Intermediate
Course: Paper 1

ADVANCED ACCOUNTING

(New Scheme of Education and Training)

Part 1

By

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Dedicated

To My Parents

Late Sh. SATPAL SHARMA

Smt. JANKI DEVI

Syllabus

PAPER 1: ADVANCED ACCOUNTING

(One paper – Three hours – 100 Marks)

Objective:

To acquire the ability to apply specific accounting standards and legislations to different transactions and events and in preparation and presentation of financial statements of various business entities.

Contents:

1. Process of formulation of Accounting Standards including Indian Accounting Standards (IFRS converged standards) and IFRSs; Convergence vs Adoption; Objective and Concepts of carve outs.
2. Framework for Preparation and Presentation of Financial Statements (as per Accounting Standards).
3. (i) Applicability of Accounting Standards to various entities

   (ii) Application of Accounting Standards:

   AS 1: Disclosure of Accounting Policies

   AS 2: Valuation of Inventories

   AS 3: Cash Flow Statements

   AS 4: Contingencies and Events Occurring After the Balance Sheet Date

   AS 5: Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

   AS 7: Construction Contracts

   AS 9: Revenue Recognition

   AS 10: Property, Plant and Equipment

   AS 11: The Effects of Changes in Foreign Exchange Rates

   AS 12: Accounting for Government Grants

   AS 13: Accounting for Investments

   AS14: Accounting for Amalgamations (excluding inter- company holdings)

   AS 15: Employee Benefits

   AS 16: Borrowing Costs

   AS 17: Segment Reporting

   AS 18: Related Party Disclosures

   AS 19: Leases

AS 20: Earnings Per Share

AS21: Consolidated Financial Statements of single subsidiaries (excluding problems involving acquisition of Interest in Subsidiary at Different Dates, Cross holding, Disposal of a Subsidiary and Foreign Subsidiaries).

AS 22: Accounting for Taxes on Income

AS 23: Accounting for Investment in Associates in Consolidated Financial Statements

AS 24: Discontinuing Operations

AS 25: Interim Financial Reporting

AS 26: Intangible Assets

AS 27: Financial Reporting of Interests in Joint Ventures

AS 28: Impairment of Assets

AS 29: Provisions, Contingent Liabilities and Contingent Assets

4. Company Accounts

   (i) Schedule III to the Companies Act, 2013 (Division I)

   (ii) Preparation of financial statements – Statement of Profit and Loss, Balance Sheet and Cash Flow Statement

   (iii) Buy back of securities

   (iv) Accounting for reconstruction of companies.

5. Accounting for Branches including foreign branches.

Note: If either new Accounting Standards (AS), Announcements and Limited Revisions to AS are issued or the earlier ones are withdrawn or new AS, Announcements and Limited Revisions to AS are issued in place of existing AS, Announcements and Limited Revisions to AS, the syllabus will accordingly include/exclude such new developments in the place of the existing ones with effect from the date to be notified by the Institute.

Contents

Accounting Standard 18 Related Party Disclosures

Question 1

Identify the related parties in the following case as per AS 18: A Ltd. holds 51% of B Ltd. B Ltd holds 51% of O Ltd. Z Ltd holds 49% of O Ltd.

(*Source: Illustration 1, Study Material*)

Answer

In relation to Reporting enterprise - A Ltd.

- B Ltd. (subsidiary) is a related party
- O Ltd.(subsidiary) is a related party In relation to Reporting enterprise - B Ltd.
- A Ltd. (holding company) is a related party
- O Ltd. (subsidiary) is a related party In relation to Reporting enterprise - O Ltd.
- A Ltd. (ultimate holding company) is a related party
- B Ltd. (holding company) is a related party
- Z Ltd. (investor/ investing party) is a related party (O Ltd being Associate of Z Ltd)

Reporting enterprise - Z Ltd.

- O Ltd. (Associate) is a related party

Question 2

Consider a scenario wherein:

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

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

(*Source: Illustration 2, Study Material*)

Answer

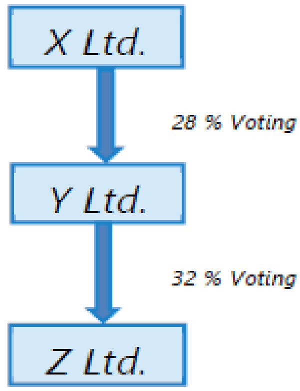
Yes – in relation to A Ltd. (the reporting enterprise), C Ltd. is a related party under AS-18. This is because A Ltd. *indirectly controls* C Ltd.

In this case, A Ltd. (together with its subsidiary B Ltd.) controls *more than one half of the voting right*s of C Ltd.

Question 3

Consider a scenario wherein:

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



In the above case, since Y Ltd. is an associate of X Ltd. – Y Ltd. is a related party to X Ltd.

Likewise, since Z Ltd. is an associate of Y Ltd. - Z Ltd. is a related party to Y Ltd.

The question is: Whether Z Ltd. is to be treated under AS-18 as a party related to X Ltd.?

(*Source: Illustration 3, Study Material*)

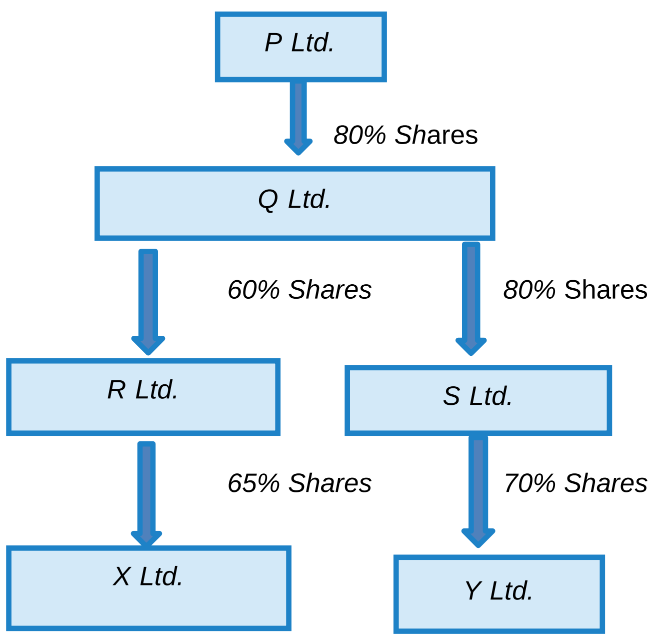
Answer

No – in relation to X Ltd. (the reporting enterprise), Z Ltd. is a **not** a related party. This is because as per the requirements of AS-18, '*associate of an associate'* is **not**

a related party.

Question 4

Consider the following organization structure related to P Ltd.



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

(*Source: Illustration 4, Study Material*)

Answer

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

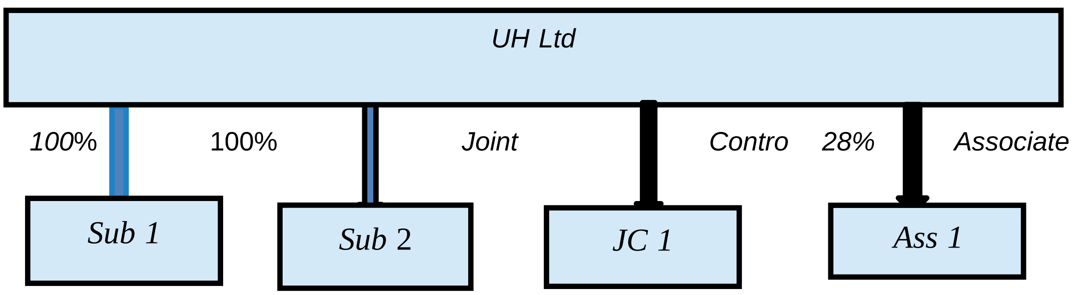
Party Name	**Relationship under AS-18**
P Ltd.	• P Ltd. has *indirect control* on R Ltd. (through Q Ltd.) • Hence R Ltd. is related to P Ltd.

Q Ltd.	• Q Ltd. has direct control of R Ltd. • Hence R Ltd. is related to Q Ltd.
S Ltd.	• R Ltd. and S Ltd. are under common control of Q Ltd. • Hence R Ltd. is related to S Ltd.
X Ltd.	• X Ltd. is controlled by R Ltd. • Hence R Ltd. is related to X Ltd.
Y Ltd.	• Y Ltd. is the sub-subsidiary of Q Ltd. • Both R Ltd. and Y Ltd. are under common control of Q Ltd. • Hence R Ltd. is related to Y Ltd.

Question 5

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

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



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

(*Source: Illustration 5, Study Material*)

Answer

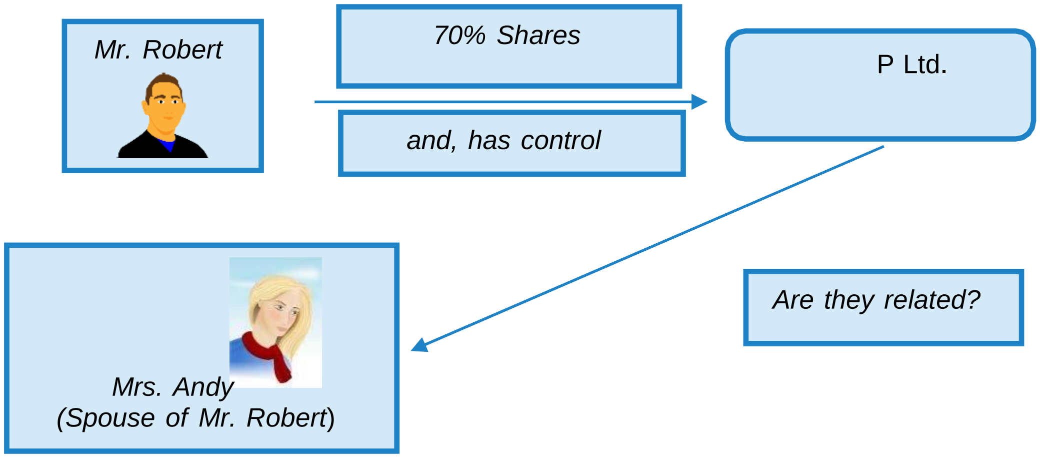
The following table identifies the related party relationships for each of the entities in the Group:

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

Question 6

Consider a scenario wherein:

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



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

(*Source: Illustration 6, Study Material*)

Answer

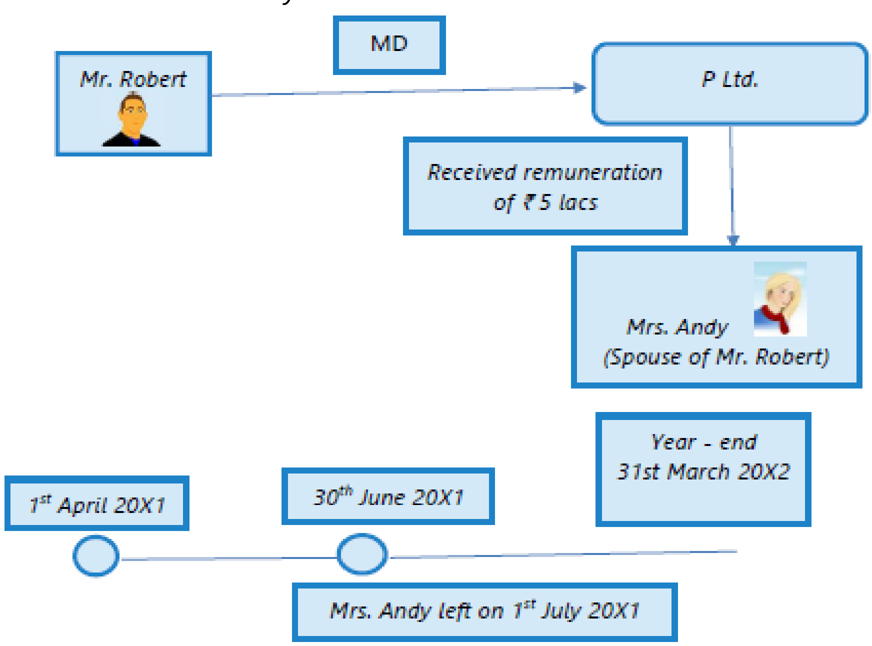
Yes – Andy is a related party to P Ltd., in view of the requirements of AS-18.

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

Question 7

Consider a scenario wherein:

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



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

(*Source: Illustration 7, Study Material*)

Answer

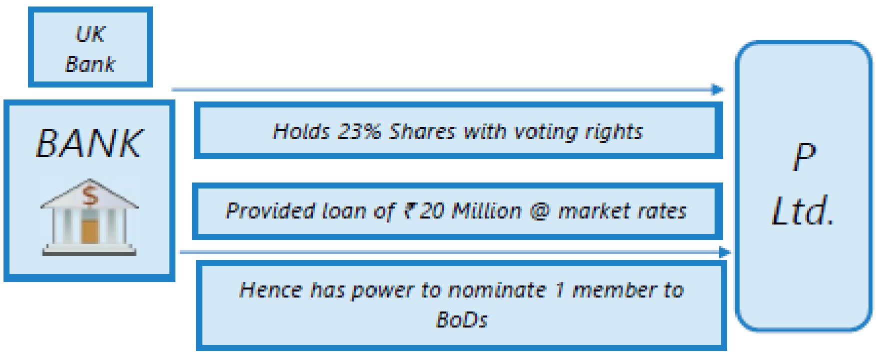
Yes – This is because as per AS-18, parties are considered to be related if *at any time during the reporting period* one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

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

Question 8

Consider a scenario wherein:

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



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

(*Source: Illustration 8, Study Material*)

Answer

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

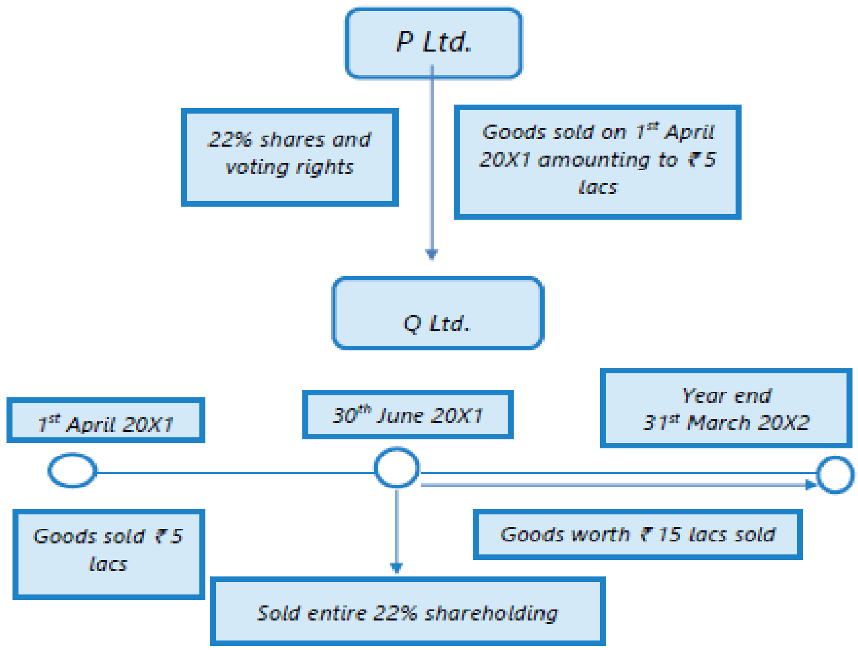
The bank is also a provider of finance to P Ltd. (the reporting enterprise) and as per AS-18, parties like providers of finance are deemed ***not to be considered*** as a related party in the course of *normal dealings with an enterprise* by virtue ***only of those dealings*.** However, this exemption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

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

Question 9

Consider a scenario wherein:

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



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

(*Source: Illustration 9, Study Material*)

Answer

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

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

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

Question 10

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

(*Source: Illustration 10, Study Material*)

Answer

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

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

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

Question 11

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

(*Source: Question 6, Study Material*)

Answer

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

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

(i) The name of the transacting related party;

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

(iii) A description of the nature of transactions;

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

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

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

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

Question 12

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

(*Source: Question 7, Study Material*)

Answer

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

In case, where (1) a statute or (2) a regulator or (3) a similar competent authority governing an enterprise prohibit the enterprise to disclose certain information, which is required to be disclosed as per AS 18, disclosure of such information is ***not warranted.*** For example, banks are obliged by law to maintain confidentiality in respect of their customers' transactions and AS-18 would not override the obligation to preserve the confidentiality of customers' dealings.

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

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

Question 13

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

(*Source: Question 8, Study Material*)

Answer

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

Question 14

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

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

(*Source: Question 9, Study Material*)

Answer

According to AS 18 on 'Related Party Disclosures', parties are considered to be related if *at any time during the reporting period* one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Hence Mr. Raj, a relative of key management personnel, should be identified as related party for disclosure in the financial statements for the year ended 31.3.20X2.

Question 15

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

(*Source: Question 10, Study Material*)

Answer

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

Question 16

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

M Ltd. holds 61 % shares of S Ltd. S Ltd. holds 51 % shares of F Ltd. C Ltd. holds 49% shares of F Ltd.

(Give your answer - Reporting Entity wise for M Ltd., S Ltd., C Ltd. and F Ltd.)

(*Source: Question 11, Study Material*)

Answer

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

QUESTION BANK

Question 17

Is remuneration paid to Board of Directors a related party transaction? Explain.

(*RTP May 2018*)

Answer:

In case of a Company, the Managing Director, whole time director, manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered Key Managerial Personnel (KMP).

Persons who do not have the authority and responsibility for planning, directing and controlling the activities of the enterprise would not be KMP. Conversely, persons without any formal titles may be considered to be KMP, if they plan, direct and control the activities of the enterprise.

Hence, remuneration paid to Board of Directors will be considered as related party transaction.

Question 18

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

(i) Mr. Sumit, a relative of Managing Director, received remuneration of ₹2,10,000 for his services in the company for the period from 1st April, 2017 to 30th June, 2017. He left the service on 1st July, 2017.

Should the relative be identified as a related party as on closing date i.e. on 31-3-2018 for the purpose of AS 18.

(ii) Goods sold amounting to ₹50 lakhs to associate company during the 1st quarter ended on 30th June, 2017. After that related party relationship ceased to exist. However, goods were supplied as was supplied to any other ordinary customer.

Decide whether transactions of the entire year have to be disclosed as related party transactions.

(November 2018) (5 marks)

Answer

(i) According to AS 18 'Related Party Disclosures', parties are considered to be related if at any time during the reporting period, one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Hence, Mr. Sumit a relative of key management personnel should be identified as related party as at the closing date i.e. on 31.3.2018 as he received remuneration for his services in the company from 1st April, 2017 to 30th June, 2017and this period comes under the reporting period.

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

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

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

Question 19

Sun Ltd. sold goods for ₹50 lakhs to Moon Ltd. during financial year ended 31st March 2017 at normal selling price followed by Sun Ltd. The Managing Director of Sun Ltd. holds 75% shares of Moon Ltd. The Chief accountant of Sun Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. You are required to examine and advise whether the contention of the Chief Accountant is correct?

(*RTP November 2018*)

Answer:

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

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

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

Question 20

SP hotels Limited enters into an agreement with Mr. A for running its hotel for a fixed return payable to the later every year. The contract involves the day-to-day management of the hotel, while all financial and operating policy decisions are taken by the Board of Directors of the company. Mr. A does not own any voting power in SP Hotels Limited. Would he be considered as a related party of SP Hotels Limited"?

Answer*:*

Mr. A will not be considered as a related party of SP Hotels Limited in view of paragraph 3(c) of AS 18 which states, Individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual". In the above example, in the absence of share ownership, Mr. A would not be considered to exercise significant influence on SP Hotels Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr. A does not have the ability to director instruct the board of directors does not qualify him as a key management personnel.

Question 21

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

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

(ii) Mr. Subhash Kumar is Managing Director of A Ltd. and also holds 72% capital of B Ltd. (B Ltd. is subsidiary of A Ltd.)

(*May 2019*) (*5 Marks*)

Answer:

(i) (a) Reporting entity- Maya Ltd.
- Sheetal Ltd. (subsidiary) is a related party
- Fair Ltd. (subsidiary) is a related party

(b) Reporting entity- Sheetal Ltd.
- Maya Ltd. (holding company) is a related party
- Fair Ltd. (subsidiary) is a related party

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

(d) Reporting entity- Care Ltd.
- Fair Ltd. (associate) is a related party

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

Question 22

Arohi Ltd. sold goods for ₹90 lakhs to Anya Ltd. during financial year ended 31-3-2019. The Managing Director of Arohi Ltd. own 100% of Anya Ltd. The sales were made to Anya Ltd. at normal selling prices followed by Arohi Ltd. The Chief accountant of Arohi Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. Is the Chief Accountant correct? Comment in accordance with AS 18.

(*May 2020*)

Answer

As per AS 18 'Related Party Disclosures', Enterprises over which the key management personnel is able to exercise significant influence are related parties. This includes enterprises owned by directors or major shareholders of the reporting enterprise that have a member of key management in common with the reporting enterprise. In the given case, Arohi Ltd. and Anya Ltd. are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price. Hence the contention of Chief Accountant of Arohi Ltd. is wrong.

Question 23

You are required to identify the related parties in the following cases as per AS 18: M Ltd. holds 61 % shares of S Ltd.

S Ltd. holds 51 % shares of F Ltd.

C Ltd. holds 49% shares of F Ltd.

(Give your answer - Reporting Entity wise for M Ltd., S Ltd., C Ltd. and F Ltd.)

(*MTP, May, 2020*) (*5 marks*)

Answer:

(i) (a) Reporting entity- M Ltd.
- S Ltd. (subsidiary) is a related party
- F Ltd.(subsidiary) is a related party

(b) Reporting entity- S Ltd.
- M Ltd. (holding company) is a related party
- F Ltd. (subsidiary) is a related party

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

(d) Reporting entity- C Ltd.
- F Ltd. (associate) is a related party

Question 24

(i) Mr. Arnav a relative of key management personnel received remuneration of ₹3,00,000 for his services in the company for the period April 1, 2019 to June 30, 2019. On July 1, 2019 he left the job. Should Mr. Arnav be identified as Related Party at the closing date i.e. March 31, 2020 for the purposes of AS 18?

(ii) A limited company sold goods to its associate company for the 1st quarter ending June 30, 2020. After that, the related party relationship ceased to exist. However, goods were supplied continuously even after June 30, 2020 as was supplied to another ordinary customer. Does this require disclosure as related party transaction for the entire financial year?

(*MTP, October, 2020*) (*5 marks*)

Answer

(i) According to AS 18 'Related Party Disclosures', parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Hence**,** Mr. Arnav a relative of key management personnel should be identified as related party as at the closing date i.e. on 31.3.2020.

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

Question 25

On the basis of provisions of AS 18 'Related Party Disclosures':

(i) Identify the related parties in the following cases:
X Limited holds 60% shares of Y Limited
Y Limited holds 55% shares of W Limited
Z Limited holds 35% shares of W Limited

(ii) Himalaya Limited sold goods for ₹40 Lakhs to Aravalli Limited during financial year ended on March 31, 2019. The Managing Director of Himalaya Limited owns 80% shares of Aravalli Limited. The sales were made to Aravalli Limited at normal selling prices followed by Himalaya Limited. The chief accountant of Himalaya Limited contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per AS 18. You are required to comment on this.

(*RTP, November, 2020*)

Answer

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

(ii) Himalaya Ltd. and Aravalli Ltd are related parties since key management personnel of Himalaya Ltd. ie. its managing director holds 80% in Aravalli Ltd. and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price. Hence the contention of Chief Accountant of Himalaya Ltd that these sales require no disclosure under related party Transactions, is wrong.

Question 26

(i) Khushi Limited enter into an agreement with Mr. Happy for running a business for a fixed amount payable to the later every year. The contract states that the day-to-day management of the business will be handled by. Mr. Happy, while all financial and operating policy decisions are taken by the Board of Directors of the Company. Mr. Happy does not own any voting power in Khushi Limited.

(ii) Shri Bhanu a relative of key management personnel received remuneration of ₹3,50,000 for his services in the company for the period from 1st April, 2020 to 30th June, 2020. On 1st July, 2020, he left the service.

You are required to suggest how the above transactions will be treated as at the closing date i.e. on 31st March, 2021 for the purposes of AS 18- Related Party Disclosures.

(*July, 2021 Suggested*) (*5 Marks*)

Answer

(i) Mr. Happy will not be considered as a related party of Khushi Limited in view of provisions of AS 18 "Related Party Disclosures" which states, "individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual are related parties".

In the given case, in the absence of share ownership, Mr. Happy would not be considered to exercise significant influence on Khushi Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr Happy does not have the ability to direct or instruct the board of directors does not qualify him as a key management personnel.

(ii) According to AS 18 on ‘Related Party Disclosures’, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Hence, Shri Bhanu, a relative of key management personnel should be identified as related party for disclosure in the financial statements for the year ended 31.3.2021 as he received remuneration for his services in the company for the period from 1st April,2020 to 30th June,2020.

Question 27

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

(b) A Limited has two Associates, B Limited and C Limited, and owns 25 per cent of the voting power of B Limited and 30 per cent of the voting power of C Limited. Would B Limited be considered a related party for the purpose of financial statements of C Limited?

(*RTP November 2021*)

Answer

(a) Omega Bank Limited would be a related party of B Limited. As per AS 18 “associates and joint ventures of the reporting enterprise and the investing party of venture in respect of which the reporting enterprise is an associate or a joint venturer” are related party relationship. Further, an associate has been defined as “an enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of the party”. Significant influence has been defined to be “participation in the financial and /or operating policy decisions of an enterprise, but not control of those policies”. Further, it is given in the standard that significant influence may be gained by share ownership, agreement or statute. As regards share ownership, there is a presumption that ownership of 20 per cent or more of the voting power enables the enterprise to exercise significant influence, unless it could be clearly demonstrated otherwise. In the given example, Omega Bank Limited exercises significant influence over B Limited by virtue of ownership of 25 per cent of the voting power.

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

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

Question 28

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

(b) Define “Key management personnel” in the context of AS 18.

(*RTP May, 2022*)

Answer

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

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

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

(b) In context of AS 18, "Key management personnel" are those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. For example, in the case of a company, the managing director(s), whole time director(s), manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.

Question 29

SP hotels Limited enters into an agreement with Mr. A for running its hotel for a fixed return payable to the later every year. The contract involves the day-to-day management of the hotel, while all financial and operating policy decisions are taken by the Board of Directors of the company. Mr. A does not own any voting power in SP Hotels Limited. Would he be considered as a related party of SP Hotels Limited?

(*RTP November, 2022*)

Answer

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

Question 30

Is remuneration paid to Board of Directors a related party transaction? Explain.

(*RTP May, 2023*)

Answer

In case of a Company, the Managing Director, whole time director, manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered Key Managerial Personnel (KMP).

Persons who do not have the authority and responsibility for planning, directing and controlling the activities of the enterprise would not be KMP. Conversely, persons without any formal titles may be considered to be KMP, if they plan, direct and control the activities of the enterprise.

Further, as per Companies Act, 2013, a related party includes a director or his relative. The Act, defines a director as a director appointed to the Board of a Company.

Hence, remuneration paid to Board of Directors will be considered as related party transaction.

Question 31

Answer the following with respect to AS-18

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

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

(iii) Asha Ltd. sells all the manufactured furniture of ₹1,00,00,000 to Sasha Ltd. as per agreement. Sasha Ltd. is the only customer to. Asha Ltd. In the financial statements, Asha Ltd. wants to. present Sasha company as a related party. Comment on the disclosure requirement.

(*G-II, May, 2023*) (*5 Marks*)

<u>Question Arrangement</u>

AS 18

Topic	Question Numbers
Identification of Related Party Relations	1, 2, 3, 4, 5, 6, 7, 8, 9, 14, 15, 16, 18, 21, 23, 25, 27
Disclosure	10, 19, 22, 20, 26, 29
MD Remuneration	17, 30
Theory	11, 12, 13, 24, 28, 31

Accounting Standard 25
Interim Financial Reporting

Question 1

Sincere Corporation is dealing in seasonal product. Sales pattern of the product quarter-wise is as follows:

1st quarter 30th June	*10%*
2nd quarter 30th September	*10%*
3rd quarter 31st December	*60%*
4th quarter 31st March	*20%*

Information regarding the 1st quarter ended on 30th June, 20X1 is as follows:

Sales	*80 crores*
Salary and other expenses	*60 crores*
Advertisement expenses (routine)	*4 crores*
Administrative and selling expenses	*8 crores*

While preparing interim financial report for first quarter Sincere Corporation wants to defer ₹10 crores expenditure to third quarter on the argument that third quarter is having more sales, therefore, the third quarter should be debited by more expenditure. Considering the seasonal nature of business and the expenditures are uniform throughout all quarters, calculate the result of the first quarter as per AS 25. Also give a comment on the company's view.

Answer

Particulars	**(₹In crores)**	
Result of first quarter ended 30th June, *20X1*	80	
Turnover Other Income	Nil	
Total (a)		80
Less: Changes in inventories		Nil
Salaries and other cost		60
Administrative and selling Expenses (4+8)		12
Total (b)		72
Profit (a)-(b)		8

According to AS 25, the Income and Expense should be recognized when they are earned and incurred respectively. Therefore, seasonal incomes will be recognized when they occur. Thus, the company's view is not as per AS 25.

Question 2

The accounting year of X Ltd. ends on 30th September, 20X1 and it makes its reports quarterly. However for the purpose of tax, year ends on 31st March every year. For the Accounting year from 1-10-20X0 to 30-9-20X1, the quarterly income is as under:

1st quarter ending on 31st December, 20X0	*₹200 crores*
2nd quarter ending on 31st March, 20X1	*₹200 crores*
3rd quarter ending on 30th June, 20X1	*₹200 crores*
4th quarter ending on 30th September, 20X1	*₹200 crores*
Total	*₹800 crores*

Average actual tax rate for the financial year ending on 31st March, 20X1 is 20% and for financial year ending 31st March, 20X2 is 30%. Calculate tax expense for each quarter.

Answer

Calculation of tax expense

1st quarter ending on 31st December, 20X0	200 ×20%	₹40 lakhs
2nd quarter ending on 31st March, 20X1	200 ×20%	₹40 lakhs
3rd quarter ending on 30th June, 20X1	200 ×30%	₹60 lakhs
4th quarter ending on 30th September, 20X1	200 ×30%	₹60 lakhs

Question 3

Accountants of Poornima Ltd. showed a net profit of ₹7,20,000 for the third quarter of 20X1 after incorporating the following:

(i) Bad debts of ₹40,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.

(ii) Extra ordinary loss of ₹35,000 incurred during the quarter has been fully recognized in this quarter.

(iii) Additional depreciation of ₹45,000 resulting from the change in the method of charge of depreciation assuming that ₹45,000 is the charge for the 3rd quarter only.

Ascertain the correct quarterly income.

Answer

In the above case, the quarterly income has not been correctly stated. As per AS 25 "Interim Financial Reporting", the quarterly income should be adjusted and restated as follows:

Bad debts of ₹40,000 have been incurred during current quarter. Out of this, the company has deferred 50% (i.e.) ₹20,000 to the next quarter. Therefore, ₹20,000 should be deducted from ₹7,20,000. The treatment of extra-ordinary loss of ₹35,000 being recognized in the same quarter is correct.

Recognising additional depreciation of ₹45,000 in the same quarter is in tune with AS 25. Hence no adjustments are required for these two items.

Poornima Ltd should report quarterly income as ₹7,00,000 (₹7,20,000 – ₹20,000).

Question 4

Intelligent Corporation (ICorp.) is dealing in seasonal products. The quarterly sales pattern of the product is given below:

Quarter I	***II***	***III***	***IV***
Ending 30th June *15%*	*30th September* *15%*	*31st December* *50%*	*31st March* *25%*

For the First quarter ending 30th June, 20X1, ICorp. gives you the following information:

	₹crores
Sales	*50*
Salary and other expenses	*30*
Advertisement expenses (routine)	*02*
Administrative and selling expenses	*08*

While preparing interim financial report for the first quarter, 'I–Corp.' wants to defer ₹21 crores expenditure to third quarter on the argument that third quarter is having more sales, therefore, third quarter should be debited by higher expenditure, considering the seasonal nature of business and that the expenditures are uniform throughout all quarters.

Calculate the result of first quarter as per AS 25 and comment on the company's view.

Answer

Result of the first quarter ended 30th June, 20X1

			(₹in crores)
Turnover			50
Add: Other Income			Nil
Total			50
Less: Change in inventories	Nil		
Salaries and other cost		30	
Administrative and selling expenses (8 + 2)		10	40
Profit			10

As per AS 25 on Interim Financial Reporting, the income and expense should be recognized when they are earned and incurred respectively. As per AS 25, the costs should be anticipated or deferred only when

(i) it is appropriate to anticipate that type of cost at the end of the financial year, and

(ii) costs are incurred unevenly during the financial year of an enterprise.

Therefore, the argument given by I-Corp relating to deferment of ₹21 crores is not tenable as expenditures are uniform throughout all quarters.

Question 5

What are the periods for which Interim financial Statements are required to be presented? You are required to answer your question in light of preparation of financial statements for the period ended and as at 31st December, 20X1. The Financial Year is FY 20X1-X2.

(*Source: Question 5, Study Material*)

Answer

As per Accounting Standard 25, Interim reports should include interim financial statements (condensed or complete) for periods as given below.

Statement	***Current period***	***Comparative period***
Balance sheet	End of current interim period	End of immediately preceding financial year
Statement of profit and loss	Current interim period and cumulatively for the year-to-date	Comparable interim period and year-to-date of immediately preceding financial year
Cash flow statement	Cumulatively for the current financial year-to-date	Comparable year-to-date of immediately preceding financial year

In light of the above, following periods needs to be covered in interim financial statements for the period ended and as at 31st December, *20X1:*

Balance Sheet	as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year (As at 31 December 20X1 and 31 March 20X1).
Statements of Profit and Loss	for the current interim period and cumulatively for the current financial year to date, with comparative statements of profit and loss for the comparable interim periods (current and year-to-date) of the immediately preceding financial year. (for 3 months and 9 months i.e., year to date ended 31 December 20X1 and same for 31 December 20X0 being comparative period).

Cash Flow Statement	cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year. (year to date i.e., 1 April 20X1 to 31 December 20X1 and 1 April 20X0 to 31 December 20X0).

Question 6

Whether quarterly financial results presented under Clause 41 of the Listing Agreement entered into between Stock Exchanges and the listed enterprises meet the definition of 'interim financial report' as per AS 25 and the provisions of AS 25 should be applied on the same?

(*Source: Question 6, Study Material*)

Answer

The presentation and disclosure requirements contained in AS 25 should be applied only if an enterprise prepares and presents an 'interim financial report' as defined in AS 25. Accordingly, presentation and disclosure requirements contained in AS 25 are not required to be applied in respect of interim financial results (which do not meet the definition of 'interim financial report' as per AS 25) presented by an enterprise.

The quarterly financial results presented under Clause 41 of the Listing Agreement do not meet the definition of 'interim financial report' as per AS 25. However, the recognition and measurement principles laid down in AS 25 should be applied for recognition and measurement of items contained in such interim financial results.

Question 7

Whether the impairment loss recognized on property, plant and equipment in first quarter of the financial year can be reversed in the second quarter in that financial year?

(*Source: Question 7, Study Material*)

Answer

As per AS 25, the principles for recognising and measuring losses from inventory write-downs, restructurings, or impairments in an interim period are the same as those that an enterprise would follow if it prepared only annual financial statements. However, if such items are recognised and measured in one interim period and the estimate changes in a subsequent interim period of that financial year, the original estimate is changed in the subsequent interim period either by accrual of an additional amount of loss or by reversal of the previously recognised amount. In light of the same, the impairment loss recognized in one quarter can be reversed in the another quarter of the financial year, if favourable indicator exists as per AS 28 and the recoverable amount increased in comparison to earlier period.

Question 8

In view of the provisions of Accounting Standard 25 on Interim Financial Reporting, on what basis will you calculate, for an interim period, the provision in respect of defined benefit schemes like pension, gratuity etc. for the employees?

(*Source: Question 8, Study Material*)

Answer

Accounting Standard 25 suggests that provision in respect of defined benefit schemes like pension and gratuity for an interim period should be calculated based on the year-to-date basis by using the actuarially determined rates at the end of the prior financial year, adjusted for significant market fluctuations since that time and for significant curtailments, settlements or other significant one-time events.

Question 9

On 30th June, 20X1, Asmitha Ltd. incurred ₹2,00,000, net loss from disposal of a business segment. Also, on 31st July, 20X1, the company paid ₹60,000 for property taxes assessed for the calendar year 20X1. How the above transactions should be included in determination of net income of Asmitha Ltd. for the six months interim period ended on 30th September, 20X1.

(*Source: Question 9, Study Material*)

Answer

According to Para 10 of AS 25 "Interim Financial Reporting", if an enterprise prepares and presents a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial statements. As at 30th September, 20X1, Asmitha Ltd would report the entire amount of ₹2,00,000 as loss on the disposal of its business segment since the loss was incurred during interim period. A cost charged as an expense in an annual period should be allocated to interim periods on accrual basis.

Since ₹60,000 Property tax payment relates to entire calendar year 20X1,

₹30,000 would be reported as an expense for six months ended on 30th September, 20X1 while out of the remaining ₹30,000, ₹15,000 for January, 20X1 to March, 20X1 should be shown as payment of the outstanding amount of previous year and another ₹15,000 related to quarter October, 20X1 to December, 20X1 would be reported as prepaid expenses.

Question 10

An enterprise reports quarterly, estimates an annual income of ₹10 lakhs. Assume tax rates on 1st ₹5,00,000 at 30% and on the balance income at 40%. The estimated quarterly income are ₹75,000, ₹2,50,000, ₹3,75,000 and ₹3,00,000.

Calculate the tax expense to be recognized in each quarter.

(*Source: Question 10, Study Material*)

Answer

As per para 29 of AS 25 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

		₹
Estimated Annual Income	(A)	10,00,000
Tax expense:		
30% on ₹5,00,000		1,50,000
40% on remaining ₹5,00,000		2,00,000
	(B)	3,50,000

Weighted average annual income tax rate =

$$\frac{B}{A} = \frac{3,50,000}{10,00,000} = 35\%$$

A 10,00,000		
Tax expense to be recognized in each of the quarterly reports		₹
Quarter I -	₹ 75,000 x 35%	26,250
Quarter II -	₹2,50,000 x 35%	87,500
Quarter III -	₹3,75,000 x 35%	1,31,250
Quarter IV -	₹3,00,000 x 35%	1,05,000
	₹10,00,000	3,50,000

Question 11

Antarbarti Limited reported a Profit Before Tax (PBT) of ₹4 lakhs for the third quarter ending 30-09-20X1. On enquiry you observe the following. Give the treatment required under AS 25:

- *(i) Dividend income of ₹4 lakhs received during the quarter has been recognized to the extent of ₹1 lakh only.*
- *(ii) 80% of sales promotion expenses ₹15 lakhs incurred in the third quarter has been deferred to the fourth quarter as the sales in the last quarter is high.*
- *(iii) In the third quarter, the company changed depreciation method from WDV to SLM, which resulted in excess depreciation of ₹12 lakhs. The entire amount has been debited in the third quarter, though the share of the third quarter is only ₹3 lakhs.*
- *(iv) ₹2 lakhs extra-ordinary gain received in third quarter was allocated equally to the third and fourth quarter.*
- *(v) Cumulative loss resulting from change in method of inventory valuation was recognized in the third quarter of ₹3 lakhs. Out of this loss ₹1 lakh relates to previous quarters.*
- *(vi) Sale of investment in the first quarter resulted in a gain of ₹20 lakhs. The company had apportioned this equally to the four quarters.*

Prepare the adjusted profit before tax for the third quarter.

(*Source: Question 11, Study Material*)

Answer

As per para 36 of AS 25 "Interim Financial Reporting", seasonal or occasional revenue and cost within a financial year should not be deferred as of interim date until it is appropriate to defer at the end of the enterprise's financial year. Therefore, dividend income, extra-ordinary gain, and gain on sale of investment received during 3rd quarter should be recognised in the 3rd quarter only. Similarly, sales promotion expenses incurred in the 3rd quarter should also be charged in the 3rd quarter only.

Further, as per AS 10, Property, Plant and Equipment, if there is change in the depreciation method, such a change should be accounted for as a change in accounting estimate in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, and applied prospectively. Therefore, no adjustment would be required due to change in the method of depreciation.

Accordingly, the adjusted profit before tax for the 3rd quarter will be as follows:

Statement showing Adjusted Profit Before Tax for the third quarter

	(₹in lakhs)
Profit before tax (as reported)	4
Add: Dividend income ₹(4-1) lakhs	3
Excess depreciation charged in the 3rd quarter, due to change in the method	-
Extra ordinary gain ₹(2-1) lakhs	1
Cumulative loss due to change in the	
method of inventory valuation should be	1
applied retrospectively ₹(3-2) lakhs	9
	(12)
Less: Sales promotion expenses (80% of ₹15 lakhs)	(5)
Gain on sale of investment (occasional gain should not be deferred)	
Adjusted Profit before tax for the third quarter	(8)

Question Arrangement

AS 25

Topic	Question Numbers
Interim Financial Results	6
Quarterly Calculation of Profits	1, 4, 3, 9, 11
Theory	7, 8
Comparative Periods	5
Tax Calculation	2, 10

Accounting Standard 13
Accounting for Investments

Question 1

An unquoted long term investment is carried in the books at a cost of ₹2 lakhs. The published accounts of the unlisted company received in May, 20X1 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than ₹20,000. How will you deal with this in preparing the financial statements of R Ltd. for the year ended 31^{st} March, 20X1?

(*Source: Illustration 1, Study Material*)

Answer

Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution should be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. AS 13 (Revised) 'Accounting for Investments' states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. On the above basis, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to ₹20,000 in the financial statements for the year ended 31^{st} March, 20X1.

Question 2

X Ltd. on 1-1-20X1 had made an investment of ₹600 lakhs in the equity shares of Y Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realisable value of all such investment on 31 -3-20X1 became ₹200 lakhs as Y Ltd. lost a case of copyright. From the given market conditions, it is apparent that the reduction in the value is not temporary in nature. How will you recognise the reduction in financial statements for the year ended on 31 -3-20X1?

(*Source: Illustration 2, Study Material*)

Answer

X Ltd. invested ₹600 lakhs in the equity shares of Y Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. ₹300 lakhs and remaining as temporary (current) investment i.e. ₹300 lakhs. Irrespective of the fact that investment has been held by X Ltd. only for 3 months (from 1.1.20X1 to 31.3.20X1), AS 13 (Revised) lays emphasis on intention of the investor to classify the investment as current or long term even though the long term investment may be readily marketable.

In the given situation, the realisable value of all such investments on 31.3.20X1 became ₹200 lakhs i.e. ₹100 lakhs in respect of current investment and ₹100 lakhs in respect of long term investment.

As per AS 13 (Revised), 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value.

Accordingly, the carrying value of investment held as temporary investment should be shown at realisable value i.e. at ₹100 lakhs. The reduction of ₹200 lakhs in the carrying value of current investment will be charged to the profit and loss account.

The Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long term investment, the carrying amount is reduced to recognise the decline.

Here, Y Ltd. lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quiet a substantial figure. Losing the case of copyright may affect the business and the performance of the company in the long run. Accordingly, it will be appropriate to reduce the carrying amount of long term investment by ₹200 lakhs and show the investments at ₹100 lakhs, since the downfall in the value of shares is other than temporary. The reduction of ₹200 lakhs in the carrying value of long term investment will also be charged to the Statement of profit and loss.

Question 3

ABC Ltd. wants to re-classify its investments in accordance with AS 13 (Revised). Decide and state on the amount of transfer, based on the following information:

(1) A portion of current investments purchased for ₹20 lakhs, to be reclassified as long term investment, as the company has decided to retain them. The market value as on the date of Balance Sheet was ₹25 lakhs.

(2) Another portion of current investments purchased for ₹15 lakhs, to be reclassified as long term investments. The market value of these investments as on the date of balance sheet was ₹6.5 lakhs.

(3) Certain long term investments no longer considered for holding purposes, to be reclassified as current investments. The original cost of these was ₹18 lakhs but had been written down to ₹12 lakhs to recognise other than temporary decline as per AS 13 (Revised).

(*Source: Illustration 3, Study Material*)

Answer

As per AS 13 (Revised), where investments are reclassified from current to long- term, transfers are made at the lower of cost and fair value at the date of transfer.

(1) In the first case, the market value of the investment is ₹25 lakhs, which is higher than its cost i.e. ₹20 lakhs. Therefore, the transfer to long term investments should be carried at cost i.e. ₹20 lakhs.

(2) In the second case, the market value of the investment is ₹6.5 lakhs, which is lower than its cost i.e. ₹15 lakhs. Therefore, the transfer to long term investments should be carried in the books at the market value i.e. ₹6.5 lakhs. The loss of ₹8.5 lakhs should be charged to profit and loss account.

As per AS 13 (Revised), where long-term investments are re-classified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

(3) In the third case, the book value of the investment is ₹12 lakhs, which is lower than its cost i.e. ₹18 lakhs. Here, the transfer should be at carrying amount and hence this re-classified current investment should be carried at ₹12 lakhs.

Question 4

M/s Innovative Garments Manufacturing Company Limited invested in the shares of another company on 1st October, 20X3 at a cost of ₹2,50,000. It also earlier purchased Gold of ₹4,00,000 and Silver of ₹2,00,000 on 1st March, 20X1. Market value as on 31st March, 20X4 of above investments are as follows:

	₹
Shares	*2,25,000*
Gold	*6,00,000*
Silver	*3,50,000*

How above investments will be shown in the books of accounts of M/s Innovative Garments Manufacturing Company Limited for the year ending 31st March, 20 X4 as per the provisions of Accounting Standard 13 "Accounting for Investments"?

(*Source: Illustration 4, Study Material*)

Answer

As per AS 13 (Revised) 'Accounting for Investments', for investment in shares if the investment is purchased with an intention to hold for short-term period (less than one year), then it will be classified as current investment and to be carried at lower of cost and fair value, i.e., in case of shares, at lower of cost (₹2,50,000) and market value (₹2,25,000) as on 31 March 20X4, i.e., ₹2,25,000.

If equity shares are acquired with an intention to hold for long term period (more than one year), then should be considered as long-term investment to be shown at cost in the Balance Sheet of the company. However, provision for diminution should be made to recognise a decline, if other than temporary, in the value of the investments.

Gold and silver are generally purchased with an intention to hold it for long term period (more than one year) until and unless given otherwise. Hence, the investment in Gold and Silver (purchased on 1st March, 20X1) should continue to be shown at cost (since there is no 'other than temporary' diminution) as on 31st March, 20X4, i.e., ₹4,00,000 and ₹2,00,000 respectively, though their market values have been increased.

Question 5

In 20X1, M/s. Wye Ltd. issued 12% fully paid debentures of ₹100 each, interest being payable half yearly on 30th September and 31st March of every accounting year.

On 1st December, 20X2, M/s. Bull & Bear purchased 10,000 of these debentures at ₹101 ex-interest price, also paying brokerage @ 1% of ex-interest amount of the purchase. On 1st March, 20X3 the firm sold all these debentures at ₹103 ex-interest price, again paying brokerage @ 1% of ex-interest amount. Prepare Investment Account in the books of M/s. Bull & Bear for the period 1st December, 20X2 to 1st March, 20X3.

(*Source: Illustration 5, Study Material*)

Answer

In the books of M/s Bull & Bear
Investment Account
for the period from 1st December 20X2 to 1st March, 20X3
(Scrip: 12% Debentures of M/s. Wye Ltd.)

Date	Particulars	Nominal Value (₹)	Interest	Cost (₹)	Date	Particulars	Nominal Value (₹)	Interest	Cost (₹)
1.12.20X2	To Bank A/c (W.N.1)	10,00,000	20,000	10,20,100	1.03.20X3	By Bank A/c (W.N.2)	10,00,000	50,000	10,19,700
1.3.20X3	To Profit & loss A/c* (b.f.)	-	30,000		1.3.20X3	By Profit & loss A/c (b.f.)			400
		10,00,000	50,000	10,20,100			10,00,000	50,000	10,20,100

** This represents income for M/s. Bull & Bear for the period 1st December, 20X2 to 1st March, 20X3, i.e., interest for three months- 1st December, 20X2 to 28 February, 20X3).*

Working Notes:

1.	Cost of 12% debentures purchased on 1.12.20X2		₹
	Cost Value (10,000 × ₹101)	=	10,10,000
	Add: Brokerage (1% of ₹10,10,000)	=	10,100
	Total	=	10,20,100
2.	Sale proceeds of 12% debentures sold		₹
	Sales Price (10,000 × ₹103)	=	10,30,000
	Less: Brokerage (1% of ₹10,30,000)	=	(10,300)
	Total	=	10,19,700

Question 6

On 1.4.20X1, Mr. Krishna Murty purchased 1,000 equity shares of ₹100 each in TELCO Ltd. @ ₹120 each from a Broker, who charged 2% brokerage. He incurred 50 paise per ₹100 as cost of shares transfer stamps. On 31.1.20X2, Bonus was declared in the ratio of 1: 2. Before and after the record date of bonus shares, the shares were quoted at ₹175 per share and ₹90 per share respectively. On 31.3.20X2, Mr. Krishna Murty sold bonus shares to a Broker, who charged 2% brokerage.

Show the Investment Account in the books of Mr. Krishna Murty, who held the shares as Current assets and closing value of investments shall be made at Cost or Market value whichever is lower.

(*Source: Illustration 6, Study Material*)

Answer

In the books of Mr. Krishna Murty
Investment Account for the year ended 31st March, 20X2
(Scrip: Equity Shares of TELCO Ltd.)

Date	*Particulars*	*Nominal Value (₹)*	*Cost (₹)*	*Date*	*Particulars*	*Nominal Value (₹)*	*Cost (₹)*
1.4.20X1	To Bank A/c (W.N.1)	1,00,000	1,23,000	31.3.20X2	By Bank A/c (W.N.2)	50,000	44,100
31.1.20X2	To Bonus shares (W.N.5)	50,000	—	31.3.20X2	By Balance c/d (W.N.4)	1,00,000	82,000
31.3.20X2	To Profit & loss A/c (W.N.3)	—	3,100				
		1,50,000	1,26,100			1,50,000	1,26,100

Working Notes:

1. Cost of equity shares purchased on 1.4.20X1 = (1,000 × ₹120) + (2% of ₹1,20,000) + (½% of ₹1,20,000) = ₹1,23,000
2. Sale proceeds of equity shares (bonus) sold on 31st March, 20X2= (500 × ₹90) – (2% of ₹45,000) = ₹44,100.
3. Profit on sale of bonus shares on 31st March, 20X2
   = Sale proceeds – Average Cost
   Sale proceeds = ₹44,100
   Average cost = ₹(1,23,000 /1,50,000) x 50,000 = ₹41,000
   Profit = ₹44,100 – ₹41,000 = ₹3,100.
4. Valuation of equity shares on 31st March, 20X2
   Cost = (₹1,23,000/1,50,000) x 1,00,000 = ₹82,000
   Market Value = 1,000 shares × ₹90 = ₹90,000
   Closing balance has been valued at ₹82,000 being lower than the market value.
5. Bonus shares do not have any cost.

Question 7

Mr. X purchased 500 equity shares of ₹100 each in Omega Co. Ltd. for ₹62,500 inclusive of brokerage and stamp duty. Some years later the company resolved to capitalise its profits and to issue to the holders of equity shares, one equity bonus share for every share held by them. Prior to capitalisation, the shares of Omega Co. Ltd. were quoted at ₹175 per share. After the capitalisation, the shares were quoted at ₹92.50 per share. Mr. X. sold the bonus shares and received at ₹90 per share.

Prepare the Investment Account in X's books on average cost basis.

(*Source: Illustration 7, Study Material*)

Answer

In the books of X Investment Account
[Scrip: Equity shares in Omega Co. Ltd.]

Particulars	**Nominal Value ₹**	**Cost ₹**	**Particulars**	**Nominal Value ₹**	**Cost ₹**
To Cash	50,000	62,500	By Cash - Sale (500 x 90)	50,000	45,000
To Bonus shares (W.N.1)	50,000	-	By Balance c/d (W.N. 3)	50,000	31,250
To P & L A/c (W.N. 2)	-	13,750			
	1,00,000	76,250		1,00,000	76,250
To Balance b/d	50,000	31,250			

Working Notes:

1. Bonus shares do not have any cost.
2. Profit on sale of bonus shares = Sales proceeds – Average cost

   Sales proceeds = ₹45,000

   Average cost = $\frac{500}{1000} \times 62{,}500$ = ₹31,250

   Profit = ₹45,000 – ₹31,250 = ₹13,750.
3. Valuation of Closing Balance of Shares at the end of year

   The total cost of 1,000 share including bonus is ₹62,500

   Therefore, cost of 500 shares

   (carried forward) is = $\frac{500}{1000} \times 62{,}500$ = ₹31,250

   Market price of 500 shares = 92.50 x 500 = ₹46,250

   Cost being lower than the market price, therefore shares are carried forward at cost.

Question 8

On 1st April, 20X1, Rajat has 50,000 equity shares of P Ltd. at a book value of ₹15 per share (nominal value ₹10 each). He provides you the further information:

(1) On 20th June, 20X1 he purchased another 10,000 shares of P Ltd. at ₹16 per share.

(2) On 1st August, 20X1, P Ltd. issued one equity bonus share for every six shares held by the shareholders.

(3) On 31st October, 20X1, the directors of P Ltd. announced a right issue which entitles the holders to subscribe three shares for every seven shares at ₹15 per share. Shareholders can transfer their rights in full or in part.

Rajat sold 1/3rd of entitlement to Umang for a consideration of ₹2 per share and subscribed the rest on 5th November, 20X1.

You are required to prepare Investment A/c in the books of Rajat for the year ending 31st March, 20X2.

(*Source: Illustration 8, Study Material*)

Answer

In the books of Rajat
Investment Account
(Equity shares in P Ltd.)

Date	Particulars	No. of shares	Amount (₹)	Date	Particulars	No. of shares	Amount (₹)
1.4.X1	To Balance b/d	50,000	7,50,000	31.3.X2	By Balance c/d (Bal. fig.)	90,000	12,10,000
20.6.X1	To Bank A/c	10,000	1,60,000				
1.8.X1	To Bonus issue (W.N.1)	10,000	-				
5.11.X1	To Bank A/c (right shares) (W.N.4)	20,000	3,00,000				
		90,000	12,10,000			90,000	12,10,000

Working Notes:

(1) Bonus shares = $\frac{50{,}000 + 10{,}000}{6}$ = 10,000 shares

(2) Right shares = $\frac{50{,}000 + 10{,}000 + 10{,}000}{7} \times 3$ = 30,000 shares

(3) Sale of rights = 30,000 shares × $\frac{1}{3}$ × ₹2 = ₹20,000 to be credited to statement of profit and loss

(4) Rights subscribed = 30,000 shares × $\frac{2}{3}$ × ₹15 × ₹ 30,000

Question 9

On 1.4.20X1, Sundar had 25,000 equity shares of 'X' Ltd. at a book value of ₹15 per share (Nominal value ₹10). On 20.6.20X1, he purchased another 5,000 shares of the company at ₹16 per share. The directors of X Ltd. announced a bonus and rights issue. No dividend was payable on these issues. The terms of the issue are as follows:

Bonus basis 1:6 (Date 16.8.20X1).

Rights basis 3:7 (Date 31.8.20X1) Price ₹15 per share. Due date for payment 30.9.20X1.

Shareholders were entitled to transfer their rights in full or in part. Accordingly, Sundar sold 33.33% of his entitlement to Sekhar for a consideration of ₹2 per share.

Dividends: Dividends for the year ended 31.3.20X1 at the rate of 20% were declared by X Ltd. and received by Sundar on 31.10.20X1. Dividends for shares acquired by him on 20.6.20X1 are to be adjusted against the cost of purchase.

On 15.11.20X1, Sundar sold 25,000 equity shares at a premium of ₹5 per share. You are required to prepare in the books of Sundar.

(1) Investment Account

(2) Profit & Loss Account.

For your exercise, assume that the books are closed on 31.12.20X1 and shares are valued at average cost.

(*Source: Illustration 9, Study Material*)

Answer

Books of Sundar Investment Account
(Scrip: Equity Shares in X Ltd.)

		No.	Amount ₹			No.	Amount ₹
1.4.20X1	To Bal b/d	25,000	3,75,000	31.10.20X1	By Bank (dividend	—	10,000
20.6.20X1	To Bank	5,000	80,000				
16.8.20X1	To Bonus (W.N.1)	5,000	—		On shares acquired on 20/6/20X1) (W.N.4)		
30.9.20X1	To Bank (Rights Shares) (W.N.3)	10,000	1,50,000				
15.11.20X1	To Profit (on sale of shares)		44,444	15.11.20X1	By Bank (Sale of shares)	25,000	3,75,000
				31.12.20X1	By Bal. c/d (W.N.6)	20,000	2,64,444
		45,000	6,49,444			45,000	6,49,444

Profit and Loss Account (An extract)

To Balance c/d	1,04,444	By Profit transferred	44,444
		By Sale of rights (W.N.3)	10,000
		By Dividend (W.N.4)	50,000
	1,04,444		1,04,444

Working Notes:

(1) **Bonus shares =** $\frac{(25{,}000 + 5{,}000)}{6}$ = 5,000 shares

(2) **Right shares =** $\frac{25{,}000 + 5{,}000 + 5{,}000}{7} \times 3$ = 15,000 shares

(3) Right shares renounced = 15,000×1/3 = 5,000 shares

Sale of right shares = 5,000 x 2 = ₹10,000

Right shares subscribed = 15,000 – 5,000 = 10,000 shares

Amount paid for subscription of right shares = 10,000 x 15 = ₹1,50,000

(4) Dividend received = 25,000 (shares as on 1st April 20X1) × 10 × 20% = ₹50,000

Dividend on shares purchased on 20.6.20X1 = 5,000×10×20% = ₹10,000 is adjusted to Investment A/c

(5) Profit on sale of 25,000 shares

= Sales proceeds – Average cost

Sales proceeds = ₹3,75,000

Average cost $= \left(\dfrac{(3,75,000+80,000+1,50,000-10,000)}{45,000}\right)\times 25,000 =$ ₹3,30,556

Profit = ₹3,75,000– ₹3,30,556= ₹44,444.

(6) Cost of shares on 31.12.20X1

$$\left(\frac{(3,75,000+80,000+1,50,000-10,000)}{45,000}\right)\times 20,000 = ₹2,64,444$$

Reference: The students are also advised to refer the full bare text of AS 13 (Revised) "Accounting for Investments".

Question 10

Briefly explain disclosure requirements for Investments as per AS-13.

(*Source: Question 6, Study Material*)

Answer

The disclosure requirements as per AS 13 (Revised) are as follows:

(i) Accounting policies followed for the determination of carrying amount of investments.

(ii) Classification of investment into current and long term.

(iii) The amount included in profit and loss statements for

  (a) Interest, dividends and rentals for long term and current investments, disclosing therein gross income and tax deducted at source thereon;

  (b) Profits and losses on disposal of current investment and changes in carrying amount of such investments;

  (c) Profits and losses and disposal of long term investments and changes in carrying amount of investments.

(iv) Aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments;

(v) Any significant restrictions on investments like minimum holding period for sale/disposal, utilisation of sale proceeds or non-remittance of sale proceeds of investment held outside India.

(vi) Other disclosures required by the relevant statute governing the enterprises

Question 11

How will you classify the investments as per AS 13? Explain in Brief.

(*Source: Question 7, Study Material*)

Answer

The investments are classified into two categories as per AS 13, viz., Current Investments and Long-term Investments.

A current Investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost and fair value. Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss.

A long-term investment is an investment other than a current investment. Long term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognise the decline. The reduction in carrying amount is charged to the statement of profit and loss.

Question 12

Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without providing for any diminution in value is correct and in accordance with the provisions of AS 13. If not, what should have been the accounting treatment in such a situation? Explain in brief.

(*Source: Question 8, Study Material*)

Answer

The accounting treatment 'at cost' under the head 'Long Term Investment' in the financial statements of the company without providing for any diminution in value is correct and is in accordance with the provisions of AS 13 provided that there is no decline, other than temporary, in the value of investment. If the decline in the value of investment is, other than temporary, compared to the time when the shares were purchased, provision is required to be made.

Question 13

Mr. X acquires 200 shares of a company on cum-right basis for ₹70,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at ₹107 each. He does not subscribe but sells all the rights for ₹12,000. The market value of the shares after their becoming ex- rights has also gone down to ₹60,000. What should be the accounting treatment in this case?

(*Source: Question 9, Study Material*)

Answer

As per AS 13, where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value. In this case, the amount of the ex-right market value of 200 shares bought by X immediately after the declaration of rights falls to ₹60,000. In this case, out of sale proceeds of ₹12,000, ₹10,000 may be applied to reduce the carrying amount to bring it to the market value and ₹2,000 would be credited to the profit and loss account.

Question 14

On 1st April, 20X1, XY Ltd. has 15,000 equity shares of ABC Ltd. at a book value of ₹15 per share (nominal value ₹10 per share). On 1st June, 20X1, XY Ltd. acquired 5,000 equity shares of ABC Ltd. for ₹1,00,000. ABC Ltd. announced a bonus and right issue.

(1) Bonus was declared, at the rate of one equity share for every five shares held, on 1st July 20X1.

(2) Right shares are to be issued to the existing shareholders on 1st September 20X1. The company will issue one right share for every 6 shares at 20% premium. No dividend was payable on these shares.

(3) Dividend for the year ended 31.3.20X1 were declared by ABC Ltd. @ 20%, which was received by XY Ltd. on 31st October 20X1.

XY Ltd.

(i) Took up half the right issue.

(ii) Sold the remaining rights for ₹8 per share.

(iii) Sold half of its shareholdings on 1st January 20X2 at ₹16.50 per share. Brokerage being 1%.

You are required to prepare Investment account of XY Ltd. for the year ended 31st March 20X2 assuming the shares are being valued at average cost.

(*Source: Question 10, Study Material*)

Answer

In the books of XY Ltd.

Investment in equity shares of ABC Ltd. for the year ended 31st March, 20X2

Date	Particulars	No.	Dividend ₹	Amount ₹	Date	Particulars	No.	Dividend	Amount
20X1 April 1	To Balance b/d	15,000	-	2,25,000	20X1 Oct. 31	By Bank A/c (W.N. 5)	-	30,000	10,000
June 1	To Bank A/c	5,000	--	1,00,000	20X2 Jan. 1	By Bank A/c (W.N.4)	13,000	-	2,12,355
July 1	To Bonus Issue (W.N. 1)	4,000	-	-	March 31	By Balance c/d (W.N. 6)	13,000	-	1,69,500
Sept.1	To Bank A/c (W.N. 2)	2,000	-	24,000					
20X2 Jan 1	To P & L A/c (W.N. 4)	-	-	42,855					
“20X2 March 31	To P & L A/c	-	30,000	-					
		26,000	30,000	3,91,855			26,000	30,000	3,91,855

Working Notes:

1. **Calculation of no. of bonus shares issued**

$$\text{Bonus Shares} = \frac{15,000 \text{ shares} + 5,000 \text{ shares}}{5} \text{ x } 1 = 4,000 \text{ shares}$$

2. **Calculation of right shares subscribed**

$$\text{Right Shares} = \frac{15,000 \text{ shares} + 5,000 \text{ shares} + 4,000 \text{ shares}}{6} = 4,000 \text{ shares}$$

$$\text{Shares subscribed by XY Ltd.} = \frac{4,000}{2} = 2,000 \text{ shares}$$

Value of right shares subscribed = 2,000 shares @ ₹12 per share
= ₹24,000

3. **Calculation of sale of right entitlement**

2,000 shares x ₹8 per share = ₹16,000

Amount received from sale of rights will be credited to statement of profit and loss.

4. **Calculation of profit on sale of shares**

Total holding =	15,000 shares	original
	5,000 shares	purchased
	4,000 shares	bonus
	2,000 shares	right shares
	26,000 shares	

50% of the holdings were sold

i.e. 13,000 shares (26,000 x1/2) were sold.

Cost of total holdings of 26,000 shares (on average basis)

= ₹2,25,000 + ₹1,00,000 + ₹24,000– ₹10,000 = ₹3,39,000

Average cost of 13,000 shares would be

$$= \frac{3,39,000}{26,000} \times 13,000 = ₹1,69,500$$

Sale proceeds of 13,000 shares (13,000 x ₹16.50)	2,14,500
Less: 1% Brokerage	(2,145)
	2,12,355
Less: Cost of 13,000 shares	(1,69,500)
Profit on sale	42,855

5. Dividend received on investment held as on 1st April, 20X1

= 15,000 shares x ₹ 10 x 20%

= ₹ 30,000 will be transferred to Profit and Loss A/c

Dividend received on shares purchased on 1st June, 20X1

= 5,000 shares x ₹10 x 20% = ₹10,000 will be adjusted to Investment A/c

Note: It is presumed that no dividend is received on bonus shares as bonus shares are declared on 1st July, 20X1 and dividend pertains to the year ended 31.3.20X1.

6. Calculation of closing value of shares (on average basis) as on 31st March, 20X2

$$13,000 \times \frac{3,39,000}{26,000} = ₹1,69,500$$

Question 15

The following information is presented by Mr. Z (a stock broker), relating to his holding in 9% Central Government Bonds.

Opening balance (nominal value) ₹1,20,000, Cost ₹1,18,000 (Nominal value of each unit is ₹100).

1.3.20X1	*Purchased 200 units, ex-interest at ₹98.*
1.7.20X1	*Sold 500 units, ex-interest out of original holding at ₹100.*
1.10.20X1	*Purchased 150 units at ₹98, cum interest.*
1.11.20X1	*Sold 300 units, ex-interest at ₹99 out of original holdings.*

Interest dates are 30th September and 31st March. Mr. Z closes his books every 31st December. Show the investment account as it would appear in his books. Mr. Z follows FIFO method.

(*Source: Question 11, Study Material*)

Answer

In the Books of Mr. Z

9% Central Government Bonds (Investment) Account

Particulars		**Nominal Value**	**Interest**	**Principal**	**Particulars**		**Nominal Value**	**Interest**	**Principal**
20X1		**₹**	**₹**	**₹**	**20X1**		**₹**	**₹**	**₹**
Jan.1	To Balance b/d (W.N.1)	1,20,000	2,700	1,18,000	Mar. 31	By Bank A/c (W.N.3)	-	6,300	-
March 1	To Bank A/c (W.N.2)	20,000	750	19,600	July 1	By Bank A/c (W.N.4)	50,000	1,125	50,000
July 1	To P&L A/c (W.N.5)	-	-	833	Sept. 30	By Bank A/c (W.N.6)	-	4,050	-
Oct. 1	To Bank A/c (150 x 98)	15,000	-	14,700	Nov. 1	By Bank A/c (W.N.7)	30,000	225	29,700
Nov. 1	To P&L A/c (W.N.8)	-	-	200	Dec. 31	By Balance c/d (W.N. 9 & W.N.10)	75,000	1,688	73,633
Dec. 31	To P&L A/c (b.f.) (Transfer)		9,938						
		1,55,000	13,388	1,53,333			1,55,000	13,388	1,53,333

Working Note:

1. Interest element in opening balance of bonds = 1,20,000 x 9% x 3/12 = ₹2,700
2. **Purchase of bonds on 1. 3.20X1**

   Interest element in purchase of bonds = 200 x 100 x 9% x 5/12 = ₹750 Investment element in purchase of bonds = 200 x 98 = ₹19,600
3. Interest for half-year ended 31 March = 1,400 x 100 x 9% x 6/12 = ₹6,300
4. **Sale of bonds on 1.7.20X1**

   Interest element = 500 x 100 x 9% x 3/12 = ₹1,125

   Investment element = 500 x 100 = ₹50,000
5. **Profit on sale of bonds on 1.7.20X1**

   Cost of bonds = (1,18,000/ 1,200) x 500 = ₹49,167 Sale proceeds = ₹50,000

   Profit element = ₹833
6. **Interest for half-year ended 30 September**

   = 900 x 100 x 9% x 6/12 = ₹4,050
7. **Sale of bonds on 1.11.20X1**

   Interest element = 300 x 100 x 9% x 1/12 = ₹225

   Investment element = 300 x 99 = ₹29,700
8. **Profit on sale of bonds on 1.11.20X1**

   Cost of bonds = (1,18,000/ 1,200) x 300 = ₹29,500 Sale proceeds = ₹29,700

   Profit element = ₹200
9. **Closing value of investment**

Calculation of closing balance:	***Nominal value***		***₹***
Bonds in hand remained in hand at 31st December 20X1			
From original holding (1,20,000 – 50,000 – 30,000) =	40,000	$\frac{1,18,000}{1,20,000} \times 40,000$	39,333
Purchased on 1st March	20,000		19,600
Purchased on 1st October	15,000		14,700
	75,000		73,633

10. Interest element in closing balance of bonds = 750 x 100 x 9% x 3/12 = ₹1,688

Question 16

Mr. Purohit furnishes the following details relating to his holding in 8% Debentures (₹100 each) of P Ltd., held as Current assets:

1.4.20X1	*Opening balance – Nominal value ₹1,20,000, Cost ₹1,18,000*
1.7.20X1	*100 Debentures purchased ex-interest at ₹98*
1.10.20X1	*Sold 200 Debentures ex-interest at ₹100*
1.1.20X2	*Purchased 50 Debentures at ₹98 ex-interest*
1.2.20X2	*Sold 200 Debentures ex-interest at ₹99*

Due dates of interest are 30th September and 31st March.

Mr. Purohit closes his books on 31.3.20X2. Brokerage at 1% is to be paid for each transaction (at ex-interest price). Show Investment account as it would appear in his books. Assume FIFO method. Market value of 8% Debentures of P Limited on 31.3.20X2 is ₹99.

(*Source: Question 12, Study Material*)

Answer

Investment A/c of Mr. Purohit for the year ending on 31-3-20X2
(Scrip: 8% Debentures of P Limited)
(Interest Payable on 30th September and 31st March)

Date	Particulars	Nominal Value	Interest	Cost	Date	Particulars	Nominal Value	Interest	Cost
			₹	₹				₹	₹
1.4.20X1	To Balance b/d	1,20,000	-	1,18,000	30.9.20X1	By Bank (1,300 x 100 x 8% x 6/12)	-	5,200	-
1.7.20X1	To Bank (ex-Interest) (W.N.1)	10,000	200	9,898	1.10.20X1	By Bank (W.N.4)	20,000	-	19,800
1.10.20X1	To Profit & Loss A/c (W.N.4)			133	1.2.20X2	By Bank (ex-Interest) (W.N.5)	20,000	533	19,602
1.1.20X2	To Bank (ex-Interest) (W.N.2)	5,000	100	4,949	1.2.20X2	By Profit & Loss A/c (W.N.5)			64
31.3.20X2	To Profit & Loss A/c (Bal. fig.)	-	9,233		31.3.20X2	By Bank (950 x 100 x 8% x 6/12)	-	3,800	-
					31.3.20X2	By Balance c/d (W.N.3)	95,000	-	93,514
		1,35,000	9,533	1,32,980			1,35,000	9,533	1,32,980

Working Notes:

1. **Purchase of debentures on 1.7.20X1**

   Interest element = 100 x 100 x 8% x 3/12 = ₹200

   Investment element = (100 x 98) + [1% (100 x 98)] = ₹9,898

2. **Purchase of debentures on 1.1.20X2**

   Interest element = 50 x 100 x 8% x 3/12 = ₹100

   Investment element = {(50 x 98) + [1%(50 x 98)]} = ₹4,949

3. **Valuation of closing balance as on 31.3.20X2:**

   Market value of 950 Debentures at ₹99 = ₹94,050 Cost of

   800 Debentures cost = $\left(\frac{1{,}18{,}000}{1{,}20{,}000} \times 80{,}000\right)$=78,667

100 Debentures cost	=	9,898
50 Debentures cost	=	4,949
		93,514

   Value at the end = ₹93,514, i.e., whichever is less

4. **Profit on sale of debentures as on 1.10.20X1**

	₹
Sales price of debentures (200 x ₹100)	20,000
Less: Brokerage @ 1%	(200)
	19,800
Less: Cost of Debentures $\left(\frac{1{,}18{,}000}{1{,}20{,}000} \times 20{,}000\right) =$	(19,667)
Profit on sale	133

5. Loss on sale of debentures as on 1.2.20X2

	₹
Sales price of debentures (200 x ₹99)	19,800
Less: Brokerage @ 1%	(198)
	19,602
Less: Cost of Debentures $\left(\frac{1,18,000}{1,20,000} \times 20,000\right) =$	(19,666)
Loss on sale	64
Interest element in sale of investment = 200 x 100 x 8% x 4/12	₹533

Question 17

On 1st April, 20X1, Mr. Vijay had 30,000 Equity shares in X Ltd. at a book value of ₹4,50,000 (Face Value ₹10 per share). On 22nd June, 20X1, he purchased another 5000 shares of the same company for ₹80,000.

The Directors of X Ltd. announced a bonus of equity shares in the ratio of one share for seven shares held on 10th August, 20X1.

On 31st August, 20X1 the Company made a right issue in the ratio of three shares for every eight shares held, on payment of ₹15 per share. Due date for the payment was 30th September, 20X1, Mr. Vijay subscribed to 2/3rd of the right shares and sold the remaining of his entitlement to Viru for a consideration of ₹2 per share.

On 31st October, 20X1, Vijay received dividends from X Ltd. @ 20% for the year ended 31st March, 20X1. Dividend for the shares acquired by him on 22nd June, 20X1 to be adjusted against the cost of purchase.

On 15th November, 20X1 Vijay sold 20,000 Equity shares at a premium of ₹5 per share.

You are required to prepare Investment Account in the books of Mr. Vijay for the year ended 31st March, 20X2 assuming the shares are being valued at average cost.

(*Source: Question 13, Study Material*)

Answer

Investment Account in Books of Vijay (Scrip: Equity Shares in X Ltd.)

