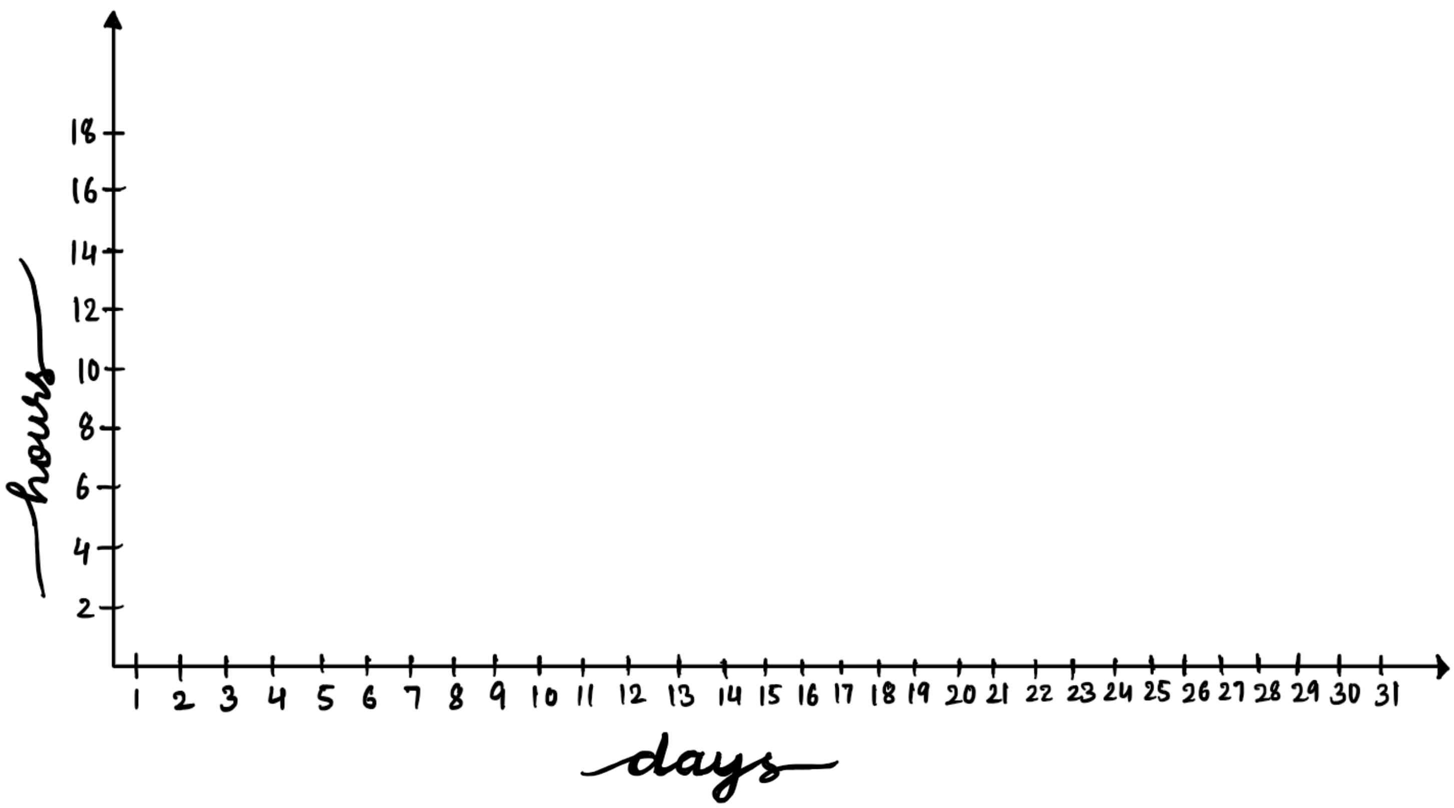
Planner

goals

1st month of PL

				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

Productivity Graph



Study Plan

1st WEEK To do	2nd WEEK To do	3rd WEEK To do	4th WEEK To do
☐	☐	☐	☐
☐	☐	☐	☐
☐	☐	☐	☐
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☐	☐	☐	☐
☐	☐	☐	☐
☐	☐	☐	☐
Weekly test ☐	Weekly test ☐	Weekly test ☐	Weekly test ☐

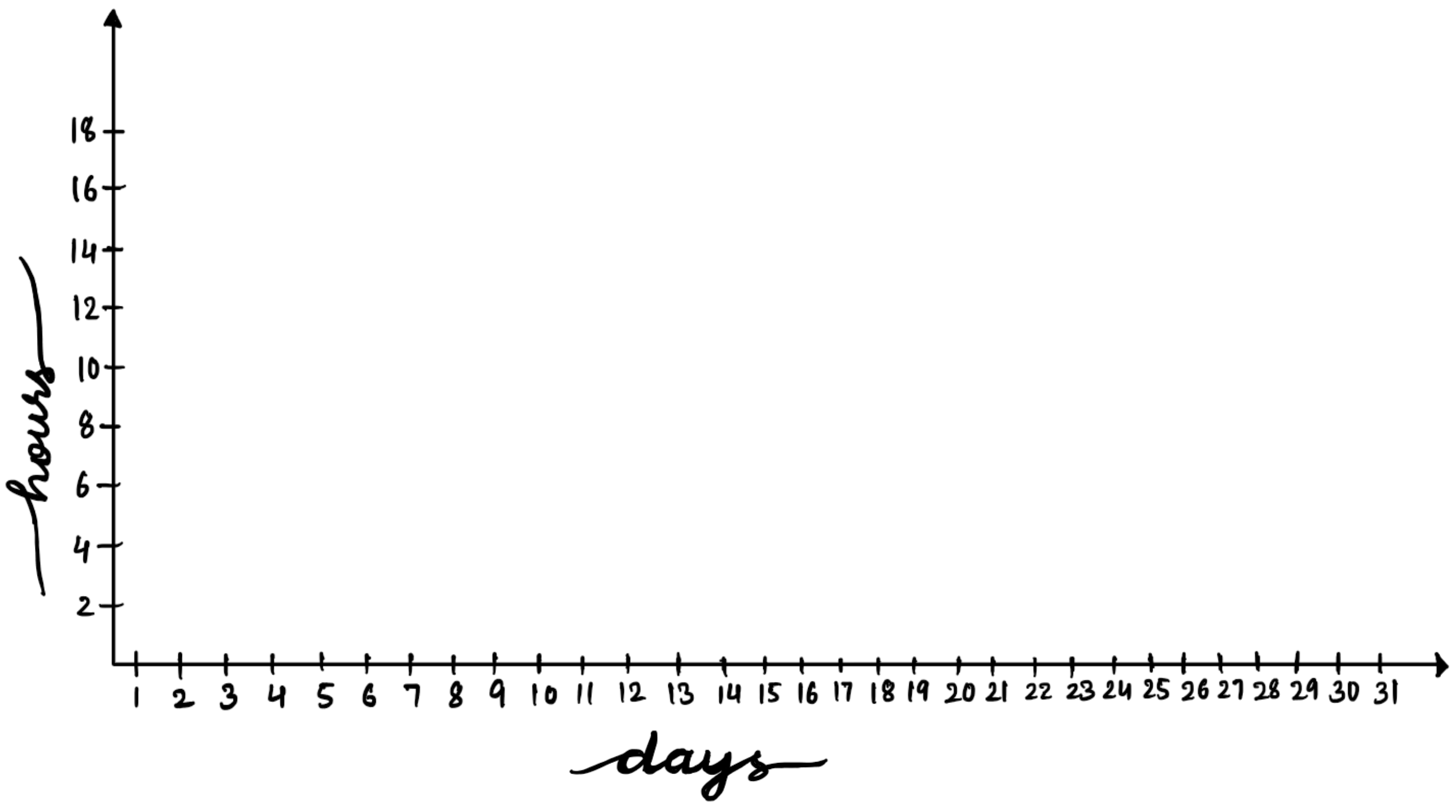
Planner

goals

2nd month of PL

				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

Productivity Graph



Study Plan

1st WEEK To do	2nd WEEK To do	3rd WEEK To do	4th WEEK To do
☐	☐	☐	☐
☐	☐	☐	☐
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☐	☐	☐	☐
☐	☐	☐	☐
Weekly test ☐	Weekly test ☐	Weekly test ☐	Weekly test ☐

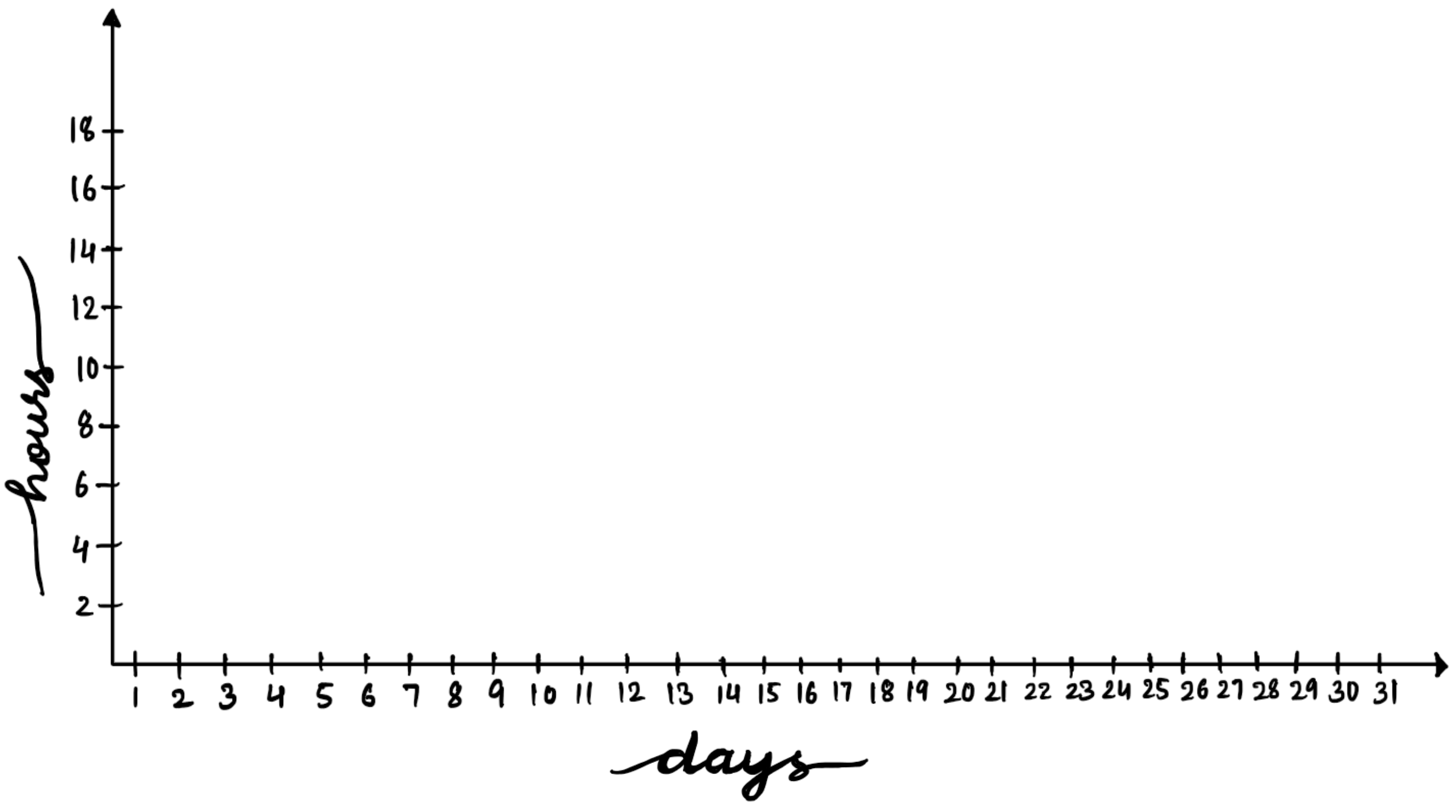
Planner

goals

3rd month of PL

				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

Productivity Graph



Study Plan

1st WEEK
To do

Weekly test

2nd WEEK
To do

Weekly test

3rd WEEK
To do

Weekly test

4th WEEK
To do

Weekly test

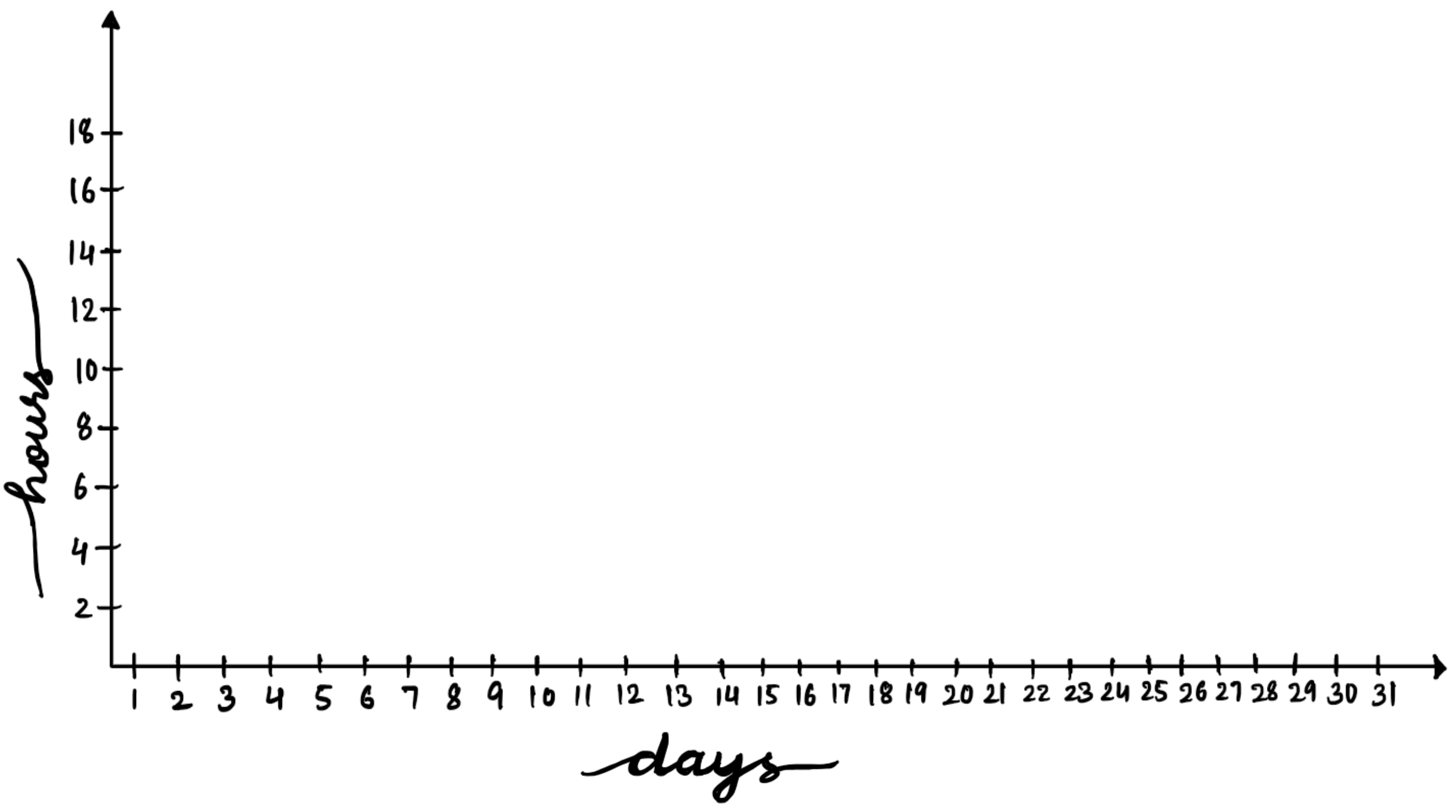
Planner

goals

4th month of PL

				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

Productivity Graph



Study Plan

1st WEEK To do	2nd WEEK To do	3rd WEEK To do	4th WEEK To do
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☐	☐	☐	☐
☐	☐	☐	☐
Weekly test ☐	Weekly test ☐	Weekly test ☐	Weekly test ☐

INDEX

4

Financial Statements of Companies

PART I – FORM OF BALANCE SHEET

Name of the Company........................

Balance Sheet as at ....

(Rupees in...........)

			PARTICULARS	NOTES NO	FIGURES FOR THE CURRENT REPORTING PERIOD	FIGURES FOR THE PREVIOUS REPORTING PERIOD
			EQUITY AND LIABILITIES			
1.			**Shareholders' funds**			
	a		Share capital			
	b		Reserves and Surplus			
	c		Money received against share warrants			
2.			**Share application money pending allotment**			
3.			**Non-Current Liabilities**			
	a		Long-term borrowings			
	b		Deferred Tax Liabilities (Net) (AS 22)			
	c		Other Long Term Liabilities			
	d		Long-Term Provisions (D) (AS 29)			
4.			**Current Liabilities**			
	a		Short-Term Borrowings (E)			
	b		Trade Payables [GSR 679 (E) dated 04.09.15]			
			(A) Total outstanding dues of micro enterprises and Small enterprises, and			
			(B) Total outstanding dues of creditors other than micro enterprises and small enterprises			
	c		Other Current Liabilities			
	d		Short-Term Provisions			

			TOTAL			
			ASSETS			
1			**Non-current assets**			
	a		Property, Plant and Equipment & Intangible Assets			
		i	Property, Plant & Equipments (AS 10)			
		ii	Intangible assets (AS 26)			
		iii	Capital Work-in-progress (AS 10)			
		iv	Intangible assets under development			
	b		Non-Current Investments (AS 13)			
.	c		Deferred Tax Assets (Net) (AS 22)			
	d		Long-term loans & advances			
	e		Other non-current assets			
2			**Current assets**			
	a		Current investments			
	b		Inventories (AS 2)			
	c		Trade receivables			
	d		Cash and cash equivalents (AS 3)			
	e		Short-term loans and advances			
	f		Other current assets			
			Total			

NOTE A SHARE CAPITAL

PARTICULARS	CURRENT YEAR		PREVIOUS YEAR	
	NUMBER OF SHARES	RS.	NUMBER OF SHARES	RS.
Authorised Capital				
________shares of Rs. ___ each				
Issued Capital				
________shares of Rs. ___ each				
Subscribed Capital and fully paid up				
________shares of Rs. ___ each Rs.___ per share paid up				
Subscribed Capital but not fully paid up				

________shares of Rs. ___ each Rs.___ per share paid up				
Total				

A. RESERVES AND SURPLUS

PARTICULARS	RS.	RS.
(a) Capital Reserve	xxx	xxx
(b) Capital Redemption Reserve	xxx	xxx
(c) Securities Premium	xxx	xxx
(d) Debenture Redemption Reserve	(xxx)	(xxx)
(e) Revaluation Reserve	xxx	xxx
(f) Surplus; the balance as per profit and loss statement		
(g) Other Reserves – (specify the nature and purpose)		

B. LONG TERM BORROWINGS

PARTICULARS	RS.	RS.
Bonds/Debentures		
Term Loans		
From Banks		
From Other Parties		
Deferred Payment Liabilities		
Deposits		
Loans and Advances from Related Parties		
Long term Maturities of Finance Lease obligations		
Other Loans and Advances (specify nature)		

C. LONG TERM PROVISIONS

PARTICULARS	RS.	RS.
Employee benefits provision like gratuity, provident fund etc		
Other provisions (specify the nature)		

D. SHORT TERM BORROWINGS

PARTICULARS	RS.	RS.
Loans repayable on demand		
From Bank		
From Other Parties		
Loans and Advances from Related Parties		

Deposits		
Other Loans and Advances (specify nature)		

E. TRADE PAYABLES

PARTICULARS	Outstanding for following periods from due date of payment				
	Less than 1 year	1-2 years	2-3 Years	More than 3 Years	Total
i) MSME					
ii) Others					
iii) Disputed dues – MSME					
iv) Disputed dues - Others					

F. OTHER CURRENT LIABILITIES

PARTICULARS	RS.	RS.
Interest accrued but not due on Borrowings		
Interest accrued and due on Borrowings		
Income received in advance		
Unpaid Dividends		
Application Money received for allotment of securities and due for refund and interest accrued thereon.		
Other Payables (specify nature e.g.)		

G. SHORT TERM PROVISIONS

PARTICULARS	RS.	RS.
Provision for Income Tax		
Provision for employee benefits.		
Others (specify nature)		

H. TANGIBLE ASSETS

ASSET	ORIGINAL COST IN THE BEG	ADD.	DISPOSAL	ORIGINAL COST AT THE END	TOTAL DEPRECIATION IN THE BEG	DEPRECIATION FOR CURRENT YEAR	DEPRECIATION ON ASSET DISPOSED OFF	TOTAL DEPRECIATION AT THE END
A	B	C	D	E=B+C-D	F	G	H	I=F+G-H
Land								
Building								
Plant & Equipment								
Furniture and Fixtures								
Vehicles								

I. INTANGIBLE ASSETS

ASSET	ORIGINAL COST IN THE BEG	ADD.	DISPOSAL	ORIGINAL COST AT THE END	TOTAL DEPRECIATION IN THE BEG	DEPRECIATION FOR CURRENT YEAR	DEPRECIATION ON ASSET DISPOSED OFF	TOTAL DEPRECIATION AT THE END
A	B	C	D	E=B+C-D	F	G	H	I=F+G-H
Goodwill								
Brands								
Trademarks								
Computer Software								
Mining Rights.								

J. NON-CURRENT INVESTMENTS

PARTICULARS	RS.	RS.
Investments Property		
Investments In Equity Instruments		
Investments In Preference Shares		
Investments In Government or Trust Securities		
Investments In Debentures or Bonds		
Investments In Mutual Funds		
Investments In Partnership Firms		
Other Non – Current Investments (Specify Nature)		

K. LONG TERM LOANS AND ADVANCES

PARTICULARS	RS.	RS.
Capital Advances		
Security Deposits		
Loans and Advances to Related Parties		
Other Loans and Advances (specify nature)		

The above shall also be sub-classified as follows:

i) Secured, considered goods

ii) Unsecured, considered goods

iii) Doubtful

L. OTHER NON – CURRENT ASSETS

PARTICULARS	RS.	RS.
Long Term Trade Receivables		
a) Secured, Considered Good		
b) Unsecured, Considered Good		
c) Doubtful		
Security Deposit		
Other (specify nature e.g.)		

M. CURRENT INVESTMENTS

PARTICULARS	RS.	RS.
Investments In Equity Instruments		
Investments In Preference Shares		

Investments In Government or Trust Securities		
Investments In Debentures or Bonds		
Investments In Mutual Funds		
Investments In Partnership Firms		
Other Current Investments (Specify Nature)		

N. INVENTORIES

PARTICULARS	RS.	RS.
Raw – Materials		
Work – in Progress		
Finished Goods		
Stores & Spares		
Loose tools		
Stock in trade		
Goods in transit		
Others (specify nature)		

O. TRADE RECEIVABLES

PARTICULARS	Outstanding for following periods from due date of payment					
	Less than 6 Months	6 Months – 1 Year	1-2 Year	2-3 Year	More than 3 Years	Total
i) Undisputed Trade Receivables – Considered good						
ii) Undisputed Trade Receivables – Considered Doubtful						
iii) Disputed Trade Receivables – Considered good						
iv) Disputed Trade Receivables – Considered Doubtful						

P. CASH AND CASH EQUIVALENTS

PARTICULARS	RS.	RS.
Bank Balance		
Cheques/Drafts on hand		
Cash Balance		
Others (specify nature)		

Q. SHORT – TERM LOANS AND ADVANCES

PARTICULARS	RS.	RS.
Loans and Advances to Related Parties		
Other Loans and Advances (specify nature)		

NOTES: SAME AS FOR LONG – TERM LOANS AND ADVANCES

R. OTHER CURRENT ASSETS

PARTICULARS	RS.	RS.
Prepaid Expenses		

This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset categories.

S. CONTINGENT LIABILITIES AND COMMITMENTS (TO THE EXTENT NOT PROVIDED FOR)

PARTICULARS	RS.	RS.
i. Contingent Liabilities		
(a) Claims against the company not acknowledged as debt (e.g., Towards Excise, Customs, VAT, Service Tax, Income Tax, Suppliers, Customers)		
(b) Guarantees (e.g. to Banks on behalf of others)		
(c) Other money for which the company is contingently liable (e.g. Bills Discounted but not yet matured)		
ii. Commitments		
(a) Estimated amount of contracts remaining to be executed on Capital Account and not provided for;		
(b) Uncalled Liability on Shares and Other Investments (e.g. Debentures) partly paid		
(c) Other Commitments (e.g. Arrears of Fixed Cumulative Dividends on Preference Shares)		

PART II – FORM OF STATEMENT OF PROFIT AND LOSS

Name of the Company.........................

Profit and loss statement for the year ended ....

(Rupees in............)

	PARTICULARS	NOTE NO.	FIGURES FOR THE CURRENT REPORTING PERIOD		FIGURES FOR THE PREVIOUS REPORTING PERIOD	
I.	Revenue from operations (AS 9 & AS 7)			xxx		xxx
II.	Other income			xxx		xxx
III.	**Total Revenue (I + II)**			xxx		xxx
IV.	**Expenses:**					
	Cost of materials consumed			xxx		xxx
	Purchases of Stock-in-Trade			xxx		xxx
	Changes in inventories of finished goods / work-in-progress and Stock-in-Trade			xxx		xxx
	Employee benefits expense (AS 15)					
	Finance costs (AS 16)					
	Depreciation and amortization expense (AS 10)					
	Other expenses					
	Total expenses			**xxx**		**xxx**
V.	Profit before exceptional and extraordinary items and tax (III-IV)			xxx		xxx
VI.	Exceptional items (AS 5)			xxx		xxx
VII.	Profit before extraordinary items and tax (V - VI)			xxx		xxx
VIII.	Extraordinary Items (AS 5)			xxx		xxx
IX.	Profit before tax (VII- VIII)			xxx		xxx
X	Tax expense:					
	(1) Current tax (AS 22)		xxx		xxx	
	(2) Deferred tax (AS 22)		xxx		xxx	
XI	Profit (Loss) for the period from continuing operations (IX-X)			**xxx**		**xxx**
XII	Profit/(loss) from discontinuing operations			xxx		xxx

XIII	Tax expense of discontinuing operations (AS 24)			xxx		xxx
XIV	Profit/(loss) from Discontinuing operations (after tax) (XII-XIII)			xxx		xxx
XV	Profit (Loss) for the period (XI + XIV)			**xxx**		**xxx**
XVI	Earnings per equity share: (AS 20)					
	(1) Basic			xxx		xxx
	(2) Diluted			xxx		xxx

Notes to Statement of Profit and Loss

Note 1: Revenue from operations

Particulars	Rs.	Rs.
(a) From Sale of Products	xxx	xxx
(b) From Sale of Services	xxx	xxx
(c) From Other Operating Revenues [Trading Commission]	xxx	xxx
(d) Less: Excise Duty	(xxx)	(xxx)
	xxx	xxx

Note 2: Other Income

Particulars	Rs.	Rs.
(a) Interest Income (in case of a company other than a finance company)	xxx	xxx
(b) Dividends From Subsidiary companies	xxx	xxx
(c) Dividend Income Form Companies other than Subsidiary Companies	xxx	xxx
(d) Net Gain/Loss on Sale of Investments [Gain – Loss)]	xxx	xxx
(e) Other Non-Operating Income (Net of Expenses) directly attributable to such income) [Income – Expenses)]	xxx	xxx
	xxx	xxx

Note 3: Cost of Materials Consumed

PARTICULARS	RS.	RS.
(a) Opening Stock of Materials	xxx	xxx
(b) Add: Purchase of Materials	xxx	xxx
(c) Less: Closing Stock of Materials	(xxx)	(xxx)
Cost of Materials consumed	xxx	xxx

Note 4: Changes in Inventories

PARTICULARS	WORK – IN- PROGRESS RS.	FINISHED GOODS RS.	TOTAL
Less: Opening Stock	xxx	xxx	xxx
Closing Stock	(xxx)	(xxx)	(xxx)
	xxx	xxx	xxx

Note: Can be Negative

Note 5: Employee Benefits Expense

PARTICULARS	RS.	RS.
Salaries and Wages	xxx	xxx
Contribution To Provident and Other Funds	xxx	xxx
Expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP)	xxx	xxx
Staff Welfare Expenses	xxx	xxx
	xxx	xxx

Note: Directors are not employees

Note 6: Finance Costs

PARTICULARS	RS.	RS.
Interest Expense	xxx	xxx
Other Borrowing Costs	xxx	xxx
	xxx	xxx

Note: Also includes cost of arranging borrowing funds

Note 7: Depreciation and Amortization Expense

PARTICULARS	RS.	RS.
Buildings	xxx	xxx
Plant and Equipment	xxx	xxx
Vehicles	xxx	xxx
Office Equipment	xxx	xxx
Brands	xxx	xxx
Computer Software	xxx	xxx

Note 8: Other Expenses

PARTICULARS	RS.	RS.
(a) Consumption of Stores and Spare Parts	xxx	xxx
(b) Power and Fuel	xxx	xxx
(c) Rent.	xxx	xxx
(d) Repairs to Buildings	xxx	xxx
(e) Repairs to Machinery	xxx	xxx
(f) Insurance	xxx	xxx
(g) Rates and Taxes [Excluding Taxes on Income]	xxx	xxx
(h) Miscellaneous Expenses	xxx	xxx
(i) Provisions for Losses of Subsidiary Companies	xxx	xxx
(j) Payments to the Auditor as:		
(a) Auditor	xxx	xxx
(b) For Taxation Matters	xxx	xxx
(c) For Company Law Matters	xxx	xxx
(d) For Management Services	xxx	xxx
(e) For other Services	xxx	xxx
(f) For Reimbursement of Expenses	xxx	xxx
	xxx	xxx

Note: Will include preliminary expenses and directors remuneration.

इस्पेशल Adjustments

1. ERRORS & RECTIFICATIONS

Sale of assets shown as suspense

Wrong Entry

Bank A/c	Dr.
To Suspense A/c	

Correct Entry

Suspense A/c	Dr.
Acc. Depreciation	
To PPE	
To Gain	

Purchase include advt. Exp.

Adv. Exp. A/c	Dr.
To Purchase A/c	

2. LOOSE TOOLS

If question is silent

If no depreciation is given → Inventory

If depreciation on loose tool is given → PPE

3. REVALUATION OF PPE

Upward

Assets	Dr.
To Rev. Res. A/c	

Downward

P & L A/c	Dr.
To Assets	

4. INTERIM DIVIDEND

Shown under Trial Balance.

Deduct from Reserve & Surplus

Not shown in Trial Balance

P & L A/c	Dr.
To Interim Dividend Payable A/c	

5. DIVIDEND

Never Deduct from P & L

Deduct from Reserve & Surplus

Note for student...

CHAPTER 4 - FINANCIAL STATEMENTS OF COMPANIES

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	Additional Question						
2	ICAI Practical Question 5						
3	MTP April 2022						
4	MTP April 2022						
5	QP May 2022						
6	ICAI PRACTICAL Q 3						
7	ICAI Practical Question 3 similar, Nov 20 RTP						
8	ICAI P. Q. 4						
9	Question (RTP Nov 19)						
10	QP JULY 21						
11	RTP Nov 21						
12	ICAI Illustration 8						
TEST IN TIME PASS IN TIME							
1	Additional Question						
2	Additional Question						

1. Additional Question

The following is the Draft Profit & Loss A/c of Harsha Ltd., the year ended 31st March, 20X1: (ICAI Module Q.3 similar) (May 20 RTP)

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

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

2. ICAI Practical Question 5

Ring Ltd. was registered with a nominal capital of Rs. 10,00,000 divided into shares of 100 each. The following Trial Balance is extracted from the books on 31st March, 20X2

Particulars	Rs.	Particulars	Rs.
Buildings	5,80,000	Sales	10,40,000
Machinery	2,00,000	Outstanding Expenses	4,000
Closing Stock	1,80,000	Provision for Doubtful Debts	6,000
Loose Tools	46,000	(1-4-20X1)	
Purchases (Adjusted)	4,20,000	Equity Share Capital	4,00,000

Salaries	1,20,000	General Reserve	80,000
Directors' Fees	20,000	Profit and Loss A/c	50,000
Rent	52,000	(1-4-20X1)	
Depreciation	40,000	Creditors	1,84,000
Bad Debts	12,000	Provision for depreciation:	
Investment	2,40,000	On Building 1,00,000	
Interest accrued on investments	4,000	On Machinery 1,10,000	2,10,000
Debenture Interest	56,000	14% Debentures	4,00,000
Advance Tax	1,20,000	Interest on Debentures	28,000
Sundry expenses	36,000	accrued but not due	
Debtors	2,50,000	Interest on Investments	24,000
Bank	60,000	Unclaimed dividend	10,000
	24,36,000		**24,36,000**

You are required to prepare statem-ent of Profit and Loss for the year ending 31st March, 20X2 and Balance sheet as at that date after taking into consideration the following information:

(a) Closing stock is more than opening stock by Rs. 1,60,000;

(b) Provide to doubtful debts @ 4% on Debtors

(c) Make a provision for income tax @ 30%.

(d) Depreciation expense included depreciation of Rs. 16,000 on Building and that of Rs. 24,000 on Machinery.

(e) The directors declared a dividend @ 25% on 2nd April 2012 and transfer to General Reserve @ 10%

(f) Bills Discounted but not yet matured Rs. 20,000.

3. MTP April 2022

XYZ Ltd. proposes to declare 10% dividend out of General Reserves due to inadequacy of profits in the year ending 31-03-2020.

From the following particulars ascertain the amount that can be utilized from general reserves, according to the Companies Rules, 2014:

	(₹)
8,00,000 Equity Shares of ₹ 10 each fully paid up	80,00,000
General Reserves	25,00,000
Revaluation Reserves	6,50,000
Net profit for the year	1,42,500

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

4. MTP April 2022

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

Balance Sheet (Extract) as on 31st March, 2020

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

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

5. QP May 2022

The following information is provided by Exe Limited for 31st March, 2022:

Particulars	₹
Net profit before Income Tax and Managerial Remuneration, but after Depreciation and provision for Repairs	9,40,000
Depreciations provided in the Book	4,05,000
Provision for repairs for Machinery during the year	35,000
Depreciations Allowable under schedule II	3,40,000
Actual Expenditure incurred on Repairs during the year	25,000
provision for Income Tax	1,50,000

You are required to calculate the Managerial Remunerations for Exe Limited as on 31st March,2022 in the following situations:

(i) There is only one Whole Time Director.

(ii) There are two Whole Time Directors.

(iii) There are two Whole Time Directors, a part time Director and a Manager.

6. ICAI PRACTICAL Q 3

On 31st March, 20X1 Bose and Sen Ltd. provides to you the following ledger balances after preparing its Profit and Loss Account for the year ended 31st March, 20X1:

Credit Balances:

	₹
Equity shares capital, fully paid shares of ₹10 each	70,00,000
General Reserve	15,49,100
Loan from State Finance Corporation	10,50,000
(Secured by hypothecation of Plant & Machinery Repayable	
within one year₹ 2,00,000)	
Loans: Unsecured (Long term)	8,47,000
Sundry Creditors for goods &expenses	14,00,000
(Payable within 6 months)	
Profit & Loss Account	7,00,000
Provision for Taxation	8,16,900
	1,33,63,000

Debit Balances:

	₹
Calls in arrear	7,000
Land	14,00,000
Buildings	20,50,000
Plant and Machinery	36,75,000
Furniture& Fixture	3,50,000
Inventories: Finished goods	14,00,000
Raw Materials	3,50,000
Trade Receivables	14,00,000
Advances: Short-term	2,98,900
Cash in hand	2,10,000
Balances with banks	17,29,000
Preliminary Expenses	93,100
Patents & Trademarks	4,00,000
	1,33,63,000

The following additional information is also provided in respect of the above balances:

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

(ii) Cost of Building ₹ 28,00,000

(iii) Cost of Plant & Machinery ₹ 49,00,000

Cost of Furniture & Fixture ₹ 4,37,500

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

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

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

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

You are not required to give previous year's figures. You are required to prepare the Balance Sheet of the Company as on 31stMarch, 20X1 as required under Schedule III to the Companies Act, 2013.

7. **ICAI Practical Question 3 similar, Nov 20 RTP**

On 31st March, 2020, Om Ltd. provides to you the following ledger balances after preparing its Profit and Loss Account for the year ended 31st March, 2020:

Credit Balances

Particulars	₹
Equity shares capital (fully paid shares of ₹ 10 each)	1,05,00,000
General Reserve	21,84,000
Loan from State Finance Corporation	15,75,000
(Secured by hypothecation of Plant & Machinery - Repayable	
within one year ₹ 3,00,000)	
Loans: Unsecured (Long term)	12,70,500
Sundry Creditors for goods & expenses (Payable within 6 months)	21,00,000
Profit & Loss Account	10,50,000
Provision for Taxation	12,25,350
	199,04,850

Debit Balances

Particulars	₹
Calls in arrear	10,500
Land	21,00,000
Buildings	30,75,000
Plant and Machinery	55,12,500
Furniture & Fixture	5,25,000
Inventories : Finished goods	21,00,000
Raw Materials	5,25,000
Trade Receivables	21,00,000
Advances: Short-term	4,48,350
Cash in hand	3,15,000
Balances with banks	25,93,500
Patents & Trade marks	6,00,000
	199,04,850

The following additional information is also provided in respect of the above balances:

(i) 6,30,000 fully paid equity shares were allotted as consideration for land & buildings.

(ii) Cost of Building ₹ 42,00,000

(iii) Cost of Plant & Machinery ₹ 73,50,000

(iv) Cost of Furniture & Fixture ₹ 6,56,250

(v) Trade receivables for ₹ 5,70,000 are due for more than 6 months.

(vi) The amount of Balances with Bank includes ₹ 27,000 with a bank which is not a scheduled Bank and the deposits of ₹ 7,50,000 are for a period of 9 months.

(vii) Unsecured loan includes ₹ 3,00,000 from a Bank and ₹ 1,50,000 from related parties.

You are not required to give previous year figures. You are required to prepare the Balance Sheet of the Company as on 31st March, 2020 as required under Schedule III of the Companies Act, 2013.

8. ICAI Practical Question 4

From the following particulars furnished by Alpha Ltd., prepare the Balance Sheet as on 31st March 20X1 as required by Part I, Schedule III of the Companies Act, 2013.

Particulars	₹	Debit ₹	Credit ₹
Equity shares capital, (Face Value of Rs.100 each)			50,00,000
Call in Arrears		5,000	
Land and Building		27,50,000	
Plant and 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
		9478500	9478500

The following additional information is also provided:

1) 10,000 Equity shares were issued for consideration other than cash.
2) Trade receivables of Rs. 2,60,000 are due for more than 6 months.
3) The cost of the Assets were:
   Building Rs. 30,00,000, Plant & Machinery Rs. 35,00,000 and Furniture Rs. 3,12,500
4) 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.
5) Balance at Bank includes Rs. 10,000 with Omega Bank Ltd., which is not a Scheduled Bank.
6) Transfer Rs. 20,000 to general reserve is proposed by Board of directors.
7) Board of directors has declared dividend of 5% on the paid up capital on 2nd April 2011

9. Question (RTP Nov 19)

The following balance appeared in the books of Oliva Company Ltd. as on 31-03-2019.

Particulars		₹	**Particulars**		₹
Inventory 01-04-2018			Sales		17,10,000
-Raw Material	30,000		Interest		3,900
-Finished goods	46,500	76,500	Profit and Loss A/c		48,000
Purchases		12,15,000	Share Capital		3,15,000
Manufacturing Expenses		2,70,000	Secured Loans: Short-term Long-term	 4,500 21,000	 25,500
Salaries and wages		40,200	Fixed Deposits (unsecured): Short -term	 1,500	
General Charges		16,500	Long - term	3,300	4,800
Interim Dividend paid (inclusive of Dividend Distribution Tax)		27,000	Trade payables		3,27,000

Building		1,01,000			
Plant and Machinery		70,400			
Furniture		10,200			
Motor Vehicles		40,800			
Stores and Spare Parts Consumed		45,000			
Investments: Current	4,500				
Non-Current	7,500	12,000			
Trade receivables		2,38,500			
Cash in Bank		2,71,100			
		24,34,200			24,34,200

From the above balance and the following information, prepare the company's Profit and Loss Account for the year ended 31st March, 2019 and Company's Balance Sheet as on that date:

1. Inventory on 31st March,2019 Raw material ₹ 25,800 & finished goods ₹ 60,000.
2. Outstanding Expenses: Manufacturing Expenses ₹ 67,500 & Salaries & Wages ₹ 4,500.
3. Interest accrued on Securities ₹ 300.
4. General Charges prepaid ₹ 2,490.
5. Provide depreciation: Building @ 2% p.a., Machinery @ 10% p.a., Furniture @ 10% p.a. & Motor Vehicles @ 20% p.a.
6. Current maturity of long term loan is ₹ 1,000.
7. The Taxation provision of 40% on net profit is considered.

10. QP JULY 21

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

	Dr.	Cr.
Equity Capital (Shares of ₹ 100 each)		8,05,000
5,000, 6% preference shares of ₹ 100 each		5,00,000
9% Debentures		4,00,000
General Reserve		40,00,000

Profit & Loss A/c (of previous year)		72,000
Sales		60,00,000
Trade Payables		10,40,000
Provision for Depreciation on Plant & Machinery		1,72,000
Suspense Account		40,000
Land at cost	24,00,000	
Plant & Machinery at cost	7,70,000	
Trade Receivables	19,60,000	
Inventories (31-03-2020)	9,50,000	
Bank	2,30,900	
Adjusted Purchases	22,32,100	
Factory Expenses	15,00,000	
Administration Expenses	3,00,000	
Selling Expenses	14,00,000	
Debenture Interest	36,000	
Goodwill	12,50,000	
	1,30,29,000	1,30,29,000

Additional Information:

(i) The authorised share capital of the company is :

5,000, 6% preference shares of ₹ 100 each 5,00,000

10,000, equity shares of ₹ 100 each 10,00,000

Issued equity capital as on 1st April 2020 stood at ₹ 7,20,000, that is 6,000 shares fully paid and 2,000 shares ₹ 60 paid. The directors made a call of ₹ 40 per share on 1st October 2020. A shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ ₹ 90 per share as fully paid.

(ii) On 31st March 2021, the Directors declared a dividend of 5% on equity shares, transferring any amount that may be required from General Reserve. Ignore Taxation.

(iii) The company on the advice of independent valuer wishes to revalue the land at ₹ 36,00,000.

(iv) Suspense account of ₹ 40,000 represents amount received for the sale of some of the machinery on 1-4-2020. The cost of the machinery was ₹ 1,00,000 and the accumulated depreciation thereon being ₹ 30,000.

(v) Depreciation is to be provided on plant and machinery at 10% on cost.

(vi) Amortize 1/5th of Goodwill.

