CA INTER

VIGHNAHARTA

LIST FOR

ADVANCE ACCOUNTING

MOST IMPORTANT QUESTIONS with ANSWERS

By: Vinit Mishra Sir

ॐ गं गणपतये नमः

सरस्वती महामाये दिव्य तेज स्वरूपिणी।
हंस वाहिनी समायुक्ता विद्या दानं करोतु मे।

CA Dreamers the Avenger

Our Proud Moment

Congratulations!

AIR-4

ARUL KUMAR

(STUDENT OF TOP-20)

AIR-10

MEGHANA SAWAKAR

(STUDENT OF TOP-20)

We are waiting for the

NEXT RANK HOLDERS

Is That You

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BUY BACK OF SHARES

Q.1: **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. **[Jan 21 (4 Marks)]**

ANSWER:

Journal Entries in the books of Umang Ltd.

			Dr. (₹)	Cr. (₹)
1.	Bank A/c	Dr.	25,00,000	
	Profit and Loss A/c	Dr.	5,00,000	
	To Investment A/c			30,00,000
	(Being investment sold for the purpose of buy-back of Equity Shares)			
2.	Bank A/c	Dr.	20,00,000	
	To 12% Pref. Share capital A/c			20,00,000
	(Being 12% Pref. Shares issued for ₹ 20,00,000)			
3.	Equity shares capital A/c	Dr.	50,00,000	
	Premium payable on buy-back	Dr.	25,00,000	
	To Equity shares buy-back A/c Equity shareholders A/c			75,00,000
	(Being the amount due on buy-back of equity shares)			
4.	Equity shares buy-back A/c Equity shareholders A/c	Dr.	75,00,000	
	To Bank A/c			75,00,000
	(Being payment made for buy-back of equity shares)			
5.	Securities Premium A/c	Dr.	15,00,000	
	General Reserve A/c	Dr.	10,00,000	
	To Premium payable on buy-back			25,00,000
	(Being premium payable on buy-back charged from Securities premium)			
6.	General Reserve A/c	Dr.	30,00,000	
	To Capital Redemption Reserve A/c			30,00,000
	(Being creation of capital redemption reserve to the extent of the equity shares bought back after deducting fresh pref. shares issued)			

Q.2: 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)	30,000	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. [July 21 (15 Marks)]

ANSWER:

Statement determining the maximum number of shares to be bought back

Number of shares (in crores)

Particulars	When loan fund is	
	₹ 25,00,000	₹ 1,20,00,000
Shares Outstanding Test (W.N.1)	75,000	75,000
Resources Test (W.N.2)	41,750	41,750
Debt Equity Ratio Test (W.N.3)	94,000	Nil
Maximum number of shares that can be bought back [Least of the above]	41,750	Nil

Journal Entries for the Buy-Back (applicable only when loan fund is ₹ 25,00,000)

	Particulars		Debit	Credit ₹
(a)	Equity shares buy-back account	Dr.	12,52,500	
	To Bank Account			12,
	(Being payment for buy-back of 41,750 equity shares of ₹ 10 each @ ₹ 30 per share)			
(b)	Equity shares capital account	Dr.	4,17,500	
	Premium Payable on buy-back account	Dr.	8,35,000	
	To Equity share buy-back account			12,52,500
	(Being cancellation of shares bought back)			
	Securities Premium account	Dr.	6,00,000	
	General Reserve/Profit & Loss A/c	Dr.	2,35,000	
	To Premium Payable on buy-back account			8,35,000
	(Being Premium Payable on buy-back account charged to securities premium and general reserve/Profit & Loss A/c)			

(c)	General Reserve* Dr.	4,17,500	
	To Capital redemption reserve account		4,17,500
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)		

*Profit and Loss account balance amounting ₹ 2,10,000 may also be used and General Reserve may be debited for the balance amount.

Working Notes:

1. Share Outstanding Test

Particulars	(Shares in crores)
Number of shares outstanding	3,00,000
25% of the shares outstanding	75,000

2. Resources Test

Particulars	
Paid up capital (₹)	30,00,000
Free reserves (₹) (12,00,000 + 6,00,000 + 2,10,000)	20,10,000
Shareholders' funds (₹)	50,10,000
25% of Shareholders fund (₹)	₹ 12,52,500
Buy-back price per share	₹ 30
Number of shares that can be bought back	41,750 shares

3. Resources Test

	Particulars	When loan fund is	
(a)	Loan funds (₹)	₹ 25,00,000	₹ 1,20,00,000
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹) (a/2)	12,50,000	60,00,000
(c)	Present equity shareholders fund (₹)	50,10,000	50,10,000

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y' Then

Equation 1: (Present Equity – Transfer to CRR) – Minimum Equity to be maintained = Maximum Permitted Buy-Back

$= (50,10,000 - x) - 12,50,000 = y$

$= 37,60,000 - x = y$ (1)

Equation 2: Maximum Permitted Buy-Back x Nominal value Per Share/ Offer Price Per Share

$y/30 \times 10 = x$

or

$3x = y$ (2)

by solving the above two equations we get

x = ₹ 9,40,000 and

y = ₹ 28,20,000

In situation 2, first equation will be negative. Buy back not possible in this situation.

Q.3: **M/s. Vriddhi Infra Ltd. (a non-listed company) provide the following information as on 31.3.2020:**

	(₹)
Land and Building	21,50,000
Plant & Machinery	15,00,000
Non- current Investment	2,00,000
Trade Receivables	5,50,000
Inventories	1,80,000
Cash and Cash Equivalents	40,000
Share capital:1,00,000 Equity Shares of ₹ 10 each fully paid up	10,00,000
Securities Premium	3,00,000
General Reserve	2,50,000
Profit & Loss Account (Surplus)	1,50,000
10% Debentures (Secured by floating charge on all assets)	20,00,000
Unsecured Loans	8,00,000
Trade Payables	1,20,000

On 21st April, 2020 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, 2020, the company achieved the target of buy back. On 1st May, 2020 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 required to pass necessary Journal Entries for the above transactions. **[RTP May 2021]**

ANSWER:

In the books of Vriddhi Infta Ltd.

Journal Entries

Date	Particulars		Dr.	Cr.
2020			₹	₹
April 21	Bank A/c	Dr.	2,50,000	
	To Investment A/c			2,00,000
	To Profit on sale of investment			50,000
	(Being investment sold on profit)			
April 25	Equity share capital A/c	Dr.	1,50,000	
	Securities premium A/c	Dr.	75,000	
	To Equity shares buy back A/c			2,25,000
	(Being the amount due to equity shareholders on buy back)			
	Equity shares buy back A/c	Dr.	2,25,000	
	To Bank A/c			2,25,000

	(Being the payment made on account of buy back of 15,000 Equity Shares)		
	General Reserve A/c OR P&L A/c Dr. To Capital redemption reserve A/c (Being amount equal to nominal value of buy back shares transferred from free reserves to capital redemption reserve account as per the law)	1,50,000	1,50,000
May 1	Capital redemption reserve A/c Dr. To Bonus shares A/c (W.N.1) (Being the utilization of capital redemption reserve to issue bonus shares)	1,06,250	1,06,250
	Bonus shares A/c Dr. To Equity share capital A/c (Being issue of one bonus equity share for every ten equity shares held)	1,06,250	1,06,250

Working Note:

Amount of bonus shares = $\left[(1{,}00{,}000 - 15{,}000) \times \frac{1}{8}\right] \times 10$

= ₹ 1,06,250

Q.4: What do you mean by equity shares with differential rights. Explain in brief **[RTP May 21]**

ANSWER:

Equity shares with Differential Rights means the share with dissimilar rights as to dividend, voting or otherwise.

OR

E, F, G and H hold Equity Capital in Alpha Co. in the proportion of 30:30:20:20. S, T, U and V hold preference share capital in the proportion of 40:30:10:20. If the paid up capital of the company is ₹ 120 Lakh and Preference share capital is ₹ 60 Lakh, You are required to calculate their voting rights in case of resolution of winding up of the company.

ANSWER:

E, F, G and H hold Equity capital is held by in the proportion of 30:30:20:20 and S, T, U and V hold preference share capital in the proportion of 40 : 30 : 10 : 20. As the paid up equity share capital of the company is ₹ 120 Lakhs and Preference share capital is ₹ 60 Lakhs (2 : 1), then relative weights in the voting right of equity shareholders and preference shareholders will be 2/3 and 1/3. The respective voting right of various shareholders will be

E = 2/3X30/100 = 3/15

F = 2/3X30/100 = 3/15

G = 2/3X20/100 = 2/15

H = 2/3X20/100 = 2/15

S = 1/3X40/100 = 2/15

T = 1/3X30/100 = 1/10

U = 1/3X10/100 = 1/30

V = 1/3X20/100 = 1/15

Q.5: M Ltd. furnishes the following Balance sheet as at 31st March, 20X1:

Particulars	Notes	₹ (in 000)
Equity and Liabilities		
1. Shareholders' funds		
A. Share Capital	1	5,000
B. Reserves and Surplus	2	6,310
2. Non-current liabilities		
Long term borrowings	3	400
3. Current liabilities		
A. Trade Payables		40
Total		11,750
Assets		
1. Non-current assets		
A. Property, plant and Equipment	4	2,750
B. Non-Current Investments (at cost)		5,000
2. Current assets		
A. Inventories		1,000
B. Trade receivables		2,000
C. Cash and Cash equivalents		1,000
Total		11,750

Notes to accounts

Particulars		₹ in ('000)
1. Share Capital		
Authorized, Issued and Subscribed Capital:		
3,00,000 Equity shares of ₹ 10 each fully paid up		3,000
20,000 9% Preference Shares of 100 each		2,000
Total		5,000
2. Reserves and Surplus		
Capital reserve		10
Revenue reserve		4,000
Securities premium		500
Profit and Loss account		1,800
Total		6,310
3. Long term borrowings		
10% Debentures		400
4. Property, plant and Equipment (PPE)		
PPE: Cost		3,000
Less: Provision for depreciation		(250)
Net carrying value		2,750

The company passed a resolution to buy-back 20% of its equity capital @ ₹ 15 per share. For this purpose, it sold its investments of ₹ 30 lakhs for ₹ 25 lakhs.

You are required to pass necessary Journal entries. [ICAI Material]

SOLUTION:

Journal Entries in the books of M Ltd.

	Particulars		**Dr.**	**Cr.**
			(₹ in '000)	**(₹ in '000)**
1.	Bank A/c	Dr.	2,500	
	Profit and Loss A/c	Dr.	500	
	To Investment A/c			3,000
	(Being investment sold for the purpose of buy-back of Equity Shares)			
2.	Equity shares capital A/c	Dr.	600	
	Premium payable on buy-back	Dr.	300	
	To Equity shares buy-back A/c			900
	(Being the amount due on buy-back of equity shares)			
3.	Equity shares buy-back A/c	Dr.	900	
	To Bank A/c			900
	(Being payment made for buy-back of equity shares)			
4.	Securities premium A/c	Dr.	300	
	To Premium payable on buy-back			300
	(Being Premium payable on buy-back charged from Securities Premium)			
5.	Revenue reserve A/c	Dr.	600	
	To Capital Redemption Reserve A/c			600
	(Being Creation of capital redemption reserve to the extent of the equity shares bought back)			

Q.6: Complicated Ltd. (an unlisted company) gives the following information as on 31.3.2021:

Particulars	**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**
Property, plant and equipment	**46,50,000**
Current assets	**40,00,000**

The Company wants to buy back 25,000 equity shares of ₹ 10 each, on 1st April, 2021 at ₹ 15 per share. Buy back of shares is duly authorized by its Articles and necessary resolution has been passed by the Company for this. The buy-back of shares by the Company is also within the provisions of the Companies Act, 2013. The

payment for buy back of shares was made by the Company out of sufficient bank balance available shown as part of Current Assets.

You are required to prepare the necessary journal entries towards buy back of shares and prepare the Balance Sheet of the company after buy back of shares. **[RTP May 22]**

ANSWER:

As per the information given in the question, buy-back of 25,000 shares @ ₹ 15, as desired by the company, is within the provisions of the Companies Act, 2013.

Journal Entries for buy-back of shares

			Debit (₹)	Credit (₹)
(a)	Equity shares buy-back account	Dr.	3,75,000	
	To Bank Account			3,75,000
	(Being buy back of 25,000 equity shares of ₹ 10 each @ 15 per share)			
(b)	Equity share capital account	Dr.	2,50,000	
	Premium payable on buyback account	Dr.	1,25,000	
	To Equity shares buy-back account			3,75,000
	(Being cancellation of shares bought back)			
(c)	Securities premium account	Dr.	1,25,000	
	To Premium payable on buyback account			1,25,000
	(Being Premium payable on buyback adjusted against securities premium account)			
(d)	Revenue reserve account	Dr.	2,50,000	
	To Capital redemption reserve account			2,50,000
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)			

Balance Sheet of Complicated Ltd. as at 1st April, 2021

	Particulars	Note No.	Amount ₹
I	**EQUITY AND LIABILITIES**		
	1. Shareholders' funds		
	(a) Share Capital	1	11,00,000
	(b) Reserve and surplus	2	23,50,000
	2. Non-current Liabilities		
	(a) Long-term borrowings	3	28,75,000
	3. Current Liabilities		
	(a) Short-term borrowings	4	16,50,000
	(b) Other current liabilities	5	3,00,000
	Total		**82,75,000**
II	**ASSETS**		
	1. Non-current Assets		
	(a) Property, Plant and Equipment		46,50,000

	2. Current Assets (₹ 40,00,000 - ₹ 3,75,000)		**36,25,000**
	Total		**82,75,000**

Notes to Accounts

			₹	₹
1.	Share Capital			
	Equity share capital			
	1,10,000 Equity shares of ₹10 each			11,00,000
2.	Reserves and Surplus			
	Capital Reserve		2,00,000	
	Capital Redemption Reserve		2,50,000	
	Securities Premium	2,50,000		
	Less: Utilization for share buy-back	(1,25,000)	1,25,000	
	Share Option Outstanding Account		4,00,000	
	Revenue reserves	15,00,000		
	Less: transfer to CRR	(2,50,000)	12,50,000	
	Surplus i.e. Profit and Loss A/c		1,25,000	23,50,000
3.	Long-term borrowings			
	Secured			
	12% Debentures		18,75,000	
	Unsecured loans		10,00,000	28,75,000
4.	Short-term borrowings			
	Current maturities of long-term borrowings			16,50,000
5.	Other Current Liabilities			
	Unpaid dividend		1,00,000	
	Application money received for allotment due for refund		2,00,000	3,00,000

Q.7: Explain the conditions for equity shares with differential rights under the Companies (Share Capital and Debentures) Rules. **[RTP May 22]**

ANSWER:

Companies (Share Capital and Debentures) Rules deal with equity shares with differential rights. The rules lay down the following conditions to be compulsorily complied with:

- The articles of association of the company authorizes the issue of shares with differential rights;
- The issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders: Provided that where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot;
- The voting power in respect of shares with differential rights shall not exceed seventy four percent of the total voting power including voting power in respect of equity shares with differential rights issued at any point of time;
- The company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;

- The company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;
- The company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;

  Provided that a company may issue equity shares with differential rights upon expiry of five years from the end of financial year in which such default was made good.
- The company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, under which such companies being regulated by sectoral regulators.

Q.8: L, M, N and O hold Equity capital in the proportion of 30:30:20:20 in Hill Ltd. X, Y, Z and K hold preference share capital in the proportion of 40:30:20:10. You are required to identify the voting rights of shareholders in case of resolution of winding up of the company if the paid-up capital of the company is ₹ 60 Lakh and preference share capital is ₹ 30 Lakh. **[RTP May 22]**

ANSWER:

L, M, N and O hold Equity capital is held by in the proportion of 30:30:20:20 and X, Y, Z and K hold preference share capital in the proportion of 40:30:20:10. As the paid-up equity share capital of the company is ₹ 60 Lakhs and Preference share capital is ₹ 30 Lakh (2:1), then relative weights in the voting right of equity shareholders and preference shareholders will be 2/3 and 1/3. The respective voting right of various shareholders will be

L = 2/3X30/100 = 3/15

M = 2/3X30/100 = 3/15

N = 2/3X20/100 = 2/15

O = 2/3X20/100 = 2/15

X = 1/3X40/100 = 2/15

Y = 1/3X30/100 = 1/10

Z = 1/3X20/100 = 1/15

K = 1/3X10/100 = 1/30

Q.1: **The following is the Balance Sheet of Weak Ltd. as at 31.3.20X1:**

	Particulars	Notes	₹
I.	**Equity and Liabilities**		
	1) Shareholder's Funds		
	(a) Share Capital	1	1,50,00,000
	(b) Reserves and Surplus	2	(6,00,000)
	2) Non-current liabilities		
	(a) Long-term borrowings	3	40,00,000
	3) Current Liabilities		
	(a) Trade Payables		50,00,000
	(b) Short term provisions	4	1,00,000
	Total		2,35,00,000
II.	**Assets**		
	1) Non-current assets		
	(a) Property, plant and Equipment		1,25,00,000
	(b) Non-current investment	5	10,00,000
	2) Current Assets		1,00,00,000
	Total		2,35,00,000

Notes to Accounts

		₹
1.	**Share Capital**	
	Equity share capital	
	1,00,000 Equity Shares of ₹ 100 each	1,00,00,000
	50,000, 12% Cumulative Preference shares of ₹ 100 each	50,00,000
		1,50,00,000
2.	**Reserves and Surplus**	
	Debit balance of Profit and loss Account	(6,00,000)
		(6,00,000)
3.	**Long-term borrowings**	
	40,000, 10% debentures of ₹ 100 each	40,00,000
		40,00,000
4.	**Short term provisions**	1,00,000
	Provision for taxation	1,00,000
5.	**Non-current investments**	
	Investments (market value of ₹ 9,50,000)	10,00,000
		10,00,000

The following scheme of reorganization is sanctioned:

(i) **All the existing equity shares are reduced to ₹ 40 each.**

(ii) **All preference shares are reduced to ₹ 60 each.**

(iii) **The rate of interest on debentures is increased to 12%. The debenture holders surrender their existing debentures of ₹ 100 each and exchange the same for fresh debentures of ₹ 70 each for every debenture held by them.**

(iv) **One of the creditors of the company to whom the company owes ₹ 20,00,000 decides to forgo 40% of his claim. He is allotted 30,000 equity shares of ₹ 40 each in full satisfaction of his claim.**

(v) **Property, plant and equipment are to be written down by 30%.**

(vi) **Current assets are to be revalued at ₹ 45,00,000.**

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

(viii) **Investments to be brought to their market value.**

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

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

ANSWER:

Journal Entries in the books of Weak Ltd.

			Dr. (₹)	Cr. (₹)
(i)	Equity share capital (₹ 100) A/c	Dr.	1,00,00,000	
	To Equity Share Capital (₹ 40) A/c			40,00,000
	To Capital Reduction A/c			60,00,000
	(Being conversation of equity share capital of ₹ 100 each into ₹ 40 each as per reconstruction scheme)			
(ii)	12% cumulative Preference Share capital (₹ 100) A/c	Dr.	50,00,000	
	To 12% Cumulative Preference Share Capital (₹ 60) A/c			30,00,000
	To Capital Reduction A/c			
	(Being conversion of 12% cumulative preference share capital of ₹ 100 each into ₹ 60 each as per reconstruction scheme)			20,00,000
(iii)	10% Debentures A/c	Dr.	40,00,000	
	To 12% Debentures A/c			28,00,000
	To Capital Reduction A/c			12,00,000
	(Being 12% debentures issued to 10% debenture-holders for 70% of their claims. The balance transferred to capital reduction account as per reconstruction scheme)			
(iv)	Trade payable A/c	Dr.	20,00,000	
	To Equity Shares capital A/c			12,00,000
	To Capital Reduction A/c			8,00,000
	(Being a creditor of ₹ 20,00,000 agreed to surrender his claim by 40% and was allotted 30,000 equity shares of ₹ 40 each in full settlement of his dues as per reconstruction scheme)			
(v)	Provision for Taxation A/c	Dr.	1,00,000	
	Capital Reduction A/c	Dr.	50,000	
	To Current assets (bank A/c) A/c			1,50,000
	(Being liability for taxation settled)			
(vi)	Capital Reduction A/c	Dr.	99,00,000	

		Dr.	Cr.
	To P & L A/c		6,00,000
	To Property, plant and equipment A/c		37,50,000
	To Current Assets A/c		55,00,000
	To Investments A/c		50,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Property, plant and equipment, Current Assets, Investments through capital reduction account)		
(vii)	Capital Reduction A/c Dr.	50,000	
	To Capital Reserve A/c		50,000
	(Being balance in capital reduction account transferred to capital reserve account)		

Balance Sheet of Weak Ltd. (and reduced) as at 31.3.20X1

	Particulars	Notes	₹
I.	**Equity and Liabilities**		
	1) Shareholder's Funds		
	(a) Share Capital	1	82,00,000
	(b) Reserves and Surplus	2	50,000
	2) Non-current liabilities		
	(a) Long-term borrowings	3	28,00,000
	3) Current Liabilities		
	(a) Trade Payables		30,00,000
	Total		1,40,50,000
II.	**Assets**		
	1) Non-current assets		
	(a) Property, plant and Equipment	4	87,50,000
	(b) Investments	5	9,50,000
	2) Current Assets	6	43,50,000
	Total		1,40,50,000

Notes to Accounts

			₹
1.	**Share Capital**		
	Equity share capital		
	Issued, subscribed and paid up		
	1,30,000 equity shares of ₹ 40 each		52,00,000
	Preference share capital		
	Issued, subscribed and paid up		
	50,000 12% Cumulative Preference shares of ₹ 60 each		30,00,000
	Total		82,00,000
2.	**Reserves and Surplus**		
	Capital Reserve		50,000
3.	**Long-term borrowings**		
	Secured		

	12% Debentures		28,00,000
4.	**Property, plant and Equipment** Total PPE Adjustment under scheme of reconstruction	1,25,00,000 (37,50,000)	87,50,000
5.	**Investments** Adjustment under scheme of reconstruction	10,00,000 (50,000)	9,50,000
6.	**Current assets** Adjustment under scheme of reconstruction	45,00,000 (1,50,000)	43,50,000

Working Note:

Capital Reduction Account

		₹			₹
To	Current Assets	50,000	By	Equity Share capital	60,00,000
To	P & L A/c	6,00,000	By	12% Cumulative preference share capital	20,00,000
To	Property, plant and equipment Current assets	37,50,000	By	10% Debentures	12,00,000
To	Investment	55,00,000	By	Trade payables	8,00,000
To	Capital Reserve (bal. fig.)	50,000			
To		50,000			
		1,00,00,000			1,00,00,000

Q.2: **Z Limited provides the following information as on 31st March, 2021:**

Particulars	Amount in ₹
Share Capital:	
5,00,000 Equity shares of ₹ 10 each fully paid up	**50,00,000**
9% 20,000 Preference shares of ₹ 100 each fully paid up	**20,00,000**
Reserves and Surplus:	
Profit and Loss Account (Dr. balance)	**14,60,000**
Non-Current Liabilities:	
10% Secured Debentures	**16,00,000**
Current Liabilities:	
Interest due on Debentures	**1,60,000**
Trade Payables	**5,00,000**
Loan from Directors	**1,00,000**
Bank Overdraft	**1,00,000**
Provision for tax	**1,00,000**
Non-Current Assets:	
Property, Plant and Equipment:	
Land & Building	**30,00,000**
Plant & Machinery	**12,50,000**

Furniture & Fixtures	2,50,000
Intangible Assets:	
Goodwill	11,00,000
Patents	5,00,000
Current Assets:	
Trade Investments	5,00,000
Trade receivables	5,00,000
Inventory	10,00,000

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.

(i) All the equity shares to be converted into fully paid equity shares of ₹ 5.00 each.

(ii) 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.

(iii) 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.

(iv) Persons relating to trade payables, other than Mr. Y and Mr. Z also agreed to forgo their 50% claims.

(v) Directors also waived 60% of their loans and accepted equity shares for the balance.

(vi) Capital commitments of ₹ 3.00 lacs were cancelled on payment of ₹ 15,000 as penalty.

(vii) Directors refunded ₹ 1,00,000 of the fees previously received by them.

(viii) Reconstruction expenses paid ₹ 15,000.

(ix) The taxation liability of the company was settled for ₹ 75,000 and was paid immediately.

(x) The Assets were revalued as under:

Land and Building	32,00,000
Plant and Machinery	6,00,000
Inventory	7,50,000
Trade Receivables	4,00,000
Furniture and Fixtures	1,50,000
Trade Investments	4,50,000

You are required to pass journal entries for all the above-mentioned transactions including amounts to be written off for Goodwill, Patents and Loss in Profit and Loss account. Also prepare Bank Account and Reconstruction A/c. [RTP May 22]

Answer:

Journal Entries in the Books of Z Ltd.

			(₹)	(₹)
(i)	Equity Shares Capital (₹ 10 each) A/c	Dr.	50,00,000	
	To Equity Shares Capital (₹ 5 each) A/c			25,00,000

	To Reconstruction A/c (Being conversion of 5,00,000 equity shares of ₹ 10 each fully paid into same number of fully paid equity shares of ₹ 5 each as per scheme of reconstruction.)		25,00,000
(ii)	9% Preference Share Capital (₹ 100 each) A/c Dr. To 10% Preference Shares Capital (₹ 50 each) A/c To Reconstruction A/c (Being conversion of 9% preference share of ₹ 100 each into same number of 10% preference share of ₹ 50 each and claims of preference dividends settled as per scheme of reconstruction.)	20,00,000	 10,00,000 10,00,000
(iii)	10% Secured Debentures A/c Dr. Trade payables A/c Dr. Interest on Debentures payable A/c Dr. Bank A/c Dr. To 12% Debentures A/c To Reconstruction A/c (Being ₹ 11,56,000 due to Y (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)	9,60,000 1,00,000 96,000 1,00,000	 6,78,000 5,78,000
(iv)	10% Secured Debentures A/c Dr. Trade Payables Interest on debentures payable A/c Bank A/c To 12% debentures A/c To Reconstruction A/c (Being ₹ 7,64,000 due to Z (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)	6,40,000 60,000 64,000 60,000	 4,42,000 3,82,000
(v)	Trade payables A/c Dr. To reconstruction A/c (Being remaining trade payables sacrificed 50% of their claim.)	1,70,000	 1,70,000
(vi)	Directors' Loan A/c Dr. To Equity Share Capital (₹ 5) A/c To Reconstruction A/c (Being Directors' loan claim settled by issuing 8,000 equity shares of ₹ 5 each as per scheme of reconstruction.)	1,00,000	 40,000 60,000
(vii)	Reconstruction A/c Dr. To Bank A/c (Being payment made towards penalty of 5% for cancellation of capital commitments of ₹ 3 Lakhs)	15,000	 15,000
(viii)	Bank A/c Dr. To Reconstruction A/c	1,00,000	 1,00,000

	(Being refund of fees by directors credited to reconstruction A/c.)		
(ix)	Reconstruction A/c Dr. To Bank A/c (Being payment of reconstruction expenses.)	15,000	 15,000
(x)	Provision for Tax A/c Dr. To Bank A/c To Reconstruction A/c (Being payment of tax liability in full settlement against provision for tax)	1,00,000	 75,000 25,000
(xi)	Land and Building A/c Dr. To Reconstruction A/c (Being appreciation in value of Land & Building recorded)	2,00,000	 2,00,000
(xii)	Reconstruction A/c Dr. To Goodwill A/c To Patent A/c To Profit and Loss A/c To Plant and Machinery A/c To Furniture & Fixture A/c To Trade Investment A/c To Inventory A/c To Trade Receivables A/c To Capital Reserve (bal. fig.) (Being writing off of losses and reduction in the value of assets as per scheme of reconstruction, balance of reconstruction A/c transfer to Capital Reserve.)	49,85,000	 11,00,000 5,00,000 14,60,000 6,50,000 1,00,000 50,000 2,50,000 1,00,000 7,75,000

Bank Account

Particulars	₹	Particulars	₹
To Reconstruction (Y)	1,00,000	By Balance b/d (overdraft)	1,00,000
To Reconstructions (Z)	60,000	By Reconstruction A/c (capital commitment penalty paid)	15,000
To Reconstruction A/c (refund of earlier fees by directors)	1,00,000	By Reconstruction A/c (reconstruction expenses paid)	15,000
		By Provision for tax A/c (tax paid)	75,000
		By Balance c/d	55,000
	2,60,000		2,60,000

Reconstruction Account

Particulars	₹	Particulars	₹
To Bank (Penalty)	15,000	By Equity Shares	

To	Bank (reconstruction expenses)	15,000		Capital A/c	25,00,000
To	Goodwill	11,00,000	By	9% Pref. Share	
To	Patent	5,00,000		Capital A/c	10,00,000
To	P & L A/c	14,60,000	By	Mr. Y (Settlement)	5,78,000
To	P & M	6,50,000	By	Mr. Z (Settlement)	3,82,000
To	Furniture and Fixtures	1,00,000	By	Trade Payables A/c	1,70,000
To	Trade investment	50,000	By	Director's loan	60,000
To	Inventory	2,50,000	By	Bank	1,00,000
To	Trade Receivables	1,00,000	By	Provision for tax	25,000
To	Capital Reserve (bal. fig.)	7,75,000	By	Land and Building	2,00,000
		50,15,000			50,15,000

Q.3: P and Q were partners sharing profits equally of P & Q Co. Their Balance Sheet as on March 31, 2021 was as follows:

Balance sheet as on 31st March, 2021

Equity and Liabilities		₹	Assets	₹
Capitals:			Bank	30,000
P	1,00,000		Debtors	25,000
Q	50,000	1,50,000	Stock	35,000
Creditors		20,000	Furniture	40,000
Q's current account		10,000	Machinery	60,000
Reserves		15,000	P's current account	10,000
Bank overdraft		5,000		
		2,00,000		2,00,000

The firm was dissolved on the above date:

P took over 50% of the stock at 10% less on its book value, and the remaining stock was sold at a gain of 15%. Furniture and Machinery realized for ₹ 30,000 and ₹ 50,000 respectively; There was an unrecorded investment which was sold for ₹ 25,000; Debtors realized 90% only and ₹ 1,245 were recovered for bad debts written off last year; There was an outstanding bill for repairs which had to be paid for ₹ 2,000.

You are required to prepare Realization Account, Partners' capital accounts (including transfer of current account balances) and Bank Account in the books of the firm.

[RTP Nov 21]

ANSWER:

Book of P & Q Co.

Realization Account

Particulars			₹	Particulars			₹
To	Debtors	25,000		By	Creditors		20,000
To	Stock	35,000		By	Bank overdraft		5,000
To	Furniture	40,000		By	Bank:		

To	Machinery	60,000	1,60,000	Investment	25,000	
To	Bank:			Furniture	30,000	
	Creditors	20,000		Machinery	50,000	
	Bank overdraft	5,000		Debtors (90%)	22,500	
	Outstanding bill	2,000	27,000	Stock	20,125	
To	Profit transferred to:			Bad debts Recovered	1,245	1,48,870
	P's capital	1,310		By P's capital (stock taken over)		15,750
	Q's capital	1,310	2,620			
			1,89,620			1,89,620

Partners' Capital Accounts

	P	Q		P	Q
To P's current Account	16,940		By Balance b/d	1,00,000	50,000
To Bank	83,060	68,810	By Q's current Account		18,810
	1,00,000	68,810		1,00,000	68,810

Bank Account

	₹		₹
To Balance b/d	30,000	By Realization	27,000
To Realization	1,48,870	By P's capital	83,060
		By Q's capital	68,810
	1,78,870		1,78,870

Working Note:

Partners' Current Accounts

	P	Q		P	Q
To Balance b/d	10,000		By Balance b/d		10,000
To Realization	15,750		By Reserves	7,500	7,500
To Q's capital		18,810	By Realization (profit)	1,310	1,310
			By P's Capital	16,940	
	25,750	18,810		25,750	18,810

Q.4: Differentiate on ordinary partnership firm with an LLP (Limited Liability Partnership) in respect of the following:

(1) Applicable Law

(2) Perpetual Succession

(3) Ownership of Assets

(4) Liability of Partners/ Members

(5) Principal-Agent Relationship **[RTP Nov 21]**

ANSWER:

Key Elements	Partnerships	LLPs
Applicable Law	Indian Partnership Act 1932	The Limited Liability Partnerships Act, 2008
Perpetual Succession	Partnerships do not have perpetual succession	It has perpetual succession and individual partners may come and go
Ownership of Assets	Firm cannot own any assets. The partners own the assets of the firm	The LLP as an independent entity can own assets
Liability of Partners/ Members	Unlimited: Partners are severally and jointly liable for actions of other partners and the firm and their liability extends to personal assets	Limited to the extent of their contribution towards LLP except in case of intentional fraud or wrongful act of omission or commission by a partner.
Principal-Agent Relationship	Partners are the agents of the firm and of each other	Partners are agents of the firm only and not of other partners

Q.5: The following is the Balance Sheet of M/s. R and S as on 31st March, 2019:

Equity and Liabilities	₹	Assets	₹
Capital Accounts:		**Machinery**	**54,000**
R	**50,000**	**Furniture**	**5,000**
S	**30,000**	**Investments (non-trading)**	**50,000**
Reserves	**20,000**	**Stock**	**20,000**
Loan Account of S	**15,000**	**Debtors**	**21,000**
Creditors	**40,000**	**Cash**	**5,000**
	1,55,000		**1,55,000**

It was agreed that Mr. T is to be admitted for a fourth share in the future profits from 1st April, 2019. He is required to contribute cash towards goodwill and ₹ 15,000 towards capital.

The following further information is furnished:

(a) R & S share the profits in the ratio 3 : 2.

(b) R was receiving salary of ₹ 750 per month from the very inception of the firm in 2012 in addition to share of profit.

(c) The future profit ratio between R, S & T will be 2:1:1. R will not get any salary after the admission of T.

(d) It was agreed that the value of goodwill of the firm shall be determined on the basis of 3 years' purchase of the average profits from business of the last 5 years. Goodwill was not to be raised in the books. The particulars of the profits are as under:

Year ended	Profit/(Loss)
31st March, 2015	25,000
31st March, 2016	12,500
31st March, 2017	(2,500)
31st March, 2018	35,000
31st March, 2019	30,000

The above Profits and Losses are after charging the Salary of R. The Profit of the year ended 31st March, 2015 included an extraneous profit of ₹ 40,000 and the loss for the year ended 31st March, 2017 was on account of loss by strike to the extent of ₹ 20,000.

(e) The cash trading profit for the year ended 31st March, 2020 was ₹ 50,000 before depreciation.

(f) The partners had drawn each ₹ 1,000 per month as drawings.

(g) The value of other assets and liabilities as on 31st March, 2020 were as under:

	₹
Machinery (before depreciation)	60,000
Furniture (before depreciation)	10,000
Investment	50,000
Stock	15,000
Debtors	30,000
Creditors	20,000

(h) Provide depreciation @ 10% on Machinery and @ 5% on Furniture on the closing balance and interest is accumulated @ 6% on S's loan. The loan along with interest would not be repaid within next 12 months.

(i) Investments (non-trading) are held from inception of the firm and interest is received @ 10% p.a.

(j) The partners applied for conversion of the firm into Karma Ltd., a Private Limited Company. Certificate was received on 1st April, 2020. They decided to convert Capital Accounts of the partners into share capital in the ratio of 2:1:1 on the basis of a total capital as on 31st March, 2020. If necessary, partners have to subscribe to fresh capital or withdraw.

Prepare the Profit and Loss Account of the firm for the year ended 31st March, 2020 and the Balance sheet of the Company as at 1st April, 2020. [RTP Nov 21]

ANSWER:

M/s R, S and T

Profit and Loss Account for the year ending on 31st March, 2020

		₹			₹
To	Depreciation on Machinery	6,000	By	Trading Profit	50,000
To	Depreciation on furniture	500	By	Interest on Investment	5,000
To	Interest on S's loan	900			
To	Net Profit to:				
	R's Capital A/c	23,800			
	S's Capital A/c	11,900			
	T's Capital A/c	11,900			
		55,000			55,000

Balance Sheet of the Karma Pvt. Ltd. as at 1st April, 2020

		Notes No.	₹
I	**Equity and Liabilities**		
	Shareholders' funds		
	Share capital		1,41,600
	Current liabilities		

		Note	₹
	Short term borrowings	1	15,900
	Trade payables		20,000
	Total		1,77,500
II	**Assets**		
	Non-Current assets		
	Property, plant & Equipment (PPE)	2	63,500
	Non-current investments		50,000
	Current assets		
	Inventories		15,000
	Trade receivables		30,000
	Cash and cash equivalents		19,000
	Total		1,77,500

Notes to Accounts

			₹
1.	**Short term borrowings**		
	Loan from S		15,900
2.	**PPF**		
	Machinery	54,000	
	Furniture	9,500	63,500

Working Notes:

1. Calculation of goodwill

	2014-15 ₹	**2015-16** ₹	**2016-17** ₹	**2017-18** ₹	**2018-19** ₹
Profits / (Loss)	25,000	12,500	(2,500)	35,000	30,000
Adjustment for extraneous profit of 2014-15 and abnormal loss of 2016-17	(40,000)	-	20,000	-	-
	(15,000)	12,500	17,500	35,000	30,000
Add: Salary of R (750 x 12)	9,000	9,000	9,000	9,000	9,000
	(6,000)	21,500	26,500	44,000	39,000
Less: Interest on non-trading investment	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)
	(11,000)	16,500	21,500	39,000	34,000
Total Profit from 2015-16 to 2018-19					1,11,000
Less: Loss for 2014-15					(11,000)
					1,00,000
Average Profit					20,000
Goodwill equal to 3 years purchase					60,000
Contribution from T for ¼ share					15,000

2. **Calculation of sacrificing ratio of Partners R and S on admission of T**

	Old Share	New Share	Sacrificing share	Gaining share
R	3/5	1/2	$\frac{3}{5} - \frac{1}{2} = \frac{6-5}{10} = \frac{1}{10}$	
S	2/5	1/4	$\frac{2}{5} - \frac{1}{4} = \frac{8-5}{20} = \frac{3}{20}$	
T		1/4		1/4

3. **Goodwill adjustment entry through Partners' capital accounts (in their sacrificing ratio of 2:3)**

	₹	₹
T's capital A/c Dr.	15,000	
To R's capital A/c		6,000
To S's capital A/c		9,000
(T's share in goodwill adjusted through R and S)		

4. **Partners' Capital Account**

	R	S	T		R	S	T
	₹	₹	₹		₹	₹	₹
To Drawings (1,000 x 12)	12,000	12,000	12,000	By Balance b/d	50,000	30,000	--
To R			6,000	By General Reserve	12,000	8,000	--
To S			9,000	By T	6,000	9,000	--
To Balance c/d	79,800	46,900	14,900	By Bank (15,000 + 15,000)	--	--	30,000
				By Profit & Loss A/c	23,800	11,900	11,900
	91,800	58,900	41,900		91,800	58,900	41,900

5. **Balance Sheet of the firm as on 31st March, 2020**

Equity and Liabilities	₹	₹	Assets	₹	₹
R's Capital	79,800		Machinery	60,000	
S's Capital	46,900		Less: Depreciation	(6,000)	54,000
T's Capital	14,900	1,41,600	Furniture	10,000	
			Less: Depreciation	(500)	9,500
S's Loan	15,000		Investments		50,000
Add: Interest due	900	15,900	Stock-in-trade		15,000
Creditors		20,000	Debtors		30,000
			Cash (W.N.6)		19,000
		1,77,500			1,77,500

6. **Cash balance as on 31.3.2020**

	₹	₹
Cash trading profit		50,000
Add: Investment Interest		5,000
Add: Decrease in Stock Balance		5,000
		60,000

Less: Increase in Debtors	9,000	
Less: Decrease in Creditors	20,000	(29,000)
		31,000
Add: Opening cash balance	5,000	
Add: Cash brought in by T	30,000	35,000
		66,000
Less: Drawings (12,000 + 12,000 + 12,000)	36,000	
Less: Additions to Machine (60,000 - 54,000)	6,000	
Furniture (10,000 – 5,000)	5,000	(47,000)
Closing cash balance		19,000

7. **Distribution of shares – Conversion into Company**

		₹
Capital:	R	79,800
	S	46,900
	T	14,900
Share Capital		1,41,600
Distribution of shares:	R (1/2)	70,800
	S (1/4)	35,400
	T (1/4)	35,400

R and S should withdraw capital of ₹ 9,000 (₹ 79,800 – ₹ 70,800) and ₹11,500 (₹ 46,900 – ₹ 35,400) respectively and T should subscribe shares of ₹ 20,500 (₹35,400 – ₹ 14,900).

Q.6: Shine Ltd. provides the following information as on 31st March, 2021:

(₹ in '000)

	Amount
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**
Property, Plant and Equipment	**43,750**
Investments (Market value ₹ 3325 thousand)	**3,500**
Current Assets (Including Bank Balance)	**35,000**
Profit and Loss Account (Dr. balance)	**2,100**

The following Scheme of Internal Reconstruction is approved and put into effect on 31st March, 2021.

(i) All the existing equity shares are reduced to ₹ 4 each.

(ii) All preference shares are reduced to ₹ 60 each.

(iii) 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.

(iv) Investments are to be brought to their market value.

(v) The Taxation Liability is settled at ₹ 5,25,000 out of current Assets.

(vi) The balance of Profit and Loss Account to be written off and balance of Current Assets left after settlement of taxation liability are revalued at ₹1,57,50,000.

(vii) 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.

(viii) Property, plant and equipment to be written down to 80%.

You are required to given journal entries for the above transactions and prepare capital reduction account.

[RTP Nov 21]

ANSWER:

Journal Entries in the books of Shine Ltd.

