carrying amount at the beginning & end of the period
Additional Disclosures	The financial statements should also disclose: ❖ The existence and amounts of restrictions on title, and property, plant & equipment pledged as security for liabilities; ❖ The amount of expenditure recognised in carrying amount of an item of property, plant and equipment in the course of its construction; ❖ The amount of contractual commitments for the acquisition of property, plant and equipment; ❖ If it is not disclosed separately on the face of the statement of profit and loss, the amount of compensation from third parties for items of property, plant & equipment that were impaired, lost or given up that is included in the statement of P&L; and ❖ The amount of assets retired from active use and held for disposal.

Disclosures related to Revalued Assets	If items of property, plant and equipment are stated at revalued amounts, the following should be disclosed: ❖ The effective date of the revaluation; ❖ Whether an independent valuer was involved; ❖ Methods & significant assumptions applied in estimating fair values of item ❖ The extent to which fair values of the items were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques; and ❖ The revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

ASSIGNMENT QUESTIONS

Question 1 *(RTP May 2018) / (ICAI Study Material)* *Pg no._____*

Entity A, a supermarket chain, is renovating one of its major stores. The store will have more available space for in store promotion outlets after the renovation & will include a restaurant. Management is preparing the budgets for the year after store reopens, which include the cost of remodelling & the expectation of 15% increase in sales resulting from the store renovations, which will attract new customers. State whether remodeling cost will be capitalized or not.

Solution

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 2 *(ICAI Study Material)* *Pg no._____*

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:
a) Setup costs of ₹ 5,00,000 to install machinery in the new location.
b) Rent of ₹ 15,00,000
c) Removal costs of ₹3,00,000 to transport machinery from old location to temporary location.
You are required to advise can these costs be capitalised into the cost of the new building?

Solution

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 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 be capable of operating in the manner intended by management.
Conclusion: The costs to be incurred by the company do not meet that requirement of AS 10 and cannot, therefore, be capitalised

Question 3 *(ICAI Study Material)* *Pg no._____*

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?

Solution

As per provisions of AS 10, any cost directly attributable to bring the assets to location and condition necessary for it to be capable of operating in the manner indicated by management are called directly attributable costs and would be included in the costs of an item of PPE.
Management of Entity A 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 and thus the expenditure should be considered part of the asset.

However, the cost of salaries of staff engaged in preparation of restaurant before its opening are in the nature of operating expenditure that would be incurred if the restaurant was open and 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 these should be expensed.

Question 4 *(ICAI Study Material)* *Pg no._____*

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, the net operating costs incurred should be capitalised. Comment.

Solution

The net operating costs should not be capitalised, but should be recognised in the Statement of Profit and Loss. 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 5 *(ICAI Study Material) (Similar)* *Pg no._____*

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) Costs of testing whether asset is functioning properly, after deducting the net proceeds

(4) Initial operating losses, such as those incurred while demand for the output of an item builds up.

(5) 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.

(6) Trade discounts and rebates.

(7) Costs of relocating or reorganizing part or all of the operations of an enterprise.

(8) Installation and assembly costs.

(9) Cost of site preparation

(10) Administration and other general overhead costs.

Solution

ITEMS	HEADS	ITEMS	HEADS

*Considered that this cost of testing is after deducting net proceeds from selling any items produced while bringing asset to that location & condition otherwise if net proceeds are after fixing the asset to its location and condition (asset ready for use), it will be classified under category (iii) i.e. Cost not included in determining the carrying amount of an item of PPE.

Question 6 *(RTP May 2021)* *Pg no._____*

You are required to give correct accounting treatment for the following in line with provisions of AS 10:

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)?

Solution

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 item will flow to the entity; &
(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.

Question 7 *(RTP May 2019) (Similar) / (ICAI Study Material)* *Pg no._____*

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)	25,00,000
Initial delivery and handling costs	2,00,000
Cost of site preparation	6,00,000
Consultants used for advice on the acquisition of the plant	7,00,000
Interest charges paid to supplier of plant for deferred credit	2,00,000
Estimated dismantling costs to be incurred after 7 years	3,00,000
Operating losses before commercial production	4,00,000

Please advise ABC Ltd. on the costs that can be capitalized in accordance with AS 10 (Revised).

Solution

According to AS 10 (Revised), these costs can be capitalized

Cost of the plant (cost per supplier's invoice plus taxes)	25,00,000
Initial delivery and handling costs	2,00,000
Cost of site preparation	6,00,000
Consultant's fees	7,00,000
Estimated dismantling costs to be incurred after 7 years	3,00,000
	43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 2,00,000 and operating losses before commercial production amounting to ₹ 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 *(RTP May 2023)* *Pg no._____*

Star Limited purchased machinery for 6,80,000 (inclusive of GST of 40,000). Input credit is available for entire amount of the GST paid.

The company incurred the following other expenses for installation.

	₹
Cost of preparation of site for installation	21,200
Total labour charges (200 out of total of 500 men hours worked, were spent for installation of the machinery)	56,000
Spare parts and tools consumed in installation	5,000
Total salary of supervisor (time spent for installation was 25% of the total time worked.)	26,000
Total technical expenses (1/10 relates to the plant installation)	34,000
Test run & experimental production charges	18,000
Consultancy changes to architect for plant set up	11,000
Depreciation on assets used for the installation	12,000

The machine was ready for use on 15-1-2022 but was used from 1-2-2022. 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.

Question 9 *Pg no._____*

J Ltd. purchased machinery from K Ltd. on 30.09.2021. The price was ₹ 370.44 lakhs after charging 8% Tax and giving a trade discount of 2% on the quoted price. Transport charges were 0.25% on the quoted price and installation charges come to 1% on the quoted price.

A loan of ₹ 300 lakhs was taken from the bank on which interest at 15% per annum was to be paid. Machinery was ready for use on 1.12.2021.

However, it was actually put to use only on 1.5.2022. Find out the cost of the machine.

Question 10 *Pg no._____*

Alex Ltd. intends to set up a solar plant. Alex Ltd. has acquired a dilapidated factory, having an area of 7,500 acres at a cost of ₹ 70,000 per acre. Alex Ltd. has incurred ₹ 50,00,000 on demolishing the old factory building thereon. A sum of ₹ 43,57,500 (including 5% GST) was realized from sale of material salvaged from the site. Alex Ltd. also incurred Stamp Duty and Registration Charges of 5% of Land Value, paid Legal and Consultancy Charges ₹ 5,00,000 for land acquisition and incurred ₹ 2,00,000 on Title Guarantee Insurance.

Compute the value of land acquired.

Question 11 *(RTP Nov 2019) / (RTP Nov 2020) (Similar)* Pg no._____

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 ₹ 1,41,870. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month. The technician's services were given by Department B to Department A, which billed the services at ₹ 49,500 per month after adding 10% profit margin. The machine was purchased at ₹ 1,58,34,000 inclusive of IGST @ 12% for which input credit is available to Shrishti Ltd. ₹ 55,770 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. Ascertain the amount at which the Machinery should be capitalized under AS 10 considering that IGST credit is availed by the Shrishti Limited. Internally booked profits should be eliminated in arriving at the cost of machine.

Question 12 *(ICAI Study Material)* Pg no._____

Entity A exchanges surplus land with a book value of ₹ 10,00,000 for cash of ₹ 20,00,000 and plant and machinery valued at ₹ 25,00,000. What will be the measurement cost of the assets received? (Consider that transaction has commercial substance)

Solution

In the given case, Plant & Machinery is valued at ₹ 25,00,000, which is assumed to be fair value in absence of 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 ₹ 45,00,000 (Cash 20,00,000 + Plant & Machinery 25,00,000). Since land of book value ₹ 10,00,000 is transferred in exchange of assets worth ₹ 45,00,000, a gain of ₹ 35,00,000 will be recognised in the books of Entity A.

ENTRY:

Question 13 *(ICAI Study Material)* Pg no._____

Entity A exchanges car X with a book value of ₹ 13,00,000 and a fair value of ₹ 13,25,000 for cash of ₹ 15,000 and car Y which has a fair value of ₹ 13,10,000. The transaction lacks commercial substance as the company's cash flows are not expected to change as a result of the exchange. It is in the same position as it was before the transaction. What will be the measurement cost of the assets received?

Solution

Since the transactions lacks commercial substance, the entity recognizes the assets received at the book value of car X. Therefore, it recognizes cash of ₹ 15,000 and car Y as PPE with a carrying value of ₹ 12,85,000.

ENTRY:

Question 14 *(ICAI Study Material)* Pg no._____

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 management want to apply the revaluation model as per AS 10 to the subsequent measurement of office buildings but continue to apply the historical cost model to the industrial buildings. State whether this is acceptable under AS 10 or not with reasons?

Solution

Entity A's management can apply the revaluation model only to the office buildings. The office buildings can be clearly distinguished from the industrial buildings in terms of their function, their nature and their general location. AS 10 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. All properties within the class of office buildings must, therefore, be carried at revalued amount.

Question 15 Pg no._____

A Ltd. has an item of plant with an initial cost of ₹ 1,00,000. At the date of revaluation, accumulated depreciation amounted to ₹ 55,000. The fair value of the asset, by reference to transactions in similar assets, is assessed to be ₹ 65,000.

Pass Journal Entries with regard to Revaluation?

Solution

The entries to be passed would be:

Accumulated depreciation A/c Dr. To Asset A/c (Being elimination of accumulated depreciation against the cost of the asset)	55,000	 55,000
Asset A/c Dr. To Revaluation Surplus (Being increase of net asset value to Fair value)	20,000	 20,000

Note: The net result is that the asset has a carrying amount of ₹ 65,000 [1,00,000 – 55,000 + 20,000.]

Question 16 *(RTP May 2020) / (ICAI Study Material)* Pg no._____

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?

Solution

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 of Entity A is not acceptable.

Question 17 *(RTP May 2018)* Pg no._____

In the year 2021-22, an entity has acquired a new freehold building with a useful life of 50 years for ₹ 90,00,000. 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	20,00,000
Roof	25	10,00,000
Lifts	20	5,00,000
Fixtures	10	5,00,000
Remainder of building	50	50,00,000
		90,00,000

Calculate depreciation for the year 2021-22 as per componentization method

Question 18 *(ICAI Study Material)* Pg no._____

Entity B manufactures industrial chemicals and uses blending machines in the production process. The output 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.

Solution

Management should determine the depreciation method based on production output. 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 determining the blending machines' useful life.

Question 19 Pg no._____

A machinery with a useful life of 6 years was purchased on 1st April, 2019 for ₹ 1,50,000. Depreciation was provided on straight line method for first three years considering a residual value of 10% of cost.
In the beginning of fourth year the company reassessed the remaining useful life of the machinery at 4 years and residual value was estimated at 5% of original cost.
The accountant recalculated the revised depreciation historically and charged the difference to profit and loss account. You are required to comment on the treatment by accountant and calculate depreciation to be charged for the fourth year.

Question 20 Pg no._____

Argon Ltd. purchased a shop on 1st January, 2007 at a cost of ₹ 8,50,000. The useful life of the shop is estimated as 30 years with residual value of ₹ 25,000 and depreciation is provided on a straight line basis. The shop was revalued on 30th June, 2021 for ₹ 19,50,000 and the revaluation was incorporated in the accounts.
Calculate:

a) The surplus on revaluation;
b) Depreciation to be charged in the Profit and Loss account for the year ended on 31st December, 2021.

Question 21 *Pg no._____*

Hema Ltd. purchased a machinery on 1.04.2014 for ₹ 15,00,000. The company charged straight line depreciation based on 15 years working life estimate and residual value ₹ 3,00,000. At the beginning of the 4th year, the company by way of systematic evaluation revalued the machinery upward by 20% of net book value as on date and also re-estimated the useful life as 7 years and scrap value as nil. The increase in net book value was credited directly to revaluation reserves. Deprecation (on SLM basis) later on was charged to Profit & Loss Account. At the beginning of 8th year the company decided to dispose off the machinery and estimated the realizable value to ₹ 2,00,000.
You are required to ascertain the amount to be charged to Profit & Loss Account at the beginning of 8th year with reference to AS-10

Question 22 *Pg no._____*

Fire Ltd. purchased equipment for its power plant from Urja Ltd. during the year 2020-21 at a cost of ₹ 100 lacs. Fire Ltd. they paid only 90% and balance 10% was to be paid after one year on satisfactory performance of the equipment. During the Financial year 2021-22, Urja Ltd. waived off the balance 10% amount which was credited to Profit and Loss account by Fire Ltd. as discount received. Is this accounting treatment correct? State in line with Accounting Standards.

Question 23 *Pg no._____*

Ascertain the value at which various items of Fixed Assets are to be shown in the Financial Statements of Velvet Ltd. and amount to be debited to the Profit and Loss Account in the context of the relevant Accounting Standard. Narrations for the adjustments made should form part of the answer:

(i) Balance of Office Equipment as on 01.04.2021 is ₹ 1,20,000. On 1.04.2021, out of the above office equipment having book value ₹ 20,000 has been retired from use and held for disposal. The net realizable value of the same is ₹ 2,000. Rate of depreciation is 15% p.a. on WDV basis.

(ii) Book Value of Plant and Machinery as on 01.04.2021 was ₹ 7,20,000. On 01.08.2021 an item of machinery was purchased in exchange for 500 equity shares of face value ₹ 10. The Fair Market value of equity shares on 01.08.2021 was ₹ 120. Rate of depreciation is 10% p.a. on WDV basis.

Question 24 *(ICAI Study Material)* *Pg no._____*

Entity A carried plant and machinery in its books at ₹ 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 ₹ 20,00,000. The machines were acquired by the insurance company and the company did not receive the ₹ 20,00,000 as cash compensation. State, how Entity A should account for the same?

Solution

Entity A should account for a loss in the Statement of Profit and Loss on de-recognition of the carrying value of plant 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.

Question 25 *(RTP Nov 2022)* Pg no.____

RS Ltd. has acquired a heavy plant at a cost of ₹ 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 was acquired at price of ₹ 50,00,000) and requires replacement, as further maintenance is uneconomical. The remainder of the plant is perfect and is expected to last for next 8 years. The cost of a new boiler is ₹ 60,00,000.
Can the cost of the new boiler be recognised as an asset, and, if so, what should be the carrying value of the plant at the end of second year?

Solution:
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

Particular	₹
Original cost of plant	₹ 2,00,00,000
Less: Accumulated depreciation [(2,00,00,000 /10) x 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	
WDV of Boiler (replaced) after 2 years (50,00,000/10 x 8)	40,00,000
	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 26 *(ICAI Study Material)* Pg no.____

Bharat Infrastructure Ltd. acquired a heavy machinery at a cost of ₹ 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 to last for the remaining 4 years. The cost of the new turbine is ₹ 450 lakhs. Give the accounting treatment for the new turbine, assuming SLM Depreciation and a discount rate of 8%.

Solution:
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 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 ₹ 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 = ₹ 450 lakhs ÷ 1.08^6 = ₹ 283.58 lakhs
Current carrying amount of turbine (to be de-recognised) =
Estimated cost ₹ 283.58 lakhs (-) SLM depreciation at 10% (useful life 10 years) for 6 years ₹ 170.15 lakhs= ₹ 113.43 lakhs.
Hence revised carrying amount of the machinery will be as under:

Particulars	₹ in lakhs
Historical Cost [₹ 1,000 lakhs (–) SLM Depreciation at 10% (10 year life) 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

Question 27 *(ICAI Study Material)* *Pg no._____*

Akshar Ltd. installed a new Plant (not a qualifying asset), at its production facility, and incurred the following costs:

a. Cost of the Plant (as per supplier's invoice): ₹ 30,00,000
b. Initial delivery and handling costs: ₹ 1,00,000
c. Cost of site preparation: ₹ 2,00,000
d. Consultant fee for advice on acquisition of Plant: ₹ 50,000
e. Interest charges paid to supplier against deferred credit: ₹ 1,00,000
f. Estimate of Dismantling and Site Restoration costs: ₹ 50,000 after 10 years (Present Value is ₹ 30,000)
g. Operating losses before commercial production: ₹ 40,000

The company identified motors installed in the Plant as a separate component and a cost of ₹ 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 ₹ 6,00,000 and estimated 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 ₹ 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 whole for ₹ 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.

Solution:

Cost at Initial Recognition:

Particulars	₹
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 = ₹ 5,00,000 out of ₹ 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 ₹ 40,000 incurred before commercial production is not a directly attributable cost, and hence excluded from cost of asset. These costs are expensed to the P/L as and when they are incurred.

1) Recognition of Motors Replacement

Particulars	₹
Cost of Motors determined above	5,63,333
Less: Depreciation for 4 years (as per SLM)	3,75,555
5,63,333 ÷ 6 years x 4 years	
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 ₹ 1,87,778. Further, the acquisition cost of new motors of ₹ 6,00,000 would be capitalized as a separate component. This amount will be depreciated over the next 5 years at ₹ 6,00,000 ÷ 5 years = ₹ 1,20,000 p.a.

2) Revaluation

Particulars	₹
Cost of the Plant at initial recognition [from (1) above]	28,16,667
Less: SLM Depreciation for 4 years: ₹ 28,16,667 ÷ 10 years x 4 years	(11,26,667)
Carrying Amount of Plant at the end of Year 4	16,90,000
Revalued Amount of Plant (Excluding Motors, since the same is treated as a separate component: ₹ 25,00,000 – ₹ 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

3) 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 ₹ 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 ₹ 2,10,000 would be transferred directly to Retained Earnings.
b. The allocation of disposal proceeds of ₹ 6,00,000 for the plant as whole is apportioned based on carrying 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 the reasoning 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.

PRACTICE QUESTIONS

Question 1 *(Inter Nov 2018) (5 Marks)* *Pg no.*_____

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 ₹ 7,50,000 Construction and remodelling cost of restaurant ₹ 30,00,000. Explain the treatment of these expenditures as per provisions of AS 10 "Property, Plant and Equipment".

Solution

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 ₹ 30,00,000 and thus the expenditure should be considered part of the asset.
However, the cost of salaries of staff engaged in preparation of restaurant ₹ 7,50,000 before its opening are in the nature of operating expenditure that would be incurred if the restaurant was open and 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, ₹ 7,50,000 should be expensed.

Question 2 *(RTP May 2021)* *Pg no.*_____

You are required to give correct accounting treatment for the following in line with provisions of AS 10: 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 period, including expenditure related to construction and remodelling costs (₹ 18 lakhs), salaries of staff (₹ 2 lakhs) who will be preparing the store before its opening and related utilities costs (₹ 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 books of accounts?

Solution

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 ₹ 18 lakh should be considered as part of the cost of the asset. However, the cost of salaries of the staff ₹ 2 lakh and utilities cost ₹ 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.

Question 3 *(RTP May 2020)* Pg no.______

The following items are given to you:

ITEMS

(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);

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

(3) Costs of opening a new facility or business, such as, inauguration costs;

(4) Purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

With reference to AS 10 "PPE", classify the items under the following 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.

Solution

(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 carrying amount of an item of PPE.

(3) 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.

(4) 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 4 *(RTP May 2022)* Pg no.______

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.

Solution:

Included in Cost: Point no. 1,2,3,5,8

Excluded from Cost: Point no. 4,6,7

Question 5 *(RTP Nov 2018)* Pg no.______

ABC Ltd. is installing new plant at its production factory. It provides you following information:

Cost of the plant (cost per supplier's invoice plus taxes)	31,25,000
Estimated dismantling costs to be incurred after 5 years	2,50,000
Initial Operating losses before commercial production	3,75,000
Initial delivery and handling costs	1,85,000
Cost of site preparation	4,50,000
Consultants used for advice on the acquisition of the plant	6,50,000

Please advise ABC Ltd. on the costs that can be capitalised for plant in accordance with AS 10: Property, Plant and Equipment.

Solution

As per AS 10 'Property, Plant and Equipment', the costs to be capitalized by ABC Ltd. are:

Cost of the plant (cost per supplier's invoice plus taxes)	31,25,000
Estimated dismantling costs to be incurred after 5 years	2,50,000
Initial delivery and handling costs	1,85,000
Cost of site preparation	4,50,000
Consultants used for advice on the acquisition of the plant	6,50,000
	46,60,000

Note: Operating losses before commercial production amounting to ₹ 3,75,000 will not be capitalized as per AS 10. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 6 *(ICAI Study Material)* Pg no._____

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 ₹ 1.10 crores on demolishing the old Factory Building thereon. A sum of ₹ 63,00,000 (including 5% GST thereon) was realized from the sale of material salvaged from the site. Preet Ltd. incurred Stamp Duty and Registration Charges of 7% of land value, paid legal and consultancy charges ₹ 8,00,000 for land acquisition and incurred ₹ 1,25,000 on title guarantee insurance. Compute the value of the land acquired.

Solution:

Particulars	₹ (in Lakhs)
Purchase Price: 5,000 acres x ₹ 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) [₹ 110 lakhs (–)₹ 60 lakhs (₹ 63 lakhs x 100/105)]	50.00
Cost of Land	3,269.25

Question 7 *(RTP Nov 2020) / (ICAI Study Material)* Pg no._____

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 of ₹ 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.

Solution

Particulars		Amount
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 8 *(Inter July 2021) (5 Marks)* *Pg no._____*

(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 be prepared 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.

(ii) B Limited, which operates a major chain of retail stores, has acquired a new store location. The new location 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 budget for this period including expenditure related to construction and re-modelling costs, salary of staff who shall be preparing the store before its opening and related utilities cost. How would such expenditure be treated in the books of B Limited?

Solution

(i) 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

(ii) 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 manner intended 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 cost of 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 9 (ICAI Study Material) Pg no.______

Entity B constructs a machine for its own use. Construction is completed on 1st November 2021 but the company does not begin using the machine until 1st March 2022. Comment

Solution

The entity should begin charging depreciation from the date the machine is ready for use – that is, 1st November 2021. 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 10 Pg no.______

In the year 2021-22, an entity has acquired a new freehold building with a useful life of 25 years for ₹ 45,00,000. 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	10,00,000
Roof	25	5,00,000
Lifts	10	2,50,000
Fixtures	5	2,50,000
Remainder of building	25	25,00,000
		45,00,000

(i) Calculate depreciation for the year 2021-22 as per componentization method.
(ii) Also state the treatment, in case Roof requires replacement at the end of its useful life.

Solution

(i) Statement showing amount of depreciation as per Componentization Method

Component	Depreciation = Cost / Useful life	Depreciation (p.a.)
Land	-	Nil
Roof	5,00,000/25	20,000
Lifts	2,50,000/10	25,000
Fixtures	2,50,000/5	50,000
Remainder of building	25,00,000/25	1,00,000
		1,95,000

(ii) When the roof requires replacement at the end of its useful life, the carrying amount will be Nil. The cost of replacing the roof should be recognised as a new component.

Question 11 (ICAI Study Material) / (RTP Nov 2021) (Similar) Pg no.______

A property costing ₹ 10,00,000 is bought in 2021. 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 2021 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 2021

Solution

Case (a)

The company considers that 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 ₹ 5,000 [{10,00,000 – 9,00,000} ÷ 20].

Question 12 *(RTP May 2020) / (ICAI Study Material)* Pg no._____

Entity A purchased an asset on 1st January 2018 for ₹ 1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil. On 1st January 2022, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years. Calculate amount of depreciation for each year, if company charges depreciation on Straight Line basis.

Solution
The entity has charged depreciation using the SLM at ₹ 10,000 p.a. i.e (1,00,000/10 years).
On 1st January 2022, the asset's net book value is [1,00,000 – (10,000 x 4)] ₹ 60,000.
Remaining useful life is 4 years. The company should amend annual provision for depreciation to charge the unamortised cost over the revised remaining life of 4 years. Consequently, it should charge depreciation for the next 4 years at ₹ 15,000 per annum i.e. (60,000 / 4 years).

Question 13 *(ICAI Study Material)* Pg no._____

Arka Ltd. purchased machinery for ₹ 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 ₹ 2,700 lakhs and the same was adopted. What will be the carrying amount of the asset at the end of Year 5 and Year 6? Assume no change in the useful life.

Solution:

Particulars	₹ in lakhs
Original Cost of the Asset	3,000.00
Less: Depreciation for 4 years (₹ 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 (₹ 2,700 lakhs ÷ 6 years)	450.00
Carrying Amount at the end of Year 5	2,250.00
Less: Depreciation for Year 6 (₹ 2,700 lakhs ÷ 6 years)	450.00
Carrying Amount at the end of Year 6	1,800.00

Question 14 Pg no._____

B Ltd. owns an asset with an original cost of ₹ 2,00,000. On acquisition, management determined that the useful life was 10 years and the residual value would be ₹ 20,000. The asset is now 8 years old, and during this time there have been no revisions to the assessed residual value. At the end of year 8, management has reviewed the useful life and residual value and has determined that the useful life can be extended to 12 years in view of the maintenance program adopted by the company. As a result, the residual value will reduce to ₹ 10,000. How would the above changes in estimates be made by B Ltd.?

Solution
The asset has a carrying amount of ₹ 56,000 at the end of year 8 [₹ 2,00,000 – ₹ 1,44,000] i.e. Accumulated Depreciation. Accumulated depreciation is calculated as
Depreciable amount {Cost less residual value} = ₹ 2,00,000 – ₹ 20,000 = ₹ 1,80,000.

Annual depreciation = Depreciable amount / Useful life = 1,80,000 / 10 = ₹ 18,000.
Accumulated depreciation = 18,000 × No. of years (8) = ₹ 1,44,000.
Revision of the useful life to 12 years results in a remaining useful life of 4 years (12 – 8).
The revised depreciable amount is ₹ 46,000. (56,000 – 10,000)
Thus, depreciation should be charged in future at ₹ 11,500 per annum (₹ 46,000/4 years).

Question 15 *(Inter Nov 2020) (5 Marks)* Pg no.______

A Ltd. had following assets. Calculate depreciation for the year ended 31st March, 2022 for each asset as per AS 10 (Revised):

a) Machinery purchased for ₹ 10 lakhs on 1st April, 2017 and residual value after useful life of 5 years, based on 2017 prices is ₹ 10 lakhs.
b) Land for ₹ 50 lakhs.
c) Machinery is constructed for ₹5,00,000 for its own use (useful life is 10 years). Construction is completed on 1st April, 2021, but the company does not begin using the machine until 31st March, 2022.
d) Machinery purchased on 1st April, 2019 for ₹ 50,000 with useful life of 5 years & residual value is Nil. On 1st April, 2021, management decided to use this asset for further 2 years only

Solution Computation of Amount of Depreciation as per AS 10

		Amount
(i)	Machinery purchased on 1/4/17 for ₹ 10 lakhs (having residual value of ₹ 10 lakhs) Reason: The company considers that residual value, based on prices prevailing at the balance sheet date, will equal the cost. Therefore, thereis 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, 2021. 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 SLM at 10,000 p.a. i.e (50,000/5 years). On 1st April, 2021 the asset's net book value is [50,000 – (10,000 x 2)] i.e. ₹ 30,000. The remaining useful life is 2 years as per revised estimate. The company should amend annual provision for depreciation to charge unamortized cost over 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 16 *(Inter May 2022) (5 Marks)* Pg no.______

XYZ Limited provided you the following information for the year ended 31 st March, 2022.

(i) 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. You are required to calculate revaluation loss as per AS 10 and give its treatment in the books of accounts.

(ii) 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 statements as per AS 10 (Revised).

Solution:

(i) 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 directly to 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 & loss account	e=c-d	6,000

(ii) AS 10 states that the carrying amount of an item of property, plant and equipment is derecognized 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 17 *(ICAI Study Material)* *Pg no.______*

Skanda Ltd. acquired a machinery for ₹ 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 ₹ 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 ₹ 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 ₹ 42,50,000 now?

Solution:

Particulars	₹
Original Cost of the Asset	2,50,00,000
Less: Depreciation for 2 years (₹ 2,50,00,000 x 10% x 2 years)	(50,00,000)
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 (₹ 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 = ₹ 1,12,50,000	Disposal Proceeds = ₹ 42,50,000
Book Value Less Disposal Proceeds = Loss recognized in Profit or Loss	₹ 1,87,50,000 – ₹ 1,12,50,000 = ₹ 75,00,000 (Loss)	₹ 1,87,50,000 – ₹ 42,50,000 = ₹ 1,45,00,000 (Loss)
Revaluation Surplus directly transferred to Retained Earnings	₹ 1,00,00,000	₹ 1,00,00,000

Question 18 *(ICAI Study Material)* *Pg no._____*

A company changed its method of depreciation from SLM to WDV. How should the change be recognised?

Solution

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.

Question 19 *(ICAI Study Material)* *Pg no._____*

A company has debited the Building Account with the Cost of the Land on which the building stands & has provided depreciation on such total cost. Comment on the accounting treatment.

Solution

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 useful life 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.

Question 20 *(ICAI Study Material)* *Pg no._____*

An entity is setting up a manufacturing plant. Construction of the plant is completed in August and the plant is ready for commercial production in November. However, the entity commences production in March. When should be company start charging depreciation.

Solution

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 operating 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.

Question 21 *(ICAI Study Material)* *Pg no._____*

Which factors should be considered by a company while determining useful life?

Solution

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 shifts for 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 a change 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.

Question 22 *(ICAI Study Material)* *Pg no._____*

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 necessary to 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.

(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 relevant Accounting Standards.

Solution

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 recorded in 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 the asset 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 to run 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 company is 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 off the cost of the asset (which was already paid for) over the useful life of 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 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.

(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 treatment of 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 complying with the Accounting Standards.

THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES

AS 11

Scope	AS-11 should be applied in ❖ Accounting for transactions in foreign currencies ❖ Translating the financial statements of foreign operations. ❖ Accounting for foreign currency transactions in the nature of forward exchange contracts	
FOREIGN CURRENCY TRANSACTIONS		
Meaning	It is a transaction which is denominated or requires settlement in a foreign currency.	
Examples	➢ Buying and selling of goods or services in foreign currency ➢ Lending or borrowing in foreign currency. ➢ Acquisition and disposition of asset denominated in foreign currency.	
Initial recognition	→ All transactions should be recorded at spot rate i.e. rate of foreign exchange at the date of transaction. → If spot rate is not given then average rate of week or month can be used	
Subsequent recognition /reporting at subsequent balance sheet dates	*Monetary Item*	These are the items which are receivable or payable in fixed or determinable amounts of money. Example: Cash, debtors, creditors, etc. *Use exchange rate at the balance sheet date*
	Non-monetary item	These all assets and liabilities other than monetary items. Example: Fixed assets, inventories and investments in equity shares. *Use exchange rate at the date of transaction.* If item carried at fair value, then use the exchange rate that existed when the values were determined
Recognition of exchange differences	*Monetary Item*	To be recognized as expenses or income i.e. to be debited or credited to P & L A/c
	Non-monetary item	No subsequent recognition is required, there does not arise any exchange difference.
SPECIAL CASE (MONETARY ITEMS) PARA 46 AND 46A		
Applicability	Exchange differences arising or reporting of long-term foreign currency monetary items. (LTFCMI). Application of this Para is optional but once exercised it is irrevocable & applies to all such foreign currency monetary items.	
Meaning of LTFCMI	An asset or liability should be designated as LTFCMI if – ➢ Asset or liability is expressed in a foreign currency and ➢ Has a term of 12 months or more at the date of origination of the asset or liability.	
Exchange difference on LTFCMI	*Related to depreciable capital assets*	Add to/deduct from cost of asset and depreciate over the balance life of the asset

<table>
<tr><td></td><td>Others</td><td>Accumulate in FCMITDA and amortize over the balance period of such long term item
FCMITDA: Foreign Currency Monetary Item Translation Difference Account
Disclosed under Reserve & Surplus as separate line item</td></tr>
<tr><td>Disclosure requirements</td><td colspan="2">• Fact of such option
• Amount remaining to be amortized in the financial statements of the period in which such option is exercised and in every subsequent period so long as any exchange difference remains unamortized.</td></tr>
<tr><td colspan="3">FOREIGN OPERATIONS</td></tr>
<tr><td>Integral Foreign Operations</td><td colspan="2">• It is a foreign operation, the activities of which are integral part of those of the reporting enterprise. The business of IFO is carried on as if it were an extension of the reporting enterprises operations.</td></tr>
<tr><td>Non- Integral Foreign Operations</td><td colspan="2">• It is a foreign operation that is not an integral foreign operation. The business of NIFO is carried on in substantially independent way by accumulating cash & other monetary items, incurring expenses, generating income & arranging borrowing in its own local currency.</td></tr>
<tr><td colspan="3">FORWARD EXCHANGE CONTRACTS</td></tr>
<tr><td>Meaning</td><td colspan="2">It means an agreement to exchange different currencies at a forward rate. Forward rate is the specified exchange rate for exchange of two currencies at a specified future date.</td></tr>
<tr><td rowspan="2">Categories</td><td>For Trading or speculation purposes</td><td>Gain or loss recognized in the Statement of P&L for the period. The premium or discount on the forward exchange contract is not recognised separately.
At each balance sheet date the value of contract is marked to its current market value and the gain or loss on the contract is recognised.</td></tr>
<tr><td>Not for Trading or speculation</td><td>Premium or discount – amortize as expense or income over the life of contract.</td></tr>
<tr><td colspan="3">DISCLOSURE REQUIREMENTS</td></tr>
<tr><td colspan="3">❖ An enterprise should disclose:
(a) The amount of exchange differences included in the net profit or loss for the period.
(b) Net exchange differences accumulated in foreign currency translation reserve as a separate component of shareholders’ funds, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.
❖ When the reporting currency is different from the currency of the country in which the enterprise is domiciled, the reason for using a different currency should be disclosed. The reason for any change in the reporting currency should also be disclosed.
❖ When there is a change in the classification of a significant foreign operation, an enterprise should disclose:
(a) The nature of the change in classification
(b) The reason for the change
(c) The impact of the change in classification on shareholders' funds and
(d) The impact on net profit or loss for each prior period presented had the change in classification occurred at the beginning of the earliest period presented.</td></tr>
</table>

ASSIGNMENT QUESTIONS

Question 1 *(RTP Nov 2018) / (RTP Nov 2020) (ICAI Study Material)* Pg no.______

	Exchange Rate per $
Goods purchased on 1.1.2021 of US $ 15,000	₹ 75
Exchange rate on 31.3.2021	₹ 74
Date of actual payment 7.7.2021	₹ 73

Ascertain the loss/gain for financial years 2020-21 and 2021-22, also give their treatment as per AS 11.

Question 2 *(RTP Nov 2022)* Pg no.______

A company had imported raw materials worth US Dollars 6,00,000 on 5th January, 2021, when the exchange rate was ₹ 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, 2021 when the exchange rate was ₹ 47 per US Dollar. However, on 31st March, 2021, the rate of exchange was ₹ 48 per US Dollar. The company passed an entry on 31st March, 2021 adjusting the cost of raw materials consumed for the difference between ₹ 47 and ₹ 43 per US Dollar.

In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss

Question 3 *(ICAI Study Material)* Pg no.______

Kalim Ltd. borrowed US$ 4,50,000 on 01/01/2021, which will be repaid as on 31/07/2021. Kalim 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$ = ₹ 48.00
31/03/2021 1 US$ = ₹ 49.00
31/07/2021 1 US$ = ₹ 49.50

Question 4 *(RTP May 2022)* Pg no.______

Kumar Ltd. borrowed US $ 3,00,000 on 31-12-2020 which will be repaid (settled) as on 30-6-2021. Kumar Ltd. prepares its financial statements ending on 31-3-2021. Rate of exchange between reporting currency (Rupee) and foreign currency (US $) on different dates are as under:

31-12-2020 1 US $ = ₹ 44.00; 31-3-2021 1 US $ = ₹ 44.50; 30-6-2021 1 US $ = ₹ 44.75

(i) Calculate borrowings in reporting currency to be recognised in the books on above mentioned dates & also show journal entries for the same.

(ii) If borrowings was repaid (settled) on 28-2-2021 on which date exchange rate was 1 US$= ₹ 44.20 than what entry should be passed?

Question 5 *(RTP Nov 2019) / (ICAI Study Material)* Pg no.______

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3.2021

a) Trade receivables as on 31.3.2021 in the books of XYZ Ltd. include an amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, i.e. at US $ 1= ₹ 58.50.

b) Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at US $ 1 = ₹ 55.60, taking exchange rate prevailing at the date of transaction.

US $ 1 = ₹ 61.20 on 31.3.2021.

Question 6 Pg no._____

Beekay Ltd. purchased fixed assets costing ₹ 5,000 lakh on 01.04.2021 payable in foreign currency (US$) on 05.04.2022. Exchange rate of 1 US$ = ₹ 50.00 and ₹ 54.98 as on 01.04.2021 and 31.03.2022 respectively. The company also obtained a soft loan of US$ 1 lakh on 01.04.2021 payable in three annual equal instalments. First instalment was due on 01.05.2022.

You are required to state, how these transactions would be accounted for in the books of accounts ending 31st March, 2022.

Question 7 *(ICAI Study Material)* Pg no._____

A Ltd. has borrowed USD 10,000 in foreign currency on April 1, 2021 at 5% p.a. annual interest and acquired a depreciable asset. The exchange rates are as under:

01/04/2021 1 US$ = ₹ 48.00
31/03/2022 1 US$ = ₹ 51.00

You are required to pass the journal entries in the following cases:

(i) Option under Para 46A is not availed.
(ii) Option under Para 46A is availed.
(iii) The loan was taken to finance the operations of the entity (and not to procure a depreciable asset).

In all cases, assume interest accrued on 31 March 2022 is paid on the same date.

Question 8 Pg no._____

Option Ltd. is engaged in the manufacturing of steel. For its steel plant, it required machineries of latest technology. It usually resorts to Long Term Foreign Currency Borrowings for its fund requirements. On 1st April, 2021, it borrowed US $1 million from International Funding Agency, USA when exchange rate was 1 $ = ₹ 52. The funds were used for acquiring machineries on the same date to be used in three different steel plants. The useful life of the machineries is 10 years and their residual value is ₹ 20,00,000.

Earlier also company used to purchase machineries out of foreign borrowings. The exchange differences arising on such borrowings were charged to profit and loss account and were not capitalised even though the company had an option to capitalise it as per notified AS 11 (notification issued by MCA in 2009).

Now for this new purchase of machinery, Option Ltd, is interested to avail the option of capitalising the same to the cost of asset. Exchange rate on 31st March, 2022 is 1 US $ = ₹ 51. Assume that on 31st March, 2022, Option Ltd. is not having any old Long term foreign currency borrowings except for the amount borrowed for machinery purchased on 1st April, 2021.

Can Option Ltd. capitalise the exchange difference to the cost of asset on 31st March, 2022? If yes, then calculate the depreciation amount on machineries as on 31st March, 2022.

Question 9 Pg no._____

Om Ld. Purchased an item of property, plant and equipment for US $ 50 Lakh on 01.04.2021 and the same was fully financed by the foreign currency loan (US $) repayable in 5 equal instalments annually. Exchange rate at the time of purchase was 1 US $ = ₹ 60. As on 31.03.2022 the first instalment was paid when 1 US $ = ₹ 62.

The entire loss on exchange was included in cost of goods 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 arising out of loan restatement and payment.

Calculate the amount of exchange loss, its treatment and depreciation on this item of property, plant and equipment.

Solution

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's a long term foreign currency monetary item. Thus the entire exchange loss due to variation of ₹ 20 Lakh on 31.03.2022 on payment of US $10 Lakh, 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 unamortized depreciable amount should also be provided.

Calculation of Exchange Loss:

Foreign Currency Loan (in ₹) = $ 50 Lakh x 60 = ₹ 3,000 Lakh

Exchange Loss on outstanding loan on 31.03.2022 = US $ 40 Lakh x (62-60) = ₹ 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 2021-22 = 20% of (3,000+100) = ₹ 620 Lakh.

Question 10 – *(RTP Nov 2018) / (RTP Nov 2020)* *Pg no._____*

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) Investment in Equity Shares

(iii) Trade Receivables

(iv) Property, Plant & Equipment.

Solution

As per AS 11, 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 realised 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 realised from or required to disburse, such item at the balance sheet date.

Share capital	Non-monetary
Trade receivables	Monetary
Investment in Equity Shares	Non-monetary
Property, Plant & Equipment	Non-monetary

Question 11 *Pg no._____*

Stem Ltd. purchased a Plant for US$ 30,000 on 30th November, 2021 payable after 6 months. The company entered into a forward contract for 6 months @ ₹ 62.15 per dollar. On 30th November, 2021; the exchange rate was ₹ 60.75 per dollar. How will you recognise the profit or loss on forward contract in the books of Stem Ltd. for the year ended 31st March, 2022?

Question 12 *(ICAI Study Material)* Pg no._____

Mr. A bought a forward contract for three months of US$ 1,00,000 on 1st December at 1 US$ = ₹ 47.10 when exchange rate was US$ 1 = ₹ 47.02. On 31st December when he closed his books exchange rate was US$ 1 = ₹ 47.15. On 31st January, he decided to sell the contract at ₹ 47.18 per dollar. Show how the profits from contract will be recognized in the books.

Question 13 Pg no._____

"The company had a engineering contract with a foreign government, work to be carried out in foreign country and payments to be received in dollars. The work was completed in the year 2021, and the entire contracted amount was duly recorded in the books of the company at the prevalent exchange rate on the date of completion of the work. However, payments to the extent of ₹ 40 crores could not be released by the Foreign Government because of temporary foreign exchange crisis in that country. These ₹40 crores unrealized at the end, if converted at the yearend rate would amount to ₹ 40.50 crores. The Company has adopted and follows the following accounting policy:

"In respect of foreign currency transactions, current assets and current liabilities are revalued at year end rates. However, if there is a net loss, due to exchange difference, the same is charged off to the P&L account, but if there is a net gain, the same is ignored in view of the prudent accounting policies of not recording unrealized gains due to exchange rate fluctuations".

Comment on the appropriateness of the above.

Solution

In given case the recoverability of ₹ 40 Crores is not doubtful or uncertain but just deferred temporarily hence it should be translated using exchange rates at the close of the year. Further AS-11 clearly mentions that net difference shall be transferred to profit and loss account. Hence, we can say that exchange difference favourable or unfavorable both shall be considered at the yearend rather to ignore the gains and recording just losses.

PRACTICE QUESTIONS

Question 1

Pg no._____

Sunshine Company Limited imported raw materials worth US Dollars 9,000 on 25th February, 2021, when the exchange rate was ₹ 44 per US Dollar. The transaction was recorded in the books at the above mentioned rate. The payment for the transaction was made on 10th April, 2021, when the exchange rate was ₹ 48 per US Dollar. At the year end 31st March, 2021, the rate of exchange was ₹ 49 per US Dollar.

The Chief Accountant of the company passed an entry on 31st March, 2021 adjusting the cost of raw material consumed for the difference between ₹ 48 and ₹ 44 per US Dollar. Discuss whether this treatment is justified as per the provisions of AS-11 (Revised).

Solution

As per AS 11, initial recognition of a foreign currency transaction is done in the reporting currency by applying the exchange rate at the date of the transaction. Accordingly, on 25th February 2021, the raw material purchased and its creditors will be recorded at US dollar 9,000 × ₹ 44 = ₹ 3,96,000.

Also, as per standard, on balance sheet date such transaction is reported at closing rate of exchange, hence it will be valued at the closing rate i.e. ₹ 49 per US dollar (USD 9,000 x ₹ 49 = ₹ 4,41,000) at 31st March, 2021, irrespective of the payment made for the same subsequently at lower rate in the next financial year.

The difference of ₹ 5 (49 – 44) per US dollar i.e. ₹ 45,000 (USD 9,000 x ₹ 5) will be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2021 and will not be adjusted against the cost of raw materials.

In the subsequent year on settlement date, the company would recognize or provide in the Profit and Loss account an exchange gain of ₹ 1 per US dollar, i.e. the difference from balance sheet date to the date of settlement between ₹ 49 and ₹ 48 per US dollar i.e. ₹ 9,000.

Hence, the accounting treatment adopted by the Chief Accountant of the company is incorrect i.e. it is not in accordance with the provisions of AS 11

Question 2 *(Inter May 2018) (5 Marks)*

Pg no._____

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$ =	68.50
31/03/2021	1 US$ =	69.50
31/07/2021	1 US$ =	70.00

You are required to pass necessary journal entries in the books of ABC Ltd. as per AS 11.

Solution

Date	Particulars	Dr.	Cr.
Jan. 01, 2021	Bank A/c (5,00,000*68.50) Dr.	3,42,50,000	
	To Foreign Loan A/c		3,42,50,000
Mar. 31, 2021	Foreign Exchange Difference A/c Dr.	5,00,000	
	To Foreign Loan A/c		5,00,000
	[5,00,000*(69.50-68.50)]		
Mar. 31, 2021	Profit & Loss A/c Dr.	5,00,000	
	To Foreign Exchange Difference A/c		5,00,000
Jul. 31, 2021	Foreign Loan A/c Dr.	3,47,50,000	

	Foreign Exchange Difference A/c Dr.	2,50,000	
	To Bank A/c		3,50,00,000
	Profit & Loss A/c Dr.	2,50,000	
	To Foreign Exchange Difference A/c		2,50,000

Question 3 Pg no._____

Explain briefly the accounting treatment needed in the following cases as per AS 11:

(i) Sundry Debtors include amount receivable from Ted of U.S., ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at $1 = ₹ 38.70.