You are required to prepare H Limited's Balance Sheet as on 31-3-2021 and Statement of Profit and Loss with notes to accounts for the year ended 31-3-2021 as per Schedule III of the Companies Act, 2013. Ignore previous years' figures & taxation.

11. RTP Nov 21

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

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

(ii) Share option outstanding account.

(iii) Unpaid matured debenture and interest accrued thereon.

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

(v) Calls unpaid.

12. ICAI Illustration 8

From the following particulars furnished by Pioneer Ltd., prepare the Balance Sheet as at 31st March, 2015 as required by Schedule III of the Companies Act. Give notes at the foot of the Balance Sheet as may be found necessary -

Particulars		Dr.Rs.	Cr.Rs.
Equity Capital (Face value of Rs.100)			10,00,000
Calls in Arrears		1,000	
Land		2,00,000	
Building		3,50,000	
Plant and Machinery		5,25,000	
Furniture		50,000	
General Reserve			2,10,000
Loan from State Financial Corporation			1,50,000
Inventory :			
Finished Goods	2,00,000		
Raw Materials	50,000	2,50,000	
Provision for Taxation			68,000
Trade receivables		2,00,000	
Advances		42,700	
Dividend Payable			60,000
Profit and Loss Account			86,700
Cash Balance		30,000	

Cash at Bank	2,47,000	
Loans (Unsecured)		1,21,000
Trade payables (For Goods and Expenses)		2,00,000
	18,95,700	**18,95,700**

The following additional information is also provided :

1) 2,000 equity shares were issued for consideration other than cash.
2) Trade receivables of Rs.52,000 are due for more than six months.
3) The cost of assets:

    Building Rs.4,00,000

    Plant and Machinery Rs.7,00,000

    Furniture Rs.62,500
4) The balance of Rs.1,50,000 in the loan account with State Finance Corporation is inclusive of Rs.7,500 for interest accrued but not due. The loan is secured by hypothecation of the Plant and Machinery.
5) Balance at Bank includes Rs.2,000 with Perfect Bank Ltd., which is not a Scheduled Bank.
6) The company had contract for the erection of machinery at Rs.1,50,000 which is still incomplete.

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. Additional Question

The following is the Trial Balance of Omega Limited as on 31.3.2015: (Figures in Rs. '000)

Particulars	Debit	Particulars	Credit
Land at cost	220	Equity Capital (Shares of Rs. 10 each)	300
Plant & Machinery at cost	770	10% Debentures	200
Trade Receivables	96	General Reserve	130
Inventories (31.3.15)	86	Profit & Loss A/c	72
Bank	20	Securities Premium	40
Adjusted Purchases	320	Sales	700
Factory Expenses	60	Trade Payables	52
Administration Expenses	30	Provision for Depreciation	172
Selling Expenses	30	Suspense Account	4
Debenture Interest	20		
Interim Dividend Paid	18		
	1670		**1670**

Additional Information:

(i) The authorised share capital of the company is 40,000 shares of Rs. 10 each.

(ii) The company on the advice of independent valuer wish to revalue the land at Rs. 3,60,000.

(iiii) declared final dividend @ 10%.

(iv) Suspense account of Rs. 4,000 represents cash received for the sale of some of the machinery on 1.4.14. The cost of the machinery was Rs. 10,000 and the accumulated depreciation thereon being Rs. 8,000.

(v) Depreciation is to be provided on plant and machinery at 10% on cost.

You are required to prepare Omega Limited's Balance Sheet as on 31.3.2015 and Statement of Profit and Loss with notes to accounts for the year ended 31.3.2015 as per Schedule III. Ignore previous years' figures & taxation.

2. Additional Question

Due to inadequacy of profits during the year ended 31st March, 2015, XYZ Ltd. proposes to declare 10% dividend out of general reserves. From the following particulars, ascertain the amount that can be utilized from general reserves, according to the Companies (Declaration of dividend out of Reserves) Rules, 2014:

Particulars	Rs.
17,500 9% Preference shares of Rs. 100 each, fully paid up	17,50,000
8,00,000 Equity shares of Rs. 10 each, fully paid up	80,00,000
General Reserves as on 1.4.2014	25,00,000
Capital Reserves as on 1.4.2014	3,00,000
Revaluation Reserves as on 1.4.2014	3,50,000
Net profit for the year ended 31st March, 2015	3,00,000

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

MCQs

1. Trade payables as per Schedule III will include:
   a) Dues payable in respect to statutory obligation
   b) Interest accrued on trade payables
   c) Bills payables.
   d) Bills receivables

2. Securities Premium Account is shown on the liabilities side in the Balance Sheet under the heading:
   a) Reserves and Surplus.
   b) Current Liabilities.
   c) Share Capital.
   d) Share application money pending allotment

3. "Fixed assets held for sale" will be classified in the company's balance sheet as
   a) Current asset
   b) Non-current asset
   c) Capital work- in- progress
   d) Deferred tax assets

4. Current maturities of long- term debt will come under
   a) Current Liabilities.
   b) Short term borrowings.
   c) Long term borrowings.
   d) Short term provisions

5. Declaration of dividends for current year is made after providing for
   a) Depreciation of past years only.
   b) Depreciation on assets for the current year and arrears of depreciation of past years (if any)
   c) Depreciation on current year only and by forgoing arrears of depreciation of past years.
   d) Excluding current year depreciation

Answers									
1.	(c)	2.	(a)	3.	(a)	4	(b)	5.	(b)

5 Cashflow Statement

Presentation of Cash Flow Statements

The Cash Flow Statement should report cash flows during the period classified by

Operating Activities | Investing Activities | Financing Activities

OPERATING ACTIVITIES

Principal revenue-producing activities of the enterprise

EXAMPLES

1. Cash receipts from the sale of goods and the rendering of services;
2. Cash receipts from royalties, fees, commissions and other revenue;
3. Cash payments to suppliers for goods and services;
4. Cash payments to and on behalf of employees;

INVESTING ACTIVITIES

represent the extent to which expenditures have been made for resources intended to generate future income and cash flows.

EXAMPLES

1. Cash payments to acquire fixed assets.
2. Cash receipts from disposal of fixed assets.
3. Cash payments to acquire shares, warrants or debt instruments of other enterprises and interests in joint venture
4. Cash receipts from disposal of shares, warrants or debt instruments of other enterprises and interests in joint ventures.
5. Cash advances and loans made to third parties
6. Cash receipts from the repayment of advances and loans made to third parties.

FINANCING ACTIVITIES

It is useful in predicting claims on future cash flows by providers of funds [both capital and borrowings] to the enterprise

EXAMPLES

1. Cash proceeds from issuing shares or other similar instruments;
2. Cash proceeds from issuing debentures, loans, notes, bonds and other short or long term borrowings; and.
3. Cash repayments of amounts borrowed.

इस्पेशल Adjustments

FOREIGN CURRENCY

Cash flows are recorded in reporting currency using exchange rate prevailing on the date of cash flow. The effect of changes in exchange rates on cash and cash equivalents held in a foreign currency should be reported as a separate part of the reconciliation of the changes in cash and cash equivalents during the period.

EXTRA ORDINARY ITEMS

Cash flow from extra ordinary items shall also be classified in operating, investing and financing activity. If such categorization is not possible then show it in operating activity.

INTERESTS AND DIVIDEND

Interest and Dividend shall be classified as follows:

For a Financial Enterprise:

- Interest paid, Interest and Dividend received as operating activity.
- Dividend paid as financing activity.

For other Enterprises:

- Interest and Dividend paid as financing activity.
- Interest and dividend received as investing activity.

TREATMENT OF TAX

Cash flows arising from tax payment or refund should be classified as cash flow from operating activities unless they can be specifically identified with financing or investing activities.

CASH FLOW STATEMENT – PROFORMA

CASH FLOW STATEMENT – DIRECT METHOD

No.	Particulars	Rs	Rs
A.	Cash flows operating activities:	-----	
	Cash receipts from customers	-----	
	Cash paid to suppliers and employees	-----	
	Cash generated from operations	-----	
	Income taxes paid	-----	
	Cash flow before extraordinary item	-----	
	Proceeds from earthquake disaster settlement	-----	
	Net cash from operating activities		-----
B.	Cash flows from investing activities:	-----	
	Purchase of fixed assets	-----	
	Proceeds from sale of equipment	-----	
	Interest received	-----	
	Dividends received	-----	
	Net cash from investing activities		-----
C.	Cash flows from financing activities:		
	Proceeds from issuance of share capital	-----	
	Proceeds from long term borrowings	-----	
	Repayment of long term borrowings	-----	
	Interest paid	-----	
	Dividends paid	-----	
	Net cash used in financing activities		-----
D.	Net Increase/Decrease in cash and cash equivalents(A+B+C)		-----
E.	Cash and cash equivalents at beginning of period		-----
F.	Cash and cash equivalents at end of period (D+E)		-----

CASH FLOW STATEMENT – INDIRECT METHOD

No.	Particulars	Rs	Rs
A.	Cash flows operating activities:	-----	
	Net profit before taxation, and extraordinary items adjustments for:	-----	
	Depreciation	-----	
	Foreign exchange loss	-----	
	Interest income	-----	
	Dividend income	-----	
	Interest expense	-----	
	Operating profit before working capital changes Increase in sundry debtors	-----	
	Decrease in inventories	-----	
	Decrease in sundry creditors	-----	
	Cash generated from operations	-----	
	Income taxes paid	-----	
	Cash flow before extraordinary items	-----	
	Proceeds from earthquake disaster settlement	-----	
	Net cash from operating activities		-----
B.	Cash flows from investing activities:	-----	
	Purchase of fixed assets	-----	
	Proceeds from sale of equipment	-----	
	Interest received	-----	
	Dividends received	-----	
	Net cash from investing activities		-----
C.	Cash flows from financing activities:		
	Proceeds from issuance of share capital	-----	
	Proceeds from long term borrowings	-----	
	Repayment of long term borrowings	-----	
	Interest paid	-----	
	Dividends paid	-----	
	Net cash used in financing activities		-----
D.	Net Increase/Decrease in cash and cash equivalents(A+B+C)		-----
E.	Cash and cash equivalents at beginning of period		-----
F.	Cash and cash equivalents at end of period (D+E)		-----

Note for student...

CHAPTER 5 – CASHFLOW STATEMENT

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	QP May 2019 Q5 b						
2	RTP Nov 19						
3	May 20 RTP						
4	Mock Test – Oct 20						
5	QP May 2018						
6	ICAI Practical Question 1						
7	QP Jan 21						
8	QP Nov 19						
9	ICAI Illustration 8						
TEST IN TIME PASS IN TIME							
1	Question						
2	Question						

1. **QP May 2019 Q 5 b**

The following information was provided by M/s PQR Ltd. for the year ended 31st March, 2019

1. Gross Profit Ratio was 25% for the year, it amounts to ₹ 3,75,000.
2. Company sold goods for cash only.
3. Opening inventory was lesser than closing inventory by ₹ 25,000.
4. Wages paid during the year ₹ 5,55,000.
5. Office expenses paid during the year ₹ 35,000.
6. Selling expenses paid during the year ₹ 15,000.
7. Dividend paid during the year ₹ 40,000 (including dividend distribution tax).
8. Bank Loan repaid during the year ₹ 2,05,000 (included interest ₹5,000)
9. Trade Payables on 31st March, 2018 were ₹ 50,000 and on 31st March, 2019 were ₹ 35,000.
10. Amount paid to Trade payables during the year ₹6,10,000
11. Income Tax paid during the year amounts to ₹ 55,000 (Provision for taxation as on 31st March, 2019 ₹ 30,000)
12. Investments of ₹ 8,20,000 sold during the year at a profit of ₹ 20,000.
13. Depreciation on furniture amounts to ₹40,000.
14. Depreciation on other tangible assets amounts to ₹20,000.
15. Plant and Machinery purchased on 15th November, 2018 for ₹3,50,000.
16. On 31st March, 2019 ₹2,00,000, 7% Debentures issued at face value in an exchange for a plant.
17. Cash and Cash equivalents on 31st March, 2018 ₹2,25,000.

(A) Prepare cash flow statement for the year ended 31st March, 2019, using direct method.

(B) Calculate cash flow from operating activities, using indirect method.

2. RTP Nov 19

From the following information, prepare a Cash Flow Statement for the year ended 31st March, 2019.

Balance Sheet

	Particulars	Note	31.03.2019 (₹)	31.03.2018 (₹)
I	**EQUIT Y AND LIABILIT ES**			
	(1) Shareholder's Funds			
	(a) Share Capital	1	3,50,000	3,00,000
	(b) Reserves and Surplus	2	82,000	38,000
	(2) Non-Current Liabilities			
	(3) Current Liabilities			
	(a) Trade Payables		65,000	44,000
	(b) Other Current Liabilities	3	37,000	27,000
	(c)Short term Provisions (provision for tax)	4	32,000	28,000
	Total		**5,66,000**	**4,37,000**
	ASSET S			
II	**(1)Non-current Assets**			
	(a)Tangible Assets		2,66,000	1,90,000
	(b)Intangible Assets (Goodwill)		47,000	60,000
	Non-Current Investments		35,000	10,000
	(2)Current Assets			
	(a) Inventories		78,000	85,000
	(b) Trade Receivables		1,08,000	75,000
	(c) Cash & Cash Equivalents		32,000	17,000
	Total		**5,66,000**	**4,37,000**

Note 1: Share Capital

Particulars	31.03.2019 (₹)	31.03.2018 (₹)
Equity Share Capital	2,50,000	1,50,000
8% Preference Share Capital	1,00,000	1,50,000
Total	**3,50,000**	**3,00,000**

Note 2: Reserves and Surplus

Particulars	31.03.2019 (₹)	31.03.2018 (₹)
General Reserve	30,000	20,000
Profit and Loss A/c	27,000	18,000

Capital Reserve	25,000	
Total	**82,000**	**38,000**

Note 3: Current Liabilities

Particulars	31.03.2019(₹)	31.03.2018 (₹)
Dividend declared	37,000	27,000

Note 4: Tangible Assets

Particulars	31.03.2019 (₹)	31.03.2018 (₹)
Land & Building	75,000	1,00,000
Machinery	1,91,000	90,000
Total	**2,66,000**	**1,90,000**

Additional Information:

i. ₹ 18,000 depreciation for the year has been written off on plant and machinery and no depreciation has been charged on Land and Building.

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

iii. A plant was sold for ₹ 12,000 WDV being ₹ 15,000 on the date of sale (after charging depreciation).

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

v. An interim dividend of ₹ 10,000 including Dividend Distribution T ax has been paid.

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

vii. Amount of provision for tax existing on 31.3.2018 was paid during the year 2018 -19.

3. May 20 RTP

The following figures have been extracted from the books of X Limited for the year ended on 31.3.2019. You are required to prepare a 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 ₹ 20 lakhs:

(a) Depreciation on Property, Plant & Equipment ₹ 5 lakhs.

(b) Discount on issue of Debentures written off ₹ 30,000.

(c) Interest on Debentures paid ₹ 3,50,000.

(d) Book value of investments ₹ 3 lakhs (Sale of Investments for ₹ 3,20,000).

(e) Interest received on investments ₹ 60,000.

(f) Compensation received ₹ 90,000 by the company in a suit filed.

(ii) Income tax paid during the year ₹ 10,50,000.

(iii) 15,000, 10% preference shares of ₹ 100 each were redeemed on 31.3.2019 at a premium of 5%. Further the company issued 50,000 equity shares of ₹ 10 each at a premium of 20% on 2.4.2018. Dividend on preference shares were paid at the time of redemption.

(iv) Dividend paid for the year 2017-2018 ₹ 5 lakhs and interim dividend paid ₹ 3 lakhs for the year 2018-2019.

(v) Land was purchased on 2 4.2018 for ₹ 2,40,000 for which the company issued 20,000 equity shares of ₹ 10 each at a premium of 20% to the land owner as consideration.

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

Particulars	As on 31.3.2018	As on 31.3.2019
	₹	₹
Inventory	12,00,000	13,18,000
Trade receivables	2,58,000	2,53100
Cash in hand	1,96,300	35,300
Trade payables	2,11,000	2,11,300
Outstanding expenses	75,000	81,800

4. Mock Test – Oct 20

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

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

5. QP May 2018

Classify the following activities as

(i) Operating Activities, (ii) Investing activities, (iii) Financial activities and (iv) Cash Equivalents.

(1) Cash receipts from Trade Receivables

(2) Marketable Securities

(3) Purchase of investment

(4) Proceeds from long term borrowings

(5) Wages and Salaries paid

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

6. ICAI Practical Question 1

Classify the following activities as (a) Operating activities, (b) Investing activities (c) Financing activities (d) Cash equivalents with reference to AS 3 (Revised).

(a) Brokerage paid on purchase of investments
(b) Underwriting commission paid
(c) Trading commission received
(d) Proceeds from sale of investment
(e) Purchase of goodwill
(f) Redemption of preference shares
(g) Rent received from property held as investment
(h) Interest paid on long-term borrowings
(i) Marketable securities (having risk of change in value)
(j) Refund of income tax received

7. QP Jan 21

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

1. Net profit before taking into account income tax and after taking into account the following items was ₹ 30 lakhs
   i. Depreciation on property , plant and 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 Investment ₹ 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 vender took 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 year 2019 -2020 were as:

Particulars	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	2,40,000	3,70,500
Trade Payables	2,84,000	2,87,300
Outstanding Expenses	97,000	1,01,400

You are required to prepare a cash Flow Statement for the year ended 31st March, 2020 as per AS 3 (revised) using the indirect method

8. QP Nov 19

Prepare cash flow from investing as per AS 3 of M/s Shubham Creative Limited for year ended 31.3.2019

Particulars	Amount (₹)
Machinery acquired by issue of shares at face value	2,00,000
Claim received for loss of machinery in earthquake	55,000
Unsecured loans given to associates	5,00,000
Interest on loan received form associate company	70,000
Pre-acquisition dividend received on investment made	52,000
Debenture interest paid	1,45,200
Term loan repaid	4,50,000
Interest received on investment (TDS of ₹ 8,200 was deducted on the above interest)	73,800
Purchased debentures of X Ltd., on 1st December, 2018 which are redeemable within 3 months	3,00,000
Book value of plant & machinery sold (loss incurred ₹ 9600)	90,000

9. ICAI Illustration 8

Ms. Jyoti of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year ended 31st March, 2015:

Particulars	(in lakhs)
Net Profit	25,000
Dividend paid	8,535
Provision for Income tax	5,000
Income tax paid during the year	4,248
Loss on sale of assets (net)	40
Book value of the assets sold	185
Depreciation charged to Profit & Loss Account	20,000
Profit on sale of Investments	100

Carrying amount of Investment sold	27,765
Interest income received on investments	2,506
Interest expenses of the year	10,000
Interest paid during the year	10,520
Increase in Working Capital (excluding Cash & Bank Balance)	56,081
Purchase of fixed assets	14,560
Investment in joint venture	3,850
Expenditure on construction work in progress	34,740
Proceeds from calls in arrear	2
Receipt of grant for capital projects	12
Proceeds from long-term borrowings	25,980
Proceeds from short-term borrowings	20,575
Opening cash and Bank balance	5,003
Closing cash and Bank balance	6,988

Prepare the Cash Flow Statement for the year 2015 in accordance with AS3. (Make necessary assumptions).

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Test In Time...Pass In Time

1. Question

From the following details relating to the Accounts of Grow More Ltd. prepare Cash Flow Statement:

Liabilities	31.03.2015 (₹)	31.03.2014 (₹)
Share Capital	10,00,000	8,00,000
Reserve	2,00,000	1,50,000
Profit and Loss Account	1,00,000	60,000
Debentures	2,00,000	–
Provision for taxation	1,00,000	70,000
Dividend payable	2,00,000	1,00,000
Trade payables	7,00,000	8,20,000
	25,00,000	20,00,000
Assets		
Plant and Machinery	7,00,000	5,00,000
Land and Building	6,00,000	4,00,000
Investments	1,00,000	–
Trade receivables	5,00,000	7,00,000
Inventories	4,00,000	2,00,000
Cash on hand/Bank	2,00,000	2,00,000
	25,00,000	20,00,000

(i) Depreciation @ 25 % was charged on the opening value of Plant and Machinery.

(ii) At the year end, one old machine costing 50,000(WDV20,000) was sold for 35,000. Purchase was also made at the year end.

(iii) 50,000 was paid towards Income tax during the year.

(iv) Building under construction was not subject to any depreciation. Prepare Cashflow Statement.

2. Question

Prepare cash flow statement of M/s MNT Ltd. for the year ended 31 st March, 2015 with the help of the following information:

(1) Company sold goods for cash only.

(2) Gross Profit Ratio was 30% for the year, gross profit amounts to 3,82,500.

(3) Opening inventory was lesser than closing inventory by 35,000.

(4) Wages paid during the year 4,92,500.

(5) Office and selling expenses paid during the year 75,000.

(6) Dividend paid during the year 30,000 (including dividend distribution tax.)

(7) Bank loan repaid during the year 2,15,000 (included interest 15,000)

(8) Trade payables on 31st March,2014 exceed the balance on 31st March, 2015 by 25,000.

(9) Amount paid to trade payables during the year 4,60,000.

(10) Tax paid during the year amounts to 65,000 (Provision for taxation as on 31.03.2015 45,000).

(11) Investments of 7,00,000 sold during the year at a profit of 20,000.

(12) Depreciation on fixed assets amounts to 85,000.

(13) Plant and machinery purchased on 15 November,2014 for 2,50,000.

(14) Cash and Cash Equivalents on 31st March,2014 2,00,000.

(15) Cash and Cash Equivalents on 31stMarch,2015 6,07,500.

MCQs

1. While preparing cash flow statement, conversion of debt to equity
   a) Should be shown as a financing activity.
   b) Should be shown as an investing activity.
   c) Should not be shown as it is a non-cash transaction.
   d) Should not be shown as operating activity.

2. Which of the following would be considered a 'cash-flow item from an "investing" activity'?
   a) Cash outflow to the government for payment of taxes.
   b) Cash outflow to purchase bonds issued by another company.
   c) Cash outflow to shareholders as dividends
   d) Cash outflow to make payment to trade payables.

3. All of the following would be included in a company's operating activities except:
   a) Income tax payments
   b) Collections from customers or Cash payments to suppliers
   c) Dividend payments
   d) Office and selling expenses.

4. Hari Uttam, a stock broking firm, received` 1,50,000 as premium for forward contracts entered for purchase of equity shares. How will you classify this amount in the cash flow statement of the firm?
   a) Operating Activities.
   b) Investing Activities.
   c) Financing Activities.
   d) Non-cash transaction

5. As per AS 3 on Cash Flow Statements, cash received by a manufacturing company from sale of shares of ABC Company Ltd. should be classified as
   a) Operating activity.
   b) Financing activity.
   c) Investing activity.
   d) Non-cash transaction

Answers									
1.	(c)	2.	(b)	3.	(c)	4.	(a)	5.	(c)

6 Buyback of Securities

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

Revaluation Reserve cannot be used for buy-back of securities as it represents unrealised profits.

SOURCES OF FUNDS FOR BUYBACK

A company may purchase its own shares or others specified securities out of –

- Free Reserves (or)
- Securities Premium A/c (or)
- Proceeds of the issue of any share or other specified securities

Provided that no buyback of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

PREMIUM PAID ON BUYBACK OF SHARES

Premium paid on Buy-back of shares shall be paid first out of Securities Premium and then free Reserves.

For Example:–

Buyback

Face value = ₹100

Redemption Value = ₹120

Face value = ₹100
- Free Reserves → CRR
- Fresh Issue

Premium on Buyback = ₹20 → Securities Premium, Free Reserves

TRANSFER OF CERTAIN SUMS TO CAPITAL REDEMPTION RESERVE

Where a company purchases its own shares out of free reserves or securities premium, a sum equal to the nominal value of the shares so purchased shall be transferred to the Capital Redemption Reserve [CRR] Account and details of such transfer must be disclosed in the balance sheet.

CRR CREATION

Face value of Buy-back	xxx
Less: Fresh issue of shares	(xxx)
	xxx

Fresh issue of shares: Equity Shares ✓ | Preference shares ✓ | Debentures ✗

THREE TEST CONDITIONS

HOW TO CALCULATE THE MAXIMUM NO. OF SHARES THAT CAN BE BOUGHT BACK?

Step 1 Calculate the maximum no. of Equity shares that can be bought back as per following 3 tests :—

TEST	MAX. NO. OF SHARES THAT CAN BE BROUGHT BACK.
I. Outstanding share test	= 25% of total outstanding Equity Shares.
II. Resources test.	$= \dfrac{25\% \text{ of [paid up capital + Free Reserves]}}{\text{Buy back price per share}}$
III. Debt - Equity Ratio Test	$= \dfrac{\text{Paid up capital (after buyback) + Free Reserves [after buyback]} - \text{minimum Equity funds (i.e. Debt fund/2)}}{\text{Buyback Price per share}}$

Step 2 Max. no. of equity shares that can be bought back = least in above 3 tests.

ACCOUNTING ENTRIES

The various journal entries to be passed on buyback are given as follows→

Date	Particulars	LF	Dr.	Cr.
1	**To make partly paid Equity Shares Fully paid up**			
a)	On making final call			
	Equity Share Final Call A/c Dr. To Equity Share Capital A/c			
b)	On Receipt of Final Call			
	Bank A/c Dr. To Equity Share Final Call A/c			
2	**To realise investments to provide cash for buy back**			
	Bank A/c [With Sale Proceeds] Dr. Profit & Loss a/c [With Loss] Dr. To Investment A/c [With Book Value] To Profit & Loss A/c [With Profit]			
3.	**To issue fresh other kind of Shares of Securities (Say Preference Shares / Debentures)**			
(a)	On receipt of Application Money			
	Bank A/c Dr. To Pref. Share Application & Allotment A/c			
(b)	On Allotment			
(i)	**If at par**			
	Pref-share Application & Allotment A/c Dr. To Pref. Share Capital A/c			
(ii)	**If at Premium**			
	Pref. Share Application & Allotment A/c Dr. To Pref. Share Capital A/c To Securities Premium A/c			

4	Make Amount due on Buy-back			
	Equity Share Capital A/c [With Nominal Value] Dr. Securities Premium A/c [With Premium] Dr. General Reserves A/c [With Balancing Figure] Dr. To Equity Shares Buy Back A/c [With Total]			
5	To Make Payment on buy-back of Equity Shares			
	Equity Shares Buy Back A/c [With Amount Paid] Dr. To Bank A/c			
6	To Transfer Free Reserves to Capital Redemption Reserve Account equal to the Nominal Value of Equity Shares bought back out of Free Reserves			
	Revenue Reserves Dr. Profit & Loss A/c Dr. To Capital Redemption Reserve A/c			

Note for student...

CHAPTER 6 – BUYBACK OF SECURITIES

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	Mock Test Paper I, ICAI PQ No 1						
2	RTP MAY 20						
3	QP JULY 21						
4	QP JULY 21						
TEST IN TIME PASS IN TIME							
1	Question						
2	Question						

1. Mock Test Paper I, ICAI PQ No I

SMM Ltd. has the following capital structure as on 31st March, 20X1: ₹ in crore

SNo.	Particulars	Situation I	Situation II
(i)	Equity share capital (shares of ₹ 10 each)	1,200	1,200
(ii)	Reserves:		
	General Reserves	1,080	1,080
	Securities Premium	400	400
	Profit & Loss	200	200
	Infrastructure Development Reserve (Statutory Reserve)	320	320
(iii)	Loan Funds	3,200	6,000

The company has offered buy back price of ₹ 30 per equity share. You are required to calculate maximum permissible number of equity shares that can be bought back in both situations and also required to pass necessary Journal Entries.

2. RTP MAY 20

The following was the Balance Sheet of C Ltd. as on 31st March ,2019:

Equity & Liabilities	₹ Lakhs	Assets	₹ Lakhs
Share Capital:		Fixed Assets	14,000
Equity shares of ₹ 10 each Fully Paid Up	8,000	Investments	2,350
10% Redeemable Pref. Shares of ₹ 10 each Fully Paid Up	2,500	Cash at Bank	2,300
Reserves & Surplus		Other Current Assets	8,250
Capital Redemption Reserve	1,000		
Securities Premium	800		
General Reserve	6,000		
Profit & Loss Account	300		

Secured Loans:			
9% Debentures	5,000		
Current Liabilities:			
Trade payables	2,300		
Sundry Provisions	1,000		
	26,900		26,900

On 1st April, 2019 the Company redeemed all its Preference Shares at a Premium of 10% and bought back 10% of its Equity Shares at ₹ 20 per Share. In order to make cash available, the Company sold all the Investments for ₹ 2,500 lakhs.

You are required to pass journal entries for the above and prepare the Company's Balance sheet immediately after buyback of equity shares and redemption of preference shares.

3. QP JULY 21

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

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

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

4. QP JULY 21

i. Explain the meaning of Equity Shares with Differential Rights. Can Preference Shares be also issued with differential rights ?

ii. In Jugnu Limited A, B, C and D hold equity share capital in the proportion of 30:30:30: 10 and M, N, O and P hold preference share capital in proportion of 40:20:30:10.

You are required to calculate their voting rights in case of resolution of winding up of the company, if the paid up Equity Share Capital of the company is ₹ 100 Lakhs and Preference Share Capital is ₹ 50 Lakhs.

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Test In Time...Pass In Time

1. Question

Dee Limited {a non listed company} furnishes the following summarised balance sheet as at 31st March 2012.

	₹'000	₹'000
Liabilities		
Share capital		
Advance capital		30,00
Issue and subscribed capital		
2,50,000 Equity shares of Rs 10 each fully paid	25,00	
2000, 10% Preference shares of Rs 100 each	2,00	
(Issued two months back for the purpose of buy back)		27,00
Reserve and surplus		
Capital reserve	10,00	
Revenue reserve	30,00	
Securities premium	22,00	
Profit and loss account	35,00	97,00
Current liabilities and provision		14,00
		1,38,00
Assets		
Fixed assets		93,00
Investments		30,00
Current assets, loans and advances {including cash and bank balance}		15,00
		1,38,00

The company passes a resolution to buy back 20% of its equity capital @ Rs 50 per share. For this purpose, it sold all of its investment for Rs 22,00,000.

You are required to pass necessary journal entries and prepare the balance sheet.

2. Question

The following summarized Balance Sheet Pee Limited (a non-listed company) **furnishes** as at 31st March, 2017:

Particulars		₹
Equity & Liabilities		
Share capital:		
Authorised capital		
2,50,000 Equity shares of ₹ 10 each fully paid up	25,00,000	
5,000, 10% Preference shares of ₹ 100 each	5,00,000	30,00,000
Issued and subscribed capital:		
2,40,000 Equity shares of ₹ 10 each fully paid up	24,00,000	
3,000, 10% Preference shares of ₹ 100 each	3,00,000	27,00,000
(Issued two months back for the purpose of buy back)		
Reserves and surplus:		
Capital reserve	10,00,000	
Revenue reserve	25,00,000	
Securities premium	27,00,000	
Profit and loss account	35,00,000	97,00,000
Current liabilities		
Trade payables	13,00,000	
Other current Liabilities	3,00,000	16,00,000
		1,40,00,000
Assets		
Tangible assets		
Building	25,00,000	
Machinery	31,00,000	
furniture	20,00,000	76,00,000
Non-current Investments		30,00,000
Current assets		
Inventory	12,00,000	
Trade receivables	7,00,000	
cash and bank balance	15,00,000	34,00,000
		1,40,00,000

On 1st April, 2017, the company passed a resolution to buy back 20% of its equity capital @ ₹ 60 per share. For this purpose, it sold all of its investment for ₹ 25,00,000.

The company achieved its target of buy-back. You are required to:

a) Give necessary journal entries and
b) Give the Balance Sheet of the company after buy back of shares.

MCQs

1. As per section 68(1) of the Companies Act, buy-back of own shares by the company, shall not exceed
   a) 25% of the total paid-up capital and free reserves of the company.
   b) 20% of the total paid-up capital and free reserves of the company.
   c) 15% of the total paid-up capital and free reserves of the company.
   d) 10% of the total paid-up capital and free reserves of the company.

2. The companies are permitted to buy-back their own shares out of
   a) Free reserves and Securities premium.
   b) Proceeds of the issue of any shares.
   c) Both (a) and (b)
   d) Neither (a) nor (b).

3. When a company purchases its own shares out of free reserves; a sum equal to nominal value of shares so purchased shall be transferred to
   a) Revenue redemption reserve.
   b) Capital redemption reserve.
   c) Buy-back reserve
   d) Special reserve

4. State which of the following statements is true?
   a) Buy-back is for more than twenty-five per cent of the total paid-up capital and free reserves of the company.
   b) Partly paid shares cannot be bought back by a company.
   c) Buy-back of equity shares in any financial year shall exceed twenty-five per cent of its total paid-up equity capital in that financial year.
   d) Partly paid shares can be bought back by a company.

5. Premium (excess of buy-back price over the par value) paid on buy-back should be adjusted against
   a) Free reserves.
   b) Securities premium.
   c) Both (a) and (b).
   d) Neither (a) nor (b).

6. Advantages of Buy-back of shares include to
   a) Encourage others to make hostile bid to take over the company.
   b) Decrease promoters holding as the shares which are bought back are cancelled.
   c) Discourage others to make hostile bid to take over the company as the buy-back will increase the promoters holding.
   d) All of the above.

Answers											
1.	(a)	2.	(c)	3.	(b)	4.	(b)	5.	(c)	6.	(c)

7

Amalgamation of Companies

Amalgamation

the process of merger of two or more companies into a single entity or where one company takes over the other by outright purchase. Therefore, the term 'amalgamation' contemplates two kinds of activities:

(i) two or more companies join to form a new company

OR

(ii) Absorption and blending of one by the others.

TYPES OF AMAGAMATION

[methods of Accounting as per AS-14]

- Amalgamation in the nature of merger → Pooling of Interest method
- Amalgamation in the nature of Purchase. → The Purchase method.

Example - 1

Company A (TRANSFEROR) is taken over by Company B. (TRANSFEREE)

ABSORPTION

Example - 2

TRANSFEROR COMPANY

$\underbrace{\text{Company A + Company B}}$

AMALGAMATION

TRANSFEREE COMPANY

Company C

Example - 3

Suffering losses for past 5 years

Company A

TRANSFEROR

Transferor is a subsidiary company

Company B.

TRANSFEREE

take over existing

EXTERNAL RECONSTRUCTION

Amalgamation

In the books of Transferor
↓
[the one who is selling the business]
↓
Liquidation proceedings are applicable.
↓
BALANCE SHEET

In the books of Transferee
↓
[the one who is buying the business]
↓
AS-14 is applicable to only transferee

	Cash

Step 1: Empty the Balance sheet into 2 Accounts → Realisation A/c; → Shareholder A/c → Equity shareholder, → Preference shareholder; → Cash /bank A/c

Step 2: Make purchase consideration due from transferee

Step 3: Discharge of purchase consideration

Step 4: Distribute purchase consideration to shareholder.

Amalgamation in the nature of merger.

As per AS-14, Amalgamation is in the nature of merger which satisfies all the following conditions:—

1. All the assets and liabilities of the transferor company, become, after amalgamation, the assets and liabilities of the transferee company.

II Shareholders holding not less than 90% of the face value of equity shares of the transferor company become equity shareholders of the transferee Company.

III The consideration is discharged by the transferee co. wholly by the issue of equity shares in the transferee co., except that cash may be paid in respect of any fractional shares.

IV The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

V No adjustment is intended to be made to the book values of the transferor company when they are incorporated in the financial statement of the transferee co.

If any one or more of above conditions are not satisfied in an amalgamation, such amalgamation is called amalgamation in the nature of purchase

The Pooling of Interest Method

Conditions

- All assets, liabilities and reserves of transferor company should be recorded at their existing carrying amounts and in the same form as at the date of the amalgamation.
- The balance of P&L A/c of the transferor company should be aggregated with the corresponding balance of the transferee company of transferred to the general reserve, if any.
- If at the time of the amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies should be adopted following the amalgamation.
- The difference between the amount recorded as share capital issued and the amount of share capital of the transferor company should be adjusted in reserves.

Accounting Entries

Respective assets A/c [Book value] Dr.
Reserves A/c* Dr.
To Respective Liability [Book value]
To Respective Reserve A/c ["]
To Business Purchase A/c
To Reserves A/c*

Particulars	Rs.	Rs.
Purchase Consideration		
Less Net Asset		
Less Reserves		
Balance	+ (Capital Reserve)	- (Capital Reserve)

The Purchase Method

1. All or some assets and liabilities of transferor are taken over.
2. Accounted at book value or at fair value
3. Only statutory reserves of transferor co. should be recorded by debiting Amalgamation Adjustment A/c

   Amalgamation Adjustment A/c.....Dr
   To Statutory Reserves A/c
4. Statutory reserves will be shown in Reserves & Surplus.
5. Goodwill arising on amalgamation should be amortised over a period not exceeding 5 years, unless a longer period can be justified.
6. Provision for unrealised profit on stock held is adjusted against goodwill or Capital Reserves.
7. Liquidation expenses to be borne by transferee company are adjusted against goodwill or Capital Reserves.

Accounting Entry

Respective assets A/c [Fair Value] Dr
Goodwill A/c [Balancing Figure]
To Respective liability [Fair Value]
To Business Purchase A/c
To Capital Reserve A/c [Balancing figure]

Particulars	Rs.	Rs.
Purchase Consideration		
Less Net Asset		
Balance	+ (Goodwill)	- (Capital Reserve)

Methods of calculating Purchase Consideration

1 Lumpsum Method

Transferee Co. agrees to pay a lumpsum/fixed amount to shareholders of transferor co.

2 Net Payment Method

Payment is made to Equity shareholders / Preference shareholders by way of cash, issue of shares and debenture.

3 Net Assets Method

Purchase Consideration = Assets - Outside liabilities

[excluding fictitious assets] [excluding Share Capital and reserves]

Discharge of PC →

Cash	xxx
Equity shares of transferee	xxx
Preference shares of transferee	xxx
PC	xxx

4 Intrinsic Value of shares (or) Share exchange method

Purchase Consideration is calculated at Intrinsic value of shares of transferor or transferee co. and ratio of shares is computed and multiplied with Intrinsic value.

IN THE BOOKS OF TRANSFEROR COMPANY				
NO.	PARTICULARS	LF	(Dr.) Rs	(Cr.) Rs
1	Transfer of books value of the assets			
	Realisation A/c Dr.			
	To Sundry Assets (Individually)			
2	Transfer of liabilities / provision			
	Sundry liabilities / provision A/c (Individually) Dr.			
	To Realisation A/c			
3	a) Transfer of amount due to debenture holders			
	b) Debenture holders liability taken over by transferee company			
	Debentures A/c Dr.			
	Realisation A/c Dr.			
	(Premium payable on redemption)			
	To Debenture holders A/c			
	Debenture holders A/c Dr.			
	To Realisation A/c			
	OR			
	Debentures A/c Dr.			
	To Realisation A/c (face value transferred)			
4	Transfer of amount due to preference shareholders			
	Preference Share Capital A/c Dr.			
	Realisation A/c Dr.			
	(Arrears of dividend/ premium payable)			
	To Preference shareholders A/c			
5	Transfer of Equity Share Capital, Reserves and surplus balances			
	Equity Share Capital A/c Dr.			
	Reserves A/ (Individually) Dr.			
	Profit and Loss A/c Dr.			
	To Equity Shareholders A/c			
6	Transfer of fictitious assets, write offs, accumulated losses etc.			
	Equity shareholders A/c Dr.			
	To Profit and Loss A/c			
	To Discount on Issue of shares A/c			

	To Preliminary Expenses A/c			
	To Other Accounts (Individually)			
7	Purchase Consideration due			
	Transferee Company's A/c Dr.			
	To Realisation A/c			
8	Discharge of Purchase Consideration			
	Cash I Bank A/c Dr.			
	Equity shares in Transferee Company A/c Dr.			
	Preference shares in Transferee Company A/c Dr.			
	To Transferee Company's A/c			
9	Disposal of assets not taken over by the Transferee Company.			
	Cash / Bank A/c Dr.			
	To Realisation A/c			
10	Liquidation Expenses			
	Realisation A/c Dr.			
	To Cash / Bank A/c			
11	Discharge of liabilities not taken over by Transferee company			
	Realisation A/c Dr.			
	To Bank A/c			
12	Settlement of Debenture holders dues (Debentures not taken over by Transferee Company)			
	Realisation A/c Dr.			
	To Cash / Bank A/c			
13	Settlement of preference shareholders dues			
	Preference shareholders A/c Dr.			
	To Preference Shares in Transferee Company A/c			
	To Equity Shares in Transferee Company A/c			
	To Bank A/c			
14	Transfer of profit or loss on realisation Profit Loss			
	Realisation A/c Dr.			
	To Equity shareholders A/c			
	Equity shareholders A/c Dr.			
	To Realisation A/c			

15	Settlement of Equity shareholders accounts (dividend under liquidation)			
	Equity shareholders A/c Dr.			
	To Cash / Bank A/c			
	To Equity shares in Transferee Company			
	To Pref. shares in Transferee company			
	To Debentures in Transferee company			

IN THE BOOKS OF TRANSFEREE COMPANY				
NO.	PARTICULARS	LF	(Dr.) Rs.	(Cr.) Rs.
1	Purchase of business			
	Business Purchase A/c Dr.			
	To Liquidator of Transferor Company A/c			
2	Recording of assets and Liabilities			
	a) Purchase Method			
	Respective assets A/c (Fair Value) Dr.			
	Goodwill A/c (Balancing Fig.)			
	To Respective Liability A/c (Fair Value)			
	To Business Purchase A/c			
	To Capital Reserve A/c (Balancing Fig.)			
	b) Pooling of Interest Method			
	Respective Asset A/c (Book Value) Dr.			
	Reserve A/c * Dr.			
	To Respective Liability A/c (Book Value)			
	To Respective Reserve A/c (Book Value)			
	To Business Purchase A/c			
	To Reserve A/c #			
3	Discharge of purchase consideration			
	Liquidator of Transferor Company A/c Dr.			
	Discount on issue of shares A/c Dr.			
	To Cash / Bank A/c			
	To Equity Share Capital A/c			

	To Preference Share Capital A/c			
	To Debentures A/c			
	To Securities Premium A/c			
4	Liquidation Expenses			
	(if to be borne by transferee company)			
	a) paid by Transferee Company			
	Goodwill and / or Capital Reserve A/c Dr.			
	Reserve A/c Dr.			
	To Cash / Bank A/c			
	b) paid by Transferor Company			
	Goodwill and / or Capital Reserve A/c Dr.			
	To Liquidator of Transferor Company A/c			
	Reserve A/c Dr.			
	Liquidator of Transferor Company A/c Dr.			
	To Cash / Bank A/c			
5	Statutory Reserves of Transferor Company to be recorded in the books of Transferee Company under purchase method			
	Amalgamation Adjustment A/c Dr.			
	To Respective Statutory Reserve A/c			
6	Provision for unrealised profit on stock held out of inter-company purchases			
	a) Pooling Interest Method			
	Revenue Reserves / Profit and Loss A/c Dr.			
	To Stock Account			
	b) Purchase Method			
	Goodwill and /or Capital Reserve A/c			
	To Stock Account			
7	Issue of Debentures to discharge the existing Debenture holders.			
	Debentures in Transferor Co. A/c Dr.			
	Discount on issue of debentures A/c Dr.			
	To Debentures in Transferor Co. A/c			
	To Security Premium A/c			

* Difference between purchase consideration and paid up capital of Transferor Company.