			₹ '000	₹ '000
(i)	Equity shares capital (₹ 10) A/c	Dr.	35,000	
	To Equity Share Capital (₹ 4) A/c			14,000
	To Capital Reduction A/c			21,000
	(Being conversion of equity share capital of ₹ 10 each into ₹ 4 each as per reconstruction scheme)			
(ii)	8% Cumulative Preference Share capital (₹ 100) A/c	Dr.	17,500	
	To 8% Cumulative Preference Share Capital (₹ 60) A/c			10,500
	To Capital Reduction A/c			7,000
	(Being conversion of 6% cumulative preference shares capital of ₹ 100 each into ₹ 60 each as per reconstruction scheme)			
(iii)	6% Debentures (₹ 100) A/c	Dr.	14,000	
	To 9% Debentures (₹ 80) A/c			11,200
	To Capital Reduction A/c			2,800
	(Being 9% debentures of ₹ 80 each issued to existing 6% debenture holders. The balance transferred to capital reduction account as per reconstruction scheme)			
(iv)	Sundry Creditors A/c	Dr.	7,000	
	To Equity share Capital (₹ 4) A/c			3,500
	To Capital Reduction A/c			3,500
	(Being a creditor of ₹ 70,00,000 agreed to surrender his claim by 50% and was allotted 8,75,000 equity shares of ₹ 4 each in full settlement of his dues as per reconstruction scheme)			
(v)	Provisions for Taxation A/c	Dr.	350	
	Capital Reduction A/c	Dr.	175	
	To Liability for Taxation A/c			525
	(Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)			
(vi)	Liability for Taxation A/c	Dr.	525	
	To Current Assets (Bank A/c)			525

	(Being the payment of tax liability)		
(vii)	Capital Reduction A/c Dr.	34,125	
	To P & L A/c		2,100
	To PPE A/c		8,750
	To Current Assets A/c		18,725
	To Investments A/c		175
	To Capital Reserve A/c (Bal. fig.)		4,375
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Fixed Assets, Current Assets, Investments and the Balance transferred to Capital Reserve)		

Capital Reduction Account

To	Liability for taxation A/c	175	By	Equity share capital	21,000
To	P & L A/c	2,100	By	8% Cumulative preferences Share capital	7,000
To	Fixed Assets	8,750	By	6% Debentures	2,800
To	Current assets	18,725	By	Sundry creditors	3,500
To	Investment	175			
To	Capital Reserve (Bal. fig.)	4,375			
		34,300			34,300

Q.7: The following is the Balance Sheet of Purple Limited as at 31st March, 2022:

Particulars	Note	Amount in ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	15,00,000
(b) Reserve and Surplus	2	(3,00,000)
(2) Current Liabilities		
(a) Trade Payables		2,20,000
(b) Short Term Borrowing – 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:

(i) The preference shares are converted from 6% to 8% but revalued in a manner in which the total return on them remains unaffected.

(ii) The value of equity shares is brought down to ₹ 8 per share.

(iii) The arrears of dividend on preference shares are cancelled.

(iv) The debit balance of Goodwill account is written off entirely.

(v) Land and Building and Plant and Machinery are revalued at 85% and 80% of their respective book values.

(vi) Book debts amounting to ₹ 14,400 are to be treated as bad and hence to be written off.

(vii) The company expects to earn a profit at the rate of ₹ 90,000 per annum from the current year which would be utilized entirely for reducing the debit balance of Profit and loss accounts for 3 years. The remaining balance of the said account would be written off at the time of capital reduction process.

(viii) The balance of total capital reduction is to be utilized in writing down Patents.

(ix) A secured loan of ₹ 4,80,000 bearing interest at 12% per annum is to be obtained by mortgaging tangible fixed assets for repayment of bank overdraft and for providing additional funds for working capital.

You are required to give journal entries incorporating the above scheme of reconstruction, capital reduction account and prepare the reconstructed Balance Sheet.

[Nov 2022 (20 Marks)]

ANSWER:

Journal Entries in the books of Purple Ltd.

	Particulars		Debit (₹)	Credit (₹)
1.	6% Preference share capital A/c	Dr.	6,00,000	
	To 8% Preference share capital A/c			4,50,000
	To Capital reduction A/c			1,50,000
	(Being 6% preference shares converted to 8% preference shares so that return to pref. shareholders remains unaffected)			
2.	Equity share capital A/c (₹ 10)	Dr.	9,00,000	
	To Equity shares Capital A/c (₹ 8)			7,20,000

	Particulars		Dr. (₹)	Cr. (₹)
	To Capital reduction A/c			1,80,000
	(Being equity capital reduced to nominal value of ₹ 8 each)			
3.	Capital Reduction A/c	Dr.	3,30,000	
	To Goodwill A/c			84,600
	To Land and Building A/c			81,100
	To Plant and Machinery A/c			96,000
	To Trade Receivables A/c (Book debts)			14,400
	To Patents A/c (Bal. fig.)			24,000
	To Profit and loss A/c			30,000
	(Being losses and assets written off to the extent required)			
4.	Bank A/c	Dr.	4,80,000	
	To Bank Loan A/c			4,80,000
	(Being Loan taken)			
5.	Bank overdraft A/c	Dr.	2,00,000	
	To Bank A/c			2,00,000
	(Being Bank overdraft repaid)			

Capital Reduction Account

	Particulars	₹		Particulars	₹
To	Goodwill A/c	84,600	By	Equity Share Capital A/c	1,80,000
To	Land & Building A/c	81,000	By	6% Preference Shares Capital A/c	1,50,000
To	Plant and Machinery A/c	96,000			
To	Trade receivables (Book Debts) A/c	14,400			
To	Profit & Loss A/c	30,000			
To	Patents A/c (Bal. fig.)	24,000			
		3,30,000			3,30,000

Balance Sheet of Purple Ltd. (and reduced)

As at 31.3.2022

		Particulars	Notes	₹
		Equity and Liabilities		
1.		**Shareholders' funds**		
	(a)	Share capital	1	11,70,000
	(b)	Reserves and surplus	2	(2,70,000)
2.		**Current liabilities**		
	(a)	Short term borrowings (Secured Bank Loan)		4,80,000
	(b)	Trade Payables		2,20,000
		Total		16,00,000
		Assets		
1.		**Non-current assets**		

	(a) Property, plant and equipment	3	8,43,000
	(b) Intangible assets	4	12,000
2.	**Current Assets**		
	(a) Inventory		1,70,000
	(b) Trade receivables	5	2,87,600
	(c) Cash and cash equivalents (7,600 + 4,80,000 - 2,00,000)		2,87,600
	Total		16,00,000

Notes to Accounts:

			₹
1.	Share Capital		
	Authorized		
	Issued, subscribed and paid up:		
	90,000 equity shares of ₹ 8 each fully paid	7,20,000	
	8% Preference share capital*	4,50,000	11,70,000
2.	Reserves and Surplus		
	Profit and Loss account (Dr. balance)		(2,70,000)
3.	Property Plant and equipment		
	Land and Building	4,59,000	
	Plant and Machinery	3,84,000	8,43,000
4.	Intangible assets		
	Patent ₹ (36,000 – 24,000)		12,000
5.	Trade Receivables		
	Sundry Debtors	3,01.800	
	Less: Bad Debts	(14,400)	2,87,400

Note: *Face value of preference share is not given in the question (pre and post reconstruction) and hence any suitable value of preference share may be assumed.

Working Notes:

1. Calculation of new Preference Shares

Rate of return : 6% on Preference Shares

Dividend : (6/100) x ₹ 6,00,000 = ₹ 36,000

Rate of return : 8% on Preference Shares

Dividend : (8/100) x X = ₹ 36,000

X = (36,000/8) x 100 = ₹ 4,50,000

New Preference Share Capital = ₹ 4,50,000

Old Preference Share Capital = ₹ 6,00,000

(6,00,000 – 4,50,000) = ₹ 1,50,000 Amount taken to capital Reduction A/c.

2. Since the company expects to earn a profit of ₹ 90,000 p.a. consecutively for three years and it shall be used to write-off debit balance of P & L account, hence ₹ 2,70,000 being loss shall be shown in the Balance Sheet under Reserve & Surplus head and ₹ 30,000 shall be written-off from Capital Reduction A/c.

3. **Calculation of Amount written off on Land & Building and Plant & Machinery**

Land & Building = (85/100) x 5,40,000 = ₹ 4,59,000

Plant & Machinery = (80/100) x 4,80,000 = ₹ 3,84,000

Reduced by:

Land & Building = (5,40,000 - 4,59,000) = ₹ 81,000

Plant & Machinery = (4,80,000 - 3,84,000) = ₹ 96,000

AMLGAMATION OF COMPANIES

Q.1: 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)

Liabilities	High Ltd.	Low Ltd.	Assets	High Ltd.	Low Ltd.
Share Capital:			Property, Plant and Equipment:		
Equity Shares of ₹ 100 each	1000	850	Land & Building	670	385
14% Pref Shares of ₹ 100 each	320	175	Plant & Machinery	475	355
Reserves & Surplus:			Investments	95	80
Revaluation Reserve	225	110	Current Assets:		
General Reserve	360	240	Stock	415	389
Investment Allowance Reserve	80	40	Sundry Debtors	322	213
P & L Account	85	82	Bills Receivables	35	-
Non-Current Liabilities:			Cash & Bank	303	166
Secured Loans:					
13% Debentures (₹ 100 each)	100	56			
Unsecured Loans (Public Deposits)	50	-			
Current Liabilities & Provisions:		-			
Sundry Creditors	65	35			
Bills Payable	30	-			
TOTAL	2315	1588	TOTAL	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 the 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. [Nov 2020 (15 Marks)]

ANSWER:

Balance Sheet of Little Ltd. as at 1st April, 2020

Particulars	Note No.	(₹ in lakhs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,150.0
(b) Reserves and Surplus	2	2,437.8
(2) Non-Current Liabilities		
Long-term borrowings	3	135.2
Other Borrowings- Unsecured Loans		50
(3) Current Liabilities		
Trade payables	4	130.0
Total		3,903
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	1,885
(b) Non-current investment (95 + 80)		175
(2) Current assets		
(a) Inventory (415+389)		804
(b) Trade receivables	6	570
(c) Cash and bank balances (303 + 166)		469
Total		3,903

Notes to Accounts

		(₹ in lakhs)	(₹ in lakhs)
1.	Share Capital		
	Equity share capital (W.N.1)		
	65,50,000 Equity shares of 10 each	655	
	4,95,000 Preference shares of ₹ 100 each	495	
	(all the above shares are allotted as fully paid-up pursuant to contracts without payment being received in cash)		1,150
2.	Reserves and surplus		
	Securities Premium Account (W.N.3)		
	(1080+ 681.25)	1,761.25	
	Capital Reserve (W.N. 2)(283.33 + 393.22)	676.55	
	Investment Allowance Reserve (80 + 40)	120	
	Amalgamation Adjustment Reserve (80 + 40)	(120)	2,437.8
3.	Long-term borrowings		
	15% Debentures		135.2
4.	Trade payables		

	Sundry Creditors: High Ltd.		65	
	Low Ltd.		35	
	Bills Payable : High Ltd.		30	130
5.	Property, Plant and Equipment			
	Land and Building : High Ltd.	670		
	Low Ltd.	385	1055	
	Plant and Machinery : High Ltd.	475		
	Low Ltd.	355	830	1,885
6.	Trade receivables			
	Sundry Debtors : High Ltd.		322	
	Low Ltd.		213	
	Bills Receivables: High Ltd.		35	570

Working Notes:

			(₹ in lakhs)	
			High Ltd.	**Low Ltd.**
(1)	Computation of Purchase consideration			
	(a) Preference shareholders:			
	$\left(\frac{3,20,00,000}{100}\text{ i.e. } 3,20,000 \text{ shares}\right)$ x ₹ 125 each		400	
	$\left(\frac{1,75,00,000}{100}\text{ i.e. } 1,75,000 \text{ shares}\right)$ x ₹ 125 each			218.75
	(b) Equity shareholders:			
	$\left(\frac{10,00,00,000 \times 4}{100}\text{ i.e. } 40,00,000 \text{ shares}\right)$ x ₹ 35 each		1,400	
	$\left(\frac{8,50,00,000 \times 3}{100}\text{ i.e. } 25,00,000 \text{ shares}\right)$ x ₹ 35 each		______	892.50
	Amount of Purchase consideration		1,800	1,111.25
(2)	Computation of Capital Reserve Assets taken over:			
	Land and Building		670	385
	Plant and Machinery		475	355
	Investments		95	80
	Inventory		415	389
	Trade receivables		322	213
	Bills Receivables		35	
	Cash and bank		303	166
			2,315	1,588
	Less: Liabilities taken over:			
	Debentures	86.67		48.53
	Unsecured Loan	50		
	Creditors	65		35
	Bills Payable	30		
			231.67	83.53

	Net assets taken over	2083.33	1,504.47
	Purchase consideration	1,800	1,111.25
	Capital reserve	283.33	393.22
(3)	Computation of securities premium		
	On preference share capital	80	
	High Ltd. – 3,20,000 x 25		43.75
	Low Ltd. – 1,75,000 x 25		
	On equity share capital		
	High Ltd. – 40,00,000 x 25	1,000	
	Low Ltd. – 25,50,000 x 25		637.5
	Total	1080	681.25
(4)	Issue of Debentures (₹ In Lakhs) High Ltd.- 15% fresh issue of debenture for 13% old debentures = 100 X 13% /15% = 86.67(rounded off) Low Ltd.- 15% fresh issue of debenture for 13% old debentures = 56 X 13% /15% = 48.53 (rounded off) Total number of debentures issued = 86.67 + 48.53 = 135.20 Lakhs		

Q.2: 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%.**

(i) **Plant and Machinery of Galaxy Ltd. are to be valued at ₹ 2,52,000.**

(ii) **Goodwill is to be valued at :**

Galaxy Ltd. ₹ 4,48,000

Glory Ltd. ₹ 1,68,000

(iii) **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 :

(1) **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.**

(2) **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.** **[Nov 21 (20 Marks)]**

ANSWER:

(i) **Calculation of Purchase consideration (or basis for issue of shares of Glorious Ltd.)**

	Galaxy Ltd.	Glory Ltd.
Purchase Consideration:	₹	₹
Goodwill	4,48,000	1,68,000
Freehold property	5,88,000	3,36,000
Plant and Machinery	2,52,000	84,000
Motor vehicles	56,000	-
Inventory	3,36,000	4,38,000
Trade receivables	4,62,000	-
Cash at Bank	2,38,000	24,000
	23,80,000	10,50,000
Less: Liabilities:		
6% Debentures (3,00,000 x 110%)	-	(3,30,000)
Trade payables	(4,20,000)	

Net Assets taken over	19,60,000	7,20,000
To be satisfied by issue of shares of Glorious. Ltd. @ ₹ 10 each	1,96,000	72,000

(ii) Balance Sheet of Glorious Ltd. as at 1st April, 2020

		Particulars	Note No	Amount
				₹
		EQUITY AND LIABILITIES		
1		Shareholders' funds		
	(a)	Share capital	1	26,80,000
	(b)	Reserves and surplus	2	30,000
2		Non-current liabilities		
	(a)	Long-term borrowings	3	3,00,000
3		Current liabilities		
	(a)	Trade payables		4,20,000
		Total		34,30,000
		ASSETS		
1		Non-current assets		
	(a)			
	i	Property, plant and equipment	4	13,16,000
	ii	Intangible assets	5	6,16,000
2		Current assets		
	(a)	Inventories	6	7,74,000
	(b)	Trade receivables		4,62,000
	(c)	Cash and cash equivalents	7	2,62,000
		Total		34,30,000

Notes to accounts:

		₹	₹
1.	Share Capital		
	Equity share capital		
	2,68,000 shares of ₹ 10 each		26,80,000
	(All the above shares are issued for consideration other than cash)		
2.	Reserves and surplus		
	Securities Premium		
	(10% premium on debentures of ₹3,00,000)		30,000
3.	Long-term borrowings		
	Secured		
	8% 3,000 Debentures of ₹100 each		3,00,000
4.	Property Plant and Equipment		

	Freehold property		
	Galaxy Ltd.	5,88,000	
	Glory Ltd.	3,36,000	9,24,000
	Plant and Machinery		
	Galaxy Ltd.	2,52,000	
	Glory Ltd.	84,000	3,36,000
	Motor vehicles - Galaxy Ltd.		56,000
			13,16,000
5	Intangible assets		
	Goodwill		
	Galaxy Ltd.	4,48,000	
	Glory Ltd.	1,68,000	6,16,000
6	Inventories		
	Galaxy Ltd.	3,36,000	
	Glory Ltd.	4,38,000	7,74,000
7	Cash and cash equivalents		
	Galaxy Ltd.	2,38,000	
	Glory Ltd.(As per working note)	24,000	2,62,000

Working note:

Calculation of cash balance of Glory Limited to be taken over by Glorious Limited

		₹
Cash balance as at 31st March, 2020		1,04,000
Add: Received from debtors		1,10,000
		2,14,000
Less: paid to creditors		(1,80,000)
		34,000
Less: Commission to liquidators		
On Debtors @ 5%	5,500	
On Creditors @ 2.5%	4,500	
		(10,000)
		24,000

Note:

1. It is assumed that the nominal value of debentures of Glory Ltd. is ₹ 100 each.
2. As per the information given in the question, debentures of Glory Ltd. are to be discharged by the issue of debentures of Glorious Ltd. at premium of 10%. It is assumed in the above solution that the debentures are issued at premium of ₹ 10 for discharge of debentures of ₹ 3,30,000. Alternative answer considering other reasonable assumption is also possible.

Q.3: Robert Ltd. and Diamond Ltd. give the following information as at 31.03.2020:

	Robert Ltd. (Rs. in lakhs)	Diamond Ltd. (Rs. in lakhs)
Equity Share Capital (Fully paid shares of Rs. 10 each)	22,500	9,000
Securities Premium	4,500	-
Foreign Project Reserve	-	465
General Reserve	14,250	4,800
Profit and Loss Account	4,305	1,162.5
12% Debentures	-	1,500
Trade payables	1,800	694.5
Provisions	2,745	1,053
Land and Buildings	9,000	-
Plant and Machinery	21,000	7,500
Furniture, Fixtures and Fittings	3,456	2,550
Inventory	11,793	6.061.5
Trade receivables	3,180	1,650
Cash at Bank	1,671	913.5

All the bills receivable held by Diamond Ltd. were Robert Ltd.'s acceptances.

On 1st April 2020, Robert Ltd. took over Diamond Ltd. in an amalgamation in the nature of merger. It was agreed that in discharge of consideration for the business, Robert Ltd. would allot three fully paid equity shares of Rs. 10 each at par for every two shares held in Diamond Ltd. It was also agreed that 12% debentures in Diamond Ltd. would be converted into 13% debentures in Robert Ltd. of the same amount and denomination.

Details of trade receivables and trade payables are as under:

Particulars	Robert Ltd.	Diamond Ltd.
	(Rs. in lakhs)	
Trade Payables:		
Creditors	1,620	694.5
Bills Payable	180	-
	1,800	694.5
Trade receivables:		
Debtors	3,180	1,530
Bills Receivables	-	120
	3,180	1,650

Expenses of amalgamation amounting to Rs. 1.5 lakhs were borne by Robert Ltd.

You are required to:

(i) Pass journal entries in the books of Robert Ltd. and

(ii) Prepare Robert Ltd.'s Balance Sheet immediately after the merger.

[MTP March 21 (20 Marks)]

ANSWER:

Books of Robert Ltd.

Journal Entries

		(Rs. In Lacs)	(Rs. In Lacs)
Business Purchase A/c	Dr.	13,500	
To Liquidator of Diamond Ltd.			13,500
(Being business of Diamond Ltd. taken over for consideration settled as per agreement)			
Plant and Machinery	Dr.	7,500	
Furniture & Fittings	Dr.	2,550	
Inventory	Dr.	6,061.5	
Debtors	Dr.	1,530	
Cash at Bank	Dr.	913.5	
Bills Receivable	Dr.	120	
To Foreign Project Reserve			465
To General Reserve Rs. (4,800 - 4,500)			300
To Profit and Loss A/c			1,162.5
To Liability for 12% Debentures			1,500
To Creditors			694.5
To Provisions			1,053
To Business Purchase A/c			13,500
(Being assets & liabilities taken over from Diamond Ltd.)			
Liquidator of Diamond Ltd. A/c	Dr.	13,500	
To Equity Share Capital A/c			13,500
(Purchase consideration discharged in the form of equity shares)			
Profit & Loss A/c	Dr.	1.5	
To Bank A/c			1.5
(Liquidation expenses paid and charged to P& L A/c)			
Liability for 12% Debentures A/c	Dr.	1,500	
To 13% Debentures A/c			1,500
(12% debentures discharged by issue of 13% debentures)			
Bills Payable A/c	Dr.	120	
To Bills Receivables A/c			120
(Cancellation of mutual owing on account of bills)			

Balance Sheet of Robert Ltd. as at 1st April, 2020 (after merger)

		Particulars	Notes	Rs. (in lakhs)
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	36,000
	B	Reserves and Surplus	2	24,981
2		Non-current liabilities		
	A	Long-term borrowings	3	1,500
3		Current liabilities		

	A	Trade Payables (1,800 + 694.5 – 120)		2,374.5
	B	Short-term provisions (2,745 + 1,053)		3,798
		Total		68,653.5
		Assets		
1		Non-current assets		
	A	Property, Plant & Equipment	4	43,506
2		Current assets		
	A	Inventories (11,793+6,061.5)		17,854.5
	B	Trade receivables (3,180+1,650-120)		4,710
	C	Cash and cash equivalents (1,671+913.5-1.5)		2,583
		Total		68,653.5

Notes to Accounts

		Rs.
1.	Share Capital	
	Equity share capital	
	Authorized, issued, subscribed and paid-up: 36 crores equity shares of Rs. 10 each (out of these shares, 13.5 crores shares have been issued for consideration other than cash)	36,000
2.	Reserves and Surplus	
	General Reserve	14,550
	Securities Premium	4,500
	Foreign Project Reserve	465
	Profit and Loss Account Rs. (4,305 + 1,162.5 - 1.5)	5,466
	Total	24,981
3.	Long-term borrowings	
	Secured	
	13% Debentures	1,500
4.	PPE	
	Land & Buildings	9,000
	Plant & Machinery	28,500
	Furniture & Fittings	6,006
	Total	43,506

Working Note:

Computation of purchase consideration

Purchase consideration was discharged in the form of three equity shares of Robert Ltd. for every two equity shares held in Diamond Ltd.

Purchase consideration = Rs. 9,000 lacs x $\frac{3}{2}$ = Rs. 13,500 lacs

Q.4: 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	6,000	3,600
	Equity Shares of ₹ 100 each		
	Reserves and Surplus		
2.	General Reserves	360	180
	Profit and Loss Account	72	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:

(i) Compute No. of shares to be issued by Black Limited to White Limited against purchase consideration.

(ii) Calculate the balance of Net Current Assets of Black Limited and White Limited as on 1st July, 2020.

(iii) Give balance of Profit or Loss of Black Limited as on 1st July, 2020

(iv) **Give balance of Property Plant and Equipment as on 1st July, 2020 after takeover.**

[July 21 (10 Marks)]

ANSWER:

(i) **No. of shares issued by Black Ltd. to White Ltd. against purchase consideration**

White Ltd.		₹	₹
Goodwill			2,40,000
Property, plant and equipment		24,00,000	
Less: Depreciation [24,00,000 x 10% x 3/12]		(60,000)	
		23,40,000	
Add: Appreciation		1,20,000	24,60,000
Inventory			7,20,000
Trade receivables			10,80,000
Cash and Bank balances		4,20,000	
Add: Profit after depreciation	2,40,000		
Add: Depreciation (non-cash)	60,000	3,00,000	
Less: Dividend [36,00,000 x 10%]		3,60,000	3,60,000
			48,60,000
Less: Trade payables			(3,60,000)
Purchase Consideration			45,00,000
Number of shares to be issued by Black Ltd. @ ₹ 100 each			45,000 shares

(ii) **Calculation of Net Current Assets as on 01.07.2020**

	₹	**Black Ltd.** ₹	₹	**White Ltd.** ₹
Current assets:				
Inventory		9,60,000		7,20,000
Trade receivables		16,80,000		10,80,000
Cash and Bank	14,40,000		4,20,000	
Less: Dividend	(6,00,000)		(3,60,000)	
Add: Profit after depreciation	4,80,000		2,40,000	
Add: Depreciation being noncash	90,000	14,10,000	60,000	3,60,000
		40,50,000		21,60,000
Less: Trade payables		(6,00,000)		(3,60,000)
		34,50,000		18,00,000

(iii) **Profit and Loss Account balance of Black Ltd. as on 1.07.2020**

	₹
P & L A/c balance as on 31.03.2020	7,20,000
Less: Dividend paid	(6,00,000)

	1,20,000
Add: Estimated profit for 3 months after charging depreciation	4,80,000
	6,00,000

(iv) Property, plant and equipment as on 01.07.2020

Property, plant and equipment of Black Ltd. as on 31.03.2020		36,00,000
Less: Depreciation for 3 months [36,00,000 x 10% x 3/12]		(90,000)
		35,10,000
Property, plant and equipment of White Ltd.		
Taken over as on 31.03.2020	24,00,000	
Less: Proportionate depreciation for 3 months on fixed assets	(60,000)	
	23,40,000	
Add: Appreciation above the estimated book value	1,20,000	24,60,000
Total Property, plant and equipment as on 1.7.2020		59,70,000

Q.5: 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 and 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 three years. Preference shareholders to forgo dividend for two years. For balance dividend, equity shares of equal amount are issued at par.

(d) Equity shareholders are issued one share at par for every three shares held in Mohan Ltd.

(ii) Current Assets are to be taken at book value (except inventory, which is to be reduced by 10%). Goodwill is to be eliminated. The Property, plant and equipment is taken over at ₹ 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.

[RTP May 21]

ANSWER:

In the books of Mohan Ltd.

(i) Realisation Account

Liabilities	₹	Assets	₹
To Goodwill	10,000	By 10% Debentures	2,00,000
To Property, plant and equipment	3,40,000	By Interest accrued on debentures	20,000
To Inventory	80,000	By Trade payables	1,50,000
To Trade receivables	1,10,000	By Ravi Ltd. (Purchase consideration) (W.N.1)	1,65,400
To Bank (20,000 – 5,000)	15,000	By Equity shareholders A/c (loss on realization) (Bal. fig.)	25,000
To Preference Shareholders A/c (W.N.2)	5,400		
	5,60,400		5,60,400

(ii) Equity Shareholders' Account

	₹		₹
To Profit & loss A/c	1,70,000	By Equity Share capital	3,00,000
To Expenses*	5,000		
To Equity shares in Ravi Ltd.	1,00,000		
To Realization A/c	25,000		
	3,00,000		3,00,000

*Alternatively, expenses may be routed through Realization account.

In the books of Ravi Ltd.

(i) Bank Account

	₹		₹
To Business Purchase	15,000	By Balance c/d (Bal. fig.)	1,09,600
To Equity shares application & allotment A/c (W.N. 3)	94,600		
	1,09,600		1,09,600

(ii) Balance Sheet as at 31st March, 2020

	Particulars	Notes	₹
I.	**EQUITY AND LIABILITIES**		
	(1) Shareholders' funds		
	Share capital	1	4,00,000
	(2) Non-current liabilities		
	Long-term borrowings	2	2,00,000
	Total		6,00,000
II.	**Assets**		
	(1) Non-current assets		
	(a) Property, Plant Equipment		3,08,400
	(2) Current assets		
	(a) Inventories		72,000
	(b) Trade receivables		1,10,000
	(c) Cash and cash equivalents		1,09,600
	Total		6,00,000

Notes to Accounts

		₹
1.	**Share capital**	
	Authorised share capital	
	40,000 equity shares of ₹ 10 each	4,00,000
	Issued and subscribed	
	40,000 shares of ₹ 10 each fully paid up	4,00,000
	(out of the above, 30,540 (W.N.3) shares have been allotted as fully paid-up pursuant to contract without payment being received in cash)	
2.	**Long Term Borrowings**	
	10% Debentures	2,00,000

Working Notes:

(1) Calculation of Purchase consideration

	₹
Payment to preference shareholders	
6,000 equity shares @ ₹ 10	60,000
For arrears of dividend: (6,000 x ₹ 10) x 9%	5,400
Payment to equity shareholders	
(30,000 shares x 1/3) @ ₹ 10	1,00,000
Total purchase consideration	1,65,400

(2) Preference Shareholders' Account in books of Mohan Ltd.

	₹		₹

To	Equity Shares in Ravi Ltd.	65,400	By	Preference Share capital	60,000
			By	Realization A/c (Bal. fig.)	5,400
		65,400			65,400

(3) Preference Shareholders' Account in books of Mohan Ltd.

	Number of shares	
Authorized equity shares		40,000
Less: Equity shares issued for		
Interest accrued on debentures	2,000	
Trade payables of Mohan Ltd.	12,000	
Preference shareholders of Mohan Ltd.	6,000	
Arrears of preference dividend	540	
Equity shareholders of Mohan Ltd.	10,000	(30,540)
Number of equity shares issued to public at par for cash		9,460

Q.6: The following are the Balance Sheets of Aakash Limited and Ganga Limited as at March 31, 2021:

Particulars	Note No.	Aakash Limited (₹)	Ganga Limited (₹)
I. Equity and Liabilities:			
(2) 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
(3) Non-Current Liabilities:			
(a) Secured Loans	3	3,20,00,000	1,60,00,000
(b) Unsecured Loans	4	1,72,00,000	--
(4) 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 Aakash Ganga Limited. The realizable value of all the Current Assets (including pledged inventory) is 80% of book value in case of Aakash Limited and 70% for Ganga Limited.

(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 accured 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.

[RTP May 22]

ANSWER:

Balance sheet of Aakash Ganga Ltd. as at 1st April, 2021

	Particulars	Note No.	(₹)
I	**EQUITY AND LIABILITIES**		
	1. Shareholders' funds		
	(a) Share Capital	1	1,40,00,000
	2. Non-current Liabilities		
	(a) Long-term borrowings	2	2,12,60,000
	3. Current Liabilities		
	(a) Trade Payables	3	73,60,000
	(b) Other current liabilities	4	1,64,00,000
	Total		**5,90,20,000**
II	**ASSETS**		
	1. Non-current Assets		
	(a) Property, Plant and Equipment	5	2,04,00,000
	(b) Intangible assets	6	1,54,20,000
	2. Current Assets		
	(a) Cash and cash equivalents		40,00,000
	(b) Other current assets	7	1,92,00,000
	Total		**5,90,20,000**

Notes to Accounts

				₹
1.	Share Capital			
	Issued, subscribed & Paid up:			
	14,00,000 equity shares of ₹ 10 each, fully paid up (W.N.4)			1,40,00,000
	(of the above 10,00,000 shares have been issued for consideration other than cash)			
2.	Long Term borrowings			
	Secured Loans			
	Aakash Limited	25,60,000		
	Ganga Limited	1,44,00,000	1,69,60,000	
	Unsecured Loans		43,00,000	2,12,60,000
3.	Trade Payables (W.N.1)			
	Aakash Limited		4,80,000	
	Ganga Limited		28,80,000	73,60,000
4.	Other current liabilities			
	Statutory Liabilities			
	Aakash Limited		1,44,00,000	
	Ganga Limited		20,00,000	1,64,00,000
5.	Property, Plant & equipment			
	Aakash Limited		68,00,000	

	Ganga Limited	1,36,00,000	2,04,00,000
6.	Intangible assets		
	Goodwill (W.N.3)		1,54,20,000
7.	Other Current Assets		
	Aakash Limited	57,60,000	
	Ganga Limited	1,34,40,000	1,92,00,000

Working Notes:

1. Value of total liabilities taken over by AakashGanga Ltd (₹)

	Aakash Limited		Ganga Limited	
Current liabilities				
Statutory liabilities	1,44,00,000		20,00,000	
Liability to employees	60,00,000		36,00,000	
Trade payables @ 80%	44,80,000	2,48,80,000	28,80,000	84,80,000
Secured loans				
Given in Balance Sheet	3,20,00,000		1,60,00,000	
Interest waived	--		16,00,000	1,44,00,000
Value of Inventory (80% of ₹ 3,68,00,000)	2,94,40,000	25,60,000		
Unsecured Loans (25% of ₹ 1,72,00,000)		43,00,000		--
		3,17,40,000		2,28,80,000

2. Assets taken over by AakashGanga Ltd. (₹)

	Aakash Limited	Ganga Limited
	(₹)	(₹)
Property, Plant & Equipment	68,00,000	1,36,00,000
Current Assets		
(80% and 70% respectively of book value)	57,60,000	1,34,40,000
	1,25,60,000	2,70,40,000

3. Goodwill/ Capital Reserves on amalgamation (₹)

Liabilities taken over (W.N.1)	3,17,40,000	2,28,80,000
Equity shares to be issued to Preference shareholders	4,00,000	--
A	3,21,40,000	2,28,80,000
Less: Total assets taken over (W.N.2) B	(1,25,60,000)	(2,70,40,000)
A-B	1,95,80,000	(41,60,000)
	Goodwill	Capital Reserve
Net Goodwill (1,95,80,000 – 41,60,000)	1,54,20,000	

4. Equity shares issued by AakashGanga Ltd. (₹)

	(i)	For Cash		40,00,000
		For consideration other than cash		
	(ii)	In Discharge of Liabilities to Employees	96,00,000	
	(iii)	To Preference Shareholders	4,00,000	1,00,00,000
				1,40,00,0000
		No. of shares @ ₹ 10		14,00,000

Q.7: List the conditions to be fulfilled as per AS 14 (Revised) for an amalgamation to be in the nature of merger, in the case of companies. **[MTP March 22 (4 Marks)]**

ANSWER:

Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions.

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company and the business of the transferor company is intended to be carried on, after the amalgamation, by 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) 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.

Q.8: Heera Ltd. and Rita Ltd. agreed to amalgamate their business. The scheme envisaged a share capital, equal to the combined capital of Heera Ltd. and Rita Ltd. for the purpose of acquiring the assets, liabilities and undertakings of the two companies in exchange for share in HR Ltd.

Heera Ltd. and Rita Ltd. make available the following information as on 31st March, 2021 (the date of amalgamation):

	Heera Ltd. (₹)	Rita Ltd. (₹)
Property, Plant and Equipment	7,20,000	10,80,000
Inventories	3,60,000	6,60,000
Trade receivables	4,80,000	7,80,000
Cash at Bank	3,00,000	-
Share Capital	6,00,000	8,40,000
Reserves	10,20,000	6,00,000
Bank Overdraft	-	5,40,000
Trade payables	2,40,000	5,40,000

The consideration was to be based on the net assets of the companies as shown above but subject to an additional payment to Heera Ltd. for its goodwill to be calculated as its weighted average of net profits for the three years ended 31st March, 2021. The weights for this purpose for the years 2018-19, 2019-20 and 2020-21 were agreed as 1, 2 and 3 respectively.

The profit had been:

2018-19 ₹ 3,00,000; 2019-20 ₹ 5,25,000 and 2020-21 ₹ 6,30,000.

The shares of HR Ltd. were to be issued to Heera Ltd. and Rita Ltd.at a premium and in proportion to the agreed net assets value of these companies.

In order to raise working capital, HR Ltd. proceeded to issue 72,000 shares of ₹ 10 each at the same rate of premium as issued for discharging purchase consideration to Heera Ltd. and Rita Ltd.

You are required to calculate the number of shares issued to Heera Ltd. and Rita Ltd. and prepare necessary journal entries in the books of HR Ltd. **[RTP Nov 21]**

ANSWER:

Calculation of number of shares issued to Heera Ltd. and Rita Ltd.

Amount of Shares Capital as per balance sheet	₹
Heera Ltd.	6,00,000
Rita Ltd.	8,40,000
	14,40,000

Share of Heera Ltd. = ₹ 14,40,000 x [21,60,000/ (21,60,000 + 14,40,000)]

= ₹ 8,64,000 or 86,400 shares

Securities premium = ₹ 21,60,000 – ₹ 8,64,000 = ₹ 12,96,000

Premium per share = ₹ 12,96,000 / ₹ 86,400 = ₹ 15

Issued 86,400 shares @ ₹ 10 each at a premium of ₹ 15 per share

Share of Rita Ltd. = ₹ 14,40,000 x [14,40,000/ (21,60,000 + 14,40,000)]

= ₹ 5,76,000 or 57,600 shares

Securities premium = ₹ 14,40,000 – ₹ 5,76,000 = ₹ 8,64,000

Premium per share = ₹ 8,64,000 / ₹ 57,600 = ₹ 15

Issued 57,600 shares @ ₹ 10 each at a premium of ₹ 15 per share

Journal Entries in the books of HR Ltd.

		Dr.	Cr.
Particulars		**Amount (₹)**	**Amount (₹)**
Business purchase account	Dr.	36,00,000	
To Liquidator of Heera Ltd. account			21,60,000
To Liquidator of Rita Ltd. account			14,40,000
(Being the amount of purchase consideration payable to liquidator of Heera Ltd. and Rita ltd. for assets taken over)			
Goodwill	Dr.	5,40,000	
PPE account	Dr.	7,20,000	
Inventory account	Dr.	3,60,000	
Trade receivables account	Dr.	4,80,000	
Cash at bank	Dr.	3,00,000	
To Trade payables account			2,40,000
To Business purchase account			21,60,000
(Being assets and liabilities of Heera Ltd. taken over)			
PPE account	Dr.	10,80,000	

		Dr. (₹)	Cr. (₹)
Inventory account	Dr.	6,60,000	
Trade receivables account	Dr.	7,80,000	
To Bank overdraft account			5,40,000
To Trade payables account			5,40,000
To Business purchase account			14,40,000
(Being assets and liabilities of Rita Ltd. taken over)			
Liquidator of Heera Ltd. Account	Dr.	21,60,000	
To Equity share capital account (86,400 x ₹10)			8,64,000
To Securities premium (86,400 x ₹ 15)			12,96,000
(Being the allotment of shares as per agreement for discharge of purchase consideration)			
Liquidator of Rita Ltd. account	Dr.	14,40,000	
To Equity share capital account (57,600 x ₹ 10)			5,76,000
To Securities premium (57,600 x ₹ 15)			8,64,000
(Being the allotment of shares as per agreement for discharge of purchase consideration)			
Bank A/c		18,00,000	
To Equity share capital account (72,000 x ₹ 10)			7,20,000
To Securities Premium (72,000 x ₹ 15)			10,80,000
(Equity share capital issued to raise working capital)			

Working Notes:

1. Calculation of goodwill of Heera Ltd.

Particulars	Amount (₹)	Weight	Weighted amount (₹)
2018-19	3,00,000	1	3,00,000
2019-20	5,25,000	2	10,50,000
2020-21	6,30,000	3	18,90,000
Total (a+b+c)	14,55,000	6	32,40,000
Weighted Average = [Total weighted amount / Total of weight] [₹ 32,40,000/6]			
Goodwill			5,40,000

2. Calculation of Net assets

	Heera Ltd. (₹)	Rita Ltd. (₹)
Assets		
Goodwill	5,40,000	
PPE	7,20,000	10,80,000
Inventory	3,60,000	6,60,000
Trade receivable	4,80,000	7,80,000
Cash at bank	3,00,000	
Less: Liabilities		

	Bank overdraft		5,40,000
	Trade payables	2,40,000	5,40,000
	Net assets or Purchase consideration	21,60,000	14,40,000

BRANCH ACCOUNTS

Q.1: DM Delhi has a branch in London which is an integral foreign operation of DM. At the end of the year 31st March, 2021, the branch furnishes the following trail balance in U.K. Pound:

Particulars	£	£
	Dr.	Cr.
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

Particulars	Amount Rs.	Particulars	Amount Rs.
To Balance b/d	20,10,000	By Bank A/c	52,16,000
To Goods sent to branch	49,26,000	By Balance c/d	17,20,000
	69,36,000		69,36,000

The following further information is given:

(a) Fixed assets are to be depreciated @ 10% p.a. on WDV.

(b) On 31st March, 2021:

Expenses outstanding	-	£ 400
Prepaid expenses	-	£ 200
Closing stock	-	£ 8,000

(c) Rate of Exchange:

1st April, 2017	-	Rs. 70 to £ 1
1st April, 2020	-	Rs. 76 to £ 1
31st March, 2021	-	Rs. 77 to £ 1
Average	-	Rs. 75 to £ 1

You are required to prepare: (1) Trial balance, incorporating adjustments of outstanding and prepaid expenses, converting U.K. pound into Indian rupees; and (2) Trading and profit and loss account for the year ended 31st March, 2021 of London branch as would appear in the books of Delhi head office of DM.

[MTP April 21 (8 Marks)]

ANSWER:

Trial Balance of London Branch as on 31st March, 2021

Particulars	U.K. Pound	Rate Per U.K. Pound	Dr. (Rs.)	Cr. (Rs.)
Fixed Assets	24,000	70	16,80,000	
Stock (as on 1st April, 2020)	11,200	76	8,51,200	
Goods from Head Office	64,000	-	49,26,000	
Sales	96,000	75		72,00,000
Purchases	12,000	75	9,00,000	
Expenses (4,800 + 400 – 200)	5,000	75	3,75,000	
Debtors	4,800	77	3,69,600	
Creditors	3,200	77		2,46,400
Outstanding Expenses	400	77		30,800
Prepaid expenses	200	77	15,400	
Cash at Bank	1,200	77	92,400	
Head office Account		-		17,20,000
Difference in Exchange				12,400
			92,09,600	92,09,600

Closing stock will be (8,000 × 77) = Rs. 6,16,000

Trading and Profit & Loss A/c

for the year ended 31st March, 2021

	Particulars	Amount (Rs.)		Particulars	Amount (Rs.)
To	Opening Stock	8,51,200	By	Sales	72,00,000
To	Purchases	9,00,000	By	Closing Stock	6,16,000
To	Goods from H.O.	49,26,000			
To	Gross Profit	11,38,800			
		78,16,000			78,16,000
To	Expenses	3,75,000	By	Gross Profit	11,38,800
To	Depreciation	1,68,000	By	Profit due to Exchange difference	12,400
To	Net Profit	6,08,200			
		11,51,200			11,51,200

Working Note:

Since London Branch is an integral foreign operation. Hence, (1) Fixed assets (cost and depreciation) are translated using the exchange rate at the date of purchase of the assets. (2) Exchange difference arising on translation of the financial statement is charged to Profit and Loss Account.

Q.2: From the following details of Western Branch Office of M/s. Alpha for the year ending 31st March, 2020, ascertain branch stock reserve in respect of unrealized profit in opening stock and closing stock:

(i) Goods are sent to the branch at invoice price and branch also maintains stock at the same price.

(ii) Sale price is cost plus 40%.

(iii) Invoice price is cost plus 15%.