		No.	***Amount***			***No.***	***Amount***
			₹				₹
1.4.20X1	To Bal b/d	30,000	4,50,000	31.10.20X1	By Bank (dividend on shares acquired on 22.6.20X1)	—	10,000
22.6.20X1	To Bank	5,000	80,000				
10.8.20X1	To Bonus	5,000	–				
30.9.20X1	To Bank (Rights Shares)	10,000	1,50,000				
15.11.20X1	To P&L A/c (Profit on sale of shares)		32,000	15.11.20X1	By Bank (Sale of shares)	20,000	3,00,000
				31.3.20X2	By Bal. c/d	30,000	4,02,000
		50,000	7,12,000			50,000	7,12,000

Working Notes:

(1) **Bonus Shares** = (30,000 + 5,000) / 7 = 5,000 shares

(2) **Right Shares** $= \frac{(30,000\ 5,000\ 5,000)}{8} \times 3 = 15,000$ shares

(3) **Rights shares sold** = 15,000×1/3 = 5,000 shares

(4) **Dividend received** = 30,000×10×20% = ₹60,000 will be taken to P&L statement

(5) Dividend on shares purchased on 22.6.20X1

= 5,000×10×20%

= ₹10,000 is adjusted to Investment A/c

(6) Profit on sale of 20,000 shares

= Sales proceeds – Average cost Sales proceeds

= ₹3,00,000

$$\text{Average cost} = \frac{(4,50,000 + 80,000 + 1,50,000 - 10,000)}{50,000} \times 20,000$$

= ₹2,68,000

Profit = ₹3,00,000– ₹2,68,000= ₹32,000.

(7) Cost of shares on 31.3.20X2

$$\frac{(4,50,000 + 80,000 + 1,50,000 - 10,000)}{50,000} \times 30,000 = ₹4,02,000$$

(8) Sale of rights amounting ₹10,000 (₹2 x 5,000 shares) will not be shown in investment A/c but will directly be taken to P & L statement.

Question 18

Blue-chip Equity Investments Ltd., wants to re-classify its investments in accordance with AS 13 (Revised). State the values, at which the investments have to be reclassified in the following cases:

(i) Long term investments in Company A, costing ₹8.5 lakhs are to be re-classified as current. The company had reduced the value of these investments to ₹6.5 lakhs to recognise 'other than temporary' decline in value. The fair value on date of transfer is ₹6.8 lakhs.

(ii) Long term investments in Company B, costing ₹7 lakhs are to be re-classified as current. The fair value on date of transfer is ₹8 lakhs and book value is ₹7 lakhs.

(iii) Current investment in Company C, costing ₹10 lakhs are to be re-classified as long term as the company wants to retain them. The market value on date of transfer is ₹12 lakhs.

(*Source: Question 14, Study Material*)

Answer

As per AS 13 (Revised) 'Accounting for Investments', where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer**.** And where investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹6.5 lakhs in the books.

(ii) The carrying / book value of the long term investment is same as cost i.e. ₹7 lakhs. Hence this long term investment will be reclassified as current investment at book value of ₹7 lakhs only.

(iii) In this case, reclassification of current investment into long-term investments will be made at ₹10 lakhs as cost is less than its market value of ₹12 lakhs.

QUESTION BANK

Question 19

On 15th June, 2018, Y limited wants to re-classify its investments in accordance with AS 13 (revised). Decided and state the amount of transfer, based on the following information:

(1) A portion of long term investments purchases on 1st March, 2017 are to be re-classified as current investments. The original cost of these investments was ₹14 lakhs but had been written down by ₹2 lakhs (to recognize 'other than temporary' decline in value). The market value of these investments on 15th June, 2018 was ₹11 lakhs.

(2) Another portion of long term investments purchases on 15th January, 2017 are to be re-classified as current investments. The original cost of these investments was ₹7 lakhs but had been written down to ₹5 lakhs (to recognize 'other than temporary' decline in value). The fair value of these investments on 15th June, 2018 was ₹4.5 lakhs.

(3) A portion of current investments purchases on 15th March, 2018 for ₹7 lakhs are to be re-classified as long term investments, as the company has decided to retain them. The market value of these investments on 31st March, 2018 was ₹6 lakhs and fair value on 15th June, 2018 was ₹8.5 lakhs.

(4) Another portion of current investments purchases on 7th December, 2017 for ₹4 lakhs are to be re-classified as long term investments. The market value of these investments was :

on 31st March, 2018	₹3.5 lakhs
on 15th June, 2018	₹3.8 lakhs

(*May 2019*) (*5 Marks*)

Answer

As per AS 13 (Revised) 'Accounting for Investments', where long-term investments are reclassified as current investments, transfers are **made at the lower of cost and carrying amount** at the date of transfer; and where investments are reclassified from current to long term, transfers are made **at lower of cost and fair value** on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹12 lakhs in the books.

(ii) In this case also, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹5 lakhs in the books.

(iii) In this case, reclassification of current investment into long-term investments will be made at ₹7 lakhs as cost is less than its fair value of ₹8.5 lakhs on the date of transfer.

(iv) In this case, market value (considered as fair value) is ₹3.8 lakhs on the date of transfer which is lower than the cost of ₹4 lakhs. The reclassification of current investment into long-term investments will be made at ₹3.8 lakhs.

Question 20

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

As per the provisions of AS-13, a current investments is an investment that is by its nature is readily realizable and is intended to be held for not more than six months from the date on which such investment is made.

(*May 2019*) (*1 Marks*)

Answer

False: A current investment is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made.

Question 21

Paridhi Electronics Ltd. has current investment (X Ltd.'s shares) purchased for ₹5 lakhs, which the company want to reclassify as long term investment on 31.3.2018. The market value of these investments as on date of Balance Sheet was ₹2.5 lakhs. How will you deal with this as on 31.3.18 with reference to AS-13?

(*RTP May 2019*)

Answer:

As per AS 13 'Accounting for Investments', where investments are reclassified from current to long-term, transfers are made at the lower of cost or fair value at the date of transfer.

In the given case, the market value of the investment (X Ltd. shares) is ₹2.50 lakhs, which is lower than its cost i.e. ₹5 lakhs. Therefore, the transfer to long term investments should be made at cost of ₹2.50 lakhs. The loss of ₹2.50 lakhs should be charged to profit and loss account.

Question 22

Paridhi Electronics Ltd. invested in the shares of another unlisted company on 1st May 2012 at a cost of ₹3,00,000 with the intention of holding more than a year. The published accounts of unlisted company received in January, 2017 reveals that the company has incurred cash losses with decline in market share and investment of Paridhi Electronics Ltd. may not fetch more than ₹45,000.

You are required to explain how you wilt deal with the above in the financial statements of the Paridhi Electronics Ltd. as on 31.3.17 with reference to AS 13?

(*RTP May 2018*)

Answer:

As per AS 13, "Accounting for Investments" Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. The standard also states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment.

On this basis, the facts of the case given in the question clearly suggest that the provision for diminution should be made to reduce the carrying amount of shares to ₹45,000 in the financial statements for the year ended 31st March, 2017 and charge the difference of loss of ₹2,55,000 to profit and loss account.

Question 23

M/s Active Builders Ltd. invested in the shares of another company (with an intention to hold the shares for short term period) on 31st October, 2016 at a cost of ₹4,50,000. It also earlier purchased Gold of ₹5,00,000 and Silver of ₹2,25,000 on 31st March, 2014.

Market values as on 31st March, 2017 of the above investments are as follows:

Shares ₹3,75,000; Gold ₹7,50,000 and Silver ₹4,35,000

You are required explain how will the above investments be shown in the books of account of M/s Active Builders Ltd. for the year ending 31st March, 2017 as per the provisions of AS 13?

(*RTP November 2018*)

Answer:

As per AS 13 'Accounting for Investments', if the shares are purchased with an intention to hold for short-term period then investment will be shown at the realizable value. In the given case, shares purchased on 31st October, 2016, will be valued at ₹3,75,000 as on 31st March, 2017.

Gold and silver are generally purchased with an intention to hold it for long term period until and unless given otherwise. Hence, the investment in gold and silver (purchased on 31st March, 2014) shall continue to be shown at cost as on 31st March, 2017 i.e., ₹5,00,000 and ₹2,25,000 respectively, though their realizable values have been increased.

Thus the shares, gold and silver will be shown at ₹3,75,000, ₹5,00,000 and ₹2,25,000 respectively and hence, total investment will be valued at ₹11,00,000 in the books of account of M/s Active Builders for the year ending 31st March, 2017 as per provisions of AS 13.

Question 24

Z Bank has classified its total investment on 31-3-2021 into three categories (a) held to maturity (b) available for sale (c) held for trading as per the RBI Guidelines. 'Held to maturity' investments are carried at acquisition cost less amortized amount. 'Available for sale' investments are carried at marked to market. 'Held for trading' investments are valued at weekly intervals at market rates. Net depreciation, if any, is charged to revenue and net appreciation, if any, is ignored. You are required to comment whether the policy of the bank is in accordance with AS 13?

(*MTP, November, 2021/RTP, November 2021*) (*5 Marks*)

Answer

As per AS 13 'Accounting for Investments', the accounting standard is not applicable to Bank, Insurance Company, Mutual Funds. In this case Z Bank is a bank, therefore, AS 13 does not apply to it. For banks, the RBI has issued separate guidelines for classification and valuation of its investment and Z Bank should comply with those RBI Guidelines/Norms. Therefore, though Z Bank has not followed the provisions of AS 13, yet it would not be said as non-compliance since, it is complying with the norms stipulated by the RBI.

Question 25

Mr. Mohan has invested some money in various Mutual funds.

Following information in this regard is given:

Mutual Funds	Date of purchase	Purchase cost (₹)	Brokerage Cost (₹)	Stamp duty (₹)	Market value as on 31.03.2021 (₹)
A	01.05.2017	50,000	200	20	48,225
B	05.08.2020	25,000	150	25	24,220
C	01.01.2021	75,000	300	75	78,190
D	07.05.2020	70,000	275	50	65,880

You are required to;

1. Classify his investment in accordance with AS-13 (revised).
2. Value of Investment in mutual fund as on 31.03.2021

(*Suggested December 2021*) (*5 Marks*)

Answer

As per AS 13 "Accounting for Investments", a current investment is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost and fair value.

A long-term investment is an investment other than a current investment. Long term investments are usually carried at cost. If there is a decline, other than temporary, in the value of a long-term investment; the carrying amount is reduced to recognize the decline.

Mutual Funds	Classification	Cost (₹)	Market value (₹)	Carrying value (₹)
A	Long-term Investment	50,220	48,225*	50,220
B	Current Investment	25,175	24,220	24,220
C	Current Investment	75,375	78,190	75,375
D	Current Investment	70,325	65,880	65,880
Total				2,15,695

**Note: ***The reduction in value of Mutual fund A is considered to be temporary. If reduction in Market value is assumed as other than temporary in nature, then the carrying value of ₹48,225 will be considered.

Question 26

On 1st January 20X1, Singh had 20,000 equity shares in X Ltd. Nominal value of the shares was ₹10 each but their book value was ₹ 16 per share. On 1st June 20X1, Singh purchased 5,000 more equity shares in the company at a premium of ₹ 4 per share.

On 30th June, 20X1, the directors of X Ltd. announced a bonus and rights issue. Bonus was declared at the rate of one equity share for every five shares held and these shares were received on 2nd August, 20X1.

The terms of the rights issue were:

(a) Rights shares to be issued to the existing holders on 10th August, 20X1.

(b) Rights issue would entitle the holders to subscribe to additional equity shares in the Company at the rate of one share per every three held at ₹ 15 per share-the whole sum being payable by 30th September, 20X1.

(c) Existing shareholders were entitled to transfer their rights to outsiders, either wholly or in part.

(d) Singh exercised his option under the issue for 50% of his entitlements and the balance of rights he sold to Ananth for a consideration of ₹ 1.50 per share.

(e) Dividends for the year ended 31st March, 20X1, at the rate of 15% were declared by the Company and received by Singh on 20th October, 20X1.

(f) On 1st November, 20X1, Singh sold 20,000 equity shares at a premium of ₹ 3 per share.

The market price of share on 31-12-20X1 was ₹ 14. Show the Investment Account as it would appear in Singh's books on 31-12-20X1 and the value of shares held on that date.

(*Study Material*)

Answer

Investment Account-Equity Shares in X Ltd.

Date		*No. of shares*	*Dividend*	*Amount*	*Date*		*No. of shares*	*Dividend*	*Amount*
			₹	₹				₹	₹
20X1					20X1				
Jan. 1	To Bal. b/d	20,000	-	3,20,000	Oct. 20	By Bank (dividend) [20,000 x 10 x 15%] [5,000 x 10 x 15%]		30,000	7,500
June 1	To Bank	5,000	-	70,000	Nov. 1	By Bank	20,000		2,60,000
Aug. 2	To Bonus Issue	5,000		—	Nov. 1	By P & L A/c (W.N.2)			1,429
Sep. 30	To Bank (Right) (W.N.1)	5,000	-	75,000	Dec. 31	By Balance c/d (W.N.3)	15,000		1,96,071
Dec.31	To Profit & Loss A/c (Dividend income)		30,000						
		35,000	30,000	4,65,000			35,000	30,000	4,65,000
Jan. 1, 20X2	To Balance b/d	15,000		1,96,071					

Working Notes:

1. **Right shares**

   No. of right shares issued = (20,000 + 5,000 + 5,000)/ 3 = 10,000 shares No. of right shares subscribed = 10,000 x 50% = 5,000 shares

   Amount of right shares issued = 5,000 x 15 = ₹ 75,000 No. of right shares sold = 10,000 – 5,000 = 5,000 shares

   Sale of right shares = 5,000 x 1.5 = ₹ 7,500 to be credited to statement of profit and loss

2. **Cost of shares sold — Amount paid for 35,000 shares**

	₹
(₹3,20,000 + ₹ 70,000 + ₹ 75,000)	4,65,000
Less: Dividend on shares purchased on June 1 (since the dividend pertains to the year ended 31st March, 20x1, i.e., the pre- acquisition period)	(7,500)
Cost of 35,000 shares	4,57,500
Cost of 20,000 shares (Average cost basis)	2,61,429
Sale proceeds	2,60,000
Loss on sale	1,429

3. **Value of investment at the end of the year**

   Assuming investment as current investment, closing balance will be valued based on lower of cost or net realisable value.

   Here, Net realisable value is ₹14 per share i.e. 15,000 shares x ₹ 14 = ₹ 2,10,000 and cost = $\frac{4,57,500}{35,000} \times 15,000 =$

   ₹ 1,96,071. Therefore, value of investment at the 35,000 end of the year will be ₹ 1,96,071.

Question 27

A Limited purchased 5,000 equity shares (nominal value ₹ 100 each) of Allianz Limited for ₹ 105 each on 1st April, 20X1. The shares were quoted cum dividend. On 15th May, 20X1, Allianz Limited declared & paid dividend of 2% for year ended 31st March, 20X1. On 30th June, 20X1 Allianz Limited issued bonus shares in ratio of 1:5. On 1st October, 20X1 Allianz Limited issued rights share in the ratio of 1:12 @ 45 per share. A Limited subscribed to half of the rights issue and the balance was sold at ₹ 5 per right entitlement. The company declared interim dividend of 1% on 30th November, 20X1. Right shares were not entitled to dividend. The company sold 3,000 shares on 31st December, 20X1 at ₹ 95 per share. The company A Ltd. incurred 2% as brokerage while buying and selling shares.

You are required to prepare Investment Account in books of A Ltd for the year ended 31st March, 20X2.

(*Study Material*)

Answer

In the books of A Ltd.

Investment in equity shares of Allianz Ltd. for the year ended 31st March, 20X2

Date	*Particulars*	*No.*	*Income* ₹	*Amount* ₹	*Date*	*Particulars*	*No.*	*Income* ₹	*Amount* ₹
20X1					20X1				
April 1	To Bank A/c (W.N.1)	5,000	-	5,35,500	May 15	By Bank A/c (dividend) (W.N.6)	-	-	10,000
June 30	To Bonus Issue (W.N 2)	1,000	-	-					
Oct. 1	To Bank A/c (W.N. 3)	250	-	11,250	Nov. 30	By Bank A/c (Interim dividend) (W.N.7)	-	6,000	-
Dec.31	To P & L A/c (W.N. 5)	-	-	21,660	Dec. 31	By Bank A/c (W.N. 5)	3,000	-	2,79,300
20X2					20X2				
March 31	To P & L A/c (b.f.)	-	6,000	-	March 31	By Balance c/d (W.N. 7)	3,250	-	2,79,110
		6,250	6,000	5,68,410			6,250	6,000	5,68,410

Working Notes:

1. **Calculation of cost of purchase on 1st April, 20X1**

   ₹ 105 X 5,000 shares = ₹ 5,25,000

   Add: Brokerage (2%) = ₹ 10,500

   ₹ 5,35,500

2. Calculation of number of bonus shares issued

$$\text{Bonus Shares} = \frac{5,000}{5} \times 1 = 1,000$$

3. Calculation of right shares subscribed

$$\text{Right Shares} = \frac{6,000}{12} = 500 \text{ shares}$$

$$\text{Shares subscribed} = \frac{500}{2} = 250 \text{ shares}$$

Value of right shares subscribed = 250 shares @ ₹ 45 per share = ₹ 11,250

4. Calculation of sale of right entitlement

250 shares x ₹ 5 per share = ₹ 1,250

(Amount received from sale of rights will be credited to P&L a/c)

5. Calculation of profit on sale of shares

Total holding	= 5,000 shares	original
	1,000 shares	bonus
	250 shares	right shares
	6,250 shares	

3,000 shares were sold on 31.12.20X1

Cost of total holdings of 6,250 shares (on average basis)

= ₹ 5,35,500 + ₹ 11,250 – ₹ 10,000 = ₹ 5,36,750

Average cost of 3,000 shares would be

$$= \frac{5,36,750}{6,250} \times 3,000 = ₹\ 2,57,640$$

	₹
Sale proceeds of 3,000 shares (3,000 x ₹ 95)	2,85,000
Less: 2% Brokerage	(5,700)
	2,79,300
Less: Cost of 3,000 shares	(2,57,640)
Profit on sale	21,660

6. Dividend received on investment held as on 15th May, 20X1

= ₹ 10,000 (5,000 x ₹ 100 x 2%) adjusted to Investment A/c

7. Dividend amounting ₹ 6,000 received on 30.11.20X1 will be credited to P&L A/c

8. Calculation of closing value of shares (on average basis) as on 31st March, 20X2

$$= \frac{5,36,750}{6,250} \times 3,250 = ₹\ 2,79,110$$

Question 28

Smart Investments made the following investments in the year 20X1-X2: 12% State Government Bonds having nominal value ₹100

Date	***Particulars***
01.04.20X1	*Opening Balance (1200 bonds) book value of ₹ 126,000*
02.05.20X1	*Purchased 2,000 bonds @ ₹ 100 cum interest*
30.09.20X1	*Sold 1,500 bonds at ₹ 105 ex interest*

Interest on the bonds is received on 30th June and 31st Dec. each year.

Equity Shares of X Ltd.	
15.04.20X1	*Purchased 5,000 equity shares @ ₹ 200 on cum right basis; Brokerage of 1% (on cum-right price) was paid in addition (Nominal Value of shares ₹ 10)*
03.06.20X1	*The company announced a bonus issue of 2 shares for every 5 shares held.*
16.08.20X1	*The company made a rights issue of 1 share for every 7 shares held at ₹ 250 per share. The entire money was payable by 31.08.20X1.*
22.8.20X1	*Rights to the extent of 20% was sold @ ₹ 60. The remaining rights were subscribed.*

02.09.20X1	*Dividend @ 15% for the year ended 31.03.20X1 was received on 16.09.20X1*
15.12.20X1	*Sold 3,000 shares @ ₹ 300. Brokerage of 1% was incurred extra.*
15.01.20X2	*Received interim dividend @ 10% for the year 20X1 –X2*
31.03.20X2	*The shares were quoted in the stock exchange @ ₹ 220*

Prepare Investment Accounts in the books of Smart Investments. Assume that the average cost method is followed.

(*Study Material*)

Answer

In the books of Smart Investments
12% Govt. Bonds for the year ended 31st March, 20X2

Date	Particulars		Nos.	Interest	Amount	Date	Particulars		Nos.	Interest	Amount
1.4.X1	To	Opening balance b/d (W.N.7)	1,200	3,600	1,26,000	30.6.X1	By	Bank A/c (Interest) (3,200 x 100 x 12% x 6/12)	-	19,200	-
2.5.X1	To	Bank A/c (W.N.8)	2,000	8,000	1,92,000	30.9.X1	By	Bank A/c (W.N.1 & W.N.9)	1,500	4,500	1,57,500
30.9.X1	To	P & L A/c (Profit on Sale) (W.N.1)			8,437.50	31.12.X1	By	Bank A/c (Interest) (1,700 x 100 x 12% x 6/12)	-	10,200	-
31.3.X2	To	P & L A/c (Interest)		27,400		31.3.X2	By	Bal. c/d (W.N.2 & W.N.10)	1,700	5,100	1,68,937.50
			3,200	39,000	3,26,437.50				3,200	39,000	3,26,437.50

Investments in Equity shares of X Ltd. for year ended 31.3.20X2

Date	Particulars		Nos.	Dividend	Amount	Date	Particulars		Nos.	Dividend	Amount
15.4.X1	To	Bank A/c (W.N.3)	5,000		10,10,000						
3.6.X1	To	Bonus Issue	2,000	-	-	16.9.X1	By	Bank (Dividend) (5,000 x 10 x 15%) (refer note 1 and 2)	-	-	7,500
31.8.X1	To	Bank A/c (W.N.11)	800		2,00,000	15.12.X1	By	Bank (Sale) (W.N.4)	3,000	-	8,91,000
15.12.X1	To	P & L A/c (W.N.5)			4,28,500	15.1.X2	By	Bank (interim dividend) (W.N.12)		4,800	
31.3.X2	To	P & L A/c		4,800		31.3.X2	By	Bal. c/d (W.N.6)	4,800		7,40,000
			7800	4,800	16,38,500				7800	4,800	16,38,500

Working Notes:

1. **Profit on sale of bonds on 30.9.X1**
   = Sales proceeds – Average cost
   Sales proceeds = ₹1,57,500 (i.e., 1,500 x 105)
   Average cost = ₹ [(1,26,000+1,92,000) ×1,500/3,200] = 1,49,062.50 Profit = 1,57,500– ₹ 1,49,062.50=₹8,437.50
2. **Valuation of bonds on 31st March, 20X2**
   Cost = ₹3,18,000/3,200 x1,700 = 1,68,937.50
3. **Cost of equity shares purchased on 15/4/20X1**
   = Cost + Brokerage
   = (5,000 ×₹ 200) + 1% of (5,000 ×₹ 200) =₹ 10,10,000
4. **Sale proceeds of equity shares on 15/12/20X1**
   = Sale price – Brokerage
   = (3,000 ×₹ 300) – 1% of (3,000 ×₹ 300) =₹ 8,91,000.
5. **Profit on sale of shares on 15/12/20X1**
   = Sales proceeds – Average cost
   Sales proceeds = ₹ 8,91,000
   Average cost = ₹ [(10,10,000+2,00,000-7,500) × 3,000/7,800]
   = ₹ [12,02,500 × 3,000/7,800] = 4,62,500
   Profit = ₹ 8,91,000 – ₹4,62,500=₹ 4,28,500.

6. Valuation of equity shares on 31st March, 20X2

Cost = ₹ [12,02,500× 4,800/7,800]= ₹ 7,40,000

Market Value = 4,800 shares × ₹ 220 = ₹ 10,56,000

Closing stock of equity shares has been valued at ₹ 7,40,000 i.e. cost being lower than the market value.

7. Interest accrued on opening balance of bonds = 1,200 x 100 x 12% x 3/12
= ₹ 3,600

8. Interest element in bonds purchased on 02.05.20X1
= 2,000 x 100 x 12% x 4/12 = ₹ 8,000

Cost of investment (amount in investment column)
= (2,000 x 100) – 8,000 = ₹ 1,92,000

9. Interest element in bonds sold on 30.09.20X1
= 1,500 x 100 x 12% x 3/12 = ₹ 4,500

10. Interest accrued on closing balance of bonds
= 1,700 x 100 x 12% x 3/12 = ₹ 5,100

11. Right shares

No. of right shares issued = (5,000 + 2,000) x 1/7 = 1,000 shares

No. of right shares sold = 1,000 x 20% = 200 shares

Proceeds from sale of right shares = 200 x 60 = ₹ 12,000
to be credited to statement of profit and loss

No. of right shares subscribed = 1,000 – 200 = 800 shares

Amount of right shares subscribed = 800 x 250 = ₹ 2,00,000

12. Amount of interim dividend = (5,000 + 2,000 + 800 – 3,000) x 10 x 10%
= ₹ 4,800

Note:

1. It is presumed that no dividend is received on bonus shares as bonus shares are declared on 3.6.20X1 and dividend pertains to the year ended 31.03.20X1.
2. The amount of dividend for the period, for which shares were not held by the investor, has been treated as capital receipt.

Question 29

Mr. Brown has made following transactions during the financial year 20X1-X2:

Date	***Particulars***
01.05.20X1	*Purchased 24,000 12% Bonds of ₹ 100 each at ₹ 84 cum-interest. Interest is payable on 30th September and 31st March every year.*
15.06.20X1	*Purchased 1,50,000 equity shares of ₹ 10 each in Alpha Limited for ₹ 25 each through a broker, who charged brokerage @ 2%.*
10.07.20X1	*Purchased 60,000 equity shares of ₹ 10 each in Beeta Limited for ₹ 44 each through a broker, who charged brokerage @2%.*
14.10.20X1	*Alpha Limited made a bonus issue of two shares for every three shares held.*
31.10.20X1	*Sold 80,000 shares in Alpha Limited for ₹ 22 each.*
01.01.20X2	*Received 15% interim dividend on equity shares of Alpha Limited. 15.01.20X2 Beeta Limited made a right issue of one equity share for every four shares held at ₹ 5 per share. Mr. Brown exercised his option for 40% of his entitlements and sold the balance rights in the market at ₹ 2.25 per share.*
01.03.20X2	*Sold 15,000 12% Bonds at ₹ 90 ex-interest.*
15.03.20X2	*Received 18% interim dividend on equity shares of Beeta Limited. Interest on 12% Bonds was duly received on due dates.*

Prepare separate investment account for 12% Bonds, Equity Shares of Alpha Limited and Equity Shares of Beeta Limited in the books of Mr. Brown for the year ended on 31st March, 20X2.

(*Study Material*)

Answer

In the books of Mr. Brown

12% Bonds for the year ended 31st March, 20X2

Date	*Particulars*	*No.*	*Income* ₹	*Amount* ₹	*Date*	*Particulars*	*No.*	*Income* ₹	*Amount* ₹
20X1 May, 1	To Bank A/c (W.N.7)	24,000	24,000	19,92,000	20X1 Sept. 30	By Bank-Interest (24,000 x 100 × 12% x 6/12)	-	1,44,000	
20X2 March 1	To P & L A/c (W.N.1)	-	-	1,05,000	20X2 Mar. 1	By Bank A/c (W.N.8)	15,000	75,000	13,50,000

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
20X2 March 31	To P & L A/c (b.f.)		2,49,000		20X2 Mar. 31	By Bank-Interest (9,000 x 100 x 12% x 6/12)		54,000	
						By Balance c/d (W.N.2)	9,000	-	7,47,000
		24,000	2,73,000	20,97,000			24,000	2,73,000	20,97,000

Investment in Equity shares of Alpha Ltd. for the year ended 31st March, 20X2

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
20X1 June 15	To Bank A/c ([1,50,000 x 25] + [2% x (1,50,000 x 25)])	1,50,000	--	38,25,000	20X1 Oct. 31	By Bank A/c	80,000	-	17,60,000
Oct. 14	To Bonus Issue (1,50,000/3 x 2)	1,00,000	-	-	20X2 Jan. 1	By Bank A/c – dividend (1,70,000 x 10 x 15%)		2,55,000	
20X1 Oct. 31	To P & L A/c (W.N.3)			5,36,000	March 31	By Balance c/d (W.N.4)	1,70,000	-	26,01,000
20X2 Mar. 31	To P & L A/c		2,55,000						
		2,50,000	2,55,000	43,61,000			2,50,000	2,55,000	43,61,000

Investment in Equity shares of Beeta Ltd. for the year ended 31st March, 20X2

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
20X1 July 10	To Bank A/c ([60,000 x 44] + [2% x (60,000 x 44)])	60,000	--	26,92,800	20X2 Mar. 15	By Bank – dividend [(60,000 + 6,000) x 10 x 18%]	-	1,18,800	
20X2 Jan. 15	To Bank A/c (W.N. 5)	6,000	-	30,000	March 31	By Balance c/d (bal. fig.)	66,000	-	27,22,800
March 31	To P & L A/c	-	1,18,800	-					
		66,000	1,18,800	27,22,800			66,000	1,18,800	27,22,800

Working Notes:

1. **Profit on sale of 12% Bond**

Sales price ₹ 13,50,000

Less: Cost of bond sold $= \frac{19,92,000}{24,000} \times 15,000$ $(₹\,12,45,000)$

Profit on sale <u>₹ 1,05,000</u>

2. **Closing balance as on 31.3.20X2 of 12 % Bond**

$$= \frac{19,92,000}{24,000} \times 9,000 = ₹7,47,000$$

3. **Profit on sale of equity shares of Alpha Ltd.**

Sales price ₹ 17,60,000

Less: Cost of bond sold = $= \frac{38,25,000}{2,50,000} \times 80,000$ $(₹12,24,000)$

Profit on sale <u>₹ 5,36,000</u>

4. **Closing balance as on 31.3.20X2 of equity shares of Alpha Ltd.**

$$= \frac{38,25,000}{2,50,000} \times 1,70,000 \quad = (₹\,26,01,000)$$

5. **Calculation of right shares subscribed by Beeta Ltd.**

$$\text{Right Shares} = \frac{60,000 \text{ shares}}{4} \times 1 = 15,000 \text{ shares}$$

Shares subscribed by Mr. Brown = 15,000 x 40%= 6,000 shares

Value of right shares subscribed = 6,000 shares @ ₹ 5 per share = ₹ 30,000

6. Calculation of sale of right entitlement by Beeta Ltd.

No. of right shares sold = 15,000 - 6,000 = 9,000 shares

Sale value of right = 9,000 shares x ₹ 2.25 per share = ₹ 20,250

Note: As per para 13 of AS 13, sale proceeds of rights is to be credited to P & L A/c.

7. Purchase of bonds on 01.05.20X1

Interest element in purchase of bonds = 24,000 x 100 x 12% x 1/12 = ₹ 24,000 Investment element in purchase of bonds = (24,000 x 84) – 24,000 = ₹ 19,92,000

8. Sale of bonds on 01.03.20X2

Interest element in purchase of bonds = 15,000 x 100 x 12% x 5/12 = ₹ 75,000 Investment element in purchase of bonds = 15,000 x 90 = ₹ 13,50,000

Question 30

Following transactions of Nisha took place during the financial year 2017-18:

1st April, 2017	Purchased 9,000 8% bonds of ₹100 each at ₹80.50 cum-interest. Interest is payable on 1st November and 1st May.
1st May, 2017	Received half year's interest on 8% bonds.
10th July, 2017	Purchased 12,000 equity shares of ₹10 each in Moon Limited for ₹44 each through a broker, who charged brokerage @ 2%.
1st October, 2017	Sold 2,250 8% bonds at ₹81 Ex-interest.
1st November, 2017	Received half year's interest on 8% bonds.
15th January, 2018	Moon Limited made a rights issue of one equity share for every four Equity shares held at ₹5 per share. Nisha exercised the option for 40% of her entitlements and sold the balance rights in the market at ₹2.25 per share.
15th March, 2018	Received 18% interim dividend on equity shares of Moon Limited.

Prepare separate investment account for 8% bonds and equity shares of Moon Limited in the books of Nisha for the year ended on 31st March, 2018. Assume that the average cost method is followed.

(*November 2018*) (*10 Marks*)

Answer:

In the books of Nisha
8% Bonds for the year ended 31st March, 2018

Date	*Particulars*	*No.*	*Income* ₹	*Amount* ₹	*Date*	*Particulars*	*No.*	*Income* ₹	*Amount* ₹
2017 1 April,	To Bank A/c	9,000	30,000	6,94,500	1 May 2017	By Bank-Interest	-	36,000	
Oct. 1	To P & L A/c (W.N .1)	-	-	8,625	1 Oct. 2017	By Bank A/c	2,250	7,500	1,82,250
2018 March 31	To P & L A/c		63,000		1 Nov. 2018	By Bank-Interest		27,000	
					2018 Mar. 31	By Balance c/d (W.N .2)	6,750	22,500	5,20,875
		9,000	70,500	7,03,125			9,000	70,500	7,03,125

Investment in Equity shares of Moon Ltd. for the year ended 31st March, 2018

Date	*Particulars*	*No.*	*Income* ₹	*Amount* ₹	*Date*	*Particulars*	*No.*	*Income* ₹	*Amount* ₹
2017 July 10	To Bank A/c	12,000	—	5,38,560	2018 March 15	By Bank – dividend *	—	23,760	
2018 Jan. 15	To Bank A/c (W.N. 3)	1,200	—	6,000	March 31	By Balance c/d (bal. fig.)	13,200	—	5,44,560
March 31	To P & L A/c	—	23,760						
		13,200	23,760	5,44,560			13,200	23,760	5,44,560

***** Considering that dividend was received on right shares also.

Working Notes:

1. Profit on sale of 8% Bonds

Sales price	₹ 1,82,250
Less: Cost of bond sold = 6,94,500/9,000x 2,250	(₹ 1,73,625)
Profit on sale	₹ 8,625

2. **Closing balance as on 31.3.2018 of 8 % Bonds**
   6,94,500/ 9,000 x 6,750= ₹ 5,20,875
3. **Calculation of right shares subscribed by Moon Ltd.**
   Right Shares = 12,000/4 x 1= 3,000 shares
   Shares subscribed by Nisha = 3,000 x 40%= 1,200 shares
   Value of right shares subscribed = 1,200 shares @ ₹ 5 per share = ₹ 6,000
4. **Calculation of sale of right entitlement by Moon Ltd.**
   No. of right shares sold = 3,000 – 1,200 = 1,800 rights for ₹ 4,050
   Note: As per para 13 of AS 13, sale proceeds of rights are to be credited to P & L A/c.

Question 31

A Ltd. purchased on 1st April, 2018 8% convertible debenture in C Ltd. of face value of ₹ 2,00,000 @ ₹ 108. On 1st July, 2018 A Ltd. purchased another ₹ 1,00,000 debenture @ ₹ 112 cum interest.

On 1st October, 2018 ₹ 80,000 debenture was sold @ ₹ 105. On 1st December, 2018, C Ltd. give option for conversion of 8% convertible debentures into equity share of ₹ 10 each. A Ltd. receive 5,000 equity share in C Ltd. in conversion of 25% debenture held on that date. The market price of debenture and equity share in C Ltd. at the end of year 2018 is ₹ 110 and ₹ 15 respectively.

Interest on debenture is payable each year on 31st March, and 30th September.

The accounting year of A Ltd. is calendar year.

Prepare investment account in the books of A Ltd. on average cost basis.

(*RTP May 2019*) (*MTP April, 2022, 8 Marks*)

Answer:

Investment Account for the year ending on 31st December, 2018
Scrip : 8% Convertible Debentures in C Ltd.
[Interest Payable on 31st March and 30th September]

Date	Particulars	Nominal value (₹)	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value (₹)	Interest (₹)	Cost (₹)
1.4.18	To Bank A/c	2,00,000	-	2,16,000	30.09.18	By Bank A/c	-	12,000	-
1.7.18	To Bank A/c (W.N .1)	1,00,000	2,000	1,10,000		[₹3,00,000 x 8% x (6/12]			
31.12.18	To P & L A/c [Interest]	-	14,033	-	1.10.18	By Bank A/c	80,000		84,000
					1.10.18	By P&L A/c (loss) (W.N .1)			2,933
					1.12.18	By Bank A/c (Accrued interest) (₹ 55,000 x .08 x 2/12)		733	
					1.12.18	By Equity shares in C Ltd. (W.N . 3 and 4)	55,000		59,767
					31.12.18	By Balance c/d (W.N .5)	1,65,000	3,300	1,79,300
		3,00,000	16,033	3,26,000			3,00,000	16,033	3,26,000

SCRIP: Equity Shares in C LTD.

Date	Particulars	Cost (₹)	Date	Particulars	Cost (₹)
1.12.18	T o 8 % debentures	59,767	31.12.18	By balance c /d	59,767

Working Notes:

(i) Cost of Debenture purchased on 1st July = ₹1,12,000 – ₹2,000 (Interest)
= ₹1,10,000

(ii) Cost of Debentures sold on 1st Oct.
= (₹2,16,000 + ₹1,10,000) x 80,000/3,00,000 = ₹ 86,933

(iii) Loss on sale of Debentures = ₹ 86,933– ₹84,000 = ₹2,933
Nominal value of debentures converted into equity shares = ₹ 55,000
[(₹ 3,00,000 – 80,000) x.25]
Interest received before the conversion of debentures
Interest on 25% of total debentures = 55,000 x 8% x 2/12 = 733

(iv) Cost of Debentures converted = (₹ 2,16,000 + ₹1,10,000) x 55,000/3,00,000
= ₹ 59,767

(v) Cost of closing balance of Debentures = (₹ 2,16,000 + ₹1,10,000) x 1,65,000 / 3,00,000
= ₹ 1,79,300

(vii) Closing balance of Debentures has been valued at cost being lower than the market value i.e. ₹ 1,81,500 (₹ 1,65,000 @ ₹ 110)

(viii) 5,000 equity Shares in C Ltd. will be valued at cost of ₹ 59,767 being lower than the market value ₹ 75,000 (₹ 15 x5,000)

Note: It is assumed that interest on debentures, which are converted into cash, has been received at the time of conversion.

Question 32

Akash Ltd. had 4,000 equity share of X Limited, at a book value of ₹ 15 per share (face value of ₹ 10 each) on 1st April 2017. On 1st September 2017, Akash Ltd. acquired 1,000 equity shares of X Limited at a premium of ₹ 4 per share. X Limited announced a bonus and right issue for existing shareholders.

The terms of bonus and right issue were—

(1) Bonus was declared, at the rate of two equity shares for every five equity shares held on 30th September, 2017.

(2) Right shares are to be issued to the existing shareholders on 1st December, 2017. The company issued two right shares for every seven shares held at 25% premium. No dividend was payable on these shares. The whole sum being payable by 31st December, 2017.

(3) Existing shareholders were entitled to transfer their rights to outsiders, either wholly or in part.

(4) Akash Ltd. exercised its option under the issue for 50% of its entitlements and sold the remaining rights for ₹ 8 per share.

(5) Dividend for the year ended 31st March 2017, at the rate of 20% was declared by the company and received by Akash Ltd., on 20th January 2018.

(6) On 1st February 2018, Akash Ltd., sold half of its shareholdings at a premium of ₹ 4 per share.

(7) The market price of share on 31.03.2018 was ₹ 13 per share.

You are required to prepare the Investment Account of Akash Ltd. for the year ended 31st March, 2018 and determine the value of share held on that date assuming the investment as current investment. Consider average cost basis for ascertainment of cost for equity share sold.

(*RTP November 2018*)

Answer:

Investment Account-Equity Shares in X Ltd.

Date		No. of shares	Dividend	Amount	Date		No. of shares	Dividend	Amount
		₹	₹	₹			₹	₹	₹
2017					2018				
April 1	To Balance b/d	4,000	-	60,000	Jan. 20	By Bank (dividend)		8,000	2,000
Sept 1	To Bank	1,000	-	14,000	Feb.1	By Bank	4,000		56,000
Sept.30	To Bonus Issue	2,000		—	Mar. 31	By Balance c/d	4,000		42,250
Dec.1	To Bank (Right)	1,000	-	12,500					
2018									
Feb. 1	To Profit & Loss A/c			13,750					
Mar. 31	To Profit & Loss A/c (Dividend income)		8,000						
		8,000	8,000	1,00,250			8,000	8,000	1,00,250
April. 1	To Balance b/d	4,000		42,250					

Working Notes:

1. Cost of shares sold — Amount paid for 8,000 shares

	₹
(₹ 60,000 + ₹ 14,000 + ₹ 12,500)	86,500
Less: Dividend on shares purchased on 1st Sept, 2017	(2,000)
Cost of 8,000 shares	84,500
Cost of 4,000 shares (Average cost basis*)	42,250
Sale proceeds (4,000 shares @ 14)	56,000
Profit on sale	13,750

* For ascertainment of cost for equity shares sold, average cost basis has been applied.

2. Value of investment at the end of the year

Closing balance will be valued based on lower of cost (₹ 42,250) or net realizable value (₹13 × 4,000). Thus investment will be valued at ₹ 42,250.

3. Calculation of sale of right entitlement

1,000 shares × ₹ 8 per share = ₹ 8,000

Amount received from sale of rights will be credited to P & L A/c as per AS 13 'Accounting for Investments'.

4. Dividend received on investment held as on 1st April, 2017

= 4,000 shares × ₹ 10 × 20%

= ₹ 8,000 will be transferred to Profit and Loss A/c

Dividend received on shares purchased on 1st Sep. 2017

= 1,000 shares × ₹ 10 × 20% = ₹ 2,000 will be adjusted to Investment A/c

Note: It is presumed that no dividend is received on bonus shares as bonus shares are declared on 30st Sept., 2017 and dividend pertains to the year ended 31.3.2017.

Question 33

Alpha Ltd. purchased 5,000, 13.5% Debentures of Face Value of ₹ 100 each of Pergot Ltd. on 1st May 2017 @ ₹ 105 on cum interest basis. The interest on these instruments is payable on 31st & 30th of March & September respectively. On August 1st 2017 the company again purchased 2,500 of such debentures @ ₹ 102.50 each on cum interest basis. On October 1st, 2017 the company sold 2,000 Debentures @ ₹ 103 each on ex-interest basis. The market value of the debentures as at the close of the year was ₹ 106. You are required to prepare the Investment in Debentures Account in the books of Alpha Ltd. for the year ended 31st Dec. 2017 on Average Cost Basis.

(*RTP May 2018*)

Answer:

8. Books of Alpha Ltd.
Investment in 13.5% Debentures in Pergot Ltd. Account
(Interest payable on 31st March & 30th September)

Date	Particulars	Nominal	Interest	Amount	Date	Particulars	Nominal	Interest	Amount
2017		₹	₹	₹	2017		₹	₹	₹
May 1	To Bank	5,00,000	5,625	5,19,375	Sept.30	By Bank (6 months Int)		50,625	
Aug.1	To Bank	2,50,000	11,250	2,45,000	Oct.1	By Bank	2,00,000		2,06,000
Oct.1	To P&L A/c			2,167					
Dec.31	To P&L A/c		52,313		Dec.31	By Balance c/d	5,50,000	18,563	5,60,542
		7,50,000	69,188	7,66,542			7,50,000	69,188	7,66,542

Note: Cost being lower than Market Value the debentures are carried forward at Cost.

Working Notes:

1. Interest paid on ₹ 5,00,000 purchased on May 1st, 2017 for the month of April 2017, as part of purchase price: 5,00,000 x 13.5% x 1/12 = ₹ 5,625
2. Interest received on 30th Sept. 2017
   On ₹ 5,00,000 = 5,00,000 x 13.5% x 1/2 = 33,750
   On ₹ 2,50,000 = 2,50,000 x 13.5% x 1/2 = 16,875
   Total ₹ 50,625
3. Interest paid on ₹ 2,50,000 purchased on Aug. 1st 2017 for April 2017 to July 2017 as part of purchase price: 2,50,000 x 13.5% x 4/12 = ₹ 11,250
4. Loss on Sale of Debentures Cost of acquisition
   (₹ 5,19,375 + ₹ 2,45,000) x ₹ 2,00,000/₹ 7,50,000 = 2,03,833
   Less: Sale Price (2,000 x 103) = 2,06,000
   Profit on sale = ₹ 2,167
5. Cost of Balance Debentures
   (₹ 5,19,375 + ₹ 2,45,000) x ₹ 5,50,000/₹ 7,50,000 = ₹ 5,60,542
6. Interest on Closing Debentures for period Oct.-Dec. 2017 carried forward (accrued interest)
   ₹ 5,50,000 x 13.5% x 3/12 = ₹ 18,563

Question 34

In 2015, Royal Ltd. issued 12% fully paid debentures of ₹ 100 each, interest being payable half yearly on 30th September and 31st March of every accounting year.

On 1st December, 2016, M/s. Kumar purchased 10,000 of these debentures at ₹101 cum-interest price, also paying brokerage @ 1% of cum-interest amount of the purchase. On 1st March, 2017 the firm sold all of these debentures at ₹106 cum-interest price, again paying brokerage @ 1 % of cum-interest amount. Prepare Investment Account in the books of M/s. Kumar for the period 1st December, 2016 to 1st March, 2017.

(*MTP March 2019*) (*6 Marks*)

Answer:

In the books of M/s Kumar
Investment Account
for the period from 1st December 2016 to 1st March, 2017
(Scrip: 12% Debentures of Royal Ltd.)

Date	Particulars	Nominal Value (₹)	Interest	Cost (₹)	Date	Particulars	Nominal Value (₹)	Interest	Cost (₹)
1.12.2016	To Bank A/c (W.N .1)	10,00,000	20,000	10,00,100	1.03.2017	By Bank A/c (W.N .2)	10,00,000	50,000	9,99,400
1.3.2017	To Profit & loss A/c	-	30,000		1.3.2017	By Profit & loss A/c			700
		10,00,000	50,000	10,00,100			10,00,000	50,000	10,00,100

Working Notes:

(i) Cost of 12% debentures purchased on 1.12.2016 ₹

Cost Value (10,000 × ₹101)	= 10,10,000
Add: Brokerage (1% of ₹10,10,000)	= 10,100
Less: Cum Interest (10,000 x 100 x12% x 2/12)	= (20,000)
Total	= 10,00,100

(ii) Sale proceeds of 12% debentures sold on 1st March, 2017 ₹

Sales Price (10,000 × ₹106)	= 10,60,000
Less: Brokerage (1% of ₹10,60,000)	= (10,600)
Less: Cum Interest (10,000 x 100 x12% x 5/12)	= (50,000)
Total	= 9,99,400

Question 35

Gopal holds 2,000, 15% Debentures of ₹ 100 each in Ritu Industries Ltd. as on April 1, 2015 at a cost of ₹2,10,000. Interest is payable on June, 30 and December, 31 each year. On May 1, 2015, 1,000 debentures are purchased cum-interest at ₹ 1,07,000. On November 1, 2015, 1,200 debentures are sold ex-interest at ₹1,14,600. On November 30, 2015, 800 debentures are purchased ex-interest at ₹ 76,800. On December 31, 2015, 800 debentures are sold cum-interest for ₹ 1,10,000. You are required to prepare the Investment Account showing value of holdings on March 31, 2016 at cost, using FIFO Method.

(*MTP April 2019*) (*10 Marks*)

Answer:

Investment Account of Gopal
For the year ended 31.3.2016
(Script: 15% Debentures in Ritu Industries Ltd.)
(Interest payable on 30th June and 31st December)

Date	Particulars	Nominal Value ₹	Interest ₹	Cost ₹	Date	Particulars	Nominal Value ₹	Interest ₹	Cost ₹
1.04.15	To Balance A/c	2,00,000	7,500	2,10,000	30.06.15	By Bank A/c	-	22,500	
1.05.15	To Bank A/c	1,00,000	5,000	1,02,000	1.11.15	By Bank A/c	1,20,000	6,000	1,14,600
30.11.15	To Bank A/c	80,000	5,000	76,800	1.11.15	By Profit & Loss A/c	-	-	11,400
31.12.15	To Profit & Loss A/c			20,000	31.12.15	By Bank A/c	80,000	6,000	1,04,000
31.03.16	To Profit & Loss A/c		37,250		31.12.15	By Bank A/c	-	13,500	-
	(Bal. fig.)				31.12.15	By Bank A/c	-	6,750	-
					31.3.16	By Bal. c/d	1,80,000	-	1,78,800
		3,80,000	54,750	4,08,800			3,80,000	54,750	4,08,800

Working Notes:

(i) Accrued Interest as on 1st April, 2015 = $₹ 2,00,000 \times \frac{15}{100} \times \frac{3}{12} = ₹ 7,500$

(ii) Accrued Interest as on 1.5.2015 = $₹\ 1,00,000 \times \frac{15}{100} \times \frac{4}{12} = ₹ 5,000$

(iii) Cost of Investment for purchase on 1st May = ₹ 1,07,000 – ₹ 5,000 = ₹ 1,02,000

(iv) Interest received as on 30.6.2015 = $₹\ 3,00,000 \times \frac{15}{100} \times \frac{6}{12} = ₹ 22,500$

(v) Accrued Interest on debentures sold on 1.11.2015= $₹\ 1,20,000 \times \frac{15}{100} \times \frac{4}{12} = ₹ 6,000$

(vi) Accrued Interest = $₹\ 80,000 \times \frac{15}{100} \times \frac{5}{12} = ₹ 5,000$

(vii) Accrued Interest on sold debentures 31.12.2015 = $₹\ 80,000 \times \frac{15}{100} \times \frac{6}{12} = ₹ 6,000$

(viii) Sale Price of Investment on 31st Dec. = ₹ 1,10,000 – ₹ 6,000 = ₹ 1,04,000

(ix) Loss on Sale of Debenture on 1.1.2015

Sale Price of Debenture	1,14,600
Less: Cost Price of debenture	
$\frac{2,10,000}{2,00,000} \times ₹ 1,20,000$	1,26,000
Loss on sale	11,400

(x) Accrued interest as on 31.12.2015 = $₹\ 1,80,000 \times \frac{15}{100} \times \frac{6}{12} = ₹ 13,500$

(xi) Accrued Interest = $₹\ 1,80,000 \times \frac{15}{100} \times \frac{3}{12} = ₹ 6,750$

(xii) Cost of investment as on 31st Marc h = ₹ 1,02,000 + ₹ 76,800 = ₹ 1,78,800

(xiii) Profit on debentures sold on 31st Dec ember
= ₹ 1,04,000 –(₹ 2,10,000x800/2,000) =₹ 20,000

Question 36

Meera carried out the following transactions in the shares of Kumar Ltd.:

(1) On 1st April, 2017 she purchased 40,000 equity shares of ₹ 1 each fully paid up for ₹ 60,000.

(2) On 15th May 2017, Meera sold 8,000 shares for ₹ 15,200.

(3) At a meeting on 15th June 2017, the company decided:

(i) To make a bonus issue of one fully paid up share for every four shares held on 1st June 2017, and

(ii) To give its members the right to apply for one share for every five shares held on 1st June 2017 at a price of ₹ 1.50 per share of which 75 paise is payable on or before 15th July 2017 and the balance, 75 paise per share, on or before 15th September, 2017.

The shares issued under (i) and (ii) were not to rank for dividend for the year ending 31st December 2017.

(a) Meera received her bonus shares and took up 4000 shares under the right issue, paying the sum thereon when due and selling the rights of the remaining shares at 40 paise per share; the proceeds were received on 30 th September 2017.

(b) On 15th March 2018, she received a dividend from Kumar Ltd. of 15 per cent in respect of the year ended 31st Dec 2017.

(c) On 30th March, 2018 she received ₹ 28,000 from the sale of 20,000 shares.

You are required to record these transactions in the Investment Account in Meera's books for the year ended 31st March 2018 transferring any profits or losses on these transactions to Profit and Loss account. Apply average cost basis.
Expenses and tax to be ignored.

(*MTP October, 2018*) (*8 Marks*)

Answer:

In the books of Meera Investment Account (Shares in Kumar Limited)

Date	Particulars	No. of Shares	Income	Amount	Date	Particulars	No. of Shares	Income	Amount
2017			₹	₹	**2017**			₹	₹
April 1	To Bank (Purchases)	40,000	-	60,000	May	By Bank (Sale)	8,000	-	15,200
May	To Profit & Loss A/c (W.N.1)	-	-	3,200					
June	To Bonus Issue	8,000	-	Nil	2018				
July	To Bank (@ 75 p. paid on 4,000 shares)	4,000	-	3,000	Mar. 15	By Bank (Dividend @ 15% on ₹ 32,000)		4,800	-
Sept.	To Bank (@ 75 p. paid on 4,000 shares)	-	-	3,000	Mar. 30	By Bank (Sale)	20,000	-	28,000
2018 Mar. 31	To Profit & Loss A/c (W.N.2)			3,455	Mar. 31	By Balance c/d $\left(\frac{24,000}{44,000} \times 54,000\right)$	24,000	-	29,455
	To Profit & Loss A/c	-	4,800						
		52,000	4,800	72,655			52,000	4,800	72,655

Working Notes:

(1)	**Profit on Sale on 15-5-2017:**		
	Cost of 8,000 shares @ ₹1.50	₹ 12,000	
	Less: Sales price	₹ 15,200	
	Profit		₹ 3,200
(2)	**Cost of 20,000 shares sold:**		
	Cost of 44,000 shares (48,000 + 6,000)		₹ 54,000
	$\therefore$ Cost of 20,000 shares $\left(\frac{\text{Rs. } 54,000}{44,000} \times 20,000 \text{ shares}\right)$		₹ 24,545
	Profit on sale of 20,000 shares (₹ 28,000 – ₹ 24,545)		₹ 3,455

Question 37

A Pvt. Ltd. follows the calendar year for accounting purposes. The company purchased 5,000 (nos.) 13.5% Convertible Debentures of Face Value of ₹ 100 each of P Ltd. on 1st May 2018 @ ₹ 105 on cum interest basis. The interest on these instruments is payable on 31st March & 30th September respectively. On August 1st 2018 the company again purchased 2,500 of such debentures @ ₹ 102.50 each on cum interest basis. On 1st October, 2018 the company sold 2,000 Debentures @ ₹ 103 each. On 31st December, 2018 the company received 10,000 equity shares of ₹ 10 each in P Ltd. on conversion of 20% of its holdings. Interest for 3 months on converted debentures was also received on 31.12.2018. The market value of the debentures and equity shares as at the close of the year were ₹ 106 and ₹ 9 respectively. Prepare the Debenture Investment Account & Equity Shares Investment Account in the books of A Pvt. Ltd. for the year 2018 on Average Cost Basis.

(*RTP November 2019*)

Answer

Books of A Pvt. Ltd.
Investment in 13.5% Convertible Debentures in P Ltd. Account
(Interest payable 31st March & 30th September)

Date	*Particulars*	*Nominal*	*Interest*	*Amount*	*Date*	*Particulars*	*Nominal*	*Interest*	*Amount*
		₹	₹	₹			₹	₹	₹
2018					2018				
May 1	To Bank	5,00,000	5,625	5,19,375	Sept. 30	By Bank (6 months Int)		50,625	
Aug.1	To Bank	2,50,000	11,250	2,45,000	Oct.1	By Bank	2,00,000		2,06,000
Oct.1	To P&L A/c			2,167					
Dec. 31	To P&L A/c		52,313		Dec. 31	By Equity share	1,10,000		1,12,108
					Dec. 31	By Bank (See note1)		3,713	
					Dec. 31	By Balance c/d	4,40,000	14,850	4,48,434
		7,50,000	69,188	7,66,542			7,50,000	69,188	7,66,542

Note 1: ₹ 3,713 received on 31.12.2018 represents interest on the debentures converted till date of conversion.
Note 2: Cost being lower than Market Value the debentures are carried forward at Cost.

Investment in Equity shares in P Ltd. Account

Date	***Particulars***	***Nominal***	***Amount***	***Date***	***Particulars***	***Nominal***	***Amount***
		₹	₹			₹	₹
2018				2018			
Dec 31	To 13.5% Deb.	1,00,000	1,12,108	Dec.31	By P&L A/c		22,108
				Dec.31	By Bal. c/d	1,00,000	90,000
		1,00,000	1,12,108			1,00,000	1,12,108

Note 1: Cost being higher than Market Value the shares are carried forward at Market Value.

Working Notes:

1. Interest paid on ₹ 5,00,000 purchased on May 1st, 2018 for the month of April 2018, as part of purchase price: 5,00,000 x 13.5% x 1/12 = ₹ 5,625
2. Interest received on 30th Sept. 2018

On ₹ 5,00,000 = 5,00,000 x 13.5% x ½ = 33,750
On ₹ 2,50,000 = 2,50,000 x 13.5% x ½ = 16,875
Total ₹ 50,625

3. Interest paid on ₹ 2,50,000 purchased on Aug. 1st 2018 for April 2018 to July 2018 as part of purchase price: 2,50,000 x 13.5% x 4/12 = ₹ 11,250
4. Loss on Sale of Debentures Cost of acquisition

(₹ 5,19,375 + ₹ 2,45,000) x ₹ 2,00,000/₹ 7,50,000 = 2,03,833
Less: Sale Price (2,000 x 103) = 2,06,000
Profit on sale = ₹ 2,167

5. Interest on 1,100 Debentures (being those converted) for 3 months i.e. Oct-Dec. 2018 1,10,000 x 13.5% x 3/12 = ₹ 3,713
6. Cost of Debentures converted to Equity Shares

(₹ 5,19,375 + ₹ 2,45,000) x 1,10,000/7,50,000= ₹ 1,12,108

7. Cost of Balance Debentures

(₹ 5,19,375 + ₹ 2,45,000) x ₹ 4,40,000/₹ 7,50,000 = ₹ 4,48,434

8. Interest on Closing Debentures for period Oct.- Dec. 2018 carried forward (accrued interest)

₹ 4,40,000 x 13.5% x 3/12 = ₹ 14,850

Question 38

Mr. Harsh provides the following details relating to his holding in 10% debentures (face value of ₹100 each) of Exe Ltd., held as current assets:

1.4.2018	opening balance - 12,500 debentures, cost ₹12,25,000
1.6.2018	purchased 9,000 debentures @ ₹98 each ex-interest
1.11.2018	purchased 12,000 debentures @ ₹115 each cum-interest
31.1.2019	soled 13,500 debentures @ ₹110 each cum-interest
31.3.2019	Market value of debentures @ ₹115 each

Due dates of interest are 30th June and 31st December
Brokerage at 1% is to be paid for each transaction. Mr. Harsh closes his books on 31.3.2019.
Show investment account as it would appear in his books assuming FIFO method is followed

(*Suggested November 2019*) (*10 Marks*)/(*RTP May 2022*)

Answer

Investment Account of Mr. Harsh for the year ending on 31-3-2019
(Scrip: 10% Debentures of Exe Limited)
(Interest Payable on 30th June and 31st December)

Date	Particulars	Nominal Value ₹	Interest ₹	Cost ₹	Date	Particulars	Nominal Value ₹	Interest ₹	Cost ₹
1.4.18	To Balance b/d	12,50,000	31,250	12,25,000	30.6.18	By Bank 21,500 x 100 x 10% x 1/2	-	1,07,500	-
1.6.18	To Bank (ex-Interest) (W.N.1)	9,00,000	37,500	8,90,820	31.12.19	By Bank 33,500 x 100x10% x 1/2		1,67,500	

Date	Particulars	Nominal Value ₹	Interest ₹	Cost ₹	Date	Particulars	Nominal Value ₹	Interest ₹	Cost ₹
1.11.18	To Bank (cum-Interest) (W.N.2)	12,00,000	40,000	13,53,800	31.1.19	By Bank (W.N.3)	13,50,000	11,250	14,58,900
31.1.19	To Profit & Loss A/c (W.N.3)			1,34,920	31.3.19	By Balance c/d (W.N.4)	20,00,000	50,000	21,45,640 -
31.3.19	To Profit & Loss A/c (Bal. fig.)		2,27,500						
		33,50,000	3,36,250	36,04,540			33,50,000	3,36,250	36,04,540

Working Notes:

1. **Purchase of debentures on 1.6.18**

   Interest element = 9,000 x 100 x 10% x 5/12 = ₹ 37,500

   Investment element = (9,000 x 98) + [1%(9,000 x 98)] = ₹ 8,90,820

2. **Purchase of debentures on 1.11.2018**

   Interest element = 12,000 x 100 x 10% x 4/12 = ₹ 40,000

   Investment element = 12,000 X 1 15 X 101% less 40,000 = ₹ 13,53,800

3. **Profit on sale of debentures as on 31.1.19**

	₹
Sales price of debentures (13,500 x ₹ 110)	14,85,000
Less: Brokerage @ 1%	(14,850)
	14,70,150
Less: Interest (1,35,000/ 12)	(11,250)
	14,58,900
Less: Cost of Debentures [(12,25,000 + (890820 X 1,00,000/ 9,00,000)]	(13,23,980)
Profit on sale	1,34,920

4. **Valuation of closing balance as on 31.3.2019:**

   Market value of 20,000 Debentures at ₹ 115 = ₹ 23,00,000

   Cost of

   8,000 Debentures = 8,90,820/ 9,000 X 8,000 = 7,91,840

   12,000 Debentures = 13,53,800

   Total 21,45,640

   Value at the end is ₹ 21,45,640, i.e., which is less than market value of ₹ 23,00,000.

Question 39

(a) In 2018, Royal Ltd. issued 12% fully paid debentures of ₹ 100 each, interest being payable half yearly on 30th September and 31st March of every accounting year. On 1st December, 2019, M/s. Kumar purchased 10,000 of these debentures at ₹ 101 (cum-interest) price. On 1st March, 2020 the firm sold all of these debentures at ₹ 106 (cum-interest) price.

You are required to prepare Investment (Debentures) Account in the books of M/s. Kumar for the period 1st December, 2019 to 1st March, 2020.

(b) Mr. X acquires 200 shares of a company on cum-right basis for ₹ 60,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at ₹ 105 each. He does not subscribe but sells all the rights for ₹ 15,000. The market value of the shares after their becoming ex-rights has also gone down to ₹ 50,000. What should be the accounting treatment in this case?

[*RTP, November 2020*]

Answer

(a) Investment Account in the books of M/s Kumar for the period from 1st December 2019 to 1st March, 2020

(Scrip: 12% Debentures of Royal Ltd.)

Date	Particulars	Nominal Value (₹)	Interest	Cost (₹)	Date	Particulars	Nominal Value (₹)	Interest	Cost (₹)
1.12.2019	To Bank A/c (W.N.1)	10,00,000	20,000	9,90,000	1.03.2020	By Bank A/c (W.N.2)	10,00,000	50,000	10,10,000
1.3.2020	To Profit & loss A/c		30,000	20,000					
		10,00,000	50,000	10,10,000			10,00,000	50,000	10,10,000

Working Notes:

(i)	Cost of 12% debentures purchased on 1.12.2019		₹
	Cost Value (10,000 x ₹101)	=	10,10,000
	Less: Interest (10,000 x 100 x12% x 2/12)	=	(20,000)
	Total	=	9,90,000
(ii)	Sale proceeds of 12% debentures sold on 1st March, 2020 Sales Price (10,000 x ₹106)		₹
		=	10,60,000
	Less: Interest (10,000 x 100 x12% x 5/12)	=	(50,000)
	Total	=	10,10,000

(b) As per AS 13, where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value. In this case, the amount of the ex-right market value of 200 shares bought by X immediately after the declaration of rights falls to ₹50,000. In this case, out of sale proceeds of ₹ 15,000, ₹ 10,000 may be applied to reduce the carrying amount to bring it to the market value ₹50,000 and ₹ 5,000 would be credited to the profit and loss account.

Question 40

On 1st April, 2019, Mr. Vijay had 30,000 Equity shares in X Ltd. (the company) at a book value of ₹ 4,50,000 (Face Value ₹ 10 per share). On 22nd June, 2019, he purchased another 5000 shares of the same company for ₹ 80,000.

The Directors of X Ltd. announced a bonus of equity shares in the ratio of one share for seven shares held on 10th August, 2019.

On 31st August, 2019 the Company made a right issue in the ratio of three shares for every eight shares held, on payment of ₹ 15 per share. Due date for the payment was 30th September, 2019, Mr. Vijay subscribed to 2/3rd of the right shares and sold the remaining of his entitlement to Viru for a consideration of ₹ 2 per share.

On 31stOctober,2019, Vijay received dividends from X Ltd. @ 20% for the year ended 31st March, 2019. Dividend for the shares acquired by him on 22ndJune,2019 to be adjusted against the cost of purchase.

On 15th November, 2019 Vijay sold 20,000 Equity shares at a premium of ₹ 5 per share.

You are required to prepare Investment Account in the books of Mr. Vijay for the year ended 31st March, 2020 assuming the shares are being valued at average cost.

(10 Marks) (MTP, May 2020)

Answer:

Books of Vijay
Investment Account
(Scrip: Equity Shares in X Ltd.)

		No.	Amount			No.	Amount
			₹				₹
1.4.2019	To Bal b/d	30,000	4,50,000	31.10.2019	By Bank (dividend on shares acquired on 22/6/2019)	—	10,000
22.6.2019	To Bank	5,000	80,000				
10.8.2019	To Bonus	5,000	-				
30.9.2019	To Bank (Rights Shares)	10,000	1,50,000				
15.11.2019	To Profit (on sale of shares)		32,000	15.11.2019	By Bank (Sale of shares)	20,000	3,00,000
				31.3.2020	By Bal. c/d	30,000	4,02,000
		50,000	7,12,000			50,000	7,12,000

Working Notes:

(1) Bonus Shares = (30,000 + 5,000) / 7 = 5,000 shares

(2) Right Shares $= \dfrac{(30{,}000+5{,}000+5{,}000)}{8}\times 3 = 15{,}000\text{shares}$

(3) Rights shares sold = 15,000×1/3 = 5,000 shares

(4) Dividend received = 30,000×10×20% = ₹60,000 will be taken to P&L statement

(5) Dividend on shares purchased on 22.6.2019= 5,000×10×20% = ₹ 10,000 is adjusted to Investment A/c

(6) Profit on sale of 20,000 shares

= Sales proceeds – Average cost Sales proceeds = ₹ 3,00,000

Average cost = $= \dfrac{(4{,}50{,}000+80{,}000+1{,}50{,}000-10{,}000)}{50{,}000}\times 20{,}000 = \text{Rs.}2{,}68{,}000$

Profit = ₹ 3,00,000– ₹2,68,000= ₹32,000.

(7) Cost of shares on 31.3.2018

$$= \frac{(4,50,000 + 80,000 + 1,50,000 - 10,000)}{50,000} \times 30,000 = \text{Rs.}4,02,000$$

(8) Sale of rights amounting ₹ 10,000 (₹ 2 x 5,000 shares) will not be shown in investment A/c but will directly be taken to P & L statement.

Question 41

P Ltd. had 8,000 equity shares of K Ltd., at a book value of ₹ 15 per share (face value of ₹ 10 each) on 1st April, 2019. On 1st September, 2019, P Ltd. acquired another 2,000 equity shares of K Ltd. at a premium of ₹4 per share. K Ltd. announced a bonus and right issue for existing shareholders.

The term of bonus and right issue were:

(i) Bonus was declared at the rate for two equity shares for every five shares held on 30th September, 2019.

(ii) Right shares are to be issued to the existing shareholders on 1st December, 219. The Company had issued two right shares for every seven shares held at 25% premium on face value. No dividend was payable on these shares. The whole sum being payable by 31st December, 2019.

(iii) Existing shareholders were entitled to transfer their right to outsiders either wholly or in part.

(iv) P Ltd. exercised its option under the issue for 50% of its entitlements and sold the remaining rights for ₹8 per share.

(v) Dividend for the year ended 31st March, 2019 at the rate of 20% was declared by K Ltd. and received by P Ltd. on 20th January, 2020.

(vi) On 1st February, 2020, P Ltd. sold half of its shareholdings at a premium of ₹ 4 per share.

(vii) The market price of share on 31st March, 2020 was ₹13 per share.

You are required to prepare the Investment account of P Ltd. for the year ended 31st March,2020 and determine the value of shares held on that date, assuming the investment as current investment. Consider average cost basis for ascertainment for cost for equity shares sold. (*Suggested, January, 2021*) (*10 marks*)

Answer

Investment Account-Equity Shares in K Ltd.

Date		***No. of shares***	***Dividend***	***Amount***	***Date***		***No. of shares***	***Dividend***	***Amount***
			₹	₹				₹	₹
1.4.19	To Bal.b/d	8,000	-	1,20,000	20.1.20	By Bank (dividend) [8,000 x 10 x 20%] and [2,000 x 10 x 20%]		16,000	4,000
1.9.19	To Bank	2,000	-	28,000	1.2.20	By Bank	8,000		1,12,000
30.9.19	To Bonus Issue	4,000		—					
31.12.19	To Bank (Right) (W.N.1)	2,000	-	25,000	31.3.20	By Balance c/d (W.N. 3)	8,000		84,500
20.1.20	To Profit & Loss A/c (Dividend income)		16,000						
1.2.20	To P& L A/c (profit on sale)			27,500					
		16,000	16,000	2,00,500			16,000	16,000	2,00,500

Working Notes:

1. Right shares

No. of right shares issued = (8,000 + 2,000 + 4,000)/ 7 X 2= 4,000 No. of right shares subscribed = 4,000 x 50% = 2,000 shares Value of right shares issued = 2,000 x ₹12.50 = ₹ 25,000

No. of right shares sold = 2,000 shares

Sale of right shares = 2,000 x ₹ 8 = ₹ 16,000 to be credited to statement of profit and loss

2. Cost of shares sold — Amount paid for 16,000 shares

	₹
(₹1,20,000 + ₹ 28,000 + ₹ 25,000)	1,73,000
Less: Dividend on shares purchased on Sept. 1 (since the dividend pertains to the year ended 31st March, 2019, i.e., the pre-acquisition period)	(4,000)
Cost of 16,000 shares	1,69,000
Cost of 8,000 shares (Average cost basis)	84,500
Sale proceeds (8,000 X ₹14)	1,12,000
Profit on sale	27,500

3. **Value of investment at the end of the year**

   Assuming investment as current investment, closing balance will be valued based on lower of cost or net realizable value.

   Here, Net realizable value is ₹13 per share i.e., 8,000 shares x ₹ 13 = ₹ 1,04,000 and cost = 84,500. Therefore, value of investment at the end of the year will be ₹ 84,500.

Question 42

On 1st April, 2019 Mr. Shyam had an opening balance of 1000 equity shares of X Ltd ₹ 1,20,000 (face value ₹100 each).

On 5.04.2019 he further purchased 200 cum-right shares for ₹ 135 each. On 8.04.2019 the director of X Ltd announced right issue in the ratio of 1:6.

Mr. Shyam waived off 100% of his entitlement of right issue in the favour of Mr. Rahul at the rate of ₹ 20 each.

All the shares held by Shyam had been acquired on cum right basis and the total market price (ex-right) of all these shares after the declaration of rights got reduced by ₹ 3,400.

On 10.10.2019 Shyam sold 350 shares for ₹ 140 each. 31.03.2020 The market price of each share is ₹ 125 each.

You are required to prepare the Investment account in the books of Mr. Shyam for the year ended 31.03.2020 assuming that the shares are being valued at average cost. (*RTP, May 2021*)

Answer

In the books of Mr. Shyam

for the year ending on 31-3-2020 (Scrip: Equity Shares of X Limited)

Date	Particulars	Qty	Amount	Date	Particulars	Qty	Amount
1.4.2019	To Balance b/d	1000	1,20,000	8.04.2019	By Bank A/c (W.N.1)		3,400
5.04.2019	To Bank (200x ₹135)	200	27,000	10.10.2019	By Bank A/c (350x ₹140)	350	49,000
10.10.2019	To Profit & Loss A/c (W.N.2)		7,117	31.3.2020	By Balance c/d (W.N.3)	850	1,01,717
		1200	1,54,117			1200	1,54,117

Working Notes:

1. Sale of Rights ₹ 4,000

The market price of all shares of X Ltd after shares becoming ex-rights has been reduced by ₹ 3,400

In this case out of sale proceeds of ₹4,000; ₹ 3,400 may be applied to reduce the carrying amount to the market value and ₹ 600 would be credited to the profit and loss account.

2. Profit on sale of 350 shares

	Amount
Sale price of 350 shares (350 shares X 140 each)	₹ 49,000
Less: Cost of 350 shares [(1,20,000+27,000-3,400) X350]/1200	₹ 41,883
Profit	₹ 7,117

3. Valuation of 850 shares as on 31.03.2020

Particulars	Amount
Cost price of 850 shares [(1,20,000 +27,000 -3,400) x 850 /1,200]	₹ 1,01,717
Fair Value as on 31.03.2020 [850 X ₹ 125 each]	₹ 1,06,250
Cost price or fair value whichever is less	₹ 1,01,717

Question 43

On 1st April, 2019 Mr. H had 30,000 equity shares of ABC Ltd. at book value of ₹ 18 per share (Nominal value 10 per share). On 10th June, 2019, H purchased another 10,000 equity shares of the ABC ltd. at ₹ 16 per share through a broker who charged 1.5% brokerage.

The directors of ABC Ltd. announced a bonus and a right issue. The terms of the issues were as follows:

(i) Bonus shares were declared at the rate of one equity share for every four shares held on 15th July, 2019.

(ii) Right shares were to be issued to the existing equity shareholders on 31st August, 2019. The company decides to issue one right share for every five equity shares held at 20% premium and the due date for payment will be 30th September, 2019. Shareholders were entitled to transfer their rights in full or in part.

(iii) No dividend was payable on these issues.

Mr. H subscribed 60% of the rights entitlements and sold the remaining rights for consideration of ₹ 5 per share.

Dividends for the year ending 31st March, 2019 was declared by ABC Ltd. at the rate of 20% and received by Mr. H on 31st October, 2019.

On 15th January, 2020 Mr. H sold half of his shareholdings at ₹ 17.50 per share and brokerage was charged @1%.

You are required to prepare Investment account in the books of Mr. H for the year ending 31st March, 2020, assuming the shares are valued at average cost.

(*10 Marks*) (*Suggested November 2020*)

Answer

In the books of Mr. H

Investment in equity shares of ABC Ltd. for the year ended 31st March, 2020

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
2019 April 1	To Balance b/d	30,000	-	5,40,000	2019 Oct.	By Bank A/c (W.N. 5)	-	60,000	20,000
June	To Bank A/c	10,000	--	1,62,400	20X2 Jan.	By Bank A/c (W.N.4)	28,000	-	4,85,100
July	To Bonus Issue (W.N. 1)	10,000	-	-	March 31	By Balance c/d (W.N. 6)	28,000	-	3,77,200
Sept.	To Bank A/c (W.N. 2)	6,000	-	72,000					
2020 Jan.	To P & L A/c (W.N. 4)	-	-	1,07,900					
March 31	To P & L A/c	-	60,000	-					
		56,000	60,000	8,82,300			56,000	60,000	8,82,300

Working Notes:

1. Calculation of no. of bonus shares issued

Bonus Shares = (30,000 + 10,000) divided by 4= 10,000 shares

2. Calculation of right shares subscribed

$$\text{Right Shares} = \frac{30,000 \text{ shares} + 10,000 \text{ shares} + 10,000 \text{ shares}}{5}$$

10,000 shares

Shares subscribed 10,000 x 60% = 6,000 shares

Value of right shares subscribed = 6,000 shares @ ₹ 12 per share = ₹ 72,000

3. Calculation of sale of right entitlement

Amount received from sale of rights will be 4,000 shares x ₹ 5 per share

= ₹ 20,000 and it will be credited to statement of profit and loss.