Difference between paid up capital of transferor company and purchase consideration.

INTER CO-OWINGS

At the time of merger, inter company dues are required to be eliminated. The dues are resulting out of inter company transactions effected prior to and remained unsettled as on the date of merger.

NO.	PARTICULARS		LF	(Dr.) Rs	(Cr.) Rs
(1)	Sundry Debtors - Sundry Creditors				
	Sundry Creditors A/c.	Dr.			
	To Sundry Debtors A/c.				
(2)	Bills Receivable – Bills Payable				
	Bills Payable A/c.	Dr.			
	To Bills Receivable A/c.				
(3)	Current Accounts				
	Current A/c. (Credit balance)	Dr.			
	To Current A/c. (Debit balance)				
(4)	Intern Company loans				
	Loan Received A/c.	Dr.			
	To Loan Given A/c.				
(5)	Interest receivable – Interest payable				
	Interest Payable A/c.	Dr.			
	To Interest Receivable A/c.				

In the books of transferee company

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
(1)	For elimination of inter-company dues, an asset of one company is set-off against a liability of another				
	Respective Liability A/c	Dr.			
	To Respective Asset A/c				

Unrealised Profit on Stock

$$\text{Transferor} \underset{\text{buys stock}}{\overset{\text{sells stock}}{\rightleftarrows}} \text{Transferee}$$

The stock holding company values the stock at its cost price [i.e invoice price of seller which is inclusive of profit must be eliminated

NO.	PARTICULARS	LF	(Dr.) Rs	(Cr.)Rs
(1)	Pooling Interest Method			
	Profit and Loss A/c / Revenue Reserves A/c Dr.			
	To Stock Account			
(2)	Purchase Method			
	Goodwill and/or Capital Reserve A/c Dr.			
	To Stock Account			

Note for student...

CHAPTER 7 – AMALGAMATION OF COMPANIES

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ILLUSTRATION 3 (QP May 2018, Nov 20 RTP)						
2	QP JULY 21						
3	MTP April 2022 Series 2						
4	RTP Nov 22						
5	QP NOV 20						
6	RTP MAY 20						
7	QP MAY 19						
8	MTP Oct 22 (Series 2)						
9	RTP Nov 2018						
10	RTP MAY 2018						
11	ICAI ILLUSTRATION 10						
TEST IN TIME PASS IN TIME							
1	Question						
2	Question						

I. ILLUSTRATION 3 (QP May 2018, Nov 20 RTP)

The financial position of X Ltd. and Y Ltd. as on 31st March 2018 was as under

Particulars	X Ltd. (₹)	Y Ltd. (₹)
Equity and Liabilities		
Equity Shares of ₹ 10 each	30,00,000	9,00,000
9% Preference Shares of ₹ 100 each	3,00,000	-
10% Preference Shares of ₹ 100 each	-	3,00,000
General Reserve	2,10,000	2,10,000
Retirement Gratuity Fund (long term)	1,50,000	60,000
Trade Payables	3,90,000	2,40,000
Total	**40,50,000**	**17,10,000**
Assets		
Goodwill	1,50,000	75,000
Land & Buildings	9,00,000	3,00,000
Plant & Machinery	15,00,000	4,50,000
Inventories	7,50,000	5,25,000
Trade Receivables	6,00,000	3,00,000
Cash and Bank	1,50,000	60,000
Total	**40,50,000**	**17,10,000**

X Ltd. absorbs Y Ltd. on the following terms :

(i) 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of X Ltd.

(ii) Goodwill of Y Ltd. on absorption is to be computed based upon two times of average profits of preceding three financial years (2016-17 : ₹ 90,000; 2015-16 : ₹ 78,000 and 2014-15 : ₹ 72,000). The profits of 2014-15 included credit of an insurance claim of ₹ 25,000 (fire occurred in 2013-14 and loss by fire (30,000 was booked in Profit and Loss Account of that year). In the year 2015-16, there was an embezzlement of cash by an employee amounting to ₹ 10,000.

(iii) Land & Buildings are valued at ₹ 5,00,000 and the Plant & Machinery at ₹ 4,00,000.

(iv) Inventories are to be taken over at 10% less value and Provision for Doubtful Debts is to be created @ 2.5%

(v) There was an unrecorded current asset in the books of Y Ltd. whose fair value amounted to

₹ 15,000 and such asset was also taken over by X Ltd.

(vi) The trade payables of Y Ltd. included ₹ 20,000 payable to X Ltd.

(vii) Equity Shareholders of Y Ltd. will be issued Equity Shares @ 5% premium.

You are required to

(i) Prepare Realisation No in the books of Y Ltd.

(ii) Show journal entries in the books of X Ltd.

(iii) Prepare the Balance Sheet of X Ltd. after absorption as at 31St March, 2018.

2. QP JULY 21

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**	**White Limited (₹ in**

		000)	000)
1.	Share Capital Equity Shares of ₹ 100 each	6,000	3,600
2.	Reserves and Surplus		
	General Reserve	360	180
	Profit and Loss Account	720	480
	Total	1,080	660

Black Limited takes over White Limited on 1st July, 2020.

No Balance Sheet of White Limited is available as on that date. It is, however estimated that White Limited earned profit of ₹ 2,40,000 after charging proportionate depreciation @ 10% p.a. on Property Plant and Equipment, during April-June, 2020.

Estimated profit of Black Limited during these 3 months was ₹ 4,80,000 after charging proportionate depreciation @ 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.

3. MTP **April** 2022 Series 2

Sulpher Ltd. and Diamond Ltd. give the following information as at 31.03.2022:

	Sulpher Ltd.(₹ in lakhs)	Diamond Ltd.(₹ in lakhs)
Equity Share Capital (Fully paid shares of ₹ 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 Sulpher Ltd.'s acceptances.

On 1st April 2022, Sulpher Ltd. took over Diamond Ltd. in an amalgamation in the nature of merger. It was agreed that in discharge of consideration for the business, Sulpher Ltd. would allot three fully paid equity shares of ₹ 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 Sulpher Ltd. of the same amount and denomination.

Details of trade receivables and trade payables are as under

Particulars (₹ in lakhs)	Sulpher Ltd.	Diamond Ltd.
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 ` 1.5 lakhs were borne by Sulpher Ltd.

You are required to:

i) Pass journal entries in the books of Sulpher Ltd. and
ii) Prepare Sulpher Ltd.'s Balance Sheet immediately after the merger.

4. RTP Nov 22

The balance sheets of Truth Limited and Myth Limited as at 31.03.2021 is given below. Myth Limited is to be amalgamated with Truth Limited from 1.04.2021. The amalgamation is to be carried out in the nature of purchase.

Particulars	Note No.	Truth Ltd. (₹)	Myth Ltd. (₹)
(I) Equity and Liabilities			
1. Shareholders' Funds			
(a) Share Capital	1	10,00,000	4,00,000
(b) Reserves and Surplus	2	11,35,000	4,13,000
2. Non -Current Liabilities	3	-	1,50,000
3. Current Liabilities	4	1,40,000	1,82,000
Total		22,75,000	11,45,000
(2) Assets			
1. Non -Current Assets			
(a) Property, Plant & Equipment		15,75,000	6,80,000
(b) Investments		1,87,500	1,00,000
2. Current Assets	5	5,12,500	3,65,000
Total		22,75,000	11,45,000

Note No.	Particulars	Truth Limited (₹)	Myth Limited (₹)
1	Share Capital		
	Equity shares of ₹ 10 each	10,00,000	4,00,000
2	Reserves & Surplus		
	General Reserve	5,05,000	2,30,000

	Profit & Loss A/c	4,45,000	1,58,000
	Export Profit Reserve	1,85,000	25,000
		11,35,000	4,13,000
3	Non- Current Liabilities		
	14% Debentures	---	1,50,000
4	Current Liabilities		
	Trade Payables	90,000	1,42,000
	Other Current Liabilities	50,000	40,000
5	Current Assets	1,40,000	1,82,000
	Inventory	2,15,000	85,000
	Trade Receivables	2,02,500	1,75,000
	Cash and Cash equivalents	95,000	1,05,000
		5,12,500	3,65,000

Truth Limited would issue 12% debentures to discharge the claim of the debenture holders of Myth Limited so as to maintain their present annual interest income. Non-trade investment, which constitute 80% of their respective total investments yielded income of 20% to Truth Limited and 15% to Myth Limited. This income is to be deducted from profits while computing average profit for the purpose of calculating goodwill. Profit before tax of both the companies during the last 3 years were as follows:

	Truth Limited (₹)	Myth Limited (₹)
2018-2019	8,20,000	2,55,000
2019-2020	7,45,000	2,15,000
2020-2021	6,04,000	2,14,000

Goodwill is to be calculated on the basis of simple average of three years profit by using Capitalization method taking 18% as normal rate of return. Ignore taxation. Purchase consideration is to be discharged by Truth Limited on the basis of intrinsic value per share. Prepare Balance Sheet of Truth Limited after the amalgamation.

5. QP NOV 20

High Ltd. and Low Ltd. were amalgamated on and from, Ist 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:

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 Ist April, 2020 after the amalgamation has been carried out in basis of in the nature of Purchase.

6. RTP MAY 20

P Ltd. and Q Ltd. agreed to amalgamate and form a new company called PQ Ltd. The summarized balance sheets of both the companies on the date of amalgamation stood as below:

Liabilities	P Ltd. ₹	Q Ltd. ₹	Assets	P Ltd. ₹	Q Ltd. ₹
Equity Shares (₹ 100 each)	8,20,000	3,20,000	Land & Building	4,50,000	3,40,000
9% Pref. Shares (₹ 100 each)	3,80,000	2,80,000	Furniture & Fittings	1,00,000	50,000
8% Debentures	2,00,000	1,00,000	Plant & Machinery	6,20,000	4,50,000
General Reserve	1,50,000	50,000	Trade receivables	3,25,000	1,50,000
Profit & Loss A/c	3,52,000	2,05,000	Inventory	2,33,000	1,05,000
Unsecured Loan	-	1,75,000	Cash at bank	2,08,000	1,75,000
Trade payables	88,000	1,60,000	Cash in hand	54,000	20,000
	19,90,000	12,90,000		19,90,000	12,90,000

PQ Ltd. took over the assets and liabilities of both the companies at book value after creating provision @ 5% on inventory and trade receivables respectively and depreciating Furniture & Fittings by @ 10%, Plant and Machinery by @ 10%. The trade receivables of P Ltd. include ₹ 25,000 due from Q Ltd.

PQ Ltd. will issue:

i) 5 Preference shares of ₹ 20 each @ ₹ 18 paid up at a premium of ₹ 4 per share for each pref. share held in both the companies.

ii) 6 Equity shares of ₹ 20 each @ ₹ 18 paid up a premium of ₹ 4 per share for each equity share held in both the companies.

iii) 6% Debentures to discharge the 8% debentures of both the companies.

iv) 20,000 new equity shares of ₹ 20 each for cash @ ₹ 18 paid up at a premium of ₹ 4 per share.

PQ Ltd. will pay cash to equity shareholders of both the companies in order to adjust their rights

as per the intrinsic value of the shares of both the companies.
You are required to prepare ledger accounts in the books of P Ltd. and Q Ltd. to close their books.

7. QP MAY 19

The following are the summarized Balance Sheet of VT Ltd. and MG Ltd. as on 31st March, 2018:

Particulars	VT Ltd. (₹)	MG Ltd. (₹)
Equity and Liabilities		
Equity Shares of ₹ 10 each	12,00,000	6,00,000
10% Pref. Shares of ₹ 100 each	4,00,000	2,00,000
Reserve and Surplus	6,00,000	4,00,000
12% Debentures	4,00,000	3,00,000
Trade Payables	5,00,000	3,00,000
Total	31,00,000	18,00,000
Assets		
Fixed Assets	14,00,000	5,00,000
Investment	1,60,000	1,60,000
Inventory	4,80,000	6,40,000
Trade Receivables	8,40,000	4,20,000
Cash at Bank	2,20,000	80,000
Total	31,00,000	18,00,000

Details of Trade receivables and trade payables are as under:

	VT Ltd. (₹)	MG Ltd. (₹)
Trade Receivable		
Debtors	7,20,000	3,80,000
Bills Receivable	1,20,000	40,000
	8,40,000	4,20,000
Trade Payables		
Sundry Creditors	4,40,000	2,50,000

Bills Payable	60,000	50,000
	5,00,000	3,00,000

Fixed Assets of both the companies are to be revalued at 15% above book value. Inventory in Trade and Debtors are taken over at 5% lesser than their book value.

Both the companies are to pay 10% equity dividend, Preference dividend having been already paid.

After the above transactions are given effect to, VT Ltd. will absorb MG Ltd. on the following terms:

(i) VT Ltd. will issue 16 Equity Shares of ₹ 10 each at par against 12 Shares of MG Ltd.

(ii) 10% Preference Shareholders of MG Ltd. will be paid at 10% discount by issue of 10% Preference Shares of ₹ 100 each, at par, in VT. Ltd.

(iii) 12% Debenture holders of MG Ltd. are to be paid at 8% premium, by 12% Debentures in VT Ltd., issued at a discount of 10%.

(iv) ₹ 60,000 is to be paid by VT Ltd. to MG Ltd. for Liquidation expenses.

(v) Sundry Debtors of MG Ltd. includes ₹ 20,000 due from VT Ltd. You are required to prepare:

(1) Journal entries in the books of VT Ltd.

(2) Statement of consideration payable by VT Ltd.

8. MTP Oct 22 (Series 2)

A Limited and B Limited are carrying on business of same nature. On 31 st March, 2021 the information given by both these companies is as follows:

	A Ltd. (₹)	B Ltd. (₹)
Share Capital		
- Equity Shares 10 each (Fully Paid)	12,00,000	7,20,000
- 10% Preference Shares of ₹ 100 each	6,00,000	-
- 8% Preference Shares of ₹ 100 each	-	5,00,000
General Reserve	3,00,000	2,50,000

Investment Allowance Reserve	-	60,000
Security Premium	2,40,000	-
Export Profit Reserve	1,80,000	1,20,000
Profit & Loss Account	2,16,000	1,92,000
9% Debentures (₹ 10 each)	3,00,000	2,00,000
Secured Loan	-	3,60,000
Sundry Creditors	3,12,000	2,04,000
Bills Payable	75,000	1,00,000
Other Current Liabilities	50,000	75,000
Land and Building	10,80,000	8,40,000
Plant and Machinery	6,00,000	5,60,000
Office Equipment	3,45,000	2,10,000
Investments	96,000	3,00,000
Stock in Trade	6,30,000	4,20,000
Sundry Debtors	4,90,000	3,20,000
Bills Receivables	60,000	70,000
Cash at Bank	1,72,000	61,000

A Limited take over B Limited on the above date, both companies agreeing on a scheme of Amalgamation on the following terms:

(a) A Limited will issue 80,000 Equity Shares of ₹ 10 each at par to the Equity Shareholders of B Limited.

(b) A Limited will issue 10% Preference Shares of ₹ 100 each to discharge the Preference Shareholders of B Limited at 15% premium in such a way that the existing dividend quantum of the preference shareholders of B Limited will not get affected. Accordingly, ₹ 5,00,000 pref. shares are discharged at ₹ 5,75,000 (5,00,000X 115%) by issue of 4,000 preference shares of ₹ 100 each at premium of ₹ 43.75 each.

(c) The Debentures of B Limited will be converted into equivalent number of Debentures of A Limited.

(d) All the Bills Receivable of A Limited were accepted by B Limited.

(e) A contingent liability of B Limited amounting to ₹ 72,000 to be treated as actual liability in trade payables.

(f) Expenses of Amalgamation amounted to ₹ 12,000 were borne by A Limited.

You are required to pass opening Journal Entries in the books of A Limited and prepare the opening Balance Sheet of A Limited as on 1st April, 2021 after amalgamation, assuming that the amalgamation is in the nature of Merger.

9. RTP Nov 2018

The financial position of two companies Alex Ltd. and Beta Ltd. as on 31st March, 2017 was as under:

Assets	Alex Ltd. (₹)	Beta Ltd. (₹)
Goodwill	1,40,000	70,000
Building	8,40,000	2,80,000
Machinery	14,00,000	4,20,000
Inventory	7,00,000	4,90,000
Trade receivables	5,60,000	2,80,000
Cash at Bank	1,40,000	56,000
	37,80,000	15,96,000
Liabilities	**Alex Ltd. (₹)**	**Beta Ltd. (₹)**
Share Capital:		
Equity Shares of ₹ 10 each	28,00,000	8,40,000
8% Preference Shares of ₹ 100 each	2,80,000	–
10% Preference Shares of ₹ 100 each	–	2,80,000
General Reserve	1,96,000	1,96,000
Retirement Gratuity fund	1,40,000	56,000
Trade payables	3,64,000	2,24,000
	37,80,000	15,96,000

Beta Ltd.is absorbed by Alex Ltd. on the following terms:

1. 10% Preference Shareholders are to be paid at 10% premium by issue of 8% Preference Shares of Alex Ltd.
2. Goodwill of Beta Ltd. is valued at ₹ 1,40,000, Buildings are valued at ₹ 4,20,000 and the Machinery at ₹ 4,48,000.

3. Inventory to be taken over at 10% less value and Provision for Doubtful Debts to be created @ 7.5%.
4. Equity Shareholders of Beta Ltd. will be issued Equity Shares of Alex Ltd. @ 5% premium.

You are required to:

(a) Prepare necessary Ledger Accounts to close the books of Beta Ltd.
(b) Prepare the acquisition entries in the books of Alex Ltd.
(c) Also prepare the Balance Sheet after absorption as at 31st March, 2017. Ans.

10. RTP MAY 2018

P Ltd. and Q Ltd. agreed to amalgamate their business. The scheme envisaged a share capital, equal to the combined capital of P Ltd. and Q Ltd. for the purpose of acquiring the assets, liabilities and undertakings of the two companies in exchange for share in PQ Ltd. The Summarized Balance Sheets of P Ltd. and Q Ltd. as on 31st March, 2017 (the date of amalgamation) are given below:

Summarized balance sheets as at 31-03-2017

Liabilities	P Ltd. ₹	Q Ltd. ₹	Assets	P Ltd. ₹	Q Ltd. ₹
Equity & liabilities:			Assets:		
Shareholders Fund			Non-current Assets:		
a. Share Capital	6,00,000	8,40,000	Fixed Assets (excluding Goodwill)	7,20,000	10,80,000
b. Reserves	10,20,000	6,00,000	Current Assets		
Current Liabilities			a. Inventories	3,60,000	6,60,000
Bank Overdraft	-	5,40,000	b. Trade receivables	4,80,000	7,80,000
Trade payables	2,40,000	5,40,000	c. Cash at Bank	3,00,000	-
	18,60,000	25,20,000		18,60,000	25,20,000

The consideration was to be based on the net assets of the companies as shown in the above Balance Sheets, but subject to an additional payment to P Ltd. for its goodwill to be calculated as its weighted average of net profits for the three years ended 31 st March, 2017. The weights for this purpose for the years 2014-15, 2015-16 and 2016-17 were agreed as 1, 2 and 3 respectively. The profit had been:

2014-15 ₹ 3,00,000; 2015-16 ₹ 5,25,000 and 2016-17 ₹ 6,30,000.

The shares of PQ Ltd. were to be issued to P Ltd. and Q Ltd. at a premium and in proportion to the agreed net assets value of these companies.

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

You are required to:

1. **Calculate** the number of shares issued to P Ltd. and Q Ltd; and
2. **Prepare** required journal entries in the books of PQ Ltd.; and
3. **Prepare** the Balance Sheet of PQ Ltd. as per Schedule III after recording the necessary journal entries.

11. ICAI ILLUSTRATION 10

The following are the summarized Balance Sheets of P Ltd. and Q Ltd. as on 31st March, 20X1:

		Particulars	Notes	₹ P Ltd	₹ Q Ltd
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	8,00,000	4,00,000
	B	Reserves and Surplus		3,00,000	2,00,000
2		**Non-current liabilities**			
	A	Long-term borrowings	2	2,00,000	1,50,000
3		**Current liabilities**			
		Trade Payables		2,50,000	1,50,000
		Total		15,50,000	9,00,000
		Assets			
1		**Non-current assets**			

	A	Property, Plant and Equipment		7,00,000	2,50,000
	B	Non-current investments		80,000	80,000
2		**Current assets**			
	A	Inventories		2,40,000	3,20,000
	B	Trade receivables		4,20,000	2,10,000
	C	Cash and Cash equivalents		1,10,000	40,000
		Total		15,50,000	9,00,000

Notes to accounts

			P Ltd.	Q Ltd.
1	**Share Capital**			
	Equity shares of ₹ 10 each		6,00,000	3,00,000
	10% Preference Shares of ₹ 100 each		2,00,000	1,00,000
			8,00,000	4,00,000
2	**Long term borrowings**			
	12% Debentures		2,00,000	1,50,000
			2,00,000	1,50,000

Details of Trade receivables and trade payables are as under:

Particulars	P Ltd. (₹)	Q Ltd. (₹)
Trade receivables		
Debtors	3,60,000	1,90,000
Bills Receivable	60,000	20,000
	4,20,000	2,10,000
Trade payables		
Sundry Creditors	2,20,000	1,25,000
Bills Payable	30,000	25,000
	2,50,000	1,50,000

Property, plant and equipment of both the companies are to be revalued at 15% above book value. Both the companies are to pay 10% Equity dividend, but Preference dividend having been already paid.

After the above transactions are given effect to, P Ltd. will absorb Q Ltd. on the following terms:

(i) 8 Equity Shares of ₹ 10 each will be issued by P Ltd. at par against 6 shares of Q Ltd.

(ii) 10% Preference Shareholders of Q Ltd. will be paid at 10% discount by issue of 10% Preference Shares of ₹ 100 each at par in P Ltd.

(iii) 12% Debenture holders of Q Ltd. are to be paid at 8% premium by 12% Debentures in P Ltd. issued at a discount of 10%.

(iv) ₹ 30,000 is to be paid by P Ltd. to Q Ltd. for Liquidation expenses. Sundry Creditors of Q Ltd. include ₹ 10,000 due to P Ltd.

(v) Inventory in Trade and Debtors are taken over at 5% lesser than their book value by P Ltd

Prepare:

(a) Journal entries in the books of P Ltd.

(b) Statement of consideration payable by P Ltd.

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. Question

The following is the summarized Balance Sheet of 'A' Ltd. as on 31.3.20 17:

Liabilities	Rs.	Assets	Rs.
14,000 Equity shares of Rs. 100 each, fully paid up	14,00,000	Sundry assets	18,00,000
General reserve	10,000		
10% Debentures	2,00,000		
Trade payables	1,40,000		
Bank overdraft	50,000		
	18,00,000		18,00,000

B Ltd. agreed to take over the business of 'A' Ltd. Calculate purchase consideration under Net Assets method on the basis: Market value of 75% of the sundry assets is estimated to be 12% more than the book value and that of the remaining 25% at 8% less than the book value. The liabilities are taken over at book values. There is an unrecorded liability of Rs. 25,000.

2. Question

Consider the following summarized balance sheets of X Ltd. and Y Ltd.

Balance Sheet as on 31st March, 20X1

Liabilities	X Ltd.	Y Ltd.	Assets	X Ltd.	Y Ltd.
	Rs.'000	Rs.'000		Rs.'000	Rs.'000
Equity Share Capital (₹ 10 each)	50,00	30,00	Land & Building	25,00	15,50
14% Preference Share Capital (₹ 100 each)	22,00	17,00	Plant & Machinery	32,50	17,00
General Reserve	5,00	2,50	Furniture & Fittings	5,75	3,50
Export Profit Reserve	3,00	2,00	Investments	7,00	5,00
Investment Allowance Reserve		1,00	Inventory	12,50	9,50
Profit & Loss A/c	7,50	5,00	Trade receivables	9,00	10,30
13% Debentures (₹ 100 each)	5,00	3,50	Cash & Bank	7,25	5,20
Trade payables	4,50	3,50			
Other Current Liabilities	2,00	1,50			
	99,00	66,00		99,00	66,00

X Ltd. takes over Y Ltd. on 1st April, 20X1. X Ltd. discharges the purchase consideration as below:

- Issued 3,50,000 equity shares of ₹ 10 each at par to the equity shareholders of Y Ltd.
- Issued 15% preference shares of ₹ 100 each to discharge the preference shareholders of Y Ltd. at 10% premium.

The debentures of Y Ltd. will be converted into equivalent number of debentures of X Ltd.

The statutory reserves of Y Ltd. are to be maintained for 2 more years.

Show the balance sheet of X Ltd. after amalgamation on the assumption that:

- the amalgamation is in the nature of merger.
- the amalgamation is in the nature of purchase.

MCQs

1. In case of amalgamation, the entry for elimination of unrealized profit or loss on stock is made
   a) By the vendor company
   b) By the purchasing company
   c) By the third party
   d) By the court

2. If expenses of liquidation of the vendor company are paid by the purchasing company then, in purchasing company's book, the account debited is
   a) Goodwill account.
   b) Liquidation expense account.
   c) Vendor company account.
   d) General reserve.

3. Amalgamation adjustment reserve is opened in the books of the amalgamated company to incorporate
   a) Assets of the amalgamating company.
   b) Non- Statutory reserves of the amalgamating company.
   c) Statutory reserves of the amalgamating company.
   d) General reserve of the amalgamating company.

4. Amalgamation Adjustment Reserve is presented in the financial statements of the transferee company as
   a) Other current asset.
   b) Separate line item with a negative sign under the head 'Reserves and Surplus'.
   c) Other non-current assets.
   d) Investment of the company

5. A company into which the vendor company is merged is called
   a) Transferee company.
   b) Transferor company.
   c) Selling company.
   d) Acquiree company.

6. If the purchase consideration is more than net assets (at agreed values) of the transferor company, difference shall be recorded as __________ in the books of the transferee company.
   a) Goodwill.

b) Capital Reserve.

c) Profit.

d) Loss.

Answer											
1.	(b)	2.	(a)	3.	(c)	4.	(b)	5.	(a)	6.	(a)

8 Consolidated Financial Statements

DEFINITION

For the purpose of AS - 21, the following terms are used with the meanings specified.

Control

The ownership, directly or indirectly through subsidiary (ies), 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 so as to obtain economic benefits from its activities.

MINORITY INTEREST

Is that part of the net results of operations and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiary

A **SUBSIDIARY** is an enterprise that is controlled by another subsidiary [known as the parent]

A **PARENT** is an enterprise that has one or more subsidiaries.

A **GROUP** is a parent and all its subsidiaries

EQUITY

Is the residual interest in the assets of an enterprise after deducting all its liabilities.

CONSOLIDATED FINANCIAL STATEMENT

Are the financial statements of a group presented as those of a single enterprise.

Items in Consolidated financial Statement [CFS]

Includes

- Consolidated Balance sheet
- Consolidated statement of Profit & loss.
- notes
- Other statements and explanatory material that form an integral part thereof.

Consolidated cash flow statement is presented in case a parent presents its own cash flow statement.

CFS are presented, to the extent possible, in the same format as that adopted by the parent for its separate financial statements.

Subsidiary should be excluded from consolidation when:-

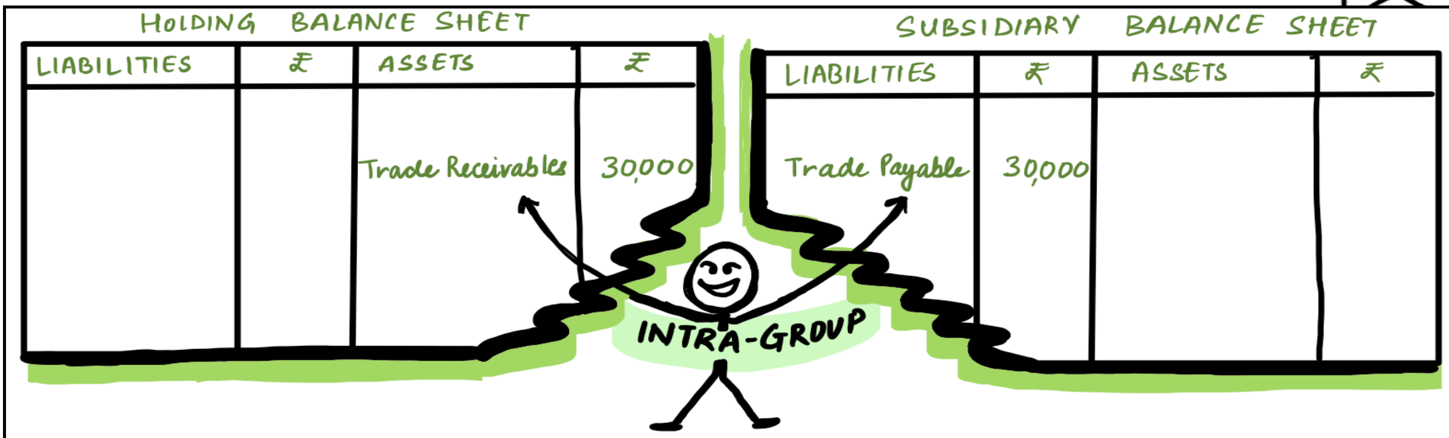
Control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future,

It operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent.

In consolidated financial statement, investment in such subsidiaries should be accounted for in accordance with Accounting standard (AS) 13, Accounting for investment. The reasons for not consolidating a subsidiary should be disclosed in the consolidated financial statements.

INTRAGROUP BALANCES & INTRAGROUP TRANSACTIONS

Intragroup balances & intragroup transactions and resulting unrealized profits should be eliminated in full. Unrealised losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.



CONSOLIDATED BALANCE SHEET

LIABILITIES	₹	ASSETS	₹
Trade Payables 30000 Less Contra (30000)	NIL	Trade Receivables 30,000 Less Contra (30,000)	NIL

ELIMINATION OF UNREALISED PROFIT

Elimination of unrealized Profit

(A) Inventories

(B) Non Current assets

Unrealized Profit on Inventories

DOWNSTREAM

Holding Co. is seller and Subsidiary Co is the buyer

H → S

- Deduct from Consolidated Reserves and Surplus.
- Deduct from Inventory in Consolidated Balance Sheet.

UPSTREAM

Subsidiary Co. is a seller and Holding Co. is the buyer.

H ← S

- Deduct from Post Acquisition Profit of Subsidiary in Analysis of profit [After time adjustment]
- Deduct Inventory from Consolidated Balance sheet.

MINORITY INTEREST

Minority interest should be presented in the consolidated balance sheet separately from liabilities and equity of the parent's shareholders. Minority in the income of the group should also be separately presented.

The losses applicable to the minority interest in the equity of the subsidiary.

⇩

The excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the majority has a binding obligation to and is able to make good the losses.

⇩

If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

Minority Interest (Becoming Negative)

- Minority Interest cannot be negative, if share of loss of minority interest makes it negative
- Subsequently when, subsidiary converts into profit, share of minority interest in profits will be transferred to holding reserves and surplus to the extent loss absorbed.

If a subsidiary has outstanding cumulative preference share which are held outside the group, the parent computes its share of profit or losses after adjusting for the subsidiary's preference dividends, whether or not dividend have been declared.

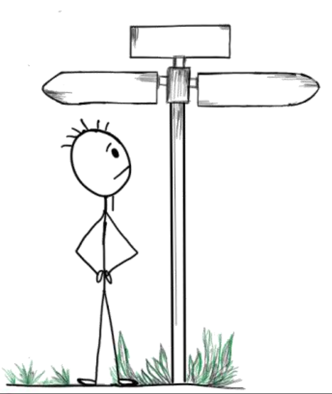
Steps to consolidate

1. DATE OF ACQUISITION AND SHAREHOLDING PATTERN

2. ANALYSIS OF PROFIT

PARTICULARS	PRE-ACQUISITION	POST-ACQUISITION	TOTAL	REMARK
Balances	XXX	XXX (B/F)	XXX	
Dividend [within the Period of AOP] irrespective of its source i.e Pre or Post		XXX		Entire Dividend Paid
Bonus [if entry is passed]		XXX		Entire Bonus Paid
	XXX	XXX		
Time Adjustments	XXX	(XXX)		
Dividend	(XXX)	(XXX)		
Bonus [If entry is passed]	(XXX)			
Bonus Issue [If no entry is passed]	(XXX)			
Revaluation of Assets	XXX/(XXX)			
Additional Depreciation/ Savings		XXX/(XXX)		
Elimination of unrealized Profit/loss.		XXX/(XXX)		
Holdings share	XXX	XXX		
Minority Interest				

3. COST OF CONTROL [Date of acquisition]



Particulars	₹
Cost of Acquisition [Investment]	XXX
(-) Pre-Acquisition dividend [Only share of Holding]	(XXX)
(A)	
Net Assets represented by	
Share Capital	XXX
(-) Pre acquisition Reserves	(XXX)
(B)	XXX

A - B = Goodwill [if positive] / Capital Reserve [if negative]

4. MINORITY INTEREST

Particulars	₹
Equity share Capital [Minority share]	XXX
(+) Pre acquisition profit [minority share]	XXX
Minority Interest on date of acquisition	XXX
(+) Post acquisition Profit	XXX
Minority Interest as on date of consolidation	XXX

5. CONSOLIDATED RESERVES AND SURPLUS

Particulars			
Holding Reserves & Surplus (+) Post Acquisition Profit from Analysis of Profit (–) Unrealised Profit on downstream (+) Capital Reserve [Step 3] (–) Rectification in dividend [Holding's share]			

Revaluation of Assets and Liabilities

FOR ASSETS

Fair Value > Carrying Amount

Add increase in value to pre-acquisition reserve of subsidiary [AOP]

and

Increase in fair value in assets in Consolidated Balance Sheet.

Assets A/c Dr
To Pre-P&L A/c

Fair Value < Carrying Amount

Deduct from pre-acquisition reserves of subsidiary [AOP]

and

Deduct decrease in fair value from respective assets in Consolidated Balance sheet.

Pre-P&L A/c Dr
To Assets A/c

FOR LIABILITIES

Fair Value > Carrying Amount

Deduct fair value increase from pre-acquisition profit of subsidiary [AOP]

and

Add increases in Liability in Consolidation Balance Sheet

Fair Value < Carrying Amount

Add FV increase in pre-acqusition profits of subsidiary [AOP]

and

Deduct increase from Liability in Consolidated Balance sheet.

Revaluation in case of depreciable assets

Additional depreciation would arise in case of initial upward or reversal of excess depreciation would arise in case of downward revaluation. Effect of addional depreciation or savings in depreciation should be adjusted from post-acquisition profits [AOP].

EXAMPLE 1: Balance Sheet 31.03.2023 [When acquisition date is at the beginning]

A purchased 70% shares of B on 01.04.2022

Fixed Assets Book Value = 60 Cr. On 01.04.2022

Depreciation Rate = 20% WDV

As on date of acquisition there is an Upward Revaluation of asset by 10%

Book Value 01.04.22	60 Cr.
(+) Upward Revaluation 10%	6 Cr. (60 Cr. on 10%)
Revised Value as on 01.04.22	66 Cr.

Depreciation	
- On Revalued Figure (66 Cr. X 20%)	13.20
- Actually Charged (60 Cr. X 20%)	(12)
Additional depreciation to be reduced from **post acquisition profit**	**1.20**

EXAMPLE 2: Acquisition date 30.09.2022 [When acquisition is in between the year]

Fair Value as on 30.09.2022 (Working Note. 1)	59.4
(-) Book Value as on 30.09.2022	54
Revaluation Profit	5.4

Working Note. 1

Opening	60 CR
(-) Depreciation (6 CR X 6/12 X 20%)	(6)
Carrying Amount before revaluation	**54**
(+) 10% on 54 [Upward Revaluation5.4]	
Fair Value as on 30.09.2022	59.4 Cr.

Calculation of Depreciation

Depreciation of Revalued figure (59.4 X 20% X 6/12)	5.94	59.4
(-) already charged (60 Cr. X 20% X 6/12)	6	54
Increase in post acquisition profit [AOP]	**0.06**	5.4

Note for the above Example 2

Presentation of PPE in Consolidated Financial Statements

Particulars	**Amount**
Book Value of Holding	XXX
Book Value of Subsidiary	XXX
	XXX
+ Revaluation on PPE	XXX
(-) Depreciation on only Revaluation	(XXX)
PPE for Consolidated Financial Statements	XXX

EXAMPLE 3

a) A Ltd. holds 80% of the equity capital and voting power in B Ltd. A Ltd. sells inventories costing ₹ 180 lacs to B Ltd at a price of ₹ 200 lacs. The entire inventories remain unsold with B Ltd. at the financial year end i.e. 31 March 20X1.

b) A Ltd. holds 75% of the equity capital and voting power in B Ltd. A Ltd. purchases inventories costing ₹ 150 lacs from B Ltd at a price of ₹ 200 lacs. The entire inventories remain unsold with A Ltd. at the financial year end i.e. 31 March 20X1.

Suggest the accounting treatment for the above mentioned transactions in the consolidated financial statements of A Ltd. giving reference of the relevant guidance/standard.

SOLUTION

a) This would be the case of downstream transaction. In the consolidated profit and loss account for the year ended 31 March 20X1, entire transaction of sale and purchase of ₹ 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales).

Further, the unrealized profits of ₹ 20 lacs (i.e. ₹ 200 lacs – ₹ 180 lacs), would be eliminated from the consolidated financial statements for financial year ended 31 March 20X1, by reducing the consolidated profits/ increasing the consolidated losses, and reducing the value of closing inventories as of 31 March 20X1.

b) This would be the case of upstream transaction. In the consolidated profit and loss account for the year ended 31 March 20X1, entire transaction of sale and purchase of ₹ 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales).

Further, the unrealized profits of ₹ 50 lacs (i.e. ₹ 200 lacs – ₹ 150 lacs), would be eliminated in the consolidated financial statements for financial year ended 31 March 20X1, by reducing the value of closing inventories by ₹ 50 lacs as of 31 March 20X1. In the consolidated balance sheet as of 31 March 20X1, A Ltd.'s share of profit from B Ltd will be reduced by ₹ 37.50 lacs (being 75% of ₹ 50 lacs) and the minority's share of the profits of B Ltd would be reduced by ₹ 12.50 lacs (being 25% of ₹ 50 lacs).

DIVIDEND

Standalone Financial Statements

HOLDING COMPANY		SUBSIDIARY COMPANY	
Reserves		Reserves	

Holding Company

Cash / Bank A/c Dr
To Dividend A/c
[Post incorporation Profit]

or

Cash / Bank A/c Dr
To Investment A/c
[Pre incorporation Profit]
as per AS-13

Subsidiary Company

Profit and Loss A/c Dr
To Dividend Payable A/c

Dividend Payable A/c Dr
To Cash / Bank A/c

Consolidated financial Statements

RESERVES

Source of Dividend = Pre

Source of Dividend = Post

SOURCE OF DIVIDEND

PRE

CORRECT ENTRY

Cash / Bank A/c Dr.
To Investment A/c

WRONG ENTRY

Cash / Bank A/c Dr.
To Profit and loss A/c

RECTIFIED ENTRY

Profit and loss A/c Dr
To Investment A/c

POST

CORRECT ENTRY

Cash / Bank A/c Dr.
To Profit and loss A/c

WRONG ENTRY

Cash / Bank A/c Dr.
To Investment A/c

RECTIFIED ENTRY

Investment A/c Dr.
To Profit and loss A/c

BONUS ISSUE

1. Bonus issue is the issue of shares to existing shareholders without any additional consideration. This means that number of shares outstanding increases, but there is not corresponding increase in company's resources.

2. Journal in the Books of Subsidiary.

Particulars	Dr. (Rs.)	Cr. (Rs.)
Reserves A/c Dr.	XXX	
To Share Capital A/c		XXX
(Being Reserves Capitalised)		

3. Journal in the books of holding or minority. No journal entry is passed, only no. of shares will increase without any further investment.

4. There will be no change in shareholding pattern post Bonus Issue.

Example : Before Bonus issue = Holding 8000 Shares
= Minority 2000 Shares

Company gave bonus share of 1 for every 2 shares held

∴ Revised shareholding pattern.

Particular	Calculation	Shareholding Pattern
Holding	8000 X ½ + 8000 = 12,000	80% (12/15)
	2000 X ½ + 2000 = 3000	20% (3/15)
Minority	Total 15000	

CONSOLIDATED PROFIT & LOSS ACCOUNT

Line by line addition of items of P & L as on consolidate.

Elimination of inter company transaction.

- ✓ Inter group sale and purchase
- ✓ Inter group expenses [Other than purchases]
- ✓ Inter group incomes [Other than Sales]

Elimination of unrealized profit inventory

Elimination of dividend payment

CONSOLIDATED CASH FLOW

Add line by line items of cashflow statement of Holding & Subsidiary as full amount as approving in their separate cash flow state as on consolidation date.

Elimination inter group transaction

[In case of dividend paid by subsidiary company, only parent company share in eliminated].

TREATMENT OF SUBSIDIARY COMPANY HAVING PREFERENCE SHARE CAPITAL

- Outstanding cumulative preference shares issued by subsidiary company are considered in a same manner as any other liability and therefore cost associated to such shares need to be adjusted for.
- While computing share of P & L of the Subsidiary adjustments regarding outstanding dividend on preference shares held outside the group to be made.
- In case of Non cumulative preference share no such adjustment is required.

Note for student...