(iv) Other information from accounts of branch:

Opening Stock as on 01-04-2019	3,45,000
Goods sent during the year by Head office to Branch	16,10,000
Sales during the year	21,00,000
Expenses incurred at the branch	45,000

[MTP Oct 21(4 Marks)]

ANSWER:

Branch Stock Reserve in respect of unrealized profit

on opening stock = ₹ 3,45,000 x (15/115) = ₹ 45,000

on closing stock = ₹ 2,30,000 x (15/115) = ₹ 30,000

Working Note: ₹

Cost Price	100
Invoice Price	115
Sale Price	140
Calculation of closing stock at invoice price	₹
Opening stock at invoice price	3,45,000
Goods received during the year at invoice price	16,10,000
	19,55,000
Less: cost of goods sold at invoice price [21,00,000 X (115/140)]	(17,25,000)
Closing stock	2,30,000

Q.3: Pass necessary journal entries in the books of an independent Branch of a Company, wherever required, to rectify or adjust the following:

(i) Branch incurred travelling expenses of ₹ 4,000 on behalf of other Branches, but not recorded in the books of Branch.

(ii) Goods dispatched by the Head office amounting to ₹ 8,000, but not received by the Branch till date of reconciliation. The Goods have been received subsequently.

(iii) Provision for doubtful debts, whose accounts are kept by the Head Office, not provided earlier for ₹ 2,000.

(iv) Branch paid ₹ 2,000 as salary to a Head Office Manager, but the amount paid has been debited by the Branch to Salaries Account. [MTP Nov 21 (4 Marks)]

ANSWER:

Journal Entries in Books of Branch

		Amount in ₹

		Dr.	Cr.
(i)	Head Office Account Dr.	4,000	
	To Cash Account		4,000
	(Being expenditure incurred on account of other branch, now recorded in books)		
(ii)	Goods-in-transit Account Dr.	8,000	
	To Head Office Account		8,000
	(Being goods sent by Head Office still in-transit)		
(iii)	Provision for Doubtful Debts A/c Dr.	2,000	
	To Head Office Account		2,000
	(Being the provision for doubtful debts not provides earlier, now provided for)		
(iv)	Head Office Account Dr.	2,000	
	To Salaries Account		2,000
	(Being rectification of salary paid on behalf of Head Office)		

Q.4: Delta Ltd. has a branch at Kanpur. Goods are invoiced from head office to Brach at cost plus 50%. Branch remits all cash received to head office and all expenses are met by head office.

Prepare necessary Ledger accounts in the books of Delta Ltd. under Stock and Debtors system to show profit earned at the branch for the year ending 31st March, 2021

Following information related to Branch is given:

Stock on 1st April, 2020 (Invoice price)	**31,200**	**Goods returned by Debtors**	**3,000**
Debtors on 1st April, 2020	**17,400**	**Surplus in stock (Invoice price)**	**600**
Goods invoiced at cost	**72,000**	**Expenses at Branch**	**13,400**
Sales at Branch : Cash sales	**20,000**	**Discount allowed to Debtors**	**700**
Credit sales	**68,200**	**Debtors on 31st March, 2021**	**14,300**

[Dec 21 (10 Marks)]

ANSWER:

Books of Delta Ltd.

Kanpur Branch Stock Account

	₹		₹
To Balance b/d – Opening Stock	31,200	By Bank A/c – Cash Sales	20,000
To Brach Debtors A/c – Sales Return	3,000	By Branch Debtors A/c – Credit Sales	68,200
To Goods Sent to Branch A/c (72,000 + 50% of 72,000)	1,08,000	By Balance c/d – Closing stock	54,600
To Surplus in Stock	600		
	1,42,800		1,42,800

Kanpur Branch Stock Adjustment Account

	₹		₹

To	Branch Profit and Loss Account	28,400	By	Balance b/d (1/3 of ₹ 31,200)	10,400
To	Balance c/d (1/3 of 54,600)	18,200	By	Goods sent to Branch A/c (1/3 of ₹ 1,08,000)	36,000
			By	Surplus in stock	200
		46,600			46,600

Goods Sent to Branch Account

		₹			₹
To	Kanpur Branch Stock Adjustment A/c	36,000	By	Kanpur Branch Stock A/c	1,08,000
To	Purchases A/c	72,000			
		1,08,000			1,08,000

Branch Debtors Account

		₹			₹
To	Balance b/d	17,400	By	Bank (Bal fig.)	67,600
To	Branch Stock A/c	68,200	By	Brach Expenses A/c (Discount allowed)	700
			By	Branch Stock – Sales Returns	3,000
			By	Balance c/d	14,300
		85,600			85,600

Branch Expenses Account

		₹			₹
To	Bank A/c (expenses)	13,400	By	Brach Profit & Loss A/c (Transfer)	14,100
To	Branch Debtors A/c (Discount allowed)*	700			
		14,100			14,100

Branch Profit & Loss Account for the year ending 31st March 2021

		₹			₹
To	Balance Expenses A/c	14,100	By	Branch Adjustment A/c	28,400
To	Net Profit	14,700	By	Surplus in stock (Cost	400
		28,800			28,800

Note: *Discount allowed to debtors may be shown in Branch Profit and Loss account directly instead of transferring it through Branch Expenses account.

Q.5: Lal & Co. of Jaipur has a branch in Patna to which goods are sent @ 20% above cost. The branch makes both cash & credit sales. Branch expenses are paid direct from Head office and the branch has to remit all cash received into the bank account of Head office. Branch doesn't maintain any books of accounts but sends monthly returns to the head office.

Following further details are given for the year ended 31st March, 2020:

	Amount (₹)
Goods received from Head office at Invoice Price	4,20,000
Goods returned to Head office at Invoice Price	30,000
Cash sales for the year 2019-20	92,500
Credit Sales for the year 2019-20	3,12,500
Stock at Branch as on 01-04-2019 at Invoice price	36,000
Sundry Debtors at Patna branch as on 01-04-2019	48,000
Cash received from Debtors	2,19,000
Discount allowed to Debtors	3,750
Goods returned by customer at Patna Branch	7,000
Bad debts written off	2,750
Amount recovered from Bad debts previously written off as Bad	500
Rent, Rates & taxes at Branch	12,000
Salaries & Wages at Branch	36,000
Office Expenses (at Branch)	4,600
Stock at Branch as on 31-03-2020 at cost price	62,500

Prepare necessary ledger accounts in the books of Head Office by following Stock and Debtors method and ascertain Branch profit. **[RTP Nov 21]**

ANSWER:

Branch Stock Account

			₹				₹	₹	₹
1.4.19	To	Balance b/d (opening stock)	36,000	31.3.20	By	Sales:			
31.3.20	To	Goods Sent to Branch A/c	4,20,000			Cash		92,500	
						Credit	3,12,500		
	To	Branch P&L	47,000			Less: Return	(7,000)	3,05,500)	3,98,000
					By	Goods sent to branch-return			30,000
					By	Balance c/d (closing stock)			75,000
			5,03,000						5,03,000
1.4.20	To	Balance b/d	75,000						

Branch Debtors Account

			₹				₹
1.4.19	To	Balance b/d	48,000	31.3.20	By	Cash	2,19,000
31.3.20	To	Sales	3,12,500		By	Returns	7,000
					By	Discounts	3,750
					By	Bad debts	2,750
					By	Balance c/d	1,28,000
			3,60,500				3,60,500
1.4.20	To	Balance b/d	1,28,000				

Branch Expenses Account

		₹			₹
31.3.20	To Salaries & Wages	36,000	31.3.20	By Branch P&L A/c	59,100
	To Rent, Rates & Taxes	12,000			
	To Office Expenses	4,600			
	To Discounts	3,750			
	To Bad Debts	2,750			
		59,100			59,100

Branch Profit & Loss Account for year ended 31.3.20

		₹			₹
31.3.20	To Branch Expenses A/c	59,100	31.3.20	By Branch Stock	47,000
	To Net Profit transferred to General P&L A/c	46,900		By Branch Stock Adjustment account	58,500
				By Bad debts recovered	500
		1,06,000			1,06,000

Brach Stock Adjustment Account for year ended 31.3.20

		₹			₹
31.3.20	To Goods sent to branch (30,000 x 1/6) – returns	5,000	31.3.20	By Balance b/d (36,000 x 1/6)	6,000
	To Branch P&L A/c	58,500		By Goods sent to branch (4,20,000 x 1/6)	70,000
	To Balance c/d (75,000 x 1/6)	12,500			
		76,000			76,000

Q.6: L Ltd. has its head office at Mumbai and two branches at Pune and Goa. The branches purchase goods independently. Pune branch makes a profit of one third on cost and Goa branch makes a profit of 20% on sales. Goods are also supplied by one branch to another at the respective sales price. From the following particulars, prepare the Trading and Profit and Loss Account of Pune branch and find out the profit or loss made by it considering the reserve for unrealised profits:

Particulars	Pune Branch (₹)	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 Administration Expenses	13,250	7,000
Selling and Distribution Expenses	15,000	10,000

Information:

(i) Opening stock at Pune Branch includes goods of ₹ 10,000 (invoice price) taken from Goa Branch.

(ii) Opening stock at Goa Branch includes goods of invoice price ₹ 17,000 taken from Pune Branch.

(iii) The Pune Branch sales includes transfer of goods to Goa Branch at selling price ₹ 20,000

(iv) The sales of Goa Branch include transfer of goods to Pune Branch at selling price ₹ 15,000.

(v) Closing stock at Pune Branch includes goods received from Goa Branch (invoice price ₹ 5,000.)

(vi) Closing stock at Goa Branch includes goods of ₹ 4,000 (invoice price).

[MTP March 22 (6 Marks)]

ANSWER:

Pune Branch Trading and Profit and Loss Account

Particulars	₹	Particulars	₹
To Opening Stock (including ₹ 10,000 from Goa Branch)	40,000	By Sales (including ₹ 20,000 to Goa Branch)	2,80,000
To Purchases	2,00,000	By Closing Stock (Including ₹ 5,000 from Goa branch)	30,000
To Chargeable Expenses	15,000		
To Gross Profit c/d (before making adjustment for unrealised profit)	55,000		
	3,10,000		3,10,000
To Stock Reserve (For unrealised profit in Closing Stock lying at Goa Branch) (₹ 4,000 x 25/100)	1,000	By Gross Profit b/d	55,000
To Office & Adm. Expenses	13,250	By Stock Reserve (for unrealised profit in Opening Stock lying at Goa Branch) (₹ 17,000 x 25/100)	4,250
To Selling & Distribution Expenses	15,000		
To Net Profit	30,000		
	59,250		59,250

Q.7: **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 H.O.	Salem B.O.
	Amount (₹)	Amount (₹)
Purchases:		
Refined Oil	27,50,000	
Ghee	48,28,000	
Direct Expenses	6,35,800	
Expenses paid by H.O.		76,800
Sales:		
Refined Oil	24,10,000	5,95,000

Ghee	38,40,500	14,50,000
Collection during the year		20,15,000
Remittance by Branch to Head Office		19,50,000

Chennai H.O.		
Balance as on	01-04-2020 Amount (₹)	31-03-2021 Amount (₹)
Stock:		
Refined Oil	44,000	8,90,000
Ghee	10,65,000	15,70,000
Building	5,10,800	7,14,780
Furniture & Fixtures	88,600	79,740

Salem Branch Office		
Balance as on	01.04.2020 Amount (₹)	31.03.2021 Amount (₹)
Stock:		
Refined Oil	22,500	19,500
Ghee	40,000	90,000
Sundry Debtors	1,80,000	?
Cash in hand	25,690	?
Furniture & Fixtures	23,800	21,420

Additional information:

(i) Addition to Building on 01-04-2020 ₹ 2,41,600 by H.O.

(ii) Rate of depreciation: Furniture & Fixtures @ 10% and Building @ 5% (already adjusted in the above figure)

(iii) The Branch Manager is entitled to 10% commission on Branch profits (after charging his commission).

(iv) The General Manager is entitled to a salary of ₹ 20,000 per month.

(v) General expenses incurred by Head Office is ₹ 1,86,000.

You are requested to prepare Branch Account in the Head Office books and also prepare Chena Swami's Trading and Profit & loss Account (excluding branch transactions) for the year ended 31st March, 2021.

[RTP May -2022]

ANSWER:

In the books of Mr. Chena Swami

Salem Branch Account

	₹		₹
To Balance b/d		By Bank (Remittance to H.O.)	19,50,000
Opening stock:			
Ghee	40,000	By Balance c/d	

	Refined Oil	22,500	Closing stock:	
	Debtors	1,80,000	Refined oil	19,500
	Cash on hand	25,690	Ghee	90,000
	Furniture & Fittings	23,800	Debtors (W.N.1)	2,10,000
To	Goods sent to Branch A/c		Cash on hand (W.N.2)	44,800
	Refined Oil	5,40,000	Furniture & fittings	21,420
	(30 x ₹ 1,500 x 12)			
	Ghee	12,00,000		
	(20 x ₹ 5,000 x 12)			
To	Bank (Expenses paid by H.O.)	76,800		
To	Manager's commission in profits 10% (2,26,930 x 10/110)	20,630		
To	Net Profit transferred to General P & L A/c	2,06,300		
		23,35,720		23,35,720

Mr. Chena Swami

Trading and Profit and Loss account for the year ended 31st March, 2021

(Excluding branch transactions)

			₹			₹
To	Opening Stock:			By	Sales:	
	Refined Oil		44,000		Refined Oil	24,10,000
	Ghee		10,65,000		Ghee	38,40,500
To	Purchase:			By	Closing Stock:	
	Refined Oil	27,50,000			Refined Oil	8,90,000
	Less: Goods sent to Branch	(5,40,000)	22,10,000		Ghee	15,70,000
	Ghee	48,28,000				
	Less: Goods sent to Branch	(12,00,000)	36,28,000			
To	Direct Expenses		6,35,800			
To	Gross Profit		11,27,700			
			87,10,500			87,10,500
To	Manager's Salary		2,40,000	By	Gross Profit	11,27,700
To	General Expenses		1,86,000	By	Branch Profit transferred	2,06,300
To	Depreciation					
	Furniture (88,600 – 79,740)		8,860			
	Building (5,10,800 + 2,41,600 – 7,14,780)		37, 620			
To	Net profit		8,61,520			

	13,34,000		13,34,000

Working Notes:

(1) Debtors Account

	₹		₹
To Balance b/d	1,80,000	By Cash collections	20,15,000
To Sales made during the year:		By Balance c/d	2,10,000
Refined oil	5,95,000	(Bal. Figure)	
Ghee	14,50,000		
	22,25,000		22,25,000

(2) Branch Cash Account

	₹		₹
To Balance b/d	25,690	By Remittance	19,50,000
To Collections	20,15,000	By Exp.	45,890
		By Balance c/d (Bal. Figure)	44,800
	20,40,690		20,40,690

Q.8: Ganesh Ltd. has head office at Delhi (India) branch at New York. New York branch is an integral foreign operation of Ganesh Ltd. New York branch furnishes you with its trial balance as on 31st March, 2020 and the additional information given thereafter:

	Dr. ($)	Cr. ($)
Stock on 1st April, 2019	300	--
Purchases and sales	800	1,500
Sundry Debtors and creditors	400	300
Bills of exchange	120	240
Sundry expenses	1,080	--
Bank Balance	420	--
Delhi office A/c	--	1,080
	3,120	3,120

The rates of exchange may be taken as follows:

- **On 1.4.2019 @ ₹ 40 per US $**
- **On 31.3.2020 @ ₹ 42 per US $**
- **Average exchange rate for the year @ ₹ 41 per US $.**

New York branch account showed a debit balance of ₹ 44,380 on 31.3.2020 in Delhi books and there were no items pending reconciliation.

You are asked to prepare trial balance of New York in ₹ in the books of Ganesh Ltd.

[MTP March 22 (4 Marks)]

ANSWER:

In the books of Ganesh Ltd.

New York Branch Trial Balance in (₹) as on 31st March, 2020

	Conversion rate per US $	Dr.	Cr.
	(₹)	(₹)	(₹)
Stock on 1.4.19	40	12,000	
Purchases and sales	41	32,800	61,500
Sundry debtors and creditors	42	16,800	12,600
Bills of exchange	42	5,040	10,080
Sundry expenses	41	44,280	
Bank balance	42	17,640	
Delhi office A/c	--		44,380
		1,28,560	1,28,560

Q.9: Manohar of Mohali has a branch at Noida to which the goods are supplied from Mohali but the cost thereof is not recorded in the Head Office books. On 31st March, 2020 the Brach Balance Sheet was as follows:

Liabilities	₹	Assets	₹
Creditors Balance	62,000	Debtors Balance	2,24,000
Head Office	1,88,000	Building Extension A/c	
		Closed by transfer to H.O. A/c	-
		Cash at Bank	26,000
	2,50,000		2,00,000

During the six months ending on 30-09-2020, the following transactions took place at Noida:

	₹		₹
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.	52,000	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. [July 21 (10 Marks)]

ANSWER:

Journal Entries in the Books of Noida Branch

Particulars		Debit (₹)	Credit (₹)
Salary Advance A/c	Dr.	5,000	
To Salaries A/c			5,000

(Being the amount paid as advance adjusted by debit to Salary Advance A/c)			
Prepared Insurance A/c (11,200 x 6/12)	Dr.	5,600	
To Fire Insurance A/c			5,600
(Being the six months premium transferred to the Prepaid Insurance A/c)			
Head Office A/c	Dr.	1,44,900	
To Purchases A/c			64,500
To Wages A/c			24,000
To Salaries A/c (15,600 – 5000)			10,600
To General Expenses A/c			7,800
To Fire Insurance A/c (11,200 x 6/12)			5,600
To Manager's Salary A/c			16,400
To Discount Allowed A/c			16,000
(Being the transfer of various revenue accounts to the HO A/c for closing the accounts)			
Sales A/c	Dr.	2,78,000	
Discount Earned A/c	Dr.	4,600	
To Head Office A/c			2,82,600
(Being the transfer of various revenue accounts to HO)			
Head Office A/c	Dr.	14,000	
To Building A/c			14,000
(Being the transfer of amounts spent on building extension to HO A/c)			

Head Office Account

2020	Particulars	Amount (₹)	2020	Particulars	Amount (₹)
Sept 30	To Cash Remittance	52,900	April 1	By Balance b/d	1,88,000
	To Sundries* (Revenue)	1,44,900		By Sundries* (Revenue)	2,82,600
	To Building A/c	14,000			
	To Building c/d	2,58,800			
	Total	4,70,600		Total	4,70,600

*Instead of using Sundries (Revenue) A/c, the concerned revenue accounts can be posted in the ledger.

Balance Sheet of Noida Branch

As at 30th Sept 2020

Liabilities	Amt (₹)	Assets	Amt (₹)
Creditors	33,400	Debtors	2,29,000
Head Office A/c	2,58,800	Salary Advance	5,000
		Prepaid Insurance	5,600
		Building Extension A/c Transferred to HO	
		Cash in Hand	5,600
		Cash at Bank	47,000

Total	2,92,200	Total	2,92,200

Working Notes

Cash and Bank Account

Particulars	Amt (₹)	Particulars	Amt (₹)
To Balance b/d	26,000	By Wages	24,000
To Collection from debtors	2,57,000	By Salaries	15,600
		By Insurance	11,200
		By General Expenses	7,800
		By HO A/c	52,900
		By Manager's Salary	16,400
		By Creditors	88,500
		By Building A/c	14,000
		By Balance c/d	
		– Cash in Hand	5,600
		– Cash at bank	47,000
Total	2,83,000	Total	2,83,000

Debtors Account

Particulars	Amt (₹)	Particulars	Amt (₹)
To Balance b/d	2,24,000	By Cash Collection	2,57,000
To Sales A/c	2,78,000	By Discount (Allowed)	16,000
		By Balance c/d	2,29,000
Total	5,02,000	Total	5,02,000

Creditors Account

Particulars	Amt (₹)	Particulars	Amt (₹)
To Cash A/c	88,500	By Balance b/d	62,000
To Discount (Earned)	4,600	By Purchases	64,500
To Balance c/d	33,400		
Total	1,26,500	Total	1,26,500

Note:

Since the date of payment of fire insurance has not been mentioned in the question, it is assumed that it was paid on 01 April 2020. Alternative answer considering otherwise also possible.

COMPANY FINAL ACCOUNT

Q.1: Om Ltd. has authorized capital of ₹ 50 lakhs divided into 5,00,000 equity shares of ₹ 10 each. Their books show the following ledger balances as on 31st March, 2021:

	₹		₹
Inventory 1.4.2020	6,65,000	Bank Current Account (Dr. balance)	20,000
Discounts & Rebates allowed	30,000	Cash in hand	11,000
Carriage Inward	57,500		
Purchases	12,32,500	Calls in Arrear @ ₹ 2 per share	10,000
Rate, Taxes and Insurance	55,000	Equity share capital	20,00,000
Furniture & Fixtures	1,50,000	(2,00,000 shares of ₹ 10 each)	
Business Expenses	56,000	Trade Payables	2,40,500
Wages	14,79,000	Sales	36,17,000
Freehold Land	7,30,000	Rent (Cr.)	30,000
Plant & Machinery	7,50,000	Transfer fees received	6,500
Engineering Tools	1,50,000	Profit & Loss A/c (Cr.)	67,000
Trade Receivables	4,00,500	Repairs to Building	56,500
Advertisement Expenses	15,000	Bad debts	25,500
Commission & Brokerage Expenses	67,500		

The inventory (valued at cost or market value, which is lower) as on 31st March, 2021 was ₹ 7,05,000. Outstanding liabilities for wages ₹ 25,000 and business expenses ₹ 36,500. It was decided to transfer ₹ 10,000 to reserves.

Charge depreciation on written down values of Plant & Machinery @ 5%, Engineering Tools @ 20% and Furniture & Fixtures @10%. Provide ₹ 25,000 as doubtful debts for trade receivables. Provide for income tax @ 30%. It was decided to transfer ₹ 10,000 to reserves.

You are required to prepare Statement of Profit & Loss for the year ended 31st March, 2021 and Balance Sheet as at that date. [RTP May 2021]

ANSWER:

Balance Sheet of Om Ltd. as at 31st March, 2021

		Particulars	Note No.	(₹)
I	EQUITY AND LIABILITIES			
	(1)	**Shareholders' Funds**		
		(a) Share Capital	1	19,90,000
		(b) Reserves and Surplus	2	3,82,000
	(2)	**Current Liabilities**		
		(a) Trade Payables		2,40,500
		(b) Other Current Liabilities	3	61,500
		(c) Short-Term Provisions	4	1,35,000
		Total		28,09,000

II	**ASSETS**		
	(1) Non-Current Assets		
	(a) Property, Plant and Equipment	5	16,97,500
	(2) Current Assets		
	(a) Inventories		7,05,000
	(b) Trade Receivables	6	3,75,500
	(c) Cash and Cash Equivalents	7	31,000
	Total		28,09,000

Statement of Profit and Loss of Om Ltd.

for the year ended 31st March, 2021

	Particulars	Note No.	(₹)
I	Revenue from Operations		36,17,000
II	Other Income	8	36,500
III	**Total Revenue [I + II]**		**36,53,500**
IV	Expenses:		
	Cost of purchases		12,32,500
	Changes in Inventories [6,65,000-7,05,000]		(40,000)
	Employee Benefits Expenses	9	15,04,000
	Depreciation and Amortization Expenses		82,500
	Other Expenses	10	4,24,500
	Total Expenses		**32,03,500**
V	**Profit before Tax (III-IV)**		4,50,000
VI	**Tax Expenses @ 30%**		(1,35,000)
VII	**Profit for the period**		3,15,000

Notes to Accounts:

1. Share Capital

Authorized Capital	
5,00,000 Equity Shares of ₹ 10 each	50,00,000
Issued Capital	
2,00,000 Equity Shares of ₹ 10 each	20,00,000
Subscribed Capital and fully paid	
1,95,000 Equity Shares of ₹10 each	19,50,000
Subscribed Capital but not fully paid	
5,000 Equity Shares of ₹10 each ₹ 8 paid	40,000
(Call unpaid ₹10,000)	19,90,000

2. Reserves and Surplus

General Reserve		10,000
Surplus i.e. Balance in Statement of Profit & Loss:		

Opening Balance	67,000	
Add: Profit for the period	3,15,000	
Less: Transfer to Reserve	(10,000)	3,72,000
		3,82,000

3. Other Current Liabilities

Outstanding Expenses [25,000 + 36,500]	61,500

4. Short-term Provisions

Provision for Tax	1,35,000

5. Property, Plant and Equipment

Particulars	Value given (₹)	Depreciation rate	Depreciation Charged (₹)	Written down value at the end (₹)
Land	7,30,000		-	7,30,000
Plant & Machinery	7,50,000	5%	37,500	7,12,500
Furniture & Fixtures	1,50,000	10%	15,000	1,35,000
Engineering Tools	1,50,000	20%	30,000	1,20,000
	17,80,000		82,500	16,97,500

6. Trade Receivables

Trade receivables	4,00,500
Less: Provisions for doubtful debts	(25,000)
	3,75,500

7. Cash & Cash Equivalent

Cash Balance	11,000
Bank Balance in current A/c	20,000
	31,000

8. Other Income

Miscellaneous Income (Transfer fees)	6,500
Rental Income	30,000
	36,500

9. Employee benefits expenses

Wages	14,79,000
Add: Outstanding wages	25,000
	15,04,000

10. Other Expenses

Carriage Inwards	57,500
Discount & Rebates	30,000
Advertisement	15,000

	Rate, Taxes and Insurance	55,000
	Repairs to Buildings	56,500
	Commission & Brokerage	67,500
	Miscellaneous Expenses [56,000+36,500] (Business Expenses)	92,500
	Bad Debts	25,500
	Provision for Doubtful Debts	25,000
		4,24,500

Q.2:

(a) **XYZ Ltd. is having inadequacy of profits in the year ending 31-03-2021 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%.

(b) **Mohit Ltd. provides the following information as on 31st March, 2021:**

Liabilities	₹
Authorized capital:	
1,00,000, 14% preference shares of ₹100	1,00,00,000
10,00,000 Equity shares of ₹100 each	10,00,00,000
	11,00,00,000
Issued and subscribed capital:	
77,500, 14% preference shares of ₹ 100 each fully paid	77,50,000
5,40,000 Equity shares of ₹ 100 each, ₹ 80 paid-up	4,32,00,000
Share suspense account	90,00,000
Reserves and surplus	
Capital reserves (₹ 5,00,000 is revaluation reserve)	8,77,500
Securities premium Secured loans:	2,25,000
15% Debentures	2,92,50,000
Unsecured loans:	
Public deposits	16,65,000
Cash credit loan from SBI (short term)	5,92,500
Current Liabilities:	
Trade Payables	15,52,500
Assets:	
Investment in shares, debentures, etc.	3,50,50,000
Profit and Loss account (Dr. balance)	68,50,000

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

[RTP May 2021]

ANSWER:

(a) Amount that can be drawn from reserves for (10% dividend on ₹ 50,00,000 i.e. ₹ 5,00,000)

Profits available

Current year profit ₹ 1,42,500

Amount which can be utilized from reserves (₹ 5,00,000 – 1,42,500) ₹ 3,57,500

Conditions as per Companies (Declaration of dividend out of Reserves) Rules, 20X1:

Condition I

Since 10% is lower than the average rate of dividend (12%), 10% dividend can be declared.

Condition II

Maximum amount that can be drawn from the accumulated profits and reserves should not exceed 10% of paid up capital plus free reserves ie. ₹ 7,50,000 [10% of (50,00,000 + 25,00,000)]

Condition III

The balance of reserves after drawl ₹ 21,42,500 (₹ 25,00,000 - ₹ 3,57,500) should not fall below 15 % of its paid up capital i.e. ₹ 7,50,000 (15% of ₹ 50,00,000]

Since all the three conditions are satisfied, the company can withdraw ₹ 3,57,500 from accumulated reserve (as per Declaration and Payment of Dividend Rules, 2014).

(b) Computation of effective capital:

	Where Mohit Ltd. is a non-investment company	**Where Mohit Ltd. is an investment company**
Paid-up share capital —		
77,500, 14% Preference shares	77,50,000	77,50,000
5,40,000 Equity shares	4,32,00,000	4,32,00,000
Capital reserves	3,77,500	3,77,500
Securities premium	2,25,000	2,25,000
15% Debentures	2,92,50,000	2,92,50,000
Public Deposits	16,65,000	16,65,000
(A)	8,24,67,500	8,24,67,500
Investments	3,50,50,000	-
Profit and Loss account (Dr. balance)	68,50,000	68,50,000
(B)	4,19,00,000	68,50,000
Effective capital (A–B)	4,05,67,500	7,56,17,500

Q.3:

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

(b) **Aman started a business on 1st April 2020 with ₹ 24,00,000 represented by 1,20,000 units of ₹ 20 each. During the financial year ending on 31st March, 2021, 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 2020-21 if Financial Capital is maintained at historical cost.** [RTP May 2021]

ANSWER:

(a) (i) **Qualitative Characteristics of Financial Statements:**

Understandability, Relevance, Comparability, Reliability & Faithful Representation

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

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

(b)

Particulars	Financial Capital Maintenance at Historical Cost (₹)
Closing equity (₹ 30 x 1,20,000 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)

Q.4: **The following is the Draft Profit & Loss A/c of Brown Ltd. the year ended 31st March, 2020:**

	Amount (₹)		Amount (₹)
To Administrative expenses	4,99,200	By Balance b/d	6,27,550
To Advertisement	1,18,200	By Balance from Trading A/c	38,15,890
To Commission on sales	95,225	By Subsidies received from Govt.	
To Director's Fees	1,35,940	By Profit on sale of forfeited shares	2,50,000
To Interest on debentures	28,460		
To Managerial remuneration	2,75,550		20,000
To Depreciation on fixed assets	4,82,565		
To Provision for Taxation	11,50,200		
To General Reserve	4,50,000		
To Investment Revaluation Reserve			
To Balance c/d	52,800		
	14,25,300		
	47,13,440		47,13,440

Depreciation on fixed assets as per Schedule II of the Companies Act, 2013 was ₹ 5,15,675. You are required to calculate the maximum limit of managerial remuneration as per Companies Act, 2013. [Jan 21 (4 Marks)]

ANSWER:

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

	₹	₹
Balance from Trading A/c		38,15,890
Add: Subsidies received from Government		2,50,000
		40,65,890

Less: Administrative, selling and distribution expenses (4,99,200 + 1,18,200 + 95,225)	7,12,625	
Director's fees	1,35,940	
Interest on debentures	28,460	
Depreciation on fixed assets as per Schedule II	5,15,675	(13,92,700)
Profit u/s 198		26,73,190

Maximum Managerial remuneration under Companies Act, 2013 = 11% of ₹ 26,73,190 = ₹ 2,94,051 (rounded off).

Note:

1. Investment Revaluation reserve not to be deducted for calculation of profit under section 198;
2. Profit on sale of forfeited shares not to added for calculation of profit under section 198.

*Alternative presentation of the above answer also possible by starting from Net profit as per Profit and Loss Account.

Q.5: List the Criteria for classification of non-corporate entities as level I Entities for the purpose of application of Accounting Standards as per the Institute of Chartered Accountants of India. **[Jan 21 (4 Marks)]**

ANSWER:

Criteria for classification of non-corporate entities as level 1 entities for purpose of application of Accounting Standards decided by the Institute of Chartered Accountants of India is given below:

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

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

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

(iii) All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees fifty crore in the immediately preceding accounting year.

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

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

Q.6: From the following particulars furnished by Alpha Ltd., prepare the Balance Sheet as on 31st March, 2020 as required by Part I, Schedule III of the Companies Act, 2013.

Particulars		Debit Rs.	Credit Rs.
Equity Share Capital (Face value of Rs. 100 each)			**50,00,000**
Call in Arrears		**5,000**	
Building		**27,50,000**	
Plant & Machinery		**26,25,000**	
Furniture		**2,50,000**	
General Reserve			**10,50,000**
Loan from State Financial Corporation			**7,50,000**
Inventory:			
Raw Materials	**2,50,000**		
Finished Goods	**10,00,000**	**12,50,000**	

Provision for Taxation			6,40,000
Trade receivables		10,00,000	
Short term Advances		2,13,500	
Profit & Loss Account			4,33,500
Cash in Hand		1,50,000	
Cash at Bank		12,35,000	
Unsecured Loan			6,05,000
Trade payables (for Goods and Expenses)			8,00,000
Loans & advances from related parties			2,00,000

The following additional information is also provided:

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

(ii) Trade receivables of Rs. 2,60,000 are due for more than 6 months.

(iii) The cost of the Assets were:

Building Rs. 30,00,000, Plant & Machinery Rs. 35,00,000 and Furniture Rs. 3,12,500

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

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

(vi) Transfer Rs. 20,000 to general reserve as proposed by Board of directors.

[MTP March 21 (15 Marks)]

ANSWER:

Alpha Ltd.

Balance sheet as at 31st March, 2020

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	49,95,000
	b	Reserves and Surplus	2	14,83,500
2		**Non-current liabilities**		
		Long-term borrowings	3	13,17,500
3		**Current liabilities**		
	a	Trade Payables		8,00,000
	b	Other current liabilities	4	37,500
	c	Short-term provisions	5	6,40,000
	d	Short-term borrowings		2,00,000
		Total		**94,73,500**
		Assets		
1		**Non-current assets**		
		Property, Plant & equipment	6	56,25,000

2	**Current assets**		
a	Inventories	7	12,50,000
b	Trade receivables	8	10,00,000
c	Cash and bank balances	9	13,85,000
d	Short-term loans and advances		2,13,500
	Total		**94,73,500**

Notes to Accounts

			Rs.
1.	**Share Capital**		
	Equity share capital		
	Issued & subscribed & called up		
	50,000 Equity Shares of Rs. 100 each		
	(of the above 10,000 shares have been issued for consideration other than cash)	50,00,000	
	Less: Calls in arrears	(5,000)	49,95,000
	Total		49,95,000
2.	**Reserves and Surplus**		
	General Reserve	10,50,000	
	Add: current year transfer	20,000	10,70,000
	Profit & Loss balance		
	Profit for the year	4,33,500	
	Less: Appropriations:		
	Transfer to General reserve	(20,000)	
			4,13,500
			14,83,500
3.	**Long-term borrowing**		
	Secured Term Loan		
	State Financial Corporation Loan (7,50,000-37,500)		
	(Secured by hypothecation of Plant and Machinery)		7,12,500
	Unsecured Loan		6,05,000
	Total		13,17,500
4.	**Other current liabilities**		
	Interest accrued but not due on loans (SFC)		37,500
5.	**Short-term provisions**		
	Provision for taxation		6,40,000
6.	**Property, plant and Equipment**		
	Land and Building	30,00,000	
		(2,50,000)	27,50,000

	Less: Depreciation	(b.f.)	
	Plant & Machinery	35,00,000	
		(8,75,000)	26,25,000
	Less: Depreciation	(b.f.)	
	Furniture & Fittings	3,12,500	
	Less: Depreciation	(62,500) (b.f.)	2,50,000
	Total		56,25,000
7.	**Inventories**		
	Raw Materials		2,50,000
	Finished goods		10,00,000
	Total		12,50,000
8.	**Trade receivables**		
	Outstanding for a period exceeding six months		2,60,000
	Other Amounts		7,40,000
	Total		10,00,000
9.	**Cash and bank balances**		
	Cash and cash equivalents		
	Cash at bank		
	With Scheduled Bank	12,25,000	
	With other (Omega Bank Ltd.)	10,000	12,35,000
	Cash in hand		1,50,000
	Other bank balances		Nil
	Total		13,85,000

Q.7: **The following extract of Balance Sheet (Extract) as on 31st March, 2020**

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

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

OR

Following items appear in the Trial Balance of Hello Ltd. as on 31st March, 2020:

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

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 3 shares held. Company decided that there should be the minimum reduction in free reserves. You are required to given the necessary journal Entries in the books Hello Ltd. **[MTP March 21 (4 Marks)]**

ANSWER:

Computation of effective capital:

		Rs.
Paid-up share capital-		
20,000, 14% Preference shares		20,00,000
1,20,000 Equity shares		96,00,000
Capital reserves (excluding revaluation reserve)		45,000
Securities premium		50,000
15% Debentures		65,00,000
Public Deposits		3,70,000
	(A)	1,85,65,000
Investments		75,00,000
Profit and Loss account (Dr. balance)		15,00,000
	(B)	90,00,000
Effective capital	(A–B)	95,65,000

OR

Particulars		Dr.	Cr.
Capital Redemption Reserve A/c	Dr.	1,40,000	
Securities Premium A/c (considered to be realized in cash)	Dr.	80,000	
General Reserve A/c (balancing figure)	Dr.	80,000	
To Bonus to Shareholders			3,00,000
(Being issue of bonus shares by utilization of various Reserves, as per resolution dated ....)			
Bonus to Shareholders A/c	Dr.	3,00,000	
To Equity Share Capital			3,00,000
(Being capitalization of profit)			

Q.8: You are required to prepare a Balance Sheet as at 31st March 2020, as per Schedule III of the Companies Act, 2013, from the following information of Mehar Ltd.:

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)

Term Loans (Secured)	40,00,000	Investments (Non-current)	9,00,000
Trade payables	45,80,000	Profit for the year	32,00,000
Cash and Bank Balances	38,40,000	Trade receivables	49,00,000
Staff Advances	2,20,000	Miscellaneous Expenses	2,32,000
Other advances (given by Co.)	14,88,000	Loan from other parties	8,00,000
Provision for Taxation	10,20,000	Provision for Doubtful Debts	80,000
Securities Premium	19,00,000	Stores	16,00,000
Loose Tools	2,00,000	Finished Goods	30,00,000
General Reserve	62,00,000	Plant and Machinery (WDV)	2,14,00,000

Additional Information: -

1. **Share Capital consists of-**

   (a) **1,20,000 Equity Shares of Rs. 100 each fully paid up.**

   (b) **40,000, 10% Redeemable Preference Shares of Rs. 100 each fully paid up.**

2. **Write off the amount of Miscellaneous Expenses in full, amounting Rs. 2,32,000.**

[MTP April 21 (14 Marks)]

ANSWER:

Balance Sheet of Mehar Ltd. as at 31st March, 2020

		Note	Rs.
I	**EQUITY AND LIABILITIES:**		
(1)	(a) Share Capital	1	1,60,00,000
	(b) Reserves and Surplus	2	110,68,000
(2)	**Non-current Liabilities**		
	Long term Borrowings- Terms Loans (Secured)		40,00,000
(3)	**Current Liabilities**		
	(a) Trade Payables		45,80,000
	(b) Other current liabilities	3	8,00,000
	(c) Short-term Provisions (Provision for taxation)		10,20,000
	Total		**3,74,68,000**
II	**ASSETS**		
(1)	**Non-current Assets**		
	(a) Property, Plant and Equipment	4	214,00,000
	(b) Non- current Investments		9,00,000
(2)	**Current Assets:**		
	(a) Inventories	5	48,00,000
	(b) Trade Receivables	6	48,20,000
	(c) Cash and Cash Equivalents		38,40,000
	(d) Short-term Loans and Advances	7	17,08,000

	Total		3,74,68,000

Notes to accounts

				(Rs.)
1.	**Share Capital**			
	Authorized, issued, subscribed & called up			
	1,20,000, Equity Shares of Rs. 100 each		1,20,00,000	
	40,000 10% Redeemable Preference Shares of 100 each		40,00,000	1,60,00,000
2.	**Reserves and Surplus**			
	Securities Premium Account		19,00,000	
	General reserve		62,00,000	
	Profit & Loss Balance			
	Opening balance	-		
	Profit for the period	32,00,000		
	Less: Miscellaneous Expenditure written off	(2,32,000)	29,68,000	110,68,000
3.	**Other current liabilities**			
	Loan from other parties			8,00,000
4.	**Property, plant and equipment**			
	Plant and Machinery (WDV)			214,00,000
5.	**Inventories**			
	Finished Goods		30,00,000	
	Stores		16,00,000	
	Loose Tools		2,00,000	48,00,000
6.	**Trade Receivables**			
	Trade receivables		49,00,000	
	Less: Provision for Doubtful Debts		(80,000)	48,20,000
7.	**Short term loans & Advances**			
	Staff Advances*		2,20,000	
	Other Advances*		14,88,000	17,08,000

*Considered to be short term.

Q.1: The following figures have been extracted from the books of Manan Jo Limited for the year ended on 31.3.2020. You are required to prepare the Cash Flow statement as per AS 3 using indirect method.

(i) Net profit before taking into account income tax and income from law suits but after taking 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 02-04-2019 at a premium of 5%.

(v) Further the company issued 75,000 equity shares of ₹10 each at a premium of 20% on 30.3.2020 (Out of 75,000 equity shares, 25,000 equity shares were issued to a supplier of machinery)

(vi) Dividend for FY 2018-19 on preference shares were paid at the time of redemption.

(vii) Dividend on Equity shares paid on 31.01.2020 for the year 2018-2019 ₹ 7.50 lakhs (including dividend distribution tax) and interim dividend paid ₹ 2.50 lakhs for the year 2019-2020.

(viii) Land was purchased on 02.4.2019 for ₹3,00,000 for which the company issued 22,000 equity shares of ₹ 10 each at a premium of 20% to the land owner and balance in cash as consideration.

(ix) Current assets and current liabilities in the beginning and at the end of the years were as detailed below :

	As on 01.04.2019	As on 31.3.2020
	₹	₹
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

[Nov 2020 (10 Marks)]

ANSWER:

Manan Ltd.

Cash Flow Statement

For the year ended 31st March, 2020

	₹	₹
Cash flow from Operating activities		
Net profit before income tax and extraordinary items:		30,00,000
Adjustments for:		

Depreciation on Property, plant and equipment	7,50,000	
Discount on issue of debentures	45,000	
Interest on debentures paid	5,25,000	
Interest on investments received	(90,000)	
Profit on sale of investments	(30,000)	12,00,000
Operating profit before working capital changes		42,00,000
Adjustment for:		
increase in inventory	(1,77,000)	
Decrease in trade receivable	7,350	
Increase in trade payables	450	
Increase in outstanding expenses	10,200	(1,59,000)
Cash generated from operations		40,41,000
Income tax paid		(15,75,000)
Cash flow from ordinary items		24,66,000
Cash flow from extraordinary items:		
Compensation received in a suit filed		1,35,000
Net cash flow from operating activities		26,01,000
Cash flow from Investing Activities;		
Sale proceeds of investments	4,80,000	
Interest received on investments	90,000	
Purchase of land (3,00,000 less 2,64,000)	(36,000)	
Net cash flow from investing activities		5,34,000
Cash flow from Financing Activities		
Proceeds of issue of equity shares of 20% premium	6,00,000	
Redemption of preference shares at 5% premium	(23,62,500)	
Preference dividend paid	(2,25,000)	
Interest on debentures paid	(5,25,000)	
Dividend paid (7,50,000 + 2,50,000)	(10,00,000)	
Net cash used in financing activities		(35,12,500)
Net decrease in cash and cash equivalents during the year		(3,77,500)
Add: Cash and cash equivalents as on 31.3.2019		3,94,450
Cash and cash equivalents as on 31.3.2020		16,950

Q.2: Prepare cash flow from investing activities as per AS-3 of M/s Subham Creative Limited for year ended 31.3.2019.