(ii) Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at $1 = ₹ 35.60, taking exchange rate prevailing at the date of transactions.

Exchange rates at the end of the year were as under:

$1 Receivable = ₹ 45.80 $ 1 Payable = ₹ 45.90

Solution

AS 11 provides that exchange differences attributable to monetary items should be taken to Statement of Profit and Loss. In case option under para 46A is exercised, exchange differences arising on long-term foreign currency monetary items can be adjusted in the cost of depreciable capital asset or in other cases transferred in Foreign Currency Monetary Item Translation Difference A/c (FCMITD) and amortised.

Trade Receivables

Particulars	Foreign currency	Rate	₹
Initial recognition	US $ 12,919.90	38.70	5,00,000
Rate on B/S date		45.80	
Exchange Difference	US $ 12,919.90	7.10	91,731
Gain or loss			Gain
Treatment			Credit to Profit & Loss A/c ₹ 91,731

Long Term loan

Particulars	Foreign currency	Rate	₹
Initial recognition	US $ 1,68,539.33	35.60	60,00,000
Rate on B/S date		45.90	
Exchange Difference	US $ 1,68,539.33	10.30	17,35,955
Gain or loss			Loss
Treatment			Debit to Profit & Loss A/c ₹ 17,35,955 or transfer to FCMITD A/c and amortise.

Question 4 *(Inter Nov 2018) (5 Marks)* Pg no._____

(i) ABC Ltd. a Indian Company obtained long term loan from WWW private Ltd., a U.S. company amounting to ₹ 30,00,000. It was recorded at US $1 = ₹ 60.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2022) was US $1 = ₹ 62.00.

(ii) Trade receivable includes amount receivable from Preksha Ltd., ₹ 10,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹ 59.00. The exchange rate on balance sheet date (31.03.2022) was US $1 = ₹ 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.

Solution

Amount of Exchange difference and its Accounting Treatment

	Long term Loan	Foreign Currency Rate	₹
(i)	Initial recognition US $ 50,000 ₹ (30,00,000/60)	1 US $ = ₹ 60	30,00,000
	Rate on Balance sheet date	1 US $ = ₹ 62	
	Exchange Difference Loss US $ 50,000 x ₹ (62 – 60)		1,00,000
	Treatment: Credit Loan A/c and Debit FCMITD A/c or Profit and Loss A/c by ₹ 1,00,000		
	Trade receivables		
(ii)	Initial recognition US $ 16,949.152* (₹10,00,000/59)	1 US $ = ₹ 59	10,00,000
	Rate on Balance sheet date	1 US $ = ₹ 62	
	Exchange Difference Gain US $ 16,949.152* x ₹ (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 ₹ 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 ₹ 50,847.456 is required to be transferred to Profit and Loss A/c.

Question 5 *(Inter Jan 2021) (5 Marks)* *Pg no._____*

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.03.2022

(i) 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, 2022
US $ 1= ₹ 72.50 on 1st April, 2021.

(ii) Long term loan taken on 1st April, 2021 from a U.S. company amounting to ₹ 75,00,000. ₹ 5,00,000 was repaid on 31st December, 2021, recorded at US $ 1 = ₹ 70.50. Interest has been paid as and when debited by the US company.
US $1= ₹ 73.50 on 31st March, 2022
US $1=1 ₹ 72.50 on 1st April, 2021

Solution

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 Currency Rate	Amount (₹)
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 $ = 72.50	75,00,000
Rate on Balance sheet date	1 US $ = 73.50	
Exchange Difference Loss after adjustment of exchange gain 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		67,987.48*
Treatment: Credit Loan A/c and Debit FCMITD A/C or Profit and Loss A/c by ₹ 67,987.48		

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 has not been given in the question and hence it has been assumed that the transaction took place during the year ended 31 March 2022

Question 6 *(Inter Dec 2021) (5 Marks)* *Pg no._____*

(i) PP Ltd. an Indian Company acquired long term finance from WW (P) Ltd. a U.S. company, amounting to ₹ 40,88,952. The transaction was recorded at US $1 = ₹ 72.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2021) is US $1 = ₹ 73.60.

(ii) Trade receivables of PP Ltd. include amount receivable from Preksha Ltd., ₹ 20,00,150 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹ 73.40. The exchange rate on balance sheet date (31.03.2021) is US $1 = ₹ 73.60. Exchange rate on 1st April, 2020 is US $1 = ₹ 74.00.

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 PP Ltd.

Solution

(i) Long term Finance

	Foreign Currency Rate	₹
Initial recognition US $ 56,791 (40,88,952/72)	1 US $ = ₹ 72	40,88,952
Rate on Balance sheet date	1 US $ = ₹ 73.60	
Exchange Difference Loss [US $ 56,791 x (73.60 – 72)]		90,866 (rounded off)

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.
Treatment needed in this case: PP Ltd. can either Debit Foreign Currency Monetary Item Translation Difference (FCMITD) A/c or Debit Profit & Loss A/c by ₹ 90,866 & Credit Loan A/c

(ii) Trade Receivables

	Foreign Currency Rate	₹
Initial recognition US $ 27,250 (20,00,150/ 73.40)	1 US $ = ₹ 73.40	20,00,150
Rate on Balance sheet date	1 US $ = ₹ 73.60	
Exchange Difference Gain [US $ 27,250 X (73.60-73.40)]		5,450

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences on trade receivables amounting ₹ 5,450 is required to be transferred to Profit and Loss A/c.
Treatment needed in this case: Credit Profit and loss account by ₹ 5,450.

Question 7

Pg no._____

Legal Ltd. is engaged in the manufacturing of rubber. For its plant, it required machineries of latest technology. It usually resorts to Long Term Foreign Currency Borrowings for its fund requirements. On 1st April, 2021, it borrowed US $1 million from International Funding Agency, USA when exchange rate was 1 $ = ₹ 63. The funds were used for acquiring machineries, on the same date, to be used in three different plants. The useful life of the machineries is 10 years and their residual value is ₹ 30,00,000.
Earlier also the company used to purchase machineries out of foreign borrowings. The exchange differences arising on such borrowings were charged to P&L A/c and were not capitalized even though the company had an option to capitalize it as per notified AS 11.

Now for this new purchase of machinery, Legal Ltd, is interested to avail the option of capitalizing the same to the cost of asset. Exchange rate on 31st March, 2022 is 1 US $ = ₹ 62. Assume that on 31st March, 2022, Legal Ltd. is not having any old long term foreign currency borrowings except for the amount borrowed for machinery purchased on 1st April, 2021.

Comment whether Legal Ltd. can capitalize the exchange difference to the cost of asset on 31st March, 2022. If yes, then calculate the depreciation amount on machineries as on 31st March, 2022.

Solution

As per paragraph 46A of AS 11, 'The Effects of Changes in Foreign Exchange Rates', in respect of accounting periods commencing on or after 1st April, 2011, for an enterprise which had earlier exercised the option under paragraph 46 or not (such option to be irrevocable and to be applied to all such foreign currency monetary items), the 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 depreciable capital asset, can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset.

Accordingly, though Legal Ltd. had not earlier exercised the option, yet it can avail the option to capitalize the exchange difference to the cost of machinery by virtue of para 46A of AS 11. Further, since Legal Ltd. has no earlier long term foreign currency borrowings, it is not required to apply capitalization option to earlier borrowing also.

Exchange difference to be capitalized and depreciation amount

Cost of the asset in $	1 million
Exchange rate on 1st April, 2021	1$ = ₹ 63
Cost of the asset in ₹ (1 million x ₹ 63)	63 million
Less: Exchange differences as on 31st March, 2022 (63-62) x $ 1 million (Gain)	(1 million)
	62 million
Less: Depreciation for 2021-22 (62 million - 3 million) /10 years	(5.90 million)
	56.10 million

Question 8

Pg no.______

Opportunity Ltd. purchased an equipment costing ₹ 24,00,000 lakhs on 1.4.2021 and the same was fully financed by foreign currency loan (US Dollars) payable in four annual equal installments. Exchange rates were 1 Dollar = ₹ 60.00 and ₹ 62.50 as on 1.4.2021 and 31.3.2022 respectively. First installment was paid on 31.3.2022. The entire difference in foreign exchange has been capitalized. You are required to state that how these transactions would be accounted for.

Solution

As per AS 11, exchange differences arising on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, should be recognized 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 will be recognized as income or expense.

Calculation of Exchange Difference:

Foreign currency loan = ₹ 24,00,000/60 = 40,000 US Dollars

Exchange difference = 40,000 US Dollars × (62.50-60.00) = ₹ 1,00,000

(including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting ₹ 1,00,000 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 availed the option for capitalisation of exchange difference as per para 46/ 46A of AS 11.

However, as per para 46A of the standard, the 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, in so far as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset

Accordingly, in case Opportunity Ltd. opts for capitalizing the exchange difference, then the entire amount of exchange difference of ₹ 1,00,000 will be capitalised to 'Equipment account'. This capitalized exchange difference will be depreciated over the useful life of the asset.

Cost of the asset on the reporting date

Initial cost of Equipment	₹ 24,00,000
Add: Exchange difference as on 31.3.2022	₹ 1,00,000
Total cost on the reporting date	₹ 25,00,000

Question 9 *(ICAI Study Material)* Pg no.______

A Ltd. purchased fixed assets costing ₹3,000 lakhs on 1.1.2021 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40.00 & ₹ 42.50 as on 1.1.2021 & 31.12.2021 respectively. First instalment was paid on 31.12.2021. The entire difference in foreign exchange has been capitalised.
You are required to state, how these transactions would be accounted for.

Solution

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 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 recognized as income or expense.

Calculation of Exchange Difference:
Foreign currency loan = 3,000 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 capitalization available under para 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 done the correct treatment.

Question 10 *(RTP May 2021)* Pg no.______

(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., ₹ 10,00,000 recorded at the prevailing exchange rate on the date of transaction, transaction recorded at US $1 = ₹ 80.00. The exchange rate on balance sheet date (31.03.2022) was US $1 = ₹ 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.

Solution

(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	₹
Trade Payables		
Initial recognition US $ 12,500* (₹10,00,000/80)	1 US $ = ₹ 80	10,00,000
Rate on Balance sheet date	1 US $ = ₹ 85	
Exchange Difference Loss US $ 12,500* x ₹ (85-80)		62,500
Treatment: Debit Profit and Loss A/c by ₹ 62,500		
and Credit Trade Payables		

Thus, Exchange Difference on trade payables amounting ₹ 62,500 is required to be transferred to Profit and Loss

Question 11 *(ICAI Study Material)* *Pg no.____*

Classify the following items into Monetary and Non-monetary:

(i) Inventories; (ii) Trade Receivables; (iii) Investment in Equity Shares; (iv) Property, plant & equipment

Solution

Inventories- Non-monetary;
Trade Receivables - Monetary
Investment in Equity Shares – Non-monetary;
Property, Plant & Equipment - Non-monetary

Question 12 *(RTP May 2019) / (ICAI Study Material) / (RTP Nov 2021) (Similar)* *Pg no.____*

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 2021, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st Feb. was ₹ 48.85. How will you recognize the profit or loss on forward contract in the books of Rau Ltd.

Solution

Calculation of profit or loss to be recognized in the books of Rau Ltd.

	₹
Forward contract rate	49.15
Less: Spot rate	(48.85)
Loss/Premium on Contract	0.30
Forward Contract Amount	$1,00,000
Total loss on entering into forward contract = ($1,00,000 × ₹ 0.30)	₹ 30,000
Contract period	3 months
Loss for the period 1st February, 2021 to 31st March, 2021 i.e. 2 months falling in the year 2020-2021 will be ₹ 30,000*2/3 =	₹ 20,000

Balance loss of ₹ 10,000 (i.e. ₹ 30,000 – ₹ 20,000) for the month of April, 2021 will be recognized in the financial year 2021-2022.

Question 13 *(RTP May 2018) / (RTP Nov 2019)* *Pg no.____*

Power Track Ltd. purchased a plant for US$ 50,000 on 31st October, 2021 payable after 6 months. The company entered into a forward contract for 6 months @ ₹ 64.25 per Dollar. On 31st October, 2021, the exchange rate was ₹ 61.50 per Dollar. You are required to recognise the profit or loss on forward contract in the books of company for year ended 31st March, 2022

Solution

Calculation of profit or loss to be recognized in the books of Power Track Limited

	₹
Forward contract rate	64.25
Less: Spot rate	(61.50)
Loss/Premium on Contract	2.75
Forward Contract Amount	$50,000
Total loss on entering into forward contract = ($50,000 × ₹ 2.75)	₹ 1,37,500
Contract period	6 months
Loss for the period 1st November, 2021 to 31st March, 2022 i.e. 5 months falling in the year 2021-2022 will be ₹ 1,37,500*5/6 =	₹ 1,14,583

Thus, the loss amounting to ₹ 1,14,583 for the period is to be recognized in the year ended 31st March, 2022.

Question 14 *(Inter Nov 2018) (5 Marks) / (RTP May 2020)* Pg no._____

AXE Limited purchased fixed assets costing $ 5,00,000 on 1st Jan. 2021 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 2021 for five months @ ₹ 62.50 per dollar. The exchange rate per dollar was as follows:

On 1st January, 2021 ₹ 60.75 per dollar
On 31st March, 2021 ₹ 63.00 per dollar

You are required to state how the profit or loss on forward contract would be recognized in the books of AXE Limited for the year ending 2020-21, as per the provisions of AS 11.

Solution

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	₹ 62.50
Less: Spot Rate	(₹ 60.75)
Premium on Contract	₹ 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 2020-21; therefore loss to be recognized in 2020-21 (8,75,000/5) x 3 = ₹ 5,25,000. Rest ₹ 3,50,000 will be recognized in the following year 2021-22.

Question 15 Pg no._____

Mr. Y bought a forward contract for three months of US $ 2,00,000 on 1st December 2021 at 1 US $ = ₹ 44.10 when the exchange rate was 1 US $ = ₹ 43.90. On 31-12-2021, when he closed his books, exchange rate was 1 US $ = ₹ 44.20. On 31st January, 2022 he decided to sell the contract at ₹ 44.30 per Dollar. Show how the profits from the contract will be recognized in the books of Mr. Y.

Solution

As per AS 11, in recording a forward exchange contract intended for trading or speculation purpose, the premium or discount on the contract is ignored and at each balance sheet date, the value of contract is marked to its current market value and the gain or loss on the contract is recognised. Since the forward
contract was for speculation purposes the premium on forward contract i.e. the difference between the spot rate and the forward contract rate will not be recorded in the books.
Only when the forward contract is sold the difference between the forward contract rate and sale rate will be recorded in the Profit & Loss Account.

	₹
Sale rate	44.30
Less: Contract rate	(44.10)
Profit on sale of contract per US$	00.20

Contract Amount US $ 2,00,000
Total profit (2,00,000 x 0.20) ₹ 40,000

Question 16 *(Inter Nov 2022) (5 Marks)* *Pg no._____*

a) Jared Limited purchased a Machine for US $ 20,000 on 31st December, 2021 payable after four months. It entered into a forward contract for four months @ ₹ 78.85 per US $. On 31st December,2021 the exchange rate was ₹ 77.50 per US $.
How will you recognize the Profit or Loss on Forward Contract for the year ended 31st March,2022 in the books of Jared Limited?

b) 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.

Solution:

(a)

Forward Rate	78.85
Less: Spot Rate	(77.50)
Premium on Contract	1.35
Contract Amount	US$ 20,000
Total Loss (20,000 x 1.35)	₹ 27,000

Contract period 4 months (3 months falling in the year ended 31 st March, 2022)
Loss to be recognized (₹27,000x 3/4) = ₹ 20,250 in the year ended 31st March, 2022.

(b) 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 difference 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.

ACCOUNTING FOR GOVERNMENT GRANTS

AS 12

<table>
<tr><td>Meaning of Government</td><td colspan="2">Refers to government, government agencies and similar bodies whether local, national or international.</td></tr>
<tr><td>Meaning of Government Grants</td><td colspan="2">Assistance by Government in cash/kind to an enterprise for past or future compliance with certain conditions</td></tr>
<tr><td>Other nomenclatures</td><td colspan="2">Subsidies, Cash incentives, duty drawback etc.</td></tr>
<tr><td>Recognition</td><td colspan="2">When there is a reasonable assurance that
➢ The enterprise will comply with the conditions attached to them and
➢ The grants will be received</td></tr>
<tr><td>Scope Exclusion</td><td colspan="2">This Standard does not deal with:
➢ Government assistance other than in the form of government grants.
➢ Government participation in the ownership of the enterprise.</td></tr>
<tr><td colspan="3">SPECIFIC FIXED ASSETS</td></tr>
<tr><td>Meaning</td><td colspan="2">Government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such asset. Other conditions may also be attached restricting the type or location of assets or periods during which they are to be acquired or held.</td></tr>
<tr><td>Method 1</td><td colspan="2">➢ Grant-should be presented in balance sheet by showing it as a deduction from gross value of the concerned asset while arriving at its book value.
➢ If the grant amount equals the whole of the fixed asset cost, then the assets should be shown in the balance sheet at a nominal value.</td></tr>
<tr><td rowspan="2">Method 2</td><td>Related to Depreciable asset</td><td>Should be treated as deferred income which should be recognized in the P & L statement on a systematic and rational basis over the useful life of the asset i.e. income is allocated over the period and in the proportions in which depreciation on related assets in charged.</td></tr>
<tr><td>Related to Non-Depreciable asset</td><td>Should be credited to capital reserve.
However, if a grant related to a non-depreciable asset requires fulfillment of certain obligations, the grant should be credited to income over the same period over which the cost of meeting such obligations is charged to income.</td></tr>
<tr><td colspan="3">REVENUE</td></tr>
<tr><td>Treatment</td><td colspan="2">❖ Such grants should be recognized in the Statement of P&L on a systematic basis so as to match them with the related cost.
❖ These grants may be shown separately under the head 'other income' or alternatively, these may be deducted from the related expenses.</td></tr>
</table>

PROMOTER'S CONTRIBUTION	
Meaning	These are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay & no repayment is ordinarily expected in respect thereof.
Example	Central investment subsidy scheme (capital subsidy), investment in backward area etc.
Accounting	Treated as capital reserve and treated as part of shareholders funds. These cannot be distributed as dividend, nor considered as deferred income.
NON-MONETARY GRANT	
Assets given at concessional rate	It should be accounted for on the basis of its acquisition cost
Assets given free of cost	It should be recorded at a nominal value
GRANT RECEIVABLE AS COMPENSATION FOR EXPENSE/LOSS	
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 recognised and disclosed in the profit and loss statement of the period in which they are receivable, as an extraordinary item if appropriate.	
REFUND OF GOVERNMENT GRANTS	
Nature	Government grants sometimes become refundable because certain conditions are not fulfilled & are treated as an extraordinary item (AS 5).
Related to Revenue	Applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.
Related to Specific Fixed Asset	Recorded by increasing the book value of the asset or by reducing the deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value is provided prospectively over the residual useful life of the asset.
In the nature of Promoter's Contribution	Where a grant which is 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 recoverable by the government is reduced from the capital reserve.
DISCLOSURE REQUIREMENTS	
(i) the accounting policy adopted for government grants, including the methods of presentation in the financial statements;	
(ii) the nature and extent of government grants recognised in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.	

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* Pg no._____

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the asset government granted it a grant for ₹ 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if

Case 1: Grant is deducted from the value of fixed asset.

Case 2: Grant is treated as deferred income.

Question 2 *(ICAI Study Material) (Similar)* Pg no._____

A Ltd. purchased machinery for ₹ 40 lakhs. (Useful life 4 years and residual value ₹ 8 lakhs) Government grant received is ₹ 16 lakhs. Grant becomes refundable in the third year.

Pass necessary journal entries for 3 years, if:

(1) the grant is credited to Fixed Assets A/c.

(2) the grant is credited to Deferred Grant A/c.

Question 3 Pg no._____

A fixed asset is purchased for ₹ 25 lakhs. Government grant received towards it is ₹ 10 lakhs. Residual Value is ₹ 5 lakhs and useful life is 5 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 refundable to the extent of ₹ 6 lakhs due to non compliance with certain conditions. Pass journal entries for first two years.

Question 4 *(ICAI Study Material)* Pg no._____

On 1.4.2018 ABC Ltd. received Government grant of ₹ 300 lakhs for acquisition of a machinery costing ₹ 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 2021 due to nonfulfillment 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 the year 2021?

Question 5 Pg no._____

Yogya Ltd. received a specific grant of ₹ 300 lakhs for acquiring the plant of ₹ 1,500 lakhs during 2018-19 having useful life of 10 years. The grant received was credited to deferred income and shown in the balance sheet. During 2021-22, due to noncompliance of conditions laid down for the grant the company had to refund the grant to the Government.

Balance in the deferred income on that date was ₹ 210 lakhs and written down value of plant was ₹ 1,050 lakhs.

(i) What should be the treatment for 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? Assume that depreciation is charged on assets as per straight line method.

(ii) What should be the treatment of the refund if grant was deducted from the cost of the plant during 2018-19?

Question 6 *(RTP May 2021) / (RTP May 2023)* Pg no._____

Hygiene Ltd. had received a grant of ₹ 50 lakh in 2013 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 2021. The company debited the said amount to its machinery in 2021 on payment of the same. It also reworked the depreciation for the said machinery from the date of its purchase and passed necessary adjusting entries in the year 2021 to incorporate the retrospective impact of same. State whether treatment done by company is correct or not.

Solution

AS 12, "Accounting for Government Grants", requires that the amount refundable in respect of a government grant related to a specific fixed asset is 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. 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 relevant Accounting Standards.

Question 7 *(ICAI Study Material)* *Pg no._____*

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 if the grant is:

a) Shown separately as Other Income; and ;
b) Deducted against the Salary costs.

Question 8 *(ICAI Study Material)* *Pg no._____*

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 to refund the entire grant of 90 lakhs.
You are required to pass the necessary journal entries in the books of the company for refund of the grant if the grant was shown separately as Other Income

Question 9 *(ICAI Study Material)* *Pg no._____*

Supriya Ltd. received grant of ₹ 2,500 lakhs during accounting year 2020-21 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 2021-22, it was found that conditions of grants were not complied with and the grant had to be refunded to the government in full. Elucidate the current accounting treatment, with reference to provisions of AS-12.

Solution

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 charged immediately to profit and loss statement.

In the present case, the amount of refund of government grant should be shown in the profit & loss account of the company as an extraordinary item during the year 2021-22.

Question 10 Pg no._____

M/s A Ltd. has set up its business in a designated backward area with an investment of ₹ 200 Lakhs. The Company is eligible for 25% subsidy and has received ₹ 50 Lakhs from the Government. Explain the treatment of the Capital Subsidy received from the Government in the Books of the Company

Solution

As per AS 12 "Accounting for Govt. Grants", Where the government grants are of the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve.

Subsidy received by A Ltd. is in the nature of promoter's contribution, since this grant is given with reference to the total investment in an undertaking and by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof. Therefore, this grant should be treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

Question 11 *(ICAI Study Material)* Pg no._____

Santosh Ltd. has received a grant of ₹ 8 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed ₹ 2 crores as dividend. Also, Santosh Ltd. received land free of cost from the State Government but it has not recorded it at all in the books as no money has been spent.

In the light of AS 12 examine, whether the treatment of both the grants is correct.

Solution

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 available for distribution of dividend.

In the second case, even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value.

The treatment of both the elements of the grant is incorrect as per AS 12.

Question 12 *(RTP May 2020) / (RTP Nov 2020) / (ICAI Study Material)* Pg no._____

How would you treat the following in accounts in accordance with AS-12 'Government Grants'?

a) ₹ 35 Lakhs received from Local Authority for providing Medical facilities to employees.

b) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in a notified backward area. This subsidy is in nature of promoters' contribution.

c) ₹ 10 Lakhs Grant received from the Central Government on installation of antipollution equipment

Solution

a) ₹ 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in the 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, ₹ 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

b) 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 ₹ 100 lakhs should be credited to capital reserve.

c) ₹ 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 recognised 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, ₹ 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 13 *(RTP May 2018) / (RTP Nov 2021) (Similar)* *Pg no._____*

D Ltd. acquired a machine on 01-04-2018 for ₹ 20,00,000. The useful life is 5 years. The company had applied on 01-04-2018, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 2021. The Company's Fixed Assets Account for the financial year 2021-22 shows a credit balance as under:

Particulars	₹
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation (from 2018-19- to 2020-21 on Straight Line Method)	(12,00,000)
	8,00,000
Less: Grant received	(16,00,000)
Balance	(8,00,000)

How should the company deal with this asset in its accounts for 2021-22? Can it charge depreciation or negative depreciation for 2021-22? Can it credit ₹ 8,00,000 to Capital Reserve?

Solution

From the above account, it is inferred that the Company follows Reduction Method 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 2021-22 or 2022-23 as the depreciable amount is now Nil. In respect of Depreciable Assets, AS-12 does not permit the crediting of the grant or any part thereof to Capital Reserve A/c.

Question 14 *Pg no._____*

An Indian company is engaged by a research company based in USA to carry out research in India, in consideration of billing to be done by Indian company based on cost plus 20% mark up. The Company based in USA paid a sum of ₹ 10 crores to an Indian company to acquire equipment to be used for research. The equipment is owned by the Indian company and a

condition is attached in the agreement with the US company that such equipment is to be used for at least 5 years for research work of that company.
How should the amount of ₹ 10 crores be accounted-as capital reserve or as credit to profit and loss account or by credit to the account of the equipment?

Solution

As per AS 12 'Government Grants', grants meant to subsidize or reduce expenses is taken to the Statement of Profit and loss in proportion to the savings and where the grant is related to fixed assets, the value of the fixed asset is stated net of grant and depreciation is provided accordingly. Government Grants in the nature of promoter's contribution is however taken to Capital reserves.

In the given case, the Company has received an amount from a research company in USA to acquire equipment's to be used in research in India which is to be owned by the Indian Company only. The same can be considered as private grant and AS 12 do not apply to private grants. Since the amount received is towards capital items, therefore it is not possible that credit arising out of a grant can be taken to statement of profit and loss. If such grant received is credited to profit and loss, profit or loss position could be easily manipulated through such private grants.

However, in the present case, grant should either be shown as Capital Reserve (not revenue reserves) with proper disclosures or credited to Equipment Account.

Question 15 *(Inter May 2022) (5 Marks)* Pg no._____

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 water in 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.

Solution

(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, grant amounting ₹ 10 crores is treated as deferred income which is recognized in the profit & 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 amount of ₹ 50 lakhs received from Govt. for setting up a project for supply of arsenic free water should either 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.

(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.

PRACTICE QUESTIONS

Question 1 Pg no._____

ABC Limited purchased a machinery for ₹ 25,00,000 which has estimated useful life of 10 years with the salvage value of ₹5,00,000. On purchase of the assets Central Government pays a grant for ₹5,00,000. Pass the journal entries with narrations in the books of the company for the first year, treating grant as deferred income.

Solution

Year	Particulars	L.F.	Dr.	Cr.
1	Machinery A/c Dr.		25,00,000	
	To Bank Account			25,00,000
	(Being machinery purchased)			
	Bank A/c Dr.		5,00,000	
	To Deferred Government Grant A/c			5,00,000
	(Being grant received from the government treated as deferred income)			
	Depreciation A/c Dr. (25,00,000-5,00,000)/10		2,00,000	
	To Machinery A/c			2,00,000
	(Being depreciation charged SLM)			
	Profit & Loss A/c Dr.		2,00,000	
	To Depreciation A/c			2,00,000
	(Being depreciation transferred to Profit and Loss Account at the end of year 1)			
	Deferred Government Grant A/c Dr. (5,00,000/10)		50,000	
	To Profit & Loss A/c			50,000
	(Being proportionate grant taken to P/L A/c)			

Question 2 *(Inter Jan 2021) (5 Marks)* Pg no._____

Darshan Ltd. purchased a Machinery on 1st April, 2018 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. Calculate the amount of depreciation and grant to be recognized in profit & loss account for the year ending 31st March, 2019, 31st March, 2020, 31st March, 2021 & 31st March, 2022. Darshan Ltd. follows straight line method for charging depreciation.

Solution

As per 12 "Accounting for government grants", grants related to depreciable assets, if treated as deferred income are recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Amount of depreciation & grant to be recognized in the Profit & Loss account each year

Depreciation per year:

	Amount (in Lakhs)
Cost of the Asset	130
Less: Salvage Value	(60)
	70
Depreciation per year (70 Lakhs/4)	17.50

₹ 17.50 Lakhs depreciation will be recognized for the year ending 31st March, 2019, 31st March, 2020, 31st March, 2021 and 31st March, 2022.
Amount of grant recognized in P&L Account each year: 40 lakhs /4 years = ₹ 10 Lakhs for the year ending 31st March, 2019, 31st March, 2020, 31st March, 2021 and 31st March, 2022.

Question 3

Pg no._____

Ram Ltd. purchased machinery for ₹ 80 lakhs. (useful life 4 years and residual value ₹ 8 lakhs). Government grant received is ₹ 32 lakhs.
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
(i) the grant is credited to Fixed Assets A/c.
(ii) the grant is credited to Deferred Grant A/c

Solution
(i) Grant is credited to Fixed Assets A/c
a) Journal Entry (at the time of refund of grant)

Particulars	L.F.	Dr. (in Lakhs)	Cr. (in Lakhs)
Fixed Asset Account Dr.		32	
To Bank Account			32
(Being government grant refunded)			

b) Value of Fixed Assets after two years but before refund of grant
Fixed assets initially recorded in the books = ₹ 80 lakhs – ₹ 32 lakhs = ₹ 48 lakhs
Depreciation for each year = (₹ 48 lakhs – ₹8 lakhs)/4 years
= ₹ 10 lakhs per year for first two years.
Value of the assets before refund of grant =₹ 48 lakhs - ₹ 20 lakhs = ₹ 28 lakhs

c) Value of Fixed Assets after refund of grant

Value of Fixed Assets before refund of grant	₹ 28 lakhs
Add Refund of grant	₹ 32 lakhs
	₹ 60 lakhs

d) Amount of depreciation for remaining two years
Value of the fixed assets after refund of grant –residual value of the assets / No. of years
= (₹ 60 lakhs - ₹ 8 lakhs) / 2 = ₹ 26 lakhs per annum will be charged for next two years.

(ii) Grant is credited to Deferred Grant A/c
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 (₹ 32 lakhs /4 years) = ₹ 8 lakhs x 2 years = ₹ 16 lakhs will be credited to Profit & Loss A/c and ₹ 16 lakhs will be the balance of Deferred Grant A/c after two years.
a) Journal Entry (at the time of refund of grant)

Particulars	L.F.	Dr. (in Lakhs)	Cr. (in Lakhs)
Deferred Grant A/c Dr.		16	
P&L A/c Dr.		16	
To Bank Account			32
(Being government grant refunded)			

b) Value of Fixed Assets after two years but before refund of grant
Fixed assets initially recorded in the books = ₹ 80 lakhs
Depreciation for each year = (₹ 80 lakhs – ₹8 lakhs)/4 years = ₹ 18 lakhs per year
Book value of fixed assets after 2 years = ₹ 80 lakhs – (₹ 18 lakhs x 2 years) = ₹ 44 lakhs

c) 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 continue to be shown in the books at ₹ 44 lakhs.

d) Amount of depreciation for remaining two years
Depreciation will continue to be charged at ₹ 18 lakhs per annum for the remaining two years

Question 4 *(ICAI Study Material) / (RTP May 2022) (Similar)* *Pg no._____*

A fixed asset is purchased for ₹ 20 lakhs. Government grant received towards it is ₹ 8 lakhs. Residual Value is ₹ 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 refundable to the extent of ₹ 5 lakhs due to non compliance with certain conditions. Pass journal entries for first 2 years.

Solution

Year	Particulars	L.F.	Dr. (in Lakhs)	Cr. (in Lakhs)
1	Fixed Asset Account Dr.		20	
	To Bank Account			20
	(Being fixed asset purchased)			
	Bank Account Dr.		8	
	To Fixed Asset Account			8
	(Being grant received from government reduced the cost of fixed asset)			
	Depreciation Account (W.N.1) Dr.		2	
	To Fixed Asset Account			2
	(Being depreciation charged on Straight Line method (SLM))			
	Profit & Loss Account Dr.		2	
	To Depreciation Account			2
	(Being depreciation transferred to Profit and Loss Account at the end of year 1)			
2	Fixed Asset Account Dr.		5	
	To Bank Account			5
	(Being grant on asset partly refunded which increased cost of fixed asset)			
	Depreciation Account (W.N.2) Dr.		3.67	
	To Fixed Asset Account			3.67
	(Being depreciation charged on SLM on revised value of fixed asset)			
	Profit & Loss Account Dr.		3.67	
	To Depreciation Account			3.67
	(Being depreciation transferred to Profit and Loss Account at the end of year 2)			

Working Notes:

1. Depreciation for Year 1

Cost of the Asset	20
Less: Government grant received	(8)
	12
Depreciation (12-4)/4	2

2. Depreciation for Year 2

Cost of the Asset	20
Less: Government grant received	(8)
	12
Less: Depreciation for the first year	(2)
Book value at the end of 1st year	10
Add: Government grant refundable	5
	15
Depreciation for the second year (15-4)/3	3.67

Question 5 *(Inter May 2018) (5 Marks)* *Pg no._____*

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 on 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?

Solution

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%	(80.00)
1st April 2019	Book value	320.00
31st March 2020	Less: Depreciation @ 20%	(64.00)
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.

Question 6 *(Inter Nov 2020) (5 Marks)* *Pg no._____*

On 1st April, 2018, 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 2021 due to noncompliance 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 the year 2021-22. Pass necessary Journal Entries for the year 2021-22.

Solution

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 (300 – 60)	240.00
31st March 2019	Less: Depreciation @ 10%	(24.00)
1st April 2019	Book value	216.00
31st March 2020	Less: Depreciation @ 10%	(21.60)
1st April 2020	Book value	194.40
31st March 2021	Less: Depreciation @ 10%	(19.44)
1st April 2021	Book value	174.96
	Less: Depreciation @ 10% for 2 months	(2.916)
1st June 2021	Book value	172.044
June 2021	Add: Refund of grant	60.00
	Revised Book value	232.044

Depreciation @ 10% on the revised book value amounting ₹ 232.044 lakhs is to be provided prospectively over the residual useful life of the asset.

**considered refund of grant at beginning of June month and depreciation for two months already charged. Alternative answer considering otherwise also possible.*

Year	Particulars	L.F.	Dr. (in Lakhs)	Cr. (in Lakhs)
2021-22	Machinery Account Dr.		60	
	To Bank Account			60
	(Being government grant on asset refunded which increased cost of fixed asset)			
	Depreciation Account (W.N.) 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 at end of year (2.916+19.337)]			

Question 7 (RTP May 2019) Pg no._____

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2018-19 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet. 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 ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2021-22 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 2018-19 assuming plant account showed the balance of ₹ 84 lakhs as on 1.4.2021?

Solution

As per para 21 of AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

(i) In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 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.

(ii) If the grant was deducted from the cost of the plant in the year 2018-19 then, para 21 of AS-12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by ₹ 30 lakhs. The increased cost of ₹ 30 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2021-22 shall be (84 + 30)/7 years = ₹ 16.286 lakhs presuming the depreciation is charged on SLM.

Question 8 *(RTP Nov 2018)* *Pg no._____*

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 2018-19. Plant has useful life of 10 years. The grant received was credited to deferred income in the balance sheet. 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 ₹ 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 2021-22 in P&L Account?

(ii) What should be the treatment of the refund, if grant was deducted from cost of the plant during 2018-19 assuming plant account showed the balance of ₹ 56 lakhs as on 1.4.2021?

You are required to explain in the line with provisions of AS 12.

Solution

As per para 21 of AS 12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

(i) In this case the grant refunded is ₹ 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 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.

(ii) If the grant was deducted from the cost of the plant in the year 2018-19 then, para 21 of AS 12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by ₹ 15 lakhs. The increased cost of ₹ 15 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2021-22 shall be (56+15)/7 years = ₹ 10.14 lakhs presuming the depreciation is charged on SLM.

Question 9 *(ICAI Study Material)* Pg no._____

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 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 ₹ 7,00,000. Pass the journal entry for refund of the grant as per the first method.

Solution

Year	Particulars	L.F.	Dr.	Cr.
2	Fixed Asset Account Dr.		7,00,000	
	To Bank Account			7,00,000
	(Being grant on asset partly refunded which increased cost of fixed asset)			

Question 10 *(RTP Nov 2019) / (RTP Nov 2022)* Pg no._____

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 ₹ 80 crores in the eligible investments. The company is eligible for the subsidy and has received ₹ 20 crores from the government in February 2022. 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?

Solution

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 (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.

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.

Question 11 *(ICAI Study Material)* Pg no._____

Top & Top Limited has set up its business in a designated backward area which entitles the company to 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 ₹ 50 crore in capital assets received ₹ 10 crore from the Government in January, 2022 (accounting period being 2021-2022). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 2022. Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.

Solution

As per 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 12 *(Inter May 2019) (1 Marks)* *Pg no._____*

State whether the following statement is '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.

Solution

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 13 *Pg no._____*

Explain in brief treatment of Refund of Government Grants in line with AS 12 in the following situations

a) When Government Grant is related to revenue,

b) When Government Grant is related to specific fixed assets,

c) When Government Grant is in the nature of Promoter's contribution.

Solution

As per AS 12, refund of Government Grant is treated in the following manner:

(a) When Government Grant is related to Revenue:

(i) The amount of refund is first adjusted against any unamortized deferred credit balance still remaining in respect of the Grant.

(ii) Any excess refund over such deferred credit balance or where no deferred credit exists, is immediately charged to Profit & Loss Account.

(b) When Government Grant is related to specific Fixed Asset:

(i) The amount of refund will increase the Book Value of the Asset, if at the time of receipt of Grant, the cost of asset was reduced by the amount of Grant.

(ii) If at the time of receipt, the Grant amount was credited to Deferred Grant Account, then the amount of refund will first reduce the unamortized balance of Deferred Grant Account.

(c) When the Government Grant is in the nature of Promoter's Contribution:

Capital Reserve will be reduced by the amount of refund.

Question 14 *(Inter July 2021) (5 Marks)* *Pg no._____*

Alps Limited has received the following Grants from the Government during the year ended 31st March, 2021:

a) ₹ 120 Lacs received as Subsidy from the Central Government for setting up an Industrial undertaking in Medak, a notified backward area.
b) ₹ 15 Lacs Grant received from the Central Government on installation of Effluent Treatment Plant.
c) ₹ 25 Lacs received from State Government for providing Medical facilities to its workmen during the pandemic.

Advise Alps Limited on the treatment of the above Grants in its books of Account in accordance with AS-12 "Government Grants".

Solution

a) 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 outl ay 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)
b) As per AS 12 'Accounting for Government Grants', two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives –
   (i) 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.
   (ii) 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.
c) ₹ 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 credit in 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.

Question 15 *(RTP May 2021)* *Pg no._____*

ABC Ltd. received two acres of land received for set up of plant. It also received ₹ 2 lakhs received for purchase of machinery of ₹ 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?

Solution

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 recognised 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 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. Accordingly, the grant of ₹ 2 lakhs is deducted from the cost of the machinery. Machinery will be recognised in the books at ₹ 10 lakhs – ₹ 2 lakhs = ₹ 8 lakhs and depreciation will be charged on it as follows:
  ₹ 8 lakhs/ 5 years = ₹ 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. ₹ 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, ₹ 40,000 [₹ 2 lakhs / 5 years] should be credited to profit and loss each year over the period of 5 years.

Question 16

Pg no._____

P Limited belongs to the engineering industry. The Chief Accountant has prepared the draft accounts for the year ended 31.03.2022. You are required to advise the company on the following item from the viewpoint of finalisation of accounts, taking note of the mandatory accounting standards:

The company purchased on 01.04.2021 special purpose machinery for ₹25 lakhs. It received a Central Government Grant for 20% of the price. The machine has an effective life of 10 years.

Solution

AS 12 'Accounting for Government Grants' regards two methods of presentation, of grants related to specific fixed assets, in financial statements as acceptable alternatives.

Under the first method, the grant of ₹ 5,00,000 can be shown as a deduction from the gross book value of the machinery 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.

Under the second method, it can be treated as deferred income which should be recognised in the profit and loss statement over the useful life of 10 years in the proportions in which depreciation on machinery will be charged. The deferred income pending its apportionment to profit and loss account should be disclosed in the balance sheet.

The following should also be disclosed:

a. the accounting policy adopted for government grants, including the methods of presentation in the financial statements;
b. the nature and extent of government grants recognised in the financial statement of ₹ 5 lakhs.

EMPLOYEE BENEFITS

AS 15

Objective & Applicability	To prescribe accounting treatment and disclosure for employee benefits in the books of employer except employee share-based payments. The Standard addresses only the accounting of employee benefits by employers. The Standard makes 4 things very clear at the outset: (i) the Standard is applicable to benefits provided to all types of employees (whether full-time, part-time, or casual staff); (ii) employee benefits can be paid in cash or in kind; (iii) employee benefits include benefits provided to employees and their dependents (spouses, children and others); and (iv) payment can be made directly to employees, their dependent or to any other party(e.g., legal heirs, nominees, insurance companies, trust etc.)
Basis	The Standard is based on the premise that the costs associated with employees benefits should be matched with the timing of their service. This requires assessment of the anticipated costs and their timing in future and aligning those costs over the period of their service. <u>Example</u>: Pension payable to an employee must be recognized as a cost during the service period itself, irrespective of the fact that the pension is payable after the service is completed.
Meaning of Employee	AS 15 does not define who is an ‘employee’, but states in that "an employee may provide services to an entity on a full-time, part-time, permanent, casual or temporary basis. For the purpose of this Standard, employees include directors and other management personnel". The <u>*following indicators*</u> may suggest an employee relationship may be more likely to exist, and may help in making individual judgements: • A contract of employment exists • Individuals are considered employees for legal/tax/social security purposes • There is a large amount of oversight and direction by the employer and necessary tools, equipment and materials are provided by the employer • Services are performed at a location specified by the employer.
Employer Employee Relationship	The Standard is applicable to all forms of employer employee relationships. There is no requirement for a formal employer employee relationship. Several factors need to be considered to determine the nature of 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”.
Employee Benefits	Employee benefits include: (a) <u>Short-term employee benefits</u> (e.g., wages, salaries, paid annual leave & sick leave, profit sharing bonuses etc. (payable within 12 months of the year-end) and non-monetary benefits for current employees.

<table>
<tr><td></td><td colspan="2">(b) Post-employment benefits (e.g., gratuity, pension, provident fund, post employment medical care etc.).
(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)</td></tr>
<tr><td colspan="3">Short Term Employee Benefits</td></tr>
<tr><td>Meaning</td><td colspan="2">These benefits (other than termination benefits) are payable within 12 months after the end of the period in which the service is rendered.
Accounting for these benefits is generally straightforward because no actuarial assumptions are required to measure the obligation or cost.</td></tr>
<tr><td>Categories</td><td colspan="2">➢ regular period benefits (e.g., wages, salaries)
➢ short-term compensated absences (e.g., paid annual leave, maternity leave, sick leave etc.)
➢ profit sharing and bonuses payable within 12 months after the end of the period in which employee render the related services and
➢ non-monetary benefits (e.g., medical care, housing, cars etc.</td></tr>
<tr><td>Recognition</td><td colspan="2">➢ The general criteria is that an enterprise should recognize as an expense (unless another AS permits a different treatment) the undiscounted amount of all short-term employee benefits attributable to services that been already rendered in the period.
➢ Any difference between the amount of expenses so recognized and cash payments made during the period should be treated as a liability or prepayment (asset) as appropriate.
There are further requirements in respect of short-term compensated absences and profit sharing and bonus plans.</td></tr>
<tr><td rowspan="2">Short Term Compensated Absences</td><td rowspan="2">Accumulating</td><td>Those that are carried forward and can be used in future periods if the current period's entitlement is not used in full. These may be
a) Vesting: those that are carried forward and can be used in future periods if the current period's entitlement is not used in full.
b) Non Vesting: It implies that when employees are not entitled to a cash payment for unused entitlement on leaving. An obligation arises as employees render service that increases their entitlement to future compensated absences.</td></tr>
<tr><td>➢ The expected cost should be recognized when employees render the service that increase their entitlement to future compensated absences.
➢ 'An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date'.</td></tr>
</table>

<table>
<tr><td rowspan="2"></td><td></td><td>➢ No distinction should be made between vesting and non-vesting entitlements. However, in measuring non-vesting entitlements, the possibility of employees leaving the enterprise before receiving them should be taken into account.</td></tr>
<tr><td>Non Accumulating</td><td>These do not carry forward and are not directly linked to the services rendered by employees in the past (e.g., maternity leave). Therefore, an enterprise recognizes no liability or expense until the time of the absence.
In other words, the cost of non-accumulating absences should be recognized as and when they arise.</td></tr>
<tr><td>Profit Sharing and Bonus Plans</td><td colspan="2">Recognition of expenses for profit sharing and bonus plans would depend on fulfillment of conditions mentioned in the standard. The conditions are:
○ Enterprise has a present obligation to make such payments as a result of past events; and
○ Reliable estimate of the obligation can be made.
The 2nd condition can be satisfied only when the profit sharing and bonus plans contained a formula for determining the amount of benefit.
The enterprise should recognize the expected cost of profit sharing and bonus payments in the financial statements.