CHAPTER 8 – CONSOLIDATED FINANCIAL STATEMENTS

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI Illustration No 13						
2	ICAI Practical Q No 4						
3	ICAI Illustration No 3						
4	RTP Nov 2018 Q13						
5	QP May19 Q 5a						
6	RTP NOV 20, Exam Nov 19						
7	QP NOV 20						
8	QP NOV 18						
9	RTP Nov 22						
10	Question						
TEST IN TIME PASS IN TIME							
1	QP July 21						
2	QP July 21						

1. ICAI Illustration No 13

Subsidiary B Ltd. provides the following balance sheet:

Particulars	Note No.	20X0 (₹)	20X1 (₹)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	1	5,00,000	5,00,000
(b) Reserves and Surplus	2	2,86,000	7,14,000
(2) Current Liabilities			
(a) Short term borrowings	3	--	1,70,000
(b) Trade Payables		4,90,000	4,94,000
(c) Short-term provisions	4	3,10,000	4,30,000
Total		15,86,000	23,08,000
II. Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment	5	2,72,000	2,24,000
(b) Non-current Investment			4,00,000
(2) Current assets			
(a) Inventories		5,97,000	7,42,000
(b) Trade Receivables		5,94,000	8,91,000
(c) Cash & Cash Equivalents		51,000	3,000
(d) Other current assets	6	72,000	48,000
Total		15,86,000	23,08,000

Notes to Accounts

		20X0 (₹)	20X1 (₹)
1.	Share capital		
	5,000 equity shares of ₹10 each, fully paid up	5,00,000	5,00,000
2.	Reserves and Surplus		
	General Reserves	2,86,000	7,14,000
3.	Short term borrowings		
	Bank overdraft	--	1,70,000
4.	Short term provisions		
	Provision for taxation	3,10,000	4,30,000
5.	Property, plant and equipment		

	Cost	3,20,000	3,20,000
	Less: Depreciation	(48,000)	(96,000)
	Total	2,72,000	2,24,000
6.	**Other current Assets**		
	Prepaid expenses	72,000	48,000

Also consider the following information:

a) B Ltd. is a subsidiary of A Ltd. Both the companies follow calendar year as the accounting year.

b) A Ltd. values inventory on LIFO basis while B Ltd. used FIFO basis. To bring B Ltd.'s values in line with those of A Ltd. its value of inventory is required to be reduced by ₹12,000 at the end of 20X0 and ₹34,000 at the end of 20X1.

c) B Ltd. deducts 1% from Trade Receivables as a general provision against doubtful debts.

d) Prepaid expenses in B Ltd. include advertising expenditure carried forward of ₹ 60,000 in 20X0 and ₹30,000 in 20X1, being part of initial advertising expenditure of₹90,000 in 20X0 which is being written off over three years. Similar amount of advertising expenditure of A Ltd. has been fully written off in 20X0.

Restate the balance sheet of B Ltd. as on 31st December, 20X1 after considering the above information, for the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by A Ltd. and B Ltd. uniform.

2. **ICAI Practical Q No 4**

A Ltd. acquired 1,600 ordinary shares of ₹100 each of B Ltd. on 1st July, 20x1. On 31st December, 20x1 the summarized balance sheets of the two companies were as given below:

Balance Sheet of A Ltd. and its subsidiary, B Ltd.

as at 31st December, 20X1

Particulars	Note No.	A Ltd. (₹)	B Ltd. (₹)
I. Equity and Liabilities			
(1) **Shareholder's Funds**			
(a) Share Capital	1	5,00,000	2,00,000
(b) Reserves and Surplus	2	2,97,200	1,82,000

(2) Current Liabilities			
(a) Trade Payables		47,100	17,400
(b) Short term borrowings	3	80,000	
Total		9,24,300	3,99,400
II. **Assets**			
(1) **Non-current assets** (d) Property, Plant and Equipment	4	3,90,000	3,15,000
(b) Non-current Investments	5	3,40,000	--
(2) Current assets			
(a) Inventories		1,20,000	36,400
(b) Trade receivables		59,800	40,000
(c) Cash & Cash equivalents	6	14,500	8,000
Total		9,24,300	3,99,400

Notes to Accounts

		A Ltd. ₹	B Ltd. ₹
1.	**Share Capital**		
	5,000 shares of ₹100 each, fully paid up	5,00,000	-
	2,000 shares of ₹100 each, fully paid up	-	2,00,000
	Total	5,00,000	2,00,000
2.	**Reserves and Surplus**		
	General Reserves	2,40,000	1,00,000
	Profit & loss	57,200	82,000
	Total	2,97,200	1,82,000
3.	**Short term borrowings**		
	Bank overdraft	80,000	--
4.	**Property plant and equipment**		
	Land and building	1,50,000	1,80,000
	Plant & Machinery	2,40,000	1,35,000
	Total	3,90,000	3,15,000
5.	**Non-current Investments**		
	Investment in B Ltd (at cost)	3,40,000	--
6.	**Cash & Cash equivalents**		
	Cash	14,500	8,000

The Profit & Loss Account of B Ltd. showed a credit balance of ₹30,000 on 1st January, 20X1 out of which a dividend of 10% was paid on 1st August, 20X1; A Ltd. credited the dividend received to its Profit & Loss Account. The Plant & Machinery which stood at ₹ 1,50,000 on 1st January, 20X1 was considered as worth ₹1,80,000 on 1st July, 20X1; this figure is to be considered while consolidating the Balance Sheets. The rate of depreciation on plant & machinery is 10% (computed on the basis of useful lives).

Prepare consolidated Balance Sheet as at 31st December, 20X1.

3. **ICAI Illustration No 3**

Exe Ltd. acquires 70% of equity shares of Zed Ltd. as on 31st March, 20X1 at a cost of ₹70 lakhs. The following information is available from the balance sheet of Zed Ltd. as on 31st March, 20X1:

Particulars	₹in lakhs
Property, Plant and equipment	120
Investments	55
Current Assets	70
Loans & Advances	15
15% Debentures	90
Current Liabilities	50

The following revaluations have been agreed upon (not included in the above figures):

Fixed Assets Up by 20%

Investments Down by 10%

Zed Ltd. declared and paid dividend @ 20% on its equity shares as on 31st March, 20X1. Exe Ltd. purchased the shares of Zed Ltd. @ ₹20 per share.

Calculate the amount of goodwill/capital reserve on acquisition of shares of Zed Ltd.

4. **RTP Nov 2018 Q13**

The Summarised Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017 are as follows:

Particulars	Amounts as at 31st March, 2017	
	X Ltd. (₹ in lakhs)	Y Ltd. (₹ in lakhs)
LIABILITIES		
Share Capital:		
Authorised	20,000	8,000
Issues and subscribed:		
Equity share of ₹ 10 each, fully paid up	15,000	6,000
15% preference shares of ₹ 10 each, fully paid up	4,000	1,000
General Reserves	2,500	1,450
Profit & Loss Account	2,750	1,250
Trade payables	1,646	1,027
ASSESTS	**25,896**	**10,727**
Land & Building	3,550	1,510
Plant & Machinery	5,275	3,600
Furniture & Fittings	1,945	655
Investment in Y Ltd.: 450 Lakh Equity share in Y Ltd. purchased on 1st April, 16	6,800	
Inventory	4,142	2,520
Trade Receivables	3,010	1,882
Cash and Bank Balance	1,174	560
	25,896	**10,727**

The following information is also given to you

(a) 10% dividend on Equity shares was declared by Y Ltd. on 31 st March, 2016 for the year ended 31st March, 2016. X Ltd. credited the dividend received to its Profit & Loss Account.

(b) Credit Balance of Profit & Loss account of Y Ltd. as on 1st April, 2016 was ₹ 650 Lakhs.

(c) General Reserve of Y Ltd. stood at same ₹ 1,450 Lakhs as on 1st April, 2016.

(d) Y Ltd.'s Plant & machinery showed a balance of ₹ 4,000 Lakh on Ist April 2016. At the time of purchase of shares in Y Ltd., X Ltd. revalued Y's Ltd. Plant & Machinery upward by ₹ 1,000 Lakh.

(e) Included in Trade Payables of Y Ltd. are ₹ 50 Lakh for goods supplied by X Ltd.

(f) On 31st March, 2017, Y's ltd. inventory included goods for ₹ 150 lakhs which it had purchased from X Ltd. X Ltd. sold goods to Y Ltd. at cost plus 25%.

You are required to prepare a Consolidated Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017 giving working notes. (Ignoring dividend on preference shares)

5. **QP May19 Q 5a**

H Ltd. acquire 70% of equity share of S Ltd. as on 1st January, 2011 at a cost of ₹ 5,00,000 when S Ltd. had an equity share capital of ₹ 5,00,000 and reserves and surplus of ₹ 40,000.

Both the companies follow calendar year as the accounting year.

In the four consecutive years, S Ltd. performed badly and suffered losses of ₹ 1,25,000, ₹ 2,00,000, ₹ 2,50,000 and ₹ 60,000 respectively.

Thereafter in 2015, S Ltd. experienced turnaround and registered an annual profit of ₹ 25,000. In the next two years i.e. 2016 and 2017, S Ltd. recorded annual profits of ₹ 50,000 and ₹ 75,000 respectively.

Show the Minority Interests and Cost of Control at the end of each year for the purpose of consolidation.

6. **RTP NOV 20, Exam Nov 19**

From the following data, determine Minority Interest on the date of acquisition and on the date of consolidation in each case:

Case	Subsidiary Company	% of Share Owned	Cost	Date of Acquisition		Consolidation date	
				01-01-2019		31-12-2019	
				Share	Profit and	Share	Profit and

				Capital	Loss A/c	Capital	Loss A/c
Case-A	X	90%	2,00,000	1,50,000	75,000	1,50,000	85,000
Case-B	Y	75%	1,75,000	1,40,000	60,000	1,40,000	20,000
Case-C	Z	70%	98,000	40,000	20,000	40,000	20,000
Case-D	M	95%	75,000	60,000	35,000	60,000	55,000
Case-E	N	100%	1,00,000	40,000	40,000	40,000	65,000

7. **QP NOV 20**

H Limited acquired 64000 Equity Shares of ₹ 10 each in S Ltd. as on 1st October, 2019. The Balance Sheets of the two companies as on 31st March, 2020 were as under:

Particulars	H Ltd. (₹)	S Ltd. (₹)
Equities and Liabilities:		
Equity Share Capital: Shares of ₹ 10 each	20,00,000	8,00,000
General Reserve (1st April, 2019)	9,60,000	4,20,000
Profit & Loss Account	2,28,800	3,28,000
Preliminary Expenses (1st April, 2019)	-	(20,000)
Bank Overdraft	3,00,000	-
Bills Payable	-	52,000
Trade Payables	1,66,400	80,000
Total	36,55,200	16,60,000
Assets:		
Land and Building	7,20,000	7,60,000
Plant & Machinery	9,60,000	5,40,000
Investment in Equity Shares of S Ltd.	12,27,200	-
Inventories	4,56,000	1,68,000
Trade Receivables	1,76,000	1,60,000
Bills Receivable	59,200	-
Cash in Hand	56,800	32,000
Total	36,55,200	16,60,000

Additional Information:

1. The Profit & Loss Account of S Ltd. showed credit balance of ₹ 1,20,000 on 1st April, 2019. S Ltd. paid a dividend of 10% out of the same on 1st November, 2019 for the year 2018-19. The dividend was correctly accounted for by H Ltd.

2. The Plant & Machinery of S Ltd. which stood at ₹ 6,00,000 on 1st April, 2019 was considered worth ₹ 5,20,000 on the date of acquisition by H Ltd. S Ltd. charges depreciation @ 10% per annum on Plant & Machinery.

Prepare consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31st March, 2020 as per Schedule III of the Companies Act, 2013.

8. **QP NOV 18**

The Profit and Loss Accounts of A Ltd. and its subsidiary B Ltd. for the year ended 31st March, 2018 are given below :

₹ in Lakhs

Incomes	A Ltd.	B Ltd.
Sales and other income	7,500	1,500
Increase in Inventory	1,500	300
Total	9,000	1,800
Expenses		
Raw material consumed	1,200	300
Wages and Salaries	1,200	225
Production expenses	300	150
Administrative expenses	300	150
Selling and distribution expenses	300	75
Interest	150	75
Depreciation	150	75
Total	3,600	1,050
Profit before tax	5,400	750
Provision for tax	1,800	300
Profit after tax	3,600	450
Dividend paid	1,800	225

Balance of Profit	1,800	225

The following information is also given:

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

(ii) Administrative expenses of B Ltd include ₹ 8 Lakhs paid to A Ltd as consultancy fees.

(iii) Selling and distribution expenses of A Ltd include ₹15 Lakhs paid to B Ltd as commission.

(iv) A Ltd holds 72% of the Equity Capital of B Ltd. The Equity Capital of B Ltd prior to 2016-17 is ₹1,500 Lakhs

Prepare a consolidated Profit and Loss Account for the year ended 31st March, 2018.

9. **RTP Nov 22**

On 31st March, 2022, H Ltd. and S Ltd. give the following information:

	H Ltd. (₹ in 000's)	S Ltd. (₹ in 000's)
Equity Share Capital – Authorised	5,000	3,000
Issued and subscribed in Equity Shares of ₹ 10 each fully paid	4,000	2,400
General Reserve	928	690
Profit and Loss Account (Cr. Balance)	1,305	810
Trade payables	611	507
Provision for Taxation	220	180
Other Provisions	65	17
Plant and Machinery	2,541	2,450
Furniture and Fittings	615	298
Investment in the Equity Shares of S Ltd.	1,500	–
Inventory	983	786
Trade receivables	820	778
Cash and Bank Balances	410	102

Sundry Advances (Dr. balances)	260	190

Following Additional Information is available:

(a) H Ltd. purchased 90 thousand Equity Shares in S Ltd. on 1st April, 2021. On that date the following balances stood in the books of S Ltd.:

General Reserve ₹ 1,500 thousand; Profit and Loss Account ₹ 633 thousand.

(b) On 14th July, 2021 S Ltd. declared a dividend of 20% out of pre-acquisition profits. H Ltd. credited the dividend received to its Profit and Loss Account.

(c) On 1st November, 2021, S Ltd. issued 3 fully paid Equity Shares of ₹ 10 each, for every 5 shares held as bonus shares out of pre-acquisition General Reserve.

(d) On 31st March, 2021, the Inventory of S Ltd. included goods purchased for ₹ 50 thousand from H Ltd., which had made a profit of 25% on cost.

(e) Details of Trade payables and Trade receivables:

	H Ltd. (₹ in 000's)	S Ltd. (₹ in 000's)
Trade payables		
Bills Payable	124	80
Sundry creditors	487	427
	611	507
Trade receivables		
Debtors	700	683
Bills Receivables	120	95
	820	778

Prepare a consolidated Balance Sheet as at 31st March, 2022.

10. **Question**

H Ltd. Holds share capital of S Ltd. On 31.03.2015 whose Balance Sheets are as follows :

Particulars	H	S	Particulars	H	S
Share Capital @₹10 each	20,000	10,000	Fixed Assets [Tangible]	30,000	15,000
General Reserves			Current Assets	35,000	25,000
P/L Account (1.4.14)	10,000	5,000	8,000 Shares in S Ltd.	10,000	
10% Debentures	5,000	4,000			
Sundry Creditors	20,000	10,000			
P/L Account for the year	10,000	5,000			
	10,000	6,000			
Total	**75,000**	**40,000**	**Total**	**75,000**	**40,000**

H Limited acquired shares in S Limited on 01.10.2014. S Limited has a balance of₹4,000 in General Reserve on 01.04.2014. On the account fire goods costing₹2000 of S Limited were destroyed in June, 2014. The loss has been charged to the Profit and Loss Account for the year.

Required to prepare a consolidated Balance Sheet. Required to compile consolidated Balance Sheet on 31.03.2015.

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. QP July 21

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.

2. QP July 21

The Trial Balances of X Limited and Y Limited as on 31st March, 2021 were as under:

	X Limited (₹ In 000)		Y Limited (₹ In 000)	
	Dr.	Cr.	Dr.	Cr.
Equity Share capital (Share of ₹ 100 each)		2,000		400
7% Preference share capital		-		400
Reserves		600		200
6% Debentures		400		400
Trade Receivables/Trade Payables	160	180	100	120
Profit & Loss A/c balance		40		30
Purchases /Sales	1,000	1,800	1,200	1,900
Wages and Salaries	200		300	
Debenture Interest	24	7	24	
General Expenses	160		120	
Preference share dividend up to 30.09.2020			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.

MCQs

1. Minority interest should be presented in the consolidated balance sheet
   a) As a part of liabilities.
   b) As a part of equity of the parent's shareholders.
   c) Separately from liabilities and the equity of the parent's shareholders.
   d) As a part of assets.

2. Minority of the subsidiary is entitled to
   a) Capital profits of the subsidiary company.
   b) Revenue profits of the subsidiary company.
   c) Both capital and revenue profits of the subsidiary company.
   d) Neither capital nor revenue profits of the subsidiary.

3. In consolidation of accounts of holding and subsidiary company _________ is eliminated in full.
   a) Current liabilities of subsidiary company.
   b) Reserves and surplus of both holding and subsidiary company.
   c) Mutual indebtedness.
   d) Nothing.

4. In consolidated balance sheet, the share of the outsiders in the net assets of the subsidiary must be shown as
   a) Minority interest.
   b) Capital reserve.
   c) Current liability.
   d) Current assets.

5. Provision for Tax made by the subsidiary company will appear in the consolidated balance sheet as an item of
   a) Current liability.
   b) Revenue profit.
   c) Capital profit.
   d) Current assets.

Answers									
1.	(c)	2.	(c)	3.	(c)	4.	(a)	5.	(a)

9

Accounting for Reconstruction of Companies

RECONSTRUCTION

a process by which affairs of a company are reorganized by revaluation of assets, reassessment of liabilities and by writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares.

Internal Reconstruction

In case of internal reconstruction, the company's existing financial structure is reorganised without dissolving the existing company and without forming a new company. Taking a wider meaning of the term 'Internal Reconstruction'

External Reconstruction

covered under 'Amalgamation in the nature of merger' in AS-14.

methods

- Alteration of share Capital
  - Sub division & consolidation of shares.
  - Conversion of shares into stock or vica versa.
- Variation of Shareholder's Rights
- Reduction of share capital
- Compromise / Arrangement
- Surrender of Shares

ALTERATION OF SHARE CAPITAL

ACCOUNTING ENTRIES

The accounting entries in each case of alteration of share capital will be as under:-

(a) For increase in share capital

Example – X Ltd issued 10,000 Equity Shares of ₹ 10 each at par.

DATE	PARTICULARS	LF	Dr. (₹)	Cr. (₹)
(i)	Bank A/c Dr.		1,00,000	
	To Equity Share Application and Allotment A/c			1,00,000
	(Being the application money received)			
(ii)	Equity share Application and Allotment A/c Dr.		1,00,000	
	To Equity Share Capital A/c			1,00,000
	(Being 10,000 Equity Shares of Rs. 10 each allotted at par)			

(b) For consolidation of shares

Example – X Ltd having 10,000 Equity Shares of ₹ 10 each decides to convert the share capital into Equity Shares of ₹ 100 each.

DATE	PARTICULARS	LF	Dr. (₹)	Cr. (₹)
(i)	Equity Share Capital (₹10) A/c Dr.		1,00,000	
	To Equity Share Capital (₹100) A/c			1,00,000
	(Being 10,000 Equity Shares of ₹10 each converted into 1000 shares of ₹100 each)			

(c) For sub-division of shares

Example – X Ltd having 1000 Equity Shares of ₹ 100 each decides to convert the share capital into Equity Shares of ₹ 10 each.

DATE	PARTICULARS	LF	Dr. (₹)	Cr. (₹)
(i)	Equity Share Capital (₹100) A/c Dr.		1,00,000	
	To Equity Share Capital (₹10) A/c			1,00,000
	(Being 1000 Equity Shares of ₹100 each converted into 10,000 shares of ₹10 each)			

(d) For conversion of shares into stock

Example – X Ltd having 10,000 Equity Shares of ₹ 10 each decides to convert the share capital into Equity Stock.

DATE	PARTICULARS	LF	Dr. ( )	Cr. ( )
(i)	Equity Share Capital (₹10) A/c Dr.		1,00,000	
	To Equity Stock A/c			1,00,000
	(Being 1,000 Equity Stock of ₹10 each converted into equity stocks)			

(e) For conversion of stocks into shares

Example – X Ltd having Equity Stock of ₹ 1,00,000 decides to convert the Equity Stock into Equity Share Capital of ₹ 10 each.

DATE	PARTICULARS	LF	Dr. ( )	Cr. ( )
(i)	Equity Stock A/c Dr.		1,00,000	
	To Equity Share Capital (₹10) A/c			1,00,000
	(Being Equity Stock in of ₹1,00,000 converted into 10,000 equity shares of ₹10 each)			

(f) For Cancelling unissued shares

No accounting entry is required to be passed. The authorized share capital gets reduced by the amount of unissued shares now cancelled.

DATE	PARTICULARS	LF	Dr. ( )	Cr. ( )
(i)	No Entry			

REDUCTION OF SHARE CAPITAL

Section 66 of the Companies Act, 2013 lays down the procedure in respect of reduction of share capital.

NO	PARTICULARS	MEANING	EXAMPLE	ACCOUNTING TREATMENT
1.	When liability of the shareholders is extinguished or reduced in respect of unpaid amount on the shares held by them	Shareholders are not called upon to pay the unpaid amount on shares held by them in future.	Company decides to reduce ₹ 10 per share, into ₹ 7.5 per share fully paid up, by cancelling the unpaid amount of ₹ 2.5 per share	Share Capital (Partly Paid-Up) A/c Dr. (₹ 7.5 (F.V. ₹10) X No. of Shares) To Share Capital (Fully Paid-up) A/c (₹ 7.5 (F.V. - ₹ 7.5) X No. of Shares)

2.	When excess paid up capital is paid off	Company refund excess capital to shareholder	company having fully paid-up share of ₹ 10 each, decides to pay-off ₹ 2 per share to make it of ₹ 8 fully paid-up	Share Capital A/c Dr. (₹ 10 X No. of Shares) To Share Capital A/c (₹ 8) (₹ 8 X No. of Shares) To Shareholders A/c (₹ 2 X No. of Shares) Shareholders A/c Dr. (₹ 2 X No. of Shares) To Bank A/c (₹ 2 X No. of Shares)
3.	When the paid up capital which is lost or not represented is cancelled	Nominal value of the share remains the same and only the paid value is reduced.	Shareholders may agree to reduce the paid capital of ₹ 100 per share to paid value of ₹ 10 per share	Share Capital A/c Dr. (₹ 90 X No. of Shares) To Capital Reduction A/c (₹ 90 X No. of Shares)
		Reduction in both nominal and paid up values		Share Capital A/c Dr. (₹ 100 X No. of Shares) To Share Capital A/c (₹ 10 X No. of Shares) To Capital Reduction A/c (₹ 90 X No. of Shares)

The amount of reduction is credited to a new account called Capital Reduction Account (or Reconstruction Account).

VARIATION OF SHAREHOLDER's RIGHTS

Example 1 → X Ltd. has 1000, 10% cum pref shares of ₹ 100 each. At a class meeting of cum pref shareholders, it was decided that the rate of dividend be reduced to 9%. In such a case following Journal Entry will be passed.

No.	Particulars	LF	Dr. ₹	Cr. ₹
	10% Cum. Pref. Share Capital A/c Dr.		1,00,000	
	To 9% Cum Pref. Share Capital A/c			1,00,000

Example 2 → Y Ltd. has 1000, 10% cumulative pref. shares of ₹ 100 each. At a meeting of cum pref. shareholders, it was decided that the existing cumulative pref. shares to be converted into non-cumulative pref. shares.

No.	Particulars	LF	Dr. ₹	Cr. ₹
	10% Cum. Pref. Share Capital A/c Dr.		1,00,000	
	To 10% Non Cum Pref. Share Capital A/c			1,00,000

SCHEME OF COMPROMISE AND ARRANGEMENT

A scheme of compromise and arrangement is an agreement between a company and its members and outside liabilities when the company faces financial problems.

No.	Particulars		LF	Dr.	Cr.
1	When equity shareholders give up their claim to reserves and accumulated profits				
	Reserves A/c (With the amount of reserve)	Dr.			
	To Reconstruction A/c				
2	Settlement of outside liabilities at lesser amount				
	Outside Liabilities A/c (With the amount of sacrifice)	Dr.			
	Provision Account, if any (Made by creditors debenture holders A/c)	Dr.			
	To Reconstruction A/c				

SURRENDER OF SHARES

In this method, shares are divided into shares are smaller denominations and then the shareholders are made to surrender their shares to company. These shares are then alloted to debentureholders and creditors so that their liabilities are reduced. The unutilized surrendered shares are then cancelled by transferred to Reconstruction A/c.

ACCOUNTING ENTRIES

DATE	PARTICULARS	LF	Dr.	Cr.
1	To reduce both the nominal value and paid up value of shares			
	Share Capital A/c (100 each) Dr.		100	
	To Share Capital A/c (80 each)			80
	To Reconstruction A/c / Capital Reduction A/c			20
2	To reduce only the paid up value of shares			
	Share Capital A/c Dr.		20	
	To Reconstruction A/c / Capital Reduction A/c			20
3	(a) To pay the Arrears of Preference Dividend			
	Reconstruction A/c Dr.			
	To Bank A/c / Share Capital A/c			
	(b) To cancel the Arrears of preference dividend			
	No journal entry is required to cancel a Contingent Liability			
4	To reduce the claims of Debenture holders			
	Debentures A/c Dr.			
	Interest on Debentures A/c Dr.			
	To New Debentures A/c / Share Capital A/c / Bank A/c			
	To Reconstruction A/c			
5	To reduce the claims of trade creditors			
	Trade Creditors A/c Dr.			
	To Share Capital A/c / Bank A/c			
	To Reconstruction A/c			
6	To Settle the Tax Liability			
	Provision for Tax A/c Dr.			
	To Bank A/c			
	To Reconstruction A/c			
7	To pay reconstruction expenses			
	Reconstruction A/c Dr.			
	To Bank A/c			
8	To pay for cancellation of Capital Commitments etc.			

	Reconstruction A/c Dr.			
	To Bank A/c			
9	To Record the bad debts and doubtful debts			
	Reconstruction A/c (With Total) Dr.			
	To Debtors A/c (With Bad debts)			
	To Provision for doubtful debts A/c (With Doubtful debts)			
10	To record the appreciation in value of assets			
	Investments A/c / Land & Building A/c Dr.			
	To Reconstruction A/c			
11	To transfer capital reserve for reconstruction purpose			
	Capital reserve A/c Dr.			
	To Reconstruction A/c			
12	To write off the accumulated losses, fictitious assets and the over valuation of over valued assets			
	Capital Reduction A/c / Reconstruction A/c Dr.			
	To Profit & loss A/c			
	To Preliminary Expenses A/c			
	To Underwriting Commission A/c			
	To Discount on issue of Shares / Debentures A/c			
	To Goodwill A/c (To the extent of over valuation)			
	To Patents A/c (To the extent of over valuation)			
	To Trade marks A/c (To the extent of over valuation)			
	To Copy right A/c (To the extent of over valuation)			
	To Other overvalued assets (Individually)			
13	To transfer the credit balance of reconstruction A/c / Capital reconstruction A/c *			
	Capital reduction A/c / Reconstruction A/c Dr.			
	To Capital Reserve A/c			

*In case debit balance: Use capital reserve, Security Premium, General Reserve / P & L and if still debit balance persists, show it in Balance sheet as capital loss.

Note : Even if the question is silent, the debit balance of P and L account and Unamortized expense item shall be written off to the extent balance available in Reconstruction/ Capital Reduction A/c

Note for student...

CHAPTER 9 – ACCOUNTING FOR RECONSTRUCTION OF COMPANIES

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI Illustration No 6						
2	ICAI PRACTICAL Q 3						
3	RTP MAY 20						
4	QP JULY 21						
5	MTP March 2022 Test Series 1						
TEST IN TIME PASS IN TIME							
1	Question						
2	Question						

1. ICAI Illustration No 6

Vaibhav Ltd. gives the following ledger balances as at 31st March 20X1

	₹
Property, Plant and Equipment	2,50,00,000
Investments (Market-value ₹ 19,00,000)	20,00,000
Current Assets	2,00,00,000
P & L A/c (Dr. balance)	12,00,000
Share Capital: Equity Shares of ₹ 100 each	2,00,00,000
6%, Cumulative Preference Shares of ₹ 100 each	1,00,00,000
5% Debentures of ₹ 100 each	80,00,000
Creditors	1,00,00,000
Provision for taxation	2,00,000

The following scheme of Internal Reconstruction is sanctioned:

1. All the existing equity shares are reduced to ₹ 40 each.
2. All preference shares are reduced to ₹ 60 each.
3. The rate of Interest on Debentures increased to 6%. The Debenture holders surrender their existing debentures of ₹ 100 each and exchange the same for fresh debentures of ₹ 70 each for every debenture held by them.
4. Fixed assets are to be written down by 20%
5. Current assets are to be revalued at ₹ 90,00,000.
6. Investments are to be brought to their market value.
7. One of the creditors of the company to whom the company owes ₹ 40,00,000 decides to forgo 40% of his claim. The creditor is allotted with 60000 equity shares of ₹ 40 each in full and final settlement of his claim.
8. The taxation liability is to be settled at ₹ 3,00,000.
9. It is decided to write off the debit balance of Profit & Loss A/c.

Pass journal entries and show the Balance Sheet of the company after giving effect to the above.

2. ICAI PRACTICAL Q 3

Green Limited had decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the summarized Balance Sheet of the Company on 31.3.20X1 before reconstruction:

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	65,00,000
	B	Reserves and Surplus	2	(20,00,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	15,00,000
3		**Current liabilities**		
	A	Trade Payables		5,00,000
		Total		65,00,000
		Assets		
1		Non-current assets		
	A	Property, plant and equipment	4	45,00,000
	B	Intangible assets	5	20,00,000
2		Current assets		Nil
		Total		65,00,000

Notes to Accounts

		₹
1	**Share Capital**	
	Equity share capital	
	Authorized share capital	
	1,50,000 Equity shares of ₹ 50 each	75,00,000
	Issued, subscribed and paid up capital	
	50,000 Equity Shares of ₹ 50 each	25,00,000
	1,00,000 Equity shares of ₹ 50 each, ₹ 40 paid up	40,00,000
2	**Reserves and Surplus**	65,00,000
	Debit balance of Profit and loss Account	(20,00,000)
3	**Long-term borrowings**	(20,00,000)
	Secured: 12% First debentures	5,00,000
	12% Second debentures	10,00,000
4	**Property, Plant and Equipment**	15,00,000
	Building	10,00,000

	Plant	10,00,000
	Computers	25,00,000
5	**Intangible assets**	45,00,000
	Goodwill	20,00,000
		20,00,000

The following is the interest of Mr. X and Mr. Y in Green Limited:

	Mr. X	Mr. Y
12% First Debentures	3,00,000	2,00,000
12% Second Debentures	7,00,000	3,00,000
Trade payables	2,00,000	1,00,000
	12,00,000	6,00,000
Fully paid up ₹ 50 shares	3,00,000	2,00,000
Parly paid up shares (₹ 40 paid up)	5,00,000	5,00,000

The following Scheme of Reconstruction is approved by all parties interested and also by the Court:

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

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

c) Mr. Y is to cancel ₹ 3,00,000 of his total debt (other than equity shares) and to accept new 14% First Debentures for the balance.

d) The amount thus rendered available by the scheme shall be utilised in writing off of Goodwill, Profit and Loss A/c Loss and the balance to write off the value of computers.

You are required to draw the Journal Entries to record the same and also show the Balance Sheet of the reconstructed company.

3. RTP MAY 20

The following is the Balance Sheet of Star Ltd. as on 31st March, 2019:

				₹
A.	**Equity & Liabilities**			
	1.	**Shareholders' Fund:**		
		(a)	**Share Capital:**	
			9,000 7% Preference Shares of ₹ 100 each fully paid	9,00,000
			10,000 Equity Shares of ₹ 100 each fully paid	10,00,000
		(b)	**Reserve & Surplus:**	
			Profit & Loss Account	(2,00,000)
	2.	**Non-current liabilities:**		
			"A" 6% Debentures (Secured on Bombay Works)	3,00,000
			"B" 6% Debentures (Secured on Chennai Works)	3,50,000
	3.	**Current Liabilities and Provisions:**		
		(a)	Workmen's Compensation Fund:	
			Bombay Works	10,000
			Chennai Works	5,000
		(b)	Trade Payables	1,25,000
			Total	24,90,000
B.	**Assets:**			
	Non- current Assets:			
	1.	**PPE:**		
			Bombay Works	9,50,000
			Chennai Works	7,75,000
	2.	**Investment:**		
			Investments for Workman's Compensation Fund	15,000
	3.	**Current Assets:**		
		(a)	Inventories	4,50,000
		(b)	Trade Receivables	2,50,000
		(c)	Cash at Bank	50,000
				24,90,000

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

(i) Paid up value of 7% Preference Share to be reduced to ₹ 80, but the rate of dividend being raised to 9%.

(ii) Paid up value of Equity Shares to be reduced to ₹ 10.

(iii) The directors to refund ₹ 50,000 of the fees previously received by them.

(iv) Debenture holders forego their interest of ₹ 26,000 which is included among the trade payables.

(v) The preference shareholders agreed to waive their claims for preference share dividend, which is in arrears for the last three years.

(vi) "B" 6% Debenture holders agreed to take over the Chennai Works at ₹ 4,25,000 and to accept an allotment of 1,500 equity shares of ₹ 10 each at par, and upon their forming a company called Zia Ltd. (to take over the Chennai Works) they allotted 9,000 equity shares of ₹ 10 each fully paid at par to Star Ltd.

(vii) The Chennai Worksmen's compensation fund disclosed that there were actual liabilities of ₹ 1,000 only. As a consequence, the investments of the fund were realized to the extent of the balance. Entire investments were sold at a profit of 10% on book value and the proceeds were utilized for part payment of the creditors.

(viii) Inventory was to be written off by ₹ 1,90,000 and a provision for doubtful debts is to be made to the extent of ₹ 20,000.

(ix) Chennai works completely written off.

(x) Any balance of the Capital Reduction Account is to be applied as two-third to write off the value of Bombay Works and one-third to Capital Reserve.

Pass necessary Journal Entries in the books of Star Ltd. after the scheme has been carried into effect.

4. QP JULY 21

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

(i) The shareholders to receive in lieu of their present holding at 7,50,000 shares of ₹ 10 each, the following:

- New fully paid ₹ 10 Equity Shares equal to 3/5th of their holding.
- Fully paid ₹ 10, 6% Preference Shares to the extent of 2/5th of the above new equity shares.
- 7% Debentures of ₹ 250,000.

(ii) Goodwill which stood at ₹ 2,70,000 is to be completely written off.

(iii) Plant & Machinery to be reduced by ₹ 1,00,000, Furniture to be reduced by ₹ 88,000 and Building to be appreciated by ₹ 1,50,000.

(iv) Investment of ₹ 6,00,000 to be brought down to its existing market price of ₹ 1,80,000.

(v) Write off Profit & Loss Account debit balance of ₹ 2,25,000.

In case of any shortfall, the balance of General Reserve of ₹ 42,000 can be utilized to write off the losses under reconstruction scheme.

You are required to show the necessary Journal Entries in the books of Sapra Limited of the above reconstruction scheme considering that balance in General Reserve is utilized to write off the losses.

5. MTP March 2022 Test Series I

Preeti Limited gives the following information as on 31st March 2021, was as follows:

	(₹)
Authorized and subscribed capital:	
20,000 Equity shares of ₹ 100 each fully paid	20,00,000
Unsecured loans:	
15% Debentures	6,00,000

Interest payable thereon	90,000
Current Liabilities:	
Trade payables	1,04,000
Provision for income tax	72,000
Property, plant and equipment:	
Machineries	7,00,000
Current Assets:	
Inventory	5,06,000
Trade receivables	4,60,000
Bank	40,000
Profit & loss A/c (Dr.)	11,60,000

It was decided to reconstruct the company for which necessary resolution was passed and sanctions were obtained from the appropriate authorities. Accordingly, it was decided that:

i) Each share be sub-divided into 10 fully paid up equity shares of ₹ 10 each.

ii) After sub-division, each shareholder shall surrender to the company 50% of his holding for the purpose of reissue to debenture holders and trade payables as necessary.

iii) Out of shares surrendered 20,000 shares of ₹ 10 each shall be converted into 10% Preference shares of ₹ 10 each fully paid up.

iv) The claims of the debenture holders shall be reduced by 50%. In consideration of the reduction, the debenture holder shall receive Preference Shares of ₹ 2,00,000 which are converted out of shares surrendered.

v) Trade payables claim shall be reduced by 25%. Remaining trade payables are to be settled by the issue of equity shares of ₹ 10 each out of shares surrendered.

vi) Balance of Profit and Loss account to be written off.

vii) The shares surrendered and not re-issued shall be cancelled.

Pass Journal Entries giving effect to the above.

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. Question

The Balance Sheet of Vaibhav Ltd. as on 31st March 20X1 is as follows:

Liabilities	₹	Assets	₹
Equity Shares of ₹ 100 each	2,00,00,000	Fixed Assets	2,50,00,000
6%, Cumulative Preference Shares of ₹ 100 each	1,00,00,000	Investments (Market Value ₹ 19,00,000)	20,00,000
5% Debentures of ₹ 100 each	80,00,000	Current Assets	2,00,00,000
Sundry Creditors	1,00,00,000	P & L A/c	12,00,000
Provision for taxation	2,00,000		
TOTAL	4,82,00,000	TOTAL	4,82,00,000

The following scheme of Internal Reconstruction is sanctioned:

1. All the existing equity shares are reduced to ₹ 40 each.
2. All preference shares are reduced to ₹ 60 each.
3. The rate of Interest on Debentures increased to 6%. The Debenture holders surrender their existing debentures of ₹ 100 each and exchange the same for fresh debentures of ₹ 70 each for every debenture held by them.
4. Fixed assets are to be written down by 20%
5. Current assets are to be revalued at ₹ 90,00,000.
6. Investments are to be brought to their market value.
7. One of the creditors of the company to whom the company owes ₹ 40,00,000 decides to forgo 40% of his claim. The creditor is allotted with 60000 equity shares of ₹ 40 each in full and final settlement of his claim.
8. The taxation liability is to be settled at ₹ 3,00,000.
9. It is decided to write off the debit balance of Profit & Loss A/c.

Pass journal entries and show the Balance Sheet of the company after giving effect to the above.

2. Question

The Summarised Balance Sheet of Revise Limited as at 31st March, 2012 was as follows :

Liabilities	₹	Assets	₹
Authorised & subscribed capital:		Fixed Assets:	
10,000 Equity shares of ₹ 100 each fully paid	10,00,000	Machineries	1,00,000
Unsecured Loans:		Current assets:	
12% Debentures	2,00,000	Inventory	3,20,000
Accrued interest	24,000	Trade receivables	2,70,000
Current liabilities		Bank	30,000
Trade payables	72,000	Profit and loss account	6,00,000
Provision for income tax	24,000		
	13,20,000		13,20,000

It was decided to reconstruct the company for which necessary resolution was passed and sanctions were obtained from appropriate authorities. Accordingly, it was decided that:

a) Each share is sub-divided into ten fully paid up equity shares of ₹ 10 each.

b) After sub-division, each shareholder shall surrender to the company 50% of his holding, for the purpose of re-issue to debenture holders and trade payables as necessary.

c) Out of shares surrendered, 10,000 shares of ₹ 10 each shall be converted into 12% preference shares of ₹ 10 each, fully paid up.

d) The claims of the debenture-holders shall be reduced by 75 per cent. In consideration of the reduction, the debenture holders shall receive preference shares of ₹ 1,00,000 which are converted out of shares surrendered.

e) Trade payables claim shall be reduced to 50 per cent, it is to be settled by the issue of equity shares of ₹ 10 each out of shares surrendered.

f) Balance of profit and loss account to be written off.

g) The shares surrendered and not re-issued shall be cancelled.

You are required to show the journal entries giving effect to the above and the resultant Balance Sheet.

MCQs

1. When the object of reconstruction is usually to re-organise capital or to compound with creditors or to effect economies then such type of reconstruction is called
   a) Internal reconstruction with liquidation
   b) Internal reconstruction without liquidation of the company
   c) External reconstruction
   d) None of the above.

2. The accumulated losses under scheme of internal reconstruction are written off against
   a) Capital Reduction account
   b) Share Capital account
   c) Shareholders' account
   d) Reserve and surplus.

3. A process of reconstruction, which is carried out without liquidating the company and forming a new one is called
   a) Internal reconstruction.
   b) External reconstruction.
   c) Amalgamation in the nature of merger.
   d) Amalgamation in the nature of purchase.

4. Reconstruction is a process by which affairs of a company are reorganized by
   a) Revaluation of assets and Reassessment of liabilities.
   b) Writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares.
   c) Both (a) and (b).
   d) None of the above.

5. For reduction of the share capital, the permission has to be sought from
   a) Court.
   b) Controller.
   c) State government.
   d) Shareholders.

6. In case of internal reconstruction
   a) Only one company is liquidated.
   b) Two or more companies are liquidated.
   c) No company is liquidated.

d) Two companies amalgamated.

Answers											
1.	(b)	2.	(a)	3.	(a)	4.	(c)	5.	(a)	6.	(c)

10 Accounting for Branch including Foreign Branches

BRANCH ACCOUNTS

DEPENDENT BRANCH

- Branch doesnot maintain separate books of Accounts
- HO records on behalf of branch in HO's books

INDEPENDENT BRANCH

- branch maintains its books on its own

methods of maintaining accounts of Dependent Branches.

- Debtors method.
- Stock and Debtors method
- Final Accounts method
- Whole sale branches method

methods of maintaining accounts of Independent Branches.

- Domestic
- Foreign

BASIS	BRANCH ACCOUNTS	DEPARTMENTAL ACCOUNTS
1. Maintenance of accounts	Branch accounts may be maintained either at branch or at head office.	Departmental accounts are maintained at one place only.
2. Apportionment of common expenses	As expenses in respect of each branch can be identified, so the apportionment problem never arises.	Common expenses are distributed among the departments concerned on some equitable basis considered suitable in the case.
3. Reconciliation	Reconciliation of head office and branch accounts is necessary in case of Branches maintaining independent accounting records at the end of the accounting year.	Such problem never arises.
4. Conversion of foreign currency figures	At the time of finalization of accounts, conversion of figures of foreign branch is necessary.	Such problem never arises.

DEBTORS METHOD

BRANCH ACCOUNT

Particulars	₹	Particulars	₹
To Balance b/d		By Balance b/d :-	
Opening stock	xxx	Opening Creditors	xxx
Opening Debtors	xxx	Opening outstanding Exp.	xxx
Opening Petty Cash	xxx		
Opening fixed Assets	xxx	By Bank [remittances to HO]	
Opening Prepaid Expenses	xxx	By Branch	xxx
		By Branch Debtors directly to H.O.	xxx
To Goods sent to branch A/cs :-			
Goods sent by H.O.	xxx	By Goods Sent to branch A/c	
Goods sent by other branches	xxx	Returned by Branch	xxx
		Returned by Branch debtors directly to H.O sent to other branches.	xxx
To bank [Remittances by H.O.]	xxx		
To balance c/d :-		By Balance c/d :-	
Closing Creditors	xxx	Closing stock-in-hand	xxx
Closing outstanding Exp.	xxx	Closing stock-in-transit	xxx
Closing outstanding manager's commission	xxx	Closing cash-in-transit	xxx
		Closing Debtors	xxx
		Closing Petty cash.	xxx
*To Net Profit t/f to General P&L A/c	xxx	Closing Fixed assets	xxx
		Closing Prepaid expenses.	xxx
		*By Net loss t/f to General P&L A/c.	xxx
	xxx		xxx

Memorandum Branch Debtors Accounts.

Particulars	₹	Particulars	₹
To balance b/d		By Branch Stock A/c [Returns to Branch]	
To Branch Stock A/c [credit sales]		By Goods sent to branch [Direct Returns to H.O.]	
		By Branch cash/Branch A/c [Remittance to Branch]	
		By Cash /Bank A/c [Direct Remittance to HO]	
		By Bad Debts A/c	
		By Discount Allowed A/c	
		By Balance c/d.	