Particulars	Amount (Rs.)
Machinery acquired by issue of shares at face value	**2,00,000**
Claim received for loss of machinery in earthquake	**55,000**

Unsecured loans given to associates	**5,00,000**
Interest on loan received 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 Rs. 8,200 was deducted on the above interest)	**73,800**
Book value of plant & machinery sold (loss incurred Rs. 9,600)	**90,000**

[MTP March 21 (4 Marks)]

ANSWER:

Cash Flow Statement from Investing Activities of Subham Creative Limited for year ended 31-03-2019

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

Note:

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

Q.3: The following are the extracts of Balance Sheet and Statement of Profit and Loss of Supriya Ltd.:

Extract of Balance Sheet

		Particulars	Notes	2021 (₹'000)	2020 (₹'000)
		Equity and Liabilities			
1		**Shareholder's funds**			
	(a)	**Share capital**	1	500	200
2		**Non- current liabilities**			
	(a)	**Long term loan from bank**		---	250
3		**Current liabilities**			
	(a)	**Trade Payables**		1,000	3,047
		Assets			
1		**Non-current assets**			

2	(a)	Property, Plant and Equipment		230	128
		Current assets			
	(a)	Trade receivables		2,000	4,783
	(b)	Cash & cash equivalents (Cash balance)		212	35

Extract of Statement of Profit and Loss

	Particulars	Notes	2021 (₹'000)	2020 (₹'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	2021 (₹'000)	2020 (₹'000)
1	Share Capital		
	Equity Shares of ₹10 each, fully paid up	500	200
2	Other expenses		
	Overheads	115	110

Q.4: Prepare Cash Flow Statement of Supriya Ltd. for the year ended 31st March, 2021 in accordance with AS-3 (Revised) using direct method. All transactions were done in cash only. There were no outstanding/prepaid expenses as on 31st March, 2020 and on 31st March, 2021. Ignore deprecation. Dividend amounting ₹ 80,000 was paid during the year ended 31st March, 2021. [RTP May 2021]

ANSWER:

Supriya Ltd.

Cash Flow Statement for the year ended 31st March, 2021 (Using direct method)

		(₹ '000)
Cash flows from operating activities		
Cash receipts from customers	2,783	
Cash payments to suppliers	(2,047)	
Cash paid to employees	(69)	
Other cash payments (for overheads)	(115)	
Cash generated from operations	552	
Income taxes paid	(243)	
Net cash from operating activities		309
Cash flows from investing activities		
Payment for purchase of Property, Plant and Equipment	(102)	
Net cash used in investing activities		(102)
Cash flows from financing activities		

Proceeds from issuance of share capital	300	
Bank loan repaid	(250)	
Dividend paid	(80)	
Net cash used in financing activities		(30)
Net increase in cash and cash equivalents		177
Cash and cash equivalents at beginning of period		35
Cash and cash equivalents at end of period		212

Q.5: Following information was extracted from the books of S Ltd. for the year ended 31st March, 2020 :

(1) Net profit before talking 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 a premium of 20% on 10th April,2019.

(4) 20,000,9% Preference Shares of ₹100 each were redeemed on 31st March, 2020 at a premium of 5%

(5) Dividend paid during the year amounted to ₹11 Lakhs (including dividend distribution tax)

(6) A new Plant costing ₹7 Lakhs was purchased in part exchange of an old plant on 1st January, 2020. 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, 2020.

(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 31.03.2020 was ₹ 14,76,000.

The inventory on 31.03.2019 was correctly valued at ₹ 13,50,000.

(8) Current Assets and Current Liabilities in the beginning and at the end of year 2019-2020 were as:

	As on 1st April,2019 (₹)	As on 31st March,2020 (₹)
Inventory	13,50,000	14,76,000
Trade Receivables	3,27,000	3,13,200
Cash & Bank Balances	2,40,700	3,70,500
Trade Payables	2,84,700	2,87,300
Outstanding Expenses	97,000	1,01,400

You are require to prepare a Cash Flow Statement for the year ended 31st March, 2020 as per AS 3 (revised) using the indirect method. [Jan 21 (12 Marks)]

ANSWER:

S Ltd.

Cash Flow Statement for the year ended 31st March, 2020

	₹	₹
Cash flows from operating activities		

Net profit before taxation*		30,00,000
Adjustments for:		
Depreciation on PPE	7,00,000	
Discount on debentures	45,000	
Profit on sale of investments	(25,000)	
Interest income on investments	(70,000)	
Interest on debentures	4,35,000	
Stock adjustment {14,76,000 less 16,40,000 (14,76,000/90 X 100)}	1,64,000	
Operating profit before working capital changes		12,49,000
Changes in working capital (Excluding cash and bank balance):		42,49,000
Less: Increase in inventory {16,40,000 (14,76,000/90 X 100) less 13,50,000}	(2,90,000)	
Add: Decrease in Trade receivables	13,800	
Increase in trade payables	2,600	
Increase in o/s expenses	4,400	(2,69,200)
Cash generated from operations		39,79,800
Less: Income taxes paid		(12,80,000)
Net cash generated from operating activities		26,99,800
Cash flows from investing activities		
Sale of investments	3,75,000	
Interest received	70,000	
Payments for purchase of fixed assets (7,00,000 – 6,00,000)	(1,00,000)	
Net cash used in investing activities		3,45,000
Cash flows from financing activities		
Redemption of Preference shares	(21,00,000)	
Issue of shares	7,20,000	
Interest paid	(4,35,000)	
Dividend paid	(11,00,000)	
Net cash used in financing activities		(29,15,000)
Net increase in cash		1,29,800
Cash at beginning of the period		2,40,700
Cash at end of the period		3,70,500

*Net profit given in the question is after considering only the items listed as information point (1) of the question; hence amount of loss on plant not added back.

Q.6: Following is the cash flow abstract of Alpha Ltd. for the year ended 31st March, 2021:

Cash Flow (Abstract)

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

Prepare Cash Flow Statement for the year ended 31st March, 2021 in accordance with AS 3. **[MTP April 21 (5 Marks)]**

ANSWER:

Cash Flow Statement for the year ended 31.3.2021

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

Q.7: From the following information, prepare the Cash Flow from Financing activities as per AS 3 'Cash Flow Statements' as the accountant of XYZ Limited is not able to decide and seeks your advice:

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

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

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

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

(v) Proceeds of ₹ 5,00,000 from sale of patent.

(vi) Proceeds of ₹ 12,00,000 from long term borrowing.

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

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

(ix) Interest of ₹ 1,44,000 paid on long-term borrowing. **[MTP Oct 21 (5 Marks)]**

ANSWER:

Statement showing Cash Flow from Financing Activities

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

Q.8: **The following figures have been extracted from the books of Manan Limited for the year ended on 31.3.2020. You are required to prepare the Cash Flow statement as per AS 3 using indirect method.**

(i) Net profit before taking into account income tax and income from law suits but after taking 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 02-04-2019 at a premium of 5%.

(v) Further the company issued 75,000 equity shares of ₹ 10 each at a premium of 20% on 30.3.2020 (Out of 75,000 equity shares, 25,000 equity shares were issued to a supplier of machinery)

(vi) Dividend for FY 2018-19 on preference shares were paid at the time of redemption.

(vii) Dividend on Equity shares paid on 31.01.2020 for the year 2018-2019 ₹ 7.50 lakhs and interim dividend paid ₹ 2.50 lakhs for the year 2019-2020.

(viii) Land was purchased on 02.4.2019 for ₹ 3,00,000 for which the company issued 22,000 equity shares of ₹ 10 each at a premium of 20% to the land owner and balance in cash as consideration.

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

	As on 01.04.2019	As on 31.3.2020
	₹	₹
Inventory	18,00,000	19,77,000
Trade receivables	3,87,000	3,79,650
Cash in hand	3,94,450	16,950
Trade payables	3,16,500	3,16,950
Outstanding expenses	1,12,500	1,22,700

[MTP Nov 21 (10 Marks)]

ANSWER:

Manan Ltd.

Cash Flow Statement

For the year ended 31st March, 2020

	₹	₹
Cash flow from operating Activities		
Net profit before income tax and extraordinary items:		30,00,000
Adjustments for:		
Depreciation on Property, plant and equipment	7,50,000	
Discount on issue of debentures	45,000	
Interest on debentures paid	5,25,000	
Interest on investment received	(90,000)	
Profit on sale of investments	(30,000)	12,00,000
Operating profit before working capital changes		42,00,000
Adjustments for:		
Increase in inventory	(1,77,000)	
Decrease in trade receivable	7,350	
Increase in trade payables	450	
Increase in outstanding expenses	10,200	(1,59,000)
Cash generated from operations		40,41,000
Income tax paid		(15,75,000)
Cash flow from ordinary items		24,66,000
Cash flow from extraordinary items:		
Compensation receive in a suit filed		1,35,000
Net cash flow from operating activities		26,01,000
Cash flow from Investments	4,80,000	
Sale proceeds of investments	90,000	

Purchase of land (3,00,000 less 2,64,000)	(36,000)	
Net cash flow from investing activities		5,34,000
Cash flow from Financing Activities		
Proceeds of issue of equity shares at 20% premium	6,00,000	
Redemption of preference shares at 5% premium	(23,62,500)	
Preference dividend paid	(2,25,000)	
Interest on debentures paid	(5,25,000)	
Dividend paid (7,50,000 + 2,50,000)	(10,00,000)	
Net cash used in financing activities		(35,12,500)
Net decrease in cash and cash equivalent during the year		(3,77,500)
Add: Cash and cash equivalents as on 31.3.2019		3,94,450
Cash and cash equivalents as on 31.3.2020		16,950

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Q.1: A Ltd. and its subsidiary B Ltd. give the following information for the year ended 31st March, 2020:

(Rs. In Lakhs)

	A Ltd.	B Ltd.
Sales and other income	7,500	1,500
Increase in Inventory	1,500	300
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

The following information is also given:

(i) A Ltd sold goods of Rs. 180 Lakhs to B Ltd at cost plus 25% (1/6 of such goods were still in inventory of B Ltd at the end of the year).

(ii) A Ltd. holds 72% of the Equity Capital of B Ltd and the Equity Capital of B Ltd is Rs.1,500 Lakhs on 1.4.2019 (date of acquisition of shares).

(iii) Administrative expenses of B Ltd include Rs. 8 Lakhs paid to A Ltd as consultancy fees. Moreover, selling and distribution expenses of A Ltd include Rs.15 Lakhs paid to B Ltd as commission.

You are required to prepare a consolidated Statement of Profit and Loss Account of A Ltd. with its subsidiary B Ltd. for the year ended 31st March, 2020. [MTP March 21 (15 Marks)]

ANSWER:

Consolidated Profit & Loss Account of A Ltd. and its subsidiary B Ltd.

For the year ended on 31st March, 2020

Particulars		Note No.	Rs. in Lacs
I.	Revenue from operations	1	8,797
II.	Total revenue		8,797
III.	Expenses		
	Cost of Material purchased/consumed	3	1,770
	Changes of Inventories of finished goods	2	(1,794)
	Employee benefit expense	4	1,425
	Finance cost	6	225
	Depreciation and amortization expense	7	225
	Other expenses	5	802
	Total expenses		2,653
IV.	Profit before Tax(II-III)		6,144

Notes to Accounts

		Rs. In Lacs	Rs. In Lacs
1.	Revenue from operations		
	Sales and other income		
	A Ltd.	7,500	
	B Ltd.	1,500	
		9,000	
	Less: Inter-company Sales	(180)	
	Consultancy fees received by A Ltd. from B Ltd.	(8)	
	Commission received by B Ltd. from A Ltd.	(15)	8,797
2.	Increase in Inventory		
	A Ltd.	1,500	
	B Ltd.	300	
		1,800	
	Less: Unrealized profits Rs. 180 x 1/6 x 25/125	(6)	1,794
3.	Cost of Material purchased/ consumed		
	A Ltd.	1,200	
	B Ltd.	300	
		1,500	
	Less: Purchases by B Ltd. from A Ltd.	(180)	1,320
	Direct Expenses		
	A Ltd.	300	
	B Ltd.	150	450
			1,770
4.	Employee benefits and expenses		
	Wages and Salaries:		
	A Ltd.	1,200	
	B Ltd.	225	1,425
5.	Other Expenses		
	Administrative Expenses		
	A Ltd.	300	
	B Ltd.	150	
		450	
	Less: Consultancy fees received by A Ltd. from B Ltd.	(8)	442
	Selling and Distribution Expenses:		
	A Ltd.	300	
	B Ltd.	75	
		375	

	Less: Commission received from B Ltd. from A Ltd.	(15)	360
			802
6.	Finance Cost		
	Interest:		
	A Ltd.	150	
	B Ltd.	75	225
7.	Depreciation and Amortization		
	Depreciation:		
	A Ltd.	150	
	B Ltd.	75	225

Q.2: H Ltd. and its subsidiary S Ltd. Give the following information as on 31st March, 2021:

	H Ltd. (Rs.)	S Ltd. (Rs.)
Share Capital		
Equity Share Capital (fully paid up shares of Rs. 10 each)	12,00,000	2,00,000
Reserves and Surplus		
General Reserve	4,35,000	1,55,000
Cr. Balance in Profit and Loss Account	2,80,000	65,000
Current Liabilities		
Trade Payables	3,22,000	1,23,000
Non-Current Assets		
Property, Plant and Equipment		
Machinery	6,40,000	1,80,000
Furniture	3,75,000	34,000
Non-Current Investments		
Shares in S Ltd. – 16,000 shares @ Rs. 20 each	3,20,000	-
Current Assets		
Inventories	2,68,000	62,000
Trade Receivables	4,70,000	2,35,000
Cash and Bank	1,64,000	32,000

H Ltd. acquired the 80% shares of S Ltd. on 1st April, 2020. On the date of acquisition, General Reserve and Profit Loss Account of S Ltd. stood at Rs. 50,000 and Rs. 30,000 respectively.

Machinery (book value Rs. 2,00,000) and Furniture (book value Rs. 40,000) of S Ltd. were revalued at Rs. 3,00,000 and Rs. 30,000 respectively on 1st April,2020 for the purpose of fixing the price of its shares (rates of depreciation on W.D.V basis: Machinery 10% and Furniture 15%). Trade Payables of H Ltd. include Rs. 35,000 due to S Ltd. for goods supplied since the acquisition of the shares. These goods are charged at 10% above cost. The inventories of H Ltd. includes goods costing Rs. 55,000 (cost to H Ltd.) purchased from S Ltd.

You are required to prepare the Consolidated Balance Sheet of H Ltd. With its subsidiary as at 31st March, 2021. **[MTP April 21 (16 Marks)]**

ANSWER:

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd.

As at 31st March, 2021

Particulars	**Note No.**	**(Rs.)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		12,00,000
(1,20,000 equity shares of Rs. 10 each)		
(b) Reserves and Surplus	1	8,16,200
(2) Minority Interest (W.N.4)		99,300
(3) Current Liabilities		
(a) Trade Payables	2	4,10,000
Total		25,25,500
II. Assets		
(1) Non-current assets		
(i) Property, plant and equipment	3	13,10,500
(ii) Intangible assets	4	24,000
(2) Current assets		
(i) Inventories	5	3,25,000
(ii) Trade Receivables	6	6,70,000
(iii) Cash at Bank	7	1,96,000
Total		25,25,500

Notes to Accounts

				Rs.
1.	Reserves and Surplus			
	General Reserves		4,35,000	
	Add: 80% share of S Ltd.'s post-acquisition reserves (W.N.3)		84,000	5,19,000
	Profit and Loss Account		2,80,000	
	Add: 80% share of S Ltd.'s post-acquisition profits (W.N.3)	21,200		
	Less: Unrealised gain	(4,000)	17,200	2,97,200
				8,16,200
2.	Trade Payables			
	H Ltd.		3,22,000	
	S Ltd.		1,23,000	
	Less: Mutual transaction		(35,000)	4,10,000
3.	Property, plant and equipment			
	Machinery			
	H Ltd.		6,40,000	
	S Ltd.	2,00,000		

	Add: Appreciation	1,00,000		
		3,00,000		
	Less: Depreciation	(30,000)	2,70,000	9,10,000
	Furniture			
	H. Ltd.		3,75,000	
	S Ltd.	40,000		
	Less: Decrease in value	(10,000)		
		30,000		
	Less: Depreciation	(4,500)	25,500	4,00,500
				13,10,500
4.	Intangible assets			
	Goodwill [WN 5]			24,000
5.	Inventories			
	H Ltd.		2,68,000	
	S Ltd.		62,000	3,30,000
	Less: Inventory reserve			(5,000)
				3,25,000
6.	Trade Receivables			
	H Ltd.		4,70,000	
	S Ltd.		2,35,000	
				7,05,000
	Less: Mutual transaction			(35,000)
				6,70,000
7.	Cash and Bank			
	H Ltd.		1,64,000	
	S Ltd.		32,000	1,96,000

Working Notes:

1. **Profit or loss on revaluation of assets in the books of S Ltd. and their book values as on 1.4.2020**

	Rs.
Machinery	
Revaluation as on 1.4.2020	3,00,000
Less: Book value as on 1.4.2020	(2,00,000)
Profit on revaluation	1,00,000
Furniture	
Revaluation as on 1.4.2020	30,000
Less: Book value as on 1.4.2020	(40,000)
Loss on revaluation	(10,000)

2. **Calculation of short/excess depreciation**

	Machinery	Furniture
Upward/ (Downward) Revaluation	1,00,000	(10,000)
Rate of depreciation	10% p.a.	15% p.a.
Difference [(short)/excess]	(10,000)	1,500

3. Analysis of reserves and profits of S Ltd. as on 31.03.2021

	Pre-acquisition profit upto 1.4.2020	Post-acquisition profits (1.4.2020 – 31.3.2021)	
	(Capital profits)	General Reserve	Profit and loss account
General reserve as on 31.3.2021	50,000	1,05,000	
Profit and loss account as on 31.3.2021	30,000		35,000
Upward Revaluation of machinery as on 1.4.2020	1,00,000		
Downward Revaluation of Furniture as on 1.4.2020			
Short depreciation on machinery	(10,000)		
Excess depreciation on furniture			(10,000)
Total			
			1,500
	1,70,000	1,05,000	26,500

4. Minority Interest

	Rs.
Paid-up value of (2,00,000 x 20%)	40,000
Add: 20% share of pre-acquisition profits and reserves	
[(20% of (50,000 + 30,000)]	16,000
20% share of profit on revaluation	18,000
20% share of post-acquisition reserves	21,000
20% share of post-acquisition profit	5,300
	1,00,300
Less: Unrealised Profit on Inventory	
(55,000 x 10/110) x 20%	(1,000)
	99,300

5. Cost of Control or Goodwill

Cost of Investment		3,20,000
Less: Paid-up value of 80% shares	1,60,000	
80% share of pre-acquisition profits and reserves		
(Rs. 64,000 + Rs.72,000)	1,36,000	(2,96,000)
Cost of control or Goodwill		24,000

Q.3: The Trial Balance 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 up to 30.09.2020		7	14	
Inventory (as on 31.03.2021)	200		100	
Cash at Bank	27		12	
Investment in Y Limited	1,056		-	
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. [July 21 (15 Marks)]

ANSWER:

Consolidated Profit and Loss Account of X Ltd. and Y Ltd.

for the year ended 31st March, 2021

Particulars	Note No.	₹
I. Revenue from operations	1	35,80,000
II. Total revenue		35,80,000
III. Expenses		
Cost of Material purchased/Consumed	2	20,80,000
Changes of Inventories of finished goods		-
Employee benefit expense	3	5,00,000
Finance cost	4	48,000
Depreciation and amortization expense	5	4,57,000

	Other expenses	6	2,80,000
	Total expenses		33,65,000
IV.	Profit before Tax (II – III)		2,15,000
Profit transferred to Consolidated Balance Sheet			
Profit After Tax			2,15,000
Preference dividend		7,000	
Preference dividend payable		7,000	(14,000)
			2,01,000
Share in pre-acquisition loss (WN 3)			1,800
Share of Minority interest in losses (WN 1)			1,800
Less: Investment Account – dividend for 3 months (Prior to acquisition)			(3,500)
	Inventory reserve (WN 2)		(6,000)
Profit to be transferred to consolidated balance sheet			1,95,100

Note to Accounts

		₹	₹
1	Revenue from Operations		
	X Ltd.	18,00,000	
	Y Ltd.	19,00,000	
	Total	37,00,000	
	Less: Intra-group sales (X sold to Y)	(1,20,000)	35,80,000
2	Cost of Materials Purchased/ Consumed		
	X Ltd.	10,00,000	
	Y Ltd.	12,00,000	
	Total	22,00,000	
	Less: Intra-group sales (X sold to Y)	(1,20,000)	20,80,000
3	Employee benefit and expenses		
	Wages and salaries		
	H Ltd.	2,00,000	
	S Ltd.	3,00,000	5,00,000
4.	Finance cost		
	Interest		
	H Ltd.	24,000	
	S Ltd.	24,000	48,000
5	Depreciation		
	H Ltd.	2,20,000	
	S Ltd.	2,37,000	4,57,000
6	Other expenses		
	H Ltd.	1,60,000	

	S Ltd.	1,20,000	2,80,000

Working Note

1. Profit of Subsidiary

Revenue from Operations		19,00,000
Less: Expenses		
Cost of Material purchased/Consumed	12,00,000	
Changes of Inventories of finished goods	-	
Employee benefit expense	3,00,000	
Finance cost	24,000	
Depreciation and amortization expense	2,37,000	
Other expenses	1,20,000	
Total expenses		(18,81,000)
Profit Before Tax		19,000
Less: Preference Dividend	14,000	
Less: Preference Dividend Payable	14,000	(28,000)
Profit available for shareholders		(9,000)
Minority Share (20% of loss ₹9,000)		(1,800)

2. **Inventory reserve =** $\left[\frac{1,20,000}{4} \times \frac{25}{125}\right]$ = ₹ 6,000

3. **Pre-acquisition loss** = 80% of 3 month's profit up to 30th June, 2020 i.e. 80% of ¼ of loss ₹ 9,000. Hence, pre-acquisition loss = ₹ 1,800

Investment account includes Preference dividends for 3 months prior to acquisition i.e. ₹ 4,00,000

Q.4: 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. **[July 21 (5 Marks)]**

ANSWER:

	₹
60% of the Equity Share Capital ₹ 100 Lakhs	60
60% of Accumulated Reserve ₹ 70 Lakhs (40 + 30) Lakhs	42
Book value of shares of short Ltd.	102

(i) Goodwill / Capital Reserve computation on consolidation of balance sheet

Long Ltd. paid a positive differential of ₹ 10 Lakhs (112 - 102). This differential ₹ 10 Lakhs is called goodwill and is shown in the balance sheet under the head intangibles

(ii) If Long Ltd. showed the investment in Short Ltd. at carrying amount of ₹ 104 Lakhs, then the goodwill will be ₹ 2 Lakhs.

If the consideration paid is ₹ 92 lakhs, then there would have been capital reserve amounting ₹ 10 Lakhs (102- 92).

Q.5: 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: **[RTP May 21]**

	₹ in lakhs
Property, plant and equipment	**360**
Investments	**90**
Current Assets	**140**
Loans & Advances	**30**
15% Debentures	**180**
Current Liabilities	**100**

ANSWER:

Net assets of B Ltd. as on 31st March, 2021

	₹ in lakhs	₹ in lakhs
Property, plant and equipment		360
Investments		90
Current Assets		140
Loans and Advances		30
Total Assets		620
Less: 15% Debentures	180.0	
Current Liabilities	100.0	(280)
Equity / Net Worth		340
Share of Minority Interest in net assets (30% of 340)		102
A Ltd.'s share in net assets (70% of 340)		238
A Ltd.'s cost of acquisition of shares of B Ltd. (₹140 lakhs)		(140)
Capital reserve		98

Q.6: From the following information of Beta Ltd. and its subsidiary Gamma Ltd. drawn up at 31st March, 2021, prepare a consolidated balances sheet as at that date:

	Beta Ltd.	Gamma Ltd.
	₹	₹
Share Capital:		
Shares of ₹ 100 each	**15,00,000**	**2,50,000**
Reserves	**5,00,000**	**1,87,500**
Profit and Loss Account	**2,50,000**	**62,500**
Trade Payables	**3,75,000**	**1,42,500**

Property, Plant and Equipment:		
Machinery	7,50,000	2,25,000
Furniture	3,75,000	42,500
Other non-current assets	11,00,000	3,75,000
Non-current Investments:		
Shares in Gamma Ltd.: 2,000 shares at ₹ 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%.]

ANSWER:

Consolidated Balance Sheet of Beta Ltd. and its Subsidiary Gamma Ltd.

as at 31st March, 2021

	Particulars	Note No.	(₹)
I	**EQUITY AND LIABILITIES**		
	1. Shareholders' funds		
	(a) Share Capital		15,00,000
	(b) Reserves and Surplus	1	8,61,500
	2. Minority Interest (W.N.5)		1,20,375
	3. Current Liabilities		
	(a) Trade Payables	2	5,17,500
	Total		**29,99,375**
II	**ASSETS**		
	1. Non-current Assets		
	(a) (i) Property, Plant and Equipment	3	14,94,375
	(ii) Intangible assets	4	30,000
	(b) Other non-current assets	5	14,75,000
	Total		**29,99,375**

Notes to Accounts

				₹
1.	**Reserves and Surplus**			
	Reserves		5,00,000	
	Add: 4/5th share of Gamma Ltd.'s post- acquisition reserves (W.N.3)		1,00,000	6,00,000
	Profit and Loss Account		2,50,00	
	Add: 4/5th share of Gamma Ltd.'s post-acquisition profits (W.N.4)		11,500	2,61,500

				8,61,500
2.	**Trade Payables**			
	Beta Ltd.		3,75,000	
	Gamma Ltd.		1,42,500	5,17,500
3.	**Property, Plant and Equipment**			
	Machinery			
	Beta Ltd.		7,50,000	
	Gamma Ltd.	2,50,000		
	Add: Appreciation	1,25,000		
		3,75,000		
	Less: Depreciation	(37,500)	3,37,500	
	Furniture			
	Beta Ltd.		3,75,000	
	Gamma Ltd.	50,000		
	Less: Decrease in value	(12,500)		
		37,500		
	Less: Depreciation	(5,625)	31,875	14,94,37
4.	**Intangible assets**			
	Goodwill [WN 6]			30,000
5.	**Other non-current assets**			
	Beta Ltd.		11,00,000	
	Gamma Ltd.		3,75,000	14,75,00

Working Notes:

1.	**Pre-acquisition profits and reserves of Gamma Ltd.**	₹
	Reserves	62,500
	Profit and Loss Account	37,500
		1,00,000
	Beta Ltd.'s = 4/5 x 1,00,000	80,000
	Minority Interest = 1/5 x 1,00,000	20,000
2.	**Profit on revaluation of assets of Gamma Ltd.**	
	Profit on Machinery ₹ (3,75,000 – 2,50,000)	1,25,000
	Less: Loss on Furniture ₹ (50,000 – 37,500)	12,500
	Net Profit on revaluation	1,12,500
	Beta Ltd.'s share 4/5 x 1,12,500	90,000
	Minority Interest 1/5 x 1,12,500	22,500
3.	**Post-acquisition reserves of Gamma Ltd.**	
	Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 1,87,500 – 62,500)	1,25,000
	Beta Ltd.'s share 4/5 x 1,25,000	1,00,000

	Minority interest 1/5 x 25,000	25,000
4.	**Post-acquisition profit of Gamma Ltd.**	
	Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = ₹ 62,500 – 37,500)	25,000
	Add: Excess depreciation charged on furniture @ 15% on ₹ 12,500 i.e. (50,000 – 37,500)	1,875
		26,875
	Less: Under depreciation on machinery @ 10% on ₹ 1,25,000 i.e. (3,75,000 – 2,50,000)	(12,500)
	Adjusted post-acquisition profits	14,375
	Beta Ltd.'s share 4/5 x 14,375	11,500
	Minority Interest 1/5 x 14,375	2,875
5.	**Minority Interest**	
	Paid-up value of (2,500 – 2,000) = 500 shares held by outsiders i.e. 500 x ₹ 100	50,000
	Add: 1/5th share of pre-acquisition profits and reserves	20,000
	1/5th share of profit on revaluation	22,500
	1/5th share of post-acquisition reserves	25,000
	1/5th share of post-acquisition profit	2,875
		1,20,375
6.	**Cost of Control or Goodwill**	
	Paid-up value of 2,000 shares held by Beta Ltd. i.e. 2,000 x ₹ 100	2,00,000
	Add: 4/5th share of pre-acquisition profits and reserves	80,000
	4/5th share of profit of the revaluation	90,000
	Intrinsic value of shares on the date of acquisition	3,70,000
	Price paid by Beta Ltd. for 2,000 shares	4,00,000
	Less: Intrinsic value of the shares	(3,70,000)
	Cost of control or Goodwill	30,000

Q.7: On 31st March, 2015, 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, 2021:

	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 31.3.2021 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, 2021 (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account in each of the following cases:

(a) Before issue of bonus shares.

(b) Immediately after issue of bonus shares. **[RTP Nov 21]**

ANSWER:

Shareholding pattern

Particulars	Numbers of Shares	% of holding
a. P Ltd.		
(i) Purchased on 31.03.2015	1,05,000	
(ii) Bonus Issue (1,05,000/2)	52,500	
Total	1,57,500	70%
b. Minority Interest	67,500	30%

Calculations of (i) Cost of Control/ Capital Reserve: (ii) Minority Interest; (iii) consolidated Profit and Loss Account as on 31st March, 2021:

(a) Before issue of bonus shares

(i)	Cost of Control/ capital reserve	₹	₹
	Investment in Q Ltd.		12,00,000
	Less: Face value of investments	10,50,000	
	Capital profits (W.N.)	63,000	(11,13,000)
	Cost of control		87,000
(ii)	Minority Interest		₹
	Share Capital		4,50,000
	Capital profit (W.N.)		27,000
	Revenue Profits (W.N.)		6,79,500
			11,56,500
(iii)	Consolidated profit and loss account – P Ltd.		₹
	Balance		15,75,000

	Add: Share in revenue profit of Q Ltd. (W.N.)		15,85,500
			31,60,500

(b) Immediately after issue of bonus shares

(i)	Cost of Control/ capital reserve	₹	₹
	Face value of investment (₹ 10,50,000 + ₹ 5,25,000)	15,75,000	
	Capital Profits (W.N.)	63,000	16,38,000
	Less: Investment in Q Ltd.		(12,00,000)
	Capital reserve		4,38,000
(ii)	**Minority Interest**		**₹**
	Share Capital (₹4,50,000 + ₹ 2,25,000)		6,75,000
	Capital Profits (W.N.)		27,000
	Revenue Profits (W.N.)		4,54,500
			11,56,500
(iii)	**Consolidated Profit and Loss Account – P Ltd.**		**₹**
	Balance		15,76,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		10,56,500
			26,35,500

Working Note:

Analysis of Profits of Q Ltd.

	Capital Profits	Revenue Profits	
	(Before and after issue of bonus shares) ₹	Before Bonus Issue ₹	After Bonus Issue ₹
Pre-incorporation profits	30,000		
Profit and loss account on 31.3.2015	60,000		
	90,000		
General reserve*		19,05,000	19,05,000
Less: Bonus shares			(7,50,000)
			11,55,000
Profit for period of 1st April, 2015 to 31st March, 2021 (₹ 4,20,000 - ₹ 60,000)		3,60,000	3,60,000
		22,65,000	15,15,000
P Ltd.'s share (70%)	63,000	15,85,500	10,60,500
Minority's share (30%)	27,000	6,79,500	4,54,500

*Share of P Ltd. in General reserve has been adjusted in consolidated Profit and Loss Account.

Q.8: Consider the following information of subsidiary MNT Ltd. –

Liabilities	2019-20 Amount in ₹	2020-21 Amount in ₹
Issued and subscribed: 7,500 Equity Shares of ₹ 100 each	7,50,000	7,50,000
Revenue Reserve	2,14,000	5,05,000
Securities Premium	72,000	2,07,000
Trade Payables	2,90,000	2,46,000
Bank Overdraft	-	1,70,000
Provision for Taxation	2,62,000	4,30,000
Property, plant and equipment (Cost)	9,20,000	9,20,000
Less: Accumulated Depreciation	(1,70,000)	(2,82,500)
	7,50,000	6,37,500
Investment (at cost)	-	5,30,000
Inventory	4,12,300	6,90,000
Trade Receivable	2,95,000	3,43,000
Prepared expenses	78,000	65,000
Cash at Bank	52,700	42,500

Other Information:

(1) MNT Ltd. is a subsidiary of LTC Ltd.

(2) LTC Ltd. values inventory on FIFO basis, while MNT Ltd. used LIFO basis. To bring MNT Ltd.'s inventories values in line with those of LTC Ltd., its value of inventory is required to be reduced by ₹ 5,000 at the end of 2019-2020 and increased by ₹ 12,000 at the end of 2020-2021. (Inventory of 2019-20 has been sold out during the year 2020-21)

(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 2019-20 and ₹ 12,500 in 2020-21 being part of initial Sales Promotion expenditure of ₹ 37,500 in 2019-20, which is being written off over three years. Similar nature of Sales Promotion expenditure of LIC Ltd. has been fully written off in 2019-20.

Restate the balance sheet of MNT Ltd. as on 31st March, 2021 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. [MTP Oct 21 (16 Marks)]

ANSWER:

Restated Balance Sheet of MNT Ltd.

As at 31st March 2021

	Particulars	Note No.	(₹)
I.	**Equity and Liabilities**		
	(1) Shareholder's Funds		
	(a) Share Capital		7,50,000
	(b) Reserves and Surplus	1	7,18,500
	(2) Current Liabilities		
	(a) Short term borrowings	2	1,70,000

	(b) Trade Payables		2,46,000
	(c) Short-term provision	3	4,30,000
	Total		23,14,500
II.	Assets		
	(1) Non-current assets		
	(a) Property, Plant & Equipment	4	6,37,500
	(b) Non-current Investment		5,30,000
	(2) Current assets		
	(a) Inventories (6,90,000 + 12,000)	5	7,02,000
	(b) Trade Receivables $\left(\frac{3,43,000}{98} \text{ x } 100\right)$		3,50,000
	(c) Cash & Cash Equivalents		42,500
	(d) Other current assets	6	52,500
	Total		23,14,500

Notes to Accounts

			₹
1.	Resaves and Surplus		
	Revenue Reserve (refer W.N.)	5,11,500	
	Securities Premium	2,07,000	7,18,500
2.	**Short term borrowings**		
	Bank overdraft		1,70,000
3.	Short-term provision		
	Provision for taxation		4,30,000
4.	Property, Plant and Equipment		
	Cost	9,20,000	
	Less: Depreciation to date	(2,82,500)	6,37,500
5.	**Inventories**	6,90,000	
	Increase in value as per FIFO	12,000	7,02,00
6.	**Other current assets**		
	Prepaid expenses (After adjusting sales promotion expenses to be written off each year) (65,000 – 12,500)		52,500

Working Note:

Adjustment revenue reserves of MNT Ltd.:

	₹	₹
Revenue reserve as given		5,05,000
Add: Provision for doubtful debts [3,43,000 x 2/98)	7,000	
Add: Increase in value of inventory	12,000	19,000

		5,24,000
Less: Sales Promotion expenditure to be written off		(12,500)
Adjusted revenue reserve		5,11,500

ACCOUNTING
STANDARDS

ACCOUNTING STANDARD 1

Disclosure of Accounting Policies

QUESTION - 1

In the books of M/s Prashant Ltd., closing inventory as on 31.03.20X2 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 20X1-X2. On the basis of weighted average method, closing inventory as on 31.03.20X2 amounts to ₹ 1,47,000. Realisable value of the inventory as on 31.03.20X2 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 the change in accounting policy in the following manner:

'The company values its inventory at lower of cost and net realizable value. Since net realizable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 201X1-X2, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by ₹ 16,000.

QUESTION - 2

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

(i) Value year-end inventory at works cost (₹ 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 20X1-20X2.

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:

(i) During the year inventory has been valued at factory cost, against the practice of valuing it at prime cost as was the practice till last year. This has been done to take cognizance of the more capital intensive method of production on account of heavy capital expenditure during the year. As a 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.

(ii) 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.

(iii) 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 - 3

XYZ Company is engaged in the business of financial services and is undergoing tight liquidity position, since most of the assets of the company are blocked in various claims/petitions in a Special Court. XYZ has accepted Inter-Corporate Deposits (ICDs) and, it is making its best efforts to settle the dues. There were claims at varied rates of interest, from lenders, from the due date of ICDs to the date of repayment. The company has provided interest, as per the terms of the contract till the due date and a note for non-provision of interest on the due date to date of repayment was affected in the financial statements. On account of uncertainties existing regarding the determination of the amount and in the absence of any specific legal obligation at present as per the terms of contracts, the company considers that these claims are in the nature of "claims against the company not acknowledged as debt", and the same has been disclosed by way of a note in the accounts instead of making a provision in the profit and loss accounts. State whether the treatment done by the Company is correct or not.

SOLUTION:

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

Also as per AS 1, 'accrual' is one of the fundamental accounting assumptions. Irrespective of the terms 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 - 4

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

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

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

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

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

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 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.

(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 the 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.

QUESTION - 5

The draft results of Surya Ltd. for the year ended 31st March, 2020, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of ₹ 10 crores. The board in consultation with the managing director, decided to value year-end inventory at works cost (₹ 50 crores) instead of the hitherto method of valuation of inventory at prime cost (₹ 30 crores). As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2019-2020. **[RTP May 2021]**

ANSWER:

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

Notes on Accounts:

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

QUESTION - 6

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

(i) Does this amount to change in accounting policy?

(ii) Can the company change the method of accounting?

(iii) Explain how it will be disclosed in the annual accounts of HIL Ltd. for the year 2019-20.

[MTP March 21 (5 Marks)]

ANSWER:

The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be

made but the basis for making provision will not constitute accounting policy. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory from Rs. 4 lakhs to Rs. 3 lakhs 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 2019-20 in the following manner:

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

QUESTION - 7

State whether the following statements are 'True' or 'False' in line with the provisions of AS 1. Also give reason for your answer.

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

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

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

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

(v) There is no single list of accounting policies which are applicable to all circumstances.

[MTP April 21 & MTP March 22 (5 Marks)]

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ANSWER:

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

(ii) **False;** As per AS 1, if the fundamental accounting assumptions, viz. Going Concern, Consistency 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 the significant accounting policies as such should form part of the financial statements and they should be disclosed at 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 - 8

In the books of Rani Ltd., closing inventory as on 31.03.2020 amounts to ₹ 1,75,000 (valued on the basis of FIFO method). The Company decides to change from FIFO method to weighted average method for ascertaining the costs of inventory from the year 2019-20. On the basis of weighted average method, closing inventory as on 31.03.2020 amounts to ₹ 1,59,000. Realizable value of the inventory as on 31.03.2020 amounts to ₹ 2,07,000. Discuss disclosure requirements of change in accounting policy as per AS 1. **[MTP Nov 21 (5 Marks)]**

ANSWER:

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

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

ACCOUNTING STANDARD 2

Valuation of Inventory

QUESTION - 1

Mr. Mehul gives the following information relating to items forming part of inventory as on 31.3.20X1. His factory produces Product X using Raw material A.

(i) 600 units of Raw material A (purchased @ ₹ 120). Replacement cost of raw material A as on 31-3-20X1 is ₹ 90 per unit.

(ii) 500 units of partly finished goods in the process of producing X and cost incurred till date ₹ 260 per unit. These units can be finished next year by incurring additional cost of ₹ 60 per unit.

(iii) 1500 units of finished Product X and total cost incurred ₹ 320 per unit.

Expected selling price of Product X is ₹ 300 per unit.

Determine how each item of inventory will be valued as on 31-3-20X1. Also calculate the value of total inventory as on 31-3-20X1.

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 realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value. In the given case, selling price of product X is ₹ 300 and total cost per unit for production is ₹ 320.

Hence the valuation will be done as under:

(i) 600 units of raw material will be written down to replacement cost as market value of finished product is less than its cost, hence valued at ₹ 90 per unit.

(ii) 500 units of partly finished goods will be valued at 240 per unit i.e. lower of cost (₹ 260) or Net realisable value ₹ 240 (Estimated selling price ₹ 300 per unit less additional cost of ₹ 60).

(iii) 1,500 units of finished product X will be valued at NRV of ₹ 300 per unit since it is lower than cost ₹ 320 of product X.

Valuation of Total Inventory as on 31.03.20X1:

	Units	Cost (₹)	NRV/ Replacement cost	Value = units x cost or NRV whichever is less (₹)
Raw material A	600	120	90	54,000
Partly finished goods	500	260	240	1,20,000
Finished goods X	1,500	320	300	4,50,000
Value of Inventory				6,24,000

QUESTION - 2

On 31st March 20X1, a business firm finds that cost of a partly finished unit on that date is ₹ 530. The unit can be finished in 20X1-X2 by an additional expenditure of ₹ 310. The finished unit can be sold for ₹ 750 subject to payment of 4% brokerage on selling price. The firm seeks your advice regarding the amount at which the unfinished unit should be valued as at 31st March, 20X1 for preparation of final accounts. Assume that the partly finished unit cannot be sold in semi-finished form and its NRV is zero without processing it further.

SOLUTION:

Valuation of unfinished unit

	₹
Net selling price	750
Less: Estimated cost of completion	(310)
	440
Less: Brokerage (4% of 750)	(30)
Net Realisable value	410
Cost of inventory	530
Value of inventory (Lower of cost and net realisable value)	410

QUESTION - 3

The inventory of Rich Ltd. as on 31st March, 2020 comprises of Product – A: 200 units and Product – B: 800 units.

Details of cost for these products are:

Product – A: Material cost, wages cost and overhead cost of each unit are ₹ 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.