Example
A profit-sharing plan requires an enterprise to pay a specified proportion of its net profit for the year to employees who serve throughout the year. If no employees leave during the year, the total profit-sharing payments for the year will be 3% of net profit. The enterprise estimates that staff turnover will reduce the payments to 2.5% of net profit.
The enterprise recognises a liability and an expense of 2.5% of net profit.</td></tr>
<tr><td colspan="3">Post Employment Benefits</td></tr>
<tr><td colspan="3">The accounting treatment and disclosures required for a post-employment benefit plan depend upon whether it is a defined contribution or a defined benefit plan</td></tr>
<tr><td>Defined Contribution Plans (DCP)</td><td colspan="2">These are post-employment benefit plans under which an enterprise pays fixed contributions into a separate fund and will have no obligation to pay further contributions.
Under defined contribution plans, actuarial risk (that benefits will be less than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the employee.
<u>Example</u>: Provident Fund</td></tr>
<tr><td>Defined Benefit Plans (DBP)</td><td colspan="2">These are post-employment benefit plans other than defined contribution plans. In defined benefits plans, the actuarial and investment risk fall on the employer.
In defined contribution plans, the contribution is charged to income statement, whereas in defined benefit plans, detailed actuarial calculation is performed to determine the charge</td></tr>
</table>

<u>Is Gratuity Scheme DCP or DBP?</u>

An enterprise may pay insurance premiums to fund a post-employment benefit plan. The enterprise should treat such a plan as a defined contribution plan unless the enterprise will have an obligation to either:

(a) pay the employee benefits directly when they fall due; or
(b) pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods

Accounting Treatment	In the Balance Sheet of the enterprise, 'the amount recognized as a defined benefit liability should be the net total of the following amounts: (a) the present value of defined benefit obligation at the balance sheet date (b) minus any past service cost not yet recognized (c) minus the fair value at the balance sheet date of plan assets (if any) out of which the obligations are to be settled directly.' In case where fair value of plan assets is high, it may so happen that the net amount under defined benefit liability turns negative (giving rise to net assets). AS 15 states that the enterprise, in such a situation, should measure the resulting asset at the lower of: a) the amount so determined; and b) the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan The recognition of expenses relating to defined benefits in the Statement of Profit and Loss is stated in Para 61 of the Standard. The Standard identifies seven components of defined employee benefit costs: (a) current service cost; (b) interest cost; (c) the expected return on any plan assets (and on any reimbursement rights); (d) actuarial gains and losses (to the extent they are recognized); (e) past service cost (to the extent they are recognized); (f) the effect of any curtailments or settlements;* and (g) the extent to which the negative net amount of defined benefit liability exceeds the amount mentioned in Para 59(b) of the Standard *A settlement occurs when an employer enters into a transaction that eliminates all further legal or constructive obligations for part or whole of the benefits provided under a defined benefit plan. <u>*For example*</u>, the commuted portion of pension. A curtailment occurs when an employer either commits to reduce the number of employees covered by a plan or reduces the benefits under a plan. The gains or losses on the settlement or curtailment of a defined benefit plan should be recognized when the settlement or curtailment occurs.
Actuarial Assumptions	The actuarial assumptions should be unbiased and mutually compatible. They are an enterprise's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits. They should be neither imprudent nor excessively conservative and should reflect the economic relationships between factors such as inflation, rates of salary increase, return on plan assets and discount rates.

	AS 15 explains that actuarial assumptions comprise: (a) *demographic assumptions* about the future characteristics of current and former employees (and their dependents) who are eligible for benefits. Demographic assumptions deal with matters such as: • mortality, both during and after employment; • rates of employee turnover, disability and early retirement • the proportion of plan members with dependents who will be eligible for benefits; • claim rates under medical plans; and (b) *financial assumptions*, dealing with items such as: • the discount rate • future salary and benefit levels • in the case of medical benefits, future medical costs, including, where material, the cost of administering claims and benefit payments and • the expected rate of return on plan assets
Actuarial Gains and Losses	Actuarial gains and losses comprise: • experience adjustments (the effects of difference between the previous actuarial assumptions and what has actually occurred); and • the effects of changes in actuarial assumptions. Actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense.

Other Long Term Employee Benefits

Other long-term employee benefits include, for example:

(a) long-term compensated absences such as long-service or sabbatical leave;
(b) jubilee or other long-service benefits;
(c) long-term disability benefits;
(d) profit-sharing and bonuses payable twelve months or more after the end of the period in which the employees render the related services and
(e) deferred compensation paid 12 months or more after end of period in which it is earned

Termination Benefits

Termination Benefits are employee benefits payable as a result of either an enterprise's decision to terminate an employee's employment before the normal retirement date or an employee's decision to accept voluntary redundancy in exchange for those benefits (e.g., payments under VRS).

Termination benefits are recognized by an enterprise as a liability and an expense only when the enterprise has

(a) a detailed formal plan for the termination which is duly approved, and
(b) a reliable estimate can be made of the amount of the obligation.

Where the termination benefits fall due within twelve months after the balance sheet date, an undiscounted amount of such benefits should be recognized as liability in the balance sheet with a corresponding charge to Profit & Loss Account. However, when the termination benefits fall due more than 12 months after the balance sheet date, such benefits should be discounted using an appropriate discount rate. Where an offer has been made to encourage voluntary redundancy, the termination benefits should be measured by reference to the number of employees expected to accept the offer.

Where there is uncertainty with regard to the number of employees who will accept an offer of voluntary redundancy, a contingent liability exists and should be so disclosed as per AS 29 'Provisions, Contingent Liabilities and Contingent Assets'.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

Entity XY is required to pay salary of ₹ 2 crore for the year 2021-22. It actually paid a salary of ₹ 1.90 crore up to 31st March 2022, and balance in April 2022. Determine the actual costs to be recognized in the year 2021-22 and any amounts to be shown through balance sheet.

Solution:

Total expense for the year (2021-22)	₹ 2 crore
Amount to be shown under liability (unpaid)	₹ 2 crore – 1.90 ₹crore = ₹ 10 lakhs

Question 2 *(ICAI Study Material)* *Pg no._____*

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.

Solution:

As 15 defines 'Short-term' benefits as employee benefits (other than termination benefits) which fall due wholly within twelve months after the 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 period in 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 "expected to occur". In other words, where employees are entitled to earned leave which can be carried forward to future periods, the benefit would be a 'short-term benefit' provided the employee is entitled to either encash or utilise the benefit during the 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 forward during 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 be determined without discounting and if the benefit is determined as long-term, it would be recognised and measured as "Other long-term benefits" in accordance with 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 3 *(ICAI Study Material)* *Pg no._____*

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 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:

a. 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.
b. 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.

Solution:

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 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,

(a) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15 (Revised).
(b) 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 according to actuarial valuation.
(c) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

Question 4 *(ICAI Study Material)* *Pg no._____*

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 on the following items from the viewpoint of finalization of accounts, taking note of the mandatory accounting standards.

Solution:

According to AS 15 'Employee Benefits', actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense.

Therefore, surplus amount of ₹ 6 lakhs is required to be credited to the profit and loss statement of the current year.

Question 5 *(ICAI Study Material)* *Pg no._____*

The following data apply to 'X' Ltd. defined benefit pension plan for the year ended 31.03.2022 calculate the actual return on plan assets:

- Benefits paid	2,00,000
- Employer contribution	2,80,000
- Fair market value of plan assets on 31.03.2022	11,40,000
- Fair market value of plan assets as on 31.03.2021	8,00,000

Question 6 *(ICAI Study Material)* *Pg no._____*

As on 1st April, 2021 the fair value of plan assets was ₹ 1,00,000 in respect of a pension plan of Zeleous Ltd. On 30th September, 2021 the plan paid out benefits of ₹ 19,000 and received inward contributions of ₹ 49,000. On 31st March, 2022 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 2021- 2022 were ₹ 600.

On 1st April, 2021, 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.

Question 7 *(ICAI Study Material)* *Pg no._____*

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 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.

Rock Star Ltd. estimates the share of unamortized service cost that relates to the part of the obligation at ₹18 (10% of ₹180). Calculate gain from curtailment and liability after curtailment to be recognised in the 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 current actuarial 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.

Solution:

Gain from curtailment is estimated as under:

	₹
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 estimated as 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 8 *(ICAI Study Material)* *Pg no._____*

An employee Roshan has joined a company XYZ Ltd. in the year 2021. The annual emoluments of Roshan as decided is ₹ 14,90,210. The company also has a policy of giving a lump sum payment of 25% of the last drawn 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 complete the minimum five year term before retiring. Thus he will get 5 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)

PRACTICE QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

What are the types of Employees benefits and what is the objective of Introduction of this Standard i.e. AS 15?

Solution:

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 by an employer to pay for medical care of its employees), paid annual leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, 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 life insurance and post-employment medical 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
d) 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:

i. a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and
ii. an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Question 2 *(ICAI Study Material)* *Pg no._____*

In case an enterprise allows unutilised employee benefits, e.g., medical care, leave travel, etc., to be carried forward, whether it is required to recognise a provision in respect of carried forward benefits.

Solution:

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 the cost of such benefit the probability of the employee availing such benefit should be considered.

Question 3 *(ICAI Study Material)* *Pg no._____*

Whether an enterprise is required to provide for employee benefits arising from informal practices?

Solution:

AS 15 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 determining whether 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 bargaining process and not during any informal process. If the employer has not set a pattern of benefits that can be projected reliably to give rise to an obligation there is no requirement to provide for 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 benefits should be included in the measurement of the benefit obligation.

Question 4 *(ICAI Study Material)* *Pg no._____*

The fair value of plan assets of Anupam Ltd. was ₹ 2,00,000 in respect of employee benefit pension plan as on 1st April, 2021. On 30th September, 2021 the plan paid out benefits of ₹ 25,000 and received inward contributions of ₹ 55,000. On 31st March, 2022 the fair value of plan assets was ₹ 3,00,000. On 1st April, 2021 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, 2022, as per AS 15.

Solution:

Computation of Expected Returns on Plan Assets as on 31st March, 2022, as per AS 15

	₹
Return on opening value of plan assets of ₹ 2,00,000 (held for the year) @ 10.25%	20,500
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, 2022	22,000

Computation of Actual Returns on Plan Assets as on 31st March, 2022, as per AS 15

	₹	₹
Fair value of Plan Assets as on 31st March, 2022		3,00,000
Less: Fair value of Plan Assets as on 1st April, 2021	2,00,000	
Contribution as on received as 30th September, 2021	55,000	(2,55,000)
		45,000
Add: Benefits paid as on 30th September, 2021		25,000
Actual returns on Plan Assets as on 31st March 2022		70,000

BORROWING COSTS

AS 16

Objective	✓ The objective is accounting for borrowing costs. It does not deal with the actual or imputed cost of owner's equity including preference share capital not classified as liability.
Meaning	✓ These are the interest and other costs incurred by an enterprise in connection with the borrowing of funds.
Inclusions	✓ It includes the following: ❖ Interest & related charges on bank borrowings (short term & long term) ❖ amortization of discounts or premiums relating to borrowings ❖ amortization of ancillary costs incurred ❖ finance charges in respect of assets acquired under finance leases ❖ exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Capitalisation of 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.
These are treated as directly attributable when such borrowing costs would have been avoided if the expenditure on the qualifying asset have not been made. Determination of such directly attributable amount is an exercise of judgement.
Borrowing cost on any item other than the qualifying asset should be written off in the P&L A/c in the period in which they are incurred.
To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the <u>*actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.*</u>
To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditure on that asset. The capitalisation 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. The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.

QUALIFYING ASSETS

Meaning	✓ A qualifying asset is an asset (tangible or intangible) that necessarily takes a substantial period of time to get ready for its intended use or sale.
Substantial Period	✓ Substantial period of time depends on the facts & circumstances of each case. However, a period of 12 months may be considered a substantial period of time unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case

Inclusions	✓ Following assets take >= 12 months to get ready to use : ❖ Assets that are constructed for own use of enterprise like manufacturing plants, power generation facilities, etc. ❖ Inventories where time is major factor to bring a change in their condition e.g. Liquor & Timber ❖ Investment Properties (Building meant for capital appreciation and earning rental income)
Exclusions	✓ Assets that are ready for intended use when acquired are not qualifying asset.

COMMENCEMENT OF CAPITALISATION

The capitalisation of borrowing costs should commence when all the following conditions are satisfied:

- expenditure for acquisition, construction or production of a qualifying asset is being incurred
- borrowing costs are being incurred
- activities that are necessary to prepare the asset for its intended use or sale are in progress.

SUSPENSION OF CAPITALISATION

General Rule	✓ Capitalisation of borrowing costs should be suspended during extended periods in which active development is interrupted.
Exception	✓ Capitalisation of borrowing costs is not normally suspended during period when substantial technical and administrative work is being carried out. ✓ When a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example: Capitalisation continues during extended period needed for inventories to mature or the extended period during which high water levels delay construction of a bridge, if such high water levels are common during construction period in the geographic region involved.

CESSATION OF CAPITALISATION

- Capitalisation 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
- Construction in Parts: 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 of that part are complete.

DISCLOSURE REQUIREMENTS

The financial statements should disclose:

- the accounting policy adopted for borrowing costs
- the amount of borrowing costs capitalised during the period.

ASSIGNMENT QUESTIONS

Question 1 Pg no.____

X Limited began construction of a new plant on 1st April 2021 and obtained a special loan of 8 lakhs to finance the construction of the plant. The rate of interest on loan was 10 % per annum. The expenditure that was made on the construction project of plant was as follows:

Date	Amount (in ₹)
1st April 2021	10,00,000
1st August 2021	24,00,000
1st January 2022	4,00,000

The Company's other outstanding non - specific loan was ₹ 46,00,000 at an interest of 12% p.a. The construction of the plant was completed on 31-3-2022.
Calculate the amount to be capitalized including amount of interest as per provision of AS 16.

Question 2 *(ICAI Study Material)* Pg no.____

X Ltd. began construction of a new building on 1st January, 2021. It obtained ₹ 1 lakh special loan to finance the construction of the building on 1st January, 2021 at an interest rate of 10%. The company's 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:

Month	Amount (in ₹)
January 2021	2,00,000
April 2021	2,50,000
July 2021	4,50,000
December 2021	1,20,000

Building was completed by 31st December, 2021. Following the principles prescribed in AS 16 'Borrowing Cost,' calculate the amount of interest to be capitalized and pass one Journal Entry for capitalizing the cost and borrowing cost in respect of the building.

Question 3 Pg no.____

Small Limited began construction of a building on 1st April, 2021 which is expected to cost ₹ 25,00,000. The construction of the building was financed through a special loan of ₹ 5,00,000 obtained at an interest rate of 10% per annum on 1st April, 2021. Further, expenditure on the building was financed through other non-specific finance arrangements of the company. Details of non-specific finance arrangements are as under:

Amount	Rate of Interest
₹ 30,00,000	12% p.a.
₹ 20,00,000	15% p.a.

Cumulative expenses incurred on the building were as follows:

	₹
1st April, 2021	5,00,000
1st July, 2021	13,00,000
1st November, 2021	20,00,000
31st January, 2022	25,00,000

Construction of the building was completed on 31st March, 2022. Following the principles specified in AS 16 'Borrowing Cost', calculate the amount of interest to be capitalized.

Question 4 — *(Inter May 2022) (5 Marks)* Pg no._____

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:

	₹
1st April,2021	10,00,000
1st April,2021	24,00,000
1st January,2022	4,00,000

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:

a) Calculate the amount of interest to be capitalized as per the provisions of AS 16 "Borrowing Cost".

b) Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant.

Solution:

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
Add: Amount of interest to be capitalized (W.N.)	3,24,000
	41,24,000

Journal Entry

		₹	₹
31st,	Plant A/c	41,24,000	
March	To Bank A/c		41,24,000
2022	[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 x 8 x12%)/12	1,12,000
1st January, 2022	4,00,000	On non-specific borrowings	₹ (4,00,000 x 3 x 12%)/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	10,00,000
	14,00,000 x 8/12	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
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 amount had been utilized in parts.

Question 5 *Pg no._____*

ABC Limited has started construction of an asset on 1st December, 2020, which continues till 31st March, 2021 (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 2020 and ₹ 4 lakh in each of the months of January to March 2021.
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, 2021. Interest was paid on the overdraft at 10% until 1st January, 2021 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'

Question 6 *(ICAI Study Material) (Similar)* *Pg no._____*

GHI Limited obtained a loan for ₹ 70 lakhs on 15th April, 2021 from JKL Bank, to be utilized as:

Particulars	Amount (in ₹ Lakhs)
Construction of Factory shed	25
Purchase of Machinery	20
Working capital	15
Advance for purchase of Truck	10

In March 2022, construction of the factory shed was completed and machinery, which was ready for its intended use, was installed. Delivery of Truck was received in the next financial year. Total interest of ₹ 9,10,000 was charged by the bank for the financial year ending 31-03-2022. Show the treatment of interest under AS 16 and also explain the nature of Assets.

Question 7 *(RTP May 2020) (Similar)* *Pg no._____*

Suhana Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.05.2021, to be utilized as:

Particulars	Amount (in ₹ Lakhs)
Construction of Factory shed	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's 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. Show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

Question 8 *(RTP May 2019)* Pg no._____

M/s. Zen Bridge Construction Limited obtained a loan of ₹ 64 crores to be utilized as under:

S. No.	Particulars	Amount (in ₹)
1.	Construction of Hill link road in Kedarnath:(work was held up totally for a month during the year due to heavy rain which are common in the geographic region involved)	50 crores
2.	Purchase of equipments and machineries	6 crores
3.	Working capital	4 crores
4.	Purchase of vehicles	1 crore
5.	Advance for tools/cranes etc.	1 crore
6.	Purchase of technical know-how	2 crores
7.	Total interest charged by bank for year ending 31st March, 2022	1.60 crores

Show the treatment of interest according to Accounting Standard by M/s. Zen Bridge Construction Limited.

Question 9 Pg no._____

Rohini Limited has obtained loan from an Institution for ₹ 500 lacs for modernization and renovation of its plant and machinery. The installation of plant and machinery was completed on 31.3.2022 amounting to ₹ 320 lacs and ₹ 50 lacs were advanced to suppliers of additional assets and the balance of ₹ 130 lacs has been utilized for working capital requirements. Total interest paid for the above loan amounted to ₹ 65 lacs during 2021-22.

You are required to state how the interest on institutional loan is to be accounted for in the year 2021-22.

Question 10 Pg no._____

Raj & Co. has taken a loan of US$ 20,000 at the beginning of the financial year for a specific project at an interest rate of 6% per annum, payable annually. On the day of taking loan, the exchange rate between 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.

Question 11 Pg no._____

XYZ Ltd. has taken a loan of US$20,000 on April 1, 2021 for a specific project at 5% payable annually. On April 1, 2021 the exchange rate between the currencies was ₹ 40 per US$. The exchange rate as at March 31, 2022 is ₹ 43 per US$.

Calculate the amount of exchange difference arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs, if the corresponding amount could have been borrowed by XYZ Ltd. in local currency at an interest rate of

(a) 11% p.a. and
(b) 13% p.a. as on April 1, 2021

Question 12 *(RTP Nov 2020) (Similar) / (ICAI Study Material)* Pg no._____

Rainbow Limited borrowed an amount of ₹ 150 crores on 1.4.2021 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 is 13% p.a., the accountant of Rainbow Ltd. capitalized ₹ 19.50 crores for the accounting period ending on 31.3.2022. Due to surplus fund out of ₹ 150 crores, income of ₹ 3.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant AS.

Solution

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 capitalisation 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 capitalisation 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. Hence, in the above case, treatment of accountant of Rainbow Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2021-2022 should be calculated as follows

	₹ in crores
Actual Interest for 2021-22 (11% of 150 crores)	16.50
Less: Income on temporary investment from specific borrowings	(3.50)
Borrowing costs to be capitalized during year 2021-22	13.00

Question 13 *(RTP Nov 2018)* Pg no._____

A company incorporated in June 2021, 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. 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.

Solution

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, Explanation to the above para 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 justified 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.

The above paras imply 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 conclusive yardstick. It may so happen that an asset under normal circumstances may take more than 12 months to 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 14 *(ICAI Study Material)* *Pg no._____*

Take Ltd. has borrowed ₹ 30 lakhs from State Bank of India during the financial year 2021-22. The borrowings 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, 2022, since the said project was not complete, the directors of Take Ltd. resolved to capitalize the interest accruing on borrowings amounting to ₹ 4 lakhs and add it to the cost of investments. Comment

Solution

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 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, 2022.

Question 15 *(RTP May 2022)* *Pg no._____*

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 level of 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?

Solution:

As per AS 16 Borrowing Costs "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". 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 stage at 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 all the activities necessary to prepare the asset are complete. Thus, the borrowing cost incurred during the normal period of test runs (after the installation) are required to be capitalized.

Question 16 (RTP Nov 2022) / (ICAI Study Material) Pg no._____

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	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.

Solution:

	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
5.	Total loan	2,00,00,000
6.	Interest on loan used for Phases I & II, based on proportionate Loan amount = (30,00,000*98,00,000)/2,21,00,000 =	13,30,317 (approx.)
7.	Interest on loan used for Phases III & IV, based on proportionate Loan amount	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 ₹ 6,65,158.50 (i.e. ₹ 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 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.

2. 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 till assets construction work is completed, and thereafter capitalized in the ratio of cost of assets. No part of this interest amount should be charged/expensed off during the year since the work on these phases has not been completed yet.

PRACTICE QUESTIONS

Question 1 Pg no.______

Axe Limited began construction of a new plant on 1st April, 2021 and obtained a special loan of ₹ 4,00,000 to finance the construction of the plant. The rate of interest on loan was 10%. The expenditure that were made on the project of plant were as follows:

Date	Amount (in ₹)
1st April 2021	5,00,000
1st August 2021	12,00,000
1st January 2022	2,00,000

The company's other outstanding non-specific loan was ₹ 23,00,000 at an interest rate of 12%. The construction of the plant completed on 31st March, 2022. You are required to:
(a) Calculate amount of interest to be capitalized as per provisions of AS 16 "Borrowing Cost".
(b) Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant.

Solution

Total expenses to be capitalized for Plant

Cost of Plant ₹ (5,00,000+12,00,000+2,00,000)	19,00,000
Add: Amount of interest to be capitalized	1,54,000
	20,54,000

Journal Entry

Date	Particulars	L.F.	Dr.	Cr.
31.03.2022	Plant account Dr.		20,54,000	
	To Bank account			20,54,000
	(Being amount of cost of Plant and borrowing cost thereon capitalized)			

Working Note: Computation of average accumulated expenses

5,00,000 x 12 / 12	5,00,000
12,00,000 x 8/ 12	8,00,000
2,00,000 x 3 / 12	50,000
	13,50,000

Interest on average accumulated expenses

Specific borrowings (₹ 4,00,000 x 10%)	40,000
Non-specific borrowings (₹ 9,50,000* x 12.00%)	1,14,000
Amount of interest to be capitalized	1,54,000

*(₹ 13,50,000 – ₹ 4,00,000)

Question 2 Pg no.______

G Ltd. began construction of a new building on 1st January, 2021. It obtained ₹ 1 lakh special loan to finance the construction of the building on 1st January, 2021 at an interest rate of 11%. The company's other outstanding two non-specific loans were:

Amount	Rate of Interest
₹ 3,00,000	12%
₹ 7,00,000	14%

The expenditures that were made on the building project were as follows

	₹
January 2021	1,60,000
May 2021	2,70,000

August 2021	4,20,000
December 2021	1,50,000

Building was completed by 31st December, 2021. Following the principles prescribed in AS 16 'Borrowing Cost,' calculate the amount of interest to be capitalized and pass one Journal Entry for capitalizing the cost and borrowing cost in respect of the building.

Solution

Computation of average accumulated expenses

1,60,000 x 12 / 12	1,60,000
2,70,000 x 8/ 12	1,80,000
4,20,000 x 5 / 12	1,75,000
1,50,000 x 1 / 12	12,500
	5,27,500

Calculation of average interest rate other than for specific borrowings

Amount of loan	Rate of Interest	Amount of interest
3,00,000	12%	36,000
7,00,000	14%	98,000
10,00,000		1,34,000
Weighted average rate of interest {(1,34,000/ 10,00,000) x 100}		13.40%

Interest on average accumulated expenses

Specific borrowings (₹ 1,00,000 x 11%)	11,000
Non-specific borrowings (₹ 4,27,500* x 13.40%)	57,285
Amount of interest to be capitalized	68,285

*(₹ 5,27,500 – ₹ 1,00,000)

Total expenses to be capitalized for building

Cost of building ₹(1,60,000+2,70,000+4,20,000+1,50,000)	10,00,000
Add: Amount of interest to be capitalized	68,285
	10,68,285

Journal Entry

Date	Particulars	L.F.	Dr.	Cr.
31.12.2021	Building account Dr.		10,68,285	
	To Bank account			10,68,285
	(Being amount of cost of building and borrowing cost thereon capitalized)			

Question 3 *(Inter May 2019) (5 Marks)* Pg no._____

First Ltd. began construction of a new factory building on 1st April, 2021. It obtained ₹ 2,00,000 as a special loan to finance the construction of the factory building on 1st April, 2021 at an interest rate of 8% per annum. Further, expenditure on construction of the factory building was financed through other non-specific loans.

Details of other outstanding non-specific loans were:

Amount	Rate of Interest p.a.
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
1st April, 2021	3,00,000
31st May, 2021	2,40,000

1st August, 2021	4,00,000
31st December, 2021	3,60,000

The construction of factory building was completed by 31st March, 2022.
As per the provisions of AS 16, you are required to:
(1) Calculate the amount of interest to be capitalized.
(2) Pass Journal entry for capitalizing cost & borrowing cost in respect of factory building

Solution

Computation of average accumulated expenses

3,00,000 x 12 / 12	3,00,000
2,40,000 x 10/ 12	2,00,000
4,00,000 x 8 / 12	2,66,667
3,60,000 x 3 / 12	90,000
	8,56,667

Calculation of average interest rate other than for specific borrowings

Amount of loan	Rate of Interest	Amount of interest
4,00,000	9%	36,000
5,00,000	12%	60,000
3,00,000	14%	42,000
12,00,000		1,38,000
Weighted average rate of interest {(1,38,000/ 12,00,000) x 100}		11.50%

Interest on average accumulated expenses

Specific borrowings (₹ 2,00,000 x 8%)	16,000
Non-specific borrowings (₹ 6,56,667* x 11.50%)	75,517
Amount of interest to be capitalized	91,517

*(₹ 8,56,667 – ₹ 2,00,000)

Total expenses to be capitalized for building

Cost of building ₹(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	L.F.	Dr.	Cr.
31.03.2022	Building account Dr.		13,91,517	
	To Building WIP A/c*			13,00,000
	To Borrowing Costs A/c			91,517
	(Being amount of cost of building and borrowing cost thereon capitalized)			

*Considering that ₹ 13,00,000 was debited to Building WIP A/c earlier.

Question 4 ***(RTP May 2023)*** *Pg no._____*

Expert Limited issued 12% secured debentures of ₹ 100 lakhs on 01.06.2021. Money raised from debentures to be utilized as under:

Intended Purpose	Amount (₹ in lakhs)
Construction of factory building	40
Purchase of Machinery	15
Working Capital	30
Purchase of Furniture	2
Purchase of Truck	13

Additional Information:
(i) Interest on debentures for the Financial Year 2021-2022 was paid by the Company.
(ii) During the year, the company invested idle fund of ₹ 5 lakhs (out of the money raised from debentures) in Bank's fixed deposit and earned interest of ₹ 50,000.
(iii) In March, 2022 construction of factory building was not completed (it is expected that it will take another 6 months).
(iv) In March 2022, Machinery was installed and ready for its intended use.
(v) Furniture was put to use at the end of March 2022.
(vi) 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 the year ended 31st March, 2022 in the Books of Expert Limited.

Solution

According to 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. As per the Standard, 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. The amount of 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 P&L A/c
Construction of factory building	Qualifying Asset	9,50,000x40/100 = 3,80,000	Nil
Purchase of Machinery	Not a Qualifying Asset	Nil	9,50,000x15/100 = 1,42,500
Working Capital	Not a Qualifying Asset	Nil	9,50,000x30/100 = 2,85,000
Purchase of Furniture	Not a Qualifying Asset	Nil	9,50,000x2/100 = 19,000
Purchase of Truck	Not a Qualifying Asset	Nil	9,50,000x13/100 = 1,23,500
		3,80,000	5,70,000

Question 5 *(Inter Nov 2020) (5 Marks)* Pg no._____

On 15th April, 2021 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, 2022 construction of shed was completed & machinery was installed. Total interest charged by the bank for the year ending 31st March, 2022 was ₹ 40 lakhs. In the context of provisions of AS 16, show the treatment of interest and also explain the nature of Assets

Solution

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 also are 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 & related borrowing cost will be charged to P&L A/c.

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, 2022.

Question 6 *(ICAI Study Material)* Pg no.______

On 1st April, 2021, Amazing Construction Ltd. obtained a loan of ₹ 32 crores to be utilized as:-

S. No.	Particulars	Amount (in ₹)
1.	Construction of sealink across two cities:(work was held up totally for a month during the year due to high water levels)	25 crores
2.	Purchase of equipments and machineries	3 crores
3.	Working capital	2 crores
4.	Purchase of vehicles	50 Lakhs
5.	Advance for tools/cranes etc	50 Lakhs
6.	Purchase of technical know-how	1 crore
7.	Total interest charged by bank for year ending 31st March, 2022	80 Lakhs

Show the treatment of interest by Amazing Construction Ltd.

Solution

Treatment of Interest (Borrowing cost) as per AS 16 'Borrowing Costs'

Particulars	Whether Q.A.	Interest to be capitalized	Interest to be charged to P&L A/c
Construction of sealink across 2 cities	Yes	80,00,000*25/32= 62,50,000	
Purchase of equipments & machineries	No		80,00,000*3/32= 7,50,000
Working capital	No		80,00,000*2/32= 5,00,000
Purchase of vehicles	No		80,00,000*0.5/32= 1,25,000
Advance for tools/cranes etc	No		80,00,000*0.5/32= 1,25,000

Purchase of technical know-how	No		80,00,000*1/32= 2,50,000
		62,50,000	17,50,000

Notes:

As per AS 16, assets have been defined as 'qualifying asset' and 'non-qualifying asset'.

a) Qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale; whereas,

b) Non-qualifying asset is an asset which is ready for its intended use or sale at the time of its acquisition.

c) As per AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets should be capitalized as part of the cost of that asset. Other borrowing costs are recognized as expense in the period in which they are incurred.

d) 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.

Question 7 *(ICAI Study Material)* Pg no._____

The company has obtained Institutional Term Loan of ₹ 580 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 2022 amounted to ₹ 406 lakhs, ₹ 58 lakhs has been advanced to 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 2021-2022 on the entire Institutional Term Loan of ₹ 580 lakhs.

Solution

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. 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:

Particulars	Whether Qualifying Asset	Interest to be capitalized	Interest to be charged to P&L A/c
Modernisation and renovation of plant and machinery	Yes	52.20*406/580 = 36.54	
Advance to supplies for additional assets	Yes	52.20*58/580 = 5.22	
Working capital	No		52.20*116/580 = 10.44
		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 account for year ended 31st March, 2022.

Question 8 *(RTP May 2021)* *Pg no._____*

Shan Builders 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, exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2022 ₹ 62 per US $. If Shan Builders Limited borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%. Compute Borrowing Cost & exchange difference for the year ending 31st March, 2022 as per applicable Accounting Standards.

Solution

a) Interest for the period 2021-22 = US$ 10 lakhs x 4% × ₹ 62 per US$ = ₹24.80 lakhs
b) Increase in liability towards the principal amount = US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs
c) Interest that would have resulted if the loan was taken in Indian currency = US$ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs
d) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 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 ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

Question 9 *(RTP May 2023)* *Pg no._____*

ABC Builders Limited had borrowed a sum of US $ 15,00,000 at the beginning of Financial year 2021-22 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, 2022 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, 2022 as per applicable Accounting Standards. (Applicable LIBOR is 1%).

Solution

(i) Interest for the period 2021-22 = US $ 15 lakhs x 5% × ₹ 76 per US $ = ₹ 57 lakhs
(ii) Increase in liability towards 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% = ₹ 102.6 lakhs
(iv) Difference between interest on local currency borrowing and foreign currency borrowing= ₹ 102.6 lakhs - ₹ 57 lakhs = ₹ 45.6 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 10 *(RTP May 2018) / (RTP Nov 2019) / (RTP Nov 2021)* *Pg no._____*

In May, 2021, Capacity Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2022 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 ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2022 amounted to ₹ 25 lakhs.

Can ₹ 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

Solution

According to AS 16 'Borrowing Costs', capitalisation of borrowing costs should cease when substantially all the activities to prepare the qualifying asset for its intended use or sale are completed.

In the given case, since the qualifying asset was ready to use in January, 2022, therefore, interest till that date can only be capitalized. Hence, interest of ₹ 18 lakhs will only be capitalized. The balance of ₹ 7 lakhs (i.e. 25-18) will be debited to Profit and Loss Account.

Question 11 *Pg no._____*

A company capitalizes interest cost of holding investments and adds to cost of investment every year, thereby understating interest cost in profit and loss account. Comment on the accounting treatment done by the company in context of the relevant AS.

Solution

Investments other than investment properties are not qualifying assets as per AS-16 Borrowing Costs. Therefore, interest cost of holding such investments cannot be capitalized. Further, even interest in respect of investment properties can only be capitalized if such properties meet the definition of qualifying asset, namely, that it necessarily takes a substantial period of time to get ready for its intended use or sale. Also, where the investment properties meet the definition of 'qualifying asset', for the capitalization of borrowing costs, the other requirements of the standard such as that borrowing costs should be directly attributable to the acquisition or construction of the investment property and suspension of capitalization have to be complied with.

Question 12 *(RTP May 2022)* *Pg no._____*

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?

Solution:

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 physical construction 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 13 - *(ICAI Study Material)* Pg no._____

H Ltd. incurs borrowing costs for the purpose of construction of a qualifying asset for its own use. The construction gets completed on May 31, 2023. However, decoration work is under process which is expected to be completed by November 2023 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 2023.

Solution:

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, 2023. The borrowing cost incurred thereafter cannot be capitalized as the asset was ready for its intended use on May 31, 2023. The fact that decoration work was being carried out should not be considered as the asset was ready for its intended use on May 31, 2023

Question 14 *(ICAI Study Material)* Pg no._____

ABC Ltd. is in the process of getting an entertainment park constructed. For this purpose, it has taken loan 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 public, while construction on the remaining part is continuing. Whether the capitalization of borrowing cost should continue for whole park until construction continues?

Solution:

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.

SEGMENT REPORTING

AS 17

Objective	To establish principles for reporting financial information, about the different types of products and services an enterprise produces and the different geographical areas in which it operates. Such information helps users of financial statements: (a) better understand the performance of the enterprise; (b) better assess the risks and returns of the enterprise; and (c) make more informed judgements about the enterprise as a whole
Business segment	A distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. *Factors that should be considered in determining whether products or services are related include:* (a) the nature of the products or services; (b) the nature of the production processes; (c) the type or class of customers for the products or services; (d) the methods used to distribute the products or provide services; and (e) if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.
Geographical segment	A distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments. *Factors that should be considered in identifying geographical segments include:* (a) similarity of economic and political conditions; (b) relationships between operations in different geographical areas; (c) proximity of operations; (d) special risks associated with operations in a particular area; (e) exchange control regulations; and (f) the underlying currency risks
Reportable segment	A business or a geographical segment identified on the basis of foregoing definitions for which segment information is required to be disclosed by this Standard.
Segment revenue	Aggregate of ✓ the portion of enterprise revenue that is directly attributable to a segment, ✓ the relevant portion of enterprise revenue that can be allocated on a reasonable basis to a segment, and ✓ revenue from transactions with other segments of the enterprise.

	<u>Segment revenue does not include:</u> ☒ extraordinary items as defined in AS 5 ☒ interest or dividend income, including interest earned on advances or loans to other segments unless operations of segment are primarily of a financial nature ☒ Gains on sale of investment or on extinguishment of debt unless operations of segment are primarily of a financial nature
Segment expense	Aggregate of ✓ the expense resulting from the operating activities of a segment that is directly attributable to the segment, and ✓ the relevant portion of enterprise expense that can be allocated on a reasonable basis to the segment, and ✓ expense relating to transactions with other segments of the enterprise. <u>Segment expense does not include:</u> ☒ extraordinary items as defined in AS 5 ☒ interest expense, including interest incurred on advances or loans from other segments, unless operations of the segment are primarily of a financial nature; ☒ income tax expense; and ☒ general administrative expenses, head-office expenses, and other expenses that arise at the enterprise level and relate to the enterprise as a whole.
Segment result	Segment revenue less Segment expense.
Segment assets	Those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment assets do not include income tax assets & assets used for general enterprise or head office purposes
Segment liabilities	Those operating liabilities that result from the operating activities of a segment and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment liabilities do not include income tax liabilities and borrowings and other liabilities that are incurred for financing rather than operating purposes
Identifying Reportable Segments	Primary and Secondary Segment Reporting Formats ➢ The ***<u>dominant source and nature of risks and returns</u>*** of an enterprise should govern whether its primary segment reporting format will be business segments or geographical segments. ➢ If the risks and returns of an enterprise are affected predominantly by differences in the products and services it produces, its primary format for reporting segment information should be business segments, with secondary information reported geographically & vice versa. *Organizational and management structure of an enterprise and its internal financial reporting system normally provide the best evidence of the predominant source of risks and returns of the enterprise for the purpose of its segment reporting*

Identifying Reportable Segments (Quantitative Threshold) (Materiality Test)	A business segment or geographical segment should be identified as a reportable segment if: ➢ its revenue from sales to external customers & from transactions with other segments is 10% or more of total revenue, external & internal, of all segments; or ➢ its segment result, whether profit or loss, is 10 % or more of – (i) the combined result of all segments in profit, or (ii) 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.
Points to remember	❖ A business segment or a geographical segment which is not a reportable segment may be designated as a reportable segment despite its size at the discretion of the management of the enterprise. If that segment is not designated as a reportable segment, it should be included as an unallocated reconciling item. ❖ If total external revenue attributable to reportable segments constitutes < 75% of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10% thresholds until at least 75 % of total enterprise revenue is included in reportable segments. (Overall Test) ❖ A segment identified as a reportable segment in the immediately preceding period because it satisfied the relevant 10% thresholds should continue to be a reportable segment for the current period notwithstanding that its revenue, result, and assets all no longer meet the 10% thresholds
Primary Reporting Format	An enterprise should disclose the following for each reportable segment: ➢ segment revenue, classified into segment revenue from sales to external customers and segment revenue from transactions with other segments; ➢ segment result; ➢ total carrying amount of segment assets; ➢ total amount of segment liabilities; ➢ total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets); ➢ total amount of expense included in the segment result for depreciation and amortization in respect of segment assets for the period; and ➢ total amount of significant non-cash expenses, other than depreciation and amortization in respect of segment assets, that were included in segment expense &, therefore, deducted in measuring segment result.
Secondary Reporting Format	An enterprise should disclose the following for each reportable segment: ➢ segment revenue from sales to external customers ➢ total carrying amount of segment assets; ➢ total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets); Reporting of only those segments is required which fulfill the 10% criterion. (Means reportable segments only)

Other Disclosures	In measuring and reporting segment revenue from transactions with other segments, inter-segment transfers should be measured on the basis that enterprise actually used to price those transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Changes in accounting policies adopted for segment reporting that have a material effect on segment information should be disclosed. Such disclosure should include a description of the nature of the change, and the financial effect of the change if it is reasonably determinable. An enterprise should comply with the requirements of this Standard fully and not selectively. If a single financial report contains both consolidated financial statements and separate financial statements of the parent, segment information need be presented only on the basis of the consolidated financial statements.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* Pg no._____

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.

Question 2 *(ICAI Study Material)* Pg no._____

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.

Question 3 *(ICAI Study Material)* Pg no._____

Microtech Ltd. produces batteries for scooters, cars, trucks, and specialised batteries for invertors and UPS. How many segments should it have and why?

Solution

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'

Question 4 *(ICAI Study Material)* Pg no._____

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.

Solution

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.

Question 5 *(RTP May 2018/Nov 2019/Nov 2020/May 2021/May/Nov 2022 (Sim.)/ICAI Study Material)* *Pg no.____*

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?

Solution

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 intersegment 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 6 *(ICAI Study Material)* *Pg no.____*

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
	10,800
Bright Bar Division	
Sales to Fitting Division	45
Export Sales to Rwanda	300
	345
Fitting Division	
Export Sales to Maldives	270

Particulars	Head Office ₹ ('000)	Forging Shop Division ₹ ('000)	Bright Bar Division ₹ ('000)	Fitting Division ₹ ('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

Question 7 *(RTP Nov 2018) / (ICAI Study Material)* *Pg no.____*

Calculate 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 Transaction from C Transaction from A	 1,00,000 10,000	 50,000 25,000	 50,000 1,00,000	 1,50,000 60,000 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 Transaction from C Transaction from A	 75,000 6,000	 40,000 18,000	 30,000 82,000	 1,05,000 46,000 1,00,000

Question 8 *(RTP May 2019) / (ICAI Study Material)* Pg no._____

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?

Solution

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 of this segment if the thresholds prescribed in the AS 17 are met.

Question 9 *(RTP Nov 2021)* Pg no._____

(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.

Solution

(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 use 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 respect to 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 are similar. This would ensure that the chemicals having significantly different risks and returns are not included in a single business segment.

(b) As per AS 17, "Changes in accounting policies adopted for segment reporting that have a material effect on segment information should be disclosed. Such disclosure should include a description of the nature of the change, and the financial effect of the change if it is 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 10 - *(RTP May 2022) / (ICAI Study Material)* *Pg no._____*

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.

Solution

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 resources between different regions etc., may be considered for the purpose identifying 'urban and 'rural' as separate geographical segment.
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 of that information for assessing the risks and returns of the enterprise."

PRACTICE QUESTIONS

Question 1 *(Inter Nov 2019) (5 Marks)* Pg no._____

Mac Ltd. gives the following data regarding its six segments:

₹ in lakhs

Particulars	A	B	C	D	E	A	Total
Segment Assets	80	160	60	40	40	20	400
Segment Results	100	(380)	20	20	(20)	60	(200)
Segment Revenue	600	1240	160	120	160	120	2,400

The accountant contends that segments 'A' and 'B' alone are reportable segments. Is he justified in his view? Discuss in the context of AS-17 'Segment Reporting'.

Solution

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

(i) 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

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

(1) The combined result of all segments in profit; or

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

(iii) 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,

On the basis of turnover criteria segments A and B are reportable segments.

On the basis of the result criteria, segments A, B and F are reportable segments (since their results in absolute amount are 10% or more of ₹ 400 lakhs).

On the basis of asset criteria, all segments except F are 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. Hence, the opinion of accountant is wrong.

Question 2 *(RTP May 2020) / (RTP May 2023) (Similar)* Pg no._____

The Chief Accountant of Cotton Garments Ltd. 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'.

Solution

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

(i) 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
(ii) Its segment result whether profit or loss is 10% or more of:
(1) The combined result of all segments in profit; or
(2) The combined result of all segments in loss, whichever is greater in absolute amount; or
(iii) 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,
(a) On the basis of revenue from sales criteria, segment A is a reportable segment.
(b) On the basis of the result criteria, segments A & E are reportable segments (since their results in absolute amount is 10% or more of ₹ 100 crore).
(c) On the basis of asset criteria, all segments except E are reportable segments.

Since all the segments are covered in atleast one of the above criteria, all segments have to be reported upon in accordance with AS 17. Hence, the opinion of chief accountant that only segment 'A' is reportable is wrong.

Question 3 *(Inter Nov 2020) (5 Marks)* *Pg no._____*

The accountant of Parag Limited has furnished you with the following data related to its Business Divisions:

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.

Solution

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:
a) 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
b) Its segment result whether profit or loss is 10% or more of:
The combined result of all segments in profit; or
The combined result of all segments in loss, whichever is greater in absolute amount; or
c) Its segment assets are 10% or more of the total assets of all segments.