4. Calculation of profit/loss on sale of shares-

Total holding = 30,000 shares original

10,000 shares purchased

10,000 shares bonus

6,000 shares right shares

56,000

50% of the holdings were sold i.e. 28,000 shares (56,000 x1/2) were sold. Cost of total holdings of 56,000 shares = ₹ 5,40,000 + ₹ 1,62,400 + ₹ 72,000– ₹ 20,000 = ₹ 7,54,400

Average cost of shares sold would be:

$$= \frac{7,54,400 \times 28,000}{56,000} \times 28,000 = ₹3,77,200$$

	₹
Sale proceeds of 28,000 shares (28,000 x ₹17.50)	4,90,000
Less: 1% Brokerage	(4,900)
	4,85,100
Less: Cost of 28,000 shares sold	(3,77,200)
Profit on sale	1,07,900

5. Dividend received on investment held as on 1st April, 2019

= 30,000 shares x ₹ 10 x 20%

= ₹ 60,000 will be transferred to Profit and Loss A/c and Dividend received on shares purchased on 10th June, 2019

= 10,000 shares x ₹ 10 x 20% = ₹20,000 will be adjusted to Investment A/c

6. Calculation of closing value of shares (on average basis) as on 31st March, 2020

$$\frac{7,54,400}{56,000} \times 28,000 = ₹\,3,77,200$$

Question 44

Remo Ltd. held on 1st April, 2021, 1000 9% Government Securities at ₹ 90,000 (Face Value of Security ₹ 100 each). Three month's interest had accrued on the above date. On 1st May, the company purchased the same Government Securities of the face value of ₹ 80,000 at ₹ 95 cum-interest. On 1st June, ₹ 60,000 face value of the security was sold at ₹ 94 cum-interest. Interest on the security was paid each year on 30th June and 31st December and was credited by the bank on the same date. On 30th September, ₹ 40,000 face value of the Govt. securities were sold at ₹ 97 cum-interest. On 1st December, the company purchased the same security ₹ 10,000 at par ex-interest. On 1st March, the company sold ₹ 10,000 face value of the government securities at ₹ 95 ex- interest.

You are required to draw up the 9% Government Security Account in the books of Remo Limited. FIFO method shall be followed.

Calculation shall be made to the nearest rupee or multiple thereof.

(*RTP May, 2023*)

Answer

In the Books of Remo Ltd.

9% Government Securities (Investment) Account

Particulars		***Face Value***	***Interest***	***Cost***	***Particulars***		***Face Value***	***Interest***	***Cost***
2021		***₹***	***₹***	***₹***	***2021***		***₹***	***₹***	***₹***
April 1	To Balance b/d	1,00,000	2,250	90,000	June 1	By Bank A/c	60,000	2,250	54,150
May 1	To Bank A/c	80,000	2,400	73,600	June 30	By Bank A/c	-	5,400	-
June 1	To P&L A/c	-	-	150	Sept. 30	By Bank A/c	40,000	900	37,900
Sept. 30	To P & L A/c	-	-	1,900	Dec. 31	By Bank A/c	-	4,050	-
Dec. 1	To Bank A/c	10,000	375	10,000	Mar.1 2022	By Bank A/c	10,000	150	9,500
Mar. 1 2022	To P&L A/c	-	-	300	Mar. 31 2022	By Balance c/d	80,000	1,800	74,400
Mar. 31, 2022	To P&L A/c (Transfer)	-	9,525	-					
		1,90,000	14,550	1,75,950			1,90,000	14,550	1,75,950

Working Notes:

1. Interest accrued on 1st April 2021 = ₹1,00,000 x 9% x 3/12 = ₹ 2,250
2. Accrued Interest on 800 units as on 01 05.2021 = ₹ 80,000 x 9/100 x 4/12 = ₹ 2,400
3. Cost of Investment for purchase on 01.05.2021 = ₹ 76,000 - ₹ 2,400 = ₹ 73,600
4. Accrued Interest on 600 units as on 01 06.2021 = ₹ 60,000 x 9/100 x 5/12 = ₹ 2,250
5. Profit on Securities sold on 1st June = ₹ 54,150 (56,400 – 2,250)- ₹ 54,000 (60,000 x 90,000/1,00,000) = ₹ 150
6. Interest received on 30 06.2021 = ₹1,20,000 x 9/100 x 6/12 = ₹ 5,400
7. Accrued Interest on 400 units as on 30 09.2021 = ₹ 40,000 x 9/100 x 3/12 = ₹ 900
8. Cost of 400 Govt. Securities sold on 30.09.2021 = 40,000 x 90,000/1,00,000 = ₹ 36,000
9. Profit on securities sold on 30th September = ₹37,900 (38,800-900) - ₹ 36,000 = ₹ 1,900
10. Accrued Interest on 1 12.2021 = ₹ 10,000 x 9/100 x 5/12 = ₹ 375
11. Interest received on 31 12.2021 = ₹ 90,000 x 9/100 x 6/12 = ₹ 4,050
12. Accrued Interest on 100 units as on 01 03.2022 = ₹ 10,000 x 9/100 x 2/12 = ₹ 150
13. Cost of 100 Govt. Securities sold on 01.03.2022 = ₹ 10,000 x 73,600/80,000 = ₹ 9,200
14. Profit on securities sold on 01.03.2022 = ₹ 9,500 - ₹ 9,200 = ₹ 300
15.

Calculation of closing balance:	***Units***	***₹***
Securities in hand remained in hand at 31/3/2022		
From original holding (1,00,000 – 60,000 – 40,000)		-
Purchased on 1st May (80,000 – 10,000)	70,000	64,400
Purchased on 1st December	10,000	10,000
	80,000	74,400

Question 45

The following information is given for Mr. Atwood for the year ended 31.03.2023 :

01.04.2022	Mr. Atwood has 3,000 equity shares in Sun Limited at a book value of ₹3,30,000 (nominal value ₹ 100 each).
01.07.2022	Purchased 1,500 equity shares in Sun Limited for ₹1,38,600.
01.08.2022	Purchased 5,000, 9% Bonds at ₹97 cum-interest (face value ₹100). The due dates of interest are 1st September and 1sl March.
02.10.2022	Dividend declared on equity shares and paid by Sun Limited for the year 2021-2022 @ 10%.
15.10.2022	Sun Limited made a bonus issue of two equity shares for every five shares held.
01.01.2023	1,000 equity shares in Sun Limited sold @ ₹115 per share.
31.03.2023	Sold 4,000, 9% Bonds @ ₹99 ex-interest

- The market price of Equity Shares of Sun Limited is ₹125 each and Bonds ₹98 each on 31st March 2023.
- Interest on bonds was received on due dates.

You are required to prepare Investment Account in the books of Mr. Atwood for the year ended 31st March 2023, assuming that the investments are valued at the average cost or market value, whichever is lower. (Round off to nearest Rupee)

(*G-I, May, 2023*) (*10 Marks*)

Question Arrangement

AS 13

Topic	Question Numbers
Valuation of Investments	1, 2, 24
Classification of Investments	3, 21, 19, 18, 22
Selection of Lower Value	4, 23, 25
Disclosures	10
General	11, 12, 20
Investment in Debentures	5, 34, 15, 16, 31, 33, 35, 38, 44
Bonus	6, 7
Bonus and Rights	8, 9, 14, 17, 26, 27, 32, 36, 40, 41, 42, 43, 45
Mix Questions	28, 29, 30, 37
Cum Right Share	13, 39
Others	11, 12, 20, 24

Accounting Standard 19 Leases

Question 1

S. Square Private Limited has taken machinery on finance lease from S.K. Ltd. The information is as under:

Lease term = 4 years

Fair value at inception of lease = ₹20,00,000 Lease rent = ₹6,25,000 p.a. at the end of year Guaranteed residual value = ₹1,25,000 Expected residual value = ₹3,75,000

Implicit interest rate = 15%

Discounted rates for 1st year, 2nd year, 3rd year and 4th year are 0.8696, 0.7561,

0.6575 and 0.5718 respectively.

Calculate the value of the lease liability as per AS-19 and disclose impact of this on Balance sheet and Profit & loss account at the end of year 1

(*Source: Illustration 1, Study Material*)

Answer

According to para 11 of AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the lower of the fair value of the leased asset at the inception of the finance lease and the present value of the minimum lease payments from the standpoint of the lessee.

In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease. Present value of minimum lease payments will be calculated as follows:

Year	Minimum Lease Payment ₹	Implicit interest rate (Discount rate @15%)	Present value ₹
1	6,25,000	0.8696	5,43,500
2	6,25,000	0.7561	4,72,563
3	6,25,000	0.6575	4,10,937
4	7,50,000	0.5718	4,28,850
Total	26,25,000		18,55,850

Present value of minimum lease payments ₹18,55,850 is less than fair value at the inception of lease i.e. ₹20,00,000, therefore, the asset and corresponding lease liability should be recognised at ₹18,55,850 as per AS 19.

Question 2

Prakash Limited leased a machine to Badal Limited on the following terms:

		(₹ In lakhs)
(i)	*Fair value of the machine*	*28.3*
(ii)	*Lease term*	*5 years*
(iii)	*Lease rental per annum*	*8.00*
(iv)	*Guaranteed residual value*	*1.60*
(v)	*Expected residual value*	*3.00*
(vi)	*Internal rate of return*	*15%*

Discounted rates for 1st year to 5th year are 0.8696, 0.7561, 0.6575, 0.5718, and 0.4972 respectively.

Ascertain Unearned Finance Income.

(*Source: Illustration 2, Study Material*)

Answer

As per AS 19 on Leases, ***unearned finance income*** is the difference between (a) the ***gross investment*** in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

Where:

(a) ***Gross investment*** in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

Gross investment = Minimum lease payments + Unguaranteed residual value

= [Total lease rent + Guaranteed residual value (GRV)] + Unguaranteed residual value (URV)

= [(₹8,00,000 × 5 years) + ₹1,60,000] + ₹1,40,000

= ₹43,00,000 (a)

(b) Table showing present value of (i) Minimum lease payments (MLP) and

(ii) Unguaranteed residual value (URV).

Year	MLP inclusive of URV ₹	Internal rate of return (Discount factor @ 15%)	Present Value ₹
1	8,00,000	0.8696	6,95,680
2	8,00,000	0.7561	6,04,880
3	8,00,000	0.6575	5,26,000
4	8,00,000	0.5718	4,57,440
5	8,00,000	0.4972	3,97,760
	1,60,000 (GRV)	0.4972	79,552
	41,60,000		27,61,312 (i)
	1,40,000 (URV)	0.4972	69,608 (ii)
	43,00,000	(i)+ (ii)	28,30,920 (b)

Unearned Finance Income (a) - (b) = ₹43,00,000 – ₹28,30,920= ₹14,69,080.

Question 3

A Ltd. sold machinery having WDV of ₹40 lakhs to B Ltd. for ₹50 lakhs and the same machinery was leased back by B Ltd. to A Ltd. The lease back is operating lease. Comment if –

(a) Sale price of ₹50 lakhs is equal to fair value.

(b) Fair value is ₹60 lakhs.

(c) Fair value is ₹45 lakhs and sale price is ₹38 lakhs.

(d) Fair value is ₹40 lakhs and sale price is ₹50 lakhs.

(e) Fair value is ₹46 lakhs and sale price is ₹50 lakhs

(f) Fair value is ₹35 lakhs and sale price is ₹39 lakhs.

(*Source: Illustration 3, Study Material*)

Answer

Following will be the treatment in the given cases:

(a) When sales price of ₹50 lakhs is equal to fair value, A Ltd. should immediately recognise the profit of ₹10 lakhs (i.e. 50 – 40) in its books.

(b) When fair value is ₹60 lakhs then also profit of ₹10 lakhs should be immediately recognised by A Ltd.

(c) When fair value of leased machinery is ₹45 lakhs & sales price is ₹38 lakhs, then loss of ₹2 lakhs (40 – 38) to be immediately recognised by A Ltd. in its books provided loss is not compensated by future lease payment, otherwise defer and amortise the loss.

(d) When fair value is ₹40 lakhs & sales price is ₹50 lakhs then, profit of ₹10 lakhs is to be deferred and amortised over the lease period.

(e) When fair value is ₹46 lakhs & sales price is ₹50 lakhs, profit of ₹6 lakhs (46 - 40) to be immediately recognised in its books and balance profit of ₹4 lakhs (50-46) is to be amortised/deferred over lease period.

(f) When fair value is ₹35 lakhs & sales price is ₹39 lakhs, then the loss of ₹5 lakhs (40-35) to be immediately recognised by A Ltd. in its books and profit of ₹4 lakhs (39-35) should be amortised/deferred over lease period.

Question 4

Explain the types of lease as per AS 19.

(*Source: Question 6, Study Material*)

Answer

For the purpose of accounting AS 19, classifies leases into two categories as follows:

1. Finance Lease
2. Operating Lease

Finance Lease:

It is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership.

As per para 8 of the standard, in following situations, the lease transactions are called Finance lease:

1. The lessee will get the ownership of leased asset at the end of the lease term.
2. The lessee has an option to buy the leased asset at the end of the lease term at price, which is lower than its expected fair value at the date on which option will be exercised.
3. The lease term covers the major part of the life of asset even if title is not transferred.
4. At the beginning of lease term, present value of minimum lease rental covers the initial fair value.
5. The asset given on lease to lessee is of specialized nature and can only be used by the lessee without major modification.

Operating Lease:

It is lease, which does not transfer all the risks and rewards incidental to ownership.

Question 5

Explain the accounting treatment for a sale and leaseback transaction under Operating lease.

(*Source: Question 7, Study Material*)

Answer

As per AS 19, where sale and leaseback results in operating lease, then the accounting treatment in different situations is as follows:

Situation 1: Sale price = Fair Value

Profit or loss should be recognized immediately. Situation 2: Sale Price < Fair Value

Profit should be recognized immediately. The loss should also be recognized immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used.

Situation 3: Sale Price > Fair Value

The excess over fair value should be deferred and amortized over the period for which the asset is expected to be used.

Question 6

What do you understand by the term "Interest rate implicit on lease"?

(*Source: Question 8, Study Material*)

Answer

As per para 3 of AS 19 'Leases' the interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of:

(a) the minimum lease payments under a finance lease from the standpoint of the lessor; and

(b) any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.

Question 7

What are the disclosures requirements for operating leases by the lessee as per AS-19?

(*Source: Question 9, Study Material*)

Answer

As per AS 19, lessees are required to make following disclosures for operating leases:

(a) the total of future minimum lease payments under non-cancelable operating leases for each of the following periods:
   (i) not later than one year;
   (ii) later than one year and not later than five years;
   (iii) later than five years;

(b) the total of future minimum sublease payments expected to be received under non- cancelable subleases at the balance sheet date;

(c) lease payments recognized in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;

(d) sub-lease payments received (or receivable) recognized in the statement of profit and loss for the period;

(e) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:
   (i) the basis on which contingent rent payments are determined;
   (ii) the existence and terms of renewal or purchase options and escalation clauses; and
   (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Question 8

Classify the following into either operating or finance lease:

(i) Lessee has option to purchase the asset at lower than fair value, at the end of lease term;

(ii) Economic life of the asset is 7 years, lease term is 6 years, but asset is not acquired at the end of the lease term;

(iii) Economic life of the asset is 6 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee;

(iv) Present value (PV) of Minimum lease payment (MLP) = "X". Fair value of the asset is "Y".

(*Source: Question 10, Study Material*)

Answer

(i) If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, it is a Finance Lease.

(ii) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.

(iii) Since the asset is procured only for the use of lessee, it is a finance lease.

(iv) The lease is a finance lease if X = Y, or where X substantially equals Y.

Question 9

A machine was given on 3 years operating lease by a dealer of the machine for equal annual lease rentals to yield 30% profit margin on cost ₹1,50,000. Economic life of the machine is 5 years and output from the machine are estimated as 40,000 units, 50,000 units, 60,000 units, 80,000 units and 70,000 units consecutively for 5 years. Straight line depreciation in proportion of output is considered appropriate. Compute the following:

(i) Annual Lease Rent

(ii) Lease Rent income to be recognized in each operating year and

(iii) Depreciation for 3 years of lease.

(*Source: Question 11, Study Material*)

Answer

(i) Annual lease rent

Total lease rent

$$= 130\% \text{ of } ₹1,50,000 \times \frac{\text{Output during lease period}}{\text{Total output}}$$

= 130% of ₹1,50,000 x (40,000 +50,000+ 60,000)/(40,000 + 50,000 + 60,000 + 80,000 + 70,000)

= 1,95,000 x 1,50,000 units/3,00,000 units = ₹97,500

Annual lease rent = ₹97,500 / 3 = ₹32,500

(ii) Lease rent Income to be recognized in each operating year

Total lease rent should be recognised as income in proportion of output during lease period, i.e. in the proportion of 40 : 50 : 60.

Hence income recognised in years 1, 2 and 3 will be as: Year 1 ₹26,000, Year 2 ₹32,500 and

Year 3 ₹39,000.

(iii) Depreciation for three years of lease

Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹1,50,000 should be allocated over useful life 5 years in proportion of output, i.e. in proportion of 40 : 50 : 60 : 80 : 70 .

Depreciation for year 1 is ₹20,000, year 2 = 25,000 and year 3 = 30,000**.**

<u>Question 10</u>

Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being ₹7,00,000.

The economic life of machine as well as the lease term is 3 years. At the end of each year Lessee Ltd. pays ₹3,00,000. The Lessee has guaranteed a residual value of ₹22,000 on expiry of the lease to the Lessor. However, Lessor Ltd., estimates that the residual value of the machinery will be only ₹15,000. The implicit rate of return is 15% p.a. and present value factors at 15% are 0.869, 0.756 and 0.657 at the end of first, second and third years respectively.

Calculate the value of machinery to be considered by Lessee Ltd. and the finance charges in each year.

(*Source: Question 12, Study Material*)

Answer

As per para 11 of AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

Computation of Value of machinery:

Present value of minimum lease payment = ₹6,99,054 (See working note below)

Fair value of leased asset = ₹7,00,000

Therefore, the recognition will be at the lower of the two i.e. 6,99,054

Working Note - Present value of minimum lease payments:

Annual lease rental × PVIF+ Present value of guaranteed residual value

= ₹3,00,000 × (0.869 + 0.756 + 0.657) + ₹22,000 × 0.657

= ₹6,84,600 + ₹14,454 = 6,99,054

Computation of finance charges:

Year	Finance charge	Payment	Reduction in outstanding liability	Outstanding liability
1st Year beginning	–	–	–	6,99,054
End of 1st year	1,04,858	3,00,000	1,95,142	5,03,912
End of 2nd year	75,587	3,00,000	2,24,413	2,79,499
End of 3rd year	41,925	3,00,000	2,58,075	21,424

<u>Question 11</u>

B&P Ltd. availed a lease from N&L Ltd. The conditions of the lease terms are as under:

(i) Lease period is 3 years, in the beginning of the year 2009, for equipment costing ₹10,00,000 and has an expected useful life of 5 years.

(ii) The Fair market value is also ₹10,00,000

(iii) The property reverts back to the lessor on termination of the lease.

(iv) The unguaranteed residual value is estimated at ₹1,00,000 at the end of the year 2011.

(v) 3 equal annual payments are made at the end of each year.

(vi) Consider IRR = 10%.

The present value off ₹1 due at the end of 3rd year at 10% rate of interest is ₹0.7513. The present value of annuity of ₹1 due at the end of 3rd year at 10% IRR is ₹2.4868.

State whether the lease constitute finance lease and also calculate unearned finance income.

(*Source: Question 13, Study Material*)

Answer

Computation of annual lease payment:

Particulars	₹
Cost of equipment	10,00,000
Unguaranteed residual value	1,00,000
Present value of unguaranteed residual value	
(₹1,00,000 x 0.7513)	75,130
Present value of lease payments	
(₹10,00,000 - ₹75,130)	9,24,870
Present value of annuity for three years is 2.4868	
Annual lease payment [9,24,870/2.4868]	3,71,911.70

Classification of lease:

Parameter 1:

The present value of lease payment i.e., ₹9,24,870 which equals 92.48% of the fair market value i.e., ₹10,00,000.

The present value of minimum lease payments substantially covers the fair value of the leased asset

Parameter 2:

The lease term (i.e. 3 years) covers the major part of the life of asset (i.e. 5 years).

Therefore, it constitutes a finance lease.

Computation of Unearned Finance Income:

Particulars	₹
Total lease payments (₹3,71,911.70 x 3)	11,15,735
Add: Unguaranteed residual value	1,00,000
Gross investment in the lease	1,215,735
Less: Present value of lease payments and residual value i.e. Net Investment (₹75,130 + ₹9,24,870)	(10,00,000)
Unearned finance income	**2,15,735**

Question 12

X Ltd. sold machinery having WDV of ₹300 lakhs to Y Ltd. for ₹400 lakhs and the same machinery was leased back by Y Ltd. to X Ltd. The lease back arrangement is operating lease.

Give your comments in the following situations:

(i) Sale price of ₹400 lakhs is equal to fair value.

(ii) Fair value is ₹450 lakhs.

(iii) Fair value is ₹350 lakhs and the sale price is ₹250 lakhs.

(iv) Fair value is ₹300 lakhs and sale price is ₹400 lakhs.

(v) Fair value is ₹250 lakhs and sale price is ₹290 lakhs.

(*Source: Question 14, Study Material*)

Answer

Accounting Treatment:

S. No.	Particulars	Accounting Treatment
(i)	When sale price of ₹ 400 lakhs is equal to fair value	X Ltd. should immediately recognize the profit of ₹100 lakhs (i.e. 400 – 300) in its books.
(ii)	When fair value is ₹ 450 lakhs	Profit of ₹100 lakhs should be immediately recognized by X Ltd.
(iii)	When fair value of leased machinery is ₹350 lakhs & sales price is ₹250 lakhs	Then loss of ₹50 lakhs (300 – 250) to be immediately recognized by X Ltd. in its books provided loss is not compensated by future lease payment.
(iv)	When fair value is ₹300 lakhs & sales price is ₹400 lakhs	Then, profit of ₹100 lakhs is to be deferred and amortized over the lease period.
(v)	When fair value is ₹250 lakhs & sales price is ₹290 lakhs	Then the loss of ₹50 lakhs (300-250) to be immediately recognized by X Ltd. in its books and profit of ₹40 lakhs (290-250) should be amortized/ deferred over lease period.

QUESTION BANK

Question 13

State any four situations when a lease would be classified as Finance Lease.

(May, 2015, 4 Marks)

Answer

Finance Lease is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership. As per AS 19, in following situations, the lease transactions would be classified as Finance lease:

(i) The lessee will get the ownership of leased asset at the end of the lease term.

(ii) The lessee has an option to buy the leased asset at the end of the lease term at price, which is lower than its expected fair value at the date on which option will be exercised.

(iii) The lease term covers the major part of the life of asset even if title is not transferred.

(iv) At the beginning of lease term, present value of minimum lease rental covers the initial fair value.

Question 14

Aksat International Limited has given a machinery on lease for 36 months and its useful life is 60 months. Cost & fair market value of the machinery is ₹5,00,000. The amount will be paid in 3 equal annual installments and the lessee will return the machinery to lessor at termination of lease. The unguaranteed residual value at the end of 3 years is ₹50,000. IRR of investment is 10% and present value of annuity factor of ₹1 due at the end of 3 years at 10% IRR is 2.4868 and present value of ₹1 due at the end of 3rd year at 10% IRR is 0.7513.

You are required to comment with reason whether the lease constitute finance lease or operating lease. If it is finance lease, calculate unearned finance income.

(*November 2015, 5 Marks*)

Answer:

Determination of Nature of Lease

Present value of unguaranteed residual value at the end of 3rd year
= ₹50,000 x 0.7513
= ₹37,565

Present value of lease payments = ₹5,00,000 – ₹37,565
= ₹4,62,435

The percentage of present value of lease payments to fair value of the equipment is

(₹4,62,435/ ₹5,00,000) x 100 = 92.487%.

Since, lease payments substantially covers the major portion of the fair value; the lease constitutes a finance lease.

Calculation of Unearned Finance Income

Annual lease payment	=	₹4,62,435/ 2.4868 =₹1,85,956 (approx.)
Gross investment in the lease	=	Total minimum lease payments + unguaranteed residual value
	=	(₹1,85,956 × 3) + ₹50,000
	=	₹5,57,868 + ₹50,000 = ₹6,07,868
Unearned finance income	=	Gross investment - Present value of minimum lease payments and unguaranteed residual value
	=	₹6,07,868 – ₹5,00,000 = ₹1,07,868

Question 15

WIN Ltd. has entered into a three year lease arrangement with Tanya sports club in respect of Fitness Equipments costing ₹16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Values of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be ₹1,33,500. The assets would revert to the lessor at the end of the lease. Given that the implicit rate of interest is 10%.

You are required to calculate the amount of the annual lease payment and the unearned finance income. Discounting Factor at 10% for years 1, 2 and 3 are 0.909, 0.826 and 0.751 respectively.

(*RTP May 2018*)

Answer:

(i) Computation of annual lease payment to the lessor

	₹
Cost of equipment	16,99,999.50
Unguaranteed residual value	1,33,500.00
Present value of residual value after third year @ 10% (₹1,33,500 x 0.751)	1,00,258.50

	₹
Fair value to be recovered from lease payments (₹16,99,999.5 - ₹1,00,258.5)	15,99,741.00
Present value of annuity for three years is 2.486	
Annual lease payment = ₹15,99,741/2.486	6,43,500.00

(ii) Computation of Unearned Finance Income

		₹
Total lease payments (₹6,43,500 x 3)		19,30,500
Add:	Unguaranteed residual value	1,33,500
	Gross investment in the lease	20,64,000.00
Less:	Present value of investment (lease payments and residual value) (₹1,00,258.5 + ₹15,99,741)	(16,99,999.50)
Unearned finance income		3,64,000.50

Question 16

ABC Ltd. took a machine on lease from XYZ Ltd., the fair value being ₹10,00,000. The economic life of the machine as well as the lease term is 4 years. At the end of each year, ABC Ltd. pays ₹3,50,000. The lessee has guaranteed a residual value of ₹50,000 on expiry of the lease to the lessor. However, XYZ Ltd. estimates that the salvage value of the machine will be only ₹35,000 only. It was not practicable for the lessee to determine the interest rate implicit in the lease, However the incremental borrowing rate of ABC Ltd. is determined at 16.4%. PV factors at 16.4% for year 1, year 2, year 3 and year 4 are 0.8591, 0.7381, 0.6341 and 0.5447 respectively. You are required to calculate the value of machinery to be considered by ABC Ltd. and the finance charges for each year.

(*MTP April 2018/2019; March 2019; October 2019 & RTP November 2018/May 2020*) (*5 Marks*)

Answer:

As per AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

Value of machinery

In the given case, fair value of the machinery is ₹10, 00,000 which is more than net present value of minimum lease payments of ₹9,98,835 (Refer working Note). Hence, the machine and the corresponding liability will be recorded at value of ₹9,98,835 in the books of ABC Ltd.

Calculation of finance charges for each year

Year	Finance charge	Payment	Reduction in outstanding liability	Outstanding liability
1st year beginning	-	-	-	9,98,835
End of 1st year	1,63,809	3,50,000	1,86,191	8,12,644
End of 2nd year	1,33,274	3,50,000	2,16,726	5,95,918
End of 3rd year	97,731	3,50,000	2,52,269	3,43,649
End of 4th year	56,358	4,00,000*	3,43,642	7**

Working Note:

Present value of minimum lease payments

Annual lease rental x PV factor 3,50,000 x (0.8591+ 0.7381+ 0.6341+ 0.5447)	₹9,71,600
Present value of guaranteed residual value 50,000 x (0.5447)	₹27,235
	₹9,98,835

** includes guaranteed residual value of ₹50,000 (considered to be paid).*

*** it should be nil, difference of ₹7 due to approximations.*

Question 17

Sun Limited wishes to obtain a machine costing ₹30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 5 years. It enters into an agreement with Star Ltd., for a lease rental for ₹3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Su n Limited is not sure about the treatment of these lease rentals and seeks your advise. You are required to explain the necessary accounting treatment in line with AS 19. (use annuity factor at @ 15% for 3 years as 3.36)

(*MTP August 2018*) (*5 Marks*)

Answer:

As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV - Annuity Factor can be computed as:

Annuity Factor (Year 1 to Year 5)	3.36 (approx.)
Present Value of minimum lease payments (₹3 lakhs each year)	₹10.08 lakhs (approx.)

Thus present value of minimum lease payments is ₹10.08 lakhs and the fair value of the machine is ₹30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for five years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Question 18

Jaya Ltd. took a machine on lease from Deluxe Ltd., the fair value being ₹11,50,000. Economic life of the machine as well as lease term is 4 years. At the end of each years, lessee pays ₹3,50,000 to lessor. Jaya Ltd. has guaranteed a residual value of ₹70,000 on expiry of the lease to Deluxe Ltd., however Deluxe Ltd. estimates that residual value will be only ₹25,000. The implicit rate of return is 10% p.a. and present value factors at 10% are: 0.909, 0.826, 0.751 and 0.683 at the end of 1st, 2nd, 3rd and 4th year respectively.

Calculate the value of machinery to be considered by Jaya Ltd. and the value of the lease liability as per AS-19.

(*May 2019*) (*5 Marks*)

Answer:

According to para 11 of AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of the finance lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee.

In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease. Present value of minimum lease payments will be calculated as follows:

Year	*Minimum Lease Payment* ₹	*Internal rate of return (Discount rate @10%)*	*Present value* ₹
1	3,50,000	0.909	3,18,150
2	3,50,000	0.826	2,89,100
3	3,50,000	0.751	2,62,850
4	4,20,000	0.683	2,86,860
Total	14,70,000		11,56,960

* *Minimum Lease Payment of 4th year includes guaranteed residual value amounting i.e. 3,50,000 + 70,000 = 4,20,000.*

Present value of minimum lease payments ₹11,56,960 is more than fair value at the inception of lease i.e. ₹11,50,000, therefore, the lease liability and machinery should be recognized in the books at ₹11,50,000 as per AS 19.

Question 19

Sun Limited wishes to obtain a machine costing ₹30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 3 years. It enters into an agreement with Star Ltd., for a lease rental for ₹3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Suraj Limited is not sure about the treatment of these lease rentals and seeks your advice. (use annuity factor at @ 15% for 3 years as 3.36)

(*RTP November 2019*)

Answer:

As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment• amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

Annuity Factor (Year 1 to Year 3)	3.36
Present Value of minimum lease payments (₹3 lakhs each year)	₹10.08 lakhs (approx.)

Thus present value of minimum lease payments is ₹10.08 lakhs and the fair value of the machine is ₹30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for three years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

• In calculating the present value of the of minimum lease payments, the discount rate is the interest rate implicit in the lease.

Question 20

Classify the following into either operating lease or finance lease with reason:

(1) Economic life of asset is 10 years, lease term is 9 years, but asset is not acquired at the end of lease term.

(2) Lessee has option to purchase the asset at lower than fair value at the end of lease term.

(3) Lease payments should be recognized as an expense in the statement of Profit & Loss of a lessee.

(4) Present Value (PV) of Minimum Lease Payment (MLP) = "X". Fair value of the asset is "Y". And X = Y.

(5) Economic life of the asset is 5 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee.

(*November 2019, New Course, 5 Marks*)

Answer

(i) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.

(ii) If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, it is a Finance Lease.

(iii) It is an operating lease under which lease payments are recognized as expense in the profit and loss account of lessee to have better matching between cost and revenue.

(iv) The lease is a finance lease if X = Y, or where X substantially equals Y.

(v) Since the asset is of special nature and has been procured only for the use of lessee, it is a finance lease.

Question 21

(a) Classify the following into either operating or finance lease:

(i) Present value (PV) of Minimum lease payment (MLP) = "X". Fair value of the asset is "Y".

(ii) Economic life of the asset is 7 years, lease term is 6.5 years, but asset is not acquired at the end of the lease term;

(iii) Economic life of the asset is 6 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee .

(b) Viral Ltd. sold machinery having WDV of ₹40 lakhs to Saral Ltd. for ₹50 lakhs and the same machinery was leased back by Saral Ltd. to Viral Ltd. The lease back is in nature of operating lease. You are required to explain the treatment in the given cases –

(i) Fair value is ₹45 lakhs and sale price is ₹38 lakhs.

(ii) Fair value is ₹40 lakhs and sale price is ₹50 lakhs.

(iii) Fair value is ₹46 lakhs and sale price is ₹50 lakhs

(*RTP, November, 2020*)

Answer

(a) (i) The lease is a finance lease if X = Y, or if X substantially equals Y otherwise operating.

(ii) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.

(iii) Since the asset is procured only for the use of lessee, it is a finance lease.

(b) As per AS 19, where sale and leaseback results in operating lease, then the accounting treatment in different situations is as follows:

Situation 1: Sale price = Fair Value

Profit or loss should be recognized immediately.

Situation 2: Sale Price < Fair Value

Profit should be recognized immediately. The loss should also be recognized immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used.

Situation 3: Sale Price > Fair Value

The excess over fair value should be deferred and amortized over the period for which the asset is expected to be used.

Following will be the treatment in the situations given in the question:

(i) When fair value of leased machinery is ₹45 lakhs & sales price is ₹38 lakhs, then loss of ₹2 lakhs (40 – 38) to be immediately recognized by A Ltd. in its books provided loss is not compensated by future lease payment.

(ii) When fair value is ₹40 lakhs & sales price is ₹50 lakhs then, profit of ₹10 lakhs is to be deferred and amortized over the lease period.

(iii) When fair value is ₹46 lakhs & sales price is ₹50 lakhs, profit of ₹6 lakhs (46 less 40) to be immediately recognized in its books and balance profit of ₹4 lakhs (50-46) is to be amortized/deferred over lease period.

Question 22

A machine was given on 3 years operating lease by a dealer of the machine for equal annual lease rentals to yield 30% profit margin on cost ₹1,50,000. Economic life of the machine is 5 years and output from the machine are estimated as 40,000 units, 50,000 units, 60,000 units, 80,000 units and 70,000 units consecutively for 5 years. Straight line depreciation in proportion of output is considered appropriate.

You are required to compute: (i) Annual Lease Rent and (ii) Lease Rent income to be recognized in each operating year.

(*MTP, March, 2021*) (*5 marks*)

Answer

(i) Annual lease rent

Total lease rent

$$= 130\% \text{ of Rs.}1,50,000 \times \frac{\text{Output during lease period}}{\text{Total output}}$$

= 130% of ₹1,50,000 x (40,000 +50,000+ 60,000)/(40,000 + 50,000 + 60,000 + 80,000 + 70,000)

= 1,95,000 x 1,50,000 units/3,00,000 units = ₹97,500

Annual lease rent = ₹97,500 / 3 = ₹32,500

(ii) Lease rent Income to be recognized in each operating year

Total lease rent should be recognized as income in proportion of output during lease period, i.e. in the proportion of 40 : 50 : 60.

Hence income recognized in years 1, 2 and 3 will be as:

Year 1 ₹26,000,

Year 2 ₹32,500 and

Year 3 ₹39,000.

Question 23

You are required to give the necessary journal entry at the inception of lease to record the asset taken on finance lease in books of lessee from the following information:

Lease period	=	5 years;
Annual lease rents	=	₹50,000 at the end of each year.
Guaranteed residual value	=	₹25,000
Fair Value at the inception (beginning) of lease	=	₹2,00,000

Interest rate implicit on lease is = 12.6% (Discounted rates for year 1 to 5 are .890, .790, .700, .622 and .552 respectively).

(*MTP, April, 2021*) (*5 marks*)

Answer

Present value of minimum lease payment is computed below:

Year	MLP ₹	DF (12.6%)	PV ₹
1	50,000	0.890	44,500
2	50,000	0.790	39,500
3	50,000	0.700	35,000
4	50,000	0.622	31,100
5	50,000	0.552	27,600
5	25,000	0.552	13,800
			1,91,500

Present value of minimum lease payment = ₹1,91,500 Fair value of leased asset = ₹2,00,000

As per AS 19, on the date of inception of Lease, Lessee should show it as an asset and corresponding liability at lower of Fair value of leased asset at the inception of the lease and present value of minimum lease payments from the standpoint of the lessee. The accounting entry at the inception of lease to record the asset taken on finance lease in books of lessee is suggested below:

	₹	₹
Asset A/c Dr.	1,91,500	
To Lessor (Lease Liability) A/c		1,91,500
(Being recognition of finance lease as asset and liability)		

Question 24

Sooraj Limited wishes to obtain a machine costing ₹30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 3 years. It enters into an agreement with Star Ltd., for a lease rental for ₹3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Sooraj Limited is not sure about the treatment of these lease rentals and seeks your advice. (use annuity factor at @ 15% for 3 years as 3.36)

(*RTP, May, 2021*)

Answer

As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment∗ amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

∗ *In calculating the present value of the of minimum lease payments, the discount rate is the interest rate implicit in the lease.*

Annuity Factor (Year 1 to Year 3) Present Value of minimum lease payments (₹3 lakhs each year)	3.36 ₹10.08 lakhs

Thus present value of minimum lease payments is ₹10.08 lakhs and the fair value of the machine is ₹30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for three years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Question 25

X Ltd. sold machinery having WDV of ₹300 lakhs to Y Ltd. for ₹400 lakhs and the same machinery was leased back by Y Ltd. to X Ltd. The lease back arrangement is operating lease. Give your comments in the following situations:

(i) Sale price of ₹400 lakhs is equal to fair value.
(ii) Fair value is ₹450 lakhs.
(iii) Fair value is ₹350 lakhs and the sale price is ₹250 lakhs.
(iv) Fair value is ₹300 lakhs and sale price is ₹400 lakhs.
(v) Fair value is ₹250 lakhs and sale price is ₹290 lakhs.

(Suggested, January, 2021) (5 marks)

Answer

Following will be the treatment in the given cases:

(i) When sale price of ₹400 lakhs is equal to fair value, X Ltd. should immediately recognise the profit of ₹100 lakhs (i.e. 400 – 300) in its books.
(ii) When fair value is ₹450 lakhs then also profit of ₹100 lakhs should be immediately recognised by X Ltd.
(iii) When fair value of leased machinery is ₹350 lakhs & sales price is ₹250 lakhs, then loss of ₹50 lakhs (300 – 250) to be immediately recognised by X Ltd. in its books provided loss is not compensated by future lease payment.
(iv) When fair value is ₹300 lakhs & sales price is ₹400 lakhs then, profit of ₹100 lakhs is to be deferred and amortised over the lease period.
(v) When fair value is ₹250 lakhs & sales price is ₹290 lakhs, then the loss of ₹50 lakhs (300-250) to be immediately recognised by X Ltd. in its books and profit of ₹40 lakhs (290-250) should be amortised/deferred over lease period.

Question 26

A machine was given on 3 years operating lease by a dealer of the machine for equal annual lease rentals to yield 30% profit margin on cost of ₹2, 25,000. Economic life of the machine is 5 years and output from the machine is estimated as 60,000 units, 75,000 units, 90,000 units, 1,20,000 units and 1,05,000 units consecutively for I years. Straight line depreciation in proportion of output is considered appropriate. You are required to compute the following as per AS-19.

(i) Annual Lease Rent
(ii) Lease Rent income to be recognised in each operating year and
(iii) Depreciation for 3 years of lease

(*Question Paper of December 2021*) *(5 Marks)*

Answer

(i) Annual lease rent

Total lease rent

= 130% of ₹2,25,000 × Output during lease period/ Total output

= 130% of ₹2,25,000 x (60,000 +75,000+ 90,000)/(60,000 + 75,000 + 90,000 + 1,20,000 + 1,05,000)

= 2,92,500 x 2,25,000 units/4,50,000 units = ₹1,46,250

Annual lease rent = ₹1,46,250 / 3 = ₹48,750

(ii) Lease rent Income to be recognized in each operating year

Total lease rent should be recognized as income in proportion of output during lease period, i.e. in the proportion of 60,000 : 75,000 : 90,000 or 4:5:6

Hence income recognized in years 1, 2 and 3 will be as:

Year 1 ₹39,000,

Year 2 ₹48,750 and

Year 3 ₹58,500.

(iii) Depreciation for three years of lease

Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹2,25,000 should be allocated over useful life 5 years in proportion of output, i.e. in proportion of 60 :75: 90 : 120 : 105 .

Depreciation for year 1 is ₹30,000, year 2 = 37,500 and year 3 = 45,000.

Question 27

WIN Ltd. has entered into a three year lease arrangement with Tanya sports club in respect of Fitness Equipment's costing ₹ 16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Values of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be ₹ 1,33,500. The assets would revert to the lessor at the end of the lease. Given that the implicit rate of interest is 10%. You are required to compute the amount of the annual lease payment and the unearned finance income. Discounting Factor at 10% for years 1, 2 and 3 are 0.909, 0.826 and 0.751 respectively.

(*RTP November, 2022*)

Answer

(i) Computation of annual lease payment to the lessor

	₹
Cost of equipment	16,99,999.50
Unguaranteed residual value	1,33,500.00
Present value of residual value after third year @ 10% (₹ 1,33,500 × 0.751)	1,00,258.50
Fair value to be recovered from lease payments (₹ 16,99,999.5– ₹ 1,00,258.5)	15,99,741.00
Present value of annuity for three years is 2.486	
Annual lease payment = ₹ 15,99,741/ 2.486	6,43,500.00

(ii) Computation of Unearned Finance Income

	₹
Total lease payments (₹ 6,43,500 x 3)	19,30,500
Add: Unguaranteed residual value	1,33,500
Gross investment in the lease	20,64,000.00
Less: Present value of investment (lease payments and residual value) (₹1,00,258.5+ ₹ 15,99,741)	(16,99,999.50)
Unearned finance income	3,64,000.50

Question 28

WIN Ltd. has entered into a three year lease arrangement with Tanya sports club in respect of Fitness Equipments costing ₹ 16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Values of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be ₹ 1,33,500. The assets would revert to the lessor at the end of the lease. Given that the implicit rate of interest is 10%.

You are required to calculate the amount of the annual lease payment and the unearned finance income. Discounting Factor at 10% for years 1, 2 and 3 are 0.909, 0.826 and 0.751 respectively.

(*RTP May, 2023*)

Answer

(i) Computation of annual lease payment to the lessor

	₹
Cost of equipment	16,99,999.50
Unguaranteed residual value	1,33,500.00
Present value of residual value after third year @ 10% (₹ 1,33,500 × 0.751)	1,00,258.50
Fair value to be recovered from lease payments (₹ 16,99,999.5– ₹ 1,00,258.5)	15,99,741.00
Present value of annuity for three years is 2.486	
Annual lease payment = ₹ 15,99,741/ 2.486	6,43,500.00

(ii) Computation of Unearned Finance Income

	₹
Total lease payments (₹ 6,43,500 x 3)	19,30,500
Add: Unguaranteed residual value	1,33,500
Gross investment in the lease	20,64,000.00
Less: Present value of investment (lease payments and residual value) (₹ 1,00,258.5+ ₹ 15,99,741)	(16,99,999.50)
Unearned finance income	3,64,000.50

Question Arrangement

Topic AS 19

Topic	Question Numbers
Identification of Lease	8, 20, 13
Financial Lease in the books of Lessee	1, 10, 16, 18, 23
Financially in the books of Lessor	2, 14, 15, 11, 27, 28
Operating Lease	17, 19, 24, 9, 22, 26
Leaseback	21, 3, 12, 25
Others	4, 6, 7, 5

Accounting Standard 26
Intangible Assets

Question 1

ABC Ltd. developed know-how by incurring expenditure of ₹20 lakhs, The know-how was used by the company from 1.4.20X1. The useful life of the asset is 10 years from the year of commencement of its use. The company has not amortised the asset till 31.3.20X8. Pass Journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.20X8.

Answer

Journal Entry

		₹	₹
Profit and Loss A/c (Prior period item)	Dr.	12,00,000	
Amortization A/c	Dr.	2,00,000	
To Know-how A/c*			14,00,000
[Being amortization of 7 years (out of which amortization of 6 years charged as prior period item)]			

Question 2

The company had spent ₹45 lakhs for publicity and research expenses on one of its new consumer product, which was marketed in the accounting year 20X1 -20X2, but proved to be a failure. State, how you will deal with the following matters in the accounts of U Ltd. for the year ended 31st March, 20X2.

Answer

In the given case, the company spent ₹45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/benefit because of the failure of the product. Thus, according to AS 26 'Intangible Assets', the company should charge the total amount of ₹45 lakhs as an expense in the profit and loss account.

Question 3

A company with a turnover of ₹250 crores and an annual advertising budget of ₹2 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹25 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of ₹2 crore incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the company correct?

Answer

According to AS 26 'Intangible Assets', "expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset".

AS 26 mentions that expenditure on advertising and promotional activities should be recognised as an expense when incurred.

In the given case, advertisement expenditure of ₹2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹25 crores.

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* As per para 63 of AS 26 "Intangible Assets", there is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.

Here, no intangible asset or other asset is acquired or created that can be recognised. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹2 crores to the Profit and Loss account of the year is correct.

Question 4

What is meant by Intangible Assets and what are the important factors to consider the recognition of item as an Intangible asset? What is the recognition criteria in accordance with the provisions of AS 26?

Answer

An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Below are the 3 key ingredients to be satisfied to cover an item as an intangible asset under this standard:

- identifiability,
- control over a resource and
- expectation (i.e. probable – 50% plus) of future economic benefits flowing to the enterprise.

The recognition of an item as an intangible asset requires an enterprise to demonstrate that the item meets the definition of an intangible asset and recognition criteria set out as below:

a. It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
b. The cost of the asset can be measured reliably.

Question 5

What is the measurement criteria at the time of initial recognition of Intangible assets acquired through separate acquisition?

Answer

If an intangible asset is acquired separately, the cost of the intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

The cost of an intangible asset comprises:

- its purchase price,
- any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), and
- any directly attributable expenditure on making the asset ready for its intended use. Directly attributable expenditure includes, for example, professional fees for legal services.
- Any trade discounts and rebates are deducted in arriving at the cost.

Question 6

What is the criteria for recognition and measurement of Internally generated intangible assets. Describe which kind of cost is considered for capitalisation with respect to provisions of AS 26. Whether the same applies for internally generated goodwill also?

Answer

To assess whether an internally generated intangible asset meets the criteria for recognition, an enterprise classifies the generation of the asset into 2 phases:

- Research Phase &
- Development Phase

Research Phase - The expenses related to Research phase is expensed off in statement of Profit and loss.

Development Phase - Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the conditions given in para 6.15.

<u>Cost of an Internally Generated Intangible Asset</u>

The cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria. Reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports is prohibited.

The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and making the asset ready for its intended use from the time when the intangible asset first meets the recognition criteria. For details, refer para 6.16.

Internally generated goodwill is not recognised as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

Question 7

Advise the complete accounting treatment for Research and development phase as per AS 26.

Answer

Research phase means acquisition of knowledge and Development phase means application of knowledge.

The expenditure related to Research phase is expensed off in statement of Profit and loss. However, the expenditure incurred in Development phase is capitalised as a cost of the internally generated intangible asset.

If an enterprise cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the enterprise treats the expenditure on that project as if it were incurred in the research phase only.

Question 8

What is meant by Amortisation of an Intangible asset. What are the different methods for amortisation as per AS 26?

Answer

Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

The amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used. A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include

- the straight-line method,
- the diminishing balance method and
- the unit of production method.

The method used for an asset is selected based on the expected pattern of consumption of economic benefits and is consistently applied from period to period, unless there is a change in the expected pattern of consumption of economic benefits to be derived from that asset.

Question 9

Swift Ltd. acquired a patent at a cost of ₹80,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset at ₹10,00,000 per annum. The company had amortized the patent at 10,00,000 per annum in first two years on the basis of economic benefits derived from the product manufactured under the patent. After two years it was found that the product life-cycle may continue for another 5 years from then. The patent was renewable and Swift Ltd. got it renewed after expiry of five years. The net cash flows from the product during these 5 years were expected to be ₹36,00,000, ₹46,00,000, ₹44,00,000, ₹40,00,000 and ₹34,00,000. Find out the amortization cost of the patent for each of the years.

Answer

Swift Limited amortised ₹10,00,000 per annum for the first two years i.e. ₹20,00,000. The remaining carrying cost can be amortised during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

S	Net cash flows ₹	Amortisation Ratio	Amortisation Amount ₹
I	-	0.125	10,00,000
II	-	0.125	10,00,000
III	36,00,000	0.180	10,80,000
IV	46,00,000	0.230	13,80,000
V	44,00,000	0.220	13,20,000
VI	40,00,000	0.200	12,00,000
VII	34,00,000	0.170	10,20,000
Total	2,00,00,000	1.000	80,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹60,00,000 has been amortised in the ratio of net cash flows arising from the product of Swift Ltd.

Question 10

AB Ltd. launched a project for producing product X in October, 20X1. The Company incurred ₹20 lakhs towards Research. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.

Advise the Company as per the applicable Accounting Standard.

Answer

As per para 41 of AS 26 "Intangible Assets", expenditure on research should be recognised as an expense when it is incurred. Hence, the expenses amounting ₹20 lakhs incurred on the research has to be charged to the statement of profit and loss in the current year ending 31st March, 20X2.

Question 11

During 20X1-X2, an enterprise incurred costs to develop and produce a routine low risk computer software product, as follows:

Particular	***₹***
Completion of detailed program and design (Phase 1)	*50,000*
Coding and Testing (Phase 2)	*40,000*
Other coding costs (Phase 3 & 4)	*63,000*
Testing costs (Phase 3 & 4)	*18,000*
Product masters for training materials (Phase 5)	*19,500*
Packing the products (1,500 units) (Phase 6)	*16,500*

Answer

As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed program design, coding and testing. In this case, ₹90,000 would be recorded as an expense (₹50,000 for completion of detailed program design and ₹40,000 for coding and testing to establish technological feasibility/asset recognition criteria). Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (63,000+ 18,000+ 19,500) = ₹1,00,500. Packing cost ₹16,500 should be recognized as expenses and charged to P & L A/c.

QUESTION BANK

Question 12

A company acquired a patent at a cost of ₹160 lakhs for a period of 5 years and the product life cycle is also 5 years. The company capitalized the cost and started amortising the asset at ₹16 lakhs per year based on the economic benefits derived from the product manufactured under the patent. After 2 years it was found that the product life cycle may continue for another 5 years from then (the patent is renewable and the company can get it renewed after 5 years). The net cash flows from the product during these 5 years were expected to be ₹50 lakhs, ₹30 lakhs, ₹60 lakhs, ₹70 lakhs and ₹40 lakhs. Find out the amortization cost of the patent for each of the years.

(May 2018) (5 Marks)

Answer:

Company amortized ₹16,00,000 per annum for the first two years. Hence, Amortization for the first two years (₹16,00,000 x 2) = ₹32,00,000.

Remaining carrying cost after two years = ₹1,60,00,000 - ₹32,00,000
= ₹1,28,00,000

Since after two years it was found that the product life cycle may continue for another 5 years, hence the remaining carrying cost ₹128 lakhs will be amortized during next 5 years in the ratio of net cash arising from the sale of the products of Fast Limited.

The amortization cost of the patents may be computed as follows:

Year	Net cash flows	Amortization Ratio	Amortization Amount ₹
I	-	0.1	16,00,000
II	-	0.1	16,00,000
III	50,00,000	0.2	25,60,000
IV	30,00,000	0.12	15,36,000
V	60,00,000	0.24	30,72,000
VI	70,00,000	0.28	35,84,000
VII	40,00,000	0.16	20,48,000
Total	250,00,000	1.000	160,00,000

Question 13

K Ltd. launched a project for producing product X in October, 2016. The Company incurred ₹40 lakhs towards Research and Development expenses upto 31st March, 2017. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.

You are required to advise the Company as per the applicable Accounting Standard.

(*RTP May 2018*)

Answer:

As per provisions of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognized when no future economic benefits are expected from its use according to para 87 of the standard. Thus, the manager cannot defer the expenditure write off to future years in the given case. Hence, the expenses amounting ₹40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2017.

Question 14

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

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

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

You are required to determine the amortization method in line with AS 26.

(*MTP April 2018/2019 & October 2019*) (*5 Marks*)

Answer:

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

In the instant case, the pattern of economic benefit in the form of net operating cash flow vis-a-vis production is determined reliably. A Ltd. should amortize the license fee of ₹200 lakhs as under:

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

Question 15

Desire Ltd. acquired a patent at a cost of ₹1,00,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset on SLM. After two years it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be ₹45,00,000, ₹42,00,000, ₹40,00,000, ₹38,00,000 and ₹35,00,000. Patent is renewable and company changed amortization method from 3rd year (i.e. from SLM to ratio of expected new cash flows).

You are required to compute the amortization cost of the patent for each of the years (1st year to 7th year).

(*RTP November 2018*)

Answer*:*

Desire Limited amortised ₹20,00,000 per annum for the first two years i.e. ₹40,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	Net cash flows ₹	Amortization Ratio	Amortization Amount ₹
I	-	0.200	20,00,000
II	-	0.200	20,00,000
III	45,00,000	0.225	13,50,000
IV	42,00,000	0.21	12,60,000
V	40,00,000	0.20	12,00,000
VI	38,00,000	0.19	11,40,000
VII	35,00,000	0.175	10,50,000
Total	2,00,00,000	1.000	1,00,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹60,00,000 has been amortized in the ratio of net cash flows arising from the product of Desire Ltd.

Question 16

A Company with a turnover of ₹375 crores and an annual advertising budget of ₹3 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹37.5 croes from the new product. The company had debited to its

Profit and Loss account the total expenditure of ₹3 crores incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the Company correct?

(*RTP May, 2019*)

Answer*:*

According to AS 26 'Intangible Assets', "expenditure on an intangible item should be recognized as an expense when it is incurred unless it forms part of the cost of an intangible asset'.

In the given case, advertisement expenditure of ₹3 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹37.5 crores. Here, no intangible asset or another asset is acquired or created that can be recognized.

Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹3 crores to the Profit and Loss account of the year is correct.

Question 17

K Ltd. launched a project for producing product X in October, 2016. The Company incurred ₹40 lakhs towards Research and Development expenses upto 31st March, 2018. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years. Advise the Company as per the applicable Accounting Standard.

(MTP-March 2019/ RTP November 2019) (5 Marks)

Answer*:*

As per provisions of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognized when no future economic benefits are expected from its use according to para 87 of the standard. Thus, the manager cannot defer the expenditure write off to future years in the given case. Hence, the expenses amounting ₹40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2018.

Question 18

As per provision of AS-26, how would you deal to the following situations:

(1) ₹23,00,000 paid by a manufacturing company to the legal advisor defending the patent of a product is treated as a capital expenditure.

(2) During the year 2018-19, a company spent ₹7,00,000 for publicity and research expenses on one of its new consumer product which was marketed in the same accounting year but proved to be a failure.

(3) A company spent ₹25,00,000 in the past three years to develop a product, these expenses were charged to profit and loss account since they did not meet AS-26 criteria for capitalization. In the current year approval of the concerned authority has been received. The company wishes to capitalize ₹25,00,000 by disclosing it as a prior period item.

(4) A company with a turnover of ₹200 crores and an annual advertising budget of ₹50,00,000 had taken up for the marketing of a new product by a company. It was estimated that the company would have a turnover of ₹20 crore from the new product. The company had debited to its Profit & Loss Account the total expenditure of ₹50,00,000 incurred on extensive special initial advertisement campaign for the new product.

(*November 2019, 5 Marks*)

Answer

As per AS 26 “Intangible Assets”, subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense when it is incurred unless (a) it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and (b) expenditure can be measured and attributed to the asset reliably. If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

(i) In the given case, the legal expenses to defend the patent of a product amounting ₹23,00,000 should not be capitalized and be charged to Profit and Loss Statement.

(ii) The company is required to expense the entire amount of ₹7,00,000 in the Profit and Loss account for the year ended 31 st March, 2019 because no benefit will arise in the future.

(iii) As per AS 26, expenditure on an intangible item that was initially recognized as an expense by a reporting enterprise in previous annual financial statements should not be recognized as part of the cost of an intangible asset at a later date. Thus the company cannot capitalize the amount of ₹25,00,000 and it should be recognized as expense

(iv) Expenditure of ₹50,00,000 on advertising and promotional activities should always be charged to Profit and Loss Statement. Hence, the company has done the corre ct treatment by debiting the sum of 50 lakhs to Profit and Loss Account.

Question 19

A company acquired patent right for ₹1200 lakhs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of estimated future cash flows which are as under:

Year	1	2	3	4	5
Estimated future cash flows (₹ in lakhs)	600	600	600	300	300

After 3rd year, it was ascertained that the patent would have an estimated balance future life of 3 years and the estimated cash flow after 5th year is expected to be ₹150 lakhs. You are required to determine the amortization pattern under Accounting Standard 26.

(*May 2020*)

Answer

Amortization of cost of patent as per AS 26

Year	***Estimated future cash flow (₹ in lakhs)***	***Amortization Ratio***	***Amortized Amount (₹ in lakhs)***
1	600	.25	300
2	600	.25	300
3	600	.25	300
4	300	.40 (Revised)	120
5	300	.40 (Revised)	120
6	150	.20 (Revised)	60
			1,200

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (600: 600: 600: 300: 300).

The unamortized amount of the patent after third year will be ₹300 lakh (1,200-900) which will be amortized in the ratio of revised estimated future cash flows (300:300:150) in the fourth, fifth and sixth year.

Question 20

Sudesh Ltd. acquired a patent at a cost of ₹2,40,00,000 for a period of 5 years and the product life-cycle was also 5 years. The company capitalized the cost and started amortizing the asset at ₹48,00,000 per annum. After two years it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be ₹36,00,000, ₹46,00,000, ₹44,00,000, ₹40,00,000 and ₹34,00,000. Find out the amortization cost of the patent for each of the years if the patent was renewable and Sudesh Ltd. got it renewed after expiry of five years.

(*MTP, October, 2020*) (*5 marks*)

Answer

The entity amortised ₹48,00,000 per annum for the first two years i.e. ₹96,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	**Net cash flows ₹**	**Amortization Ratio**	**Amortization Amount ₹**
I	-	0.20	48,00,000
II	-	0.20	48,00,000
III	36,00,000	0.180	25,92,000
IV	46,00,000	0.230	33,12,000
V	44,00,000	0.220	31,68,000
VI	40,00,000	0.200	28,80,000
VII	34,00,000	0.170	24,48,000
Total	2,00,00,000	1.000	2,40,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹1,44,00,000 has been amortized in the ratio of net cash flows arising from the product of Change Ltd.

Question 21

X Ltd. carried on business of manufacturing of Bakery products. The company has two trademarks "Sun" and "Surya". One month before the company knows through one of the marketing managers that both trademarks have allegedly been infringed by other competitors engaged in the same field. After investigation, legal department of the company informed that it had weak case on trademark "Sun" and strong case in regard to trademark "Surya"'. X Ltd. incurred additional legal fees to stop infringement on both trademarks. Both trademarks have a remaining legal life of 10 years. How should X Ltd. account for these legal costs incurred relating to the two trademarks?

(*RTP, November, 2020*)

Answer

As per AS 26, subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense. However, if the subsequent expenditure enables the asset to generate future economic benefits in excess of its originally assessed standard of performance or can be measured and attributed to the asset reliably, then such subsequent expenditure should be added to the cost of the intangible asset.

The legal costs incurred for both the trademarks do not enable them to generate future economic benefits in excess of its originally assessed standard of performance. They only ensure to maintain them if the case is decided in favour of the company. Therefore, such legal costs incurred for both trademarks must be recognized as an expense.

Question 22

RC Ltd. is showing an intangible asset at ₹72 lakhs as on 31 -3-2020. This asset was acquired for ₹120 lakhs as on 01-04-2014 and the same was used from that date. The company has been following the policy of amortization of the intangible assets over a period of 15 years, on straight line basis.

You are required to comment on the accounting treatment of asset with reference to AS 26 “Intangible Assets” and also give the necessary rectification journal entry in the books.

(*MTP, March, 2021*) (*5 marks*)

Answer

As per AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. The Company has been following the policy of amortization of the intangible asset over a period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS 26.

Accordingly, the company would be required to restate the carrying amount of intangible asset as on 31.3.2020 at ₹48 lakhs i.e. ₹120 lakhs less ₹72 lakhs (₹120 Lakhs / 10 years x 6 years = 72 Lakhs). The difference of ₹24 Lakhs (₹72 lakhs – ₹48 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹48 lakhs will be amortized over remaining 4 years by amortizing ₹12 lakhs per year**.**

The necessary journal entry (for rectification) will be

Revenue Reserves	Dr. ₹24 Lakhs	
To Intangible Assets		₹24 Lakhs

(Adjustment to reserves due to restatement of the carrying amount of intangible asset)

Question 23

Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred ₹10 lakh on research during first 5 months of the financial year 2020-21. The development of the process began on 1st September, 2020 and upto 31st March, 2021, a sum of ₹8 lakh was incurred as Development Phase Expenditure, which meets assets recognition criteria. From 1st April, 2021, the Company has implemented the new process design and it is likely that this will result in after tax saving of ₹2 lakh per annum for next five years. The cost of capital is 10%. The present value of annuity factor of ₹1 for 5 years @ 10% is 3.7908.

Decide the treatment of Research and Development Cost of the project as per AS 26.

(*MTP, April, 2021*) (*5 marks*)

Answer

Research Expenditure – According to AS 26 ‘Intangible Assets’, the expenditure on research of new process design for its product ₹10 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. It is presumed that the entire expenditure is incurred in the financial year 2020-21. Hence, it should be written off as an expense in that year itself.

Cost of internally generated intangible asset – it is given that development phase expenditure amounting ₹8 lakhs incurred upto 31st March, 2021 meets asset recognition criteria. As per AS 26, for measurement of such internally generated intangible asset, fair value should be estimated by discounting estimated future net cash flows.

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

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

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

The difference of ₹0.418 lakhs (i.e. ₹8 lakhs – ₹7.582 lakhs) will be amortized by Plymouth for the financial year 2020-21.

Amortisation - The company can amortise ₹7.582 lakhs over a period of five years by charging ₹1.516 lakhs per annum from the financial year 2021-2022 onwards.

Question 24

Swift Limited acquired patent rights to manufacture Solar Roof Top Panels at a cost of ₹600 lacs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of future cash flows which are estimated as under:

Year	**1**	**2**	**3**	**4**	**5**
Cash Flows (₹ in lacs)	300	300	300	150	150

After 3rd year, it was estimated that the patents would have an estimated balance future life of 3 years and Swift Ltd. expected the estimated cash flow after 5th year to be ₹75 Lacs. Determine the amortization cost of the patent for each of the above years as per Accounting Standard 26.

(*Suggested, November, 2020*)

Answer

Amortization of cost of patent as per AS 26

Year	**Estimated future cash flow (₹ in lakhs)**	**Amortization Ratio**	**Amortized Amount (₹ in lakhs)**
1	300	.25	150
2	300	.25	150

Year	Estimated future cash flow (₹ in lakhs)	Amortization Ratio	Amortized Amount (₹ in lakhs)
3	300	.25	150
4	150	.10	60
5	150	.10	60
6	75	.05	30
		1.00	600

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (300: 300: 300: 150: 150).The unamortized amount of the patent after third year will be ₹150 lakh (600-450) which will be amortized in the ratio of revised estimated future cash flows (150:150:75 or 2:2:1) in the fourth, fifth and sixth year.

Question 25

M/s. Pasa Ltd. is developing a new production process. During the financial year ended 31st March, 2019, the total expenditure incurred on the process was ₹80 lakhs. The production process met the criteria for recognition as an intangible asset on 1st November, 2018. Expenditure incurred till this date was ₹42 lakhs.

Further expenditure incurred on the process for the financial year ending 31st March, 2020 was ₹90 lakhs. As on 31.03.2020, the recoverable amount of know how embodied in the process is estimated to be ₹82 lakhs. This includes estimates of future cash outflows and inflows.

You are required to work out:

(1) What is the expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2019 ?

(2) What is the carrying amount of the intangible asset as on 31st March, 2019?

(3) What amount of expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2020 ?

What is the carrying amount of the intangible asset as on 31st March, 2020?

(*Suggested, November, 2020*) (*5 marks*)

Answer

As per AS 26 ‘Intangible Assets’

(i) Expenditure to be charged to Profit and Loss account for the year ending 31.03.2019

₹42 lakhs is recognized as an expense because the recognition criteria were not met until 1st November, 2018. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the balance sheet.

(ii) Carrying value of intangible asset as on 31.03.2019

At the end of financial year, on 31st March 2019, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹38 (80-42) lakhs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st November 2018)

(iii) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2020

	(*₹ in lacs*)
Carrying Amount as on 31.03.2019	38
Expenditure during 2019 – 2020	90
Book Value	128
Recoverable Amount	(82)
Impairment loss to be charged to Profit and loss account	46

₹46 lakhs to be charged to Profit and loss account for the year ending 31.03.2020.

(iv) Carrying value of intangible asset as on 31.03.2020

	(*₹ in lacs*)
Book Value	128
Less: Impairment loss	(46)
Carrying amount as on 31.03.2020	82

Question 26

A Company acquired for its internal use a software on 01.03.2020 from U.K. for £ 1,50,000. The exchange rate on the date was as ₹100 per £. The seller allowed trade discount @ 2.5%. The other expenditures were:

(i) Import Duty 10%

(ii) Additional Import Duty 5%

(iii) Entry Tax 2% (Recoverable later from tax department).

(iv) Installation expenses ₹1,50,000.

(v) Professional fees for clearance from customs ₹50,000.

Compute the cost of software to be Capitalized as per relevant AS.

(*Suggested, January, 2021*) (*5 marks*)

Answer

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

Purchase cost of the software	£ 1,50,000
Less: Trade discount @ 2.5%	£ (3,750)
	£1,46,250
Cost in ₹(UK £1,46,250 x ₹100)	146,25,000
Add: Import duty on cost @ 10% (₹)	14,62,500
	160,87,500
Add: Additional import duty @ 5% (₹)	8,04,375
	168,91,875
Add: Installation expenses (₹)	1,50,000
Add: Professional fee for clearance from customs (₹)	50,000
Cost of the software to be capitalized (₹)	170,91,875

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

Question 27

During 2020-21, an enterprise incurred costs to develop and produce a routine low risk computer software product, as follows:

Particular	₹
Completion of detailed program and design (Phase 1)	50,000
Coding and Testing (Phase 2)	40,000
Other coding costs (Phase 3 & 4)	63,000
Testing costs (Phase 3 & 4)	18,000
Product masters for training materials (Phase 5)	19,500
Packing the products (1,500 units) (Phase 6)	16,500

After completion of phase 2, it was established that the product is technically feasible for the market. You are required to state how the above cost to be recognized in the books of accounts as per AS 26.

(*MTP*, *October 2021*) (*5 Marks*)

Answer

As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed program design or working model.

In this case, ₹90,000 would be recorded as an expense (₹50,000 for completion of detailed program design and ₹40,000 for coding and testing to establish technological feasibility/asset recognition criteria).

Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (63,000+ 18,000+ 19,500) = ₹1,00,500. Packing cost ₹16,500 should be recognized as expenses and charged to P & L A/c.

Question 28

A company is showing an intangible asset at ₹88 lakhs as on 01.04.2021. This asset was acquired for ₹120 lakhs on 01.04.2017 and the same was available for use from that date. The company has been following the policy of amortization of the intangible assets over a period of 15 years on straight line basis. Comment on the accounting treatment of the above with reference to the relevant Accounting Standard.

(*RTP November 2021*)

Answer

As per AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Company has been following the policy of amortization of the intangible asset over a period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS 26. Accordingly, the company would be required to restate the carrying amount of intangible asset as on 01.04.2021 at ₹72 lakhs i.e. ₹120 lakhs less ₹48 lakhs

$$\left(\frac{₹120\,\text{Lakhs}}{10\,\text{years}} \times ₹4\,\text{years} = 48\,\text{Lakhs}\right)$$

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

Question 29

(a) PQR Ltd. has acquired a Brand from another company for ₹100 lakhs. PQR Ltd. contends that since the said brand is a very popular and famous brand, no amortization needs to be provided. Comment on this in line with the Accounting Standards.

(b) X Ltd. is engaged in the business of newspaper and radio broadcasting. It operates through different brand names. During the year ended 31st March, 2021, it incurred substantial amount on business communication and branding expenses by participation in various corporate social responsibility initiatives. The company expects to benefit by this expenditure by attracting new customers over a period of time and accordingly it has capitalized the same under brand development expenses and intends to amortize the same over the period in which it expects the benefits to flow. As the accountant of the company do you concur with these views? You are required to explain in line with provisions of Accounting Standards.

(*RTP May, 2022*)

Answer

(a) AS 26 'Intangible Assets" provides that an intangible asset should be measured initially at cost. After initial recognition, an intangible asset should be carried at cost less any accumulated amortization and any accumulated impairment losses. The amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life for computing amortization. There is a rebuttable presumption that the useful life of an intangible asset will not exceed 10 years from the date when the asset is available for use. It must be ensured that the value of brand is amortized in accordance with AS 26, as brand is considered to be intangible asset. The contention of PQR Ltd. that Brand is very popular and famous, hence no amortization needs to be provided is not correct as there is no persuasive evidence that the useful life of the intangible asset will exceed 10 years.

(b) As per AS 26 on Intangible Assets, expenditure on an intangible item should be recognized as on expense when it is incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria. An intangible asset should be recognized if, and only if: (i) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and (ii) the cost of the asset can be measured reliably. In the given case, no intangible assets or other asset is acquired or created that can be recognized, the accounting treatment by the company to amortize the entire expenditure over the period in which it expects the benefits to flow is not correct and the same should be debited to the profit and loss statement during the year ended 31st March, 2021.

Question 30

Surgical Ltd. is developing a new production process. of surgical equipment. During the financial year ended 31st March, 2020 the total expenditure incurred on the process was ₹67 lakhs. The production process met the criteria. for recognition as an intangible assets on 1st January, 2020. Expenditure incurred till this date was ₹35 lakhs.

Further expenditure incurred on the process for the financial year ending 31st March, 2021 was ₹105 lakhs. As on 31st March, 2021, the recoverable amount of technique embodied in the process is estimated to be ₹89 lakhs. This includes estimates of future cash outflows and inflows.

Under the provisions of AS 26, you are required to ascertain:

(i) The expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2020;

(ii) Carrying amount of the intangible asset as on 31st March, 2020;

(iii) Expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2021;

(iv) Carrying amount of the intangible asset as on 31st March, 2021.

(*Question Paper of December 2021*) *(5 Marks)*

Answer:

As per AS 26 'Intangible Assets'

(i) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2020

₹35 lakhs is recognized as an expense because the recognition criteria were not met until 1stJanuary 2020. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the balance sheet.

(ii) Carrying value of intangible asset as on 31.03.2020

At the end of financial year, on 31st March 2020, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹32 (67-35) lacs (expenditure incurred since the date the recognition criteria were met, i.e., from 1stJanuary 2020).

(iii) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2021

	(₹ in lacs)
Carrying Amount as on 31.03.2020	32
Expenditure during 2020 – 2021	105
Book Value	137
Recoverable Amount	(89)
Impairment loss	48

₹48 lakhs to be charged to Profit and loss account for the year ending 31.03.2021.

(iv) Carrying value of intangible asset as on 31.03.2021

	(₹ in lacs)
Book Value	137
Less: Impairment loss	(48)
Carrying amount as on 31.03.2021	89

Question 31

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

Further expenditure incurred on the process for the Financial Year ending 31st March, 2014 was ₹90 lacs. As on 31.03.2014, the recoverable amount of know-how embodied in the process is estimated to be ₹82 lacs. This includes estimates of future cash outflows and inflows.

You are required to work out:

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

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

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

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

(*May, 2015, 5 Marks*)

Answer

As per AS 26 'Intangible Assets'

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

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

(ii) **Carrying value of intangible asset as on 31.03.2013**

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

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

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

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

(iv) **Carrying value of intangible asset as on 31.03.2014**

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

Question 32

A Company with a turnover of ₹375 crores and an annual advertising budget of ₹3 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹37.5 crores from the new product. The Company had debited to its Profit and Loss account and total expenditure of ₹3 crores incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the Company correct? (*November, 2016, 5 Marks*)

Answer

According to AS 26 'Intangible Assets', "expenditure on an intangible item should be recognized as an expense when it is incurred unless it forms part of the cost of an intangible asset".

In the given case, advertisement expenditure of ₹3 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹37.5 crores. Here, no intangible asset or another asset is acquired or created that can be recognized.

Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹3 crores to the Profit and Loss account of the year is correct.

Question 33

K Ltd. launched a project for producing product X in October, 2021. The Company incurred ₹ 40 lakhs towards Research and Development expenses upto 31st March, 2022. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.

Advise the Company as per the applicable Accounting Standard.

(*RTP November, 2022*)

Answer

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

Hence, the expenses amounting ₹ 40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2022.

Question Arrangement

AS 26

Topic	Question Numbers
Deferred Expenditures	2, 3, 10, 13, 17, 33, 16, 32
Purchase of Intangible Assets	26
Internally Generated Intangible Assets	23, 25, 30, 31, 11, 27, 29
Trademark Expenses	21
Amortisation	1, 22, 28, 9, 12, 15, 19, 20, 24, 14
Theory	4, 5, 6, 7, 8
Mix	18

Accounting Standard 28
Impairment of Assets

Question 1

Ergo Industries Ltd. gives the following estimates of cash flows relating to Property, Plant and Equipment on 31-12-20X1. The discount rate is 15%.

Year	***Cash Flow (₹ in lakhs)***
20X2	*4000*
20X3	*6000*
20X4	*6000*
20X5	*8000*
20X6	*4000*

Residual value at the end of 20X6	=	*₹1000 lakhs*
Property, Plant and Equipment purchased on 1-1-20XX	=	*₹40,000 lakhs*
Useful life	=	*8 years*
Net selling price on 31-12-20X1	=	*₹20,000 lakhs*

Calculate on 31-12-20X1:

(a) Carrying amount at the end of 20X1
(b) Value in use on 31-12-20X1
(c) Recoverable amount on 31-12-20X1
(d) Impairment loss to be recognized for the year ended 31-12-20X1
(e) Revised carrying amount
(f) Depreciation charge for 20X2.

Note: *The year 20XX is the immediate preceding year before the year 20X0.*

(*Source: Illustration 1, Study Material*)

Answer

Calculation of value in use

Year	***Cash Flow***	***Discount as per 15%***	***Discounted cash flow***
20X2	4,000	0.870	3,480
20X3	6,000	0.756	4,536
20X4	6,000	0.658	3,948
20X5	8,000	0.572	4,576
20X6	4,000	0.497	1,988
20X6	(residual) 1,000	0.497	497
			19,025

(a) Calculation of carrying amount:

Original cost = ₹40,000 lakhs

Depreciation for 3 years = [(40,000-1000) ×3/8] = ₹14,625 lakhs

Carrying amount on 31-12-20X1 = [40,000-14,625] = ₹25,375 lakhs

(b) Value in use = ₹19,025 lakhs

(c) Recoverable amount = higher of value in use and net selling price i.e. ₹20,000 lakhs.