[RTP May 2021]

ANSWER:

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 x 200 = 8,000	
Wages cost	₹ 30 x 200 = 6,000	
Overhead	₹ 20 x 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 x 800 = 36,000	
Wages cost	₹ 35 x 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 - 4

Mr. Jatin gives the following information relating to the items forming part of the inventory as on 31.03.2019. His enterprise produces product P using Raw Material X.

(ii) 900 units of Raw Material X (purchases @ ₹ 100 per unit). Replacement cost of Raw Material X as on 3103.2019 is ₹ 80 per unit

(i) 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.

(ii) 800 units of Finished goods P and total cost incurred is ₹ 295 per unit.

Expected selling price of product P is ₹280 per unit, subject to a payment of 5% brokerage on selling price.

Determine how each item of inventory will be valued as on 31.03.2019.

Also calculate the value of total Inventory as on 31.03.2019. **[Jan 2021 (5 Marks)]**

ANSWER:

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.

Valuation of Total Inventory as on 31.03.2019:

	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 - 5

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 and finished output is in stock at the year end. State with reference to Accounting Standard, how will you value the inventories in this case? What will be treatment for normal and abnormal waste? **[MTP March 21 (5 Marks)]**

ANSWER:

As per para 13 of AS 2 (Revised), abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred.

In this case, normal waste is 250 MT and abnormal waste is 50 MT. The cost of 250 MT will be included in determining the cost of inventories (finished goods) at the year end. The cost of abnormal waste (50 MT x 1,052.6315 = ₹ 52,632) will be charged to the profit and loss statement.

Cost per MT (Normal Quantity of 4,750 MT) = 50,00,000 / 4,750 = ₹ 1,052.6315

Total value of inventory = 4,700 MT x ₹ 1,052.6315 = ₹ 49,47,368.

QUESTION - 6

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

(ii) X Limited purchased goods at the cost of Rs. 40 lakhs in October, 2020. Till March, 2021, 75% of the stocks were sold. The company wants to disclose closing stock at Rs. 10 lakhs. The expected sale value is Rs. 11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct value of closing stock to be disclosed as at 31.3.2021. [MTP April 21 (5 Marks)]

ANSWER:

(i) As per AS 2 'Valuation of Inventories', certain costs are excluded from the cost of the inventories and are recognized as expenses in the period in which incurred. Examples of such costs are:

(a) Abnormal amount of wasted materials, labour, or other production costs;

(b) Storage costs, unless those costs are necessary in the production process prior to a further production stage;

(c) Administrative overheads that do not contribute to bringing the inventories to their present location and condition; and

(d) Selling and distribution costs.

(ii) As per AS 2 "Valuation of Inventories", the inventories are to be valued at lower of cost or net realizable value. In this case, the cost of inventory is Rs. 10 lakhs. The net realizable value is 11,00,000 × 90% = Rs. 9,90,000. So, the stock should be valued at Rs. 9,90,000.

QUESTION - 7

From the following information provided by XYZ Limited you are required to compute the closing inventory:

Raw Material P	
Closing balance	**600 units**
	₹ per unit
Cost price including GST	**250**
Input tax credit available	**20**
Freight inward	**30**
Handling charges	**15**
Replacement cost	**180**
Finished goods Q	
Closing balance	**1500 units**
	₹ per unit
Material consumed	**250**
Direct labour	**70**
Direct overhead	**30**

Total fixed overhead for the year was ₹ 3,00,000 on a normal capacity of 30,000 units while actual production has been of 25,000 units.

Calculate the value of closing stock, when

(i) Net realizable value of the finished goods Q is ₹ 450 per unit.

(ii) Net Realizable value of the Finished Goods Q is 340 per unit. [MTP Oct 21 (5 Marks)]

ANSWER:

(i) When Net Realizable Value of the Finished Good Q is ₹ 450 unit Value of Closing Stock:

	Valuation Base	Qty.	Rate (₹)	Amount (₹)
Raw Material P	Cost	600	275	1,65,000
Finished Good Q	Cost	1,500	360	5,40,000
Total value of closing Stock				7,05,000

(ii) When Net Realizable Value of the Finished Good Q is ₹ 340 per unit

Since NRV of finished goods Q is less than its cost i.e. ₹ 360 (Refer W.N.), raw material P is to be valued at replacement cost and finished goods is to be valued at NRV.

Value of Closing Stock:

	Valuation Base	Qty.	Rate (₹)	Amount (₹)
Raw material P	Replacement cost	600	180	1,08,000
Finished good Q	Net Realisable Value	1,500	340	5,10,000
Total value of closing stock				6,18,000

Working Note:

Statement showing calculation of cost of raw material P and finished good Q

Raw Material P	₹
Cost Price (250-20)	230
Add: Freight Inward	30
Handing charges	15
Cost	275
Finished Goods Q	₹
Materials Consumed	250
Direct Labour	70
Variable overheads	30
Fixed overheads (₹ 3,00,000/ 30,000 units)	10
	360

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ACCOUNTING STANDARD 4

Contingencies and Events Occurring After the Balance Sheet

QUESTION - 1

During the year 20X1 – 20X2, Raj Ltd. was sued by a competitor for ₹ 15 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Raj Ltd. provided for a sum of ₹ 10 lakhs in its financial statements for the year ended 31st March, 20X2. On 18th May, 20X2, the Court decided in favour of the party alleging infringement of the trademark and ordered Raj Ltd. to pay the aggrieved party a sum of ₹ 14 lakhs. The financial statements were prepared by the company's management on 30th April, 20X2, and approved by the board on 30th May, 20X2.

SOLUTION:

As per AS 4 (Revised), Adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

In the given case, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 20X1-X2 for which the provisions was also made by it, the decision of the Court on 18th May, 20X2, for payment of the penalty will constitute as an adjusting event because it is and 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 them to its competitor.

Had the judgment of the court been delivered on 1st June, 20X2, it would be considered as an event occurring after the approval of the financial statements which is not covered by AS 4 (Revised). In that case, no adjustment in the financial statements of 20X1-X2 would have been required.

QUESTION - 2

Surya Limited follows the financial year from April to March. It has provided the following information.

(i) A suit against the Company's Advertisement was filed by a party on 5th April, 2021, claiming damages of ₹ 5 lakhs.

(ii) 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.

(iii) 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.

(iv) 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, you are required to state with reasons whether the above events are to be treated as Contingencies, Adjusting Events or Non-Adjusting Events occurring after Balance Sheet date.

[July 21 (5 Marks)]

ANSWER:

(i) 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.

(ii) 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.

(iii) 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.

(iv) 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 - 3

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?

[RTP May 21]

ANSWER:

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 - 4

Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31st March 2020 are to be approved by the approving authority on 30th 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 31st March 2020. The company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realizable value, whichever is lower. During the month of April 2020, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during April, 2020 at a price of ₹ 4,000 per machine.

(ii) A fire has broken out in the company's godown on 15th April 2020. The company has estimated a loss of ₹ 25 lakhs of which 75% is recoverable from the Insurance company.

(iii) 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 statements for the year ended 31 March 2020. **[RTP May 22]**

ANSWER:

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

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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:

(i) Since on 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an adjusting event. Hence, Tee Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realizable 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.

(ii) A fire took place after the balance sheet date i.e. during 2020-2021 financial year. Hence, the financial statements for the year 2019-2020 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.

(iii) 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 - 5

The financial statement of Alpha Ltd. for the year 2019-2020 were approved by the Board of Directors on 15th July, 2020. The following information was provided:

(i) A suit against the company's advertisement was filed by a party on 20th April, 2020 claiming damages of ₹ 25 lakhs.

(ii) The terms and conditions for acquisition of business of another company had been decided by March, 2020. But the financial resources were arranged in April, 2020 and amount invested was ₹ 50 lakhs.

(iii) Theft of cash of ₹ 5 lakhs by the cashier on 31st March, 2020, was detected on 16th July, 2020.

(iv) The company started a negotiation with a party to sell an immovable property for ₹ 40 lakhs in March, 2020. The book value of the property is ₹ 30 lakhs on 31st March, 2020. However, the deed was registered on 15th April, 2020.

(v) A major fire had damaged the assets in a factory on 5th April, 2020. However, the assets were fully insured.

With reference to AS 4, state whether the above mentioned events will be treated as contingencies, adjusting events or non-adjusting events occurring after the balance sheet date. **[MTP March 22]**

ANSWER:

(i) **Non-adjusting event:** Suit filed against the company is a contingent liability but it was not existing as on date of balance sheet date as the suit was filed on 20th April after the balance sheet date. As per AS 4, 'Contingencies' is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur. Hence, it will have no effect on financial statement and will be a non-adjusting event.

(ii) **Adjusting event:** In the given case, terms and conditions for acquisition of business were finalised before the balance sheet date and carried out before the closure of the books of accounts but transaction for payment of financial resources was effected in April, 2020. Hence, necessary adjustment to assets and liabilities for acquisition of business is necessary in the financial statements for the year ended 31st March 2020.

(iii) **Non-adjusting event:** Only those events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustments to assets and liabilities as at the balance sheet date or may require disclosure. In the given case, as the theft of cash was detected on 16th July, 2020 ie after approval of financial statements, no adjustment is required.

(iv) **Non-adjusting event:** Adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. In the given case, sale of

immovable property was under proposal stage (negotiations only started) on the balance sheet date, and was not finalized. Therefore, adjustment to assets for sale of immovable property is not necessary in the financial statements for the year ended 31st March, 2020. Disclosure may be given in Report of approving Authority.

(v) **Non-adjusting event:** Adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The condition of fire occurrence was not existing on the balance sheet date. Only the disclosure regarding fire and loss, being completely insured may be given in the report of approving authority.

QUESTION - 6

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. **[RTP Nov 21]**

ANSWER:

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 - 7

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.**

You are required to state with reasons, how the above transactions will be dealt with in the financial statement for the year ended 31st March 2020. **[MTP Oct 21]**

ANSWER:

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:

(i) Since on 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an adjusting event. Hence, Tee Ltd. needs to adjust the amounts recognized in its financial 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.

(ii) A fire took place after the balance sheet date i.e. during 2020-2021 financial year. Hence, corresponding financials of 2019-2020 financial year should not be adjusted for loss occurred due to fire. However, in this circumstance, the going concern assumption will be evaluated. In case the going concern assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements. Otherwise, disclosure be given.

(iii) Since the transfer of risk and reward and sale was complete in the month of May, 2020 when conveyance and possession got complete, no revenue should be recognised with respect to it in the financial statements of 2019-2020. However, a disclosure for the same should be given by the entity.

(iv) Since the notice has been received after 31 March but before 30 June 2020 (approval date), the said grant shall be adjusted in the financial statements for financial year 2019-2020 because the violation of the conditions took place in the financial year 2019-2020 and the company must be aware of it.

QUESTION - 8

An earthquake destroyed a major warehouse of PQR Ltd. on 30.4.2021. The accounting year of the company ended on 31.3.2021. The accounts were approved on 30.6.2021. The loss from earthquake is estimated at ₹ 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.

ANSWER:

AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.3.2021. Therefore, loss occurred due to earthquake is not to be recognized in the financial year 2020-2021.

However, according the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation

of the financial statements. As per the information given in the question, the earthquake has caused major destruction; therefore, fundamental accounting assumption of going concern is called upon.

Hence, the fact of earthquake together with an estimated loss of ₹ 25 lakhs should be disclosed in the Report of the Directors for the financial year 2020-2021.

QUESTION - 9

As per the provision of AS 4, you are required to state with reason whether the following transactions are adjusting event or non-adjusting event for the year ended 31.03.2021 in the books of NEW Ltd. (accounts of the company were approved by board of directors on 10.07.2021):

1. **Equity Dividend for the year 2020-21 was declared at the rate of 7% on 15.05.2021.**
2. **On 05.03.2021, ₹ 53,000 cash was collected from a customer but not deposited by the cashier. This fraud was detected on 22.06.2021.**
3. **One Building got damaged due to occurrence of fire on 23.05.2021. Loss was estimated to be ₹ 81,00,000.**

[Dec 21 (5 Marks)]

ANSWER:

(i) If dividends are declared after the balance sheet date but before the financial statements are approved, the dividends are not recognized as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise. Such dividends are disclosed in the notes. Thus, no liability for dividends needs to be recognized in financial statement for financial year ended 31st March, 2021 and declaration of dividend is non-adjusting event.

(ii) As per AS 4 'Contingencies and Events occurring after the Balance Sheet Date' an event occurring 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.

(iii) AS 4 states that adjustments to assts 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.

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ACCOUNTING STANDARD 5

Net Profit or Loss for The Period, Prior Period Items and Changes in Accounting Policies

QUESTION - 1

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, 20X1 to September, 20X7 has been received and paid in February, 20X8. However, the same was accounted in the year 20X8-X9. Comment on treatment done in the said case.

SOLUTION:

The final bill having been paid in February, 20X8 should have been accounted for in the annual accounts of the company for the year ended 31st March, 20X8. However, it seems that as a result of error or omission in the preparation of the financial statements of prior period i.e., for the year ended 31st March 20X8, this material charge has arisen in the current period i.e., year ended 31st March, 20X9. Therefore it should be treated as 'Prior period item' as per AS 5. As per AS 5, prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of Profit and loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

It may be mentioned that it is an expense arising from the ordinary course of business. Although abnormal in amount or infrequent in occurrence, such an expense does not qualify an extraordinary item as per AS 5. For better understanding, the fact that power bill is accounted for at provisional rates billed by the state electricity board and final adjustment thereof is made as and when final bill is received may be mentioned as an accounting policy.

QUESTION - 2

(i) During the year 20X1-20X2, a medium size manufacturing company wrote down its inventories to net realisable value by ₹ 5,00,000. Is a separate disclosure necessary?

(ii) A company signed an agreement with the Employees Union on 1.9.20X2 for revision of wages with retrospective effect from 30.0.20X1. This would cost the company an additional liability of ₹ 5,00,000 per annum. Is a disclosure necessary for the amount paid in 20X2-X3?

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 require separate disclosure of items of income and expense in accordance with AS 5 include the write-down of inventories to net realisable value as well as the reversal of such write-downs.

(ii) It is given that revision of wages took place on 1st September, 20X2 with retrospective effect from 30.9.20X1. Therefore wages payable for the half year from 1.10.20X2 to 31.3.20X3 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 1 ½ 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 - 3

The company finds that the inventory sheets of 31.3.20X1 did not include two pages containing details of inventory worth ₹ 14.5 lakhs. State, how you will deal with the following matters in the accounts of Omega Ltd. for the year ended 31st March, 20X2.

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 vide AS 5. Separate disclosure of this item as a prior period item is required as per AS 5.

QUESTION - 4

Explain whether the following will constitute a 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 organisation. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organisation.

SOLUTION:

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.

(i) Accordingly, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy.

(ii) Similarly, the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial will not be treated as a change in an accounting policy.

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QUESTION - 5

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. **(5 Marks)**

ANSWER:

Classification of given items is as follows:

Sr. No.	Particulars	Remarks

(i)	Actual bad debts turning out to be more than provisions	Change in Accounting Estimates
(ii)	Change from Cost model to Revaluation model for measurement of carrying amount of PPE	Change in Accounting Policy
(iii)	Government grant receivable as compensation for expenses incurred in previous accounting period	Extra -ordinary Items
(iv)	Treating operating lease as finance lease.	Prior- period Items
(v)	Capitalisation of borrowing cost on working capital	Prior-period Items (as interest on working capital loans is not eligible for capitalization)
(vi)	Legislative changes having long term retrospective application	Ordinary Activity
(vii)	Change in the method of depreciation from straight line to WDV	Change in Accounting Estimates
(viii)	Government grant becoming refundable	Extra -ordinary Items
(ix)	Applying 10% depreciation instead of 15% on furniture	Prior- period Items
(x)	Change in useful life of fixed assets	Change in Accounting Estimates

QUESTION - 6

A company created a provision of Rs. 7,50,000 for staff welfare while preparing the financial statements for the year 2020-21. On 31st March 2021, in a meeting with staff welfare association, it was decided to increase the amount of provision for staff welfare to Rs. 10,00,000. The accounts were approved by Board of Directors on 15th April, 2021.

You are required to explain the treatment of such revision in financial statements for the year ended 31st March 2021 in line with the provisions of AS 5? **[MTP March 21 (5 Marks)]**

ANSWER:

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the change in amount of staff welfare provision amounting 2,50,000 is neither a prior period item nor an extraordinary item. It is a change in estimate, which has been occurred in the year 2020-21.

As per the provisions of the standard, normally, all items of income and expense which are recognized in a period are included in the determination of the net profit or loss for the period. This includes extraordinary items and the effects of changes in accounting estimates. However, the effect of such change in accounting estimate should be classified using the same classification in the statement of profit and loss, as was used previously, for the estimate.

QUESTION - 7

S.T.B. Ltd. makes provision for expenses amounting Rs. 7,00,000 as on March 31, 2020, but the actual expenses during the year ending March 31, 2021 comes to Rs. 9,00,000 against provision made during the last year. State with reasons whether difference of Rs. 2,00,000 is to be treated as prior period item as per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'. **[MTP April 21 (5 Marks)]**

ANSWER:

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', as a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. Estimates may have to be revised, if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.

As per the standard, the effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. Thus, revision of an estimate by its nature i.e. the difference of Rs. 2 lakhs, is not a prior period item. Therefore, in the given case expenses amounting Rs. 2,00,000 (i.e. Rs. 9,00,000 – Rs. 7,00,000) recorded in the current year, should not be regarded as prior period item.

QUESTION - 8

XYZ Ltd. is in the process of finalizing its account for the year ended 31st March, 2020. The company seeks your advice on the following:

The company's 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. **[RTP May 21]**

ANSWER:

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 alongwith disclosure as contingent liability of ₹ 3.70 crore.

ACCOUNTING STANDARD 7

Construction Contracts

QUESTION - 1

A firm of contractors obtained a contract for construction of bridges across river Revathi. The following details are available in the records kept for the year ended 31st March, 20X1.

	(₹ in lakhs)
Total Contract Price	1,000
Work Certified for the cost incurred	500
Work yet not Certified for the cost incurred	105
Estimated further Cost to Completion	495
Progress Payment Received	400
To be Received	140

The firm seeks your advice and assistance in the presentation of accounts keeping in view the requirements of AS 7 issued by your institute.

SOLUTION:

(a)	Amount of foreseeable loss	(₹ in lakhs)
	Total Cost of construction (500 + 105 + 495)	1,100
	Less: Total contract price	(1,000)
	Total foreseeable loss to be recognized as expense	100

According AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(b)	Contract work-in-progress i.e. cost incurred to date are ₹ 605 lakhs	(₹ in lakhs)
	Work certified	500
	Work not certified	105
		605

This is 55% (605/1, 100 x 100) of total costs of construction.

(c) Proportion of total contract value recognised as revenue: 55% of ₹ 1,000 lakhs = ₹ 550 lakhs

(d) Amount due from/to customers = (Contract costs + Recognised profits – Recognised Losses) – (Progress payments received + Progress payments to be received)

= (605 + Nil – 100) – (400 + 140) ₹ in lakhs

= [505 – 540] ₹ in lakhs

Amount due to customers = ₹ 35 lakhs

The amount of ₹ 35 lakhs will be shown in the balance sheet as liability.

(e) The relevant disclosures under AS 7 are given below:

	₹ in lakhs
Contract revenue	550

Contract expenses	605
Recognised profits less recognised losses	(100)
Progress billings ₹ (400 + 140)	540
Retentions (billed but not received from contractee)	140
Gross amount due to customers	35

QUESTION - 2

On 1st December, 20X1, Vishwakarma Construction Co. Ltd. undertook a contract to construct a building for ₹ 85 lakhs. On 31st March, 20X2, the company found that it had already spent ₹ 64,99,000 on the construction. Prudent estimate of additional cost for completion was ₹ 32,01,000. What amount should be recognized in the statement of profit and loss for the year ended 31st March, 20X2 as per provisions of Accounting Standard 7 (Revised)?

SOLUTION:

	₹
Cost incurred till 31st March, 20X2	64,99,000
Prudent estimate of additional cost for completion	32,01,000
Total cost of construction	97,00,000
Less: Contract price	(85,00,000)
Total foreseeable loss	12,00,000

According to AS 7, the amount of ₹ 12,00,000 is required to be recognised as an expense.

Contract work in progress = $\frac{₹\ 64{,}99{,}000 \times 100}{97{,}00{,}000}$ = 67%

Proportion of total contract value recognised as turnover:

= 67% of ₹ 85,00,000 = ₹ 56,95,000.

QUESTION - 3

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.

[Nov 2020 (5 Marks)]

ANSWER:

Year 1	₹
Actual expenditure	8,60,000
Future estimated expenditure	10,00,000
Total Expenditure	18,60,000

% of work completed = $\frac{8{,}60{,}000}{18{,}60{,}000}$ x 100 = 46.24% (rounded off)

Revenue to be recognized = 20,00,000 x 46.24%

= ₹ 9,24,800

Year 2 ₹

	₹
Actual expenditure	4,75,000
Future Expenditure	8,60,000
	17,35,000

% of work completed = $\frac{4,75,000 + 8,60,000}{17,35,000}$ = 76.95% (rounded off)

Revenue to be recognized (cumulative) = 20,00,000 x 76.95%

= 15,39,000

Less: revenue recognized in Year 1 = (9,24,800)

Revenue to be recognized in Year 2 = ₹ 6,14,200

Year 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 - 4

Akar Ltd. Signed on 01/04/19, a construction contract for Rs. 1,50,00,000. Following particulars are extracted in respect of contract, for the period ending 3/03/20:

Material issued Rs. 75,00,000

Labour charges paid Rs. 36,00,000

Hire charges of Plant Rs. 10,00,000

Other contract cost incurred Rs. 15,00,000

Out of material issued, material lying unused at the end of period is Rs. 4,00,000

Laobur charges of Rs. 2,00,000 are still outstanding on 31.3.20.

It is estimated that by spending further Rs. 33,50,000 (including material unused Rs. 4,00,000), the work can be completed in all respect.

You are require to compute profit/ loss to be taken to Profit & Loss Account and additional provision for foreseeable loss as per AS 7. **[MTP March 21 (5 Marks)]**

ANSWER:

Statement showing the amount of profit/loss to be taken to Profit and Loss Account and additional provision for the foreseeable loss as per AS 7

	Cost of Construction	₹	₹
	Material Issued	75,00,000	
Less:	Unused Material at the end of period	4,00,000	71,00,000
	Labour Charges paid	36,00,000	
Add:	Outstanding on 31.03.2020	2 ,00,000	38,00,000
	Hire Charges of Plant		10,00,000
	Other Contract cost incurred		15,00,000
	Cost incurred upto 31.03.2020		1,34,00,000
Add:	Estimated future cost		33,50,000
	Total Estimated cost of construction		1,67,50,000

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	Degree of completion (1,34,00,000/1,67,50,00 0 x 100)		80%
	Revenue recognized (80% of 1,50,00,000)		1,20,00,000
	Total foreseeable loss (1,67,50,000 - 1,50 ,00, 0 00)		17,50,000
Less:	Loss for the current year (1,34,00,000 - 1,20 , 0 0,000)		14,00,000
	Loss to be provided for		3,50,000

QUESTION - 5

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 Expenses for workers engaged at site - ₹ 16 Lakhs (out of which ₹ 1 Lakh is still unpaid)

(iv) Specific Contract Costs - ₹ 5 lakhs

(v) Sub-Contract costs for work executed - ₹ 7 Lakhs, Advances paid to sub-contractors - ₹ 4 Lakhs

(vi) Further Cost estimated to be incurred to complete the contract - ₹ 35 Lakhs

You are required to compute the Percentage of Completion, the Contract Revenue and Cost to be recognized as per AS-7. **[July 21 (5 Marks)]**

ANSWER:

Computation of contract cost

	₹ in Lakh	₹ in Lakh
Material cost incurred on the contract (net of closing stock)	21-4	17
Add: Labour cost incurred on the contact (including 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 contact 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 - 6

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. **[RTP May 21]**

ANSWER:

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 both the conditions are met:

(i) The contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and

(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 - 7

ABC Ltd., a construction contractor, undertakes the construction of commercial complex for XYZ Ltd. ABC Ltd. submitted separate proposals for each of 3 units of commercial complex. A single 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 ABC Ltd., should treat it as a single contract or three separate contracts. **[RTP May 21]**

ANSWER:

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.

ABC Ltd. has submitted separate proposals for each of the 3 units of commercial complex. Also the revenue and completion time has been laid down for each unit separately which implies separate negotiation for them.

Therefore, ABC Ltd. is required to treat construction of each unit as a separate construction contract as the above-mentioned conditions of AS 7 are fulfilled in the given case.

QUESTION - 8

B Ltd. undertook a construction contract for ₹ 50 crores in April, 2020. 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 that the cost of completion of the contract would be ₹ 53 crores.

Can the company provide for the expected loss in the financial Statements for the year ended 31st March, 2021? Explain.'

ANSWER:

As per para 35 of AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately. Therefore, the foreseeable loss of ₹ 3 crores (₹ 53 crores less ₹ 50 crores) should be recognized as an expense immediately in the year ended 31st March, 2021. The amount of loss is determined irrespective of

(i) Whether or not work has commenced on the contract;

(ii) Stage of completion of contract activity; or

(iii) The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance provisions of AS 7.

ACCOUNTING STANDARD 9

Revenue Recognition

QUESTION - 1

The Board of Directors decided on 31.3.20X2 to increase the sale price of certain items retrospectively from 1st January, 20X2. In view of this price revision with effect from 1st January 20X2, the company has to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2. Accountant cannot make up his mind whether to include ₹ 15 lakhs in the sales for 20X1-20X2.Advise.

SOLUTION:

Price revision was effected during the current accounting period 20X1-20X2. As a result, the company stands to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2. If the company is able to assess the ultimate collection with reasonable certainty, then additional revenue arising out of the said price revision may be recognized in 20X1-20X2.

QUESTION - 3

A claim lodged with the Railways in March, 20X1 for loss of goods of ₹ 2,00,000 had been passed for payment in March, 20X3 for ₹ 1,50,000. No entry was passed in the books of the company, when the claim was lodged. Advise P Co. Ltd. about the treatment of the following in the Final Statement of Accounts for the year ended 31st March, 20X3.

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 can not 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 - 2

Tonk Tanners is engaged in manufacturing of leather shoes. They provide you the following information for the year ended 31st March,2020:

(i) 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.

(ii) On 10th January, 2020, Tonk Tanner supplied shoes worth ₹ 4,50,000 to Shani Shoes and concurrently agrees to re-purchase the same goods on 11th April. 2020.

(iii) 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 April, 2020.

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. **[RTP May 21]**

ANSWER:

(i) Shoes sent to Mohan Shoes (consignee) for consignment sale

In case goods are sent for consignment sale, revenue is recognized when significant risks of ownership have passed from seller to the buyer.

In the given case, Mohan Shoes is the consignee i.e. an agent of Tonk Tanners and not the buyer. Therefore, the risk and reward is considered to vest with Tonk Tanners only till the time the sale is 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.

(ii) Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date

For such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue and should not be recognised as revenue in the year 2019-2020. Hence, sale of ₹ 4,50,000 to Shani Shoes should not be recognized as revenue.

(iii) 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 - 3

An infrastructure company has constructed a mall and entered into agreement with tenants towards license fee (monthly rental) and variable license fee, a percentage on the turnover of the tenant (on an annual basis). Chief Financial Officer of the company wants to account/recognize license fee as income for 12 months during current year and variable license fee as income during next year, since invoice is raised in the subsequent year. Comment whether the treatment desired by the CFO is correct or not. **[RTP May 22]**

ANSWER:

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 - 4

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. **[RTP May 22]**

ANSWER:

(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 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.

QUESTION - 5

New Era Publications publishes a monthly magazine on 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The Sale of spaces 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? **[MTP March 22 (5 Marks)]**

ANSWER:

As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method as the service is performed, whichever relates the revenue to the work accomplished. In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is published and hence revenue is recognized on that date. In this case, 15.03.2020 is 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. Since, the revenue of ₹ 3,00,000 will be recognised in the March, 2020, ₹ 60,000 will be 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 in the year ended 31.03.2020 after the magazine is published on 02.04.2020. The amount received from sale of advertising space on 10.03.2020 of ₹ 2,40,000 will be considered as an advance from advertisers as on 31.03.2020.

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QUESTION - 6

(a) How will you recognize revenue in the following cases:

1. Installation Fees;

2. Advertising and Insurance agency commissions;

3. Subscriptions for publications.

(b) Shipra Ltd., has been successful jewellers for the past 100 years and sales are against cash only (returns are negligible). The company also diversified into apparels. A young senior executive was put in charge of Apparels business and sales increased 5 times. One of the conditions for sales is that dealers can return the unsold stocks within one month of the end of season. Sales return for the year was 25% of sales. Suggest a suitable Revenue Recognition Policy, with reference to AS 9. **[RTP Nov 21]**

ANSWER:

(a) **Installation Fees:** In cases where installation fees are other than incidental to the sale of a product, they should be recognized as revenue only when the equipment is installed and accepted by the customer.

Advertising and insurance agency commissions: Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed. Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

Subscription for publications: Revenue received or billed should be deferred and recognized either on a straight-line basis over time or, where the items delivered vary in value from period to period, revenue should be based on the sales value of the item delivered in relation to the total sales value of all items covered by the subscription.

(b) As per AS 9 "Revenue recognition", revenue recognition is mainly concerned with the timing of recognition of revenue in statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exists regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

Effect of Uncertainty – In the case of the jewellery business the company is selling for cash and returns are negligible. Hence, revenue can be recognized on sales. On the other hand, in Apparels Industry, the dealers have a right to return the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 25% of its sales. The company may disclose suitable revenue recognition policy in its financial statements separately for both jewellery and Apparels business.

QUESTION - 7

Old Era Publication Publishes a popular monthly magazine on 15th of every month. The publication sells the advertising space on terms of 90% payable in advance and the balance 10% payable within 30 days of release of the publication. The space for March 2020 issue of magazine was sold in the month of February, 2020. The magazine was published as per schedule on 15Th of the month. The amount of ₹ 2,70,000 has been received upto 31st March, 2020 and ₹ 30,000 was received on 10th April, 2020 for advertisement published in the March issue of the publication.

Please advise the accountant the amount of revenue to be recognized in the context of the provisions of AS 9 'Revenue Recognition' during the year ending on 31st March, 2020. **[MTP Oct 21 (5 Marks)]**

ANSWER:

Definition: As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished.

Analysis of given case: In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is appeared for public and hence revenue is recognized on that date. In this case, it is 15.03.2020, the date of publication of the magazine.

Accounting treatment for given situation: Hence, ₹ 3,00,000 (₹ 2,70,000 + ₹ 30,000) is recognized as income in March, 2020. The terms of payment are not relevant for considering the date on which revenue is to be recognized. ₹ 30,000 is treated as amount due from advertisers as on 31.03.2020 and ₹ 2,70,000 will be treated as payment received against the sale.

ACCOUNTING STANDARD 10

Property, Plant and Equipment

QUESTION - 1

Entity A has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site. The following incremental costs will be incurred:

1. **Setup costs of ₹ 5,00,000 to install machinery in the new location.**
2. **Rent of ₹ 15,00,000**
3. **Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.**

Can these costs be capitalised into the cost of the new building?

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. The costs to be incurred by the company are in the nature of costs of relocating or reorganising operations of the company and do not meet the requirement of AS 10 (Revised) and therefore, cannot be capitalised.

QUESTION - 2

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			₹
Purchase Price		Given	1,58,00,000
Add:	Site Preparation Cost	Given	1,40,000
	Technician's Salary	Specific/Attributable overheads for 3 months (45,000 x 3)	1,35,000
	Initial Delivery Cost	Transportation	50,000
	Professional Fess for Installation	Architect's Fees	30,000
Total Cost of Machinery			1,61,55,000

QUESTION - 3

With reference to AS-10 Revised, classify the items under the following heads:

HEADS

(i) Purchase Price of Property, Plant and Equipment (PPE)

(ii) Directly attributable cost of PPE or

(iii) Cost not included in determining the carrying amount of an item of PPE.

ITEMS

(1) **Import duties and non-refundable purchase taxes.**

(2) **Initial delivery and handling costs.**

(3) **Initial operating losses, such as those incurred while demand for the output of an item builds up.**

(4) **Costs incurred while and 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.**

(5) **Trade discounts and rebates.**

(6) **Costs of relocating or reorganizing part or all of the operations of an enterprise.**

(7) **Installation and assembly costs.**

(8) **Administration and other general overhead costs.**

SOLUTION:

Heads

(i) Purchase price of PPE

(ii) Directly attributable cost of PPE

(iii) Cost not included in determining the carrying amount of an item of PPE

Items		Classified under Head
1	Import duties and non-refundable purchase taxes	(i)
2	Initial Delivery and handling costs	(ii)
3	Initial operating losses, such as those incurred while demand for the output of an item builds up	(iii)
4.	Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.	(iii)
5.	Trade discounts and rebates (deducted for computing purchase price)	(i)
6.	Costs of relocating or reorganizing part or all of the operations of an enterprise.	(iii)
7.	Installation and assembly costs	(ii)
8.	Administration and other general overheads costs	(iii)

QUESTION - 4

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

1.	Cost of the plant (cost per supplier's invoice plus taxes)	₹ 25,00,000
2.	Initial delivery and handling costs	₹ 2,00,000
3.	Cost of site preparation	₹ 6,00,000
4.	Consultants used for advise on the acquisition of the plant	₹ 7,00,000
5.	Interest charges paid to supplier of plant for deferred credit	₹ 2,00,000
6.	Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
7.	Operating losses before commercial production	₹ 4,00,000

Please advise ABC Ltd. on the cost that can be capitalised in accordance with AS 10 (Revised).

SOLUTION:

According to AS 10 (Revised), these costs can be capitalised:

1.	Cost of the plant	₹ 25,00,000
2.	Initial delivery and handling costs	₹ 2,00,000
3.	Cost of site preparation	₹ 6,00,000
4.	Consultants' fees	₹ 7,00,000
5.	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 capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

QUESTION - 5

A Ltd. had following assets. Calculate depreciation for the year ended 31st March, 2020 for each asset as per AS 10 (Revised):

(i) Machinery purchased for ₹ 10 lakhs on 1st April, 2015 and residual value after useful life of 5 years, based on 2015 prices is ₹ 10 lakhs.

(ii) Land for ₹ 50 lakhs.

(iii) A Machinery is constructed for ₹ 5,00,000 for its own use (useful life is 10 years). Construction is completed on 1st April, 2019, but the company does not begin using the machine until 31st March, 2020.

(iv) Machinery purchased on 1st April.2017 for ₹ 50,000 with useful life of 5 years and residual value is NIL. On 1st April, 2019, management decided to use this asset for further 2 years only. [Nov 2020 (5 Marks)]

ANSWER:

Computation of amount of depreciation as per AS 10

		₹
(i)	Machinery purchased on 1/4/15 for ₹ 10 lakhs (having residual value of ₹ 10 lakhs) Reason: The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost. Therefore, there is no depreciable amount and depreciation is correctly zero.	Nil
(ii)	Land (50 lakhs) (considered freehold) Reason: Land has an unlimited useful life and therefore, it is not depreciated.	Nil
(iii)	Machinery constructed for own use (₹ 5,00,000/10) Reason: The entity should begin charging depreciation from the date the machine is ready for use i.e. 1st April, 2019. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.	50,000
(iv)	Machinery having revised useful life Reason: The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e (50,000/5 years). On 1st April, 2019 the asset's net book value is [50,000 – (10,000 x 2)] i.e. ₹ 30,000. The remaining useful life is 2 years as per revised estimate. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of 2 years. Consequently, it should charge depreciation for the next 2 years at ₹ 15,000 per annum i.e. (30,000 / 2 years).	15,000

QUESTION - 6

You are required to give the correct accounting treatment for the following in line with provisions of AS 10:

(a) Trozen Ltd. operates a major chain of supermarkets all over India. It acquires a new store in Pune which requires significant renovation expenditure. It is expected that the renovations will be done in 2 months during which the store will be closed. The budget for this 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?

(b) ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs the expenditure on the construction/development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Can ABC Ltd. capitalize expenditure incurred on these items as property, plant and equipment (PPE)? [RTP May 2021]

ANSWER:

(a) Trozen Ltd. should capitalize the costs of construction and remodelling the supermarket, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended. The supermarket cannot be opened without incurring the remodelling expenditure. Therefore, this construction and remodelling expenditure of ₹ 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.

(b) AS 10 states that the cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:

(a) It is probable that future economic benefits associated with the item will flow to the entity; and

(b) The cost of the item can be measured reliably.

Further, the standard provides that the standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. The cost of an item of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalization of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In view of this, even though ABC Ltd. may not be able to recognize expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalized as a part of overall cost of the project. From this, it can be concluded that, in the given case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalized as part of the items of property, plant and equipment of the refinery.

QUESTION - 7

Explain how financial capital is maintained at historical cost?

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

ANSWER:

Financial capital maintenance at historical cost: Under this convention, opening and closing assets are stated at respective historical costs to ascertain opening and closing equity. If retained profit is greater than or equals to zero, the capital is said to be maintained at historical costs. This means the business will have enough funds to replace its assets at historical costs. This is quite right as long as prices do not rise.

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

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

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

QUESTION - 8

Neon Enterprise operates a major chain of restaurants located in different cities. The company has acquired a new restaurant located at Chandigarh. The new-restaurant requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the restaurant will be closed.

Management has prepared the following budget for this period –

Salaries of the staff engaged in preparation of restaurant before its opening	**Rs. 7,50,000**
Construction and remodelling cost of restaurant	**Rs. 30,00,000**

Explain the treatment of these expenditures as per the provisions of AS 10 "Property, Plant and Equipment".

[MTP March 21 (5 Marks)]

ANSWER:

As per provisions of AS 10, any cost directly attributable to bring the assets to the location and conditions necessary for it to be capable of operating in the manner indicated by the management are called directly attributable costs and would be included in the costs of an item of PPE.

Management of Neon Enterprise should capitalize the costs of construction and remodelling the restaurant, because they are necessary to bring the restaurant to the condition necessary for it to be capable of operating in the manner intended by management. The restaurant cannot be opened without incurring the construction and remodelling expenditure amounting Rs. 30,00,000 and thus the expenditure should be considered part of the asset.

However, the cost of salaries of staff engaged in preparation of restaurant Rs. 7,50,000 before its opening are in the nature of operating expenditure that would be incurred if the restaurant was 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, Rs. 7,50,000 should be expensed.

CA DREAMERS THE AVENGER

ACCOUNTING STANDARD 11

The Effects of Changes in Foreign Exchange Rates

QUESTION - 1

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 20X1, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st Feb. was ₹ 48.85. How will you recognise the profit or loss on forward contract in the books of Rau Ltd.?

SOLUTION:

Forward Rate	₹ 49.15
Less: Spot Rate	(₹ 48.85)
Premium on Contract	₹ 0.30
Contract Amount	US$ 1,00,000
Total Loss (1,00,000 x 0.30)	₹ 30,000

Contract period 3 months (2 months falling in the year ended 31st March, 20X1)

Loss to be recognised (30,000/3) x 2 = ₹ 20,000 in the year ended 31st March, 20X1. Rest ₹ 10,000 will be recognised in the following year.

In recording a forward exchange contract intended for trading or speculation purposes, the premium or discount on the contract is ignored and at each balance sheet date, the value of the contract is marked to its current market value and the gain or loss on the contract is recognised.

QUESTION - 2

Assets and liabilities and income and expenditure items in respect of foreign branches (integral foreign operations) are translated into Indian rupees at the prevailing rate of exchange at the 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 the statement of profit and loss. Comment.

SOLUTION:

The financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures described in AS 11. The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself.

Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. For practical reasons, a rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realisable value is translated applying exchange rate when realisable value is determined which is generally closing rate.

Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account. Exchange difference arising on the translation of the financial statement of foreign operation may have tax effect which should be dealt as per AS 22 'Accounting for Taxes on Income'.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11.

QUESTION - 3

A business having the Head Office in Kolkata has a branch in UK. The following is the trail balance of Branch as at 31.03.20X4:

Account Name	Amount in £	
	Dr.	Cr.
Machinery (purchased on 01.04.20X1)	5,000	
Debtors	1,600	
Opening Stock	400	
Goods received from Head Office Account	6,100	
(Recorded in HO books as ₹ 4,02,000)		
Sales		20,000
Purchases	10,000	
Wages	1,000	
Salaries	1,200	
Cash	3,200	
Remittances to Head Office (Recorded in HO books as ₹ ₹ 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 31.03.20X4.**
- **Depreciation @ 10% p.a. is to be charged on Machinery.**
- **Prepare the trial balance after been converted in Indian Rupees.**
- **Exchange rates of Pounds on different dates are as follow:**
- **01.04.20X1 – ₹ 61; 01.04.20X3 – ₹ 63 & 31.03.20X4 – ₹ 67**

SOLUTION:

Trial Balance of the Foreign Branch converted into Indian Rupees as on March 31, 20X4

Particulars	£ (Dr.)	£ (Cr.)	Conversation Basis	₹ (Dr.)	₹ (Cr.)
Machinery	5,000		Transaction date rate	3,05,000	
Debtors	1,600		Closing Rate	1,07,200	
Opening Stock	400		Opening Rate	25,200	
Goods Received from HO	6,100		Actuals	4,02,000	
Sales		20,000	Average Rate		13,00,000
Purchases	10,000		Average Rate	6,50,000	
Wages	1,000		Average Rate	65,000	
Salaries	1,200		Average Rate	78,000	
Cash	3,200		Closing Rate	2,14,400	

Remittance to HO	2,900		Actuals	1,91,000	
HO Account		7,400	Actuals		4,90,000
Creditors		4,000	Closing Rate		2,68,000
Exchange Rate Difference			Balancing Figure	20,200	
	31,400	31,400		20,58,000	20,58,000
Closing Stock	700		Closing Rate	46,900	
Depreciation	500		Fixed Asset Rate	30,500	

QUESTION - 4

A Ltd. purchased fixed assets accosting ₹ 3,000 lakhs on 1.1.20X1 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹40.00 and ₹ 42.50 as on 1.1.20X1 and 31.12.20X1 respectively. First instalment was paid on 31.12.20X1. The entire difference in foreign exchange has been capitalised.

You are required to state, how these transaction 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 recognised as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognised as income or expense.