Memorandum Branch Stock A/c

Particulars	₹	Particulars	₹
To Balance b/d		By Branch Cash A/c [Cash Sales]	
To Goods sent to branch A/c		By Branch Debtors A/c [Credit Sales]	
To Branch Debtors A/c [Returns to Branch]		By Goods sent to branch [Returns]	
To Goods sent to branch [From other branch]		By Goods sent to branch A/c [to other branch]	
To branch Debtors A/c [Direct Returns to H.O.]	Selling Price	By Goods sent to Branch A/c [Direct Returns to HO by Debtors]	Invoice Price
		By Abnormal loss	
		By Normal loss	
		By Balance c/d :-	
		In transit	
		In hand.	

Memorandum Branch Cash Account

Particulars	₹	Particulars	₹
To Cash Sales		By Cash Purchases	
To Remittances from H.O		By Payment to Creditors [Cr Purchases]	
To Debtors		By Petty Cash A/c	
To Insurance claim		By Rent	
		By Salaries	
		By Insurances	
		By Cash remitted to H.O (b/f)	

Memorandum branch Petty Cash A/c

Particulars	₹	Particulars	₹
To Balance b/d		By Petty Expense	
To Cash A/c (b/f)		By Balance c/d.	

STOCK & DEBTORS METHOD

Branch Stock Account

Particulars	₹	Particulars	₹
To Balance b/d	xxx	By Branch Cash A/c [Cash Sales]	xxx
To Goods sent to branch	xxx	By Branch Debtors A/c [Credit Sales]	xxx
To Branch Debtors A/c [Return by customers to branch]	xxx	By Goods sent to branch A/c [T/f of goods to other Branch]	xxx
To Goods sent to Branch A/c [T/f of goods from other branch]	xxx	By Branch Adjustment [Load on Abnormal loss due to fire etc]	xxx
To Branch Adjustment A/c [Excess of Selling Price over Invoice Price] (i.e surplus)	xxx	By Branch Profit & Loss [Cost of Abnormal loss due to fire etc]	xxx
		By Branch Adjustment [Normal loss].	xxx
		By Balance c/d :-	
		In hand	xxx
		In transit	xxx

Branch Adjustment A/c

Particulars	₹	Particulars	₹
To Direct Expenses like wages etc	xxx	By Stock Reserve A/c [Load on opening stock]	xxx
To Branch Stock A/c [Load on Abnormal loss due to fire, etc]	xxx	By Goods Sent to branch A/c [Load on Net Goods sent]	xxx
To branch Stock A/c [Normal Loss]	xxx	By Branch Stock A/c [Excess of selling Price over Invoice Price] (Surplus)	xxx
To Stock Reserve A/c [Load on closing stock]	xxx		
To Gross Profit t/f to branch P&L A/c	xxx		
	xxx		xxx

Branch Expenses A/c

Particulars	₹	Particular	₹
To Salaries	xxx	By Branch Profit and loss A/c	xxx
To Rent	xxx		
To Petty Expenses	xxx		
To Bad Debts	xxx		
To Discount	xxx		
To Depreciation	xxx		

Branch Profit and Loss A/c

Particulars	₹	Particulars	₹
To Branch Stock A/c [cost of Abnormal loss]		By Branch Adjustment A/c (Gross Profit b/d)	
To Branch Expenses		By Branch Cash A/c [Insurance claim received] / Insurance co [claim admitted but not rece.]	
To Manager's Commission			
* To Net Profit t/f General P&L A/c		* By Net loss t/f to General P&L A/c	

Branch Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d		By Branch Cash	
To branch Stock A/c [credit Sales]		By Bills Receivable A/c	
To Bills Receivable A/c [B/R dishonoured]		By cash	
		By Branch Stock	
		By Goods sent to branch	
		By discount	
		By bad debts	
		By Balance c/d.	

Goods sent to Branch A/c

Particulars	₹	Particulars	₹
To Branch Stock A/c (Returns)		By Branch Stock A/c [goods sent]	
To Branch Adjustment A/c [Load on net goods sent]			
To Purchases / Trading A/c			

FINAL ACCOUNT METHOD

Branch Trading and Profit and loss Account for the year ended on ....

PARTICULARS	₹	PARTICULARS	₹
To opening Stock (at cost)	xxx	By Sales	
To Goods sent xxx		Cash xxx	
Less Returns to HO (xxx)	xxx	Credit xxx	
To Direct Purchases	xxx	Less Returns from Branch debtors (xxx)	xxx
To Direct Expenses	xxx	By Abnormal loss due to fire etc.	
To Gross profit c/d	xxx	By closing stock:	
		Direct Purchases xxx	
		Supplied by H.O xxx	
		In transit xxx	xxx
	xxx		xxx
To branch expenses	xxx	By Gross Profit b/d	xxx
To Abnormal loss due to fire etc.	xxx	By Bank A/c / Insurance Co. [Insurance claim]	xxx
To Net profit t/f to general P&L A/c	xxx		
	xxx		xxx

Wholesale branch Method

(a) BRANCH STOCK ACCOUNT [AT WHOLESALE PRICE]/ BRANCH TRADING ACCOUNT

Dr. Cr.

Particulars	₹	Particulars	₹
To Balance b/d [at wholesale Price]	xxx	By Sales [at Retail Price / List Price / catalogue Price]	
To Goods sent to branch [at wholesale price]	xxx	Cash xxx	
Sent xxx		Credit xxx	
Less - Returns to H.O xxx	xxx	Less Return xxx	xxx
To Gross Profit t/f to P&L A/c	xxx	By Abnormal loss [at wholesale Price]	xxx
		By Balance c/d [at wholesale Price]	xxx
	xxx		xxx

(b) BRANCH PROFIT AND LOSS ACCOUNT

Dr. Cr.

Particulars	₹	Particulars	₹
To Branch Expenses	xxx	By Gross Profit b/d	xxx
To Abnormal Loss [at wholesale Price]	xxx	By claim from Insurance Co. [if any]	xxx
To Net Profit t/f to H.O P&L a/c	xxx		
	xxx		xxx

(c) BRANCH STOCK RESERVE ACCOUNT

Dr. Cr.

Particulars	₹	Particulars	₹
To H.O P&L A/c [T/f of opening stock reserve]	xxx	By Balance b/d [wholesale Profit included in opening stock]	xxx
To Balance c/d [wholesale profit included in closing stock]	xxx	By H.O. P&L A/c [wholesale Profit included in closing stock	xxx
	xxx		xxx

(d) AN EXTRACT OF H.O. PROFIT AND LOSS ACCOUNT

Dr. Cr.

Particulars	₹	Particulars	₹
To Stock Reserve A/c [Provision made for unrealised wholesale Profit included in closing stock]	xxx	By Branch Profit and Loss A/c [Net Profit]	xxx
		By Stock Reserve A/c [transfer of provision for unrealised profit included in opening stock, now no longer required]	xxx
	xxx		xxx

Independent branch

Head office

- Source document
- journal [subsidiary book]
- ledger
- Trial Balance
- financial Statement

Trading P& L

Branch

- Source document
- journal [subsidiary book]
- ledger
- Trial Balance
- financial Statement

Trading P& L

journal entries

No.	Transaction	H.O. Books	Branch Books
1.	When Goods are sent by H.O. to Branch	Branch A/c Dr. To G.S .T. Branch A/c	Goods Recd. from H.O. A/c Dr. To H.O. A/c
2.	When goods are returned by the Branch to H.O.	G. S. T. Branch A/c Dr. To Branch A/c	H.O. A/c Dr. To Goods recd. From H.O. A/c
3.	Branch expenses paid by the H.O.	Branch A/c Dr. To Cash / Bank A/c	Expenses A/c Dr. To H.O. A/c
4.	Proportion of H.O. Exp. Charged to Branch	Branch A/c Dr. To Expenses A/c	Expenses A/c Dr. To H.O. A/c
5.	Payment made to the Branch by H.O.	Branch A/c Dr. To Cash/ Bank A/c	Cash/ bank A/c Dr. To H.O. A/c
6.	Branch Drs. Collected by the H.O.	Cash/Bank A/c Dr. To Branch A/c	H.O. A/c Dr. To Drs. A/c
7.	Dividend collected by the Branch on behalf of the H.O.	Branch A/c Dr. To Dividend A/c	Cash/ Bank A/c Dr. To H.O. A/c
8.	Cash remitted by Branch to H.O.	Cash/ Bank A/c Dr. To Branch A/c	H.O. A/c Dr. To Cash/Bank A/c
9.	Branch Assets Purchased by the Branch	No entry	Assets A/c Dr. To Cash/Bank A/c
10.	Depreciation in respect of the above assets	No entry	Depreciation A/c Dr. To Assets A/c
11.	Fixed Assets Purchased by the Branch But recorded are maintained by the H.O. (i.e. F. A. A/c will appear in the books of the H. O.)	Branch Assets A/c Dr. To Branch A/c	H.O. A/c Dr. To Cash/ Bank A/c
12.	Depreciation in respect of the above assets	Branch A/c Dr. To Branch Assets A/c	Depreciation A/c Dr. To H.O. A/c

इस्पेशल Adjustments

GOODS-IN-TRANSIT

When the head office sends goods to the branch, it immediately debits the Branch accounting in its books and credits the Goods Sent to Branch A/c. But the branch will pass entry (in respect of this transaction) only when it receives the goods and vice versa. These goods which are on the way to branch/head office are called 'Goods-in-transit.

Some accounting adjustment is required, if there are still some goods in transit at the end of the year. For goods-in-transit' the balance in the Head Office A/c in the books of the branch will not tally with that of Branch A/c in the books of the head office.

No.	Particulars	LF	Rs	Rs
(a)	**When the adjustment entry is passed in the books of the head office:**			
	Goods-in-Transit A/c Dr.			
	To Branch A/c			
(b)	**When the adjustment entry is passed in the books of the branch :**			
	Goods-in-Transit A/c Dr.			
	To Head Office A/c			

For reconciling these balances, adjustment entry may be passed either in the books of the head office or in the books of the branch, but not in both sets of books. On principle, the adjustment entry should be passed in the books of the head office because all in-transit items are detected by the head office after receiving copy of Trial Balance (or copy of Final Accounts) and at this stage, it is not desirable to change the balances in the branch books. Goods-in-Transit are shown in the Balance Sheet of head office.

CASH-IN-TRANSIT

Branch may send cash to head office at regular intervals. At the end of the Accounting period, if there is any cash-in-transit it should be adjusted just like goods-in-transit. Here also, adjustment entry may be passed either in the head office books or the branch books. For the reasons explained above, the entry should be passed in the head office books only.

The entry will be:

No.	Particulars	LF	Rs	Rs
(a)	Cash-in-Transit A/c Dr.			
	To Branch A/c			

DEPRECIATION ON BRANCH FIXED ASSETS

Branch Assets A/c may be maintained at branch or at head office. Accouting entry for depreciation will differ according to situations.

If the accounts of branch fixed assets are maintained at branch

No.	Particulars	LF	(Dr.) Rs	(Cr.) Rs
	Depreciation A/c Dr.			
	To Fixed Assets A/c			
	[No entry is to be passed in the head office books]			

If the accounts of branch fixed assets are maintained at Head Office

In this case, all entries regarding purchase or sale of such assets are made in the head office books only. No entry is passed in the books of the branch in this respect. For example, when a branch fixed asset is purchased, the head office debits Branch Fixed Assets A/c and credits Bank A/c/Branch A/c (if paid by branch).

As the assets are used by the branch, the depreciation for such assets is also to be charged to the branch. For depreciation the following entry is passed:

No.	Particulars	LF	(Dr.) Rs	(Cr.) Rs
(a)	In the books of the Head Office			
	Branch A/c Dr.			
	To Branch Fixed Assets A/c			
	(Being the depreciation on branch fixed assets)			
(b)	In the books of branch			
	Depreciation A/c Dr.			
	To Head office A/c			
	(Being the depreciation on fixed assets)			

INTER-BRANCH TRANSACTIONS

It is quite possible that one branch may send goods (or cash) to another branch directly, with of course, the consent of the head office.

The following entries are passed:

Head Office	Sending Branch	Receiving Branch
Receiving Branch A/c Dr.	Head Office A/c Dr.	Goods from H.O. A/c Dr.
To Sending Branch A/c	To Goods Sent to H.O. A/c	To Head Office A/c
(Being goods transferred to ....branch	(Being goods sent to .... branch as per head office instruction)	(Being goods received from branch as per head office instruction)

Foreign branch

Meaning of foreign branch

A branch outside the home country in which head office is situated is known as a foreign branch. It may be noted that the accounting principles which apply to a home branch (i.e., Inland Branch), also apply to a foreign after converting the trial balance of the foreign branch in the home currency.

FOREIGN BRANCH

Integral Foreign Operations [IFO]

A foreign operation, the activities of which are an integral part of those of the reporting enterprise is known as Integral Foreign Operations (IFO). [e.g. Foreign Branch]

↓

Recognised as Income or Expenses in the Statement of Profit & Loss for the period in which they arise.

Non-Integral Foreign Operations [NIFO]

A foreign operation, that is not an integral part of the reporting enterprise. Is known as non Integral Foreign Operations (NIFO). [e.g. Foreign Branch / Subsidiary]

↓

Accumulated in Foreign Currency Translation Reserve in the Balance Sheet until the disposal of Net Investment.

The distinctive feature of foreign branches is that information received from the foreign branch will be in foreign currency and must be converted into the currency of the H.O. before it can be used for accounting purpose. The following are the different rates used for conversion of Branch Trial Balance-

- Opening Rate – Rate of exchange prevailing at the beginning
- Closing Rate – Rate of exchange prevailing at the end
- Average Rate – Average rate of exchange prevailing during the period/year
- Special Rate – Rate of exchange prevailing on the desired date

Particulars	Integral	Non Integral
Income & Expenses	Average Rate	Average Rate
Assets and Liabilities		
1) Monetary	Closing rate	Closing rate
2) Non Monetary		Closing rate
• Historical Cost	Historical rate	Closing rate
• Revaluation Model	Rate on date of Revaluation	Closing rate
3) Inventory	Closing rate (But if rate on date of purchase is available, then that rate)	Closing rate

Note for student...

CHAPTER 10 – BRANCH ACCOUNTING

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	Question						
2	ICAI Illustration 2						
3	ICAI Practical Q.8						
4	RTP NOV 21						
5	QP JULY 21						
6	RTP May 22						
7	Illustration 15						
8	ICAI P.Q. 3						
9	ICAI P.Q. 4						
10	ICAI P.Q. 7						
11	QP Nov 20						
12	QP May 22						
TEST IN TIME PASS IN TIME							
1	ICAI Practical Q.5						
2	ICAI Practical Q.9, RTP Nov 18 similar						

1. Question

Multichained Stores Ltd., Delhi has its branches at Lucknow and Chennai. It charges goods to its branches at cost plus 25%. Following information is available of the transactions of the Lucknow branch for the year ended on 31st March, 2008.

Balances on 1.4.2007: Stock Rs 30,000; Debtors Rs 10,000 and Petty Cash Rs 50.

Transactions during 2007-08 (Lucknow branch) (all figures in rupees):

Goods sent to Lucknow branch at Invoice price	3,25,000	Cash sent for Petty expenses	34,000
Goods returned to Head Office at Invoice price	10,000	Bad debts at Branch	500
Cash sales	1,00,000	Goods transferred to Chennai branch under H.O. advice	15,000
Credit sales	1,75,000	Insurance charges paid by H.O.	500
Goods pilferred (Invoice price)	2,000	Goods returned by Debtors	500
Goods lost in fire (Invoice price)	5,000	Insurance Co. paid to H.O. for loss by fire at Lucknow	3,000

Balances on 31.3.2008: Petty Cash Rs 230; Debtors Rs 14,000.

Goods worth Rs 15,000 (included above) sent by Lucknow branch to Chennai branch was in transit on 31.3.2008.

Show the following accounts in the books of Multichained Stores Ltd.

(a) Lucknow Branch Stock Account; (b) Lucknow Branch Debtors Account; (c) Lucknow Branch Adjustment Account; (d) Lucknow Branch Profit and Loss Account; (e) Stock Reserve Account; and, (f) Goods Sent to Lucknow Branch Account.

2. ICAI Illustration 2

The Bombay Traders invoiced goods to its Delhi branch at cost. Head Office paid all the branch expenses from its bank account, except petty cash expenses which were met by the Branch. All the cash collected by the branch was banked on the same day to the credit of the Head Office. The following is a summary of the transactions entered into at the branch during the year ended December 31, 20X1.

Particulars	₹	Particulars	₹
Balances as on 1.1.20X1:			
Stock	7,000	Bad Debts	600
Debtors	12,600	Goods returned by customers	500
Petty Cash,	200	Salaries & Wages	6,200
Goods sent from H.O.	26,000	Rent & Rates	1,200
Goods returned to H.O.	1,000	Sundry Expenses	800
Cash Sales	17,500	Cash received from Sundry	
Credit Sales	28,400	Debtors	28,500
Allowances to customers	200	Balances as on 31.12.20X1:	
Discount to customers	1,400	Stock	6,500
		Debtors	9,800
		Petty Cash	100

Prepare: (a) Branch Account (Debtors Method), (b) Branch Stock Account, Branch Profit & Loss Account, Branch Debtors and Branch Expenses Account by adopting the Stock and Debtors Method and (c) Branch Trading and Profit & Loss Account to prove the results as disclosed by the Branch Account.

3. ICAI Practical Q.8

Beta, having head office at mumbai has a branch at nagpur. The head office does wholesale trade only at cost plus 80%. The goods are sent to branch at the wholesale price viz., cost plus 80%. The branch at nagpur is wholly engaged in retail trade and the goods are sold at cost to h.o. plus 100%.

Following details are furnished for the year ended 31st march, 20x1:

Particulars	**Head Office (₹)**	**Branch (₹)**
Opening stock	2,25,000	
Purchases	25,50,000	
Goods sent to branch (Cost to H.O. plus 80%)	9,54,000	
Sales	27,81,000	9,50,000

Office expenses	90,000	8,500
Selling expenses	72,000	6,300
Staff salary	65,000	12,000

You are required to prepare Trading and Profit and Loss Account of the head office and branch for the year ended 31st March, 20X1.

4. RTP NOV 21

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.

5. QP JULY 21

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

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

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

	₹		₹
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 ofadvance of 5,000)	15,600	Discount earned	4,600
General Expenses	7,800	Cash paid to creditors	88,500
Fire Insurance (Paid for oneyear)	11,200	Building Account (furtherpayment)	14,000
Remittance to H.O.	52,900	Cash in Hand	5,600
		Cash at Bank	47,000

Set out the Head Office Account in Noida Books and the Branch Balance Sheet as on 30.09.2020. Also give journal entries in the Noida books.

6. RTP May 22

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 Brach 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.

7. Illustration 15

S & M Ltd., Bombay, have a branch in Sydney, Australia. Sydney branch is an integral foreign operation of S & M Ltd.

At the end of 31st March, 20X2, the following ledger balances have been extracted from the books of the Bombay Office and the Sydney Office:

Particulars	Bombay (₹ thousands)		Sydney (Austr dollars thousands)	
	Debit	Credit	Debit	Credit
Share Capital	–	2,000	–	–

Reserves & Surplus	–	1,000	–	–
Land	500	–	–	–
Buildings (Cost)	1,000	–	–	–
Buildings Dep. Reserve	–	200	–	–
Plant & Machinery (Cost)	2,500	–	200	–
Plant & Machinery Dep. Reserve	–	600	–	130
Debtors / Creditors	280	200	60	30
Stock (1.4.20X1)	100	–	20	–
Branch Stock Reserve	–	4	–	–
Cash & Bank Balances	10	–	10	–
Purchases / Sales	240	520	20	123
Goods sent to Branch	–	100	5	–
Managing Director's salary	30	–	–	–
Wages & Salaries	75	–	45	–
Rent	–	–	12	–
Office Expenses	25	–	18	–
Commission Receipts	–	256	–	100
Branch / H.O. Current A/c	120	–	–	7
	4,880	4,880	390	390

The following information is also available:

(1) Stock as at 31.3.20X2:

Bombay ₹ 1,50,000 Sydney A $ 3,125

You are required to convert the Sydney Branch Trial Balance into rupees; (use the following rates of exchange :

Opening rate	A $ = ₹ 20
Closing rate	A $ = ₹ 24
Average rate	A $ = ₹ 22
For Fixed Assets	A $ = ₹ 18

8. ICAI Practical Q.3

Show adjustment journal entry in the books of head office at the end of April, 20X1 for incorporation of inter-branch transactions assuming that only head office maintains different branch accounts in its books.

A. Delhi branch:

(1) Received goods from Mumbai – ₹ 35,000 and ₹ 15,000 from Kolkata.

(2) Sent goods to Chennai – ₹ 25,000, Kolkata – ₹ 20,000.

(3) Bill Receivable received – ₹ 20,000 from Chennai.

(4) Acceptances sent to Mumbai – ₹ 25,000, Kolkata – ₹ 10,000.

B. Mumbai Branch (apart from the above) :

(5) Received goods from Kolkata – ₹ 15,000, Delhi – ₹ 20,000.

(6) Cash sent to Delhi – ₹ 15,000, Kolkata – ₹ 7,000.

C. Chennai Branch (apart from the above) :

(7) Received goods from Kolkata – ₹ 30,000.

(8) Acceptances and Cash sent to Kolkata – ₹ 20,000 and ₹10,000 respectively.

D. Kolkata Branch (apart from the above) :

(9) Sent goods to Chennai – ₹ 35,000.

(10) Paid cash to Chennai – ₹15,000.

(11) Acceptances sent to Chennai – ₹15,000.

9. ICAI Practical Q.4

Give Journal Entries in the books of Branch A to rectify or adjust the following:

(i) Head Office expenses ₹ 3,500 allocated to the Branch, but not recorded in the Branch Books.

(ii) Depreciation of branch assets, whose accounts are kept by the Head Office not provided earlier for ₹ 1,500.

(iii) Branch paid ₹ 2,000 as salary to a H.O. Inspector, but the amount paid has been debited by the Branch to Salaries account.

(iv) H.O. collected ₹ 10,000 directly from a customer on behalf of the Branch, but no intimation to this effect has been received by the Branch.

(v) A remittance of ₹ 15,000 sent by the Branch has not yet been received by the Head Office.

(vi) Branch A incurred advertisement expenses of ₹ 3,000 on behalf of Branch B.

10. ICAI Practical Q.7

M/s Marena, Delhi has a branch at Bangalore to which office goods are invoiced at cost plus 25%. The branch sells both for cash and on credit. Branch Expenses are paid direct from head office and the Branch has to remit all cash received into the Head Office Bank Account.

From the following details, relating to calendar year 20X1, prepare the accounts in the Head Office Ledger and ascertain the Branch Profit under Stock and Debtors Method'.

Branch does not maintain any books of account, but sends weekly returns to the Head Office.

Particulars	₹
Goods received from Head Office at invoice price	45,00,000
Returns to Heads Office at invoice price	90,000
Stock at Bangalore as on 1st January, 20X1	4,50,000
Sales during the year - Cash	15,00,000
- Credit	27,00,000
Sundry Debtors at Bangalore as on 1st January, 20X1	5,40,000
Cash received from Debtors	24,00,000
Discount allowed to Debtors	45,000
Bad Debts in the year	30,000
Sales returns at Bangalore Branch	60,000
Rent, Rates and Taxes at Branch	1,35,000
Salaries, Wages and Bonus at Branch	4,50,000
Office Expenses	45,000
Stock at Branch on 31st December, 20X1 at invoice price	9,00,000

11. QP Nov 20

Vijay & Co. of Jaipur has a branch in Patna to which goods are sent @ 20% above cost. The branch makes both cash & credit sales. Branch expenses are paid direct from Head office and the branch has to be 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

Particulars	Amount (₹)
Goods received from head office at invoice price	8,40,000
Goods returned to head office at invoice price	60,000
Cash sales for the year 2019-20	1,85,000
Credit Sales for the year 2019-20	6,25,000
Stock at branch as on 1-4-2019 at invoice price	72,000
S. Debtors at Patna branch as on 1-4-2019	96,000
Cash received from Debtors	4,38,000
Discount allowed to Debtors	7500
Goods returned by customers at Patna Branch	14,000
Bad debts written off	5,500
Amount recovered from Bad debts previously written off as Bad	1,000
Rent Rates & Taxes at Branch	24,000
Salaries & Wages at Branch	72,000
Office Expenses (at Branch)	9,200
Stock at Branch as on 31-3-2020 at cost price	1,25,000

Prepare necessary ledger accounts in the books of Head office by following Stock and Debtors method and ascertain Branch Profit.

12. QP May 22

Walkaway Footwear has its head office at Nagpur and Branch at patna. It invoiced goods to its branch at 20% less than the list price which is cost plus 100% with instruction that cash sale were to be made at invoice price and credit sale at catalogue price (i.e. list price).

The following information was available at the branch for the year ended 31st March, 2022.

(Figures in ₹)

Stock on 1st April, 2021 (invoice price)	12,000
Debtors on 1st April, 2021	10,000
Goods received from head office (invoice price)	1,32,000
Sales : cash 46,000 Credit 1,00,000 ₹	1,46,000
Cash received form debtors	85,000
Expenses at branch	17,500
Debtors on 31st March, 2022	25,000
Stock on 31st March, 2022 (invoice price)	17,600
Remittances to head office	1,20,000

You are required to prepare Branch Stock Account. Branch Adjustment Account, Branch profit and Loss Account and Branch Debtor Account for the year ended 31st March, 2022.

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. ICAI Practical Q.5

Widespread invoices goods to its branch at cost plus 20%. The branch sells goods for cash as well as on credit. The branch meets its expenses out of cash collected from its debtors and cash sales and remits the balance of cash to head office after withholding ₹ 10,000 necessary for meeting immediate requirements of cash. On 31st March, 20X1 the assets at the branch were as follows:

Particulars	₹ ('000)
Cash in Hand	10
Trade Debtors	384
Stock, at Invoice Price	1,080
Furniture and Fittings	500

During the accounting year ended 31st March, 20X2 the invoice price of goods dispatched by the head office to the branch amounted to ₹ 1 crore 32 lakhs. Out of the goods received by it, the branch sent back to head office goods invoiced at ₹ 72,000. Other transactions at the branch during the year were as follows:

Particulars	(₹ '000)
Cash Sales	9,700
Credit Sales	3,140
Cash collected by Branch from Credit Customers	2,842
Cash Discount allowed to Debtors	58
Returns by Customers	102
Bad Debts written off	37
Expenses paid by Branch	842

On 1st January, 20X2 the branch purchased new furniture for ₹ 1 lakh for which payment was made by head office through a cheque.

On 31st March, 20X2 branch expenses amounting to ₹ 6,000 were outstanding and cash in hand was again ₹ 10,000. Furniture is subject to depreciation @ 16% per annum on diminishing balance method.

Prepare Branch Account in the books of head office for the year ended 31st March, 20X2.

2. ICAI Practical Q.9, RTP Nov 18 similar

Pass necessary Journal entries in the books of an independent Branch of a business entity to rectify or adjust the following:

(i) *Income of ₹ 2,800 allocated to the Branch by Head Office but not recorded in the Branch books.*

(ii) *Branch paid ₹3,000 as salary to a Head Office Manager, but the amount paid has been debited by the Branch to Salaries Account.*

(iii) *Branch incurred travelling expenses of ₹5,000 on behalf of other Branches, this was not recorded in the books of Branch.*

(iv) *A remittance of ₹ 1,50,000 sent by the Branch has not received by Head Office on the date of reconciliation of Accounts.*

(v) *Head Office allocates ₹75,000 to the Branch as Head Office expenses, which has not yet been recorded by the Branch.*

(vi) *Head Office collected ₹30,000 directly from a Branch Customer. The intimation of the fact has been received by the Branch only now, not recorded till now.*

(vii) *Goods dispatched by the Head office amounting to ₹10,000, but not received by the Branch till date of reconciliation. The Goods have been received subsequently.*

MCQs

1. If goods are invoiced to branches at cost, trading results of branch can be ascertained by
   a) Debtors method.
   b) Stock and debtors method.
   c) Either (a) or (b).
   d) Both (a) and (b).

2. Under branch trading and profit loss account method
   a) H.O prepares profit and loss account.
   b) Each branch is treated separate entity.
   c) Both (a) and (b).
   d) Either (a) or (b).

3. Goods may be invoiced to branch at
   a) Cost or Selling price.
   b) Wholesale price.
   c) Both (a) and (b).
   d) Either (a) or (b).

4. Under debtors method, opening balance of debtors is
   a) Debited to branch account.
   b) Credited to branch account.
   c) Debited to H.O account.
   d) Credited to H.O account.

5. Cost of goods returned by branch will have the following effect
   a) Goods sent to branch account will be debited.
   b) Branch stock account will be credited.
   c) Both (a) and (b).
   d) Either (a) or (b).

Answers									
1.	(c)	2.	(c)	3.	(c)	4.	(a)	5.	(c)

AS 1 Disclosure of Accounting Policies

ACCOUNTING POLICIES

- Are specific principles, and
- methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.

Need ???

- Better understanding
- Enable users to compare financial statement of one enterprise through time.
- Comparison of financial statement of different enterprises
- Required by law
- View presented in the financial statement can be significantly affected by the accounting policies.

Primary objective

Accounting policies should represent a true and fair view of the state of affairs of the enterprise as at balance sheet date and of the period ended on that date.

Consideration for selection of Accounting Policies

Prudence

Accounting Policy should be such that it considers foreseeable losses or outflows in future.

Substance over form

The accounting treatment and presentation in financial statement of transactions and events should be governed by their substance and not merely by the legal form.

Materiality

Financial statement should disclose all "material" items.

Material items are those items the knowledge of which might influence the decisions of the users of the FS.

Fundmental Accounting Assumption

Going Concern

The enterprise is normally viewed as continuing the operation for the foreseeable future.

Consistency

It is assumed that accounting policies are followed consistently [i.e. always following one pattern] from one period to another.

Accrual

Revenue and costs are accrued, as they are earned or incurred [and not as money is received or paid].

Change in Accounting Policies

A change in accounting policies should be made in following circumstances :-

(i) Compliance with statute [i.e law]
(ii) Compliance with an accounting standard
(iii) change would result in more appropriate presentation

The effect of change in accounting policies on FS of current period should be disclosed to the extent it is ascertainable. If the effect is not ascertainable the fact should be disclosed.

Disclosure

All significant accounting policies adopted

should be disclosed at one place as a part of financial statement

Note for student...

AS 2 Valuation of Inventories

Inventories are assets

a) held for sale in the ordinary course of business [finished goods]
b) In the process of production for such sale [Raw material and work-in-progress] or
c) In the form of materials or supplies to be consumed in the production process or in the rendering of services [stores, spares, raw material, consumables]

Inventory should be valued at lower of

Cost (or) Net Realisable value [NRV]

COST OF INVENTORIES

Purchase Cost + Conversion cost + Other Cost

Following should not be included in cost of inventory :–

a) Interest and other borrowing cost
b) Storage Cost
c) Administrative Overhead.
d) Selling and distribution Cost
e) Abnormal losses / wastages.

NET REALISABLE VALUE [NRV]

Estimated selling price in the ordinary course of business	xxx
less estimated costs of completion	(xxx)
less estimated costs necessary to make the sale	(xxx)
Net Realisable Value.	xxx

COST OF INVENTORY

PURCHASE COST

Includes	Excludes
(+) Purchase Price	(–) Trade discount
(+) non-recoverable Duties and taxes	(–) Rebates
(+) Freight Inwards	(–) Duty draw backs
(+) other expenditure directly attributable to acquisition	(–) recoverable duties and taxes
	(–) others costs

FINISHED GOODS

Cost of Conversion

includes costs directly related to the units of production. They includes, for example

- Direct Labour
- Direct Expenses
- Production Overhead
  - Variable Overhead
  - Fixed Overhead

ALLOCATION OF VARIABLE OVERHEADS

Amount of Allocation = Variable overhead per unit X Actual Production

ALLOCATION OF FIXED OVERHEADS

The allocation of fixed **production overheads for the purpose of their inclusion in the costs of conversion is based on Normal Capacity of the production facilities.**

Normal capacity is the production expected to be achieved on an average over a number of periods or seasons under normal circumstances.

a) **The actual level of production may be used if it approximates normal capacity.**

b) **Allocation per Unit = Fixed production overheads / Normal Capacity**

c) **Fixed overheads to be included in cost of inventory = Actual Production X Allocation per unit**

Actual production may be equal or more or less than Normal Capacity. Let us discuss the treatment in each case.

Case 1: Actual Production and Normal Capacity are same.

The overheads will be included in Cost of inventory at the rate determined on the basis of Normal Capacity.

Case 2: Actual Production is less than Normal Capacity

a) The overheads will be included in Cost of inventory at the rate determined on the basis of Normal Capacity.

b) When Actual Production is less than Normal Capacity an element of fixed overheads will remain unallocated.

c) Such unallocated Fixed overheads should be recognised as an expense in the period in which they are incurred.

Case 3: Actual Production is more than Normal Capacity

a) In the periods of abnormally high production the amount of fixed overheads allocated to each unit is revised so that inventories are not valued above cost. In this case the fixed overheads will be included in Cost of inventory at the rate determined on the basis of actual Capacity.

	Case 1	Case 2	Case 3
Normal Capacity			
Fixed Overheads			
Actual Production			
Allocation of fixed overheads per unit			
Actual sales			
Actual inventory			
Amount included in cost of sales			
Amount included in cost of inventory			
Amount Charged as period cost (Under absorption)			

COST FORMULA

methods of valuation

Specific Identification Method

directly linking the cost with specific items of inventories

First in First out Method [FIFO]

assumes that the items of inventory which were purchased or produced first are, consumed or sold first.

Weighted Weighted Cost Method [WAC]

The average may be calculated on a periodic basis, or after every purchase depending upon the circumstances of the enterprise.

techniques for the measurement of cost

Standard Cost

Standard Price of
- material
- labour
- overhead

are taken and they regularly reviewed based on revised prices.

↓

Can be used when cost records are maintained properly and every product is having different profit margin.

Retail Method

Sale Price is to be adjusted with percentage of gross profit.

↓

Can be used where there are wide variety of products with similar margin

VALUATION OF RAW MATERIAL OR SUPPLIES

If finished product in which raw material or supplies is used, is sold below its cost, raw material or supplies is written down to its NRV [Replacement price of raw material]

Stock of Raw material

Normal Quantity held for Production

- Finished goods for which raw material will be used will be sold at or Above cost → **Cost**
- Finished Goods will be sold at below cost → **lower of Cost & NRV**

Excess Quantity [Due to let us say overbuying] → **lower of Cost & NRV**

ALLOCATION OF COST TO JOINT PRODUCT AND BY PRODUCT

When more than one product is produced in the process

- **Outcome → Joint Products**
  - When the cost of conversion of each product is separately identifiable
    - Cost of each product is calculated on the basis of separate cost incurred.
  - When the cost of conversion of each product is not separately identifiable
    - Allocation of cost is based on relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production.
- **Outcome → Main Product with a By-Product**
  - When the by-products is immaterial
    - By product is measured at NRV and this value is deducted from the cost of the main product.
  - When the by-products is material
    - By product is treated as joint product and accordingly, the accounting is done

Note for student...

AS 2 - VALUATION OF INVENTORIES

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	IPCC QP JAN 21						
2	QUESTION						
3	ICAI – ILLU. 1						
4	INTER RTP MAY 2020 (IPCC RTP MAY 2020)						
5	RTP NOV 15 , QP NOV 12						
6	RTP MAY 2013						
7	MOCK TEST 2						
8	RTP Nov 2015						
9	RTP May 16., RTP May 22						
10	RTP MAY 2017						
11	ICAI - ILLU. 3, MTP APR 22						
12	INTER RTP MAY 2019, ICAI - ILLU. 5						
13	INTER RTP NOV 2019 , IPCC RTP NOV 2019, INTER RTP NOV 2016, INTER RTP NOV 2017						
14	Mock test oct 21 series 1						
TEST IN TIME PASS IN TIME							
1	QP May 22						
2	IPCC QP MAY 2019						

1. IPCC QP JAN 21

A company purchased 20,000 Kg of certain material at ₹ 140 per Kg. Purchase price includes the GST of ₹ 1,00,000, in respect of which full input tax credit is admissible. The company availed full GST input tax credit. Freight inward incurred ₹ 1,20,000. Unloading charges ₹ 32,000. Normal Loss during transit is 8% The enterprise actually received 18,200 Kg and consumed 16,500 Kg. compute cast of inventory as per AS 2 and also allocate material cost

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventories,**

a. Inventories should be valued at the **lower of cost and net realisable value.**
b. The **cost** of inventories should **comprise** all costs of **purchase,** costs of **conversion** and other costs incurred in bringing the inventories to their **present location** and condition.
c. 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 realisable value. In such circumstances, the **replacement cost** of the materials may be the best available measure of their net realisable value.

ANALYSIS:

Computation of cost of Inventory and allocation of material cost as per AS 2 is as follows:

Particulars	**Amount**
Purchase Price (20,000 X ₹ 140)	28,00,000
Less: Input Tax Credit	(1,00,000)
	27,00,000
Add: Freight and Unloading charges	1,52,000
(A) Total Material Cost	28,52,000
(B) Number of units normally received 92% of 20,000 kgs	18,400 Kg
Normal Cost per Kg (A) / (B)	₹ 155

Conclusion: Allocation of Material Cost:

Particulars	Kg	₹ / Kg	₹
Material Consumed	16,500	155	25,57,500
Cost of Inventory	1,700	155	2,63,500
Abnormal Loss	200	155	31,000
Total Material Cost	**18,400**		**28,52,000**

2. QUESTION

Vidya Ltd.'s normal production volume is 50,000 units and the Fixed Overheads are estimated at Rs.5,00,000. Give the treatment of Fixed Production OH under AS-2, if actual production during a period was – (a) 42,000 units, (b) 50,000 units and (c) 60,000 units.

SOLUTION

REFERENCE:

As per AS 2, Fixed production overheads are those indirect costs of production that **remain relatively constant** regardless of the volume of production.

- The allocation of **fixed production overheads** for the purpose of their inclusion in the costs of **conversion** is **based on the normal capacity** of the production facilities.
- The amount of fixed production overheads allocated to each unit of production is **not increased as a consequence of low production or idle plant.** Unallocated overheads are recognised as an expense in the period in which they are incurred.
- In periods of **abnormally** high production, the amount of fixed production overheads allocated to each unit of production **is decreased** so that inventories are **not measured above cost**

ANALYSIS:

Fixed Production OH Recovery Rate (based on Normal Capacity) = Rs.5,00,000 ÷ 50,000 = Rs.10 per unit.

The treatment of Fixed OH in different cases is as under:

	Particulars	Situation (a)	Situation (b)	Situation (c)
1.	Normal Production	50,000 units	50,000 units	50,000 units

2.	Actual Production	42,000 units	50,000 units	60,000 units
3.	Difference in Production (1 – 2)	8,000 units (Short) Actual < Normal	Nil Actual = Normal	10,000 units (Excess) Actual > Normal
4.	Recovery Rate to be used as per AS – 2	Normal Rate = Rs.10 per unit	Normal Rate = Rs.10 per unit	Revised Rate = Rs.5,00,000 ÷ 60,000 = Rs.8.33 per unit
5.	Inventoriable Costs, i.e. Recovered Costs	42,000 units x Rs.10 = Rs.4,20,000	50,000 units x Rs.10 = Rs.5,00,000	60,000 units x Rs.8.33=Rs.5,00,000
6.	Balance treated as Period Costs	Rs.80,000	Nil	Nil

3. ILLUSTRATION 1

Vidya Ltd deals in 3 products A, B and C, which are neither similar nor interchangeable. At the end of a financial year, the Historical Cost and NRV of items of Closing Stock are given below. Determine the value of Closing Stock.

Items	Historical Cost (in Rs. Lakhs)	Net Realisable Value (in Rs. Lakhs)
A	40	28
B	32	32
C	16	24

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventories**, Inventories should be valued at the **lower of cost** and **net realisable value.**

ANALYSIS:

The Value of Closing Stocks is determined as under :

Stock Item	Historical Cost	NRV	Valuation = Least of Cost or NRV
A	Rs.40 lakhs	Rs.28 lakhs	Rs.28 lakhs
B	Rs.32 lakhs	Rs.32 lakhs	Rs.32 lakhs
C	Rs.16 lakhs	Rs.24 lakhs	Rs.16 lakhs
Total			Rs.76 lakhs

4. INTER RTP MAY 2020 (IPCC RTP MAY 2020)

Particulars		Kg.	₹
Opening Inventory:	Finished Goods	1,000	25,000
	Raw Materials	1,100	11,000
Purchases		10,000	1,00,000
Labour			76,500
Overheads (Fixed)			75,000
Sales		10,000	2,80,000
Closing Inventory:	Raw Materials	900	
	Finished Goods	1200	

The expected production for the year was 15,000 kg of the finished product. Due to fall in market demand the sales price for the finished goods was ₹ 20 per kg and the replacement cost for the raw material was ₹ 9.50 per kg on the closing day. You are required to calculate the closing inventory as on that date.

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventories,**

d. Inventories should be valued at the **lower of cost and net realisable value.**

e. The **cost** of inventories should **comprise** all costs of **purchase,** costs of **conversion** and other costs incurred in bringing the inventories to their **present location** and condition.

f. 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 realisable value. In such circumstances, the **replacement cost** of the materials may be the best available measure of their net realisable value.

ANALYSIS:

Raw material consumed	Rs / Kg	Kg
Opening value of Raw Material (11,000 / 1,100)	10	1,100
Add: Purchase value of Raw Material (1,00,000 / 10,000)	10	10,000

Less: Closing value of Raw Material (given)		900
Raw Material Consumed		**10,200**

Calculation of cost for closing inventory

Particulars	₹
Cost of Raw Material (10,200kg x 10)	1,02,000
Direct Labour	76,500
Fixed Overhead (75,000 X 10,200 / 15,000)	51,000
Cost of Production	**2,29,500**
Cost of closing inventory per unit (2,29,500/10,200)	₹ 22.50
Net Realisable Value per unit (Given)	₹ 20.00

As per the above analysis and reference, closing inventory will be valued at ₹ 20.

As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacement cost i.e., ₹ 9.50.

CONCLUSION:

Particulars	**Rs.**
Finished Goods (1,200kg X 20)	24,000
Raw Material (900kg X 9.50)	8,550
Value of Closing Inventory	**32,550**

5. RTP NOV 2015 , SUGGESTED NOV 2012

In a manufacturing process of Vijay Limited, one by-product BP emerges besides two main products MP1 and MP2 apart from scrap. Details of cost of production process is here under:

Item	**Unit**	**Amount (Rs)**	**Output (Unit)**	**Closing stock as on 31.03.2012**
Raw Material	15000	1,60,000	MP1 – 6250	800
Wages	-	82,000	MP2 – 5000	200
Fixed Overhead	-	58,000	BP – 1600	-
Variable Overhead	-	40,000	-	-

Average market price of MP1 and MP2 is Rs.80 per unit and Rs.50 per unit respectively, by product is sold @ 25 per unit. There is a profit of Rs.5,000 on sale of by-product after incurring separate processing charges of Rs.4,000 and packing charges of Rs6,000. Rs.6,000 was realized from sale of scrap. Calculate the value of Closing Stock of MP1 and MP2 as on 31.03.2012.