Recoverable amount = ₹20,000 lakhs

(d) **Impairment Loss** = ₹(25,375-20,000) = ₹5,375 lakhs

(e) **Revised carrying amount** = ₹(25,375-5,375) = ₹20,000 lakhs

(f) **Depreciation charge for 20X2** = (20,000-1000)/5 = ₹3,800 lakhs

Question 2

X Ltd. is having a plant (asset) carrying amount of which is ₹100 lakhs on 31.3.20X1. Its balance useful life is 5 years and residual value at the end of 5 years is ₹5 lakhs. Estimated future cash flow from using the plant in next 5 years are:

For the year ended on	Estimated cash flow (₹ in lakhs)
31.3.20X2	50
31.3.20X3	30
31.3.20X4	30
31.3.20X5	20
31.3.20X6	20

Calculate "value in use" for plant if the discount rate is 10% and also calculate the recoverable amount if net selling price of plant on 31.3.20X1 is ₹60 lakhs.

(*Source: Illustration 2, Study Material*)

Answer

Present value of future cash flow

Year ended	***Future Cash Flow***	***Discount @ 10% Rate***	***Discounted cash flow***
31.3.20X2	50	0.909	45.45
31.3.20X3	30	0.826	24.78
31.3.20X4	30	0.751	22.53
31.3.20X5	20	0.683	13.66
31.3.20X6	20	0.620	12.40
			118.82
Present value of residual price on 31.3.20X6 = 5 × 0.620			3.10
Present value of estimated cash flow by use of an asset and residual value, which is called "value in use".			121.92

If net selling price of plant on 31.3.20X1 is ₹60 lakhs, the recoverable amount will be higher of ₹121.92 lakhs (value in use) and ₹60 lakhs (net selling price), hence recoverable amount is ₹121.92 lakhs.

Question 3

G Ltd., acquired a machine on 1st April, 20X0 for ₹7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 20X4, the carrying value of the machine was reassessed at ₹5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March, 20X6, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only ₹79 lakhs. You are required to calculate the loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd. G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

(*Source: Illustration 3, Study Material*)

Answer

Statement Showing Impairment Loss

		(₹ in crores)
Carrying amount of the machine as on 1st April, 20X0		7.00
Depreciation for 4 years i.e. 20X0-20X1 to 20X3-20X $\frac{7 \text{ crores}}{7 \text{ years}} \times 4 \, years$		(4.00)
Carrying amount as on 31.03.20X4		3.00
Add: Upward Revaluation (credited to Revaluation Reserve account)		2.10
Carrying amount of the machine as on 1st April, 20X4 (revalued)		5.10
Less: Depreciation for 2 years i.e. 20X4-20X5& 20X5-20X6 $\frac{5.10 \text{ crores}}{3 \text{ years}} \times 3 \text{ years}$		(3.40)
Carrying amount as on 31.03.20X6		1.70
Less: Recoverable amount		(0.79)
Impairment loss		0.91
Less: Balance in revaluation reserve as on 31.03.20X6:		
Balance in revaluation reserve as on 31.03.20X4		2.10
Less: Enhanced depreciation met from revaluation reserve 20X4-20 X 5 & 20X5-20 X 6 = [(1.70 – 1.00) x 2 years]	(1.40)	
Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 “Impairment of Assets”		(0.70)
Impairment Loss to be debited to profit and loss account		0.21

Question 4

X Ltd. purchased a Property, Plant and Equipment four years ago for ₹150 lakhs and depreciates it at 10% p.a. on straight line method. At the end of the fourth year, it has revalued the asset at ₹75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of revaluation, the market price is ₹67.50 lakhs and expected disposal costs are ₹3 lakhs. What will be the treatment in respect of impairment loss on the basis that fair value for revaluation purpose is determined by market value and the value in use is estimated at ₹60 lakhs?

(*Source: Illustration 4, Study Material*)

Answer

Treatment of Impairment Loss

As per para 57 of AS 28 “Impairment of assets”, if the recoverable amount (higher of net selling price and its value in use) of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. In the given case, net selling price is ₹64.50 lakhs (₹67.50 lakhs – ₹3 lakhs) and value in use is ₹60 lakhs. Therefore, recoverable amount will be ₹64.50 lakhs. Impairment loss will be calculated as ₹10.50 lakhs [₹75 lakhs (Carrying Amount after revaluation - Refer Working Note) less ₹64.50 lakhs (Recoverable Amount)].

Thus impairment loss of ₹10.50 lakhs should be recognised as an expense in the Statement of Profit and Loss immediately since there was downward revaluation of asset which was already charged to Statement of Profit and Loss.

Working Note:

Calculation of carrying amount of the Property, Plant and Equipment at the end of the fourth year on revaluation

	(₹ in lakhs)
Purchase price of a Property, Plant and Equipment	150.00
Less: Depreciation for four years [(150 lakhs / 10 years) x 4 years]	(60.00)
Carrying value at the end of fourth year	90.00
Less: Downward revaluation charged to profit and loss account	(15.00)
Revalued carrying amount	75.00

Question 5

Write short note on impairment of asset and its application to inventory.

(*Source: Question 5, Study Material*)

Answer

The objective of AS 28 'Impairment of Assets' is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this Standard requires the enterprise to recognize an impairment loss.

- If carrying amount < = Recoverable amount : Asset is not impaired
- If carrying amount > Recoverable amount : Asset is impaired Impairment Loss = Carrying Amount – Recoverable Amount

Recoverable amount is the higher of net selling price and its value in use This standard should be applied in accounting for the impairment of all assets, other than (i) inventories (AS 2, Valuation of Inventories); (ii) assets arising from construction contracts (AS 7, Accounting for Construction Contracts); (iii) financial assets, including investments that are included in the scope of AS 13, Accounting for Investments; and (iv) deferred tax assets (AS 22, Accounting for Taxes on Income). AS 28 does not apply to inventories, assets arising from construction contracts, deferred tax assets or investments because other accounting standards applicable to these assets already contain specific requirements for recognizing and measuring the impairment related to these assets.

Question 6

A publisher owns 150 magazine titles of which 70 were purchased and 80 were self-created. The price paid for a purchased magazine title is recognized as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognized as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for each magazine title. Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economic lives and replace them immediately with new titles for the same customer segment. What is the cash-generating unit for an individual magazine title?

(*Source: Question 6, Study Material*)

Answer

It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other titles in the customer segment, cash inflows from direct sales and advertising are identifiable for each title. In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis.

Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent of each other and that each magazine title is a separate cash-generating unit.

Question 7

An asset does not meet the requirements of environment laws which have been recently enacted. The asset has to be destroyed as per the law. The asset is carried in the Balance Sheet at the year end at ₹6,00,000. The estimated cost of destroying the asset is ₹70,000. How is the asset to be accounted for?

(*Source: Question 7, Study Material*)

Answer

As per AS 28 "Impairment of Assets", impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount, where recoverable amount is the higher of an asset's net selling price* and its value in use**. In the given case, recoverable amount will be nil [higher of value in use (nil) and net selling price (negative ₹70,000)]. Thus impairment loss will be calculated as ₹6,00,000 [carrying amount (₹6,00,000) – recoverable amount (nil)]. Therefore, asset is to be fully impaired and impairment loss of ₹6,00,000 has to be recognized as an expense immediately in the statement of Profit and Loss as per para 58 of AS 28.

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* *Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. In the given case, Net Selling Price = Selling price – Cost of disposal = Nil – ₹70,000 = (₹70,000)*

** *Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. In the given case, value in use is nil.*

Further, as per para 60 of AS 28, When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an enterprise should recognise a liability if, and only if, that is required by another Accounting Standard. Hence, the entity should recognize liability for cost of disposal of ₹70,000 as per AS 10 & 29.

Question 8

Venus Ltd. has a fixed asset, which is carried in the Balance Sheet on 31.3.20X1 at ₹500 lakhs. As at that date the value in use is ₹400 lakhs and the net selling price is ₹375 lakhs.

From the above data:

(i) Calculate impairment loss.

(ii) Prepare journal entries for adjustment of impairment loss.

(iii) Show, how impairment loss will be shown in the Balance Sheet.

(*Source: Question 8, Study Material*)

Answer

(i) Recoverable amount is higher of value in use ₹400 lakhs and net selling price ₹375 lakhs.

Recoverable amount = ₹400 lakhs

Impairment loss = Carried Amount – Recoverable amount

= ₹500 lakhs – ₹400 lakhs = ₹100 lakhs.

(ii) Journal Entries

	Particulars	**Dr. Amount (₹ in lakhs)**	**Cr. Amount (₹ in lakhs)**
(i)	Impairment loss account Dr.	100	
	To Provision for Accumulated Impairment Loss Account		100
	(Being the entry for accounting impairment loss)		
(ii)	Profit and loss account Dr.	100	
	To Impairment loss		100
	(Being the entry to transfer impairment loss to profit and loss account)		

(iii) Balance Sheet of Venus Ltd. as on 31.3.20X1

	(₹ in lakhs)
Fixed Asset	
Asset less depreciation	500
Less: Impairment loss	(100)
	400

Question 9

Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 20X1 for ₹60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 20X1-20X2 the carrying amount was ₹41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch ₹36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of ₹54 crore per annum and has a carrying amount of ₹3.46 crore. All such machines put together could fetch a sum of ₹4.44 crore if disposed. Discuss the applicability of Impairment loss.

(*Source: Question 9, Study Material*)

Answer

As per provisions of AS 28 "Impairment of Assets", impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit which is group of asset to which the damaged machine belongs is not impaired; and the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.

Question 10

From the following details of an asset

(i) Find out impairment loss

(ii) Treatment of impairment loss

(iii) Current year depreciation Particulars of asset:

Cost of asset	₹56 lakhs
Useful life period	10 years
Salvage value	Nil
Current carrying value	₹27.30 lakhs
Useful life remaining	3 years
Recoverable amount	₹12 lakhs
Upward revaluation done in last year	₹14 lakhs

(*Source: Question 10, Study Material*)

Answer

According to AS 28 "Impairment of Assets", an impairment loss on a revalued asset is recognised as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

Impairment Loss and its treatment	₹
Current carrying amount (including revaluation amount of ₹14 lakhs)	27,30,000
Less: Current recoverable amount	(12,00,000)
Impairment Loss	15,30,000
Impairment loss charged to revaluation reserve	14,00,000
Impairment loss charged to profit and loss account	1,30,000

After the recognition of an impairment loss, the depreciation (amortization) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

In the given case, the carrying amount of the asset will be reduced to

₹12,00,000 after impairment. This amount is required to be depreciated over remaining useful life of 3 years (including current year). Therefore, the depreciation for the current year will be ₹4,00,000.

Question 11

A plant was acquired 15 years ago at a cost of ₹5 crores. Its accumulated depreciation as at 31st March, 20X1 was ₹4.15 crores. Depreciation estimated for the financial year 20X1-20X2 is ₹25 lakhs. Estimated Net Selling Price as on 31st March, 20X1 was ₹30 lakhs, which is expected to decline by 20 per cent by the end of the next financial year.

Its value in use has been computed at ₹35 lakhs as on 1st April, 20X1, which is expected to decrease by 30 per cent by the end of the financial year.

(i) Assuming that other conditions for applicability of the impairment Accounting Standard are satisfied, what should be the carrying amount of this plant as at 31st March, 20X2?

(ii) How much will be the amount of write off for the financial year ended 31st March, 20X2?

(iii) If the plant had been revalued ten years ago and the current revaluation reserves against this plant were to be ₹12 lakhs, how would you answer to questions (i) and (ii) above?

(iv) If the value in use was zero and the enterprise were required to incur a cost of ₹2 lakhs to dispose of the plant, what would be your response to questions (i) and (ii) above?

(*Source: Question 11, Study Material*)

Answer

As per AS 28 "Impairment of Assets", if the recoverable amount[1] of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount and that reduction is an impairment loss. An impairment loss on a revalued asset is recognized as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

In the given case, recoverable amount (higher of asset's net selling price and value in use) will be ₹24.5 lakhs on 31.3.20X2 according to the provisions of AS 28 [Refer working note].

		(₹ in lakhs)
(i)	Carrying amount of plant (after impairment) as on 31st March, 20X2	24.50
(ii)	Amount of write off (impairment loss) for the financial year ended 31st March, 20X2 [₹60 lakhs – ₹24.5 lakhs]	35.50
(iii)	If the plant had been revalued ten years ago	
	Debit to revaluation reserve	12.00
	Amount charged to profit and loss account (₹35.50 lakhs – ₹12 lakhs)	23.50
(iv)	If Value in use is zero	
	Value in use (a)	Nil
	Net selling price (b)	(-)2.00
	Recoverable amount [higher of (a) and (b)]	Nil
	Carrying amount (closing book value)	Nil
	Amount of write off (impairment loss) (₹60 lakhs – Nil)	60.00
	Entire book value of plant will be written off and charged to profit and loss account.	

Working Note:

Calculation of Closing Book Value, Estimated Net Selling Value and Estimated Value in Use of Plant at 31st March, 20X2

	(₹ in lakhs)
Opening book value as on 1.4.20X1 (₹500 lakhs – ₹415 lakhs)	85
Less: Depreciation for financial year 20X1–20X2	(25)
Closing book value as on 31.3.20X2	60
Estimated net selling price as on 1.4.20X1	30
Less: Estimated decrease during the year (20% of ₹30 lakhs)	(6)
Estimated net selling price as on 31.3.20X2	24
Estimated value in use as on 1.4.20X1	35.0
Less: Estimated decrease during the year (30% of ₹35 lakhs)	(10.5)
Estimated value in use as on 31.3.20X2	24.5

1 Recoverable amount is the higher of an asset's net selling price and its value in use.

Question Arrangement

AS 28

Topic	Question Numbers
Calculation of Impairment Loss	1, 3, 4, 8, 9, 10, 11
Calculation of Value in Use	2
Identification of Cash Generating Units	6
Negative Recoverable Amount	7
Theory	5

Accounting Standard 15
Employee Benefits

Question 1

What are the kinds of employees covered in the revised AS 15 and whether a formal employer employee relationship is necessary or not, for benefits to be covered under the Standard?

(*Source: Illustration 1, Study Material*)

Answer

The Standard does not define the term "employee". Paragraph 6 of the Standard states that 'an employee may provide services to an enterprise on a full time, part time, permanent, casual or temporary basis and the term would also include the whole-time directors and other management personnel. The Standard is applicable to all forms of employer employee relationships. There is no requirement for a formal employer employee relationship. Several factors need to be considered to determine the nature of relationship.

Generally, 'outsourcing contracts' may not meet the definition of employer - employee relationship. However, such contracts need to be carefully examined to distinguish between a "contract of service" and a "contract for services". A 'contract for services' implies a contract for rendering services, e.g., professional or technical services which is subject to limited direction and control whereas a 'contract of service' implies a relationship of an employer and employee, and the person is obliged to obey orders in the work to be performed and as to its mode and manner of performance.

Question 2

Whether an enterprise is required to provide for employee benefits arising from informal practices?

(*Source: Illustration 2, Study Material*)

Answer

Paragraph 3(c) of the Standard defines employee benefits to include those informal practices that give rise to an obligation where the enterprise has no realistic alternative but to pay employee benefits. The historical pattern of granting such benefits, the expectation created and the impact on the relationship with employees in the event such benefit is withdrawn should be considered in determining whether the informal practice gives rise to a benefit covered by the Standard. For example, where an employer has a practice of making a lumpsum payment on occasion of a festival or regularly grants advances against informal benefits to employees it would be necessary to provide for such benefits.

Careful judgement should be applied in assessing whether an obligation has arisen particularly in instances where an enterprise's practice is to provide improvements only during the collective bargaining process and not during any informal process. If the employer has not set a pattern of benefits that can be projected reliably to give rise to an obligation there is no requirement to provide for the benefits.

However, if the practice established by an employer was that of a consistent benefit granted either as part of union negotiations or otherwise that clearly established a pattern (e.g., a cost of living adjustment or fixed rupee increase), it could be concluded that an obligation exists and that those additional benefits should be included in the measurement of the benefit obligation.

Employee benefits include:

(a) Short-term employee benefits (e.g., wages, salaries, paid annual leave and sick leave, profit sharing bonuses etc. (payable within 12 months of the year-end) and non-monetary benefits for current employees.

(b) Post-employment benefits (e.g., gratuity, pension, provident fund, post- employment medical care etc.).

(c) long-term employee benefits (e.g., long-service leave, long-term disability benefits, bonuses not wholly payable within 12 months of the year end etc.), and

(d) termination benefits (e.g. VRS payments)

The Standard lays down recognition and measurement criteria and disclosure requirements for the above four types of employee benefits separately.

Question 3

Entity XY is required to pay salary of ₹ 2 crore for the year 20X1-X2. It actually paid a salary of ₹ 1.90 crore up to 31st March 20X2, and balance in April 20X2. Determine the actual costs to be recognized in the year 20X1-X2 and any amounts to be shown through balance sheet.

(*Source: Illustration 3, Study Material*)

Answer

Total expense for the year (20X1-X2)	₹ 2 crore
Amount to be shown under liability (unpaid)	₹ 2 crore – 1.90 ₹crore
	= ₹ 10 lakhs

Question 4

Whether an entitlement to earned leave which can be carried forward to future periods is a short -term employee benefit or a long-term employee benefit.

(*Source: Illustration 4, Study Material*)

Answer

Paragraph 7.2 of the Standard defines 'Short-term' benefits as employee benefits (other than termination benefits) which fall due wholly within twelve months after the end of the period in which the employees render the related service. Paragraph 8(b) of the Standard illustrates the term 'Short -term benefits' to include "short term compensated absences (such as paid annual leave) where the absences are expected to occur within twelve months after the end of the period in which the employees render the related employee service".

Paragraph 7.2 of the Standard uses "falls due" as the basis, paragraph 8(b) of the Standard uses "expected to occur" as the basis to illustrate classification of short term compensated absences. A reading of paragraph 8(b) together with paragraph 7.2 would imply that the classification of short -term compensated absences should be only when absences have "fallen due" and are also "expected to occur". In other words, where employees are entitled to earned leave which can be carried forward to future periods, the benefit would be a 'short-term benefit' provided the employee is entitled to either encash or utilise the benefit during the twelve months after the end of the period when the employee became entitled to the leave and is also expected to utilise the leave.

Where there are restrictions on encashment and/or availment, clearly the compensated absence has not fallen due and the benefit of compensated absences is more likely to be a long-term benefit. For example, where an employee has 100 days of earned leave which he is entitled to an unlimited carry forward, but the rules of the enterprise allow him to encash/utilise only 30 days during the next twelve months, the benefit would be considered as a 'long-term' benefit. In some situations, where there is no restriction but the absence is not expected to wholly occur in the next twelve months, the benefit should be considered as 'long-term'. For example, where an employee has 400 days carry forward earned leave and the past pattern indicates that the employees are unlikely to avail / encash the entire carry forward during the next twelve months, the benefit would not be 'short-term'.

Whilst it is necessary to consider the earned leave which "falls due", the pattern of actual utilisation/ encashment by employees, although reflective of the behavioural pattern of employees, does determine the status of the benefit, i.e., whether 'short-term' or 'long-term'. The value of short-term benefits should be determined without discounting and if the benefit is determined as long-term, it would be recognised and measured as "Other long-term benefits" in accordance with paragraph 129 of the Standard.

The categorisation in 'short-term' or 'long-term' employee benefits should be done on the basis of the overall behavioural pattern of all the employees of the enterprise and not on individual basis.

Question 5

In case an enterprise allows unutilised employee benefits, e.g., medical care, leave travel, etc., to be carried forward, whether it is required to recognise a provision in respect of carried forward benefits.

(*Source: Illustration 5, Study Material*)

Answer

A provision should be recognised for all benefits (conditional or unconditional) which an employee becomes entitled to as a result of rendering of the service and should be recorded as part of the cost of service rendered during the period in which the service was rendered which resulted the entitlement. In estimating the cost of such benefit the probability of the employee availing such benefit should be considered.

Question 6

Omega Limited belongs to the engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of ₹ 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 2 lakhs instead of ₹ 5 lakhs. The average remaining life of the employees is estimated to be 6 years. You are required to advise the company on the following items from the viewpoint of finalization of accounts, taking note of the mandatory accounting standards.

(*Source: Illustration 6, Study Material*)

Answer

According to AS 15 (Revised 2005) 'Employee Benefits', actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense. Therefore, surplus amount of ₹ 6 lakhs is required to be credited to the profit and loss statement of the current year.

Question 7

As on 1st April, 20X1 the fair value of plan assets was ₹ 1,00,000 in respect of a pension plan of Zeleous Ltd. On 30th September, 20X1 the plan paid out benefits of

₹ 19,000 and received inward contributions of ₹ 49,000. On 31st March, 20X2 the fair value of plan assets was ₹ 1,50,000 and present value of the defined benefit obligation was ₹ 1,47,920. Actuarial losses on the obligations for the year 20X1- 20X2 were ₹ 600.

On 1st April, 20X1, the company made the following estimates, based on its market studies, understanding and prevailing prices.

	%
Interest & dividend income, after tax payable by the fund	*9.25*
Realised and unrealised gains on plan assets (after tax)	*2.00*
Fund administrative costs	*(1.00)*
Expected Rate of Return	*10.25*

You are required to find the expected and actual returns on plan assets.

(*Source: Illustration 7, Study Material*)

Answer

Computation of Expected and Actual Returns on Plan Assets

		₹
Return on ₹ 1,00,000 held for 12 months at 10.25%		10,250
Return on ₹ 30,000 (49,000-19,000) held for six months at 5% (equivalent to 10.25% annually, compounded every six months)		1,500
Expected return on plan assets for 20X1-20X2		11,750
Fair value of plan assets as on 31 March, 20X2		1,50,000
Less: Fair value of plan assets as on 1 April,20X1	1,00,000	
Contributions received	49,000	(1,49,000)
		1,000
Add: Benefits paid		19,000
Actual return on plan assets		20,000

Alternatively, the above question may be solved without giving compound effect to rate of return.

Question 8

Rock Star Ltd. discontinues a business segment. Under the agreement with employee's union, the employees of the discontinued segment will earn no further benefit. This is a curtailment without settlement, because employees will continue to receive benefits for services rendered before discontinuance of the business segment. Curtailment reduces the gross obligation for various reasons including change in actuarial assumptions made before curtailment. If the benefits are determined based on the last pay drawn by employees, the gross obligation reduces after the curtailment because the last pay earlier assumed is no longer valid.

Rock Star Ltd. estimates the share of unamortized service cost that relates to the part of the obligation at ₹ 18 (10% of ₹ 180). Calculate the gain from curtailment and liability after curtailment to be recognised in the balance sheet of Rock Star Ltd. on the basis of given information:

- *(a) Immediately before the curtailment, gross obligation is estimated at ₹ 6,000 based on current actuarial assumption.*
- *(b) The fair value of plan assets on the date is estimated at ₹ 5,100.*
- *(c) The unamortized past service cost is ₹ 180.*
- *(d) Curtailment reduces the obligation by ₹ 600, which is 10% of the gross obligation.*

(*Source: Illustration 8, Study Material*)

Answer

Gain from curtailment is estimated as under:

	₹
Reduction in gross obligation	600
Less: Proportion of unamortised past service cost	(18)
Gain from curtailment	582

The liability to be recognised after curtailment in the balance sheet is estimated as under:

	₹
Reduced gross obligation (90% of ₹ 6,000)	5,400
Less: Fair value of plan assets	(5,100)
	300
Less: Unamortised past service cost (90% of ₹ 180)	(162)
Liability to be recognised in the balance sheet	138

Question 9

An employee Roshan has joined a company XYZ Ltd. in the year 20X1. The annual emoluments of Roshan as decided is ₹ 14,90,210. The company also has a policy of giving a lump sum payment of 25% of the last drawn annual salary of the employee for each completed year of service if the employee retires after completing minimum 5 years of service. The salary of the Roshan is expected to grow @ 10% per annum.

The company has inducted Roshan in the beginning of the year and it is expected that he will complete the minimum five year term before retiring. Thus he will get 5 yearly increment.

What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined Benefit obligation? Also calculate the current service cost and the interest cost to be charged per year assuming a discount rate of 8%.

(P.V factor for 8% - 0.735, 0.794, 0.857, 0.926, 1)

(*Source: Illustration 9, Study Material*)

Answer

Calculation of Defined Benefit Obligation (DBO)

Expected last drawn salary = ₹ 14,90,210 x 110% x 110% x 110% x 110% x 110%

= ₹ 24,00,000

Defined Benefit Obligation (DBO) = ₹ 24,00,000 x 25% x 5 = ₹ 30,00,000

Amount of ₹ 6,00,000 will be charged to Profit and Loss Account of the company every year as cost for Defined Benefit Obligation.

Calculation of Current Service Cost

Year	Equal apportioned amount of DBO [i.e. ₹ 30,00,000/5 years]	Discounting @ 8% PV factor	Current service cost (Present Value)
a	b	c	d = b x c
1	6,00,000	0.735 (4 Years)	4,41,000
2	6,00,000	0.794 (3 Years)	4,76,400
3	6,00,000	0.857 (2 Years)	5,14,200
4	6,00,000	0.926 (1 Year)	5,55,600
5	6,00,000	1 (0 Year)	6,00,000

Calculation of Interest Cost to be charged per year

Year	***Opening balance***	***Interest cost***	***Current service cost***	***Closing balance***
a	**b**	**c = b x 8%**	**d**	**e = b + c + d**
1	0	0	4,41,000	4,41,000
2	4,41,000	35,280	4,76,400	9,52,680
3	9,52,680	76,214	5,14,200	15,43,094
4	15,43,094	1,23,447	5,55,600	22,22,141
5	22,22,141	1,77,859*	6,00,000	30,00,000

*Due to approximations used in calculation, this figure is adjusted accordingly.

Question 10

What are the types of Employees benefits and what is the objective of Introduction of this Standard i.e. AS 15?

Answer

There are four types of employee benefits according to AS 15 (Revised 2005). They are:

(a) short-term employee benefits, such as wages, salaries and social security contributions (e.g., contribution to an insurance company by an employer to pay for medical care of its employees), paid annual leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

(b) post-employment benefits such as gratuity, pension, other retirement benefits, post-employment life insurance and post-employment medical care;

(c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation; and

(d) termination benefits.

Because each category identified in (a) to (d) above has different characteristics, this Statement establishes separate requirements for each category.

The objective of AS 15 is to prescribe the accounting and disclosure for employee benefits. The statement requires an enterprise to recognise:

(a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

(b) an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Question 11

A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food and stay during the travel. Alternatively, employees can claim a lump sum amount equal to one month pay last drawn.

The company's contentions in this matter are:

(i) Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.

(ii) Since it is not related to the length of service of the employees, it is accounted for on claim basis.

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer.

Answer

The present case falls under the category of defined benefit scheme under Para 49 of AS 15 (Revised) "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. Thus,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15 (Revised).

(2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

Question 12

The following data apply to 'X' Ltd. defined benefit pension plan for the year ended 31.03.20X2 calculate the actual return on plan assets:

- Benefits paid	*2,00,000*
- Employer contribution	*2,80,000*
- Fair market value of plan assets on 31.03.20X2	*11,40,000*
- Fair market value of plan assets as on 31.03.20X1	*8,00,000*

Answer

	₹
Fair value of plan assets on 31.3.20X1	8,00,000
Add: Employer contribution	2,80,000
Less: Benefits paid	(2,00,000)
(A)	8,80,000
Fair market value of plan assets at 31.3.20X2 (B)	11,40,000
Actual return on plan assets (B-A)	2,60,000

Question 13

The fair value of plan assets of Anupam Ltd. was ₹ 2,00,000 in respect of employee benefit pension plan as on 1st April, 20X1. On 30th September, 20X1 the plan paid out benefits of ₹ 25,000 and received inward contributions of ₹ 55,000. On 31st March, 20X2 the fair value of plan assets was ₹ 3,00,000. On 1st April, 20X1 the company made the following estimates, based on its market studies and prevailing prices.

	%
Interest and dividend income (after tax) payable by fund	*10.25*
Realized gains on plan assets (after tax)	*3.00*
Fund administrative costs	*(3.00)*
Expected rate of return	*10.25*

Calculate the expected and actual returns on plan assets as on 31 st March, 20X2, as per AS 15.

Answer

Computation of Expected Returns on Plan Assets as on 31st March, 20X2, as per AS 15

	₹
Return on opening value of plan assets of ₹ 2,00,000 (held for the year) @ 10.25%	20,500
Add: Return on net gain of ₹ 30,000 (i.e. ₹ 55,000 – ₹ 25,000) during the year i.e. held for six months @ 5% (equivalent to 10.25% annually, compounded every six months)	1,500
Expected return on plan assets as on 31st March, 20X2	22,000

Computation of Actual Returns on Plan Assets as on 31st March, 20X2, as per AS 15

	₹	₹
Fair value of Plan Assets as on 31st March, 20X2		3,00,000
Less: Fair value of Plan Assets 1st April, 20X1 as on	(2,00,000)	
Add: Contribution received as 30th September, 20X1 on	55,000	(2,55,000)
		45,000
Add: Benefits paid as on 30th September, 20X1		25,000
Actual returns on Plan Assets an on 31st March, 20X2		70,000

Question Arrangement

AS 15

Topic	Question Numbers
Short-term Employee Benefits	3
Long-term Employee Benefits, Ex Losses	7
Plan Assets Calculation of Return	7, 12, 13
Curtailment	8
Preparation of Liability Sheet	9, 1, 10, 2, 4, 5, 11

Accounting Standard 29 (Revised) Provisions, Contingent Liabilities and Contingent Assets

Question 1

At the end of the financial year ending on 31st December, 20X1, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

	Probability	*Loss (₹)*
In respect of five cases (Win)	*100%*	
Next ten cases (Win)	*50%*	
Lose (Low damages)	*40%*	*1,20,000*
Lose (High damages)	*10%*	*2,00,000*
Remaining five cases		
Win	*50%*	
Lose (Low damages)	*30%*	*1,00,000*
Lose (High damages)	*20%*	*2,10,000*

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof.

Answer

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

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

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

(iii) The possibility of an outflow of resources embodying economic benefits is not remote.

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

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 50% and for remaining five cases is 50%. As per AS 29 (Revised), we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is remote, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 40% of ₹ 1,20,000 + 10% of ₹ 2,00,000
= ₹ 48,000 + ₹ 20,000 = ₹ 68,000

Expected loss in remaining five cases = 30% of ₹ 1,00,000 + 20% of ₹ 2,10,000
= ₹ 30,000 + ₹ 42,000 = ₹ 72,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of ₹ 10,40,000 (₹ 68,000 × 10 + ₹ 72,000 × 5) as contingent liability.

Question 2

EXOX Ltd. is in the process of finalising its accounts for the year ended 31st March, 20X2. The company seeks your advice on the following:

(i) The Company's sales tax assessment for assessment year 20X1-X2 has been completed on 14th February, 20X4 with a demand of ₹ 2.76 crore. The company paid the entire due under protest without prejudice to its right of appeal. The Company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore.

(ii) The Company has entered into a wage agreement in May, 20X2 whereby the labour union has accepted a revision in wage from June, 20X1. The agreement provided that the hike till May, 20X2 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September, 20X2.

Answer

(i) Since the company is not appealing against the addition of ₹ 0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 20X4. The amount paid under protest can be kept under the heading 'Loans & Advances' and disclosed as a contingent liability of ₹ 2.10 crore.

(ii) The arrears for the period from June, 20X1 to March, 20X2 are required to be provided for in the accounts of the company for the year ended on 31st March, 20X2.

Question 3

When should provision be recognized as per provisions of AS 29? Explain in brief.

Answer

A provision should be recognised only when: (a) An enterprise has a present obligation as a result of a past event; (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) A reliable estimate can be made of the amount of the obligation.

Question 4

Sun Ltd. has entered into a sale contract of ₹ 5 crores with X Ltd. during 20X1-20X2 financial year. The profit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 20X2-20X3 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of ₹ 1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 20X1-20X2 financial year. As on balance sheet date (31.3.20X2), the goods were not manufactured, and it was unlikely that Sun Ltd. will be able to meet the contractual obligation.

(i) Should Sun Ltd. provide for contingency as per AS 29?

(ii) Should provision be measured as the excess of compensation to be paid over the profit?

Answer

(i) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognized. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Sun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for the contingency amounting ₹ 1.5 crores as per AS 29.

(ii) Provision should not be measured as the excess of compensation to be paid over the profit. The goods were not manufactured before 31st March, 20X2 and no profit had accrued for the financial year 20X1-20X2. Therefore, provision should be made for the full amount of compensation amounting ₹ 1.50 crores.

Question 5

An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. At 31st March 20X1, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary?

Answer

As per para 29 of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event.

However, when environmental damage is caused, there may be no obligation to remedy the consequences. The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted.

In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean-up cost in the year in which the law is virtually certain to be enacted.

QUESTION BANK

Question 6

The company has not made provision for warrantee in respect of certain goods considering that the company can claim the warranty cost from the original supplier.

You are required to examine in line with the provisions of AS 29.

(*RTP May 2018*)

Answer:

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

It is apparent from the question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it can be said that the accounting treatment adopted by the company with respect to warranty is not correct.

Question 7

Sun Ltd. has entered into a sale contract of ₹5 crores with X Ltd. during 2015-2016 financial year. The profit on this transaction is ₹1 crore. The delivery of goods to take place during the first month of 2016-2017 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of ₹1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 2015-2016 financial year. As on balance sheet date (31.3.2016), the goods were not manufactured and it was unlikely that Sun Ltd. will be in a position to meet the contractual obligation.

(i) Should Sun Ltd. provide for contingency as per AS 29? Explain.

(ii) Should provision be measured as the excess of compensation to be paid over the profit?

(*MTP March 2018*) (*5 Marks*)

Answer:

(i) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Sun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for the contingency amounting ₹1.5 crores as per AS 29.

(ii) Provision should not be measured as the excess of compensation to be paid over the profit. The goods were not manufactured before 31st March, 2016 and no profit had accrued for the financial year 2015-2016. Therefore, provision should be made for the full amount of compensation amounting ₹1.50 crores.

Question 8

M/s. XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of ₹200 lakhs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS 29? You are required to explain in brief giving reasons for your answer.

(*RTP November 2018*)

Answer:

As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when

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

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

(c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of ₹200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

Question 9

An airline is required by law to overhaul its aircraft once in every five years. The pacific Airlines which operate aircrafts does not provide any provision as required by law in its final accounts. Discuss with reference to relevant Accounting Standard 29.

(*MTP August 2018*) (*5 Marks*)

Answer:

A provision should be recognized only when an enterprise has a present obligation arising from a past event or obligation. In the given case, there is no present obligation but a future one, therefore no provision is recognized as per AS 29.

The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts. Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts. Further, the enterprise can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation after completion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime. A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than five years.

Question 10

XYZ Ltd. has not made provision for warrantee in respect of certain goods due to the fact that the company can claim the warranty cost from the original supplier. Hence the accountant of the company says that the company is not having any liability for warrantees on a particular date as the amount gets reimbursed. You are required to comment on the accounting treatment done by the XYZ Ltd. in line with the provisions of AS 29.

(*RTP November 2019*)

Answer

As per para 46 of AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.

It is apparent from the question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it is viewed that the accounting treatment adopted by the company with respect to warranty is not correct.

Question 11

A Ltd. provides after sales warranty for two years to its customers. Based on past experience, the company has the following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period.

Less than 1 year: 2% provision

More than 1 year: 3% provision

The company has raised invoices as under:

Invoice Date	**Amount (₹)**
11th February 2017	60,000
25th December, 2017	40,000
04th October, 2018	1,35,000

Calculate the provision to be made for warranty under AS-29 as at 31st March, 2018 and 31st March, 2019. Also compute amount to be debited to P & L account for the year ended 31st March, 2019.

(*November 2019, New Course, 5 Marks*)

Answer

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

As at 31st March, 2018	= ₹ 60,000 x .02 + ₹ 40,000 x .03
	= ₹ 1,200 + ₹ 1,200 = ₹ 2,400
As at 31st March, 2019	= ₹ 40,000 x .02 + ₹ 1,35,000 x .03
	= ₹ 800 + ₹ 4,050 = ₹ 4,850

Amount debited to Profit and Loss Account for year ended 31st March, 2019

	₹
Balance of provision required as on 31.03.2019	4,850
Less: Opening Balance as on 1.4.2018	(2,400)
Amount debited to profit and loss account	2,450

Note: No provision will be made on 31st March, 2019 in respect of sales amounting ₹ 60,000 made on 11th February, 2017 as the warranty period of 2 years has already expired.

Question 12

With reference to AS 29, how would you deal with the following in the annual accounts of the company at the Balance Sheet dates:

(i) An organization operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten percent arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted.

(ii) During 2018-19 Ace Ltd. gives a guarantee of certain borrowings of Brew Ltd., whose financial condition at that time is sound. During 2019-20, the financial condition of Brew Ltd. deteriorates and on 31st December, 2019, it goes into liquidation. (Balance Sheet date 31-3-19).

(*May 2020*)

Answer

(i) The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is probable. Thus, a provision is recognized for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig. However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. So, no provision is required for the cost of extraction of oil at balance sheet date.

Ten per cent of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.

(ii) As per AS 29, for a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation.

The obligating event is the giving of the guarantee by Ace Ltd. for certain borrowings of Brew Ltd., which gives rise to an obligation. No outflow of benefits is probable at 31 March, 2019.Thus no provision is recognized. The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

During 2019-20, the financial condition of Brew Ltd. deteriorates and finally goes into liquidation. The obligating event is the giving of the guarantee, which gives rise to a legal obligation. At 31 March, 2020, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Thus, provision is recognized for the best estimate of the obligation.

Question 13

With reference to AS29 “Provisions, Contingent Liabilities and Contingent Assets”, define:

(i) A Provision

(ii) A Liability

(iii) A Contingent Asset

(iv) Present Obligation

(*May 2016, 4 Marks*)

Answer

(i) ***A Provision*** is a liability which can be measured only by using a substantial degree of estimation.

(ii) **A *Liability*** is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

(iii) **A *Contingent asset*** is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

(iv) ***Present obligation -*** An obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

Question 14

M/s. XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of ₹ 200 lacs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS-29? Explain in brief giving reasons for your answer.

(*November, 2016, 4 Marks*)

Answer

As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets’, a provision should be recognized when

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

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

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of ₹ 200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

Question 15

(a) How will you distinguish contingent assets with Contingent Liabilities. Explain in brief.

(b) Alpha Ltd. has entered into a sale contract of ₹ 7 crores with Gamma Ltd. during 2018-19 financial year. The profit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 2019-20 financial year. In case of failure of Alpha Ltd. to deliver within the schedule, a compensation of ₹2 crores is to be paid to Gamma Ltd. Alpha Ltd. planned to manufacture the goods during the last month of 2018-19 financial year. As on balance sheet date (31.3.2019), the goods were not manufactured and it was unlikely that Alpha Ltd. will be in a position to meet the contractual obligation. You are required to advise Alpha Ltd. on requirement o f provision for contingency in the financial statements for the year ended 31st March, 2019, in line with provisions of AS 29?

(*RTP, November, 2020*)

Answer

(a) **A Contingent liability is a** possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

A present obligation that arises from past events but is not recognized because:

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

(ii) A reliable estimate of the amount of the obligation cannot be made.

An enterprise should not recognize a contingent liability but should be disclosed. A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain. An enterprise should not recognize a contingent asset, since this may result in the recognition of income that may never be realized. However, when the realization of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate. A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and, the corresponding approving authority in the case of any other enterprise), where an inflow of economic benefits is probable. Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

(b) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognized. Alpha Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Alpha Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Alpha Ltd. should provide for the contingency amounting ₹ 2 crores as per AS 29.

Question 16

(i) XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of ₹ 200 lacs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS 29 ? Explain in brief giving reasons for your answer.

(ii) What is meant by "Restructuring Provision" as per AS 29? What costs are excluded while computing such provision as per the standard?

(*MTP, April, 2021*) (*5 marks*)

Answer

(i) As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when

- an enterprise has a present obligation as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of ₹ 200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

(ii) As per AS 29, a restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both: (a) necessarily entailed by the restructuring; and (b) Not associated with the ongoing activities of the enterprise. A restructuring provision does not include such costs as: (a) Retraining or relocating continuing staff; (b) Marketing; or (c) Investment in new systems and distribution networks.

Question 17

(a) The company has not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier.

You are required to **examine** in line with the provisions of AS 29.

(b) Explain whether provision is required in the following situations in li ne with AS 29:

(i) There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation;

(ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.

(iii) There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.

(*RTP, May, 2021*)

Answer

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

It is apparent from the question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it can be said that the accounting treatment adopted by the company with respect to warranty is not correct.

(b) (i) There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation – Provision is recognised. Disclosures are required for the provision.

(ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources – No provision is recognised. Disclosures are required for the contingent liability.

(iii) There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote – No provision is recognised. No disclosure is required.

Question 18

With reference to AS 29, how would you deal with the following in the Annual Accounts of the company at the Balance Sheet date:

(i) The company operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Eighty five percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and fifteen percent arise through the extraction of oil. At the balance sheet date, rig has been constructed but no oil has been extracted.

(ii) The Government introduces a number of changes to the taxation laws. As a result of these changes, the company will need to train a large proportion of its accounting and legal workforce in order to ensure continued compliances with tax law regulations. At the balance sheet date, no retraining of staff has taken place.

(*Suggested, November, 2020*) (*5 marks*)

Answer

(i) The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is probable. Thus, a provision is recognized for the best estimate of 85% of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig.

However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. So, no provision is required for the cost of extraction of oil at balance sheet date. 15% of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.

(ii) As per AS 29, a provision for restructuring costs is recognized only when the recognition criteria for provisions are met. A restructuring provision does not include costs as of retraining or relocating continuing staff.

The expenditures of training the staff related to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognized on the same basis as if they arose independently of a restructuring. At the balance sheet date, no such expenditure has been incurred hence no provision is required.

Question 24

A Limited sells goods with unlimited right of return to its customers. The following pattern has been observed in the Return of Sales:

Time frame of Return from date of purchase	% of Cumulative Sales
Between 0-1 month	6%
Between 1-2 months	7%
Between 2-3 months	8%

The Company has made Sales of ₹ 36 Lakhs in the month of January, ₹ 48 Lakhs in the month of February and of ₹ 60 Lakhs in the month of March. The Total Sales for the Financial Year have been ₹ 400 Lakhs and the Cost of Sales was ₹ 320 Lakhs. You are required to determine the amount of Provision to be made and Revenue to be recognized as on 31st March.

(July, 2021 Suggested) (5 Marks)

Answer

Amount of provision

The goods are sold with a right to return. The existence of such right gives rise to a present obligation on the company as per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets'. According to the standard, a provision should be created on the Balance sheet date, for sales returns after the Balance Sheet date, at the best estimate of the loss expected, along with any estimated incremental cost that would be necessary to resell the goods expected to be returned.

Sales during	Sales value (₹ in lacs)	Sales value (cumulative) ₹ (in lacs)	Likely returns (%)	Likely returns ₹ (in lacs)	Provision @ 20% (₹ in lacs) (Refer W.N.)
March	60	60	6%	3.60	0.720
February	48	108	7%	7.56	1.512
January	36	144	8%	11.52	2.304
Total				22.68	4.536

Revenue to be recognized

Revenue in respect of sale of goods is recognized fully at the time of sale itself assumed that the company has complied with the conditions stated in AS 9 relating to recognition of revenue in the case of sale of goods. As per AS 9, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) Seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods. AS 9 also provides that in case of retail sales offering a guarantee of 'money back, if not completely satisfied, it may be appropriate to recognize the sale but to make a suitable provision for returns based on previous experiences.

Therefore, sale of ₹ 36 lakhs, ₹ 48 lakhs and ₹ 60 lakhs made in the months of January, February and March will be recognized at full value. Thus, total revenue to be recognized for RS. 400 lacs for the year.

Working Note:

Calculation of Profit % on sales

	(*₹ in lacs*)
Sales for the year	400
Less: Cost of sales	(320)
Profit	80

Question 25

Saharsh Ltd. is engaged in manufacturing of electric home appliances. The company is in the process of finalizing its accounts for the year ended 31.3.2020 and needs your expert advice on the following issues in line with the provisions of AS 29:

(i) A case has been filed against the company in the consumer court and a notice for levy of a penalty of ₹ 20 lakhs has been received. The company has appointed a lawyer to defend the case for a fee of ₹ 2 lakhs. 50% of the fees has been paid and balance 50% will be paid after finalisation of the case. There are 75% chances that the penalty may not be levied.

(ii) The company had committed to supply a consignment worth ₹ 1 crore to one of its dealers by the year-end. As per the contract, if delivery is not made on time, a compensation of 15% is to be paid on the value of delayed/lost consignment. While the consignment was in transit, one of the trucks carrying goods worth ₹ 30 lakhs met with an accident. It was however covered by Insurance. According to the surveyor's report, the policy amount is collectable, subject to 10% deduction. Before closing the books of accounts, the company has received the information that the policy amount has been processed and the dealer has also claimed the compensation for the consignment of goods worth ₹ 30 lakhs which was in transit.

(*MTP*, *October 2021*) (*5 Marks*)

Answer

(i) As per AS 29, an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

Liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

In the given case, there are 75% chances that the penalty may not be levied. Accordingly, Saharsh Ltd. should not make the provision for penalty.

However, a provision should be made for remaining 50% fees of the lawyer in the financial statements of financial year 2019-2020.

(ii) Loss due to accident ₹ 30,00,000

Insurance claim receivable by company = ₹ 30,00,000 x 90%	=	₹ 27,00,000	
Loss to be recognised in the books for 2019-2020		₹ 3,00,000	
Insurance claim receivable to be recorded in the books		₹ 27,00,000	

Compensation claim by dealer against company to be provided for in the books = ₹ 30,00,000 x 15% = ₹ 4,50,000.

Question 26

(a) A company, incorporated as NPO under the Companies Act, is having main objective to promote the trade by organizing trade fairs / exhibitions. While organizing the trade fair and exhibitions, it decided to charge 5% contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies, 5% contingency charges are levied separately in the invoice, the contingency charges in respect of fairs organized by the company itself are inbuilt in the space rent charged from the participants. Both are credited to Income and Expenditure Account of the company.

The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/ exhibitors, etc., due to fire, terrorist attack, stampede, natural calamities and other public and third party liability. The chances of occurrence of these events are high because of large crowds visiting the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated.

The accounting treatment and disclosure was made by the company in its financial statements as: (i) 5% contingency charges are treated as income and matching provision for the same is also being made in accounts and (ii) suitable disclosure to this effect is also made in the notes forming part of accounts.

You are required to comment whether creation of provision for contingencies considering the facts and circumstances of the case is required in line with AS 29.

(b) An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. On 31st March 2021, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary considering the circumstances in line with provisions of AS 29?

(*RTP November 2021*)

Answer

(a) As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", a provision should be recognized when (a) An enterprise has a present obligation as a result of a past event and (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

From the above, it is clear that for the contingencies considered by the company, neither a present obligation exists because of past event, nor a reliable estimate can be made of the amount of the obligation. Accordingly, a provision cannot be recognized for such contingencies under the facts and circumstances of the case.

(b) As per AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event. However, when environmental damage is caused there may be no obligation to remedy the consequences. The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted. In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean-up cost in the year in which the law is virtually certain to be enacted.

Question 27

Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2020. It seeks your advice in the following cases:

(i) Chaos Limited has filed a court case in 2014-2015 against its competitors. It became evident to its lawyers during the year ended 31st March, 2020 that Chaos Limited may lose the case and would have to pay ₹ 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.

(ii) A new regulation has been passed in 2019-2020 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2021. The company estimates an expenditure of ₹ 10,00,000 for the said upgrade.

(iii) The company gives one year warranty for its healthcare equipment under the contract of sale that it will make good any manufacturing defect by repair or replacement. As per past experience, it is probable that there will be 1% such cases and estimated cost of repair/replacement is estimated at 10% of such sale value. During the year, the company has made a sale of ₹ 5 crores.

Kindly give your answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29.

(*RTP May, 2022*)

Answer

Principles for recognition of provisions: As per AS 29, "a provision shall be recognised when:

(i) an entity has a present obligation (legal or constructive) as a result of a past event;

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

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

Accounting treatment under the given scenarios:

(i) On 31st March, 2020, since it is evident to the lawyer that Chaos Limited may lose the case and also a reliable estimate of the outflow can be made as ₹ 3,00,000, there is a present obligation. Hence, provision should be recognised for ₹ 3,00,000 for the amount which may be required to settle the obligation.

(ii) Under new regulation, an entity is required to upgrade its facilities by 31st March, 2021. However, on 31st March, 2020, i.e. at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations. Hence, no provision should be recognized on 31st March, 2020 for upgrading the facilities by 31st March, 2021.

(iii) The obligating event is the sale of health care equipment with a warranty, which gives rise to a legal obligation. Here, an outflow of resources embodying economic benefits in settlement is probable for the warranties as a whole. Hence, a provision is recognized for the best estimate of the costs of making good under the warranty products sold before the end of the reporting period as follows:

Probability of warranty cases for the entity where repair/replacement may be required as per past experience = 1% of ₹ 5,00,00,000 = ₹ 5,00,000

Estimated cost of repair/replacement = ₹ 5,00,000 x 10% = ₹ 50,000.

Question 28

At the end of the financial year ending on 31stMarch, 2022, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

Particulars	***Probability***	***Loss (₹)***
In respect of five cases (Win)	*100%*	-
Next ten cases (Win)	*50%*	-
Lose (Low damages)	*40%*	*12,00,000*
Lose (High damages)	*10%*	*20,00,000*
Remaining five cases Win	*50%*	-
Lose (Low damages)	*30%*	*10,00,000*
Lose (High damages)	*20%*	*21,00,000*

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof as per AS - 29.

(*Suggested November, 2022*) (*4 Marks*)

Answer

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

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

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

(iii) The possibility of an outflow of resources embodying economic benefits is not remote.

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

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 50% and for remaining five cases is 50%. As per AS 29 (Revised), we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is remote, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 40% of ₹ 12,00,000 + 10% of ₹ 20,00,000
= ₹ 4,80,000 + ₹ 2,00,000
= 6,80,000

Expected loss in remaining five cases = 30% of ₹ 10,00,000 + 20% of ₹ 21,00,000
= ₹ 3,00,000 + ₹ 4,20,000
= ₹ 7,20,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of 1,04,00,000 (₹ 6,80,000 × 10 + ₹ 7,20,000 × 5) as contingent liability.

Question 29

Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2022. It seeks your advice in the following cases:

(i) Chaos Limited entered into an agreement to supply 1 lac face masks to D Limited by 30th April, 2022 failing which it will have to pay a penalty of ₹ 10 per item not supplied. On 31st March, 2022 Chaos Limited assessed that it could only supply 50,000 face masks to D Limited by 30th April, 2022.

(ii) Chaos Limited has filed a court case in 2014-2015 against its competitors. It is evident to its lawyers that Chaos Limited may lose the case and would have to pay ₹ 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.

(iii) A new regulation has been passed in 2021-22 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2023. The company estimates an expenditure of ₹ 10,00,000 for the said upgrade.

Kindly give your answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29.

(*RTP November, 2022*)

Answer

Principles for recognition of provisions:

As per AS 29, "a provision shall be recognised when:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;

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

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

Accounting treatment under the given scenarios:

(i) In this case, there is no present obligation arising out of a past event as the goods are scheduled for delivery on 30th April, 2022 and there is no delay as at 31st March, 2022. Hence, there is no present obligation to pay the penalty in the current year. Therefore, no provision can be recognized in the instant case.

(ii) On 31st March, 2022, since it is evident to the lawyer that Chaos Limited may lose the case and also a reliable estimate of the outflow can be made as ₹ 3,00,000, there is a present obligation. Hence, provision should be recognised for ₹ 3,00,000 for the amount which may be required to settle the obligation.

(iii) Under new regulation, an entity is required to upgrade its facilities by 31st March, 2023. However, on 31st March, 2022, i.e. at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations. Hence, no provision should be recognised on 31st March, 2022 for upgrading the facilities by 31st March, 2023.

Question Arrangement

AS 29

Topic	Question Numbers
Probability-Based Calculations	1, 28
Appeals	2
Owners' Contracts	4, 7, 15
Oil Companies	5, 12, 18
Copyright	8, 14
Overall	9
Warranty	10
Calculation of Warranty Amount	11
Returns	24
Others	25, 26, 27, 29
Theory	3, 13, 6, 16, 17, 11, 24

Accounting Standard 4 Contingencies and Events Occurring after the Balance Sheet Date

Question 1

In X Co. Ltd., theft of cash of ₹ 5 lakhs by the cashier in January, 20X1 was detected only in May, 20X1. The accounts of the company were not yet approved by the Board of Directors of the company.

Decide whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.20X1.

(*Source: Illustration 1, Study Material*)

Answer

As per AS 4 (Revised) 'Contingencies and Events occurring after the Balance Sheet Date', an event occurring after the balance sheet date may require adjustment to the reported amounts of assets, liabilities, expenses or incomes. If conditions were existing on balance sheet date.

If a fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognise the loss amounting ₹ 5,00,000 and adjust the accounts of the company for the year ended 31st March, 20X1.

Question 2

An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.20X2. The accounting year of the company ended on 31.3.20X2. The accounts were approved on 30.6.20X2. The loss from earthquake is estimated at ₹ 30 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company.

(*Source: Illustration 2, Study Material*)

Answer

AS 4 (Revised) "Contingencies and Events Occurring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.3.20X2. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 20X1- 20X2.

However, according to the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the earthquake has caused major destruction; therefore, fundamental accounting assumption of going concern would have to be evaluated. Considering that the going concern assumption is still valid, the fact of earthquake together with an estimated loss of ₹ 30 lakhs should be disclosed in the report of the approving authority for financial year 20X1-X2 to enable users of financial statements to make proper evaluations and decisions.

Question 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.

(*Source: Illustration 3, Study Material*)

Answer

As per AS 4 (Revised) "Contingencies and Events Occurring After the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. In the given case, company should make the provision for doubtful debts, as legal suit has been filed on 31st March, 20X1 and the chances of recovery from the suit are not good. Though, the actual result of legal suit will be known in future yet situation of non-recovery from the debtors exists before finalisation of financial statements. Therefore, provision for doubtful debts should be made for the year ended on 31st March, 20X1.

Question 4

In preparing the financial statements of R Ltd. for the year ended 31st March, 20X1, you come across the following information. State with reasons, how you would deal with this in the financial statements:

The company invested 100 lakhs in April, 20X1 before approval of Financial Statements by the Board of directors in the acquisition of another company doing similar business, the negotiations for which had started during the year.

(*Source: Illustration 4, Study Material*)

Answer

AS 4 (Revised) defines "Events Occurring after the Balance Sheet Date" as those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Approving Authority in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 20X1. The disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 100 lakhs in April, 20X1 for the acquisition of another company should be disclosed in the report of the Approving Authority to enable users of financial statements to make proper evaluations and decisions.

Question 5

A Limited Company closed its accounting year on 30.6.20X1 and the accounts for that period were considered and approved by the board of directors on 20th August, 20X1. The company was engaged in laying pipeline for an oil company deep beneath the earth. While doing the boring work on 1.9.20X1 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of ₹ 80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.20X1.

(*Source: Illustration 5, Study Material*)

Answer

AS 4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date defines 'events occurring after the balance sheet date' as 'significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors in the case of a company'. The given case is discussed in the light of the above-mentioned definition and requirements given in AS 4 (Revised). In this case the incidence, which was expected to push up cost, became evident after the date of approval of the accounts. So it is not an 'event occurring after the balance sheet date'.

Question 6

While preparing its final accounts for the year ended 31st March, 20X1 a company made a provision for bad debts @ 5% of its total trade receivables. In the last week of February, 20X1 a trade receivable for ₹ 2 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 20X1 the trade receivable became a bankrupt. Can the company provide for the full loss arising out of insolvency of the trade receivable in the final accounts for the year ended 31st March, 20X1?

(*Source: Illustration 6, Study Material*)

Answer

As per Accounting Standard 4, Assets and Liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist estimation of amounts relating to conditions existing at the balance sheet date.

So full provision for bad debt amounting to ₹ 2 lakhs should be made to cover the loss arising due to the insolvency in the Final Accounts for the year ended 31st March, 20X1. It is because earthquake took place before the balance sheet date.

Had the earthquake taken place after 31st March, 20X1, then this would have been treated as non-adjusting event and only disclosure required as per AS 4 (Revised), would have been sufficient.

Question 7

Y Ltd. has book debts and has a doubt over recoverability of some of the book debts. The amount that cannot be recovered is not quantifiable. Thus, Y Ltd. is of the opinion that provision for doubtful debts should not be created. Y Ltd. creates provision for certain other expenses on estimated basis.

Whether contention of Y Ltd. is correct?

(*Source: Illustration 7, Study Material*)

Answer

As per AS 4, "Contingencies and Events Occurring After the Balance Sheet Date" if it is likely that a contingency will result in a loss to an entity then it should create provision for that contingency on the estimated basis.

Based on the above, the contention that provision for doubtful debt is not be created merely because the amount is not quantifiable is not correct. Hence Y Ltd. should make provision in the books on the basis of estimation.

Question 8

A Ltd. has sold its building for ₹ 50 lakhs to B Ltd. and has also given the possession to B Ltd. The book value of the building is ₹ 30 lakhs. As on 31st March, 20X1, the documentation and legal formalities are pending. The company has not recorded the sale and has shown the amount received as advance. Do you agree with this treatment?

Answer

The economic reality and substance of the transaction is that the rights and beneficial interest in the property has been transferred although legal title has not been transferred. A Ltd. should record the sale and recognise the gain of ₹ 20 lakhs in its profit and loss account. The building should be derecognized in the financial statements.

Question 9

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.

Answer

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

In the given case, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 20X1-X2 for which the provision was also made by it, the decision of the Court on 18th May, 20X2, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Raj Ltd. should adjust the provision upward by ₹ 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

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

QUESTION BANK

Question 10

ABC Ltd. could not recover ₹ 10 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company were finalized for the year ended 31.3.2005 by making a provision @ 20% of the amount due from the said debtor. The debtor became bankrupt in April, 2005 and nothing is recoverable from him.

Do you advise the company to provide for the entire loss of ₹ 10 lakhs in the books of account for the year ended 31st March, 2005?

(*November 2005, 4 Marks*)

Answer

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

In the given case, bankruptcy of the debtor in April, 2005 and consequent non-recovery of debt is an event occurring after the balance sheet date which materially affects the determination of profits for the year ended 31.3.2005. Therefore, the company should be advised to provide for the entire amount of ₹ 10 lakhs according to para 8 of AS 4.

Question 11

X Ltd. entered into an agreement to sell its immovable property included in the Balance Sheet at ₹ 10 lacs to another company for ₹ 15 lacs. The agreement to sell was concluded on 28th February, 2006 and the sale deed was registered on 1st May, 2006. Comment with reference to AS 4.

(*November 2006, 4 Marks*)

Answer

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

In the given case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 15th February, 2009 *i.e.* before the balance sheet date.

Registration of the sale deed on 30th April, 2009, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of immovable property is necessary in the financial statements for the year ended 31st March, 2009.

Question 12

In X Co. Ltd., theft of cash of ₹ 5 lakhs by the cashier in January, 2007 was detected only in May, 2007. The accounts of the company were not yet approved by the Board of Directors of the company. Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.2007. Decide.

(*May 2007, 2 Marks*)

Answer

As per paragraph 13 of AS 4 (revised) 'Contingencies and Events occurring after the Balance Sheet Date', an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes.

If a fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognize the loss amounting ₹5,00,000 and adjust the accounts of the company for the year ended 31st March, 2007.

Question 13

An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.2009. The accounting year of the company ended on 31.3.2009. The accounts were approved on 30.6.2009. The loss from earthquake is estimated at ₹ 30 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company?

(*November 2009, 2 Marks*)

Answer

Para 8.3 of AS 4 "Contingencies and Events Occuring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The destruction of warehouse due to earthquake did not exist on the balance sheet date *i.e.* 31.3.2009. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 2008-2009.

However, according to para 8.6 of the standard, unusual changes affecting the existence or sub-stratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the earthquake has caused major destruction; therefore fundamental accounting assumption of going concern is called upon. Hence, the fact of earthquake together with an estimated loss of ₹30 lakhs should be disclosed in the Report of the Directors for the financial year 2008-2009.

Question 14

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

(*May, 2010, 2 Marks*)

Answer

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

Question 15

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

(*November, 2010 & November 2011, 5 Marks*)

Answer

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

A debtor for ₹3,00,000 suffered heavy loss due to earthquake in the first week of March, 2010 and he became bankrupt in April, 2010 (after the Balance Sheet date). The loss was also not covered by any insurance policy. Accordingly, full provision for bad debts amounting ₹3,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March, 2010.

Question 16

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

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

(*May 2012, 4 Marks*)

Answer

As per AS-4 'Contingencies and Events Occurring after the Balance Sheet Date' issued by the Council of the Institute of Chartered Accountants of India, 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.

Adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

In the given case cash of ₹6,00,000 of A-One limited was embezzled during March 2012. However it came to the notice of management during April 2012 only. As the financial statements are not yet approved by the Board of directors of the company, embezzlement of cash should be adjusted in the books of accounts for the year ending March, 2012.

If embezzlement of cash comes to the notice of the management only after approval of financial statement by the board of directors, then it should not be adjusted or disclosed in the financial statements or books of accounts for the year ending March, 2012.

Question 17

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

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

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

(*May 2013, 4 Marks*)

Answer

Nature of Transaction on the date of Balance Sheet (31st March, 2013	*Treatment in the Books of Accounts*
Cheques collected by the marketing personnel of the company from the stockists on or before 31st March, 2013.	In this case, the company has collected the amount before 31st March through its Marketing Personnel. Marketing Personnel being employees of the company, the collection of cheques constitutes a *"receipt"* by the company, before the Balance Sheet date. Subsequent realization in April provides additional evidence of the matter, and hence the Company can consider this as an "*Adjusting Event"* and account for such items as "*Cheques in Hand"*.
Cheques sent by the stockists through courier on or before 31st March, 2013.	In this case, the Company has not *"received"* the Cheques before 31st March, 2013. Hence, mere sending of the cheques by the Stockists through Courier can not be treated as receipt on the Balance Sheet date. Therefore, this amount should not be adjusted in the accounts.

Question 18

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

(i) An agreement to sell a land for ₹ 30 lakh to another company was entered into on 1st March, 2013. The value of land is shown at ₹ 20 lakh in the Balance Sheet as on 31st March, 2012. However, the Sale Deed was registered on 15th April, 2013.

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

(*November 2013, 5 Marks*)

Answer

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

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

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

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

Question 19

With reference to AS-4 “Contingencies and events occurring after the balance sheet date”, state whether the following events will be treated as contingencies, adjusting events or non-adjusting events occurring after balance sheet in case of a company which follows April to March as its financial year.

(i) A major fire has damaged the assets in a factory on 5th April, 5 days after the year end. However, the assets are fully insured and the books have not been approved by the Directors.

(ii) A suit against the company’s advertisement was filed by a party on 10th April, 10 days after the year end claiming damages of ₹ 20 lakhs.

(iii) It sends a proposal to purchase an immovable property for ₹ 30 lakhs in March. The book value of the property is ₹ 20 lakhs as on year end date. However, the deed was registered as on 15th April.

(iv) The terms and conditions for acquisition of business of another company have been decided by March end. But the financial resources were arranged in April and amount invested was ₹ 40 lakhs.

(v) Theft of cash of ₹ 2 lakhs by the cashier on 31st March but was detected the next day after the financial statements have been approved by the Directors.

(*May 2016, 5 Marks*)

Answer

According to AS 4 on ‘Contingencies and Events Occurring after the Balance Sheet Date’, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. However, adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. “Contingencies” used in the Standard is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur.

(i) Fire has occurred after the balance sheet date and also the loss is totally insured. Therefore, the event becomes immaterial and the event is **non-adjusting** in nature.

(ii) The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of ₹ 20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a **non-adjusting** event.

(iii) In the given case, proposal for deal of immovable property was sent before the closure of the books of accounts. This is a **non-adjusting** event as only the proposal was sent and no agreement was effected in the month of March i.e. before the balance sheet date.

(iv) As the term and conditions of acquisition of business of another company had been decided by the end of March, acquisition of business is an **adjusting event** occurring after the balance sheet date. Adjustment to assets and liabilities is required since the event affects the determination and the condition of the amounts stated in the financial statements for the financial year ended on 31st March.

(v) Since the financial statements have been approved before detection of theft by the cashier of ₹ 2,00,000, it becomes a **non-adjusting** event and no disclosure is required in the report of the Approving Authority.

Question 20

While preparing its final accounts for the year ended 31st March, 2016, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2016 a debtor for ₹20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2016 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2016?

Comment with reference to relevant Accounting Standard. (*November, 2016, 5 Marks*)

Answer

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

A debtor for ₹ 20,00,000 suffered heavy loss due to earthquake in the last week of February, 2016 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in April, 2016 (after the balance sheet date) is only an additional information related to the condition existing on the balance sheet date. However, bankruptcy of debtors is an adjusting event.

Accordingly, full provision for bad debts amounting ₹ 20,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2016. Since the company has already made 5% provision of its total debtors, additional provision amounting ₹ 19,00,000 shall be made (20,00,000 x 95%).

Question 21

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).

(*November 2018*) (*5 Marks*)

Answer:

As per AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date", an event occurring after the balance sheet date should be an adjusting event even if it does not reflect any condition existing on the balance sheet date, if the event is such as to indicate that the fundamental accounting assumption of going concern is no longer appropriate.

The fire occurred in the factory and office premises of an enterprise after 31 March, 2018 but before approval of financial statement of 30.4.18. The loss by fire is of such a magnitude that it is not reasonable to expect the Dee Ltd. to start operations again, i.e., the going concern assumption is not valid. Since the fire occurred after 31/03/18, the loss on fire is not a result of any condition existing on 31/03/18. But the loss due to fire is an adjusting event the entire accounts need to be prepared on a liquidation basis with adequate disclosures by the company by way of note in its financial statements in the following manner:

"Major fire occurred in the factory and office premises on 15th April, 2018 which has made impossible for the enterprise to start operations again. Therefore, the financial statements have been prepared on liquidation basis."

Question 22

The Board of Directors of New Graphics Ltd. in its Board Meeting held on 18th April, 2017, considered and approved the Audited Financial results along with Auditors Report for the Financial Year ended 31st March, 2017 and recommended a dividend of ₹2 per equity share (on 2 crore fully paid up equity shares of ₹10 each) for the year ended31st March, 2017 and if approved by the members at the forthcoming Annual General Meeting of the company on 18th June, 2017, the same will be paid to all the eligible shareholders.

Discuss on the accounting treatment and presentation of the said proposed dividend in the annual accounts of the company for the year ended 31st March, 2017 as per the applicable Accounting Standard and other Statutory Requirements.

(*RTP May 2019*)

Answer:

As per the amendment in AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" vide Companies (Accounting Standards) Amendments Rules, 2016 dated 30th March, 2016, the events which take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature.

However, dividends declared after the balance sheet date but before approval of financial statements are not recognized as a liability at the balance sheet date because no statutory obligation exists at that time. Hence such dividends are disclosed in the notes to financial statements.

No, provision for proposed dividends is not required to be made. Such proposed dividends are to be disclosed in the notes to financial statements. Accordingly, the dividend of ₹4 crores recommended by New Graphics Ltd. in its Board meeting on 18th April, 2017 shall not be accounted for in the books for the year 2016-17 irrespective of the fact that it pertains to the year 2016-17 and will be paid after approval in the Annual General Meeting of the members/shareholders.

Question 23

While preparing its final accounts for the year ended 31st March, 2017, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2017 a debtor for ₹20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2017 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2017? You are required to advise the company in line with AS 4.

(*RTP November 2018*)

Answer:

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

A debtor for ₹20,00,000 suffered heavy loss due to earthquake in the last week of February, 2017 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in April, 2017 (after the balance sheet date) is only an additional information related to the condition existing on the balance sheet date.

Accordingly, full provision for bad debts amounting ₹20,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2017. Since the company has already made 5% provision of its total debtors, additional provision amounting ₹19,00,000 shall be made (20,00,000 × 95%) for the year ended 31st March, 2017.

Question 24

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 5th 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 10th April, 10 days after the year end claiming damages of ₹20 lakhs.

(*RTP May 2018*)

Answer:

According to AS 4 on 'Contingencies and Events Occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. However, adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. "Contingencies" used in the Standard is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur.

(i) Fire has occurred after the balance sheet date and also the loss is totally insured. Therefore, the event becomes immaterial and the event is non-adjusting in nature.

(ii) The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of ₹20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a non-adjusting event.

Question 25

While preparing its final accounts for the year ended 31st March, 2016, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2016 a debtor for ₹20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2016 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2016?

Comment with reference to relevant Accounting Standard.

(*MTP March 2019*) (*5 Marks*)

Answer:

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

A debtor for ₹20,00,000 suffered heavy loss due to earthquake in the last week of February, 2016 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in April, 2016 (after the balance sheet date) is only an additional information related to the condition existing on the balance sheet date.

Accordingly, full provision for bad debts amounting ₹20,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2016. Since the company has already made 5% provision of its total debtors, additional provision amounting ₹19,00,000 shall be made (20,00,000 x 95%).

Question 26

Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31 March 2020 are to be approved by the approving authority on 30 June 2020. During the first quarter of 2020-2021, the following events/transactions has taken place. The accountant of the company seeks your guidance for the following:

(i) Tee Ltd. has an inventory of 50 stitching machines costing at ₹ 5,500 per machine as on 31 March 2020. On 31 March 2020 the company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realisable value, whichever is lower. During the month of April 2020, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during this month at a price of ₹ 4,000 per machine.

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

(iii) The company has entered into a sale agreement on 30 March 2020 to sell a property for a consideration of ₹ 7,50,000 which is being carried in the books at ₹ 5,50,000 at the year end. The transfer of risk and reward and sale is complete in the month of May 2020 when conveyance and possession get completed.

(iv) The company has received, during the year 2018-2019, a government grant of ₹ 15 lakhs for purchase of a machine. The company has received a notice for refund of the said grant on 15 June, 2020 due to violation of some of the conditions of grant during the year 2019-2020.

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

(*MTP*, *October 2021*) (*5 Marks*)

Answer

Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and by the corresponding approving authority in the case of any other entity.

Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern is not appropriate.

In the given case, financial statements are approved by the approving authority on 30 June 2020.

On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:

(i) Since on 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an adjusting event. Hence, Tee Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realisable value at the end of the reporting period. Accordingly, inventory should be written down to ₹ 4,000 per machine. Total value of inventory in the books will be 50 machines x ₹ 4,000 = ₹ 2,00,000.

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

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

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

Question 27

XYZ Ltd. operates its business into various segments. Its financial year ended on 31st March, 2020 and the financial statements were approved by their approving authority on 15th June, 2020. The following material events took place:

(a) A major property was sold (it was included in the balance sheet at ₹ 25,00,000) for which contracts had been exchanged on 15th March, 2020. The sale was completed on 15th May, 2020 at a price of ₹ 26,50,000.

(b) On 2nd April, 2020, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of ₹ 10 million would be fully covered by the insurance company.

(c) A claim for damage amounting to ₹ 8 million for breach of patent had been received by the entity prior to the year-end. It is the director's opinion, backed by legal advice that the claim will ultimately prove to be baseless. But it is still estimated that it would involve a considerable expenditure on legal fees.

You are required to state with reasons, how each of the above items should be dealt with in the financial statements of XYZ Ltd. for the year ended 31st March, 2020.

(*RTP November 2021*)

Answer

Treatment as per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date'

(a) The sale of property should be treated as an adjusting event since contracts had been exchanged prior to the year-end. The effect of the sale should be reflected in the financial statements ended on 31.3.2020 and the profit on sale of property ₹ 1,50,000 would be considered.

(b) The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover. Also, since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.

(c) On the basis of evidence provided, the claim against the company will not succeed. Thus, ₹ 8 million should not be provided in the account, but should be disclosed by means of a contingent liability with full details of the facts. Provision should be made for legal fee expected to be incurred to the extent that they are not expected to be recovered.

Question 28

Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31st March 2020 are to be approved by the approving authority on 30th June 2020. During the first quarter of 2020-2021, the following events / transactions has taken place. The accountant of the company seeks your guidance for the following:

(i) Tee Ltd. has an inventory of 50 stitching machines costing at ₹ 5,500 per machine as on 31st March 2020. The company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realizable value, whichever is lower. During the month of April 2020, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during April, 2020 at a price of ₹ 4,000 per machine.

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

(iii) A suit against the company's advertisement was filed by a party on 10th April, 2020 10 days after the year end claiming damages of ₹ 20 lakhs.

You are required to state with reasons, how the above transactions will be dealt with in the financial statements for the year ended 31 March 2020.

(*RTP May, 2022*)

Answer

Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity. Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern is not appropriate. In the given case, financial statements are approved by the approving authority on 30 June 2020. On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:

(i) Since on 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an adjusting event. Hence, Tee Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realizable value at the end of the reporting period. Accordingly, inventory should be written down to ₹ 4,000 per machine. Total value of inventory in the books will be 50 machines x ₹ 4,000 = ₹ 2,00,000.

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

(iii) The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of ₹ 20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a non-adjusting event.

Question 29

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

1. Equity Dividend for the year 2020-21 was declared at the rate of 7% on 15.05.2021.
2. On 05.03.2021, ₹ 53,000 cash was collected from a customer but not deposited by the cashier. This fraud was detected on 22.06.2021.

3. One Building got damaged due to occurrence of fire on 23.05.2021. Loss was estimated to be ₹ 81,00,000.

(*Question Paper of December 2021*) (*5 Marks*)

Answer:

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

(ii) As per AS 4 'Contingencies and Events occurring after the Balance Sheet Date' an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes if such events relate to conditions existing at the balance sheet date. In the given case, fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognize the loss. Thus loss amounting ₹ 53,000 should be adjusted in the accounts of the company for the year ended 31st March, 2021 as it is adjusting event.

(iii) AS 4 states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The damage of one building due to fire did not exist on the balance sheet date i.e. 31.3.2021. Therefore, loss occurred due to fire is not to be recognized in the financial year 2020-2021 as it is non-adjusting event.