Calculation of Exchange Difference:

Foreign currency loan = $\frac{₹\ 3,000\ \text{lakhs}}{₹\ 40}$ = 75 lakhs US Dollars

Exchange difference = 75 lakhs US Dollars x (42.50 – 40.00) = ₹ 187.50 lakhs (including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange difference amounting ₹ 187.50 lakhs should be charged to profit and loss account for the year.

Note: The above answer has been given on the basis that the company has not exercised the option of capitalisation available under paragraph 46 of AS 11. However, if the company opts to avail the benefit given in paragraph 46A, then nothing is required to be done since the company has done the correct treatment.

QUESTION - 5

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3. 20X1.

Trade receivables include amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $ 1= ₹58.50.

Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at US $ 1 = ₹ 55.60, taking exchange rate prevailing at the date of transaction. US $ 1 = ₹61.20 was on 31.3. 20X1.

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 recognised as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during 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 amortised over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

Trade receivables	Foreign Currency Rate	₹
Initial recognition US $ 8,547 (5,00,000/58.50)	1 US $ = ₹ 58.50	5,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Gain US $ 8,547 X (61.20 – 58.50)		23,077
Treatment: Credit Profit and Loss A/c by ₹ 23.077		
Long term Loan		
Initial recognition US $ 1,07,913.67 (60,00,000/55.60)	1 US $ = ₹55.60	60,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Loss US $ 1,07,913.67 X (61.20 – 55.60)		6,04,317
Treatment: Credit Loan A/c		
And Debit FCMITD A/c or Profit and Loss A/c by ₹ 6,04,317		

Thus Exchange Difference on Long term loan amounting ₹ 6,04,317 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting ₹ 23,077 is required to be transferred to Profit and Loss A/c.

QUESTION - 6

Shan Builders Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2019-20 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, 2020 ₹ 62 per US $. If Shan Builders Limited had borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%. You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2020 as per applicable Accounting Standards. **[RTP May 21]**

ANSWER:

(i) Interest for the period 2019-20

= US $ 10 lakhs x 4% × ₹ 62 per US $ = ₹ 24.80 lakhs

(ii) Increase in the liability towards the principal amount

= US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency

= US $ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs

(iv) 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 - 7

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3. 20X1.

Trade receivables include amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $ 1= ₹58.50.

Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at US $ 1 = ₹ 55.60, taking exchange rate prevailing at the date of transaction. US $ 1 = ₹61.20 was on 31.3. 20X1.

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 recognised as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during 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 amortised over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

Trade receivables	Foreign Currency Rate	₹
Initial recognition US $ 8,547 (5,00,000/58.50)	1 US $ = ₹ 58.50	5,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Gain US $ 8,547 X (61.20 – 58.50)		23,077
Treatment: Credit Profit and Loss A/c by ₹ 23.077		
Long term Loan		
Initial recognition US $ 1,07,913.67 (60,00,000/55.60)	1 US $ = ₹55.60	60,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Loss US $ 1,07,913.67 X (61.20 – 55.60)		6,04,317
Treatment: Credit Loan A/c		
And Debit FCMITD A/c or Profit and Loss A/c by ₹ 6,04,317		

Thus Exchange Difference on Long term loan amounting ₹ 6,04,317 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting ₹ 23,077 is required to be transferred to Profit and Loss A/c.

QUESTION - 8

Answer the Following:

(i) PP Ltd. and 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, talking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.02.2021) 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. [Dec 21 (5 Marks)]

ANSWER:

(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 statement and amortized over the balance period of such long-term asset/ liability, by recognition as income or expenses 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 and Loss A/c by ₹ 90,866 and 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.

CA DREAMERS THE AVENGER

ACCOUNTING STANDARD 12

Accounting for Government Grants

QUESTION - 1

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. Pass the necessary journal entries in the books of the company for first two years if the grant amount is deduced from the value of fixed asset.

SOLUTION:

Journal in the books of Z Ltd.

Year	Particulars		₹ (Dr.)	₹ (Cr.)
1st	Fixed Assets Account	Dr.	50,00,000	
	To Bank Account			50,00,000
	(Being Fixed Assets Purchased)			
	Bank Account	Dr.	10,00,000	
	To Fixed Assets Account			10,00,000
	(Being grant received from the government)			
	Depreciation Account	Dr.	7,00,000	
	To Fixed Assets Account			7,00,000
	(Being Depreciation charged on SLM)			
	Profit & Loss Account	Dr.	7,00,000	
	To Depreciation Account			7,00,000
	(Being Depreciation transferred to P/L Account)			
2nd	Depreciation Account	Dr.	7,00,000	
	To Fixed Assets Account			7,00,000
	(Being Depreciation charged on SLM)			
	Profit & Loss Account	Dr.	7,00,000	
	To Depreciation Account			7,00,000
	(Being Depreciation transferred to P/L Account)			

QUESTION - 2

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. Pass the necessary journal entries in the books of the company for first two years if the grant is treated as deferred income.

SOLUTION:

Journal in the books of Z Ltd.

Year	Particulars		₹ (Dr.)	₹ (Cr.)
1st	Fixed Assets Account	Dr.	50,00,000	
	To Bank Account			50,00,000
	(Being fixed assets purchased)			

	Bank Account Dr. To Deferred Government Grant Account (Being grant received from the government)	10,00,000	10,00,000
	Depreciation Account Dr. To Fixed Assets Account (Being depreciation charged on SLM	9,00,000	9,00,000
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to P/L Account)	9,00,000	9,00,000
	Deferred Government Grants Account Dr. To Profit & Loss Account (Being proportionate government grant taken to P/L Account)	2,00,000	2,00,000
2nd	Depreciation Account Dr. To Fixed Assets Account (Being depreciation charged on SLM)	9,00,000	9,00,000
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to P/L Account)	9,00,000	9,00,000
	Deferred Government Grant Account Dr. To Profit & Loss Account (Being proportionate government grant taken to P/L Account)	2,00,000	2,00,000

QUESTION - 3

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 two years.

SOLUTION:

Journal Entries

Year	Particulars	₹ (Dr.)	₹ (Cr.)
1.	Fixed Assets Account Dr. To Bank Account (Being fixed assets purchased)	20	20
	Bank Account Dr. To Fixed Assets Account (Being grant received from the government reduced the cost of fixed asset)	8	8
	Bank Account Dr. To Fixed Asset Account (Being grant received from the government reduced the cost of fixed asset)	8	8
	Depreciation Account (W.N.1) Dr.	2	

	To Fixed Asset Account (Being depreciation charged on Straight Line method (SLM)		2
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 1)	2	2
2.	Fixed Assets Account Dr. To Bank Account (Being government grant on asset partly refunded which increased the cost of fixed asset)	5	5
	Depreciation Account (W.N.2) Dr. To Fixed Asset Account (Being depreciation charged on SLM on revised value of fixed asset prospectively)	3.67	3.67
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 2)	3.67	3.67

Working Notes:

1. Depreciation for Year 1

	₹ in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
	12
Depreciation $\left[\frac{12-4}{4}\right]$	2

2. Depreciation for Year 2

	₹ in lakhs
Cost of the Asset	20
Less: Government Grant received	(8)
	12
Less: Depreciation for the first year $\left[\frac{12-4}{4}\right]$	2
	10
Add: Government grant refundable	5
	15
Depreciation for the second year $\left[\frac{15-4}{3}\right]$	3,67

QUESTION - 4

On 1.4.20X1, ABC Ltd. received Government grant of ₹ 300 lakhs for acquisition of 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 20X4 due to non-fulfillment of certain conditions.

How you would deal with the refund of grant in the books of ABC Ltd. assuming that the company did not charge any depreciation for year 20X4?

SOLUTION:

According to para 21 of AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing deferred income balance, as appropriate, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

		(₹ in lakhs)
1st April, 20X1	Acquisition cost of machinery (₹ 1,500 - ₹ 300)	1,200.00
31St March, 20X2	Less: Depreciation @ 20%	(240.00)
	Book value	960.00
31st March, 20X3	Less: Depreciation @ 20%	(192.00)
	Book value	7,68.00
31st March, 20X4	Less; Depreciation @ 20%	(153.60)
1st April, 20X4	Book value	614.40
May, 20X4	Add: Refund of grant	300.00
	Revised Books value	914.40

Depreciation @ 20% on the revised books value amounting ₹ 914.40 lakhs is to be provided prospectively over the residual useful life of the asset.

QUESTION - 5

A Ltd. purchased a machinery for ₹ 40 lakhs. (Useful life 4 years and residual value ₹ 8 lakhs) Government grant received is ₹ 16 lakhs.

Show the Journal Entry to be passed at the time of refund of grant in the third year and the value of the fixed assets, if:

(1) the grant is credited to Fixed Assets A/c.

(2) the grant is credited to Deferred Grant A/c.

SOLUTION:

In the books of A Ltd.

Journal Entries (at the time of refund of grant)

(1) If the grant is credited to Fixed Assets Account:

		₹	₹
I	Fixed Assets A/c Dr. To Bank A/c (Being grant refunded)	16 lakhs	 17 akhs

II. The balance of fixed assets after two years depreciation will be ₹16 lakhs (W.N.1) and after refund of grant it will become (₹16 lakhs + ₹16 lakhs) = ₹32 lakhs on which depreciation will be charged for remaining two years. Depreciation = (32-8)/2 = ₹12 lakhs p.a. will be charged for next two years.

(2) If the grant is credited to Deferred Grant Account:

As per para 14 of AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is

charged. Accordingly, in the first two years (₹16 lakhs /4 years) = ₹4 lakhs p.a. x 2 years = ₹ 8 lakhs were credited to Profit and Loss Account and ₹ 8 lakhs was the balance of Deferred Grant Account after two years.

Therefore, on refund in the 3rd year, following entry will be passed:

			₹	₹
I	Deferred Grant A/c	Dr.	8 lakhs	
	Profit & Loss A/c	Dr.	8 lakhs	
	To Bank A/c			16 lakhs
	(Being Government grant refunded)			

II. Deferred grant account will become Nil. The Fixed assets will continue to be shown in the books at ₹ 24 lakhs (W.N.2) and deprecation will continue to be charged at ₹ 8 lakhs per annum for the remaining two years.

Working Notes:

1. **Balance of Fixed Assets after two years but before refund (under first alternative)**

   Fixed assets initially recorded in the books = ₹40 lakhs – ₹16 lakhs = ₹24 lakhs

   Depreciation p.a. = (₹24 lakhs – ₹8 lakhs)/4 years = ₹4 lakhs per year

   Value of fixed assets after two years but before refund of grant

   = ₹24 lakhs – (₹4 lakhs x 2 years) = ₹16 lakhs

2. **Balance of Fixed Assets after two years but before refund (under second alternative)**

   Fixed assets initially recorded in the books = ₹40 lakhs

   Depreciation p.a. = (₹40 lakhs – ₹8 lakhs)/4 years = ₹8 lakhs per year

   Book value of fixed assets after two years = ₹40 lakhs – (₹8 lakhs x 2 years)

   = ₹24 lakhs

   Note: Value of fixed assets given above is after refund of government grant.

CA DREAMERS THE AVENGER

QUESTION - 6

Supriya Ltd. received a grant of ₹ 2,500 lakhs during the accounting year 20X1-20X2 from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilisation. However, during the year 20X2-20X3, it was found that the conditions of grants were not complied with and the grant had to be refunded to the government in full. Elucidate the current accounting treatment, with reference to the provisions of AS-12

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 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.

In the present case, the amount of refund of government grant should be shown in the profit & loss account of the company as an extraordinary item during the year.

QUESTION - 7

On 1st April, 2016, Mac Ltd. received a Government Grant of ₹ 60 lakhs for acquisition of machinery costing ₹ 300 lakhs. The grant was credited to the cost of the asset. The estimated useful life of the machinery is 10 years. The machinery is depreciated @ 10% on WDV basis. The company had to refund the grant in June 2019 due to non-compliance of certain conditions.

How the refund of the grant is dealt with in the books of Mac Ltd. assuming that the company did not charge any depreciation for the year 2019-20.

Pass necessary Journal Entries for the year 2019-20. **[Nov 2020 (5 Marks)]**

ANSWER:

		(₹ in lakhs)
1st April, 2016	Acquisition cost of machinery	300.00
	Less: Government Grant	60.00
		240.00
31st March, 2017	Less: Depreciation @ 10%	(24.00)
1st April, 2017	Book value	216.00
31st March, 2018	Less: Depreciation @ 10%	(21.60)
1st April, 2018	Book value	194.40
31st March, 2019	Less: Depreciation @ 10%	(19.44)
1st April, 2019	Book value	174.96
	Less: Depreciation @ 10% for 2 months	(2.916)
1st June, 2019	Book value	172.044
June 2019	Add: Refund of grant*	60.00
	Revised book value	232.044

Depreciation @10% on the revised book value amounting to ₹ 232.044 lakhs is to be provided prospectively over the residual useful life of the machinery.

*considered refund of grant at beginning of June month and depreciation for two months already charged. Alternative answer considering otherwise also possible.

Journal Entries

Particulars		Dr.	Cr.
Machinery Account To Bank Account (Being government grant on asset partly refunded which increased the cost of fixed asset)	Dr.	60	60
Depreciation Account To Machinery Account (Being depreciation charged on revised value of fixed asset prospectively for 10 months)	Dr.	19.337	19,337
Profit & Loss Account To Depreciation Account (Being depreciation transferred to Profit and Loss Account amounting to ₹(2.916 + 19.337 = 22.253)	Dr.	22.253	22.253

QUESTION - 8

Darshan Ltd. purchased a Machinery on 1st April, 2016 for ₹ 130 lakhs (Useful life is 4Years). Government grant received is ₹ 40 lakhs for the purchase of above Machinery.

Salvage value at the end of useful life is estimated at ₹ 60 lakhs.

Darshan Ltd. decides to treat the grant as deferred income.

Your are required to calculate the amount of depreciation and grant to be recognized in profit & loss account for the year ending 31st March, 2017,31st March, 2018, 31st March, 2019 & 31st March, 2020.

Darshan Ltd. follows straight line method for charging depreciation. **[Jan 21 (5 Marks)]**

ANSWER:

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 and grant to be recognized in the profit and loss account each year

Depreciation per year:

	₹ 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, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

Amount of grant recognized in Profit and Loss account each year:

40 lakhs /4 years = ₹ 10 Lakhs for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

ACCOUNTING STANDARD 13

Accounting for Investments

QUESTION - 1

On 1st April, 2019 Mr. H had 30,000 equity shares of ABC Ltd. at book value of ₹ 18 per share (Nominal value 10 per share). On 10th June, 2019, H purchased another 10,000 equity shares of the ABC ltd. at ₹ 16 per share through a broker who charged 1.5% brokerage.

The directors of ABC Ltd. announced a bonus and a right issue. The terms of the issues were as follows:

(i) Bonus shares were declared at the rate of one equity share for every four shares held on 15th July, 2019.

(ii) Right shares were to be issued to the existing equity shareholders on 31st August, 2019. The company decides to issue one right share for every five equity shares held at 20% premium and the due date for payment will be 30th September, 2019. Shareholders were entitled to transfer their rights in full or in part.

(iii) No dividend was payable on these issues.

Mr. H subscribed 60% of the rights entitlements and sold the remaining rights for consideration of ₹ 5 per share.

Dividends for the year ending 31st March, 2019 was declared by ABC Ltd. at the rate of 20% and received by Mr. H on 31st October, 2019.

On 15th January, 2020 Mr. H sold half of his shareholdings at ₹ 17.50 per share and brokerage was charged @1 %.

You are required to prepare Investment account in the books of Mr. H for the year ending 31st March, 2020, assuming the shares are valued at average cost. **[Nov 2020 (10 Marks)]**

ANSWER:

In the books of Mr. H

Investment in equity shares of ABC Ltd. for the year ended 31st March, 2020

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
2019 April 1	To Balance b/d	30,000	-	5,40,000	2019 Oct.	By Bank A/c (W.N. 5)	-	60,000	20,000
June	To Bank A/c	10,000	--	1,62,400	20X2 Jan.	By Bank A/c (W.N.4)	28,000	-	4,85,100
July	To Bonus Issue (W.N. 1)	10,000	-	-	March 31	By Balance c/d (W.N. 6)	28,000	-	3,77,200
Sept.	To Bank A/c (W.N. 2)	6,000	-	72,000					
2020 Jan.	To P & L A/c (W.N. 4)	-	-	1,07,900					
March 31	To P & L A/c	-	60,000	-					
		56,000	60,000	8,82,300			56,000	60,000	8,82,300

Working Notes:

1. Calculation of no. of bonus shares issued

   Bonus Shares = (30,000 + 10,000) divided by 4= 10,000 shares

2. Calculation of right shares subscribed

   Right Shares = $\frac{30,000 \text{ shares} + 10,000 \text{ shares} + 10,000 \text{ shares}}{5}$

   =10,000 Shares

   Shares subscribed 10,000 x 60% = 6,000 shares

   Value of right shares subscribed = 6,000 shares @ 12 per shares = ₹ 72,000

3. Calculation of sale of right entitlement

   Amount received from sale of rights will be 4,000 shares x ₹ 5 per share

   = ₹ 20,000 and it will be credited to statement of profit and loss.

4. Calculation of profit/loss on sale of shares-

   Total holding = 30,000 shares original

   10,000 shares purchased

   10,000 shares bonus

   6,000 shares right shares

   56,000

   50% of the holdings were sold i.e. 28,000 shares (56,000 x1/2) were sold.

   Cost of total holdings of 56,000 shares

   = ₹ 5,40,000 + ₹ 1,62,400 + ₹ 72,000 – ₹ 20,000 = ₹ 7,54,400

   Average cost of shares sold would be:

   = $\frac{7,54,400}{56,000}$ x 28,000 = ₹ 3,77,200

	₹
Sale proceeds of 28,000 shares (28,000 x ₹17.50)	4,90,000
Less: 1% Brokerage	(4,900)
	4,85,100
Less: Cost of 28,000 shares sold	(3,77,200)
Profit on sale	1,07,900

5. Dividend received on investment held as on 1st April, 2019

   = 30,000 shares x ₹ 10 x 20%

   = ₹ 60,000 will be transferred to Profit and Loss A/c and

   Dividend received on shares purchased on 10th June, 2019

   = 10,000 shares x ₹ 10 x 20% = ₹20,000 will be adjusted to Investment A/c

6. Calculation of closing value of shares (on average basis) as on 31st March, 2020

   = $\frac{7,54,400}{56,000}$ x 28,000 = ₹ 3,77,200

QUESTION - 2

On 1st April, 2019 Mr. Shyam had an opening balance of 1000 equity shares of X Ltd ₹ 1,20,000 (face value ₹100 each).

On 5.04.2019 he further purchased 200 cum-right shares for ₹ 135 each. On 8.04.2019 the director of X Ltd announced right issue in the ratio of 1:6.

Mr. Shyam waived off 100% of his entitlement of right issue in the favour of Mr. Rahul at the rate of ₹ 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 10.10.2019 Shyam sold 350 shares for ₹ 140 each.

31.03.2020 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 31.03.2020 assuming that the shares are being valued at average cost. [RTP May 2021]

ANSWER:

In the books of Mr. Shyam

For the year ending on 31-3-2020

(Scrip: Equity Shares of X Limited)

Date	Particulars	Qty	Amount	Date	Particulars	Qty	Amount
1.4.2019	To Balance b/d	1000	1,20,000	8.04.2019	By Bank A/c (W.N.1)		3,400
5.04.2019	To Bank (200x ₹135)	200	27,000	10.10.2019	By Bank A/c (350x ₹140)	350	49,000
10.10.2019	To Profit & Loss A/c (W.N.2)		7,117	31.3.2020	By Balance c/d (W.N.3)	850	1,01,717
		1200	1,54,117			1200	1,54,117

Working Notes:

1. Sale of Rights ₹ 4,000

The market price of all shares of X Ltd after shares becoming ex-rights has been reduced by ₹ 3,400

In this case out of sale proceeds of ₹4,000; ₹ 3,400 may be applied to reduce the carrying amount to the market value and ₹ 600 would be credited to the profit and loss account.

2. **Profit on sale of 350 shares**

	Amount
Sale price of 350 shares (350 shares x 140 each)	₹ 49,000
Less: Cost of 350 shares [(1,20,000 + 27,000 – 3,400) x 350] /1200	₹ 41,833
Profit	₹ 7,117

3. **Valuation of 850 shares as on 31.03.2020**

Particulars	Amount
Cost price of 850 shares [(1,20,000 +27,000 -3,400) x 850 /1,200]	₹ 1,01,717
Fair Value as on 31.03.2020 [850 X ₹ 125 each]	₹ 1,06,250
Cost price or fair value whichever is less	₹ 1,01,717

QUESTION - 3

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.

[Jan 21 (5 Marks)]

ANSWER:

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 are less than its market value of ₹ 13.5 lakhs.

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.

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QUESTION - 4

P Ltd. had 8,000 equity shares of K Ltd., at a book value of ₹ 15 per share (face value of ₹ 10 each) on 1st April, 2019. On 1st September, 2019, P Ltd. acquired another 2,000 equity shares of K Ltd. at a premium of ₹ 4 per share. K Ltd. announced a bonus and right issue for existing shareholders.

The term of bonus and right issue were:

(i) Bonus was declared at the rate for two equity shares for every five shares held on 30th September, 2019.

(ii) Right shares are to be issued to the existing shareholders on 1st December, 2019. The Company had issued two right shares for every seven shares held at 25% premium on face value. No dividend was payable on these shares. The whole sum being payable by 31st December, 2019.

(iii) Existing shareholders were entitled to transfer their right to outsiders either wholly or in part.

(iv) P Ltd. exercised its option under the issue for 50% of its entitlements and sold the remaining rights for ₹8 per share.

(v) Dividend for the year ended 31st March, 2019 at the rate of 20% was declared by K Ltd. and received by P Ltd. on 20th January, 2020.

(vi) On 1st February, 2020, P Ltd. sold half of its shareholdings at a premium of ₹ 4 per share.

(vii) The market price of share on 31st March, 2020 was ₹13 per share.

You are required to prepare the Investment account of P Ltd. for the year ended 31st March, 2020 and determine the value of shares held on that date, assuming the investment as current investment. Consider average cost basis for ascertainment for cost for equity shares sold.

ANSWER:

Investment Account-Equity Shares in K Ltd.

Date		No. of shares	Dividend	Amount	Date		No. of shares	Dividend	Amount
			₹	₹				₹	₹
1.4.19	To Bal.b/d	8,000	-	1,20,000	20.1.20	By Bank (dividend) [8,000 x 10 x 20%] and [2,000 x 10 x 20%]		16,000	4,000
1.9.19	To Bank	2,000	-	28,000	1.2.20	By Bank	8,000		1,12,000
30.9.19	To Bonus Issue	4,000		—					
31.12.19	To Bank (Right) (W.N.1)	2,000	-	25,000	31.3.20	By Balance c/d (W.N. 3)	8,000		84,500
20.1.20	To Profit & Loss A/c (Dividend income)		16,000						
1.2.20	To P& L A/c (profit on sale)			27,500					
		16,000	16,000	2,00,500			16,000	16,000	2,00,500

Working Notes:

1. **Right shares**

No. of right shares issued = (8,000 + 2,000 + 4,000)/ 7 X 2= 4,000

No. of right shares subscribed = 4,000 x 50% = 2,000 shares

Value of right shares issued = 2,000 x ₹12.50 = ₹ 25,000

No. of right shares sold = 2,000 shares

Sale of right shares = 2,000 x ₹ 8 = ₹ 16,000 to be credited to statement of profit and loss

2. **Cost of shares sold — Amount paid for 16,000 shares**

	₹
(₹1,20,000 + ₹ 28,000 + ₹ 25,000)	1,73,000
Less: Dividend on shares purchased on Sept.1 (since the dividend pertains to the year ended 31st March, 2019, i.e., the pre-acquisition period)	(4,000)
Cost of 16,000 shares	1,69,000
Cost of 8,000 shares (Average cost basis)	84,500

Sale proceeds (8,000 X ₹14)	1,12,000
Profit on sale	27,500

3. Value of investment at the end of the year

Assuming investment as current investment, closing balance will be valued based on lower of cost or net realizable value.

Here, Net realizable value is ₹13 per share i.e., 8,000 shares x ₹ 13 = ₹ 1,04,000 and cost = 84,500. Therefore, value of investment at the end of the year will be ₹ 84,500.

QUESTION - 5

On 1st April, 2019, Rajat has 50,000 equity shares of P Ltd. at a book value of Rs. 15 per share (face value Rs. 10 each). He provides you the further information:

(1) On 20th June, 2019 he purchased another 10,000 shares of P Ltd. at Rs. 16 per share.

(2) On 1st August, 2019, P Ltd. issued one equity bonus share for every six shares held by the shareholders.

(3) On 31st October, 2019, the directors of P Ltd. announced a right issue which entitles the holders to subscribe three shares for every seven shares at Rs. 15 per share. Shareholders can transfer their rights in full or in part.

Rajat sold 1/3rd of entitlement to Umang for a consideration of Rs. 2 per share and subscribed the rest on 5th November, 2019.

You are required to prepare Investment A/c in the books of Rajat for the year ending 31st March, 2020.

[MTP March 21 (8 Marks)]

ANSWER:

In the books of Rajat

Investment Account

(Equity shares in P Ltd.)

Date	Particulars	No. of shares	Amount (Rs.)	Date	Particulars	No. of shares	Amount (Rs.)
1.4.19	To Balance b/d	50,000	7,50,000	31.3.20	By Balance c/d (Bal. fig.)	90,000	12,10,000
20.6.19	To Bank A/c	10,000	1,60,000				
1.8.19	To Bonus issue (W.N.1)	10,000	--				
5.11.19	To Bank A/c (right shares) (W.N.4)	20,000	3,00,000				
		90,000	12,10,000			90,000	12,10,000

Working Notes:

(1) Bonus shares $= \frac{50,000 + 10,000}{6} = 10,000$ shares

(2) Right shares $= \frac{50,000 + 10,000 + 10,000}{7} \times 3 = 30,000$ shares

(3) Sale of rights = 30,000 shares x $\frac{1}{3}$ x Rs. 2 = Rs. 20,000 to be credited to P & L A/c as per AS 13.

Rights subscribed = 30,000 shares x $\frac{2}{3}$ x ₹ 15 = Rs. 3,00,000

QUESTION - 6

A Ltd. purchased on 1st April, 2020 8% convertible debenture in C Ltd. of face value of Rs. 2,00,000 @ Rs. 108. On 1st July, 2020 A Ltd. purchased another Rs. 1,00,000 debentures @ Rs. 112 cum interest. On 1st October, 2020 Rs. 80,000 debentures were sold @ Rs. 105. On 1st December, 2020, C Ltd. give option for conversion of 8% convertible debentures into equity share of Rs. 10 each. A Ltd. received 5,000 equity shares in C Ltd. in conversion of 25% debentures held on that date. The market price of debenture and equity share in C Ltd. on 31st December, 2020 is Rs. 110 and Rs. 15 respectively. Interest on debenture is payable each year on 31st March, and 30th September. Prepare investment account in the books of A Ltd. on average cost basis for the accounting year ended 31st December, 2020. **[MTP April 21 (8 Marks)]**

ANSWER:

Investment Account for the year ending on 31st December, 2020

Scrip : 8% Convertible Debentures in C Ltd.

[Interest Payable on 31st March and 30th September]

Date	Particulars	Nominal value Rs.	Interest Rs.	Cost Rs.	Date	Particulars	Nominal Value (Rs.)	Interest (Rs.)	Cost (Rs.)
1.4.20	To Bank A/c	2,00,000	-	2,16,000	3.9.20	By Bank A/c [Rs. 3,00,000 x 8% x 6/12]	-	12,000	-
1.7.20	To Bank A/c (W.N.1)	1,00,000	2,000	1,10,000					
31.12.20	To P&L A/c [Interest]	-	14,033	-	1.10.20	By Bank A/c	80,000		84,000
					1.10.20	By P & L A/c (loss) (W.N.3)			2,933
					1.12.20	By Bank A/c (Accrued interest) (Rs. 55,000 x .08 x 2/12)		733	
					1.12.20	By Equity shares in C Ltd. (W.N. 3 and 4)	55,000		59,767
					31.12.20	By Balance c/d (W.N.5)	1,65,000	3,300	1,79,300
		3,00,000	16,033	3,26,000			3,00,000	16,033	3,26,000

SCRIP: Equity Shares in C Ltd.

Date	Particulars	Cost (Rs.)	Date	Particulars	Cost (Rs.)
1.12.20	To 8 % debentures	59,767	31.12.20	By balance c/d	59,767

Working Notes:

(i) Cost of Debenture purchased on 1st July = Rs.1,12,000 – Rs.2,000 (Interest) = Rs.1,10,000

(ii) Cost of Debentures sold on 1st Oct.

= (Rs.2,16,000 + Rs.1,10,000) x 80,000/3,00,000 = Rs. 86,933

(iii) Loss on sale of Debentures = Rs. 86,933– Rs.84,000 = Rs.2,933

Nominal value of debentures converted into equity shares =Rs. 55,000

[(Rs. 3,00,000 – 80,000) x.25]

Interest received before the conversion of debentures

Interest on 25% of total debentures = 55,000 x 8% x 2/12 = 733

(iv) Cost of Debentures converted = (Rs. 2,16,000 + Rs.1,10,000) x 55,000/3,00,000

= Rs. 59,767

(v) Cost of closing balance of Debentures = (Rs. 2,16,000 + Rs.1,10,000) x 1,65,000 / 3,00,000

= Rs. 1,79,300

(vi) Closing balance of Debentures has been valued at cost.

(vii) 5,000 equity Shares in C Ltd. will be valued at cost of Rs. 59,767 being lower than the market value Rs. 75,000 (Rs. 15 x5,000)

Note: It is assumed that interest on debentures, which are converted into cash, has been received at the time of conversion.

QUESTION - 7

Mr. Z has made following transactions during the financial year 2020-21:

Investment 1: 8% Corporate Bonds having face value ₹ 100.

Date	Particulars
01-06-2020	Purchased 36,000 Bonds at ₹ 86 cum-interest. Interest is payable on 30th September and 31st March, every year
15-02-2021	Sold 24,000 Bonds at ₹ 92 ex-interest

Interest on the bonds is received on 30th September and 31st March.

Investment 2: Equity Shares of G Ltd. having face value ₹ 10

Date	Particulars
01-04-2020	Opening balance 8000 equity shares at a book value of ₹ 190 per share
01-05-2020	Purchased 7,000 equity shares@ ₹ 230 on cum right basis; 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 Z* Ltd. as Long term Investment. On 15th May 2021, the shares were quoted in the stock exchange @ ₹ 180.

You are required to:

(i) Prepare Investment Accounts in the books of Mr. Z for the year 2020-21, assuming that the average cost method is followed.

(ii) Profit and loss Account for the year 2020-21, based on the above information.

(iii) Suggest values at which investment in equity shares should be reclassified in accordance with AS 13.

[July 21 (20 Marks)]

ANSWER:

I. **In the books of Mr. Z**

Investment in 8% Corporate Bonds Account

For the period 01 April 2020 to 31 March 2021

Date	Particulars	Nos	Interest (₹)	Amount (₹)	Date	Particulars	Nos	Interest (₹)	Amount (₹)
1/6/20	To Bank A/c (WN 1)	36,000	48,000	30,48,000	30/9/20	By Bank A/c (interest 36,000 x 100 x 8% x 6/12)		1,44,000	
15/2/21	To Profit & Loss A/c (WN 3)			1,76,000	15/2/21	By Bank A/c (WN2)	24,000	72,000	22,08,000
31/3/21	To Profit & Loss A/c		2,16,000		31/3/21	By Bank A/c (Interest 12,000 x 100 x 8% x 6/12)		48,000	
						By Balance c/d (WN4)	12,000		10,16,000
	Total	36,000	2,64,000	32,24,000		**Total**	36,000	2,64,000	32,24,000

Note: For computing the interest on the bonds sold on 15 Feb 2021, if number of days (138 days) is taken instead of months, the interest received on 15.02.2021 should be ₹72,592 and the total interest transferred to Profit & Loss Account should be ₹ 2,16,592.

Investment in Equity Shares of G Ltd.

For the period 1st April 2020 to 31 March 2021

Date	Particulars	Nos	Dividend (₹)	Amount (₹)	Date	Particulars	Nos	Dividend (₹)	Amount (₹)
01/4/20	To balance b/d	8,000		15,20,000	16/9/20	By Bank A/c (WN 7)		48,000	42,000
01/5/20	To Bank A/c (WN 5)	7,000		16,26,100	1/12/20	By Bank A/c (WN 8)	7,000		18,01,800
15/6/20	To Bonus Shares	6,000			25/1/21	By Bank A/c (WN 10)		48,300	
25/8/20	To Bank A/c (Right Shares) (WN 6)	2,100		4,83,000					
01/12/20	To Profit & Loss A/c (Sale of Shares) (WN 9)			7,14,800					
31/3/21	To Profit & Loss A/c		96,300						
					31/3/21	By Balance c/d (WN 11)	16,100		25,00,100
	Total	23,100	96,300	43,43,900		Total	23,100	96,300	43,43,900

Working Notes

1. Computation of the Interest element in the bonds purchased on 01 June 2020

No of Bonds purchased	36,000
Face value per bond	₹ 100
Face value of the bonds purchased	₹ 36,00,000
Interest Rate	8%
Interest Account	36,00,000 x 8% x 2/12
	₹ 48,000
Cum-interest per bond	₹ 86
Value of bond excluding interest	36,000 x 86 – 48,000

	₹ 30,48,000

2. Computation of the Interest element in the bonds sold on 15 Feb 2021

No of Bonds sold	24,000
Face value per bond	₹ 100
Face value of the bonds sold	₹ 24,00,000
Interest Rate	8%
Interest Amount	24,00,000 x 8% x 4.5/12
	= ₹ 72,000

3. Computation of Profit on Sale of Bonds on 15 Feb 2021

No of Bonds sold	24,000
Face value per bond	₹ 100
Ex- interest Rate per bond	₹ 92
Sales proceeds	₹ 22,08,000
Average Cost of Bonds	(30,48,000/36,000) x 24,000
	₹ 20,32,000
Profit on sale of bonds	Sale Proceeds – Average Cost
	22,08,000 – 20,32,000
	₹ 1,76,000

4. Valuation of Bonds as on 31 March 2021

No. of Bonds held as on 31 Mar. 2021	12,000
Average cost of Bonds	(30,48,000/36,000) x 12,000
	₹ 10,16,000

5. Computation of the cost of the equity shares purchased on 01 May 2020

No of shares purchased	7,000
Cum right price per share	₹ 230
Cost of purchase	₹ 16,10,000
Brokerage @ 1%	₹ 16,100
Cost including brokerage	₹ 16,26,100

6. Right shares

No. of Right Shares Issued	(8,000 + 7,000 + 6,000)/7 = 3,000 shares
No of right shares sold	3,000 shares x 30% = 900 shares
Proceeds from sale of right shares to be credited to statement of profit & loss	900 shares x ₹ 75 = ₹ 67,500
No of right shares subscribed	3,000-900 = 2,100 shares
Amount of right shares subscribed	2,100 x 230 = ₹ 4,83,000

7. Computation of Dividend Received on 16 Sept 2020

No of shares held during the period of dividend	8,000 shares
Dividend per share	₹ 6
Dividend Amount	8,000 x 6 = ₹ 48,000
No of shares received after the period of dividend (excluding bonus & right shares)	7,000 shares

Dividend per share	₹ 6
Dividend Amount	7,000 x 6 = ₹ 42,000

The amount of dividend for the period for which the shares were not held by the investor has been treated as capital receipt. Thus ₹ 42,000 shall be treated as capital receipt

8. Sale Proceeds for the shares sold on 1st Dec. 2020

No of shares sold	7,000 Shares
Sale Price per share	₹ 260
Proceeds from sale of share	7,000 x 260 = ₹ 18,20,000
Less: Brokerage @ 1%	₹ 18,200
Net Sale Proceeds	₹ 18.01,800

9. Profit on sale of Shares on 1st Dec. 2020

Sale Proceeds	₹18,01,800
Average Cost	(15,20,000 + 16,26,100 + 4,83,000 – 42,000)/23,100 x 7000
	= ₹ 10,87,000
Profit on sale of shares	Sale Proceeds – Average Cost
	= ₹ 18,01,800 – 10,87,000
	= ₹ 7,14,800

10. Computation of Amount of Interim Dividend

No. of shares held	8,000 + 7,000 + 6,000 + 2,100 – 7,000
	= 16,100
Dividend per share	₹ 3 per share
Dividend Received	16,100 shares x ₹ 3 per share
	= ₹ 48,300

11. Valuation of shares of shares as on 31 March 2021

Cost of Shares	(15,20,00 + 16,26,100 + 4,83,000 – 42,000)/23,100 x 16,100
	= 25,00,100
Market Value of Shares	₹ 260 x 16,100 = ₹ 41,86,000

Closing stock of equity shares has been value at ₹ 25,00,100 i.e. cost being lower than its market value.

II. Profit & Loss Account (Extract)

For the period 01 April 2020 to 31 March 2021

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance c/d	12,70,600	By Investment in 8% Corporate Bonds Account (Profit on sale of Bonds)	1,76,000
		By Investment in 8% Corporate Bonds Account (Interest on bonds)	2,16,000
		By Sale of Right Shares	67,500
		By Investment in Equity Shares of G Ltd. (Profit on sale of shares)	7,14,800
		By Investment in Equity Shares of G Ltd. (Dividend Income)	96,300

III. As per AS 13, when investments are classified from Current Investments to Long term Investments, transfer is made at Cost and Fair value, whichever is less (as on the date of transfer). So, in the given case valuation shall be done as follows:

Date of reclassification/transfer – 15 May 2021

Per Unit Cost of 16,100 shares held – ₹ 25,00,100/16,100 shares – ₹ 155.29

Market Price/Fair Value per share – ₹ 180

As the cost per unit is lower than its fair value, the shares are to be transferred at its cost i.e., at ₹ 155.29 per share on 15 May 2021

Note:

1. In the eight last line of the question, investment in equity shares of G Ltd. was wrongly printed as Z Ltd. in the question paper. In the above solution, it has been considered as investment in G Ltd. If considered as Investment in equity shares in Z Ltd. (some other investment and not investment in G Ltd.), then the cost of the investment for shares in Z Ltd. will not be available.

2. The entire amount of sale proceeds from rights has been credited to Profit and Loss account in the above solution. However, the sale proceeds of rights in respect of 7,000 shares (purchased cum right on 1.5.20) can be applied to reduce the carrying amount of such investments (without crediting it to profit and loss account) considering that the value of these shares has reduced after becoming their ex-right. In that case, ₹ 22,500 (67,500X 7/21) will be applied to reduce the carrying amount of investment and ₹ 45,000 will be credited to profit and loss account.

QUESTION - 8

On 1st April, 2019, Mr. Vijay had 30,000 Equity shares in X Ltd. (the company) at a book value of ₹ 4,50,000 (Face Value ₹ 10 per share). On 22nd June, 2019, he purchased another 5000 shares of the same company for ₹ 80,000. The Directors of X Ltd. announced a bonus of equity shares in the ratio of one share for seven shares held on 10th August, 2019.

On 31st August, 2019 the Company made a right issue in the ratio of three shares for every eight shares held, on payment of ₹ 15 per share. Due date for the payment was 30th September, 2019, Mr. Vijay subscribed to 2/3rd of the right shares and sold the remaining of his entitlement to Viru for a consideration of ₹ 2 per share.

On 31stOctober,2019, Vijay received dividends from X Ltd. @ 20% for the year ended 31st March, 2019. Dividend for the shares acquired by him on 22nd June,2019 to be adjusted against the cost of purchase.

On 15th November, 2019 Vijay sold 20,000 Equity shares at a premium of ₹ 5 per share.

You are required to prepare Investment Account in the books of Mr. Vijay for the year ended 31st March, 2020 assuming the shares are being valued at average cost.

[MTP Oct 21 (8 Marks)]

ANSWER:

Books of Vijay

Investment Account

(Scrip: Equity Shares in X Ltd.)

		No.	Amount			No.	Amount
			₹				₹
1.4.2019	To Bal b/d	30,000	4,50,000	31.10.2019	By Bank (dividend on shares acquired on 22/6/2019)	--	10,000
22.6.2019	To Bank	5,000	80,000				
10,8,2019	To Bonus	5,000	-				
30.9.2019	To Bank (Rights Shares)	10,000	1,50,000				
15.11.2019	To Profit (on sale of shares)		32,000	15.11.2019	By Bank (Sale of Shares)	20,000	3,00,000

				31.2.2020	By Bal. C/d	30,000	4,02,000
		50,000	7,12,000			50,000	7,12,000

Working Notes:

(1) Bonus Shares = (30,000 + 5,000) / 7 = 5,000 shares

(2) Right Shares = $\frac{(30,000 + 5,000 + 5,000)}{8}$ x 3 = 15,000 shares

(3) Rights shares sold = 15,000 x 1/3 = 5,000 shares

(4) Dividend received = 30,000 x 10 x 20% = ₹ 60,000 will be taken to P&L statement

(5) Dividend on shares purchased on 22.6.2019 = 5,000 x 10 x 20% = ₹ 10,000 is adjusted to Investment A/c

(6) Profit on sale of 20,000 shares

= Sales proceeds – Average cost

Sales proceeds = ₹ 3,00,000

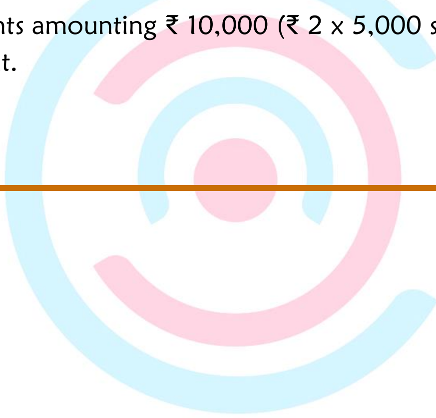
Average Cost = $\frac{(4,50,000 + 80,000 + 1,50,000 - 10,000)}{50,000}$ x 20,000 = ₹ 2,68,000

Profit = ₹ 3,00,000 - ₹ 2,68,000 = ₹ 32,000.

(7) Cost of Shares on 31.3.2020

$\frac{(4,50,000 + 80,000 + 1,50,000 - 10,000)}{50,000}$ x 30,000 = ₹ 4,02,000

Sale of rights amounting ₹ 10,000 (₹ 2 x 5,000 shares) will not be shown in investment A/c but will directly be taken to P & L statement.