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 D are 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 4 *(Inter Jan 2021) (5 Marks)* *Pg no._____*

The Senior Accountant of AMF Ltd. gives the following data regarding its five segments:

Division	P	Q	R	S	T	Total
Segment Assets	80	30	20	20	10	160
Segment Result	(190)	10	10	(10)	30	(150)
Segment Revenue	620	80	60	80	60	900

The Senior Accountant is of the opinion that segment "P" alone should be reported. Is he justified in his view? Examine his opinion in the light of provision of AS-17 'Segment Reporting'.

Solution

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

a) 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

b) Its segment result whether profit or loss is 10% or more of:
The combined result of all segments in profit; or
The combined result of all segments in loss, whichever is greater in absolute amount; or

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

Accordingly,

(a) On the basis of revenue from sales criteria, segment P is a reportable segment.

(b) On the basis of the result criteria, segments P & T are reportable segments (since their results in absolute amount is 10% or more of 200 Lakhs).

(c) On the basis of asset criteria, all segments except T are 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 AS 17. Hence, the opinion of chief accountant that only segment 'P' is reportable is wrong.

Question 5 *(Inter May 2022) (5 Marks) / (ICAI Study Material)* *Pg no._____*

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)

Solution

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:

(i) The combined result of all segments in profit; i.e. ₹ 250 Lakhs or

(ii) The combined result of all segments in loss; i.e. ₹ 300 Lakhs
whichever is greater in absolute amount 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 6 *(Inter May 2018) (5 Marks)/(ICAI Study Material)* Pg no._____

M/s 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.

Solution

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.

Question 7 *(ICAI Study Material)* Pg no._____

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

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
O	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.

Solution

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% = ₹ 60

Asset Test:
Combined total assets of all the segment = ₹ 1,02,750
10% thresholds = ₹ 1,02,750 x 10% = 10,275

Accordingly, quantitative thresholds are calculated below:

Segment	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

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

RELATED PARTY DISCLOSURES

AS 18

Scope	This Standard should be applied in reporting related party relationships and transactions between a reporting enterprise and its related parties. The requirements of this Standard apply to the financial statements of each reporting enterprise as also to consolidated financial statements presented by a holding company.
Related Party Relationships	***Related party - parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.*** AS 18 deals only with related party relationships described in (a) to (e) below: a) Enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries). b) Associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture. c) Individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual. d) Key management personnel and relatives of such personnel and e) Enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.
No Related Parties	***The following are deemed not to be related parties:*** a) Two companies simply because they have a director in common (unless the director is able to affect the policies of both companies in their mutual dealings). b) A single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence and c) The parties listed below, in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of the enterprise or participate in its decision-making process): ❖ Providers of finance ❖ Trade unions ❖ Public utilities ❖ Government departments and government agencies including government sponsored bodies

Important Definitions	Related party transaction	A transfer of resources or obligations between related parties, regardless of whether or not a price is charged.
	Control	➢ ownership, directly or indirectly, of more than one half of the voting power of an enterprise, or ➢ control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or ➢ a substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of the enterprise.
	Significant influence	Participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies. Significant influence may be exercised in several ways, for example, (1) by representation on the board of directors;, (2) participation in the policy making process; (3) material inter-company transactions, (4) interchange of managerial personnel or (5) dependence on technical information. Significant influence may be gained by share ownership, statute or agreement.
	Key management personnel	Those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. *For example,* in the case of a company, the managing 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.
	Substantial interest	An enterprise is considered to have a substantial interest in another enterprise if that enterprise owns, directly or indirectly, 20% or more interest in the voting power of the other enterprise. Similarly, an individual is considered to have a substantial interest in an enterprise, if that individual owns, directly or indirectly, 20% or more interest in the voting power of the enterprise.
The Related Party Issue	➢ Related party relationships are a normal feature of commerce and business. ➢ Without related party disclosures, there is a general presumption that transactions reflected in financial statements are consummated on an arm's length basis between independent parties. However, that presumption may not be valid when related party relationships exist because related parties may enter into transactions which unrelated parties would not enter into. Also, transactions between related parties may not be effected at the same terms and conditions as between unrelated parties.	

	➢ The operating results and financial position of an enterprise may be affected by a related party relationship even if related party transactions do not occur. ➢ Sometimes, transactions would not have taken place if the related party relationship had not existed.
Disclosure Requirements	*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. If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following: → The name of the transacting related party; → A description of the relationship between the parties; → A description of the nature of transactions; → Volume of the transactions either as an amount or as an appropriate proportion; → Any other elements of the related party transactions necessary for an understanding of the financial statements; → 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; → Amounts written off or written back in the period in respect of debts due from or to related parties.
Exceptions of disclosure requirements	➢ Related party disclosure requirements as laid down in AS 18 do not apply in circumstances where providing such disclosures would conflict with the reporting enterprise's duties of confidentiality as specifically required in terms of a statute or by any regulator or similar competent authority. ➢ No disclosure is required in consolidated financial statements in respect of intragroup transactions. ➢ No disclosure is required in the financial statements of state-controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)*

Identify the related parties in the following cases 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.

Solution

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

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

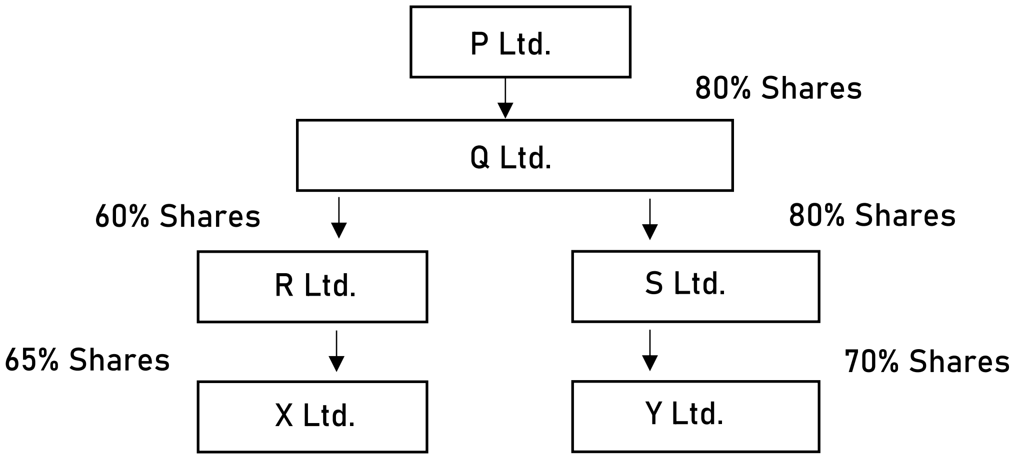
Reporting entity- O Ltd.
- A Ltd. (holding company) is a related party
- B Ltd. (holding company) is a related party
- Z Ltd. (investor/ investing party) is a related party (O Ltd. being Associate of Z Ltd.)

Reporting entity- Z Ltd.
- O Ltd. (associate) is a related party

Question 2 *(ICAI Study Material)*

Pg no._____

Consider the following organization structure related to P Ltd.



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

Solution:

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

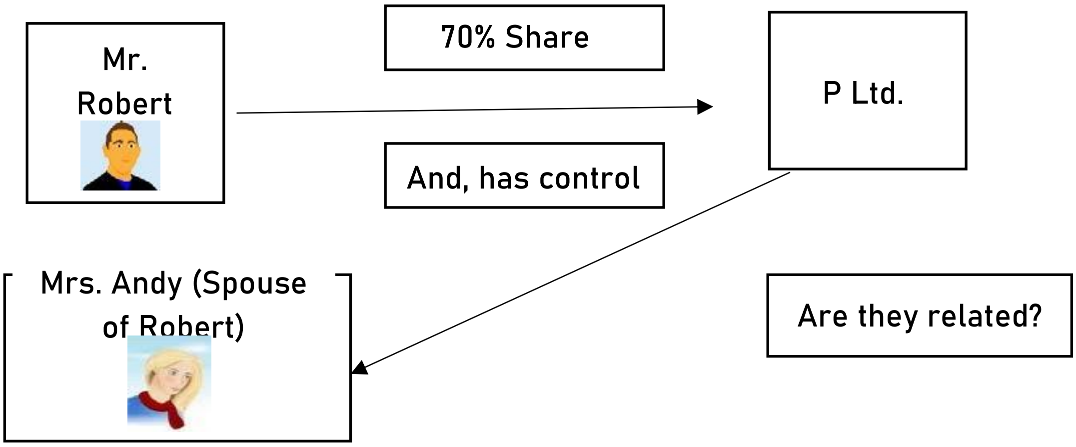
Party Name	Relationship under AS-18
P Ltd.	• P Ltd. has indirect control on R Ltd. (through Q Ltd.) • Hence R Ltd. is related to P Ltd.
Q Ltd.	• Q Ltd. has direct control of R Ltd. • Hence R Ltd. is related to Q Ltd.
S Ltd.	• R Ltd. and S Ltd. are under common control of Q Ltd. • Hence R Ltd. is related 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 3 *(ICAI Study Material)* Pg no._____

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?

Solution:

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.

Question 4 *(RTP May 2020) / (ICAI Study Material)*

Narmada Ltd. sold goods for ₹ 90 lakhs to Ganga Ltd. during financial year ended 31-3-2020. The Managing Director of Narmada Ltd. own 100% of Ganga Ltd. The sales were made to Ganga Ltd. at normal selling prices followed 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?

Solution

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.

Question 5 *(ICAI Study Material)*

A) Mr. Raj a relative of key management personnel received remuneration of ₹ 2,50,000 for his services in the company for the period from 1.4.2019 to 30.6.2019. On 1.7.2019, he left the service. Should the relative be identified as at the closing date i.e. on 31.3.2020 for the purposes of AS 18?

Solution

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 relative as at the closing date i.e. on 31.3.2020.

B) X Ltd. sold goods to its associate Company for the 1st quarter ending 30.6.2019. After that, the 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.

Solution

As per AS 18, transactions of X Ltd. with its associate company for the first quarter ending 30.06.2019 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 6 *(ICAI Study Material)* *Pg no._____*

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)?

Solution:

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.

Question 7 *(RTP May 2019) / (RTP Nov 2019) / (RTP Nov 2022)*

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 own any voting power in SP Hotels Limited. Would he be considered as a related party of SP Hotels Limited"?

Solution

Mr. A will not be considered as a related party of SP Hotels Limited in view of paragraph 3(c) of AS 18 which states, "individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual".

In the above example, 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 directors does not qualify him as a key management personnel

Question 8

P Ltd. has 60% voting right in Q Ltd. Q Ltd. has 20% voting right in R Ltd. Also, P Ltd. directly enjoys voting right of 14% in R Ltd. R Ltd. is a listed company and regularly supplies goods to P Ltd. The management of R Ltd. has not disclosed its relationship with P Ltd.
How would you assess the situation from the viewpoint of AS 18 on Related Party Disclosures?

Solution

P Ltd. has direct economic interest in R Ltd. to the extent of 14%, and through Q Ltd. (in which it is the majority shareholders) it has further control of 12% in R Ltd. (60% of Q Ltd.'s 20%). These two taken together (14% + 12%) make the total control of 26%.

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 making financial and/or operating decisions.

Since, P Ltd. has total control of 26% (directly and indirectly by Q Ltd.) in R Ltd. which is less than half of the voting power of R Ltd., P Ltd. is said to have significant influence over R Ltd. Also it is given in the question that R Ltd. is a listed company and regularly supplies goods to P Ltd. Therefore, related party disclosure, as per AS 18, is required by R Ltd. in its financial statements, in respect of goods supplied to P Ltd.

Question 9 *(RTP May 2018) / (RTP May 2023) (Similar)*

Is remuneration paid to Key Managerial Personnel or Non Executive Directors or Board of Directors a related party transaction?

Solution

Key Managerial Personnel (KMP) are those persons who have the authority and responsibility for planning, directing & controlling the activities of the reporting enterprise.

In case of a company, the Managing Director, Whole time Director, Manager & any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered KMP.
Persons who do not have the authority & responsibility for planning, directing & 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 & control the activities of the enterprise.

A non executive director may not be involved in either of these activities mentioned above. In fact besides his activity is more in the nature of an advisory and guiding function. Even if he is involved in planning stage, being non executive, he will not be involved in controlling the activities. Hence remuneration paid to nonexecutive director is not a related party transaction.

Further as per Companies Act, 2013 a related party includes a director or his relative. The Act defines a director as a director appointed to the Board of a company. Therefore as per Companies Act, a non executive director would be considered as a related party. Hence remuneration paid to them will be considered as related party transaction.

Question 10 - *(RTP Nov 2021)*

(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 B Limited be considered a related party for the purpose of financial statements of C Limited?

Solution

(a) Omega Bank Limited would be a related party of B Limited. As per AS 18 “associates and joint ventures of the reporting enterprise and the investing party of venture in respect of which the reporting enterprise is an associate or a joint venturer” 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 /or operating 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 enterprise to exercise significant influence, unless it could be clearly demonstrated otherwise. In the given example, Omega 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 voting power. 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 venturer” 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 party of C Limited.

Question 11 *(ICAI Study Material)*

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?

Solution

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 of confidentiality, 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 enterprise 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 its ensuing financial statements.

PRACTICE QUESTIONS

Question 1 *(Inter May 2019) (5 Marks) / (ICAI Study Material)*

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.)

(ii) Mr. Subhash Kumar is Managing Director of A Ltd. and also holds 72% capital of B Ltd.

Solution

(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 of B 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. will also be construed as related to each other.

Question 2 *(RTP Nov 2020)*

(a) Identify the related parties in the following cases as per AS-18
X Ltd. holds 60 % shares of Y Ltd.
Y Ltd. holds 55 % shares of W Ltd.
Z Ltd. holds 35% shares of W Ltd.

(b) Himalaya Ltd. sold goods for ₹ 40 lakhs to Aravalli Ltd. during financial year ended 31st March 2020. The Managing Director of Himalaya Ltd. owns 80% shares of Aravalli Ltd. The sales were made to Aravalli Limited at normal selling prices followed by Himalaya Ltd. The Chief accountant of Himalaya 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 AS 18. You are required to comment on this.

Solution

A) X Ltd., Y Ltd. & W Ltd. are related to each other. Z Ltd. & W Ltd. are related to each other by virtue of associate relationship. However, neither X Ltd. nor Y Ltd. is related to Z Ltd. and vice versa since neither control nor does significant influence exist between them.

B) Himalaya Ltd. and Aravalli Ltd. are related parties since key management personnel of Himalaya Ltd. i.e. its managing director holds 80% shares in Aravalli Ltd. and hence disclosure of transaction between them is required irrespective of whether transaction was done at normal selling price. Hence the contention of Himalaya Ltd. that these sales require no disclosure under related party transactions is wrong.

Question 3 ***(ICAI Study Material)*** *Pg no._____*

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.?

Solution:

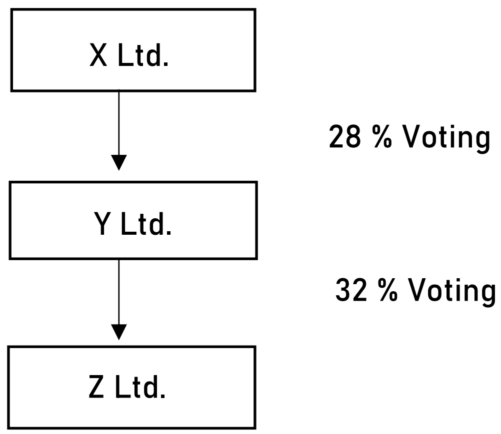
Yes – in relation to A Ltd. (the reporting enterprise), C Ltd. is a related party under AS-18. This is because A Ltd. indirectly controls C Ltd.

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

Question 4 ***(ICAI Study Material)*** *Pg no._____*

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.?

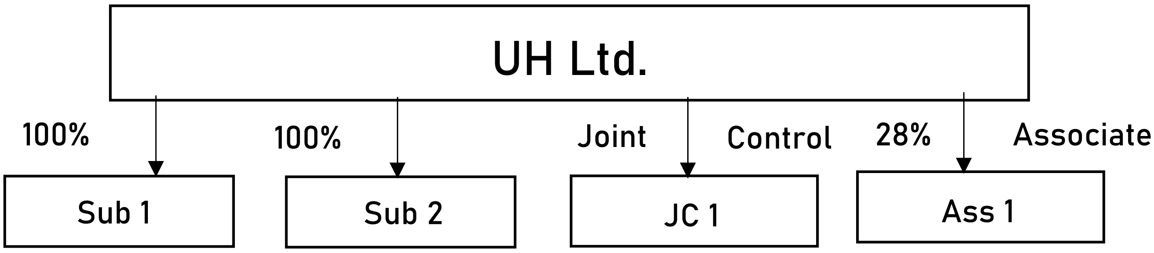
Solution:

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.

Question 5 ***(ICAI Study Material)*** *Pg no._____*

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
- 28% 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

Solution:

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

Reporting enterprise	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.

Question 6 *(RTP Nov 2018)*

Sun Ltd. sold goods for ₹ 50 lakhs to Moon Ltd. during financial year ended 31st March 2020 at normal selling price followed by Sun Ltd. The Managing Director of Sun Ltd. holds 75% shares of Moon Ltd. The Chief accountant of Sun 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. You are required to examine and advise whether the contention of the Chief Accountant is correct?

Solution

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, Sun Ltd. and Moon 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 Sun Ltd is wrong.

Question 7 – *(ICAI Study Material)* *Pg no._____*

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 2021 through 30th June 2021
- Andy left the services of P Ltd. on 1st July 2021
- Consider 31st March 2022 as the year-end date for P Ltd.

Whether Andy is to be identified as related party at the year-end date (31st March 2022) for the purposes of AS-18?

Solution:
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 at the year-end date (i.e. 31st March 2022). This is because the remuneration Andy received from P Ltd. (for the period April 2021 to 30 June 2021) falls within the reporting year April 2021 to March 2022.

Question 8 – *(ICAI Study Material)* Pg no._____

Consider a scenario wherein:

a. P Ltd. hold 22% shares and voting rights in Q Ltd. (and hence Q Ltd. is an associate of P Ltd.)
b. On 1st April 2021, P Ltd. sold certain goods to Q Ltd. amounting to Rs. 5 lacs
c. On 30th June 2021, P Ltd. sold its entire 22% stake in Q Ltd. (and hence the related party relationship ceased to exist after 30th June 2021)
d. However, P Ltd. continued supply goods to Q Ltd. subsequent to 30th June 2021 (just like any other customer) and sold goods worth Rs. 15 lacs during 9-month period ended 31st March 2022
e. Consider 31st March 2022 as the year-end date for P Ltd.

Determine whether the transaction for the entire year (ending on 31st March 2022) is required to be disclosed under AS-18 as related party transaction.

Solution
No – This is because as per AS-18, the disclosure requirements under the Standard relate only to the period during related party relationship existed.
Accordingly, only transactions between P Ltd and Q Ltd till 30th June 2021 (being sale of goods worth Rs. 5 lacs) are required to be reported / disclosed under AS- 18.
Transactions entered into after 30th June 2021 are not required to be disclosed under AS-18.

Question 9 *(Inter Nov 2018) (5 Marks)*

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

a) Mr. Sumit, a relative of Managing Director, received remuneration of ₹ 2,10,000 for his services in the company for the period from 1st April, 2019 to 30th June, 2019. He left the service on 1st July, 2019. Should the relative be identified as a related party as on closing date i.e. on 31-3-2020 for the purpose of AS-18.
b) Goods sold amounting to ₹ 50 lakhs to associate company during the 1st quarter ended on 30th June, 2019. 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 transactions.

Solution

a) According to AS 18 '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. Sumit a relative of key management personnel should be identified as related party as at the closing date i.e. on 31.3.2020 as he received remuneration for his services in the company from 1st April, 2019 to 30th June, 2019 and this period comes under the reporting period.

b) 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 30.06.2019 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, 2019 for ₹ 50 Lakhs only are required to be disclosed as related party transaction on 31.3.20.

Question 10 — *(Inter July 2021) (5 Marks)*

(i) Khushi Limited enter into an agreement with Mr. Happy for running a business for a fixed amount payable to the later every year. The contract states that the day-to-day management of the business will be handled by. Mr. Happy, while all financial and operating policy decisions are taken by the Board of Directors of the Company. Mr. Happy does not own any voting power in Khushi Limited.

(ii) Shri Bhanu a relative of key management personnel received remuneration of ₹ 3,50,000 for his services in the company for the period from 1st April, 2020 to 30th June, 2020. On 1st July, 2020, he left the service.

You are required to suggest how the above transactions will be treated as at the closing date i.e. on 31st March, 2021 for the purposes of AS 18- Related Party Disclosures.

Solution

(i) Mr. Happy will not be considered as a related party of Khushi Limited in view of provisions of AS 18 "Related Party Disclosures" which states, "individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual are related parties".

In the given case, in the absence of share ownership, Mr. Happy would not be considered to exercise significant influence on Khushi Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr Happy does not have the ability to direct or instruct the board of directors does not qualify him as a key management personnel.

(ii) 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, Shri Bhanu, 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 as he received remuneration for his services in the company for the period from 1st April,2020 to 30th June,2020.

Question 11

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

Solution

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:

a) the name of the transacting related party;

b) a description of the relationship between the parties;

c) a description of the nature of transactions;
d) volume of the transactions either as an amount or as an appropriate proportion;
e) any other elements of the related party transactions necessary for an understanding of the financial statements;
f) the amounts or appropriate proportions of outstanding items pertaining to related parties at balance sheet date & provisions for doubtful debts due from such parties at that date; &
g) amounts written off or written back in the period in respect of debts due from or to related parties.

Question 12 – *(RTP May 2021)*

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

Solution

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 making financial 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 policy decisions 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 influence may also not be exercised as an investing party (R Ltd.) holds, directly or indirectly through intermediaries only 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.

Question 13 – *(RTP May 2022)*

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 and the company be considered as related parties?

Solution

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 voting power of an enterprise, or
- Control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or
- a substantial interest in voting power and the power to direct, by statue or agreement, the financial and/or operating 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 business merely by virtue of the resulting economic dependence" would not be deemed to be related parties.

Question 14 – *(ICAI Study Material)*

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?

Solution

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.

LEASES

AS 19

INTRODUCTION

Meaning of Lease	✓ Lease means transfer of right to use assets for specified period against consideration/series of consideration.	
Parties in Lease	*Lessor*	✓ The party who transfers the asset is called 'Lessor'.
	Lessee	✓ The party to whom asset is transferred is called 'Lessee'.
Scope	*This Standard should be applied in accounting for all leases other than:* ✓ lease agreements to explore for or use natural resources, such as oil, gas, timber, metals and other mineral rights ✓ licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights ✓ lease agreements to use lands	

TYPES OF LEASE

Finance Lease
A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. Title may or may not eventually be transferred.
Deterministic Conditions: Atleast one of the following conditions must be satisfied to recognize the lease as Finance Lease
→ Transfer of ownership of the asset to the lessee by the end of the lease term.
→ Where lessee has purchase option at very reduced rate & lessee is certain to opt for purchase at inception.
→ Where lease period covers substantial period of economic life of asset.
→ At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.
→ The leased asset is of a specialised nature such that only the lessee can use it without major modifications being made.
Suggestive Conditions: Even if all the conditions are met – It does not necessarily imply that it is a finance lease.
→ If the lessee can cancel the lease and the lessor's losses associated with the cancellation are borne by the lessee
→ If gains or losses from the fluctuations in the residual value accrue to the lessee (for example if the lessor agrees to allow rent rebate equaling most of the disposal value of leased asset at the end of the lease);
→ If the lessee can continue the lease for a secondary period at a rent, which is substantially lower than market rent.
Operating Lease
A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership.

SOME IMPORTANT TERMS

Minimum lease payments	✓ These are the payments over the lease term that the lessee is, or can be required, to make excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with: ❖ in case of lessee, any residual value guaranteed by or on behalf of lessee or ❖ in the case of the lessor, any residual value guaranteed to the lessor: ▪ by or on behalf of the lessee ▪ by an independent third party financially capable of meeting this guarantee.
Fair Value	✓ It is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.
Economic Life	✓ Economic life is either: ❖ the period over which an asset is expected to be economically usable by one or more users or ❖ the number of production or similar units expected to be obtained from the asset by one or more users.
Useful life	✓ Useful life of a leased asset is either: ❖ the period over which leased asset is expected to be used by the lessee, or ❖ the number of production or similar units expected to be obtained from the use of the asset by the lessee.
Residual Value	✓ Residual value of a leased asset is the estimated fair value of the asset at the end of the lease term.
Guaranteed residual value	✓ GRV is : ❖ in the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party on behalf of the lessee (amount of the guarantee being the maximum amount that could, in any event, become payable) and ❖ in the case of the lessor, that part of the residual value which is guaranteed by or on behalf of the lessee, or by an independent third party who is financially capable of discharging the obligations under the guarantee.
Unguaranteed residual value	✓ Unguaranteed residual value of leased asset is the amount by which the residual value of the asset exceeds its guaranteed residual value.
Gross Investment	✓ Gross investment in the lease is the aggregate of the minimum lease payments under a finance lease from the standpoint of the lessor and any unguaranteed residual value accruing to the lessor.
Unearned finance income	✓ Unearned finance income is the difference between: ❖ the gross investment in the lease and ❖ the present value of ▪ the 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.

Net investment	✓ Net investment is gross investment less unearned finance income.
The interest rate implicit	✓ The interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of ❖ the minimum lease payments under a finance lease from the standpoint of the lessor; and ❖ any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.
Lessee's incremental borrowing rate of interest	✓ It is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.
Contingent rent	✓ It is that portion of the lease payments that is not fixed in amount but is based on a factor other than just passage of time (e.g., percentage of sales, amount of usage, price indices, market rates of interest).
Non-Cancellable Lease	✓ a lease that is cancellable only: (a) upon the occurrence of some remote contingency; or (b) with the permission of the lessor; or (c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain

LEASES IN FINANCIAL STATEMENTS OF LESSOR

Finance Lease

1. The lessor should recognise assets given under a finance lease in its balance sheet as a receivable at an amount equal to the net investment in the lease.
2. The lessor should make the following disclosures for finance leases:
   a. a reconciliation between the total gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date. In addition, an enterprise should disclose the total gross investment in the lease and the present value of minimum lease payments receivable at the balance sheet date, for each of the following periods:
      i. not later than one year
      ii. later than one year and not later than five years
      iii. later than five years
   b. unearned finance income
   c. the unguaranteed residual values accruing to the benefit of the lessor
   d. the accumulated provision for uncollectible minimum lease payments receivable
   e. contingent rents recognised in the statement of profit and loss for the period
   f. a general description of the significant leasing arrangements of the lessor
   g. accounting policy adopted in respect of initial direct costs.

Operating Lease

1. The lessor should present an asset given under operating lease in its balance sheet under fixed assets. Lease income from operating leases should be recognised 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 in which benefit derived from the use of the leased asset is diminished

2. The lessor should, in addition to the requirements of AS 10, Property, Plant & Equipment and the governing statute, make the following disclosures for operating leases:
   a. for each class of assets, the gross carrying amount, the accumulated depreciation and accumulated impairment losses at the balance sheet date; and
      i. the depreciation recognised in the statement of profit and loss for the period
      ii. impairment losses recognised in the statement of profit and loss for the period
      iii. impairment losses reversed in the statement of profit and loss for the period
   b. the future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods:
      i. not later than one year
      ii. later than one year and not later than five years
      iii. later than five years
   c. total contingent rents recognised as income in statement of profit & loss for the period
   d. a general description of the lessor 's significant leasing arrangements
   e. accounting policy adopted in respect of initial direct costs.

LEASES IN FINANCIAL STATEMENTS OF LESSEE

Finance Lease

1. At the inception of a finance lease, the lessee should recognise the lease as an asset and a liability. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of the lease or present value of the minimum lease payments from the standpoint of the lessee whichever is lower.
2. The lessee should, in addition to the requirements of AS 10 (New), Property, Plant & Equipment and the governing statute, make the following disclosures for finance leases:
   a. assets acquired under finance lease as segregated from the assets owned
   b. for each class of assets, the net carrying amount at the balance sheet date
   c. a reconciliation between the total of minimum lease payments at the balance sheet date and their present value. In addition, an enterprise should disclose the total of minimum lease payments at the balance sheet date, and their present value, for each of the following periods:
      i. not later than one year
      ii. later than one year and not later than five years; (iii)
      iii. later than five years
   d. contingent rents recognised as expense in statement of profit and loss for the period
   e. the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date
   f. 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
      iii. restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Operating Lease

1. Lease payments under an operating lease should be recognised 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.
2. The lessee should make the following disclosures for operating leases:

a. the total of future minimum lease payments under non- cancellable operating leases for each of the following 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-cancellable subleases at the balance sheet date
c. lease payments recognised in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents
d. sub-lease payments received (or receivable) recognised in the statement of profit and loss for the period
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
   iii. restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

SALE AND LEASEBACK TRANSACTIONS

1. A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor. The lease payments and the sale price are usually interdependent as they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends upon the type of lease involved.
2. If a sale and leaseback transaction results in a finance lease, any excess or deficiency of sales proceeds over the carrying amount should not be immediately recognised as income or loss in the financial statements of seller-lessee. Instead, it should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.
3. If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately.
   a. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used.
   b. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no.*_____

S. Square Private Limited has taken machinery on finance lease from S.K. Ltd. The information is as under:

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 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 the lease liability as per AS-19 & finance charges of each year.

Question 2 *(ICAI Study Material)* *Pg no.*_____

Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being ₹ 7,00,000. The economic life of machine as well as the lease term is 3 years. At the end of each year Lessee Ltd. pays ₹ 3,00,000. The Lessee has guaranteed a residual value of ₹ 22,000 on expiry of the lease to the Lessor. However, Lessor Ltd., estimates that the residual value of the machinery will be only ₹ 15,000. The implicit rate of return is 15% p.a. and present value factors at 15% are 0.869, 0.756 and 0.657 at the end of first, second and third years respectively.
Calculate the value of machinery to be considered by Lessee Ltd. and the finance charges in each year.

Question 3 *(RTP Nov 2018) / (RTP May 2020)* *Pg no.*_____

ABC Ltd. took a machine on lease from XYZ Ltd., the fair value being ₹ 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 ₹ 3,50,000. The lessee has guaranteed a residual value of ₹ 50,000 on expiry of the lease to the lessor. However, XYZ Ltd. estimates that the residual value of the machinery will be ₹ 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.

Question 4 *(ICAI Study Material)* *Pg no.*_____

Prakash Limited leased a machine to Badal Limited on the following terms:

Lease Term	5 Years
Fair value of Machine	₹ 28.3 Lakhs
Lease Rent per annum	₹ 8 Lakhs
Guaranteed residual value	₹ 1.60 Lakhs
Expected residual value	₹ 3 Lakhs
Internal Rate of Return	15%

Discounted rates for 1st year to 5th year are 0.8696, 0.7561, 0.6575, 0.5718, and 0.4972 respectively. Ascertain Unearned Finance Income.

Question 5 *Pg no.*_____

Jet Carriers Ltd. has initiated a lease for four years in respect of a vehicle costing ₹ 20,00,000 with expected useful life of 5 years. The asset would revert to the company under the lease agreement. The other information available in respect of lease agreement is:

1) The unguaranteed residual value of the equipment after the expiry of the lease term is estimated at ₹ 2,50,000
2) The implicit rate of interest is 10%.
3) The annual payments have been determined in such a way that the present value of the lease payment plus the residual value is equal to the cost of asset.

Ascertain in the hand of Jet Carriers Ltd.

a) The annual lease payment.
b) The unearned finance income.
c) The segregation of finance income.

(a) PV Residual value for 4 years @ 10% is 0.683. (b) PV Factor for 4 years @ 10% is 3.16987.

Question 6 *(ICAI Study Material)* Pg no._____

B&P Ltd. availed a lease from N&L Ltd. The conditions of the lease terms are as under:

a) Lease period is 3 years, in the beginning of the year 2019, for equipment costing ₹ 10,00,000 and has an expected useful life of 5 years
b) The Fair market value is also ₹ 10,00,000.
c) The property reverts back to the lessor on termination of the lease.
d) The unguaranteed residual value is estimated at ₹ 1,00,000 at the end of the year 2021.
e) 3 equal annual payments are made at the end of each year.

The present value of ₹ 1 due at the end of 3rd year at 10% rate of interest is ₹ 0.7513. The present value of annuity of ₹ 1 due at the end of 3rd year at 10% IRR is ₹ 2.4868. State whether the lease constitute finance lease & calculate unearned finance income. (Consider IRR = 10%.)

Question 7 Pg no._____

What do you understand by the term "Interest rate implicit on lease"? Calculate the interest rate implicit on lease from the following details:

Annual lease rent	₹ 80,000 at the end of each year
Lease period	5 Years
Guaranteed residual value	₹ 40,000
Unguaranteed residual value	₹ 24,000
Fair value at the inception of lease	₹ 3,20,000

Discounted rates for the first 5 years are as below:

At 10% 0.909, 0.826, 0.751, 0.683, 0621

At 14% 0.877, 0.769, 0.675, 0.592, 0.519

Question 8 *(RTP May 2022) (Similar)* Pg no._____

Classify the following into either operating lease or Finance lease:-

a) Ownership of the asset gets vested to the lessee at the end of lease term.
b) Lessee has option to purchase the asset at lower than fair value, at the end of lease term.
c) Economic life of the asset is 7 years, lease term is 6.5 years, but the asset is not acquired at the end of the lease term.
d) Present Value (PV) of Minimum Lease Payment (MLP) = 'X'. Fair value of the asset is 'Y'
e) 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 the use of the lessee.

Question 9 Pg no._____

Suppose outputs from machine taken on 3-year operating lease are estimated as 10,000 units in year 1, 20,000 units in year 2 and 50,000 units in year 3. The agreed annual lease payments are ₹ 25,000, ₹ 45,000 and ₹ 50,000 respectively.

Pass entries in books of lessee for 3 years.

Question 10 Pg no._____

Suppose outputs from a machine of economic life of 6 years are estimated as 10,000 units in year 1, 20,000 units in year 2 and 30,000 units in year 3, 40,000 units in year 4, 20,000 units in year 5 and 5,000 units in year 6. The machine was given on 3-year operating lease by a dealer of the machine for equal annual lease rentals to yield 20% profit margin on cost ₹ 5,00,000. Straight-line depreciation in proportion of output is considered appropriate. Calculate lease rentals and pass entries in books of lessor for 1st year.

Question 11 Pg no._____

On 1st January, 2020, Santa Ltd. sold equipment for ₹ 6,14,460. The carrying amount of the equipment on that date was ₹ 1,00,000. The sale was a part of the package under which Banta Ltd. leased the asset to Santa Ltd. for ten years term. The economic life of the asset is estimated as 10 years. The minimum lease rents payable by the lessee has been fixed at ₹ 1,00,000 payable annually beginning from 31st December, 2020. The incremental borrowing interest rate of Santa Ltd. is estimated at 10% p.a. Calculate the net effect on the Statement of profit and loss in the books of Santa Ltd.

Question 12 *(RTP Nov 2020) (May 2022) (Similar) / (ICAI Study Material)* Pg no._____

A Ltd. sold machinery having WDV of ₹ 40 lakhs to B Ltd. for ₹ 50 lakhs & the same machinery was leased back by B Ltd. to A Ltd. The lease back is operating lease. Comment if –

(a) Sale price of ₹ 50 lakhs is equal to fair value.
(b) Fair value is ₹ 60 lakhs.
(c) Fair value is ₹ 45 lakhs and sale price is ₹ 38 lakhs.
(d) Fair value is ₹ 40 lakhs and sale price is ₹ 50 lakhs.
(e) Fair value is ₹ 46 lakhs and sale price is ₹ 50 lakhs
(f) Fair value is ₹ 35 lakhs and sale price is ₹ 39 lakhs.

PRACTICE QUESTIONS

Question 1 Pg no._____

Annual lease rent = ₹ 80,000 at the end of each year
Lease period = 5 years Guaranteed residual value = ₹ 28,000
Fair value at the inception (beginning) of lease = ₹ 3,00,000
Interest rate implicit on lease is 12.6%. The present value factors at 12.6% are 0.89, 0.79, 0.7, 0.622, 0.552 at the end of first, second, third, fourth and fifth year respectively.
Show the Journal entry to record the asset taken on finance lease in the books of the lessee.

Solution

Journal entry in the books of Lessee

Particulars	L.F.	Dr.	Cr.
Asset A/c Dr.		2,99,776	
To Lessor			2,99,776
(Being recognition of finance lease as an asset and a liability)			

Working Note:

Year	Lease Payments	Discounting Factor (12.6%)	Present Value
1	80,000	0.89	71,200
2	80,000	0.79	63,200
3	80,000	0.70	56,000
4	80,000	0.622	49,760
5	80,000	0.552	44,160
5	28,000 (GRV)	0.552	15,456
			2,99,776

Question 2 *(Inter May 2019) (5 Marks)* Pg no._____

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 of return is 10% p.a. and present value factors at 10% are: 0.909, 0.826, 0.751 and 0.683 at the end of 1st, 2nd, 3rd and 4th year respectively. Calculate the value of machinery to be considered by Jaya Ltd. and the value of the lease liability as per AS-19.

Solution

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 lessee, the amount recorded as an asset and a liability should be present value of minimum lease payments from standpoint of 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	Lease Payments	Discounting Factor (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 (3,50,000+70,000 GRV)	0.683	2,86,860
			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.

Question 3

Pg no.______

Sun Limited leased a machine to Moon Limited on the following terms:

Fair value at inception of lease	₹ 50,00,000
Lease Term	4 Years
Lease Rent 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 AS19

Solution

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 should be 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	Lease Payments	Discounting Factor (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 (16,00,000+3,00,000 GRV)	0.5718	10,86,420
			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:

(a) Gross investment in the lease is the aggregate of (i) minimum lease payments from the stand point of 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 x 4 years) + ₹ 3,00,000] + ₹ 1,50,000 = ₹ 68,50,000

(b) 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

Question 4 *(RTP May 2018)/ (RTP Nov 2022) / (RTP May 2023)* Pg no._____

WIN Ltd. has entered into a three-year lease arrangement with Tanya sports club in respect of Fitness Equipments costing ₹ 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 ₹ 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 compute 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.

Solution

Computation of annual lease payment to the lessor

Cost of equipment	16,99,999.50
Unguaranteed residual value	1,33,500
Present value of residual value after third year @ 10% (₹ 1,33,500 × 0.751)	1,00,258.50
Fair value to be recovered from lease payments (₹ 16,99,999.5– ₹ 1,00,258.5)	15,99,741
Present value of annuity for three years is 2.486	
Annual lease payment = ₹ 15,99,741/ 2.486	6,43,500

Computation of Unearned Finance Income

Total lease payments (₹ 6,43,500 x 3)	19,30,500
Add: Unguaranteed residual value	1,33,500
Gross investment in the lease	20,64,000
Less: Present value of investment (lease payments and residual value) (₹ 1,00,258.5+ ₹ 15,99,741)	(16,99,999.50)
Unearned finance income	3,64,000.50

Question 5 Pg no._____

X Ltd. has leased equipment over its useful life that costs ₹ 7,46,55,100 for a three year lease period. After the lease term the asset would revert to the Lessor. You are informed that:

(i) The estimated unguaranteed residual value would be ₹ 1 lakh only.

(ii) The annual lease payments have been structured in such a way that sum of their present values together with that of the residual value of the asset will equal the cost thereof.

(iii) Implicit interest rate is 10%. You are required to ascertain the annual lease payment and the unearned finance income. Annual lease payments are made at the end of each accounting year. P.V. factor @ 10% for years 1 to 3 are 0.909, 0.826 and 0.751 respectively

Solution

Computation of annual lease payment to the lessor

Cost of equipment	7,46,55,100
Unguaranteed residual value	1,00,000
Present value of residual value after third year @ 10% (₹ 1,00,000 × 0.751)	75,100

Fair value to be recovered from lease payments (₹ 7,46,55,100 – ₹ 75,100)	7,45,80,000
Present value of annuity for three years is 2.486	
Annual lease payment = ₹ 7,45,80,000/ 2.486	3,00,00,000

Computation of Unearned Finance Income

Total lease payments (₹ 3,00,00,000 x 3)	9,00,00,000
Add: Unguaranteed residual value	1,00,000
Gross investment in the lease	9,01,00,000
Less: Present value of investment (lease payments and residual value) (₹ 7,45,80,000+ ₹ 75,100)	(7,46,55,100)
Unearned finance income	1,54,44,900

Question 6 Pg no._____

A machine having expected useful life of 6 years, is leased for 4 years. Both the cost and the fair value of the machinery are ₹ 7,00,000. The amount will be paid in 4 equal instalments and at the termination of lease, lessor will get back the machinery. The unguaranteed residual value at the end of the 4th year is ₹ 70,000. The IRR of the investment is 10%. The present value of annuity factor of ₹ 1 due at the end of 4th year at 10% IRR is 3.169. The present value of ₹ 1 due at the end of 4th year at 10% rate of interest is 0.683. State with reasons whether the lease constitutes finance lease and also compute the unearned finance income

Solution

Determination of nature of lease

Fair value of asset ₹ 7,00,000

Unguaranteed residual value ₹ 70,000

Present value of residual value at the end of 4th Year = ₹ 70,000 x 0.683 = ₹ 47,810

Present value of lease payment recoverable = ₹ 7,00,000 - ₹ 47,810 = ₹ 6,52,190

Percentage of present value of lease payment to fair value of asset is

= (₹ 6,52,190/₹7,00,000)x100 = 93.17%

Since it substantially covers the major portion of lease payment and life of the asset, the lease constitutes a finance lease

Calculation of Unearned finance income

Annual lease payment = ₹ 6,52,190 / 3.169 = ₹ 2,05,803 (approx.)

Gross investment in the lease = Total minimum lease payment + unguaranteed residual value.

= (₹ 2,05,803 x 4) + ₹70000

= ₹ 8,23,212 + ₹70,000

= ₹ 8,93,212

Unearned finance income = Gross investment – Present value of minimum lease payment and unguaranteed residual value.

= ₹ 8,93,212 – ₹ 7,00,000 (₹ 6,52,190 + ₹ 47,810) = ₹ 1,93,212

Question 7 *(RTP May 2019)* Pg no._____

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 ₹ 5,00,000. The amount will be paid in 3 equal annual installments and the lessee will retune the machinery to lessor at termination of lease. The unguaranteed residual value at the end of 3 years is ₹ 50,000. IRR of investment is 10% and present value of annuity factory of ₹ 1 due at the end of 3 years at 10% IRR is 2.4868 and present value of ₹ 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.

Solution

Determination of Nature of Lease

Present value of unguaranteed residual value at the end of 3rd year = 50,000 x 0.7513 = 37,565

Present value of lease payments = ₹ 5,00,000 – ₹37,565 = ₹ 4,62,435

Percentage of present value of lease payments to fair value of asset

= (₹ 4,62,435/ ₹ 5,00,000) x 100 = 92.487%.

Since, lease payments substantially covers the major portion of the fair value; the lease constitutes a finance lease.

Calculation of Unearned Finance Income

Annual lease payment = ₹ 4,62,435/ 2.4868 =₹ 1,85,956 (approx.)

Gross investment in the lease = Total minimum lease payments + unguaranteed residual value

= (₹ 1,85,956 × 3) + ₹ 50,000

= ₹ 5,57,868 + ₹ 50,000 = ₹ 6,07,868

Unearned finance income = Gross investment - Present value of minimum lease payments and unguaranteed residual value

= ₹ 6,07,868 – ₹ 5,00,000 = ₹ 1,07,868

Question 8 *(RTP Nov 2019) / (RTP May 2021)* *Pg no._____*

Sun Limited wishes to obtain a machine costing ₹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₹3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Suraj Limited is not sure about the treatment of these lease rentals and seeks your advise. (Use annuity factor at @ 15% for 5 years as 3.36)

Solution

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 (₹ 3 Lakh each year)	₹ 10.08 Lakhs (approx.)

Thus, present value of minimum lease payments is ₹10.08 lakhs and the fair value of the machine is ₹ 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 machine is 14 years while the lease is only for five years. Therefore, lease agreement is an operating lease.

Lease payments 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 9 *(RTP Nov 2020) (Similar) / (ICAI Study Material)* *Pg no._____*

Classify the following into either operating lease or Finance lease:-

a) Lessee has option to purchase the asset at lower than fair value, at the end of lease term.
b) Economic life of the asset is 7 years, lease term is 6 years, but the asset is not acquired at the end of the lease term.
c) 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 the use of the lessee.
d) Present Value (PV) of Minimum Lease Payment (MLP) = 'X'. Fair value of the asset is 'Y'

Solution

a) If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, it is a Finance Lease.
b) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.
c) Since the asset is procured only for the use of lessee, it is a finance lease.
d) The lease is a finance lease if X = Y, or where X substantially equals Y.

Question 10 *(Inter Nov 2019) (5 Marks)* *Pg no._____*

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 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". X = Y.
(5) Economic 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.

Solution

(1) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.
(2) If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, it is a Finance Lease.
(3) It is an operating lease under which lease payments are recognized as expense in the profit and loss account of lessee to have better matching between cost and revenue.
(4) The lease is a finance lease if X = Y, or where X substantially equals Y.
(5) Since the asset is of special nature and has been procured only for the use of lessee, it is a finance lease.