SOLUTION

REFERENCE:

As per **AS 2**, When the costs of **conversion** of each product are **not separately identifiable** (joint or by products), they are **allocated** between the products **on a rational and consistent basis.**

ANALYSIS:

Joint Cost = Rs.1,60,000 + Rs.82,000 + Rs.58,000 + Rs.40,000 = Rs.3,40,000

NRV of By-product = Sale Price Rs.40,000 (1,600 x 25) – Further Cost 10,000 = Rs.30,000

NRV of By-product and Scrap = Rs.30,000 + Rs.6,000 = Rs.36,000

Net Joint Cost = Rs.3,40,000 – Rs.36,000 = Rs.3,04,000.

Particulars	MP 1	MP 2	Total
Production Quantity	6,250	5,000	11,250
Apportionment Joint Cost based on sale value	2,02,667	1,01,333	3,04,000
(80 x 6,250) : (50 x 5,000) or 2:1			
Average Joint Cost	32.43	20.27	-
Closing Stock Units	800	200	-
Value	**25,944**	**4,054**	**29,998**

Note: it is assumed that Net Realisable Value is more than Cost. The Profit on by-product is irrelevant, since only Net Realisable Value has to be considered.

6. RTP MAY 2013

The closing inventory at cost of a Company amounted to Rs.9,56,700. The following items were included at cost in the total:

(i) 350 Shirts, which had cost Rs.380 each and normally sold for Rs.750 each. Owing to a defect in manufacture, they were all sold after the balance sheet date at 50% of their normal price. Selling expenses amounted to 5% of the proceeds.

(ii) 700 Trousers, which had cost Rs.520 each. These too were found to be defective. Selling expenses for the batch totalled Rs.3,800. They were sold for Rs.950 each. What should be the closing inventory value (to the nearest rupee), after considering the above items?

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventory**, Inventories should be valued at the **lower of cost and net realisable value**. Net realisable value is the **estimated selling price** in the ordinary course of business less the **estimated costs of completion** and the estimated costs necessary to make the sale.

ANALYSIS:

Valuation of closing stock

Particulars	₹
Value of closing inventory (given)	9,56,700
Less: Adjustment to bring the stock of shirts at net realizable value (W.N.1)	(8,313)
Revised value of closing inventory as per AS 2	9,48,387

Working Note:

1. **Valuation of Shirts as per AS 2**

Particulars	**Shirt**	**Trouser**
Cost price per unit	380	520
Selling Price	375 (750 X 50%)	950
Less : Selling expense	18.75 5% of Rs.375	5.43 (3800/700 units)
Net Realisable Value	356.25	944.57
Lower of NRV and cost	356.25	520
Excess of cost over NRV	**23.75**	-

Therefore, **value of inventory of shirts is to be reduced by Rs.8,313** (Rs.23.75 x 350 shirts)

Since, inventory of trousers is already carried at cost, no further adjustment is required in the total value of closing inventories.

7. MOCK TEST 2

Omega Ltd., has a normal wastage of 4% in the production process. During the year 2016 -17, the Company used 12,000 MT of raw material costing Rs. 150 per MT. At the end of the year 630

MT of wastage was ascertained in stock. The accountant wants to know how this wastage is to be treated in the books.

You are required to compute the amount of normal and abnormal loss and treatment thereof in line with AS 2 "Valuation of inventories".

SOLUTION

REFERENCE:

As per **AS 2 'Valuation of Inventories'**, **abnormal** amounts of **wasted** materials, labour and other production costs are **excluded from cost** of inventories and such costs are **recognized as expenses** in the period in which they are incurred. The **normal** loss will be **included in determining the cost** of inventories (finished goods) at the year end.

ANALYSIS: Calculation of Normal Loss and Abnormal Loss:

Particulars	Quantity	Rs.
Material used @ Rs. 150	12,000 MT	18,00,000
Normal Loss (4% X 12,000 MT)	480 MT	
Value of Material per unit	11,520 MT	156.25 (18,00,000 / 11,520)
Abnormal Loss in Quantity (630 MT – 480 MT)	150 MT	
Value of Abnormal Loss (150 MT X 156.25)		**23,437.50**

Conclusion: Amount of Rs. 23,437.50 will be charged to the Profit and Loss statement as Abnormal Loss.

8. (RTP Nov 2015)

CC Ltd., a Pharmaceutical Company, while valuing its finished stock at the year end wants to include interest on Bank Overdraft as an element of cost, for the reason that overdraft has been taken specifically for the purpose of financing current assets like inventory and for meeting day to day working expenses". State your comments on this treatment.

SOLUTION

REFERENCE:

As per **AS 2 'Valuation of Inventories'**, cost of inventories **comprises** all costs of **purchase,** costs of **conversion** and other costs incurred in bringing the inventories to their **present location** and condition. It further states that **Interest** and other **borrowing costs** are usually **not included** in the cost of inventories because generally such costs are not related in bringing the inventories to their present location and condition.

ANALYSIS:

As per the reference above, the **proposal** of CC Ltd. to include interest on bank overdraft as an element of cost is **not acceptable** because it does not form part of cost of production.

CONCLUSION:

The treatment by CC Ltd for Interest is **incorrect.**

9. (RTP May 2016., RTP May 2022)

On the basis of information given below, find the value of inventory (by periodic inventory method) as per AS 2, to be considered while preparing the Balance Sheet as on 31st March, 2015 on weighted Average Basis.

Details of Purchases:

Date of purchase	Unit (Nos.)	Purchase cost per unit (₹)
01-03-2015	20	108
08-03-2015.	15	107
17-03-2015	30	109
25-03-2015	15	107

Details of issue of Inventory:

Date of Issue	Unit (Nos.)
03-03-2015	10
12-03-2015	20
18-03-2015	10
24-03-2015	20

Net realizable value of inventory as on 31st March, 2015 is ₹ 107.75 per unit. What will be the value of Inventory as per AS 2?

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventory**, Inventories should be valued at the **lower of cost and net realisable value.**

ANALYSIS:

Net Realisable Value of Inventory as on 31st March, 2015 (₹ 107.75 x 20 units)	₹ 2,155
Value of inventory as per Weighted Average basis	
Total units purchased and total cost:	
01.03.2015 (₹ 108 x 20 units)	₹ 2160
08.3.2015 (₹ 107 x 15 units)	₹ 1605
17.03.2015 (₹ 109 x 30 units)	₹ 3270
25.03.2015 (₹ 107 x 15 units)	₹ 1605
Total 80 units	₹ 8640
Weighted Average Cost = ₹ 8640/80 units	₹ 108
Total Value (₹ 108 x 20 units)	₹ 2,160

Value of inventory to be considered while preparing Balance Sheet as on 31st March, 2015 is, Cost or Net Realisable value whichever is lower i.e. ₹ 2,155.

10. RTP MAY 2017

Suraj Stores is a departmental store, which sell goods on retail basis. It makes a gross profit of 20% on net sales. The following figures for the year-end are available:

Opening Inventory ₹ 50,000; Purchases ₹ 3,60,000; Purchase Returns ₹ 10,000; Freight Inwards ₹ 10,000; Gross Sales ₹ 4,50,000; Sales Returns ₹ 11,250; Carriage Outwards ₹ 5,000.

Compute the estimated cost of the inventory on the closing date.

SOLUTION

ANALYSIS:

Calculation of cost of closing inventory

Particulars	₹
Opening Inventory	50,000
Purchases less returns (₹3,60,000 –₹ 10,000)	3,50,000
Freight Inwards	10,000
	4,10,000
Less: Net Sales (₹ 4,50,000 –₹ 11,250)	(4,38,750)
	(28,750)
Add: Gross Profits (₹ 4,38,750 x 20%)	87,750
Closing Inventory	**59,000**

II. ICAI ILLUSTRATION 3, MTP APRIL 2022

In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input is ₹ 1,000. The entire quantity of waste is on stock at the year end. State with reference to Accounting Standard, how will you value the inventories in this case?

SOLUTION

REFERENCE:

As per **AS 2 'Valuation of Inventories'**, **abnormal** amounts of **wasted** materials, labour and other production costs are **excluded from cost** of inventories and such costs are **recognized as expenses** in the period in which they are incurred. The **normal** loss will be **included in determining the cost** of inventories (finished goods) at the year end.

ANALYSIS:

Particulars	Quantity	Rs.
Input Value of Material @ Rs. 1000	5,000 MT	50,00,000
Normal Loss (5% X 5,000 MT)	250 MT	
Value of Material per unit	4,750 MT	1052.6315 (50,00,000 / 4,750)
Abnormal Loss in Quantity (300 MT – 250 MT)	50 MT	
Value of Abnormal Loss (50 MT X 1052.6315)		52,632
Value of Inventory	**4750**	49,47,368 **(50,00,000 – 52,632)**

The **cost of abnormal waste** ₹ **52,632** will be charged to the profit and loss statement.

12. INTER RTP MAY 2019, ICAI ILLUSTRATION 5

On 31st March 2017, a business firm finds that cost of a partly finished unit on that date is ₹ 530. The unit can be finished in 2017-18 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, 2017 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

<u>REFERENCE:</u>

As per **AS 2, Inventories** should be valued at the **lower of cost and net realisable value.** Net realisable value is the **estimated selling price** in the ordinary course of business **less** the **estimated costs of completion** and the estimated costs necessary to make the sale.

Valuation of unfinished unit

Particulars	₹
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**

13. INTER RTP NOV 2019 , IPCC RTP NOV 2019, INTER RTP NOV 2016, INTER RTP NOV 2017

Hello Ltd. purchased goods at the cost of ₹ 20 lakhs in October. Till the end of the financial year, 75% of the stocks were sold. The Company wants to disclose closing stock at ₹ 5 lakhs. The expected sale value is ₹ 5.5 lakhs and a commission at 10% on sale is payable to the agent. You are required to ascertain the value of closing stock?

SOLUTION

REFERENCE:

As per **AS 2, Inventories** should be valued at the **lower of cost and net realisable value.** Net realisable value is the **estimated selling price** in the ordinary course of business **less** the **estimated costs of completion** and the estimated costs necessary to make the sale.

ANALYSIS & CONCLUSION:

Particulars	₹
Expected selling price	5,50,000
Less: Commission (10% of 5,50,000)	(55,000)
Net Realisable Value	4,95,000
Cost of inventory [20,00,000 - (75% X 20,00,000)]	5,00,000
Value of inventory (Lower of cost and net realisable value)	4,95,000

14. Mock test oct 21 series I

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

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

Direct labour	70
Direct overhead	30

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

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

(ii) Net Realizable value of the Finished Good Q is ₹ 340 per unit.

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventories,**

a. Inventories should be valued at the **lower of cost and net realisable value.**

b. The **cost** of inventories should **comprise** all costs of **purchase,** costs of **conversion** and other costs incurred in bringing the inventories to their **present location** and condition.

c. 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 realisable value. In such circumstances, the **replacement cost** of the materials may be the best available measure of their net realisable value.

ANALYSIS:

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

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

(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
Handling 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

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. QP May 22

SM Enterprises is a leading distributor of petrol. A detail inventory of petrol in hand is taken when the books are closed at the end of each month. For the end Month of June 2021 following information is available:

i) Sales for the month of June 2021 was ₹ 30,40,000

ii) General overheads cost ₹ 4,00,000.

iii) Inventory at beginning 10,000 litres @ ₹ 92 per litre.

iv) Purchases – June 1 2021, 20,000 litres @ ₹ 90 per litre, June 30 2021, 10,000 Liters @ ₹ 95 per litre.

v) Closing inventory 13,000 litres.

You are required to computer the following by FIFO method as per AS 2:

i) Value of Inventory on 30th June, 2021.

ii) Amount of cost of goods sold for June,2021.

iii) Profit/Loss for the months of June, 2021.

2. IPCC QP MAY 2019

The closing stock of finished goods at cost of a company amounted to ₹ 4,50,000. The following items were included at cost in the total:

a. 100 coats, which had cost ₹ 2,200 each and normally sold for ₹ 4,000 each. Owing to a defect in manufacture, they were all sold after the balance sheet date at 50% of their normal selling price.

b. 200 skirts, which had cost ₹ 50 each. These too were found to be defective. Remedial work in April cost ₹ 2 per skirt, and selling expenses for the batch totaled ₹ 200. They were sold for ₹ 55 each.

c. Shirts which had cost ₹ 50,000, their net realizable value at Balance sheet date was ₹ 55,000. Commission @ 10% on sales is payable to agents.

What should the inventory value be according to AS 2 after considering the above items?

MCQs

1. Which item of inventory is under the scope of AS 2 (Revised)?
   a) WIP arising under construction contracts
   b) Raw materials
   c) Shares
   d) Debentures held as stock in trade.

2. Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be
   a) sold at or above cost.
   b) sold above cost.
   c) sold less than cost.
   d) sold at market value(where market value is more than cost).

3. All of the following costs are excluded while computing value of inventories except?
   a) Selling and Distribution costs
   b) Allocated fixed production overheads based on normal capacity.
   c) Abnormal wastage
   d) Storage costs (which is necessary part of the production process)

4. Identify the statement(s) which is/are incorrect.
   a) Storage costs which is a necessary part of the production process is included in inventory valuation.
   b) Administration overheads are never included in inventory valuation.
   c) Full amount of variable production overheads incurred are included in inventory valuation.
   d) Administration overheads are always included in inventory valuation.

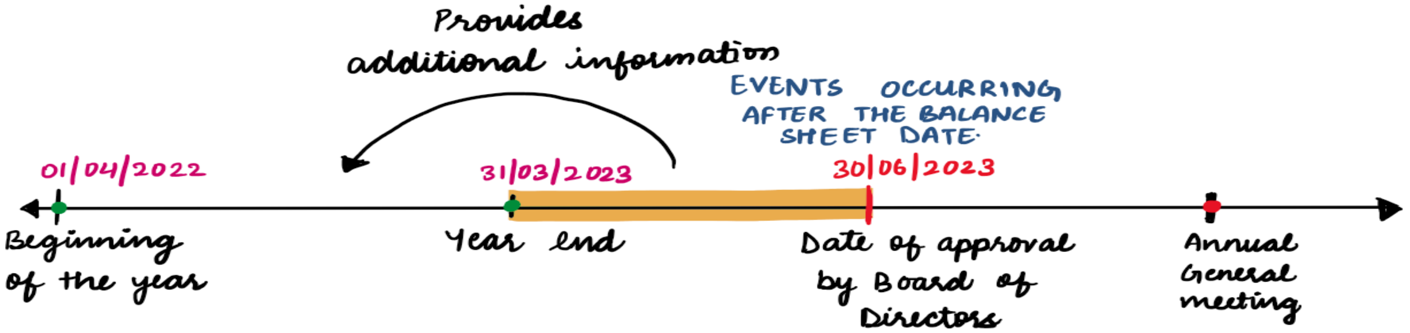
Answers							
1.	(b)	2.	(a)	3.	(b)	4.	(b)

AS 4

Contingencies and Events Occurring After the Balance Sheet Date

Covered in AS-29

- those significant events
- both favourable and unfavourable events.
- that occur between the balance sheet date on which the financial statement are approved.
- by the BOD.



2 types of events that can be identified

ADJUSTING EVENT

1. Conditions existing on Balance sheet date
2. Events occurring after the Balance sheet date provides an additional information on the balance sheet date.
3. The additional information materially affects the amounts on the Balance sheet date.

treatment

Adjust the balances of assets and liabilities as on Balance sheet date

↓

Second Effect in P&L A/c

NON-ADJUSTING EVENT

1. No conditions exists on Balance sheet date.
2. Subsequent events doesnot affects amount on the Balance sheet date

treatment

Donot adjust the balances on the balance sheet date

↓

only disclosure is required in Notes to A/cs, if material

EXAMPLE

ADJUSTING EVENTS

1. Loss on a trade receivables which is confirmed by insolvency of a customer
2. Discovery of fraud and error that show that FS were incorrect
3. Sale of inventories after the Balance sheet date may provide evidence about their NRV as at that date.
4. Resolution of a court case which confirms that the enterprise had already had a present obligation at the Balance sheet date.
5. The receipt of information concerning clarification of tax law.

NON-ADJUSTING EVENTS

1. Takeover of other business unit.
2. Decline in market value of investment.
3. Destruction a major production plant by fire so long as going concern is not affected.
4. Amalgamation effected after the balance sheet date
5. Initial disclosure event as regard discontinuing operation which occurs after the balance sheet.
6. Allotment of shares & debentures

EXCEPTION

STATUTORY REQUIREMENT

or

ITEM OF SPECIAL NATURE

EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

affects the going concern assumption of the entity, such events should be considered & FS should be adjusted as on the balance sheet date.

If the entity doesnot have going concern assumption, it should prepare FS on liquidation basis.

Note for student...

AS 4 – CONTINGENCIES & EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI ILLUSTRATION 3						
2	ICAI ILLUSTRATION 7 (Similar to ICAI – P.Q.6)						
3	INTER QP MAY 2019 / ICAI PRACTICAL QUESTION 15						
4	QP JULY 21						
5	QP DEC 21						
6	RTP May 2018 / RTP MAY 20						
7	RTP NOV 21						
8	MTP OCT 21 Series I						
9	MTP March 2022 Test Series I						
TEST IN TIME PASS IN TIME							
1	QP Nov 18						
2	Exam Nov 22						

1. ICAI ILLUSTRATION 3

A company has filed a legal suit against the debtor from whom ₹ 15 lakh is recoverable as on 31.3.20X1. The chances of recovery by way of legal suit are not good as per legal opinion given by the counsel in April, 20X1. Can the company provide for full amount of ₹ 15 lakhs as provision for doubtful debts? Discuss.

SOLUTION

FACTS:

Legal suit has been filed for recovery of ₹ 15 lakh from debtor for which the recovery chances are not good as per the legal opinion received in April 20X1.

REFERENCE:

As per **AS 4 (Revised) 'Contingencies and Events occurring after the Balance Sheet Date'**, an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes. **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.**

ANALYSIS:

As per the facts and reference above, the **condition** of recovery from debtors **existed at the Balance sheet date.** Hence, the company should **make the provision** for doubtful debts, as legal suit has been filed on 31st March, 20X1 and the **chances of recovery** from the suit **are not good.** Though, the actual result of legal suit will be known in future yet situation of **non-recovery** from the debtors **exists before finalisation** of financial statements.

CONCLUSION:

Provision for doubtful debts should be made for the year ended on 31st March, 20X1.

2. ICAI ILLUSTRATION 7 (Similar to ICAI – P.Q.6)

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

FACTS:

Raj Ltd. has been sued for infringement of a trademark during the year 20X1-20X2. Court decision has been received on 18th May 20X2 and Financial Statements have been approved by Board of Directors on 30th May 20X2.

REFERENCE:

As per **AS 4 (Revised) 'Contingencies and Events occurring after the Balance Sheet Date'**, an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes. **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.**

ANALYSIS:

In the given case, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 20X1-X2 for which the provision was also made by it, the decision of the Court on 18th May, 20X2, for payment of the penalty will **constitute as an adjusting event** because it is an event occurred **before approval** of the financial statements.

CONCLUSION:

Raj Ltd. should adjust the provision upward by ₹ 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

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

3. INTER QP MAY 2019 / ICAI PRACTICAL QUESTION 15

The financial statements of Alpha Ltd. for the year 20X1-20X2 were approved by the Board of Directors on 15th July, 20X2. The following information was provided:

i. A suit against the company's advertisement was filed by a party on 20th April, 20X2 claiming damages of ₹ 25 lakhs.

ii. The terms and conditions for acquisition of business of another company had been decided by March, 20X2. But the financial resources were arranged in April, 20X2 and amount invested was ₹ 50 lakhs.

iii. Theft of cash of ₹ 5 lakhs by the cashier on 31st March, 20X2, was detected on 16th July, 20X2.

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.

As per **AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date"** 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.**

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.

Further, '**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.

SOLUTION

FACTS:

Financial statements of Alpha Ltd. for the year 20X1-20X2 were approved by the Board of Directors on 15th July, 20X2.

REFERENCE:

ANALYSIS (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 20th April after the balance sheet date.

CONCLUSION:

The suit will have **no effect** on financial statement of 20X1-20X2 and will be a **non- adjusting event.**

ANALYSIS (ii):

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, 20X2. Hence, **necessary adjustment** to assets and liabilities for acquisition of business is **necessary** in the financial statements for the year ended 31st March 20X2.

CONCLUSION:

The acquisition of business will be an **adjusting event.**

ANALYSIS (iii):

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, 20X2 i.e., **after approval** of financial statements, it will **not require** adjustment nor disclosure.

CONCLUSION:

The theft will be a **non-adjusting event** and no adjustment in financial statement is required.

4. QP JULY 21

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.

SOLUTION

REFERENCE:

As per **AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date"** 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.**

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.

Further, '**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.

ANALYSIS (i):

As per the above reference of AS 4, 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. This **event does not pertain** to conditions on the balance sheet date.

CONCLUSION:

The suit will have **no effect on financial statements** and it will be a **non-adjusting event.**

ANALYSIS (ii):

The proposal to sell an immovable property was made before 31st March, 2021 but the final deed was registered on 15th April. Sale cannot be shown in the financial statements for the year ended 31st March, 2021.

CONCLUSION:

Sale of **immovable property** is an **event** occurring **after the balance sheet date** and is a **non-adjusting event.** 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.

ANALYSIS (iii):

The 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. The finalization of terms and conditions amount to **significant event before** Balance sheet date.

CONCLUSION:
Acquisition of business 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.

ANALYSIS (iv):
The theft of cash was detected **after approval of financial statements**. As per AS 4, 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.

CONCLUSION: No adjustment is required for the theft in F Y 2020-21. It is a non-adjusting event.

5. QP DEC 21

As per provision of AS 4, you are required to state with reason whether the following transaction 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 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.

SOLUTION

In the books of NEW Ltd., classification of events as per AS 4 is as follows:

REFERENCE:
As per **AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date"** 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.**
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.

Further, '**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.

i) FACTS:

Equity Dividend for year 2020-21 was declared on 15.05.2021.

ANALYSIS:

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.

No liability for dividends should be recognized in financial statements for financial year ended 31st March, 2021. Dividends are **disclosed in the notes.**

CONCLUSION:

Declaration of dividend is **non-adjusting event.**

ii) FACTS:

Cashier has incurred a fraud by collecting the cash but not depositing it ₹ 53,000

ANALYSIS:

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.**

CONCLUSION:

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) FACTS:

Estimated loss due to Fire is ₹ 81,00,000 which occurred on 23.05.2021.

ANALYSIS:

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.

The damage of one building due to fire did not exist on the balance sheet date i.e. 31.3.2021. 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.**

CONCLUSION:

Loss occurred due to fire is not to be recognized in the financial year 2020-2021 as it is **non-adjusting event.** 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.

6. RTP May 2018 / RTP MAY 20

With reference to AS 4 "Contingencies and events occurring after the balance sheet date", **identify** whether the following events will be treated as contingencies, adjusting events or non-adjusting events occurring after balance sheet date in case of a company which follows April to March as its financial year.

I. A major fire has damaged the assets in a factory on 5^{th} April, 5 days after the year end. However, the assets are fully insured and the books have not been approved by the Directors.

II. A suit against the company's advertisement was filed by a party on 10^{th} April, 10 days after the year end claiming damages of ₹ 20 lakhs.

SOLUTION

REFERENCE:

As per **AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date"** 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.**

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.

Further, '**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.

ANALYSIS (i):

Adjustments to **assets and liabilities** are required for **events occurring after the balance sheet date** that provide **additional information materially affecting** the determination of the amounts relating to **conditions existing** at the balance sheet date. However, adjustments to assets and liabilities are **not appropriate** for events occurring after the balance sheet date, if such **events do not** relate to **conditions existing at the balance sheet date**.

Fire has occurred **after the balance sheet date** and also the loss is totally insured. Therefore, the event becomes **immaterial.**

CONCLUSION:

The event is a **non-adjusting event.**

ANALYSIS (ii):

The **contingency is restricted to conditions** existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of ₹ 20 lakhs. Therefore, it **does not fit** into the definition of a **contingency.**

CONCLUSION:

The event is a **non-adjusting event.**

7. RTP NOV 21

XYZ Ltd. operates its business into various segments. Its financial year ended on 31st March, 2020 and the financial statements were approved by their approving authority on 15th June, 2020. The following material events took place:

a) A major property was sold (it was included in the balance sheet at ₹ 25,00,000) for which contracts had been exchanged on 15th March, 2020. The sale was completed on 15th May, 2020 at a price of ₹ 26,50,000.

b) On 2nd April, 2020, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of ₹ 10 million would be fully covered by the insurance company.

c) A claim for damage amounting to ₹ 8 million for breach of patent had been received by the entity prior to the year-end. It is the director's opinion, backed by legal advice that the claim will ultimately prove to be baseless. But it is still estimated that it would involve a considerable expenditure on legal fees.

You are required to state with reasons, how each of the above items should be dealt with in the financial statements of XYZ Ltd. for the year ended 31st March, 2020.

SOLUTION

FACTS:

XYZ Ltd.'s financial statements for 31st March 2020 are approved by the approving authority on 15th June 2020. It operates its business into various segments.

REFERENCE:

As per **AS 4 (Revised) 'Contingencies and Events occurring after the Balance Sheet Date'**, 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.**

'**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.

On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:

ANALYSIS (a):

As the contract for sale asset has been exchanged on 15th March, 2020 it is a **condition existing on balance sheet date.** Also, the sale has been completed on 15th May 2020 which is before the approval of financial statements. Hence, The **effect of the sale should be reflected** in the financial statements ended on 31.3.2020.

CONCLUSION:

The sale of property should be treated as an **adjusting event** and the **profit on sale** of property ₹ 1,50,000 would be **considered.**

ANALYSIS (b):

The destruction of plant by fire occurred on 2nd April which is 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.

CONCLUSION:

The event of destruction of plant by fire is a **non-adjusting event.** 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.

ANALYSIS (c):

On the basis of legal advice and director's opinion, the claim against the company will not succeed. Thus, ₹ 8 million should not be provided in the account.

CONCLUSION:

It 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.

8. Mock test OCT 21 Series I

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.

SOLUTION

REFERENCE:

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:

ANALYSIS:

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.

CONCLUSION:

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.

(i) 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.

(ii) 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.

(iii) 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.

9. MTP March 2022 Test Series I

The financial statements 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 lakh 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.

SOLUTION

i)

FACTS:

A suit has been filed by a party on 20th April, 2020 claiming damages of ₹ 25 lakhs

REFERENCE:

As per **AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date"** 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.**

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.

Further, '**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.

ANALYSIS:

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 which is after the balance sheet date.

CONCLUSION:

The suit will have **no effect on financial statement** and will be a non-adjusting event.

ii)

FACTS:

Alpha Ltd. has invested ₹ 50 lakhs in April 2020 for acquisition of another company for which the terms and conditions had been decided by March, 2020. Financial Statements were approved by Board of Directors on 15th July 2020.

ANALYSIS:

As the 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**, the event will be classified as an **Adjusting event**. Even though the transaction for payment of financial resources was effected in April, 2020.

CONCLUSION:

Adjustment should be made to **assets and liabilities** for acquisition of business in the financial statements for the year ended 31st March 2020.

iii)

FACTS:

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

ANALYSIS:

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, the **theft** of cash was detected on 16th July, 2020 i.e., **after approval of financial statements** by Board of Directors. Financial Statements were approved by Board of Directors on 15th July 2020.

CONCLUSION:

The theft will be a **non-adjusting event** as per AS 4.

iv)

FACTS:

Alpha Ltd.'s property sale deed was registered on 15th April, 2020.

ANALYSIS:

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.

Disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise.

In the given case, **sale of immovable property** was under proposal stage (negotiations only started) on the balance sheet date, and was **not finalized.**

CONCLUSION:

The event will be classified as **non-adjusting event.** 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)

FACTS:

Aplha Ltd.'s assets in the factory have been damaged by fire on 5th April, 2020. The assets were fully insured.

REFERENCE:

As per **AS4 (Revised) defines "Events Occurring after the Balance Sheet Date"**, 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.

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

ANALYSIS:

The condition of fire occurrence was **not existing** on the balance sheet date. Since it is said that the loss would be fully recovered by the insurance company, the **going concern assumption** having regard to the extent of insurance cover **is valid.**

CONCLUSION:

The event of loss by fire will be classified as a **non-adjusting event.** Only the disclosure regarding fire and loss, being completely insured may be **given in the report** of approving authority.

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Test In Time...Pass In Time

1. QP Nov 18

The accounting year of Dee Limited ended on 31st March, 2018 but the accounts were approved on 30th April, 2018. On 15th April, 2018 a fire occurred in the factory and office premises. The loss by fire is of such a magnitude that it was not possible to expect the enterprise Dee Limited to start operation again.

State with reasons, whether the loss due to fire is an adjusting or non- adjusting event and how the fact of loss is to be disclosed by the company in the context of the provisions of AS-4 (Revised).

2. Exam Nov 22

MN Limited operated its business into various segments. Its financial year ended on 31st March, 2022 and financial statements were approved by their approving authority on 15th june,2022. The following material events took place:

(i) On 7th April,2022, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of ₹ 15 crores would be fully covered by the insurance company.

(ii) A claim for damage amounting to ₹ 12 crores for breach of patent has 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.

(iii) A Major property was sold (it was included in the balance sheet at ₹37,50,000) for which contracts has been exchange on 15th March, 2022. The sale was completed on 15th May,2022 at a price of 39,75,000.

You are required to state with reasons, haw each of the above items should be dealt with in the financial statements of MN Limited for the year ended 31st March,2022 as per AS-4.

MCQs

1. Cash amounting to ₹ 4 lakhs, stolen by the cashier in the month of March 20X1, was detected in April, 20X1. The financial statements for the year ended 31st March, 20X1 were approved by the Board of Directors on 15th May, 20X1. As per Accounting Standards, this is _____ for the financial statements year ended on 31st March, 20X1.
   a) An Adjusting event.
   b) Non-adjusting event.
   c) Contingency.
   d) Provision

2. As per Accounting Standards, events occurring after the balance sheet date are
   a) Only favourable events that occur between the balance sheet date and the date when the financial statements are approved by the Board of directors.
   b) Only unfavourable events that occur between the balance sheet date and the date when the financial statements are approved by the Board of directors.
   c) 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.
   d) Those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are not approved by the Board of directors.

3. AS 4 does not apply to
   a) Obligation under retirement benefit plans.
   b) Commitments arising from long term lease contracts.
   c) liabilities of life assurance and general insurance enterprises arising from policies issued
   d) Both (a) & (b).

4. A Ltd. sold its building for ₹ 50 lakhs to B Ltd. and has also given the possession to B Ltd. The book value of the building is ₹ 30 lakhs. As on 31st March, 20X1, the documentation and legal formalities are pending. For the financial year ended 31st March, 20X1
   a) The company should record the sale.
   b) The company should recognise the profit of ₹ 20 lakhs in its profit and loss account.
   c) Both (a) and (b).
   d) The company should disclose the profit of ₹ 20 lakhs in notes to accounts.

Answers							
1.	(a)	2.	(c)	3.	(d)	4.	(c)

AS 5

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

OBJECTIVE

To prescribes the criteria for classification & disclosure of certain items, such as Prior Period items, Extra Ordinary items, changes in accounting policies, etc in profit & loss account to enhance its comparability.

Net Profit and loss for the Period

Profit or loss arises on account of ordinary activities and extra-ordinary items. Both these components should be disclosed separately and on the face of the statement of Profit & loss

PROFIT/ LOSS FROM ORDINARY ACTIVITIES

Activities normally undertaken as part of business & incidental activities

↓

Activities of special size, nature or incidence to be considered & disclosed separately.

EXTRA-ORDINARY ITEMS

Items of income & expenses that arise from events or transactions clearly distinct from ordinary activities of the enterprises and therefore, are not expected to recur frequently or regularly

Prior Period Items

Income and expenses arising in current period as a result of errors or omissions in preparations of FS of prior periods. It is infrequent or different from changes in accounting estimates.

Changes in Accounting Policies

A change in the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of FS.

Allowed only if :–

(i) Required by statute, or
(ii) Required by AS, or
(iii) leads to appropriate presentation of FS.

CHANGES IN ACCOUNTING ESTIMATE

An estimate may have to be revised consequent to changes occurring in the circumstances based on which the estimate was made, or new information, more experience or subsequent developments.

DISCLOSURE

NET PROFIT OR LOSS FOR THE PERIOD

ORDINARY ACTIVITIES

When items of income and expenses within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain performance of entity, Nature and amount of such items should be disclosed separately.

EXTRA-ORDINARY ITEMS

Disclosed in the statement of profit and loss as a part of net profit or loss for the period. Nature and amount of each item separately disclosed in a manner that its impact on current profit or loss can be perceived.

PRIOR PERIOD ITEMS

The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current period or loss can be perceived.

CHANGES IN ACCOUNTING POLICIES

- Change
- Impact & resulting adjustment, in the period of change.
- If impact not ascertainable then, such fact.
- No material impact in the current period but has a material in later periods, facts of change in the year of change.

DISCLOSURE

Disclose in the year of change
- Nature and amount of change
- If not practical to quantify the amount, disclose such fact.

Note for student...

AS 5 - NET PROFIT OR LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS AND CHANGES IN ACCOUNTING POLICIES

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	EXAM NOV 22						
2	ICAI ILLUSTRATION 3, RTP May 2017						
3	ICAI ILLUSTRATION 4, RTP Nov 2015, RTP Nov 2017						
4	RTP Nov 2018 / Inter RTP Nov 2019						
5	QP May 2018, RTP May 2019						
6	RTP NOV 20						
7	MTP OCT 22 (SERIES 2)						
TEST IN TIME PASS IN TIME							
1	QP JAN 21						
2	MAY 22 EXAM						

1. **EXAM NOV 22**

The Account of Shiva Limited has sought your option with relevant reason, whether the following transactions will be treated as change in Account policies or change in Accounting Estimates for the year ended 31st March, 2021. Please advise him in the following situations in accordance with the provisions of AS-5:

(i) Provisions for doubtful debts was created @ 3% till 31st March, 2020. Form the Financial year 2020-2021, the rate of provision has been changed to 4%.

(ii) During the year ended 31st March, 2021, the management has introduced a formal gratuity scheme in place of-hoc ex-gratia payments to employees on retirement.

(iii) Till 31st March,2020 the furniture was depreciated on straight line basis over a period of 5 years. Form the financial year 2020-2021, the useful life of furniture has been changed to 3 years.

(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organizations. Such employees will get pensions of ₹20,000 per month. Earlier there was on such scheme of pension in the organization.

(v) During the years ended 31st March, 2021 there was change in cost formula in measuring in the cost of inventories.

SOLUTION

REFERENCE:

As per **AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'**, Accounting policies are the **specific accounting principles** and the **methods of applying those principles** adopted by an enterprise in the preparation and presentation of **financial statements.**

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) **ANALYSIS:** 3% provision for doubtful debts was created till 31st March, 2020. Subsequently in 2020-21, the estimates were revised based to create 4% provision. **This change will affect** only **current year.**

CONCLUSION: Change in rate of provision of doubtful debt is **change in estimate** and is not change in accounting policy.

(ii) ***ANALYSIS:*** *Introduction of a formal retirement gratuity scheme is a transaction which is substantially different from the previous one (Ad hoc payment). It is an adoption of an accounting policy for events or transactions that* ***differ in substance*** *from previously occurring events or transactions*

CONCLUSION: *Introduction of formal gratuity scheme will* ***not be treated as change in an accounting policy.***

(iii) ***ANALYSIS:*** *Till 2019-20, the furniture was depreciated on straight line basis over a period of 5 years. In 2020-21, useful life of furniture has been changed from 5 years to 3 years. It is a change in estimate.*

CONCLUSION: *Change in useful life* ***is not a change in accounting policy.***

(iv) ***ANALYSIS:*** *As per the reference above, Management deciding to pay pension to those employees who have retired after completing 5 years of service in the organization will* ***not be a change in accounting policy.***

Adoption of a new accounting policy *for events or transactions which* ***did not occur previously*** *should* ***not be treated*** *as a change in an accounting policy.*

CONCLUSION: *The introduction of new pension scheme is* ***not a change in accounting policy.***

(v) ***ANALYSIS:*** ***Change in cost formula*** *used in measurement of cost of inventories change would result in a* ***more appropriate presentation*** *of the financial statements.*

CONCLUSION: *Change in Cost formula is a* ***change in accounting policy.***

2. ICAI ILLUSTRATION 3, RTP May 2017

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

REFERENCE:

AS 5 - 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.'*

ANALYSIS / CONCLUSION:

Rectification of error in inventory valuation is **a prior period item** vide provisions of AS 5. ₹ 14.5 lakhs must be **added to the opening inventory** of 1/4/20X1. It is also necessary to show ₹ 14.5 lakhs as a prior period adjustment in the Profit and loss Account. **Separate disclosure** of this item as a prior period item is **required** as per AS 5.

3. ICAI ILLUSTRATION 4, RTP Nov 2015, RTP Nov 2017

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

REFERENCE:

As per **AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'**, Accounting policies are the **specific accounting principles** and the **methods of applying those principles** adopted by an enterprise in the preparation and presentation of **financial statements.**

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) **ANALYSIS:**

Introduction of a formal **retirement gratuity scheme** is a transaction which is **substantially different** from the previous one (Ad hoc payment). It is an adoption of an accounting policy for events or transactions that **differ in substance** from previously occurring events or transactions.

CONCLUSION:

Introduction of formal gratuity scheme will **not be treated as change in an accounting policy.**

(ii) **ANALYSIS:**

As per the reference above, Management deciding to **pay pension** to those employees who have retired after completing 5 years of service in the organization will **not be a change in accounting policy.**

Since it is an **adoption of a new accounting policy** for events or transactions which did not occur previously or that were **immaterial.**

CONCLUSION:

The introduction of new pension scheme is **not a change in accounting policy.**

4. RTP Nov 2018 / Inter RTP Nov 2019

The accountant of Mobile Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2017. You are required to advise him in the following situations in accordance with the provisions of AS 5

(i) Provision for doubtful debts was created @ 2% till 31st March, 2016. From the Financial year 2016-2017, the rate of provision has been changed to 3%.

(ii) During the year ended 31st March, 2017, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.

(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.

(v) During the year ended 31st March, 2017, there was change in cost formula in measuring the cost of inventories.

SOLUTION

REFERENCE:

As per **AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'**, Accounting policies are the **specific accounting principles** and the **methods of applying those principles** adopted by an enterprise in the preparation and presentation of **financial statements.**

*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) **ANALYSIS:** Mobile limited created 2% provision for doubtful debts till 31st March, 2016. In 2016-17, the company revised the estimates based on the changed circumstances and wants to create 3% provision. This **change will affect only current year.**

CONCLUSION: Change in rate of provision of doubtful debt is **change in estimate and is not change in accounting policy.**

(ii) **ANALYSIS:** Introduction of a formal **retirement gratuity scheme** is a transaction which is **substantially different** from the previous one (Ad hoc payment). It is an **adoption of an accounting policy** for events or transactions that differ in substance from previously occurring events or transactions.

CONCLUSION: Introduction of formal gratuity scheme will **not be treated as change in an accounting policy.**

(iii) **ANALYSIS:** Till 2015-16, the furniture was depreciated on straight line basis over a period of 5 years. In 2016-17, useful life of furniture has been changed from 5 years to 3 years. It is a **change in estimate.**

CONCLUSION: Change in useful life is **not a change in accounting policy.**

(iv) **ANALYSIS:** As per the reference above, Management deciding to pay pension to those employees who have retired after completing 5 years of service in the organization will **not be a change in accounting policy.**

Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy.

CONCLUSION: The introduction of new pension scheme is **not a change in accounting policy.**

(v) **ANALYSIS: Change in cost formula** used in measurement of cost of inventories change would result in a **more appropriate presentation** of the financial statements.
CONCLUSION: Change in Cost formula is a **change in accounting policy.**

5. QP May 2018, RTP May 2019

PQR Ltd. is in the process of finalizing its accounts for the year ended 31st March, 2018. The company seeks your advice on the following:

i) Goods worth ₹ 5,00,000 were destroyed due to flood in September, 2015. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2015-16. In March, 2018, the claim was passed and the company received a payment of ₹ 3,50,000 against the claim. Explain the treatment of such receipt in final account for the year ended 31st March, 2018.

ii) Company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2017-18. Subsequently, on a review of the credit period allowed and financial capacity of the customers, the company decides to increase the provision to 8% on debtors as on 31.03.2018. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard, can this revision be considered as an extraordinary item or prior period item?

SOLUTION

i) **REFERENCE: AS 5 - 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.'

ANALYSIS: In the given case, it is clearly a **case of error/omission** in preparation of financial statements for the year 2015-16 for not recording the loss due to flood.

CONCLUSION: Claim received in the financial year 2017- 18 is a **prior period item** and should be **separately disclosed** in the statement of Profit and Loss.

Note: As per my understanding, the claim was not approved till March 2018 due to which there is no event which requires the recording of claim received in Year 2015-16. As it became definite in March 2018, the claim should have been recorded in 2017-18. It should not be a prior period item.

ii) **REFERENCE:** As per **AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', extraordinary items** are income or expenses that arise from events or transactions that are **clearly distinct from the ordinary activities** of the enterprise and, therefore, are **not expected** to recur **frequently** or regularly.

ANALYSIS: The revision in rate of provision for doubtful debts will be considered as change in estimate and is neither a prior period item nor an extraordinary item.

PQR Ltd. created 2.5% provision for doubtful debts for the year 2017-2018. Subsequently, the company **revised the estimate** based on the changed circumstances and wants to create 8% provision. It is a **change in estimate.**

CONCLUSION: The effect of the change should be **shown in the profit and loss** account for the year ending 31st March, 2018.

6. RTP NOV 20

The Accountant of Virush Limited has sought your opinion, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2020. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

(i) Till the previous year the machinery was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.

(ii) Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement.

SOLUTION

REFERENCE:

As per **AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'**, Accounting policies are the **specific accounting principles** and the **methods of applying those principles** adopted by an enterprise in the preparation and presentation of **financial statements.**

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) **ANALYSIS:** Till March 2019, the machinery was depreciated on **straight line basis** over a period of 5 years. In 2019-20, useful life of machinery has been changed from 5 years to 3 years. It is a **change in estimate.**

CONCLUSION: Change in useful life is not a **change in accounting policy.**

(ii) **ANALYSIS:** Introduction of a formal **retirement gratuity scheme** is a transaction which is **substantially different** from the previous one (Ad hoc payment). It is an adoption of an accounting policy for events or transactions that **differ in substance** from previously occurring events or transactions.