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ACCOUNTING STANDARD 15

Employee Benefits

QUESTION - 1

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 - 2

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 (Revised 2005) '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 - 3

As on 1st April, 20X1 the fair value of plan assets was ₹ 1,00,000 in respect of a pension plan of Zeleous Ltd. On 30th September, 20X1 the plan paid out benefits of ₹ 19,000 and received inward contributions of ₹ 49,000. On 31st March, 20X2 the fair value of plan assets was₹ 1,50,000 and present value of the defined benefit obligation was ₹ 1,47,920. Actuarial losses on the obligations for the year 20X1-20X2 were ₹ 600.

On 1st April, 20X1, the company made the following estimates, based on its market studies, understanding and prevailing prices.

	%
Interest & dividend income, after tax payable by the fund	**9.25**
Realised and unrealised gains on plan assets (after tax)	**2.00**
Fund administrative costs	**(1.00)**
Expected Rate of Return	**10.25**

You are required to find the expected and actual returns on plan assets.

SOLUTION

Computation of Expected and Actual Returns on Plan Assets

	₹
Return on ₹ 1,00,000 held for 12 months at 10.25%	10,250
Return on ₹ 30,000 (49,000-19,000) held for six months at 5% (equivalent to 10.25% annually, compounded every six months)	1,500

Expected return on plan assets for 20X1-20X2		11,750
Fair value of plan assets as on 31 March, 20X2		1,50,000
Less: Fair value of plan assets as on 1 April, 20X1	1,00,000	
Contributions received	49,000	(1,49,000)
		1,000
Add: Benefits paid		19,000
Actual return on plan assets		20,000

Alternatively, the above question may be solved without giving compound effect to rate of return.

QUESTION - 4

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 the 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.

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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 - 5

An employee Roshan has joined a company XYZ Ltd. in the year 20X1. 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)

<u>SOLUTION</u>

Calculation of Defined Benefit Obligation (DBO)

Expected last drawn salary = ₹ 14,90,210 x 110% x 110% x 110% x 110% x 110%

= ₹ 24,00,000

Defined Benefit Obligation (DBO) = ₹ 24,00,000 x 25% x 5 = ₹ 30,00,000

Amount of ₹ 6,00,000 will be charged to Profit and Loss Account of the company every year as cost for Defined Benefit Obligation.

Calculation of Current Service Cost

Year	Equal apportioned amount of DBO [i.e. ₹30,00,000/5 years]	Discounting @ 8% PV factor	Current services cost (Present Value)
a	b	c	d = b x c
1	6,00,000	0.735 (4 Years)	4,41,000
2	6,00,000	0.794 (3 Years)	4,76,400
3	6,00,000	0.857 (2 Years)	5,14,200
4	6,00,000	0.926 (1 Year)	5,55,600
5	6,00,000	1 (0 Year)	6,00,000

Calculation of Interest Cost to be charged per year

Year	Opening Balance	Interest Cost	Current Service Cost	Closing Balance
a	b	c = b x 8%	d	e = b + c + d
1	0	0	4,41,000	4,41,000
2	4,41,000	35,280	4,76,400	9,52,680
3	9,52,680	76,214	5,14,200	15,43,094
4	15,43,094	1,23,447	5,55,600	22,22,141
5	22,22,141	1,77,859*	6,00,000	30,00,000

*Due to approximations used in calculation, this figure is adjusted accordingly.

QUESTION - 6

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:

(i) **Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.**

(ii) **Since it is not related to the length of service of the employees, it is accounted for on claim basis.**

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer.

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,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15 (Revised).

(2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowances. The amount of provision should be calculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

QUESTION - 7

The following data apply to 'X' Ltd. defined benefit pension plan for the year ended 31.03.20X2 calculate the actual return on plan assets:

– Benefits paid	2,00,000
– Employer contribution	2,80,000
– Fair market value of plan assets on 31.03.20X2	11,40,000
– Fair market value of plan assets as on 31.03.20X1	8,00,00

SOLUTION

		₹
Fair value of plan assets on 31.3.20X1		8,00,000
Add: Employer contribution		2,80,000
Less: Benefits paid		(2,00,000)
	(A)	8,80,000
Fair market value of plan assets at 31.3.20X2	(B)	11,40,000
Actual return on plan assets		2,60,000
	(B – A)	

QUESTION - 8

The fair value of plan assets of Anupam Ltd. was ₹ 2,00,000 in respect of employee benefit pension plan as on 1st April, 20X1. On 30th September, 20X1 the plan paid out benefits of ₹ 25,000 and received inward contributions of ₹ 55,000. On 31st March, 20X2 the fair value of plan assets was ₹ 3,00,000. On 1st April, 20X1 the company made the following estimates, based on its market studies and prevailing prices.

	%
Interest and dividend income (after tax) payable by fund	10.25

Realized gains on plan assets (after tax)	**3.00**
Fund administrative costs	**(3.00)**
Expected rate of return	**10.25**

Calculate the expected and actual returns on plan assets as on 31st March, 20X2, as per AS 15.

SOLUTION

Computation of Expected Returns on Plan Assets as on 31st March, 20X2, 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, 20X2	22,000

Computation of Actual Returns on Plan Assets as on 31st March, 20X2, as per AS 15

	₹	₹
Fair value of Plan Assets as on 31st March, 20X2		3,00,000
Less: Fair value of Plan Assets as on 1st April, 20X1	(2,00,000)	
Add: Contribution received as on 30th September, 20X1	55,000	(2,55,000)
		45,000
Add: Benefits paid as on 30th September, 20X1		25,000
Actual returns on Plan Assets as on 31st March, 20X2		70,000

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ACCOUNTING STANDARD 16

Borrowing Costs

QUESTION - 1

X Ltd. began construction of a new building on 1st January, 20X1. It obtained ₹ 1 lakhs special loan to finance the construction of the building on 1st January, 20X1 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:

		₹
January	20X1	2,00,000
April	20X1	2,50,000
July	20X1	4,50,000
December	20X1	1,20,000

Building was completed by 31st December 20X1. Following the principles prescribed in AS 16 'Borrowing Cost,' calculate the amount of interest to be capitalised and pass on Journal Entry for capitalising the cost borrowing cost in respect of the building.

SOLUTION:

(i) Computation of weighted average accumulated expenses

		₹
₹ 2,00,000 x 12/12	=	2,00,000
₹ 2,50,000 x 9/12	=	1,87,500
₹ 4,50,000 x 6/12	=	2,25,000
₹ 1,20,0000 x 1/12	=	10,000
		6,22,500

(ii) Calculation of weighted average interest rate other than for specific borrowings

Amount of loan (₹)	Rate of interest	Amount of interest (₹)
5,00,000	11%	= 55,000
9,00,000	13%	= 1,17,000
14,00,000		1,72,000
Weighted average rate of interest $\left(\frac{1,72,000}{14,00,000} \text{ x } 100\right)$		= 12.585% (approx.)

(iii) Interest on weighted average accumulated expenses

	₹
Specific borrowings (₹ 1,00,000 x 10%) =	10,000
Non-specific borrowing (₹ 5,22,500* x 12.285%) =	64,189
Amount of interest to be capitalised =	74,189

(iv) Total expenses to be capitalised for building

	₹
Cost of building ₹ (2,00,000 + 2,50,000 + 4,50,000 + 1,20,000)	10,20,000
Add: Amount of interest to be capitalised	74,189
	10,94,189

(v) Journal Entry

Date	Particulars	Dr. (₹)	Cr. (₹)
31.12.20X1	Building account Dr.	10,94,189	
	To Bank Account		10,94,189
	(Being amount of cost of building and borrowing cost thereon capitalised)		

QUESTION - 2

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, 20X2 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 20X1-20X2 on the entire Institutional Term Loan of ₹ 580 lakhs.

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SOLUTION:

As per para 6 of AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expenses in the period in which they are incurred.

A qualifying asset is an asset that necessary takes a substantial period of time* to get ready for its intended use or sale.

The treatment for total interest amount of ₹ 52.20 lakhs can be given as:

Purpose	Nature	Interest to be capitalised	Interest to be charged to Profit and loss account
		₹ in lakhs	₹ in lakhs
Modernisation and renovation of plant and machinery	Qualifying asset	$**52.20 \times \frac{406}{580} = 36.54$	
Advance to supplies for additional assets	Qualifying asset	$**52.20 \times \frac{58}{580} = 5.22$	
Working Capital	Not a qualifying asset		$**52.20 \times \frac{116}{580} = 10.44$
		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, 20X2.

QUESTION - 3

On 1st April, 20X1, Amazing Construction Ltd. obtained a loan of ₹ 32 crores to be utilised as under:

(i)	**Construction of sealink across two cities:** **(work was help up totally for a month during the year due to high water levels)**	:	**₹ 25 crores**
(ii)	**Purchase of equipments and machineries**	:	**₹ 3 crores**
(iii)	**Working capital**	:	**₹ 2 crores**
(iv)	**Purchase of vehicles**	:	**₹ 50,00,000**
(vi)	**Purchase of technical know-how**	:	**₹ 1 crores**
(vii)	**Total interest charged by the bank for the year ending 31st March, 20X2**	:	**₹ 80,00,000**

Show the treatment of interest by Amazing Construction Ltd.

SOLUTION:

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use.

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

The treatment of interest by Amazing Construction Ltd. can be shown as:

	Qualifying Asset	Interest to be capitalised ₹	Interest to be charged to Profit & Loss A/c ₹	
Construction of sea-link	Yes	62,50,000		[80,00,000 x (25/32)]
Purchase of equipment and machineries	No		7,50,000	[80,00,000 x (3/32)]
Working capital	No		5,00,000	[80,00,000 x (2/32)]
Purchase of vehicles	No		1,25,000	[80,00,000 x (0.5/32)]
Advance for tools, cranes etc.	No.		1,25,000	[80,00,000 x (0.5/32)]
Purchase of technical know-how	No		2,50,000	[80,00,000 x (1/32)]
Total		62,50,000	17,50,000	

QUESTION - 4

On 15th April, 2019 RBM Ltd. obtained a Term Loan from the Bank for ₹ 320 lakhs to be utilized as under:

	₹ (in lakhs)
Construction for factory shed	**240**
Purchase of Machinery	**30**
Working capital	**24**
Purchase of Vehicles	**12**
Advance for tools/cranes etc.	**8**
Purchase of technical know how	**6**

In March, 2020 construction of shed was completed and machinery was installed. Total interest charged by the bank for the year ending 31st March, 2020 was ₹ 40 lakhs.

In the context of provisions of AS 16 'Borrowing Costs', show the treatment of interest and also explain the nature of Assets. **[Nov 2020 (5 Marks)]**

ANSWER:

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 and related borrowing cost will be charged to Profit and Loss statement.

Qualifying Asset as per AS 16 (construction of a shed) = ₹ 240 lakhs

Borrowing cost to be capitalized = ₹ 40 lakhs x 240/320 = ₹ 30 lakhs

Interest to be debited to Profit or Loss account: ₹ (40 – 30) = ₹ 10 lakhs.

Note: Assumed that construction of factory shed completed on 31st March, 2020.

QUESTION - 5

When capitalization of borrowing cost should cease as per Accounting Standard 16? Explain in brief.

[RTP May 2021]

ANSWER:

Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalization of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

QUESTION - 6

U Limited has obtained a term loan of ₹ 620 lacs for a complete renovation and modernization of its Factory on 1st April, 2020. Plant and Machinery was acquired under the modernization scheme and installation was completed on 30th April, 2021. An expenditure of ₹ 564 lacs was incurred on this Plant and Machinery and the balance loan of ₹ 56 lacs has been used for working capital purposes. The company has paid total interest of ₹ 68.20 lacs during financial year 2020-2021 on the above loan. The accountant seeks your advice how to account for the interest paid in the books of accounts. Will your answer be different, if the whole process of renovation and modernization gets completed by 28th February, 2021?

ANSWER:

Borrowing Cost: As per AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Borrowing costs should be expensed except where they are directly attributable to acquisition, construction or production of qualifying asset.

Qualifying Asset: A qualifying asset is an asset that necessarily takes a substantial period of time (ordinarily, a period of twelve months unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case) to get ready for its intended use or sale.

(i) When construction of asset completed on 30th April, 2021

The treatment for total borrowing cost of ₹ 68.20 lakhs will be as follows:

Purpose	Nature	Interest to be capitalized ₹ in lakhs	Interest to be charged to profit and loss account ₹ in lakhs
Plant and machinery under Modernization and renovation scheme	Qualifying assets	[68.20 x (564/620)] = 62.04	
Working Capital	Not a qualifying asset		[68.20 x (56/620)] = 6.16
		62.04	6.16

(ii) When construction of assets is completed by 28th February, 2019

In this scenario, when the process of renovation gets completed in less than 12 months, the plant and machinery will not be considered as qualifying assets (until and unless the entity specifically considers that the asset took substantial period of time for completing their construction) and the whole of interest will be required to be charged off / expensed off to Profit and loss account.

QUESTION - 7

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'. **[MTP Nov 21 (5 Marks)]**

ANSWER:

Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	Period of outstanding balance	Amount of loan (₹)	Rate of interest p.a.	Weighted average amount of interest
	a	b	c	d = [(b x c) x (a/12)]
9% Debentures	12 months	20,00,000	9%	1,80,000
Bank overdraft	9 months	4,00,000	10%	30,000
	2 months	4,00,000	12%	8,000
	1 month	8,00,000	12%	8,000

		36,00,000		2,26,000

Weighted average cost of borrowings

= {20,00,000 x (12/12)} + {4,00,000 x (11/12)} + {8,00,000 x (1/12)} = 24,33,334

Capitalisation rate = [(Weighted average amount of interest/ Weighted average of general borrowings) x 100] = [(2,26,000/24,33,334) x 100] = 9.29% p.a.

ACCOUNTING STANDARD 17

Segment Reporting

QUESTION - 1

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 - 2

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

SOLUTION:

Diversifiers Ltd.

Segmental Report

(₹ '000)

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

Sales Revenue by Geographical Market

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

QUESTION - 3

Microtech Ltd. produce batteries for scooters, cars, trucks, and specialised batteries for investors 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 inventors and UPS are affected by different set of factors. In case of automobile batteries, the risks and return are affected by the Government policy, road conditions, quality of automobiles, etc. whereas in case of batteries for investors 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

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.

[Nov 2020 (5 Marks)]

ANSWER:

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

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

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

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

whichever is greater in absolute amount; or

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

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

On the basis of the result criteria, segments A, B and C are reportable segments (since their results in

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 - 5

The Senior Accountant of AMF Ltd. gives the following data regarding its five segments:

(₹ in lakhs)

Particulars	P	Q	R	S	T	Total
	(₹)	(₹)	(₹)	(₹)	(₹)	(₹)
Segment Assets	80	30	20	20	10	160
Segment Results	(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'.

ANSWER:

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

(ii) 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

(iii) 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

(iv) 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 - 6

A Company has an inter-segment transfer pricing policy of charging at cost less 5%.

The market prices are generally 20% above cost.

You are required to examine whether the policy adopted by the company is correct or not? **[RTP May 21]**

ANSWER:

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

QUESTION - 7

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.

ANSWER:

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

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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 enterprises and about its operations in particulars geographical areas, and the usefulness of that information for assessing the risks and returns of the enterprise."

QUESTION - 8

(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 change in the basis of allocation of revenue and expenses to segments? Explain. **[RTP Nov 21]**

ANSWER:

(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) They 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 materials 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.

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ACCOUNTING STANDARD 18

Related Party Disclosures

QUESTION - 1

(i) Mr. Raj a relative of key management personnel received remuneration of Rs. 2,50,000 for his services in the company for the period from 1.4.2020 to 30.6.2020. On 1.7.2020, he left the service. Should the relative be identified as at the closing date i.e. on 31.3.2021 for the purposes of AS 18?

(ii) X Ltd. sold goods to its associate Company during the 1st quarter ending 30.6.2020. After that, the related party relationship ceased to exist. However, goods were supplied as were supplied to any other ordinary customer. Decide whether transactions of the entire year need disclosure as related party transaction.

[MTP March 21 (5 Marks)]

ANSWER:

(i) According to AS 18 on 'Related Party Disclosures', parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Hence, Mr. Raj, a relative of key management personnel should be identified as related party for disclosure in the financial statements for the year ended 31.3.2021.

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

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QUESTION - 2

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? Also explain the required related party disclosure requirements under AS 18? **[MTP April 21 (5 Marks)]**

ANSWER:

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

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

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

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

(i) The name of the transacting related party;

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

(iii) A description of the nature of transactions;

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

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

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

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

QUESTION - 3

(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.

[July 2021 (5 Marks)]

ANSWER:

(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 - 4

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

[RTP May 21]

ANSWER:

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 - 5

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? **[RTP May 22]**

ANSWER:

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

- 'Ownership, directly or indirectly, of more than one-half of the voting power of an enterprise, or
- Control of the composition of the board of directors in the case of a company or of the composition of 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 - 6

Define "Key management personnel" in the context of AS 18. **[RTP May 22]**

ANSWER:

In context of AS 18, "Key management personnel" are those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. For example, in the case of a company, the managing director(s), whole time director(s), manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.

QUESTION - 7

(i) Mr. Arnav a relative of key management personnel received remuneration of ₹ 3,00,000 for his services in the company for the period April 1, 2019 to June 30, 2019. On July 1, 2019 he left the job.

Should Mr. Arnav be identified as Related Party at the closing date i.e. March 31, 2020 for the purposes of AS 18?

(ii) A limited company sold goods to its associate company for the 1st quarter ending June 30, 2020. After that, the related party relationship ceased to exist. However, goods were supplied continuously even after June 30, 2020 as was supplied to another ordinary customer. Does this require disclosure as related party transaction for the entire financial year? **[MTP March 22 (5 Marks)]**

ANSWER:

(i) 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. Arnav a relative of key management personnel should be identified as related party as at the closing date i.e. on 31.3.2020.

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

QUESTION - 8

(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 a party for the purpose of financial statements of C Limited? **[RTP Nov 21]**

ANSWER:

(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 parties 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 partly or venture in respect of which the reporting enterprise is an associate or a joint venture" are also related parties. As B Limited is not an associate of C Limited, nor is it being controlled, directly or indirectly, by C Limited or is not so controlling C Limited, it is not a related party of C Limited.

ACCOUNTING STANDARD 19

Leases

QUESTION - 1

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 and disclose impact of this on Balance sheet and Profit & loss account at the end of year 1

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 lower of the fair value of the leased asset at the inception of the finance lease and the present value of the minimum lease payments from the standpoint of the lessee.

In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease. Present value of minimum lease payments will be calculated as follows:

Year	Minimum Lease Payment ₹	Implicit interest rate (Discount rate @ 15%)	Present value ₹
1	6,25,000	0.8696	5,43,500
2	6,25,000	0.7561	4,72,563
3	6,25,000	0.6575	4,10,937
4	7,50,000*	0.5718	4,28,850
Total	26,25,000		18,55,850

* Minimum lease Payment of 4th year includes guaranteed residual value amounting ₹ 1,25,000.

Present value of minimum lease payments ₹ 18,55,850 is less than fair value at the inception of lease i.e. ₹ 20,00,000, therefore, the asset and corresponding lease liability should be recognised at ₹ 18,55,850 as per AS 19.

QUESTION - 2

Prakash Limited leased a machine to Badal Limited on the following terms:

		(₹ in lakhs)
(i)	Fair value of the machine	48.00
(ii)	Lease term	5 years
(iii)	Lease rental per annum	8.00
(iv)	Guaranteed residual value	1.60

(v)	Expected residual value	3.00
(vi)	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.

SOLUTION:

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)

= [(₹ 8,00,000 × 5 years) + ₹ 1,60,000] + ₹ 1,40,000 = ₹ 43,00,000 (a)

(b) Table showing present value of (i) Minimum lease payments (MLP) and (ii) Unguaranteed residual value (URV).

Year	MLP inclusive of URV ₹	Internal rate of return (Discount factor @ 15%)	Present Value ₹
1	8,00,000	0.8696	6,95,680
2	8,00,000	0.7561	6,04,880
3	8,00,000	0.6575	5,26,000
4	8,00,000	0.5718	4,57,440
5	8,00,000	0.4972	3,97,760
	1,60,000 (GRV)	0.4972	79,552
	41,60,000		27,61,312 (i)
	1,40,000 (URV)	0.4972	69,608 (ii)
	43,00,000	(i) + (ii)	28,30,920 (b)

Unearned Finance Income (a) – (b) = ₹ 43,00,000 - ₹ 28,30,920 = ₹ 14,69,080.

QUESTION - 3

A Ltd. sold machinery having WDV of ₹ 40 lakhs to B Ltd. for ₹ 50 lakhs and 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.

SOLUTION:

Following will be the treatment in the given cases:

(a) When sales price of ₹ 50 lakhs is equal to fair value, A Ltd. should immediately recognise the profit of ₹ 10 lakhs (i.e. 50 – 40) in its books.

(b) When fair value is ₹ 60 lakhs then also profit of ₹ 10 lakhs should be immediately recognised by A Ltd.

(c) When fair value of leased machinery is ₹ 45 lakhs & sales price is ₹ 38 lakhs, then loss of ₹ 2 lakhs (40 – 38) to be immediately recognised by A Ltd. in its books provided loss is not compensated by future lease payment.

(d) When fair value is ₹ 40 lakhs & sales price is ₹ 50 lakhs then, profit of ₹ 10 lakhs is to be deferred and amortised over the lease period.

(e) When fair value is ₹ 46 lakhs & sales price is ₹ 50 lakhs, profit of ₹ 6 lakhs (46 - 40) to be immediately recognised in its books and balance profit of ₹ 4 lakhs (50-46) is to be amortised/deferred over lease period.

(f) When fair value is ₹ 35 lakhs & sales price is ₹ 39 lakhs, then the loss of ₹ 5 lakhs (40 – 35) to be immediately recognised by A Ltd. in its books and profit of ₹ 4 lakhs (39 – 35) should be amortised/ deferred over lease period.

QUESTION - 4

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 Rs. 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.

You are required to compute: (i) Annual Lease Rent and (ii) Lease Rent income to be recognized in each operating year. **[MTP March 2021 (5 Marks)]**

ANSWER:

(i) Annual lease rent

Total lease rent

= 130% of Rs. 1,50,000 x $\frac{\text{Output during lease period}}{\text{Total output}}$

= 130% of Rs. 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 = Rs. 97,500

Annual lease rent = Rs. 97,500 / 3 = Rs. 32,500

(ii) Lease rent income to be recognized in each operating year

Total lease rent should be recognized as income in proportion of output during lease period, i.e. in the proportion of 40 : 50 : 60.

Hence income recognized in years 1, 2 and 3 will be as:

Year 1 Rs. 26,000,

Year 2 Rs. 32,500 and

Year 3 Rs. 39,000.

QUESTION - 5

You are required to give the necessary journal entry at the inception of lease to record the asset taken on finance lease in books of lessee from the following information:

Lease period	**=**	**5 years;**
Annual lease rents	**=**	**Rs. 50,000 at the end of each year.**
Guaranteed residual value	**=**	**Rs. 25,000**
Fair Value at the inception (beginning) of lease	**=**	**Rs. 2,00,000**

Interest rate implicit on lease is = 12.6% (Discounted rates for year 1 to 5 are .890, .790, .700, .622 and .552 respectively). **[MTP April 21 (5 Marks)]**

ANSWER:

Present value of minimum lease payment is computed below:

Year	MLP (Rs.)	DF (12.6%)	PV (Rs.)
1	50,000	0.890	44,500
2	50,000	0.790	39,500
3	50,000	0.700	35,000
4	50,000	0.622	31,100
5	50,000	0.552	27,600
5	25,000	0.552	13,800
			1,91,500

Present value of minimum lease payment = Rs. 1,91,500

Fair value of leased asset = Rs. 2,00,000

As per AS 19, on the date of inception of Lease, Lessee should show it as an asset and corresponding liability at lower of Fair value of leased asset at the inception of the lease and present value of minimum lease payments from the standpoint of the lessee. The accounting entry at the inception of lease to record the asset taken on finance lease in books of lessee is suggested below:

	Rs.	Rs.
Asset A/c Dr.	1,91,500	
To Lessor (Lease Liability) A/c		1,91,500
(Being recognition of finance lease as asset and liability)		

QUESTION - 6

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.

You are required to calculate the value of the lease liability as per AS-19 and also disclose impact of this on Balance sheet and Profit & loss account at the end of year 1.

[MTP Nov 21 (5 Marks)]

ANSWER:

According to AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the lower of the fair value of the leased asset at the inception of the finance lease and the present value of the minimum lease payments from the standpoint of the lessee.

In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease. Present value of minimum lease payments will be calculated as follows:

Year	Minimum lease Payment (₹)	Implicit interest rate (Discount rate @ 15%)	Present value (₹)
1	6,25,000	0.8696	5,43,500
2	6,25,000	0.7561	4,72,563

3	6,25,000	0.6575	4,10,937
4	7,50,000*	0.5718	4,28,850
Total	26,25,000		18,55,850

Present value of minimum lease payments ₹ 18,55,850 is less than fair value at the inception of lease i.e. ₹ 20,00,000, therefore, the asset and corresponding lease liability should be recognised at ₹ 18,55,850 as per AS 19.

QUESTION - 7

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.

(i) Annual Lease Rent

(ii) Lease Rent income to be recognised in each operating year and

(iii) Depreciation for 3 years of lease **[Dec 21 (5 Marks)]**

ANSWER:

(i) Annual lease rent

Total lease rent

= 130% of ₹ 2,25,000 x Output during lease period/ Total output

= 130% of ₹ 2,25,000 x (60,000 + 75,000 + 90,000)/ (60,000 + 75,000 + 90,000 + 1,20,000 + 1,05,000)

= 2,92,500 x 2,25,000 units/ 4,50,000 units = ₹ 1,46,250

Annual lease rent = ₹ 1,46,250 / 3 = ₹ 48,750

(ii) Lease rent Income to be recognized in each operating year

Total lease rent should be recognized as income in proportion of output during lease period, i.e. 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

Yare 3 ₹ 58,500.

(iii) Depreciation for three years of lease

Since deprecation 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.

ACCOUNTING STANDARD 20

Earnings Per Share

QUESTION - 1

Net profit for the year 20X1	**₹ 11,00,000**
Net profit for the year 20X2	**₹ 15,00,000**
No. of shares outstanding prior to rights issue	**5,00,000 shares**
Rights issue price	**₹ 15.00**
Last date to exercise rights	**1st March 20X2**

Rights issue is one new share for each five outstanding (i.e. 1,00,000 new shares)

Fair value of one equity share immediately prior to exercise of rights on 1st March 20X2 was ₹ 21.00. Compute Basic Earnings Per Share.

SOLUTION:

$$\frac{\text{Fair value of shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the exercise}}$$

$$\frac{(21.00 \text{ x } 5{,}00{,}000 \text{ shaes}) + (₹\ 15.00 \text{ x } 1{,}00{,}000 \text{ Shares})}{5{,}00{,}000 \text{ Shares} + 1{,}00{,}000 \text{ Shares}}$$

Theoretical ex-rights fair value per share = ₹ 20.00

Computation of adjustment factor:

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights vlaue per share}} \quad \frac{(21.00)}{(20.00)} = 1.05$$

Computation of earnings per share:

EPS for the year 20X1 as originally reported: ₹ 11,00,000/5,00,000 shares = ₹ 2.20

EPS for the year 20X1 restated for rights issue: ₹ 11,00,000/ (5,00,000 shares x 1.05) = ₹ 2.10

EPS for the year 20X2 including effects of rights issue:

(5,00,000 x 1.05 x 2/12) + (6,00,000 x 10/12) = 5,87,500 shares

EPS = 15,00,000/5,87,500 = ₹ 2.55

QUESTION - 2

Net profit for the current year	**₹ 1,00,00,000**
No. of equity shares outstanding	**50,00,000**
Basic earnings per share	**₹ 2.00**
No. of 12% convertible debentures of ₹ 100 each	**1,00,000**
Each debentures is convertible into 10 equity shares	
Interest expenses for the current year	**₹ 12,00,000**
Tax relating to interest expenses (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

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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 - 3

Net profit for the year 20X1	**₹ 12,00,000**
Weighted average number of equity shares outstanding during the year 20X1	**5,00,000 shares**
Average fair value of one equity share during the year 20X1	**₹ 20.00**
Weighted average number of shares under option during the year 20X1	**1,00,000 shares**
Exercise price for shares under option during the year 20X1	**₹ 15.00**

Compute Basic and Diluted Earnings Per Share.

SOLUTION:

Computation of earnings per share

	Earnings ₹	Shares	Earnings/Share ₹
Net Profit for the year 20X1	12,00,000		
Weighted average no. of Shares during Year 2021		5,00,000	
Basic earnings per share			2.40
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value (100,000 x 15.00)/20.00		(75,000)	
Diluted earnings per share	12,00,000	5,25,000	2.29

QUESTION - 4

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. [RTP May 22]

ANSWER:

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.

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.

QUESTION - 5

On 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 remining ₹ 5 was called up and paid by all shareholders except on 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 and dividend distribution tax on such dividend totalling to ₹ 3,40,000.

You are required to compute Basic EPS for the year ended 31st March, 2020 as per Accounting Standard 20 "Earnings Per Share". **[MTP March 22 (5 Marks)]**

ANSWER:

Basic Earnings per share (EPS) =

$$\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{21,96,000}{4,57,500 \text{ Shares (as per working note)}} = ₹\ 4.80 \text{ per share}$$

Working Notes:

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 share	Weighted average no. of equity shares
	₹	₹	₹
1.4.2020	6,00,000	5	6,00,000 x 5/10 x 5/12 = 1,25,000
1.9.2020	5,40,000	10	5,40,000 x 7/12 = 3,15,000
1.9.2020	60,000	5	60,000 x 5/10 x 7/12 = 17,500
Total weighted average equity shares			4,57,500

QUESTION - 6

On 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 ₹ 3,40,000 on preference shares. You are required to compute Basic EPS for the year ended 31st March, 2020 as per Accounting Standard 20 "Earnings Per Share". **[MTP Oct. 21]**

ANSWER:

Basic Earnings per share (EPS) =

$$\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$\frac{21,96,000}{4,57,500 \text{ Shares (as per working note)}} = ₹\ 4.80 \text{ per share}$$

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
	₹	₹	₹
1.4.2020	6,00,000	5	6,00,000 x 5/10 x 5/12 = 1,25,000
1.9.2020	5,40,000	10	5,40,000 x 7/12 = 3,15,000

1.9.2020	60,000	5	60,000 x 5/10 x 7/12 = 17,500
	Total weighted average equity shares		4,57,500

QUESTION - 7

The following information relates to XYZ Limited for the year ended 31st March, 2021:

Net Profit for the year after tax: ₹ 37,50,000

Number of Equity Shares of ₹ 10 each outstanding: ₹ 5,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

Particulars	No.
8% Convertible Debentures of ₹ 100 each	50,000
Equity Shares to be issued on conversion	55,000

The Rate of Income Tax: 30%.

You are required to calculated Basic and Diluted Earnings Per Share (EPS). [MTP Nov 21 (5 Marks)]

ANSWER:

Computation of basic earnings per share

Net profit for the current year / Weighted average number of equity shares outstanding during the year

₹ 37,50,000 / 5,00,000 = ₹ 7.50 per share

Computation of diluted earnings per share $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

Adjusted net profit for the current year

	₹
Net profit for the current year	37,50,000
Add: Interest expense for the current year	4,00,000
Less: Tax relating to interest expenses (30% of ₹ 4,00,000)	(1,20,000)
Adjusted net profit for the current year	40,30,000

Number of equity shares resulting from conversion of debentures

= 55,000 Equity shares (given in the question)

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

= 5,55,000 shares (5,00,000 + 55,000)

Diluted earnings per share

= 40,30,000/ 5,55,000 = ₹ 7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

QUESTION - 8

"At the time of 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 basis and diluted earnings per share for the year 2020-21 from the following information:

(i) Net profit after tax for the year ₹ 64,12,500

(ii) No. of equity shares outstanding 15,00,000

(iii)	**No. of 9% convertible debentures of ₹ 100 issued on 1st July, 2020**	**75,000**
(iv)	**Each debenture is convertible into 8 Equity Shares**	
(v)	**Tax relating to interest expenses**	**35%**

[Dec 21 (5 Marks)]

ANSWER:

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 Shares', 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 for year 2020-21

$$\frac{\text{Adjusted net proift for the current year}}{\text{Weighted average nubmer of equity shares}}$$

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 x 8)

Weighted average no. of equity shares used to compute diluted EPS:

(15,00,000 x 12/12 + 6,00,000 x 9/12)

= 19,50,000 Shares

Diluted earnings per share: (67,41,562/ 19,50,000) = ₹ 3.46

Working Note:

Interest expense for 9 months = 7,50,000 x 9% x 9/12 = ₹ 5,06,250

Tax expense 35% on interest is ₹ 1,77,188 (5,06,250, x 35%)

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ACCOUNTING STANDARD 22

Accounting for Taxes on Income

QUESTION - 1

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%.

SOLUTION:

Table showing calculation of deferred tax assets/ liability

Particulars	**Amount**	**Timing differences**	**Deferred tax**	**Amount @ 50%**
	₹			₹
Excess depreciation as per tax records (₹ 5,00,000 - ₹ 2,00,000)	3,00,000	Timing	Deferred taxa liability	1,50,000
Unamortised preliminary expenses as per tax records	30,000	Timing	Deferred tax asset	(15,000)
Net deferred tax liability				1,35,000

QUESTION - 2

From the following details of A Ltd. for the year ended 31-03-20X1, calculate the deferred tax asset/ liability as per AS 22 and amount of tax to be debited to the Profit and Loss Account for the year.

Particulars	₹
Accenting 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%**

SOLUTION:

Tax as per accounting profit 6,00,000 x 20% = ₹ 1,20,000

Tax as per Income-tax Profit 60,000 x 20% = ₹ 12,000

Tax as per MAT 3,50,000 x 7.50% = ₹ 26,250

Tax expense = Current Tax + deferred Tax

₹ 1,20,000 = ₹ 12,000 + Deferred Tax

Therefore, Deferred Tax liability as on 31-03-20X1

= ₹ 1,20,000 - ₹ 12,000 = ₹ 1,08,000

Amount of tax to be debited in Profit and Loss account for the year 31-03-20X!

Current Tax + Deferred Tax Liability + Excess of MAT over current tax

= ₹ 12,000 + ₹ 1,08,000 + ₹ 14,250 (26,250 – 12,000)

= ₹ 1,34,250

QUESTION - 3

PQR Ltd.'s accounting year ends on 31st March. The company made a loss of ₹ 2,00,000 for the year ending 31.3.20X1. For the year ending 31.3.20X2 and 31.3.20X3, it made profits of ₹ 1,00,000 and ₹ 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.20X1, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the year ending 20X2 and 20X3 for tax purposes. Prepare a statement of Profit and Loss for the years ending 20X1, 20X2 and 20X3.

SOLUTION:

Statement of Profit and Loss

	31.2.20X1	31.3.20X2	31.3.20X3
	₹	₹	₹
Profit (Loss)	(2,00,000)	1,00,000	1,20,000
Less: Current tax (20,000 x 40%)			(8,000)
Deferred tax:			
Tax effect of timing differences originating during the year (2,00,000 x 40%)	80,000		
Tax effect of timing differences reversed/ adjusted during the year (1,00,000 x 40%)		(40,000)	(40,000)
Profit (Loss) After Tax Effect	(1,20,000)	60,000	72,000

QUESTION - 4

Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognises revenue from these contracts on percentage of completion method for financial statements during 20X0-20X1, 20X1-20X2 and 20X2-20X3 for ₹ 11,00,000, ₹16,00,000 and ₹ 21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognised revenue of ₹ 7,00,000, ₹ 18,00,000 and ₹ 23,00,000 for the years 20X0-20X1, 20X1-20X2 and 20X2-20X3 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 20X0-20X1, 20X1-20X2 and 20X2-20X3.

SOLUTION:

Calculation of Deferred Tax Asset/Liability in Omega Limited

Year	Accounting Income	Taxable Income	Timing Difference	Timing Difference (balance)	Deferred Tax	Deferred Tax Liability (balance)
20X0-20X1	11,00,000	7,00,000	4,00,000	4,00,000	1,40,000	1,40,000
20X1-20X2	16,00,000	18,00,000	(2,00,000)	2,00,000	(70,000)	70,000
20X2-20X3	21,00,000	23,00,000	(2,00,000)	NIL	(70,000)	NIL
	48,00,000	48,00,000				

QUESTION - 5

From the following details of Aditya Limited for accounting year ended on 31st March, 2020:

Particulars	₹
Accounting profit	15,00,000
Book profit as per MAT	7,50,000
Profit as per Income tax Act	2,50,000
Tax Rate	20%
MAT Rate	7.5%

Calculate the deferred tax asset/liability as per AS 22 and amount of tax to be debited to the profit and loss account for the year. [Nov 2020 (5 Marks)]

ANSWER:

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

QUESTION - 6

The following particulars are stated in the Balance Sheet of HS Ltd. as on 31-3-2019 :

Particulars	(₹ in lakhs)
Deferred Tax Liability (Cr.)	60.00
Deferred Tax Assets (Dr.)	30.00
The following transactions were reported during the year 2019-20 :	
Depreciation as per accounting records	160.00
Depreciation as per income tax records	140.00
Items disallowed for tax purposes in 2018-19 but allowed in 2019-20	20.00
Donation to Private Trust	20.00
Tax rate	30%

There were no additions to fixed assets during the year. You are required to show the impact of various items on Deferred Tax Assets and Deferred Tax Liability as on 31-3-2020 as per AS-22. [Jan 21 (5 Marks)]

ANSWER:

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

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(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 - 7

The following particulars are stated in the Balance Sheet of Deep Limited as on 31st March, 2020:

	(₹ in Lakhs)
Deferred Tax Liability (Cr.)	**28.00**
Deferred Tax Assets (Dr.)	**14.00**

The following transactions were reported during the year 2020-2021:

(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 entie 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. **[July 21 (5 Marks)]**

ANSWER:

Impact of various items in terms of deferred tax liability /deferred tax asset on 31.3.21

Transactions	Analysis	Nature difference	Effect	Amount (₹)
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier year of useful life of the assets in comparison to later year.	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 - 8

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. **[RTP May 21]**

ANSWER:

Statement of Profit and Loss for the year ended 31st March, 2019 (Extract)

		₹
Profit before depreciation and taxes		6,40,000
Less: Depreciation for accounting purposes (2,80,000+30,000)		(3,10,000)
Profit before taxes (A)		3,30,000
Less: Tax expense (B)		
Current tax (W.N.1) (3,30,000 x 40%)	1,32,000	
Deferred tax (W.N.2)	NIL	(1,32,000)
Profit after tax (A-B)		1,98,000

Working Notes:

1. **Computation of taxable income**

	Amount (₹)
Profit before depreciation and tax	6,40,000
Less: Depreciation for tax purpose (1,90,000 + 1,20,000)	(3,10,000)
Taxable income	3,30,000
Tax on taxable income @ 40%	1,32,000

2. **Impact various items in terms of deferred tax liability / deferred tax asset**

S. No.	Transactions	Analysis	Nature of difference	Effect	Amount (₹)
(i)	Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years	Responding timing difference	Reversal of DTL	(2,80,000 - 1,90,000) x 40% = (36,000)
(ii)	Depreciation on new machinery	Due to allowance of full amount as Expenditure under IT Act, tax payable in	Timing difference	Creation of DTL	(1,20,000 – 30,000) x 40% = 36,000

	Net impact	the earlier years is less.			NIL

QUESTION - 9

What are the disclosure requirements for deferred tax assets and deferred tax liabilities in the balance sheet as per AS 22? **[RTP May 21]**

ANSWER:

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.

ACCOUNTING STANDARD 23

Accounting for Investments in Associates in Consolidated Financial Statements

QUESTION - 1

A Ltd. acquire 45% of B Ltd. shares on April 01, 20X1, the price paid was ₹ 15,00,000. Following are the extracts of balance sheet of B Ltd. as of 1 April 20X1:

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 20X2. Calculate the amount at which the investment in B Ltd. should be shown in the consolidated balance sheet of A Ltd. as on March 31, 20X2.

SOLUTION

Calculation of Goodwill/ Capital Reserve under Equity Method

Particulars		₹	₹
Investment in B Ltd.	(A)		15,00,000
Equity Shares		10,00,000	
Security Premium		1,00,000	
Reserves & Surplus		5,00,000	
Net Assets		16,00,000	
45% of Net Asset	(B)		7,20,000
Goodwill (A – B)			7,80,000

Calculation of Carrying Amount of Investment in the year ended on 31st March, 20X2

Particulars	₹
Investment in Associate as per AS 23:	
Share of Net Assets on 1 April 20X1	7,20,000
Add: Goodwill	7,80,000
Cost of Investment	15,00,000
Add: Profit during the year (3,00,000 x 45%)	1,35,000
Less: Dividend paid (1,00,000 x 45%)	(45,000)
Carrying Amount of Investment	15,90,000

QUESTION - 2

A Ltd. acquired 40% share in B Ltd. on April 01, 20X1 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 20X1-20X2, B Ltd. suffered a loss of ₹ 10,00,000; during 20X2-20X3 loss of ₹ 12,50,000 and during 20X3-20X4 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% shares 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, 20X1 : 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, 20X2:

Investment in Associate as per AS 23	₹
Share of Net Assets on 1 April, 20X1	4,80,000
Add: Goodwill	5,20,000
Cost of Investment	10,00,000
Less: Loss for the year (10,00,000 x 40%)	(4,00,000)
Carrying Amount of Investment	6,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X2: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 20X1	4,80,000	
Less: Share of Loss as Above	(4,00,000)	
	80,000	
Add: Goodwill	5,20,000	6,00,000

Calculation of Carrying Amount of Investment as at 31 March, 20X3:

Investment in Associate as per AS 23	₹
Carrying Amount of Investment as on 31 March, 20X2	6,00,000
Less: Loss for the Year (12,50,000 x 40%)	(5,00,000)
Carrying Amount of Investment	1,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X3: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 20X1	4,80,000	
Less: Share of Loss As above (₹ 4,00,000 + ₹ 5,00,000)	(4,20,000)	
Add: Goodwill		1,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X4:

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Investment in Associate as per AS 23	₹
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	
Carrying Amount of Investment	

Consolidated Balance Sheet (Extract) as on March 31, 20X4: ASSETS

Investment in Associate as per AS 23	₹
Investment in B Ltd.	--

QUESTION - 3

Bright Ltd. acquired 30% of East India Ltd. shares for ₹ 2,00,000 on 01-06-20X1. By such an acquisition Bright can exercise significant influence over East India Ltd. During the financial year ending on 31-03-20X1 East India earned profits ₹ 80,000 and declared a dividend of ₹ 50,000 on 12-08-20X1. East India reported earnings of ₹ 3,00,000 for the financial year ending on 31-03-20X2 (assume profits to accrue evenly) and declared dividends of ₹ 60,000 on 12-06-20X2.