Question 11 *(ICAI Study Material)* *Pg no._____*

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 ₹ 1,50,000. Economic life of the machine is 5 years and output from the machine are estimated as 40,000 units, 50,000 units, 60,000 units, 80,000 units and 70,000 units consecutively for 5 years.

Straight line depreciation in proportion of output is considered appropriate. Compute the following:

(i) Annual Lease Rent
(ii) Lease Rent income to be recognized in each operating year and
(iii) Depreciation for 3 years of lease

Solution

(i) Annual lease rent

Total lease rent

$= 130\%$ of ₹ 1,50,000 × $\dfrac{\text{Output during lease period}}{\text{Total Output}}$

= 130% of ₹ 1,50,000 x (40,000 +50,000+ 60,000)/(40,000 + 50,000 + 60,000 + 80,000 +70,000)

= 1,95,000 x 1,50,000 units/3,00,000 units = ₹ 97,500

Annual lease rent = ₹ 97,500 / 3 = ₹ 32,500

(ii) Lease rent Income to be recognized in each operating year
Total lease rent should be recognised as income in proportion of output during lease period, i.e. in the proportion of 40 : 50 : 60.
Hence income recognised in years 1, 2 and 3 will be as:
Year 1 ₹ 26,000, Year 2 ₹ 32,500 and Year 3 ₹ 39,000.

(iii) Deprecation for three years of lease
Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹ 1,50,000 should be allocated over useful life 5 years in proportion of output, i.e. in proportion of 40:50:60:80:70.
Depreciation for year 1 is ₹ 20,000, year 2 = 25,000 and year 3 = 30,000.

Question 12 *(Inter Dec 2021) (5 Marks)* Pg no._____

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 ₹ 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.
a) Annual Lease Rent
b) Lease Rent income to be recognized in each operating year and
c) Depreciation for 3 years lease

Solution

a) Annual lease rent
Total lease rent = 130% of ₹ 2,25,000 × Output during lease period/ Total output
= 130% of 2,25,000x (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 = ₹ 1,46,250
Annual lease rent = ₹ 1,46,250 / 3 = ₹ 48,750

b) 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. in the 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 ₹ 39,000, Year 2 ₹ 48,750 and Year 3 ₹ 58,500.

c) Depreciation for three years of lease
Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹ 2,25,000 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 ₹ 30,000, year 2 = 37,500 and year 3 = 45,000.

Question 13 *(Inter May 2018) (5 Marks)* Pg no._____

A Ltd. sold JCB having WDV of ₹ 20 lakhs to B Ltd. for ₹ 24 lakhs and the same JCB was leased back by B Ltd. to A Ltd. The lease is operating lease. In context of Accounting Standard 19 "Leases" explain the accounting treatment of profit or loss in the books of A Ltd. if
(i) Sale price of ₹ 24 lakhs is equal to fair value.
(ii) Fair value is ₹ 20 lakhs and sale price is ₹ 24 lakhs.
(iii) Fair value is ₹ 22 lakhs and sale price is ₹ 25 lakhs.
(iv) Fair value is ₹ 25 lakhs and sale price is ₹ 18 lakhs.
(v) Fair value is ₹ 18 lakhs and sale price is ₹ 19 lakhs

Solution

Following will be the treatment in the given cases:

(i) When sale price of ₹ 24 lakhs is equal to fair value, A Ltd. should immediately recognise the profit of ₹4 lakhs (i.e. 24 – 20) in its books.

(ii) When fair value is ₹ 20 lakhs & sale price is ₹ 24 lakhs then profit of ₹ 4 lakhs is to be deferred and amortised over the lease period.

(iii) When fair value is ₹ 22 lakhs & sale price is ₹ 25 lakhs, profit of ₹ 2 lakhs (22 - 20) to be immediately recognised in its books and balance profit of ₹3 lakhs (25-22) is to be amortised/deferred over lease period.

(iv) When fair value of leased machinery is ₹ 25 lakhs & sale price is ₹ 18 lakhs, then loss of ₹ 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 ₹ 18 lakhs & sale price is ₹ 19 lakhs, then the loss of ₹ 2 lakhs (20-18) to be immediately recognised by A Ltd. in its books and profit of ₹ 1 lakhs (19-18) should be amortised/deferred over lease period

Question 14 *(Inter Jan 2021) (5 Marks) / (ICAI Study Material)* Pg no._____

X Ltd. sold machinery having WDV of ₹ 300 lakhs to Y Ltd. for ₹ 400 lakhs and the same machinery was leased back by Y Ltd. to X Ltd. The lease back arrangement is operating lease. Give your comments in the following situations:

(i) Sale price of ₹ 400 lakhs is equal to fair value.

(ii) Fair value is ₹ 450 lakhs.

(iii) Fair value is ₹ 350 lakhs and the sale price is ₹ 250 lakhs.

(iv) Fair value is ₹ 300 lakhs and sale price is ₹ 400 lakhs.

(v) Fair value is ₹ 250 lakhs and sale price is ₹ 290 lakhs.

Solution

Following will be the treatment in the given cases:

(i) When sale price of ₹ 400 lakhs is equal to fair value, X Ltd. should immediately recognise the profit of ₹100 lakhs (i.e. 400 – 300) in its books.

(ii) When fair value is ₹ 450 lakhs then also profit of ₹100 lakhs should be immediately recognised by X Ltd.

(iii) When fair value of leased machinery is ₹ 350 lakhs & sales price is ₹ 250 lakhs, then loss of ₹ 50 lakhs (300 – 250) to be immediately recognised by X Ltd. in its books provided loss is not compensated by future lease payment.

(iv) When fair value is ₹ 300 lakhs & sales price is ₹ 400 lakhs then, profit of ₹ 100 lakhs is to be deferred and amortised over the lease period.

(v) When fair value is ₹ 250 lakhs & sales price is ₹ 290 lakhs, then the loss of ₹ 50 lakhs (300-250) to be immediately recognised by X Ltd. in its books and profit of ₹ 40 lakhs (290-250) should be amortised/deferred over lease period.

Question 15 *(Inter May 2022) (5 Marks)* Pg no._____

What are the disclosures requirements for operating leases by the lessee as per AS-19?

Solution

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 the following 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-cancelable subleases at the balance sheet date;
c) lease payments recognised in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;
d) sub-lease payments received (or receivable) recognised in the statement of profit and loss for the period;
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, additional debt, and further leasing.

EARNINGS PER SHARE

AS 20

INTRODUCTION

The objective of AS 20 is to describe principles for determination and presentation of earnings per share which will improve comparison of performance among different enterprises for the same period and among different accounting periods for the same enterprise.

Earnings per share (EPS) is a financial ratio indicating the amount of profit or loss for the period attributable to each equity share and AS 20 gives computational methodology for determination and presentation of basic and diluted earnings per share.

EPS is of 2 types
- Basic EPS
- Diluted EPS

Basic Earnings Per Share

$$\frac{\text{Net profit (loss) attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the period}}$$

- All items of income and expense which are recognised in a period, including tax expense and extraordinary items, are included in the determination of the net profit or loss for the period
- The number of shares used in the denominator for basic EPS should be the weighted average number of equity shares outstanding during the period.

Presentation

An enterprise should present basic and diluted earnings per share on the face of the statement of profit and loss for each class of equity shares that has a different right to share in the net profit for the period. An enterprise should present basic and diluted earnings per share with equal prominence for all periods presented. AS 20 requires an enterprise to present basic and diluted earnings per share, even if the amounts disclosed are negative (a loss per share).

Disclosure

An enterprise should disclose the following:

a) Where the statement of profit and loss includes extraordinary items (as defined is AS 5), basic and diluted EPS computed on the basis of earnings excluding extraordinary items (net of tax expense);

b) The amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net profit or loss for the period;

c) The weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other; and

d) The nominal value of shares along with the earnings per share figures.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* Pg no._____

Date	Particulars	Purchased	Sold	Balance
1st January	Balance at beginning of year	1800	-	1800
31st May	Issue of shares for cash	600	-	2400
1st November	Buy back of shares	-	300	2100

Calculate weighted number of shares. Calculate Earnings per share also if Net Profit for the year is ₹ 16,80,000.

Question 2 Pg no._____

From the following information relating to Y Ltd. Calculate Earnings Per Share (EPS):

Particulars	₹ (in crores)
Profit before V.R.S. payments but after depreciation	75.00
Depreciation	10.00
VRS payments	32.10
Provision for taxation	15.00
Paid up share capital (shares of ₹ 10 each fully paid)	93.00

Question 3 *(ICAI Study Material)* Pg no._____

Date	Particulars	No. of Shares	Face Value	Paid up Value
1st January	Balance at beginning of year	1800	₹ 10	₹ 10
31st October	Issue of shares	600	₹ 10	₹ 5

Calculate weighted number of shares.

Question 4 Pg no._____

In April, 2019 a Limited Company issued 1,20,000 equity shares of ₹ 100 each. ₹50 per share was called up on that date which was paid by all shareholders. The remaining ₹ 50 was called up on 1.9.2019. All shareholders paid the sum in September, 2019, except on shareholder having 24,000 shares. The net profit for the year ended 31.3.2020 is ₹ 2,64,000 after dividend on preference shares of ₹ 64,000.

Compute basic EPS for year ended 31.3.2020 as per AS 20.

Question 5 *(ICAI Study Material)* Pg no._____

Net profit for the year 2019	₹ 18,00,000
Net profit for the year 2020	₹ 60,00,000
No. of equity shares outstanding until 30th Sept 2020	20,00,000

Bonus issue 1st October 2020 was 2 equity shares for each equity share outstanding at 30th September, 2020. Calculate Basic Earnings Per Share.

Question 6 Pg no._____

(i) State how would you compute, based on AS-20, the weighted average number of equity shares in the following case:

Date	Particulars	No. of Shares
1st April,2019	Balance of equity shares	4,80,000
31st August,2019	Equity shares issued for cash	3,60,000
1st February,2020	Equity shares bought back	1,80,000
31st March,2020	Balance of equity shares	6,60,000

(ii) Compute adjusted earnings per share and basic EPS based on the following information:

Net profit 2018-19	₹ 11,40,000
Net profit 2019-20	₹ 22,50,000
No. of equity shares outstanding until 31st December, 2019	5,00,000

Bonus issue on 1st Jan,2020, 1 equity share for each equity share outstanding at 31st Dec, 2019.

Question 7

Pg no._____

Compute Basic and Adjusted Earnings per share from the following information:

Net Profit for 2018-19	₹ 22 lakhs
Net Profit for 2019-20	₹ 33 lakhs
No. of shares before Rights Issue	110,000
Rights issue Ratio	One for Every Four Held
Rights Issue Price	₹ 180
Date of exercising Rights option	31.7.2019 (fully subscribed on this date)
Fair value of share before Rights Issue	₹ 270

All workings may be rounded off to two decimals.

Question 8 *(ICAI Study Material)*

Pg no._____

X Ltd. supplied the following information. You are required to compute the basic earnings per share. (Accounting Year 01.01 to 31.12)

Net Profit For	₹
Year 2021	20,00,000
Year 2022	30,00,000

No of shares outstanding prior to right issue 10,00,000 shares.

Right issue : One new share for each four shares outstanding i.e. 2,50,000 shares.

: Right Issue price ₹ 20

: Last date to exercise right 31st March, 2022

Fair value of one equity share immediately prior to exercise of rights on 31.03.2022 is ₹ 25.

Question 9 *(ICAI Study Material)*

Pg no._____

Calculate Diluted EPS.

No. of equity shares outstanding	30,00,000
Basic earnings per share	5
No. of 12% convertible debentures of ₹ 100 each. Each debenture is convertible into 10 equity shares	50,000
Tax rate	30%

Question 10

Pg no._____

Calculate the diluted earnings per share from the following information:

Net profit for the current year	₹17,10,000
No. of equity shares outstanding	4,00,000
No. of 8% convertible debentures of ₹ 100 each. Each debenture is convertible into 10 equity shares	20,000
Interest expenses for the current year	₹ 1,20,000
Tax relating to interest expenses	30%

Question 11

Pg no._____

From the information furnished you are required to compute the Basic and Diluted EPS for accounting year 01-04-2019 to 31-03-2020 & adjusted EPS for year 01-04-2018 to 31-03-2019.

Net profit for year ended 31-03-2019	75,50,000
Net profit for year ended 31-03-2020	1,00,25,000
No. of equity shares as on 01-04-2019	50,00,250
Bonus issue on 01-01-2020	1 share for every 2 held
No. of 12% Convertible Debentures of ₹ 100 each issued on 01-01-2020	1,00,000
Conversion ratio of Debentures	10 shares per debenture
Tax rate	30%

Question 12 *(ICAI Study Material)* Pg no._____

Net profit for the year 2020	₹ 12,00,000
Weighted avg. no. of equity shares outstanding during the year 2020	5,00,000 shares
Average fair value of one equity share during the year 2020	₹ 20.00
Weighted avg. no. of shares under option during the year 2020	1,00,000 shares
Exercise price for shares under option during the year 2020	₹ 15.00

Compute Basic and Diluted Earnings Per Share.

Question 13 Pg no._____

Calculate Basic EPS & Diluted EPS for the year 2019-20

Earnings ₹ 10 Lacs

01/04/2019	Equity Shares	2,00,000 shares
	8% Convertible Debentures	₹ 3,00,000 (convertible into 50,000 equity shares)
	9% Convertible Preference Shares	₹ 4,00,000 (convertible into 1,000 equity shares)
01/07/2019	Shares Warrants Issues	10,000

Consider tax rate of 30%

Question 14 *(RTP May 2021) / (ICAI Study Material)* Pg no._____

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:

a) Equity Shares issued in exchange of cash,

b) Equity Shares issued as a result of conversion of a debt instrument,

c) Equity Shares issued in exchange for the settlement of a liability of the enterprise,

d) Equity Shares issued for rendering of services to the enterprise,

e) Equity Shares issued in lieu of interest and/or principal of an other financial instrument,

f) Equity Shares issued as consideration for the acquisition of an asset other than in cash.

Also define Potential Equity Share.

Solution

The following dates should be considered for consideration of weights for the purpose of calculation of weighted average number of shares in the given situations:

a) Date of Cash receivable

b) Date of conversion

c) Date on which settlement becomes effective

d) When the services are rendered

e) Date when interest ceases to accrue

f) 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.

Question 15 *(RTP Nov 2021)* *Pg no._____*

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?

Solution

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. AS 20 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 emphasis on 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 16 *(RTP May 2022) / (ICAI Study Material)* *Pg no._____*

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 ₹ 2,40,000, a loss from discontinuing operations of ₹ 3,60,000 and accordingly a net loss of ₹ 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?

Solution

a) 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 other similar 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 of all dilutive potential equity shares.

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 were outstanding, pursuant to the requirement of the standard.

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 or increase loss per share from continuing ordinary operations". As income from continuing ordinary operations, ₹ 2,40,000 would be considered and not ₹ (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 ₹ 240 to ₹ 200.
Thus, the basic E.P.S would be ₹ (120) and diluted E.P.S. would be ₹ (100).

PRACTICE QUESTIONS

Question 1 Pg no.______

Compute Basic Earnings per share from the following information:

Date	Particulars	No.of Shares
1st April, 2019	Balance at the beginning of the year	1500
1st August, 2019	Issue of shares for cash	600
31st March,2020	Buy back of shares	500

Net profit for the year ended 31st March, 2020 was ₹ 2,75,000.

Solution

Computation of weighted average number of shares outstanding during the period

Date	No.of Shares	Period Outstanding	Weighted average number of shares
1st April, 2019	1500	12 months	1,500*12/12 = 1,500
1st August, 2019	600	8 months	600*8/12 = 400
31st March, 2020	500	0 months	(500)*0/12 = (0)
			1,900

Basic Earnings per share (EPS) = Net profit attributable to equity shareholders / Weighted average number of equity shares O/s during year

= 2,75,000 / 1,900 Shares

= ₹ 144.74 per share

Question 2 (Inter May 2018) (5 Marks) / (ICAI Study Material) Pg no.______

As at 1st April, 2019 a company had 6,00,000 equity shares of ₹ 10 each (₹ 5 paid up by all shareholders). On 1st September, 2019 the remaining ₹ 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, 2020 was ₹ 21,96,000 after considering dividend on preference shares totalling to ₹ 3,40,000. Compute Basic EPS for the year ended 31st March, 2020 as per Accounting Standard 20 "Earnings Per Share".

Solution

Basic Earnings per share (EPS) = Net profit attributable to equity shareholders / Weighted average number of equity shares outstanding during year

= 21,96,000 / 4,57,500 Shares (as per working note)

= ₹ 4.80 per share

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 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 Equity shares	Amount paid per share	Weighted average no. of equity shares
1.4.2019	6,00,000	5	6,00,000*5/10*5/12 = 1,25,000

1.9.2019	5,40,000	10	5,40,000*7/12 = 3,15,000
1.9.2019	60,000	5	60,000*5/10*7/12 = 17,500
Total shares			4,57,500

Question 3

Pg no._____

(i) Explain the concept of 'weighted average number of equity shares outstanding during the period'. Also compute weighted average no. of equity shares in the following case:

Date	Particulars	No. of Shares
1st April,2019	Balance of equity shares	7,20,000
31st August,2019	Equity shares issued for cash	2,40,000
1st February,2020	Equity shares bought back	1,20,000
31st March,2020	Balance of equity shares	8,40,000

(ii) Compute adjusted earnings per share and basic EPS based on the following information:

Net profit 2018-19	₹ 7,20,000
Net profit 2019-20	₹ 24,00,000
No. of equity shares outstanding until 31st December, 2019	8,00,000

Bonus issue on 1st Jan, 2020, 2 equity shares for each equity share o/s at 31st December, 2019.

Solution

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 equity shares
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

Earning per share

Basic EPS 2019-20 = ₹ 24,00,000/24,00,000 = ₹ 1

Adjusted EPS 2018-19 = ₹ 7,20,000/24,00,000 = ₹ 0.30

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 2018-19, the earliest period reported.

Question 4 *(ICAI Study Material)*

Pg no._____

From the following information compute Basic and Adjusted Earnings per share:

Net Profit for 2018-19	₹ 11 lakhs
Net Profit for 2019-20	₹ 15 lakhs
No. of shares before Rights Issue	5 Lakhs
Rights issue Ratio	One for Every 5 Held
Issue Price	₹ 15
Last Date of exercising Rights option	01-06-2019
Fair value of share before Rights Issue	₹ 21 per share

Solution

Computation of theoretical ex-rights fair value per share

$$= \frac{\text{Fair value of o/s shares prior to right exercise + Total Amt. received from exercise of rights}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

$$= \frac{(21.00 \times 5,00,000 \text{ shares}) + (15.00 \times 1,00,000 \text{ shares})}{5,00,000 \text{ shares} + 1,00,000 \text{ shares}}$$

Theoretical ex-rights fair value per share = ₹ 20.00
Paid Part in Right Issue = 1,00,000 * 15/20 = 75,000 shares
Bonus Part in Right Issue = 1,00,000 – 75,000 = 25,000 shares

Computation of earnings per share

	Year 2018-19	Year 2019-20
EPS for the year 2018-19 as originally reported: (₹ 11,00,000/5,00,000 shares)	₹ 2.20	
EPS for the year 2018-19 restated for rights issue: [₹ 11,00,000/ (5,00,000 shares + 25,000 shares)]	₹ 2.10	
EPS for the year 2019-20 including effects of rights issue $\frac{15,00,000}{\{(5,00,000 + 25,000)*12/12\}+ (75,000 \times 10/12)}$		₹ 2.55

Alternatively : Computation of adjustment factor

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex – rights value per share}} = \frac{21.00}{20.00} = 1.05$$

Computation of earnings per share

	Year 2018-19	Year 2019-20
EPS for the year 2018-19 as originally reported: (₹ 11,00,000/5,00,000 shares)	₹ 2.20	
EPS for the year 2018-19 restated for rights issue: [₹ 11,00,000/ (5,00,000 shares x 1.05)]	₹ 2.10	
EPS for the year 2019-20 including effects of rights issue $\frac{15,00,000}{(5,00,000 \times 1.05 \times 2/12)+ (6,00,000 \times 10/12)}$		₹ 2.55

Question 5 *(RTP Nov 2018)* *Pg no._____*

The following information is available for TON Ltd. for the accounting year 2018-19 & 2019-20:

Net Profit For	₹
Year 2018 – 2019	35,00,000
Year 2019 – 2020	45,00,000

No. of shares outstanding prior to right issue 15,00,000 shares.
Right issue : One new share for each 3 shares outstanding i.e. 5,00,000 shares
: Right issue price ₹ 25
: Last date to exercise rights 31st July, 2019
Fair value of one equity share immediately prior to exercise of rights on 31.07.2019 is ₹ 35.
You are required to compute:
(i) Basic earnings per share for the year 2018-19.
(ii) Restated basic earnings per share for the year 2018-19 for right issue.
(iii) Basic earnings per share for the year 2019-20

Solution

Computation of theoretical ex-rights fair value per share

$$= \frac{\text{Fair value of o/s shares prior to right exercise + Total Amt. received from exercise of rights}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

$$= \frac{(35.00 \times 15,00,000 \text{ shares}) + (25.00 \times 5,00,000 \text{ shares})}{15,00,000 \text{ shares} + 5,00,000 \text{ shares}}$$

Theoretical ex-rights fair value per share = ₹ 32.50

Paid Part in Right Issue = 5,00,000 * 25/32.50 = 3,84,615 shares
Bonus Part in Right Issue = 5,00,000 – 3,84,615 = 1,15,385 shares

Computation of earnings per share

	Year 18 – 19	Year 19 – 20
EPS for the year 18 - 19 as originally reported: (₹ 35,00,000/15,00,000 shares)	2.33	
EPS for the year 18 - 19 restated for rights issue: [₹ 35,00,000/(15,00,000 shares + 1,15,385 shares)]	2.17	
EPS for the year 19-20 including effects of rights issue $\frac{45,00,000}{\{(15,00,000 + 1,15,385)*12/12\} + (3,84,615 \times 8/12)}$		2.40

Question 6 *(Inter Nov 2019) (5 Marks) / (RTP May 2023)* *Pg no._____*

Following information is supplied by K Ltd.:
Number of shares outstanding prior to right issue - 2,50,000 shares.
Right issue - two new share for each 5 outstanding shares (i.e. 1,00,000 new shares)
Right issue price – ₹ 98
Last date of exercising rights - 30-06-2019.
Fair value of one equity share immediately prior to exercise of right on 30-06-2019 is ₹ 102.
Net Profit to equity shareholders:
2018-2019 – ₹ 50,00,000
2019-2020 ₹ 75,00,000
You are required to calculate the basic earnings per share as per AS-20 Earnings per Share.

Solution

Computation of theoretical ex-rights fair value per share

$$= \frac{\text{Fair value of o/s shares prior to right exercise + Total Amt. received from exercise of rights}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

$$= \frac{(102.00 \times 2,50,000 \text{ shares}) + (98.00 \times 1,00,000 \text{ shares})}{2,50,000 \text{ shares} + 1,00,000 \text{ shares}}$$

Theoretical ex-rights fair value per share = ₹ 100.86
Paid Part in Right Issue = 1,00,000 * 98/100.86 = 97,164 shares
Bonus Part in Right Issue = 1,00,000 – 97,164 = 2,836 shares

Computation of earnings per share

	Year 18 – 19	Year 19 – 20
EPS for the year 18 - 19 as originally reported: (₹ 50,00,000/2,50,000 shares)	20.00	
EPS for the year 18 - 19 restated for rights issue: [₹ 50,00,000/(2,50,000 shares + 2,836 shares)]	19.78	
EPS for the year 19-20 including effects of rights issue $\frac{75,00,000}{\{(2,50,000 + 2,836)*12/12\} + (97,164 \times 9/12)}$		23.03

Question 7 *(RTP Nov 2020)* *Pg no._____*

A-One Limited supplied the following information. You are required to compute earnings per share as per AS 20. Net Profit attributable to equity shareholders

Year 2018-19	1,00,00,000
Year 2019-20	1,50,00,000

No of shares outstanding prior to right issue 50,00,000 shares.
Right issue : One new share for each four shares outstanding i.e. 12,50,000 shares.

: Right Issue price ₹ 96
: Last date to exercise right 30th June, 2019

Fair value of one equity share immediately prior to exercise of rights on 30.06.2019 is ₹ 101.

Solution

Computation of theoretical ex-rights fair value per share

$$= \frac{\text{Fair value of o/s shares prior to right exercise + Total Amt. received from exercise of rights}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

$$= \frac{(101.00 \times 50{,}00{,}000 \text{ shares}) + (96.00 \times 12{,}50{,}000 \text{ shares})}{50{,}00{,}000 \text{ shares} + 12{,}50{,}000 \text{ shares}}$$

Theoretical ex-rights fair value per share = ₹ 100

Paid Part in Right Issue = 12,50,000 * 96/100 = 12,00,000 shares

Bonus Part in Right Issue = 12,50,000 – 12,00,000 = 50,000 shares

Computation of earnings per share

	Year 18 – 19	Year 19 – 20
EPS for the year 18 - 19 as originally reported: (₹ 1,00,00,000/50,00,000 shares)	2.00	
EPS for the year 18 - 19 restated for rights issue: [₹ 1,00,00,000/(50,00,000 shares + 50,000 shares)]	1.98	
EPS for the year 19-20 including effects of rights issue $\frac{1{,}50{,}00{,}000}{\{(50{,}00{,}000 + 50{,}000)*12/12\} + (12{,}00{,}000 \times 9/12)}$		2.52

Question 8 *(Inter May 2022) (5 Marks) / (ICAI Study Material)* Pg no.______

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.

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:

(i) 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.

(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?

Solution

(i) Calculation of Basic Earnings per share for the year ended 31st March, 2022 including the comparative figure:

(a) 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

(b) Adjusted Earnings per share after taking into consideration bonus issue

Adjusted Basic EPS = Earnings for the year 2020-2021 / Total outstanding shares +Bonus issue

= ₹ 6,23,00,000 / (10,00,000+ 5,00,000)

= ₹ 6,23,00,000 / 15,00,000 = ₹ 41.53 per share

(c) Basic EPS for the year 2021-2022

Basic EPS = (Total Earnings – Preference Shares Dividend) / (Total shares outstanding at the beginning + 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 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 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 9 *(ICAI Study Material)* *Pg no._____*

Net profit for the current year	₹ 1,00,00,000
No. of equity shares outstanding	50,00,000
Basic earnings per share	₹ 2
No. of 12% convertible debentures of ₹ 100 each. Each debenture is convertible into 10 equity shares	1,00,000
Interest expense for the current year	₹ 12,00,000
Tax relating to interest expense (30%)	₹ 3,60,000

Compute Diluted Earnings Per Share.

Solution

Adjusted net profit for the current year (1,00,00,000 + 12,00,000 – 3,60,000) = ₹ 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) = ₹ 1.81

Question 10 *(RTP May 2018)* *Pg no._____*

Mohur Ltd. has equity capital of ₹ 40,00,000 consisting of fully paid equity shares of ₹ 10 each. The net profit for the year 2019-2020 was ₹ 60,00,000. It has also issued 36,000, 10% convertible debentures of ₹ 50 each. Each debenture is convertible into five equity shares. The tax rate applicable is 30%. You are required to compute the amount of diluted earnings for the year 2019-2020.

Solution

Adjusted net profit for the current year (60,00,000 + 1,80,000 – 54,000) = ₹ 61,26,000

No. of equity shares resulting from conversion of debentures: 36,000*5= 1,80,000 Shares

No. of equity shares used to compute diluted EPS: (4,00,000 + 1,80,000) = 5,80,000 Shares

Diluted earnings per share: (61,26,000/1,80,000) = ₹ 10.56

Question 11 *(Inter Nov 2018) (5 Marks)* Pg no._____

From following information given by Sampark Ltd., Calculate Basis EPS & Diluted EPS as per AS 20:

	₹
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	50,0000
Each debenture is convertible into 8 Equity Shares	
Interest expense for the current year	6,00,000
Tax saving relating to interest expense (30%)	1,80,000

Solution

Calculation of Basic Earnings Per Share

$$\text{Basic EPS} = \frac{\text{Net Profit for the current year}}{\text{No. of Equity Shares}}$$

$$= \frac{2,50,00,000}{50,00,000}$$

Basic EPS per share = ₹ 5

Calculation of Diluted Earnings Per Share

$$\text{Diluted EPS} = \frac{\text{Adjusted net profit for the current year}}{\text{Weighted average no. of Equity Shares}}$$

Adjusted net profit for the current year	₹
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) = ₹ 4.71 (Approx.)

Question 12 *(RTP May 2019)* Pg no._____

"While calculating diluted EPS, effect is given to all dilutive potential equity shares that were outstanding during that period." Explain this statement in the light of relevant AS.
Also calculate the diluted earnings per share from the following information:

Net profit for the current year (after tax)	₹1,00,00,000
No. of equity shares outstanding	10,00,000
No. of 10% convertible debentures of ₹ 100 each. (Each debenture is compulsorily & fully convertible into 10 equity shares)	1,00,000
Debenture interest expenses for the current year	₹ 5,00,000
Assume applicable income tax rate @ 30%	

Solution

"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.

Computation of diluted earnings per share = Adjusted net profit for the current year / Weighted average number of equity shares

Net profit for the current year	1,00,00,000
Add: Interest expense for the current year	5,00,000
Less: Tax relating to interest expense (30% of ₹ 5,00,000)	(1,50,000)
Adjusted net profit for the current year	1,03,50,000

Note: Conversion of convertible debentures into Equity Share is a 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.

Weighted average number of equity shares

Number of equity shares resulting from conversion = (1,00,000 X 100)/10 = 10,00,000

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

= [(10,00,000 x 12) + (10,00,000 x 6*)]/12 = 15,00,000 shares

*Interest on debentures for full year amounts to ₹ 10,00,000 (i.e. 10% of ₹ 1,00,00,000). However, interest expense amounting ₹ 5,00,000 has been given in the question. It may be concluded that debentures have been issued during the year and interest has been provided for 6 months.

Diluted earnings per share = 1,03,50,000 / 15,00,000 shares

= ₹ 6.90 per share

Question 13 (RTP May 2018/RTP Nov 2019 (Sim.)/RTP May 2020)/Nov 2022 (Similar) Pg no._____

The following information relates to M/s. XYZ Limited for the year ended 31st March, 2020:

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

Number of Equity Shares of ₹ 10 each outstanding: ₹ 10,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

Particulars	No.
8% Convertible Debentures of ₹ 100 each	1,00,000
Equity Shares to be issued on conversion	1,10,000

The Rate of Income Tax: 30%. Calculate Basic and Diluted Earnings Per Share (EPS).

Solution

Basic Earnings per share (EPS) = Net profit attributable to equity shareholders / Weighted average no. of equity shares o/s during year

= 75,00,000 / 10,00,000 Shares

= ₹ 7.5 per share

Computation of diluted earnings per share = Adjusted net profit for the current year / Weighted average number of equity shares

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 ₹ 8,00,000)	(2,40,000)
Adjusted net profit for the current year	80,60,000

Number of equity shares resulting from conversion of deb. = 1,10,000 Equity shares (given)

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 = 80,60,000 / 11,10,000 shares

= ₹ 7.26 per share

Question 14 *(Inter Dec 2021) (5 Marks)* Pg no._____

"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:

Net profit after tax for the year	64,12,500
No. of equity shares outstanding	15,00,000
No. of 9% convertible debentures of ₹ 100 each issued on 1st July,2020	75,000
Each debenture is convertible into 8 equity shares	
Tax relating to interest expense	35%

Solution

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 = ₹ 4.275 or ₹ 4.28

Computation of diluted earnings per share = $\dfrac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

Adjusted net profit for the current year will be (64,12,500 + 5,06,250 – 1,77,188) = ₹ 67,41,562

No. 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%)

Question 15 *(Inter Nov 2022) (5 Marks)* Pg no._____

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
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.

Solution:

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 2022		30,00,000	
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 year 2022		30,00,000	
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.

Question 16

Pg no._____

For Accounting year 1-4-2019 to 31-3-2020

Net profit attributable to equity shareholders	1,00,00,000
No. of equity shares outstanding	20,00,000
Average fair value of one equity share during the year	75

Potential Equity Shares	
Options	1,00,000 with exercise price of ₹ 60
Convertible Preference Shares	8,00,000 shares entitled to cumulative dividend of ₹8 per share. Each preference share is convertible into 2 equity shares
12% Convertible Debentures of ₹ 100 each	Nominal amount ₹ 10,00,00,000. Each debenture is convertible into 4 equity shares.
Tax rate	30%

Calculate diluted earnings per share as per AS 20.

Solution

Incremental Earnings per share (IEPS) = $\frac{\text{Increase in Earnings}}{\text{Increase in number of equity shares}}$

(1) Options

IEPS = $\frac{\text{Nil}}{\text{20,000 Shares*}}$ = Nil

1,00,000(75-60)/75 = 20,000

(2) Convertible Preference Shares

IEPS = $\frac{(8*8,00,000)}{(2*8,00,000)} = \frac{64,00,000}{16,00,000} = 4$

(3) Convertible Debentures

IEPS = $\frac{(10,00,00,000)*12\%*(1-0.30)}{(4*10,00,000)}$

= $\frac{84,00,000}{40,00,000}$ = 2.10

It may be noted from the above that options are most dilutive as their earnings per incremental share is nil. Hence, for the purpose of computation of diluted earnings per share, options will be considered first. 12% convertible debentures being second most dilutive will be considered next and thereafter convertible preference shares will be considered.

Conversion of Diluted Earnings Per Share

	Net Profit Attributable	No. of Equity Shares	Earnings per Share	
As reported	1,00,00,000	20,00,000	5	
Options	-	20,000		
	1,00,00,000	20,20,000	4.95	Dilutive
12% Convertible Debentures	84,00,000	40,00,000		
	1,84,00,000	60,20,000	3.06	Dilutive
Convertible Preference Shares	64,00,000	16,00,000		
	2,48,00,000	76,20,000	3.25	Anti Dilutive

Since diluted earnings per share is increased when taking the convertible preference shares into account (from ₹ 3.06 to ₹ 3.25), the convertible preference shares are anti-dilutive and are ignored in the calculation of diluted earnings per share. Therefore, diluted earnings per share is ₹ 3.06

ACCOUNTING FOR TAXES ON INCOME

AS 22

<table>
<tr><td>Scope</td><td colspan="2">This standard prescribes the accounting treatment of taxes on income and follows the concept of matching expenses against revenue for the period.
This includes determination of the amount of the expense or saving related to taxes on income in respect of an accounting period & disclosure of such an amount in the financial statements.
The differences between taxable income and accounting income can be classified into permanent differences and timing differences</td></tr>
<tr><td rowspan="7">Definitions</td><td>Accounting income (loss)</td><td>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.</td></tr>
<tr><td>Taxable income (tax loss)</td><td>Amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income-tax payable (recoverable) is determined.</td></tr>
<tr><td>Tax expense (tax saving)</td><td>Aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period</td></tr>
<tr><td>Current tax</td><td>Amount of income tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period.</td></tr>
<tr><td>Deferred tax</td><td>Tax effect of timing differences.</td></tr>
<tr><td>Timing differences</td><td>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.</td></tr>
<tr><td>Permanent differences</td><td>Differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently</td></tr>
<tr><td>Recognition</td><td colspan="2">❖ Tax expense for the period, comprising current tax and deferred tax, should be included in the determination of net profit or loss for the period.
❖ Permanent differences do not result in deferred tax assets or deferred tax liabilities.
❖ Taxes on income are considered to be an expense incurred by the enterprise in earning income and are accrued in the same period as the revenue and expenses to which they relate. Such matching may result into timing differences.
❖ The tax effects of timing differences are included in the tax expense in the statement of profit and loss and as deferred tax assets or as deferred tax liabilities, in the balance sheet.</td></tr>
<tr><td>Deferred Tax Assets</td><td colspan="2">❖ While recognizing the tax effect of timing differences, consideration of prudence cannot be ignored. Therefore, deferred tax assets are recognised and carried forward only to the extent that there is a reasonable certainty of their realisation.</td></tr>
</table>

<table>
<tr><td></td><td colspan="2">❖ This reasonable level of certainty would normally be achieved by examining the past record of the enterprise and by making realistic estimates of profits for the future.
❖ Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, <u>deferred tax assets should be recognised</u> only to the extent that there is <u>virtual certainty supported by convincing evidence</u> that sufficient future taxable income will be available against which such deferred tax assets can be realised.</td></tr>
<tr><td>Re-Assessment of Unrecognized Deferred Tax Assets</td><td colspan="2">At each balance sheet date, an enterprise re-assesses unrecognized deferred tax assets. The enterprise recognizes previously unrecognized deferred tax assets to the extent that it has become reasonably certain or virtually certain, as the case may be, that sufficient future taxable income will be available against which such deferred tax assets can be realized</td></tr>
<tr><td>Measurement</td><td colspan="2">➢ Current tax should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws.
➢ Deferred tax assets and liabilities are usually measured using the tax rates and tax laws that have been enacted by the balance sheet date.
➢ However, certain announcements of tax rates and tax laws by the government may have the substantive effect of actual enactment. In these circumstances, deferred tax assets and liabilities are measured using such announced tax rate and tax laws.
➢ Deferred tax assets and liabilities should not be discounted to their present value.</td></tr>
<tr><td rowspan="2">Disclosure</td><td>Statement of profit & loss</td><td>Under AS 22, there is no specific requirement to disclose current tax and deferred tax in the statement of profit and loss. However, considering the requirements under the Companies Act, 2013, the amount of income tax and other taxes on profits should be disclosed.</td></tr>
<tr><td>Balance sheet</td><td>Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities.</td></tr>
<tr><td>Accounting for Taxes on Income in the situations of Tax Holiday</td><td colspan="2">❖ The deferred tax in respect of timing differences which reverse during the tax holiday period should not be recognised to the extent the enterprise's gross total income is subject to the deduction during the tax holiday period as per the requirements of the Act.
❖ Deferred tax in respect of timing differences which 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 as laid down in AS 22. For the above purposes, the timing differences which originate first should be considered to reverse first</td></tr>
</table>

ASSIGNMENT QUESTIONS

Question 1 Pg no._____

X Ltd., has provided the following information:
On 1st April, 2017 it purchased machinery at a cost of ₹ 3,00,000. The machine has a useful life of 3 years & expected scrap value of zero. The asset is eligible for 100% depreciation allowance for tax purposes and SLM is appropriated for accounting purposes. X Ltd. has profit before depreciation & taxes of ₹ 5,00,000 & the corporate tax is 40% each year.
Prepare P&L extract and pass journal entries for 3 years.
Case 1: Tax Rate 40% each year
Case 2: Tax Rate 40%, 35% & 38% respectively for year 2017-18, 2018-19, 2019-20.

Question 2 *(ICAI Study Material)* Pg no._____

Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognizes revenue from these contracts on percentage of completion method for financial statements during 2017-2018, 2018-2019 and 2019-2020 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 years 2017-2018, 2018-2019 and 2019-2020 respectively. Income-tax rate 35%. Compute the amount of deferred tax asset/ liability for the years 2017-2018, 2018-2019 and 2019-2020.

Question 3 *(RTP May 2018) / (ICAI Study Material)* Pg no._____

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/ liability should be recognised as transition adjustment? Tax rate 50%

Question 4 *(RTP May 2020)* Pg no._____

The following particulars are stated in the Balance Sheet of PQR Ltd. as on 31.03.2019

	(₹ In Lakhs)
Deferred Tax Liability (Cr.)	30.00
Deferred Tax Assets (Dr.)	15.00

The following transactions were reported during the year 2019-20

(i)	Tax Rate	30%
		(₹ In Lakhs)
(ii)	Depreciation as per Books	80.00
	Depreciation for tax purposes	70.00
(iii)	Items disallowed in 2018-19 & allowed for tax purposes in 2019-20	10.00
(iv)	Donations to Private Trusts made in 2019-20	10.00

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 31.03.2020.

Question 5 *(RTP May 2021)* Pg no._____

The following information is furnished in respect of Slate Ltd. for the year ending 31-3-2019:
(i) Depreciation as per books ₹ 2,80,000
Depreciation for tax purpose ₹ 1,90,000
The above depreciation does not include depreciation on new additions.

(ii) A new machinery purchased on 1.4.18 costing ₹ 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 ₹ 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

Question 6 *(ICAI Study Material)* Pg no._____

ABC Company Ltd. had an investment in Venture Capital amounting 10 Crores. Venture capital in turn had invested in the below portfolio companies (New Start-ups) on behalf of ABC Ltd:

Portfolio Companies	Amount of investment (₹ in Crores)
Oscar Limited	2
Zee Limited	3
Star Limited	4
Sony Limited	1
Total	10

During the FY 2019-2020, Venture Capital had sold their investment in Star Limited and realised an amount of ₹ 8 Crores on sale of shares of star Limited and entire proceeds of ₹ 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 as at year end is 2 Crores.
(2) Company had to pay a capital gain tax @ 20% on the net sale consideration of ₹ 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

Question 7 *(ICAI Study Material)* Pg no._____

PQR Ltd.'s accounting year ends on 31st March. The company made a loss of ₹ 2,00,000 for the year ending 31.3.2018. For the years ending 31.3.2019 and 31.3.2020, 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 31.3.2018, 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 2019 and 2020 for tax purposes.
Prepare a statement of Profit and Loss for the years ending 2018, 2019 and 2020

Question 8 *(RTP Nov 2018)* Pg no._____

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 ₹ 1,000 lakhs and ₹ 2,000 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by ₹ 50 lakhs. Assuming tax rate of 40%, you are required to compute to the deferred tax liability at the end of the second year and any charge to the Profit and Loss account

Solution

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 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 ₹ 1,000 lakhs depreciation, timing difference amounting ₹ 400 lakhs (₹ 50 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognized. However, for ₹ 600 lakhs (₹ 1,000 lakhs – ₹ 400 lakhs), deferred tax liability will be recognized for ₹ 240 lakhs (40% of ₹ 600 lakhs) in first year. In the second year, the entire amount of timing difference of ₹ 2,000 lakhs will reverse only after-tax holiday period and hence, will be recognized in full. Deferred tax liability amounting ₹ 800 lakhs (40% of ₹ 2,000 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 ₹ 1,040 lakhs (240 lakhs + 800 lakhs).

Question 9 *(ICAI Study Material)* *Pg no._____*

From the following details of A Ltd. for the year ended 31-03-2020, 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%

Question 10 *(RTP May 2021)* *Pg no._____*

What are the disclosure requirements for deferred tax assets and deferred tax liabilities in the balance sheet as per AS 22?

Solution

The break-up of deferred tax assets and deferred tax liabilities into major components of the respective 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, separately from current assets and current liabilities. The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

Question 11 *(RTP Nov 2021)* *Pg no._____*

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.

Solution

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 same governing taxation laws.

Question 12 *(RTP May 2019)* *Pg no.*_____

Is it permissible not to recognize deferred tax liability on the ground that Company expects that there will be losses both for accounting & tax purposes in near future? You are required to give advice to company.

Solution

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.

PRACTICE QUESTIONS

Question 1 *(Inter May 2019) (5 Marks) / (RTP Nov 2020)* *Pg no._____*

Write short note on Timing differences and Permanent differences as per AS 22.

Solution

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 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 2 *(Inter May 2018) (5 Marks)* *Pg no._____*

Rohit Ltd. has provided the following information:

Particulars	Amount
Depreciation as per accounting records	2,50,000
Depreciation as per tax records	5,50,000
Unamortised preliminary expenses as per tax record	40,000

There is adequate evidence of future profit sufficiency. How much deferred tax assets/liability should be recognized as transition adjustment when the tax rate is 50%?

Solution

Table showing calculation of deferred tax asset / liability

Particulars	Amount	Timing Difference	Deferred Tax	Amount @ 50%
Excess depreciation as per tax records (5,50,000 – 2,50,000)	3,00,000	Timing	Deferred Tax Liability	1,50,000
Unamortised preliminary expenses as per tax records	40,000	Timing	Deferred Tax Asset	20,000
Net deferred tax liability				1,30,000

Net deferred tax liability amounting ₹ 1,30,000 should be recognized as transition adjustment.

Question 3 *(RTP Nov 2020)* *Pg no._____*

Rama Ltd. has provided the following information:

Particulars	Amount
Depreciation as per accounting records	6,00,000
Depreciation as per tax records	10,00,000
Unamortised 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%?

Solution

Table showing calculation of deferred tax asset / liability

Particulars	Amount	Timing Difference	Deferred Tax	Amount @ 30%
Excess depreciation as per tax records (₹ 10,00,000 – ₹ 6,00,000)	4,00,000	Timing	Deferred Tax Liability	1,20,000
Unamortised preliminary expenses as per tax records	60,000	Timing	Deferred Tax Asset	18,000
Net deferred tax liability				1,02,000

Net deferred tax liability amounting 1,02,000 should be recognized as transition adjustment.