However, according to the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the fire has caused major destruction; therefore, fundamental accounting assumption of going concern would have to be evaluated. Considering that the going concern assumption is still valid, the fact of fire together with an estimated loss of ₹ 81 lakhs should be disclosed in the report of the approving authority for financial year 2020 -21 to enable users of financial statements to make proper evaluations and decisions.

Question 30

Explain accounting treatment of Contingent Gains as per AS 4 "Contingencies and Events occurring after the Balance Sheet Date".

(*RTP November, 2022*)

Answer

Accounting Treatment of Contingent Gains

Contingent gains are not recognised in financial statements since their recognition may result in the recognition of revenue which may never be realised. However, when the realisation of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate.

Question Arrangement

AS 4

Topic	Question Numbers
Theft	1, 12, 16
Earthquake	2, 13, 21
Legal Cases	9, 24
Provision for Bad debts	3, 6, 7, 10, 15, 20, 23, 25
Company Acquisition	4
Pipeline	5
Property Acquisition	8, 11, 18
Check Collection	14, 17
Proposed Dividend	22
Contingent Gains	13
Mix	19, 26, 27, 28, 29

Accounting Standard 5
Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

Question 1

From the past 5 financial years, an old outstanding balance of ₹50,000 was still appearing as sundry creditor in the current year balance sheet of People Ltd. The company is certain that this amount is not payable due to one or more reasons. Therefore, it decided to write off the said amount in its current year's books of accounts and recognize it as income. The company treated the amount of ₹ 50,000 written off as a prior period item and made the adjustments accordingly.

The company is of the view that since sundry balances were recognized in the prior period(s), its related written-off amount should be treated as a prior period item.

(*Source: Illustration 1, Study Material*)

Answer

No, the company is not correct in treating the amount written off as a prior period item. As per AS 5, prior period items are income or expenses which arise in a current year due to errors or omissions in the preparation of the financial statements of one or more prior period(s).

Writing off an old outstanding balance in the current year which is appearing in its books of accounts from the past 5 financial years does not mean that there has been an error or omission in the preparation of financial statements of prior period(s). It is just a practice adopted by the company to write off the old outstanding balances of more than 5 years in its current year books of accounts. Therefore, the amount written off is not treated as a prior period item.

Hence, adjusting the amount ₹50,000 written off as a prior period item on the basis that sundry balances were recognized in prior period(s) is not in line with AS 5.

Question 2

Fuel surcharge is billed by the State Electricity Board at provisional rates. Final bill for fuel surcharge of ₹ 5.30 lakhs for the period October, 20X1 to September, 20X7 has been received and paid in February, 20X8. However, the same was accounted in the year 20X8-X9. Comment on the accounting treatment done in the said case.

(*Source: Illustration 2, Study Material*)

Answer

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

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

Question 3

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

(ii) A company signed an agreement with the Employees Union on 1.9.20 X2 for revision of wages with retrospective effect from 30.9.20X1. This would cost the company an additional liability of ₹ 5,00,000 per annum. Is a disclosure necessary for the amount paid in 20X2-X3?

(*Source: Illustration 3, Study Material*)

Answer

(i) Although the case under consideration does not relate to extraordinary item, but the nature and amount of such item may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' states that:

"When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately."

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

(ii) It is given that revision of wages took place on 1st September, 20X2 with retrospective effect from 30.9.20X1. Therefore wages payable for the half year from 1.10.20X2 to 31.3.20X3 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. Additional wages liability of ₹ 7,50,000 (for 1½ years @ ₹ 5,00,000 per annum) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Such an expense does not qualify as an extraordinary item. However, as per AS 5, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Question 4

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.

(*Source: Illustration 4, Study Material*)

Answer

AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', defines Prior Period items as "income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods".

Rectification of error in inventory valuation is a prior period item vide AS 5. Separate disclosure of this item as a prior period item is required as per AS 5.

Question 5

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.

(*Source: Illustration 5, Study Material*)

Answer

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

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

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

Question 6

In the current year, A Ltd. changed the depreciation method from the Straight Line Method (SLM) to Written Down Value (WDV) method. When A Ltd. recomputed depreciation retrospectively as per the new method, deficiency arose in depreciation in respect of past years. Therefore, it reduced the carrying amount of the asset by the amount of deficiency and such change in carrying amount (deficiency amount) has been debited to the statement of profit and loss as an extraordinary expense.

Whether the change in the carrying amount of assets due to the change in depreciation method should be treated as an extraordinary item?

(*Source: Illustration 6, Study Material*)

Answer

No.

As per AS 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

A change in the method of charging depreciation is not an event that is clearly distinct from the ordinary activities of the entity. In the instant case, A Ltd. has changed the depreciation method and treated the reduction in carrying amount (or amount of deficiency in depreciation) of the asset as an extraordinary expense. This is not correct. Such deficiency should be treated as a normal expense.

A change in the estimated useful life of a depreciable asset (i.e. change in depreciation method) affects the depreciation in the current period and in each period during the remaining useful life of the asset. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods, is recognised in future periods.

The change in depreciation method is considered as a change in accounting estimate as per the provisions of AS 5.

Question 7

A company (Z Ltd.) is engaged in the business of providing consultancy services. A few days back, it received a notice from GST department raising a demand of GST on consultancy services provided by it for Rs. 500,000. Recently Z Ltd. paid the demand. In the books, the payment is recorded as an extraordinary expenditure.

Whether payment of tax demand raised by the taxation authority can be recognised as an extraordinary item?

Answer

No payment of tax cannot be recognised as an extraordinary item.

As per AS 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" an extraordinary item is income or expenses that arise from events or transactions that are clearly distinct from ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

In the given case, providing consultancy service is an ordinary activity of Z Ltd. Thus, GST paid pursuant to the demand raised by GST department is also a part of an ordinary activity of Z Ltd. Recognising such payments as an extra-ordinary item is contrary to AS 5.

QUESTION BANK

Question 8

As per the provisions of AS-5, extraordinary items should not be disclosed in the statement of profit and loss as a part of net profit or loss for the period.

(*May 2019*) (*1 Marks*)

Answer

False: The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

Question 9

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 extra ordinary item or prior period item?

(*May 2018*) (*5 Marks*)

Answer:

(i) As per the provisions of AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", *prior period items* are income or expenses, which arise, in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. Further, the nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on current profit or loss can be perceived.

In the given instance, it is clearly a case of error/omission in preparation of financial statements for the year 2015-16. Hence, claim received in the financial year 2017-18 is a prior period item and should be separately disclosed in the statement of Profit and Loss.

(ii) In the given case, a limited company created 2.5% provision for doubtful debts for the year 2017-2018. Subsequently, the company revised the estimates based on the changed circumstances and wants to create 8% provision.

As per AS 5, the revision in rate of provision for doubtful debts will be considered as change in estimate and is neither a prior period item nor an extraordinary item.

The effect of such change should be shown in the profit and loss account for the year ending 31st March, 2018.

Question 10

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.

(*RTP November 2018*)

Answer:

(i) In the given case, Mobile limited created 2% provision for doubtful debts till 31st March, 2016. Subsequently in 2016-17, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in an accounting policy.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

Question 11

Bela Ltd. has a vacant land measuring 20,000 sq. mts, which it had no intention to use in the future. The Company decided to sell the land to tide over its liquidity problems and made a profit of ₹10 Lakhs by selling the said land. Moreover, there was a fire in the factory and a part of the unused factory shed valued at ₹8 Lakhs was destroyed. The loss from fire was set off against the profit from sale of land and profit of ₹2 lakhs was disclosed as net profit from sale of assets.

You are required to examine the treatment and disclosure done by the company and advise the company in line with AS 5.

(*RTP May 2018*)

Answer:

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

In the given case the selling of land to tide over liquidation problems as well as fire in the Factory does not constitute ordinary activities of the Company. These items are distinct from the ordinary activities of the business. Both the events are material in nature and expected not to recur frequently or regularly. Thus, these are Extraordinary Items.

Therefore, in the given case, disclosing net profits by setting off fire losses against profit from sale of land is not correct. The profit on sale of land, and loss due to fire should be disclosed separately in the statement of profit and loss.

Question 12

Examine 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.

(*MTP March 2019*) (*5 Marks*)

Answer:

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

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

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

Question 13

The Accountant of a company has sought your opinion with relevant reasons, whether the following will be treated as change in Accounting Policy or not for the year ended 31st March, 2020. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

(i) Provision for doubtful debts was created @ 2% till 31st March, 2019. From the Financial year 2019-2020, the rate of provision has been changed to 3%.

(ii) During the year ended 31st March, 2020, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.

(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.

(v) During the year ended 31st March, 2020, there was change in cost formula in measuring the cost of inventories.

(*MTP, May, 2020*) (*5 marks*)

Answer:

(i) In the given case, company has created 2% provision for doubtful debts till 31st March, 2019. Subsequently in 2019-20, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in an accounting policy.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

Question 14

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

You are required to explain the treatment of such revision in financial statements for the year ended 31st March 2021 in line with the provisions of AS 5?

(*MTP, March, 2021*) (*5 marks*)

Answer

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

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

Question 15

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

(*MTP, April, 2021*) (*5 marks*)

Answer

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

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

Question 16

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.

(*Suggested, January, 2021*) (*5 marks*)

Answer

Classification of given items is as follows:

Sr. No.	Particulars	Remarks
(i)	Actual bad debts turning out to be more than provisions	Change in Accounting Estimates
(ii)	Change from Cost model to Revaluation model for measurement of carrying amount of PPE	Change in Accounting Policy
(iii)	Government grant receivable as compensation for expenses incurred in previous accounting period	Extra-ordinary Items
(iv)	Treating operating lease as finance lease.	Prior- period Items
(v)	Capitalisation of borrowing cost on working capital	Prior-period Items (as interest on working capital loans is not eligible for capitalization)
(vi)	Legislative changes having long-term retrospective application	Ordinary Activity
(vii)	Change in the method of depreciation from straight line to WDV	Change in Accounting Estimates
(viii)	Government grant becoming refundable	Extra-ordinary Items
(ix)	Applying 10% depreciation instead of 15% on furniture	Prior- period Items
(x)	Change in useful life of fixed assets	Change in Accounting Estimates

Question 17

(a) There was a major theft of stores valued at ₹ 10 lakhs in the preceding year which was detected only during current financial year (2020-2021). How will you deal with this information in preparing the financial statements of R Ltd. for the year ended 31st March, 2021.

(b) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organisation. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization. Explain whether this will constitute a change in accounting policy or not as per AS 5.

(*RTP November 2021*)

Answer

(a) Due to major theft of stores in the preceding year (2019-2020) which was detected only during the current financial year (2020–2021), there was overstatement of closing inventory of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year. The adjustments are required to be made in the current year as 'Prior Period Items' as per AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies. Accordingly, the adjustments relating to both opening inventory of the current year and profit brought forward from the previous year should be separately disclosed in the statement of profit and loss together with their nature and amount in a manner that their impact on the current profit or loss can be perceived. Alternatively, it may be assumed that in the preceding year, the value of inventory of stores as found out by physical verification of inventories was considered in the preparation of financial statements of the preceding year. In such a case, only the disclosure as to the theft and the resulting loss is required in the notes to the accounts for the current year i.e, year ended 31st March, 2021.

(b) As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Accordingly, the adoption of a new accounting policy of paying pension to retired employees is a policy for events or transactions which did not occur previously. Hence, it will not be treated as a change in an accounting policy.

Question 18

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, 2021. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

(i) Provision for doubtful debts was created @ 2% till 31st March, 2020. From the Financial year 2020-2021, the rate of provision has been changed to 3%.

(ii) During the year ended 31st March, 2021, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(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, 2021, there was change in cost formula in measuring the cost of inventories.

(*RTP May, 2022*)

Answer

(i) In the given case, Mobile limited created 2% 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 3% provision. Thus change in rate of provision of doubtful debt is change in accounting estimate and is not a change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in accounting policy.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in accounting estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

Question 19

The Accountant of Shiva Limited had sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policies or change in Accounting Estimates for the year ended 31st March, 2021. Please advise him in the following situations in accordance with the provisions of AS 5:

(i) Provision for doubtful debts was created @3% till 31st March, 2020. From the Financial year 2020-2021, the rate of provision has been changed to 4%.

(ii) During the year ended 31st March, 2021, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(iii) Till 31st March, 2020 the furniture was depreciated on straight line basis over a period of 5 years. From the Financial year 2020-2021, the useful life of furniture has been changed to 3 years.

(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 2021, there was change in cost formula in measuring the cost of inventories.

(*Suggested November, 2022*) (*5 Marks*)

Answer

(i) In the given case, company has created 3cer% provision for doubtful debts till 31st March, 2020. Subsequently from 1st April, 2020, the company revised the estimates based on the changed circumstances and wants to create 4% provision. Thus, change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous transaction, will neither be treated as change in an accounting policy nor change in accounting estimate.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in accounting estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is neither a change in accounting policy nor a change in accounting estimate.

Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

Question 20

Bela Ltd. has a vacant land measuring 20,000 sq. mts, which it had no intention to use in the future. The company decided to sell the land to tide over its liquidity problems and made a profit of ₹10 Lakhs by selling the said land. Moreover, there was a fire in the factory and a part of the unused factory shed valued at ₹ 8 Lakhs was destroyed. The loss from fire was set off against the profit from sale of land and profit of ₹2 lakhs was disclosed as net profit from sale of assets. Do you agree with the treatment and disclosure? If not, state your views.

(*RTP November, 2022*)

Answer

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

In the given case the selling of land to tide over liquidation problems as well as fire in the factory does not constitute ordinary activities of the Company. These items are distinct from the ordinary activities of the business. Both the events are material in nature and expected not to recur frequently or regularly. Thus, these are Extraordinary Items.

Therefore, in the given case, disclosing net profits by setting off fire losses against profit from sale of land is not correct. The profit on sale of land, and loss due to fire should be disclosed separately in the statement of profit and loss**.**

Question 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.

(*RTP May, 2023*)

Answer

Classification of given items is as follows:

Sr. No.	Particulars	Remarks
(i)	Actual bad debts turning out to be more than provisions	Change in Accounting Estimates
(ii)	Change from Cost model to Revaluation model for measurement of carrying amount of PPE	Change in Accounting Policy
(iii)	Government grant receivable as compensation for expenses incurred in previous accounting period	Extra -ordinary Items
(iv)	Treating operating lease as finance lease.	Prior- period Items
(v)	Capitalisation of borrowing cost on working capital	Prior-period Items (as interest on working capital loans is not eligible for capitalization)
(vi)	Legislative changes having long term retrospective application	Ordinary Activity
(vii)	Change in the method of depreciation from straight line to WDV	Change in Accounting Estimates
(viii)	Government grant becoming refundable	Extra -ordinary Items
(ix)	Applying 10% depreciation instead of 15% on furniture	Prior- period Items
(x)	Change in useful life of fixed assets	Change in Accounting Estimates

Question Arrangement

AS 5

Topic	Question Numbers
Change in Accounting Policies	6, 5, 12
Change in Accounting Estimates	14, 15
Extraordinary Items	8, 11, 20
Prior Period Items	2, 4, 17, 9
Ordinary Activities	3, 7, 10, 13, 18, 19, 16, 21

CHAPTER 19

Accounting Standards 22
Accounting for Taxes on Income

Question 1

Rama Ltd., has provided the following information:

	₹
Depreciation as per accounting records	*= 2,00,000*
Depreciation as per income tax records	*= 5,00,000*
Unamortised preliminary expenses as per tax record	*= 30,000*

There is adequate evidence of future profit sufficiency. How much net deferred tax asset/liability should be recognised as transition adjustment? Tax rate 50%.

(*Source: Illustration 1, Study Material*)

Answer

Table showing calculation of deferred tax asset / liability

Particulars	Amount	Timing differences	Deferred tax	Amount @ 50%
	₹			₹
Excess depreciation as per tax records (₹ 5,00,000 – ₹ 2,00,000)	3,00,000	Timing	Deferred tax liability	1,50,000
Unamortised preliminary expenses as per tax records	30,000	Timing	Deferred tax asset	(15,000)
Net deferred tax liability				1,35,000

Question 2

From the following details of A Ltd. for the year ended 31-03-20X1, calculate the deferred tax asset/ liability as per AS 22 and amount of tax to be debited to the Profit and Loss Account for the year.

Particulars	₹
Accounting Profit	*6,00,000*
Book Profit as per MAT	*3,50,000*
Profit as per Income Tax Act	*60,000*
Tax rate	*20%*
MAT rate	*7.50%*

(*Source: Illustration 2, Study Material*)

Answer

Tax as per accounting profit 6,00,000 × 20% = ₹ 1,20,000 Tax as per Income-tax

Profit 60,000 × 20% = ₹ 12,000

Tax as per MAT 3,50,000 × 7.50% = ₹ 26,250

Tax expense= Current Tax +Deferred Tax

₹ 1,20,000 = ₹ 12,000+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-20X1

= ₹ 1,20,000 – ₹ 12,000 = ₹ 1,08,000

Amount of tax to be debited in Profit and Loss account for the year 31 -03-20X1 Current Tax + Deferred Tax liability + Excess of MAT over current tax

= ₹ 12,000 + ₹ 1,08,000 + ₹ 14,250 (26,250 – 12,000) = ₹ 1,34,250

Question 3

PQR Ltd.'s accounting year ends on 31st March. The company made a loss of ₹ 2,00,000 for the year ending 31.3.20X1. For the years ending 31.3.20X2 and 31.3.20X3, it made profits of ₹ 1,00,000 and ₹ 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.20X1, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the years ending 20X2 and 20X3 for tax purposes. Prepare a statement of Profit and Loss for the years ending 20X1, 20X2 and 20X3.

(*Source: Illustration 3, Study Material*)

Answer

Statement of Profit and Loss

	31.3.20X1 ₹	31.3.20X2 ₹	31.3.20X3 ₹
Profit (Loss)	(2,00,000)	1,00,000	1,20,000
Less: Current tax (20,000 x 40%)			(8,000)
Deferred tax:			
Tax effect of timing differences originating during the year (2,00,000 x 40%)	80,000		
Tax effect of timing differences reversed/adjusted during the year (1,00,000 x 40%)		(40,000)	(40,000)
Profit (Loss) After Tax Effect	(1,20,000)	60,000	72,000

Question 4

Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognises revenue from these contracts on percentage of completion method for financial statements during 20X0-20X1, 20X1-20X2 and 20X2-20X3 for ₹ 11,00,000, ₹ 16,00,000 and ₹ 21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognised revenue of ₹ 7,00,000, ₹ 18,00,000 and ₹ 23,00,000 for the years 20X0-20X1, 20X1-20X2 and 20X2-20X3 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 20X0-20X1, 20X1- 20X2 and 20X2-20X3.

(*Source: Illustration 4, Study Material*)

Answer

Calculation of Deferred Tax Asset/Liability in Omega Limited

Year	Accounting Income	Taxable Income	Timing Difference	Timing Difference (balance)	Deferred Tax	Deferred Tax Liability (balance)
20X0-20X1	11,00,000	7,00,000	4,00,000	4,00,000	1,40,000	1,40,000
20X1-20X2	16,00,000	18,00,000	(2,00,000)	2,00,000	(70,000)	70,000
20X2-20X3	<u>21,00,000</u>	<u>23,00,000</u>	(2,00,000)	NIL	(70,000)	NIL
	48,00,000	48,00,000				

Question 5

Write short note on Timing differences and Permanent differences as per AS 22.

Answer

In current practices, companies, in general, prepare books of accounts as per Companies Act, 2013 generating Accounting Profit/Loss and Income-tax Act, 1961 generating Taxable Profit/Loss. Accounting income and taxable income for a period are seldom the same. Permanent differences are those which arise in one period and do not reverse subsequently. For e.g., an income exempt from tax or an expense that is not allowable as a deduction for tax purposes. Timing differences are those which arise in one period and are capable of reversal in one or more subsequent periods. For e.g., Depreciation etc.

Question 6

Y Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference is INR 200 lakhs and INR 400 lakhs respectively which will result in a tax liability in year 1 and 2. From the third year it is expected that the timing difference would reverse each year by INR 10 lakhs. Assuming tax rate of 40%, find out the deferred tax liability at the end of the second year and any charge to the Profit and Loss account.

Answer

As per AS 22, 'Accounting for Taxes on Income', deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognised to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income- tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognised in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of 200 lakhs timing difference due to depreciation, difference amounting 80 lakhs (10 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognised. However, for 120 lakhs (200 lakhs

– ₹ 80 lakhs), deferred tax liability will be recognised for 48 lakhs (40% of

120 lakhs) in first year. In the second year, the entire amount of timing difference of ₹ 400 lakhs will reverse only after tax holiday period and hence, will be recognised in full. Deferred tax liability amounting 160 lakhs (40% of 400 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be 208 lakhs (48 lakhs + 160 lakhs).

Question 7

Ultra Ltd. has provided the following information: Depreciation as per accounting records =INR 4,00,000 Depreciation as per tax records =INR 10,00,000

Unamortized preliminary expenses as per tax record = INR 30,000

There is adequate evidence of future profit sufficiency. How much deferred tax asset/liability should be recognized as transition adjustment when the tax rate is 50%?

Answer

Calculation of difference between taxable income and accounting income

Particulars	**Amount (₹)**
Excess depreciation as per tax ₹ (10,00,000 – 4,00,000)	6,00,000
Less: Expenses unamortized in tax records	(30,000)
Timing difference	5,70,000

Tax expense is more than the current tax due to timing difference.

Therefore deferred tax liability = 50% x 5,70,000 = 2,85,000

Question 8

Saras Ltd. closes its books as on 31st March 20X2. They have accrued

₹ 5,00,000 towards GST Liability for the month of March 20X2 by debiting their Profit and loss statement which is expected to be paid off by 21st April 20X2 . As per the provisions of Section 43B of the Income Tax Act, 1961 – Any expenditure of the nature mentioned in section 43B (e.g. taxes, duty, cess, fees, etc.) accrued in the statement of profit and loss on mercantile basis will be allowed for tax purposes in subsequent years on payment basis only. Assuming a Tax rate of 30% determine the Deferred Tax Asset/Liability as at 31st March 20X2.

Answer

Calculation of difference between taxable income and accounting income

Particulars	Amount (₹)
GST Liability debited in books	5,00,000
Less: GST Liability allowed under Income Tax Act (Section 43B)	Nil
Timing difference	5,00,000

Tax expense is less than the current tax due to timing difference. Therefore, deferred tax Asset = 30% x 5,00,000 = 1,50,000

Question 9

ABC Company limited had an investment in Venture Capital amounting ₹ 10 Crores. Venture capital in turn had invested in the below portfolio companies (New Start- ups) on behalf of ABC Limited:

Portfolio Companies	***Amount of investment (₹ in Crores)***
Oscar Limited	*2*
Zee Limited	*3*
Star Limited	*4*
Sony Limited	*1*
Total	*10*

During the FY 2019-2020, Venture Capital had sold their investment in Star Limited and realised an amount of ₹ 8 Crores on sale of shares of star Limited and entire proceeds of ₹ 8 Crores have been transferred by Venture Capital to ABC Company Limited.

The accounts manager has received the following additional information from venture capital on 31.03.2020:

(1) *8 Crores has been deducted from the cost of investment and carrying amount of investment as at year end is 2 Crores.*

(2) *Company had to pay a capital gain tax @ 20% on the net sale consideration of ₹ 4 Crores.*

(3) *Due to COVID-19, the remaining start- ups (i.e. Oscar Limited, Zee Limited, and Sony Limited) are not performing well and will soon wind up their operations. Venture capital is monitoring the situation and if required they will provide an impairment loss in June 2020 Quarter.*

You need to suggest the accounts manager what should be the correct accounting treatment as per AS 22 "Accounting for Taxes on Income".

Answer

As company had to pay capital gain tax @ 20% on the net sale consideration as per income tax laws, the company has to recognise a current tax liability of 0.8 Crores computed as under:

Particulars	Amount (₹ in Crores)
Sales Consideration	8
Cost of Investment	4
Net gain on Sale	4
Tax @ 20%	0.8

As per AS 22, Timing differences are those differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.

Particulars	Amount (₹ in Crores)	Rationale
Taxable Income	4	As per income tax laws
Accounting Income	Nil	As the same is deducted from the cost of investment
Timing Difference	4	

As per AS 22, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

Since in current scenario, due to Covid 19 the portfolio companies are not performing well, thus the company may not have sufficient future taxable income which will reverse deferred tax assets. Therefore, the company should not recognise DTA of ₹ 0.8 Crores and company should recognise only current tax liability of ₹ 0.8 Crores.

QUESTION BANK

Question 10

Write short not on Timing difference and permanent Difference as per AS 22.

(*May 2019*) (*5 Marks*)

Answer:

Matching of taxes against revenue for a period poses special problems arising from the fact that in number of cases, taxable income maybe different from the accounting income. The divergence between taxable income may be different from the accounting income arises due to two main reasons: Firstly, there are differences between items of revenue and expenses as appearing in the statement of profit and loss and the items which are considered as revenue, expenses or deductions for tax purposes, known as Permanent Difference. Secondly, there are differences between the amount in respect of a particular item of revenue or expense as recognised in the statement of profit and loss and the corresponding amount which is recognised for the computation of taxable income, known as Timing Difference.

Permanent differences are the differences between taxable income and accounting income which arise in one accounting period and do not reverse subsequently. For example, an income exempt from tax or an expense that is not allowable as a deduction for tax purposes.

Timing differences are those differences between taxable income and accounting income which arise in one accounting period and are capable of reversal in one or more subsequent periods. For e.g., Depreciation, Bonus, etc.

Question 11

Rohit Ltd. has provided the following information

Particulars	**₹**
Depreciation as per accounting records	2,50,000
Depreciation as per tax records	5,50,000
Unamortised preliminary expenses as per tax record	40,000

There is adequate evidence of future profit sufficiency. How much deferred tax assets/liability should be recognized as transition adjustment when the tax rate is 50%?

(*May 2018*) (*5 Marks*)

Answer:

Table showing calculation of deferred tax asset/liability

Particulars	**Amount ₹**	**Timing difference**	**Deferred tax**	**Amount @ 50% ₹**
Excess depreciation as per tax records (₹5,50,000 - ₹2,50,000)	3,00,000	Timing	Deferred tax liability	1,50,000
Unamortised preliminary expenses as per tax records	40,000	Timing	Deferred tax asset	(20,000)
Net deferred tax liability				1,30,000

Net deferred tax liability amounting ₹1,30,000 should be recognized as transition adjustment.

Question 12

Is it permissible not to recognize deferred tax liability on the ground that the Company expects that there will be losses both for accounting and tax purposes in near future? You are required to give advise to the company.

(*RTP May 2019*)

Answer:

The Company should provide for deferred tax liability on the timing differences irrespective for the fact that these timing differences will reverse in the period in which the Company expects to be in loss both from the accounting as well as tax point of view. It may, however, be added that the deferred tax liability recognized at the balance sheet date will give rise to future taxable income at the time of reversal thereof.

Question 13

Beta Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference resulting in a tax liability in year 1 and 2 is ₹1,000 lakhs and ₹2,000 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by ₹50 lakhs. Assuming tax rate of 40%, you are required to compute to the deferred tax liability at the end of the second year and any charge to the Profit and Loss account.

(*RTP November 2018*)

Answer:

As per para 13 of Accounting Standard (AS) 22, Accounting for Taxes on Income", deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognized to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income-tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognized in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of ₹1,000 lakhs depreciation, timing difference amounting ₹400 lakhs (₹50 lakhs × 8 years) will reverse in the tax holiday period and therefore, should not be recognized. However, for ₹600 lakhs (₹1,000 lakhs - ₹400 lakhs), deferred tax liability will be recognized for ₹240 lakhs (40% of ₹600 lakhs) in first year. In the second year, the entire amount of timing difference of ₹2,000 lakhs will reverse only after tax holiday period and hence, will be recognized in full. Deferred tax liability amounting ₹800 lakhs (40% of ₹2,000 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be ₹1,040 lakhs (240 lakhs + 800 lakhs).

Question 14

Gamma Limited is working on different projects which are likely to be completed within 3 years period. It recognizes revenue from these contracts on percentage of completion method for financial statements during 2014-2015, 2015-2016 and 2016-2017 for ₹11,00,000, ₹16,00,000 and ₹21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognized revenue of ₹7,00,000, ₹18,00,000 and ₹23,00,000 for the years 2014-2015, 2015-2016 and 2016-2017 respectively. Income-tax rate is 35%.

You are required to compute the amount of deferred tax asset/liability for the years 2014-2015, 2015-2016 and 2016-2017. Also describe how this amount of deferred tax asset/liability will be disclosed in the balance sheet of Omega Limited as per provisions of AS 22.

(*MTP March 2018 & 2019*) (*5 Marks*)

Answer:

Gamma Limited

Calculation of Deferred Tax Asset/Liability

Year	Accounting Income	Taxable Income	Timing Difference (balance)	Deferred Tax Liability (balance)
2014-2015	11,00,000	7,00,000	4,00,000	1,40,000
2015-2016	16,00,000	18,00,000	2,00,000	70,000
2016-2017	21,00,000	23,00,000	NIL	NIL
	48,00,000	48,00,000		

As per AS 22, deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities. The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts.

Question 15

The following particulars are stated in the Balance Sheet of PQR Ltd. as on 31.03.2018:

	(₹ in lakh)
Deferred Tax Liability (Cr.)	30.00
Deferred Tax Assets (Dr.)	15.00

The following transactions were reported during the year 2018-2019:

(i)	Tax Rate	30%
		(₹ in lakh)
(ii)	Depreciation as per books	80.00
	Depreciation for tax purposes	70.00
(iii)	Items disallowed in 2017-2018 and allowed for tax purposes in 2018-2019.	10.00
(iv)	Donations to Private Trust made in 2018-2019.	10.00

There were no additions to Fixed Assets during the year.

You are required to show the impact of various items on Deferred Tax Assets and Deferred Tax Liability as on 31.03.2019.

Answer

Impact of various items in terms of AS 22 deferred tax liability/deferred tax asset

Transactions	***Analysis***	***Nature of difference***	***Effect***	***Amount***
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	₹ (80-70) lakh × 30% = ₹3 lakh

Transactions	***Analysis***	***Nature of difference***	***Effect***	***Amount***
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	₹ 10 lakh × 30% = ₹ 3 lakh
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable

Question 16

(a) The following information is furnished in respect of Slate Ltd. for the year ending 31-3-2019:

(i) Depreciation as per books ₹ 2,80,000

Depreciation for tax purpose ₹ 1,90,000

The above depreciation does not include depreciation on new additions.

(ii) A new machinery purchased on 1.4.18 costing ₹ 1,20,000 on which 100% depreciation is allowed in the 1st year for tax purpose whereas Straight-line method is considered appropriate for accounting purpose with a life estimation of 4 years.

(iii) The company has made a profit of ₹ 6,40,000 before depreciation and taxes.

(iv) Corporate tax rate of 40%.

Prepare relevant extract of statement of Profit and Loss for the year ending 31-3-2019 and also show the effect of above items on deferred tax liability/asset as per AS 22.

(b) What are the disclosure requirements for deferred tax assets and deferred tax liabilities in the balance sheet as per AS 22?

(*RTP, May, 2021*)

Answer

(a) Statement of Profit and Loss for the year ended 31st March, 2019 (Extract)

		₹
Profit before depreciation and taxes		6,40,000
Less: Depreciation for accounting purposes (2,80,000+30,000)		(3,10,000)
Profit before taxes (A)		3,30,000
Less: Tax expense (B)		
Current tax (W.N.1) (3,30,000 x 40%)	1,32,000	
Deferred tax (W.N.2)	NIL	(1,32,000)
Profit after tax (A-B)		1,98,000

Working Notes:

1. Computation of taxable income

	Amount (₹)
Profit before depreciation and tax	6,40,000
Less: Depreciation for tax purpose (1,90,000 + 1,20,000)	(3,10,000)
Taxable income	3,30,000
Tax on taxable income @ 40%	1,32,000

2. Impact of various items in terms of deferred tax liability / deferred tax asset

S. No.	***Transactions***	***Analysis***	***Nature of difference***	***Effect***	***Amount (₹)***
(i)	Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	(2,80,000 - 1,90,000) x 40% = (36,000)
(ii)	Depreciation on new machinery	Due to Allowance of full amount as expenditure under IT Act, tax payable in the earlier years is less.	Timing difference	Creation of DTL	(1,20,000 – 30,000) x 40% = 36,000
	Net impact				NIL

(b) The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balance should be disclosed in the notes to accounts. Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities. The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

Question 17

From the following details of Aditya Limited for accounting year ended on 31st March, 2020:

Particulars	**₹**
Accounting profit	15,00,000
Book profit as per MAT	7,50,000
Profit as per Income tax Act	2,50,000
Tax Rate	20%
MAT Rate	7.5%

Calculate the deferred tax asset/liability as per AS 22 and amount of tax to be debited to the profit and loss account for the year.

(*Suggested, November, 2020) (5 marks)*

Answer

Tax as per accounting profit 15,00,000×20%= ₹ 3,00,000 Tax as per
Income-tax Profit 2,50,000×20% =₹ 50,000
Tax as per MAT 7,50,000×7.50%= ₹ 56,250
Tax expense= Current Tax +Deferred Tax ₹ 3,00,000 = ₹ 50,000+ Deferred tax
Therefore, Deferred Tax liability as on 31-03-2020
= ₹ 3,00,000 – ₹ 50,000 = ₹ 2,50,000
Amount of tax to be debited in Profit and Loss account for the year 31-03-2020
Current Tax + Deferred Tax liability + Excess of MAT over current tax
= ₹ 50,000 + ₹ 2,50,000 + ₹ 6,250 (56,250 – 50,000) = ₹ 3,06,250

Question 18

The following particulars are stated in the Balance Sheet of HS Ltd. as on 31 -3-2019:

Particulars	(₹ in lakhs)
Deferred Tax Liability (Cr.)	60.00
Deferred Tax Assets (Dr.)	30.00
The following transactions were reported during the year 2019-20:	
Depreciation as per accounting records	160.00
Depreciation as per income tax records	140.00
Items disallowed for tax purposes in 2018-19 but allowed in 2019-20	20.00
Donation to Private Trust	20.00
Tax rate	30%

There were no additions to fixed assets during the year. You are required to show the impact of various items on Deferred Tax Assets and Deferred Tax Liability as on 31-3-2020 as per AS-22.

(*Suggested, January, 2021*) (*5 marks*)

Answer

Impact of various items in terms of AS 22 deferred tax liability/deferred tax asset

(1) Difference in Depreciation-Generally, written down value method of depreciation is adopted under income Tax Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years. It is timing difference for which reversal of Deferred tax liability is required.
Reversal of DTL= ₹ (160 – 140) Lakhs X 30% = ₹6 Lakhs

(2) Disallowances, as per IT Act of earlier years- Due to disallowance tax payable for the earlier years was higher on this account. It is responding timing difference which required Reversal of Deferred tax assets.
Reversal of Deferred tax assets = ₹20 Lakhs X 30% = ₹ 6 Lakhs

(3) Donations to private trusts is not an allowable expenditure under IT Act. It is permanent difference. Hence, no reversal of tax is required.

Question 19

The following particulars are stated in the Balance Sheet of Deep Limited as on 31st March, 2020:

	(₹ In Lakhs)
Deferred Tax Liability (Cr.)	28.00
Deferred Tax Assets (Dr.)	14.00

The following transactions were reported during the year 2020 -2021:

(i) Depreciation as per books was ₹ 70 Lakhs whereas Depreciation for Tax purposes was ₹ 42 Lakhs. There were no additions to Fixed Assets during the year.

(ii) Expenses disallowed in 2019-20 and allowed for tax purposes in 2020-21 were ₹ 14 Lakhs.

(iii) Share issue expenses allowed under section 35(D) of the Income Tax Act, 1961 for the year 2020-21 (1/10th of ₹ 70.00 lakhs incurred in 2019-20).

(iv) Repairs to Plant and Machinery were made during the year for ₹ 140.00 Lakhs and was spread over the period 2020-21 and 2021-22 equally in the books. However, the entire expenditure was allowed for income-tax purposes in the year 2020-21. Tax Rate to be taken at 40%.

You are required to show the impact of above items on Deferred Tax Assets and Deferred Tax Liability as on 31st March, 2021.

*(*July, 2021 Suggested*) (*5 Marks*)*

Answer

Impact of various items in terms of deferred tax liability/deferred tax asset on 31.3.21

Transactions	Analysis	Nature of difference	Effect	Amount (₹)
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	28 lakhs × 40% = ₹ 11.20 lakhs
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	14 lakhs × 40% = 5.6 lakhs
Share issue expenses	Due to disallowance of full expenditure under IT Act, tax payable in the earlier years was higher.	Responding timing difference	Reversal of DTA	7 lakhs × 40% = ₹ 2.8 lakhs
Repairs to plant and machinery	Due to allowance of full expenditure under IT Act, tax payable of the current year will be less.	Originating timing difference	Increase in DTL	70 lakhs × 40% =28 lakhs

Question 20

Can an enterprise offset deferred tax assets and deferred tax liabilities? If yes, prescribe the conditions required for such offset as per provisions of AS 22.

(*RTP November 2021*)

Answer

Yes. It can offset deferred tax assets and deferred tax liabilities.

As per AS 22, an enterprise should offset deferred tax assets and deferred tax liabilities if:

(i) the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and

(ii) the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

Question 21

The following transactions were reported by PQR Ltd. during the year 2020-2021:

(i)	Tax Rate	30%
(ii)	Items disallowed in 2019-2020 and allowed for tax purposes in 2020-2021.	(₹ in lakh) 20.00
(iii)	Interest to Financial Institutions accounted in the books on accrual basis, but actual payment was made before the due date of filing return and allowed for tax purpose also.	20.00
(iv)	Donations to Private Trust made in 2020-2021 (not allowed under Income Tax Laws).	10.00

You are required to show impact of the above items in terms of Deferred Tax Assets/Deferred Tax Liability for the year ended 31.03.2021.

(*RTP May, 2022*)

Answer

Impact of various items in terms of deferred tax liability/deferred tax asset as per AS 22

Transactions	***Analysis***	***Nature of difference***	***Effect***	***Amount***
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Timing difference	Reversal of DTA	₹ 20 lakh × 30% = ₹ 6 lakh
Interest to financial institutions	It is allowed as deduction under IT Act, if the payment is made before the due date of filing the return of income	No timing difference	Not applicable	Not applicable
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable

Question 22

The following information is furnished in respect of Mohit Limited for the year ending 31st March,2022.

(i) *Depreciation as per accounting records ₹ 56,000*

Depreciation for income tax records ₹ 38,000

The above depreciation does not include depreciation on new addition.

(ii) *A new machinery purchased on 1st April, 2021 costing ₹ 24,000 on which 100% depreciation in allowed in the 1st Year for income tax purpose, whereas straight line method of depreciation is considered appropriate for accounting purpose with a life estimation of 4 years.*

(iii) The company has made a profit of ₹ 1,28,000 before depreciation and taxes.

(iv) Donation to private trust during the year is ₹ 15,000 (*not allowed under Income tax laws.*)

(v) Corporate tax is 40%.

Prepare relevant extract of statement of Profit & Loss for the year ending 31st March, 2022. Also show the effect of the above items on Deferred Tax Liability/Assets as per AS 22.

(Suggested November, 2022) (5 Marks)

Answer

Statement of profit and Loss for the year ended 31st March, 2022 (An Extract)

	₹
Profit before taxes and depreciation	1,28,000
Less: Depreciation (56,000+ 6,000)	62,000
Profit before tax	66,000
Less: Current tax (W.N)	(32,400)
Deferred Tax	Nil
Profit after tax	33,600

Working Note:

Computation of taxable income

	₹
Profit before taxes and depreciation	1,28,000
Less: Depreciation (38,000+ 24,000)	(62,000)
	66,000
Add: Donation*	15,000
	81,000
Current tax (40%)	32,400

Note: The profit of ₹ 1,28,000 given in the question is before depreciation and taxes. It has been considered that this amount is after making adjustment of donation amounting ₹ 15,000.

Impact of various items in terms of deferred tax liability/deferred tax asset

Transactions	***Nature of difference***	***Effect***	***Amount***
(1) Difference in depreciation (old machinery)	Timing difference	Reversal of DTL	₹ 18,000 (56,000 – 38,000) × 40% = (+) ₹ 7,200
(2) Depreciation on new machinery	Timing difference	Creation of DTL	₹ 18,000 (24,000 – 6,000) x 40% = (-) ₹ 7,200
(3) Donation to private trusts	Permanent difference	Not applicable	--
Net Effect of Deferred Tax			NIL

Question 23

Define followings as per AS 22:

(i) Accounting income (loss)

(ii) Taxable income (tax loss)

(iii) Tax expense (tax saving)

(*RTP November, 2022*)

Answer

Accounting income (loss) is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income-tax expense or adding income tax saving.

Taxable income (tax loss) is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income-tax payable (recoverable) is determined.

Taxable expenses is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.

Question Arrangement

AS 22

Topic	Question Numbers
Deferred Tax Asset and Liability Calculation	1, 7, 11, 3, 4, 14, 8, 15, 18, 19, 21, 16, 22
Minimum Alternate Tax	2, 17
Tax-free Entities	6, 13
Prudence	9, 12
Offset	20
Theory	5, 10, 23

Accounting Standard 14
Accounting for Amalgamations

Question 1

A Ltd. take over B Ltd. on April 01, 20X1 and discharges consideration for the business as follows:

(i) Issued 42,000 fully paid equity shares of ₹ 10 each at par to the equity shareholders of B Ltd.

(ii) Issued fully paid up 15% preference shares of ₹ 100 each to discharge the preference shareholders (₹ 1,70,000) of B Ltd. at a premium of 10%.

(iii) It is agreed that the debentures of B Ltd. (₹ 50,000) will be converted into equal number and amount of 13% debentures of A Ltd.

Determine the amount of purchase consideration as per AS 14.

(*Source: Illustration 1, Study Material*)

Answer

Particulars	₹
Equity Shares (42,000 x 10)	4,20,000
15% Preference Share Capital	1,70,000
Add: Premium on Redemption	17,000
Purchase Consideration	6,07,000

Note: As per AS 14, consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. Thus, payment to debenture holders are not covered by the term 'consideration'.

Question 2

A Ltd. and B Ltd. were amalgamated on and from 1st April, 20X1. A new company C Ltd. was formed to take over the business of the existing companies. A Ltd. and B Ltd. have the following ledger balances as on 31st March, 20X1:

	A Ltd. (₹ in lakhs)	***B Ltd. (₹ in lakhs)***
Land and Building	*550*	*400*
Plant and Machinery	*350*	*250*
Investments (Non-current)	*150*	*50*
Inventory	*350*	*250*
Trade Receivables	*300*	*350*
Cash and Bank	*300*	*200*

	A Ltd. (₹ in lakhs)	**B Ltd. (₹ in lakhs)**
Share Capital:		
Equity Shares of ₹ 100 each	*800*	*750*
12% Preference shares of ₹ 100 each	*300*	*200*
Reserves and Surplus:		
Revaluation Reserve	*150*	*100*
General Reserve	*170*	*150*
Investment Allowance Reserve	*50*	*50*
Profit and Loss Account	*50*	*30*
Secured Loans:		
10% Debentures (₹ 100 each)	*60*	*30*
Trade Payables	*420*	*190*

Additional Information:

(1) 10% Debenture holders of A Ltd. and B Ltd. are discharged by C Ltd. issuing such number of its 15% Debentures of ₹ 100 each so as to maintain the same amount of interest.

(2) Preference shareholders of the two companies are issued equivalent number of 15% preference shares of C Ltd. at a price of ₹ 150 per share (face value of ₹ 100).

(3) C Ltd. will issue 5 equity shares for each equity share of A Ltd. and 4 equity shares for each equity share of B Ltd. The shares are to be issued @ ₹ 30 each, having a face value of ₹ 10 per share.

(4) Investment allowance reserve is to be maintained for 4 more years.

Prepare the Balance Sheet of C Ltd. as on 1st April, 20X1 after the amalgamation has been carried out on the basis of Amalgamation in the nature of purchase.

(*Source: Illustration 2, Study Material*)

Answer

Balance Sheet of C Ltd. as at 1st April, 20X1

Particulars	**Note No.**	**(₹ in lakhs)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,200
(b) Reserves and Surplus	2	1,650
(2) Non-Current Liabilities Long-term borrowings	3	60
(3) Current Liabilities Trade payables	8	610
Total		3,520
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	4	1,550
(b) Intangible assets	5	20
(c) Non-current investments	6	200
(2) Current assets		
(a) Inventory (350 + 250)		600
(b) Trade receivables	7	650
(c) Cash and bank balances (300 + 200)		500
Total		3,520

Notes to Accounts

		(₹ in lakhs)	**(₹ in lakhs)**
1.	Share Capital		
	Equity share capital (W.N.1)		
	70,00,000[1] Equity shares of ₹ 10 each	700	
	5,00,000[2] Preference shares of ₹ 100 each	500	
	(all the above shares are allotted as fully paid-up pursuant to contracts without payment being received in cash)		1,200
2.	Reserves and surplus		
	Securities Premium Account (W.N.3) (950 + 700)	1,650	
	Investment Allowance Reserve (50 + 50)	100	
	Amalgamation Adjustment Reserve (50 + 50)	*(100)*	*1,650*
3.	Long-term borrowings		
	15% Debentures		60
4.	Property, Plant and Equipment		
	Land and Building (550 + 400)	950	
	Plant and Machinery (350 + 250)	600	1,550
5.	Intangible assets		
	Goodwill [W.N. 2] (110 – 90)		20
6.	Non-current Investments		
	Investments (150 + 50)		200
7.	Trade receivables (300 + 350)		650
8.	Trade payables (420 + 190)		610

Working Notes:

		(₹ in lakhs)	
	(a) Preference shareholders:	*A Ltd.*	*B Ltd.*
(1)	Computation of Purchase consideration		
	$\left(\frac{3,00,00,000}{100} \text{ i.e. } 3,00,000 \text{ shares}\right) \times \text{Rs.}150 \text{ each}$	450	
	$\left(\frac{2,00,00,000}{100} \text{ i.e. } 2,00,000 \text{ shares}\right) \times \text{Rs.}150 \text{ each}$		300
	(b) Equity shareholders:		
	$\left(\frac{8,00,00,000 \times 5}{100} \text{ i.e. } 40,00,000 \text{ shares}\right) \times \text{Rs.}30 \text{ each}$	1,200	
	$\left(\frac{7,50,00,000 \times 5}{100} \text{ i.e. } 30,00,000 \text{ shares}\right) \times \text{Rs.}30 \text{ each}$		900
	Amount of Purchase Consideration	1,650	1,200

1 40,00,000 + 30,00,000
2 3,00,000 + 2,00,000

			(₹ in lakhs)	
	(a) Preference shareholders:		*A Ltd.*	*B Ltd.*
(2)	Net Assets Taken Over			
	Assets taken over:			
	Land and Building		550	400
	Plant and Machinery		350	250
	Investments		150	50
	Inventory		350	250
	Trade receivables		300	350
	Cash and bank		300	200
			2,000	1,500
	Less: Liabilities taken over:			
	Debentures	40		20
	Trade payables	420		190
			460	210
	Net assets taken over		1,540	1,290
	Purchase consideration		1,650	1,200
	Goodwill		110	
	Capital reserve			90
(3)	Computation of securities premium			
	On preference share capital			
	A Ltd.- 3,00,000 x 50		150	
	B Ltd.- 2,00,000 x 50			100
	On equity share capital			
	A Ltd.- 40,00,000 x 20		800	
	B Ltd.- 30,00,000 x 20			600
	Total		950	700

Question 3

Briefly describe the disclosure requirements for amalgamation including additional disclosure, if any, for different methods of amalgamation as per AS 14 (Revised).

(*Source: Theory Question 6, Study Material*)

Answer

The disclosure requirements for amalgamations have been prescribed in paragraphs 43 to 46 of AS 14 (Revised) on Accounting for Amalgamation. Refer Para 2.5 for details.

Question 4

List the conditions to be fulfilled as per AS 14 (Revised) for an amalgamation to be in the nature of merger, in the case of companies.

(*Source: Theory Question 7, Study Material*)

Answer

According to AS 14 "Accounting for Amalgamations", Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

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

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

Question 5

Briefly explain the methods of accounting for amalgamation as per Accounting Standard-14.

(*Source: Theory Question 8, Study Material*)

Answer

As per AS 14 on 'Accounting for Amalgamations', there are two main methods of accounting for amalgamations:

The Pooling of Interest Method

Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (after making the necessary adjustments).

If at the time of amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

The Purchase Method

Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

Question 6

X Co. Ltd. having share capital of ₹ 50 lakhs divided into equity shares of ₹ 10 each was taken over by Y Co. Ltd. Y Co. Ltd. issued 11 equity shares of ₹ 10 each for every 10 shares of X Co. Ltd.

Explain how the difference will be adjusted in the books of Y Co. Ltd. for the shares issued under the 'Pooling of interests method' of amalgamation as per AS 14.

(*Source: Practical Question 9, Study Material*)

Answer

Particulars	₹
Purchase consideration = 5,00,000 x 11/10 = 55,000	55,00,000
shares of ₹ 10 each	50,00,000
Less: Share capital of X Co. Ltd.	
Difference Adjusted through General Reserve	5,00,000

Question 7

On 1st April, 2018, Tina Ltd. take over the business of Rina Ltd. and discharged purchase consideration as follows:

(i) Issued 50,000 fully paid Equity shares of ₹ 10 each at a premium of ₹ 5 per share to the equity shareholders of Rina Ltd.

(ii) Cash payment of ₹ 50,000 was made to equity shareholders of Rina Ltd.

(iii) Issued 2,000 fully paid 12% Preference shares of ₹ 100 each at par to discharge the preference shareholders of Rina Ltd.

(iv) Debentures of Rina Ltd. 20,000) will he converted into equal number and amount of 10% debentures of Tina Ltd.

Calculate the amount of Purchase consideration as per AS-14 and pass Journal Entry relating to discharge of purchase consideration in the books of Tina Ltd.

(*Source: Practical Question 10, Study Material*)

Answer

A per AS 14, consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

Computation of Purchase Consideration

Particulars	₹
Equity Shares (50,000x 15)	7,50,000
Cash payment	50,000
12% Preference Share Capital	2,00,000
Purchase Consideration	10,00,000

Note: Payment to debenture holders are not covered by the term ‘consideration’.

Journal entry

Particulars	₹	₹
Liquidation of Rina Ltd. A/c	10,00,000	
To Equity share capital A/c		5,00,000
To 12% Preference share capital A/c To Securities premium A/c		2,00,000 2,50,000
To Bank/Cash A/c		50,000
(Being payment of cash and issue of shares for discharge of purchase consideration)		

QUESTION BANK

Question 8

Som Ltd. agreed to takeover Dove Ltd. on 1st April, 2020. The terms and conditions of takeover were as follows:

(i) Som Ltd. issued 56,000 equity shares of ₹100 each at a premium of ₹10 per share to the equity shareholders of Dove Ltd.

(ii) Cash payment of ₹ 1,00,000 was made to equity shareholders of Dove Ltd.

(iii) 20,000 fully paid preference shares of ₹ 70 each issued at par to discharge the preference shareholders of Dove Ltd.

You are required to calculate the amount of purchase consideration as per the provisions of AS 14

(*RTP, November, 2020*)

Answer

As per AS 14, 'Accounting for Amalgamations' consideration for the amalgamation means the aggregate of shares and other securities issued and payment made in form of cash or other assets by the transferee company to the shareholders of the transferor company.

(i) Computation of Purchase Consideration:

		₹
(a)	Preference Shares:	
	20,000 Preference shares in Som Ltd. @ ₹ 70 per share	14,00,000
(b)	Cash	1,00,000
(c)	Equity shares: 56,000 equity shares in Som Ltd. @ ₹ 110 per share	61,60,000
		76,60,000

Question 9

Astha Ltd. is absorbed by Nistha Ltd.; the consideration being the takeover of liabilities, the payment of cost of absorption not exceeding ₹ 10,000 (actual cost ₹ 9,000); the payment of the 9% debentures of ₹ 50,000 at a premium of 20% through 8% debentures issued at a premium of 25% of face value and the payment of ₹15 per share in cash and allotment of three 11% preference shares of ₹ 10 each and four equity shares of ₹10 each at a premium of 20% fully paid for every five shares in Astha Ltd.

The number of shares of the vendor company are 1,50,000 of ₹ 10 each fully paid. Calculate purchase consideration as per AS 14.

(*RTP, May, 2021*)

Answer

As per AS 14 'Accounting for Amalgamations', the term 'consideration' has been defined as the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

The payment made by transferee company to discharge the Debenture holders and outside liabilities and cost of winding up of transferor company shall not be considered as part of purchase consideration.

Computation of Purchase Consideration

	₹
Cash payment ₹15 x 1,50,000	22,50,000
11% Preference Shares of ₹ 10 each [(1,50,000 x 3/5) x ₹ 10]	9,00,000
Equity shares of ₹ 10 each @ 20% premium [(1,50,000 x 4/5) x ₹ 12]	14,40,000
Total Purchase consideration	45,90,000

Question 10

Naresh Ltd. had the following transactions during the financial year 2019 -2020:

(i) Naresh Ltd. acquired running business of Sunil Ltd. for ₹ 10,80,000 on 15th May, 2019. The fair value of Sunil Ltd.'s net assets was ₹ 5,16,000. Naresh Ltd. is of the view that due to popularity of Sunil Ltd.'s product in the market, its goodwill exists.

(ii) Naresh Ltd. had taken a franchise on July 2019 to operate a restaurant from Sankalp Ltd. for ₹1,80,000 and at an annual fee of 10% of net revenues (after deducting expenditure). The franchise expires after 6 years. Net revenues were ₹ 60,000 during the financial year 2019-2020.

(iii) On 20th August, 2019, Naresh Ltd, incurred costs of ₹ 2,40,000 to register the patent for its product. Naresh Ltd. expects the patent's economic life to be 8 years.

Naresh Ltd. follows an accounting policy to amortize all intangibles on straight line basis over the maximum period permitted by accounting standards taking a full year amortization in the year of acquisition. Goodwill on acquisition of business to be amortized over 5 years (SLM) as per AS 14.

Prepare a schedule showing the intangible assets section in Naresh Ltd. Balance Sheet at 31st March, 2020.

(*RTP, May, 2021*)

Answer

Naresh Ltd.

Balance Sheet (Extract relating to intangible asset) as on 31st March 2020

	Note No.	₹
Assets		
(1) Non-current assets		
Intangible assets	1	8,11,200

Notes to Accounts (Extract)

		₹	₹
1.	Intangible assets		
	Goodwill (Refer to note 1)	4,51,200	
	Franchise (Refer to Note 2)	1,50,000	
	Patents (Refer to Note 3)	2,10,000	8,11,200

Working Notes:

		₹
(1)	Goodwill on acquisition of business	
	Cash paid for acquiring the business (purchase consideration)	10,80,000
	Less: Fair value of net assets acquired	(5,16,000)
	Goodwill	5,64,000
	Less: Amortisation as per AS 14 i.e. over 5 years (as per SLM)	(1,12,800)
	Balance to be shown in the balance sheet	4,51,200
(2)	Franchise	1,80,000
	Less: Amortisation (over 6 years)	(30,000)
	Balance to be shown in the balance sheet	1,50,000
(3)	Patent	2,40,000
	Less: Amortisation (over 8 years as per SLM)	(30,000)
	Balance to be shown in the balance sheet	2,10,000

Question 11

List the conditions to be fulfilled as per AS-14 (Revised) for an amalgamation to be in the nature of merger.

(*Suggested, January, 2021) (5 marks)*

Answer

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

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

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

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

Question 12

Star Limited agreed to take over Moon Limited on 1st April, 2022. The terms and conditions of takeover were as follows:

(i) Star Limited issued 70,000 Equity shares of ₹ 100 each at a premium of ₹ 10 per share to the equity shareholders of Moon Limited.

(ii) Cash payment of ₹ 1,25,000 was made to the equity shareholders of Moon Limited.

(iii) 25,000 fully paid Preference shares of ₹ 70 each issued at par to discharge the preference shareholders of Moon Limited.

You are required:

(i) to give the meaning of "consideration for the amalgamation' as per AS-14, and

(ii) Calculate the amount of purchase consideration.

(*Suggested November, 2022*) (*4 Marks*)

Answer

Consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

Computation of Purchase consideration	**(₹)**	***Form***
For Preference Shareholders of Moon Ltd. (25,000 × ₹ 70)	17,50,000	25,000 Preference
For equity shareholders of Moon Ltd. (70,000 × ₹ 110)	77,00,000	70,000 Equity shares of Star Ltd.
	1,25,000	Cash
Total Purchase consideration	95,75,000	

Accounting Standard 21
Consolidated Financial Statements

Question 1

From the following data, determine in each case:

(1) Minority interest at the date of acquisition and at the date of consolidation.

(2) Goodwill or Capital Reserve.

(3) Amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own Profit & Loss Account to be ₹2,00,000 in each case:

Case	***Subsidiary Company***	***% shares owned***	***Cost*** ₹	***Date of acquisition***		***Consolidation Date***	
				1.1.20X1		***31.12.20X1***	
				Share Capital ₹	***Profit & Loss Account*** ₹	***Share Capital*** ₹	***Profit & Loss Account*** ₹
Case 1	*A*	*90%*	*1,40,000*	*1,00,000*	*50,000*	*1,00,000*	*70,000*
Case 2	*B*	*85%*	*1,04,000*	*1,00,000*	*30,000*	*1,00,000*	*20,000*
Case 3	*C*	*80%*	*56,000*	*50,000*	*20,000*	*50,000*	*20,000*
Case 4	*D*	*100%*	*1,00,000*	*50,000*	*40,000*	*50,000*	*55,000*

(*Source: Illustration 1, Study Material*)

Answer

(1) *Minority Interest = Equity attributable to minorities*

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case it should be equal to Share Capital + Profit & Loss A/c

	Minority % Shares Owned [E]	**Minority interest as at the date of acquisition [E] x [A + B] ₹**	**Minority interest as at the date of consolidation [E] X [C + D] ₹**
Case 1 [100-90]	10 %	15,000	17,000
Case 2 [100-85]	15 %	19,500	18,000
Case 3 [100-80]	20 %	14,000	14,000
Case 4 [100-100]	NIL	Nil	Nil

A = *Share capital on 1.1.20X1*

B = *Profit & loss account balance on 1.1.20X1*

C = Share capital on 31.12.20X1

D = Profit & loss account balance on 31.12.20X1

(2) *Calculation of Goodwill or Capital Reserve*

	Shareholding % [F]	**Cost [G]**	**Total Equity [A] + [B] = [C]**	**Parent's Portion of equity [F] x [C] = H**	**Goodwill ₹ [G] - [H]**	**Capital Reserve ₹ [H] - [G]**
Case 1	90 %	1,40,000	1,50,000	1,35,000	5,000	—
Case 2	85 %	1,04,000	1,30,000	1,10,500	—	6,500
Case 3	80 %	56,000	70,000	56,000	Nil	Nil
Case 4	100 %	1,00,000	90,000	90,000	10,000	—

(3) *The balance in the Profit & Loss Account on the date of acquisition (1.1.20X1) is Capital profit, as such the balance of Consolidated Profit & Loss Account shall be equal to Holding Co.'s profit.*

On 31.12.20X1 in each case the following amount shall be added or deducted from the balance of holding Co.'s Profit & Loss account.

	% Share holding [K]	**P & L as on 1.1.20X1 [L]**	**P & L as on consolidation date [M]**	**P & L post acquisition [N] = [M]-[L]**	**Amount to be added / (deducted) from holding's P & L [O] = [K] x [N]**
1	90 %	50,000	70,000	20,000	18,000
2	85 %	30,000	20,000	(10,000)	(8,500)
3	80 %	20,000	20,000	NIL	NIL
4	100 %	40,000	55,000	15,000	15,000

Question 2

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 20X1 for ₹ 1,40,000. The issued capital of ABC Ltd., on 1st January, 20X1 was ₹1,00,000 and the balance in the Profit & Loss Account was ₹60,000.

During the year ended 31st December, 20X1, ABC Ltd. earned a profit of ₹20,000 and at year end, declared and paid a dividend of ₹ 15,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd.

What is the amount of minority interest as on 1st January, 20X1 and 31st December, 20X1? Also please check whether there should be any goodwill/ capital reserve at the date of acquisition.

(*Source: Illustration 2, Study Material*)

Answer

Total dividend paid is ₹ 15,000 (assumed to be out of post-acquisition profits), hence dividend received by XYZ will be credited to P & L.

XYZ Ltd.'s share of dividend = ₹ 15,000 X 80% = ₹ 12,000

In the books of XYZ Ltd.

	₹	₹
Bank A/c Dr.	12,000	12,000
To Profit & Loss A/c		
(Dividend received from ABC Ltd credited to P&L A/c being out of post-acquisition profits - as explained above)		
Goodwill on consolidation (at the date of acquisition):	₹	₹
Cost of shares		1,40,000
Less: Face value of capital i.e. 80% of capital	80,000	
Add: Share of capital profits [60,000X 80 %]	48,000	(1,28,000)
Goodwill		12,000

	₹	₹
Minority interest on:		
- **1st January, 20X1:**		
20% of ₹ 1,60,000 [1,00,000 + 60,000]		32,000
- **31st December, 20X1:**		
20% of ₹ 1,65,000 [1,00,000 + 60,000 + 20,000 - 15,000]		33,000

Question 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:

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

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

Property, plant and equipment	Up by 20%
Investments	Down by 10%

Zed Ltd. declared and paid dividend @ 20% on its equity shares as on 31st March, 20X1 (Face value - ₹10 per share). Exe Ltd. purchased the shares of Zed Ltd. @ ₹20 per share.

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

(*Source: Illustration 3, Study Material*)

Answer

Revalued net assets of Zed Ltd. as on 31st March, 20X1

	₹ in lakhs	**₹ in lakhs**
Property, plant and equipment [120 X 120%]		144.0
Investments [55 X 90%]		49.5
Current Assets		70.0
Loans and Advances		15.0
Total Assets after revaluation		278.5
Less: 15% Debentures	90.0	
Current Liabilities	50.0	(140.0)
Equity / Net Worth		138.5
Exe Ltd.'s share of net assets (70% of 138.5)		96.95
Exe Ltd.'s cost of acquisition of shares of Zed Ltd.		
(₹ 70 lakhs - ₹ 7 lakhs*)		63.00
Capital reserve		33.95

* Total Cost of 70 % Equity of Zed Ltd	₹ 70 lakhs
Purchase Price of each share	₹ 20
Number of shares purchased [70 lakhs /₹ 20]	3.5 lakhs
Dividend @ 20 % i.e. ₹ 2 per share	₹ 7 lakhs

Since dividend received is for pre-acquisition period, it has been reduced from the cost of investment in the subsidiary company.

Question 4

A Ltd. acquired 70% of equity shares of B Ltd. on 1.4.20X1 at cost of ₹ 10,00,000 when B Ltd. had an equity share capital of ₹ 10,00,000 and reserves and surplus of ₹80,000. In the four consecutive years, B Ltd. fared badly and suffered losses of ₹2,50,000, ₹4,00,000, ₹5,00,000 and ₹ 1,20,000 respectively. Thereafter in 20X5- X6, B Ltd. experienced turnaround and registered an annual profit of ₹50,000. In the next two years i.e. 20X6-X7 and 20X7-X8, B Ltd. recorded annual profits of ₹ 1,00,000 and ₹ 1,50,000 respectively. Show the minority interests and cost of control at the end of each year for the purpose of consolidation.

(*Source: Illustration 4, Study Material*)

Answer

The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. In such cases, AS 21 prescribes that the excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

Where the minority interest has a binding obligation (say by way of a shareholders₹ agreement), then the share of losses will be attributed to the minority interest even if it exceeds the minority interest in the equity (i.e., debit balance in minority interest). Since information on the existence of a binding obligation is not given in the question, we solve as if such obligation does not exist, and hence the minority interests will be computed as follows:

Year	***Profit/(Loss)***	***Minority Interest (30%)***	***Additional Consolidated P & L (Dr.) Cr. (for the year ended balance)***	***Minority's Share of losses borne by A Ltd.***		***Cost of Control***
				₹	***Balance***	
At the time of acquisition in 20X1		3,24,000 - (W.N.)	-			
20X1-X2	(2,50,000)	(75,000)	(1,75,000)			2,44,000 (W.N.)
Balance		2,49,000				
20X2-X3	(4,00,000)	(1,20,000)	(2,80,000)			2,44,000
Balance		1,29,000				
20X3-X4	(5,00,000)	(1,50,000)	(3,50,000)			2,44,000
		(21,000)				
	Loss of minority borne by Holding Co.	21,000	(21,000)	21,000	21,000	
Balance		Nil	(3,71,000)			
20X4-X5	(1,20,000)	(36,000)	(84,000)			2,44,000
	Loss of minority borne by Holding Co.	36,000	(36,000)	36,000	57,000	
Balance		Nil	(1,20,000)			

Year	***Profit/(Loss)***	***Minority Interest (30%)***	***Additional Consolidated P & L (Dr.) Cr. (for the year ended balance)***	***Minority's Share of losses borne by A Ltd.***		***Cost of Control***
				₹	***Balance***	
20X5-X6	50,000	15,000	35,000			2,44,000
	Profit share of minority adjusted against losses of minority absorbed by Holding Co.	(15,000)	15,000	(15,000)	42,000	
Balance		Nil	50,000			
20X6-X7	1,00,000	30,000	70,000	(30,000)	12,000	2,44,000
	Profit share of minority adjusted against losses of minority absorbed by Holding Co.	(30,000)	30,000			
Balance		Nil	100,000			
20X7-X8	1,50,000	45,000	1,05,000	(12,000)	Nil	2,44,000
		(12,000)	12,000			
Balance		33,000	1,17,000			

Working Note:

Calculation of Minority interest and Cost of control on 1.4.20X1

		Share of Holding Co.	**Minority Interest**
	100%	70%	30%
	(₹)	(₹)	(₹)
Share Capital	10,00,000	7,00,000	3,00,000
Reserve	80,000	56,000	24,000
		7,56,000	3,24,000
Less: Cost of investment		(10,00,000)	
Goodwill		2,44,000	

Question 5

Variety Ltd. holds 46% of the paid-up share capital of VR Ltd. The shares were acquired at a market price of ₹ 17 per share. The balance of shares of VR Ltd. are held by a foreign collaborating company. A memorandum of understanding has been entered into with the foreign company providing for the following:

(a) *The shares held by the foreign company will be sold to Variety Ltd. The price per share will be calculated by capitalising the yield at 15%. Yield, for this purpose, would mean 40% of the average of pre-tax profits for the last 3 years, which were ₹30 lakhs, ₹40 lakhs and ₹ 65 lakhs.*

(b) *The actual cost of the shares to the foreign company was ₹5,40,000 only. The profit that would accrue to them would be taxable at an average rate of 30%. The tax payable will be deducted from the proceeds and Variety Ltd. will pay it to the Government.*

(c) *Out of the net consideration, 50% would be remitted to the foreign company immediately and the balance will be an unsecured loan repayable after two years.*

The above agreement was approved by all concerned for being given effect to on 1.4.20X1. The total assets of VR Ltd. as on 31st March, 20X1 was ₹ 1,00,00,000. It was decided to write down Property, Plant and Equipment by ₹ 1,75,000. Current liabilities of VR Ltd. as on the same date were ₹ 20,00,000. The paid-up share capital of VR Ltd. was ₹20,00,000 divided into 2,00,000 equity shares of ₹ 10 each.

Find out goodwill/capital reserve to Variety Ltd. on acquiring wholly the shares of VR Ltd.

(*Source: Illustration 5, Study Material*)

Answer

1. Computation of Purchase Consideration

(a) Yield of VR Ltd.: $\left[\frac{40}{100} \times \frac{30+40+65}{3}\right]$ ₹ 18 lakhs

(b) Price per share of VR Ltd.:

Capitalized Yield: $\left[\frac{18 \text{ lakhs}}{0.15}\right]$ ₹ 120 lakhs

No. of shares 2 lakhs

Therefore, price per share ₹ 60

(c) Purchase Consideration for 54% shares in VR Ltd.

2 lakh shares x 54% x ₹ 60 per shares ₹ 64.80 lakhs

(d) Discharge of Purchase Consideration:

Tax at source (₹ 64.80 lakhs - ₹ 5.40 lakhs) x $\frac{30}{100}$ ₹ 17.82 lakhs

50% of purchase consideration (net of tax) in cash [₹ (64.80 - 17.82) x 50%] ₹ 23.49 lakhs

Balance - Unsecured Loan ₹ 23.49 lakhs

2. Goodwill / Capital Reserve to Variety Ltd.

	₹ in lakhs	
Total Assets	100.00	78.25
Less: Reduction in Value of Property, Plant and	(1.75)	
Equipment	98.25	
Less: Current Liabilities	(20.00)	
Net Assets of VR Ltd. on Date of Acquisition		
Purchase Consideration: 54% purchased from Foreign Co.	64.80	(80.44)
Investment: 46% existing stake	15.64	**2.19**
Goodwill on Date of Acquisition		

Question 6

A Ltd. acquired 60% shares of B Ltd. @ ₹20 per share. Following is the extract of Balance Sheet of B Ltd.:

	₹
10,00,000 Equity Shares of ₹ 10 each	*1,00,00,000*
10% Debentures	*10,00,000*
Trade Payables	*55,00,000*
Property, Plant and Equipment	*70,00,000*
Investments	*45,00,000*
Current Assets	*68,00,000*
Loans and Advances	*22,00,000*

On the same day B Ltd. declared dividend at 20% and as agreed between both the companies Property, Plant and Equipment were to be depreciated @ 10% and investment to be taken at market value of ₹60,00,000. Calculate the Goodwill or Capital Reserve to be recorded in Consolidated Financial Statements.

(*Source: Illustration 6, Study Material*)

Answer

Since dividend is declared by B Ltd. on the date of acquisition itself, it would be out of the divisible profits of B Ltd. existing on the date of acquisition i.e., preacquisition profits from the perspective of A Ltd. Accordingly, as per AS 13, such pre-acquisition dividend would be reduced from the cost of investment, as seen below in the determination of Goodwill on the date of acquisition.

	₹	₹
Assets		
Property, Plant and Equipment	70,00,000	
Less: Value written off (₹ 70 lakhs x 10%)	(7,00,000)	
	63,00,000	
Investments at Market Value	60,00,000	
Current Assets	68,00,000	
Loans and Advances	22,00,000	2,13,00,000
Less: Liabilities		
Trade Payables	55,00,000	
10% Debentures	10,00,000	(65,00,000)
Net Assets of B Ltd.		1,48,00,000
Share of A Ltd. in Net Assets of B Ltd.: 60%		88,80,000
Less: Cost of Investment in B Ltd. (60% stake):		
10,00,000 Equity Shares x 60% x ₹ 20 per share	1,20,00,000	
Less: Pre-acquisition dividend: 6,00,000 shares x ₹ 2	(12,00,000)	(1,08,00,000)
Goodwill on Date of Acquisition		**19,20,000**

Question 7

H Ltd. acquired 3,000 shares in S Ltd., at a cost of ₹4,80,000 on 31.7.20X1. The capital of S Ltd. consisted of 5,000 shares of ₹ 100 each fully paid. The Profit & Loss Account of this company for 20X1 showed an opening balance of ₹ 1,25,000 and profit for the year was ₹3,00,000. At the end of the year, it declared a dividend of 40%. Record the entry in the books of H Ltd., in respect of the dividend. Assume the profit is accruing evenly and calendar year as financial year.

(*Source: Illustration 7, Study Material*)

Answer

The profits of S Ltd., have to be divided between capital and revenue profits from the point of view of the holding company:

	Capital Profit (Preacquisition) ₹		***Revenue Profit (Postacquisition)*** ₹
Balance on 1.1.20X1	1,25,000	—	
Profit for 20X1 (3,00,000 x 7/12)	1,75,000	(3,00,000x5/12)	1,25,000
Total	3,00,000		1,25,000
Proportionate share of H Ltd. (3/5)	1,80,000		75,000

Total dividend declared = ₹ 5,00,000 X 40 % = ₹ 2,00,000

H Ltd.'s share in the dividend = ₹ 2,00,000 X 3/5 = ₹ 1,20,000

There can be two situations as regards the treatment of dividend of ₹ 1,20,000:

(1) The profit for 20X1 has been utilised to pay the dividend.

The share of H Ltd in profit for the first seven months of S Ltd = ₹ 1,05,000 (i.e. ₹ 1,75,000 x 3/5)

Profit for the remaining five months = ₹ 75,000 (i.e.₹ 1,25,000 x 3/5).

The dividend of ₹ 1,20,000 will be adjusted in this ratio of 1,05,000: 75,000 = ₹ 70,000 out of profits up to 31.7.20X1 and ₹ 50,000 out of profits after that date.

The dividend out of profits subsequent to 31.7.20X1 will be revenue income and that out of earlier profits will be capital receipt. Hence the entry will be:

		₹	₹
Bank	Dr.	1,20,000	
To Investment Account			70,000
To Profit and Loss Account			50,000

(2) Later profits have been utilised first and then pre- acquisition profits.

In such a case, the whole of ₹ 75,000 (share of H Ltd. in profits of S Ltd., after 31.7.20X1) would be received and treated as revenue income; the remaining dividend, ₹45,000 (₹1,20,000 less ₹ 75,000) would be capital receipt. The entry would be:

		₹	₹
Bank	Dr.	1,20,000	
To Investment Account			45,000
To Profit & Loss Account			75,000

Note: Point (2) discussed above can arise only if there is definite information about the profits utilized. In practice, such treatment is rare.

Question 8

A Ltd. and B Ltd. provide the following information:

		₹ 000s
	A Ltd.	**B Ltd.**
Equity Shares	*6,000*	*5,000*
6% Preference Shares	*NIL*	*1,000*
General Reserve	*1,200*	*800*
Profit and Loss Account	*1,020*	*1,790*
Trade Payables	*3,850*	*3,410*
Dividend Payable	*600*	*500*
Goodwill	*100*	*20*
Property, Plant and Equipment	*3,850*	*2,750*
Investment	*1,620*	*1,100*
Inventory	*1,900*	*4,150*
Trade Receivables	*4,600*	*4,080*
Cash & Bank	*600*	*400*

A Ltd. purchased 3/4th interest in B Ltd. at the beginning of the year at the premium of 25%. Following other information is available:

(a) *Profit & Loss Account of B Ltd. includes f 1,000 thousands bought forward from the previous year.*

(b) *The General Reserve balance is brought forward from the previous year.*

(c) *The directors of both the companies have declared a dividend of 10% on equity share capital for the previous.*

From the above information calculate Pre-and Post-acquisition Profits, Minority Interest and Cost of Control.