CONCLUSION: Introduction of formal gratuity scheme will **not be treated as change in an accounting policy.**

7. MTP OCT 22 (SERIES 2)

The management of Pluto Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as changes in Accounting Policy or not for the year ended 31st March, 2021. Please advise them in the following situations in accordance with the provisions of Accounting Standard 5:

(i) During the year ended 31st March, 2021, the management has introduced a formal retirement gratuity scheme in place of ad-hoc ex-gratia payments to its employees on retirement.

(ii) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees would receive a pension of ₹ 25,000 per month. Earlier there was no such scheme of pension in the organization.

(iii) Provision for doubtful Trade Receivables was created @ 2.5% till 31st March, 2020. From 1st April,2020, the rate of provision has been changed to 5%.

(iv) For the year ended 31st March,2021 there was change in the cost formula in measuring the cost of Inventories.

(v) Till the end of the previous year, Computers were depreciated on Straight Line Basis over a period of 5 years. From current year, the useful life of Computers has been changed to 3 years.

SOLUTION

REFERENCE:

As per **AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'**, Accounting policies are the **specific accounting principles** and the **methods of applying those principles** adopted by an enterprise in the preparation and presentation of **financial statements.**

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) **ANALYSIS:** Introduction of a formal **retirement gratuity scheme** is a transaction which is **substantially different** from the previous one (Ad hoc payment). It is an adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions

CONCLUSION: Introduction of formal gratuity scheme will not be treated as change in an accounting policy.

(ii) **ANALYSIS:** As per the reference above, Management deciding to **pay pension** to those employees who have retired after completing 5 years of service in the organization will **not be a change in accounting policy.**

Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy.

CONCLUSION: The introduction of new pension scheme is **not a change in accounting policy.**

(iii) **ANALYSIS:** Pluto limited created 2.5% provision for doubtful debts till 31st March 2020. Subsequently in 2020-21, the company **revised the estimates** based on the changed circumstances and wants to create 5% provision. This **change will affect only current year.**

CONCLUSION: Change in rate of provision of doubtful debt is change in estimate and is **not change in accounting policy.**

(iv) **ANALYSIS: Change in cost formula** used in measurement of cost of inventories change would result in a **more appropriate presentation** of the financial statements. **CONCLUSION:** Change in Cost formula is a **change in accounting policy.**

(v) **ANALYSIS:** Till 2019-20, Computer was depreciated on straight line basis over a period of 5 years. In 2020-21, useful life of Computer has been changed from 5 years to 3 years. It is a **change in estimate.**

CONCLUSION: Change in useful life is **not a change in accounting policy.**

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. QP JAN 21

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.

2. MAY 22 EXAM

TQ cycles Ltd. is in this manufacturing of bicycles, a labour intensive manufacturing sector. In April 2022, the government enhanced the minimum wages payable to workers with retrospective effect form the 1st January, 2022. Due to this legislative changes, the additional wages for the period from January 2022 to March 2022 amount to ₹ 30 Lakhs. The management asked the Finance manager to charge ₹ 30 Lakhs as period item while finalizing financial statement for the year 2022-23. Further, the Finance manager is of the view that this amount being abnormal should be disclosed as extra- ordinary item in the profit loss account for the financial year 2021-22. Discuss with references to applicable Accounting Standard.

MCQs

1. A change in the estimated life of the asset, which necessitates adjustment in the depreciation is an example of
   a) Prior period item.
   b) Ordinary item.
   c) Extraordinary item.
   d) Change in accounting estimate.

2. Which of the following is considered as an extraordinary item as per AS 5?
   e) Write down or write-off of receivables, inventory and intangible assets.
   f) Gains and losses from sale or abandonment of equipment used in a business.
   g) Effects of a strike, including those against competitors and major suppliers.
   h) Flood damage from unusually heavy rain or a normally dry environment.

3. Which one of the following is an example of extraordinary item?
   a) The write down of inventories to their net realisable value
   b) Reversal of write down of inventories
   c) Government grants become refundable
   d) Reversal of provisions.

4. Extraordinary items are income or expenses
   a) That arise from events clearly distinct from the ordinary activities of the enterprise.
   b) That are not expected to recur frequently or regularly.
   c) Both (a) and (b).
   d) None of the three.

5. An audit stock verification during the year ended 31st March, 20X1 revealed that opening stock of the year was understated by ₹ 5 lakhs due to wrong counting. While finalizing accounts, your opinion will be
   a) It is not a prior period item and no separate disclosure is required
   b) It should be treated as a prior period adjustment and should be separately disclosed in the current year's financial statement
   c) The adjustment of ₹ 5 lakhs in both opening stock of current year and profit brought forward from previous year should be made
   d) Both (b) and (c).

Answers									
1.	(d)	2.	(d)	3.	(c)	4.	(c)	5.	(d)

AS 7 Construction Contracts

A Construction Contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

A construction contract may be negotiated for the construction of a single asset such as a bridge, building, dam, pipeline road, ship or tunnel.

A construction contract may also deal with the construction of a number of assets which are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or

TYPES OF MAIN CONTRACT

COMBINING OF CONTRACT

- Group of contracts is negotiated as a single Package
- All contracts are part of single project.
- All contracts are performed concurrently or in a continuously.
- Contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin.

SEGMENTING OF CONTRACT

Usually treated separately if –

- Separate proposals
- Separate Negotiation
- Customers have ability to accept or reject each part of the contract relating to particular asset.
- Cost and revenue of each asset can be identified.

CONSTRUCTION OF ADDITIONAL ASSETS

Combine if →

- Assets donot differ significantly in design, technology or function from assets in original contract, or
- Price negotiated with regard to original contract price.

Else, segment.

CONTRACT REVENUE

Contract Revenue should comprise of :-

Initial Agreed amount + Variation amount + Claim + Incentives [if any] + Escalation clause − Penalties

VARIATION

- Is an instruction by the customer for a change in the scope of the work to be performed.
- May lead to increase or decrease in contract revenue.

Example :–

- Changes in the specification or design of the asset
- Changes in duration of contract.

CLAIM

- An amount which the contractor seeks to collect from the customer or any third party for costs that are not included in the contract.

Example :–

- Customer caused delays
- Errors in specification

INCENTIVE

- Payment are additional amounts payable to the contractors if specific performance standard are met or exceeded.

Example :–

- Early completion of the contract work.

Recognition

- Probable that customer will approve the variation and the amount of revenue arising from the variation
- The amount of revenue can be reliably measured.

Recognition

- Negotiation have reached an advanced stage such that it is probable that customer will accept the claim; and
- The amount that it is probable will be accepted by the customer can be measured reliably

Recognition

- The contract is sufficiently, advance that it is probable that the specified performance standard will be met or exceeded; and
- The amount of the incentive payment can be measured reliably.

CONTRACT COST

Contract cost should comprise of :-

Direct Costs + Allocable costs + Costs specifically chargeable to the customer – Incidental income [not included in contract revenue]

Methods of Determination of the stages of completion

methods to be chosen depending upon the nature of the contract

- Proportion that contract costs incurred for work performed upto the reporting date to the estimated total contract cost
- Surveys of work performed
- Completion of a physical proportion of the contract work.

CHANGES IN ESTIMATES

The percentage of completion method is applied on a cumulative basis in each accounting period to the current estimates of contract revenue and contract costs.

↓

Changed estimates are used in determination of the amount of revenue and expenses recognised in the statement of profit and loss in the period in which the change is made and in subsequent periods.

IMPORTANT POINTS

- Under AS-7, the contract revenues are recognised on percentage of completion method. **It may be noted that the completed contract** method is not allowed by AS-7.
- Percentage of completion method :

The recognition of contract revenue and costs with reference to stage of completion is known as percentage of completion method. In this method:

$$\% \text{ of completion} = \frac{\text{Costs incurred till date}}{\text{Costs incurred till date} + \text{Estimated costs to complete}} \times 100$$

Contract revenue to be recognized in current year

= (Contract price x % of completion) – Revenue recognized till last year.

Contract Costs to be recognized in current year

= Total costs incurred so far – Costs recognized till last year.

DISCLOSURE

1. An enterprise should disclose
   a. amount of revenue recognised
   b. methods used to determine amount of revenue recognised
   c. methods used to determine stage of completion
2. An enterprise should disclose the following for contracts in progress at the reporting date
   a. the aggregate amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;
   b. the amount of advances received (it is the amount received before the related work in completed); &
   c. The amount of retentions.
3. An enterprise should present :
   a. the gross amount due from customers for contract work as an asset; and
   b. the gross amount due to customers for contract work as liability.
4. The gross amount due from customers for contract work is the net amount of :
   a. costs incurred plus recognised profits; less
   b. The sum of recognised losses and progress billings.

For the contracts in progress for which costs incurred plus recognised profits (less recognised losses) exceeds a progress billing.

5. The gross amount due to customers for contract work is the net amount of :
   a. the sum of recognised losses and progress billings; less

b. costs incurred plus recognised profits.

For all contracts in progress for which progress billings exceeds costs incurred plus recognised profits (less recognised losses).

6. An enterprise discloses any contingencies in accordance with AS-4, contingencies and events occurring after the Balance Sheet Date. Contingencies may arise from such items as warranty costs, penalties or possible losses.

Note for student...

AS 7 – CONSTRUCTION CONTRACTS

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI ILLUSTRATION 1						
2	QP MAY 19						
3	QP MAY 19						
4	QP NOV 20						
5	JULY 21						
6	ICAI P. Q. 13						
7	ICAI P.Q. 11						
8	ICAI MOCK TEST PAPER 1 (Q NO 1 (A)), IPCC RTP NOV 2016 Q18B						
9	MTP APRIL 2022 TEST SERIES 2						
10	RTP NOV 22						
TEST IN TIME PASS IN TIME							
1	MAY 2022 EXAM						
2	MAY 2023 EXAM						

1. ICAI ILLUSTRATION 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.

Particulars	(₹ 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 recognised as expense	**100**

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

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

Percentage of completion = Cost incurred till date / Estimated total cost

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:

Particulars	Amount (in Lakhs)
Contract Costs	605
Recognised Profits / (Recognised Loss)	(100)
(A)	505
Progress payments received + Progress payments to be received (400 + 140) (B)	540
Amount due to customers (A) – (B)	**35**

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

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

Particulars	₹ in lakhs
Contract revenue	550
Contract expenses	605
Recognised profits / (Recognised losses)	(100)
Progress billings ₹ (400 + 140)	540
Retentions (billed but not received from contractee)	140
Gross amount due to customers	35

2. QP MAY 19

AP Ltd, a construction contractor, undertakes the construction of commercial complex for Kay Ltd. AP Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreement is entered into between the two parties. The agreement lays down the value of each of the 3 units, i.e. ₹ 50 Lakh ₹ 60 Lakh and ₹ 75 Lakh respectively. Agreement also lays down the completion time for each unit Comment, with reference to AS- 7, whether AP Ltd., should treat it as a single contract or three separate contracts.

SOLUTION

FACTS:

A single construction agreement has been entered between Kay Ltd. and AP Ltd. The agreement has values specified for each unit and individual completion time.

REFERENCE:

As per **AS 7 on 'Construction Contracts'**, when a **contract** covers a **number of assets**, the construction of each asset should be **treated as a separate** construction contract when:

a) **Separate proposals** have been submitted **for each asset**

b) Each asset has been subject to **separate negotiation** and the contractor and customer have been able to **accept or reject** that part of the contract relating to each asset; and

c) The **costs and revenues** of each asset can be **identified.**

ANALYSIS:

In the given case, each unit is submitted as a separate proposal, which can be **separately negotiated**, and **costs and revenues thereof can be separately identified**. For each contract, principles of revenue and cost recognition have to be applied separately and net income will be determined for each asset as per AS -7.

CONCLUSION:

Mr. AP Ltd. is required to treat construction of each unit as a **separate construction contract**

3. QP MAY 19

On 1st December, 2017, GR Construction Co. Ltd. undertook a contract to construct a building for ₹ 45 lakhs. On 31st March, 2018, the company found that it had already spent ₹ 32.50 lakhs on the construction. Additional cost of completion is estimated at ₹ 15.10 lakhs. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2018 as per provisions of AS-7?

SOLUTION

Particulars	₹ In Lakhs
Cost of construction incurred till date	32.50
Add: Estimated future cost	15.10
Total estimated cost of construction	47.60
Less: Total contract price	(45.00)
Total foreseeable loss to be recognized as expense	2.60

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

Percentage of completion till date to total estimated cost of construction
= Cost incurred till date/Estimated total cost
= (32.50/47.60)x 100 = 68.28%

Proportion of total contract value recognised as revenue for the year ended 31st March, 2018 per AS 7 (Revised)
= Contract price x percentage of completion
= ₹ 45 lakh x 68.28% = ₹ 30.73 lakhs

4. QP NOV 20

Rajendra undertook a contract ` 20,00,000 on an arrangement that 80% of the value of work done, as certified by the architect of the contractee should be paid immediately and that the remaining 20% be retained until the Contract was completed.

In Year 1, the amounts expended were ₹ 8,60,000, the work was certified for ₹ 8,00,000 and 80% of this was paid as agreed. It was estimated that future expenditure to complete the Contract would be ₹ 10,00,000.

In Year 2, the amounts expended were ₹ 4,75,000. Three-fourth of the work under contract was certified as done by December 31st and 80% of this was received accordingly. It was estimated that future expenditure to complete the Contract would be ₹ 4,00,000.

In Year 3, the amounts expended were ₹ 3,10,000 and on June 30th, the whole Contract was completed. Show how Contract revenue would be recognized in the P & L A/c of Mr. Rajendra each year.

SOLUTION

No	Particulars	Year 1	Year 2	Year 3
1	Total contract revenue	20,00,000	20,00,000	20,00,000
2	Cost incurred so far	8,60,000	13,35,000 (475000+860000)	16,45,000 (1335000+310000)
3	Cost yet to be incurred	10,00,000	4,00,000	0

No	Particulars	Year 1	Year 2	Year 3
4	Estimated total cost	18,60,000	17,35,000	16,45,000
5	% Completion	46.24%	76.95%	100%
6	Total revenue to be recognised	9,24,800 (20,00,000x46.24%)	15,39,000 (20,00,000x76.95%)	20,00,000
7	Contract revenue to be recognised for the respected year	9,24,800	6,14,200 (1539000-924800)	4,61,000 (2000000-1539000)

5. QP JULY 21

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

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

You are required to compute the Percentage of Completion, the Contract Revenue and Cost to be recognized as per AS-7.

SOLUTION

Computation of contract cost

	₹ Lakh	₹ Lakh
Material cost incurred on the contract (net of closing stock)	21-4	17
Add: Labour cost incurred on the contract (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 contract cost		80

Percentage of completion = Cost incurred till date/Estimated total cost

= ₹ 45,00,000/₹ 80,00,000

= 56.25%

Contract revenue and costs to be recognized

Contract revenue (₹ 85,00,000x56.25%) = ₹ 47,81,250

Contract costs = ₹ 45,00,000

6. ICAI PRCATICAL QUESTION 13

Akar Ltd. Signed on 01/04/X1, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the year ended 31/03/X2.

- Materials used ₹ 71,00,000
- Labour charges paid ₹ 36,00,000
- Hire charges of plant ₹ 10,00,000
- Other contract cost incurred ₹ 15,00,000
- Labour charges of ₹ 2,00,000 are still outstanding on 31.3.X2.
- It is estimated that by spending further ₹ 33,50,000 the work can be completed in all respect.

You are required to compute profit/loss for the year to be taken to Profit & Loss Account and any provision for foreseeable loss to be recognized as per AS 7.

SOLUTION

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 used		71,00,000

	Labour Charges paid	36,00,000	
Add:	Outstanding on 31.03.20X2	2,00,000	38,00,000
	Hire Charges of Plant		10,00,000
	Other Contract cost incurred		15,00,000
	Cost incurred upto 31.03.20X2		1,34,00,000
Add:	Estimated future cost		33,50,000
	Total Estimated cost of construction		1,67,50,000
	Degree of completion (1,34,00,000/1,67,50,000 x 100)		80%
	Revenue recognized (80% of 1,50,00,000)		1,20,00,000
	Total foreseeable loss WN: 1		17,50,000
Less:	Loss for the current year (1,34,00,000 - 1,20,00,000)		14,00,000
	Loss to be provided for		3,50,000

WN:1

Calculation of foreseeable loss	₹
Total cost of construction	1,67,50,000
Less: Total contract price	1,50,00,000
Total foreseeable loss to be recognised as expense	17,50,000

7. ICAI – P.Q.11

RT Enterprises has entered into a fixed price contract for construction of a tower with its customer. Initial tender price agreed is ₹ 220 crore. At the start of the contract, it is estimated that total costs to be incurred will be ₹ 200 crore. At the end of year 1, this estimate stands revised to ₹ 202 crore. Assume that the construction is expected to be completed in 3 years.

During year 2, the customer has requested for a variation in the contract. As a result of that, the total contract value will increase by ₹ 5 crore and the costs will increase by ₹ 3 crore.

RT has decided to measure the stage of completion on the basis of the proportion of contract costs incurred to the total estimated contract costs. Contract costs incurred at the end of each year is:

Year 1: ₹ 52.52 crore

Year 2: ₹ 154.20 crore (including unused material of 2.5 crore)

Year 3: ₹ 205 crore.

You are required to calculate:

(a) Stage of completion for each year.

(b) Profit to be recognised for each year.

SOLUTION

a) **Stage of completion** = Costs incurred to date / Total estimated costs

Year 1: 52.52 crore / 202 crore = 26%

Year 2: (154.20 crore – 2.50 crore) / 205 crore = 74%

Year 3: 205 crore / 205 crore = 100%

b) **Profit for the year**

	Year 1	Year 2	Year 3
Contract Revenue (1)	57.20 crore	109.30 crore	58.50 crore
	(220 crore x 26%)	(225 crore x 74% - 57.20 crore)	(225 crore x 100% - 109.30 crore – 57.20 crore)
Contract Cost (2)	52.52 crore	99.18 crore	53.30 crore
	(202 crore x 26%)	(205 crore x 74% - 52.52 crore)	(205 crore x 100% - 99.18 crore – 52.52 crore)
Contract Profit (1) – (2)	4.68 crore	10.12 crore	5.20 crore

8. ICAI MOCK TEST PAPER I (Q NO 1 (A)), IPCC RTP NOV 2016 Q18B

X Ltd. negotiates with Bharat Petroleum Corporation Ltd (BPCL), for construction of "Franchise Retail Petrol Outlet Stations". Based on proposals submitted to different "Zonal offices of BPCL, the final approval for one outlet each in Zone A, Zone B, Zone C, Zone D, is awarded to X Ltd. Agreement (in single document) is entered into with BPCL for ₹ 490 lakhs. The agreement lays down values for each of the four outlets (₹ 88 + 132 + 160 + 110 lakhs) in addition to individual completion time. Examine and Decide whether X Ltd., will treat it as a single contract or four separate contracts.

SOLUTION

FACTS:

The construction agreement of X ltd. with BPCL is a single document for 4 zones. The agreement has values specified for each outlet and individual completion time.

REFERENCE:

As per **AS 7 on 'Construction Contracts'**, when a **contract** covers a **number of assets**, the construction of each asset should be **treated as a separate** construction contract when:

a) **Separate proposals** have been submitted **for each asset**
b) Each asset has been subject to **separate negotiation** and the contractor and customer have been able to **accept or reject** that part of the contract relating to each asset; and
c) The **costs and revenues** of each asset can be **identified.**

ANALYSIS:

In the given case, each outlet is submitted as a separate proposal to different Zonal Office, which can be **separately negotiated**, and **costs and revenues** thereof can be **separately identified.** Therefore, four separate contract accounts have to be recorded and maintained in the books of X Ltd. For each contract, principles of revenue and cost recognition have to be applied separately and net income will be determined for each asset as per AS -7.

CONCLUSION:

Each asset will be treated as a **"single contract"** even if there is one document of contract.

9. MTP APRIL 2022 TEST SERIES 2

Bricks Ltd. signed on 01/04/21, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the period ending 31/03/22:

- Materials issued ₹ 75,00,000
- Labour charges paid ₹ 36,00,000
- Hire charges of plant ₹ 10,00,000
- Other contract cost incurred ₹ 15,00,000
- Out of material issued, material lying unused at the end of period is ₹ 4,00,000
- Labour charges of ₹ 2,00,000 are still outstanding on 31.3.22.

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

You are required to compute profit/loss to be taken to Profit & Loss Account and additional provision for foreseeable loss as per AS 7.

SOLUTION

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 31.03.2022	2,00,000	38,00,000
	Hire Charges of Plant		10,00,000
	Other Contract cost incurred		15,00,000
	Cost incurred upto 31.03.2022		1,34,00,000
Add:	Estimated future cost		33,50,000
	Total Estimated cost of construction		1,67,50,000
	Degree of completion (1,34,00,000/1,67,50,000 x 100)		80%
	Revenue recognized (80% of 1,50,00,000)		1,20,00,000
	Total foreseeable loss (1,67,50,000 - 1,50,00,000)		17,50,000
Less:	Loss for the current year (1,34,00,000 - 1,20,00,000)		14,00,000
	Loss to be provided for		3,50,000

WN:1

Calculation of foreseeable loss	₹
Total cost of construction	1,67,50,000
Less: Total contract price	1,50,00,000
Total foreseeable loss to be recognised as expense	17,50,000

10. RTP NOV 22

On 1st December, 2020, "Sampath" Construction Limited undertook a contract to construct a building for ₹ 108 lakhs. On 31st March, 2021 the company found that it had already spent ₹ 83.99 lakhs on the construction. A prudent estimate of additional cost for completion was ₹ 36.01 lakhs.

You are required to compute the amount of provision for foreseeable loss, which must be made in the Final Accounts for the year ended 31st March, 2021 based on AS 7 "Accounting for Construction Contracts."

SOLUTION

Calculation of foreseeable loss for the year ended 31st March, 2021

(as per AS 7 "Construction Contracts")

(₹ in lakhs)	
Cost incurred till 31st March, 2021	83.99
Prudent estimate of additional cost for completion	36.01
Total cost of construction	120.00
Less: Contract price	(108.00)
Foreseeable loss	12.00

According to AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue; the expected loss should be recognized as an expense immediately. Therefore, amount of ₹12 lakhs is required to be provided for in the books of Sampath Construction Ltd. for the year ended 31st March, 2021.

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. MAY 2022 EXAM

Grace Ltd., a firm of contractors provided the following information in respect of a contract for the year ended on 31st March, 2022:

Particulars	(₹ in '000)
Fixed contract price with an escalations clause	35,000
Work certified	17,500
Work not certified (incudes ₹ 26,25,000 for materials issue, out of which material lying unused at the end of the period is ₹ 1,40,000)	3,815
Estimated further cost to completion	17,325
Progress payment Received	14,000
Payment to be Received	4,900
Escalations in cost is by 8% and accordingly the contract price is increased by 8%	

From the above information, you are required to:

(i) compute the contract revenue to be recognised,

(ii) Calculate profit / loss for the year ended 31st March,2022 and additional provision for the loss to be made, if any, for the year ended 31st March, 2022.

2. MAY 2023 EXAM

Fisher Constructions Co. obtained a contract for constructions of a commercial complex. The following details are available are available in records of a company for the years ended 31st March, 2023:

Particulars	Amount in Lakhs
Total Contract price	24000
Work certified	12500
Work not certified	2500
Estimated further cost to completion of work	17500
Progress payment received	11000
Progress payment to be received	3000

Applying the provisions of AS 7, you are required to compute:

(i) Profit/Loss for the year ended 31 March, 2023

(ii) Contract work in progress at the end of financial year 2022-2023

(iii) Revenue to be recognized out of the total contract value

(iv) Amount due from/ to customers as at the year end

MCQs

below information relates to Questions 1 – 3:

XY Ltd. agrees to construct a building on behalf of its client GH Ltd. on 1st April 20X1. The expected completion time is 3 years. XY Ltd. incurred a cost of ₹ 30 lakh up to 31st March 20X2. It is expected that additional costs of ₹ 90 lakh. Total contract value is ₹ 112 lakh. As at 31st March 20X2, XY Ltd. has billed GH Ltd. for ₹ 42 lakh as per the agreement. Assume that the work is completed to the extent of 75% by the end of Year 2.

1. Revenue to be recognized by XY Ltd. for the year ended 31st March 20X2 is
   a) ₹ 28 lakh
   b) ₹ 42 lakh
   c) ₹ 30 lakh
   d) ₹ 32 lakh

2. Total expense to be recognised in Year 1 is
   a) ₹ 30 lakh
   b) ₹ 120 lakh
   c) ₹ 38 lakh
   d) ₹ 36 lakh

3. Revenue to be recognised for year 2 is
   a) ₹ 84 lakh
   b) ₹ 42 lakh
   c) ₹ 56 lakh
   d) ₹ 28 lakh

Below information relates to Questions 4 – 5

M/s AV has presented the information for Contract No. XY123:

Total contract value ₹ 370 lakh

Certified work completed ₹ 320 lakh

Costs incurred to date ₹ 360 lakh

Progress Payments received ₹ 300 lakh

Expected future costs to be incurred ₹ 50 lakh

4. Revenue to be recognised by M/s AV is
   a) ₹ 320 lakh
   b) ₹ 370 lakh
   c) ₹ 360 lakh
   d) ₹ 400 lakh

5. Total expense to be recognised by M/s AV is
   a) ₹ 360 lakh
   b) ₹ 400 lakh
   c) ₹ 320 lakh
   d) ₹ 360 lakh

6. LP Contractors undertakes a fixed price contract of ₹ 200 lakh. Transactions related to the contract include:

Material purchased: ₹ 80 lakh

Unused material: ₹ 30 lakh

Labour charges: ₹ 60 lakh

Machine used for 3 years for the contract. Original cost of the machine is ₹ 100 lakh. Expected useful life is 15 years.

Estimated future costs to be incurred to complete the contract: ₹ 80 lakh.

Loss on contract to be recognised is:
   a) ₹ 40 lakh
   b) ₹ 10 lakh
   c) ₹ 90 lakh
   d) ₹ 50 lakh

Answers											
1.	(a)	2.	(d)	3.	(c)	4.	(a)	5.	(d)	6.	(b)

AS 9 Revenue Recognition

Revenue is the

- Gross inflow of cash, receivables and other consideration
- Arising in the course of ordinary activities of an enterprise
- From :—
  - Sale of goods
  - Rendering of services, and
  - Use by others of enterprise resources yeilding interest, royalties and dividend.

Revenue Recognition from Sale of Goods

PERFORMANCE

- The seller has transferred to buyer all significant risks & rewards of ownership,
- The seller retains no effective control of the goods to a degree usually associate with ownership.

MEASUREMENT

- There is no significant uncertainty regarding the amount of consideration that will be derived from the sale of goods.

COLLECTABILITY

- At the time of performance it is not unreasonable to expect ultimate collection.

These illustration donot form part of the Accounting standard. Their purpose is to illustrate the application of the standard to a number of commercial situations in an endeavour to assist in clarifying application of the standard.

Delayed at Buyer's request

- Delivery is delayed at buyer's request and buyer takes title and accepts billing.
- Revenue should be recognised notwithstanding that physical delivery has not been completed. so long as there is very expectation that delivery will be made.
- Items must be on hand, identified & ready for delivery to the buyer at the time sale is recognised.

Goods sold on approval

Revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed.

Goods sold subject to installation, inspection etc.

- Revenue not to be recognized until the customer accepts delivery and installation and inspection are complete.
- In case where installation fees are other than incidental to the sale of product, they should be recognized as revenue only when the equipment is installed and accepted by the customer.

Goods sold on Guarantee

delivery is made giving the buyer an unlimited right of return. Recognition of revenue in such circumstances will depend on the substance of the agreement.

Consignment Sales.

Delivery is made whereby the recipient undertakes to sell the goods on behalf of the consignor. Revenue should not be recognised until the goods are sold to a third party.

Cash on delivery sales

Revenue should not be recognized until cash is received by the seller or his agent.

SOME SPECIAL CASES

a. **Sales where the purchaser makes a series of installment payments** to the seller, and the seller delivers the goods only **when the final payment is received**

- Revenue from such sales should not be recognized until goods are delivered.
- However, when experience indicates that most such sales have been consummated revenue may be recognized when a significant deposit is received.

b. **Partial payments** → Special orders and shipments i.e. **where payment** (or partial payment) is **received for goods not presently held in stock** eg. the stock is **still to be manufactured** or it is **to be delivered directly to the customers from a third party.**

- Revenue from such sales should not be recognized until goods are manufactured, identified and ready for delivery to the buyer by the third party.

c. **Sales / Repurchase agreement** → i.e. where **seller concurrently agrees to repurchase the same goods at a later date.**

- Such transaction that are in **substance a financing agreement,**
- The resulting cash inflow is not revenue as defined and should not be recognised.

d. **Sales to intermediate parties** i.e. **where goods are sold to distributors, dealers or others for resale.**

Revenue from such sales can generally be recognised if significant risks of ownership have passed;

Installment Sales

Revenue attributable to the sales price exclusive of interest should be recognised at the date of sale. The interest element should be recognised as revenue, proportionately to the unpaid balance due to the seller.

Subscription for publication

Revenue received or billed should be deferred. Recognise either on a straight line basis over time.

Trade Discount and Volume Rebate

given should be deducted in determining revenue.

Advertising and insurance Agency commission

Revenue should be recognized when the service is complete.

Rendering of services

Performance should be measured either under the completed services contract method or under the proportionate completion method which ever related revenue to the work accomplished.

Use of Enterprise resources by other parties.

Use of enterprise resources by others may yield revenue in the form of

- Interest
- Royalties
- Dividends

Recognition of revenue when enterprise resources are used by others

- **Interest** time basis
- **Royalties** Accrual basis depending upon the terms of agreement
- **Dividend** when right to receive the payment is established

Note for student...

AS 9 – REVENUE RECOGNITION

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI ILLUSTRATION 2						
2	ICAI ILLUSTRATION 4						
3	QP MAY 19						
4	MAY 2015						
5	QP NOV 19						
6	MTP OCT. 21 SERIES 1						
7	ICAI ILLUSTRATION 1 (New Syllabus)						
8	ICAI P.Q. 8						
9	RTP MAY 2013						
10	MTP MAR 22 SERIES 1						
TEST IN TIME PASS IN TIME							
1	QP DEC 21						
2	EXAM NOV 22						

1. ICAI ILLUSTRATION 2

Y Ltd., used certain resources of X Ltd. In return X Ltd. received ₹ 10 lakhs and ₹ 15 lakhs as interest and royalties respective from Y Ltd. during the year 20X1-X2. You are required to state whether and on what basis these revenues can be recognized by X Ltd.

SOLUTION

REFERENCE:

As per **AS 9 "Revenue Recognition"**, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) The seller of **goods has transferred to the buyer** the property in the goods for a price or **all significant risks and rewards** of ownership have been **transferred** to the buyer and the seller retains **no effective control** of the goods transferred to a degree usually associated with ownership; and

(ii) **No significant uncertainty exists** regarding the amount of the **consideration** that will be derived from the sale of the goods.

ANALYSIS:

These revenues are recognized on the following bases:

i. **Interest:** On a time proportion basis taking into account the amount outstanding and the rate applicable.

ii. **Royalties:** On an accrual basis in accordance with the terms of the relevant agreement.

CONCLUSION:

X Ltd. should **recognize interest** revenue of ₹ 10 Lakhs and **royalty** revenue of ₹ 15 Lakhs.

2. ICAI ILLUSTRATION NO 4

In the year 20X1-X2, XYZ supplied goods on Consignment basis to ABC – a retail outlet worth ₹10,00,000. As per the terms, ABC will only pay XYZ for the goods which are sold by them to the third party. Rest of the goods can be returned back to XYZ and ABC will not have any further liability for these goods.

During the year 20X1-X2, ABC has sold goods worth ₹ 5,50,000 only and rest of the goods are still lying in its store which may get sold by next year. Advise XYZ, how much revenue it can recognize in its books for period 20X1-X2.

SOLUTION

FACTS:

XYZ supplied goods on Consignment basis to ABC worth ₹10,00,000, of which goods worth ₹5,50,000 has been sold during the year 20X1-X2.

REFERENCE:

As per **AS 9 "Revenue Recognition"**, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) The seller of **goods has transferred to the buyer** the property in the goods for a price or **all significant risks and rewards** of ownership have been **transferred** to the buyer and the seller retains **no effective control** of the goods transferred to a degree usually associated with ownership; and

(ii) **No significant uncertainty exists** regarding the amount of the **consideration** that will be derived from the sale of the goods.

ANALYSIS:

Consignment **risk and rewards** are **not transferred** to the customer on just delivery of the goods and no revenue should be recognized until the goods are sold to a third party.

As per the reference and facts above, the goods worth ₹5,50,000 have been sold and ₹4,50,000 worth of goods are still with ABC for sale on behalf of XYZ. For the goods worth ₹4,50,000, ABC have **no liability** and **can be returned back** to XYZ as per the terms.

CONCLUSION:

XYZ can **recognize revenue** of ₹ 5,50,000.

3. QP MAY 19

Given below is the following information of B.S. Ltd.

i. Goods of ₹ 50,000 were sold on 18-03-2018 but at the request of the buyer these were delivered on 15-04-2018.

ii. On 13-01-2018 goods of ₹ 1,25,000 are sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-03-2018.

iii. ₹ 1,00,000 worth of goods were sold on approval basis on 01-12-2017. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-01-2018 and no approval or disapproval received for the remaining goods till 31-03-2018.

You are required to advise the accountant of B.S. Ltd., with valid reasons, the amount to be recognized as revenue for the year ended 31st March, 2018 in above cases in the context of AS-9.

SOLUTION

REFERENCE:

As per **AS 9 "Revenue Recognition"**, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) The seller of **goods has transferred to the buyer** the property in the goods for a price or **all significant risks and rewards** of ownership have been **transferred** to the buyer and the seller retains **no effective control** of the goods transferred to a degree usually associated with ownership; and

(ii) **No significant uncertainty exists** regarding the amount of the **consideration** that will be derived from the sale of the goods.

ANALYSIS (i):

The sale is complete but delivery has been **postponed** at buyer's request. Hence **both the conditions** for recognition of revenue are **satisfied.**

CONCLUSION:

B.S. Ltd. should **recognize** the entire sale of ₹ **50,000** for the year ended 31st March, 2018.

ANALYSIS (ii):

In case of **consignment sale revenue should not be recognized** until the goods are sold to a third party. As the risk and rewards are not transferred, it cannot be recognized.

CONCLUSION:

20% goods lying unsold with consignee should be treated as closing inventory and **sales** should be **recognized for ₹ 1,00,000 (80% of ₹ 1,25,000).**

ANALYSIS (iii):

In case of **goods sold on approval basis**, revenue **should not be recognized** until the goods have been **formally accepted** by the buyer or the buyer has done an act adopting the transaction or the time period for **rejection has elapsed** or where no time has been fixed, a **reasonable time has elapsed.**

CONCLUSION:

Revenue should be recognized for the total sales amounting ₹ **1,00,000** as the time period for rejecting the goods had expired.

Total revenue amounting ₹ 2,50,000 (50,000 + 1,00,000+ 1,00,000) will be recognized for the year ended 31st March, 2018 in the books of B.S. Ltd.

4. MAY 2015

A company sells the goods with right to return. The following pattern has been observed:

Timeframe of return from date of purchase	% of cumulative sales
Within 10 days	5%
Between 11 days and 20 days	7 %
Between 21 days and 30 days	8%
Between 31 days and 45 days	9 %

Company has made sale of Rs.30 lacs in the month of February 2015 and of Rs.36 lacs in the month of March, 2015. The total sales for the financial year have been Rs.450 lacs and the cost of sales was Rs.360 lacs.

Determine the amount of provision to be made and revenue to be recognised in accordance with AS 9. A year may be considered of 360 days.

SOLUTION

REFERENCE:

As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', 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.

Revenue in respect of sale of goods is recognised 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 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 provisions** for returns based on previous experiences.

ANALYSIS:

The goods are sold with a **right to return**. The existence of such right gives rise to a **present obligation** on the company. Revenue in respect of sale of goods is recognized fully at the time of sale itself assuming that the company has complied with the conditions stated in AS 9 relating to recognition of revenue in the case of sale of goods.

Sales during	Sales value (Rs. in lacs)	Sales value (cumulative) (Rs. in lacs)	Likely returns (%)	Likely returns (Rs. in lacs)	Provision @ 20% (Rs. in lacs) (Refer W.N.)
Last 10 days of March	36/3 or 12	12	5%	0.600	0.120
Previous 10 days of March	36/3 or 12	24	7%	1.680	0.336
Previous 10 days of March	36/3 or 12	36	8%	2.880	0.576
Last 15 days of February	30/2 or 15	51	9%	4.590	0.918
Total				9.75	1.950

Therefore, sale of Rs.30,00,000 and 36,00,000 made in the month of February and March, 2015 will be recognized at full value.

Working Note:

Calculation of Profit % on sales

Particulars	Rs. In Lacs
Sales for the year	450
Less: Cost of sales	(360)
Profit	90
Profit mark up on sales (90/450) x 100 = 20%	

Alternatively, AS 9 provides that Revenue should not be recognized until the goods have formally been accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has been elapsed. Based on this, an alternative view can be taken whereby the revenue shall not be recognized in full. In such a case, the revised sales will be as follows:

Particulars		Rs. In Lacs
Revised Sales when estimated sales return is 9.75 lacs	450 - 9.75	440.25
Revised Cost of Sales	440.25 x 80%	352.20
Revised Gross Profit		88.05
Given Gross Profit		90
Reduction in Gross Profit		1.95
Reduction in receivables and sales		9.75
Inventory will stand increased by		7.80

5. QP NOV 19

Indicate in each case whether revenue can be recognized and when it will be recognized as per AS 9.

(1) Trade discount and volume rebate received.

(2) Where goods are sold to distributors or others for resale.

(3) Where seller concurrently agrees to repurchase the same goods at a later date.

(4) Insurance agency commission for rendering services.

(5) On 11-03-2019 cloths worth ₹ 50,000 were sold to X mart, but due to refurbishing of their showroom being underway, on their request, clothes were delivered on 12-04-2019.

SOLUTION

As per **AS 9 "Revenue Recognition"**, the revenue should be recognized as follows:

1. Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. **Trade discounts and volume rebates** given **should be deducted** in determining revenue.
2. When goods are sold to distributor or others, revenue from such sales can generally be recognized if **significant risks of ownership have passed**; however, in some situations the buyer may in **substance be an agent** and in such cases the sale should be treated as a **consignment sale.**
3. For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in **substance a financing agreement**, the resulting cash inflow is not revenue as defined and should **not be recognized as revenue.**
4. Insurance agency commissions should be recognized on the **effective commencement or renewal dates** of the related policies.
5. On 11.03.2019, if X mart takes title and accepts billing for the goods then it is implied that the sale is complete and all **risk and reward** on ownership has been **transferred** to the buyers. Revenue should be recognized for year ended 31st March, 2019 notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made and items were ready for delivery to the buyer at the time.

6. **MOCK TEST OCT. 21 SERIES I / RTP NOV 20**

Fashion Limited is engaged in manufacturing of readymade garments. They provide you the following information on 31st March, 2021:

(i) On 15th January, 2021 garments worth ₹ 4,00,000 were sent to Anand on consignment basis of which 25% garments unsold were lying with Anand as on 31st March, 2021.

(ii) Garments worth ₹ 1,95,000 were sold to Shine boutique on 25th March, 2021 but at the request of Shine Boutique, these were delivered on 15th April, 2021.

(iii) On 1st November, 2020 garments worth ₹ 2,50,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods up to 31st December, 2020 and no approval or disapproval received for the remaining goods till 31st March, 2021.

You are required to advise the accountant of Fashion Limited, the amount to be recognised as revenue in above cases in the context of AS 9.

SOLUTION

REFERENCE:

As per **AS 9 "Revenue Recognition"**, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) The seller of **goods has transferred to the buyer** the property in the goods for a price or **all significant risks and rewards** of ownership have been **transferred** to the buyer and the seller retains **no effective control** of the goods transferred to a degree usually associated with ownership; and

(ii) **No significant uncertainty exists** regarding the amount of the **consideration** that will be derived from the sale of the goods.

ANALYSIS (i):

In case of **consignment sale** revenue should not be recognized until the goods are sold to a third party. As the **risk and rewards** are **not transferred**, it **cannot be recognized.**

CONCLUSION:

25% goods lying unsold with consignee should be treated as closing inventory and **sales should be recognized for ₹ 3,00,000 (75% of Rs. 4,00,000)** for the year ended on 31.3.21.

ANALYSIS (ii):

The sale is complete but **delivery** has been **postponed** at buyer's request. Hence **both the conditions** for recognition of revenue are **satisfied.**

CONCLUSION:

Fashion Ltd. should **recognize the entire sale of Rs.1,95,000** for the year ended 31st March, 2021.

ANALYSIS (iii):

In case of **goods sold on approval basis,** revenue should **not be recognized** until the goods have been **formally accepted** by the buyer or the buyer has done an act adopting the transaction or the time period for **rejection has elapsed** or where no time has been fixed, a **reasonable time has elapsed.**

CONCLUSION:

Revenue should be recognized for the total sales amounting Rs. 2,50,000 as the time period for rejecting the goods had expired.

Total revenue amounting Rs. 7,45,000 (3,00,000+1,95,000+2,50,000) will be recognized for the year ended 31st March, 2021 in the books of Fashion Ltd.

7. ICAI ILLUSTRATION 1 (New Syllabus)

Zigato runs a food-delivery business. As per the arrangement, Zigato allows customers to order food from local restaurants and is responsible the delivery of the food within stipulated time. During a particular year, it collects the money on orders made online as under:

Total price for the food item	-	₹ 200 lakhs
Delivery charges	-	₹ 60 lakhs
GST	-	₹ 40 lakhs
Total	-	₹ 300 lakhs

Zigato has received ₹ 300 lakhs for the above orders from customers and the orders were delivered to the customer in stipulated time.

How much revenue should be recognised by restaurants and how much revenue should be recognised by Zigato for the year?

SOLUTION

The **risks and rewards** associated with the food item are **not with Zigato**. When a customer has ordered a food item, whether the item will be prepared or not is the responsibility of the restaurant and not Zigato. Similarly, the responsibility to deliver the food item is with Zigato and the restaurant does not undertake responsibility for the same.

Therefore, the **restaurant undertakes the principal's responsibility** to prepare the food and ensure its quality. Zigato, on the other hand, is only responsible to deliver the food. Thus, **Zigato is acting as an agent.** Hence, it can only recognize revenue relating to that activity (which it does in the ordinary course of business). The **revenue for Zigato**, therefore, is ₹ **60 lakhs,** whereas, the revenue for restaurants will be ₹ 200 lakhs.

It may be noted that the GST of ₹ 40 lakhs is a liability payable to the Government (third party), hence it does not form part of revenue.

8. ICAI P.Q.8

For the year ended 31st March 20X1, KY Enterprises has entered into the following transactions.