Question 4 *(Inter Jan 2021) (5 Marks)* *Pg no._____*

The following particulars are stated in the Balance Sheet of HS Ltd. as on 31.03.2019

	(₹ In Lakhs)
Deferred Tax Liability (Cr.)	60.00
Deferred Tax Assets (Dr.)	30.00

The following transactions were reported during the year 2019-20

(i)	Tax Rate	30%
		(₹ In Lakhs)
(ii)	Depreciation as per accounting records	160.00
	Depreciation as per income tax records	140.00
(iii)	Items disallowed in 2018-19 & allowed for tax purposes in 2019-20	20.00
(iv)	Donations to Private Trusts	20.00

There were no additions to Fixed Assets during the year. You are required to show the impact of various items on Deferred Tax Assets & Deferred Tax Liability as on 31.03.20 as per AS 22.

Solution

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 comparison to 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 5 *(Inter July 2021) (5 Marks)* *Pg no._____*

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:

(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.

Solution

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, WDV method of dep. is adopted under IT Act which leads to higher dep. in earlier years of useful life of asset in comparison to later years.	Responding timing difference	Reversal of DTL	28 lakhs x 40% = ₹ 11.20 lakhs
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	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 plant and machinery	Due to allowance of full expenditure under IT Act, tax payable of the current year will be less.	Originating timing difference	Increase in DTL	70 lakhs x 40% =28 lakhs

Question 6 *(RTP May 2022)*

Pg no._____

The following transactions were reported by PQR Ltd. during the year 2020-2021:

(i)	Tax Rate	30%
		(₹ In Lakhs)
(ii)	Items disallowed in 2019-20 & allowed for tax purposes in 2020-21	20.00
(iii)	Interest to Financial Institutions accounted in the books on accrual basis, 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.

Solution

Impact of various items in terms of deferred tax liability/deferred tax asset on 31.3.21

Transactions	Analysis	Nature of difference	Effect	Amount (₹)
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Timing difference	Reversal of DTA	20 lakhs x 30% = ₹ 6 lakhs
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 Timing difference	Not Applicable	Not Applicable
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not Applicable	Not Applicable

Question 7 *(ICAI Study Material)* *Pg no._____*

Saras Ltd. closes its books as on 31st March 2022. They have accrued ₹ 5,00,000 towards GST Liability for the month of March 2022 by debiting their Profit and loss statement which is expected to be paid off by 21st April 2022 . 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 will be allowed for tax purposes in subsequent years on payment basis only. Assuming a Tax rate of 30% determine the Deferred Tax Asset/Liability as at 31st March 2022.

Solution

Calculation of difference between taxable income and accounting income

Particulars	Amount
GST Liability debited in books	5,00,000
Less: GST Liability allowed under Income Tax Act (Section 43B)	Nil
Timing difference	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

Question 8 *(Inter Nov 2022) (5 Marks)* *Pg no._____*

The following information is furnished in respect of Mohit Limited for the year ending 31st March,2022.

a) Depreciation as per accounting records ₹ 56,000
Depreciation for income tax records ₹ 38,000.
The above depreciation does not include depreciation on new addition.
b) A new machinery purchased on 1st April, 2021 costing ₹ 24,000 on which 100% depreciation in allowed in the 1st Year for income tax purpose, whereas straight line method of depreciation is considered appropriate for accounting purpose with a life estimation of 4 years.
c) The company has made a profit of ₹ 1,28,000 before depreciation and taxes.
d) Donation to private trust during the year is ₹ 15,000 (not allowed under Income tax laws.)
e) Corporate tax is 40%.

Prepare relevant extract of statement of Profit & Loss for the year ending 31 st March, 2022. Also show the effect of the above items on Deferred Tax Liability/Assets as per AS 22.

Solution:

Statement of profit and Loss for the year ended 31st March, 2022 (An Extract)

	₹
Profit before taxes and depreciation	1,28,000
Less: Depreciation (56,000+ 6,000)	(62,000)
Profit before tax	66,000
Less: Current tax (W.N)	(32,400)
Deferred Tax	Nil
Profit after tax	33,600

Working Note:

Computation of taxable income

	₹
Profit before taxes and depreciation	1,28,000
Less: Depreciation (38,000+ 24,000)	(62,000)
	66,000
Add: Donation*	15,000
	81,000
Current tax (40%)	32,400

Note: The profit of ₹ 1,28,000 given in question is before depreciation and taxes. It has been considered that this amount is after making adjustment of donation amounting ₹ 15,000.

Impact of various items in terms of deferred tax liability/deferred tax asset

	Transactions	Nature of difference	Effect	Amount
1.	Difference in depreciation (old machinery)	Timing difference	Reversal of DTL	₹ 18,000 (56,000 – 38,000) *40% = (+) ₹ 7,200
2.	Depreciation on new machinery	Timing difference	Creation of DTL	₹ 18,000 (24,000 – 6,000) *40%= (-) ₹ 7,200
3.	Donation to private trusts	Permanent difference	Not applicable	--
	Net Effect of Deferred Tax			Nil

Question 9

Pg no._____

A company, ABC Ltd., prepares its accounts annually on 31st March. The company has incurred a loss of ₹ 1,00,000 in the year 2018 and made profits of ₹ 50,000 and 60,000 in year 2019 and year 2020 respectively. Under the tax laws, loss can be carried forward for 8 years and tax rate is 40% and at the end of year 2018, it was virtually certain, supported by convincing evidence, that the company would have sufficient taxable income in the future years against which unabsorbed depreciation and carry forward of losses can be set-off. Also there is no difference between taxable income and accounting income except that set-off of loss is allowed in years 2019 and 2020 for tax purposes. Current tax in the year 2020 is ₹ 4,000. Show the effect of above transactions by preparing the Statement of Profit and Loss

Solution

Statement of Profit & Loss

	2018	2019	2020
Profit / (Loss)	(1,00,000)	50,000	60,000
Less: Current Tax	-	-	(4,000) [10,000*40%]

Deferred Tax: Tax effect of timing differences originating during the year (1,00,000 x 40%) Tax effect of timing differences reversed/ adjusted during the year (50,000 x 40%)	40,000	(20,000)	(20,000)
Profit / (Loss) after tax	(60,000)	30,000	36,000

Question 10 – *(ICAI Study Material)* Pg no._____

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 & Loss account.

Solution

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 2^{nd} year, entire amount of timing difference of ₹ 400 lakhs will reverse only after tax holiday period & hence, will be recognised in full. Deferred tax liability amounting ₹ 160 lakhs (40% of ₹ 400 lakhs) will be created by charging it to profit & loss account and total balance of deferred tax liability account at end of 2^{nd} year will be ₹ 208 lakhs (48 lakhs + 160 lakhs).

Question 11 *(RTP Nov 2019)* Pg no._____

The Accountant of Sohna Ltd. provides following information for the year ended 31-03-2020:

Particulars	₹
Accounting Profit	7,50,000
Book Profit as per MAT	4,37,500
Profit as per Income Tax Act	90,000
Tax Rate	20%
MAT Rate	7.50%

You are required to 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.

Solution

Tax as per accounting profit 7,50,000 x 20% = ₹ 1,50,000
Tax as per Income-tax Profit 90,000 x 20% = ₹ 18,000
Tax as per MAT 4,37,500 x 7.50% = ₹ 32,812.50
Tax expense= Current Tax + Deferred Tax
₹ 1,50,000 = ₹ 18,000+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-2020 = ₹ 1,50,000 – ₹ 18,000 = ₹ 1,32,000

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

= ₹ 18,000 + ₹ 1,32,000 + ₹ 14,812.50 (32,812.50 – 18,000) = ₹ 1,64,812.50

Question 12 *(Inter Nov 2019) (5 Marks)* Pg no._____

Sheetal Ltd. has provided the following information for the year ended 31-03-2020:

Particulars	₹
Accounting Profit	9,00,000
Book Profit as per MAT	5,25,000
Profit as per Income Tax Act	95,000
Tax Rate	30%
MAT Rate	7.50%

You are required to 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.

Solution

Tax as per accounting profit 9,00,000 x 30% = ₹ 2,70,000

Tax as per Income-tax Profit 95,000 x 30% = ₹ 28,500

Tax as per MAT 5,25,000 x 7.50% = ₹ 39,375

Tax expense= Current Tax + Deferred Tax

₹ 2,70,000 = ₹ 28,500+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-2020 = ₹ 2,70,000 – ₹ 28,500 = ₹ 2,41,500

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

= ₹ 28,500 + ₹ 2,41,500 + ₹ 10,875 (39,375 – 28,500) = ₹ 2,80,875

Question 13 *(Inter Nov 2020) (5 Marks)* Pg no._____

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	7.50%

You are required to 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.

Solution

Tax as per accounting profit 15,00,000 x 20% = ₹ 3,00,000

Tax as per Income-tax Profit 2,50,000 x 20% = ₹ 50,000

Tax as per MAT 7,50,000 x 7.50% = ₹ 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

ACCOUNTING FOR INVESTMENT IN ASSOCIATES IN CONSOLIDATED FINANCIAL STATEMENTS

AS 23

Coverage	AS 23 describes the principles procedures for recognizing investments in associates (in which the investor has significant influence, but not a subsidiary or joint venture of investor) in consolidated financial statements of the investor. An investor which presents consolidated financial statements should account for investments in associates as per equity method in accordance with this standard but in its separate financial statements, AS 13 will be applicable.
Objective	The objective of this Standard is to lay down principles and procedures for recognizing the investments in associates and its effect on the financial operations of the group in the consolidated financial statements. Reference to AS 23 is compulsory for the companies following AS 21 and preparing consolidated financial statement for their group.
Meaning of Associate	An associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor. *Significant influence is the power to participate in the financial and/or operating policy decisions of the investee but not control over those policies.* Any enterprise having 20% or more of the voting power or any interest directly or indirectly in any other enterprise will be assumed to have significantly influence the other enterprise unless proved otherwise. Significant influence may be gained by share ownership, statute or agreement.
Examples	<u>Example 1</u> A Ltd. has 70% holding in C Ltd. and B Ltd. also has 28% holding in the same company. So, A Ltd. with the majority holding i.e. more than 50% is the parent company i.e. a holding company. Since B Ltd. holds more than 20% but not more than 50% in C Ltd., C Ltd. will be an associate of B Ltd. <u>Example 2</u> 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. In this case, A Ltd. is parent of B Ltd. As far as the relationship between A Ltd. and C Ltd. is concerned; A Ltd. has a total of direct and indirect holding of (10 + 11) 21% in C Ltd., Thus, C Ltd. is an associate of A Ltd. It may however be noted that for consolidated financial statement purposes, the holding will be 19.9% (10% + 90% of 11%).
Accounting as per Equity Method	The equity method is a method of accounting whereby the investment is initially recorded at cost, identifying any goodwill/capital reserve arising at the time of acquisition.

	The carrying amount of the investment is adjusted thereafter for the post acquisition change in the investor's share of net assets of the investee. The consolidated statement of profit and loss reflects the investor's share of the results of operations of the investee. Goodwill/capital reserve arising on the acquisition of an associate by an investor should be included in the carrying amount of investment in the associate but should be disclosed separately. From the definition, following broad conclusions can be drawn: a. Investment is initially recorded at cost. b. Any surplus or deficit in cost and net asset to be recorded as goodwill or capital reserve. c. Distributions received from an investee reduce the carrying amount of the investment. d. Any subsequent change in share in net asset is adjusted in cost of investment and goodwill/capital reserve. e. Consolidated Profit & Loss shows the investor's share in the results of operations of the investee.
Circumstances under which Equity Method is Followed	Equity method of accounting is to be followed by all the enterprises having significant influence on their associates <u>except</u> in the following cases: a. Control is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future. b. Or 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 the investee is treated as investment according to AS 13. An investor should <u>discontinue the use of the equity method</u> 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.
Applicability of Equity Method	Many of the rules followed under equity method for an associate is similar to consolidated financial statement rules as in case of subsidiary i.e. AS 21. Investment in an associate should be recorded as per the equity method from the date when such relation comes in effect. Investment in the associate is recorded at cost and any difference in the cost and investor's share in equity on the date of acquisition is shown as goodwill or capital reserve

Step Acquisition in case of an associate	An enterprise having share of profits of more than 50% in other company, they are said to be in Parent-Subsidiary relationship. However, if the share in profits is more than 20% but upto 50% then this relationship is termed as associate relationship. This stake of 20% can be acquired either in one go or in more than one transaction. This share of stake can be increased further say from 25% to 30%. Adjustment should be made with each transaction.
Different Reporting Dates	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 to reporting 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 6 months.
Uniform Accounting Policies	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.
Carrying Value of Investment	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.
Contingencies	As per AS 4, the investor discloses in the consolidated financial statements: a. Its share of the contingencies and capital commitments of an associate for which it is also contingently liable; and b. Those contingencies that arise because the investor is severally liable for the liabilities of the associate.
Why Equity method adopted?	Investments in associates cannot be treated as a normal investment under AS 13. The intent of investing to such an extent (i.e.; 20% or more but less than 50% of equity) in an associate is an expression of the fact that the investor is not merely interested in the dividend distribution, but also is interested in the participation of decision-making process in the associate. As the investor has significant influence over the associate, the investor has a measure of responsibility for the associate's performance and, as a result, the return on its investment. The investor accounts for this stewardship by extending the scope of its consolidated financial statements to include its share of results of such an associate and so provides an analysis of earnings and investment from which more useful ratios can be calculated.

	As a result, application of the equity method in consolidated financial statements provides more informative reporting of the net assets and net income of the investor.
Disclosures	❖ In addition to the disclosures required above, an appropriate listing and description of associates including the proportion of ownership interest and, if different, the proportion of voting power held should be disclosed in the consolidated financial statements. ❖ Investments in associates accounted for using the equity method should be classified as long-term investments and disclosed separately in the consolidated balance sheet. The investor's share of the profits or losses of such investments should be disclosed separately in the consolidated statement of profit and loss. The investor's share of any extraordinary or prior period items should also be separately disclosed. ❖ The name(s) of the associate(s) of which reporting date(s) is/are different from that of the financial statements of an investor and the differences in reporting dates should be disclosed in the consolidated financial statements. ❖ In case an associate uses accounting policies other than those adopted for the consolidated financial statements for like transactions and events in similar circumstances and it is not practicable to make appropriate adjustments to the associate's financial statements, the fact should be disclosed along with a brief description of the differences in the accounting policies ❖ If an associate is not accounted for using the equity method the reasons for not doing the same. ❖ Goodwill/capital reserve arising on the acquisition of an associate by an investor should be disclosed separately though it is included in the carrying amount of the investment.
Treatment of Proposed Dividend	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.
Consideration of Potential Equity Share	The potential equity shares of the investee held by the investor should not be taken into account for determining the voting power of the investor.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)*

A Ltd. acquire 45% of B Ltd. shares on April 01, 2021, the price paid was ₹ 15,00,000. Following are the extracts of balance sheet of B Ltd. as of 1 April 2021:

Paid up Equity Share Capital	₹ 10,00,000
Securities Premium	₹ 1,00,000
Reserve & Surplus	₹ 5,00,000

B Ltd. has reported net profits of ₹ 3,00,000 and paid dividends of ₹ 1,00,000 for the year ended 31 March 2022. 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, 2022.

Question 2 *(ICAI Study Material)*

A Ltd. acquired 40% share in B Ltd. on April 01, 2021 for ₹ 10 lacs. On that date B Ltd. had 1,00,000 equity shares of ₹ 10 each fully paid and accumulated profits of ₹ 2,00,000. During the year 2021-2022, B Ltd. suffered a loss of ₹ 10,00,000; during 2022-2023 loss of ₹ 12,50,000 and during 2023-2024 again a loss of ₹ 5,00,000. Show the extract of consolidated balance sheet of A Ltd. on all the four dates recording the above events.

Solution:

Calculation of Goodwill/Capital Reserve under Equity Method

Particulars	₹
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)
Goodwill	5,20,000

Consolidated Balance Sheet (Extract) as on April 01, 2021: ASSETS

Investment in Associate as per AS 23	₹	₹
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 2022:

Investment in Associate as per AS 23	₹
Share of Net Assets on 1 April, 2021	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, 2022: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 2021	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 2023:

Investment in Associate as per AS 23	₹
Carrying Amount of Investment as on 31 March 2022	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, 2023: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 2021	4,80,000	
Less: Share of Loss as above (₹4,00,000 +₹ 5,00,000)	(9,00,000)	
	(4,20,000)	
Add: Goodwill	5,20,000	1,00,000

Calculation of Carrying Amount of Investment as at 31 March 2024:

Investment in Associate as per AS 23	₹
Carrying Amount of Investment	1,00,000
Less: Loss for the year (5,00,000 x 40% = 2,00,000, restricted to Carrying amount of Investment in B Ltd.) – refer note below	(1,00,000)
Carrying Amount of Investment	-

Consolidated Balance Sheet (Extract) as on March 31, 2024: ASSETS

Investment in Associate as per AS 23	₹
Investment in B Ltd.	-

If, under the equity method, an investor's share of losses of an associate equal or exceeds the carrying amount of the investment, the investor ordinarily discontinues recognizing its share of further losses and the investment is reported at nil value.
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.

Question 3 *(ICAI Study Material)*

Bright Ltd. acquired 30% of East India Ltd. shares for ₹ 2,00,000 on 01-06-2021. By such an acquisition Bright can exercise significant influence over East India Ltd.
During the financial year ending on 31-03-2021 East India earned profits ₹ 80,000 and declared a dividend of ₹ 50,000 on 12-08-2021. East India reported earnings of ₹ 3,00,000 for the financial year ending on 31-03-2022 (assume profits to accrue evenly) and declared dividend of ₹ 60,000 on 12-06-2022. Calculate the carrying amount of investment in:

i. Separate financial statements of Bright Ltd. as on 31-03-2022.
ii. Consolidated financial statements of Bright Ltd.; as on 31-03-2022.
iii. What will be the carrying amount as on 30-06-2022 in consolidated financial statements?

Question 4 *(ICAI Study Material)*

A Ltd. acquired 25% of shares in B Ltd. as on 31.3.2021 for ₹ 3 lakhs. TheBalance Sheet of B Ltd. as on 31.3.2021 is given below:

	₹
Share Capital	5,00,000
Reserves and Surplus	5,00,000
	10,00,000

Fixed Assets	5,00,000
Investments	2,00,000
Current Assets	3,00,000
	10,00,000

During the year ended 31.3.2022 the following are the additional informationavailable:

a. A Ltd. received dividend from B Ltd., for the year ended 31.3.2021 at 40% from Reserves
b. B Ltd., made a profit after tax of ₹ 7 lakhs for the year ended 31.3.2022.
c. B Ltd., declared a dividend @ 50% for the year ended 31.3.2022 on 30.4.2022.

A Ltd. is preparing Consolidated Financial Statements in accordance with AS21 for its various subsidiaries. Calculate:

a. Goodwill if any on acquisition of B Ltd.'s shares.
b. How A Ltd., will reflect the value of investment in B Ltd., in Consolidated Financial Statements?
c. How dividend received from B Ltd. will be shown in ConsolidatedFinancial Statements?

DISCONTINUING OPERATIONS

AS 24

Objective	AS 24 is applicable to all discontinuing operations. The objective of AS 24 is to establish principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise's cash flows, earnings-generating capacity, and financial position by segregating information about discontinuing operations from information about continuing operations.
Discontinuing Operation	A discontinuing operation is a component of an enterprise: (PARA 3) a) That the enterprise, pursuant to a single plan, is: ➢ *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 ➢ *Disposing of piecemeal*, such as by selling off the component's assets and settling its liabilities individually or ➢ 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. A component can be distinguished operationally and for financial reporting purposes - criterion (c) of the definition of a discontinuing operation - if all the following conditions are met: a. The operating assets & liabilities of the component can be directly attributed to it. b. Its revenue can be directly attributed to it. c. At least majority of its operating expenses can be directly attributed to it. Discontinuing operations are infrequent events, but this does not mean that all infrequent events are discontinuing operations. The fact that a disposal of a component of an enterprise is classified as a discontinuing operation under AS 24 does not, in itself, bring into question the enterprise's ability to continue as a going concern. *Examples of activities* that do not necessarily satisfy criterion(a)of definition, but that might do so in combination with other circumstances, include: ❖ 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. ❖ Shifting of some production or marketing activities for a particular line of business from one location to another and ❖ Closing of a facility to achieve productivity improvements or other cost savings. An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

Initial Disclosure event	Occurrence of one of the following, *whichever occurs earlier:* a) The enterprise has entered into a binding sale agreement for substantially all of assets attributable to the discontinuing operation or b) The enterprise's board of directors or similar governing body has both (i) approved a detailed, formal plan for the discontinuance and (ii) made an announcement of the plan. A detailed, formal plan for the discontinuance normally includes: ➢ identification of the major assets to be disposed of; ➢ the expected method of disposal; ➢ the period expected to be required for completion of the disposal; ➢ the principal locations affected; ➢ the location, function, and approximate number of employees who will be compensated for terminating their services; and ➢ the estimated proceeds or salvage to be realised by disposal. An enterprise's board of directors or similar governing body is considered to have made the announcement of a detailed, formal plan for discontinuance, if it has announced the main features of the plan to those affected by it, such as, lenders, stock exchanges, trade payables, trade unions, etc. in a sufficiently specific manner so as to make the enterprise demonstrably committed to the discontinuance.
Recognition and Measurement	For recognising and measuring the effect of discontinuing operations, this AS does not provide any guidelines, but for the purpose the relevant Accounting Standards should be referred.
Presentation & Disclosure (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 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 the total liabilities to be settled ❖ The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing 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
Presentation of the above disclosures	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 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 operation or enters into binding agreements for the sale of such assets or the settlement of such liabilities, it should include, in its financial statements, the following information when the events occur: a. For any gain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation, (i) the amount of the pre-tax gain or loss and (ii) income tax expense relating to the gain or loss and b. The net selling price or range of prices (which is after deducting expected disposal costs) of those net assets for which the enterprise has entered into one or more binding sale agreements, the expected timing of receipt of those cash flows and the carrying amount of those net assets on the balance sheet date.
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. Any disclosures required by AS 24 should be presented separately for each discontinuing operation.
Restatement of Prior Periods	Comparative information for prior periods that is presented in financial statements prepared after the initial disclosure event should be restated to segregate assets, liabilities, revenue, expenses, and cash flows of continuing and discontinuing operations in a manner similar to that mentioned above.
Disclosure in interim financial reports *(RTP Nov 2022)*	Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, 'Interim Financial Reporting', including: a. Any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation and b. Any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

Example 1:

Co XY runs a famous chain of restaurants. It decides to sell its stake in one of the restaurant. This restaurant contributes around 5% of total revenue to the entire business. XY does not intend to sell any other restaurant as part of its strategy.

In the above case, the sale of one restaurant out of the chain does not constitute disposal of business under a single plan, or a portion that represents a major line of business or geographical area of operations. Thus, it cannot be regarded as a discontinuing operation.

Example 2:

Group MN operates in various industries including Hotels, Airlines and Software through its subsidiaries. It has decided to sell its Airline business to be able to concentrate on other verticals. As a result, it has started to sell its aircrafts and paying off the associated liabilities. During the year, it has sold off 5 aircrafts out of the fleet of 50 aircrafts so far as part of the sale. The Airline business constitutes 25% of total group revenue.

In the above case, Airline business may be considered as discontinuing operation. This is due to the fact that the assets are sold off as part of a single plan, and that the business represents a separate major line of business, and can be distinguished both operationally and for financial reporting purposes.

Example 3:

GH, a large car manufacturing company, decides to discontinue its manufacturing operations relating to the diesel cars production. It plans to restructure the business by revamping its existing operations, and starting new manufacturing process for manufacture and sale of electric vehicles.

In the above example, it needs to be evaluated whether the restructuring is a result of continuing operations, or termination of existing operations, and accordingly it can be concluded whether it is a case of discontinuing operations or not.

Example 4:

Entity RT operates in a single state and is trading in 3 products – X, Y and Z. Details with respect to the performance of each of the products are as under:

Particulars	X	Y	Z	Total
Sales	1,00,000	14,00,000	20,00,000	35,00,000
Cost of Goods Sold	(80,000)	(10,80,000)	(14,40,000)	(26,00,000)
Gross Margin	20,000	3,20,000	5,60,000	9,00,000
Operational Expenses	(15,000)	(1,70,000)	(3,60,000)	(5,45,000)
Profit before tax	5,000	1,50,000	2,00,000	3,55,000

RT has decided to sell the business relating to Product Y to another entity. Since Product Y constitutes a major product, it may be considered as a discontinuing operations.

Instead of disposing of a component substantially in its entirety, an enterprise may discontinue and dispose of the component by selling its assets and settling its liabilities piecemeal (individually or in small groups). Thus, disposal of a component may be in progress at the end of a financial reporting period. To qualify as a discontinuing operation, the disposal must be pursuant to a single coordinated plan. An enterprise may terminate an operation by abandonment without substantial sales of assets. An abandoned operation would be a discontinuing operation if it satisfies the criteria in the definition. However, changing the scope of an operation or the manner in which it is conducted is not abandonment because that operation, although changed, is continuing.

ASSIGNMENT QUESTIONS

Question 1 *(RTP May 2018) / (RTP May 2023)*

A consumer goods producer has changed the product line as follows:

	Dish Washing Bar (per month)	Clothes Washing Bar (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	0	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 of the company has passed a resolution in March, 2022 to this effect. The company follows calendar year as its accounting year. You are required to advise whether it should be treated as a discontinuing operation or not as per AS 24?

Solution

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 liabilities individually or

(iii) Terminating through abandonment and

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

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

As per provisions of the standard, business enterprises frequently close facilities, abandon products or even 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:

(i) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or

(ii) 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 2 *(Inter July 2021) (5 Marks) / (RTP May 2021) (Similar) / (ICAI Study Material)*

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:

a) If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.
b) 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?
c) 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?

Solution

a) As per AS 24, a discontinuing operation is a component of an enterprise:

a. That the enterprise, pursuant to a single plan, is:
   (iv) 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
   (v) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or
   (vi) 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.

Mere gradual phasing is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operation'. Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

1) Gradual or evolutionary phasing out of a product line or class of service.
2) Shifting of some production or marketing activities for a particular line of business from one location to another and
3) 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 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.

b) No, the resolution is silent about stoppage of the Car segment in definite time period. Though, sale of 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.

c) 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 *(RTP Nov 2018) / (RTP May 2020) / (RTP May 2022)*

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.

Solution

Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations. According to Paragraph 9 of AS 24, examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include:

a) Gradual or evolutionary phasing out of a product line or class of service;
b) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
c) Shifting of some production or marketing activities for a particular line of business from one location to another; and
d) Closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

Question 4 *(Inter Nov 2018) (5 Marks) / (RTP May 2020) / RTP Nov 2020) / (RTP May 2022)*

What are the disclosure and presentation requirements of AS 24 for discontinuing operations?

Solution

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 (as defined in paragraph 15) 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, Segment Reporting;
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; and
h) 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 *(RTP Nov 2021)*

What are discontinuing operations as per AS 24? Should an enterprise include prescribed information relating to a discontinuing operation in its financial statements?

Solution

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 liabilities individually or
   (iii) Terminating through abandonment and
b. That represents a separate major line of business or geographical area of operations.
c. That can be distinguished operationally and for financial reporting purposes.

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.

INTERIM FINANCIAL REPORTING

AS 25

Scope	The standard prescribes the minimum contents of an interim financial report and requires that an enterprise which elects to prepare and present an interim financial report, should comply with this standard. It also lays down the principles for recognition and measurement in a complete or condensed financial statements for an interim period. Timely and reliable interim financial reporting improves the ability of investors, creditors, lenders and others to understand an enterprise's capacity to generate earnings and cash flows, its financial condition and liquidity. *AS 25 does not mandate which enterprises should be required to present interim financial reports, how frequently, or how soon after the end of an interim period. If an enterprise is required or elects to prepare and present an interim financial report, it should comply with this Standard.* A statute governing an enterprise, or a regulator may also require an enterprise to prepare and present certain information at an interim date which may be different in form and/or content as required by this Standard. In such a case, the recognition and measurement principles as laid down in this Standard are applied in respect of such information, unless otherwise specified in the statute or by the regulator.
Interim Period	Interim period is a financial reporting period shorter than a full financial year
Interim Financial Report	Interim financial report means a financial report *containing either a complete set of financial statements or a set of condensed financial statements for an interim period.* During the first year of operations of an enterprise, its annual financial reporting period may be shorter than a financial year. In such a case, that shorter period is not considered as an interim period.
Contents of an Interim Financial Report	A complete set of financial statements normally includes Balance sheet, Statement of Profit & Loss, Cash flow statement and Notes including those relating to accounting policies and other statements and explanatory material that are an integral part of the financial statements. Interim financial report may contain a complete set of financial statements or condensed financial statements. If the entity opted for a complete set of financial statements, it will be like annual set of financial statements. The condensed financial statements would include limited information as required by this standard. The recognition and measurement principles set out in this Standard apply also to complete financial statements for an interim period, and such statements would include all disclosures required by this Standard as well as those required by other Accounting Standards.

Form and Content of Interim Financial Statements	❖ 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. If an enterprise prepares and presents a set of condensed financial statements in its interim financial report, those condensed statements should include, at a minimum, each of the headings and sub-headings that were included in its most recent annual financial statements and the selected explanatory notes as required by this Statement. Additional line items or notes should be included if their omission would make the condensed interim financial statements misleading. ❖ If an enterprise presents basic & diluted earnings per share in its annual financial statements in accordance with AS 20 then it has to present basic & diluted earnings per share as per AS 20 on the face of Statement of Profit & Loss complete or condenses for an interim period also.
Selected Explanatory Notes	An enterprise should include the following information, as a minimum, in the notes to its interim financial statements, if material and if not disclosed elsewhere in the interim financial report: (a) A statement that the same accounting policies are followed in the interim financial statements as those followed in the most recent annual financial statements or, if those policies have been changed, a description of the nature and effect of the change (b) Explanatory comments about the seasonality of interim operations. (c) The nature and amount of items affecting assets, liabilities, equity, net income, or cash flows that is unusual because of their nature, size, or incidence as per AS 5. (d) The nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amounts reported in prior financial years, if those changes have a material effect in the current interim period. (e) Issuances, buy-backs, repayments and restructuring of debt, equity and potential equity shares. (f) Dividends, aggregate or per share (in absolute or percentage terms), separately for equity shares and other shares. (g) Segment revenue, segment capital employed (segment assets minus segment liabilities) and segment result for business segments or geographical segments, whichever is the enterprise's primary basis of segment reporting (disclosure of segment information is required in an enterprise's interim financial report only if the enterprise is required, in terms of AS 17, Segment Reporting, to disclose segment information in its annual financial statements). (h) The effect of changes in the composition of the enterprise during the interim period, such as amalgamations, acquisition or disposal of subsidiaries and long-term investments, restructurings, and discontinuing operations and (i) Material changes in contingent liabilities since the last annual balance sheet date. The above information should normally be reported on a financial year-to-date basis. However, the enterprise should also disclose any events or transactions that are material to an understanding of the current interim period.

Periods for which INTERIM FINANCIAL STATEMENTS are required to be presented

Interim reports should include interim financial statements (whether condensed or complete) for the periods listed in the following table:

Statement	Current Period	Comparative Period
Balance Sheet	End of current interim period	End of immediately preceding financial year
Statement of profit and loss	Current interim period and cumulatively for the year-to-date	Comparable interim period and year-to-date of immediately preceding financial year
Cash Flow Statement	Cumulatively for the current financial year-to-date	Comparable year-to-date of immediately preceding financial year

Materiality	In deciding how to recognise, measure, classify, or disclose an item for interim financial reporting purposes, materiality should be assessed in relation to the interim period financial data. "Information is material if its misstatement (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information". For reasons of understandability of the interim figures, materiality for making recognition and disclosure decision is assessed in relation to the interim period financial data. Thus, for example, unusual or extraordinary items, changes in accounting policies or estimates, and prior period items are recognised and disclosed based on materiality in relation to interim period data.
Disclosure in Annual Financial Statements	AS 5, requires disclosure, in financial statements, of the nature and (if practicable) the amount of a change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods. Similarly, if an estimate of an amount reported in an interim period is changed significantly during the final interim period of the financial year but a separate financial report is not prepared and presented for that final interim period, the nature and amount of that change in estimate should be disclosed in a note to the annual financial statements for that financial year.
Accounting Policies	Same Accounting Policies as annual financial statements. An enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. Amounts of income and expenses reported in the current interim period will reflect any changes in estimates of amounts reported in prior interim periods of the financial year. The amounts reported in prior interim periods are not retrospectively adjusted. However, the nature and amount of any significant changes in estimates be disclosed.

Changes in Accounting Policies	Preparers of interim reports in compliance with AS 25 are required to consider any changes in accounting policies that will be applied for the next annual financial statements, and to implement the changes for interim reporting purposes. If there has been any change in accounting policy since the most recent annual financial statements, the interim report is required to include a description of the nature and effect of the change.
Revenue Received Seasonally or Occasionally	Revenues that are received seasonally or occasionally within a financial year should not be anticipated or deferred as of an interim date if anticipation or deferral would not be appropriate at the end of the enterprise's financial year. *For example:* Dividend revenue, royalties, and government grants. Additionally, some enterprises consistently earn more revenues in certain interim periods of a financial year than in other interim periods, for example, seasonal revenues of retailers. Such revenues are recognised when they occur.
Cost Incurred Unevenly during the Financial Year	Costs that are incurred unevenly during an enterprise's financial year should be anticipated or deferred for interim reporting purposes if, and only if, it is also appropriate to anticipate or defer that type of cost at the end of the financial year. A cost that does not meet the definition of an asset at the end of an interim period is not deferred in the interim balance sheet. Deferral of costs as assets in an interim balance sheet in the hope that the criteria will be met before the year-end is prohibited.
Use of Estimates	The measurement procedures to be followed in an interim financial report should be designed to ensure that resulting information is reliable and that all material financial information that is relevant to an understanding of the financial position or performance of enterprise is appropriately disclosed.
Restatement of Previously Reported Interim Periods	One objective of the preceding principle is to ensure that a single accounting policy is applied to a particular class of transactions throughout an entire financial year. The effect of the principle requires that within the current financial year any change in accounting policy be applied retrospectively to the beginning of the financial year.
Transitional Provision	On the first occasion that an interim financial report is presented in accordance with this Statement, the following need not be presented in respect of all the interim periods of the current financial year: (a) Comparative statements of profit and loss for the comparable interim periods (current and year-to-date) of the immediately preceding financial year; and (b) Comparative cash flow statement for the comparable year-to-date period of the immediately preceding financial year.
Applicability of AS 25 to Interim Financial Results	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.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)*

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, 2021 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 ₹ 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.

Question 2 *(ICAI Study Material)*

The accounting year of X Ltd. ends on 30th September, 2021 and it makes its reports quarterly. However for the purpose of tax, year ends on 31st March every year. For the Accounting year from 1-10-2020 to 30-9-2021, the quarterly income is as under:

1st quarter ending on 31st December, 2020	₹ 200 crores
2nd quarter ending on 31st March, 2021	₹ 200 crores
3rd quarter ending on 30th June, 2021	₹ 200 crores
4th quarter ending on 30th September, 2021	₹ 200 crores
Total	₹ 800 crores

Average actual tax rate for the financial year ending on 31st March, 2021 is 20% and for financial year ending 31st March, 2022 is 30%. Calculate tax expense for each quarter.

Question 3 *(ICAI Study Material)*

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 & ₹ 3,00,000. Calculate the tax expense to be recognized in each quarter.

Question 4 *(ICAI Study Material)*

Accountants of Poornima Ltd. showed a net profit of ₹ 7,20,000 for the third quarterof 2021 after incorporating the following:

i. Bad debts of ₹ 40,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.

ii. Extra ordinary loss of ₹ 35,000 incurred during the quarter has been fully recognized in this quarter.

iii. Additional depreciation of ₹ 45,000 resulting from the change in the method of charge of depreciation assuming that ₹ 45,000 is the charge for the 3rd quarter only.

Ascertain the correct quarterly income.

Solution:
In the above case, 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 ₹ 40,000 have been incurred during current quarter. Out of this, the company has deferred 50% (i.e.) ₹ 20,000 to the next quarter. Therefore, ₹ 20,000 should be deducted from ₹ 7,20,000. The treatment of extra-ordinary loss of ₹35,000 being recognized in the same quarter is correct.
Recognizing additional depreciation of ₹ 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 ₹ 7,00,000 (₹ 7,20,000 – ₹ 20,000).

Question 5 *(ICAI Study Material)*

On 30th June, 2021, Asmitha Ltd. incurred ₹ 2,00,000, net loss from disposal ofa business segment. Also, on 31st July, 2021, the company paid ₹ 60,000 for property taxes assessed for the calendar year 2021. 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, 2021.

Solution:
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, 2021, Asmitha Ltd would report the entire amount of ₹ 2,00,000 as loss on the disposal of its business segment since the loss was incurred during interim period. A cost charged as an expense in an annual period should be allocated to interim periods on accrual basis. Since ₹ 60,000 Property tax payment relates to entire calendar year 2021, ₹ 30,000 would be reported as an expense for six months ended on 30th September, 2021 while out of the remaining ₹ 30,000, ₹ 15,000 for January, 2021 to March, 2021 should be shown as payment of the outstanding amount of previous year and another ₹ 15,000 related to quarter October, 2021 to December, 2021 would be reported as prepaid expenses.

Question 6 *(ICAI Study Material)*

Antarbarti Limited reported a Profit Before Tax (PBT) of ₹ 4 lakhs for the third quarter ending 30-09-2021. On enquiry you observe the following. Give the treatment required under AS 25:

a. Dividend income of ₹ 4 lakhs received during the quarter has been recognized to the extent of ₹ 1 lakh only.
b. 80% of sales promotion expenses ₹ 15 lakhs incurred in the third quarter has been deferred to the fourth quarter as the sales in the last quarter is high.
c. In the third quarter, the company changed depreciation method from WDV to SLM, which resulted in excess depreciation of ₹12 lakhs. The entire amount has been debited in the third quarter, though the share of the third quarter is only ₹ 3 lakhs.
d. ₹ 2 lakhs extra-ordinary gain received in third quarter was allocated equally to the third and fourth quarter.
e. Cumulative loss resulting from change in method of inventory valuation was recognized in the third quarter of ₹ 3 lakhs. Out of this loss ₹ 1 lakh relates to previous quarters.
f. Sale of investment in the first quarter resulted in a gain of ₹ 20 lakhs. The company had apportioned this equally to the four quarters.

Prepare the adjusted profit before tax for the third quarter.

Solution:

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 financialyear. Therefore, dividend income, extra-ordinary gain, and gain on sale of investment received during 3rd quarter should be recognised in the 3rd quarter only. Similarly, sales promotion expenses incurred 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 a change 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:

Statement showing Adjusted Profit Before Tax for the third quarter

	(₹ in lakhs)
Profit before tax (as reported)	4
Add: Dividend income ₹ (4-1) lakhs	3
Excess depreciation charged in the 3rd quarter, due to change in method	-
Extra ordinary gain ₹ (2-1) lakhs	1
Cumulative loss due to change in the method of inventory valuation should be applied retrospectively ₹ (3-2) lakhs	1
	9
Less: Sales promotion expenses (80% of ₹ 15 lakhs)	(12)
Gain on sale of investment (occasional gain should not be deferred)	(5)
Adjusted Profit before tax for the third quarter	(8)

Question 7 *(ICAI Study Material)*

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 provisions of AS 25 shouldbe applied on the same?

Solution:

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 interimfinancial results.

Question 8 *(ICAI Study Material)*

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 thatfinancial year?

Solution:

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 only annual financial statements. However, if such items are recognised and measured in one interim period and the estimate changes in a subsequent interim period of that financialyear, the original estimate is changed in 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 favourable indicator exists as per AS 28 and the recoverable amount increased in comparison to earlier period.

Question 9 *(ICAI Study Material)*

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?

Solution:

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 othersignificant one-time events.

PRACTICE QUESTIONS

Question 1 *(ICAI Study Material)*

Intelligent Corporation (I-Corp.) is dealing in seasonal products. The quarterly sales pattern of the product is given below:

Quarter I	II	III	IV
Ending 30th June 15%	30th September 15%	31st December 50%	31st March 25%

For the First quarter ending 30th June, 2021, I-Corp. gives you the following information:

	₹ crores
Sales	50
Salary and other expenses	30
Advertisement expenses (routine)	02
Administrative and selling expenses	08

While preparing interim financial report for the first quarter, 'I-Corp.' wants to defer ₹ 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.

Solution:

Result of the first quarter ended 30th June, 2021

			(₹ 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 are earned and incurred respectively. As per AS 25, the costs should be anticipated or deferred only when

i. it is appropriate to anticipate that type of cost at the end of the financial year, and
ii. costs are incurred unevenly during the financial year of an enterprise.

Therefore, the argument given by I-Corp relating to deferment of ₹ 21 crores is not tenable as expenditures are uniform throughout all quarters.

Question 2 *(ICAI Study Material)*

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, 2021. The Financial Year is FY 2021-22.

Solution:

As per Accounting Standard 25, Interim reports should include interim financial statements (condensed or complete) for periods as given below

Statement	Current period	Comparative period
Balance sheet	End of current interim period	End of immediately preceding financial year

Statement of profit and loss	Current interim period and cumulatively for the year-to-date	Comparable interim period and year-to-date of immediately preceding financial year
Cash flow statement	Cumulatively for the current financial year-to-date	Comparable year-to-date of immediately preceding financial year

In light of the above, following periods needs to be covered in interimfinancial statements for the period ended and as at 31st December, 2021:

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 2021 and 31 March 2021).
Statements of Profit and Loss	For the current interim period and cumulatively for the current financial year to date, with comparative statements ofprofit 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 2021 and same for 31 December 2020 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 2021 to 31 December 2021 and 1 April 2020to 31 December 2020).

INTANGIBLE ASSETS

AS 26

Objective	❖ To prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Accounting Standard. ❖ AS 26 requires an enterprise to recognise an intangible asset if, and only if, certain criteria are met. ❖ It also specifies how to measure the carrying amount of intangible assets and requires certain disclosures about intangible assets
Non-Applicability	❖ Intangible assets that are covered by another Accounting Standard • Intangible assets held by an enterprise for sale in ordinary course of business (AS-2) • Deferred tax assets AS-22 • Leases that fall within the scope of AS-19 • Goodwill arising on amalgamation AS-14 • Goodwill arising on consolidation AS-21 ❖ Financial assets ❖ Mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources and ❖ Intangible assets arising in insurance enterprises from contract with policy holders.
Meaning of Asset	An asset is a resource: a. Controlled by an enterprise as a result of past events and b. From which future economic benefits are expected to flow to enterprise
Monetary assets	Realizable for fixed or determinable sum under contract (assets that can be easily converted into a fixed amount of money in the immediate short term) <u>Example</u> – Debtors, Bills receivables, etc.
Non Monetary assets	No Fixed amount under contract (not readily converted into a fixed amount of money in the short term) <u>Example-</u> Goodwill, Patterns, Trade mark, Copyrights, PPE etc.
Meaning of intangible asset-	It is an → Identifiable → Non monetary asset → Without any physical substance → Held for economic benefits i.e. either for use in production or supply of goods or services, for rental to others or for administrative purposes. → Under the control of entity
Essential components	❖ It must be identifiable i.e the asset must be separable from other assets. ❖ It must be controlled by the enterprise ❖ Future economic benefits must be associated with an intangible asset
Recognition of Intangible asset	An intangible asset should be recognized if and only if → It meets all the essential elements of an intangible assets → It is probable that future economic benefits will flow to the enterprise → Cost of the asset can be measured reliably.

Future economic benefit is also flown from the skill of labour and customer loyalty but usually this flow of benefits cannot be controlled by the enterprise as employees may leave the enterprise anytime or even loyal customers may decide to purchase goods and services from other suppliers.
Hence, these items don't even qualify as intangible asset as per the definition given in AS 26

MEASUREMENT OF INTANGIBLE ASSETS

Procurement /Separate Acquisition

Cost of Intangible Assets include the following:

Purchase price	XX
Add: Non-refundable taxes & duties	XX
Add: Directly attributable expenditure on making the asset ready for its intended use.*	XX
Less: Trade discount & rebates	(XX)
Cost of Asset	XX

*Example: Professional fees for legal services

In Exchange For Another Asset or Shares/Other Securities

Cost of Intangible Asset is
- Fair Market Value (FMV) of Asset given / Securities issued

or

- Fair Market Value (FMV) of the Asset acquired

whichever is more clearly evident.

Note: (a) FMV of the shares /securities to be considered & not Book value
(b) Such value is to be seen on the date of transaction

Acquisition By Way Of Government Grant

Given at concessional rate	On the basis of their acquisition costs
Given free of cost	Record at nominal value

This may occur when a government transfers or allocates to an enterprise intangible assets such as airport landing rights, licences to operate radio or television stations, import licences, etc.