(*Source: Illustration 8, Study Material*)

Answer

Calculation of Pre- and Post-Acquisition Profits:

	Pre-Acquisition Profits (?)	**Post-Acquisition Profits (?)**
Profit & Loss Account	10,00,000	7,90,000
General Reserve	8,00,000	NIL
	18,00,000	7,90,000

	Pre-Acquisition Profits (?)	Post-Acquisition Profits (?)
Less: Share of Minority Interest: (%)	(4,50,000)	(1,97,500)
Attributable to Parent	13,50,000	5,92,500
	(Cost of Control)	(Post-acquisition Profits)

Calculation of Minority Interest:

Particulars	**₹**
Paid-up Equity Share Capital (^ 50,00,000 x %)	12,50,000
Paid-up Preference Share Capital	10,00,000
Share in Reserves:	
Profit & Loss Account: ^ 17,90,000 x %	4,47,500
General Reserve: ^ 8,00,000 x %	2,00,000
Minority Interest	**28,97,500**

Calculation of Goodwill/Capital Reserve

	₹	₹
Cost of Investment in Subsidiary: ^50,00,000 x 75% x 125% (cost + 25% premium)	46,87,500	
Less: Pre-acquisition dividend	(3,75,000)	43,12,500
Less: Net Worth of B Ltd. on Date of Acquisition (attributable to A Ltd.):		
Paid-up Capital	37,50,000	
Pre-acquisition Reserves	13,50,000	(51,00,000)
Capital Reserve		7,87,500

Question 9

On 31s March, 20X1, P Ltd. acquired 1,05,000 shares of Q Ltd. for ₹ 12,00,000. The position of Q Ltd. on that date was as under:

	₹
Property, plant and equipment	*10,50,000*
Current Assets	*6,45,000*
1,50,000 equity shares of ₹ 10 each fully paid	*15,00,000*
Pre-incorporation profits	*30,000*
Profit and Loss Account	*60,000*
Trade payables	*1,05,000*

P Ltd. and Q Ltd. give the following information on 31st March, 20X3:

	P Ltd. *₹*	***Q Ltd.*** *₹*
Equity shares of ₹ 10 each fully paid (before bonus issue)	*45,00,000*	*15,00,000*
Securities Premium	*9,00,000*	*—*
Pre-incorporation profits	*—*	*30,000*
General Reserve	*60,00,000*	*19,05,000*
Profit and Loss Account	*15,75,000*	*4,20,000*
Trade payables	*5,55,000*	*2,10,000*

	P Ltd. *₹*	***Q Ltd.*** *₹*
Property, plant and equipment	*79,20,000*	*23,10,000*
Investment: 1,05,000 Equity shares in Q Ltd. at cost	*12,00,000*	*—*
Current Assets	*44,10,000*	*17,55,000*

Directors of Q Ltd. made bonus issue on 31.3.20X3 in the ratio of one equity share of ₹ 10 each fully paid for every two equity shares held on that date. Bonus shares were issued out of post-acquisition profits by using General Reserve.

Calculate as on 31st March, 20X3 (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account in each of the following cases:

(a) Before issue of bonus shares;

(b) Immediately After issue of bonus shares.

(*Source: Illustration 9, Study Material*)

Answer

Shareholding pattern

Particulars	**Number of Shares**	**% of holding**
(a) P Ltd.		
(i) Purchased on 31.03.20X1	**1,05,000**	
(ii) Bonus Issue (1,05,000/2)	**52,500**	
Total	**1,57,500**	**70%**
(b) Minority Interest	**67,500**	**30%**

Calculations of (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account as on 31st March, 20X3:

(a) Before issue of bonus shares

(i)	**Cost of control/capital reserve**	₹	₹
	Investment in Q Ltd.		12,00,000
	Less: Face value of investments (Share Capital)	10,50,000	
	Capital profits (W.N.)	63,000	(11,13,000)
	Cost of control (i.e., Goodwill)		87,000
(ii)	**Minority Interest**		₹
	Share Capital		4,50,000
	Capital profits (W.N.)		27,000
	Revenue profits (W.N.)		6,79,500
			11,56,500
(iii)	**Consolidated profit and loss account - P Ltd.**		₹
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd.		15,85,500
	(W.N.)		31,60,500

(b) Immediately after issue of bonus shares

(i)	**Cost of control/capital reserve**	₹	₹
	Face value of investments (₹ 10,50,000 + ₹ 5,25,000)	15,75,000	
	Capital Profits (W.N.)	63,000	16,38,000
	Less: Investment in Q Ltd.		(12,00,000)
	Capital reserve		4,38,000

(ii)	Minority Interest		₹
	Share Capital (₹ 4,50,000 + ₹ 2,25,000)		6,75,000
	Capital Profits (W.N.)		27,000
	Revenue Profits (W.N.)		4,54,500
			11,56,500
(iii)	**Consolidated Profit and Loss Account - P Ltd.**		₹
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		10,60,500
			26,35,500

Working Note:

Analysis of Profits of Q Ltd.

	Capital Profits (Pre-acquisition) (Before and after issue of bonus shares) ₹	Revenue Profits (Post-acquisition)	
		Before Bonus Issue ₹	After Bonus Issue ₹
Pre-incorporation profits	30,000		
Profit and loss account on	60,000		
31.3.20X1	90,000		
General reserve*		19,05,000	19,05,000
Less: Bonus shares			(7,50,000)
			11,55,000
Profit for period of 1st April, 20X1 to 31st March, 20X3		3,60,000	3,60,000
(₹ 4,20,000 - ₹ 60,000)		22,65,000	15,15,000
P Ltd.'s share (70%)	63,000	15,85,500	10,60,500
Minority's share (30%)	27,000	6,79,500	4,54,500

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

Question 10

Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31 March, 20X1 from the following information:

	H Ltd.	*S Ltd.*
	₹	₹
PPE	*5,00,000*	*3,00,000*
Investments		
(20,000 equity shares of S Ltd.)	*2,20,000*	
Current Assets	*1,55,000*	*1,00,000*
Share capital (Fully paid equity shares of ₹ 10 each)	*5,00,000*	*2,50,000*
Profit and loss account	*2,00,000*	*1,00,000*
Trade Payables	*1,75,000*	*50,000*

H Ltd. acquired the shares of S Ltd. on 31st March, 20X1.

(*Source: Illustration 10, Study Material*)

Answer

Percentage of holding:

		No. of Shares	Percentage
Holding Co	:	20,000	(80%)
Minority shareholders	:	5,000	(20%)
TOTAL SHARES	:	25,000	

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March,20X1

		Note No	Amount (₹)
	I EQUITY AND LIABILITIES		
1	**Shareholder's Fund**		
	(a) Share Capital	1	5,00,000
	(b) Reserve and Surplus	2	2,60,000
2	**Minority interest**	3	
3	**Current Liabilities**		70,000
	(a) Trade payables	4	2,25,000
	Total		10,55,000
	II ASSETS		
1.	**Non-Current Assets**		
	PPE	5	8,00,000
2.	**Current Assets**	6	2,55,000
	Total		10,55,000

Notes to Accounts

			Amounts (₹)
1	**Share capital**		
	50,000 Equity Shares @ ₹10 each		5,00,000
2	**Reserve and Surplus**		
	Capital Reserve (W.N.)		60,000
	Profit and loss account		2,00,000
			2,60,000
3	**Minority Interest**		
	Paid up value of shares	50,000	
	Add: Share in Profit and loss account 20,000		70,000
4	**Trade payables**		
	H Ltd.		1,75,000
	S Ltd.		50,000
			2,25,000
5	**PPE**		
	H Ltd.		5,00,000
	S Ltd.		3,00,000
			8,00,000
6	**Current Assets**		
	H Ltd.		1,55,000
	S Ltd.		1,00,000
			2,55,000

Working Note:

Determination of Goodwill/(*Capital Reserve*)		**(₹)**
Cost of investment		2,20,000
Less: Paid up value of shares (80% of 2,50,000)	2,00,000	
Share in pre-acquisition profits (80% of 1,00,000)	80,000	(2,80,000)
Capital Reserve		(60,000)

Question 11

H Ltd. and S Ltd. provide the following information as at 31st March,20X2:

	H Ltd.	***S Ltd.***
	₹	*₹*
PPE	*1,00,000*	*1,30,000*
Investments (8,000 equity shares of S Ltd.)	*1,26,000*	
Current Assets	*74,000*	*70,000*
Share capital (Fully paid equity shares of ₹10 each)	*1,50,000*	*1,00,000*
Profit and loss account	*50,000*	*40,000*
Trade Payables	*1,00,000*	*60,000*

Additional information:

H Ltd. acquired the shares of S Ltd. on 1-7-20X1 and Balance of profit and loss account of S Ltd. on 1-4-20X1 was 30,000.

Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31st March, 20X2.

(*Source: Illustration 11, Study Material*)

Answer

Percentage of holding:

		No. of Shares	**Percentage**
Holding Co.	:	8,000	(80%)
Minority shareholders :		2,000	(20%)
TOTAL SHARES	:	10,000	

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd.
as at 31st March, 20X2

		Note No	Amount (₹)
	I EQUITY AND LIABILITYES		
1	Shareholder's Fund		
	(a) Share Capital	1	1,50,000
	(b) Reserve and Surplus	2	56,000
2	Minority interest	3	28,000
3	Current Liabilities		
	(a) Trade payables	4	1,60,000
	Total		**3,94,000**

Notes to Accounts

	II ASSETS		
1	Non-Current Assets:		
	PPE	5	2,30,000

	Intangible Asset		6	20,000
2	Current Assets		7	1,44,000
	Total			**3,94,000**
1	**Share capital**			1,50,000
	15,000 Equity Shares @ ₹10 each			
2	**Reserve and Surplus**			
	Profit and loss account (₹ 50,000+ 80% of 9/12 x 10,000)			56,000
3	**Minority Interest**			
	Share capital (20% of ₹ 1,00,000)	20,000		
	Share in Profit and loss account (₹ 40,000 X 20%)	8,000		28,000
4	**Trade payables**			
	H Ltd.			1,00,000
	S Ltd.			60,000
				1,60,000
5	**PPE**			
	H Ltd.			1,00,000
	S Ltd.			1,30,000
				2,30,000
6	Intangible Asset			
	Cost of Investment			1,26,000
	Less: Paid up value of shares (80% of ₹ 1,00,000)			
	Share in pre-acquisition profits			(80,000)
	80% of [30,000 + 3/12(40,000-30,000)]			(26,000)
	Goodwill			20,000
7	**Current Assets**			
	H Ltd.			74,000
	S Ltd.			70,000
				1,44,000

Question 12

From the Balance Sheets and information given below, prepare Consolidated Balance Sheet of Virat Ltd. and Anushka Ltd. as at 31st March. Virat Ltd. holds 80% of Equity Shares in Anushka Ltd. since its (Anushka Ltd.'s) incorporation.

Balance Sheet of Virat Ltd. and Anushka Ltd. as at 31st March, 20X1

Particulars	***Note No.***	***Virat Ltd. (₹)***	***Anushka Ltd. (₹)***
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	*1*	*6,00,000*	*4,00,000*
(b) Reserves and Surplus	*2*	*1,00,000*	*1,00,000*
(2) Non-current Liabilities			
Long Term Borrowings		*2,00,000*	*1,00,000*
(3) Current Liabilities			
(a) Trade Payables		*1,00,000*	*1,00,000*
Total		*10,00,000*	*7,00,000*

Particulars	***Note No.***	***Virat Ltd. (₹)***	***Anushka Ltd. (₹)***
II. Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment		*4,00,000*	*3,00,000*
(b) Non-current investments	*3*	*3,20,000*	*-*
(2) Current Assets			
(a) Inventories		*1,60,000*	*2,00,000*
(b) Trade Receivables		*80,000*	*1,40,000*
(c) Cash & Cash Equivalents		*40,000*	*60,000*
Total		*10,00,000*	*7,00,000*

Notes to Accounts

	Particulars	*(₹)*	***Virat Ltd. (₹)***	***Anushka Ltd. (₹)***
1.	***Share capital***			
	60,000 equity shares of ₹ 10 each fully paid up		*6,00,000*	*—*
	40,000 equity shares of ₹ 10 each fully paid up		*—*	*4,00,000*
	Total		*6,00,000*	*4,00,000*
2.	***Reserves and Surplus***			
	General Reserve		*1,00,000*	*1,00,000*
	Total		*1,00,000*	*1,00,000*
3.	***Non-current investments***			
	Shares in Anushka Ltd		*3,20,000*	*—*

(*Source: Illustration 12, Study Material*)

Answer

Consolidated balance Sheet of Virat Ltd. and its Subsidiary Anushka Ltd. as at 31st March, 20X1

	Particulars	**Note**	**Amount (₹)**
I	**EQUITY AND LIABILITIES:**		
(1)	**Shareholders₹ Funds:**		
	(a) Share Capital	1	6,00,000
	(b) Reserve and Surplus	2	1,80,000
(2)	**Minority Interest**	3	1,00,000
(3)	**Non-Current Liabilities:**		
	Long Term Borrowings	4	3,00,000
(4)	**Current Liabilities:**		2,00,000
	Trade Payables	5	
	Total		**13,80,000**
II	**ASSETS:**		
(1)	**Non-Current Assets**		
	Property, Plant & Equipment	6	7,00,000
(2)	**Current Assets:**		
	(a) Inventories		
	(b) Trade receivables	7	3,60,000
	(c) Cash and Cash Equivalents	8	2,20,000
		9	1,00,000
	Total		**13,80,000**

Notes to Accounts

	Particulars	₹	₹
1.	**Share capital**		
	60,000 equity shares of ₹10 each fully paid up		6,00,000
2.	**Reserves and Surplus**		
	General Reserve	1,00,000	
	Add: General reserve of Anushka Ltd (80%)	80,000	
	Total		1,80,000
3.	**Minority interest**		
	20% share in Anushka Ltd (WN 3)		1,00,000
4	**Long term borrowings**		
	Long term borrowings of Virat	2,00,000	
	Add: Long term borrowings of Anushka	1,00,000	
	Total		3,00,000
5.	**Trade payables**		
	Trade payables of Virat	1,00,000	
	Add: Trade payables of Anushka	1,00,000	
	Total		2,00,000
6.	**Property, Plant and Equipment (PPE)**		
	PPE of Virat Ltd	4,00,000	
	Add: PPE of Anushka Ltd	3,00,000	
	Total		7,00,000
7.	**Inventories**		
	Inventories of Virat Ltd	1,60,000	
	Add: Inventories of Anushka Ltd	2,00,000	
	Total		3,60,000
8.	**Trade receivables**		
	Trade receivables of Virat Ltd	80,000	
	Add: Trade receivables of Anushka Ltd	1,40,000	
	Total		2,20,000
9	**Cash and cash equivalents**		
	Cash and cash equivalents of Virat Ltd	40,000	
	Add: Cash and cash equivalents of Anushka Ltd	60,000	
	Total		1,00,000

1. Basic Information

Company Status	**Dates**	**Holding Status**
Holding Co. = Virat Ltd. Subsidiary = Anushka Ltd.	Acquisition: Anushka's Incorporation Consolidation: 31st March, 20X1	Holding Company = 80% Minority Interest = 20%

2. Analysis of General Reserves of Anushka Ltd

Since Virat holds shares in Anushka since its incorporation, the entire Reserve balance of ₹1,00,000 will be Revenue.

3. Consolidation of Balances

Holding- 80%, Minority - 20%	Total	Minority Interest	Holding Company	
Equity Capital	4,00,000	80,000	3,20,000	-
General Reserves	1,00,000	20,000	Nil (pre-acq)	80,000 (post-acq)
Total		1,00,000	3,20,000	80,000
Cost of Investment Goodwill/capital reserve			(3,20,000) NIL	-
Parent's Balance				1,00,000
Amount for Consolidated Balance Sheet				1,80,000

Question 13

From the following balance sheets of H Ltd. And its subsidiary S Ltd. drawn up at 31st March, 20X1, prepare a consolidated balance sheet as at that date, having regard to the following:

(i) Reserves and Profit and Loss Account of S Ltd. stood at ₹25,000 and ₹ 15,000 respectively on the date of acquisition of its 80% shares by H Ltd. on 1st April, 20X0.

(ii) Machinery (Book-value ₹ 1,00,000) and Furniture (Book value ₹ 20,000) of S Ltd. were revalued at ₹ 1,50,000 and ₹ 15,000 respectively on 1st April, 20X0 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.]

Balance Sheet of H Ltd. and S Ltd. as at 31st March, 20X1

Particulars	Note No.	H Ltd. (₹)	S Ltd. (₹)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	*1*	*6,00,000*	*1,00,000*
(b) Reserves and Surplus	*2*	*3,00,000*	*1,00,000*
(2) Current Liabilities			
(a) Trade Payables		*1,50,000*	*57,000*
Total		*10,50,000*	*2,57,000*
II. Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment	*3*	*4,50,000*	*1,07,000*
(b) Other non-current investments	*4*	*6,00,000*	*1,50,000*
Total		*10,50,000*	*2,57,000*

Notes to Accounts

		₹	***H Ltd. (₹)***	***S Ltd. (₹)***
1.	***Share capital***			
	6,000 equity shares of ₹ 100 each, fully paid up		*6,00,000*	*—*
	1,000 equity shares of ₹ 100 each, fully paid up		*- -*	*1,00,000*
	Total		*6,00,000*	*1,00,000*
2.	***Reserves and Surplus***			
	General reserves		*2,00,000*	*75,000*
	Profit and loss account		*1,00,000*	*25,000*
	Total		*3,00,000*	*1,00,000*

		₹	*H Ltd.* (₹)	*S Ltd.* (₹)
3.	***Property, Plant and Equipment***			
	Machinery		*3,00,000*	*90,000*
	Furniture		*1,50,000*	*17,000*
	Total		*4,50,000*	*1,07,000*
4.	***Other Non-current investments***			
	Non-current Investments		*4,40,000*	*1,50,000*
	Shares in S Ltd.		*1,60,000*	*—*
	(800 shares at ₹200 each)			
	Total		*6,00,000*	*1,50,000*

(*Source: Illustration 13, Study Material*)

Answer

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 20X1

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,00,000
(b) Reserves and Surplus	2	3,44,600
(2) Minority Interest	3	48,150
(3) Current Liabilities		
(a) Trade Payables		2,07,000
Total		**11,99,750**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	4	5,97,750
(b) Intangible assets	5	12,000
(c) Other non-current investments	6	5,90,000
Total		**11,99,750**

Notes to Accounts

				₹
1.	**Share capital**			
	6,000 equity shares of ₹ 100 each, fully paid up			6,00,000
	Total			6,00,000
2.	**Reserves and Surplus**			
	Reserves		2,00,000	
	Add: 4/5th share of S Ltd.'s post acquisition reserves (W.N.3)		40,000	2,40,000
	Profit and Loss Account		1,00,000	
	Add: 4/5th share of S Ltd.'s post acquisition profits (W.N.4)		4,600	1,04,600
	Total			3,44,600
3.	**Minority interest in S Ltd.** (WN 5)			48,150

				₹
4.	**Property, plant and equipment**			
	Machinery			
	H. Ltd.		3,00,000	
	S Ltd.	1,00,000		
	Add: Appreciation	50,000		
		1,50,000		
	Less: Depreciation (1,50,000 X 10%)*	(15,000)	1,35,000	
	Furniture			
	H. Ltd.		1,50,000	
	S Ltd.	20,000		
	Less: Decrease in value	(5,000)		
		15,000		
	Less: Depreciation (15,000 X 15%)*	(2,250)	12,750	5,97,750
5.	**Intangible assets**			
	Goodwill [WN 6]			12,000
6.	Other non-current investments			
	H Ltd.		4,40,000	
	S Ltd.		1,50,000	
	Total			5,90,000

* As an alternative manner of presentation, the solution contains only the ₹additional depreciation₹.

	₹
1. Pre-acquisition profits and reserves of S Ltd.	
Reserves	25,000
Profit and Loss Account	15,000
	40,000
H Ltd.'s = 4/5 (or 80%) x 40,000	32,000
Minority Interest= 1/5 (or 20%) x 40,000	8,000
2. Profit on revaluation of assets of S Ltd.	
Profit on Machinery ₹ (1,50,000 - 1,00,000)	50,000
Less: Loss on Furniture ₹ (20,000 - 15,000)	5,000
Net Profit on revaluation	45,000
H Ltd.'s share 4/5 x 45,000	36,000
Minority Interest 1/5 x 45,000	9,000
3. Post-acquisition reserves of S Ltd.	
Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 75,000 25,000)	50,000
H Ltd.'s share 4/5 x 50,000	40,000
Minority interest 1/5 x 50,000	10,000
4. Post -acquisition profits of S Ltd.	
Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = ₹ 25,000 - 15,000)	10,000
Add: Excess depreciation charged on furniture @ 15%	
on ₹ 5,000 i.e. (20,000 - 15,000)	750
	10,750

	₹
Less: Under depreciation on machinery @ 10% on ₹ 50,000 i.e. (1,50,000 - 1,00,000)	(5,000)
Adjusted post-acquisition profits	5,750
H Ltd.'s share 4/5 x 5,750	4,600
Minority Interest 1/5 x 5,750	1,150
5. Minority Interest	
Paid-up value of (1,000 - 800) = 200 shares held by outsiders i.e. 200 x ₹ 100 (or 1,00,000 X 20%)	20,000
Add: 1/5th share of pre-acquisition profits and reserves	8,000
1/5th share of profit on revaluation	9,000
1/5th share of post-acquisition reserves	10,000
1/5th share of post-acquisition profit	1,150
	48,150
6. Cost of Control or Goodwill	
Price paid by H Ltd. for 800 shares(A)	1,60,000
Intrinsic value of the shares-	
Paid-up value of 800 shares held by H Ltd. i.e. 800 x ₹ 100 (or 1,00,000 X 80%)	80,000
Add: 4/5th share of pre-acquisition profits and reserves	32,000
4/5th share of profit on the revaluation	36,000
Intrinsic value of shares on the date of acquisition (B)	1,48,000
Cost of control or Goodwill (A - B)	12,000

Question 14

(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.

(*Source: Illustration 14, Study Material*)

Answer

As per para 16 and 17 of AS 21, intragroup balances and intragroup transactions and resulting unrealized profits should be eliminated in full. Unrealized losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.

Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealized profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full. Unrealized losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered.

One also needs to see whether the intragroup transaction is "upstream" or "down-stream". Upstream transaction is a transaction in which the subsidiary company sells goods to holding company. While in the downstream transaction, holding company is the seller and subsidiary company is the buyer.

In the case of upstream transaction, since the goods are sold by the subsidiary to holding company; profit is made by the subsidiary company, which is ultimately shared by the holding company and the minority shareholders. In such a transaction, if some goods remain unsold at the balance sheet date, the unrealized profit on such goods should be eliminated from minority interest as well as from consolidated profit on the basis of their share-holding besides deducting the same from unsold inventory.

But in the case of downstream transaction, the whole profit is earned by the holding company, therefore, whole unrealized profit should be adjusted from unsold inventory and consolidated profit and loss account only irrespective of the percentage of the shares held by the parent.

Using above mentioned guidance, following adjustments would be required:

(a) *This would be the case of downstream transaction. In the consolidated profit and loss account for the year ended 31 March 20X1, entire 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).

Question 15

H Ltd and its subsidiary S Ltd provide the following information for the year ended 31st March, 20X3:

	***H Ltd.* (₹ in lacs)**	***S Ltd.* (₹ in lacs)**
Sales and other income	*5,000*	*1,000*
Increase in Inventory (closing less opening)	*1,000*	*200*
Raw material consumed	*800*	*200*
Wages and Salaries	*800*	*150*
Production expenses	*200*	*100*
Administrative Expenses	*200*	*100*
Selling and Distribution Expenses	*200*	*50*
Interest	*100*	*50*
Depreciation	*100*	*50*

Other Information:

H Ltd. sold goods to S Ltd. of ₹ 120 lacs at cost plus 20%. Inventory of S Ltd. includes such goods valuing ₹ 24 lacs. Administrative expenses of S Ltd. include ₹ 5 lacs paid to H Ltd. as consultancy fees. Selling and distribution expenses of H Ltd. include ₹ 10 lacs paid to S Ltd. as commission.

H Ltd. holds 80% of equity share capital of ₹ 1,000 lacs in S Ltd. prior to 20X1-20X2. H Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by S Ltd. for the year 20X1-20X2.

Prepare a consolidated statement of profit and loss.

(*Source: Illustration 15, Study Material*)

Answer

Consolidated statement of profit and loss of H Ltd. and its subsidiary S Ltd. for the year ended on 31st March, 20X3

Particulars	**Note No.**	**₹ in Lacs**
I. Revenue from operations	1	5,865
II. Total Income		**5,865**
III. Expenses		
Cost of material purchased/consumed	2	1,180

Particulars	**Note No.**	**₹ in Lacs**
Changes of inventories of finished goods	3	(1,196)
Employee benefit expense	4	950
Finance cost	5	150
Depreciation and amortization expense	6	150
Other expenses	7	535
Total expenses		**1,769**
IV. Profit before tax (II-III)		**4,096**

Notes to Accounts

		₹ in Lacs	**₹ in Lacs**
1.	Revenue from operations		
	Sales and other income		
	H Ltd.	5,000	
	S Ltd.	1,000	
		6,000	
	Less: Inter-company sales	(120)	
	Consultancy fees received by H Ltd. from S Ltd.	(5)	
	Commission received by S Ltd. from H Ltd.	(10)	5,865
2.	Cost of material purchased/consumed		
	H Ltd.	800	
	S Ltd.	200	
		1,000	
	Less: Purchases by S Ltd. from H Ltd.	(120)	880
	Direct expenses (Production)		
	H Ltd.	200	
	S Ltd.	100	300
			1,180
3.	Changes of inventories of finished goods		
	H Ltd.	1,000	
	S Ltd.	200	
	20 *Less:* Unrealized profits ₹ 24 lacs x 120	(4)	1,196
4.	Employee benefits and expenses Wages and salaries:		
	H Ltd.	800	
	S Ltd.	150	950
5.	Finance cost		
	Interest:		
	H Ltd.	100	
	S Ltd.	50	150
6.	Depreciation		
	H Ltd.	100	
	S Ltd.	50	150

		₹ in Lacs	₹ in Lacs
7.	Other expenses		
	Administrative expenses		
	H Ltd.	200	
	S Ltd.	100	
	Less: Consultancy fees received by H Ltd. from S Ltd. Selling and distribution Expenses:	(5)	295
	H Ltd.	200	
	S Ltd.	50	
	Less: Commission received by S Ltd. from H Ltd.	(10)	240
			535

Question 16

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 Equipment and	*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*

		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*

Particulars		***Note No.***	***20X0 (₹)***	***20X1 (₹)***
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 weighted average basis while B Ltd. used FIFO basis. To bring B Ltd.'s values in line with those of A Ltd, its value of inventory is required to be reduced by ₹12,000 at the end of 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 at 31st December, 20X1 after considering the above information, for the purpose of consolidation. Would restatement be necessary to make the accounting policies adopted by A Ltd. and B Ltd. uniform.

(*Source: Illustration 16, Study Material*)

Answer

As per para 20 and 21 of AS 21, Consolidated financial statements:

Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements when they are used in preparing the consolidated financial statements.

Accordingly in the given case, restatement would be required to make the accounting policies of A Ltd and B Ltd uniform.

Adjusted reserves of B Ltd.:

	₹	₹
Reserves as given		7,14,000
Add: Provision for doubtful debts		
{[8,91,000/99 X 100]-8,91,000}		9,000
		7,23,000
Less: Reduction in value of Inventory	34,000	
Advertising expenditure to be written off	30,000	(64,000)
Adjusted reserves		6,59,000

Note: No adjustment would be required in respect of opening inventory of B Ltd as that will not have any impact on P&L.

Restated Balance Sheet of B Ltd. as at 31st December, 20X1

Particulars	**Note No.**	**(₹)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	5,00,000
(b) Reserves and Surplus	2	6,59,000
(2) Current Liabilities		
(a) Short term borrowings	3	1,70,000
(b) Trade Payables		4,94,000
(c) Short-term provision	4	4,30,000
Total		22,53,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	2,24,000
(b) Non-current Investment		4,00,000
(2) Current assets		
(a) Inventories	6	7,08,000
(b) Trade Receivables	7	9,00,000
(c) Cash & Cash Equivalents		3,000
(d) Other current assets	8	18,000
Total		22,53,000

Notes to Accounts

			20X1 (₹)
1.	**Share capital**		
	5,000 equity shares of Rs 10 each, fully paid up		5,00,000
2.	**Reserves and Surplus**		
	General Reserves (refer to WN)		6,59,000
3.	**Short term borrowings**		
	Bank overdraft		1,70,000
4.	**Short term provisions**		
	Provision for taxation		4,30,000
5.	**Property, plant and equipment**		
	Cost		3,20,000
	Less: Depreciation		(96,000)
	Total		2,24,000
6.	**Inventory**		
	Actual inventory		7,42,000
	Less: Change in method of valuation		(34,000)
	Total		7,08,000
7.	**Trade receivables**		
	Actual trade receivables		8,91,000
	Add: Adjustment for provision		9,000
	Total		9,00,000
8.	**Other current Assets**		
	Prepaid expenses		48,000

Question 17

Hemant Ltd. purchased 80% shares of Power Ltd. on 1st January, 20X1 for ₹2,10,000. The issued capital of Power Ltd., on 1st January, 20X1 was ₹ 1,50,000 and the balance in the Profit & Loss Account was ₹90,000. During the year ended 31st December, 20X1, Power Ltd. earned a profit of ₹ 30,000 and at year end, declared and paid a dividend of ₹ 22,500. What is the amount of minority interest as on 1st January, 20X1 and 31st December, 20X1? Also compute goodwill/ capital reserve at the date of acquisition.

(*Source: Practical Question 6, Study Material*)

Answer

Total dividend paid is ₹ 22,500 (out of post-acquisition profits), hence dividend received by Hemant will be credited to P & L account. Hemant Ltd.'s share of dividend = ₹ 22,500 X 80% = ₹ 18,000

Goodwill on consolidation (at the date of acquisition):	₹	₹
Cost of shares		2,10,000
Less: Face value of capital i.e. 80% of capital	1,20,000	
Add: Share of capital profits [90,000 X 80 %]	72,000	(1,92,000)
Goodwill		18,000
Minority interest on:		
- **1st January, 20X1:**		
20% of ₹ 2,40,000 [1,50,000 + 90,000]		48,000
- **31st December, 20X1:**		
20% of ₹ 2,47,500 [1,50,000 + 90,000 + 30,000 - 22,500]		49,500

Question 18

King Ltd. acquires 70% of equity shares of Queen Ltd. as on 31st March, 20X1 at a cost of ₹ 140 lakhs. The following information is available from the balance sheet of Queen Ltd. as on 31st March, 20X1:

	₹ in lakhs
Property, plant and equipment	*240*
Investments	*110*
Current Assets	*140*
Loans & Advances	*30*
15% Debentures	*180*
Current Liabilities	*100*

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

Property, plant and equipment- up by 20% and Investments- down by 10%.

King Ltd. purchased the shares of Queen Ltd. @ ₹20 per share (Face value - ₹10).

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

(*Source: Practical Question 7, Study Material*)

Answer

Revalued net assets of Queen Ltd. as on 31st March, 20X1

	₹ ***in lakhs***	₹ ***in lakhs***
PPE [240 X 120%]		288
Investments [110 X 90%]		99
Current Assets		140
Loans and Advances		30
Total Assets after revaluation		557
Less: 15% Debentures	180.0	
Current Liabilities	100.0	(280)
Equity / Net Worth		277

	₹ in lakhs	₹ in lakhs
King Ltd.'s share of net assets (70% of 277)		193.9
King Ltd.'s cost of acquisition of shares of Queen Ltd.		
(₹140 lakhs)		(140)
Capital reserve		53.9

Question 19

From the following information, 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 Acquisition of 01-01-20X1*		*Consolidation date 31-12-20X1*	
				Share Capital	*Profits and Loss*	*Share Capital*	*Profit and 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*

(*Source: Practical Question 8, Study Material*)

Answer

Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case, it should be equal to Share Capital + Profit & Loss A/c

A = Share capital on 1.1.20X1

B = Profit & loss account balance on 1.1.20X1

C = Share capital on 31.12.20X1

D = Profit & loss account balance on 31.12.20X1

	Minority % Shares Owned [E]	**Minority interest as at the date of acquisition [E] x [A + B] ₹**	**Minority interest as at the date of consolidation [E] X [C + D] ₹**
Case A [100-90]	10 %	22,500	23,500
Case B [100-75]	25 %	50,000	40,000
Case C [100-70]	30 %	18,000	18,000
Case D [100-95]	5%	4,750	5,750

Question 20

A Ltd acquired 1,600 ordinary shares of ₹100 each of B Ltd on 1st July, 20X1. On 31st December, 20X1, the balance sheets of the two companies were as given below:

Balance Sheet of A Ltd. and its subsidiary, B Ltd.
as at 31st December, 20X1

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*

Particulars	***Note No.***	***A Ltd. (₹)***	***B Ltd. (₹)***
(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			
(a) Property, Plant and Equipment	*4*	*3,90,000*	*3,15,000*
(b) Non-current Investments	*5*	*3,40,000*	*--*
(2) Current assets			
(a) Inventories		*1,20,000*	*36,400*
(b) Trade receivables		*59,800*	*40,000*
(c) Cash & Cash equivalents	*6*	*14,500*	*8,000*
Total		*9,24,300*	*3,99,400*

Notes to Accounts

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

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.

(*Source: Practical Question 9, Study Material*)

Answer:

Consolidated Balance Sheet of A Ltd. and its subsidiary, B Ltd.
as at 31st December, 20X1

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	5,00,000
(b) Reserves and Surplus	2	3,08,800
(2) Minority Interest		83,600
(3) Current Liabilities		
(a) Trade Payables	3	64,500
(b) Short term borrowings	4	80,000
Total		10,36,900
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	7,41,000
(b) Intangible assets	6	17,200
(2) Current assets		
(a) Inventories	7	1,56,400
(b) Trade receivables	8	99,800
(c) Cash & Cash equivalents	9	22,500
Total		10,36,900

Notes to Accounts

				₹
1.	**Share Capital**			
	5,000 shares of ₹ 100 each			5,00,000
2.	**Reserves and Surplus**			
	Reserves		2,40,000	
	Profit & loss (Refer to W.N 8)		68,800	
	Total			3,08,800
3.	**Trade Payables**			
	A Ltd.	47,100		
	Add: B Ltd	17,400		
	Total			64,500
4.	**Short term borrowings**			
	Bank overdraft			80,000
5.	**Property, plant and equipment**			
	Land and building- A Ltd	1,50,000		
	Add: Land and building- B Ltd	1,80,000	3,30,000	
	Plant & Machinery (Refer to W.N 7)		4,11,000	
	Total			7,41,000

			₹
6.	**Intangible assets**		
	Goodwill (refer to W.N 6)		17,200
7.	**Inventories**		
	A Ltd.	1,20,000	
	B Ltd.	36,400	
	Total		1,56,400
8	**Trade Receivables**		
	A Ltd. 59,800		
	B Ltd. 40,000		
	Total		99,800
9	**Cash & Cash equivalents**		
	Cash of A Ltd	*14,500*	
	Add: cash of B Ltd.	8,000	
	Total		22,500

Share holding Pattern

Total Shares of B Ltd	2,000 shares
Shares held by A Ltd	1,600 shares i.e. 80 %
Minority Shareholding	400 shares i.e. 20 %

Working Notes:

1. The dividend @ 10% on 1,600 shares - ₹ 16,000 received by A Ltd. should have been credited to the investment A/c, being out of pre-acquisition profits. A Ltd., must pass a rectification entry, viz.

Profit & Loss Account	Dr. ₹ 16,000
To Investment	₹ 16,000

2. The Plant & Machinery of B Ltd. would stand in the books at ₹ 1,42,500 on 1st July, 20X1, considering only six months' depreciation on ₹ 1,50,000 total depreciation being ₹ 15,000. The value put on the assets being ₹ 1,80,000, there is an appreciation to the extent of ₹ 37,500 (1,80,000 - 1,42,500).

3. **Capital profits of B Ltd.**

	₹	₹
Reserve on 1st January, 20X1 (Assumed there is no movement in reserves during the year and hence balance as on 1st January 20X1 is same as of 31st December 20X1)		1,00,000
Profit & Loss Account Balance on 1st January, 20X1	30,000	
Less: Dividend paid	(20,000)	10,000
Profit for 20X1:		
Total ₹ 82,000		
Less: ₹10,000		
₹ 72,000		
Proportionate upto 1st July, 20X1 on time basis (₹ 72,000/2)		36,000
Appreciation in value of Plant & Machinery		37,500
		1,83,500
Less: 20% due to outsiders		(36,700)
Holding company's share		**1,46,800**

4. Revenue profits of B Ltd.:

Profit after 1st July, 20X1 [(82,000 - 10,000) x ½]		36,000
Less: Depreciation		
10% depreciation on ₹1,80,000 for 6 months	9,000	
Less: Depreciation already charged for 2nd half year on 1,50,000	(7,500)	(1,500)
		34,500
Less: 1/5 due to outsiders		(6,900)
Share of A Ltd.		**27,600**

5. Minority interest:

Par value of 400 shares (2,00,000 X 20%)	40,000
Add: 1/5Capital Profits [WN 3]	36,700
1/5 Revenue Profits [WN 4]	6,900
	83,600

6. Cost of Control:

Amount paid for 1,600 shares	3,40,000	
Less: Dividend out of pre-acquisition profits	(16,000)	3,24,000
Par value of shares	1,60,000	
Capital Profits -share of A Ltd. [WN 3]	1,46,800	(3,06,800)
Cost of Control or Goodwill		17,200

7. *Value of plant & Machinery:*

		2,40,000
B Ltd.	1,35,000	
Add: Appreciation on 1st July, 20X1 [1,80,000 - (1,50,000 - 7,500)]	37,500	
	1,72,500	
Add: Deprecation for 2nd half charged on prerevalued value	7,500	
Less: Depreciation on ₹1,80,000 for 6 months	(9,000)	1,71,000
		4,11,000

8. *Profit & Loss Account (Consolidated):*

A Ltd. as given	57,200	
Less: Dividend transferred to Investment A/c	(16,000)	41,200
Share of A Ltd. in revenue profits of B Ltd. (WN 4)		27,600
		68,800

Question 21

On 31st March, 20X1, the Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

Balance Sheet of H Ltd.
and its subsidiary S Ltd. as at 31st March, 20X1

Particulars	***Note No.***	***H Ltd. (₹ in Lacs)***	***S Ltd. (₹in Lacs)***
I. Equity and Liabilities			
(1) ***Shareholder's Funds***			
(a) Share Capital	*1*	*12,000*	*4,800*

Particulars	**Note No.**	**H Ltd. (₹ in Lacs)**	**S Ltd. (₹in Lacs)**
(b) Reserves and Surplus	*2*	*5,499*	*3,000*
(2) ***Current Liabilities***			
(a) Trade payables	*3*	*1,833*	*1,014*
(b) Short term provisions	*4*	*855*	*394*
(c) Other current liabilities (Dividend payable)		*1,200*	*-*
Total		*21,387*	*9,208*
II. Assets			
(1) ***Non-current assets***			
Property, Plant and Equipment	*5*	*9,468*	*5,486*
Non-current Investments (Shares in S Ltd.)		*3,000*	
(2) ***Current assets***			
(a) Inventories		*3,949*	*1,956*
(b) Trade receivables	*6*	*2,960*	*1,562*
(c) Cash and cash equivalents		*1,490*	*204*
(d) Short term loans and advances	*7*	*520*	
Total		*21,387*	*9,208*

Notes to Accounts

		H Ltd. (₹ in lacs)	**S Ltd. (₹ in lacs)**
1.	***Share Capital***		
	Authorized share capital	*15,000*	*6,000*
	Equity shares of ₹10 each, fully paid up		
	Issued and Subscribed:		
	Equity shares of ₹10 each, fully paid up	*12,000*	*4,800*
2.	***Reserves and surplus***		
	General Reserve	*2,784*	*1,380*
	Profit and Loss Account:	*2,715*	*1,620*
	Total	*5,499*	*3,000*
3.	***Trade Payables***		
	Creditors	*1,461*	*854*
	Bills Payable	*372*	*160*
		1,833	*1,014*
4.	***Short term provisions***		
	Provision for Taxation	*855*	*394*
5.	***Property, plant and equipment***		
	Land and Buildings	*2,718*	*-*
	Plant and Machinery	*4,905*	*4,900*
	Furniture and Fittings	*1,845*	*586*
	Total	*9,468*	*5,486*

		H Ltd. (₹ in lacs)	***S Ltd. (₹ in lacs)***
6.	***Trade receivables***		
	Debtors	*2,600*	*1,363*
	Bills Receivable	*360*	*199*
	Total	*2,960*	*1,562*
7.	***Short term loans and advances***		
	Sundry Advances	*520*	*--*

The following information is also provided to you:

(a) H Ltd. purchased 180 lakh shares in S Ltd. on 31st March, 20X0 when the balances of General Reserve and Profit and Loss Account of S Ltd. stood at ₹3,000 lakh and ₹ 1,200 lakh respectively.

(b) On 1st April, 20X0, S Ltd. declared a dividend @ 20% for the year ended 31st March, 20X0. H Ltd. credited the dividend received by it to its Profit and Loss Account.

(c) On 1st January, 20X1, S Ltd. issued 3 fully paid-up bonus shares for every 5 shares held out of balances of its general reserve as on 31st March, 20X0.

(d) On 31st March, 20X1, all the bills payable in S Ltd.'s balance sheet were acceptances in favour of H Ltd. But on that date, H Ltd. held only ₹ 45 lakh of these acceptances in hand, the rest having been endorsed in favour of its trade payables.

(e) On 31st March, 20X1, S Ltd.'s inventory included goods which it had purchased for ₹100 lakh from H Ltd. which made a profit @ 25% on cost.

Prepare a Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X1.

(*Source: Practical Question 10, Study Material*)

Answer

Consolidated Balance Sheet of H Ltd.
and its subsidiary S Ltd. as at 31st March, 20X1

Particulars	**Note No.**	**(₹ in Lacs)**
I. Equity and Liabilities		
(1) **Shareholder's Funds**		
(a) Share Capital	1	12,000
(b) Reserves and Surplus	2	7,159
(2) **Minority Interest [W.N.6]**		3,120
(3) **Current Liabilities**		
(a) Trade payables	3	2,802
(b) Short term provisions	4	1,249
(c) Other current liabilities	5	1,200
Total		27,530
II. Assets		
(1) **Non-current assets**		
Property, Plant and Equipment	6	14,954
(2) **Current assets**		
(a) Inventories	7	5,885
(b) Trade receivables	8	4,477
(c) Short term loans and advances	9	520
(d) Cash and cash equivalents	10	1,694
Total		27,530

Notes to Accounts

					(₹ in lacs)	(₹ in lacs)
1.	**Share Capital**					
	Authorized share capital					15,000
	Equity shares of ₹10 each, fully paid up					
	Issued and Subscribed:					
	Equity shares of ₹ 10 each, fully paid up					12,000
	Total					12,000
2.	**Reserves and surplus**					
	Capital Reserve (Note 5)				1,320	
	General Reserve (2,784 + 108) Profit and Loss Account:				2,892	
	H Ltd.		2,715			
	Less: Dividend wrongly credited 360					
	Unrealized Profit	20	(380)			
			2,335			
	Add: Share in S Ltd.'s Revenue profits		612		2,947	
	Total					7,159
3.	**Trade payables**					
	Creditors					
	H Ltd.			1,461		
	S Ltd.			854	2,315	
	Bills Payable H Ltd.			₹ 372		
	S Ltd.			₹ 160		
				₹ 532		
	Less: Mutual owing			₹ (45)	487	2,802
4.	**Short term provisions**					
	Provision for Taxation					
	H Ltd.				855	
	S Ltd.				394	
	Total					1,249
5.	**Other current liabilities**					
	Dividend payable H Ltd.					1,200
6.	**Property, plant and equipment**					
	Land and Buildings					
	H Ltd.				2,718	
	Plant and Machinery H Ltd.			₹ 4,905		
	S Ltd.			₹ 4,900	9,805	
	Furniture and Fittings H Ltd.			₹ 1,845		
	S Ltd.			₹ 586	2,431	
	Total					14,954
7.	**Inventories**					
	Stock					
	H Ltd.				3,949	
	S Ltd.				1,956	
					5,905	

			(₹ in lacs)	(₹ in lacs)
	Less: Unrealized profit		J20)	5,885
8.	**Trade receivables**			
	Debtors			
	H Ltd.	₹ 2,600		
	S Ltd.	₹ 1,363	3,963	
	Bills Receivable			
	H Ltd.	₹ 360		
	S Ltd.	₹ 199		
	₹ 559			
	Less: Mutual Owing	₹ (45)	514	4,477
9.	**Short term loans and advances**			
	Sundry Advances			520
10.	**Cash and cash equivalents**			
	Cash and Bank Balances			1,694

Share holding pattern of S Ltd.

Shares as on 31st March, 20X1 (Includes bonus shares issued on 1st January, 20X1)	480 lakh shares (4,800 lakhs/ ₹ 10)
H Ltd.'s holding as on 1st April, 20X0	180 lakhs
Add: Bonus received on 1st January, 20X1	108 lakhs (180 / 5 x 3)
Total H Ltd.'s holding as on 31st March, 20X1	288 lakhs i.e. 60 %
Minority Shareholding	[288/480x100] 40%

Working Notes:

1. S Ltd.'s General Reserve Account

	₹ in lakhs		₹ in lakhs
To Bonus to equity		By Balance b/d	3,000
shareholders (WN-8)	1,800	By Profit and Loss A/c	180
To Balance c/d	1,380	(Balancing figure)	—
	3,180		3,180

***2.* S Ltd.'s Profit and Loss Account**

	₹ in lakhs		₹ in lakhs
To General Reserve		By Balance b/d	1,200
[WN 1]	180	By Net Profit for the year*	1,200
To Dividend paid			
(20% on ₹3,000 lakhs)	600	(Balancing figure)	
To Balance c/d	1,620		—
	2,400		2,400

*Out of ₹ 1,200 lakhs profit for the year, ₹ 180 lakhs has been transferred to reserves.

3. Distribution of Revenue profits

	₹ in lakhs
Revenue profits (W. N. 2)	1,200
Less: Share of H Ltd. 60%	(720)
(General Reserve ₹ 108 + Profit and Loss Account ₹ 612)	—
Share of Minority Shareholders (40%)	480

Note: *The question can also be solved by taking ₹ 1,020 lakhs as post acquisition Profit and Loss balance and ₹ 180 lakhs as post acquisition General Reserve balance. The final answer will be same.*

4. Calculation of Capital Profits

	₹ in lakhs
General Reserve on the date of acquisition less bonus shares (₹ 3,000 - ₹ 1,800)	1,200
Profit and loss account on the date of acquisition less	600
dividend paid (₹ 1,200 - ₹ 600)	1,800

H Ltd.'s share = 60% of ₹ 1,800 lakhs = ₹ 1,080 lakhs

Minority interest = ₹ 1,800 - ₹ 1,080 = ₹ 720 lakhs

5. Calculation of capital reserve

₹ in lakhs	
Paid up value of shares held (60% of ₹4,800)	2,880
Add: Share in capital profits [WN 4]	1,080
	3,960
Less: Cost of shares less dividend received (₹ 3,000 - ₹ 360)	(2,640)
Capital reserve	1,320

6. Calculation of Minority Interest

	II ₹ in lakhs
40% of share capital (40% of ₹ 4,800)	1,920
Add: Share in revenue profits [WN 3]	480
Share in capital profits [WN 4]	720
	3,120

7. ***Unrealized profit in respect of inventory***

₹ 100 lakhs $\frac{25}{125}$ = *₹ 20 lakhs*

8. ***Computation of bonus to equity shareholders***

	₹ In lakhs
Shares as on 31 March 20X1 including bonus share issued on 1 January 20X1	4800
Or we can say these are 1 + $\frac{3}{5}$ or $\frac{8}{5}$	
i.e. Shares before bonus issue should have been $\frac{4800}{8/5}$	=3000
Accordingly, bonus issue would be (4,800–3,000)	1,800

QUESTION BANK

Question 22

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet

as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital	6,00,000	2,00,000
Reserves and surplus	1,00,000	1,50,000
Non-Current Liabilities	2,00,000	2,00,000
Current Liabilities	4,00,000	3,00,000
Total	**13,00,000**	**8,50,000**
Non-Current Assets		
Fixed Assets	3,00,000	3,00,000
Investment in 100% Share of S Ltd. Purchased on 31-03-2015	3,50,000	
Current Assets	6,50,000	5,50,000
Total	**13,00,000**	**8,50,000**

Share were purchased as on 31.03.2015. Prepare Consolidated Balance Sheet.

Answer:

Goodwill 0 Minority Interest 0 Balance sheet 18,00,000

Question 23

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet

as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital	10,00,000	5,00,000
Reserves and surplus	5,00,000	4,00,000
Current Liabilities	2,00,000	1,00,000
Total	**17,00,000**	**10,00,000**
Investment in 90% Share of S Ltd.	9,50,000	
Other Assets	7,50,000	10,00,000
Total	**17,00,000**	**10,00,000**

Share were purchased as on 31.03.2015. Prepare Consolidated Balance Sheet.

Answer:

Goodwill 1,40,000 Minority Interest 90,000 Balance sheet 18,90,000

Question 24

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet

as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital	20,00,000	12,00,000
Reserves and surplus	9,00,000	6,00,000
Current Liabilities	3,00,000	2,00,000
Total	**32,00,000**	**20,00,000**
Investment in 90% Share of S Ltd.	10,00,000	
Other Assets	22,00,000	20,00,000
Total	**32,00,000**	**20,00,000**

Share were purchased as on 31.03.2015. Prepare Consolidated Balance Sheet.

Answer:

Goodwill 6,20,000 Minority Interest 1,80,000 Balance sheet 42,00,000

Question 25

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet

as on 31st March 2015

	H Ltd.	*S Ltd.*
Equity Share Capital	7,00,000	8,00,000
Reserves and surplus	15,00,000	2,00,000
Current Liabilities	3,00,000	1,00,000
Total	**25,00,000**	**11,00,000**

	H Ltd.	*S Ltd.*
Investment in 80% Share of S Ltd.	8,20,000	
Current Assets	16,80,000	11,00,000
Total	**25,00,000**	**11,00,000**

Share were purchased as on 31.03.2015. Prepare Consolidated Balance Sheet.

Answer:

Goodwill 20,000 Minority Interest 2,00,000 Balance sheet 28,00,000

Question 26

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet

as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital	15,00,000	10,00,000
Reserves and surplus	2,00,000	1,00,000
Current Liabilities	3,00,000	1,00,000
Total	**20,00,000**	**12,00,000**
Investment in 70% Share of S Ltd.	7,50,000	
Current Assets	12,50,000	12,00,000
Total	**20,00,000**	**12,00,000**

H Ltd. had purchased share in S Ltd. on 01.04.2014 when Balance in Reserve & Surplus of S Ltd. Were ₹4,000/-. Prepare Consolidated Balance Sheet of group on 31.03.2015

Answer:

Goodwill 47,200 Minority Interest 3,30,000 Balance sheet 24,97,200

Question 27

Balance Sheet 31.3.2012

Equity & Liabilities	H	S
Shareholder Funds		
Share capital	2,00,000	1,00,000
Profit & Loss a/c	70,000	30,000
Current Liabilities		
Creditors	60,000	20,000
	3,30,000	**1,50,000**
	H	S
Non Current Assets		
Fixed Assets	1,00,000	1,20,000
Investment 60%	1,90,000	—
Current Assets	40,000	30,000
	3,30,000	**1,50,000**

H Ltd. Purchase Investment on 1-4-2011 when Balance in Profit & Loss a/c of S Ltd. was ₹18,000.

Prepare consolidated Balance Sheet

Answer:

Goodwill 1,19,200 Minority Interest 52,000 Balance sheet 4,09,200

Question 28

Balance Sheet as on 31.3.2015

Equity & Liabilities	*H Ltd.*	*S Ltd.*
Shareholder Funds		
Equity Share Capital (₹10)	100,000	50,000
Profit & Loss A/c	80,000	50,000
Current Liabilities		
Creditors	85,000	140,000
	265000	**240,000**
Non Current Assets	*H Ltd.*	*S Ltd.*
Fixed Assets	100,000	80,000
Investment in S 70%	75,000	—
Current Assets	90,000	160,000
	265000	**240,000**

Investments were purchased on 1.10.2014 balance as 1.4.2014 in P & L A/cs was ₹40,000. Prepare Consolidated Balance sheet.

Answer:

Goodwill 85,000 Minority Interest 30,000 Balance sheet 4,38,500

Question 29

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet
as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital	10,00,000	8,00,000
Reserves and Surplus	6,00,000	4,00,000
Creditors	2,00,000	1,00,000
Total	**18,00,000**	**13,00,000**
Fixed Assets	5,00,000	6,00,000
Investment 80% Share of S Ltd.	11,00,000	
Current Assets	2,00,000	7,00,000
Total	**18,00,000**	**13,00,000**

H Ltd. had purchased share in S Ltd. on 01.04.2014 when Balance in Profit & Loss of S Ltd. was ₹ 2,50,000/- S Ltd. distributed Dividend on 01/10/2014 @ 10%. H Ltd. credited dividend to its Profit & Loss Account. Prepare Consolidated Balance Sheet.

Question 30

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet
as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital	20,00,000	16,00,000
Profit & Loss	3,00,000	2,00,000
General Reserves	1,00,000	2,00,000
Creditors	6,00,000	5,00,000
Total	**30,00,000**	**25,00,000**
Fixed Assets	5,00,000	8,00,000
Goodwill	1,00,000	50,000
Investment in S Ltd. 60%	11,00,000	
Current Assets	13,00,000	16,50,000
Total	**30,00,000**	**25,00,000**

H Ltd. had purchased shares in S Ltd. on 01.01.2013. for ₹11,00,000/-. Balance in Profit & Loss and General Reserve on 01.04.2012 was ₹ 1,20,000/- each in S Ltd.

S Ltd. Paid	**Date**	**Type**	**Rate**
	01-10-2012	Final	10%

Prepare Consolidated Balance Sheet.

Question 31

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet
as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital (₹ 10)	10,00,000	9,00,000
Reserves and Surplus:		
General Reserves	2,00,000	1,00,000
Profit & Loss	3,00,000	2,00,000
Non-Current Liabilities	3,00,000	3,00,000
Current Liabilities	1,00,000	1,00,000
Total	**19,00,000**	**16,00,000**
Non-Current Assets		
Fixed Assets	4,00,000	6,00,000
Investment in share of S Ltd.	3,00,000	
Current Assets	12,00,000	10,00,000
Total	**19,00,000**	**16,00,000**

H Ltd. had purchased 50,000 shares of S Ltd. on 01.10.2013. Balance in Profit & Loss and General Reserve of S Ltd. was ₹ 1,50,000/- and ₹ 90,000/- respectively on 01.04.2013.

S Ltd. had distributed Bonus @ 1 shares for 8 held on 31.03.2014.

S Ltd. paid Dividend	**Date**	**Rate**
	01-11-2013	10%
	01-10-2014	12%

All dividends were credited to Profit & Loss of H Ltd. Prepare Consolidated Balance Sheet.

Question 32

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet

as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital (₹ 10)	7,00,000	5,00,000
Reserves and Surplus	6,00,000	4,00,000
Current Liabilities	3,00,000	3,00,000
Total	**16,00,000**	**12,00,000**
Fixed Assets	7,50,000	8,00,000
Investment in share of S Ltd.	5,00,000	
Current Assets	3,50,000	4,00,000
Total	**16,00,000**	**12,00,000**

H Ltd. held 30,000 shares of S Ltd. H Ltd. had purchased share of S Ltd. on 01-10-2014. Balance in Reserve & Surplus of S Ltd. on 01-04-2014 was ₹ 3,00,000/-

1. Bonus declared (distributed) ratio 1 : 4 by S Ltd. on 31-03-2015
2. Dividend paid by S Ltd. on 01-01-2015 @ 10%
3. Market Value of Fixed Assets of S Ltd. was increased by ₹ 50,000 on 01-10-2014. Depreciation rate @ 10% p.a. This Adjustment is yet to made in Balance Sheet.

Prepare Consolidated Balance Sheet.

Question 33

On 31st March, 2015, the abridged Balance Sheets of H Ltd. and S Ltd. stood as follows:

	H Ltd. (₹ in 000's)	S Ltd. (₹ in 000's)
Liabilities		
Equity Share Capital - Authorised	5,000	3,000
Issued and subscribed in Equity Shares or 10 each fully paid	4,000	2,400
General Reserve	928	690
Profit and Loss Account	1,305	810
Trade payables	611	507
Provision for Taxation	220	180
Other Provisions	65	17
	7,129	4,604
Assets:		
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	260	190
	7,129	4,604

Following Additional Information is available:

(a) H Ltd. purchased 90 thousand Equity Shares in S Ltd. on 1st April, 2014 at which 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, 2014 S Ltd. declared a dividend of 20% out of pre-acquisition profits and H Ltd. credited the dividend received to its Profit and Loss Account.

(c) On 1st November, 2014, 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, 2015, 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
Trade receivables		
Debtors	700	683
Bills Receivables	120	95
	820	778

Prepare a consolidated Balance Sheet as on 31st March, 2015.

(*Practice Manual*)

Answer

Consolidated Balance Sheet of H Ltd. with its subsidiary S Ltd. as on 31st March, 2012

Particulars	Note No.	(₹ in 000's)
I. Equity and Liabilities		
(1) **Shareholder's Funds**		
(*a*) Share Capital	1	4,000
(*b*) Reserves and Surplus	2	3,063
(2) **Minority Interest (W.N.6)**		1,560
(3) **Current Liabilities**		
Trade payables	3	1,118
Short term provisions	4	482
Total		10,223
II. Assets		
(1) **Non-current assets**		
Fixed assets		
Tangible assets	5	5,904
(2) **Current assets**		
(*a*) Inventories	6	1,759
(*b*) Trade receivables	7	1,598
(*c*) Cash and cash equivalents	8	512
(*d*) Short term loans and advances	9	450
Total		10,223

Notes to Accounts

			(₹ in 000's)	(₹ in 000's)
1.	Share Capital			
	Authorised share capital			
	5 lakhs equity shares of ₹ 10 each			5,000
	Issued, Subscribed and Paid up			
	4 lakhs equity shares of ₹ 10 each fully paid			4,000
2.	Reserves and surplus			
	Capital Reserve (Note 5)			
	General Reserve (₹ 928+₹ 54)		982	
	Profit and Loss Account:			
	H Ltd.	₹ 1,305		
	Add: Share in S Ltd	₹ 306		
		₹ 1,611		
	Less: Dividend wrongly credited	₹ (180)		
		₹ 1,431		
	Less: Unrealised profit	₹ (10)	1,421	3,063

			(₹ in 000's)	(₹ in 000's)
3.	Trade payables			
	Sundry Creditors H Ltd.	₹ 487		
	S Ltd.	₹ 427	914	
	Bills payable H Ltd.	₹ 124		
	S Ltd.	₹ 80	204	1,118
4.	Short –term provisions			
	Provision for Taxation H Ltd.	₹ 220		
	S Ltd.	₹ 180	400	
	Other Provisions H Ltd	₹ 65		
	S Ltd.	₹ 17	82	482
5.	Tangible Assets			
	Plant and Machinery			
	H Ltd.	₹ 2,541		
	S Ltd.	₹ 2,450	4,991	
	Furniture and fittings			
	H Ltd.	₹ 615		
	S Ltd.	₹ 298	913	5,904
6.	Inventories			
	Stock H Ltd.	₹ 983		
	S Ltd.	₹ 786		
	Less: Unrealised profit (₹ 50 x 1/5)		(10)	1,759
7	Trade receivable			
	Debtors H Ltd.	₹ 700		
	S Ltd.	₹ 683	1,383	
	Bills Receivables H Ltd.	₹120		
	S Ltd.	₹ 95	215	1,598
8	Cash and cash equivalents			
	Cash and Bank Balances H Ltd		410	
	S Ltd.		102	512
9	Short term loans and advances			
	Sundry Advances H Ltd.		260	
	S Ltd.		190	450

Working Notes:

1. **S Ltd. General Reserve**

	(₹ in 000)		(₹ in000)
To Bonus to equity shareholders $\left(\frac{2,400 \times 3}{8}\right)$	900	By Balance b/d	1,500
		By Profit and Loss A/c (Balancing figure)	90
To Balance c/d	690		
	1,590		1,590

2. **S Ltd. Profit and Loss Account**

	(₹in 000)		(₹in 000)
To General Reserve	90	By Balance b/d	633
To Dividend paid on 14.7.2009 ₹ 1,500 × 20/100	300	By Net Profit for the year (Balancing figure)	600*
To Corporate Dividend Tax (11% of ₹ 300)	33		
To Balance c/d	810		
	1,233		1,233

* Out of ₹ 6,00,000 profit for the year, ₹ 90,000 has been transferred to reserves by S Ltd.

3. **Distribution of Revenue Profits**

	₹ in '000
Revenue Profit as above	600
Share of H Ltd. (60%)	360
Share of Minority shareholders (₹ 600 – ₹ 360)	240

4. **Computation of Capital Profits**

		₹ in 000	**₹ in 000**
General Reserve on the date of acquisition			1,500
Less: Bonus issue of shares			900
			600
Profit and Loss Account balance on the date of acquisition		633	
Less: Dividends paid	₹ 300		
Corporate tax paid	₹ 33	(333)	300
			900
Share of H Ltd. (60%)			540
Share of Minority shareholders			360

5. **Computation of Capital Reserve**

		₹ in '000
60% of share capital of S Ltd.		1,440
Add: Share of H Ltd. in the capital profits as in working note (4)		540
		1,980
Less: Investments in S Ltd.	1,500	
Less: Dividends received out of pre- acquisition profits ₹ 300 × ₹ 60/100	(180)	(1,320)
		660

6. **Calculation of Minority Interest**

		₹ in '000
40% of share capital of S Ltd.		960
Add: Share of Revenue Profits		240
(Note 3) Share of Capital		360
Profits (Note 4)		1,560

Question 34

On 31st March, 2015 the summarized Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

Liabilities	**H Ltd. (₹ in lakhs)**	**S Ltd. (₹ in lakhs)**
Share Capital:		
Authorised	15,000	6,000
Issued and Subscribed:		
Equity Shares of ₹ 10 each, fully paid up	12,000	4,800
General Reserve	2,784	1,380
Profit and Loss Account	2,715	1,620
Trade payables	1,833	1,014
Provision for Taxation	855	394
Payable Dividend	1,200	
	21,387	9,208
Assets	**H Ltd. (in lakhs)**	**S Ltd. (in lakhs)**
Land and Buildings	2,718	—
Plant and Machinery	4,905	4,900
Furniture and Fittings	1,845	586
Investments in shares in S Ltd.	3,000	—
Inventory	3,949	1,956
Trade receivables	2,960	1,562
Cash and Bank Balances	1,490	204
Sundry Advances	520	—
	21,387	9,208

The following information is also provided to you:

(a) H Ltd. purchased 180 lakh shares in S Ltd. on 1st April, 2014 when the balances to General Reserve and Profit and Loss Account of S Ltd. stood at ₹ 3,000 lakh and ₹ 1,200 lakh respectively.

(b) On 31st May, 2014, S Ltd. declared a dividend @ 20% for the year ended 31st March, 2014. H Ltd. credited the dividend received by it to its Profit and Loss Account.

(c) On 1st January, 2015 S Ltd. issued 3 fully paid-up shares for every 5 shares held as bonus shares out of balances to its general reserve as on 31st March, 2014.

(d) Details of Trade payables and Trade receivables:

	H Ltd.	S Ltd.
	(₹ in lakhs)	(₹ in lakhs)
Trade payables		
Bills Payable	372	160
Sundry creditors	1,461	854
	1,833	1,014
Trade receivables		
Debtors	2,600	1,363
Bills Receivables	360	199
	2,960	1,562

(e) On 31st March, 2015 all the bills payable in S Ltd. 's balance sheet were acceptances in favour of H Ltd. But on that date, H Ltd. held only ₹ 45 lakh of these acceptances in hand, the rest having been endorsed in favour of its trade payables.

(f) On 31st March, 2015, S Ltd. 's inventory included goods which it had purchased for ₹ 100 lakh from H Ltd. which made a profit @ 25% on cost.

Prepare a Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 2015 bearing in mind the requirements of AS 21.

(*Practice Manual*)

Question 35

The following are the balance sheets of a Holding Company and Subsidiary Company as at 31.3.1996 and 1997:

Holding Company's Balance Sheet as on 31 March ….

Liabilities	*1996* ₹	*1997* ₹	*Assets*	*1996* ₹	*1997* ₹
Paid-up capital:			Bank Balance	12,000	30,000
35,000 Shares of ₹ 10 each	3,50,000	3,50,000	Goodwill	50,000	50,000
Sundry Creditors	39,000	35,000	Land and Building at cost	1,10,000	1,10,000
Reserve	41,000	57,000	Machinery *less* deprecation	80,000	75,000
Profit and Loss Account	67,000	80,000	Stock	40,000	47,000
			Sundry Debtors	55,000	60,000
			Investment:		
			9,000 Shares of ₹ 10 each at cost	1,50,000	1,50,000
	4,97,000	5,22,000		4,97,000	5,22,000

Subsidiary Company's Balance Sheet as on 31 March …

Liabilities	*1996* ₹	*1997* ₹	*Assets*	*1996* ₹	*1997* ₹
Paid-up Capital:			Goodwill	40,000	40,000
10,000 shares of ₹10 each	1,00,000	1,00,000	Machinery less depreciation	45,000	42,500
Sundry Creditors	10,000	10,000	Stock	25,000	30,000
Reserve	17,500	20,500	Sundry Debtors	22,000	32,000
Profit and Loss Account	12,000	28,500	Bank Balance	7,500	12,500
	1,39,500	1,57,000		1,39,500	1,57,000

The shares in the subsidiary company were acquired on 31 March 1996. No dividend has been declared. Prepare consolidated balance sheet as at 31 March 1997.

Question 36

From the balance sheets given below, prepare a consolidated balance sheet of X Ltd. and its subsidiary company Y Ltd. The interest of minority shareholders in Y Ltd. is to be shown as a separate item in the consolidated balance sheet.

Balance Sheet of X Ltd. as on 31 March 1995

Liabilities	₹	*Assets*	₹
12,000 Shares of ₹ 10 each	1,20,000	Freehold Building at cost	80,000
General Reserve	25,000	Plant and machinery at cost (40,000) *less* depreciation	30,000
Profit and Loss Account	12,000	Shares (2000) in subsidiary company at cost	25,000
Trade Creditors	15,000	Stock at cost	10,000
		Trade Debtors	22,000
		Bank	5,000
	1,72,000		1,72,000

Balance Sheet of Y Ltd. as on 31 March 1995

Liabilities	₹	*Assets*	₹
3,000 Shares of ₹ each	30,000	Leasehold property at cost (₹ 30,000) *less* deprecation	25,000
General Reserve as on 1-4-1994	6,000	Plant and Machinery at cost (₹ 15,000) *less* depreciation	10,000
Profit and Loss Account	9,000	Stock at cost	3,000
Trade Creditors	5,000	Trade Debtors	7,000
		Bank	5,000
	50,000		50,000

At the date of acquisition by X Ltd. of its holding of 2,000 shares in Y Ltd. the latter company had a credit balance of ₹ 6,000 in its profit and loss account.

Question 37

The balance sheets of Hindustan Ltd. and Sundram Ltd. as on 31 March 1997 were as under:

Liabilities	*Hindustan Ltd.* ₹	*Sundram Ltd.* ₹	*Assets*	*Hindustan Ltd.* ₹	*Sundram Ltd.* ₹
Shares of ₹ 100 each	2,00,000	50,000	Land and Building	60,000	—
General Reserve	30,000	10,000	Plant and Machinery	2,00,000	—
Profit and Loss Account:			Stock	40,000	85,000
Balance on 1.4.1996	40,000	20,000	Sundry Debtors	10,000	30,000
Profit for 1996-97	50,000	25,000	Bank	10,000	10,000
Creditors	30,000	30,000	300 Shares in Sundram Ltd. at cost	65,000	—
Bank overdraft	20,000	—	Bills Receivable	—	10,000
Bills payable	15,000	—			
	3,85,000	1,35,000		3,85,000	1,35,000

Shares were acquired by Hindstan Ltd. as 1 October 1996. Bills receivable held by Sundram Ltd. are all accepted by Hindustan Ltd. Included in the debtors of Sundram Ltd. are ₹ 6,000 owing by Hindustan Ltd. in respect of goods supplied. Prepare consolidated balance sheet.

Question 38

From the following information you are required to prepare a consolidated balance sheet of Karnataka Co. Ltd., and its subsidiary Bangalore Co. Ltd., as on 31.3.1998:

Balance Sheet as on 31.3.1998

Liabilities	*Karnataka* ₹	*Bangalore* ₹	*Assets*	*Karnataka* ₹	*Bangalore* ₹
Share Capital:			Fixed Assets		
Shares of ₹ 10	5,00,000	2,00,000	Goodwill	1,000,000	—
Reserve & Surplus:			Plant & Machinery	2,00,000	1,20,000
General Reserves	2,00,000	60,000	Buildings	2,00,000	1,30,000

Liabilities	*Karnataka* ₹	*Bangalore* ₹	*Assets*	*Karnataka* ₹	*Bangalore* ₹
Surplus	1,50,000	40,000	Investments in 16,000 Shares of ₹ 10 each at Bangalore Ltd.	2,00,000	—
Secured Loans			Govt. Securities	—	50,000
Against Buildings	—	80,000	Current Assets:		
Unsecured Loans	—	40,000	Stock	80,000	50,000
Current Liabilities & Provisions:			Debtors	1,00,000	40,000
Creditors	1,00,000	60,000	Bills Receivable	50,000	—
Bills Payable	50,000	20,000	Bank	20,000	80,000
			Cash	50,000	30,000
	10,00,000	5,00,000		10,00,000	5,00,000

(i) Bills Payable of Bangalore Ltd., include ₹ 10,000 due to Karnataka Ltd., which has discounted bills worth ₹ 5,000 with its Banker.

(ii) Sundry Creditors of Karnataka Co. Ltd. include ₹ 20,000 due to Bangalore Co Ltd.

(iii) The closing stock of Karnataka Ltd., include stock worth ₹ 60,000 supplied by Bangalore Ltd., which had invoiced to Karnataka Ltd., at cost *plus* 20% profit on cost.

(iv) On the date of purchase (1.1.1998) of 16,000 shares in Bangalore Ltd., by Karnataka Ltd., the balance sheet of Bangalore Ltd., showed general reserves of ₹ 20,000 and surplus of ₹ 10,000.

Question 39

Jupiter Ltd. purchased control of Neptune Ltd. on 1.10.1997. Following are the balance sheets of two companies as at 31 March 1998:

Liabilities	*Jupiter Ltd.* ₹	*Neptune Ltd.* ₹	*Assets*	*Jupiter Ltd.* ₹	*Neptune Ltd.* ₹
Equity Share Capital of ₹ 10 Share	3,60,00	1,80,000	Goodwill	6,000	24,000
General Reserve	36,000	30,000	Land & Building	60,000	60,000
Profit & Loss Account	60,000	60,000	Plant & Machinery	1,20,000	1,08,000
Creditors	60,000	42,000	Stock in trade	70,500	60,000
Bills Payable to Jupiter Ltd.	—	6,000	Debtors	30,000	54,000
Contingent Liability of Jupiter Ltd. for ₹ 9,000 for bills discounted			Investments in 13,500 Shares of Neptune Ltd.	2,02,500	—
			Cash at Bank	27,000	12,000
	5,16,000	3,18,000		5,16,000	3,18,000

Neptune Ltd. had on 1.4.1997 ₹ 30,000 in general reserve and ₹ 36,000 (Cr.) in profit and loss account. 10% dividend was received by Jupiter Ltd. in November from Neptune Ltd. for 1996-97 and this amount was credited to profit and loss Neptune Ltd. dad plant on 1.4.1997 at ₹ 1,20,000 on the date of purchase which was revalued at ₹ 1,44,000. Stock of Neptune Ltd. includes ₹ 9,600 received from Jupiter Ltd. on which it made a profit of 25% on cost. Prepare the consolidated balance sheet.

Question 40

On 1 October 1998, H. Ltd. acquired 24,000 shares of ₹ 10 each in S. Ltd. at cost of ₹ 3,40,000. The balance sheets of two companies as on 30 June 1999 were as follows:

Liabilities	*H. Ltd.* ₹	*S. Ltd.* ₹	*Assets*	*H. Ltd.* ₹	*S. Ltd.* ₹
Share Capital (₹ 10)	15,00,000	4,00,000	Goodwill	5,00,000	1,40,000
General Reserve (as per last year's account)	6,00,000	3,00,000	Land & Building	6,50,00	2,00,000
Profit & Loss Account	4,00,000	1,70,000	Machineries	6,00,000	2,00,000
Sundry Creditors	3,60,000	84,000	Stock	3,00,000	80,000
Bills Payable	1,40,000	1,20,000	Debtors	3,50,000	2,70,000

Liabilities	*H. Ltd.* ₹	*S. Ltd.* ₹	*Assets*	*H. Ltd.* ₹	*S. Ltd.* ₹
			Investments	3,40,000	—
			Bills Receivable	1,20,000	60,000
			Cash at Bank	1,40,000	1,24,000
	30,00,000	10,74,000		30,00,000	10,74,000

On 1 July 1998, the profit and loss account of S. Ltd. showed a credit balance of ₹ 80,000 out of which a dividend of 15% was paid in December 1998. The bills payable of S. Ltd. represent bills issued in favour of H. Ltd. which company still held ₹ 80,000 of the bills accepted of S. Ltd. The entire closing stock of S. Ltd. represents goods supplied by H. Ltd. at cost *plus* 20%. Prepare as consolidated balance sheet of two companies as on 30 June 1999.