On 31 March 20X1, KY supplied two machines to its customer ST. Both machines were accepted by ST on 31 March 20X1. Machine 1 was a machine that was routinely supplied by KY to many customers and the installation process was very simple.

Machine 1 was installed on 2 April 20X1 by ST's employees.

Machine 2 being more specialised in nature requires an installation process which is more complicated, requiring significant assistance from KY. Machine 2 was installed between 2 and 5 April 20X1. Details of costs and sales prices are as follows:

	Machine 1	Machine 2
Sale Price	3,20,000	3,00,000
Cost of production	1,60,000	1,50,000
Installation fee	nil	10,000

How should above transactions be recognized by KY Enterprises for theyear ended 31st March 20X1?

SOLUTION

Machine 1: As the installation process is simple, revenue from Machine 1 will be recognized on 31 March 20X1.

Revenue (Machine 1)	₹ 3,20,000
Cost of Goods Sold	₹ 1,60,000
Profit during the period	₹ 1,60,000

Since the question specifies that the machine is already accepted by ST on 31 March 20X1, the **revenue arising from sale of the machine needs to be recognized** for the year ending 31 March

20X1. This is because acceptance of the machine indicates that the **risks and rewards** pursuant to the ownership are **transferred** to ST.

Machine 2: Installation process for Machine 2 is more complicated, requiring significant assistance from KY Ltd. However, question specifies that the machine is already accepted by ST on 31 March 20X1. Assuming that there is no further approval/acceptance required from the buyer for the Machine sold, revenue from sale of Machine 2 can be recognized for the year ending 31 March 20X1.

Revenue (Machine 2)	₹ 3,00,000
Cost of Goods Sold	₹ 1,50,000
Profit during the period	₹ 1,50,000

However, installation fee which is for rendering installation services cannot be recognized until the installation is complete. Since the machine is **pending installation**, the **revenue** in respect of installation charges ₹10,000 **needs to be recognized** on 5 April 20X1 once the **installation process gets completed.**

9. (RTP MAY 2013)

M Ltd. manufactures machinery used in Steel Plants. It quotes prices in various tenders issued by Steel Plants. As per terms of contract, full price of machinery is not released by the steel plants, but 10% thereof is retained and paid after one year if there is satisfactory performance of the machinery supplied. The company accounts for only 90% of the invoice value as sales income and the balance amount in the year of receipt to the extent of actual receipts only. Comment on the treatment done by M Ltd.

SOLUTION

REFERENCE:

According to **AS 9 "Revenue Recognition"**, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) The seller of **goods has transferred to the buyer** the property in the goods for a price or **all significant risks and rewards** of ownership have been **transferred** to the buyer and the seller retains **no effective control** of the goods transferred to a degree usually associated with ownership and

(ii) **No significant uncertainty exists** regarding the amount of the **consideration** that will be derived from the sale of the goods.

ANALYSIS:

In the present case, the goods, as well as the risks and rewards of ownership have been transferred to the steel plants. The invoice raised by M Ltd. is for the full price. M Ltd. receives 90% as 10% is kept as '**Retention Money'**. Thus, M Ltd. should recognise revenue at the full invoice price, i.e., 100% of the sale price.

Depending on the **past experience** of recovering the balance 10% from the steel plants, M Ltd. can make a **provision for sales** income which is **not likely to be realised.**

CONCLUSION:

The practice adopted by M Ltd. is **not in consonance with AS 9.**

10. MTP MARCH 2022 TEST SERIES I

New Era Publications publishes a monthly magazine on 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The sale of space for the March 2020 issue was made in February 2020. The magazine was published on its scheduled date. It received 2,40,000 on 10.3.2020 and ₹ 60,000 on 10.4.2020 for the March, 2020 issue.

Discuss in the context of AS 9 the amount of revenue to be recognized and the treatment of the amount received from advertisers for the year ending 31.3.2020. What will be the treatment if the publication is delayed till 2.4.2020?

SOLUTION

REFERENCE:

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:

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.

Case I: When magazine publication is made on 15.03.2020 - **₹ 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.*

Case 2: *When 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.*

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. EXAM NOV 22

Indicate in each case whether revenue can be recognized and when it will be recognized as per AS 9.

(i) Delivery is delayed at buyer's request but buyer taken title and accepts billing.

(ii) Instalment Sales

(iii) Trade discounts and volume rebates.

(iv) Insurance agency commission for rendering services.

(v) Advertising Commission.

2. QP DEC 21

Given the following information of Rainbow Ltd:

i. On 15th November, goods worth ₹ 5,00,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods sold Upto 31st January and no approval or disapproval received for the remaining goods till 31st March.

ii. On 31st March, goods worth ₹ 2,40,000 were sold to bright Ltd. but due to refurnishing of their show-room being underway, on their request, goods were delivered on 10th April.

iii. Rainbow Ltd. supplied goods ₹ 6,00,000 to Shyam Ltd. and concurrently agrees to re-purchase the same goods on 14th April.

iv. Dew Ltd. used certain assets of Rainbow Ltd. Rainbow Ltd. received ₹ 7.5 lakhs and ₹ 12 lakhs as interest and royalties respectively from Dew Ltd. during the year 2020-21.

v. On 25th December goods of ₹ 4,00,000 were sent on consignment basis of which 40% of the goods unsold are lying with the consignee at the year end on 31st March.

In each of the above cases, you are required to advise, with valid reasons, the amount to be recognized as revenue under the provisions of AS- 9

MCQs

1. Which of the conditions mentioned below must be met to recognize revenue from the sale of goods?
   i. the entity selling does not retain any continuing influence or control over the goods;
   ii. when the goods are dispatched to the buyer;
   iii. revenue can be measured reliably;
   iv. the supplier is paid for the goods
   v. it is reasonably certain that the buyer will pay for the goods;
   vi. The buyer has paid for the goods.
   a) (i), (ii) and (v)
   b) (ii), (iii) and (iv)
   c) (i), (iii) and (v)
   d) (i), (iv) and (v)

2. Consignment inventory is an arrangement whereby inventory is held by one party but owned by another party. Which of the following indicates that the inventory in question is a consignment inventory?
   a) Manufacturer cannot require the dealer to return the inventory
   b) Dealer has the right to return the inventory
   c) Manufacture is responsible for the pricing of goods and any changes in the pricing can only be approved by the manufacturer .
   d) Manufacture is responsible for the holding the goods and any changes in the pricing can only be approved by the dealer

3. Which of the following transactions qualify as revenue for M/s AB Enterprises?
   a) Sales of ₹ 20 lakhs made under consignment sales.
   b) Sale of an old machine amounting ₹ 5 lakhs
   c) Services provided to the customer in the normal course of business. Sales recorded is ₹ 50,000.
   d) Sales of ₹ 25 lakhs made under consignment sales

4. The Accounting Club has 100 members who are required to pay an annual membership fee of ₹ 5,000 each. During the current year, all members have paid the fee. However, 5 members have paid an amount of ₹ 10,000 each. Of these, 3 members paid the current year's fee and also the previous year's dues. Remaining 2 members have paid next years' fee of ₹ 5,000 in advance. Revenue from membership fee for the current year to be recognised will be:

a) ₹ 5,25,000

b) ₹ 5,10,000

c) ₹ 5,00,000

d) ₹ 5,15,000

5. FlixNet International offers a subscription fee model to allow the paid subscribers an annual viewing of movies, sports events and other content. It allows users to register for free and have access to limited content for one month without any charges. The customer has a right to cancel the subscription within a month's time but is required to p ay for 1 year subscription fee after the free period. XY has subscribed for free viewing on 1st March 20X1. After 1 month, he has agreed to pay the annual membership and has paid ₹ 1,200 on 31st March 20X1 for the subscription that is valid up to 31st of March 20X2. Revenue that can be recognized by FlixNet for the year ended 31st March 20X2 is

a) ₹ 100

b) ₹ 1,200

c) Nil

d) ₹ 1,100

Answers									
1.	(a)	2.	(c)	3.	(c)	4.	(c)	5.	(b)

AS 10

Property, Plant and Equipment

NON - APPLICABILITY

BIOLOGICAL ASSETS

means assets which are consumed

EXAMPLE

Plants

Animals
Horse, Cattle, Sheep, Goat

Plants → BEARER PLANTS, AGRICUTURAL PRODUCE

BEARER PLANTS

AS 10 is applicable If below conditions are satisfied.

- Is used in the production or supply of agricultural produce
- Is expected to bear produce for more than a period of 12 months.
- Has a remote likelihood of being sold as agricultural product except for incidental scrap sales.

WASTING ASSETS

means mines

EXAMPLE

Mineral rights, Expenditure on exploration for and extraction of mineral oils, natural gas & similar regenerative resources.

WHAT ARE NOT BEARER PLANTS

- Plants cultivated to be harvested as Agricultural produce — Trees grown for use as lumber
- Plants cultivated to Produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales — Trees which are cultivated both for their fruit and their lumber
- Annual Crops — Maize and wheat

Property, Plant and Equipment means

tangible items

which are held for use in production, supply, rental and administration purposes

and

are expected to be used for more than 12 months.

RECOGNITION CRITERIA FOR PPE

Conditions

(i) If it is probable that future economic benefits will flow to the enterprise

and

(ii) Cost of the item can be measured reliably

Initial Recognition

Cost of an item of PPE

Includes

Purchased

- Purchase Price
- Directly attributable
- Initial estimate of decommissioning or dismanting Cost

Self - Generated

[Refer points of Purchased PPE]

- Internal profit cannot be recognised.
- Abnormal Cost is not included in the cost of the assets.
- Actual cost incurred on construction is included.

Excludes

- Cost of opening new business such as inauguration cost
- Startup Cost
- Cost of introducing a new product including advertising.
- Initial operating losses.
- Cost of relocating or reorganizing part or all the operating of enterprises
- Administrative and other general overheads.
- Abnormal cost / losses.

TREATMENT OF SUBSEQUENT COST

Repairs and Maintenance

these costs are recognised in the statement of Profit and Loss as incurred.

Replacement of Parts

An enterprise recognise in the carrying amount of an item of PPE the cost of replacing parts of such an item when that cost is incurred if the recognition criteria are met.

Regular Major Inspections

When such major inspection is performed, its cost recognised in the carrying amount of an item of PPE as a replacement, if the recognition criteria are met.

Any remaining carrying amount of the cost of the previous inspection is derecognised.

MEASUREMENT OF PPE

At Initial Recognition

An item of PPE that qualifies for recognition as an asset should be measured at its cost.

- If payment is deferred beyond normal credit terms.

Total payment - Cash equivalent

- PPE acquired in exchange for a non-monetary asset or monetary asset or combination of monetary and non-monetary assets.
- PPE purchased at the consolidated price
- PPE held by lessee under a finance lease.
- Government grant related to PPE

Subsequent Measurement at the Balance Sheet date

An enterprise should choose either Cost model (or) Revaluation model as its accounting policy and should apply that policy to an entire class of PPE

COST MODEL

Original Cost	XXX
Less:- Any Accumulated depreciation	XXX
Less:- Any Accumulated impairment losses	XXX
	XXX

REVALUATION MODEL

Fair value at the date of revaluation	XXX
Less:- Any subsequent accumulated depreciation	XXX
Less:- Any subsequent accumulated impairment losses.	XXX
CARRYING AMOUNT	XXX

FREQUENCY OF REVALUATION

[Sufficient Regularity]

- Item of PPE experience significant and volatile changes in fair value → Annual Revaluation
- Items of PPE with only insignificant changes in fair value → Revalue the item only every 3 or 5 years

ACCOUNTING TREATMENT ON REVALUATION

- **technique 1**: Change in Gross carrying amount and accumulated depreciation amount
- **technique 2**: Accumulated depreciation is eliminated against the gross carrying amount of the asset.

TREATMENT OF REVALUATION SURPLUS

The revaluation surplus included in owners interest in respect of an item of PPE may be transferred to the revenue reserve when the asset is derecognized

- **Case 1**: when whole surplus is transferred if asset if retired or disposed of
- **Case 2**: Some of the surplus may be transferred as the asset is used by an enterprise

ACCOUNTING TREATMENT ON REVALUATION

technique 1

change in Gross carrying amount and accumulated depreciation amount

↓

Gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset

technique 2

Accumulated depreciation is eliminated against the gross carrying amount of the asset.

GROSS CARRYING AMOUNT

- May be restated by reference to observable market data.
- May be restated proportionately to the change in the carrying amount.

ACCUMULATED DEPRECIATION AT THE DATE OF THE REVALUATION

- Adjusted to equal the difference between the gross carrying amount of the asset after taking into account accumulated impairment

SUBSEQUENT MEASUREMENT / REVALUATION OF ASSET

COST = ₹1000

Upward Revaluation = 1200

PPE A/c — Dr 200
To Revaluation 200

- **Upward** 300
  - PPE A/c — Dr 300
  - To Revaluation 300
- **Downward** 300
  - Revaluation A/c 200
  - P&L A/c 100
  - To PPE A/c 300

Downward Revaluation = 800

P&L A/c Dr 200
To PPE A/c 200

- **Upward** 300
  - PPE A/c — Dr 300
  - To P&L A/c 200
  - To Revaluation A/c 100
- **Downward** 300
  - P&L A/c — Dr 300
  - To PPE A/c 300

The depreciable amount of an asset should be allocated on a systematic basis over its useful life.

Depreciation

Systematic allocation of the depreciable amount of an asset over its useful life.

Component Method of Depreciation

Each part of an item of PPE with a cost of the item should be depreciated separately.

Accounting treatment

Depreciation charge for each period should be recognise in the statement of profit and loss unless it is included in the carrying amount of another asset.

Depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

Methods of depreciation

The depreciation method used should reflect the pattern in which the futures economic benefits of the assets are expected to be consumed by enterprise.

- Straight-line Method
- Diminishing Balance method
- Units of Production method

Note : The depreciation method applied to an asset should be reviewed at least at each financial year end and if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the change pattern.

Cessesation of Depreciation

- Residual value ≥ Carrying amount

(or)

- Earlier of:-
  (i) The date that the asset is retired from active use and is held for disposal
  (ii) The date that the asset is derecognised.

De-recognition

De-recognition of carrying amount of PPE

On Disposal

- By Sale
- By entering into finance lease
- By donations

When no future economic benefits are expected from its use or disposal.

Gain or loss arising from de-recognition of an item of PPE should be include in the statement of P&L when item is derecognised unless AS-19 on leases, requires otherwise on sale and leaseback.

Accounting treatment

Gain or loss arising from de-recognition of an item of PPE

= Net disposal proceeds [if any] – carrying amount of the item

Note for student...

AS 10 – PROPERTY, PLANT AND EQUIPMENT

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI - ILLUSTRATION 6						
2	ICAI - ILLUSTRATION 7						
3	INTER QP - NOV 2018						
4	INTER QP NOV 2020						
5	ICAI – P.Q. 16						
6	ICAI – P.Q. 18						
7	QP - JULY 21						
8	QUESTION						
9	QUESTION						
10	QUESTION						
11	QUESTION (Similar to ICAI P.Q.14)						
12	ICAI - ILLUSTRATION 1						
13	ICAI - ILLUSTRATION 5						
14	ICAI - ILLUSTRATION 12						
15	ICAI - ILLUSTRATION 4						
16	MTP - OCT 21 – SERIES 2						
17	MTP - OCT 20						
18	INTER RTP NOV 2019 / IPCC RTP MAY 2019 / IPCC QP NOV 2019						
TEST IN TIME PASS IN TIME							
1	IPCC QP JAN 2021						
2	QUESTION (QP MAY 22)						

1. QUESTION (ILLUSTRATION 6 – ICAI)

Entity A, which operates a major chain of Supermarkets, has acquired a new store location. The new location requires significant Renovation Expenditure. Management expects that the renovations will last for 3 Months during which the Supermarket will be closed.

Management has prepared the budget for this period including expenditure related to Construction and Re-Modelling Costs, salaries of staff who will be preparing the Store before its opening and related Utilities Costs. What will be the treatment of such expenditures?

SOLUTION

REFERENCE:

As per the provisions of **AS 10 PROPERTY, PLANT & EQUIPMENT,** the cost of an item of property, plant and equipment comprises 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.

The cost of an item of property, plant and equipment should be **recognised** as an **asset** if, and only if -

- It is **probable that future economic benefits** associated with the item will flow to the enterprise; **and**
- The cost of the item can be **measured reliably.**

ANALYSIS:

The costs of construction and re-modelling the supermarket are **necessary** to bring the store to the condition necessary for it to be capable of operating in the manner intended by management.

However, if the cost of salaries, utilities and storage of goods are in the **nature of operating expenditure** that would be incurred if the supermarket was open, then these costs are **not necessary** to bring the store to the condition necessary for it to be capable of operating in the manner intended by management and **should be expensed.**

CONCLUSION:

Construction and re-modelling cost **should be capitalized by Entity A.**

2. QUESTION (ILLUSTRATION 7 - ICAI)

An amusement park has a 'soft opening to the public, to trial run its attractions. Tickets are sold at a 50% discount during this period and the operating capacity is 80%. The official opening day of the amusement park is three months later.

Management claim that the soft opening is a trial run necessary for the amusement park to be in the condition capable of operating in the intended manner. Accordingly, the net operating costs incurred should be capitalised. Comment.

SOLUTION

FACTS:

Amusement Park management wants to capitalise the net operating costs incurred during soft opening as it is a trial run.

REFERENCE:

As per the provisions of **AS 10 PROPERTY, PLANT & EQUIPMENT,** the **cost** of an item of property, plant and equipment **comprises** 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.

AS 10 specifically mentions inauguration costs are not part of PROPERTY, PLANT & EQUIPMENT.

ANALYSIS:

As per the reference above, inauguration costs cannot be capitalised. Also, even though park is running at less than full operating capacity (80% of operating capacity), there is **sufficient evidence** that park is **capable of operating** in the manner intended by management.

CONCLUSION:

Contention of management to capitalise the cost is **incorrect.** Net operating cost should not be capitalised, but **should be recognised as expense** in the statement of profit and loss.

3. QUESTION (INTER QP - NOV 2018)

Neon Enterprise operates a major chain of restaurants located in different cities. The company has acquired a **new** restaurant located at Chandigarh. The new-restaurant requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the restaurant will be closed.

Management has prepared the following budget for this period -

Salaries of the staff engaged in preparation of restaurant before its opening ₹7,50,000

Construction and remodelling cost of restaurant ₹30,00,000

Explain the treatment of these expenditures as per the provisions of AS 10 "Property, Plant and Equipment".

SOLUTION

REFERENCE:

As per the provisions of **AS 10 PROPERTY, PLANT & EQUIPMENT**, the cost of an item of property, plant and equipment comprises 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. The cost of an item of property, plant and equipment should be **recognised** as an **asset** if, and only if -

- It is **probable that future economic benefits** associated with the item will flow to the enterprise; **and**
- The cost of the item can be **measured reliably**.

ANALYSIS:

Management of Neon enterprise should capitalise the cost of construction and remodeling 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.**

However, the cost of salaries of staff engaged in the preparation of restaurant ₹7,50,000 before its opening are of **operating nature** as they would be incurred even when the restaurant would be open.

CONCLUSION:

Construction and re-modelling cost of restaurant - **₹ 30,00,000 should be considered as a part of asset.**

Cost of Salary - **₹ 7,50,000 should be charged to Profit and Loss Account** as expense.

4. QUESTION (INTER QP NOV 2020)

A Ltd following assets. Calculate depreciation for the year ending 31st March,2020 for each assets 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 decides to use these assets for further 2 years only.

SOLUTION (i)

<u>REFERENCE:</u>

As per **AS 10, "Property, plant and equipment,"**

The residual value of an asset **may increase** to an amount equal to or **greater than its carrying amount.** If it does, the **depreciation charge** of the asset is **zero** unless and until its residual value **subsequently decreases** to an amount **below** its **carrying amount.**

<u>ANALYSIS:</u>

The company considers that the residual value, based on prices prevailing at the balance sheet date, **will equal to the cost.**

<u>CONCLUSION:</u>

Therefore, no depreciation amount and **depreciation are correctly zero.**

SOLUTION (ii)

Land has an **unlimited useful life and therefore is not depreciated**

SOLUTION (iii)

<u>REFERENCE:</u>

As per AS 10, "Property, plant and equipment,"

Depreciation of an asset **begins when it is available for use,** i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management.

<u>ANALYSIS & CONCLUSION:</u>

The entity should begin charging depreciation from the date the machine is ready for use. 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.

SOLUTION (iv)

<u>REFERENCE:</u>

As per AS 10, "Property, plant and equipment,"

Depreciation is recognised even if the fair value of the asset exceeds its carrying amount.

ANALYSIS & CONCLUSION:

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 [50000 – (10,000 x 2)] ₹ 30,000. The remaining useful life is 2 years.

The company should amend the annual provision for depreciation to charge the unamortised 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)

5. ICAI – P.Q. 16

Akshar Ltd. installed a new Plant (not a qualifying asset), at its production facility, and incurred the following costs:

- Cost of the Plant (as per supplier's invoice): ₹ 30,00,000
- Initial delivery and handling costs: ₹ 1,00,000
- Cost of site preparation: ₹ 2,00,000
- Consultant fee for advice on acquisition of Plant: ₹ 50,000
- Interest charges paid to supplier against deferred credit: ₹ 1,00,000
- Estimate of Dismantling and Site Restoration costs: ₹ 50,000 after 10 years (Present Value is ₹ 30,000)
- Operating losses before commercial production: ₹ 40,000

The company identified motors installed in the Plant as a separate component and a cost of ₹ 5,00,000 (Purchase Price) and other costs were allocated to them proportionately. The company estimates the useful life of the Plant and those of the Motors as 10 years and 6 years respectively and SLM method of Depreciation is used.

At the end of Year 4, the company replaces the Motors installed in the Plant at a cost of ₹ 6,00,000 and estimated the useful life of new motors to be 5 years. Also, the company revalued its entire class of Fixed Assets at the end of Year 4. The revalued amount of Plant as a whole is ₹ 25,00,000. At the end of Year 8, the company decides to retire the Plant from active use and also disposed the Plant as a whole for ₹ 6,00,000.

There is no change in the Dismantling and Site Restoration liability during the period of use. You are required to explain how the above transaction would be accounted in accordance with AS 10.

SOLUTION

1. ***Cost at Initial Recognition:***

Particulars	₹
Cost of the Plant (as per Invoice)	30,00,000
Initial Delivery and Handling Costs	1,00,000
Cost of Site Preparation	2,00,000
Consultants' Fees	50,000
Estimated Dismantling and Site Restoration Costs	30,000
Total Cost of Plant including Motors	33,80,000
Less: Cost of Motors identified as a separate component(1/6)*	5,63,333
Cost of the Plant (excluding Motors – balance 5/6)	**28,16,667**

* Purchase price of Motors = ₹ 5,00,000 out of ₹ 30,00,000 i.e., 1/6 of valueof Plant

Note: Since the asset is not a qualifying asset, payment of interest to the supplier is not capitalized. Further, operating losses of ₹ 40,000 incurred before commercial production is not a directly attributable cost, and hence excluded from cost of asset. These costs are expensed to the P/L as and when they are incurred.

1. ***Recognition of Motors Replacement***

Particulars	₹
Cost of Motors determined above	5,63,333
Less: Depreciation for 4 years (as per SLM) 5,63,333 ÷ 6 years x 4 years	3,75,555
Carrying Amount of Motors at the end of Year 4	**1,87,778**

Accounting: The company should derecognize the existing Carrying Amount of Motors replaced of ₹ 1,87,778. Further, the acquisition cost ofnew motors of ₹ 6,00,000 would be capitalized as a separate component. This amount will be depreciated over the next 5 years at ₹ 6,00,000 ÷ 5 years = ₹1,20,000 p.a.

2. ***Revaluation***

Particulars	₹
Cost of the Plant at initial recognition [from (1) above]	28,16,667
Less: SLM Depreciation for 4 years: ₹ 28,16,667 ÷ 10 years x4 years	11,26,667
Carrying Amount of Plant at the end of Year 4	16,90,000
Revalued Amount of Plant (Excluding Motors, since thesame is treated as a separate component: ₹ 25,00,000 –	19,00,000

₹ 6,00,000)	
Therefore, Gain on Revaluation credited to Revaluation Reserve	**2,10,000**
Revised Depreciation Charge p.a.: 19,00,000 ÷ 6 years	**3,16,667**

3. Derecognition

Particulars	**Motors**	**Plant (excluding Motors)**
Cost / Revalued Amount at end of Year 4 Less: Depreciation for Years 5-8	6,00,000 1,20,000 x 4 = 4,80,000	19,00,000 3,16,667 x 4 =12,66,668
Carrying Amount before Disposal / De-recognition Less: Disposal Proceeds ₹ 6,00,000 allocated in ratio of carrying amount	1,20,000 95,575	6,33,332 5,04,425
Loss to be written off to P/L	**24,425**	**1,28,907**

Notes:

(a) The Revaluation Surplus of ₹ 2,10,000 would be transferred directly to Retained Earnings.

(b) The allocation of disposal proceeds of ₹ 6,00,000 for the plant as whole is apportioned based on carrying amount of motors and plant (excluding motors)

Alternatively, it may be apportioned as 1/6 towards motors and 5/6 plant (excluding motors) based on the reasoning that the initially, motors amounted to 1/6 of the entire plant. This approach may not be preferable because there has been a revaluation of the plant (excluding motors) and a disposal and subsequent acquisition of the Motor, which is not in the initial proportion of 5/6 and 1/6 respectively.

6. ICAI – P.Q. 18

Preet Ltd. intends to set up a steel plant, for which it has acquired a dilapidated factor having an area of 5,000 acres at a cost of ₹ 60,000 per acre. Preet Ltd. has incurred ₹ 1.10 crores on demolishing the old Factory Building thereon. A sum of ₹ 63,00,000 (including 5% GST thereon) was realized from the sale of material salvaged from the site. Preet Ltd. incurred Stamp Duty and Registration Charges of 7% of land value, paid legal and consultancy charges ₹ 8,00,000 for land acquisition and incurred ₹ 1,25,000 on title guarantee insurance. Compute the value of the land acquired.

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **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. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

Particulars	₹
Purchase Price: 5,000 acres x ₹ 60,000 per acre	3,000.00
Stamp Duty and Registration Charges at 7%	210.00
Legal and Consultancy Fees	8.00
Title Guarantee Insurance	1.25
Demolition Expenses (Net of Salvage Income)	50.00
[₹ 110 lakhs (–)₹ 60 lakhs (₹ 63 lakhs x 100/105)]	
Cost of Land	**3,269.25**

7. QUESTION (QP - JULY 21)

B Limited, which operates a major chain of retail stores, has acquired a new store location. The new location requires substantial renovation expenditure. Management expects that the renovation will last for 4 months during which the store will be closed. Management has prepared the budget for this period including expenditure related to construction and re-modelling costs, salary of staff who shall be preparing the store before its opening and related utilities cost. How would such expenditure be treated in the books of B Limited?

SOLUTION

REFERENCE:

As per the provisions of **AS 10 PROPERTY, PLANT & EQUIPMENT,** the cost of an item of property, plant and equipment comprises 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. The cost of an item of property, plant and equipment should be **recognised** as an **asset** if, and only if -

- It is **probable that future economic benefits** associated with the item will flow to the enterprise; **and**
- The cost of the item can be **measured reliably.**

ANALYSIS:

The costs of construction and re-modelling the supermarket are **necessary** to bring the store to the condition necessary for it to be capable of operating in the manner intended by management. However, if the cost of salaries, utilities and storage of goods are in the **nature of operating expenditure** that would be incurred if the supermarket was open, then these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management and **should be expensed.**

CONCLUSION:

Only Construction and re-modelling cost **should be capitalized** by B Ltd.

8. QUESTION

Chandra Towers Ltd. [CTL] purchased a Plant from M/s. Tatamaco, on 30.09.2017 with a Quoted Price of Rs. 180 Lakhs. Tatamaco offer 3 months credit with a condition that discount of 1.25% will be allowed if the payment were made within one month. GST is 18% on the Quoted Price. Full Input Tax Credit is available. CTL incurred 2% on Transportation Costs and 3% on Erection Costs of the quoted price Pre-Operative Cost amounted to Rs. 1.50 Lakhs. The Machine was ready for use on 30th December 2017; however, it was put to use only on 1st April 2018. Find out the Original Cost

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **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. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

Particulars	Rs. Lacs
Quoted Price of Plant	180.00
GST [no adjustment is required, since full Input Tax Credit is available.]	Nil
Transportation Cost [Cost of bringing the Asset to present location [180.00 x 2%]	3.60
Erection Cost [Cost of bring the Asset to present condition] [180.00 x 3%]	5.40
Pre-Operative Cost [assuming directly relatable to the Machinery]	1.50
Total Original Cost	190.50

9. QUESTION

Janardhan Ltd. purchased Machinery from Kusuma Ltd. on 30.9.2017. The price was Rs. 370.44 Lakhs after charging 8% GST and giving a Trade Discount of 2% on the quoted price. Transport Charges were 0.25% on the Quoted Price and installation charges 1% on the Quoted Price. Expenditure incurred on the Trial Run was Materials Rs. 35,000, Wages Rs. 25,000 and Overheads Rs.15,000. The machinery was ready for use on 01.12.2017, but it was actually put to use only on 01.05.2018. Find out the cost of the machine.

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **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. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

Particulars	Computation	Rs. Lakhs
Quote Price	$370.44 \times \frac{100}{108} \times \frac{100}{98}$	350.000
Less: Trade Discount at 2%	2% of 350.00	7.000
Net Price		343.000
Add: Transportation charges	0.25% on Quoted price 0.25% x 350.00	0.875
Add: Installation Charges	1.00% On Quoted Price 1.00% x 350.00	3.500
Add: Expenses on Trial run	Materials + Wages + OH – 0.350 + 0.250 + 0.150	0.750
Total Cost of Asset		**348.125**

10. QUESTION

An Entity acquires an item of PPE for Rs. 50,000, which is depreciated over 20 years. Three years later, the asset is revalued to Rs. 60,000. Compute the amount of Revaluation Surplus.

SOLUTION

Particulars	Rs.
Revaluation Amount	60,000
Less: Carrying Amount = Cost Rs. 50,000 – 3 years Depreciation Rs. 7,500 i.e. [Rs. 50,000 / 20] x 3 years.	[42,500]
Revaluation Surplus after 3rd Year	**17,500**

AS 10

11. QUESTION (Similar to ICAI P.Q.14)

Argon Ltd purchased a shop at the beginning of year 1, at a cost of 8,50,000. The useful life of the shop is estimated as 30 years with residual value of 25,000 and depreciation is provided on a straight line basis. The shop was revalued in the middle of year 15, for 19,50,000 and the revaluation was incorporated in the accounts. Calculate:

(A) Surplus on Revaluation

(B) Depreciation to be changed in the Profit and Loss account for the year 15.

SOLUTION

Particular	₹
Original cost of Asset	8,50,000
Less: Depreciations 14.50 years (8,50,000-25,000) /30 X 14.5 years	(3,98,750)
Book value	4,51,250
Add: Revaluation Reserve to adjust Book value to ₹ 19,50,000	14,98,750
Revalued Amount = Revised Depreciable value, for balance 15,5 years	19,50,000
Less: Depreciations for remaining 6 months in year 15 (19,50,000- 25,000/15.5X ½	(62,097)
Carrying Amount at end of year 15	18,87,903
Depreciations for year 15 (8,50,000-25,000/30)X1/2 + (19,50,000-025,000/15.5X1/2)	75,847

12. QUESTION (ILLUSTRATION 1 – ICAI)

Entity A, a supermarket chain, is renovating one of its major stores. The store will have more available space for in store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers. State whether the remodelling cost will be capitalized or not.

SOLUTION

REFERENCE:

As per the provisions of **AS 10 PROPERTY, PLANT & EQUIPMENT,** the cost of an item of property, plant and equipment comprises 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. The cost of an item of property, plant and equipment should be **recognised** as an **asset** if, and only if -

- It is **probable that future economic benefits** associated with the item will flow to the enterprise; **and**
- The cost of the item can be **measured reliably.**

ANALYSIS:

The expenditure in remodeling the store **will create future economic benefit** (in the form of 15% increase in sales). Moreover, the cost of remodeling can be measured reliably.

CONCLUSION:

Construction and re-modelling cost **should be capitalized** by Entity A

13. QUESTION (ILLUSTRATION 5 – ICAI)

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

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **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. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

Particulars		Amount
Purchase Price	Given	1,58,00,000
Add: Site Preparation Cost	Given	1,40,000
Technical salary	Specific/Attributable overheads for 3 months (45,000×3)	1,35,000
Initial Delivery Cost	Transportation	50,000
Professional Fees for installation	Architect's Fees	30,000
Total cost of machinery		1,61,55,000

14. QUESTION [(ILLUSTRATION 12 – ICAI) (CHANGE IN ESTIMATE OF USEFUL LIFE)]

Entity A purchased an asset on 1st January 20X1 for 1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil. On 1st January 20X5, the directors reviewed the estimated life and decided that the asset will probably be useful for a further 4 years.

Calculate the amount of depreciation for each year, if the company charges depreciation on a Straight Line basis.

SOLUTION

FACTS:

An asset had estimated useful life of 10 years as on 1st January 20X1. On 1st January 20X5, the directors reviewed the estimated life and decided that the asset will probably be useful for a further 4 years.

REFERENCE:

As per AS 10, depreciable amount of an asset should be allocated on a **systematic basis over its useful life.**

If expected residual value and the useful life of an asset **differ from previous estimates,** the change should be accounted for as a **change in an accounting estimate** in accordance with AS 5.

ANALYSIS & CONCLUSION:

The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e. (1,00,000/10 years). On 1st January 20X5, the asset's net book value was [1,00,000 – (10,000 x 4)] ₹ 60,000. The remaining useful life is 4 years.

The company should amend the annual provision for depreciation to charge the unmortised cost over the revised remaining life of four years. **Consequently, it should charge depreciation for the next 4 years at ₹ 15,000 per annum i.e. (60,000 / 4 years)**

Particulars	₹
Net Book value of the asset as on 1st Jan 2005	60,000
Less: Revised Residual Value	Nil
Net Book Value of the asset	60,000
Depreciation per year = 60,000/4	15,000

15. QUESTION (ILLUSTRATION 4 – ICAI)

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 capitalized into the cost of the new building?

SOLUTION

REFERENCE:

As per the provisions of **AS 10 PROPERTY, PLANT & EQUIPMENT,** the cost of an item of property, plant and equipment comprises 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. The cost of an item of property, plant and equipment should be **recognised** as an **asset** if, and only if -

- It is **probable that future economic benefits** associated with the item will flow to the enterprise; **and**
- The cost of the item can be **measured reliably.**

Cost Of PROPERTY, PLANT & EQUIPMENT

Includes	**Excludes**
Purchase price	Cost of opening new business (e.g., inauguration cost)
Direct attributable costs	Cost of introducing new product or service.
Decommission, restoration and similar liabilities	Cost of conducting business in new location or with new class of people

ANALYSIS:

The costs to be incurred by the company are in the nature of costs of relocating or reorganizing operations of the company and **do not meet the requirement of AS 10.**

CONCLUSION:

The costs **cannot be capitalized.**

16. QUESTION (MTP - OCT 21 – SERIES 2)

Aarush Ltd. is installing a new plant in its factory. It provides you the following information:

Cost Of the Plant (cost as per supplier's invoice)	31,25,000
Estimated Dismantling Costs to Be Incurred After 5 Years	2,50,000
Cost Of Site Preparation	4,50,000
Initial Delivery and Handling Costs	1,85,000
Consultants used for advice on the acquisition of the plant	6,50,000

You are required to advise Aarush Ltd. on the costs that can be capitalized for the plant in accordance with AS 10 'Property, Plant and Equipment.

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **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. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

According to AS 10 'Property, Plant and Equipment', following costs will be capitalized by Aarush Ltd.:

Cost Of the Plant (cost as per supplier's invoice)	31,25,000
Initial Delivery and Handling Costs	1,85,000
Cost Of Site Preparation	4,50,000
Consultants used for advice on the acquisition of the plant	6,50,000
Estimated Dismantling Costs to Be Incurred After 5 Years	2,50,000
Total cost of plant	46,60,000

17. QUESTION (MTP - OCT 20)

Omega Ltd, a supermarket chain, is renovating one of its major stores. The store will have more available space for store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers.

Decide whether Omega Ltd. can capitalize the remodelling cost or not as per provisions of AS 10 "Property plant & Equipment".

SOLUTION

<u>REFERENCE:</u>

As per the provisions of **AS 10 PROPERTY, PLANT & EQUIPMENT**, the cost of an item of property, plant and equipment comprises 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.
The cost of an item of property, plant and equipment should be **recognised** as an **asset** if, and only if -

- It is **probable that future economic benefits** associated with the item will flow to the enterprise; **and**
- The cost of the item can be **measured reliably.**

<u>ANALYSIS:</u>

The expenditure in remodeling the store **will create future economic benefit** (in the form of 15% increase in sales). Moreover, the cost of remodeling **can be measured reliably.**

<u>CONCLUSION:</u>

Construction and re-modelling cost **should be capitalized** by Omega Ltd.

18. QUESTION (INTER RTP NOV 2019 / IPCC RTP MAY 2019 / IPCC QP NOV 2019)

Shrishti Ltd. contracted with a supplier to purchase machinery which is to be installed in its Department A in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 1,41,870. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month. The technician's services were given by Department B to Department A, which billed the services at ₹ 49,500 per month after adding 10% profit margin.
The machine was purchased at ₹ 1,58,34,000 inclusive of IGST @ 12% for which input credit is available to Shrishti Ltd. ₹ 55,770 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹ 30,000 to supervise machinery installation at the factory site.
Ascertain the amount at which the Machinery should be capitalized under AS 10 considering that IGST credit is availed by the Shristi Limited. Internally booked profits should be eliminated in arriving at the cost of the machine.

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **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. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

Particulars	Reference	Amount
Purchase Price	Given (1,58,34,000×100/112)	1,41,37,500
Add: Site Preparation Cost	Given	1,41,870
Technical salary	Specific/Attributable overheads for 3 months (45,000 ×3)	1,35,000
Initial Delivery Cost	Transportation	55,770
Professional Fees for installation	Architect's Fees	30,000
Total cost of Asset		**1,45,00,140**

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. QUESTION (IPCC QP JAN 2021)

a) A Ltd purchased an assets on 1st April 2014 for ₹ 5,00,000 and assets had useful life of 8 years With NIL residual value.
On 1st April 2019, directors reviewed the estimated life of the assets and decided that the assets would probably be useful for further 2 years with residual value of 5% of the original cost.
Calculate the amount of depreciation to be charged for each year as per AS-10, if the company charges depreciation on straight line basis

b) A company manufactures a machine for its own use. The manufacturing of machine was completed on November 1st 2019.The machine was finally capable of operating as on December 15th 2019, however company started using the machinery from February 1st 2020. The company charged depreciation from February 1st 2020. Comment in context of AS-10

2. QUESTION (QP MAY 22)

XYZ Limited provided you the following information for the years ended 31stMarch, 2022:-

i) The carrying amount of a property at the end of the year amounted to ₹ 2,16,000 (cost/value ₹ 2,50,000 and accumulated depreciated ₹ 34,000). On this date the property was revalued and was deemed to have a fair value of ₹ 1,90,000. The balance on the revaluation surplus relating to a previous revaluation gain for this property was ₹ 20,000.
You are required to calculate the revaluation loss as per AS – 10 (Revised) and give its treatment in the books of accounts.

ii) An asset that originally cost ₹ 76,000 and had accumulated depreciation of ₹ 62,000 was disposed of during the year for ₹ 4,000 cash. You are required to explain how the disposal should be accounted for in the financial statements as per AS–10 (Revised).

MCQs

1. As per AS 10 (Revised) 'Property, plant and equipment', which of the following costs is not included in the carrying amount of an item of PPE
   a) Costs of site preparation
   b) Costs of relocating
   c) Installation and assembly costs.
   d) Initial delivery and handling costs

2. As per AS 10 (Revised) 'Property, Plant and Equipment', an enterprise holding investment properties should value Investment property
   a) as per fair value
   b) under discounted cash flow model.
   c) under cost model
   d) under cash flow model

3. A plot of land with carrying amount of ₹ 1,00,000 was revalued to ₹ 1,50,000 at the end of Year Subsequently, due to drop in market values, the land was determined to have a fair value of ₹ 1,30,000 at the end of Year 4. Assuming that the entity adopts Revaluation Model, what would be the accounting treatment of Revaluation?
   a) Initial upward valuation of ₹ 50,000 credited to Revaluation Reserve. Subsequent downward revaluation of ₹ 20,000 debited to P/L.
   b) Initial upward valuation of ₹ 50,000 credited to P/L. Subsequent downward revaluation of ₹ 20,000 debited to P/L.
   c) Initial upward valuation of ₹ 50,000 credited to Revaluation Reserve. Subsequent downward revaluation of ₹ 20,000 debited to Revaluation Reserve.
   d) Initial upward valuation of ₹ 50,000 debited to P/L. Subsequent downward revaluation of ₹ 20,000 credited to P/L.

4. A plot of land with carrying amount of ₹ 1,00,000 was revalued to ₹ 90,000 at the end of Year 2. Subsequently, due to increase in market values, the land was determined to have a fair value of ₹ 1,05,000 at the end of Year 4. Assuming that the entity adopts Revaluation Model, what would be the accounting treatment of Revaluation?
   a) Initial downward valuation of ₹ 10,000 debited to Revaluation Reserve. Subsequent upward revaluation of ₹ 15,000 credited to P/L.

b) Initial downward valuation of ₹ 10,000 debited to P/L. Subsequent upward revaluation of ₹ 15,000 credited to P/L.

c) Initial downward valuation of ₹ 10,000 debited to P/L. Subsequent upward revaluation of ₹ 10,000 credited to P/L and ₹ 5,000 credited to Revaluation Reserve.

d) Initial downward valuation of ₹ 10,000 credited to P/L. Subsequent upward revaluation of ₹ 10,000 debited to P/L and ₹ 5,000 debited to Revaluation Reserve.

5. On sale of an asset which was revalued upwards, what would be the treatment of Revaluation Reserve?

a) The Revaluation Reserve is credited to P/L since the profit on sale of such asset is now realized.

b) The Revaluation Reserve is credited to Retained Earnings as a movement in reserves without impacting the P/L.

c) No change in Revaluation Reserve since profit on sale of such asset is already impacting the P/L.

d) The Revaluation Reserve is reduced from the asset value to compute profit or loss.

6. A machinery was purchased having an invoice price ₹ 1,18,000 (including GST ₹ 18,000) on 1 April 20X1. The GST amount is available as input tax credit. The rate of depreciation is 10% on SLM basis. The depreciation for 20X2-X3 would be 3

a) ₹ 10,000.

b) ₹ 11,800.

c) ₹ 9,000.

d) ₹10,500.

Answers											
1.	(b)	2.	(c)	3.	(c)	4.	(c)	5.	(b)	6.	(a)