Calculate the carrying amount of investment in:

(i) Separate Financial Statements of Bright Ltd. as on 31-03-20X2;

(ii) Consolidated Financial Statements of Bright Ltd.; as on 31-03-20X2;

(iii) What will be the carrying amount as on 30-06-20X2 in consolidated financial Statements?

SOLUTION

(i) Carrying amount of Investment in Separate Financial Statement of Bright Ltd. as on 31.03.20X2

	₹
Amount paid for investment in Associate (on 1.06.20X1)	2,00,000
Less: Pre-acquisition dividend (₹ 50,000 x 30%)	(15,000)
Carrying amount as on 31.3.20X2 as per AS 13	1,85,000

(ii) Carrying amount of investment in Consolidated Financial Statements of Bright Ltd. as on 31.3.20X2 as per AS 23

	₹
Carrying amount as per separate financial statements	1,85,000
Add: Proportionate share of 10-month profit of investee as per equity method (30% of ₹ 3,00,000 x 10/12)	75,000
Carrying amount as on 31.3.20X2	2,60,000

(iii) Carrying amount of investment in Consolidated Financial Statements of Bright Ltd. as on 31.6.20X2 as per AS 23

	₹
Carrying amount as on 31.3.20X2	2,60,000
Less: Dividend received (₹ 60,000 x 30%)	(18,000)
Carrying amount as on 30.6.20X2	2,42,000

QUESTION - 4

A Ltd. acquired 25% of shares in B Ltd. as on 31.3.20X1 for ₹ 3 lakhs. The Balance Sheet of B Ltd. as on 31.3.20X1 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 31.3.20X2 the following are the additional information available:

(i) A Ltd. received dividend from B Ltd., for the year ended 31.3.20X1 at 40% from the Reserves.

(ii) B Ltd., made a profit after tax of ₹ 7 lakhs for the year ended 31.3.20X2.

(iii) B Ltd., declared a dividend @ 50% for the year ended 31.3.20X2 on 30.4.20X2.

A Ltd. is preparing Consolidated Financial Statements in accordance with AS 21 for its various subsidiaries. Calculate:

(i) Goodwill if any on acquisition of B Ltd.'s shares.

(ii) How A Ltd., will reflect the value of investment in B Ltd., in the Consolidated Financial Statements?

(iii) How the dividend received from B Ltd. will be shown in the Consolidated Financial Statements?

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SOLUTION

In terms of AS 23, B Ltd. will be considered as an associate company of A Ltd. as shares acquired represent to more than 20%.

(i) Calculation of Goodwill

	(₹ in lakhs)
Amount paid towards acquisition of Stake in B Ltd.	3.00
Less: Pre-acquisition dividend (₹ 5,00,000 x 40% x 25%)	0.50
Cost of Investment in B Ltd.	2.50
Less: Shares in the value of Equity of B Ltd. as at the date of investment [25% of ₹ 10 lakhs (₹ 5 lakhs + ₹ 5 lakhs)]	(2.50)
Goodwill	NIL

(ii) A Ltd.

Consolidated Profit and Loss Account for the year ended 31st March, 20X2 (An extract)

		₹ in lakhs
Other income:		
Share of profits in B Ltd.		1.75
Pre-acquisition Dividend received from B Ltd.	0.50	
Transfer to investment A/c	(0.50)	Nil

(iii) A Ltd.

Consolidated Balance Sheet as on 31.3.20X2 (An extract)

		₹ in lakhs
Non-current investments		
Investment in B Ltd.		
Cost of Investment in B Ltd.	2.50	
Share of Profit for year 20X1-20X2	1.75	
	4.25	
Add: Goodwill	NIL	4.25

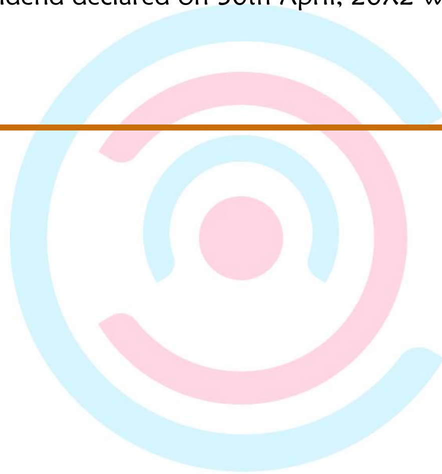
Working Notes:

(1) Pre-acquisition dividend received from B Ltd. amounting to ₹ 0.50 lakhs will be reduced from investment value in the books of A Ltd.

(2) B Ltd. made a profit of ₹ 7 lakhs for the year ended 31st March, 20X2. A Ltd.'s share in the profits of ₹ 7 lakhs is ₹ 1.75 lakhs.

Investment in B Ltd. will be increased by ₹ 1.75 lakhs and consolidated profit and Loss account of A Ltd. will be credited with ₹ 1.75 lakhs in the consolidated financial statement of A Ltd.

(3) Dividend declared on 30th April, 20X2 will not be recognized in the consolidated financial statement of A Ltd.



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ACCOUNTING STANDARD 24

Discontinuing Operations

QUESTION - 1

Rohini Limited is in the business of manufacture of passenger cars and commercial vehicles. The Company is working on a strategic plan to close the production of passenger cars and to produce only commercial vehicles over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its prospective plan it will reduce the production of passenger cars by 20% annually. It also plans to establish another new factory for the manufacture of commercial vehicles and transfer surplus employees in a phased manner.

You are required to comment:

(i) If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.

(ii) If the Company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24?

(iii) Would your answer to (ii) above be different if the Company resolves to sell the assets of the passenger car division in a phased but time bound manner? **[Study Material & July 2021(5 Marks)]**

SOLUTION:

(i) A discontinuing operation is a component of an enterprise:

(a) That the enterprise, pursuant to a single plan, is:

(i) Disposing of substantially in its entirety, such as by 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; and

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

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

(i) Gradual or evolutionary phasing out of a product line or class of service;

(ii) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(iii) Closing of a facility to achieve productivity improvements or other cost savings. In this case, it cannot be considered as Discontinuing Operation as per AS-24 as the companies' strategic plan has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.

(ii) No, the resolution is 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.

(iii) Yes, phased and time bound program resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap.

Hence this action will attract compliance of AS 24 and it will be considered as Discontinuing Operations as per AS-24.

QUESTION - 2

Arzoo Ltd. is in the business of manufacture of passenger cars and commercial vehicles. The company is working on a strategic plan to shift from the passenger car segment to the commercial vehicles segment 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 plan, it has planned that it will reduce the production of passenger cars by 20% annually. It also plans to commence another new factory for the manufacture of commercial vehicles plus transfer of employees in a phased manner. These plans have not approved from the Board of Directors and the new factory for manufacture of commercial vehicles has not yet started. You are required to comment if mere gradual phasing out in itself can be considered as a 'Discontinuing Operation' within the meaning of AS 24. **[RTP May 21]**

ANSWER:

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

(1) Gradual or evolutionary phasing out of a product line or class of service;

(2) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;

(3) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(4) Closing of a facility to achieve productivity improvements or other cost savings.

In view of the above, mere gradual phasing out in itself cannot be considered as discounting operation. The companies' Strategic plan also has no final approval from the board through a resolution and there is not specified 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.

QUESTION - 3

(i) What are the disclosure and presentation requirements of AS 24 for discontinuing operations?

(ii) Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

ANSWER:

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

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

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

(ii) Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations. According to 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:

(i) Gradual or evolutionary phasing out of a product line or class of service;

(ii) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;

(iii) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(iv) 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

What are discontinuing operations as per AS 24? Should an enterprise include prescribed information relating to a discontinuing operations in its financial statements? **[RTP Nov 21]**

ANSWER:

A discontinuing operation is 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 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.

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ACCOUNTING STANDARD 25

Interim Financial Reporting

QUESTION - 1

Sincere Corporation is dealing in seasonal product. Sales pattern of the product Quarter-wise is as follows:

1st Quarter 30th June	**10%**
2nd Quarter 30th September	**10%**
3rd Quarter 31st December	**60%**
4th Quarter 31st March	**20%**

Information regarding the 1st quarter ended on 30th June, 20X1 is as follows:

Sales	**80 Crores**
Salary and other expenses	**60 Crores**
Advertisement expenses (routine)	**4 Crores**
Administrative and selling expenses	**8 Crores**

While preparing interim financial report for first quarter Sincere Corporation wants to defer ₹ 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 results of the first quarter as per AS 25. Also give a comment on the company's view.

SOLUTION

Particulars		**(₹ in Crores)**
Result of First quarter ended 30th June, 20X1		
Turnover	80	
Other Income	Nil	
Total (a)		80
Less: Changes in inventories		Nil
Salaries and other cost		60
Administrative and selling Expenses (4+8)		12
Total (b)		72
Profit (a) – (b)		8

According to AS 25, the Income and Expenses should be recognized when they are earned and incurred respectively. Therefore, seasonal incomes will be recognized when they occur. Thus, the company's view is not as per AS 25.

QUESTION - 2

The accounting year of X Ltd. ends on 30th September, 20X1 and it makes its reports quarterly. However, for the purpose of tax, year ends on 31st March every year. For the Accounting year from 1-10-20X0 to 30-9-20X1, the quarterly income is as under:

1st quarter ending on 31st December, 20X0	**₹ 200 crores**
2nd quarter ending on 31st March, 20X1	**₹ 200 crores**

3rd quarter ending on 30th June, 20X1	₹ 200 crores
4th quarter ending on 30th September, 20X1	₹ 200 crores
Total	₹ 800 crores

Average actual tax rate for the financial year ending on 31st March, 20X1 is 20% and for financial year ending 31st March, 20X2 is 30%. Calculate tax expense for each quarter.

SOLUTION

Calculation of tax expense

1st quarter ending on 31st December, 20X0	200 x 20%	₹ 40 lakhs
2nd quarter ending on 31st March, 20X1	200 x 20%	₹ 40 lakhs
3rd quarter ending on 30th June, 20X1	200 x 30%	₹ 60 lakhs
4th quarter ending on 30th September, 20X1	200 x 30%	₹ 60 lakhs

QUESTION - 3

Accountants of Poornima Ltd. showed a net profit of ₹ 7,20,000 for the third quarter of 20X1 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, the quarterly income has not been correctly stated. As per AS 25 "Interim Financial Reporting", the quarterly income should be adjusted and restated as follows:

Bad debts of ₹ 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.

Recognising 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 - 4

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	30th September	31st December	31st March
15%	15%	50%	25%

For the First quarter ending 30th June, 20X1, I-Crop. 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, 20X1

		(₹ 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 - 5

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 other significant one-time events.

QUESTION - 6

On 30th June, 20X1, Asmitha Ltd. incurred ₹ 2,00,000, net loss from disposal of a business segment. Also, on 31st July, 20X1, the company paid ₹ 60,000 for property taxes assessed for the calendar year 20X1. How the above transactions should be included in determination of net income of Asmitha Ltd. for the six months interim period ended on 30th September, 20X1.

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, 20X1, 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 20X1, ₹ 30,000 would be reported as an expense for six months ended on 30th September, 20X1 while out of the remaining ₹ 30,000, ₹ 15,000 for January, 20X1 to March, 20X1 should be shown as payment of the outstanding amount of previous year and another ₹ 15,000 related to quarter October, 20X1 to December, 20X1 would be reported as prepaid expenses.

QUESTION - 7

An enterprise reports quarterly, estimates an annual income of ₹ 10 lakhs. Assume tax rates on 1st ₹ 5,00,000 at 30% and on the balance income at 40%. The estimated quarterly income are ₹ 75,000, ₹ 2,50,000, ₹ 3,75,000 and ₹ 3,00,000.

Calculate the tax expense to be recognized in each quarter.

SOLUTION

As per para 29 of AS 25 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

		(₹)
Estimated Annual Income	(A)	10,00,000
Tax expense:		
30% on ₹ 5,00,000		1,50,000
40% on remaining ₹ 5,00,000		2,00,000
	(B)	3,50,000

Weighted average annual income tax rate $= \frac{B}{A} = \frac{3,50,000}{10,00,000} = 35\%$

Tax expense to be recognized in each of the quarterly reports	(₹)
Quarter I - ₹ 75,000 × 35%	26,250
Quarter II - ₹ 2,50,000 × 35%	87,500
Quarter III - ₹ 3,75,000 × 35%	1,31,250
Quarter IV - ₹ 3,00,000 × 35%	1,05,000
₹ 10,00,000	3,50,000

QUESTION - 8

Antarbarti Limited reported a Profit Before Tax (PBT) of ₹ 4 lakhs for the third quarter ending 30-09-20X1. On enquiry you observe the following. Give the treatment required under AS 25:

(i) Dividend income of ₹ 4 lakhs received during the quarter has been recognized to the extent of ₹ 1 lakh only.

(ii) 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.

(iii) 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.

(iv) ₹ 2 lakhs extra-ordinary gain received in third quarter was allocated equally to the third and fourth quarter.

(v) Cumulative loss resulting from change in method of inventory valuation was recognized in the third quarter of ₹ 3 lakhs. Out of this loss ₹ 1 lakh relates to previous quarters.

(vi) 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 financial year. 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 the 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)

ACCOUNTING STANDARD 26

Intangible Assets

QUESTION - 1

ABC Ltd. developed know-how by incurring expenditure of ₹ 20 lakhs, The know-how was used by the company from 1.4.20X1. The useful life of the asset is 10 years from the year of commencement of its use. The company has not amortised the asset till 31.3.20X8. Pass Journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.20X8.

SOLUTION:

Journal Entry

		₹	₹
Profit and Loss A/c (Prior period item)	Dr.	12,00,000	
Amortization A/c	Dr.	2,00,000	
To know-how A/c			14,00,000
[Being amortization of 7 years (out of which amortization of 6 years charged as prior period item)]			

QUESTION - 2

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 Flow (₹ 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 Accounting Standard 26. **[Nov 2020 (5 Marks)]**

ANSWER:

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

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 1st 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 ?

What is the carrying amount of the intangible asset as on 31st March, 2020? **[Nov 2020]**

ANSWER:

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 1st 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 to be charged to Profit and loss account	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 - 4

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. **[Jan 21 (5 Marks)]**

ANSWER:

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

Purchase cost of the software	£ 1,50,000
Less: Trade discount @ 2.5%	£ (3,750)
	£ 1,46,250
Cost in ₹ (UK £ 1,46,250 x ₹ 100)	146,25,000
Add: Import duty on cost @ 10% (₹)	14.62.500
	160,87.500
Add: Additional import duty @5% (₹)	8,04,375
	168,91,875
Add: Installation expenses (₹)	1,50,000
Add: Professional fee for clearance from customs (₹)	50,000
Cost of the software to be capitalized (₹)	170.91.875

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 - 5

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 and at an annual fee of 10% of net revenues (after deducting expenditure). The franchise expires after 6 years. Net revenues were ₹ 60,000 during the financial year 2019-2020.**

(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.

[RTP May 21]

ANSWER:

Naresh Ltd.

Balance Sheet (Extract relating to intangible asset) as on 31st March 2020

	Note No.	₹
Assets		
(1) Non-current assets		
Intangible assets	1	8,11,200

Notes to Accounts (Extract)

		₹	₹

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1.	Intangible assets		
	Goodwill (Refer to note 1)	4,51,200	
	Franchise (Refer to Note 2)	1,50,000	
	Patents (Refer to Note 3)	2,10,000	8,11,200

Working Notes:

		₹
(1)	Goodwill on acquisition of business	
	Cash paid for acquiring the business (purchase consideration)	10,80,000
	Less: Fair value of net assets acquired	(5,16,000)
	Goodwill	5,64,000
	Less: Amortisation as per AS 14 ie. over 5 years (as per SLM)	(1,12,800)
	Balance to be shown in the balance sheet	4,51,200
(2)	Franchise	1,80,000
	Less: Amortisation (over 6 years)	(30,000)
	Balance to be shown in the balance sheet	1,50,000
(3)	Patent	2,40,000
	Less: Amortisation (over 8 years as per SLM)	(30,000)
	Balance to be shown in the balance sheet	2,10,000

QUESTION - 6

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. **[RTP May 22]**

ANSWER:

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, and only if: (i) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and (ii) the cost of the asset can be measured reliably. In the given case, no intangible assets or other asset is acquired or created that can be recognized, the accounting treatment by the company to amortize the entire expenditure over the period in which it expects the benefits to flow is not correct and the same should be debited to the profit and loss statement during the year ended 31st March, 2021.

QUESTION - 7

During 2020-21, an enterprise incurred costs to develop and produce a routine low rise computer software product, as follows:

Particular	₹
Completion of detailed program and design (Phase 1)	50,000
Coding and Testing (Phase 2)	40,000
Other coding costs (Phase 3 & 4)	63,000
Testing costs (Phase 3 & 4)	18,000
Product masters for training materials (Phase 5)	19,500

Packing the products (1,500 units) (Phase 6)	16,500

After completion of phase 2, it was established that the product is technically feasible for the market. You are required to state how the above cost to be recognized in the books of accounts as per AS 26.

[MTP Oct 21 (5 Marks)]

ANSWER:

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/ assets 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 as 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.

QUESTION - 8

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 in intangible assets 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 was ₹ 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 provision of AS 26, you are required to ascertain:

(i) The expenditure to be charged to Profit and Loss Account for the 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. **[Dec 21 (5 Marks)]**

ANSWER:

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 1st January 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

ACCOUNTING STANDARD 27

Financial Reporting of Interests in Joint Ventures

QUESTION - 1

Mr. A, Mr. B and Mr. C entered into a joint venture to purchase a land, construct and sell flats. Mr. A purchased a land for ₹ 60,00,000 on 01.01.20X1 and for the purpose he took loan from a bank for ₹ 50,00,000 @ 8% interest p.a. He also paid registering fees ₹ 60,000 on the same day. Mr. B supplied 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 30.06.20X1 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.

SOLUTION

Draft Consolidated Profit & Loss Account

Particulars	₹	₹	Particulars	₹	₹
To Purchase of Land:			By Sale of Flats:		
Mr. A		60,00,000	Mr. A	40,00,000	
To Registration Fees:			Mr. B	20,00,000	
Mr. A		60,000	Mr. C	10,00,000	70,00,000
To Materials:			By Flats taken by Venturers:		
Mr. B		9,50,000	Mr. A	10,00,000	
To Other Expenses:			Mr. B	10,00,000	
Mr. C		9,00,000	Mr. C	10,00,000	30,00,000
To Bank Interest:					
Mr. A		2,00,000			
To Profits:					
Mr. A	6,30,000				
Mr. B	6,30,000	18,90,000			
		1,00,00,000			1,00,00,000

In the Books of Mr. A Joint Venture Account

Particulars	₹	Particulars	₹
To Bank Loan (Purchase of Land)	50,00,000	By Bank (Sale of Flats)	40,00,000
To Bank: (Purchase of Land)	10,00,000	By Land & Building	10,00,000
To Bank (Registration Fees)	60,000	By Bank (Received from Mr. B)	14,20,000
To Bank (Bank Interest)	2,00,000	By Bank (Received from Mr. C)	4,70,000
To Profit on JV	6,30,000		
	68,90,000		68,90,000

In the Books of Mr. B Joint Venture Account

Particulars		₹	Particulars		₹
To	Purchases (Material Supplied)	4,50,000	By	Bank (Sale of Flats)	20,00,000
To	Bank (Materials)	5,00,000	By	Land & Building	10,00,000
To	Profit on JV	6,30,000			
To	Bank (Paid to Mr. A)	14,20,000			
		30,00,000			30,00,000

In the Books of Mr. C Joint Venture Account

Particulars		₹	Particulars		₹
To	Bank (Misc. Expenses)	9,00,000	By	Bank (Sale of Flats)	10,00,000
To	Profit on JV	6,30,000	By	Land & Building	10,00,000
To	Bank (Paid to Mr. A)	4,70,000			
		20,00,000			20,00,000

QUESTION - 2

A Ltd., B Ltd. and C Ltd. decided to jointly construct a pipeline to transport the gas from one place to another that was manufactured by them. For the purpose following expenditure was incurred by them: Buildings ₹ 12,00,000 to be depreciated @ 5% p.a., Pipeline for ₹ 60,00,000 to be depreciated @ 15% p.a., computers and other electronics for ₹ 3,00,000 to be depreciated @ 40% p.a. and various 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

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In the Books of A Ltd.

Extract of statement of Profit & Loss

Particulars	Note No.	₹
Depreciation and amortization expenses	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 amortization expenses		
	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.

Extra of draft Profit & Loss Account

Particulars	**Note No.**	**₹**
Depreciation and amortization 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

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Notes to Accounts

		₹	₹
1.	Depreciation and amortization expenses		
	Land & Building	20,000	
	Plant & Machinery	3,00,000	
	Computers	40,000	
	Vehicles	60,000	4,20,000
2.	Land & Building	4,00,000	
	Less: Depreciation	(20,000)	3,80,000
	Plant & Machinery	20,00,000	
	Less: Depreciation	(3,00,000)	17,00,000
	Computers	1,00,000	
	Less: Depreciation	(40,000)	60,000
	Vehicles	3,00,000	
	Less: Depreciation	(60,000)	2,40,000
			23,80,000

In the Books of C Ltd.

Extract of Draft Profit & Loss Account	**Note No.**	**₹**

Depreciation and amortization 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 expenses		
	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

QUESTION - 3

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 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)		1,06,000
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:		
	A Ltd.	7,25,000	
	B Ltd.	5,80,000	13,05,000
2.	**Purchases**		

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	A Ltd.	5,00,000	
	B Ltd.	4,00,000	9,00,000
3.	**Other expenses**		
	A Ltd.	1,70,000	
	B Ltd.	1,36,000	3,06,000
4.	**Closing Inventory**		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
5.	**Share Capital**		
	A Ltd.	1,96,490	
	B Ltd.	2,04,510	4,01,000
6.	**Reserves and Surplus**		
	Profit & Loss Account:		
	A Ltd.	99,500	
	B Ltd.	99,500	1,99,000
7.	**Long Term Borrowings**		
	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 and Equipment**		
	A Ltd.	3,00,000	
	B Ltd.	3,00,000	6,00,000
10.	**Inventories**		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
11.	**Other Current Assets**		
	A Ltd.	1,00,000	
	B Ltd.	1,00,000	2,00,000

QUESTION - 4

A Ltd. entered into a joint venture with B Ltd. on 1:1 basis and a new company C Ltd. was formed for the same purpose and following is the balance sheet of all the three companies:

Particulars	A Ltd.	B Ltd.	C Ltd.
Share Capital	**10,00,000**	**7,50,000**	**5,00,000**
Reserve & Surplus	**18,00,000**	**16,00,000**	**12,00,000**
Loans	**3,00,000**	**4,00,000**	**2,00,000**

Current Liabilities	4,00,000	2,50,000	1,00,000
Property, Plant and Equipment	30,50,000	26,25,000	19,50,000
Investment in JV	2,50,000	2,50,000	--
Current Assets	2,00,000	1,25,000	50,000

Prepare the balance sheet of A Ltd. and B Ltd. under proportionate consolidation method.

SOLUTION

Balance Sheet of A Ltd.

		Note No.	(₹)
I	**Equity and Liabilities**		
	1. Shareholders' funds:		
	Share Capital		10,00,000
	Reserves and Surplus	1	24,00,000
	2. Non-Current liabilities	2	4,00,000
	3. Current Liabilities	3	4,50,000
	Total		42,50,000
II	**Assets**		
	Non-current Assets		
	Property, Plant and Equipment:	4	40,25,000
	Current Assets	5	2,25,000
			42,50,000

Notes to Accounts

		₹	₹
1.	**Reserves and Surplus**		
	A Ltd.	18,00,00	
	C Ltd.	6,00,000	24,00,00
2.	Long Term Borrowings		
	Loans:		
	A Ltd.	3,00,000	
	C Ltd.	1,00,000	4,00,000
3.	Current Liabilities:		
	A Ltd.	4,00,000	
	C Ltd.	50,000	4,50,000
4.	Property, Plant and Equipment:		
	A Ltd.	30,50,000	
	C Ltd.	9,75,000	40,25,000
5.	Current Assets:		
	A Ltd.	2,00,000	

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	C Ltd.	25,000	2,25,000

Balance Sheet of B Ltd.

		Note No.	(₹)
I	**Equity and liabilities**		
	1. Shareholders' funds:		
	Share Capital		7,50,000
	Reserves and Surplus	1	22,00,000
	2. Non-current liabilities	2	5,00,000
	3. Current Liabilities	3	
			3,00,000
			37,50,000
II	**Assets**		
	1. Non-current Assets		
	Property, Plant and Equipment	4	36,00,000
	2. Current Assets	5	
			1,50,000
			37,50,000

Notes to Accounts

		₹	₹
1.	Reserves and Surplus		
	A Ltd.	16,00,000	
	C Ltd.	6,00,000	22,00,000
2.	Long Term Borrowings		
	Loans:		
	A Ltd.	4,00,000	
	C Ltd.	1,00,000	5,00,000
3.	Current Liabilities:		
	A Ltd.	2,50,000	
	C Ltd.	50,000	3,00,000
4.	Property, Plant and Equipment:		
	A Ltd.	26,25,000	
	C Ltd.	9,75,000	36,00,000
5.	Current Assets:		
	A Ltd.	1,25,000	
	C Ltd.	25,000	1,50,000

QUESTION - 5

JVR Limited has made investments of ₹ 97.84 crores in equity shares of QSR Limited in pursuance of Joint Venture agreement till 20X1-X2 (i.e., more than 12 months). The investment has been made at par. QSR Limited

has been 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. The type and extent of the investor's stake in the investee are also taken into account. However, where there is a decline, other than temporary, in the carrying amounts of long-term investments, the resultant reduction in the carrying amount is charged to the profit and loss statement.

Since the investment was made in the year 20X1-20X2 i.e., more than a year, it is a long-term investment. In the given case, though the QSR Ltd. is in continuous losses for past 2 years, yet it has a futuristic and profitable business plans and projections for the coming years. Here, one of the indicators i.e. 'losses incurred to the company' may lead to diminution in the value of the shares while the other indicator that 'the company has positive expected cash flows from its business plans' does not lead to decline in the value of shares. Considering both the facts, in case the expectation of profitable business plans and positive cash flows is based reliable presumptions (such as tender in favour of QSR Ltd., strong order book etc.), the decline will be regarded as temporary in nature and the investment in equity shares will continue to be carried at cost only.

However, should the aforesaid presumptions be based on projections without reasonable evidence backing the claims, the decline could be regarded as non-temporary in nature in which case the write down of the carrying amount become necessary in line with AS 13, thereby implying the contention of QSR Ltd. to be correct.

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ACCOUNTING STANDARD 28

Impairment of Assets

QUESTION - 1

Ergo Industries Ltd. gives the following estimates of cash flows relating to Property, Plant and Equipment on 31-12-20X1. The discount rate is 15%.

Year	Cash Flow (₹ in Lakhs)
20X2	4,000
20X3	6,000
20X4	8,000
20X5	8,000
20X6	4,000

Residual value at the end of 20X6	= ₹ 1000 lakhs
Property, Plant and Equipment purchased on 1-1-20XX	= ₹ 40,000 lakhs
Useful life	= 8 years
Net selling price on 31-12-20X1	₹ 20,000 lakhs

Calculate on 31-12-20X1:

Carrying amount at the end of 20X1

(a) Carrying amount at the end of 20X1

(b) Value in use on 31-12-20X1

(c) Recoverable amount on 31-12-20X1

(d) Impairment loss to be recognized for the year ended 31-12-20X1

(e) Revised carrying amount

(f) Depreciation charge for 20X2.

Note: The year 20XX is the immediate preceding year before the year 20X0.

SOLUTION

Calculation of value in use

Year	Cash Flow	Discount as per 15%	Discounted cash flow
20X2	4,000	0.870	3,480
20X3	6,000	0.756	4,536
20X4	6,000	0.658	3,948
20X5	8,000	0.572	4,576
20X6	4,000	0.497	1,988
20X6	(residual 1,000)	0.497	497
			19,025

(a) Calculation of carrying amount:

Original cost = ₹ 40,000 lakhs

Depreciation for 3 years = [(40,000-1000)□3/8] = ₹ 14,625 lakhs

Carrying amount on 31-12-20X1 = [40,000-14,625] = ₹ 25,375 lakhs

(b) **Value in use = ₹ 19,025 lakhs**

(c) Recoverable amount = higher of value in use and net selling price i.e. ₹ 20,000 lakhs.

Recoverable amount = ₹ 20,000 lakhs

(d) **Impairment Loss =** ₹ (25,375-20,000) = ₹ 5,375 lakhs

(e) **Revised carrying amount =** ₹ (25,375-5,375) = ₹ 20,000 lakhs

(f) **Depreciation charge for 20X2 =** (20,000-1000)/5 = ₹ 3,800 lakhs

QUESTION - 2

X Ltd. is having a plant (asset) carrying amount of which is ₹ 100 lakhs on 31.3.20X1. Its balance useful life is 5 years and residual value at the end of 5 years is ₹ 5 lakhs. Estimated future cash flow from using the plant in next 5 years are:

For the year ended on	Estimated cash flow (₹ in lakhs)
31.3.20X2	50
31.3.20X3	30
31.3.20X4	30
31.3.20X5	20
31.3.20X6	20

Calculate "value in use" for plant if the discount rate is 10% and also calculate the recoverable amount if net selling price of plant on 31.3.20X1 is ₹ 60 lakhs.

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<u>SOLUTION</u>

Present value of future cash flow

Year ended	Future Cash Flow	Discount @ 10% Rate	Discounted cash flow
31.3.20X2	50	0.909	45.45
31.3.20X3	30	0.826	24.78
31.3.20X4	30	0.751	22.53
31.3.20X5	20	0.683	13.66
31.3.20X6	20	0.620	12.40
			118.82
Present value of residual price on 31.3.20X6 = 5 × 0.620			3.10
Present value of estimated cash flow by use of an asset and residual value, which is called "value in use".			121.92

If net selling price of plant on 31.3.20X1 is ₹ 60 lakhs, the recoverable amount will be higher of ₹ 121.92 lakhs (value in use) and ₹ 60 lakhs (net selling price), hence recoverable amount is ₹ 121.92 lakhs.

QUESTION - 3

G Ltd., acquired a machine on 1st April, 20X0 for ₹ 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 20X4, the carrying value of the machine was reassessed at ₹ 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March, 20X6, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only ₹ 79 lakhs. You are required to calculate the

loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd. G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

SOLUTION

Statement Sowing Impairment Loss

	(₹ in crores)
Carrying amount of the machine as on 1st April, 20X0	7.00
Depreciation for 4 years i.e. 20X0-20X1 to 20X3-20X4 $\left[\frac{7 \text{ crores}}{7 \text{ Years}} \times 4 \text{ years}\right]$	(4.00)
Carrying amount as on 31.03.20X4	3.00
Add: Upward Revaluation (credited to Revaluation Reserve account)	2.10
Carrying amount of the machine as on 1st April, 20X4 (revalued)	5.10
Less: Depreciation for 2 years i.e. 20X4 – 20X5 & 20X5-20X6 $\left[\frac{5.10 \text{ crores}}{3 \text{ Years}} \times 2 \text{ years}\right]$	(3.40)
Carrying amount as on 31.03.20X6	1.70
Less: Recoverable amount	(0.79)
Impairment loss	0.91
Less: Balance in revaluation reserve as on 31.03.20X6:	
Balance in revaluation reserve as on 31.03.20X4	2.10
Less: Enhanced depreciation met from revaluation reserve 20X4-20X5 & 20X5-20X6=[(1.70 – 1.00) x 2 years] (140)	
Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 "Impairment of Assets"	(0.70)
Impairment Loss to be debited to profit and loss account	0.21

QUESTION - 4

X Ltd. purchased a Property, Plant and Equipment four years ago for ₹ 150 lakhs and 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 will be 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 para 57 of AS 28 "Impairment of assets", if the recoverable amount (higher of 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 revaluation of 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 4 years]	(60.00)
Carrying value of 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 - 5

An asset does not meet the requirements of environment laws which have been recently enacted. The asset has to be destroyed as per the law. The asset is carried in the Balance Sheet at the year end at ₹ 6,00,000. The estimated cost of destroying the asset is ₹ 70,000. How is the asset to be accounted for?

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 and its 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 impairment loss will be calculated as ₹ 6,00,000 [carrying amount (₹ 6,00,000) – recoverable amount (nil)]. Therefore, asset is to be fully impaired and, impairment loss of ₹ 6,00,000 has to be recognized as an expense immediately in the statement of Profit and Loss as per para 58 of AS 28.

Further, as per para 60 of AS 28, When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an enterprise should recognise a liability if, and only if, that is required by another Accounting Standard. Hence, the entity should recognize liability for cost of disposal of ₹ 70,000 as per AS 10 & 29.

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QUESTION - 6

Venus Ltd. has a fixed asset, which is carried in the Balance Sheet on 31.3.20X1 at ₹ 500 lakhs. As at that date the value in use is ₹ 400 lakhs and the net selling price is ₹ 375 lakhs.

From the above data:

(i) Calculate impairment loss.

(ii) Prepare journal entries for adjustment of impairment loss.

(iii) Show, how impairment loss will be shown in the Balance Sheet.

SOLUTION

(i) Recoverable amount is higher of value in use ₹ 400 lakhs and net selling price ₹ 375 lakhs.

Recoverable amount = ₹ 400 lakhs

Impairment loss = Carried Amount – Recoverable amount

= ₹ 500 lakhs – ₹ 400 lakhs = ₹ 100 lakhs.

(ii) Journal Entries **Amount (₹ 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 impairment loss the to profit and loss account)			

(iii) **Balance Sheet of Venus Ltd. as on 31.3.20X1**

	(₹ in Lakhs)
Fixed Asset	
Asset Less depreciation	500
Less: Impairment Loss	(100)
	400

QUESTION - 7

Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 20X1 for ₹ 60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 20X1-20X2 the carrying amount was ₹ 41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch ₹ 36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of ₹ 54 crore per annum and has a carrying amount of ₹ 3.46 crore. All such machines put together could fetch a sum of ₹ 4.44 crore if disposed. Discuss the applicability of Impairment loss.

SOLUTION

As per provisions of AS 28 "Impairment of Assets", impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit which is group of asset to which the damaged machine belongs is not impaired; and the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.

QUESTION - 8

A plant was acquired 15 years ago at a cost of ₹ 5 crores. Its accumulated depreciation as at 31st March, 20X1 was ₹ 4.15 crores. Depreciation estimated for the financial year 20X1-20X2 is ₹ 25 lakhs. Estimated Net Selling Price as on 31st March, 20X1 was ₹ 30 lakhs, which is expected to decline by 20 percent by the end of the next financial year.

Its value in use has been computed at ₹ 35 lakhs as on 1st April, 20X1, which is expected to decrease by 30 per cent by the end of the financial year.

(i) Assuming that other conditions for applicability of the impairment Accounting Standard are satisfied, what should be the carrying amount of this plant as at 31st March, 20X2?

(ii) How much will be the amount of write off for the financial year ended 31st March, 20X2?

(iii) If the plant had been revalued ten years ago and the current revaluation reserves against this plant were to be ₹ 12 lakhs, how would you answer to questions (i) and (ii) above?

(iv) 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?

SOLUTION

As per AS 28 "Impairment of Assets", if the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount and that reduction is an impairment loss. An impairment loss on a revalued asset is recognized as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

In the given case, recoverable amount (higher of asset's net selling price and value in use) will be ₹ 24.5 lakhs on 31.3.20X2 according to the provisions of AS 28 [Refer working note].

		(₹ in lakhs)
(i)	Carrying amount of plant (after impairment) as on 31st March, 20X2	24.50

(ii)	Amount of write off (impairment loss) for the financial year ended 31st March, 20X2 [₹ 60 lakhs – ₹ 24.5 lakhs]	35.50
(iii)	If the plant had been revalued ten years ago	
	Debit to revaluation reserve	12.00
	Amount charged to profit and loss account (₹ 35.50 lakhs - ₹ 12 lakhs)	23.50
(iv)	If Value in use is zero	
	Value in use (a)	Nil
	Net selling price (b)	(-) 2.00
	Recoverable amount [higher of (a) and (b)]	Nil
	Carrying amount (closing book value)	Nil
	Amount of write off (impairment loss) (₹ 60 lakhs – Nil)	60.00
	Entire book value of plant will be written off and charged to profit and loss Account.	

Working Note:

Calculation of Closing Book Value, Estimated Net Selling Value and Estimated Value in Use of Plant at 31st March, 20X2

	(₹ in lakhs)
Opening book value as on 1.4.20X1 (₹ 500 lakhs – ₹ 415 lakhs)	85
Less: Depreciation for financial year 20X1 – 20X2	(25)
Closing book value as on 31.3.20X2	60
Estimated net selling price as on 1.4.20X1	30
Less: Estimated decrease during the year (20% of ₹ 30 lakhs)	(6)
Estimated net selling price as on 31.3.20X2	24
Estimated value in use as on 1.4.20X1	35.0
Less: Estimated decrease during the year (30% of ₹ 35 lakhs)	(10.5)
Estimated value in use as on 31.3.20X2	24.5

ACCOUNTING STANDARD 29

Provisions, Contingent Liabilities and Contingent Assets

QUESTION - 1

At the end of the financial year ending on 31st December, 20X1, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

	Probability	Loss (₹)
In respect of five cases (Win)	100%	-
Next ten cases (Win)	50%	-
Lose (Low damages)	40%	1,20,000
Lose (high damages)	10%	2,00,000
Remaining five cases		
Win	50%	-
Lose (Low damages)	30%	1,00,000
Lose (High damages)	20%	2,10,000

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof.

SOLUTION:

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

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

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

(iii) The possibility of an outflow of resources embodying economic benefits is not remote.

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

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 50% and for remaining five cases is 50%. As per AS 29 (Revised), we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is remote, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 40% of ₹ 1,20,000 + 10% of ₹ 2,00,000

= ₹ 48,000 + ₹ 20,000 = ₹ 68,000

Expected loss in remaining five cases = 30% of ₹ 1,00,000 + 20% of ₹ 2,10,000

= ₹ 30,000 + ₹ 42,000 = ₹ 72,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of ₹ 10,40,000 (₹ 68,000 x 10 + ₹ 72,000 x 5) as contingent liability.

QUESTION - 2

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.** **[Nov 2020]**

ANSWER:

(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 - 3

(i) **XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of Rs. 200 lacs.**

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS 29? Explain in brief giving reasons for your answer.

(ii) **What is meant by "Restructuring Provision" as per AS 29? What costs are excluded while computing such provision as per the standard?** **[MTP April 21 (5 Marks)]**

ANSWER:

(i) As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when

- An enterprise has a present obligation as a result of a past event;
- It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- A reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of Rs. 200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

(ii) As per AS 29, a restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both: (a) necessarily entailed by the restructuring; and (b) Not associated with the ongoing activities

of the enterprise. A restructuring provision does not include such costs as: (a) Retraining or relocating continuing staff; (b) Marketing; or (c) Investment in new systems and distribution networks.

QUESTION - 4

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. [July 21 (5 Marks)]

ANSWER:

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:

(i) Seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods. AS 9 also provides that in case of retail sales offering a guarantee of 'money back, if not completely satisfied, it may be appropriate to recognize the sale but to make a suitable 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	80
Profit mark up on sales (80/400) x 100 = 20%	

QUESTION - 5

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. **[RTP May 21]**

ANSWER:

(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 - 6

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 a court case in 2014-2015 against its competitors. It became evident to its lawyers during the year ended 31st March, 2020 that Chaos Limited may lose the case and would have to pay ₹ 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. **[RTP May 22]**

ANSWER:

Principles for recognition of provisions: As per AS 29, "a provision shall be recognised when:

(i) An entity has a present obligation (legal or constructive) as a result of a past event;

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

(iii) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision 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 - 7

A company, incorporated as NPO under the Companies Act, is having main objective to promote the trade by organizing trade fairs / exhibitions. While organizing the trade fair and exhibitions, it decided to charge 5% contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies, 5% contingency 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 and Expenditure Account of the company.

The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/ exhibitors, etc., due to fire, terrorist attack, stampede, natural calamities and other public and third party liability. The chances of occurrence of these events are high because of large crowds visiting the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated.

The accounting treatment and disclosure was made by the company in its financial statements as: (i) 5% contingency charges are treated as income and matching provision for the same is also being made in accounts and (ii) suitable disclosure to this effect is also made in the notes forming part of accounts.

You are required to comment whether creation of provision for contingencies considering the facts and circumstances of the case is required in line with AS 29. **[RTP Nov 21]**

ANSWER:

As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", a provision should be recognized when (a) An enterprise has a present obligation as a result of a past event and (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

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 - 8

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:

(i) 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.

(ii) 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 ₹ 80 lakh 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.
[MTP Oct 21 (5 Marks)]

ANSWER:

(i) As per AS 19, 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.

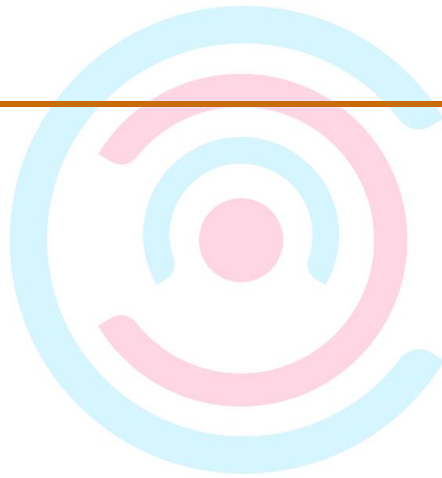
In the given case, there are 75% chances that the penalty may not be levied. Accordingly, Saharsh Ltd. should not make the provision for penalty.

However, a provision should be made for remaining 50% fees of the lawyer in the financial statements of financial year 2019-2020.

(ii)

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



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