Internally Generated Intangible Asset

Research Phase		Development Phase
✗	Deferred & Amortised	✓
✓	Charge to P&L A/c	✗

*Development Phase:

Amount Capitalised = Lower of Cost or Recoverable Amount

Where Recoverable amount = Present value of Future Cash Flows

→ If an enterprise cannot distinguish the research phase from the development phase to create an intangible asset, the expenditure should be treated as if it were incurred in the research phase only.

→ 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.

Examples of research activities are: *(Research: Acquisition of Knowledge)*

a) Activities aimed at obtaining new knowledge.
b) Search for evaluation & final selection of, applications of research findings/other knowledge
c) Search for alternatives for materials, devices, products, processes, systems or services
d) The formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

Examples of development activities are: *(Development: Application of Knowledge)*

a) The design, construction & testing of pre-production or pre-use prototypes and models.
b) The design of tools, jigs, moulds and dies involving new technology.
c) The design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production and
d) The design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

Development phase (PARA 44)	An intangible asset arising from development should be recognized if and only if an enterprise can demonstrate all of the following: → Technical feasibility established → Marketability proved → Identification of cost incurred → Realistic expectation that there will be sufficient future revenue to cover cost → Intention to complete the asset and use or sell it.
Cost of an Internally Generated Intangible Asset	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, producing and making the asset ready for its intended use from the time when the intangible asset first meets the recognition criteria. The following are not components of the cost of an internally generated intangible asset: ➢ Selling, administrative & other general overhead expenditure unless this expenditure can be directly attributed to making the asset ready for use. ➢ Clearly identified inefficiencies and initial operating losses incurred before an asset achieves planned performance and ➢ Expenditure on training the staff to operate the asset
Recognition of an expense	Expenditure on an intangible item should be recognized as an expense when it is incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria.
Subsequent Expenditure	Subsequent expenditure on an intangible asset after its purchase or its completion should be recognised as an expense when it is incurred unless: → 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 → the 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.
AMORTISATION PERIOD (PARA 63)	
Basis of allocation	Depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life.

Presumption as to the useful life	It <u>will not exceed 10 years</u> from the date when the asset is available for use unless there is persuasive evidence that intangible asset has higher useful life.
When should it commence?	Amortisation should commence when asset is available for use.
Notes	Given the history of rapid changes in technology, computer software and other intangible asset is susceptible to technological obsolescence, it is likely that useful life of the software etc. will be much shorter, say 3-5 years

AMORTISATION METHOD

Which method to follow	❖ The method used should reflect the pattern in which assets economic benefits are consumed by enterprise (In the ratio of future cash flows) ❖ If that pattern cannot be determined reliably, the SLM should be used.

REVIEW OF AMORTISATION PERIOD AND METHOD

The amortisation period and method should be reviewed at least at each financial year end. If the expected useful life of the asset is significantly different from previous estimates, the amortisation period should be changed accordingly. If there has been a significant change in the expected pattern of economic benefits from the asset, the amortisation method should be changed to reflect the changed pattern.
Such changes should be accounted for in accordance with AS 5

RECOVERABILITY OF THE CARRYING AMOUNT-IMPAIRMENT LOSSES

Impairment losses of intangible assets are calculated on the basis of AS 28. In addition to the requirements of AS on Impairment of Assets, an enterprise should estimate the recoverable amount of the following intangible assets at least at each financial year end even if there is no indication that the asset is impaired:

(a) an intangible asset that is not yet available for use; and
(b) an intangible asset that is amortised over a period exceeding ten years from the date when the asset is available for use. AS 26 requires an enterprise to test for impairment, at least annually, carrying amount of intangible asset that is not yet available for use.

<u>Example:</u>
X limited is developing a customized software for ₹ 10 Cr. It will take 3 years to complete development. The present value of future economic benefit is considered to be ₹ 15 Cr. After 2 years, 70% work is completed. However, due to change in market conditions, present value of future economic benefits are estimated to be ₹ 6 Cr only.

Company should recognize ₹ 1 Cr as impairment loss on "Intangible asset under development" as per AS 28. Only ₹ 6 Cr can be shown as "Intangible asset under development". Company cannot capitalize any further amount till the time recoverable amount increases even if work of ₹ 10 Cr is completed.

DERECOGNITION OF INTANGIBLE ASSETS I.E. RETIREMENT & DISPOSAL

When to Derecognize?	Intangible asset should be derecognized (eliminated from balance sheet) → on disposal or → when no future economic benefits are expected from its use & subsequent disposal.
Treatment	Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

DISCLOSURE REQUIREMENTS	
General Disclosures	The financial statements should disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets: 1. The useful lives or the amortization rates used. 2. The amortization methods used. 3. The gross carrying amount & the accumulated amortization (aggregated with accumulated impairment losses) at the beginning & end of period. 4. Reconciliation of carrying amount at beginning & end of period showing: • Additions, indicating separately those from internal development and through amalgamation. • Retirements and disposals. • Amortisation recognised during the period and • Other changes in the carrying amount during the period.
Other Disclosures	The financial statements should also disclose: ➢ If an intangible asset is amortised over more than ten years, the reasons why it is presumed that the useful life of an intangible asset will exceed ten years from the date when the asset is available for use. In giving these reasons, the enterprise should describe the factor(s) that played a significant role in determining the useful life of the asset. ➢ A description, the carrying amount and remaining amortization period of any individual intangible asset that is material to the financial statements of the enterprise as a whole. ➢ The existence & carrying amounts of intangible assets whose title is restricted & carrying amounts of intangible assets pledged as security for liabilities and ➢ The amount of commitments for the acquisition of intangible assets. ➢ The financial statements should disclose aggregate amount of research & development expenditure recognised as an expense during the period.

ASSIGNMENT QUESTIONS

Question 1 Pg no._____

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

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

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

Question 2 *(RTP May 2020) (Similar)* Pg no._____

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

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

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

Question 3 Pg no._____

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

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

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

Question 4 *(ICAI Study Material)* Pg no._____

Swift Ltd. acquired a patent at a cost of ₹ 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 ₹ 10,00,000 per annum. The company 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 ₹ 36,00,000, ₹ 46,00,000, ₹ 44,00,000, ₹ 40,00,000 and ₹ 34,00,000.
Find out the amortization cost of the patent for each of the years.

Question 5 *Pg no._____*

A company acquired for its internal use a software on 28.01.2020 from the USA for US $ 1,00,000. The exchange rate on that date was ₹ 52 per USD. The seller allowed trade discount @ 5 %. The other expenditure were:

a) Import Duty: 20%
b) Purchase Tax: 10%
c) Entry Tax: 5 % (Recoverable later from tax department)
d) Installation expenses: ₹ 25,000
e) Profession fees for Clearance from Customs: ₹ 20,000

Compute the cost of Software to be capitalized.

Question 6 *Pg no._____*

NDA Corporation is engaged in research on a new process design for its product. It had incurred an expenditure of ₹ 530 lakhs on research upto 31st March, 2019. The development of the process began on 1st April, 2019 and Development phase expenditure was ₹ 360 lakhs upto 31st March, 2020 which meets assets recognition criteria.
From 1st April, 2020, the company will implement the new process design which will result in after tax saving of ₹ 80 lakhs per annum for the next five years. The cost of capital of company is 10%. Explain:

1) Accounting treatment for research expenses.
2) Cost of internally generated intangible asset as per AS 26.
3) Amount of amortization of assets. (Present value of annuity factor of Re. 1 for 5 years@10%=3.7908)

Question 7 *Pg no._____*

K. International Ltd. is developing a new production process. During the financial year ending 31st March, 2019, the total expenditure incurred was ₹ 50 lakhs. This process met the criteria for recognition as an intangible asset on 1st December, 2018. Expenditure incurred till this date was ₹ 22 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2020 was ₹ 80 lakhs. As at 31st March, 2020, the recoverable amount of know-how embodied in the process is estimated to be ₹ 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 & Loss A/c for the year ending 31st March, 2019 and carrying value of intangible as on that date.
(ii) Amount to be charged to Profit & Loss A/c and carrying value of intangible as on 31st March, 2020

Ignore depreciation.

Question 8 *(RTP May 2021)* *Pg no._____*

Naresh Ltd. had the following transactions during the financial year 2019-2020:

(i) Naresh Ltd. acquired running business of Sunil Ltd. for ₹ 10,80,000 on 15th May, 2019. The fair value of Sunil Ltd.'s net assets was ₹ 5,16,000. Naresh Ltd. is of the view that due to popularity of Sunil Ltd.'s product in the market, its goodwill exists.

(ii) Naresh Ltd. had taken a franchise on July 2019 to operate a restaurant from Sankalp Ltd. for ₹ 1,80,000 & at an annual fee of 10% of net revenues (after deducting expenditure). The franchise expires after 6 years. Net revenues were ₹ 60,000 during financial year 19-20.

(iii) On 20th August, 2019, Naresh Ltd, incurred costs of ₹ 2,40,000 to register the patent for its product.

Naresh Ltd. expects the patent's economic life to be 8 years. Naresh Ltd. follows an accounting policy to amortize all intangibles on straight line basis over the maximum period permitted by accounting standards taking a full year amortization in the year of acquisition. Goodwill on acquisition of business to be amortized over 5 years (SLM) as per AS 14.
Prepare a schedule showing the intangible assets section in Naresh Ltd. Balance Sheet at 31st March, 2020.

Question 9 *(ICAI Study Material)* *Pg no._____*

ABC Ltd. developed know-how by incurring expenditure of ₹ 20 lakhs, The know-how was used by the company from 1.4.2013. 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 31.3.2020.
Pass Journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.2020.

Question 10 *Pg no._____*

Base Limited is showing an intangible asset at ₹ 85 lakhs as on 1-4-2020. This asset was acquired for ₹ 112 lakhs on 1-4-2017 and the same was available for use from that date. The company has been following the policy of amortization of the intangible asset over a period of 12 years on straight line basis. Comment on the accounting treatment of the above with reference to the relevant accounting standard.

Solution

As per para 63 of AS 26 "Intangible Assets," the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimates of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortization should commence when the asset is available for use.
Base Limited has been following the policy of amortization of the intangible asset over a period of 12 years on straight line basis. The period of 12 years is more than the maximum period of 10 years specified as per AS 26.
Accordingly, Base Limited would be required to restate the carrying amount of intangible asset as on 1.4.2020 at ₹ 112 lakhs less ₹ 33.6 lakhs {112 lakhs/10 years ×3 years} = ₹ 78.4 lakhs.

The difference of ₹ 6.6 lakhs i.e. (₹ 85 lakhs – ₹ 78.4 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹ 78.4 lakhs would be amortized over remaining 7 years by ₹ 11.2 lakhs per year.

Question 11 *Pg no._____*

On 31-03-2020, the Balance Sheet of Alpha Ltd. shows an item of Intangible assets at ₹ 30 Lakhs. The asset was acquired on 1-4-2015 for ₹ 80 lakhs and was available for use on that date. The company has been following a policy of amortizing intangible assets over a period of 8 years on straight line basis. How you will deal in the books of accounts if the company determines by applying the best estimate of its useful life on 1-4-2020, and the amortization period to be 10 years, being the best estimate of its useful life from the date, it was available for use.

Solution

As per AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on a systematic basis over its useful life. Also there is a rebuttable presumption that the useful life of an intangible asset will not exceed 10 years from the date it is available for use. The amortization should commence when the asset is available for use. As per AS 26, if there has been a significant change in the expected pattern of economic benefits from the asset, the amortization method should be changed to reflect the changed pattern.

The company has been following a policy of amortization over a period of 8 years. As on 01-4-2020, 5 years have passed and the carrying amount stands at ₹ 30 lakhs. If the same treatment were to be continued, this would have been amortized over the next 3 years. But the revised estimate of remaining useful life would extend the period by another 5 years to amortize the carrying amount, the Company would be advised to amortize the carrying value over the next 5 years.

Thus, after revision in estimated useful life, the amount of ₹ 30 lacs would be amortised over next 5 years.

Question 12 *(ICAI Study Material)* *Pg no._____*

AB Ltd. launched a project for producing product X in October, 2019. The Company incurred ₹ 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.

Solution

As per 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.

Hence, the expenses amounting ₹ 20 lakhs incurred on the research has to be charged to the statement of profit and loss in the current year ending 31st March, 2020.

Question 13 *(ICAI Study Material)* *Pg no._____*

The company had spent ₹ 45 lakhs for publicity and research expenses on one of its new consumer product, which was marketed in the accounting year 2019-2020, 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, 2020.

Solution

In the given case, the company spent ₹ 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 ₹ 45 lakhs as an expense in the profit and loss account.

Question 14 *(ICAI Study Material)* *Pg no._____*

A company with a turnover of ₹ 250 crores and an annual advertising budget of ₹ 2 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹ 25 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of ₹ 2 crore incurred on extensive special initial advertisement campaign for the new product. Is the procedure adopted by company correct?

Solution

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 ₹ 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 ₹ 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 ₹ 2 crores to the Profit and Loss account of the year is correct.

Question 15 *(ICAI Study Material)* Pg no._____

During 2019-20, an enterprise incurred costs to develop and produce a routine low risk computer software product, as follows:

	Amount (₹)
Completion of detailed programme 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 product (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

Solution

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, ₹ 90,000 would be recorded as an expense (₹ 50,000 for completion of detailed program design and ₹ 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) = ₹ 1,00,500. Packing cost ₹ 16,500 should be recognized as expenses and charged to P & L A/c.

PRACTICE QUESTIONS

Question 1 Pg no._____

A company had deferred research and development cost of ₹450 Lakhs. Sales expected in the subsequent years are as under:

Years	Sales (₹ in lakhs)
I	1200
II	900
III	600
IV	300

You are asked to suggest how should research and development cost be charged to Profit and Loss Account assuming entire cost of 450 Lakhs is development cost. If at the end of 3rd year, it is felt that no further benefit will accrue in the 4th year, how the unamortized expenditure would be dealt with in the accounts of the Company?

Solution

Based on sales, research and development cost (assumed that entire cost of ₹ 450 lakhs is development cost) is allocated as follows:

Years	Research & Development cost allocation (₹ in lakhs)
I	450/3,000*1,200=180
II	450/3,000*900=135
III	450/3,000*600=90
IV	450/3,000*300=45

If at the end of the 3rd year, the circumstances do not justify that further benefit will accrue in the 4th year, then the company has to charge the unamortised amount i.e. remaining ₹ 135 lakhs [450 – (180 + 135)] as an expense immediately.

Question 2 *(Inter Nov 2020) (5 Marks)* Pg no._____

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 5th year to be ₹ 75 Lacs. Determine the amortization cost of the patent for each of the above years as per AS 26.

Solution

Amortization of cost of Patent as per AS 26

Year	Estimated future cash flow (₹ 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) in the fourth, fifth and sixth year.

Question 3 *(RTP Nov 2018)* *Pg no._____*

Desire Ltd. acquired a patent at a cost of ₹ 1,00,00,000 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 on SLM. 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 expected to be ₹ 45,00,000, ₹ 42,00,000, ₹ 40,00,000, ₹ 38,00,000 and ₹ 35,00,000. Patent is renewable and company changed amortization method from 3rd year (i.e. from SLM to ratio of expected new cash flows).

You are required to compute the amortization cost of the patent for each of the years (1st year to 7th year).

Solution

Desire Limited amortised ₹ 20,00,000 per annum for the first two years i.e. ₹ 40,00,000. 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

Year	Net cash flows	Amortization Ratio	Amortization Amount
1	-	0.200	20,00,000
2	-	0.200	20,00,000
3	45,00,000	0.225	13,50,000
4	42,00,000	0.210	12,60,000
5	40,00,000	0.200	12,00,000
6	38,00,000	0.190	11,40,000
7	35,00,000	0.175	10,50,000
Total	2,00,00,000	1.000	1,00,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹ 60,00,000 has been amortized in the ratio of net cash flows arising from the product of Desire Ltd

Question 4 *(Inter May 2018) (5 Marks)* *Pg no._____*

A company acquired a patent at a cost of ₹ 160 lakhs for a period of 5 years and the product life cycle is also 5 years. The company capitalized the cost and started amortising the asset at ₹ 16 lakhs per year based on the economic benefits derived from the product manufactured under the patent. After 2 years it was found that the product life cycle may continue for another 5 years from then (the patent is renewable and the company can get it renewed after 5 years). The net cash flows from the product during these 5 years were expected to be ₹ 50 lakhs, ₹ 30 lakhs, ₹ 60 lakhs, ₹ 70 lakhs and ₹ 40 lakhs. Find out the amortization cost of the patent for each of the years.

Solution

Company amortized ₹ 16,00,000 per annum for the first two years. Hence, Amortization for the first two years (₹ 16,00,000 X 2) = ₹ 32,00,000.

Remaining carrying cost after two years =₹ 1,60,00,000 – ₹ 32,00,000 = ₹ 1,28,00,000

Since after two years it was found that the product life cycle may continue for another 5 years, hence the remaining carrying cost ₹128 lakhs will be amortized during next 5 years in the ratio of net cash arising from the sale of the products of Fast Limited.

The amortization cost of the patents may be computed as follows:

Year	Net cash flows	Amortization Ratio	Amortization Amount
1	-	0.1	16,00,000
2	-	0.1	16,00,000
3	50,00,000	0.2	25,60,000
4	30,00,000	0.12	15,36,000
5	60,00,000	0.24	30,72,000
6	70,00,000	0.28	35,84,000
7	40,00,000	0.16	20,48,000
Total	2,50,00,000	1.000	1,60,00,000

Question 5 *(Inter Jan 2021) (5 Marks)* *Pg no._____*

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 ₹ 100 per £. The seller allowed trade discount @ 2.5%. The other expenditures were:

(i) Import Duty 10%
(ii) Additional Import Duty 5%
(iii) Entry Tax 2% (Recoverable later from tax department).
(iv) Installation expenses ₹ 1,50,000.
(v) Professional fees for clearance from customs ₹ 50,000.

Compute the cost of software to be Capitalized as per relevant AS

Solution

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

	Amount
Purchase cost of the software (UK £)	1,50,000
Less: Trade discount @ 2.5% (UK £)	(3,750)
	1,46,250
Cost in ₹ (UK £1,46,250 x ₹ 100)	1,46,25,000
Add: Import duty on cost @ 10% (₹)	14,62,500
	1,60,87,500
Add: Additional import duty @ 5% (₹)	8,04,375
	1,68,91,875
Add: Installation expenses (₹)	1,50,000
Add: Professional fee for clearance from customs (₹)	50,000
Cost of the software to be capitalized (₹)	1,70,91,875

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

Question 6 *Pg no._____*

Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred ₹ 10 lakh on research during first 5 months of the financial year 2019-20. The development of the process began on 1st September, 2019 and upto 31st March, 2020, a sum of ₹ 8 lakh was incurred as Development Phase Expenditure, which meets assets recognition criteria.
From 1st April, 2020, the Company has implemented the new process design and it is likely that this will result in after tax saving of ₹ 2 lakh per annum for next five years.
The cost of capital is 10%. The present value of annuity factor of ₹ 1 for 5 years @ 10% is 3.7908.
Decide the treatment of Research and Development Cost of the project as per AS 26.

Solution

Research Expenditure – According to AS 26 'Intangible Assets', the expenditure on research of new process design for its product ₹ 10 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. It is presumed that the entire expenditure is incurred in the financial year 2019-20. Hence, it should be written off as an expense in that year itself.
Cost of internally generated intangible asset – it is given that development phase expenditure amounting ₹ 8 lakhs incurred upto 31st March, 2020 meets asset recognition criteria. As per AS 26, for measurement of such internally generated intangible asset, fair value should be estimated by discounting estimated future net cash flows.

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

The cost of an internally generated intangible asset would be lower of cost value ₹ 8 lakhs or present value of future net cash flows ₹ 7.582 lakhs.
Hence, cost of an internally generated intangible asset will be ₹ 7.582 lakhs.
The difference of ₹ 0.418 lakhs (i.e. ₹ 8 lakhs – ₹ 7.582 lakhs) will be amortized by Plymouth for the financial year 2019-20.
Amortisation - The company can amortize ₹ 7.582 lakhs over a period of five years by charging ₹ 1.516 lakhs per annum from the financial year 2020-2021 onwards

Question 7 *(Inter Nov 2020) (5 Marks)* *Pg no.*_____

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 ₹ 80 lakhs. The production process met the criteria for recognition as an intangible asset on 1 st November, 2018. Expenditure incurred till this date was ₹ 42 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2020 was ₹ 90 lakhs. As on 31.03.2020, the recoverable amount of know how embodied in the process is estimated to be ₹ 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?

Solution

As per AS 26 'Intangible Assets'

(i) Expenditure to be charged to Profit and Loss account for the year ending 31.03.2019
₹ 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 ₹ 38 (80-42) lakhs (expenditure incurred since the date the recognition criteria were met, i.e., from 1 st November 2018)

(iii) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2020

	(₹ in lacs)
Carrying Amount as on 31.03.2019	38
Expenditure during 2019 – 2020	90
Book Value	128
Recoverable Amount	(82)
Impairment loss	46

₹ 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

	(₹ in lacs)
Book Value	128
Less: Impairment loss	(46)
Carrying amount as on 31.03.2020	82

Question 8 *(Inter Dec 2021) (5 Marks)* *Pg no._____*

Surgical Ltd, is developing a new production process of surgical equipment. During the financial year ended 31st March 2020 the total expenditure incurred on the process was ₹ 67 lakhs. The production process met the criteria for recognition as an intangible asset on 1st January 2020. Expenditure incurred till this date was ₹ 35 lakhs. Further expenditure incurred on the process for the financial year ending 31st March 2021 ₹ 105 lakhs. As on 31st March 2021, the recoverable amount of technique embodied in the process is estimated to be ₹ 89 lakhs. This includes estimates of future cash outflows and inflows. Under the provisions of AS 26, you are required to ascertain:

(i) The expenditure to be charged to Profit & Loss Account for year ended 31st March 2020;
(ii) Carrying amount of the intangible asset as on 31st March 2020;
(iii) Expenditure to be charged to Profit and Loss Account for the year ended 31st March 2021;
(iv) Carrying amount of the intangible asset as on 31st March 2021.

Solution

As per AS 26 'Intangible Assets'

(i) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2020 ₹ 35 lakhs is recognized as an expense because the recognition criteria were not met until 1stJanuary 2020. 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 31.03.2020
At the end of financial year, on 31st March 2020, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹ 32 (67-35) lacs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st January 2020).

(iii) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2021

	(₹ in lacs)
Carrying Amount as on 31.03.2020	32
Expenditure during 2020 – 2021	105
Book Value	137
Recoverable Amount	(89)
Impairment loss	48

₹ 48 lakhs to be charged to Profit and loss account for the year ending 31.03.2021

(iv) Carrying value of intangible asset as on 31.03.2021

	(₹ in lacs)
Book Value	137
Less: Impairment loss	(48)
Carrying amount as on 31.03.2021	89

Question 9 *(RTP Nov 2021)* *Pg no.*_____

A company is showing an intangible asset at ₹ 88 lakhs as on 01.04.2020. This asset was acquired for ₹ 120 lakhs on 01.04.2016 and the same was available for use from that date. The company has been following the policy of amortization of the intangible assets over a period of 15 years on straight line basis. Comment on accounting treatment of the above with reference to relevant Accounting Standard.

Solution

As per para 63 of AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on systematic basis over the best estimate of its useful life.
There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use.
Company has been following the policy of amortization of the intangible asset over a period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS 26.
Accordingly, the company would be required to restate the carrying amount of intangible asset as on 01.04.2020 at ₹ 72 lakhs i.e. ₹ 120 lakhs less ₹ 48 lakhs.
The difference of ₹ 16 Lakhs (₹ 88 lakhs – ₹ 72 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹ 72 lakhs will be amortised over remaining 6 years by amortizing ₹ 12 lakhs per year.

Question 10 *Pg no.*_____

RC Ltd. is showing an intangible asset at ₹ 72 lakhs as on 31-3-20. This asset was acquired for ₹ 120 lakhs as on 01-04-14 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. Comment on the accounting treatment of asset with reference to AS- 26 and also give the necessary rectification journal entry.

Solution

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 period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS 26.

Accordingly, the company would be required to restate the carrying amount of intangible asset as on 31.3.2020 at ₹ 48 lakhs i.e. ₹ 120 lakhs less ₹ 72 lakhs (₹ 120 Lakhs / 10 years x 6 years = 72 Lakhs). The difference of ₹ 24 Lakhs (₹ 72 lakhs – ₹ 48 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹ 48 lakhs will be amortized over remaining 4 years by amortizing₹ 12 lakhs per year.
The necessary journal entry (for rectification) will be

Revenue Reserves	Dr.	₹ 24 Lakhs	
To Intangible Assets			₹ 24 Lakhs

(Adjustment to reserves due to restatement of the carrying amount of intangible asset)

Question 11 *(RTP May 2018) / (RTP Nov 2019) / (RTP Nov 2022)* Pg no._____

K Ltd. launched a project for producing product X in October, 2019. The Company incurred ₹ 40 lakhs towards Research and Development expenses upto 31st March, 2020. 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.

Solution

As per para 41 of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions
specified in para 44 of the standard. An intangible asset (arising from development) should be derecognized when no future economic benefits are expected from its use according to para 87 of the standard. Thus, the manager cannot defer the expenditure write off to future years in the given case.
Hence, the expenses amounting ₹ 40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2020.

Question 12 Pg no._____

A Pharma Company spent ₹33 lakhs during the accounting year ended 31st March, 2020 on a research project to develop a drug to treat "AIDS". Experts are of the view that it may take four years to establish whether the drug will be effective or not and even if found effective it may take two to three more years to produce the medicine, which can be marketed. The company wants to treat the expenditure as deferred revenue expenditure. Comment.

Solution

As per para 41 of AS 26 'Intangible Assets', no intangible asset arising from research (or from the research phase of an internal project) should be recognized. Expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred. Thus, the company cannot treat the expenditure as deferred revenue expenditure. The entire amount of ₹ 33 lakhs spent on research project should be charged as an expense in the year ended 31st March, 2020.

Question 13 *(RTP May 2019)* Pg no._____

A Company with a turnover of ₹ 375 crores and an annual advertising budget of ₹ 3 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹ 37.5 crores from the new product. The company had debited to i ts Profit and Loss account the total expenditure of ₹ 3 crores incurred on extensive special initial advertisement campaign for the new product. Is the procedure adopted by Company correct?

Solution

According to AS 26 'Intangible Assets', "expenditure on intangible item should be recognized 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 ₹ 3 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 ₹37.5 crores. Here, no intangible asset or another asset is acquired or created that can be recognized.

Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹3 crores to the Profit and Loss account of the year is correct

Question 14 *(Inter Nov 2019) (5 Marks) / (RTP May 2023)* *Pg no._____*

As per provisions of AS-26, how would you deal to the following situations:

(1) ₹ 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.

(2) During the year 2018-19, a company spent ₹ 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.

(3) A company spent ₹ 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 ₹ 25,00,000 by disclosing it as a prior period item.

(4) A company with a turnover of ₹ 200 crores and an annual advertising budget of ₹ 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 ₹ 20 crore from the new product. The company had debited to its Profit & Loss Account the total expenditure of ₹ 50,00,000 incurred on extensive special initial advertisement campaign for the new product

Solution

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 ₹ 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 ₹ 7,00,000 in the Profit and Loss account for the year ended 31st March, 2019 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 ₹ 25,00,000 and it should be recognized as expense

(4) Expenditure of ₹ 50,00,000 on advertising and promotional activities should always be charged to Profit and Loss Statement. Hence, the company has done the correct treatment by debiting the sum of 50 lakhs to Profit and Loss Account.

Question 15 *(RTP Nov 2020)* *Pg no._____*

X Ltd. carried on business of manufacturing of Bakery products. The company has two trademarks "Sun" and "Surya". One month before, the company comes to know through one of the marketing managers that both trademarks have allegedly been infringed by other competitors engaged in the same field. After investigation, legal department of the company informed that it had weak case on trademark "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?

Solution

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. 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 incurred for both trademarks must be recognized as an expense.

Question 16 *(RTP May 2022)* *Pg no._____*

(a) PQR Ltd. has acquired a Brand from another company for ₹ 100 lakhs. PQR Ltd. contends that since the said brand is a very popular and famous brand, no amortization needs to be provided. Comment on this in line with the Accounting Standards.

(b) 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 in line with provisions of Accounting Standards.

Solution

(a) 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.

(b) 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 the recognition criteria. An intangible asset should be recognized if, & 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 be debited to the profit and loss statement during the year ended 31st March, 2021.

FINANCIAL REPORTING OF INTEREST IN JOINT VENTURES

AS 27

<table>
<tr><td>Coverage</td><td colspan="2">This standard set out principles and procedures for accounting of interests in joint venture and reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors regardless of the structures or forms under which the joint venture activities take place.
The provisions of this AS need to be referred to for consolidated financial statement only when CFS is prepared and presented by the venturer.</td></tr>
<tr><td rowspan="5">Definitions</td><td>Joint venture</td><td>A contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control</td></tr>
<tr><td>Joint control</td><td>It is the contractually agreed sharing of control over an economic activity</td></tr>
<tr><td>Control</td><td>power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.</td></tr>
<tr><td>Venturer</td><td>party to a joint venture and has joint control over that joint venture</td></tr>
<tr><td>Investor</td><td>An investor in a joint venture is a party to a joint venture and does not have joint control over that joint venture.</td></tr>
<tr><td>Contractual Arrangement</td><td colspan="2">The joint venture covered under this statement is governed on the basis of contractual agreement. Non-existence of contractual agreement will disqualify an organization to be covered in AS 27.
Joint ventures with contractual agreement will be excluded from the scope of AS 27 only if the investment qualifies as subsidiary under AS 21, in this case, it will be covered by AS 21.
Contractual agreement can be in the form of written contract, minutes of discussion between parties (venturers), articles of the concern or by-laws of the relevant joint venture. Irrespective of the form of the contract, the content of the contract ideally should include the following points:
• The activity, duration and reporting obligations of the joint venture.
• The appointment of the board of directors or equivalent governing body of the joint venture and the voting rights of the venturers.
• Capital contributions by the venturers.
• The sharing by the venturers of the output, income, expenses or results of the joint venture.
If contractual agreement is signed by a party to safeguard its right, such agreement will not make the party a venturer. The contractual arrangement may identify one venturer as the operator or manager of the joint venture.

<u>Example</u>
IDBI gave loan to the joint venture entity of L&T and Tantia Construction, they signed an agreement according to which IDBI will be informed for all important decisions of the joint venture entity. This agreement is to protect the right of the IDBI, hence just signing the contractual agreement will not make investor a venturer.</td></tr>
</table>

<table>
<tr><td></td><td><u>Example</u>
Mr. A, M/s. B & Co. and C Ltd. entered into a joint venture, where according to the agreement, all the policies making decisions on financial and operating activities will be taken in a regular meeting attended by them or their representatives. Implementation and execution of these policies will be the responsibility of Mr. A. Here Mr. A is acting as venturer as well as manager of the concern.

<u>Example</u>
X Ltd invested ₹ 100 crore as initial capital along with Y Ltd and Z Ltd in GFH Ltd. The purpose of X Ltd making this investment is to grow the business of GFH Ltd along with the other investors. All investors have a right to attend to the meetings and to take decisions with respect to the business of GFH Ltd. All investors are actively involved in running the business of GFH Ltd and have a share in the returns generated by GFH Ltd in an agreed proportion.
GFH Ltd is an example of a Joint Venture and X Ltd, Y Ltd and Z Ltd are all Venturers. Similarly, just because contractual agreement has assigned the role of a manager to any of the venturer will not disqualify him as venturer.</td></tr>
<tr><td>Forms of Joint Ventures</td><td>Joint ventures may take many forms and structures, this Statement identifies them in three broad types –
▪ Jointly Controlled Operations (JCO),
▪ Jointly Controlled Assets (JCA) and
▪ Jointly Controlled Entities (JCE).
Any structure which satisfies the following characteristics can be classified as joint ventures:
(a) 2 or more venturers are bound by a contractual arrangement and
(b) The contractual arrangement establishes joint control</td></tr>
</table>

Jointly Controlled Operations (JCO)

Under this set up, venturers do not create a separate entity for their joint venture business but they use their own resources for the purpose. They raise any funds required for joint venture on their own, they incur any expenses and sales are also realised individually.

<u>Following are the key features of JCO:</u>

a. Each venturer has his own separate business.
b. There is no separate entity for joint venture business.
c. All venturers are creating their own assets and maintain them.
d. Each venturer record only his own transactions without any separate set of books maintained for the joint venture business. All the transactions of joint venture are recorded in their books only.
e. There is a common agreement between all of them.
f. Venturers use their assets for the joint venture business.
g. Venturers met the liabilities created by them for the joint venture business.
h. Venturers met the expenses of the joint venture business from their funds.
i. Any revenue generated or income earned from the joint venture is shared by the venturers as per the contract.

Since the jointly controlled operation is not purchasing assets or raising finance in its own right, the assets and liabilities used in the activities of the joint venture are those of the ventures. As such, they are accounted for in the financial statements of the venture to which they belong.

In respect of its interests in jointly controlled operations, a venturer should recognise in its separate financial statements and consequently in its consolidated financial statements:

(a) the assets that it controls and the liabilities that it incurs; and

(b) the expenses that it incurs and its share of the income that it earns from the joint venture.

Separate accounting records may not be required for the joint venture itself and financial statements may not be prepared for the joint venture. However, the venturers may prepare accounts for internal management reporting purposes so that they may assess the performance of the joint venture.

Jointly Controlled Assets (JCA)

Separate legal entity is not created in this form of joint venture but venturer owns the assets jointly, which are used by them for the purpose of generating economic benefit to each of them. They take up any expenses and liabilities related to the joint assets as per the contract.

Following points can be concluded:

- There is no separate legal identity.
- There is common control over the joint assets.
- Venturers use this asset to derive some economic benefit to themselves.
- Each venturer incurs separate expenses for their transactions.
- Expenses on jointly held assets are shared by the venturers as per the contract.
- In their financial statement, the venturer shows only their share of the asset and total income earned by them along with total expenses incurred by them.
- Since the assets, liabilities, income and expenses are already recognised in the separate financial statements of the venturer and consequently in its consolidated financial statements, no adjustments or other consolidation procedures are required in respect of these items when the venturer presents consolidated financial statements.
- Financial statements may not be prepared for the joint venture, although the venturers may prepare accounts for internal management reporting purposes so that they may assess the performance of the joint venture.

Difference between JCO & JCA	❖ In JCO, venturers use their own assets for joint venture business but in JCA they jointly own the assets to be used in joint venture. ❖ JCO is an agreement to jointly carry on the operations to earn income whereas, JCA is an agreement to jointly construct and maintain an asset to generate revenue to each venturer. ❖ Under JCO all expenses and revenues are shared at an agreed ratio, in JCA only expenses on joint assets are shared at the agreed ratio.

Jointly Controlled Entities (JCE)

This is the format where a venturer creates a new entity for their joint venture business. A jointly controlled entity is a joint venture which involves the establishment of a corporation, partnership or other entity in which each venturer has an interest.

The entity operates in the same way as other enterprises, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity.

All the venturers pool their resources under new banner and this entity purchases its own assets, create its own liabilities, expenses are incurred by the entity itself and sales are also made by this entity. The net result of the entity is shared by the venturers in the ratio agreed upon in the contractual agreement.
Each venturer usually contributes cash or other resources to the jointly controlled entity. These contributions are included in accounting records of the venturer and are recognised in its separate financial statements as an investment in the jointly controlled entity.
A jointly controlled entity maintains its own accounting records and prepares and presents financial statements in the same way as other enterprises in conformity with the requirements applicable to that jointly controlled entity.

Consolidated Financial Statements of a Venturer

Proportionate consolidation is a method of accounting and reporting whereby a venturer's share of each of the assets, liabilities, income and expenses of a jointly controlled entity is reported as separate line items in the venturer's financial statements.
Proportionate consolidation method is to be followed except in the following cases:

(a) Investment is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future. And

(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 investee is treated as investment according to AS 13.

A venturer should ***discontinue*** the use of this method 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 transfer funds to the venturer.

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 upto 50%, investments are to be accounted for in accordance with AS 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 venture relationship ceases to exist should be regarded as cost thereafter.

Following are the features of Proportionate Consolidation Method:

- Stress is given on substance over form i.e., more importance is given to the share of venturers in the profit or loss of the venture from the share of assets and liabilities rather than the nature and form of the joint venture.
- Venturer's share of joint assets, liabilities, expenses and income are shown on the separate lines in the consolidated financial statement.
- Most of the provisions of Proportionate Consolidation Method are similar to the provisions of AS 21
- As far as possible the reporting date of the financial statements of jointly controlled entity and venturers should be same. If practically it is not possible to draw up the financial statements to such date and, accordingly, those financial statements are drawn

up to different reporting dates, adjustments should be made in joint venturer's books for the effects of significant transactions or other events that occur between the jointly controlled entity's date and the date of the venturer's financial statements. In any case, the difference between reporting dates should not be more than six months.

- Accounting policies followed in the preparation of the financial statements of the jointly controlled entity and venturer should be uniform for like transactions and other events in similar circumstances. If accounting policies followed by venturer and jointly controlled entity are not uniform, then adjustments should be made in the items of the venturer to bring it in line with the accounting policy of the joint venture.
- Any asset or liability should not be adjusted by another liability or asset. Similarly any income or expense cannot be adjusted with another expense or income. Such adjustment can be made only when legally it is allowed to adjust them and such items does lead to settlement of obligation or writing off of assets.
- On the date when interest in joint entity is acquired, if the interest of venturer in net assets of the entity is less than the cost of investment in joint entity, the difference will be recognized as goodwill in the consolidated financial statement and if net asset is more than cost of investment, then the difference is recognized as capital reserve

Transactions between Venturer and Joint Venture

When venturer transfers or sells assets to Joint Venture, the venturer should recognise only that portion of the gain or loss which is attributable to the interests of the other venturers. The venturer should recognise the full amount of any loss only when the contribution or sale provides evidence of a reduction in the net realisable value of current assets or an impairment loss.

When the venturer from the joint venture purchases the assets, venturer will not recognized his share of profits in the joint venture of such transaction unless he disposes off the assets. A venturer should recognise his share of the losses resulting from these transactions in the same way as profits except that losses will be recognised in full immediately only when they represent a reduction in the net realisable value of current assets or an impairment loss.

In case the joint venture is in the form of separate entity (i.e., JCE) then provisions of above the Para will be followed only for consolidated financial statement and not for venturer's own financial statement. In the books of venturer, profit or loss from such transactions are recognised in full.

Example

A and B established a separate vehicle i.e. entity J, wherein each operator has a 50% ownership interest and each takes 50% of the output. On formation of the joint venture, A contributed a property with fair value of ₹ 110 crore and agreed to contribute his experience over the years towards this venture; and B contributed equipment with a fair value of ₹ 120 crore. The carrying values of the contributed assets were ₹ 100 crore and ₹ 80 crore, respectively.

Answer

A – Gain in consolidated financial statements

A's share in the fair value of assets contributed by entity B (50% × 120)	60
A's share in the carrying value of asset contributed by A to the joint venture (50% × 100)	(50)
Gain recognised by A	10

<table>
<tr><td>Other Points</td><td>The investors who don't have joint control over the entity recognized his share of net results and his investments in joint venture as per AS 13. In the consolidated financial statement, it is recognized as per AS 13, AS 21 or AS 23 as appropriate.
Payment to operators is recognized as an expense in CFS and in the books of operators as per AS 9, Revenue Recognition. The operator may be any of the venturers, in this case any amount received by him, as management fees for the service will be recognized as stated above in this Para.</td></tr>
<tr><td>Disclosure</td><td>A venturer should disclose the aggregate amount of the following contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities:
a. Any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities which have been incurred jointly with other venturers;
b. Its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and
c. Those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture.

A venturer should disclose the aggregate amount of the following commitments in respect of its interests in joint ventures separately from other commitments:
a. Any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and
b. Its share of the capital commitments of the joint ventures themselves.

A venturer should disclose a list of all joint ventures and description of interests in significant joint ventures. In respect of jointly controlled entities, the venturer should also disclose the proportion of ownership interest, name and country of incorporation or residence.
A venturer should disclose, in its separate financial statements, the aggregate amounts of each of the assets, liabilities, income and expenses related to its interests in the jointly controlled entities.</td></tr>
</table>

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)*

Mr. A, Mr. B and Mr. C entered into a joint venture to purchase a land, constructand sell flats. Mr. A purchased a land for ₹ 60,00,000 on 01.01.2021 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 the materials 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 incidental expenses which turnout to be ₹ 9,00,000.
On 30.06.2021 each of the venturer agreed to take away one flat 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 with the interest and net proceeds were shared by the partners equally.
You are required to prepare the draft Consolidated Profit & Loss Account and Joint Venture Account in the books of each venturer.

Question 2 *(ICAI Study Material)*

A Ltd., B Ltd. and C Ltd. decided to jointly construct a pipeline to transport the gasfrom 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 vehicles of ₹ 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.

Solution:

Consolidated Balance Sheet

		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 capital		
	A 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	
	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)		2,00,000

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 B Ltd. & C Ltd.: Same Presentation as in case of A Ltd.

Question 3 *(ICAI Study Material)*

A Ltd. a UK based company entered into a joint venture with B Ltd. in India, wherein B Ltd. will import the 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 distributed equally. A Ltd. invested 49% of total capital but has an equal share in all the assets and is equally liable for all the liabilities of the joint venture. Following is the trial balance of the joint venture at the end of the first year:

Particulars	Dr. (₹)	Cr. (₹)
Purchases	9,00,000	
Other Expenses	3,06,000	
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.

Solution:

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
	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:	7,25,000	
	A Ltd.	5,80,000	13,05,000
	B Ltd.		
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.	Reserve & Surplus:		
	Profit & Loss Account		
	A Ltd.	99,500	
	B Ltd.	99,500	1,99,000
7.	Long term Borrowing:		
	Unsecured Loans		
	A Ltd.	1,00,000	
	B Ltd.	1,00,000	2,00,000
8.	Current Liabilities:		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
9.	Property, Plant & 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 4 *(ICAI Study Material)*

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 thethree 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 consolidationmethod.

Question 5 *(ICAI Study Material)*

JVR Limited has made investments of ₹ 97.84 crores in equity shares of QSR Limited in pursuance of Joint Venture agreement till 2021-22 (i.e., morethan 12 months). The investment has been made at par. QSR Limited hasbeen in continuous losses for the last 2 years. JVR Limited is willing to reassess the carrying amount 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.

Solution:
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 in accordance 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 2021-2022 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 businessplans and positive cash flows is based reliable presumptions (such as tenderin favour of QSR Ltd., strong order book etc.), the decline will be regardedas temporary in nature and the investment in equity shares will continue tobe 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 of QSR Ltd. to be correct.

IMPAIRMENT OF ASSETS

AS 28

<table>
<tr><td>Coverage</td><td colspan="2">This standard prescribes the procedures to be applied to ensure that the assets of enterprise are carried at amount not exceeding their recoverable amount (amount to be recovered through use or sale of the asset).
The standard also lays down principles for reversal of impairment losses and prescribes certain disclosures in respect of impaired assets.</td></tr>
<tr><td>Scope</td><td colspan="2">The standard should be applied in accounting for impairment of all assets <u>except</u>
1. inventories (AS 2),
2. assets arising under construction contracts (AS 7),
3. financial assets including investments covered under AS 13, and
4. deferred tax assets (AS 22).
There are chances that the provision on account of impairment losses may increase sickness of companies and potentially sick companies may actually become sick.</td></tr>
<tr><td rowspan="6">Definitions</td><td>Impairment Loss</td><td>It is the amount by which the carrying amount of an asset exceeds its recoverable amount.</td></tr>
<tr><td>Recoverable Amount</td><td>It is the higher of an asset's net selling price and it's value in use.</td></tr>
<tr><td>Net Selling Price</td><td>It is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.</td></tr>
<tr><td>Costs of Disposal</td><td>These are incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense</td></tr>
<tr><td>Value in Use</td><td>It is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life</td></tr>
<tr><td>Carrying Amount</td><td>It is the amount at which an asset is recognised in balance sheet after deducting any accumulated depreciation (amortization) and accumulated impairment losses thereon.</td></tr>
<tr><td>Assessment</td><td colspan="2">An enterprise should assess at each balance sheet date whether there is any indication that an asset may be impaired. If any such indication exists, the enterprise should estimate the recoverable amount of the asset.
An asset is impaired when the carrying amount of the asset exceeds its recoverable amount.
In assessing whether there is any indication that an asset may be impaired, an enterprise should consider, as a minimum, the following indications:

<u>External sources of information</u>
❖ During period, an asset's market value has declined significantly more than would be expected as result of the passage of time or normal use.
❖ Significant changes with an adverse effect on the enterprise have taken place during the period, or will take place soon, in the technological, market, economic or legal environment in which the enterprise operates or in the market to which an asset is dedicated.</td></tr>
</table>

	❖ Market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially. ❖ The carrying amount of the net assets of the reporting enterprise is more than its market capitalization. <u>Internal sources of information</u> ❖ Evidence is available of obsolescence or physical damage of an asset. ❖ Significant changes with an adverse effect on the enterprise have taken place during the period or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include plans to discontinue or restructure the operation to which an asset belongs or to dispose of an asset before the previously expected date and ❖ Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected. An enterprise may identify other indications that an asset may be impaired, and these would also require the enterprise to determine the asset's recoverable amount. <u>Example</u> that indicates that an asset may be impaired because of the following: a) cash flows for acquiring the asset, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted. b) actual net cash flows or operating profit or loss flowing from the asset that are significantly worse than those budgeted. c) a significant decline in budgeted net cash flows or operating profit, or a significant increase in budgeted loss, flowing from the asset; or d) operating losses or net cash outflows for the asset when current period figures are aggregated with budgeted figures for the future. The concept of materiality applies in identifying whether the recoverable amount of an asset needs to be estimated.
Estimate of Cash Flows	Cash flow projections should be based on reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset. Greater weight should be given to external evidence. Cash flow projections should be based on the most recent approved budgets/forecasts for a maximum of 5 years. Financial budgets/forecasts over a period longer than 5 years may be used if management is confident that these projections are reliable and it can demonstrate its ability, based on experience, to forecast cash flows accurately over that longer period. *<u>Estimates of future cash flows should include:</u>* (i) Projections of net cash inflows from the continuing use of the asset (ii) projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset and that can be directly attributed, or allocated on a reasonable and consistent basis, to the asset; and (iii) Net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life

<table>
<tr>
<td></td>
<td>Care should be taken for the following points:
a. When the carrying amount of an asset does not yet include all the cash outflows to be incurred before it is ready for use or sale, estimate of any further cash outflow that is expected to be incurred before the asset is ready for use or sale should be included.
b. Cash inflows from assets that generate cash inflows from continuing use that are largely independent of the cash inflows from the asset under review should not be included.
c. Cash outflows that relate to obligations that have already been recognised as liabilities to be excluded.
d. Future cash outflows or inflows expected to arise because of restructuring of the organization should be not considered.
e. Any future capital expenditure enhancing the capacity of the assets and its related savings/outflow should be excluded.
f. Any increase in expected cash inflow from the above expenditure should also be excluded.
g. Estimates of future cash flows should not include cash inflows or outflows from financing activities and also income tax receipts or payments.
h. The estimate of net cashflow upon disposal of the asset should be the amount that an enterprise expects to obtain from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties prevailing at the date of the estimates, after deducting the estimated costs of disposal.