Question 41

The balance sheets of Ashish Ltd. and its subsidiary Anubhav Ltd. as on 31.3.1995 are as follows:

Liabilities	*Ashish Ltd.* ₹	*Anubhav Ltd.* ₹		*Assets*	*Ashish Ltd.* ₹	*Anubhav Ltd.* ₹
Share Capital:				Building	2,80,000	58,000
Equity Shares of ₹ 10 each	4,00,000	1,00,000		Plant & Machinery	2,00,000	52,000
General Reserve (1-4-1994)	2,80,000	4,000		Furniture & Fixtures	15,000	7,000
Profit & Loss account	1,70,000	72,000		Stock in trade	75,000	42,000
Sundry Creditors	70,000	35,000		Sundry Debtors	80,000	32,000
				Investments	2,00,000	—
				Cash & Bank balances	70,000	20,000
	9,20,000	2,11,000			9,20,000	2,11,000

Prepare a consolidated balance sheet together with a work sheet, having regard to the following:

(i) Ashish Ltd. had acquired in Anubhav Ltd. 8,000 shares as at 1 July 1994 at a cost of ₹2,00,000.

(ii) Stock-in-trade of Ashish Ltd. includes ₹ 6,000 relating to stock in tade at cost purchased from Anubhav Ltd. which follows the practice of charging 25% extra on the cost for determining the sale price.

(iii) Sundry creditors of Ashish Ltd. includes ₹ 10,000 on account of purchases from Anubhav Ltd. who follows the practice of charging 25% extra on the cost for detrermining the sale price.

(iv) Profit and loss account of Ashish Ltd. includes interim dividend declared after 1 July 1994 at the rate of 10% from Anubhav Ltd.

(v) Balance in profit and loss account as at 1 April 1994 of Anubhav Ltd. was ₹ 56,000, an interim dividend having been paid during the year out of the said undistributed profits.

(vi) Profits during the year 1994-95 have been earned on uniform basis throughout the year.

Question 42

Prepare a consolidated balance sheet in the books of H Company Ltd. from the following balance sheets of H. Co. Ltd. and S. Co. Ltd. and given informations:

Balance Sheets as on 31 March 1995

Liabilities	*H. Co. Ltd.* ₹	*S. Co. Ltd.* ₹
Preference Share Capital	2,00,000	40,000
Equity Share Capital of ₹ 100 each	8,00,000	4,00,000
General Reserve as on 1-4-94	2,00,000	1,20,000
Profit and Loss Account	2,80,000	1,80,000
Creditors	1,60,000	1,00,000
Bills Payable	—	40,000
	16,40,000	8,80,000
Assets		
Goodwill	80,000	60,000
Land and Building	4,00,000	2,60,000
Plant and Machinery	3,20,00	1,80,000

Liabilities	*H. Co. Ltd.* ₹	*S. Co. Ltd.* ₹
Debtors	40,000	1,50,000
Stock	2,00,000	1,80,000
3,000 Shares in S Co. Ltd. purchased on 30-9-94	4,80,000	—
Cash/Bank	1,20,000	40,000
Preliminary Expenses	—	10,000
	16,40,00	8,80,000

Informations

(1)Profit and loss Account of S Co. Ltd showed a credit balance of ₹ 1,00,000 on 1 April 1994.

(2)A dividend of 15% was paid by S Co. Ltd. in October 1994 for the year ended 31 March 1994 which was credit to profit and loss account of H Co. Ltd.

(3)Included in creditors of S Co. Ltd. ₹ 40,000 for goods supplied by H Co. Ltd. Also included in the stock of S Co. Ltd. are goods to the value of ₹ 16,000 which were supplied by H Co. Ltd. at a profit of 25% on sales.

(4)Plant and Machinery were revalued at ₹ 3,00,000 which stood in the books at ₹ 2,00,000 in the beginning.

(5)There is contingent liability of ₹ 2,000 for a pending suit in the court in the books of H Co. Ltd.

Question 43

A. Ltd. acquired 16,000 equity shares of ₹ 10 each in B. Ltd. on 1 October 1996 for ₹ 3,22,800. The balance sheets of the two companies as on 31 March 1997 were as follows:

Liabilities	*A Ltd.* ₹	*B Ltd.* ₹	*Assets*	*A Ltd.* ₹	*B Ltd.* ₹
Share capital of ₹ 10 Shares	5,00,000	2,00,000	Land & Buildings	1,80,000	1,90,000
Reserves	2,40,000	1,00,000	Plant & Machinery	2,40,000	1,35,000
Profit & Loss Account	57,200	82,000	Investments	3,60,000	—
Bank Overdraft	1,00,000	—	Stock	1,14,000	42,000
Bills Payable	—	13,000	Debtors	44,000	40,000
Sundry Creditors	69,800	20,000	Bills Receivable	14,800	—
			Cash	14,200	8,000
	9,67,000	41,5,000		9,67,000	41,5,000

Additional Information

(i) The profit and loss account of B. ltd. showed a balance of ₹ 30,000 on 1 April 1996 out of which a dividend of 10% was paid on 1 November 1996. The dividend was correctly recorded by A Ltd.

(ii) The plant and machinery of B. Ltd. which stood at ₹ 1,50,000 on 1 April 1996 was considered worth ₹1,80,000 on the date of acquisition by A Ltd.

(iii) Profits may be assumed to have accrued evenly throughout the year. Prepare a consolidated balance sheet.

Question 44

A Ltd. acquired 3,200 equity shares of ₹ 100 each on 31 March 1998. The balance sheet of two companies as on that date were:

Liabilities	*A Ltd.* ₹	*B Ltd.* ₹	*Assets*	*A Ltd.* ₹	*B Ltd.* ₹
Equity Shares of ₹ 100	10,00,000	4,00,000	Land & Buildings	3,00,000	3,60,000
Capital Reserves	—	2,40,000	Plant & Machinery	4,80,000	2,18,800
General Reserve	4,80,000	—	Investments in B Ltd. at cost	6,80,000	—
Profit & Loss Account	1,14,400	72,000	Stocks	2,40,000	72,000
Bank Overdraft	1,60,000	—	Sundry Debtors	88,000	80,000
Bills Payable (including ₹ 8,000 to A. Ltd.)	—	16,800	Bills Receivable (including ₹ 6,000 from B. Ltd.)	31,600	—
Sundry Creditors	94,200	18,000	Cash and Bank	29,000	16,000
	18,48,600	7,46,800		18,48,600	7,46,800

The following additional information is available:

(i) B Ltd. ahs made a bonus issue on 31 March 1998 of one equity share for every two shares held by its shareholders. This issue has not yet been taken into account.

(ii) Land buildings of B Ltd. are undervalued by ₹ 40,000 and plant and machinery of B Ltd. overvalued by ₹ 20,000. Values of these assets have to be adjusted accordingly.

(iii) Sundry Creditors of A Ltd. include ₹ 24,000 due to B Ltd. Prepare the consolidated balance sheet as at 31 March 1998.

Question 45

The balance-sheets of H. Co. Ltd. and its subsidiary S. Co. Ltd. as on 31st March 1993 are as follows:

Liabilities	*H Ltd.* ₹	*S Ltd.* ₹	*Assets*	*H Ltd.* ₹	*S Ltd.* ₹
Preference Share capital	1,00,000	—	Land	3,56,000	70,000
Equity Share Capital ₹ 100 fully paid	5,00,000	1,50,000	Properties	3,76,000	40,000
General Reserve	3,40,000	6,000	Plant and Machines	1,40,000	91,300
Profit and Loss Account	3,60,000	1,08,000	Investments in 1,200 shares of S. Co. on 1-4-1992	1,80,000	
Creditors	1,00,000	44,150	Stock	1,36,000	50,600
Bills Payable		24,150	Debtors and cash	2,12,000	80,400
	14,00,000	3,32,300		14,00,000	3,32,300

The other informations given are:

(a) Profit and loss account of H Co. includes an interim dividend of 10% received from S. Company.

(b) On 1-4-1992 profit and loss account of S. Co. stood at ₹ 77,500 and general reserve at ₹3,000. Also H. Co. revalued plant and machines of S. Co. at the time of purchase of shares by ₹ 20,000 more than its book value.

(c) Stock of H. Co. includes ₹ 8,000 of stock at cost purchased from S. Co. Further Debtors of S. Co. includes ₹ 24,000 for sales to H. Co. on which S. Co. made a profit of ₹ 6,000.

(d) S. Co. made a bonus issue during the year out of pre-acquisition profits for ₹ 60,000 not recorded in the books. Prepare consolidated balance sheet

Question 46

Following are the balance sheets of H. Ltd. and S. Ltd. as at 31 March, 1997:

Liabilities	*H Ltd.* ₹	*S Ltd.* ₹
Share capital:		
Shares of ₹ 100 each	5,00,000	2,00,000
General reserve as on 1.4.1996	1,00,000	60,000
Profit & loss account	1,40,000	90,000
Bills payable	—	40,000
Creditors	80,000	50,000
	8,20,000	4,40,000
Assets		
Goodwill	40,000	30,000
Other fixed assets	3,60,000	2,20,000
1,500 shares in S Ltd. at cost	2,40,000	—
Stock	1,00,000	90,000
Debtors	20,000	75,000
Cash at bank	60,000	25,000
	8,20,000	4,40,000

The profit and loss account of S Ltd. showed a balance of ₹ 50,000 on 1 April, 1996. A dividend of 15% was paid on 15 October, 1996 for the year 1995-96. The dividend was credited by H Ltd. to its profit and loss account. H Ltd. acquired the shares on 1 October, 1996. The bills payable of S Ltd. were all issued in favour of H Ltd., which company got the bills discounted. Included in the creditors of S Ltd. are ₹ 20,000 for goods supplied by H Ltd. the stock of S Ltd. includes goods to the value of ₹ 8,000 which were supplied by H Ltd. at a profit of 33-1/3% on cost. Prepare consolidated balance sheet of H Ltd. and its subsidiary S Ltd. as on 31 March. 1997. Give all your working notes clearly.

Question 47

The balance sheets of H Co. and S. Co. as on 31 March 1998 are as follows:

Liabilities	*H Co.* ₹	*S Co.* ₹	*Assets*	*H Co.* ₹	*S Co.* ₹
Preference Share Capital	3,00,000	40,000	Goodwill	70,000	60,000
Equity Share Capital of ₹ 100 each	9,00,000	4,00,000	Land & Buildings	6,00,000	2,60,000

Liabilities	*H Co.* ₹	*S Co.* ₹	*Assets*	*H Co.* ₹	*S Co.* ₹
General Reserve as on 1-4-97	2,00,000	1,20,000	Plant & Machinery	3,30,000	1,80,000
P & L Account	2,80,000	1,80,000	Investments :		
Creditors	1,60,000	1,00,000	3,000 shares in S. Co. (on 30.9.97)	4,80,000	—
Bills Payable	—	40,000	Debtors	40,000	1,50,00
			Stocks	2,00,000	1,80,000
			Cash	1,20,000	40,000
			Preliminary Exp.	—	10,000
	18,40,000	8,80,000		18,40,000	8,80,000

Informations: **1.** A dividend of 15% was paid by S Co. in October, 1997 for the year ended 31 March, 1997; **2.** Plant & Machinery of S. Co. in the beginning was ₹ 2,00,000. H. Co. revalued it by ₹ 1,00,000 more tat the time of purchase of shares; **3.** There was a bonus issue of ₹ 40,000 out of post-acquisition profits by S. Co.; **4.** Credit balance of P & L Account of S. Co on 1 April 1997 was ₹ 1,00,000; **5.** Included in stock of S. Co. are goods to the value of ₹ 16,000 which were supplied by H Co. at profit of 25% on sales. Prepare consolidated balance sheet giving working notes.

Question 48

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 reserve and surplus of ₹40,000.

Both the companies follow calendar year as the accounting year.

In the four consecutive years, S Ltd. fared 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.

(*May 2019*) (*10 Marks*)

Answer:

The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. The excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered. Accordingly,

Year	*Profit/ (Loss)*	*Minority Interest (30%)*	*Additional Consolidated P & L (Dr.) or Cr.*	*Minority's Share of losses borne by H Ltd.*		*Cost of Control*
				₹	*Balance*	
At the time of acquisition on 1.1.2011		1,62,000 (W.N.)	-			
2011	(1,25,000)	<u>(37,500)</u>	(87,500)			1,22,000 (W.N.)
Balance		1,24,500				
2012	(2,00,000)	<u>(60,000)</u>	(1,40,000)			1,22,000
Balance		64,500				
2013	(2,50,000)	<u>(75,000)</u>	(1,75,000)			1,22,000
		(10,500)				
	Loss of minority borne by Holding Co.	<u>10,500</u>	<u>(10,500)</u>	10,500	10,500	

Year	*Profit/ (Loss)*	*Minority Interest (30%)*	*Additional Consolidated P & L (Dr.) or Cr.*	*Minority's Share of losses borne by H Ltd.*		*Cost of Control*
				₹	*Balance*	
Balance		Nil	(1,85,500)			
2014	(60,000)	(18,000)	(42,000)			1,22,000
	Loss of Minority borne by Holding Co.	18,000	(18,000)	18,000	28,500	
Balance		Nil	(60,000)			
2015	25,000	7,500	17,500			1,22,000
	Profit share of minority adjusted against losses of minority absorbed by Holding Co.	(7,500)	7,500	(7,500)	21,000	
Balance		Nil	25,000			
2016	50,000	15,000	35,000	(15,000)	6,000	1,22,000
		(15,000)	15,000			
Balance		Nil	50,000			
2017	75,000	22,500	52,500	(6,000)	Nil	1,22,000
		(6,000)	6,000			
Balance		16,500	58,500			

Working Note:

Calculation of Minority interest and Cost of control on 1.1.2011

		Share of Holding Co.	*Minority Interest*
	100%	*70%*	*30%*
	(₹)	*(₹)*	*(₹)*
Share Capital	5,00,000	3,50,000	1,50,000
Reserve	40,000	28,000	12,000
		3,78,000	1,62,000
Less: Cost of investment		(5,00,000)	
Goodwill		1,22,000	

Question 49

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 2016 for ₹2,80,000. The issued capital of ABC Ltd., on 1st January, 2016 was ₹2,00,000 and the balance in the Profit & Loss Account was ₹1,20,000.

During the year ended 31st December, 2016, ABC Ltd. earned a profit of ₹40,000 and at year end, declared and paid a dividend of ₹60,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd.

You are required to compute amount of minority interest as on 1st January, 2016 and 31st December, 2016?

(*MTP March 2018*) (*5 Marks*)

Answer:

Total dividend paid = ₹60,000

Out of post-acquisition profit = ₹40,000

Out of pre-acquisition profit = ₹20,000

Hence, 2/3rd of dividend received by XYZ will be credited to P & L and 1/3rd will be credited to Investment.

XYZ Ltd.'s share of dividend = ₹60,000 × 80% = ₹48,000

In the books of XYZ Ltd.

	₹	₹
Bank A/c Dr.	48,000	
To Profit & Loss A/c		32,000
To Investments in ABC Ltd.		16,000
(Dividend received from ABC Ltd. 1/3 credited to investment A/c being out of capital profits - as explained above)		
Goodwill on Consolidation:		₹
Cost of shares less dividend out of capital profits		2,64,000
Less: Face value of capital i.e. 80% of capital	1,60,000	
Share of capital profits [1,20,000 - 20,000 (dividend portion out of pre-acquisition profits)] X 80 %	80,000	2,40,000
Goodwill		24,000
Minority interest on:		64,000
1st January, 2016: 20% of ₹3,20,000 [2,00,000 + 1,20,000]		
31st December, 2016: 20% of ₹3,00,000 [2,00,000 + 1,20,000 + 40,000 - 60,000]		60,000

Question 50

A Ltd. acquired 70% of equity shares of B Ltd. on 1.4.2010 at cost of ₹10,00,000 when B Ltd. had an equity share capital of ₹10,00,000 and reserves and surplus of ₹80,000. In the four consecutive years, B Ltd. fared badly and suffered losses of ₹2,50,000, ₹4,00,000, ₹5,00,000 and ₹1,20,000 respectively. Thereafter in 2014-15, B Ltd. experienced turnaround and registered an annual profit of ₹50,000. In the next two years i.e. 2015-16 and 2016-17, B Ltd. recorded annual profits of ₹1,00,000 and ₹1,50,000 respectively.

You are required to compute the minority interests and cost of control at the end of each year for the purpose of consolidation.

(*MTP April 2018*) (*10 Marks*)

Answer:

The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. The excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered. Accordingly,

Year	Profit/ (Loss)	Minority Interest (30%)	Additional Consolidated P & L (Dr.) Cr.	Minority's Share of losses borne by A Ltd.		Cost of Control
				₹	Balance	
At the time of acquisition in 2010		3,24,000 (W.N.)	—			
2010-11	(2,50,000)	(75,000)	(1,75,000)			2,44,000 (W.N.)
Balance		2,49,000				
2011-12	(4,00,000)	(1,20,000)	(2,80,000)			2,44,000
Balance		1,29,000				
2012-13	(5,00,000)	(1,50,000)	(3,50,000)			2,44,000
		(21,000)				
	Loss of minority borne by Holding Co.	21,000	(21,000)	21,000	21,000	
Balance		Nil	(3,71,000)			
2013-14	(1,20,000)	(36,000)	(84,000)			2,44,000
	Loss of minority borne by Holding Co.	36,000	(36,000)	36,000	57,000	
Balance		Nil	(1,20,000)			
2014-15	50,000	15,000	35,000			2,44,000
	Profit share of minority adjusted against losses of minority	(15,000)	15,000	(15,000)	42,000	

Year	Profit/ (Loss)	Minority Interest (30%)	Additional Consolidated P & L (Dr.) Cr.	Minority's Share of losses borne by A Ltd.		Cost of Control
				₹	Balance	
Balance	absorbed by Holding Co.	Nil	50,000			
2015-16	1,00,000	—	1,00,000	(30,000)	12,000	2,44,000
Balance		Nil				
2016-17	1,50,000	45,000	1,05,000	(12,000)	Nil	2,44,000
		(12,000)	12,000			
Balance		33,000	1,17,000			

Working Note:

Calculation of Minority interest and Cost of control on 1.4.2010

	100% (₹)	Share of Holding Co. 70% (₹)	Minority Interest 30% (₹)
Share Capital	10,00,000	7,00,000	3,00,000
Reserve	80,000	56,000	24,000
		7,56,000	3,24,000
Less: Cost of investment		(10,00,000)	
Goodwill		2,44,000	

Question 51

From the following data, determine the amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own Profit & Loss Account to be ₹2,00,000 in each case:

Case	Subsidiary Company	% shares owned	Cost	Date of acquisition		Consolidation Date	
				1.1.2016		31.12.2016	
				Share Capital	Profit & Loss Account	Share Capital	Profit & Loss Account
			₹	₹	₹	₹	₹
Case 1	A	90%	1,40,000	1,00,000	50,000	1,00,000	70,000
Case 2	B	85%	1,04,000	1,00,000	30,000	1,00,000	20,000
Case 3	C	80%	56,000	50,000	20,000	50,000	20,000
Case 4	D	100%	1,00,000	50,000	40,000	50,000	55,000

(*MTP April 2018*) (*5 Marks*)

Answer:

The balance in the Profit & Loss Account on the date of acquisition (1.1.2016) is Capital profit, as such the balance of Consolidated Profit & Loss Account shall be equal to Holding Co.'s profit.

On 31.12.2016 in each case the following amount shall be added or deducted from the balance of holding Co.'s Profit & Loss account.

	% Share holding [K]	P & L as on 31.12.2016 [L]	P & L as on consolidation date [M]	P & L post acquisition [N] = [M]-[L]	Amount to be added/ (deducted) from holding's P&L [O] = [K] x [N]
1	90%	50,000	70,000	20,000	18,000
2	85%	30,000	20,000	(10,000)	(8,500)
3	80%	20,000	20,000	Nil	Nil
4	100 %	40,000	55,000	15,000	15,000

Question 52

Exe Ltd. acquires 70% of equity shares of Zed Ltd. as on 31st March, 2017 at a cost of ₹70 lakhs. The following information is available from the balance sheet of Zed Ltd. as on 31st March, 2017:

	₹ in lakhs
Fixed Assets	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, 2017. 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.

(*MTP October 2018*) (*5 Marks*)

Answer:

Revalued net assets of Zed Ltd. as on 31st March, 2017

	₹ in lakhs	*₹ in lakhs*
Fixed Assets [120 X 120%]		144.0
Investments [55 X 90%]		49.5
Current Assets		70.0
Loans and Advances		15.0
Total Assets after revaluation		278.5
Less: 15% Debentures	90.0	
Current Liabilities	50.0	(140.0)
Equity/Net Worth		138.5
Exe Ltd.'s share of net assets (70% of 138.5)		96.95
Exe Ltd.'s cost of acquisition of shares of Zed Ltd.		
(₹70 lakhs – ₹7 lakhs*)		63.00
Capital reserve		33.95

* Total Cost of 70 % Equity of Zed Ltd	₹70 lakhs
Purchase Price of each share	₹20
Number of shares purchased [70 lakhs/₹20]	3.5 lakhs
Dividend @ 20 % i.e. ₹2 per share	₹7 lakhs

Since dividend received is for pre-acquisition period, it has been reduced from the cost of investment in the subsidiary company.

Question 53

The following data is provided to you:

Case	Subsidiary Company	% shares owned	Cost	Date of acquisition		Consolidation Date	
				1.1.2018		31.12.2018	
				Share Capital	Profits Loss Account	Share Capital	Profits Loss Account
			₹	₹	₹	₹	₹
Case 1	A	90%	1,40,000	1,00,000	50,000	1,00,000	70,000
Case 2	B	85%	1,04,000	1,00,000	30,000	1,00,000	20,000
Case 3	C	80%	56,000	50,000	20,000	50,000	20,000
Case 4	D	100%	1,00,000	50,000	40,000	50,000	55,000

Determine in each case:

(1) Minority interest at the date of acquisition and at the date of consolidation.

(2) Goodwill or Capital Reserve.

(*RTP May, 2019*)

Answer*:*

(1) Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case it should be equal to Share Capital + Profit & Loss A/c.

	Minority % Shares Owned [E]	Minority interest as at the date of acquisition [E] × [A+B] ₹	Minority interest as at the date of consideration [E] × [C + D] ₹
Case 1 [100-90]	10%	15,000	*17,000*
Case 2 [100-85]	15%	*19,500*	18,000
Case 3 [100-80]	20%	*14,00*	14,000
Case 4 [100-100]	Nil	*Nil*	Nil

A = Share capital on 1.1.2018

B = Profit & loss account balance on 1.1.2018

C = Share capital on 31.12.2018

D = Profit & loss account balance on 1.1.2018

(2) Calculation of Goodwill or Capital Reserve

	Shareholding % [F]	Cost [G]	Total Equity [A]+[B] = [H]	Parent's Portion of equity [F]x[H]	Goodwill ₹[G]-[H]	Capital Reserve ₹[H] - [G]
Case l	90%	1,40,000	1,50,000	1,35,000	5,000	—
Case 2	85%	1,04,000	1,30,000	1,10,500	—	6,500
Case 3	80%	56,000	70,000	56,000	Nil	Nil
Case 4	100%	1,00,000	90,000	90,000	10,000	—

Question 54

From the following data, determine the amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own Profit & Loss Account to be ₹2,00,000 in each case:

Case	Subsidiary Company	% shares owned	Cost ₹	Date of acquisition		Consolidation Date	
				1.1.2018		31.12.2018	
				Share Capital ₹	Profit & Loss Account ₹	Share Capital ₹	Profit & Loss Account ₹
Case 1	A	90%	1,40,000	1,00,000	50,000	1,00,000	70,000
Case 2	B	85%	1,04,000	1,00,000	30,000	1,00,000	20,000
Case 3	C	80%	56,000	50,000	20,000	50,000	20,000
Case 4	D	100%	1,00,000	50,000	40,000	50,000	55,000

(MTP-March 2019) (5 Marks)

Answer*:*

The balance in the Profit & Loss Account on the date of acquisition (1.1.2018) is Capital profit, as such the balance of Consolidated Profit & Loss Account shall be equal to Holding Co.'s profit.

On 31.12.2018 in each case the following amount shall be added or deducted from the balance of holding Co.'s Profit & Loss account.

	% Share holding [K]	P & L as on 31.12.2018 [L]	P & L as on consolidation date [M]	P & L post acquisition [N] = [M]-[L]	Amount to be added/ (deducted) from holding's P & L [O] = [K] x [N]
1	90%	50,000	70,000	20,000	18,000
2	85%	30,000	20,000	(10,000)	(8,500)
3	80%	20,000	20,000	Nil	Nil
4	100%	40,000	55,000	15,000	15,000

Question 55

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 2016 for ₹2,80,000. The issued capital of ABC Ltd., on 1st January, 2016 was ₹2,00,000 and the balance in the Profit & Loss Account was ₹1,20,000.

During the year ended 31st December, 2016, ABC Ltd. earned a profit of ₹40,000 and at year end, declared and paid a dividend of ₹60,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd.

What is the amount of minority interest as on 1st January, 2016 and 31st December, 2016?

(*MTP-April 2019*) (*5 Marks*)

Answer*:*

Total dividend paid = ₹60,000

Out of post-acquisition profit = ₹40,000

Out of pre-acquisition profit = ₹20,000

Hence, 2/3rd of dividend received by XYZ will be credited to P & L and 1/3rd will be credited to Investment.

XYZ Ltd.'s share of dividend = ₹60,000 X 80% = ₹48,000

In the books of XYZ Ltd.

		₹	₹
Bank A/c	Dr.	48,000	
To Profit & Loss A/c			32,000
To Investments in ABC Ltd.			16,000
(Dividend received from ABC Ltd. 1/3 credited to investment A/c being out of capital profits - as explained above)			
Goodwill on Consolidation:			₹
Cost of shares less dividend out of capital profits			2,64,000
Less: Face value of capital i.e.80% of capital		1,60,000	
		80,000	2,40,000
Add: Share of capital profits [1,20,000-20,000 (dividend portion out of pre-acquisition profits)] × 80%			24,000
Goodwill			
Minority interest on:			64,000
1st January, 2016: 20% of ₹3,20,000 [2,00,000 + 1,20,000]			
31st December, 2016: 20% of ₹3,00,000 [2,00,000 + 1,20,000 + 40,000-60,000]			60,000

Question 56

The following summarised Balance Sheets of H Ltd. and its subsidiary S Ltd. were prepared as on 31st March, 2017:

	H Ltd. (₹)	**S Ltd. (₹)**
Equity and Liabilities		
Shareholders' Funds		
Equity Share Capita! (fully paid up shares of ₹10 each)	12,00,000	2,00,000
Reserves and Surplus		
General Reserve	4,35,000	1,55,000
Profit and Loss Account	2,80,000	65,000
Current Liabilities		
Trade Payables	3,22,000	1,23,000
Total	22,37,000	5,43,000

	H Ltd. (₹)	**S Ltd. (₹)**
Assets		
Non-Current Assets		
Fixed Assets		
Machinery	6,40,000	1,80,000
Furniture	3,75,000	34,000
Non-Current Investments		
Shares in S Ltd. -16,000 shares @ ₹20 each	3,20,000	-
Current Assets		
Inventories	2,68,000	62,000
Trade Receivables	4,70,000	2,35,000
Cash and Bank	1,64,000	32,000
Total	22,37,000	5,43,000

H Ltd. acquired the 80% shares of S Ltd. on 1st April, 2016. On the date of acquisition, General Reserve and Profit Loss Account of S Ltd. stood at ₹50,000 and ₹30,000 respectively.

Machinery (hook value ₹2,00,000) and Furniture (book value ₹40,000) of S Ltd. were revalued at ₹3,00,000 and ₹30,000 respectively on 1st April,2016 for the purpose of fixing the price of its shares (rates of depreciation computed on the basis of useful lives: Machinery 10% and Furniture 15%). Trade Payables of H Ltd. include ₹35,000 due to S Ltd. for goods supplied since the acquisition of the shares. These goods are charged at 10% above cost. The inventories of H Ltd. includes goods costing ₹55,000 purchased from S Ltd.

You are required to prepare the Consolidated Balance Sheet as at 31st March, 2017.

(May 2018) (20 Marks)

Answer:

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd.
as at 31st March, 2017

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

Notes to Accounts

				₹
1.	Reserves and Surplus			
	General Reserves		4,35,000	
	Add: 80% share of S Ltd.'s post-acquisition reserves (W.N.3)		84,000	5,19,000
	Profit and Loss Account		2,80,000	
	Add: 80% share of S Ltd.'s post-acquisition profits (W.N.3)	21,200		
	Less: Unrealised gain	(4,000)	17,200	2,97,200
				8,16,200
2.	Trade Payables			
	H Ltd.		3,22,000	
	S Ltd.		1,23,000	
	Less: Mutual transaction		(35,000)	4,10,000
3.	Tangible Assets			
	Machinery			
	H. Ltd.		6,40,000	
	S Ltd.	2,00,000		
	Add: Appreciation	1,00,000		
		3,00,000		
	Less: Depreciation	(30,000)	2,70,000	9,10,000

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

Working Notes:

1. Profit or loss on revaluation of assets in the books of S Ltd. and their book values as on 1.4.2016

	₹
Machinery	
Revaluation as on 1.4.2016	3,00,000
Less: Book value as on 1.4.2016	(2,00,000)
Profit on revaluation	1,00,000
Furniture	
Revaluation as on 1.4.2016	30,000
Less: Book value as on 1.4.2016	(40,000)
Loss on revaluation	(10,000)

2. Calculation of short/excess depreciation

	Machinery	**Furniture**
Upward/(Downward) Revaluation (W.N. 4)	1,00,000	(10,000)
Rate of depreciation	10% p.a.	15% p.a.
Difference [(short)/excess]	(10,000)	1.500

3. Analysis of reserves and profits of S Ltd. as on 31.03.2017

	Pre-acquisition profit upto 1.4.2016	**Post-acquisition profits (1.4.2016-31.3.2017)**	
	(Capital profits)	**General Reserve**	**Profit and loss account**
General reserve as on 31.3.2017	50,000	1,05,000	
Profit and loss account as on 31.3.2017	30,000		35,000
Upward Revaluation of machinery as on 1.4.2016	1,00,000		
Downward Revaluation of Furniture as on 1.4.2016	(10,000)		
Short depreciation on machinery (W.N. 5)			(10,000)
Excess depreciation on furniture (W.N. 5)			1,500
Total	1,70,000	1,05,000	26,500

4. Minority Interest

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

* considered that ₹55,000 is cost to H Ltd. Alternative solution considering it as cost to S Ltd. is also possible

5. Cost of Control or Goodwill

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

Question 57

The Summarised Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017 areas 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
	25,896	10,727
ASSETS		
Land & Building	3,550	1,510
Plants Machinery	5,275	3,600
Furniture & Fittings	1,945	655
Investment in Y Ltd.:		
450 Lakh Equity share in Y Ltd. purchased on 1st April, 2016	6,800	
Inventory	4,142	2,520
Trade Receivables	3,010	1,882
Cash and Bank Balance	1,174	560
	25,896	10,727

The following information is also given to you

(a) 10% dividend on Equity shares was declared by Y Ltd. on 31st 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 1st 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).

(*RTP November 2018*)

Answer:

Consolidated Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017

	Particulars	Note No.	₹ in lakhs
I	**Equity and Liabilities**		
1	**Shareholders' Funds**		
	(a) Share Capital	1	19,000
	(b) Reserves and Surplus	2	5,620
2.	**Minority interest**	3	3,400
3.	**Current Liabilities**		
	(a) Trade payables	4	2,623
	Total		30,643
II	**Assets**		
1	**Non Current Assets**		
	Fixed Assets		
	(i) Tangible Assets	5	17,435
2	**Current Assets**		
	(a) Inventories	6	6,632
	(b) Trade Receivables	7	4,842
	(c) Cash and Cash equivalents	8	1,734
			30,643

Notes to Accounts

			₹ in lakhs
1.	Share Capital		
	Issued, Subscribed and Paid up (1,500 lakh Equity Shares of ₹10 each fully paid up)		15,000
	400 lakh Preference Shares of ₹10 each fully paid up		4,000
			19,000
2.	Reserves and Surplus		
	Credit Balance of Profit & Loss Account	2,750	
	Less: Capital Receipt wrongly credited (Dividend @ 10% on ₹4500 Lakh Equity Shares)	450	
		2,300	
	Add: Share in Y Ltd. Revenue Profit (Working Note i)	825	
		3,125	
	Less: Unrealised Profit (Working Note iv)	30	3,095
	Capital Reserve (Working Note iii)	25	
	General Reserve	2,500	2,525
			5,620
3.	**Minority interest**		
	100 Lakh Preference Shares of ₹10 fully paid up	1,000	
	150 Lakh Equity Shares of ₹10 each fully paid up	1,500	2,500
	Share in Revenue Profits (Working Note i)	275	
	Share in Capital Profit (working Note ii)	625	900
			3,400
4.	**Trade payables**		
	X Ltd.	1,646	
	Y Ltd.	1,027	
		2,673	
	Less: Mutual owing	50	2,623

			₹ in lakhs
5.	**Tangible Assets**		
	Land & Building		
	X Ltd.	3,550	
	Y Ltd	1,510	5,060
	Plants Machinery		
	X Ltd.	5,275	
	Y Ltd (Working note v)	4,500	9,775
	Furniture & Fixtures		
	X Ltd.	1,945	
	Y Ltd	655	2,600
			17,435
6.	**Inventories**		
	X Ltd.	4,142	
	Y Ltd	2,520	
		6,662	
	Less: Unrealized Profit	1301	6,632
7.	**Trade Receivables**		
	X Ltd.	3,010	
	Y Ltd	1,882	
		4,892	
	Less: Mutual Owing	50	4,842
8.	**Cash & cash Equivalents**		
	X Ltd.	1,174	
	Y Ltd	560	1,734

Working Notes

(i) Calculation of Revenue Profits

Y's Ltd Profit & Loss Account

	₹ in lakh		₹ in lakh
To Equity Dividend		By Balance b/d	650
10% of 6,000 lakh	600	By Net profit for the year (Bal Fig.)	1,200
To balance c/d	1,250		
	1,850		1,850

Depreciation provided on Plant & Machinery

Balance as on 1st April, 2016	4,000
Less Balance as 31st March 2017	3,600
	400
Hence rate of Depreciation = 400/4000 × 100	10%
Net Profit for the year ended 31st March 2017	1,200
Less: Additional Depreciation	100
Revenue Profit	1,100
X Ltd's share- 1100 × 450/600	825
Y Ltd's share = 1100 × 150/600	275

(ii) Calculation of Capital Profits

Profit & Loss Balance as on 1st April, 2016	650
Less: Dividend Paid	600
	50
Add: General Reserve as on 1st April, 2016	1,450
Add: Profit on Revaluation of Plant & machinery	1,000
Capital Profit	2,500
X Ltd's Share in Capital Profit = 2,500 × 450/600	1,875
Y Ltd's Share in Capital Profit = 2,500 × 150/600	625

(iii) Calculation of Capital Reserve

Paid up value of 450 Lakh equity shares	4,500
Add: Share in Capital Profits	1,875
	6,375
Amount Paid to acquire the 450 Lakh Equity Shares	6,800
Less: Dividend received out of Pre acquisition profits	450
	6,350
Capital Reserve = 6,375 - 6,350	25

(iv) Unrealised Profit

₹150 Lakh × 25/125* = 30 lakh

(v) Plant & Machinery of Y Ltd.

Balance as on 31st March, 2017		3,600
Add: Addition due to revaluation	1,000	
Less: Depreciation on additional Value of Plant & Machinery @ 10 %	100	900
		4,500

* ₹150 lakh considered as cost to Y Ltd.

Question 58

Consider the following summarized balance sheets of subsidiary Neel Ltd.:

	2015 ₹	2016 ₹		2015 ₹	2016 ₹
Share-Capital Issued & subscribed 2,500 equity shares of ₹100 each Reserves & Surplus	2,50,000	2,50,000	Fixed Assets Cost Less: Accumulated depreciation	1,60,000 (24,000)	1,60,000 (48,000)
				1,36,000	**1,12,000**
Revenue reserves	1,43,000	3,57,000	Investments at cost		
Current Liabilities & Provisions:			Current Assets:	—	2,00,000
Trade Payables	2,45,000	2,47,000	Inventory	2,98,500	3,71,000
Bank overdraft	—	85,000	Trade Receivables	2,97,000	4,45,500
Provision for taxation	1,55,000	2,15,000	Prepaid Expenses	36,000	24,000
			Cash at Bank	25,500	1,500
	7,93,000	**11,54,000**		**7,93,000**	**11,54,000**

Also consider the following information:

(i) Neel Ltd. is a subsidiary of Sky Ltd. Both the companies follow calendar year as the accounting year.

(ii) Sky Ltd. values inventory on LIFO basis while Neel Ltd. used FIFO basis. To bring Neel Ltd.'s values in line with those of Sky Ltd. its value of inventory is required to be reduced by ₹6,000 at the end of 2015 and ₹17,000 at the end of 2016.

(iii) Neel Ltd. deducts 1% from Trade Receivables as a general provision against doubtful debts.

(iv) Prepaid expenses in Neel Ltd. include advertising expenditure carried forward of ₹30,000 in 2015 and ₹15,000 in 2016, being part of initial advertising expenditure of ₹45,000 in 2015 which is being written off over three years. Similar amount of advertising expenditure of Sky Ltd. has been fully written off in 2015.

You are required to restate the balance sheet of Neel Ltd. as on 31st December, 2016 after considering the above information, for the purpose of consolidation. Make the necessary restatement which is necessary to make the accounting policies adopted by Sky Ltd. and Neel Ltd. uniform.

(*MTP-April 2019*) (*12 Marks*)

Answer*:*

(a) Adjusted revenue reserves of Neel Ltd.

	₹	₹
Revenue reserves as given		3,57,000
Add: Provision for doubtful debts [4,45,500/99 × 1]		4,500
		3,61,500
Less: Reduction in value of Inventory	17,000	
Advertising expenditure to be written off	15,000	(32,000)
Adjusted revenue reserve		3,29,500

Note: Since Neel Ltd. follows FIFO basis, it is assumed that opening inventory has been sold out during the year 2015. Therefore, reduction in inventory would have been taken care of by sale value. Hence no adjustment has been made for the same.

Restated Balance Sheet of Neel Ltd.
as at 31st December, 2016

	Particulars	Note No.	(₹)
I.	**Equity and Liabilities**		
	(1) Shareholder's Funds		2,50,000
	(a) Share Capital	1	3,29,500
	(b) Reserves and Surplus		
	(2) Current Liabilities		
	(a) Short term borrowings	2	85,000
	(b) Trade Payables		2,47,000
	(c) Short-term provision	3	2,15,000
	Total		**11,26,500**
II.	**Assets**		
	(1) Non-current assets		
	(a) Fixed assets		
	Tangible assets	4	1,12,000
	(b) Non-current Investment		2,00,000
	(2) Current assets		
	(a) Inventories		3,54,000
	(b) Trade Receivables		4,50,000
	(c) Cash & Cash Equivalents		1,500
	(d) Other current assets		9,000
	Total		**11,26,500**

Notes to Accounts

			₹
1.	**Reserves and Surplus**		
	Revenue Reserve (refer computation of adjusted revenue reserves of Neel Ltd)		3,29,500
2.	**Short term borrowings**		85,000
	Bank overdraft		
3.	**Short-term provision**		2,15,000
	Provision for taxation		
4.	**Tangible Assets**		
	Cost	1,60,000	
	Less: Depreciation to date	(48,000)	1,12,000
5.	**Other current assets**		
	Prepaid expenses (After adjusting advertising expenditure to be written off each year)		9,000

Question 59

The following summarised Balance Sheets of H Ltd. and its subsidiary S Ltd. were prepared as on 31st March, 2019:

	H Ltd. (₹)	S Ltd. (₹)
Equity and Liabilities		
Shareholders' Funds		
Equity Share Capital (fully paid up shares of ₹10 each)	12,00,000	2,00,000
Reserves and Surplus		
General Reserve	4,35,000	1,55,000
Profit and Loss Account	2,80,000	65,000
Current Liabilities		
Trade Payables	3,25,000	1,25,000
Total	22,40,000	5,45,000

	H Ltd. (₹)	S Ltd. (₹)
Assets		
Non-Current Assets		
Property, Plant and Equipment		
Machinery	6,40,000	1,80,000
Furniture	3,75,000	34,000
Non-Current Investments		
Shares in S Ltd. - 16,000 shares @ ₹20 each	3,20,000	-
Current Assets		
Inventories	2,68,000	62,000
Trade Receivables	4,73,000	2,37,000
Cash and Bank	1,64,000	32,000
Total	22,40,000	5,45,000

H Ltd. acquired the 80% shares of S Ltd. on 1st April, 2018. On the date of acquisition, General Reserve and Profit Loss Account of S Ltd. stood at ₹50,000 and ₹30,000 respectively.

Machinery (book value ₹2,00,000) and Furniture (book value ₹40,000) of S Ltd. were revalued at ₹3,00,000 and ₹30,000 respectively on 1st April,2018 for the purpose of fixing the price of its shares (rates of depreciation computed on the basis of useful lives: Machinery 10% and Furniture 15%). Trade Payables of H Ltd. include ₹40,000 due to S Ltd. for goods supplied since the acquisition of the shares. These goods are charged at 10% above cost. The inventories of H Ltd. Includes goods costing ₹55,000 (cost to H Ltd.) purchased from S Ltd.

You are required to prepare the Consolidated Balance Sheet of H Ltd. with its subsidiary S Ltd. as at 31st March, 2019.

(*RTP November 2019*)

Answer:

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2019

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

Notes to Accounts

				₹
1.	Reserves and Surplus			
	General Reserves		4,35,000	
	Add: 80% share of S Ltd.'s post- acquisition reserves (W.N.3)		84,000	5,19,000
	Profit and Loss Account		2,80,000	
	Add: 80% share of S Ltd.'s post- acquisition profits (W.N.3)	21,200		
	Less: Unrealised gain	(4,000)	17,200	2,97,200
				8,16,200
2.	Trade Payables			
	H Ltd.		3,25,000	
	S Ltd.		1,25,000	
	Less: Mutual transaction		(40,000)	4,10,000
3.	Tangible Assets			
	Machinery			
	H Ltd.		6,40,000	

				₹
	S Ltd.	2,00,000		
	Add: Appreciation	1,00,000		
		3,00,000		
	Less: Depreciation	(30,000)	2,70,000	9,10,000
	Furniture			
	H. Ltd.		3,75,000	
	S Ltd.	40,000		
	Less: Decrease in value	(10,000)		
		30,000		
	Less: Depreciation	(4,500)	25,500	4,00,500
				13,10,500
4.	Intangible assets			
	Goodwill [WN 5]			24,000
5.	Inventories			
	H Ltd.		2,68,000	
	S Ltd.		62,000	3,30,000
	Less: Inventory reserve			(5,000)
				3,25,000
6.	Trade Receivables			
	H Ltd.		4,73,000	
	S Ltd.		2,37,000	7,10,000
	Less: Mutual transaction			(40,000)
				6,70,000
7.	Cash and Bank			
	H Ltd.		1,64,000	
	S Ltd.		32,000	1,96,000

Working Notes:

1. Profit or loss on revaluation of assets in the books of S Ltd. and their book values as on 1.4.2018

	₹
Machinery	
Revaluation as on 1.4.2018	3,00,000
Less: Book value as on 1.4.2018	(2,00,000)
Profit on revaluation	1,00,000
Furniture	
Revaluation as on 1.4.2018	30,000
Less: Book value as on 1.4.2018	(40,000)
Loss on revaluation	(10,000)

2. Calculation of short/excess depreciation

	Machinery	***Furniture***
Upward/(Downward) Revaluation (W.N. 4)	1,00,000	(10,000)
Rate of depreciation	10% p.a.	15% p.a.
Difference [(short)/excess]	(10,000)	1,500

3. Analysis of reserves and profits of S Ltd. as on 31.03.2019

	Pre-acquisition profit upto 1.4.2018	***Post-acquisition profits (1.4.2018 – 31.3.2019)***	
	(Capital profits)	***General Reserve***	***Profit and loss account***
General reserve as on 31.3.2019	50,000	1,05,000	
Profit and loss account as on 31.3.2019	30,000		35,000
Upward Revaluation of machinery as on 1.4.2018	1,00,000		
Downward Revaluation of Furniture as on 1.4.2018	(10,000)		
Short depreciation on machinery (W.N. 5)			(10,000)
Excess depreciation on furniture (W.N. 5)			1,500
Total	1,70,000	1,05,000	26,500

4. Minority Interest

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

5. Cost of Control or Goodwill

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

Question 60

Consider the following summarized Balance Sheets of subsidiary MNT Ltd.:

Liabilities	**2017-18 Amount in ₹**	**2018-19 Amount in ₹**
Share Capital		
Issued and subscribed 7500 Equity		
Shares of ₹100 each	7,50,000	7,50,000
Reserve and Surplus		
Revenue Reserve	2,14,000	5,05,000
Securities Premium	72,000	2,07,000
Current Liabilities and Provisions		
Trade Payables	2,90,000	2,46,000
Bank Overdraft	—	1,70,000
Provision for Taxation	2,62,000	4,30,000
	15,88,000	23,08,000
Assets		
Fixed Assets (Cost)	9,20,000	9,20,000
Less: Accumulated Depreciation	(1,70,000)	(2,82,500)
	7,50,000	6,37,500
Investment at Cost	—	5,30,000
Current Assets		
Inventory	4,12,300	6,90,000
Trade Receivable	2,95,000	3,43,000
Prepaid expenses	78,000	65,000
Cash at Bank	52,700	42,500
	15,88,000	23,08,000

Other Information:

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

(2) LTC Ltd. values inventory on FIFO basis, while MNT Ltd. used LIFO basis. To bring MNT Ltd.'s inventories values in line with those of LTC Ltd., its value of inventory is required to be reduced by ₹5,000 at the end of 2017-2018 and increased by ₹12,000 at the end of 2018-2019. (Inventory of 2017-18 has been sold out during the year 2018-19)

(3) MNT Ltd. deducts 2% from Trade Receivables as a general provision against doubtful debts.

(4) Prepaid expenses in MNT Ltd. include Sales Promotion expenditure carried forward of ₹25,000 in 2017-18 and ₹12,500 in 2018-19 being part of initial Sales Promotion expenditure of ₹37,500 in 2017-18, which is being written off over three years. Similar nature of Sales Promotion expenditure of LTC Ltd. has been fully written off in 2017-18.

Restate the balance sheet of MNT Ltd. as on 31st March, 2019 after considering the above information for the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by LTC Ltd. and MNT Ltd. uniform.

(*November 2019, New Course, 10 Marks*)

Answer

Restated Balance Sheet of MNT Ltd. as at 31st December, 2019

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		7,50,000
(b) Reserves and Surplus	1	7,18,500
(2) Current Liabilities		
(a) Short term borrowings	2	1,70,000
(b) Trade Payables		2,46,000
(c) Short-term provision	3	4,30,000
Total		23,14,500
II. Assets		
(1) Non-current assets		
(a) Property, Plant & Equipment	4	6,37,500
(b) Non-current Investment		5,30,000
(2) Current assets		
(a) Inventories (6,90,000 +12,000)	5	7,02,000
(b) Trade Receivables		3,50,000
(c) Cash & Cash Equivalents		
(d) Other current assets	6	42,500
		52,500
Total		23,14,500

Notes to Accounts

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

Working Note:

Adjusted revenue reserves of MNT Ltd.:

	₹	₹
Revenue reserves as given		5,05,000
Add: Provision for doubtful debts [3,43,000 X 2/98)	7,000	
Add: Increase in value of inventory	12,000	19,000
		5,24,000
Less: Sales Promotion expenditure to be written off		(12,500)
Adjusted revenue reserve		5,11,500

Question 61

From the following summarized balance sheets of Kedar Ltd. and its subsidiary Vijay Ltd. drawn up at 31st March, 2019, prepare a consolidated balance sheet as at that date, having regard to the following:

(i) Reserves and Profit and Loss Account of Vijay Ltd. stood at ₹ 62,500 and ₹ 37,500 respectively on the date of acquisition of its 80% shares by Kedar Ltd. on 1st April, 2018.

(ii) Machinery (Book-value ₹ 2,50,000) and Furniture (Book value ₹ 50,000) of Vijay Ltd. were revalued at ₹ 3,75,000 and ₹ 37,500 respectively on 1st April, 2018 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.]

Summarised Balance Sheet of Kedar Ltd. and Vijay Ltd. as on 31st March, 2019

Liabilities	Kedar Ltd.	Vijay Ltd.	Assets	Kedar Ltd.	Vijay Ltd.
Equity and Liabilities	₹	₹	Non-current assets	₹	₹
Shareholders' funds			Fixed assets		
Share Capital			Machinery	7,50,000	2,25,000
Shares of ₹ 100 each	15,00,000	2,50,000	Furniture	3,75,000	42,500
Reserves	5,00,000	1,87,500	Other non-current assets	11,00,000	3,75,000
Profit and Loss			Non-current Investments		
Account	2,50,000	62,500	Shares in Vijay Ltd.:		
Trade Payables	3,75,000	1,42,500	2,000 shares at ₹ 200 each	4,00,000	—
	26,25,000	6,42,500		26,25,000	6,42,500

(*May 2020*)

Answer

Consolidated Balance Sheet of Kedar Ltd. and its Subsidiary Vijay Ltd. as at 31st March, 2019

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

Notes to Accounts

				₹
1.	**Reserves and Surplus**			
	Reserves		5,00,000	
	Add: 4/5th share of Vijay Ltd.'s post- acquisition reserves (W.N.3)		1,00,000	6,00,000
	Profit and Loss Account		2,50,000	
	Add: 4/5th share of Vijay Ltd.'s post- acquisition profits (W.N.4)		11,500	2,61,500
				8,61,500
2.	**Trade Payables**			
	Kedar Ltd.		3,75,000	
	Vijay Ltd.		1,42,500	5,17,500
3.	**Property, Plant & Equipment**			
	Machinery			
	Kedar Ltd.		7,50,000	

				₹
	Vijay Ltd.	2,50,000		
	Add: Appreciation	1,25,000		
		3,75,000		
	Less: Depreciation	(37,500)	3,37,500	
	Furniture	-		
	Kedar Ltd.	-	3,75,000	
	Vijay Ltd.	50,000		
	Less: Decrease in value	(12,500)		
		37,500		
	Less: Depreciation	(5,625)	31,875	14,94,375
4.	**Intangible assets**			
	Goodwill [WN 6]			30,000
5.	**Other non-current assets**			
	Kedar Ltd.		11,00,000	
	Vijay Ltd.		3,75,000	14,75,000

Working Notes:

		₹
1.	**Pre-acquisition profits and reserves of Vijay Ltd.**	
	Reserves	62,500
	Profit and Loss Account	37,500
		1,00,000
	Kedar Ltd.'s = 4/5 × 1,00,000	80,000
	Minority Interest = 1/5 × 1,00,000	20,000
2.	**Profit on revaluation of assets of Vijay Ltd.**	-
	Profit on Machinery ₹ (3,75,000 – 2,50,000)	1,25,000
	Less: Loss on Furniture ₹ (50,000 – 37,500)	12,500
	Net Profit on revaluation	1,12,500
	Kedar Ltd.'s share 4/5 × 1,12,500	90,000
	Minority Interest 1/5 × 1,12,500	22,500
3.	**Post-acquisition reserves of Vijay Ltd.**	-
	Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 1,87,500 – 62,500)	1,25,000
	Kedar Ltd.'s share 4/5 × 1,25,000	1,00,000
	Minority interest 1/5 × 25,000	25,000
4.	**Post -acquisition profits of Vijay Ltd.**	-
	Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = ₹ 62,500 – 37,500)	25,000
	Add: Excess depreciation charged on furniture @ 15%	-
	on ₹ 12,500 i.e. (50,000 – 37,500)	1,875
		26,875
	Less: Under depreciation on machinery @ 10%	-
	on ₹ 1,25,000 i.e. (3,75,000 – 2,50,000)	(12,500)
	Adjusted post-acquisition profits	14,375
	Kedar Ltd.'s share 4/5 × 14,375	11,500
	Minority Interest 1/5 × 14,375	2,875
5.	**Minority Interest**	-
	Paid-up value of (2,500 – 2,000) = 500 shares	-
	held by outsiders i.e. 500 × ₹ 100	50,000
	Add: 1/5th share of pre-acquisition profits and reserves	20,000
	1/5th share of profit on revaluation	22,500
	1/5th share of post-acquisition reserves	25,000
	1/5th share of post-acquisition profit	2,875
6.	**Cost of Control or Goodwill**	1,20,375
	Paid-up value of 2,000 shares held by Kedar Ltd. i.e. 2,000 × ₹ 100	2,00,000
	Add: 4/5th share of pre-acquisition profits and reserves	80,000
	4/5th share of profit on the revaluation	90,000
	Intrinsic value of shares on the date of acquisition	3,70,000
	Price paid by Kedar Ltd. for 2,000 shares	4,00,000
	Less: Intrinsic value of the shares	(3,70,000)
	Cost of control or Goodwill	30,000

Question 62

Given below are the Profit & Loss Accounts of Hello Ltd. and its subsidiary Sun Ltd. for the year ended 31st March, 2017:

	Hello Ltd. (₹ in lacs)	Sun Ltd. (₹ in lacs)
Incomes:		
Sales and other income	10,000	2,000
Increase in Inventory	2,000	400
	12,000	2,400
Expenses:		
Raw material consumed	1,600	400
Wages and Salaries	1,600	300
Production expenses	400	200
Administrative Expenses	400	200
Selling and Distribution Expenses	400	100
Interest	200	100
Depreciation	200	100
	4,800	1,400
Profit before tax	7,200	1,000
Provision for tax	2,400	400
Profit after tax	4,800	600
Dividend paid	2,400	300
Balance of Profit	2,400	300

Other Information:

Hello Ltd. sold goods to Sun Ltd. of ₹240 lacs at cost plus 20%. Inventory of Sun Ltd. includes such goods valuing ₹48 lacs. Administrative expenses of Sun Ltd. include ₹10 lacs paid to Hello Ltd. as consultancy fees. Selling and distribution expenses of Hello Ltd. include ₹20 lacs paid to Sun Ltd. as commission.

Hello Ltd. holds 80% of equity share capital of ₹2,000 lacs in Sun Ltd. prior to 2015-2016. Hello Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by Sun Ltd. for the year 2015-2016.

You are required to prepare a consolidated profit and loss account of Hello Ltd. and its subsidiary Sun Ltd. for the year ended 31st March, 2017.

(*RTP May 2018*)

Answer:

Consolidated Profit & Loss Account of Hello Ltd. and its subsidiary Sun Ltd.
for the year ended on 31st March, 2017

Particulars	Note No.	₹ in Lacs
I. Revenue from operations	1	11,730
II. Total revenue		11,730
III. Expenses		
Cost of Material purchased/Consumed	3	2,360
Changes of Inventories of finished goods	2	(2,392)
Employee benefit expense	4	1,900
Finance cost	6	300
Depreciation and amortization expense	7	300
Other expenses	5	1,070
Total expenses		3,538
IV. Profit before Tax (II - III)		8,192
V. Tax Expenses	8	2,800
VI. Profit After Tax		5,392
Profit transferred to Consolidated Balance Sheet		
Profit After Tax		5,392
Dividend paid		
Hello Ltd.	2,400	
Sun Ltd.	300	
	2,700	
Less: Share of Hello Ltd. in dividend of Sun Ltd.		
80% of ₹300 lacs	(240)	(2,460)
Profit to be transferred to consolidated balance sheet		2,932

Notes to Accounts

		₹ in Lacs	**₹ in Lacs**
1.	Revenue from Operations		
	Sales and other income		
	Hello Ltd.	10,000	
	Sun Ltd.	2,000	
		12,000	
	Less: Inter-company Sales	(240)	
	Consultancy fees received by Hello Ltd. from Sun Ltd.	(10)	
	Commission received by Sun Ltd. from Hello Ltd.	(20)	11,730
2.	Increase in Inventory		
	Hello Ltd.	2,000	
	Sun Ltd.	400	
		2,400	
	Less: Unrealized profits ₹48 lacs × $\frac{20}{120}$	(8)	2,392
			14,122
3.	Cost of Material purchased/consumed		
	Hello Ltd.	1,600	
	Sun Ltd.	400	
		2,000	
	Less: Purchases by Sun Ltd. from Hello Ltd.	(240)	1,760
	Direct Expenses		
	Hello Ltd.	400	
	Sun Ltd.	200	600
			2,360
4.	Employee benefits and expenses		
	Wages and Salaries:		
	Hello Ltd.	1,600	
	Sun Ltd.	300	1,900
5.	Other Expenses		
	Administrative Expenses		
	Hello Ltd.	400	
	Sun Ltd.	200	
		600	
	Less: Consultancy fees received by Hello Ltd. from Sun Ltd.	(10)	590
	Selling and Distribution Expenses:		
	Hello Ltd.	400	
	Sun Ltd.	100	
		500	
	Less: Commission received from Sun Ltd. from Hello Ltd.	(20)	480
			1,070
6.	Finance Cost		
	Interest:		
	Hello Ltd.	200	
	Sun Ltd.	100	300
7.	Depreciation and Amortization Depreciation:		
	Hello Ltd.	200	
	Sun Ltd.	100	300
8.	Provision for tax		
	Hello Ltd.	2,400	
	Sun Ltd.	400	2,800

Note: Since the amount of dividend received by Hello Ltd. for the year 2015-2016 is not given, it has not been deducted from 'sales and other income' in consolidated profit and loss account and not added to consolidated opening retained earnings (which is also not given).

Question 63

Given below are the Profit & Loss Accounts of H Ltd. and its subsidiary Ltd. for the year ended 31st March, 2017:

	H Ltd. (₹ in lacs)	S Ltd. (₹ in lacs)
Incomes:		
Sales and other income	5,000	1,000
Increase in Inventory	1,000	200
	6,000	1,200
Expenses:		
Raw material consumed	800	200
Wages and Salaries	800	150
Production expenses	200	100
Administrative Expenses	200	100
Selling and Distribution Expenses	200	50
Interest	100	50
Depreciation	100	50
	2,400	700
Profit before tax	3,600	500
Provision for tax	1,200	200
Profit after tax	2,400	300
Dividend paid	1,200	150
Balance of Profit	1,200	150

Other Information:

H Ltd. sold goods to S Ltd. of ₹120 lacs at cost plus 20%. Inventory of S Ltd. includes such goods valuing ₹24 lacs. Administrative expenses of S Ltd. include ₹5 lacs paid to H Ltd. as consultancy fees. Selling and distribution expenses of H Ltd. include ₹10 lacs paid to S Ltd. as commission.

H Ltd. holds 80% of equity share capital of ₹1,000 lacs in S Ltd. prior to 2015-2016. H Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by S Ltd. for the year 2015-2016.

You are required to prepare a consolidated profit and loss account of H Ltd. and its subsidiary S Ltd. for the year ended on 31st March, 2017.

(*MTP March 2018*) (*12 Marks*)

Answer:

Consolidated Profit & Loss Account of H Ltd. and its subsidiary S Ltd.
for the year ended on 31st March, 2017

Particulars		Note No.	₹ in Lacs
I.	Revenue from operations	1	5,865
II.	Total revenue		5,865
III.	Expenses		
	Cost of Material purchased/Consumed	3	1,180
	Changes of Inventories of finished goods	2	(1,196)
	Employee benefit expense	4	950
	Finance cost	6	150
	Depreciation and amortization expense	7	150
	Other expenses	5	535
	Total expenses		1,769
IV.	Profit before Tax (II-III)		4,096
V.	Tax Expenses	8	1,400
VI.	Profit After Tax		2,696
	Profit transferred to Consolidated Balance Sheet		
	Profit After Tax		2,696
	Dividend paid		
	H Ltd.	1,200	
	S Ltd.	150	
		1,350	
	Less: Share of H Ltd. in dividend of S Ltd.		
	80% of ₹150 lacs	(120)	(1,230)
	Profit to be transferred to consolidated balance sheet		1,466

Notes to Accounts

		₹ in lacs	₹ in lacs
1.	Revenue from Operations		
	Sales and other income		
	H Ltd.	5,000	
	S Ltd.	1,000	
		6,000	
	Less: Inter-company Sales	(120)	
	Consultancy fees received by H Ltd. from S Ltd.	(5)	
	Commission received by S Ltd. from H Ltd.	(10)	5,865
2.	Increase in Inventory		
	H Ltd.	1,000	
	S Ltd.	200	
		1,200	
	Less: Unrealized profits ₹24 lacs × 20/120	(4)	1,196
			7,061
3.	Cost of Material purchased/consumed		
	H Ltd.	800	
	S Ltd.	200	
		1,000	
	Less: Purchases by S Ltd. from H Ltd.	(120)	880
	Direct Expenses		
	H Ltd.	200	
	S Ltd.	100	300
			1,180
4.	Employee benefits and expenses		
	Wages and Salaries:		
	H Ltd.	800	
	S Ltd.	150	950
5.	Other Expenses		
	Administrative Expenses		
	H Ltd.	200	
	S Ltd.	100	
		300	
	Less: Consultancy fees received by H Ltd. from S Ltd.	(5)	295
	Selling and Distribution Expenses:		
	H Ltd.	200	
	S Ltd.	50	
		250	
	Less: Commission received from S Ltd. from H Ltd.	(10)	240
			535
6.	Finance Cost		
	Interest:		
	H Ltd.	100	
	S Ltd.	50	150
7.	Depreciation and Amortisation		
	Depreciation:		
	H Ltd.	100	
	S Ltd.	50	150
8.	Provision for tax		
	H Ltd.	1,200	
	S. Ltd.	200	1,400

Question 64

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	11
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.

(November 2018) (10 marks)

Answer:

Consolidated Profit & Loss Account of A Ltd. and its subsidiary B Ltd.
for the year ended on 31st March, 2018

Particulars	**Note No.**	**₹ in Lacs**
I. Revenue from operations	1	8,797
II. Total revenue		8,797
III. Expenses		
Cost of Material purchased/Consumed	3	1,770
Changes of Inventories of finished goods	2	(1,794)
Employee benefit expense	4	1,425
Finance cost	6	225
Depreciation and amortization expense	7	225
Other expenses	5	802
Total expenses		2,653
IV. Profit before Tax(II-III)		6,144
V. Tax Expenses	8	2,100
VI. Profit After Tax		4,044

Notes to Accounts

		₹ in Lacs	**₹ in Lacs**
1.	Revenue from Operations		
	Sales and other income		
	A Ltd.	7,500	
	B Ltd.	1,500	
		9,000	
	Less: Inter-company Sales	(180)	
	Consultancy fees received by A Ltd. from B Ltd.	(8)	
	Commission received by B Ltd. from A Ltd.	(15)	8,797

		₹ in Lacs	₹ in Lacs
2.	Increase in Inventory		
	A Ltd.	1,500	
	B Ltd.	300	
		1,800	
	Less: Unrealised profits ₹180x1/6x25/125	(6)	1,794
3.	Cost of Material purchased/consumed		
	A Ltd.	1,200	
	B Ltd.	300	
		1,500	
	Less: Purchases by B Ltd. from A Ltd.	(180)	1,320
	Direct Expenses		
	A Ltd.	300	
	B Ltd.	150	450
			1,770
4.	Employee benefits and expenses		
	Wages and Salaries:		
	A Ltd.	1,200	
	B Ltd.	225	1,425
5.	Other Expenses		
	Administrative Expenses		
	A Ltd.	300	
	B Ltd.	150	
		450	
	Less: Consultancy fees received by A Ltd. from B Ltd.	(8)	442
	Selling and Distribution Expenses:		
	A Ltd.	300	
	B Ltd.	75	
		375	
	Less: Commission received from B Ltd. from A Ltd.	(15)	360
			802
6.	Finance Cost		
	Interest:		
	A Ltd.	150	
	B Ltd.	75	225
7.	Depreciation and Amortisation		
	Depreciation:		
	A Ltd.	150	
	B Ltd.	75	225
8.	Provision for tax		
	A Ltd.	1800	
	B Ltd.	300	2100

Note: it is assumed that dividend adjustment has not be done in sales & other income of A Ltd i.e. dividend received from B Ltd is not included in other income of A Ltd. Alternative answer is possible considering is otherwise.

Question 65

(a) A Ltd holds 75% of the equity capital and voting power in B Ltd. A Ltd purchases inventories costing ₹ 150 lacs from B Ltd at a price of ₹ 200 lacs. The entire inventories remain unsold with A Ltd at the financial year end i.e. 31 March 2019. Suggest the accounting treatment for this transaction in the consolidated financial statements of A Ltd giving reference of the relevant accounting standard.

(b) 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 Capital	Profit and Loss A/c	Share Capital	Profit and 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

(*RTP, November, 2020*)

Answer

(a) As per para provisions of AS 21, Intragroup balances and intragroup transactions and resulting unrealized profits should be eliminated in full. Unrealized losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.

Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealised profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full. Unrealised losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered. One also needs to see whether the intragroup transaction is "upstream" or "down-stream". Upstream transaction is a transaction in which the subsidiary company sells goods to holding company. While in the downstream transaction, holding company is the seller and subsidiary company is the buyer.

In the case of upstream transaction, since the goods are sold by the subsidiary to holding company; profit is made by the subsidiary company, which is ultimately shared by the holding company and the minority shareholders. In such a transaction, if some goods remain unsold at the balance sheet date, the unrealized profit on such goods should be eliminated from minority interest as well as from consolidated profit on the basis of their share-holding besides deducting the same from unsold inventory.

But in the case of downstream transaction, the whole profit is earned by the holding company, therefore, whole unrealized profit should be adjusted from unsold inventory and consolidated profit and loss account only irrespective of the percentage of the shares held by the parent.

The case given in the question is the case of upstream transaction. In the consolidated profit and loss account for the year ended 31 March 2019 , entire transaction of sale and purchase of ₹ 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 2019, by reducing the value of closing inventories by ₹ 50 lacs as of 31 March 2019. In the consolidated balance sheet as of 31 March 2019, A Ltd's share of profit from B Ltd will be reduced by ₹ 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).

(b) Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case, it should be equal to Share Capital + Profit & Loss A/c

A = Share capital on 1.1.2019

B = Profit & loss account balance on 1.1.2019

C = Share capital on 31.12.2019

D = Profit & loss account balance on 31.12.2019

	Minority % Shares Owned	Minority interest as at the date of acquisition	Minority interest as at the date of consolidation
	[E]	[E] x [A + B] ₹	[E] X [C + D] ₹
Case A [100-90]	10 %	22,500	23,500
Case B [100-75]	25 %	50,000	40,000
Case C [100-70]	30 %	18,000	18,000
Case D [100-95]	5%	4,750	5,750
Case E [100-100]	NIL	NIL	NIL

Question 66

Hemant Ltd. purchased 80% shares of Power Ltd. on 1st January, 2019 for ₹ 2,10,000. The issued capital of Power Ltd., on 1st January, 2019 was ₹ 1,50,000 and the balance in the Profit & Loss Account was ₹ 90,000. During the year ended 31st December, 2019, Power Ltd. earned a profit of ₹ 30,000 and at year end, declared and paid a dividend of ₹ 22,500.

What is the amount of minority interest as on 1st January, 2019 and 31st December, 2019? Also compute goodwill/ capital reserve at the date of acquisition.

(*MTP, October, 2020*) (*6 marks*)

Answer

Total dividend paid is ₹ 22,500 (out of post-acquisition profits), hence dividend received by Hemant will be credited to P & L account. Hemant Ltd.'s share of dividend = ₹ 22,500 X 80% = ₹ 18,000

***Goodwill on consolidation* (*at the date of acquisition*):**	₹	₹
Cost of shares		2,10,000
Less: Face value of capital i.e. 80% of capital	1,20,000	
Add: Share of capital profits [90,000 X 80 %]	72,000	(1,92,000)
Goodwill		18,000
Minority interest on:		
- **1st January, 2019:**		
20% of ₹ 2,40,000 [1,50,000 + 90,000]		48,000
- **31st December, 2019:**		49,500
20% of ₹2,47,500 [1,50,000 + 90,000 + 30,000 – 22,500]		

Question 67

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 2020. What will be the accounting treatment for this transaction in the consolidated financial statements of A Ltd?

(*MTP, October, 2020*) (*4 marks*)

Answer

This would be the case of downstream transaction. In the consolidated profit and loss account for the year ended 31 March 2020, entire transaction of sale and purchase of ₹ 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 2020, by reducing the consolidated profits/ increasing the consolidated losses, and reducing the value of closing inventories as of 31 March 2020.

Question 68

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

₹ in Lakhs

	A Ltd.	**B Ltd.**
Sales and other income	7,500	1,500
Increase in Inventory	1,500	300
Raw material consumed	1,200	300
Wages and Salaries	1,200	225
Production expenses	300	150
Administrative expenses	300	150
Selling and distribution expenses	300	75
Interest	150	75
Depreciation	150	75

The following information is also given:

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

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

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

You are required to prepare a consolidated Statement of Profit and Loss Account of A Ltd. with its subsidiary B Ltd. for the year ended 31st March, 2020.

(*MTP, March, 2021*) (*15 marks*)

Answer

Consolidated Profit & Loss Account of A Ltd. and its subsidiary B Ltd.
for the year ended on 31st March, 2020

Particulars	***Note No.***	***₹ in Lacs***
(I) Revenue from operations	1	8,797
(II) Total revenue		8,797
(III) Expenses		
Cost of Material purchased/consumed	3	1,770

Particulars	***Note No.***	***₹ in Lacs***
Changes of Inventories of finished goods	2	(1,794)
Employee benefit expense	4	1,425
Finance cost	6	225
Depreciation and amortization expense	7	225
Other expenses	5	802
Total expenses		2,653
(IV) Profit before Tax(II-III)		6,144

Notes to Accounts

		₹ in Lacs	***₹ in Lacs***
1.	Revenue from Operations		
	Sales and other income		
	A Ltd.	7,500	
	B Ltd.	1,500	
		9,000	
	Less: Inter-company Sales	(180)	
	Consultancy fees received by A Ltd. from B Ltd.	(8)	8,797
	Commission received by B Ltd. from A Ltd.	(15)	
2.	Increase in Inventory		
	A Ltd.	1,500	
	B Ltd.	300	
		1,800	
	Less: Unrealized profits ₹ 180×1/6 x 25/125	(6)	1,794
3.	Cost of Material purchased/consumed		
	A Ltd.	1,200	
	B Ltd.	300	
		1,500	
	Less: Purchases by B Ltd. from A Ltd.	(180)	1,320
	Direct Expenses		
	A Ltd.	300	
	B Ltd.	150	450
			1,770
4.	Employee benefits and expenses		
	Wages and Salaries:		
	A Ltd.	1,200	
	B Ltd.	225	1,425
5.	Other Expenses		
	Administrative Expenses		
	A Ltd.	300	
	B Ltd.	150	
		450	
	Less: Consultancy fees received by A Ltd. from B Ltd.	(8)	442
	Selling and Distribution Expenses:		
	A Ltd.	300	
	B Ltd.	75	
		375	
	Less: Commission received from B Ltd. from A Ltd.	(15)	360
			802
6.	Finance Cost		
	Interest:		
	A Ltd.	150	
	B Ltd.	75	225
7.	Depreciation and Amortization		
	Depreciation:		
	A Ltd.	150	
	B Ltd.	75	225

Question 69

(a) H Ltd. and its subsidiary S Ltd. Give the following information as on 31st March, 2021:

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

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

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

You are required to prepare the Consolidated Balance Sheet of H Ltd. With its subsidiary as at 31st March, 2021.

(*MTP, April, 2021*) (*16 marks*)

Answer

(a) Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd.
as at 31st March, 2021

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

Notes to Accounts

		₹		
1.	Reserves and Surplus			
	General Reserves		4,35,000	
	Add: 80% share of S Ltd.'s post-acquisition reserves (W.N.3)		84,000	5,19,000
	Profit and Loss Account		2,80,000	
	Add: 80% share of S Ltd.'s post-acquisition profits (W.N.3)	21,200		
	Less: Unrealised gain	(4,000)	17,200	2,97,200
				8,16,200
2.	Trade Payables			
	H Ltd.		3,22,000	
	S Ltd.		1,23,000	
	Less: Mutual transaction		(35,000)	4,10,000
3.	Property, plant and equipment			
	Machinery			
	H Ltd.		6,40,000	
	S Ltd.	2,00,000		
	Add: Appreciation	1,00,000		
		3,00,000		
	Less: Depreciation	(30,000)	2,70,000	9,10,000
	Furniture			
	H. Ltd.		3,75,000	
	S Ltd.	40,000		
	Less: Decrease in value	(10,000)		
		30,000		
	Less: Depreciation	(4,500)	25,500	4,00,500
				13,10,500
4.	Intangible assets			
	Goodwill [WN 5]			24,000
5.	Inventories			
	H Ltd.		2,68,000	
	S Ltd.		62,000	3,30,000
	Less: Inventory reserve			(5,000)
				3,25,000
6.	Trade Receivables			
	H Ltd.		4,70,000	
	S Ltd.		2,35,000	
				7,05,000
	Less: Mutual transaction			(35,000)
				6,70,000
7.	Cash and Bank H Ltd.		1,64,000	
	S Ltd.		32,000	1,96,000

Working Notes:

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

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

2. Calculation of short/excess depreciation

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

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

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

4. Minority Interest

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

5. Cost of Control or Goodwill

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

Question 70

A Ltd. acquired 70% equity shares of B Ltd. @ ₹20 per share (Face value - ₹10) on 31st March, 2021 at a cost of ₹ 140 lakhs. Calculate the amount of share of A Ltd. and minority interest in the net assets of B Ltd. on this date. Also compute goodwill/capital reserve for A Ltd. on acquisition of shares of B Ltd. from the following information available from the balance sheet of B Ltd. as on 31st March, 2021:

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

(*RTP, May, 2021*)

Answer

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

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

Question 71

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.