<u>Foreign Currency Future Cash Flows</u> are estimated in currency in which it will be generated and then they are discounted for the time value of money using a discount rate appropriate for that currency we convert cashflow in the reporting currency on the basis of AS 11.</td>
</tr>
<tr>
<td>Discount Rate</td>
<td>The discount rate(s) should be a pre-tax rate(s) that reflect(s) current market assessments of the time value of money and the risks specific to the asset. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted.

An enterprise normally uses a single discount rate for the estimate of an asset's value in use. However, an enterprise uses separate discount rates for different future periods where value in use is sensitive to a difference in risks for different periods or to the term structure of interest rates.</td>
</tr>
<tr>
<td colspan="2">Recognition and Measurement of Impairment Loss</td>
</tr>
<tr>
<td colspan="2"><u>Case I</u>:
If recoverable amount of assets more than carrying amount, we ignore the difference and asset is carried on at the same book value.

Note: If there is an indication that an asset may be impaired, this may indicate that the remaining useful life, the depreciation method or the residual value for the asset need to be reviewed and adjusted under the AS 10, even if no impairment loss is recognised for the asset</td>
</tr>
</table>

Case II:
When this recoverable amount is less than the carrying amount, this difference termed as Impairment Loss.
Treatment of Impairment loss: It should be written off immediately as expenses to P&L A/c.
If assets are carried out at revalued figures then the impairment loss equivalent to revalued surplus is adjusted with it and the balance (if any) is charged to Profit & Loss Account.

Depreciation: Depreciation for the coming years on the assets are recalculated on the basis of the new carrying amount, residual value and remaining useful life of the asset, according to AS 10

Case III:
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 AS.

Identification of Cash Generating Unit (CGU)

A cash generating unit is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.
If there is any indication that an asset may be impaired, the recoverable amount should be estimated for the individual asset, if it is not possible to estimate the recoverable amount of the individual asset because the value in use of the asset cannot be determined and it is probably different from scrap value. Therefore, the enterprise estimates the recoverable amount of the cash-generating unit to which the asset belongs.
If recoverable amount cannot be determined for an individual asset, an enterprise identifies the lowest aggregation of assets that generate largely independent cash inflows from continuing use.

Example 1
A mining enterprise owns a private railway to support its mining activities. The private railway could be sold only for scrap value and the private railway does not generate cash inflows from continuing use that are largely independent of the cash inflows from the other assets of the mine.
It is not possible to estimate the recoverable amount of the private railway because the value in use of the private railway cannot be determined and it is probably different from scrap value. Therefore, the enterprise estimates the recoverable amount of the cash-generating unit to which the private railway belongs, that is, the mine as a whole.

Example 2
A bus company provides services under contract with a municipality that requires minimum service on each of five separate routes. Assets devoted to each route and the cash flows from each route can be identified separately. One of the routes operates at a significant loss.
Since the enterprise does not have the option to curtail any one bus route, the lowest level of identifiable cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets is the cash inflows generated by the five routes together. The cash-generating unit for each route is the bus company as a whole.

Recoverable Amount & Carrying Amount of a CGU

The carrying amount of a cash-generating unit should be determined consistently with the way the recoverable amount of the cash-generating unit is determined i.e., carrying amount is the summation of the carrying amount of all the assets grouped under one cash-generating unit. This also includes liability only if that liability is necessary to be considered to determine the recovery amount.
For practical reasons, the recoverable amount of a cash-generating unit is sometimes determined after consideration of assets that are not part of the cashgenerating unit or liabilities that have already been recognised in the financial statements. In such cases, the carrying amount of the cash-generating unit is increased by the carrying amount of those assets and decreased by the carrying amount of those liabilities.

Example

A company operates a mine in a country where legislation requires that the owner must restore the site on completion of its mining operations. The cost of restoration includes the replacement of the overburden, which must be removed before mining operations commence. A provision for the costs to replace the overburden was recognised as soon as the overburden was removed. The amount provided was recognised as part of the cost of the mine and is being depreciated over the mine's useful life. The carrying amount of the provision for restoration costs is ₹ 50,00,000, which is equal to the present value of the restoration costs.
The enterprise is testing the mine for impairment. The cash-generating unit for the mine is the mine as a whole. The enterprise has received various offers to buy the mine at a price of around ₹ 80,00,000; this price encompasses the fact that the buyer will take over the obligation to restore the overburden. Disposal costs for the mine are negligible. The value in use of the mine is approximately ₹ 1,20,00,000 excluding restoration costs. The carrying amount of the mine is ₹ 1,00,00,000.
The net selling price for the cash-generating unit is ₹ 80,00,000. This amount considers restoration costs that have already been provided for. As a consequence, the value in use for the cash-generating unit is determined after consideration of the restoration costs and is estimated to be ₹ 70,00,000 (₹ 1,20,00,000 less ₹ 50,00,000). The carrying amount of the cash-generating unit is ₹ 50,00,000, which is the carrying amount of mine (₹ 1,00,00,000) less the carrying amount of the provision for restoration costs (₹ 50,00,000).

Impairment Loss for a CGU

The 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. These reductions in carrying amounts should be treated as impairment losses on individual assets

The carrying amount of an asset should not be reduced below the highest of:

a. Its net selling price (if determinable);
b. Its value in use (if determinable); and
c. Zero.

The amount of the impairment loss that would otherwise have been allocated to the asset should be allocated to the other assets of the unit on a pro-rata basis.

Goodwill

Goodwill does not generate cash flows independently from other assets or groups of assets and, therefore, the recoverable amount of goodwill as an individual asset cannot be determined. As a consequence, if there is an indication that goodwill may be impaired, recoverable amount is determined for the cashgenerating unit to which goodwill belongs. This amount is then compared to the carrying amount of this cash-generating unit and any impairment loss is recognized.

Case 1: If goodwill can be allocated on a reasonable and consistent basis: An enterprise applies the 'bottom-up' test only.
Case 2: If it is not possible to allocate goodwill on a reasonable and consistent basis: An enterprise applies both the 'bottom-up' test and 'top-down' test

Corporate Assets

Key characteristics of corporate assets are that they do not generate cash inflows independently from other assets or groups of assets and their carrying amount cannot be fully attributed to the cash-generating unit under review.

Examples
Building of a headquarter or a division of the enterprise, EDP equipment or a research Centre.
In testing a cash-generating unit for impairment, an enterprise should identify all the corporate assets that relate to the cash-generating unit under review. For each identified corporate asset:

a. If the carrying amount of the corporate asset can be allocated on a reasonable and consistent basis to the cash-generating unit under review, an enterprise should apply the 'bottom-up' test only; and
b. If the carrying amount of the corporate asset cannot be allocated on a reasonable and consistent basis to the cash-generating unit under review, an enterprise should apply both the 'bottom-up' and 'top-down' tests.

Reversal of an Impairment Loss

An enterprise should assess at each balance sheet date whether there is any indication that an impairment loss recognised for an asset in prior accounting periods may no longer exist or may have decreased. If any such indication exists, the enterprise should estimate the recoverable amount of that asset. An impairment loss recognised for an asset in prior accounting periods should be reversed if there has been a change in the estimates of cash inflows, cash outflows or discount rates used to determine the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset should be increased to its recoverable amount. That increase is a reversal of an impairment loss.

Reversal for an Individual Asset
Case 1: If impairment loss was written off to profit and loss account, then the reversal of impairment loss should be recognized as income in the financial statement immediately.

Case 2: If impairment loss was adjusted with the Revaluation Reserve; then reversal of impairment loss will be written back to the reserve account to the extent it was adjusted, any surplus will be recognised as revenue. But in any case, the increased carrying amount of an asset due to a reversal of an impairment loss should not exceed the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognised for the asset in prior accounting periods. This is mainly because any further increase in value of asset is revaluation, which is governed by AS 10.

Reversal for a CGU

A reversal of an impairment loss for a cash-generating unit should be allocated to increase the carrying amount of the assets of the unit in the following order:

a. First, assets other than goodwill on a pro-rata basis based on the carrying amount of each asset in the unit; and
b. Then, to goodwill allocated to the cash-generating unit (if any),

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. The amount of the reversal of the impairment loss that would otherwise have been allocated to the asset should be allocated to the other assets of the unit on a pro-rata basis.

Reversal for Goodwill

This Statement does not permit an impairment loss to be reversed for goodwill because of a change in estimates (for example, a change in the discount rate or in the amount and timing of future cash flows of the cash generating unit to which goodwill relates), an impairment loss recognised for goodwill should not be reversed in a subsequent period unless:

a. The impairment loss was caused by a specific external event of an exceptional nature that is not expected to recur; and
b. Subsequent external events have occurred that reverse the effect of that event.

IMPAIRMENT IN CASE OF DISCONTINUING OPERATIONS

The approval and announcement of a plan for discontinuance is an indication that the assets attributable to the discontinuing operation may be impaired or that an impairment loss previously recognised for those assets should be increased or reversed.

In applying this Statement to a discontinuing operation, an enterprise determines whether the recoverable amount of an asset of a discontinuing operation is assessed for the individual asset or for the asset's cash-generating unit.

A) If in entirety: recoverable amount is determined for the discontinuing operation as a whole and an impairment loss, if any, is allocated among the assets of the discontinuing operation.
B) If in other ways such as Piecemeal distribution: Recoverable amount is determined for individual assets, unless the assets are sold in groups.
C) If the enterprise abandons the discontinuing operation, the recoverable amount is determined for individual assets as set out in this Statement.

DISCLOSURE REQUIREMENTS

For each class of assets, the financial statements should disclose:

a. The amount of impairment losses recognised in the statement of profit and loss during the period and the line item(s) of the statement of profit and loss in which those impairment losses are included;
b. The amount of reversals of impairment losses recognised in the statement of profit and loss during the period and the line item(s) of the statement of profit and loss in which those impairment losses are reversed;

c. The amount of impairment losses recognised directly against revaluation surplus during the period; and
d. The amount of reversals of impairment losses recognised directly in revaluation surplus during the period.

An enterprise that applies AS 17, Segment Reporting, should disclose the following for each reportable segment based on an enterprise's primary format (as defined in AS 17):

a. The amount of impairment losses recognised in the statement of profit and loss and directly against revaluation surplus during the period; and
b. The amount of reversals of impairment losses recognised in the statement of profit and loss and directly in revaluation surplus during the period.

If an impairment loss for an individual asset or a cash-generating unit is recognised or reversed during the period and is material to the financial statements of the reporting enterprise as a whole, an enterprise should disclose:

a. The events & circumstances that led to the recognition or reversal of impairment loss;
b. The amount of the impairment loss recognised or reversed;
c. For an individual asset:
   (i) The nature of the asset; and
   (ii) The reportable segment to which the asset belongs, based on the enterprise's primary format (as defined in AS 17, Segment Reporting);
d. For a cash-generating unit:
   (i) A description of the CGU (such as whether it is a product line, a plant, a business operation, a geographical area, a reportable segment as defined in AS 17 or other);
   (ii) The amount of the impairment loss recognised or reversed by class of assets & by reportable segment based on enterprise's primary format (as defined in AS 17); and
   (iii) If the aggregation of assets for identifying the cash-generating unit has changed since the previous estimate of the cash-generating unit's recoverable amount (if any), the enterprise should describe the current and former way of aggregating assets and the reasons for changing the way the cash-generating unit is identified;
e. Whether the recoverable amount of the asset (cash-generating unit) is its net selling price or its value in use;
f. If recoverable amount is net selling price, the basis used to determine net selling price (such as whether selling price was determined by reference to an active market or in some other way); and
g. If recoverable amount is value in use, the discount rate(s) used in the current estimate and previous estimate (if any) of value in use.

If impairment losses recognised (reversed) during the period are material in aggregate to the financial statements of the reporting enterprise as a whole, an enterprise should disclose a brief description of the following:

a. The main classes of assets affected by impairment losses (reversals of impairment losses);
b. The main events and circumstances that led to the recognition (reversal) of these impairment losses.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* Pg no.______

Ergo Industries Ltd. gives the following estimates of cash flows relating to Property, Plant and equipment on 31-12-2021. The discount rate is 15%.

Year	Cash Flow (₹ in lakhs)
2022	4000
2023	6000
2024	6000
2025	8000
2026	4000
Residual value at the end of 2026	₹ 1000 lakhs
Property, Plant and Equipment purchased on 1-1-2019	₹ 40,000 lakhs
Useful life	8 years
Net selling price on 31-12-2021	₹ 20,000 lakhs

Calculate on 31-12-2021:

(a) Carrying amount at the end of 2021
(b) Value in use on 31-12-2021
(c) Recoverable amount on 31-12-2021
(d) Impairment loss to be recognized for the year ended 31-12-2021
(e) Revised carrying amount
(f) Depreciation charge for 2022.

Question 2 *(ICAI Study Material)* Pg no.______

X Ltd. is having a plant (asset) carrying amount of which is ₹ 100 lakhs on 31.3.2021. Its balance useful life is 5 years and residual value at the end of 5 yearsis ₹ 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)
31.3.2022	50
31.3.2023	30
31.3.2024	30
31.3.2025	20
31.3.2026	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 31.3.2021 is ₹ 60 lakhs.

Question 3 *(ICAI Study Material)* Pg no.______

G Ltd., acquired a machine on 1st April, 2020 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, 2024, the carrying value of the machine was reassessed at ₹ 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March, 2026, 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 ofG Ltd. G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

Question 4 *(ICAI Study Material)* *Pg no.______*

An asset does not meet the requirements of environment laws which havebeen 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?

Solution:

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) and net 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 AS 28.

Further, as per 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.

*Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. In the given case, Net Selling Price = Selling price – Cost of disposal = Nil – ₹ 70,000 = (₹ 70,000)

**Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. In the given case, value in use is nil.

Question 5 *(ICAI Study Material)* *Pg no.______*

A plant was acquired 15 years ago at a cost of ₹ 5 crores. Its accumulated depreciation as at 31st March, 2021 was ₹ 4.15 crores. Depreciation estimated for the financial year 2021-2022 is ₹ 25 lakhs. Estimated Net Selling Price ason 31st March, 2021 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, 2021, whichis expected to decrease by 30 per cent by the end of the financial year.

a. 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, 2022?
b. How much will be the amount of write off for the financial year ended 31st March, 2022?
c. 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?
d. 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?

Question 6 *(ICAI Study Material)* *Pg no.______*

X Ltd. purchased a Property, Plant and Equipment four years ago for ₹ 150 lakhsand depreciates it at 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 revaluation, the market price is ₹ 67.50 lakhs and expected disposal costs are ₹ 3 lakhs.

What willbe the treatment in respect of impairment loss on the basis that fair value for revaluation purpose is determined by market value and the value in use is estimated at ₹ 60 lakhs?

Solution:

Treatment of Impairment Loss

As per AS 28 "Impairment of assets", if the recoverable amount (higherof net selling price and 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 amount will be ₹ 64.50 lakhs.

Impairment loss will be calculated as ₹ 10.50 lakhs [₹ 75 lakhs (Carrying Amount after revaluation - Refer 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 Profit and Loss immediately since there was downward revaluationof asset which was already charged to Statement of Profit and Loss.

Working Note:

Calculation of carrying amount of the Property, Plant and Equipment at the end of the fourth year on revaluation

	(₹ in lakhs)
Purchase price of a Property, Plant and Equipment	150.00
Less: Depreciation for four years [(150 lakhs / 10 years) x 4years]	(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

Question 7 *(ICAI Study Material)* *Pg no.______*

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 inflowsfrom 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 immediatelywith new titles for the same customer segment. What is the cash-generating unit for an individual magazine title?

Solution:

It is likely that the recoverable amount of an individual magazine title canbe 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, decisionsto abandon titles are made on an individual title basis.

Therefore, it is likely that individual magazine titles generate cash inflowsthat are largely independent of each other and that each magazine title is a separate cash-generating unit.

Question 8 *(ICAI Study Material)* *Pg no.______*

Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 2021 for ₹ 60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 2021-2022 the carrying amountwas ₹ 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, ifsold 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.

Solution:

As per provisions of AS 28 "Impairment of Assets", impairment loss is not tobe 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.

PRACTICE QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

Write short note on impairment of asset and its application to inventory.

Solution:

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.

a. If carrying amount < = Recoverable amount: Asset is not impaired
b. 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.

Question 2 *(ICAI Study Material)* *Pg no._____*

Venus Ltd. has a fixed asset, which is carried in the Balance Sheet on 31.3.2021 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:

a. Calculate impairment loss.
b. Prepare journal entries for adjustment of impairment loss.
c. Show, how impairment loss will be shown in the Balance Sheet.

Solution:

a. Recoverable amount is higher of value in use 400 lakhs & net selling price 375 lakhs
   Recoverable amount = ₹400 lakhs
   Impairment loss = Carried Amount – Recoverable amount =
   ₹500 lakhs – ₹400 lakhs = ₹100 lakhs.

b. Journal Entries (₹ in lakhs)

	Particulars	Dr.	Cr.
(i)	Impairment loss account Dr.	100	
	To Provision for Accumulated Impairment Loss Account		100
	(Being the entry for accounting impairment loss)		
(ii)	Profit and loss account Dr.	100	
	To Impairment loss		100
	(Being the entry to transfer impairmentloss to P&L A/c)		

c. Balance Sheet of Venus Ltd. as on 31.3.2021

	(₹ in lakhs)
Fixed Asset	
Asset less depreciation	500
Less: Impairment loss	(100)
	400

Question 3 *(ICAI Study Material)* *Pg no._____*

From the following details of an asset

a. Find out impairment loss
b. Treatment of impairment loss
c. Current year depreciation

Particulars of asset:

Cost of asset	₹56 lakhs
Useful life period	10 years
Salvage value	Nil
Current carrying value	₹27.30 lakhs
Useful life remaining	3 years
Recoverable amount	₹12 lakhs
Upward revaluation done in last year	₹14 lakhs

Solution:

According to AS 28 "Impairment of Assets", an impairment loss on a revalued asset is recognised as an expense in the statement of profit andloss. 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 be adjusted in future periods to allocate theasset's revised carrying amount, less its residual value (if any), on a 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.

PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

AS 29

AS-29 prescribes the guidance in respect of recognition, measurement and disclosures of provisions, contingent liabilities and contingent assets. The standard clearly defines the role of management while making an estimate for creating provisions and the auditors to vouch for the correctness or otherwise of the estimate made by the management. This ensures that manipulations do not take place at the time of creation of provisions.

Where another Accounting Standard such as AS 7; AS 9; AS 15; AS 19 and AS 22 deals with a specific type of provision, contingent liability or contingent asset, an enterprise applies that Standard instead of AS 29.

Liabilities	It 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.
Present Obligation	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 (>50%).
Possible Obligation	An obligation is a possible obligation if based on the evidence available, its existence at the balance sheet is considered not probable (< 50%).
PROVISION	
Meaning	A Provision is a liability which can be measured only by using a substantial degree of estimation.
Recognition criteria (PARA 14)	A provision should be recognized when: → An enterprise has a present obligation as a result of past event. → 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 obligation. If these conditions are not met, no provision should be recognized. *Example:* X Ltd sells refrigerators with a warranty of 6 months. The refrigerators would be repaired free of cost by X Ltd. if some problem arises during the next 6 months of sale. There is a present obligation for X Ltd because if some defect arises, X Ltd would need to incur expenses on repairs of the refrigerator. Thus, a provision is required to be made in the books of X Ltd.
Measurement of provisions	Amount recognized as provision should be the best estimate of expenditure required to settle the present obligation at the balance sheet date.
Determinants of best estimate (Illustrative)	❖ Judgement of the management of the enterprise. ❖ Experience of similar transactions ❖ Reports from independent experts ❖ Any additional evidence provided by events after the balance sheet date.
Notes	❖ Provision should not be recognized for future operating losses. ❖ Provision should be measured before tax ❖ Provision should not be discounted to its present value.

	Exception: Discounting of provision for decommissioning, restoration and similar liabilities should be done as per the pre-tax discount rate as mentioned therein. *Example:* Z Ltd takes a building on lease for 10 years. The terms of the contract provide that Z Ltd must vacate the building in its original condition. Z Ltd expects that there is a likely cost of 10 lakhs to be spent at the end of 10 years for restoration. Since there is a present obligation on X Ltd at the time of entering into the lease contract, provision to the extent of present value of this amount should be created ❖ Provision should be reviewed at each balance sheet date ❖ It should be adjusted to reflect the current best estimate ❖ If it is no longer probable that there will be outflow of resources, then provision should be reversed.
CONTINGENT LIABILITY	
Meaning	It 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* → A present obligation that arises from past events but is not recognized because ➢ it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation OR ➢ A reliable estimate of the amount of the obligation cannot be made.

	Elements	Cases				
1.	Possible obligation	X	X	X	X	√
2.	Present obligation from past events	√	√	√	√	NA
3.	Expected outflow	√	√	X	X	NA
4.	Measurability (using substantial degree of estimation)	√	X	√	X	NA
5.	Whether it is Provision(P) or Contingent liability (CL)	P	CL	CL	CL	CL

Recognition	Contingent liability should not be recognized
Disclosure	Contingent liability should be disclosed Exception: The possibility of an outflow of resources embodying economic benefits is remote (i.e. no disclosure is even required in such case).
CONTINGENT ASSETS	
Meaning	It is a possible asset that arises from past events 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 an enterprise.

Recognition	A contingent asset should not be recognized. Note: When the realization of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.
Disclosure	❖ Contingent asset should not be disclosed in the financial statements ❖ It is disclosed in the director's report.
REIMBURSEMENT	
Meaning	When some or all of the expenditure required to settle a provision is expected to be reimbursed by another party (example through insurance contracts, indemnity clauses, supplier's warranty etc.), reimbursement should be recognized when and only when it is virtually certain that reimbursement will be received if the enterprise settles the obligation.
Valuation & Disclosure	❖ Reimbursement recognized should not exceed the amount of provision. ❖ In Balance Sheet, reimbursement should be presented as a separate asset. ❖ In the Statement of P&L, provision may be presented net of the amount recognized for reimbursement.
RESTRUCTURING	
Meaning	A restructuring is a programme that is planned and controlled by management, and materially changes either: (a) the scope of a business undertaken by an enterprise; or (b) the manner in which that business is conducted
Examples	❖ sale or termination of a line of business; ❖ the closure of business locations in a country or region or the relocation of business activities from one country or region to another; ❖ changes in management structure, for example, eliminating a layer of management; and ❖ fundamental re-organizations that have a material effect on the nature and focus of the enterprise's operations.
Whether provision required?	➢ A provision for restructuring costs is recognised only when the recognition criteria for provisions set out in Para 14 are met. ➢ No obligation arises for the sale of an operation until the enterprise is committed to the sale, i.e., there is a binding sale agreement.
Inclusions & Exclusions	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.

ONEROUS CONTRACT	
Meaning	It is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the *lower* of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it.
Example	An enterprise operates profitably from a factory that it has leased under an operating lease. During December 2020 the enterprise relocates its operations to a new factory. The lease on the old factory continues for the next four years, it cannot be cancelled and the factory cannot be re-let to another user. Present obligation as a result of a past obligating event- The obligating event occurs when the lease contract becomes binding on the enterprise, which gives rise to a legal obligation. An outflow of resources embodying economic benefits in settlement- When the lease becomes onerous, an outflow of resources embodying economic benefits is probable *Conclusion*-A provision is recognised for the best estimate of the unavoidable lease payments.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)*

At the end of the financial year ending on 31st December, 2020, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by Board of Directors. The possible outcome as estimated by Board is as follows:

	Probability	Loss (₹)
In respect of five cases (Win)	100%	-
Next ten cases (Win)	50%	-
Loss (Low damages)	40%	1,20,000
Loss (High damages)	10%	2,00,000
Remaining five cases		
Win	50%	-
Loss (Low damages)	30%	1,00,000
Loss (High damages)	20%	2,10,000

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.

Question 2

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

Less than 1 year : 2% provision More than 1 year : 3% provision

The company has raised invoices as under:

Invoice Date	Amount (₹)
19th January, 2018	40,000
29th January, 2019	25,000
15th October, 2019	90,000

Calculate the provision to be made for warranty under Accounting Standard 29 as at 31st March, 2019 and 31st March, 2020. Also compute amount to be debited to Profit and Loss Account for the year ended 31st March, 2020

Question 3 *(RTP Nov 2018 & May 2019) (Similar)*

WZW Ltd. is in a dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of ₹ 1,000 lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal the same in the annual accounts of the company?

Solution

As per para 14 of AS 29, a provision should be recognized 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.

If these conditions are not met, no provision should be recognized.

A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote. The possibility of an outflow of resources embodying economic

benefits seems to be remote in the given situation, since the directors of WZW Ltd. are of the opinion that the claim can be successfully resisted by the company.
Therefore, the company shall not disclose the same as contingent liability. However, following note in this regard may be given in annual accounts of the company:
"Litigation is in process against the company relating to a dispute with competitor who alleges that the company has infringed patents and is seeking damages of ₹ 1,000 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company".

Question 4 *(ICAI Study Material / (RTP May 2021)*

AB Ltd. is in the process of finalizing its account for the year ended 31st March, 2020. The company seeks your advice on the following:

a) The company's sale tax assessment for assessment year 2017-18 has been completed on 14th February, 2020 with a demand of ₹ 5.40 crore. The company paid the entire due under protest without prejudice to its right of appeal. The company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of ₹ 3.70 crore.
b) The company has entered into a wage agreement in May 2020 whereby the labour union has accepted a revision in wage from June 2019. The agreement provides that the hike till May 2020 will not be paid to employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September 2020.

Solution

a) Since the company is not appealing against the addition of ₹ 1.70 crore (₹ 5.40 crore less ₹ 3.70 crore), therefore, the same should be provided/ expensed off in its accounts for the year ended on 31st March, 2020. However, the amount paid under protest can be kept under the heading 'Long-term Loans & Advances / Short-term Loans and Advances' as the case may be along with disclosure as contingent liability of ₹ 3.70 crore.
b) The arrears for the period from June, 2019 to March, 2020 are required to be provided for in the accounts of the company for the year ended on 31st March, 2020 assuming that negotiations for hike in wages had already started in the year 2019-20 i.e. before the balance sheet date though the agreement was entered in May, 2020.

Question 5 *(RTP Nov 2021) / (ICAI Study Material)*

An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. At 31st March 2020, 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?

Solution

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 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 finalized, an obligation arises only when the 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 is virtually certain to be enacted.

Question 6

During 2018-19, A Ltd. gives a guarantee of certain borrowings of B Ltd., whose financial condition at that time is sound. During 2019-20, the financial condition of B Ltd. deteriorates and at 30 September 2019, B Ltd. goes into liquidation.
State whether a provision is required
(a) At 31 March 2019 (b) At 31 March 2020

Solution
(a) At 31 March 2019
Present obligation as a result of a past obligating event – The obligating event is the giving of the guarantee, which gives rise to an obligation.
An outflow of resources embodying economic benefits in settlement – No outflow of benefits is probable at 31 March 2019.
Conclusion – No provision is recognised. The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

(b) At 31 March 2020
Present obligation as a result of a past obligating event – The obligating event is the giving of the guarantee, which gives rise to a legal obligation.
An outflow of resources embodying economic benefits in settlement – At 31 March 2020, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
Conclusion – A provision is recognised for the best estimate of the obligation.

Question 7 *(RTP May 2020)*

With reference to AS-29, how would you deal with the following in the annual accounts of the company at the Balance Sheet dates:

(i) 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.

(ii) 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 at 31st Dec. 2019 it goes into Liquidation. (Balance Sheet date 31-3-19 & 31-3-20)

Solution

(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 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, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at 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.

(ii) 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 is probable 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.

Question 8

Under new legislation, an enterprise is required to fit smoke filters to its factories by 30 September 2020. The enterprise has not fitted the smoke filters.
State whether a provision is required:-
(a) At the balance sheet date of 31 March 2020
(b) At the balance sheet date of 31 March 2021

Solution
(a) At 31 March 2020
Present obligation as a result of past obligating event-There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.
Conclusion - No provision is recognised for the cost of fitting the smoke filters.

(a) At 31 March 2021
Present obligation as a result of a past obligating event - There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).
An outflow of resources embodying economic benefits in settlement - Assessment of probability of incurring fines and penalties by non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.
Conclusion - No provision is recognised for the costs of fitting smoke filters. However, a provision is recognised for the best estimate of any fines and penalties that are more likely than not to be imposed

Question 9 *(RTP Nov 2021)*

A company incorporated as NPO under the Companies Act having main objectives to promote the trade by organizing trade fairs/exhibitions. When the company was 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 charges are 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 & 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 visit the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated.

The following accounting treatment and disclosure was made by the company in its financial statements:

1) 5% contingency charges are treated as income and matching provision for the same is also being made in accounts.
2) A suitable disclosure to this effect is also made in the notes forming part of accounts.

You are required to comment whether creation of provision for contingencies under the facts and circumstances of the case is in conformity with AS 29

Solution

As per paragraph 14 of AS 29, a provision should be recognised when:

1. an enterprise has a present obligation as a result of a past event
2. it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and
3. a reliable estimate can be made of the amount of obligation.

If these conditions are not met, no provisions should be recognised.

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 and circumstances of the case.

Question 10

CASE 1 Court Case

After a wedding in 2019-20, ten people died, possibly as a result of food poisoning from products sold by the enterprise. Legal proceedings are started seeking damages from the enterprise but it disputes liability. Up to the date of approval of the financial statements for the year 31 March 2020, the enterprise's lawyers advise that it is probable that the enterprise will not be found liable. However, when the enterprise prepares the financial statements for the year 31 March 2021, its lawyers advise that, owing to developments in the case, it is probable that the enterprise will be found liable.

(a) At 31 March 2020

Present obligation as a result of a past obligating event - On the basis of the evidence available when the financial statements were approved, there is no present obligation as a result of past events.

Conclusion - No provision is recognised.

The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

(b) At 31 March 2021

Present obligation as a result of a past obligating event - On the basis of the evidence available, there is a present obligation.

An outflow of resources embodying economic benefits in settlement - Probable

Conclusion - A provision is recognised for the best estimate of the amount to settle the obligation.

CASE 2 Warranties

A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On past experience, it is probable (i.e. more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event - The obligating event is the sale of the product with a warranty, which gives rise to an obligation.
An outflow of resources embodying economic benefits in settlement - Probable for the warranties as a whole
Conclusion - A provision is recognised for the best estimate of the costs of making good under the warranty products sold before the balance sheet date.

CASE 3 Refund Policy

A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

Present obligation as a result of a past obligating event - The obligating event is the sale of the product, which gives rise to an obligation because obligations also arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner.
An outflow of resources embodying economic benefits in settlement - Probable, a proportion of goods are returned for refund
Conclusion - A provision is recognised for the best estimate of the costs of refunds

CASE 4 Staff Retraining

The government introduces a number of changes to the income tax system. As a result of these changes, an enterprise in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the balance sheet date, no retraining of staff has taken place.
Present obligation as a result of a past obligating event - There is no obligation because no obligating event (retraining) has taken place.
Conclusion - No provision is recognized

CASE 5 Refurbishment Costs - No Legislative Requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the balance sheet date, the lining has been in use for three years.

Present obligation as a result of a past obligating event - There is no present obligation.
Conclusion - No provision is recognized.
The cost of replacing the lining is not recognised because, at the balance sheet date, no obligation to replace the lining exists independently of the company's future actions - even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining.

CASE 6 Refurbishment Costs – Legislative Requirement

An airline is required by law to overhaul its aircraft once every three years.

Present obligation as a result of a past obligating event - There is no present obligation.
Conclusion - No provision is recognised.
The costs of overhauling aircraft are not recognised as a provision for the same reasons as the cost of replacing the lining is not recognised as a provision in above question. Even a legal requirement to overhaul does not make the costs of overhaul a liability, because no obligation exists to overhaul the aircraft independently of the enterprise's future actions - the enterprise could avoid the future expenditure by its future actions, for example by selling the aircraft.

However, an obligation might arise to pay fines or penalties under the legislation after completion of three 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 be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than three years.

Question 11 *(ICAI Study Material)*

Sun Ltd. has entered into a sale contract of ₹ 5 crores with X Ltd. during 2019-20 financial year. The profit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 2020-21 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 2019-20 financial year. As on balance sheet date (31.3.2020), the goods were not manufactured and it was unlikely that Sun Ltd. will be in a position 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?

Solution

(i) 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 recognised. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Sun Ltd. 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 AS 29.

(ii) Provision should not be measured as the excess of compensation to be paid over the profit. The goods were not manufactured before 31st March, 2020 and no profit had accrued for the financial year 2019-2020. Therefore, provision should be made for the full amount of compensation amounting ₹ 1.5 crores.

Question 12 *(RTP May 2018) / (RTP Nov 2019)*

The company has not made provision for warrantee in respect of certain goods considering that the 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. Comment

Solution

As per AS 29, where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the 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 was viewed that the accounting treatment adopted by the company with respect to warranty is not correct.

Question 13

M/s. Shishir Ltd., a public Sector Company, provides consultancy and engineering services to its clients. In the year 2019-20, the Government set up a commission to decide about the pay revision. The pay will be revised with respect from 1-1-2017 based on the recommendations of the commission. The company makes the provision of ₹ 1250 lakhs for pay revision in the financial year 2019-20 on the estimated basis as the report of the commission is yet to come. As per the contracts with client on cost plus job, the billing is done on the actual payment made to the employees and allocated to jobs based on hours booked by these employees on each job.

The company discloses through notes to accounts: "Salaries & benefits include the provision of ₹ 1250 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/recognize the income by ₹ 1250 lakhs in Profit & Loss Account as per the terms of the contract. Otherwise, it will be the violation of matching concept & understatement of profit. Comment on his opinion with reference to relevant AS.

Solution

As per AS 29, where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the 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 employees of ₹ 1,250 lakhs will be ultimately collected from the client, as per the terms of the contract. Therefore, the liability of ₹ 1,250 lakhs is matched by the counter claim from the client. Hence, the provision for salary of employees should be matched with the reimbursable asset to be claimed from the client. It appears that the whole amount of ₹ 1,250 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 ₹ 1,250 lakhs is not as per AS-29 and also the concept of prudence will not be followed if ₹ 1,250 lakhs is simultaneously recognized as income. ₹ 1,250 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 ₹ 1,250 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 14

Mini Ltd. took a factory premises on lease on 1.4.2019 for ₹ 2,00,000 per month. The lease is operating lease. During March, 2020, Mini Ltd. relocates its operation to a new factory building. The lease on the old factory premises continues to be live upto 31.12.2022.The lease cannot be cancelled and cannot be sub-let to another user. The auditor insists that lease rent of balance 33 months upto 31.12.2022 should be provided in the accounts for the year ending 31.3.2020. Mini Ltd. seeks your advice

Solution

In accordance with AS 29 'Provisions, Contingent Liabilities and Contingent Assets', if an enterprise has a contract that is onerous, the present obligation under the contract should be recognized and measured as a provision. In the given case, the operating lease contract has become onerous* as the economic benefit of lease contract for next 33 months up to 31.12.2022 will be nil. However, the lessee, Mini Ltd., has to pay lease rent of ₹ 66,00,000 (i.e.2,00,000 p.m. for next 33 months).

Therefore, provision on account of ₹ 66,00,000 is to be provided in the accounts for the year ending 31.03.2020. Hence auditor is right.

PRACTICE QUESTIONS

Question 1

X Ltd. has its financial year ended 31.3.2020, fifteen law suits outstanding, none of which has been settled by the time the accounts are approved by the directors. The directors have estimated that the probable outcomes as below:

Result	Probability	Loss (₹)
For First ten cases		
Win	0.6	-
Loss-Low damages	0.3	90,000
Lose-High damages	0.1	2,00,000
For remaining five cases		
Win	0.5	-
Loss-Low damages	0.3	60,000
Loss-High damages	0.2	1,00,000

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

Solution

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

a) There is a present obligation arising out of past events but not recognized as provision.
b) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
c) The possibility of an outflow of resources embodying economic benefits is also remote.
d) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

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

Expected loss in first ten cases = [₹ 90,000 x 0.3 + ₹ 2,00,000 x 0.1] x 10
= [₹ 27,000 + ₹ 20,000] x 10
= ₹ 47,000 x 10 = ₹ 4,70,000

Expected loss in remaining five cases = [₹ 60,000 x 0.3 + ₹ 1,00,000 x 0.2] x 5
= [₹ 18,000 + ₹ 20,000] x 5
= ₹ 38,000 x 5 = ₹ 1,90,000

Total contingent liability = ₹ 4,70,000 + ₹ 1,90,000 = ₹ 6,60,000.

Question 2 *(Inter Nov 2022) (5 Marks)*

At the end of the financial year ending on 31st March, 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 (Win)	100%	-
Next ten cases (Win)	50%	-

Lose (Low damages)	40%	12,00,000
Lose (High damages)	10%	20,00,000
Remaining five cases (Win)	50%	-
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.

Solution:

a) 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:
b) There is a present obligation arising out of past events but not recognized as provision.
c) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
d) The possibility of an outflow of resources embodying economic benefits is not remote.
e) 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 ₹ 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.

Question 3 *(Inter Nov 2019) (5 Marks) / (RTP May 2023)*

A Ltd. provides after sales warranty for two years to its customers. Based on past experience, the company has the following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period.

Less than 1 year: 2% provision More than 1 year: 3% provision

The company has raised invoices as under:

Invoice Date	Amount (₹)
11th February, 2018	60,000
25th December, 2018	40,000
4th October, 2019	1,35,000

Calculate the provision to be made for warranty under AS-29 as at 31st March, 2019 and 31st March, 2020. Also compute amount to be debited to P & L account for the year ended 31st March, 2020.

Solution

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

As at 31st March, 2019 = ₹ 60,000 x .02 + ₹ 40,000 x .03
= ₹ 1,200 + ₹ 1,200
= ₹ 2,400

As at 31st March, 2020 = ₹ 40,000 x .02 + ₹ 1,35,000 x .03
= ₹ 800 + ₹ 4,050
= ₹ 4,850

Amount debited to Profit and Loss Account for year ended 31st March, 2020

Balance of provision required as on 31.03.2020	4,850
Less: Opening Balance as on 1.4.2019	(2,400)
Amount debited to profit and loss account	2,450

Note: No provision will be made on 31st March, 2020 in respect of sales amounting ₹ 60,000 made on 11th February, 2018 as the warranty period of 2 years has already expired

Question 4 *(ICAI Study Material)*

EXOX Ltd. is in the process of finalizing its accounts for the year ended 31st March, 2020. The company seeks your advice on the following: The Company's sales tax assessment for assessment year 2017-18 has been completed on 14th February, 2020 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 authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore.

Solution

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, 20. The amount paid under protest can be kept in the books as an advance under the heading 'Loans and Advances' and disclosed along with the contingent liability of ₹ 2.10 crore.

Question 5

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. Discuss with reference to relevant Accounting Standard 29.

Solution

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 after completion 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 be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than five years.

Question 6 *(RTP Nov 2020)*

Alpha Ltd. has entered into a sale contract of ₹ 7 crores with Gamma Ltd. during 2019-20 financial year. The profit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 2020-21 financial year. In case of failure of Alpha Ltd. to deliver within the schedule, a compensation of ₹ 2 crores is to be paid to Gamma Ltd. Alpha Ltd. planned to manufacture the goods during the last month of 2019-20 financial year. As on balance sheet date (31.3.2020), the goods were not manufactured and it was unlikely that Alpha Ltd. will be in a position to meet the contractual obligation. You are required to advise Alpha Ltd. on requirement of provision for contingency in the financial statements for the year ended 31st March, 2020, in line with provisions of AS 29?

Solution

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. 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 ₹ 2 crores as per AS 29.

Question 7 *(Inter Nov 2020) (5 Marks)*

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

Solution

(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 of the oil rig.
However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil 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 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 8 *(RTP May 2021)*

a) 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. You are required to examine in line with the provisions of AS 29.

b) 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 reliable estimate 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.
   (iii) There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.

Solution

(a) 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.

(b)
   (i) 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 recognised. Disclosures are required for the provision.
   (ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources – No provision is recognised. Disclosures are required for the contingent liability.
   (iii) 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 9

Saharsh Ltd. is engaged in manufacturing of electric home appliances. The company is in the process of finalizing its accounts for the year ended 31.3.2020 and needs your expert advice on the following issues in line with the provisions of AS 29:

a) A case has been filed against the company in the consumer court and a notice for levy of a penalty of ₹ 20 lakhs has been received. The company has appointed a lawyer to defend the case for a fee of ₹ 2 lakhs. 50% of the fees has been paid and balance 50% will be paid after finalisation of the case. There are 75% chances that the penalty may not be levied.

b) The company had committed to supply a consignment worth ₹ 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 paid on the value of delayed/lost consignment. While the consignment was in transit, one of the trucks carrying goods worth ₹ 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. Before closing 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 ₹ 30 lakhs which was in transit.

Solution

a) 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 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 financial statements of financial year 2019-2020.

b) Loss due to accident ₹ 30,00,000
Insurance claim receivable by company = ₹ 30,00,000 x 90% = ₹ 27,00,000
Loss to be recognised in the books for 2019-2020 ₹ 3,00,000
Insurance claim receivable to be recorded in the books ₹ 27,00,000
Compensation claim by dealer against company to be provided for in the books
= ₹ 30,00,000 x 15% = ₹ 4,50,000

Question 10 *(Inter July 2021) (5 Marks)*

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.

Solution

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) (Refer W.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 case of 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:

a) 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
b) 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 provision for returns based on previous experiences.

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 Profit mark up on sales (80/400) x 100 = 20%	80

Question 11 *(RTP May 2022)/ (RTP Nov 2022) (Similar)*

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:

(i) Chaos Limited has filed 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 ₹ 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.

(ii) 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 ₹ 10,00,000 for the said upgrade.

(iii) 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 ₹ 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.

Solution

Principles for recognition of provisions: As per AS 29, "a provision shall be recognised when:

a) an entity has a present obligation (legal or constructive) 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.

If these conditions are not met, no provision shall be recognised."

Accounting treatment under the given scenarios:

(i) 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 ₹ 3,00,000, there is a present obligation. Hence, provision should be recognised for ₹ 3,00,000 for the amount which may be required to settle the obligation.

(ii) Under new regulation, an entity is required to upgrade its facilities by 31st 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.

(iii) 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 good under 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 ₹ 5,00,00,000 = ₹ 5,00,000
Estimated cost of repair / replacement = ₹ 5,00,000 x 10% = ₹ 50,000.

Question 12 *(Inter May 2022) (5 Marks)*

Alloy Fabrication Limited is engaged in manufacturing of iron and steel rods. The company is in the process of finalization of the accounts for the year ended 31st March,2022 and needs your advice on the following issues in line with the provisions of AS-29:

(i) On 1st April,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.

(ii) 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.

Solution

(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.

(ii) 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 contingent liability 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.