(*Suggested, November, 2020*) (*15 marks*)

Answer

Consolidated Balance Sheet of H Ltd. and its subsidiary, S Ltd. as at 31st March, 2020

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	20,00,000
(b) Reserves and Surplus	2	13,07,200
(2) Minority Interest (W.N 4)		2,96,400

Particulars	Note No.	(₹)
(3) Current Liabilities		
(a) Trade Payables	3	2,98,400
(b) Short term borrowings		3,00,000
Total		42,02,000
II. Assets		
(1) Non-current assets		
(i) Property, Plant and Equipment	4	29,34,000
(ii) Intangible assets (W.N.5)		1,60,000
(2) Current assets		
(a) Inventories	5	6,24,000
(b) Trade receivables	6	3,95,200
(c) Cash & Cash equivalents (Cash)	7	88,800
Total		42,02,000

Notes to Accounts

			₹	₹
1.	Share Capital			
	2,00,000 equity shares of ₹ 10 each			20,00,000
2.	Reserves and Surplus			
	Reserves		9,60,000	
	Profit & loss			
	H Ltd.	2,28,800		
	S Ltd. (As per W.N. 3)	1,18,400	3,47,200	13,07,200
3.	Trade Payables			
	H Ltd.		1,66,400	
	S Ltd. (80,000+52,000)		1,32,000	2,98,400
4.	Property, Plant and Equipment			
	Land and building			
	H Ltd.	7,20,000		
	S Ltd.	7,60,000	14,80,000	
	Plant & Machinery			
	H Ltd.	9,60,000		
	S Ltd. (As per W.N. 7)	4,94,000	14,54,000	29,34,000
5.	Inventories H Ltd.			
	S Ltd.		4,56,000	
			1,68,000	6,24,000
6.	Trade Receivables			
	H Ltd.	1,76,000		
	S Ltd.	1,60,000	3,36,000	
	Bills receivable: H Ltd.		59,200	3,95,200
7.	Cash & Cash equivalents			
	Cash			
	H Ltd.		56,800	
	S Ltd.		32,000	88,800

Working Notes:

1. **Share holding pattern**

   Total Shares of S Ltd 80,000 shares

   Shares held by H Ltd 64,000 shares i.e. 80 %;

   Minority Shareholding 16,000 shares i.e. 20 %

2. **Capital profits of S Ltd.**

	₹	₹
Reserve on 1st October, 2019 (Assumed there is no movement in reserves during the year and hence balance as on 1st October, 2019 is same as of 31st March 2020)		4,20,000
Profit & Loss Account Balance on 1st April, 2019	1,20,000	

	₹	₹
Less: Dividend paid	(80,000)	40,000
Profit for year:		
Total ₹ 3,28,000		
Less: ₹ 40,000 (opening balance)		
₹ 2,88,000		
Proportionate up to 1st October, 2019 on time basis (₹ 2,88,000/2)		1,44,000
Reduction in value of Plant & Machinery (WN 6)		(50,000)
		5,54,000
Less: Preliminary expenses written off		(20,000)
Total Capital Profit		5,34,000
Holding company's share (5,34,000 X 80%)		4,27,200
Minority Interest (5,34,000 X 20%)		1,06,800

Note: Preliminary expenses as on 1st April, 2019 amounting ₹ 20,000 have been written off.

3. **Revenue profits of S Ltd.**

Profit after 1st October, 2019 (3,28,000 - 40,000)/2		1,44,000
Less 10% depreciation on ₹5,20,000 for 6 months	(26,000)	
Add: Depreciation already charged for 2nd half year on 6,00,000	30,000	
		4,000
		1,48,000
Holding company's share (1,48,000 X 80%)		1,18,400
Minority Interest (1,48,000 X 20%)		29,600

4. **Minority interest**

Par value of 16,000 shares (8,00,000 X 20%)	1,60,000
Add: 1/5 Capital Profits [WN 2]	1,06,800
1/5 Revenue Profits [WN 3]	29,600
	2,96,400

5. **Cost of Control**

Amount paid for 64,000 shares		12,27,200
Less:		
Par value of shares (8,00,000 X 80%)	6,40,000	
Capital Profits – share of H Ltd. [WN 2]	4,27,200	(10,67,200)
Cost of Control or Goodwill		1,60,000

6. **Calculation of revaluation loss on Plant and Machinery of S Ltd. on 1st October, 2019**

	₹
Value of plant and machinery as on 1st April,2019	6,00,000
Less: Depreciation for the six months	(30,000)
Value of plant and machinery as on 1st October, 2019	5,70,000
Less: Plant and machinery valued by H Ltd. on 1st October,2019	(5,20,000)
Revaluation Loss	50,000

7. **Value of plant & Machinery of S Ltd. On 31st March,2020**

Value of machinery on 1st October, 2019	5,20,000
Less: depreciation for next six month	(26,000)
	4,94,000

Question 72

On 31st March, 2020 the summarised Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

	H Ltd.	S Ltd.
	₹	₹
Shareholders' Fund		
Issued and subscribed		
Equity shares of ₹ 10 each	13,40,000	2,40,000
Reserves and Surplus	4,80,000	1,80,000
Profit & Loss Account	2,40,000	60,000

	H Ltd.	S Ltd.
	₹	₹
Secured Loans		
12% Debentures	1,00,000	-
Current Liabilities		
Trade Payables	2,00,000	1,22,000
Bank Overdraft	1,00,000	-
Bills Payable	60,000	14,800
Total	25,20,000	6,16,800
Assets		
Non-Current Assets	•	
(a) Property, Plant & Equipment	.	
Machinery	7,20,000	2,16,000
Furniture	3,60,000	40,800
(b) Investments		
Investments in S Ltd.	3,84,000	-
(19,200 shares at ₹ 20 each)		
Current Assets		
Inventories	6,00,000	2,00,000
Trade Receivables	3,00,000	90,000
Bill Receivables	1,00,000	30,000
Cash at Bank	56,000	40,000
Total	25,20,000	6,16,800

The following information is also provided to you:

(a) H Ltd. purchased 19,200 shares of S Ltd. on 1st April, 2019, when the balances of Reserves & Surplus and Profit & Loss Account of S Ltd. stood at ₹ 60,000 and ₹ 36,000 respectively.

(b) Machinery (Book value ₹ 2,40,000) and Furniture (Book value ₹ 48,000) of S Ltd were revalued at ₹ 3,60,000 and ₹ 36,000 respectively on 1st April, 2019, for the purpose of fixing the price of its shares. (Rates of depreciation computed on the basis of useful lives:
Machinery 10%, Furniture 15%).

(c) On 31st March, 2020, Bills payable of ₹ 12,000 shown in S Ltd.'s Balance Sheet had been accepted in favour of H Ltd.

You are required to prepare Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2020.

(*Suggested, January, 2021) (20 marks*)

Answer

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2020

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	13,40,000
(b) Reserves and Surplus	2	8,27,040
(2) Minority Interest		1,15,560
(3) Non- Current Liabilities		1,00,000
(a) 12% Debentures		
(4) Current Liabilities	3	3,84,800
(a) Trade Payables		1,00,000
(b) Short term Borrowings (Bank overdraft)		
Total		28,67,400
II. Assets		
(1) Non-current assets		
(a)		
(i) Property, Plant and Equipment	4	14,34,600
(ii) Intangible assets	5	28,800
(2) Current assets		
(a) Inventory (6,00,000+2,00,000)		8,00,000
(b) Trade Receivables	6	5,08,000
(c) Cash and Cash equivalents		96,000
Total		28,67,400

Notes to Accounts

				₹
1.	Share Capital			
	Equity share capital			13,40,000
	1,34,000 shares of ₹ 10 each fully paid up			
2.	Reserves and Surplus			
	Reserves		4,80,000	
	Add: 4/5th share of S Ltd.'s post-acquisition reserves (W.N.3)		96,000	5,76,000
	Profit and Loss Account		2,40,000	
	Add: 4/5th share of S Ltd.'s post- acquisition profits (W.N.4)		11,040	2,51,040
				8,27,040
3.	Trade Payables			
	H Ltd.	2,00,000		
	S Ltd.	1,22,000	3,22,000	
	Bills Payables			
	H Ltd.	60,000		
	S Ltd.	14,800	74,800	
			3,96,800	
	Less: Mutual Owings		(12,000)	3,84,800
4.	Property Plant and Equipment			
	Machinery			
	H. Ltd.		7,20,000	
	S Ltd.	2,40,000		
	Add: Appreciation	1,20,000		
		3,60,000		
	Less: Depreciation (3,60,000 X 10%)	(36,000)	3,24,000	
	Furniture			
	H. Ltd.		3,60,000	
	S Ltd.	48,000		
	Less: Decrease in value	(12,000)		
		36,000		
	Less: Depreciation (36,000 X 15%)	5,400	30,600	14,34,600
5.	Intangible assets			
	Goodwill [WN 6]			28,800
6.	Trade receivables			
	H Ltd.	3,00,000		
	S Ltd.	90,000	3,90,000	
	Bills Receivables			
	H Ltd.	1,00,000		
	S Ltd.	30,000	1,30,000	
			5,20,000	
	Less: Mutual Owings		(12,000)	5,08,000

Working Notes:

		₹
1.	Pre-acquisition profits and reserves of S Ltd.	
	Reserves	60,000
	Profit and Loss Account	36,000
		96,000
	H Ltd.'s = 4/5 (or 80%) × 96,000	76,800
	Minority Interest= 1/5 (or 20%) × 96,000	19,200
2.	Profit on revaluation of assets of S Ltd.	
	Profit on Machinery ₹ (3,60,000 – 2,40,000)	1,20,000
	Less: Loss on Furniture ₹(48,000 –36,000)	(12,000)
	Net Profit on revaluation	1,08,000
	H Ltd.'s share 4/5 × 1,08,000	86,400
	Minority Interest 1/5 × 1,08,000	21,600

3.	Post-acquisition reserves of S Ltd.	
	Total reserves	1,80,000
	Less: Pre- acquisition reserves	<u>(60,000)</u>
	Post-acquisition reserves	1,20,000
	H Ltd.'s share 4/5 × 1,20,000	96,000
	Minority interest 1/5 × 1,20,000	24,000
4.	Post -acquisition profits of S Ltd.	
	Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = ₹ 60,000 – 36,000)	24,000
	Add: Excess depreciation charged on furniture @ 15%	
	on ₹ 12,000 i.e. (48,000 – 36,000)	<u>1,800</u>
		25,800
	Less: Under depreciation on machinery @ 10% on ₹ 1,20,000 i.e. (3,60,000 – 2,40,000)	<u>(12,000)</u>
	Adjusted post-acquisition profits	<u>13,800</u>
	H Ltd.'s share 4/5 × 13,800	11,040
	Minority Interest 1/5 × 13,800	2,760
5.	Minority Interest	
	Paid-up value of (24,000 – 19,200) = 4,800 shares	
	held by outsiders i.e. 2,40,000 X 20%	48,000
	Add: 1/5th share of pre-acquisition profits and reserves	19,200
	1/5th share of profit on revaluation	21,600
	1/5th share of post-acquisition reserves	24,000
	1/5th share of post-acquisition profit	<u>2,760</u>
		1,15,560
6.	Cost of Control or Goodwill	
	Price paid by H Ltd. for 19,200 shares (A)	3,84,000
	Less: Intrinsic value of the shares	
	Paid-up value of shares held by H Ltd. i.e. 2,40,000 X 80%	1,92,000
	Add: 4/5th share of pre-acquisition profits and reserves	76,800
	4/5th share of profit on the revaluation	86,400
	Intrinsic value of shares on the date of acquisition (B)	<u>3,55,200</u>
	Cost of control or Goodwill (A – B)	28,800

<u>Question 73</u>

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

	X Limited (₹ In 000)		**Y Limited (₹ In 000)**	
	Dr.	**Cr.**	**Dr.**	**Cr.**
Equity Share capital (Share of ₹ 100 each)		2,000		400
7% Preference share capital		-		400
Reserves		600		200
6% Debentures		400		400
Trade Receivables/Trade Payables	160	180	100	120
Profit & Loss A/c balance		40		30
Purchases/Sales	1,000	1,800	1,200	1,900
Wages and Salaries	200		300	
Debenture Interest	24		24	
General Expenses	160		120	
Preference share dividend up to 30.09.2020		7	14	
Inventory (as on 31.03.2021)	200		100	
Cash at Bank	27		12	
Investment in Y Limited	1,056		-	
Fixed Assets	2,200		1,580	
Total	5,027	5,027	3,450	3,450

Investment in Y Limited was acquired on 1st July, 2020 and consisted of 80% of Equity Share Capital and 50% of Preference Share Capital.

- After acquiring control over Y Limited, X Limited supplied to Y Limited goods at cost plus 25%, the total invoice value of such goods being ₹ 1,20,000, one fourth of such goods were still lying in inventory at the end of the year.
- Depreciation to be charged @ 10% in X Limited and @ 15% in Y Limited on Fixed Assets.

You are required to prepare the Consolidated Statement of Profit and Loss for the year ended on 31st March, 2021.

(*Wrong solution of ICAI*) (*July, 2021 Suggested*) (*15 Marks*)

Answer

Consolidated Profit and Loss Account of X Ltd. and Y Ltd. for the year ended 31st March, 2021

Particulars		Note No.	₹
I.	Revenue from operations	1	35,80,000
II.	Total revenue		35,80,000
III.	Expenses		
	Cost of Material purchased/Consumed	2	20,80,000
	Changes of Inventories of finished goods		-
	Employee benefit expense	3	5,00,000
	Finance cost	4	48,000
	Depreciation and amortization expense	5	4,57,000
	Other expenses	6	2,80,000
	Total expenses		33,65,000
IV.	Profit before Tax (II-III)		2,15,000
	Profit transferred to Consolidated Balance Sheet		
	Profit After Tax		2,15,000
	Preference dividend	7,000	
	Preference dividend payable	7,000	(14,000)
			2,01,000
Share in pre-acquisition loss (WN 3)			1,800
Share of Minority interest in losses (WN 1)			1,800
Less: Investment Account- dividend for 3 months (prior to acquisition)			(3,500)
Inventory reserve (WN 2)			(6,000)
Profit to be transferred to consolidated balance sheet			1,95,100

Notes to Accounts

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

		₹	₹
6	Other expenses		
	H Ltd.	1,60,000	
	S Ltd.	1,20,000	2,80,000

Working Note

1. Profit of Subsidiary ₹

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

2. **Inventory reserve** $= \left[\frac{120,000}{4} \times \frac{25}{125}\right] = ₹\ 6,000$

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

4. Investment account includes Preference dividend for 3 months prior to acquisition i.e. ₹ 4,00,000 X 50% X 7% X1/4 = ₹ 3,500

Question 74

Long Limited acquired 60% stake in Short Limited for a consideration of ₹ 112 lakhs. On the date of acquisition Short Limited's Equity Share Capital was ₹ 100 lakhs, Revenue Reserve was ₹ 40 lakhs and balance in Profit & Loss Account was ₹ 30 lakhs. From the above information you are required to calculate Goodwill / Capital Reserve in the following situations:

(i) On consolidation of Balance Sheet.

(ii) If Long Limited showed the investment in subsidiary at a carrying amount of ₹ 104 lakhs.

(iii) If the consideration paid for acquiring the 60% stake was ₹ 92 lakhs.

(*July, 2021 Suggested*) (*5 Marks*)

Answer

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

(i) Goodwill/Capital Reserve computation on consolidation of balance sheet
Long Ltd. paid a positive differential of ₹ 10 Lakhs (112 - 102). This differential ₹ 10 Lakhs is called goodwill and is shown in the balance sheet under the head intangibles

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

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

Question 75

Consider the following information of subsidiary MNT Ltd.-

Liabilities	**2019-20**	**2020-21**
	Amount in ₹	**Amount in ₹**
Issued and subscribed: 7,500 Equity Shares of ₹ 100 each	7,50,000	7,50,000
Revenue Reserve	2,14,000	5,05,000
Securities Premium	72,000	2,07,000
Trade Payables	2,90,000	2,46,000
Bank Overdraft	-	1,70,000

Liabilities	2019-20	2020-21
Provision for Taxation	2,62,000	4,30,000
Property, plant and equipment (Cost)	9,20,000	9,20,000
Less: Accumulated Depreciation	(1,70,000)	(2,82,500)
	7,50,000	6,37,500
Investment (at cost)	-	5,30,000
Inventory	4,12,300	6,90,000
Trade Receivable	2,95,000	3,43,000
Prepaid expenses	78,000	65,000
Cash at Bank	52,700	42,500

Other Information:

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

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

(3) MNT Ltd. deducts 2% from Trade Receivables as a general provision against doubtful debts.

(4) Prepaid expenses in MNT Ltd. include Sales Promotion expenditure carried forward of ₹ 25,000 in 2019-20 and ₹ 12,500 in 2020-21 being part of initial Sales Promotion expenditure of ₹ 37,500 in 2019-20, which is being written off over three years. Similar nature of Sales Promotion expenditure of LTC Ltd. has been fully written off in 2019-20.

Restate the balance sheet of MNT Ltd. as on 31st March, 2021 after considering the above information for the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by LTC Ltd. and MNT Ltd. uniform. (*MTP*, *October 2021*) (*16 Marks*)

Answer

Restated Balance Sheet of MNT Ltd. as at 31st March 2021

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		7,50,000
(b) Reserves and Surplus	1	7,18,500
(2) Current Liabilities		
(a) Short term borrowings	2	1,70,000
(b) Trade Payables		2,46,000
(c) Short-term provision	3	4,30,000
Total		23,14,500
II. Assets		
(1) Non-current assets		
(a) Property, Plant & Equipment	4	6,37,500
(b) Non-current Investment		5,30,000
(2) Current assets		
(a) Inventories (6,90,000 +12,000)	5	7,02,000
(b) Trade Receivables $\left(\frac{3,43,000}{98}\times 100\right)$		3,50,000
(c) Cash & Cash Equivalents		42,500
(d) Other current assets	6	52,500
Total		23,14,500

Notes to Accounts

			₹
1.	Reserves and Surplus		
	Revenue Reserve (refer W.N.)	5,11,500	
	Securities Premium	2,07,000	7,18,500
2.	**Short term borrowings**		
	Bank overdraft		1,70,000
3.	Short-term provision		
	Provision for taxation		4,30,000

			₹
4.	Property, Plant and Equipment		
	Cost	9,20,000	
	Less: Depreciation to date	(2,82,500)	6,37,500
5.	**Inventories**	6,90,000	
	Increase in value as per FIFO	12,000	7,02,000
6.	**Other current assets**		
	Prepaid expenses (After adjusting sales promotion expenses to be written off each year) (65,000 -12,500)		52,500

Working Note:

Adjusted revenue reserves of MNT Ltd.:

	₹	₹
Revenue reserves as given		5,05,000
Add: Provision for doubtful debts [3,43,000 X 2/98)	7,000	
Add: Increase in value of inventory	12,000	19,000
		5,24,000
Less: Sales Promotion expenditure to be written off		(12,500)
Adjusted revenue reserve		5,11,500

Question 76

A Ltd. had acquired 80% shares of B Ltd. for ₹ 15 lakhs at the beginning of year. During the year, A Ltd. sold the investment for ₹ 30 lakhs and net assets of B Ltd. on the date of disposal was ₹ 35 lakhs. Calculate the profit or loss on disposal of this investment to be recognized in the Financial Statements of A Ltd.

(*MTP*, *October 2021*) (*4 Marks*)

Answer

Calculation of Profit/Loss on disposal of investment in subsidiary

Particulars	₹
Proceeds from the sale of Investment	30,00,000
Less: A Ltd.'s share in net assets of B Ltd.	(28,00,000)
	2,00,000

Working Note:

A Ltd.'s share in net assets of B Ltd.

	₹
Net Assets of B Ltd. on the date of disposal	35,00,000
Less: Minority Interest (20% of ₹ 35 lakhs)	(7,00,000)
A Ltd.'s share in the net assets of B Ltd.	28,00,000

Question 77

On 31st March, 2020 H Ltd. and its subsidiary S Ltd. give the following information:

	H Ltd.	**S Ltd.**
	₹	₹
Shareholders' Fund:		
Equity shares of ₹ 10 each	13,40,000	2,40,000
Reserves and Surplus	4,80,000	1,80,000
Profit & Loss Account	2,40,000	60,000
Secured Loans:		
12% Debentures	1,00,000	-
Current Liabilities:		
Creditors	2,00,000	1,22,000
Bank Overdraft	1,00,000	-
Bills Payable	60,000	14,800
Property, Plant & Equipment:		
Machinery	7,20,000	2,16,000
Furniture	3,60,000	40,800
Investments:		
Investments in S Ltd.	3,84,000	-
(19,200 shares at ₹ 20 each)		

	H Ltd.	S Ltd.
	₹	₹
Current Assets:		
Inventories	6,00,000	2,00,000
Trade Receivables	3,00,000	90,000
Bill Receivables	1,00,000	30,000
Cash at Bank	56,000	40,000

The following information is also provided to you:

(a) H Ltd. purchased 19,200 shares of S Ltd. on 1st April, 2019, when the balances of Reserves & Surplus and Profit & Loss Account of S Ltd. stood at ₹ 60,000 and ₹ 36,000 respectively.

(b) Machinery (Book value ₹ 2,40,000) and Furniture (Book value ₹ 48,000) of S Ltd were revalued at ₹ 3,60,000 and ₹ 36,000 respectively on 1st April, 2019, for the purpose of fixing the price of its shares. (Rates of depreciation computed on the basis of useful lives:
Machinery 10%, Furniture 15%).

(c) On 31st March, 2020, Bills payable of ₹ 12,000 shown in S Ltd.'s Balance Sheet had been accepted in favour of H Ltd.

You are required to prepare Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2020.

(*MTP, November, 2021*) (*20 Marks*)

Answer

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2020

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	13,40,000
(b) Reserves and Surplus	2	8,27,040
(2) Minority Interest		1,15,560
(3) Non- Current Liabilities		
(a) 12% Debentures		1,00,000
(4) Current Liabilities		
(a) Trade Payables	3	3,84,800
(b) Short term Borrowings (Bank overdraft)		1,00,000
Total		28,67,400
II. Assets		
(1) Non-current assets		
(a)		
(i) Property, Plant and Equipment	4	14,34,600
(ii) Intangible assets	5	28,800
(2) Current assets		
(a) Inventory (6,00,000+2,00,000)		8,00,000
(b) Trade Receivables	6	5,08,000
(c) Cash and Cash equivalents		96,000
Total		28,67,400

Notes to Accounts

		₹		
1.	Share Capital Equity share capital 1,34,000 shares of ₹ 10 each fully paid up			13,40,000
2.	Reserves and Surplus			
	Reserves		4,80,000	
	Add: 4/5th share of S Ltd.'s post- acquisition reserves (W.N.3)		96,000	5,76,000
	Profit and Loss Account		2,40,000	
	Add: 4/5th share of S Ltd.'s post- acquisition profits (W.N.4)		11,040	2,51,040
				8,27,040
3.	Trade Payables			
	Creditors			

		₹		
	H Ltd.	2,00,000		
	S Ltd.	1,22,000	3,22,000	
	Bills Payables			
	H Ltd.	60,000		
	S Ltd.	14,800	74,800	
			3,96,800	
	Less: Mutual Owings		(12,000)	3,84,800
4.	Property Plant and Equipment			
	Machinery			
	H. Ltd.		7,20,000	
	S Ltd.	2,40,000		
	Add: Appreciation	1,20,000		
		3,60,000		
	Less: Depreciation (3,60,000 X 10%)	(36,000)	3,24,000	
	Furniture			
	H. Ltd.		3,60,000	
	S Ltd.	48,000		
	Less: Decrease in value	(12,000)		
		36,000		
	Less: Depreciation (36,000 X 15%)	5,400	30,600	14,34,600
5.	Intangible assets			
	Goodwill [WN 6]			28,800
6.	Trade receivables			
	H Ltd.	3,00,000		
	S Ltd.	90,000	3,90,000	
	Bills Receivables			
	H Ltd.	1,00,000		
	S Ltd.	30,000	1,30,000	
			5,20,000	
	Less: Mutual Owings		(12,000)	5,08,000

Working Notes:

		₹
1.	Pre-acquisition profits and reserves of S Ltd.	
	Reserves	60,000
	Profit and Loss Account	36,000
		96,000
	H Ltd.'s = 4/5 (or 80%) × 96,000	76,800
	Minority Interest= 1/5 (or 20%) × 96,000	19,200
2.	Profit on revaluation of assets of S Ltd.	
	Profit on Machinery ₹ (3,60,000 – 2,40,000)	1,20,000
	Less: Loss on Furniture ₹(48,000 –36,000)	(12,000)
	Net Profit on revaluation	1,08,000
	H Ltd.'s share 4/5 × 1,08,000	86,400
	Minority Interest 1/5 × 1,08,000	21,600
3.	Post-acquisition reserves of S Ltd.	
	Total reserves	1,80,000
	Less: Pre-acquisition reserves	(60,000)
	Post-acquisition reserves	1,20,000
	H Ltd.'s share 4/5 × 1,20,000	96,000
	Minority interest 1/5 × 1,20,000	24,000
4.	Post -acquisition profits of S Ltd.	
	Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = ₹ 60,000 – 36,000)	24,000

	Add: Excess depreciation charged on furniture @ 15% on ₹ 12,000 i.e. (48,000 – 36,000)		1,800
	Less: Under depreciation on machinery @ 10%		25,800
	on ₹ 1,20,000 i.e. (3,60,000 – 2,40,000)		(12,000)
	Adjusted post-acquisition profits		13,800
	H Ltd.'s share 4/5 × 13,800		11,040
	Minority Interest 1/5 × 13,800		2,760
5.	Minority Interest		
	Paid-up value of (24,000 – 19,200) = 4,800 shares held by outsiders i.e. 2,40,000 X 20%		48,000
	Add: 1/5th share of pre-acquisition profits and reserves		19,200
	1/5th share of profit on revaluation		21,600
	1/5th share of post-acquisition reserves		24,000
	1/5th share of post-acquisition profit		2,760
			1,15,560
6.	Cost of Control or Goodwill		
	Price paid by H Ltd. for 19,200 shares	(A)	3,84,000
	Less: Intrinsic value of the shares		1,92,000
	Paid-up value of shares held by H Ltd. i.e. 2,40,000 X 80%		
	Add: 4/5th share of pre-acquisition profits and reserves		76,800
	4/5th share of profit on the revaluation		86,400
	Intrinsic value of shares on the date of acquisition	(B)	3,55,200
	Cost of control or Goodwill	(B-A)	28,800

Question 78

On 31st March, 2015, P Ltd. acquired 1,05,000 shares of Q Ltd. for ₹ 12,00,000. The position of Q Ltd. on that date was as under:

	₹
Property, plant and equipment	10,50,000
Current Assets	6,45,000
1,50,000 equity shares of ₹ 10 each fully paid	15,00,000
Pre-incorporation profits	30,000
Profit and Loss Account	60,000
Trade payables	1,05,000

P Ltd. and Q Ltd. give the following information on 31st March, 2021:

	P Ltd. ₹	Q Ltd. ₹
Equity shares of ₹ 10 each fully paid (before bonus issue)	45,00,000	15,00,000
Securities Premium	9,00,000	–
Pre-incorporation profits	–	30,000
General Reserve	60,00,000	19,05,000
Profit and Loss Account	15,75,000	4,20,000
Trade payables	5,55,000	2,10,000
Property, plant and equipment	79,20,000	23,10,000
Investment: 1,05,000 Equity shares in Q Ltd. at cost	12,00,000	–
Current Assets	44,10,000	17,55,000

Directors of Q Ltd. made bonus issue on 31.3.2021 in the ratio of one equity share of ₹ 10 each fully paid for every two equity shares held on that date. Bonus shares were issued out of post-acquisition profits by using General Reserve.

Calculate as on 31st March, 2021 (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (ii) Consolidated Profit and Loss Account in each of the following cases:

(a) Before issue of bonus shares.

(b) Immediately after issue of bonus shares.

(*RTP November 2021*)

Answer

Shareholding pattern

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

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

(a) Before issue of bonus shares

(i)	**Cost of control/capital reserve**	**₹**	**₹**
	Investment in Q Ltd.		12,00,000
	Less: Face value of investments	10,50,000	
	Capital profits (W.N.)	63,000	(11,13,000)
	Cost of control		87,000
(ii)	**Minority Interest**		**₹**
	Share Capital		4,50,000
	Capital profits (W.N.)		27,000
	Revenue profits (W.N.)		6,79,500
			11,56,500
(iii)	**Consolidated profit and loss account – P Ltd.**		**₹**
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		15,85,500
			31,60,500

(b) Immediately after issue of bonus shares

(i)	**Cost of control/capital reserve**	**₹**	**₹**
	Face value of investments (₹ 10,50,000 + ₹ 5,25,000)	15,75,000	
	Capital Profits (W.N.)	63,000	16,38,000
	Less: Investment in Q Ltd.		(12,00,000)
	Capital reserve		4,38,000
(ii)	**Minority Interest**		**₹**
	Share Capital (₹ 4,50,000 + ₹ 2,25,000)		6,75,000
	Capital Profits (W.N.)		27,000
	Revenue Profits (W.N.)		4,54,500
			11,56,500
(iii)	**Consolidated Profit and Loss Account – P Ltd.**		**₹**
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		10,60,500
			26,35,500

Working Note:

Analysis of Profits of Q Ltd.

	Capital Profits	**Revenue Profits**	
	(Before and after issue of bonus shares) ₹	**Before Bonus Issue** ₹	**After Bonus Issue** ₹
Pre-incorporation profits	30,000		
Profit and loss account on 31.3.2015	60,000		
General reserve*	90,000		19,05,000
Less: Bonus shares			(7,50,000)
		19,05,000	11,55,000

Profit for period of 1st April, 2015 to 31st March, 2021 (₹ 4,20,000 – ₹ 60,000)		3,60,000	3,60,000
		22,65,000	15,15,000
P Ltd.'s share (70%)	63,000	15,85,500	10,60,500
Minority's share (30%)	27,000	6,79,500	4,54,500

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

Question 79

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

	Beta Ltd.	Gamma Ltd.
	₹	₹
Share Capital:		
Shares of ₹ 100 each	15,00,000	2,50,000
Reserves	5,00,000	1,87,500
Profit and Loss Account	2,50,000	62,500
Trade Payables	3,75,000	1,42,500
Property, plant and Equipment:		
Machinery	7,50,000	2,25,000
Furniture	3,75,000	42,500
Other non-current assets	11,00,000	3,75,000
Non-current Investments:		
Shares in Gamma Ltd.: 2,000 shares at ₹ 200 each	4,00,000	

Other information:

Reserves and Profit and Loss Account of Gamma Ltd. stood at ₹ 62,500 and ₹ 37,500 respectively on the date of acquisition of its 80% shares by Beta Ltd. on 1st April, 2020.

Machinery (Book-value ₹ 2,50,000) and Furniture (Book value ₹ 50,000) of Gamma Ltd. were revalued at ₹ 3,75,000 and ₹ 37,500 respectively on 1st April, 2020 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.]

(*RTP May, 2022*)

Answer

Consolidated Balance Sheet of Beta Ltd. and its Subsidiary Gamma Ltd. as at 31st March, 2021

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

Notes to Accounts

		₹		
1.	**Reserves and Surplus**			
	Reserves		5,00,000	
	Add: 4/5th share of Gamma Ltd.'s post- acquisition reserves (W.N.3)		1,00,000	6,00,000
	Profit and Loss Account		2,50,000	
	Add: 4/5th share of Gamma Ltd.'s post- acquisition profits (W.N.4)		11,500	2,61,500
				8,61,500

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

Working Notes:

		₹
1.	**Pre-acquisition profits and reserves of Gamma Ltd.**	
	Reserves	62,500
	Profit and Loss Account	37,500
		1,00,000
	Beta Ltd.'s = 4/5 × 1,00,000	80,000
	Minority Interest = 1/5 × 1,00,000	20,000
2.	**Profit on revaluation of assets of Gamma Ltd.**	
	Profit on Machinery ₹ (3,75,000 – 2,50,000)	1,25,000
	Less: Loss on Furniture ₹ (50,000 – 37,500)	12,500
	Net Profit on revaluation	1,12,500
	Beta Ltd.'s share 4/5 × 1,12,500	90,000
	Minority Interest 1/5 × 1,12,500	22,500
3.	**Post-acquisition reserves of Gamma Ltd.**	
	Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 1,87,500 – 62,500)	1,25,000
	Beta Ltd.'s share 4/5 × 1,25,000	1,00,000
	Minority interest 1/5 × 25,000	25,000
4.	**Post -acquisition profits of Gamma Ltd.**	
	Post-acquisition profits (Profit & loss account balance less pre- acquisition profits = ₹ 62,500 – 37,500)	25,000
	Add: Excess depreciation charged on furniture @ 15%	
	on ₹ 12,500 i.e. (50,000 – 37,500)	1,875
	Less: Under depreciation on machinery @ 10%	26,875
	on ₹ 1,25,000 i.e. (3,75,000 – 2,50,000)	(12,500)
	Adjusted post-acquisition profits	14,375
	Beta Ltd.'s share 4/5 × 14,375	11,500
	Minority Interest 1/5 × 14,375	2,875
5.	**Minority Interest**	
	Paid-up value of (2,500 – 2,000) = 500 shares	
	held by outsiders i.e. 500 × ₹ 100	50,000
	Add: 1/5th share of pre-acquisition profits and reserves	20,000
	1/5th share of profit on revaluation	22,500

1/5th share of post-acquisition reserves	25,000
1/5th share of post-acquisition profit	2,875
	1,20,375
6. Cost of Control or Goodwill	
Paid-up value of 2,000 shares held by Beta Ltd. i.e. 2,000 × ₹ 100	2,00,000
Add: 4/5th share of pre-acquisition profits and reserves	80,000
4/5th share of profit on the revaluation	90,000
Intrinsic value of shares on the date of acquisition	3,70,000
Price paid by Beta Ltd. for 2,000 shares	4,00,000
Less: Intrinsic value of the shares	(3,70,000)
Cost of control or Goodwill	30,000

Question 80

Moon Ltd. and its subsidiary Star Ltd. provided the following information for the year ended 31st March, 2021.

Particulars	Moon Ltd. (₹)	Star Ltd. (₹)
Equity Share Capital	20,000,000	6,000,000
Finished Goods Inventory as on 01.04.2020	4,200,000	3,010,000
Finished Goods Inventory as on 31.03.2021	8,575,000	3,762,500
Dividend Income	1,680,000	437,500
Other non-operating Income	350,000	105,000
Raw material consumed	13,930,000	4,725,000
Selling and Distribution Expenses	3,325,000	1,575,000
Production Expenses	3,150,000	1,400,000
Loss on sale of investments	262,500	Nil
Sales and other operating income	33,250,000	19,075,000
Wages and Salaries	13,300,000	2,450,000
General and Administrative Expenses	2,800,000	1,225,000
Royalty paid	Nil	50,000
Depreciation	315,000	140,000
Interest expense	175,000	52,500

Other information:

- On 1st September, 2018 Moon Ltd. acquired 50,000 equity shares of ₹ 100 each fully paid up in Star Ltd.
- Star Ltd. paid a dividend of 10% for the year ended 31st March, 2020. The dividend was correctly accounted for by Moon Ltd.
- Moon Ltd. sold goods of ₹ 17,50,000 to Star Ltd. at a profit of 20% on selling price. Inventory of Star Ltd. includes goods of ₹ 7,00,000 received from Moon Ltd.
- Selling and Distribution expenses of Star Ltd. include ₹ 2,12,500 paid to Moon Ltd. as brokerage fees.
- General and Administrative expenses of Moon Ltd. include ₹ 2,80,000 paid to Star Ltd. as consultancy fees.
- Star Ltd. used some resources of Moon Ltd., and Star Ltd. paid ₹ 50,000 to Moon Ltd. as royalty.

Prepare consolidated statement of Profit and Loss of Moon Ltd. and its subsidiary Star Ltd. for the year ended 31.03.2021 as per schedule III of the Companies Act, 2013.

(*Question Paper of December 2021*) *(15 Marks)*

Answer

Consolidated statement of profit and loss of Moon Ltd. and its subsidiary Star Ltd. for the year ended on 31st March, 2021

Particulars	Note No.	₹
Revenue from operations	1	5,00,32,500
Other Income	2	23,10,000
Total revenue (I)		5,23,42,500
Expenses:		
Cost of material purchased/consumed	3	2,14,55,000
Changes (Increase) in inventories of finished goods	4	(49,87,500)
Employee benefit expense	5	1,57,50,000
Finance cost	6	2,27,500
Depreciation and amortization expense	7	4,55,000
Other expenses	8	84,32,500
Total expenses (II)		4,13,32,500
Profit before tax (II-III)		1,10,10,000

Notes to Accounts:

			₹	₹
1.	Revenue from operations			
	Sales and other operating revenues[1]			
	Moon Ltd.		3,32,50,000	
	Star Ltd.		190,75,000	
			523,25,000	
	Less: Inter-company sales		(17,50,000)	
	Consultancy fees received by Star Ltd. from Moon Ltd.		(2,80,000)	
	Royalty received by Moon Ltd. from Star Ltd.		(50,000)	5,00,32,500
	Brokage received by Moon Ltd. from Star Ltd.		(2,12,500)	
2.	Other Income			
	Dividend income:			
	Moon Ltd.	16,80,000		
	Star Ltd.	4,37,500	21,17,500	
	Loss on sale of investments Star Ltd.		(2,62,500)	
	Other Non-operating Income			
	Moon Ltd.	3,50,000		
	Star Ltd.	1,05,000	4,55,000	23,10,000
3.	Cost of material purchased/consumed			
	Moon Ltd.	1,39,30,000		
	Star Ltd.	47,25,000		
		1,86,55,000		
	Less: Purchases by Star Ltd. From Moon Ltd.	(17,50,000)	1,69,05,000	
	Direct expenses (Production)			
	Moon Ltd.	31,50,000		
	Star Ltd.	14,00,000	45,50,000	2,14,55,000
4.	Changes (Increase) in inventories of finished goods			
	Moon Ltd.		43,75,000	
	Star Ltd.		7,52,500	
			51,27,500	
	Less: Unrealized profits ₹ 7,00,000 × 20/100		(1,40,000)	49,87,500
5.	Employee benefits and expenses			
	Wages and salaries:			
	Moon Ltd.		1,33,00,000	
	Star Ltd.		24,50,000	1,57,50,000
6	Finance cost			
	Interest:			
	Moon Ltd.		1,75,000	
	Star Ltd.		52,500	2,27,500
7.	Depreciation			
	Moon Ltd.		3,15,000	
	Star Ltd.		1,40,000	4,55,000
8.	Other expenses			
	General & Administrative expenses:			
	Moon Ltd.	28,00,000		
	Star Ltd.	12,25,000		
		40,25,000		
	Less: Consultancy fees received by Star Ltd. from Moon Ltd.	(280,000)	37,45,000	

[1] *Consultancy fees, Royalty and brokerage received are considered as operating revenues in the given answer.*

			₹	₹
	Royalty:			
	Star Ltd.	50,000		
	Less: Received by Moon Ltd.	(50,000)	Nil	
	Selling and distribution Expenses:			
	Moon Ltd.	33,25,000		
	Star Ltd.	15,75,000		
		49,00,000		
	Less: Brokerage received by Moon Ltd. from Star Ltd.	(2,12,500)	46,87,500	84,32,500

Question 81

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 at which 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 on 31st March, 2022.

(*RTP November, 2022*)

Answer

Consolidated Balance Sheet of H Ltd. with its subsidiary S Ltd. as at 31st March, 2022

Particulars	***Note No.***	***(₹ in 000's)***
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	4,000
(b) Reserves and Surplus	2	3,063

Particulars	***Note No.***	***(₹ in 000's)***
(2) Minority Interest (W.N.6)		1,560
(3) Current Liabilities		
Trade payables	3	1,118
Short term provisions	4	482
Total		10,223
II. Assets		
(1) Non-current assets		
PPE	5	5,904
(2) Current assets		
(a) Inventories	6	1,759
(b) Trade receivables	7	1,598
(c) Cash and cash equivalents	8	512
(d) Short term loans and advances	9	450
Total		10,223

Notes to Accounts

			(₹ in 000's)	***(₹ in 000's)***
1.	Share Capital			
	Authorised share capital			
	5 lakhs equity shares of ₹ 10 each			5,000
	Issued, Subscribed and Paid up			
	4 lakhs equity shares of ₹ 10 each fully paid			4,000
2.	Reserves and surplus			
	Capital Reserve (Note 5)		679.8	
	General Reserve		928	
	Profit and Loss Account:			
	H Ltd.	₹ 1,305		
	Add: Share in S Ltd	₹ 340.20		
		₹ 1,645.20		
	Less: Dividend wrongly credited	₹ (180)		
		₹ 1,465.20		
	Less: Unrealised profit (50 X 1/5)	₹ (10)	1,455.20	3,063
3.	Trade payables			
	H Ltd.		611	
	S Ltd.		507	1,118
4.	Short –term provisions			
	Provision for Taxation H Ltd.	₹ 220		
	S Ltd.	₹ 180	400	
	Other Provisions H Ltd	₹65		
	S Ltd.		82	482
5.	PPE			
	Plant and Machinery			
	H Ltd.	₹ 2,541		
	S Ltd.	₹ 2,450	4,991	
	Furniture and fittings			
	H Ltd.	₹615		
	S Ltd.	₹298	913	5,904
6.	Inventories			
	Inventory H Ltd.	₹983		
	S Ltd.	₹786	1,769	
	Less: Unrealised profit (₹ 50 x 1/5)		(10)	1,759
7.	Trade receivables			
	H Ltd.		820	
	S Ltd.		778	1,598

		(₹ in 000's)	*(₹ in 000's)*
8.	Cash and cash equivalents		
	Cash and Bank Balances	410	
	H Ltd		
	S Ltd.	102	512
9.	Short term loans and advances		
	Sundry Advances	260	
	H Ltd.		
	S Ltd.	190	450

Working Notes:

Share holding pattern

Particulars	Number of Shares	% of holding
(a) S Ltd.		
(i) Purchased on 01.04.2021	90,000	
(ii) Bonus Issue (90,000/5 x 3)	54,000	
Total	1,44,000	60% (1,44,000 /2,40,000*x 100)
(b) Minority Interest	96,000	40%

*2,40,000 is after issue of bonus shares as per balance sheet as at 31.3.2022

1. S Ltd. General Reserve

	(₹ in 000)		*(₹ in 000)*
To Bonus to equity shareholders $\left(\frac{2,400 \times 3}{8}\right)$	900	By Balance b/d	1,500
		By Profit and Loss A/c	
To Balance c/d	690	(Balancing figure)	90
	1,590		1,590

2. S Ltd.'s Profit and Loss Account

	(₹ in 000)		*(₹ in 000)*
To General Reserve	90	By Balance b/d	633
To Dividend paid on 14.7.2021 $\frac{1,500 \times 20}{100}$	300	By Net Profit for the year (Balancing figure)	567*
To Balance c/d	810		
	1,200		1,200

* Out of ₹ 5,67,000 profit for the year, ₹ 90,000 has been transferred to reserves by S Ltd.

3. Distribution of Revenue Profits

	₹ in '000
Revenue Profit as above	567.00
Share of H Ltd. (60%)	340.20
Share of Minority shareholders (567– 340.20)	226.80

4. Computation of Capital Profits

	₹ in 000	*₹ in 000*
General Reserve on the date of acquisition		1,500
Less: Bonus issue of shares		(900)
		600
Profit and Loss Account balance on the date of acquisition	633	
Less: Dividends paid	(300)	333
		933
Share of H Ltd. (60%)		559.80
Share of Minority shareholders		373.20

5. Computation of Capital Reserve

		₹ in '000
60% of share capital of S Ltd.		1,440
Add: Share of H Ltd. in the capital profits as in working note (4)		559.80
		1,999.80
Less: Investments in S Ltd.	1,500	
Less: Dividends received out of pre- acquisition profits $\frac{`300 \times 60}{100}$	(180)	(1,320)
		679.80

6. Calculation of Minority Interest

	₹ in '000
40% of share capital of S Ltd.	960.00
Add: Share of Revenue Profits (Note 3)	226.80
Share of Capital Profits (Note 4)	373.20
	1,560.00

Question 82

G Ltd. and its subsidiary K Ltd. give the following information for the year ended 31st March, 2023 :

(₹ in crores)

Particulars		G Ltd.	K Ltd.
Sales and other Income		3000	750
Increase in Inventory		750	100
Raw material consumed'		600	100
Wages and Salaries		600	75
Production expenses		100	50
Administrative expenses		75	50
Selling-and Distribution expenses		100	25
Interest		75	30
Depreciation		75	30

The following information is also given:

(i) G Ltd. sold goods of ₹200 crores to K Ltd. at cost plus 25%. (1/5th of such goods were still in inventory of K Ltd. at the end of the year)

(ii) G Ltd. holds 75% of the Equity share capital of K Ltd. and the Equity share capital of K Ltd. is ₹ 800 crores on 01.04.2022 (date of acquisition of shares)

(iii) Administrative expenses of K Ltd. include ₹ 5 crore paid to G Ltd. as consultancy fees. Also, selling and distribution expenses of G Ltd. include ₹ 20 crores paid to K Ltd. as commission.

Prepare it consolidated statement of Profit and Loss of G Ltd. with its subsidiary K Ltd. for the year ended 31st March, 2023.

(*G-II, May, 2023*) (*10 Marks*)

Question 83

H Ltd. acquired 15000 shares in S Ltd. for ₹ 1,55,000 on July 1, 2022.

The Balance sheet of the two companies as on 31st March, 2023 were as follows:

	H Ltd. ₹	**S Ltd.** ₹
Equity and Liabilities:		
Equity Share Capital	9,00,000	2,50,000
(Fully paid shares of ₹10each)		
General Reserve	1,60,000	.40,000
Surplus i.e., Balance in Statement of Profit and Loss	80,000	25,000
Bills Payable	40,000	20,000
Trade Creditors	50,000	30,000
Total	**12,30,000**	**3,65,000**
Assets		
Machinery	7,00,000	1,50,000
Furniture	1,00,000	70,000
Investment in Equity Shares of S Ltd.	1,55,000	-

	H Ltd. ₹	S Ltd. ₹
Stock-in-Trade	1,00,000	50,000
Trade Debtors	60,000	35,000
Bills Receivable	25,000	20,000
Cash at 'Bank	90,000	40,000
Total	**12,30,000**	**3,65,000**

The following additional information is provided to you :

(i) General reserve appearing in the Balance Sheet of S Ltd. remained unchanged since 31st March, 2022.

(ii) Profit earned by S Ltd. for the year ended 31st March, 2023 amounted to ₹20,000.

(iii) H Ltd. sold goods to S Ltd. costing ₹ 8,000 for ₹ 10,000, 25% of these goods remained unsold with S Ltd. on 31st March, 2023.

(iv) Creditors of S Ltd. include ₹4000 due to H Ltd. on account of these goods.

(v) Out of Bills payable issued by S Ltd. ₹15,000 are those which, have been accepted in favour of H Ltd. Out of these, H Ltd. had endorsed by 31st March, 2023, ₹ 8000 worth of bills receivable in favour of its creditors.

You are required' to draw a consolidated Balance Sheet as on 31st March, 2023.

(*G-II, May, 2023*) (*10 Marks*)

Question Arrangement

AS 21

Topic	Question Numbers
Basics of Consolidation	74, 12, 21-26, 70, 1, 19, 51, 53, 54, 65, 10, 22-25, 12, 16, 27, 26, 35, 36, 11, 28, 37, 74
Revaluation	18, 13, 61, 72, 79, 77, 56, 59, 69
Bonus	9, 78, 44, 45, 21, 22, 31-34, 81, 47
Dividend	3, 6, 52, 2, 7, 8, 17, 49, 55, 66, 83, 38, 8, 20, 21, 29-33, 40-43, 46, 47, 47, 71
Negative Minority Interest	4, 48, 50
Unrealised Profit	14, 67
Consolidated Profit and Loss Account	15, 62-64, 68, 73, 80, 82
Same Policies	16, 58, 66, 75
Gain on Sale of Investment	76

Accounting Standard 23 Accounting for Investments in Associates in Consolidated Financial Statements

Question 1

A Ltd. acquire 45% of B Ltd. shares on April 01, 20X1, the price paid was ₹ 15,00,000. Following are the extracts of balance sheet of B Ltd. as of 1 April 20X1:

Paid up Equity Share Capital	*₹ 10,00,000*
Securities Premium	*₹ 1,00,000*
Reserve & Surplus	*₹ 5,00,000*

B Ltd. has reported net profits of ₹ 3,00,000 and paid dividends of ₹ 1,00,000 for the year ended 31 March 20X2. Calculate the amount at which the investment in B Ltd. should be shown in the consolidated balance sheet of A Ltd. as on March 31, 20X2.

(*Source: Illustration 1, Study Material*)

Answer

Calculation of Goodwill/Capital Reserve under Equity Method

Particulars		₹	₹
Investment in B Ltd.	(A)		15,00,000
Equity Shares		10,00,000	
Security Premium		1,00,000	
Reserves & Surplus		5,00,000	
Net Assets		16,00,000	
45% of Net Asset	(B)		7,20,000
Goodwill (A-B)			7,80,000

Calculation of Carrying Amount of Investment in the year ended on 31st March, 20X2

Particulars	₹
Investment in Associate as per AS 23:	
Share of Net Assets on 1 April 20X1	7,20,000
Add: Goodwill	7,80,000
Cost of Investment	15,00,000
Add: Profit during the year (3,00,000 x 45%)	1,35,000
Less: Dividend paid (1,00,000 x 45%)	(45,000)
Carrying Amount of Investment	15,90,000

Question 2

A Ltd. acquired 40% share in B Ltd. on April 01, 20X1 for ₹ 10 lacs. On that date B Ltd. had 1,00,000 equity shares of ₹ 10 each fully paid and accumulated profits of ₹ 2,00,000. During the year 20X1-20X2, B Ltd. suffered a loss of ₹ 10,00,000; during 20X2-20X3 loss of ₹ 12,50,000 and during 20X3-20X4 again a loss of ₹ 5,00,000. Show the extract of consolidated balance sheet of A Ltd. on all the four dates recording the above events.

(*Source: Illustration 2, Study Material*)

Answer

Calculation of Goodwill/Capital Reserve under Equity Method

Particulars	₹
Equity Shares	10,00,000
Reserves & Surplus	2,00,000
Net Assets	12,00,000
40% share of Net Assets	4,80,000
Less: Cost of Investment	(10,00,000)
Goodwill	5,20,000

Consolidated Balance Sheet (Extract) as on April 01, 20X1: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on April 1	4,80,000	
Add: Goodwill	5,20,000	10,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X2:

Investment in Associate as per AS 23	₹
Share of Net Assets on 1 April, 20X1	4,80,000
Add: Goodwill	5,20,000
Cost of Investment	10,00,000
Less: Loss for the year (10,00,000 x 40%)	(4,00,000)
Carrying Amount of Investment	6,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X2: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 20X1	4,80,000	
Less: Share of Loss as above	(4,00,000)	
	80,000	
Add: Goodwill	5,20,000	6,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X3:

Investment in Associate as per AS 23	₹
Carrying Amount of Investment as on 31 March 20X2	6,00,000
Less: Loss for the year (12,50,000 x 40%)	(5,00,000)
Carrying Amount of Investment	1,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X3: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 20X1	4,80,000	
Less: Share of Loss as above (₹4,00,000 +₹ 5,00,000)	(4,20,000)	
Add: Goodwill		1,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X4:

Investment in Associate as per AS 23	₹
Carrying Amount of Investment	1,00,000
Less: Loss for the year (5,00,000 x 40% = 2,00,000, restricted to Carrying amount of Investment in B Ltd.) - refer note below	
Carrying Amount of Investment	

Consolidated Balance Sheet (Extract) as on March 31, 20X4: ASSETS

Investment in Associate as per AS 23	₹
Investment in B Ltd.	-

Question 3

Describe the cases when AS 23 does not allow the use of equity method of accounting?

Answer

Equity method of accounting is to be followed by all the enterprises having significant influence on their associates except in the following cases:

(a) Control is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future. The term 'Near Future' is explained with AS 21.

Or;

(b) It operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the investor. In both the above cases, investment of investor in the share of the investee is treated as investment according to AS 13.

Question 4

When is an investor required to discontinue the use of the equity method of accounting?

Answer

An investor should discontinue the use of the equity method from the date that:

(a) It ceases to have significant influence in an associate but retains, either in whole or in part, its investment.

(b) The use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.

From the date of discontinuing the use of the equity method, investments in such associates should be accounted for in accordance with AS 13, Accounting for Investments. For this purpose, the carrying amount of the investment at that date should be regarded as cost thereafter.

Question 5

Bright Ltd. acquired 30% of East India Ltd. shares for ₹ 2,00,000 on 01-06-20X1. By such an acquisition Bright can exercise significant influence over East India Ltd. During the financial year ending on 31-03-20X1 East India earned profits ₹ 80,000 and declared a dividend of ₹ 50,000 on 12-08-20X1. East India reported earnings of ₹ 3,00,000 for the financial year ending on 31-03-20X2 (assume profits to accrue evenly) and declared dividends of ₹ 60,000 on 12-06-20X2.

Calculate the carrying amount of investment in:

(i) Separate financial statements of Bright Ltd. as on 31-03-20X2;

(ii) Consolidated financial statements of Bright Ltd.; as on 31-03-20X2;

(iii) What will be the carrying amount as on 30-06-20X2 in consolidated financial statements?

Answer

(i) Carrying amount of investment in Separate Financial Statement of Bright Ltd. as on 31.03.20X2

	₹
Amount paid for investment in Associate (on 1.06.20X1)	2,00,000
Less: Pre-acquisition dividend (₹ 50,000 x 30%)	(15,000)
Carrying amount as on 31.3.20X2 as per AS 13	1,85,000

(ii) Carrying amount of investment in Consolidated Financial Statements of Bright Ltd. as on 31.3.20X2 as per AS 23

	₹
Carrying amount as per separate financial statements	1,85,000
Add: Proportionate share of 10-month profit of	
Investee as per equity method (30% of ₹ 3,00,000 x 10/12)	75,000
Carrying amount as on 31.3.20X2	2,60,000

(iii) Carrying amount of investment in Consolidated Financial Statement of Bright Ltd. as on 30.6.20X2 as per AS 23

	₹
Carrying amount as on 31.3.20X2	2,60,000
Less: Dividend received (₹ 60,000 x 30%)	(18,000)
Carrying amount as on 30.6.20X2	2,42,000

Question 6

A Ltd. acquired 25% of shares in B Ltd. as on 31.3.20X1 for ₹ 3 lakhs. The Balance Sheet of B Ltd. as on 31.3.20X1 is given below:

	₹
Share Capital	*5,00,000*
Reserves and Surplus	*5,00,000*
	10,00,000
Fixed Assets	*5,00,000*
Investments	*2,00,000*
II. Current Assets	*3,00,000*
	10,00,000

During the year ended 31.3.20X2 the following are the additional information available:

(i) *A Ltd. received dividend from B Ltd., for the year ended 31.3.20X1 at 40% from the Reserves.*

(ii) *B Ltd., made a profit after tax of ₹ 7 lakhs for the year ended 31.3.20X2.*

(iii) *B Ltd., declared a dividend @ 50% for the year ended 31.3.20X2 on 30.4.20X2.*

A Ltd. is preparing Consolidated Financial Statements in accordance with AS 21 for its various subsidiaries. Calculate:

(i) Goodwill if any on acquisition of B Ltd.'s shares.

(ii) How A Ltd., will reflect the value of investment in B Ltd., in the Consolidated Financial Statements?

(iii) How the dividend received from B Ltd. will be shown in the Consolidated Financial Statements?

Answer

In terms of AS 23, B Ltd. will be considered as an associate company of A Ltd. as shares acquired represent to more than 20%.

(i) Calculation of Goodwill (*₹ in lakhs)*

Amount paid towards acquisition of stake in B Ltd.	3.00
Less: Pre-acquisition dividend (₹ 5,00,000 x 40% x 25%)	0.50
Cost of Investment in B Ltd.	2.50
Less: Share in the value of Equity of B Ltd. as at the date of investment [25% of ₹ 10 lakhs (₹ 5 lakhs + ₹ 5 lakhs)]	(2.50)
Goodwill	NIL

(ii) A Ltd.

Consolidated Profit and Loss Account for the year ended 31st March, 20X2 (An extract)

		₹ in lakhs
Other income:		
Share of profits in B Ltd.		1.75
Pre-acquisition Dividend received from		
B Ltd.	0.50	
Transfer to investment A/c	(0.50)	Nil

(iii) A Ltd.

Consolidated Balance Sheet as on 31.3.20X2 (An extract)

		₹ in lakhs
Non-current investments		
Investment in B Ltd.		
Cost of Investment in B Ltd.	2.50	
Share of profit for year 20X1 – 20X2	1.75	
	4.25	
Add: Goodwill	NIL	4.25

Working Notes:

1. Pre-acquisition dividend received from B Ltd. amounting to ₹ 0.50 lakhs will be reduced from investment value in the books of A Ltd.
2. B Ltd. made a profit of ₹ 7 lakhs for the year ended 31st March, 20X2. A Ltd.'s share in the profits of ₹ 7 lakhs is ₹ 1.75 lakhs. Investment in B Ltd. will be increased by ₹ 1.75 lakhs and consolidated profit and loss account of A Ltd. will be credited with ₹ 1.75 lakhs in the consolidated financial statement of A Ltd.
3. Dividend declared on 30th April, 20X2 will not be recognized in the consolidated financial statement of A Ltd.

Question Arrangement

AS 23

Topic	Question Numbers
Calculation of Goodwill and Investment	1, 2, 5, 6
Theory	3, 4

Accounting Standard 27
Financial Reporting of Interests in Joint Ventures

Question 1

Mr. A, Mr. B and Mr. C entered into a joint venture to purchase a land, construct and sell flats. Mr. A purchased a land for ₹ 60,00,000 on 01.01.20X1 and for the purpose he took loan from a bank for ₹ 50,00,000 @ 8% interest p.a. He also paid registering fees ₹ 60,000 on the same day. Mr. B supplied the materials for ₹ 4,50,000 from his godown and further he purchased the materials for ₹ 5,00,000 for the joint venture. Mr. C met all other expenses of advertising, labour and other incidental expenses which turnout to be ₹ 9,00,000. On 30.06.20X1 each of the venturer agreed to take away one flat each to be valued at ₹ 10,00,000 each flat and rest were sold by them as follow: Mr. A for ₹ 40,00,000; Mr. B for ₹ 20,00,000 and Mr. C for ₹ 10,00,000. Loan was repaid on the same day by Mr. A along with the interest and net proceeds were shared by the partners equally.

You are required to prepare the draft Consolidated Profit & Loss Account and Joint Venture Account in the books of each venturer.

(*Source: Illustration 1, Study Material*)

Answer

Draft Consolidated Profit & Loss Account

Particulars	₹	₹	Particulars	₹	₹
To Purchase of Land:			By Sale of Flats:		
Mr. A		60,00,000	Mr. A	40,00,000	
To Registration Fees:			Mr. B	20,00,000	
Mr. A		60,000	Mr. C	10,00,000	70,00,000
To Materials:			By Flats taken by Venturers:		
Mr. B		9,50,000	Mr. A	10,00,000	
To Other Expenses:			Mr. B	10,00,000	
Mr. C		9,00,000	Mr. C	10,00,000	30,00,000
To Bank Interest:					
Mr. A		2,00,000			
To Profits:					
Mr. A	6,30,000				
Mr. B	6,30,000				
Mr. C	6,30,000	18,90,000			—
		1,00,00,000			1,00,00,000

In the Books of Mr. A Joint Venture Account

Particulars	₹	Particulars	₹
To Bank Loan (Purchase of Land)	50,00,000	By Bank (Sale of Flats)	40,00,000
To Bank:(Purchase of Land)	10,00,000	By Land & Building	10,00,000
To Bank (Registration Fees)	60,000	By Bank (Received from Mr. B)	14,20,000
To Bank (Bank Interest)	2,00,000	By Bank (Received from Mr. C)	4,70,000
To Profit on JV	6,30,000		
	68,90,000		68,90,000

In the Books of Mr. B Joint Venture Account

Particulars	₹	Particulars	₹
To Purchases (Material Supplied)	4,50,000	By Bank (Sale of Flats)	20,00,000
To Bank (Materials)	5,00,000	By Land & Building	10,00,000
To Profit on JV	6,30,000		
To Bank (Paid to Mr. A)	14,20,000		
	30,00,000		30,00,000

In the Books of Mr. C Joint Venture Account

Particulars	₹	*Particulars*	₹
To Bank (Misc. Expenses)	9,00,000	By Bank (Sale of Flats)	10,00,000
To Profit on JV	6,30,000	By Land & Building	10,00,000
To Bank (Paid to Mr. A)	4,70,000		
	20,00,000		20,00,000

Question 2

A Ltd., B Ltd. and C Ltd. decided to jointly construct a pipeline to transport the gas from one place to another that was manufactured by them. For the purpose following expenditure was incurred by them: Buildings ₹ 12,00,000 to be depreciated @ 5% p.a., Pipeline for ₹ 60,00,000 to be depreciated @ 15% p.a., computers and other electronics for ₹ 3,00,000 to be depreciated @ 40% p.a. and various vehicles of ₹ 9,00,000 to be depreciated @ 20% p.a.

They also decided to equally bear the total expenditure incurred on the maintenance of the pipeline that comes to ₹ 6,00,000 each year.

You are required to show the consolidated balance sheet and the extract of Statement of Profit & Loss and Balance Sheet for each venturer.

(*Source: Illustration 2, Study Material*)

Answer

Consolidated Balance Sheet

		Note	(₹)
I	**Equity and liabilities**		
	Shareholders₹funds: Share Capital	1	71,40,000
			71,40,000
	Assets		
II	Non-current Assets		
	Property, Plant and Equipment:	2	71,40,000
			71,40,000

Notes to Accounts

			(₹)
1.	Share capital		
	A Ltd.	23,80,000	
	B Ltd.	23,80,000	
	C Ltd.	23,80,000	71,40,000

			(₹)
2.	Property, Plant and Equipment		
	Land & Building:		
	A Ltd.	3,80,000	
	B Ltd.	3,80,000	
	C Ltd.	3,80,000	11,40,000
	Plant & Machinery:		
	A Ltd.	17,00,000	
	B Ltd.	17,00,000	
	C Ltd.	17,00,000	51,00,000
	Computers:		
	A Ltd.	60,000	
	B Ltd.	60,000	
	C Ltd.	60,000	1,80,000
	Vehicles:		
	A Ltd.	2,40,000	
	B Ltd.	2,40,000	
	C Ltd.	2,40,000	7,20,000

In the Books of A Ltd.

Extract of statement of Profit & Loss

Particulars	Note No.	₹
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		200,000

Extract of Balance Sheet

	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	*Depreciation and amortisation expense*		
	Land & Building	*20,000*	
	Plant & Machinery	*3,00,000*	
	Computers	*40,000*	
	Vehicles	*60,000*	*4,20,000*
2.	*Land & Building*	*4,00,000*	
	Less*: Depreciation*	*(20,000)*	*3,80,000*
	Plant & Machinery	*20,00,000*	
	Less*: Depreciation Computers*	*(3,00,000)*	*17,00,000*
		1,00,000	
	Less*: Depreciation*	*(40,000)*	*60,000*
	Vehicles	*3,00,000*	
	Less*: Depreciation*	*(60,000)*	*2,40,000*
			23,80,000

In the Books of B Ltd.

Extract of draft Profit & Loss Account

Particulars	**Note No.**	**₹**
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		200,000

Extract of Balance Sheet

	Note No.	**₹**
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	*Depreciation and amortisation expense*		
	Land & Building	*20,000*	
	Plant & Machinery	*3,00,000*	
	Computers	*40,000*	
	Vehicles	*60,000*	*4,20,000*
2.	*Land & Building*	*4,00,000*	
	Less*: Depreciation*	*(20,000)*	*3,80,000*
	Plant & Machinery	*20,00,000*	
	Less*: Depreciation*	*(3,00,000)*	*17,00,000*
	Computers	*1,00,000*	
	Less*: Depreciation*	*(40,000)*	*60,000*
	Vehicles	*3,00,000*	
	Less*: Depreciation*	*(60,000)*	*2,40,000*
			23,80,000

In the Books of C Ltd.

Extract of Draft Profit & Loss Account	**Note No.**	**₹**
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		200,000

Extract of Balance Sheet

	Note No.	**₹**
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	Depreciation and amortisation expense		
	Land & Building	20,000	
	Plant & Machinery	3,00,000	
	Computers	40,000	
	Vehicles	60,000	4,20,000
2.	Land & Building	4,00,000	
	Less: Depreciation	(20,000)	3,80,000
	Plant & Machinery	20,00,000	
	Less: Depreciation	(3,00,000)	17,00,000

		₹	₹
	Computers	1,00,000	
	Less: Depreciation	(40,000)	60,000
	Vehicles	3,00,000	
	Less: Depreciation	(60,000)	2,40,000
			23,80,000

Question 3

A Ltd. a UK based company entered into a joint venture with B Ltd. in India, wherein B Ltd. will import the goods manufactured by A Ltd. on account of joint venture and sell them in India. A Ltd. and B Ltd. agreed to share the expenses & revenues in the ratio of 5:4 respectively whereas profits are distributed equally. A Ltd. invested 49% of total capital but has equal share in all the assets and is equally liable for all the liabilities of the joint venture. Following is the trial balance of the joint venture at the end of the first year:

Particulars	***Dr. (₹)***	***Cr. (₹)***
Purchases	*9,00,000*	
Other Expenses	*3,06,000*	
Sales		*13,05,000*
Property, Plant and Equipment	*6,00,000*	
Current Assets	*2,00,000*	
Unsecured Loans		*2,00,000*
Current Liabilities		*1,00,000*
Capital		*4,01,000*

Closing inventory was valued at ₹ 1,00,000.

You are required to prepare the Consolidated Financial Statement.

(*Source: Illustration 3, Study Material*)

Answer

Consolidated Profit & Loss Account

Particulars	***Note No.***	***(₹)***
Revenue from operations	1	13,05,000
Total Revenue (A)		13,05,000
Less: Expenses		
Purchases	2	9,00,000
Other expenses	3	3,06,000
Changes in inventories of finished goods	4	(1,00,000)
Total Expenses (B)		11,06,000
Profit Before Tax (A-B)		1,99,000

Consolidated Balance Sheet

		Note No.	**(₹)**
I	**Equity and liabilities**		
	1. Shareholders' funds:		
	Share Capital	5	4,01,000
	Reserves and Surplus	6	1,99,000
	2. Non-current liabilities		
	Long term borrowings	7	2,00,000
	3. Current Liabilities	8	1,00,000
			9,00,000

		Note No.	(₹)
II	**Assets**		
	Non-current Assets		
	Property, Plant and Equipment	9	6,00,000
	Current Assets		
	Inventories	10	1,00,000
	Other current assets	11	2,00,000
			9,00,000

Notes to Accounts

	Particulars		(₹)
1.	**Revenue from operations**		
	Sales:		
	A Ltd.	7,25,000	
	B Ltd.	5,80,000	13,05,000
2.	**Purchases**		
	A Ltd.	5,00,000	
	B Ltd.	4,00,000	9,00,000
3.	**Other expenses**		
	A Ltd.	1,70,000	
	B Ltd.	1,36,000	3,06,000
4.	**Closing Inventory**		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
5.	**Share Capital**		
	A Ltd.	1,96,490	
	B Ltd.	2,04,510	4,01,000
6.	**Reserves and Surplus**		
	Profit & Loss Account:		
	A Ltd.	99,500	
	B Ltd.	99,500	1,99,000
7.	**Long Term Borrowings**		
	Unsecured Loans:		
	A Ltd.	1,00,000	
	B Ltd.	1,00,000	2,00,000
8.	**Current Liabilities**		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
9.	**Property, Plant and Equipment**		
	A Ltd.	3,00,000	
	B Ltd.	3,00,000	6,00,000
10.	**Inventories**		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000

	Particulars		**(₹)**
11.	**Other Current Assets**		
	A Ltd.	1,00,000	
	B Ltd.	1,00,000	2,00,000

Question 4

A Ltd. entered into a joint venture with B Ltd. on 1:1 basis and a new company C Ltd. was formed for the same purpose and following is the balance sheet of all the three companies:

Particulars	***A Ltd.***	***B Ltd.***	***C Ltd.***
Share Capital	*10,00,000*	*7,50,000*	*5,00,000*
Reserve & Surplus	*18,00,000*	*16,00,000*	*12,00,000*
Loans	*3,00,000*	*4,00,000*	*2,00,000*
Current Liabilities	*4,00,000*	*2,50,000*	*1,00,000*
Property, Plant and Equipment	*30,50,000*	*26,25,000*	*19,50,000*
Investment in JV	*2,50,000*	*2,50,000*	*-*
Current Assets	*2,00,000*	*1,25,000*	*50,000*

Prepare the balance sheet of A Ltd. and B Ltd. under proportionate consolidation method.

(*Source: Illustration 4, Study Material*)

Answer

Balance Sheet of A Ltd.

		Note No.	***(₹)***
I	***Equity and liabilities***		
	1. Shareholders₹ funds:		
	Share Capital		*10,00,000*
	Reserves and Surplus	*1*	*24,00,000*
	2. Non-current liabilities	*2*	*4,00,000*
	3. Current Liabilities	*3*	*4,50,000*
	TOTAL		*42,50,000*
II	***Assets***		
	Non-current Assets		
	Property, Plant and Equipment:	*4*	*40,25,000*
	Current Assets	*5*	*2,25,000*
			42,50,000

Notes to Accounts

Balance Sheet of B Ltd.

		₹	₹
1.	*Reserves and Surplus*		
	A Ltd.	*18,00,000*	
	C Ltd.	*6,00,000*	*24,00,000*
2.	*Long Term Borrowings*		
	Loans:		
	A Ltd.	*3,00,000*	
	C Ltd.	*1,00,000*	*4,00,000*

		₹	₹
3.	*Current Liabilities:*		
	A Ltd.	*4,00,000*	
	C Ltd.	*50,000*	*4,50,000*
4.	*Property, Plant and Equipment:*		
	A Ltd.	*30,50,000*	
	C Ltd.	*9,75,000*	*40,25,000*
5.	*Current Assets:*		
	A Ltd.	*2,00,000*	
	C Ltd.	*25,000*	*2,25,000*

Balance Sheet of B Ltd.

		Note No.	***(₹)***
I	***Equity and liabilities***		
	1. Shareholders₹ funds:		
	Share Capital		*7,50,000*
	Reserves and Surplus	*1*	*22,00,000*
	2. Non-current liabilities	*2*	*5,00,000*
	3. Current Liabilities	*3*	
			3,00,000
			37,50,000
II	***Assets***		
	1. Non-current Assets		
	Property, Plant and Equipment	*4*	*36,00,000*
	2. Current Assets	*5*	
			1,50,000
			37,50,000

Notes to Accounts

		₹	₹
1.	*Reserves and Surplus*		
	A Ltd.	*16,00,000*	
	C Ltd.	*6,00,000*	*22,00,000*
2.	*Long Term Borrowings*		
	Loans:		
	A Ltd.	*4,00,000*	
	C Ltd.	*1,00,000*	*5,00,000*
3.	*Current Liabilities:*		
	A Ltd.	*2,50,000*	
	C Ltd.	*50,000*	*3,00,000*
4.	*Property, Plant and Equipment:*		
	A Ltd.	*26,25,000*	
	C Ltd.	*9,75,000*	*36,00,000*
5.	*Current Assets:*		
	A Ltd.	*1,25,000*	
	C Ltd.	*25,000*	*1,50,000*

Question 5

A and B established a separate vehicle i.e. entity J, wherein each operator has a 50% ownership interest and each takes 50% of the output. On formation of the joint venture, A contributed a property with fair value of ₹ 110 crore and agreed to contribute his experience over the years towards this venture; and B contributed equipment with a fair value of ₹ 120 crore. The carrying values of the contributed assets were ₹ 100 crore and ₹ 80 crore, respectively.

Answer

A – Gain in consolidated financial statements

A's share in the fair value of assets contributed by entity

B (50% x 120)	60
A's share in the carrying value of asset contributed by	
A to the joint venture (50% x 100)	(50)
Gain recognised by A	10

Question 6

Describe the cases when AS 27 does not allow the use of Proportionate consolidation method of accounting?

Answer

Proportionate consolidation method of accounting is to be followed except in the following cases:

(a) Investment is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future.

The term 'Near Future' is explained with AS 21.

Or

(b) joint venture operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the venturers.

In both the above cases, investment of venturer in the share of the investee is treated as investment according to AS 13.

Question 7

When is a venturer required to discontinue the use of the proportionate consolidation method?

Answer

A venturer should discontinue the use of the proportionate consolidation method from the date that:

(a) It ceases to have joint control in the joint venture but retains, either in whole or in part, its investment.

(b) The use of the proportionate consolidation method is no longer appropriate because the joint venture operates under severe long- term restrictions that significantly impair its ability to transfer funds to the venturers.

From the date of discontinuing the use of the proportionate consolidation method,

(a) If interest in entity is more than 50%, investments in such joint ventures should be accounted for in accordance with AS 21, Consolidated Financial Statement.

(b) If interest is 20% or more but up to 50%, investments are to be accounted for in accordance with AS 23, Accounting for Investment in Associates in Consolidated Financial Statement.

(c) For all other cases investment in joint venture is treated as per AS 13, Accounting for Investment.

(d) For this purpose, the carrying amount of the investment at the date on which joint venture relationship ceases to exist should be regarded as cost thereafter.

Question 8

JVR Limited has made investments of ₹ 97.84 crores in equity shares of QSR Limited in pursuance of Joint Venture agreement till 20X1-X2 (i.e., more than 12 months). The investment has been made at par. QSR Limited has been in continuous losses for the last 2 years. JVR Limited is willing to reassess the carrying amount of its investment in QSR Limited and wish to provide for diminution in value of investments. However, QSR Limited has a futuristic and profitable business plans and projection for the coming years. Discuss whether the contention of JVR Limited to bring down the carrying amount of investment in QSR Limited is in accordance with the Accounting Standard.

Answer

As per para 26 of AS 27 “Financial Reporting of Interests in Joint Ventures”, in a venturer’s separate financial statements, interest in a jointly controlled entity should be accounted for as an investment in accordance with AS 13 ‘Accounting for Investments’.

As per para 17 of AS 13 “Accounting for Investments”, long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long-term investment, the carrying amount is reduced to recognize the decline. Indicators of the value of an investment are obtained by reference to its market value, the investee’s assets and results and the expected cash flows from the investment. The type and extent of the investor’s stake in the investee are also taken into account. However, where there is a decline, other than temporary, in the carrying amounts of long-term investments, the resultant reduction in the carrying amount is charged to the profit and loss statement.

Since the investment was made in the year 20X1-20X2 i.e., more than a year, it is a long-term investment. In the given case, though the QSR Ltd. is in continuous losses for past 2 years, yet it has a futuristic and profitable business plans and projections for the coming years. Here, one of the indicators i.e. ‘losses incurred to the company’ may lead to diminution in the value of the shares while the other indicator that ‘the company has positive expected cash flows from its business plans’ does not lead to decline in the value of shares.

Considering both the facts, in case the expectation of profitable business plans and positive cash flows is based reliable presumptions (such as tender in favour of QSR Ltd., strong order book etc.), the decline will be regarded as temporary in nature and the investment in equity shares will continue to be carried at cost only.

However, should the aforesaid presumptions be based on projections without reasonable evidence backing the claims, the decline could be regarded as non-temporary in nature in which case the write down of the carrying amount become necessary in line with AS 13, thereby implying the contention of QSR Ltd. to be correct.

Question Arrangement

AS 27

Topic	Question Numbers
Meaning and Understanding of Joint Venture	1, 2, 3, 4
Gain or Loss Calculations	5
Jointly Controlled Entity	6, 7, 8